NOTE: This disposition is nonprecedential.

United States Court of Appeals for the Federal Circuit

2009-5001

EUGENE A. FISHER, Trustee,
SEYMOUR P. NAGAN IRREVOCABLE TRUST,

Plaintiff-Appellee,

v.

UNITED STATES,

Defendant-Appellant.

Judgment

ON APPEAL from the United States Court of Federal Claims

In CASE NO(S). 04-CV-1726.

This CAUSE having been heard and considered, it is

ORDERED and ADJUDGED:

Per Curiam (RADER, PLAGER, and MOORE, Circuit Judges).

AFFIRMED. See Fed. Cir. R. 36.

ENTERED BY ORDER OF THE COURT

DATE: October 9, 200

/s/ Jan Horblay
Jan Horblay, Clerk

In The United States Court of Federal Claims

No. 04-1726T

(Filed: August 6, 2008)

EUGENE A. FISHER, Trustee, SEYMOUR P. NAGAN IRREVOCABLE TRUST, Plaintiff, v. THE UNITED STATES, Defendant.	*	Trial; Mutual insurance company – participating policyholders; Demutualization; Gain on sale of stock received in exchange for ownership rights; Basis allocation rule – Treas. Reg. § 1.61-6; "Open transaction" doctrine – *Burnet v. Logan*; Limited exception to Treas. Reg. § 1.61-6 where impossible or impractical to value property; *Pierce*, *Inaja Land* and *Warren* construed; Mutual ownership rights found not to be susceptible of valuation; Expert reports on valuation; "Open transaction" exception to Treas. Reg. § 1.61-6 applicable; Refund entitled.

OPINION

Burgess J. W. Raby, Tempe, Arizona, for plaintiff.

Benjamin C. King, Jr., Tax Division, United States Department of Justice, Washington, D.C., with whom was *Eileen J. O'Connor*, Assistant Attorney General, for defendant.

ALLEGRA, Judge:

Since its infancy, the Federal income tax law has provided that gross income includes gains derived from dealings in property and that such gains generally equal the amount realized less the seller's cost basis in the property sold. Though clear in principle, these rules are not always easily applied – particularly, where the property sold was first acquired, for a lump sum, as part of a larger assemblage, and, especially, where the values of the individual components of that grouping are not readily ascertainable. For generations, courts faced with the scenario just-described have grappled with two possibilities: to treat the property sold as having little or no cost basis, so that most or all the sale proceeds are taxable, or to treat the property as sharing the cost basis of the entire bundle, such that no gain is realized until all the capital represented by that basis is recovered. These are among the possible outcomes in this tax refund suit, which involves insurance policy rights that were acquired as an indivisible package, but then separated and sold as part of a demutualization of the insurance provider.

I. FINDINGS OF FACT

Trial in this case was conducted in Phoenix, Arizona. Based on the record at trial, including the parties' joint stipulations, the court finds as follows:

Prior to 2000, Sun Life Assurance Company (Sun Life) was a Canadian mutual life insurance and financial services company that conducted business in Canada, the United States and other countries. A mutual insurance company has no shareholders, but instead is owned by its participating policyholders, which possess both ownership rights, such as voting and distribution rights, as well as the more typical contractual insurance rights.[1] Their voting rights differ from those possessed by traditional shareholders in that each policyholder has but a single vote, regardless of how many policies it owns or the amounts thereof. Once the mutual company pays its claims and operating expenses, the profits belong to the policyholders. Typically, some of those profits are returned to the policyholders as dividends, which reduce premium payments, while the remainder is retained as surplus, often accumulating from year to year. Payment of such policy dividends is largely at the discretion of the board elected by the participating policyholders. The ultimate goal of this arrangement is to provide insurance at the lowest possible cost.

