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6 IN THE UNITED STATES DISTRICT COURT  
7 FOR THE DISTRICT OF ARIZONA  
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9 Bennett and Jacquelynn Dorrance,  
10 Plaintiffs,  
11 v.  
12 United States of America,  
13 Defendant.  
14

No. CV-09-1284-PHX-GMS

**ORDER**

15 Pending before the Court are cross-motions for summary judgment. (Docs. 64,  
16 67). For the reasons stated below, both motions are denied.<sup>1</sup>

17 **BACKGROUND**

18 In 1995, Plaintiffs formed the Dorrance 1995 Legacy Trust (the “Trust”), which in  
19 turn purchased five life insurance policies in 1996. (Doc. 67-1 ¶¶ 16, 17). The policies  
20 were purchased with The Prudential Insurance Company of America (“Prudential”), Sun  
21 Life Assurance Company of Canada (“SunLife”), Phoenix Home Life Mutual Insurance  
22 Company (“Phoenix”), Principal Life Insurance Company (“Principal”), and  
23 Metropolitan Life Insurance Company (“MetLife”). (Doc. 65 ¶ 1). In the aggregate, the  
24 policies provided \$87,775,000.00 in coverage. (Doc. 67-1 ¶¶ 19–23). The Trust  
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26 <sup>1</sup> Both parties have requested oral argument. The requests are denied because the  
27 parties have had an adequate opportunity to discuss the law and evidence and oral  
28 argument will not aid the Court’s decision. *See Lake at Las Vegas Investors Group, Inc.*  
*v. Pac. Malibu Dev.*, 933 F.2d 724, 729 (9th Cir. 1991).

1 purchased the policies in the anticipation that the benefits would provide liquidity to pay  
2 Plaintiffs' estate taxes upon their death, so that Plaintiffs' heirs would not need to  
3 liquidate the family stock portfolio to pay such taxes. (Doc. 67-1 ¶ 17).

4 All of the policies were purchased with mutual insurance companies. In a mutual  
5 insurance company, the policyholders have an interest in the company itself in addition to  
6 holding a policy. This interest provides the policyholder with certain rights, including the  
7 right to vote on corporate decisions and the right to receive the mutual company's surplus  
8 should the company liquidate. (Doc. 65 ¶ 7; Doc. 67-1 ¶ 6).<sup>2</sup> Plaintiffs describe these  
9 rights as "ownership" rights, while Defendant describes them as "membership" rights.  
10 (Doc. 64 at 2; Doc. 67 at 2). At this stage in the litigation, the Court will refer to these  
11 rights as "mutual rights."<sup>3</sup> Policyholders cannot sell the mutual rights separately from  
12 their underlying policies. (Doc. 65 ¶ 9). If a life insurance policy held with a mutual  
13 insurance company is terminated, the mutual rights are extinguished as well. (Doc. 65 ¶  
14 10).

15 The five mutual life insurance companies demutualized through processes that  
16 began in 1998, 1999, and 2000, and culminated in 2000 or 2001. (Doc. 65 ¶¶ 32–38). In  
17 the process of demutualization, a mutual company changes its corporate structure into  
18 that of a stock company, often through a procedure governed by state statute. (Doc. 67-1  
19 ¶ 39; Doc. 65 ¶ 24). Policyholders must vote to approve a demutualization before the

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21 <sup>2</sup> The parties dispute the degree to which the mutual rights provided dividends.  
22 Insurance policyholders receive dividends, and as the mutual insurance companies  
23 demutualized, the companies set aside funds to ensure that these dividends continued.  
24 Plaintiffs do not deny that they continued to receive dividends after demutualization, and  
25 Defendant does not deny that the dividends come from money set aside into blocks from  
26 the companies' surplus, which in some circumstances (such as liquidation) is associated  
27 with the mutual right. (Doc 65 ¶ 23; Doc. 79-1 ¶ 23).

