

# In the United States Court of Federal Claims

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EUGENE A. FISHER, )	
Trustee, SEYMOUR P. NAGAN )	
IRREVOCABLE TRUST, for itself and )	
as Representative of all similarly situated )	
taxpayers, )	No. 04-1726 T
<u>Plaintiff,</u> )	
)	(Filed May 23, 2005)
v. )	
)	
THE UNITED STATES, )	
)	
<u>Defendant.</u> )	
)	
_____ )	

## ORDER

On March 14, 2005, plaintiff filed a motion for partial summary judgment in the above-captioned matter. On April 4, 2005, defendant filed a motion for a continuance to permit discovery pursuant to RCFC 56(f), and a motion for a stay of all other proceedings on plaintiff's motion until the Court has determined whether the case can proceed as a class action. For the following reasons, defendant's motion for a continuance is GRANTED. Defendant's motion for a stay of proceedings is DENIED.

## ***BACKGROUND***

### **I. Plaintiff's Complaint**

On December 1, 2004, plaintiff filed a complaint in the Court of Federal Claims seeking a refund of \$5,725 in taxes that plaintiff paid after it sold 3,892 shares of stock in Sun Life Financial Services ("Sun Life Financial"). Compl. ¶ 2, 14. According to plaintiff, before March 22, 2000, Sun Life Financial existed as Sun Life Assurance Company ("Sun Life Assurance"), a mutual life insurance company. *Id.* ¶ 11. Plaintiff alleges that it had acquired a Sun Life insurance policy on the lives of Seymour and Gloria Nagan in 1990. *Id.* ¶ 10. By March 22, 2000, \$194,343.64 in premiums had been paid on the policy. *Id.*

On March 22, 2000, Sun Life Assurance converted from a mutual life insurance company to Sun Life Financial, a stock life insurance company. *Id.* ¶ 13. According to plaintiff, as a result of the demutualization of Sun Life Assurance, plaintiff and other participating policyholders

exchanged their rights in the surplus and other net assets of Sun Life Assurance for the rights of stockholders in Sun Life Financial, while still retaining their rights as policyholders pursuant to their life insurance contracts. *Id.* ¶ 11.

Plaintiff opted to have the Sun Life Financial shares sold upon issuance and thus received gross sales proceeds of \$33,082 and incurred a sales commission of \$1,323, leaving net proceeds of \$31,759 from the sale of the stock. Compl. ¶ 14. Plaintiff reported this amount on its federal income tax return for 2000. Plaintiff asserts that, based on the advice of Sun Life Financial, no tax basis was claimed for the stock that was sold. Therefore, the full \$31,759 was subject to tax, and tax of \$5,725 was paid. *Id.* According to plaintiff, the correct tax basis for calculating gain on the sale of the shares of Sun Life Financial was the fair market value of that stock as of the date plaintiff took ownership of it. Plaintiff contends that since the stock was sold the same day plaintiff acquired it, the fair market value can be calculated on the gross sales price, which was \$33,082. *Id.* ¶ 15. Plaintiff concludes that the sale of the 3,892 shares of Sun Life Financial with a tax basis of \$33,082 for a net amount of \$31,759 thus resulted in no gain to plaintiff and plaintiff is therefore entitled to a refund of \$5,725, the amount of tax that was paid on the sale.

Plaintiff also alleges that it represents a class of plaintiffs including all those U.S. taxpayers who were life insurance policyholders in mutual life insurance companies that have demutualized and:

- (a) paid federal income tax on cash received in lieu of stock in the demutualization transaction or paid federal income tax on the subsequent disposition of the stock received in the demutualization transaction;
- (b) filed claims with Defendant seeking refund of part or all of the tax paid in the transactions referred to in (a); and
- (c) have either had those claims denied by Defendant or have had more than six months pass from the date of filing those claims with the Defendant as of the date that the court certifies the class or as of some other date selected by the Court.