On June 28, 1990, the Seymour P. Nagan Irrevocable Trust (the Trust) purchased a life insurance policy from Sun Life on Seymour Nagan and Gloria Hagan. The policy was for $500,000, with annual premiums at $19,763.76 per year. Under this "participating policy," plaintiff's ownership rights included the ability –

> to vote on matters submitted to participating policy holders . . . to participate in the distribution of profits of Sun Life of Canada from all its businesses, to participate in any distribution of demutualization benefits, and in the unlikely event of a liquidation if Sun Life of Canada were ever to become insolvent, to participate in the distribution of any remaining surplus after satisfaction of all obligations.

Plaintiff's right to receive distribution of profits took the form of an annual dividend representing the amount, if any, of profits not retained in surplus. These ownership rights could not be sold separate from the policy and were terminated when the policy ended.

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[1] Mutual insurance companies have a long provenance in this country, with one of the first established by Benjamin Franklin. *See generally*, Gregory N. Racz, "No Longer Your Piece of the Rock: The Silent Reorganization of Mutual Life Insurance Firms," 73 N.Y.U. L. Rev. 999 (1998); Edward X. Clinton, "The Rights of Policyholders in an Insurance Demutualization," 41 Drake L. Rev. 657 (1992) (hereinafter "Clinton").

On January 27, 1998, the Sun Life Board (the Board) requested the insurer's management to develop a plan to convert the company into a publicly-traded stock company through a so-called "demutualization."[2] On September 28, 1999, the Board voted to recommend that the policyholders approve the demutualization. It perceived that the conversion would permit the reorganized company to provide stock options to its employees, offer more diversified products and obtain, more readily, capital financing for its businesses, including those unrelated to providing insurance.

On October 29, 1999, Sun Life proposed a plan to its policyholders to demutualize. Under the plan, the policyholders would retain their insurance coverage at premiums that would be unaffected by the demutualization, but would receive shares of stock in a new holding company, Sun Life of Canada Holding Corp. (Financial Services), which would become the corporate parent of Sun Life. Those shares were to be exchanged for the ownership rights possessed by the participating policyholders, with approximately 20 percent of the shares being allocated to compensate for the loss of voting control and the remaining 80 percent of the shares being allocated to compensate for the loss of other ownership rights, including the right to receive a liquidating distribution.[3] Under the plan, eligible policyholders – those that had policies in force as of January 27, 1998 – did not have to take stock in exchange for their shares. Those in the United States, for example, could elect to sell the shares issued in connection with a planned initial public offering, an option referred to as the "cash election." If the policyholder took this election, it would receive an amount determined "by multiplying the number of Financial Services Shares sold . . . by the *Initial Share Price* at which the number of Financial Services Shares are sold in connection with the initial public offering." Policyholders were informed as to how many shares they would be issued in a "share allocation statement."

On December 15, 1999, the Board certified that the demutualization plan had been approved by the eligible policyholders. In early March of 2000, Sun Life began its initial public offerings and received various regulatory approvals to proceed with the demutualization.[4] On May 19, 2000, in response to a request from the company, the Internal Revenue Service (IRS) issued Private Letter Ruling 200020048, which dealt with various tax aspects of the demutualization. In that ruling, the IRS noted that the aforementioned ownership rights "cannot

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[2] As an alternative to the demutualization, the Board considered paying policyholders a greater percentage of the company's then-existing surplus. As of June 1999, that surplus amounted to approximately $5.7 billion (Canadian).

[3] The plan provided for a fixed allocation of seventy-five Financial Services shares for the loss of voting control. A "time-weighted" variable allocation of shares was provided in exchange for the policyholders' rights to receive surplus distributions. This variable allocation was determined under a formula that considered the cash value of the policy or policies held, the number of years the policy or policies had been in force, and the annual premiums.

[4] The cash surrender value of plaintiff's policy as of this time was $185,172.79. Total policy premiums paid through this time were $194,343.64.

be obtained by any purchase separate from an insurance contract issued by [Sun Life]." It ruled that, under section 354(a)(1) of the Internal Revenue Code of 1986 (26 U.S.C.) (the Code), "[n]o gain or loss will be recognized by the Eligible Policyholders on the deemed exchange of their Ownership Rights solely for Company stock." It further opined that the "basis of the Company stock deemed received by the Eligible Policyholders in the exchange will be the same as the basis of the Ownership rights surrendered in exchange for such Company Stock," that is, "zero." The IRS did not rule on the tax treatment to be afforded the cash received in lieu of shares exchanged for ownership rights.