28 <sup>3</sup> The Court notes that another district court, considering whether a policyholder  
was deprived of property when a mutual company demutualized and did not provide the  
policyholders any compensation for these rights, found that policyholders' interest in a  
mutual life insurance company "did not rise to the level of a property interest such as to  
render policy holders 'owners' of the corporation." *Tancredi v. Metropolitan Life Ins.*  
*Co.*, 149 F. Supp. 2d 80, 86–87 (S.D.N.Y. 2001). The decision is not binding on this  
Court.

1 process can proceed. (Doc. 67-1 ¶ 40).<sup>4</sup> Prior to seeking policyholder approval, at least  
2 one of the companies promised policyholders that if they voted for demutualization,  
3 premiums would not increase, and in fact none of the premiums Plaintiffs paid increased  
4 after demutualization. (Doc. 65 ¶ 39; Doc. 79-1 ¶ 39).

5 When the companies demutualized, policyholders (including Plaintiffs) therefore  
6 retained their policies and continued to pay the same premiums. They no longer,  
7 however, held mutual rights, and therefore could not vote on corporate decisions and had  
8 no interest in the surpluses of the new companies. (Doc. 65 ¶ 18). In exchange for the lost  
9 mutual rights, the companies provided policyholders with the option of receiving stock in  
10 the new companies or receiving a cash payment in lieu of stock. (Doc. 67-1 ¶ 55). When  
11 determining how much stock to give policyholders, the companies calculated a “fixed”  
12 component to correspond to policyholders’ loss of voting rights, and a “variable”  
13 component designed to measure “the policyholders’ contribution to the surplus of the  
14 company.” (Doc. 67-1 ¶ 55). Although the companies used slightly different methods to  
15 measure their policyholders’ contribution to the company’s surplus, all obtained  
16 independent actuarial opinions that the methods were “fair and equitable.” (Doc. 67-1 ¶  
17 56). The stock the Trust received during the demutualizations had a total value of  
18 \$1,794,771.00. (Doc. 67-1 ¶¶ 60–65). The Trust sold all the stock on June 23, 2003, for  
19 an aggregate price of \$2,248,806.00. (Doc. 67-1 ¶ 65).

20 When the Trust received its IRS Form 1099-B, the form listed the basis in the  
21 Trust’s stock as zero, consistent with IRS policy that policyholders have no basis in stock  
22 received by a policyholder during demutualization of a life insurance company. (Doc. 67-  
23 1 ¶ 66). Plaintiffs paid the taxes thereby owed, and subsequently filed this claim for  
24 relief.

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26 <sup>4</sup> For example, Arizona, state regulations require that demutualization plans be  
27 approved by the state Director of Insurance, permit companies to limit the right to vote on  
28 demutualization to policyholders whose policies are worth over \$1,000 and have been  
held more than a year, and provide that policyholders receive equity through “a fair  
formula approved by the director” that reflects the insurance company’s entire surplus.  
A.R.S. § 20-730.

1 Defendant has filed a motion for summary judgment, arguing that no part of  
2 Plaintiffs' periodic payments for their original insurance policies was paid to acquire the  
3 mutual rights under the policy, and that all of the premium was paid to purchase the  
4 policy. As a result, under this theory, Plaintiffs would have had no basis in the stock that  
5 was provided in exchange for those rights. (Doc. 64).

6 Plaintiffs likewise have filed a motion for summary judgment, arguing that the  
7 demutualization should be governed by the open transaction doctrine, which is employed  
8 in circumstances where the basis in property that is split cannot be allocated to the  
9 resulting assets. Under this theory, all of the proceeds from Plaintiffs' sale of stock would  
10 be considered return of capital from their premiums, and they would thereby owe no tax.  
11 (Doc. 67).

## 12 DISCUSSION

### 13 I. Legal Standard

14 Summary judgment is appropriate if the evidence, viewed in the light most  
15 favorable to the nonmoving party, shows "that there is no genuine issue as to any material  
16 fact and that the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c).  
17 Only disputes over facts that might affect the outcome of the suit will preclude the entry  
18 of summary judgment, and the disputed evidence must be "such that a reasonable jury  
19 could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477  
20 U.S. 242, 248 (1986). "[A] party seeking summary judgment always bears the initial  
21 responsibility of informing the district court of the basis for its motion, and identifying  
22 those portions of [the record] which it believes demonstrate the absence of a genuine  
23 issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986).

