15 T.C. 160 (1950)

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This case addresses the taxability of royalty income, the effectiveness of assigning income to discharge alimony obligations, and the deductibility of various losses, including those from property sales and abandonments.

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Summary

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The Tax Court addressed several tax issues raised by the petitioner, John Randolph Hopkins, including the nature of royalty payments he received from a drug manufacturer, the validity of assigning royalty income to cover alimony, and the deductibility of losses from the sale or abandonment of various properties. The court held that royalty payments were taxable as ordinary income, the assignment of royalty income did not relieve Hopkins of tax liability, and denied certain loss deductions due to insufficient proof of business purpose or abandonment.

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Facts

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John Randolph Hopkins received royalty payments from Lambert Pharmacal Co. based on an agreement between the company and Hopkins's great-grandfather. Hopkins assigned a portion of these royalties to his ex-wife to meet alimony obligations. He also incurred losses from the sale of properties in Massachusetts and Maryland, and claimed abandonment losses on inherited properties in New York. Additionally, he formed a corporation to manage and sell inherited property in Florida, which later resulted in a loss after a partition sale.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in Hopkins's income

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tax for the years 1939, 1940, and 1941. Hopkins petitioned the Tax Court, contesting the Commissioner's determinations regarding royalty income, alimony assignments, and various loss deductions.

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Issue(s)

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1. Whether the annual sums received by Hopkins from Lambert Pharmacal Co. constituted ordinary income or capital gains.

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2. Whether the assignment by Hopkins of $12,000 annually from the payments receivable from Lambert Pharmacal Co. was effective in relieving him of taxability on those sums.

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3. Whether Hopkins sustained a deductible loss from the sale of property in Stockbridge, Massachusetts.

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4. Whether Hopkins sustained a deductible loss from the sale of property in Cambridge, Maryland.

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5. Whether Hopkins was entitled to an abandonment loss deduction for inherited property in New York City and Irvington, New York.

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6. Whether the foreclosure of a tax lien on inherited property resulted in a capital loss, and if so, the amount of the loss.

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7. Whether the corporate entity formed by Hopkins to develop and sell Florida real estate should be disregarded, and whether the resulting loss was within the ban of section 24(b)(1)(A) of the Internal Revenue Code.

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8. Whether Hopkins was entitled to deduct back taxes paid to redeem property.

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9. Whether the discount on a loan obtained by Hopkins was deductible as interest in the years payments were made.

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10. Whether repairs to a yacht owned by Hopkins were deductible as business expenses or expenses for the maintenance of property held for the production of income.

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Holding

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1. No, because the payments were royalties under a licensing agreement, not proceeds from a sale.

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2. No, because anticipatory assignment of income does not shift tax incidence.

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3. No, because the property was primarily residential, and the farming activities were incidental.

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4. No, for the same reason as Issue 3.

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5. No for the NYC property; yes for the Irvington property, because there was a clear intent to abandon the Irvington property in 1941 and the tax arrearages greatly exceeded the fair market value.

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6. Yes, because the foreclosure was a sale or exchange of a capital asset.

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7. No, because the corporation served a legitimate business purpose and was not a sham.

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8. Yes, because under local law, the arrearages created a personal liability until redemption or foreclosure.

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9. Yes, the $1,500 discount was interest, and deductible in the years payments were made.

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10. Yes, the repairs are deductible as expenses paid for the maintenance or conservation of property held for the production of income under Section 23(a)(2), I.R.C.

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Court’s Reasoning

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The court reasoned that the 1885 instrument indicated a licensing arrangement, not a sale, due to the absence of a conveyance of exclusive rights to the Listerine formula. Regarding the alimony assignment, the court relied on the principle that anticipatory assignments of income do not shift tax liability. For the property losses, the court found that the farming activities were incidental to the residential use of the properties. As to the inherited properties, only the Irvington property showed a clear intent to abandon, substantiated by notifying the real estate agent to stop attempting to sell the property. The Court stated, “As elucidated by the Supreme Court, it appears clear that where a husband in contemplation of divorce makes an absolute transfer to his wife of securities in full settlement of all of his marital obligations, the income from the securities thereafter received by his divorced wife is taxable to her.”

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