***17 T.C. 1517 (1952)***

Amounts received from the purported sale of personal service contracts are taxable as ordinary income, not capital gains, especially where the contracts are immediately canceled and replaced by new contracts between the service provider and a third party.

### Summary

General Artists Corporation, a booking agency, sought to treat income from an agreement with MCA Artists, Ltd. as long-term capital gains. The agreement involved the transfer of agency contracts with Frank Sinatra. The Tax Court held that the income was ordinary income, not capital gains, because the contracts involved personal services, were immediately canceled and replaced, and the payments were essentially for future services performed by MCA, with a portion remitted to General Artists. This case illustrates the principle that income derived from personal services is generally taxed as ordinary income, even when structured as a sale of contract rights.

### Facts

General Artists Corporation (GAC) was a booking agency that represented entertainers. GAC had contracts with Frank Sinatra to act as his exclusive agent in variety, broadcasting, and motion picture fields, entitling GAC to 10% of Sinatra's earnings. GAC entered into an agreement with MCA Artists, Ltd. (MCA) to "sell" these contracts. MCA agreed to perform GAC's duties under the contracts and to use its best efforts to enter into new contracts with Sinatra. MCA agreed to pay GAC a percentage of the commissions earned from Sinatra's new contracts. Sinatra endorsed the agreement. GAC did not procure any new employment for Sinatra after the agreement with MCA.

### Procedural History

The Commissioner of Internal Revenue determined a deficiency in GAC's excess profits tax, arguing that the amounts received from MCA should be treated as ordinary income rather than long-term capital gains. GAC petitioned the Tax Court for review.

### Issue(s)

1. Whether the amounts received by GAC from MCA for the transfer of its agency contracts with Frank Sinatra constitute proceeds from the sale of a capital asset taxable as a long-term capital gain.

### Holding

1. No, because the contracts involved personal services, were immediately canceled

 

and replaced by new contracts, and the payments represented compensation for future services provided by MCA.

### Court's Reasoning

The Tax Court reasoned that GAC did not actually sell its agency contracts to MCA because the contracts were immediately canceled, and MCA entered into new contracts with Sinatra. The court emphasized that the contracts involved personal services. Quoting *Thurlow E. McFall, 34 B.T.A. 108*, the court stated that petitioners cannot sell contracts for personal services. The court further reasoned that the payments from MCA to GAC were essentially compensation for permitting MCA to perform services and earn commissions. The court cited the principle that assigning income does not relieve the assignor of tax liability, particularly when the income is earned on contracts obtained through the assignor's efforts. Referencing *Lucas v. Earl, 281 U.S. 111*, the court highlighted the principle that income must be taxed to him who earns it. The court concluded that GAC failed to prove that the Commissioner erred in taxing the entire amount as ordinary income. A dissenting opinion argued the contract was assignable with consent of all parties.

### Practical Implications

This case clarifies that proceeds from the transfer of personal service contracts are generally treated as ordinary income, especially when the contracts are short-term, immediately replaced, and the transferor continues to receive payments based on the transferee's performance. This principle has implications for structuring business transactions involving personal service providers, such as athletes, entertainers, and consultants. Legal professionals must consider the substance of the transaction, rather than its form, to determine the appropriate tax treatment. The case highlights the importance of distinguishing between the sale of a capital asset and the assignment of future income. Later cases have cited this decision to deny capital gains treatment for transactions that effectively represent the assignment of compensation for personal services.