### 24 II. Analysis

25 Defendant claims that Plaintiff has not met its burden of establishing that it paid  
26 anything for the mutual rights at all. (Doc. 64). Plaintiffs have alleged that the rarely-used  
27 open transaction doctrine governs this case. (Doc. 67). In 2008, the United States Court  
28 of Federal Claims ruled (in a decision after a bench trial) that demutualization of a mutual

1 insurance company is one of the “rare and extraordinary” circumstances in which the  
2 open transaction doctrine should apply. *Fisher v. United States*, 82 Fed. Cl. 780, 795  
3 (Fed. Cl. 2008) (aff’d without opinion by *Fisher v. United States*, 333 Fed. App’x. 572  
4 (2009)). Both arguments will be considered before the Court discusses the regulatory  
5 framework regarding allocating basis in divided property.

6 **A. The Burden of Proving Basis in Property**

7 Under the Internal Revenue Code, gross income includes “[g]ains derived from  
8 dealings in property.” 26 U.S.C. § 61(a)(3) (2006). The gains derived from property are  
9 defined as “the excess of the amount realized therefrom over the adjusted basis.” 26  
10 U.S.C. § 1001(a). The basis of property is defined by regulation as “the cost of such  
11 property.” 26 U.S.C. § 1012(a). The burden of establishing a basis in property “rest[s] on  
12 the taxpayer.” *Coloman v. C.I.R.*, 540 F.2d 427, 429 (9th Cir. 1976).

13 When a taxpayer offers only an “unverified statement that he had contributed  
14 property . . . to the partnership,” he has not met his burden of showing he invested in the  
15 underlying asset. *Coloman*, 540 F.2d at 427. On the other hand, when a taxpayer has  
16 shown that he made some investment into property, but cannot establish the value of that  
17 investment, his basis should not be declared zero “on the ground that it [is] impossible to  
18 tell how much he had in fact spent.” *Cohan v. Comm’r of Internal Revenue*, 39 F.2d 540,  
19 543 (2d Cir. 1930) (Hand, L., J.). In such cases, the government “should make as close an  
20 approximation as it can” to the actual basis, “bearing heavily if it chooses upon the  
21 taxpayer whose inexactitude is of his own making.” *Id.* at 544. More recent decisions of  
22 the Ninth Circuit have continued to rely on *Cohan*, noting that if “it is clear that the  
23 taxpayer is entitled to some deduction, but he cannot establish the full amount claimed, it  
24 is improper to deny the deduction in its entirety.” *United States v. Marabelles*, 724 F.2d  
25 1374, 1383 (9th Cir. 1984).

26 Plaintiffs have met their burden of showing they paid something for the mutual  
27 rights by proving that they paid premiums for policies that included the policy rights and  
28 the mutual rights. Defendant’s motion for summary judgment is therefore denied. The

1 question at issue is how that basis ought to be allocated between the two assets that were  
2 created when the companies de-mutualized.

## 3 **B. The Open Transaction Doctrine**

### 4 **1. Background**

5 The open transaction doctrine allows a taxpayer to apply gains received from the  
6 sale of a portion of a piece of property to the entire original basis without apportioning  
7 the basis between the property that was sold and the property that was retained; the  
8 doctrine is available only in “rare and exceptional” circumstances. *Fisher*, 82 Fed. Cl. at  
9 795. The doctrine was announced by the Supreme Court in *Burnet v. Logan*, 283 U.S.  
10 404 (1931), and although subsequent regulations have narrowed its scope, *Logan* remains  
11 the core authority for the open transactions doctrine. *See, e.g., Ebert v. United States*, 66  
12 Fed. Cl. 287, 292 (Fed. Cl. 2005) (“[*Logan*] addressed the question of whether a  
13 transaction whose value was contingent on future events could, in effect, be treated as a  
14 closed transaction.”); *Inaja Land Co., Ltd. v. C.I.R.*, 9 T.C. 727 (1947) (citing *Logan*  
15 when holding that “no portion of the payment in question should be considered as  
16 income, but the full amount must be treated as a return of capital and applied in reduction  
17 of petitioner’s cost basis”).

