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# TAXATION-INCOME TAX-TAXABLE PERSONS--ASSIGNMENT OF LICENSE ROYALTIES

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TAXATION—INCOME TAX—TAXABLE PERSONS—ASSIGNMENT OF LICENSE ROYALTIES—*X* contracted with a corporation controlled by him for the manufacture of machines on which he held patents. No minimum was established with respect to production or the payment of royalties. The contracts were terminable by either party upon notice, and *X* was free to make similar contracts with other manufacturers. *X* assigned all his interest in the contracts and exclusive title and power over the royalties to his wife, who thereafter received all payments and reported them as her income. The Tax Court ruled that since *X* could cancel the contracts directly, and could indirectly control the contracts through the corporation, the royalties were taxable to him.[1] The circuit court of appeals reversed, holding that there was a complete assignment of the contracts, and that *X* should not be taxed because of his indirect control, absent fraud.[2] On certiorari, *held*, reversed. The Supreme Court noted, first, that control of the corporation gave *X* power to control the flow of royalties to his wife, and even to terminate the contracts, without perpetrating any fraud; second, that *X* could negotiate other contracts, which would tend to reduce the amount of royalties paid to his wife; third, that *X* indirectly benefited from payments made to her. *Commissioner v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715 (1948).[3]

Family arrangements, offering attractive possibilities for distributing a taxpayer's income into lower tax brackets while assuring an ultimate disposition satisfactory to him, have received short shrift at the hands of a Court sensitive to the Congressional desire to tighten the tax statute,[4] and cognizant of the requirements for efficient tax administration.[5] Outright assignment of income was

[1] 6 T.C. 431 (1946). The conclusion that *X* could directly cancel the contracts seems unwarranted.

[2] Sunnen v. Commissioner, (C.C.A. 8th, 1947) 161 F. (2d) 171.

[3] See 61 HARV. L. REV. 1463 (1948), for a discussion of a question of res judicata also involved in this case.

[4] See H.R. No. 179, 68th Cong., 1st sess., p. 21 (1923), quoted by Cardozo, J., in Burnet v. Wells, 289 U.S. 670 at 675, 53 S.Ct. 761 (1933): "The purpose of this subdivision of the bill is to stop this evasion."

[5] 1 PAUL AND MERTENS, FEDERAL INCOME TAXATION, § 10.04 (1934). For discussions of the Court's approach to the cases, see Surrey, "The Supreme Court and the

summarily disposed of, Justice Holmes observing that regardless of the motive behind the assignment, the "fruit" would be attributed to the "tree" on which it grew.[6] Where title to the "tree" itself is transferred to a family member or trustee, the court has cut through technical "refinements of title," examining the basic features of the transaction to determine whether or not the donor still has a substantial interest in the income or its source.[7] The transferor's interest is sufficient to warrant taxing the income to him where the conveyance is revocable,[8] or only for a term,[9] or where it does not divest him of control over the disposition of the income,[10] or where the income is used to discharge his obligations.[11] Even an irrevocable transfer of an interest in a partnership, valid under local law, does not result in an income-tax economy if the taxpayer retains the full responsibility of management.[12] The case for taxing the transferor is strengthened if the person who receives the beneficial interest in the source of the income is the same person to whom he would have given the income had he received it himself; realization being derived from the "flow of satisfaction."[13] The decision in the principal case is consistent with the established theories. The Court, adhering to its policy of

Federal Income Tax," 35 ILL. L. REV. 779 (1941), and Surrey, "Assignments of Income and Related Devices: Choice of the Taxable Person," 33 COL. L. REV. 791 at 793 and 831 (1933).

[6] Lucas v. Earl, 281 U.S. 111, 50 S.Ct. 241 (1930) (future earnings). Accord: Helvering v. Eubank, 311 U.S. 122, 61 S.Ct. 149 (1940) (income earned but not realized); Rosenwald v. Commissioner, (C.C.A. 7th, 1929) 33 F. (2d) 423 (assignment of dividends).

[7] "The Government may look at actualities and upon determination that the form employed . . . is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute." Higgins v. Smith, 308 U.S. 473 at 477, 60 S.Ct. 355 (1940).

[8] Corliss v. Bowers, 281 U.S. 376, 50 S.Ct. 336 (1930). The case was controlled by what is now I.R.C., § 166.

[9] Harrison v. Schaffner, 312 U.S. 579, 60 S.Ct. 759 (1941). United States v. First National Bank of Birmingham, (C.C.A. 5th, 1934) 74 F. (2d) 360, contra, now seems of doubtful validity; 29 CAL. L. REV. 495 (1941). The case where the trust is not to benefit a member of the settlor's family has been distinguished. Commissioner v. Chamberlain, (C.C.A. 2d, 1941) 121 F. (2d) 765.

[10] Helvering v. Clifford, 309 U.S. 331, 60 S.Ct. 554 (1940).

[11] Helvering v. Schweitzer, 296 U.S. 551, 56 S.Ct. 304 (1935); United States v. Joliet & Chicago R.R. Co., 315 U.S. 44, 62 S.Ct. 442 (1942).

[12] Commissioner v. Tower, 327 U.S. 280, 66 S.Ct. 532 (1946); Lusthaus v. Commissioner, 327 U.S. 293, 66 S.Ct. 539 (1946). For a count of the decisions and analysis of the family partnership cases, see Sizer, "Federal Income Tax Treatment of Family Partnerships Since the Tower and Lusthaus Cases," 1947 WIS. L. REV. 293. See also Barkan, "Family Partnerships Under the Income Tax," 44 MICH. L. REV. 179 (1945).

[13] Burnet v. Wells, 289 U.S. 670, 53 S.Ct. 761 (1933); Helvering v. Horst, 311 U.S. 112, 61 S.Ct. 144 (1940); 29 CAL. L. REV. 495 (1941). In the Horst case it is suggested that this test is broad enough to embrace disposition of any income the taxpayer "could have received himself." This suggestion has not been literally accepted. Jones v. Commissioner, 2 T.C. 924 (1943). For a discussion of the "flow of satisfaction" doctrine, see 2 MERTENS, LAW OF FEDERAL INCOME TAXATION, §11.02 (1942).

looking behind the transfer of title, realistically concluded that *X* retained "something more than a memory."[14] It must be noted that in cases arising after the effective date of the Revenue Act of 1948,[15] the policy exemplified in the principal case can have significance only with respect to transactions between the taxpayer and persons other than his wife.

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[14] Principal case at 608. Where the patents as well as the contracts are assigned, a different case is presented. Nelson v. Ferguson, (C.C.A. 3d, 1932) 56 F. (2d) 121, cert. den., 286 U.S. 565, 52 S.Ct. 646 (1932).

[15] P.L. 471, 80th Cong., 2d sess., c. 168, § 301 (1948) permits husband and wife to "split" their income.