***T.C. Memo. 1953-257***

Income from property is taxable to the assignor if the assigned income is used to satisfy the assignor's debt, and the assignment does not transfer the primary obligation for the debt to the assignee.

**Summary**

Rakowsky assigned his royalty contract to his daughter, Janis, but the royalties were still being used to pay off Rakowsky's debt to Cyanamid. The Tax Court held that the royalties were taxable to Rakowsky, not Janis. The court reasoned that Janis never assumed Rakowsky's debt, and the payments directly benefited Rakowsky by reducing his outstanding obligation. Even though the royalty income was nominally paid to Janis, it was effectively controlled by Rakowsky because it was used to discharge his liability.

**Facts**

1. Rakowsky purchased a one-third interest in a corporation, paying with a $50,000 promissory note.
2. Rakowsky assigned his patent royalties to Cyanamid as security for the $50,000 note.
3. The royalty income was paid directly to Cyanamid and applied to Rakowsky's debt.
4. Rakowsky later assigned the royalty contract to his daughter, Janis, but the assignment was subject to Cyanamid's prior right to the royalties until Rakowsky's debt was paid.
5. Janis did not expressly assume Rakowsky's debt to Cyanamid.

**Procedural History**

The Commissioner of Internal Revenue determined that the royalty income paid to Cyanamid was taxable to Rakowsky. Rakowsky petitioned the Tax Court for a redetermination. The Tax Court upheld the Commissioner's determination.

**Issue(s)**

Whether royalties assigned to Rakowsky's daughter, but used to pay Rakowsky's debt to a third party, are taxable to Rakowsky.

**Holding**

Yes, because the assignment to the daughter did not relieve Rakowsky of the primary obligation for the debt, and the royalty payments directly benefited Rakowsky by reducing his indebtedness.

**Court's Reasoning**

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The court focused on whether Janis assumed Rakowsky's debt when he assigned her the royalty contract. The court determined she did not.

The court distinguished this case from situations where the assignee assumes the debt. Referencing *J. Gregory Driscoll, 3 T. C. 494*, the court highlighted that if Janis were the taxpayer, the outcome would be different. In *Driscoll*, the income was committed to paying another's debt and the assignor had not assumed the debt. Here, Rakowsky remained primarily liable for the debt to Cyanamid, and the royalty payments directly reduced his liability.

The court emphasized that the agreement stated the assignment to Janis was subject to prior agreements and contracts. Janis was obligated to comply with these preexisting agreements, but she did not become the primary debtor to Cyanamid.

The court concluded that the royalties were used to cancel Rakowsky's debt, making the income taxable to him, not his daughter. This ruling aligns with the principle that income is taxed to the one who controls it and benefits from it, even if it's nominally paid to another party.

**Practical Implications**

This case illustrates that simply assigning income to another party doesn't automatically shift the tax burden. Courts will look at the substance of the transaction to determine who ultimately controls and benefits from the income. If assigned income is used to satisfy the assignor's debt, and the assignee doesn't assume the debt, the income remains taxable to the assignor.

Attorneys must carefully analyze assignment agreements to determine whether a true transfer of economic benefit has occurred. Mere assignment of a revenue stream is insufficient to shift tax liability if the assignor continues to benefit directly from the income. This is particularly relevant in situations involving pre-existing debt obligations. Later cases would cite this case as an example of assignment of income doctrine.

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