18 The taxpayer in *Logan* owned a share of an iron company which in turn owned  
19 12% of an ore company. *Logan*, 283 U.S. at 409. The ore company apportioned the value  
20 of the ore it extracted to its shareholders, including the iron company in which the  
21 taxpayer held an interest. *Id.* In 1916, the iron company was sold to Youngstown Sheet  
22 and Tube Company; Youngstown paid the shareholders \$2,200,000 in cash and agreed to  
23 pay 60 cents for every ton of ore extracted by the ore company. *Id.* Thus, the taxpayer  
24 received, in exchange for the shares she owned, both a lump sum and an income stream  
25 that depended on the continued success of the ore company. The Commissioner  
26 originally discounted the income stream to an estimated present value, and then  
27 apportioned the taxpayer’s original basis in the fixed portion of the asset and the income  
28 stream according to the same ratio that they had to each other at the time of distribution.

1 *Id.* at 411. The Supreme Court ruled that the taxpayer had not received two assets in  
2 exchange for her stock; instead she had received cash and “the promise of future money  
3 payments wholly contingent upon facts and circumstances not possible to foretell with  
4 anything like fair certainty.” *Id.* at 413. It held that the value of the income stream could  
5 not be estimated, because it “had no ascertainable fair market value.” *Id.* It therefore  
6 allowed the taxpayer to apply the entire basis of the original stock purchase to the cash  
7 portion of the transaction; as a result she realized no gain at the time, but would only do  
8 so were the ore payments to exceed her remaining capital investment. *Id.*

9 At its core, the *Logan* Court held that the basis in the stock could not be allocated  
10 between the income stream and the cash payment because the value of the income stream  
11 was too uncertain. *Id.* at 413. Had the Court accepted the Commissioner’s allocation and  
12 the ore company subsequently seen better-than-expected production, or had it sputtered,  
13 the original basis allocation would have been incorrect. The Court did not address  
14 whether the relative cost of the income stream and the cash portion of the stock could  
15 have been determined when the stock was originally purchased; its focus was solely on  
16 the value of the separate portions of the asset at the time they were split. *Id.*

17 The open transaction doctrine has periodically been invoked by both the  
18 Government and taxpayers. The Government successfully urged application of the  
19 doctrine in *Pierce v. United States*, 49 F. Supp. 324 (Ct. Cl. 1943). There, a bank had  
20 created a security company in which its shareholders were given an interest based on  
21 their interest in the original company, without paying anything more. After a federal law  
22 mandated dissolution of the security company, a taxpayer claimed that his original basis  
23 in the stock should be allocated between his remaining bank stock and the dissolution  
24 proceeds, which he claimed represented a loss. *Id.* at 329–30. The Court found that  
25 apportionment was inappropriate because “the exact answer to the question of profit or  
26 loss may be obtained by waiting till the bank stock is sold.” *Id.* at 330.

27 A taxpayer successfully invoked the doctrine in *Inaja Land Co., Ltd. v. C.I.R.*, 9  
28 T.C. 727 (Tax. Ct. 1947). There, a company purchased land by the Owens River, near

1 Los Angeles, for \$61,000 to start a fishing club and to rent some of the property for  
2 livestock grazing. The City of Los Angeles, acting without “any right to divert, release, or  
3 suffer the release of waters into the Owens River in such a manner that such waters  
4 would flow through or over petitioner’s lands,” constructed massive concrete tunnels  
5 upstream from the landowner and dumped the resultant pollutants into the river, “which  
6 injured and killed fish and interfered with the fishing on petitioner’s lands.” *Id.* at 730.  
7 The landowner sued, and received a \$50,000 settlement in exchange for releasing any  
8 claim relating to discharging foreign water from the tunnels into the Owens River. *Id.*  
9 The question for the court was what portion of the initial purchase price could be  
10 allocated as a basis against which to apply the settlement money. The court read the  
11 settlement as the purchase of an easement over the company’s land, but agreed with the  
12 landowner that “it would be impracticable and impossible to apportion a definite basis to  
13 the easements here involved, since they could not be described by metes and bounds; that  
14 the flow of the water has changed and *will change* the course of the river; that the extent  
15 of the flood was not and *is not predictable*; and that to this date the city *has not released*  
16 *the full measure of water to which it is entitled.*” *Id.* at 736 (emphasis added).

