Jones v. Commissioner, 64 T. C. 1066 (1975)

Income from a controlled corporation, created primarily for tax avoidance, is taxable to the individual who earned the income under Sections 61(a) and 482 of the Internal Revenue Code.

Summary

Elvin V. Jones, an official court reporter, formed a corporation to handle the sale of trial transcripts. The IRS determined that the corporation's income should be taxed to Jones personally. The Tax Court agreed, finding the corporation was established mainly for tax purposes and that Jones could not assign his income to the corporation. The court held that Jones's duties as a court reporter could not be legally separated from the income generated by the corporation, and thus the income was taxable to him under Sections 61(a) and 482 of the Internal Revenue Code.

Facts

Elvin V. Jones, appointed as an official court reporter in 1964, formed Elvin V. Jones, Inc. , in 1968 to handle the production and sale of trial transcripts, particularly for a high-profile antitrust case. The corporation operated from Jones's office, used the same independent contractors, and billed clients on its own stationery. Jones certified the transcripts, which were essential to the corporation's income. The corporation paid Jones bonuses, which he reported as compensation. The IRS determined that the corporation's income should be taxed to Jones personally.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to Jones for the taxable year 1968, asserting that the corporation's income was taxable to him. Jones contested this determination and petitioned the U. S. Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the income of Elvin V. Jones, Inc. , should be reported by its sole shareholders, Elvin V. Jones and Doris E. Jones, under Section 61(a) of the Internal Revenue Code?
2. Whether the Commissioner properly allocated income and expenses of the corporation to Jones under Section 482 of the Internal Revenue Code?

Holding

1. Yes, because the corporation was formed primarily for tax avoidance and Jones could not legally assign his income as an official court reporter to the corporation.
2. Yes, because the Commissioner did not abuse his discretion in allocating the

income and expenses to Jones, given the interdependence of Jones's statutory duties and the corporation's operations.

Court's Reasoning

The court found that the corporation was not a sham for tax purposes because it engaged in substantial business activity, but it was formed primarily for tax avoidance. The court emphasized that Jones's statutory duties as an official court reporter, including certifying the transcripts, could not be legally separated from the income generated by the corporation. The court cited Section 61(a), which taxes income to the earner, and ruled that Jones could not assign his income to the corporation. Under Section 482, the court upheld the Commissioner's allocation of income and expenses to Jones, noting the lack of a legitimate transfer of assets or services between Jones and the corporation. The court distinguished this case from professional corporation cases, where the individual's income could be legally assigned to the corporation.

Practical Implications

This decision reinforces the principle that income cannot be shifted to a controlled entity to avoid taxation. It highlights the importance of genuine business purpose in forming a corporation and the limitations on assigning income earned through statutory duties. Practitioners should advise clients that the IRS may challenge arrangements that lack economic substance or are primarily for tax avoidance. This case may be cited in future disputes involving the assignment of income and the application of Section 482, particularly in cases where an individual attempts to shift income to a controlled entity. It also underscores the need for clear documentation of any legitimate business purpose for forming a corporation and the transfer of income-generating assets or services.