When the demutualization took effect, plaintiff received 3,892 shares of Financial Services stock in exchange for its voting and liquidation rights. Opting for the "cash election," plaintiff permitted Sun Life to sell those shares on the open market for $31,759.00. It reported this amount, unreduced by any basis adjustment, on its federal income tax return for 2000 and paid the resulting tax of $5,725.00. On February 11, 2004, plaintiff filed a timely claim seeking a refund of its money, and, upon the denial of that claim, filed the instant suit. On March 14, 2005, plaintiff filed a motion for partial summary judgment; on December 20, 2005, following the completion of discovery, defendant filed a cross-motion for summary judgment. On May 2, 2006, the case was reassigned to the undersigned. After a referral for alternative dispute resolution did not lead to a settlement, the court, on November 15, 2006, denied the pending dispositive motions. It found that the proceeds from the sale of the Financial Services stock could not be deemed a distribution by Sun Life of a policy dividend, or the equivalent thereof, so as to be excluded from gross income as a return of capital under the annuity rules of section 72 of the Code.[5] The court then concluded that it could not resolve, as a matter of law, plaintiff's claim that no capital gain was realized on the sale of the Financial Services Stock because the proceeds were offset by plaintiff's basis in the stock, finding that the claim presented material questions of fact that required a trial.

Trial in this case began on June 18, 2007. At trial, the parties' expert witnesses assigned dramatically different values to the basis of the ownership rights. Plaintiff's expert, Eugene Cole, testified that he could not form an opinion as to the fair market value of the ownership rights because he found the ownership rights to be inextricably tied to the policy; in his view, the ownership rights added value to the policy but never had a separate value. Defendant's expert, Mark Penny, determined that the fair market value of the ownership rights was zero. He emphasized that none of the premiums were specifically dedicated to acquiring the ownership

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[5] Section 72 of the Code provides rules governing the reporting of income corresponding to annuities received under annuity, endowment or life insurance contracts. Section 72(e)(2) excludes from gross income certain amounts not received as annuities, among them "any amount received which is in the nature of a dividend or similar distribution," as defined in section 72(e)(1)(B). In its November 15, 2006, opinion, the court held that the amounts received by plaintiff did not qualify for exclusion under these provisions, finding that plaintiff "received those proceeds upon an entirely unrelated sale of the stock it received in the demutualization." In its post-trial brief, plaintiff asks the court to reconsider this ruling. The court sees no basis for doing so.

rights, that there was no available market for the ownership rights, and that it was highly unlikely, at the time the policy was acquired, that a demutualization would occur. The latter assertion was also made by defendant's expert on the insurance industry, James Reiskytl.

II. DISCUSSION

We begin with common ground. Section 61(a)(3) of the Code provides that gross income includes "[g]ains derived from dealings in property." Section 1001(a) indicates that "[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain." This "language provides a straightforward test for realization" of income, the Supreme Court has stated, *to wit*, "to realize a gain or loss in the value of property, the taxpayer must engage in a 'sale or other disposition of [the] property." *Cottage Sav. Ass'n v. Comm'r of Internal Revenue*, 499 U.S. 554, 559 (1991); *see also Phil. Park Amusement Co. v. United States*, 126 F. Supp. 184, 187-88 (Ct. Cl. 1954). Section 1011(a) states that "adjusted basis" is the basis determined under section 1012, with adjustments not herein relevant, which the latter section generally sets as "the cost of such property." *See United States v. Hill*, 506 U.S. 546, 554-55 (1993).