17 In all of these cases, the basis a taxpayer had in the original asset could not be  
18 allocated when the asset was split because the value of the asset that the taxholder kept  
19 was “impossible to determine with fair certainty.” *Logan*, 283 U.S. at 412. Because of  
20 this uncertainty, it was not clear whether the taxpayer had, or would eventually  
21 experience, a gain or a loss on the transaction as a whole, and it was determined that a  
22 taxpayer should not “be charged with gain on pure conjecture unsupported by any  
23 foundation in ascertainable fact.” *Inaja Land*, 9 T.C. at 736. Regulations have replaced at  
24 least part of the open transactions doctrine, in particular with regards to contingent  
25 payments; there are now regulations allocating basis in any transaction that “provides for  
26 one or more payments due more than 1 year after the date of the sale or exchange.” 26  
27 C.F.R. § 1.483-1(a)(1).

28 In 2008, the Court of Federal Claims applied the open transaction doctrine in a

1 case where a taxpayer had received a cash payment in exchange for his mutual rights  
2 during the demutualization of a life insurance company. *Fisher v. United States*, 82 Fed.  
3 Cl. 780, 795 (Fed. Cl. 2008). After taking what it described as a “*tour d’horizon*” of the  
4 relevant caselaw, statutes, and regulations, the *Fisher* court noted that the open  
5 transaction doctrine remained “a viable, albeit limited, exception to the general rule  
6 enunciated” by 26 C.F.R. § 1.61-6(a). *Fisher*, 82 Fed. Cl. at 791. Writing after a trial in  
7 which the Government had argued that the mutual rights were worth nothing while the  
8 taxpayer had asserted that valuing the rights was impossible, the Court sided with the  
9 taxpayer, noting that “the ownership rights were, at the outset, inextricably tied to the  
10 underlying insurance policy and were not separately sellable.” *Id.* at 795. It thus applied  
11 the open transaction doctrine, allowing the taxpayer to treat all of the premium payments  
12 he had made during the course of the policy as capital investment, and deferring any  
13 payment on the proceeds that the taxpayer had received in exchange for his rights. *Id.* at  
14 799. The Federal Circuit affirmed without opinion. *Fisher v. United States*, 333 Fed.  
15 Appx. 572 (2009).

16 Other courts have not yet had the opportunity to consider whether application of  
17 the open transactions doctrine was appropriate in *Fisher*. See, e.g., *Cadrecha v. United*  
18 *States*, \_\_\_ Fed. Cl. \_\_\_, 2012 WL 1095359 (Fed. Cl. Apr. 2, 2012) (declining to apply  
19 *Fisher* when the taxpayer’s claim was untimely). Practitioners, however, quickly noted  
20 significant factual distinctions between historical open transaction cases and those  
21 involving demutualization of life insurance companies. In particular, one noted, “the  
22 assets usually involved in the open transaction doctrine will eventually be disposed of;  
23 conversely, life insurance policies are generally held until the death of the insured, at  
24 which time the basis is no longer needed.” Stephen J. Olsen, *Chuck v. Goliath: Basis of*  
25 *Stock Received in Demutualization of Mutual Insurance Companies*, 9 Hous. Bus. & Tax  
26 L.J. 360, 382–83 (2009). As a result, when a taxpayer is allowed to use the open  
27 transaction doctrine in the context of stock received during demutualization, he “is  
28 getting a windfall, because all of the basis may be allocated to the assets that will be sold,

1 while the asset that does not require basis has had its basis reduced.” *Id.*; see 26 U.S.C. §  
2 101(a)(1) (excluding payment under a life insurance contract from gross income), 26  
3 U.S.C. § 72(e)(6) (defining the basis in a life insurance contract that has been surrendered  
4 for cash as the aggregate of premiums paid less the amount received under the contract).

