34 T.C. 333 (1960)

Income is taxable to the party that earns it, not necessarily the party with the ability to control who earns it or receives it, unless the control is directly related to the income-generating activity itself.

Summary

The case involves a dispute over the taxability of income earned by a partnership comprised of the taxpayer's children. The Commissioner sought to attribute this income to the taxpayer, alleging that the taxpayer controlled the activities that generated the income. The Tax Court held that the taxpayer was not taxable on the income from appraisal fees, insurance commissions, and abstract/title commissions because his control was limited to directing who performed the services, not the actual performance. However, the court found the taxpayer liable for income from short-term lending activities where the taxpayer provided the capital, effectively controlling the income stream. The court distinguished between controlling the source of income and directly earning it.

Facts

Robert and Mary Crowley had four children. In 1952, they established a partnership, "The Crowley Company," comprising their four minor children. The business conducted appraisal, insurance, abstract, and title services related to the lending activities of City Federal Savings and Loan Association, where Robert was the president. The Crowley Company also engaged in short-term lending using funds mostly loaned by Robert and Mary Crowley. The Commissioner of Internal Revenue determined deficiencies against Robert and Mary Crowley, claiming that the income reported by the Crowley Company should be attributed to them because of Robert's control over City Federal Savings and Loan Association.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency to Robert and Mary Crowley and to City Federal Savings and Loan Association, asserting that certain income should be attributed to them. The Crowleys and City Federal filed petitions with the United States Tax Court challenging the deficiencies. The Tax Court consolidated the cases and considered them together. The court heard evidence, made findings of fact, and issued an opinion determining the tax liabilities.

Issue(s)

1. Whether the income reported by the Crowley Company is attributable to and includible in the income of Robert and Mary Crowley.

2. Whether income from abstract and title policy commissions reported by the Crowley Company and Crowley Corporation is attributable to and includible in the

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income of City Federal Savings and Loan Association.

3. Whether certain expenditures made by Robert and Mary Crowley are deductible as business expenses.

Holding

1. No, except for loan commissions and interest income on loans made by the Crowley Company. The court held that Robert and Mary Crowley were not taxable on income from appraisal fees, insurance commissions, and abstract/title policy commissions but were taxable on loan commissions and interest from loans the Crowley Company made using funds loaned by the Crowleys.

2. No. The income from abstract and title policy commissions was not taxable to City Federal Savings and Loan Association.

3. Yes, Robert and Mary Crowley were entitled to deduct $75 for postage and supplies in each year, but were not entitled to deduct amounts claimed for entertainment, miscellaneous expenses, or car expenses.

Court's Reasoning

The court applied the principle that income must be taxed to the one who earns it. The court distinguished between the ability to control the assignment of business and the direct earning of income. While Robert Crowley, as an executive of the savings and loan association, could direct the assignment of business, such control over the business activities did not make him liable for the income produced by it. He could designate who performed the services. The court noted that control over who provides materials or services is distinct from controlling the use of capital or the recipient of income. The court emphasized that the income was earned by the actual performance of services (e.g., appraisals, insurance) rather than by Robert's direction of who performed the services. Regarding the lending activities, the court found that Robert and Mary Crowley essentially provided the capital for these operations, thus directly earning the income. The court cited the application of the *Lucas v. Earl* and *Helvering v. Horst* cases, and held that the income from loan commissions and interest was attributable to Robert and Mary Crowley.

"There is a difference between being in a position to control who shall perform the activities which produce the income and being in a position to control either the use of income-producing capital or who shall receive income after it is produced, and we think that distinction is basic in this case."

Practical Implications

This case is important for tax planning and structuring business relationships, particularly those involving family members or entities with overlapping ownership or control. It highlights the importance of distinguishing between the ability to

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control a business and the actual performance of the income-generating activity. Attorneys advising clients on these matters need to thoroughly analyze the economic substance of the transactions. If the income is generated through the services of another entity or individual, merely controlling who provides those services does not necessarily lead to the attribution of income. However, where capital is provided, particularly when accompanied by a lack of arm’s-length terms, income may be attributed to the capital provider. Subsequent cases may distinguish this ruling where the control is much more direct and comprehensive.

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