Benson v. Commissioner, 86 T. C. 306 (1986)

The investment in a private annuity contract for tax exclusion purposes is the present value of the annuity, not the full value of the property transferred, when the property's value exceeds the annuity's value, indicating a gift element.

Summary

In Benson v. Commissioner, Marion Benson exchanged securities valued at $371,875 for an annuity agreement from the ABC trust, receiving annual payments of $24,791. 67. The court had to determine whether this was a valid annuity transaction and calculate Benson's investment in the contract for tax purposes. The court held that the transaction was a valid annuity, not a trust transfer, following the Ninth Circuit's decision in LaFargue. However, Benson's investment in the contract was deemed $177,500. 92, the present value of the annuity, rather than the full value of the securities transferred. The difference was considered a gift to the trust beneficiaries. The court also disallowed deductions for investment counseling fees and a capital loss carryover due to insufficient evidence.

Facts

Marion Benson transferred securities worth $371,875 to the ABC trust on December 14, 1964, in exchange for an annuity agreement promising annual payments of $24,791. 67 for her lifetime. The trust was established to benefit various family members. Benson occasionally received late annuity payments and advances on future payments. In 1977, the trust loaned Benson $5,000 without interest, and the trust made distributions to other beneficiaries at Benson's request. The present value of the annuity at the time of transfer was calculated as $177,500. 92.

Procedural History

The Commissioner determined tax deficiencies for Benson for the years 1974-1976 and an addition to tax for 1974, later conceding the addition. The Tax Court addressed whether the transaction was a valid annuity, the investment in the contract, and the deductibility of investment counseling fees and a capital loss carryover. The court followed the Ninth Circuit's decision in LaFargue v. Commissioner, affirming the validity of the annuity transaction.

Issue(s)

1. Whether the transaction between Benson and the ABC trust constituted an exchange of securities for an annuity or a transfer to the trust with a reservation of the right to an annual payment?
2. If a bona fide annuity, what was Benson's investment in the contract for calculating the section 72 exclusion ratio?
3. Whether Benson was entitled to a deduction for investment counseling fees paid in 1974?

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4. Whether Benson was entitled to a capital loss carryover for 1974?

Holding

1. Yes, because the transaction was a valid exchange for an annuity, following the Ninth Circuit's precedent in LaFargue v. Commissioner.
2. Benson's investment in the contract was $177,500. 92, because that was the present value of the annuity at the time of transfer, and the difference between this value and the value of the securities transferred ($194,374. 08) was considered a gift to the trust beneficiaries.
3. No, because Benson failed to establish that the fees were for the management of income-producing property or tax advice.
4. No, because Benson failed to provide sufficient evidence of the claimed capital loss in 1968.

Court's Reasoning

The court applied the Golsen rule, following the Ninth Circuit's decision in LaFargue v. Commissioner, which held that informalities in trust administration did not negate the validity of the annuity agreement. The court found that the present value of the annuity ($177,500. 92) was Benson's investment in the contract for calculating the section 72 exclusion ratio, as per precedent in cases like 212 Corp. v. Commissioner. The difference between this value and the value of the securities transferred was deemed a gift to the trust beneficiaries. The court rejected Benson's argument that Congress' rejection of proposed section 1241 in 1954 indicated a rejection of gift elements in private annuity transactions. Regarding the investment counseling fees, the court found that Benson did not establish that the fees were for the management of income-producing property or tax advice. Similarly, the court found insufficient evidence to support Benson's claimed capital loss carryover from 1968.

Practical Implications

Benson v. Commissioner clarifies that in private annuity transactions, the investment in the contract for tax purposes is the present value of the annuity, not the full value of the property transferred, when the property's value exceeds the annuity's value. This decision impacts how taxpayers and their advisors should structure and report private annuity transactions, ensuring that any gift element is properly identified and reported. The case also underscores the importance of maintaining clear records and evidence for claimed deductions and losses, as the burden of proof remains on the taxpayer. Subsequent cases involving private annuities should consider this ruling when determining the tax treatment of such transactions and the allocation between investment and gift elements.

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