5 Another commenter pointed out that the arguments advanced by the parties in  
6 *Fisher* may have made it appear more difficult to allocate basis under the regulations than  
7 it actually was. The government had only put forward expert witnesses stating that the  
8 taxpayer had paid nothing for the rights, while the taxpayer had put forward only experts  
9 claiming that calculating the cost of the rights was impossible—neither party addressed  
10 “how use of the doctrine could be avoided altogether by applying reasonable alternative  
11 basis apportionment methods.” Paul Galindo, *Revisiting the “Open Transaction”*  
12 *Doctrine: Exploring Gain Potential and the Importance of Categorizing Amounts*  
13 *Realized*, 63 Tax Lawyer 221, 234 (2009). Noting that the value of the stock and the  
14 value of the policy on the secondary market were both ascertainable at the time of  
15 demutualization, and a ratio from which to apportion basis could be calculated, the  
16 commenter wrote that apportionment “through the use of current and readily  
17 ascertainable relative fair market value data seems reasonable.” *Id.* at 244.

## 18 **2. Application**

19 Plaintiffs have failed to show that allocating basis between the mutual rights and  
20 the stock is so difficult that this case requires applying the open transactions doctrine.  
21 Despite disagreement as to what Plaintiffs may have paid for their mutual rights, there is  
22 no question that at the time of demutualization, both the value of the stock and the market  
23 value of the policy itself could be calculated. The open transactions doctrine prevents the  
24 government from forcing a taxpayer to apportion basis in transactions where only through  
25 waiting can “the exact answer to the question of profit or loss” be found. *Pierce*, 49 F.  
26 Supp. at 330. In *Inaja Land*, the rights ceded to Los Angeles were so uncertain that there  
27 remained a genuine question as to whether the land retained any value at all, because,  
28 depending on how much the city continued to pollute the river, the easement may have

1 rendered the land worthless, and the company may have in fact sold its investment at a  
2 loss. *Inaja Land*, 9 T.C. at 736.

3 Since the value of both the mutual rights and the policy itself at the time of  
4 demutualization can be determined, there is no concern here that the taxpayer will be  
5 forced to pay tax on a transaction that is later proven to show a loss. The Ninth Circuit  
6 has confirmed that “taxation of an ‘open’ transaction is deferred only to the extent that  
7 *consideration received by the seller* consists of property having no ascertainable fair  
8 market value *in the year of sale.*” *In re Steen*, 509 F.2d 1398, 1404–05 (9th Cir. 1975)  
9 (emphasis added). Here, Plaintiffs received stock, and retained a marketable life  
10 insurance policy; it is practical and possible in such circumstances to ascertain the value  
11 of these assets in the year of the sale.

12 The Court does not lightly disagree with another federal district court, and relies in  
13 some degree on arguments that do not appear to have been made before the *Fisher* court.  
14 But given the limited arguments at trial, it is not surprising that the *Fisher* court found  
15 that it was limited to deciding only whether “***none*** of the basis of the originally-acquired  
16 property is allocable to the part disposed of or that ***all*** of it is allocable thereto until  
17 exhausted?” *Id.* at 784 (double emphasis in original). At summary judgment, this Court is  
18 not so limited, and finds neither argument convincing. *See Celotex*, 477 U.S. at 323–24  
19 (noting that a purpose of summary judgment is “to isolate and dispose of factually  
20 unsupported claims” before trial).

21 The facts particular to this case show that applying the open transaction doctrine  
22 would be inequitable here. In *Fisher*, the plaintiff opted for the “cash election” upon  
23 demutualization, and thereby received an immediate payment in exchange for his mutual  
24 rights. *Fisher*, 82 Fed. Cl. at 783. Here, Plaintiffs received stock, held it for years, and  
25 sold it for \$454,035 more than its market value at the time of demutualization. (Doc. 67-1  
26 ¶ 65). The open transactions doctrine would therefore allow Plaintiffs to apply this gain  
27 to basis accrued through policy payments made before mutualization, even though the  
28 increase in value took place entirely after the rights were split. At the same time, since the

1 open transaction doctrine would not recognize any separate bases in the policy and the  
2 stock, policy payments made after the companies demutualized would increase the total  
3 basis towards which the stock sale would be applied, even though these payments were  
4 not made to obtain the mutual rights or the stock.

