16 T.C. 1435 (1951)

When income is primarily derived from capital, rather than labor or services, tax liability follows ownership of the capital asset.

Summary

Wheelock sought a determination that the transfer of a portion of their oil and gas lease interest to their son via warranty deed shifted the tax burden on the income derived from that interest. The IRS argued that the income remained taxable to Wheelock. The Tax Court held that because the income was primarily derived from the capital asset (the oil and gas leases) and not from personal services, the transfer of ownership via warranty deed effectively shifted the tax liability to the son. This ruling highlights the distinction between assigning partnership income versus transferring ownership of income-producing property.

Facts

J.N. Wheelock and his wife owned a one-eighth interest in certain oil and gas leases and producing wells. They executed a warranty deed conveying one-half of their one-eighth interest to their son, J.N. Wheelock, Jr. The income in question was primarily attributable to the large volume of oil and gas and the richness and productivity of the leases. While H.M. Harrell provided some services, the court found that capital was the primary income driver.

Procedural History

The Commissioner of Internal Revenue determined that the income from the transferred interest was still taxable to Wheelock and his wife. Wheelock petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the warranty deed conveying a portion of the oil and gas lease interest to the son effectively shifted the tax liability for the income derived from that interest.

Holding

1. Yes, because the income was primarily derived from capital (the oil and gas leases) and not from the personal services of Wheelock or his wife; therefore, tax liability follows ownership.

Court's Reasoning

The court distinguished this case from cases involving the assignment of partnership income, such as *Burnet v. Leininger*, 285 U.S. 136 (1932), and *United States v.*

Atkins. In those cases, the taxpayer remained taxable on their full share of partnership income despite assigning a portion of their interest, because the assignee did not become a true partner and the income was tied to the partnership business. Here, the court emphasized that Wheelock transferred ownership of the "corpus" (the oil and gas leases) that produced the income. The court stated that "Where income is derived from capital or where capital rather than labor and services so largely predominates in the production of the income that labor as a contributing factor may be considered de minimis, the tax liability for such income follows ownership." Because the income was primarily attributable to the capital asset, the transfer of ownership shifted the tax liability.

Practical Implications

This case clarifies that a taxpayer can shift the tax burden by transferring ownership of income-producing property, particularly when the income is primarily derived from capital and not from personal services. This contrasts with assigning partnership income, where the assignor often remains taxable. The key takeaway is the importance of distinguishing between assigning an interest in a business versus conveying actual ownership of the underlying assets that generate the income. Later cases have cited Wheelock to reinforce the principle that tax liability aligns with ownership of capital assets when capital is the primary income source. When analyzing similar cases, attorneys should focus on the source of the income and whether there was a genuine transfer of ownership of the underlying income-producing asset.

