Storz v. Commissioner, 68 T. C. 282 (1977)

The assignment of income doctrine does not apply to uncompleted contracts where the income is not earned until all events necessary for entitlement occur post-transfer.

Summary

Storz v. Commissioner dealt with whether the sale of a company's business, including uncompleted underwriting contracts, constituted an assignment of income taxable to the seller. Storz-Wachob-Bender Co. sold its business, including contracts in various stages of completion, to First Nebraska Securities. The court held that the income from these contracts was not taxable to Storz-Wachob-Bender because it was not earned until after the contracts were transferred to First Nebraska. The court also allowed a demolition loss deduction for Storz, ruling that the demolition of buildings was not integrally linked to a later sale of the land.

Facts

Storz-Wachob-Bender Co. (S-W-B), an investment banking firm, entered into a liquidation plan and sold its business to First Nebraska Securities, Inc. for the net book value of its assets plus $230,000. At the time of sale, S-W-B had several uncompleted underwriting contracts, including for Great Plains Natural Gas Co. and Data Documents, Inc. First Nebraska later computed a portion of the purchase price as "purchased income" based on the expected completion of these contracts. S-W-B did not report any part of the sale proceeds as income. Additionally, Storz demolished two buildings he owned in 1967, claiming a demolition loss deduction, and later sold the land to his wholly owned corporation.

Procedural History

The Commissioner of Internal Revenue determined deficiencies against S-W-B and Storz for unreported income from the sale and the disallowed demolition loss deduction. Storz conceded transferee liability for any deficiency against S-W-B. The Tax Court heard the case and ruled in favor of Storz on both issues.

Issue(s)

1. Whether the portion of the sale price received by S-W-B from First Nebraska for uncompleted underwriting contracts constituted an assignment of income taxable to S-W-B?
2. Whether Storz is entitled to a demolition loss deduction for the buildings demolished in 1967?

Holding

1. No, because the income from the underwriting contracts was not earned by S-W-B

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until after the contracts were transferred to First Nebraska.
2. Yes, because the demolition of the buildings was not an integral part of the later sale of the land to Storz Broadcasting Co.

Court’s Reasoning

The court applied the assignment-of-income doctrine, holding that income is taxable to the person who earns it. It found that S-W-B had not earned the income from the underwriting contracts at the time of sale because, under industry practice, such income is not earned until the securities are sold. The court distinguished this case from others where contracts were fully performed before transfer, emphasizing that significant contingencies remained until the securities were sold. The court cited Williamson v. United States, Stewart Trust v. Commissioner, and Schneider v. Commissioner to support its decision. For the demolition loss, the court found that the demolition was independent of the later land sale, allowing Storz to claim the deduction as the buildings were not purchased with intent to demolish and the demolition was not a condition of the sale.

Practical Implications

This decision clarifies that for tax purposes, income from uncompleted contracts in industries like investment banking, where payment is contingent on final sale, is not taxable to the seller until the income is earned post-transfer. This impacts how similar transactions should be structured and reported for tax purposes. It also affects legal practice in advising clients on the tax implications of business sales involving uncompleted contracts. The ruling on the demolition loss reinforces the principle that such losses are deductible unless tied directly to a subsequent sale, affecting real estate and tax planning. Subsequent cases have followed this precedent in distinguishing earned from unearned income in contract sales.

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