5 The First Circuit conducted a sophisticated analysis of the treatment of  
6 distributions after a demutualization from the perspective of the insurer in *UNUM Corp.*  
7 *v. United States*, 130 F.3d 501 (1st Cir. 1997). There, the insurance company claimed that  
8 the distributions to policyholders should be interpreted as a “policyholder dividend,” and  
9 therefore should be deductible for the insurance company. *Id.* at 517; *see* 26 U.S.C. §  
10 808(a). The court found that although UNUM had made a colorable argument based on  
11 the language of the statute, the court had an obligation to consider the statutory language  
12 in the context of the “basic policies and structure of the Code,” and that “when the  
13 language is read against the background of the statutory structure, it becomes untenable.”  
14 *UNUM*, 130 F.3d at 517 (quoting *Colonial American Life Ins. Co. v. C.I.R.*, 491 U.S.  
15 244, 257 (1989)). So here, while the difficulty in pricing the mutual rights at the time the  
16 policies were purchased bears some surface resemblance to similar difficulties in open  
17 transaction cases, applying a doctrine that would permit Plaintiffs to realize untaxed gain  
18 of nearly a half a million dollars that post-dated demutualization, and to avoid taxation  
19 entirely should they hold their insurance policy until their death, does not comport with  
20 the background and basic policies of the tax code. *Colonial American*, 491 U.S. at 257.

21 This Court need not opine on the continued viability of the open transaction  
22 doctrine, or speculate on what circumstances may trigger its application. Given the  
23 undisputed facts of this case, it need only note that the doctrine does not apply here.  
24 Summary judgment is denied to Plaintiffs.

### 25 **C. Calculating Basis in Divided Property**

26 When a taxpayer sells only one part of a piece of property, the entire cost of the  
27 property “shall be equitably apportioned among the several parts.” 26 C.F.R. § 1.61-6(a).  
28 There is no single accepted method for apportioning basis equitably. The Ninth Circuit

1 has suggested that one method for apportioning the basis to a certain property right that a  
2 taxpayer had sold while maintaining other rights would be to compare the price of the  
3 property, at the time it was originally purchased, to the market prices of similar properties  
4 without the right in question. *Gladden v. C.I.R.*, 262 F.3d 851, 856 (9th Cir. 2001)  
5 (returning the case to the district court and suggesting that “it may be possible to  
6 determine the premium price paid for the potential water rights by comparing the price of  
7 the land purchased by the partnership to prices of similar land without” such potential  
8 rights). Other circuits have suggested that basis can be equitably apportioned by  
9 comparing the fair market value of the two pieces of property at the time of division, and  
10 applying that ratio to the original cost. *See Byram v. C.I.R.*, 555 F.2d 1234, 1236 (5th Cir.  
11 1977) (“What appellants should have shown, and never did, was the fair market value of  
12 the tract.”); *see also Urbanek v. United States*, 731 F.2d 870, 873 (Fed. Cir. 1984)  
13 (holding that allocating basis “in proportion to fair market value of the interests sold and  
14 retained” is “in accord with correct accounting practice”).

15 Defendant argues that Plaintiffs did not pay a “premium” for the mutual rights by  
16 noting that Plaintiffs did not pay higher premiums after demutualization and that the  
17 mutual companies did not consider the mutual rights when calculating the prices of the  
18 policies. As noted above, at least one of the companies promised the policyholders that  
19 premiums would not rise under demutualization, perhaps to secure the votes of its  
20 policyholders. The comparison between the price of the policies pre- and post-  
21 mutualization would therefore not necessarily capture any actual premium paid by  
22 Plaintiffs for their policies relative to other policies available without mutual rights when  
23 Plaintiffs first acquired their policies.

