5 T.C. 954 (1945)

A partner's attempt to assign income from a partnership to his wife via a gift is considered an anticipatory assignment of income and is still taxable to the partner, especially where the partnership continues to operate and the wife does not become a true partner.

Summary

Robert Lubets attempted to assign his share of income from a dissolving partnership to his wife via a deed of gift. The Tax Court held that this assignment was an anticipatory assignment of income and that Robert, not his wife Lillian, was liable for the income tax on that share. The court reasoned that the partnership was still in the process of winding up its affairs, Lillian did not become a true partner with the consent of the other partner, and the income was derived from Robert's rights and obligations under the partnership agreement.

Facts

Robert and Moses Lubets operated a public accounting and real estate tax consulting partnership. In April 1941, they agreed to dissolve the partnership, with Robert taking the accounting practice and Moses the tax practice. They agreed to equally share profits from pending real estate tax cases taken on a contingent fee basis. Robert then executed a deed of gift, assigning his interest in the tax business to his wife, Lillian. Lillian performed no services for the partnership.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Robert Lubets' income tax for 1941, arguing that the income assigned to his wife was taxable to him. Lubets contested this adjustment in the Tax Court.

Issue(s)

Whether Robert Lubets or his wife, Lillian, is taxable on one-half of the net profits arising from the liquidation of the tax business of the Lubets & Lubets partnership for the period after Robert executed a deed of gift assigning his interest to her.

Holding

No, Robert Lubets is taxable on the income because the deed of gift was an anticipatory assignment of income, the partnership was still in the process of winding up its affairs, and Lillian did not become a true partner with the consent of Moses Lubets.

Court's Reasoning

The court relied on the principle that income is taxed to the one who earns it, even if assigned to another party. The court noted that the partnership was not terminated by the deed of gift, as the winding up of its affairs was ongoing. It emphasized that Lillian never became a true partner because Moses Lubets did not consent to substitute her for Robert, especially considering the original partnership agreement required both brothers' consent for liquidation matters. The court cited *Burnet v. Leininger, 285 U.S. 136*, for the proposition that a partnership interest cannot be effectively assigned without the consent of the other partners. The court found that Robert retained rights and obligations under the partnership agreement, further supporting the determination that the gift was merely an attempt to shift income tax liability. The court stated, "In the instant proceeding the principal subject matter of the gift was petitioner's interest in the outcome of the tax cases that were pending at the time of the dissolution agreement and were still pending on April 30, 1941, the date of the deed of gift. These cases were all taken on a contingent fee basis. Only if the partnership was successful in getting the tax assessment reduced would there be a fee… Under such circumstances we think the gift which petitioner made to his wife was one of 'income from property of which the donor remains the owner, for all substantial and practical purposes.'"

Practical Implications

This case reinforces the principle that taxpayers cannot avoid income tax liability by assigning income that they have a right to receive. The key takeaway is that a mere assignment of partnership income, without a genuine transfer of the underlying partnership interest and consent of the other partners, will not shift the tax burden. *Lubets* serves as a reminder to carefully structure business arrangements and gift transactions to ensure that the economic substance aligns with the desired tax consequences. Later cases have cited this ruling when assessing the validity of income-shifting arrangements, particularly in the context of partnerships and closely held businesses. For tax practitioners, it emphasizes the importance of analyzing the true nature of the transfer and the continued involvement of the assignor in the income-generating activity.

