Doll v. Commissioner, 2 T.C. 276 (1943)

Income is taxable to the person who earns it, and attempts to assign income to another party, such as through an artificial partnership, will not shift the tax liability.

Summary

Francis Doll argued that a partnership agreement with his wife, Cornelia, made half of his shoe-selling income taxable to her. The Tax Court disagreed, finding the agreement was a sham to avoid taxes. Doll continued to operate the business, control its income, and the purported partnership lacked essential characteristics like Cornelia's capital contribution or management authority. The court also rejected the argument that a state court decree recognizing the partnership was binding, as the state court case was collusive and designed to affect the federal tax liability.

Facts

Francis Doll operated a shoe-selling business, earning commissions. On December 15, 1932, Doll executed a written agreement purporting to create a partnership with his wife, Cornelia. Cornelia contributed no capital. She performed some services, such as secretarial work, for which she was compensated separately at $200/month. Francis Doll continued to operate the business as before, retaining complete control and receiving the income. Doll reported all income as his own until the tax years in question.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Francis Doll, determining that all income from the shoe-selling business was taxable to him. Doll petitioned the Tax Court for a redetermination, arguing the income was partnership income. A state court case was filed where Cornelia sued Francis, and Francis admitted to all the allegations in the suit, so that the state court could determine that the shoe business was a partnership.

Issue(s)

1. Whether the agreement between Francis and Cornelia Doll created a valid partnership for federal income tax purposes, such that half of the shoe-selling income was taxable to Cornelia.
2. Whether a state court decree recognizing the partnership was binding on the Tax Court in determining federal income tax liability.

Holding

1. No, because Francis Doll continued to control and earn the income, and the purported partnership lacked essential characteristics of a genuine partnership.

2. No, because the state court proceeding was collusive and designed to affect federal tax liability, and thus not binding on the Tax Court.

Court’s Reasoning

The court reasoned that the shoe-selling business was essentially Francis Doll’s, and the income was primarily due to his personal activities and abilities. The court emphasized that Cornelia contributed no capital, had no management authority, and received a separate salary for her services. The court stated that the arrangement was “another of those efforts to make future returns from personal services taxable to some one other than the real earner of them.” Citing *Lucas v. Earl*, 281 U.S. 111, the court found that income must be taxed to the one who earns it. Regarding the state court decree, the Tax Court found the proceeding was collusive because there was no real dispute between Francis and Cornelia. The suit was prompted by the IRS’s determination against Francis, and Francis admitted all allegations in Cornelia’s petition. The Tax Court distinguished *Freuler v. Helvering*, 291 U.S. 35, because that case involved a genuine controversy in state court.

Practical Implications

This case reinforces the principle that taxpayers cannot avoid income tax liability by artificially assigning income to another person or entity. It serves as a cautionary tale against creating sham partnerships or other arrangements solely for tax avoidance purposes. Courts will look to the substance of the arrangement, rather than its form, to determine who actually earns the income. Later cases have cited *Doll v. Commissioner* to support the principle that state court decrees are not binding on federal tax authorities when they are the product of collusion or lack a genuine adversarial proceeding. Attorneys advising clients on tax matters should emphasize the importance of ensuring that business arrangements reflect economic reality and are not merely designed to minimize tax liability.