The rules become a bit more complicated when a taxpayer transfers only a portion of an asset previously-acquired. Then, the basis of the latter asset generally must be apportioned between the portions disposed of and retained. Treas. Reg. § 1.61-6(a) provides –

> When a part of a larger property is sold, the cost or other basis of the entire property shall be equitably apportioned among the several parts, and the gain realized or loss sustained on the part of the entire property sold is the difference between the selling price and the cost or other basis allocated to such part. The sale of each part is treated as a separate transaction and gain or loss shall be computed separately on each part. Thus gain or loss shall be determined at the time of sale of each part and not deferred until the entire property has been disposed of.

Under this regulation, "where property is acquired for a lump sum and interests therein are subsequently disposed of separately, in order to compute the gain or loss from each disposition an allocation or apportionment of the cost or other basis to the several units must be made." *Fasken v. Comm'r of Internal Revenue*, 71 T.C. 650, 656-57 (1979), *acq.* 1979-2 C.B. 1; *see also Gladden v. Comm'r of Internal Revenue*, 262 F.3d 851, 853 (9th Cir. 2001) ("This regulation tells us that when property is acquired in a lump-sum purchase but then divided and sold off in parts, the cost basis of the property should generally be allocated over the several parts.").[6] This

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[6] The regulation offers the following example:

> B purchases for $25,000 property consisting of a used car lot and adjoining filling station. At the time, the fair market value of the filling station is $15,000 and the fair market value of the used car lot is $10,000. Five years later B sells the filling

apportionment is done by dividing the cost basis of the larger property among its components in proportion to their fair market values at the time they were acquired.[7]

Of course, for this formula to work, one must be able to derive the fair market values of the component parts of the larger property. The regulations presume these values are obtainable, stating that "only in rare and extraordinary cases will property be considered to have no fair market value." Treas. Reg. § 1.1001-1(a); *see also Likins-Foster Honolulu Corp. v. Comm'r of Internal Revenue*, 840 F.2d 642, 650 (9th Cir. 1988).[8] But, what if, despite this regulatory bravado, it proves impractical or impossible to derive the values needed for the basis apportionment formula, at least without engaging in undue speculation? Does that mean that ***none*** of the basis of the originally-acquired property is allocable to the part disposed of or that ***all*** of it is allocable thereto until exhausted? These questions, of course, beg a deeper inquiry as to how, if at all, Treas. Reg. § 1.61-6 applies in such circumstances – whether, for example, conditions not immediately apparent, perhaps those lying in the substructure of the income tax, serve to delimit the regulation? The parties vigorously dispute whether this is the case, with defendant arguing that the regulation, by its terms, is controlling, and plaintiff asseverating that the regulation, in the circumstances of this case, is inapposite. Deciding who is correct requires the court to study the evolution of the regulation, particularly with reference to the concepts of income realization and return of capital, as they have metamorphosed over time.

A.

While the earliest Revenue Acts defined income to include "gains from sales or dealings in property," *see* Revenue Act of 1916, ch. 463, §2(a), 39 Stat. 756, 757 (1916); Tariff Act of 1913, ch. 16, §II(B), 38 Stat. 114, 167-68 (1913), neither they, nor the supporting Treasury Regulations, provided much guidance on how to calculate such gains. Revenue laws in 1918 and

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> station for $20,000 at a time when $2,000 has been properly allowed as depreciation thereon. B's gain on this sale is $7,000, since $7,000 is the amount by which the selling price of the filling station exceeds the portion of the cost equitably allocable to the filling station at the time of purchase reduced by the depreciation properly allowed.

Treas. Reg. § 1.61-6(a) (Example (2)).

[7] *See Beaver Dam Coal Co. v. United States*, 370 F.2d 414, 416-17 (6th Cir. 1966); *Fairfield Plaza, Inc. v. Comm'r of Internal Revenue*, 39 T.C. 706, 712 (1963), *acq.* 1963-2 C.B. 3; *Ayling v. Comm'r of Internal Revenue*, 32 T.C. 704, 711 (1959), *acq.* 1959-2 C.B. 3; *Cleveland-Sandusky Brewing Corp. v. Comm'r of Internal Revenue*, 30 T.C. 539, 545 (1958), *acq.* 1958-2 C.B. 3; *John D. Byram v. Comm'r of Internal Revenue*, 34 T.C.M. (CCH) 626, 626 (1975); *see also Am. Smelting & Refining Co. v. United States*, 423 F.2d 277, 289 (Ct. Cl. 1970).