24 In *Gladden*, the taxpayer had purchased a piece of property in which rights were  
25 anticipated but had not vested; the question for the court was how to assign basis to the  
26 potential rights when the land was purchased. 262 F.3d at 854. The Ninth Circuit  
27 suggested that the district court may calculate the premium paid for such rights by  
28 comparing the price of land with such potential rights to the price of comparable land

1 without such expectations. *Id.* at 856. Under this method, the proper comparison here  
2 would be between the periodic premiums that Plaintiffs paid in order to purchase and  
3 retain their policies and the premiums that would have been required for equivalent  
4 polices offered over the same period that did not offer mutual rights.

5 True, the *Gladden* court was dealing with land that had the potential to gain rights,  
6 not land on which rights already existed. It did find, however, that the regulation on  
7 allocating property by its value “would be easy to apply . . . if the water rights had  
8 already been vested when the partnership had purchased the land.” *Id.* at 853.<sup>5</sup> Nothing in  
9 the opinion suggests that comparing the price of comparable purchases with and without  
10 such rights would be inappropriate when the rights were actual rather than potential. *Id.*

11 Such a comparison is not possible from the current record. Defendant has only  
12 compared the cost of Plaintiff’s policy before and after demutualization; it has not  
13 provided any evidence comparing the cost of Plaintiff’s policy at the time it was  
14 purchased to similar policies lacking mutual rights. *See* Douglas P. Faucette & Timothy  
15 S. Farber, *National Insurance Act of 2007 & Demutualization of Insurers: The Devil is in*  
16 *the Details*, FDCC Quarterly 109, 123 n.44 (“[A] sophisticated policyholder might have  
17 been willing to pay more for his policy, after incorporating the small probability that his  
18 mutual would liquidate or convert, and thereby owe him a portion of its otherwise-  
19 withheld surplus.”). Moreover, parties have not had the opportunity to argue that using  
20 the method suggested by *Gladden* would be more equitable than comparing the value of  
21 the rights and the policy at the time of demutualization.

22 Neither party has yet presented evidence from which the Court could equitably  
23 apportion the premiums paid before demutualization as basis in the mutual rights and  
24 basis in the policies themselves. The Court has noted that previous Ninth Circuit caselaw

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26 <sup>5</sup> The *Gladden* court noted that in this “easy case” the facts would have resembled  
27 *Inaja Land*, and Plaintiffs urge the court to therefore apply the open transactions doctrine.  
28 The *Gladden* court did not suggest that in cases where the rights had vested the open  
transaction doctrine always applied, and neither *Gladden* nor this case present the  
uncertainty regarding present value that governed *Inaja Land*.

1 suggests that the best method for such apportionment would be to compare the cost of  
2 Plaintiffs' policies to the cost of comparable policies issued by non-mutual insurance  
3 companies at the time of issuance. *Gladden*, 262 F.3d at 856. On the other hand,  
4 commenters writing specifically about the issue of applying basis to mutual rights have  
5 suggested that comparing the market value of the policy and the stock at the time of  
6 demutualization, and applying that ratio to the premium payments, would be more  
7 appropriate.

8 The Court need not address, at summary judgment, which method of  
9 apportionment is appropriate. Plaintiffs have shown that they may have paid something  
10 for the mutual rights. The open transactions doctrine does not apply because the facts  
11 here do not present "elements of value so speculative in character as to prohibit any  
12 reasonably based projection of worth." *Campbell v. United States*, 661 F.2d 209, 215 (Ct.  
13 Cl. 1981), The regulation requires basis to be apportioned equitably. 26 C.F.R. § 1.61-  
14 6(a). The Court reminds the parties that, as in *Fisher*, the trial will be to the bench. *See*  
15 *Galloway v. United States*, 319 U.S. 372, 388 (1943) (holding that the Seventh  
16 Amendment right to a jury trial does not apply in suits against the United States because  
17 it "hardly can be maintained that under the common law in 1791 jury trial was a matter of  
18 right for persons asserting claims against the sovereign"). Parties will not bring forward  
19 arguments that have been rejected in this order, but are free to argue that either method,  
20 or some other equitable method of allocating basis, is appropriate.

21 **IT IS THEREFORE ORDERED:**

- 22 1. Defendant's Motion for Summary Judgment (Doc. 64) is **denied**.
- 23 2. Plaintiffs' Motion for Summary Judgment (Doc. 67) is **denied**.

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