

Wesenberg v. Commissioner, 69 T. C. 1005 (1978)

An individual cannot shift the tax burden of their earned income to a trust by assigning their services and income to it.

Summary

In *Wesenberg v. Commissioner*, Richard Wesenberg attempted to assign his lifetime services and future income to a family trust, aiming to shift the tax liability to the trust. The U. S. Tax Court ruled that this was an ineffective assignment of income, affirming that income must be taxed to the one who earns it. The court also determined that Wesenberg, as the trust's trustee, retained sufficient control over the trust to be treated as its owner under the grantor trust rules, making him liable for the trust's income and expenses. The decision highlighted the importance of control in determining tax liability and upheld a negligence penalty due to the tax avoidance intent behind the trust's creation.

Facts

Richard Wesenberg, a physician, created the Richard L. Wesenberg Family Estate Trust in 1972, purporting to convey his lifetime services and future income to the trust. He directed his employer, the University of Colorado Medical School, to pay his salary directly to the trust. Wesenberg, his wife Nancy, and a colleague, Marvin J. Roesler, were named trustees. The trust also assumed Wesenberg's personal debts and assets. The trustees held meetings where they made decisions benefiting Wesenberg and his wife, including providing them with a rent-free residence and monthly consultant fees. Wesenberg reported income from the trust on his personal tax return, excluding the university salary.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to the Wesenbergs, reallocating the university salary paid to the trust back to Richard as income, and reallocating trust expenses to the Wesenbergs. The case was brought before the U. S. Tax Court, which ruled on the effectiveness of the income assignment, the applicability of the grantor trust rules, and the deduction for book-writing expenses incurred by Richard.

Issue(s)

1. Whether the purported conveyance of Richard Wesenberg's lifetime services to a family trust effectively shifted the incidence of taxation on the compensation he earned but paid to the trust.
2. Whether the trust's income and expense items were properly reportable by the Wesenbergs under the grantor trust rules.
3. Whether the Wesenbergs were entitled to deduct expenditures incurred by Richard in writing a book.

4. Whether the Wesenbergs were liable for an addition to tax under section 6653(a) for negligence or intentional disregard of rules and regulations.

Holding

1. No, because the assignment of income was ineffective as Wesenberg retained control over the services and income, thus the compensation was includable in his gross income.
2. Yes, because Wesenberg's powers as trustee were sufficient to treat him as the owner of the entire trust under the grantor trust rules, making the trust's income and expenses reportable by the Wesenbergs.
3. Yes, because the Wesenbergs substantiated the expenses related to the book, entitling them to the full deduction claimed.
4. Yes, because the underpayment was due to negligence or intentional disregard of tax rules, given the trust's design as a tax avoidance scheme.

Court's Reasoning

The court applied the principle that income must be taxed to the one who earns it, citing cases like *Lucas v. Earl* and *Commissioner v. Culbertson*. It determined that Wesenberg's purported assignment of his services to the trust was an anticipatory assignment of income, ineffective for shifting tax liability. The court also analyzed the trust's structure and the powers retained by Wesenberg, finding that he controlled the trust's assets and income, subjecting it to the grantor trust rules under sections 671-677 of the Internal Revenue Code. The court noted that the trust's beneficiaries had no right to income unless the trustees, dominated by Wesenberg, decided otherwise. The court also found the trust to be a tax avoidance scheme, justifying the negligence penalty under section 6653(a).

Practical Implications

This decision reinforces that an individual cannot avoid tax liability by assigning income to a trust they control. Legal practitioners must advise clients that such strategies will be scrutinized, particularly where the grantor retains significant control over the trust's operations. The case emphasizes the importance of the grantor trust rules in determining tax liability and serves as a cautionary tale against using trusts for tax avoidance. Subsequent cases have cited *Wesenberg* when addressing similar attempts to assign income to trusts. Businesses and individuals must carefully structure trusts to avoid similar pitfalls, ensuring they do not retain control that would subject the trust to the grantor trust rules.