[8] In 1934, Judge Learned Hand took issue with the predecessor of this regulation, stating "'fair market value' is not nearly so universal a phenomenon as to justify such a comment, and the implication is misleading." *Helvering v. Walbridge*, 70 F.2d 683, 684 (2d Cir. 1934).

1921 conditioned the realization of income on the receipt of property with a "fair market value, if any."[9] Early regulations interpreted this statutory language as conditioning the occurrence of a taxable event on the receipt of property with a cash equivalency, stating that to "complete or close a transaction from which income may be realized," there must be a "change into the equivalent of cash."[10] Shortly after these regulations were promulgated, the Treasury Department, in 1921, issued the progenitor of Treas. Reg. §1.61-6. That regulation, Treas. Reg. 45, art. 43 (1921), dealt with the subdivision of real estate into lots and provided:

> Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold . . . the cost . . . shall be equitably apportioned to the several lots or parcels . . . to the end that any gain derived from the sale of any such lots or parcels which constitute taxable income may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss on every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. . . .

See also Treas. Reg, 62, art. 43 (1922); ***Heiner v. Mellon***, 304 U.S. 271, 275 (1938) (citing cases applying the early versions of the regulation).

Other regulations promulgated around this same time took a different tack, however. They recognized that apportioning a basis among assets acquired as a bundle might, in some situations, prove impractical, requiring income recognition to be deferred until the original cost of the whole bundle was recovered. One of these, Treas. Reg. 45, art. 39 (1921), applied to common stock "received as a bonus with the purchase of preferred stock or bonds." It provided, generally, for the apportionment of basis between the various securities purchased, but indicated that "if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost." *See also* Treas. Reg. 62, art. 39 (1922). Similarly, Treas. Reg. 45, art. 1567 (1921), which dealt with the non-taxable exchanges, provided that where a taxpayer received two kinds of property in such an exchange, the cost of the property originally-possessed had to be apportioned among the new properties. *Id.* But, "[i]f no fair apportionment is practicable," the regulation continued, "no profit on any subsequent sale of any part of the property received in exchange is realized until out of the proceeds of sale shall have been recovered the entire cost of

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[9] *See* Revenue Act of 1921, Pub. L. No. 98, § 202(c), 42 Stat. 227 (1921); Revenue Act of 1918, Pub. L. No. 254, § 202(b), 40 Stat. 1057, 1060 (1919) ("[w]hen property is exchanged for other property, the property received in exchange shall for the purposes of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any"); *see also* Jeffrey L. Kwall, "Out of the Open-Transaction Doctrine: A New Theory for Taxing Contingent Payment Sales," 81 N.C. L. Rev. 977, 992 (2003) (hereinafter "Kwall").

[10] Treas. Reg. No. 45, art. 1563 (1919); *see also* Loren D. Prescott, Jr., *"Cottage Saving Association v. Commissioner*: Refining the Concept of Realization," 60 Fordham L. Rev. 437, 445-46 (1991).

the original property." *Id.*; *see also* Treas. Reg. 62, art. 1567 (1922); *Green v. Comm'r of Internal Revenue*, 33 B.T.A. 824, 828 (1935) (discussing the evolution of this regulation).