Compl. ¶ 5. In its prayer for relief, plaintiff requested that the Court:

- (A). Determine that this action is a proper class action, certify Plaintiff as class representative under rule 23 of the Rules of the Court, and certify Plaintiff's counsel as class counsel;
- (B). Determine that Plaintiff, in its individual capacity, is entitled to a refund of the \$5,725 of federal income tax it paid on the sale of its Sun Life Financial Services stock; and that the other members of the class are entitled to similar refunds of the federal income tax they paid on their disposition of stock, or rights thereto, in demutualization of the life insurance companies in which they held policies, based

upon allowing as tax basis in calculating gain the fair market value of such stock at the time received.

Compl. at 5-6. Defendant filed its answer on March 5, 2005.

## **II. Plaintiff's Motion for Partial Summary Judgment**

Plaintiff filed a motion for partial summary judgment on March 14, 2005, arguing that the fair market value of the Sun Life Financial stock when received became plaintiff's tax basis for that stock, and that therefore plaintiff realized no taxable gain on the sale of the stock.

Plaintiff asserts that as part of its insurance policy, plaintiff had ownership rights in Sun Life Assurance prior to demutualization. Mot. for Partial Summ. J. at 2. These rights entitled plaintiff to receive dividends in the event of a surplus, distributions in the event of liquidation, and to vote on the election of directors and other matters relating to the company that in a stock corporation would be required to be voted on by the shareholders. Plaintiff maintains that the ownership rights were an integral part of the life insurance contract. *Id.* Plaintiff had two sets of rights tied together under one life insurance contract: ownership rights and death benefits. *Id.* at 7. According to plaintiff, when Sun Life Assurance demutualized, plaintiff lost its ownership rights in Sun Life Assurance and became entitled to receive shares of common stock in Sun Life Financial. *Id.* On the basis of those assertions, plaintiff makes two arguments to support its motion.

Plaintiff first argues that pursuant to section 72(e) of the Internal Revenue Code ("I.R.C."), the benefit plaintiff received as a result of its ownership interest in Sun Life Assurance, *i.e.*, the value of the stock in Sun Life Financial, should have been excluded from plaintiff's income for tax purposes until the amounts received under the Sun Life Assurance insurance policy exceeded the total policy premiums paid. Mot. for Partial Summ. J. at 5-6 (citing I.R.C. § 72(e); Treas. Reg. § 1.72-1; *Moseley v. Commissioner*, 72 T.C. 183, 185-86 (1979)). Plaintiff concludes, therefore, that under I.R.C. section 72(e), the correct tax treatment to be accorded the \$31,759 received from the stock sale is to exclude it from plaintiff's gross income and treat it as a reduction, or partial recovery, of the investment in the policy, which as of March 22, 2000 was \$194,343.64.

Plaintiff appears to argue in the alternative that the demutualization should be treated as a corporate reorganization. According to plaintiff, the companies involved in demutualization have commonly sought and obtained private letter rulings from the Internal Revenue Service dealing with the tax consequences of the related corporate reorganizations. Mot. for Partial Summ. J. at 8. Such rulings generally have held that the transfer of policyholders' ownership rights for stock would be treated as would any other exchange of stock in a corporation for either stock of the same corporation (qualifying as tax-free under I.R.C. section 1036) or for stock pursuant to the reorganization by a party to the reorganization (qualifying as tax-free under I.R.C. section 354). *See, e.g.*, LTR 200020048, LTR 200011035, LTR 200022052, LTR 200002010.

P. App. 4, 23, 42. Plaintiff argues that, despite the applicability of sections 354 and 1036 to its case, the IRS disallowed plaintiff's claim for a refund. The IRS based its disallowance on Revenue Ruling 71-233, 1971-1 CB 113. *See* Notice of Disallowance of Claim, Compl. Ex. B. Plaintiff argues that Rev. Rul. 71-233 is not a proper basis for the disallowance. According to Rev. Rul. 71-233:

Payment by each policyholder of the premiums called for the by the insurance contracts issued by X represents payment for the cost of insurance and an investment in his contract but not an investment in the assets of X. His proprietary interest in the assets of X arises solely by virtue of the fact that he is a policyholder of X. Therefore, the basis of each policyholder's proprietary interest in X is zero.

