Vercio v. Commissioner, 73 T. C. 1246 (1980)

Assigning future income to a trust does not shift the tax liability from the individual who earns the income to the trust.

Summary

In Vercio v. Commissioner, the Tax Court ruled that the taxpayers' attempt to assign their future income to a family trust was an ineffective anticipatory assignment of income, thus the income remained taxable to the taxpayers. The trust was created to ostensibly shift the tax burden on income from the taxpayers' services to the trust, but the court found that the taxpayers retained control over the income's earning. Additionally, the court applied the grantor trust rules, treating the taxpayers as owners of the trust due to their retained powers over trust income. The case also addressed penalties for negligence and failure to file timely returns.

Facts

Raymond and Roseanne Vercio, along with Ray and Wilma Hailey, created family trusts to which they purported to convey their lifetime services and all remuneration from those services. The trust instruments allowed income to be used for the benefit of the grantors or their spouses. The taxpayers then attempted to report income and expenses through the trusts to minimize their tax liabilities. The IRS challenged these arrangements, asserting that the income should be taxed to the individuals who earned it.

Procedural History

The IRS issued notices of deficiency to the Vercio and Hailey taxpayers, asserting that the trusts were ineffective for tax purposes and that the income should be taxed to the individuals. The taxpayers contested these determinations in the U. S. Tax Court, where the cases were consolidated. The Tax Court ruled in favor of the IRS, determining that the purported assignments of income were invalid and that the taxpayers were liable for the deficiencies and penalties.

Issue(s)

1. Whether the conveyances of the taxpayers' lifetime services to family trusts were effective to shift the incidence of taxation on the income earned from those services.
2. Whether certain income and expense items reported by the trusts should have been included on the taxpayers' Federal income tax returns under sections 671 through 677.
3. Whether the taxpayers are liable for additions to tax under section 6653(a).
4. Whether the Vercio taxpayers are liable for additions to tax under section 6651(a).

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. No, because the taxpayers retained ultimate control over the earning of the income, and the assignment was an anticipatory assignment of income, which is not recognized for tax purposes.
2. Yes, because the grantors were treated as owners of the entire trust under sections 671 and 677 due to their retained powers over trust income.
3. Yes, because the taxpayers were negligent or intentionally disregarded rules and regulations.
4. Yes, because the Vercio taxpayers failed to file their returns within the prescribed time.

Court's Reasoning

The court applied the principle that income must be taxed to the person who earns it, as established in cases like Lucas v. Earl and Commissioner v. Culbertson. The taxpayers' attempt to assign their future income to the trusts was deemed an anticipatory assignment of income, which the court found ineffective. The court noted that the taxpayers retained control over the earning of the income, as evidenced by the lack of enforceable contracts between the taxpayers and the trusts regarding their services. The court also applied the grantor trust rules, finding that the taxpayers were owners of the trusts under section 677 because they retained powers to apply trust income for their own benefit or that of their spouses. The court upheld the negligence penalties under section 6653(a) due to the taxpayers' awareness of the IRS's position on such trusts and the advice of their legal and accounting professionals. The court also upheld the late filing penalty for the Vercio taxpayers under section 6651(a).

Practical Implications

This decision reinforces the principle that attempts to shift income to another entity through anticipatory assignments will be disregarded for tax purposes if the original earner retains control over the income's generation. Legal practitioners should advise clients against using similar trust arrangements to avoid taxes, as they are likely to be challenged by the IRS. The case also highlights the importance of the grantor trust rules in determining tax liability, particularly when the grantor retains powers over trust income. Taxpayers should be aware that such arrangements can lead to penalties for negligence and failure to file timely returns. Subsequent cases, such as Wesenberg v. Commissioner, have followed this ruling, further solidifying its impact on tax law.

© 2025 SCOTUSreports.com. All rights reserved.