The use of "cash equivalency" principles to govern the realization of income soon proved unworkable. *See* 64 Cong. Rec. 2851 (1923) (stmt. of Rep. Green); Hearings Before the S. Finance Comm., 67th Cong. 199 (1921) (stmt. of Dr. T.S. Adams, Tax Advisor, Treas. Dept.). This led Congress, in 1924, largely to abandon these principles in favor of enacting the predecessor of section 1001(a) of the Code and, with it, the concept of "amount realized" – defined, as it is today, to include the fair market value of property other than money or money equivalents received in a transaction. *See* Revenue Act of 1924, Pub. L. No. 68-176, § 202(c), 43 Stat. 253, 255 (1924); *see also Campbell v. United States*, 661 F.2d 209, 216 (Ct. Cl. 1981); *Warren Jones Co. v. Comm'r of Internal Revenue*, 524 F.2d 788, 791-92 (9th Cir. 1975). The accompanying Committee Reports criticized prior law as being "so indefinite that it can not be applied with accuracy, nor consistency," H.R. Rep. No. 68-179, at 13 (1924), *reprinted in* J.S. Seidman, Legislative History Of Federal Income Tax Laws 1938-1861, at 686 (1938), leading to "[g]reat difficulty . . . in administering" the law, S. Rep. No. 68-398, at 13-14 (1924), *reprinted in* Seidman, *supra*, at 686-87. *See also* Kwall, *supra*, at 994. The implication was clear – Congress desired more certainty in determining the timing and amount of the gains realized upon sales or exchanges. *See* Bradley T. Borden, "Reverse Like-Kind Exchanges: A Principled Approach," 20 Va. Tax Rev. 659, 665-66 (2001).

Into this evolving legal environment was born the so-called "open transaction" doctrine, an accouchement traced to *Burnet v. Logan*, 283 U.S. 404 (1931). In that case, Mrs. Logan sold stock of a closely-held corporation which assets included stock in a second corporation that owned a mine lease. *Id.* at 409. She and the other shareholders, which included her mother, exchanged the stock for cash and a stream of annual payments corresponding to the amount of iron ore extracted from the mine. The IRS argued that, at the time of the sale, the right to receive the mining royalties could be estimated based upon the amount of reserves at the mine and that the transaction should be taxed based upon the value of that estimate. *Id.* at 412.[11] The Supreme Court demurred, holding that Mrs. Logan was entitled to recoup her capital investment in the stock before paying income tax based on the supposed market value of the mineral payments. It reasoned:

> As annual payments on account of extracted ore come in, they can be readily apportioned first as return of capital and later as profit. The liability for income tax ultimately can be fairly determined without resort to mere estimates,

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[11] As to 1916, the year of sale, the Commissioner acknowledged that "no taxable income had been derived from the sale when made" because that consideration had not exceeded Mrs. Logan's basis of her stock. *Logan v. Comm'r of Internal Revenue*, 42 F.2d 193, 194 (2d Cir. 1930, *aff'd sub nom.*, *Burnet v. Logan*, 283 U.S. 404 (1931). As to later years (1917-1920), however, the Commissioner claimed that a "a portion of each payment under the contract was a return of capital and a portion represented gain." *Logan v. Comm'r of Internal Revenue*, 12 B.T.A. 586, 599-600 (1928), *rev'd*, 42 F.2d 193 (2d Cir. 1930), *aff'd sub nom.*, *Burnet v. Logan*, 283 U.S. 404 (1931).

> assumptions, and speculations. When the profit, if any, is actually realized, the taxpayer will be required to respond. The consideration for the sale was \$2,200,000 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper sense equivalent to cash. It had no ascertainable fair market value. The transaction was not a closed one. . . . She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture.

Id. Notably, Mrs. Logan's mother owned stock in the same company and sold it on the same terms. She, however, died and her payments under the same sales agreement were valued for estate tax purposes. *Id.* at 413-14.[12] The Supreme Court, however, summarily dismissed the notion that the valuation of the payment stream for estate tax purposes should be used for income tax purposes, stating "[s]ome valuation – speculative or otherwise – was necessary in order to close the estate. It may never yield as much, it may yield more." *Id.; see also* 1 Mertens Law of Fed. Income Tax'n § 5:15 (2008).