*Id.* Plaintiff disputes the conclusion arrived at in Rev. Rul. 71-233, and contends instead that basis of the proprietary interest is an indeterminate portion of the premiums paid, not zero. Mot. for Partial Summ. J. at 9. Plaintiff argues that the zero basis conclusion set forth in Rev. Rul. 71-233 fails the test for judicial deference set forth in *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944). Therefore, plaintiff concludes, the IRS incorrectly relied on Rev. Rul. 71-233 in disallowing plaintiff's claim for a refund.

#### ***DEFENDANT'S MOTION FOR A CONTINUANCE***

In response to plaintiff's motion for partial summary judgment, defendant filed a motion for a continuance, pursuant to Rule 56(f) of the Rules of the Court of Federal Claims ("RCFC"), requesting a 120-day continuance in order to conduct discovery that defendant contends is necessary to respond to plaintiff's summary judgment motion. Defendant also requests that it be given a period of 20 days after the conclusion of the discovery period within which to file a response. According to RCFC 56(f):

Should it appear from the affidavits of a party opposing [a motion for summary judgment] that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

Defendant first argues that the documents in support of plaintiff's motion fail to develop the facts related to the demutualization of the life insurance company in issue. Defendant states that it needs a copy of the insurance policy issued to the Seymour P. Nagan Trust ("Trust"), and all amendments thereto, in order to determine what rights and privileges the Trust had that were allegedly surrendered in exchange for stock in Sun Life Financial.

Next, defendant states that it needs the entire plan of demutualization. Plaintiff attached only a few pages of the plan to its motion for partial summary judgment. *See Mot. for Partial Summ. J. Ex. A.* Defendant contends that the full details of the plan at issue and the information provided by Sun Life Assurance to the policyholders is necessary for a full understanding of the transaction at issue.

Defendant then argues that because any proposed demutualization would have been submitted to state regulators and approved under the laws of a particular state, defendant needs to determine the state in which the demutualization occurred. Defendant states it also needs to determine the state agency responsible for regulating the insurance company, and to obtain all communications between the state regulators and the insurance company.

Finally, defendant states that it needs information regarding the schedule and proof of payment of premiums and any policyholder dividends, any policy loans or death benefits, the income tax treatment of those items, and accounting records related to the manner in which the insurance company accounted for the rights and privileges held by policyholders. Defendant contends that this information is necessary in order to determine the nature of any equity interest that plaintiff, as a policyholder, might have held in the insurance company. Defendant emphasizes that the answer to that question is central to the argument raised in plaintiff's motion.

Plaintiff opposes defendant's motion for a continuance, arguing that the zero basis issue addressed in its motion for summary judgment is purely legal, and that therefore discovery is not required in order to respond. Determining the basis that plaintiff had in the Sun Life Financial stock, however, appears to involve questions of fact, as well as the application of law to the pertinent facts. The IRS based its determination that plaintiff had a zero basis in the Sun Life Financial stock on the nature of plaintiff's equity interest in Sun Life Assurance prior to demutualization. According to defendant, the IRS concluded that plaintiff, as a policyholder, only had a contractual right and any equity interest plaintiff might have had was unascertainable. Defendant contends that since the equity interest was unascertainable at the time of demutualization, plaintiff's basis in that interest – and consequently its shares of Sun Life Financial stock – was zero. The discovery requested by defendant relates to the nature and extent of any equity interest that plaintiff had in Sun Life Assurance at the time of demutualization, an issue that appears to involve factual as well as legal issues.

