Rubin v. Commissioner, 56 T. C. 1155 (1971)

The IRS can use Section 482 to allocate income between a corporation and its controlling shareholder when the income is derived from services performed by the shareholder.

Summary

In Rubin v. Commissioner, the U. S. Tax Court ruled that the IRS could allocate income from a corporation, Park Mills, to its controlling shareholder, Richard Rubin, under Section 482 of the Internal Revenue Code. Rubin, who performed management services for another corporation, Dorman Mills, through Park Mills, argued that Section 482 did not apply to allocations between a corporation and an individual. The court disagreed, finding that Rubin operated a management business and merely assigned its income to Park Mills. The decision highlights the broad remedial scope of Section 482, allowing income reallocation to prevent tax evasion and clearly reflect income among commonly controlled entities.

Facts

Richard Rubin, the controlling shareholder of Park Mills, entered into a contract where Park Mills provided management services to Dorman Mills. Rubin personally performed these services. The IRS sought to tax the income received by Park Mills to Rubin, arguing it was his personal income. Initially, the Tax Court held the income taxable to Rubin under Section 61, but this was reversed on appeal. The case was remanded to consider the applicability of Section 482 for income allocation between Park Mills and Rubin.

Procedural History

The Tax Court initially ruled in favor of the IRS, taxing the income to Rubin under Section 61. The Second Circuit reversed this decision and remanded the case for consideration under Section 482. On remand, the Tax Court held that Section 482 could be applied to allocate income from Park Mills to Rubin.

Issue(s)

1. Whether Section 482 of the Internal Revenue Code authorizes the IRS to allocate income from a corporation to an individual who is a controlling shareholder of that corporation.
2. Whether the IRS provided adequate notice of its intent to rely on Section 482.

Holding

1. Yes, because Section 482 is remedial and allows for income allocation among commonly controlled entities, including between a corporation and its controlling shareholder when the shareholder operates an independent business and assigns

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income to the corporation.
2. Yes, because Rubin was given fair notice of the IRS's intent to rely on Section 482 well in advance of trial, satisfying the notice requirement.

Court's Reasoning

The court's reasoning focused on the broad, remedial nature of Section 482, designed to prevent tax evasion and clearly reflect income. The court found that Rubin was not merely an employee but operated a management business and assigned its income to Park Mills. The court relied on precedent cases like Ach and Borge, where similar income allocations were upheld. The court rejected Rubin's argument that Section 482 did not apply to allocations between a corporation and an individual, stating that Rubin's management activities constituted a separate business. The court also dismissed Rubin's procedural arguments, finding that the IRS had given adequate notice of its intent to use Section 482. The court emphasized that the allocation was necessary to correct income distortion, citing Rubin's control over both corporations and the lack of any real employment relationship with Park Mills.

Practical Implications

This decision expands the IRS's authority under Section 482 to allocate income between a corporation and its controlling shareholder when the shareholder's activities constitute a separate business. Tax practitioners must be aware that income assignment to a controlled corporation may be challenged under Section 482, particularly when the shareholder retains control over the income-generating activities. The case underscores the need for clear contractual arrangements and documentation to support the legitimacy of income allocation between related parties. Subsequent cases have applied this ruling to similar situations involving personal service corporations and their controlling shareholders, reinforcing the IRS's ability to use Section 482 to prevent tax evasion through income shifting.

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