As viewed by the *Logan* Court, then, the income tax law did not resolve every doubt in favor of taxation – irreducible values could exist in that world, with the effect of postponing the recognition of income. In the years that followed, the predecessor regulations to Treas. Reg. § 1.61-6 and the "open transaction" doctrine developed like a pavane – intertwined in theory, but rarely touching in the decisional law. A dozen years after *Logan*, in *Pierce v. United States*, 49 F. Supp. 324 (Ct. Cl. 1943), it was not the taxpayer, but the United States, that claimed that a transaction was still open. In that case, the First National Bank of the City of New York, in order to give its stockholders the benefits of investments in securities that could not then be lawfully held by a bank, organized a separate company, First Security Company, to invest in such securities. Each of the certificates of stock in the bank was endorsed with a statement that the stockholder had an interest in the dividends or profits, and, in case of dissolution, in the distribution of capital of the Security Company, ratable with its interest in the bank. *Id.* at 329. Via this arrangement, the shareholders also had limited control over the Security Company, albeit control exercised through the votes of the holders of two-thirds of the bank stock. Neither the bank stock by itself, nor the interest represented by the endorsement, could be transferred separately from the other. Between 1928 and 1932, the plaintiffs' testator bought thirty-five shares of the bank stock with the endorsements. The Banking Act of 1933, however, banned the securities arrangement used by the bank, causing the Security Company to be dissolved; transferable interests in the proceeds of the dissolution were issued to the bank stockholders and the endorsements were removed from the stockholders' certificates of bank stock. The plaintiffs' testator received his interest in the proceeds of the dissolution on December 6, 1933, and

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[12] In making this estimate, the Commissioner projected the amount of contingent payments the shareholders would receive by examining the mine's capacity, a projected price for the mine's product, and the mine's projected useful life. *Id.* at 411 n.1.

promptly sold them on January 29, 1934, allegedly at a loss, on account of which they sought a refund of income taxes.

The United States contended that –

> the sale by plaintiffs' testator of the declarations of interest in the dissolution of the Security Company may not be treated separately as showing a loss, since his interest in the Security Company was acquired in combination with his stock in the bank, and the answer to the question whether a loss or profit resulted from the transaction cannot be had until the bank stock is sold, so that it may be known how much the combined investment has sold for.

Id. at 330. While conceding that "in some instances apportionment of the amount of a single purchase price to several items purchased for that single total price may be had," defendant asseverated that the situation presented was "not a proper case for such an apportionment, since it would not be practicable here." *Id.* The court took the latter contention to mean that "no particular value could be assigned to the interest in the Security Company represented by the indorsement on the bank stock, as of the date of the purchase of the bank stock, with any degree of assurance that that assignment of value was correct, or even approximately so," requiring the "answer to the question of profit or loss" to wait "till the bank stock is sold." *Id.* Readily agreeing with this proposition, the court reasoned that "an attempt here to attribute a certain value to the interests in the Security Company acquired by plaintiffs' testator involves us largely in guess-work." *Id.* Rejecting plaintiffs' attempt to value the endorsement, the court found that "we do not think that the situation calls for such a rough estimate, when by patience the exact answer may be obtained." *Id.*[13] The upshot, the court concluded, was that "the Commissioner acted within his powers in refusing to permit the deduction." *Id.*

The focus of our inquiry next shifts to *Inaja Land Co., Ltd. v. Comm'r of Internal Revenue*, 9 T.C. 727 (1947), *acq.* 1948-1 C.B. 2, an "open transaction" case much debated by the parties here. There, the taxpayer owned about 1,200 acres of land on the banks of a river that it had purchased for $61,000. The land was used for fishing and for grazing. In 1934, the City of Los Angeles began altering the flow of the water in the river; ultimately it paid the taxpayer $50,000 for a perpetual easement to allow water to flow over the land toward the city. A tax dispute arose over the treatment of this money. The Tax Court found that the amount received constituted proceeds from the disposition of an interest in real property, that is, the easement. It concluded, however, that it would be wholly impracticable and impossible to apportion a cost basis to the easement involved because the easement could not be described by metes and bounds

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[13] The court particularly focused on the fact that the endorsement was not separately sellable from the shares, noting that "the locking device increases the practical difficulty of attributing a correct valuation to either piece of property as of the time of purchase, since the very fact of the restraint usually affects the value of the combination and each of its components in amounts difficult to measure." *Pierce*, 49 F. Supp. at 330.