Plaintiff also argues that discovery is not required because the information sought by defendant has been provided to the IRS in connection with other proceedings. In response, defendant states that it is in the process of obtaining from the IRS the background files related to the rulings referenced by plaintiff. Those files, however, may be unavailable or incomplete. Defendant adds that much of the discovery sought relates to matters that are probably not included in the IRS file, such as correspondence between Sun Life Assurance and plaintiff and state regulators, as well as details of demutualization-related proceedings before state regulatory bodies. Finally, defendant contends that the documents related to the schedule and proof of payment of premiums, policyholder dividends, policy loans or death benefits, the income tax

treatment of those items, and accounting records related to the manner in which Sun Life Assurance accounted for policyholder's rights and privileges would not be expected to be in the IRS files.

Defendant has made a sufficient showing that it needs to conduct discovery to ascertain facts essential to justify its opposition to plaintiff's motion for partial summary judgment. The Court, therefore, grants defendant's motion for a continuance. The Court also grants defendant's request that it be given a period of 20 days after the conclusion of the discovery period within which to file a response to plaintiff's motion.

### ***DEFENDANT'S MOTION FOR A STAY OF THE PROCEEDINGS***

Defendant also filed a motion for a stay of all other proceedings on plaintiff's motion for partial summary judgment pending the Court's determination of whether the case can proceed as a class action.

RCFC 23(c)(1) states: "When a person sues or is sued as a representative of a class, the court must – at an early practicable time – determine by order whether to certify the action as a class action." In its complaint, plaintiff requested that the Court certify the action as a class action. Compl. ¶¶ 5-9. Defendant argues that the Court should decide plaintiff's request for class certification before proceeding on the merits.<sup>1</sup> Def. Mot. for Stay at 2.

Defendant argues that the Supreme Court has held that there is "nothing in either the language or history of Rule 23 that gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action. Indeed, such a procedure contravenes the Rule by allowing a representative plaintiff to secure the benefits of a class action without first satisfying the requirements for it." *Eisen v. Carlise & Jacquelin*, 417 U.S. 156, 177 (1974).

This Court does not intend to rule on plaintiff's request for class certification based upon its view of the merits of plaintiff's claims. The Court, however, believes it would be desirable to have the parties complete briefing on plaintiff's summary judgment motion and at the same time require that plaintiff file a motion for class certification by a date certain. The goal would be to have both motions fully briefed at the time the Court determines whether the case may properly

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<sup>1</sup> Defendant notes that normally discovery would be stayed pending determination of class certification. However, in this case defendant proposes the limited discovery sought in its motion for continuance because it relates only to the facts set forth in plaintiff's motion and to plaintiff's proposed findings of uncontroverted facts. Defendant suggests that such discovery be conducted concurrently with the proceedings on class certification so as to avoid any undue delay. Def. Mot. for Continuance at 1 n.1. The Court agrees with that approach and will order that, in addition, briefing on the summary judgment motion be completed concurrently with the proceedings on class certification.

proceed as a class action. Whether or not the Court grants class certification, it will presumably have to deal with the merits of plaintiff's claims either as a representative of a class or as an individual.

Accordingly, the Court will order the parties to brief plaintiff's motion for class certification while defendant conducts its Rule 56(f) discovery, responds to plaintiff's summary judgment motion, and plaintiff files its reply. The Court will therefore deny defendant's motion for a stay of proceedings and will direct plaintiff to file a motion for class certification within 30 days of the date of this Order.

### ***CONCLUSION***

For the reasons stated above, defendant's motion for a continuance is GRANTED, and defendant's motion for a stay of proceedings is DENIED.

The Court ORDERS that defendant shall conduct discovery as set forth in its motion for continuance for a period of 120 days, concluding **Tuesday, September 20, 2005**. Defendant shall thereafter file its opposition to plaintiff's motion for partial summary judgment by **Monday, October 10, 2005**. Plaintiff shall file a reply by **Monday, October 24, 2005**.

The Court FURTHER ORDERS that plaintiff shall file a motion for class certification by **Thursday, June 23, 2005**. The parties shall file responsive briefs in accordance with deadlines set forth in RCFC 7.2.

IT IS SO ORDERED.

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GEORGE W. MILLER  
Judge