***Wood v. Commissioner*, 27 T.C. 536 (1957)**

Income from an assigned property interest that is still subject to a community debt is taxable to the assignor to the extent that the debt is relieved by the income, even if the assignee now owns the fee of the interest.

Summary

The case concerns the tax liability of a divorced woman, Myrtle Wood, regarding income generated from her assigned oil property interest, which was burdened by community debt. Wood had assigned a portion of her interest to her attorney, Sam Pittman, in consideration for legal services during her divorce. The Commissioner determined Wood was taxable on all the income generated by this property, including the portion assigned to Pittman. The court agreed, holding that because the income from the properties was used to satisfy community debt, Wood was responsible for the taxes on the income, even though she assigned a part of her interest. The court further determined that Wood's interest was a present interest, not a remainder, despite the fact that creditors had priority to the funds. The ruling illustrates how the satisfaction of community debts from income can determine tax liability, even after property ownership has been reassigned.

Facts

Myrtle J. Wood and Fred M. Wood were divorced in 1951. During their marriage, they owned community property, including a 45% interest in a joint oil venture with Pierce Withers and Robert W. McCullough. The agreement stated income was to be used to pay expenses, and the balance was to be applied to the debt Withers was owed. In the divorce decree, Myrtle Wood was awarded a one-half interest (22.5%) in the 45% interest in the oil properties. The decree specified that she would receive her interest after the payment of community debts. The court held that the parties understood Myrtle's interest in the property was a present interest, and that she was to pay her one-half share of community indebtedness from the property. Shortly after the divorce, Myrtle assigned one-third of her interest to her attorney, Sam Pittman, in exchange for his services. The income from the oil properties was used to satisfy community debt, and the Commissioner of Internal Revenue asserted deficiencies in Myrtle Wood's income taxes for 1951 and 1952, claiming the income was taxable to her. The case was brought to the U.S. Tax Court.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies and additions to the tax for the years 1951 and 1952. Myrtle J. Wood contested the Commissioner's determination in the U.S. Tax Court. The Tax Court heard the case, considered the evidence and arguments presented by both sides, and issued a ruling.

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Issue(s)

1. Whether Myrtle Wood was taxable on one-half of the income from the 45% interest in the joint oil venture during the years in question.

2. Whether the amount of income allocable to one-third of the one-half interest, which Myrtle assigned to Sam I. Pittman, was taxable to her.

3. Whether the Commissioner correctly computed the allowance for depletion on gross income as required by sections 23 (m) and 114 (b) (3) of the Internal Revenue Code of 1939.

Holding

1. Yes, because the interest was a present interest subject to the indebtedness, and the income was used to satisfy community debt.

2. Yes, because the assignment of a portion of her interest did not absolve her of the tax liability since income was applied to pay off community debt.

3. Yes, because the Commissioner's method of computation was consistent with the custom in the oil and gas business.

Court's Reasoning

The court determined that Wood held a present, not a remainder interest, in the oil properties. The court reasoned that, as an undivided interest holder, Wood's interest was a present interest burdened by the indebtedness to the Withers estate, especially because the agreement stated that income would be applied to the debt owed to Withers. The court relied on the principle that income is taxed to the party who has an economic interest in the property. As the income was used to satisfy community debts, the economic benefit flowed to Wood, making her liable for the taxes.

The court found that the assignment of a portion of her interest to Pittman did not change her tax liability because the income continued to satisfy community debt, even after the assignment. The Court cited "the assignor of the royalty interest [was] taxable on the income from the royalties to the extent the prior indebtedness was relieved."

Concerning the depletion allowance, the court deferred to the Commissioner's explanation of how gross income is calculated in the oil and gas industry. Because Wood offered no evidence to the contrary, the Court upheld the Commissioner's method.

The court cited the *Hopkins v. Bacon*, 282 U.S. 122 (1930), to clarify that because of the community property laws in Texas, Wood had a present vested interest in the

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community property and one-half of the income from the community property was income of the wife. The court clarified that the divorce decree did not change this relationship.

Practical Implications

This case illustrates the importance of considering community debt and its impact on tax liability, even when property ownership is altered by assignment or divorce. Attorneys should carefully analyze the substance of transactions, not just the form, to determine who benefits economically from income-generating assets. Specifically, any arrangement where income is used to satisfy prior debt is highly likely to result in the income being taxed to the party who would have been responsible for that debt. This case highlights that the assignment of the right to receive income does not necessarily shift the tax liability if the income is used to satisfy a debt the assignor would otherwise be obligated to pay. This has implications in any area of law that has tax considerations, including family law, business law, and estate planning.

Later cases have followed this logic, emphasizing that the substance of a transaction matters over its form when determining tax liability. The ruling reinforces the principle that assignment of income does not necessarily transfer the tax obligation. The focus is always on who earns or controls the income, and who benefits economically.

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