12 T.C. 1212 (1949)

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Income from a contract is taxable to the entity that earned it, regardless of any prior assignment of the income to another party.

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Summary

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Essex Construction Co. was awarded a government construction contract but assigned it to its president. The Tax Court addressed whether the profits from this contract were taxable to the corporation or to its president, the assignee. The court held that the income was taxable to the corporation because the corporation initially earned the income through the contract and actively participated in essential aspects of the contract's fulfillment, even after the assignment. The court also determined that a payment made to the company president by an architect was not taxable to the corporation as it was a personal transaction.

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Facts

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Essex Construction Co. (petitioner) was awarded a contract by the Federal Public Housing Authority. Unable to meet the government's bond requirements, Essex partnered with McLean and Wright. The contract stipulated that it could not be assigned. Simultaneously with the government contract, Essex entered into an agreement with McLean, Wright, and Frank B. Essex, Sr. (president of Essex Construction), where McLean and Wright would perform the work and Essex would receive 36% of the net profits, paid directly to Essex, Sr. Essex also executed an agreement to assign all rights and interest in the contract to Essex, Sr., who provided an indemnity to protect Essex from loss.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in Essex Construction's income tax, declared value excess profits tax, and excess profits tax. Essex Construction petitioned the Tax Court for a redetermination of these deficiencies. The central issue was whether the profits from the assigned government contract were taxable to the corporation or its assignee (the president). The Tax Court ruled in favor of the Commissioner, holding the income taxable to the corporation.

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Issue(s)

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1. Whether the income derived from the government construction contract, initially awarded to Essex Construction and subsequently assigned to its president, is taxable to the corporation or to the president, the assignee.

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2. Whether a payment made to the petitioner's president by an architect employed to work on the contract is taxable to the petitioner.

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Holding

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1. No, because the corporation initially earned the income through the contract and actively participated in essential aspects of the contract's fulfillment, rendering the assignment ineffective for tax purposes.

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2. No, because the payment was a personal transaction between the architect and the president, with no benefit accruing to the corporation.

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Court's Reasoning

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The court reasoned that the income was attributable to Essex Construction under

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two possible views. First, if Essex Construction's role was complete upon securing the contract, the subsequent payments to its president were essentially corporate earnings distributed to a stockholder. Second, even if certain activities remained for Essex Construction to complete, the renegotiation of the contract and final release from obligations constituted performance by the corporation, making the income taxable to it regardless of the prior assignment.

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The court distinguished this case from others where assignments were effective, emphasizing that Essex Construction continued to participate and maintain an interest in the contract after the assignment. As the court stated, "Under the latter approach, the earning of the profit was carried out by petitioner and whatever performance was required as to its participation was completed by it. On that theory, no prior assignment of the earnings would prevent their taxation to petitioner."

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Regarding the payment to the president by the architect, the court found no basis for taxing it to the corporation, stating, "Petitioner did not receive the money. It did not earn it, and was never entitled to it."

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