Benningfield v. Commissioner, 81 T. C. 408 (1983)

An anticipatory assignment of income cannot be used to avoid income tax on earned wages.

Summary

In Benningfield v. Commissioner, the Tax Court rejected a taxpayer's attempt to avoid income tax through an anticipatory assignment of income scheme. Max Benningfield endorsed his wages to a trust, which then purportedly resold the wages to another entity, with the majority of the funds being returned to Benningfield as 'gifts. ' The court held that Benningfield remained taxable on the income, as he controlled its earning. Additionally, the court disallowed a deduction for 'financial counseling' fees, as no actual services were rendered, and upheld a negligence penalty due to the scheme's implausibility.

Facts

Max Eugene Benningfield, Jr. , a steamfitter, entered into an 'Intrusted Personal Services Contract' with Professional & Technical Services (PTS) on December 25, 1979. Under this contract, Benningfield purported to sell his future services to PTS, who then resold them to International Dynamics, Inc. (IDI). Benningfield endorsed two paychecks to PTS, which were then 'resold' to IDI, with 92% of the amount returned to Benningfield as 'gifts' from IDI Credit Union. Additionally, Benningfield paid $3,550 to IDI for 'financial counseling' services to be performed in 1980, but received $3,195 back as a 'gift' on the same day. Benningfield claimed a deduction for the full amount of the paychecks as a 'factor discount on receivables sold' and another deduction for the 'financial counseling' fee.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to Benningfield for the tax year 1979, disallowing the deductions for the 'factor discount on receivables sold' and 'financial counseling,' and imposing a negligence penalty under section 6653(a). Benningfield petitioned the Tax Court, which upheld the Commissioner's determination.

Issue(s)

1. Whether Benningfield's endorsement of his wages to PTS and their subsequent 'resale' to IDI constituted an effective assignment of income for tax purposes.
2. Whether Benningfield was entitled to deduct the full amount of his paychecks as a 'factor discount on receivables sold. '
3. Whether Benningfield was entitled to a deduction for 'financial counseling' fees paid to IDI.
4. Whether Benningfield was liable for the negligence addition under section 6653(a).

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Holding

1. No, because Benningfield controlled the earning of the income and the arrangement was an anticipatory assignment of income.
2. No, because the arrangement was not a valid sale of accounts receivable but an attempt to shift tax liability.
3. No, because no actual services were rendered, and the 'payment' was offset by a 'gift' from IDI Credit Union.
4. Yes, because Benningfield's participation in the scheme was negligent and disregarded tax laws and regulations.

Court's Reasoning

The Tax Court applied the principle from Lucas v. Earl that income must be taxed to the one who earns it, rejecting Benningfield's attempt to shift the tax incidence to PTS. The court found that PTS did not control the earning of the income, as there was no meaningful right to direct Benningfield's activities, and no contract between PTS and Benningfield's employer. The court also noted that Benningfield's expectation of receiving back most of his wages as 'gifts' demonstrated the scheme's tax avoidance intent. Regarding the 'financial counseling' deduction, the court found that no services were actually rendered, and the payment was effectively offset by a 'gift,' thus not constituting a deductible expense. The court upheld the negligence penalty, citing the scheme's implausibility and Benningfield's failure to seek legal advice, referencing similar cases where negligence penalties were upheld for similar tax-avoidance schemes.

Practical Implications

Benningfield v. Commissioner reinforces that anticipatory assignments of income are ineffective for tax avoidance. Taxpayers cannot avoid income tax by assigning their wages to a third party, even if the arrangement is structured as a sale of 'accounts receivable. ' Practitioners should advise clients against participating in such schemes, as they are likely to be disallowed and may result in penalties. The decision also highlights the importance of substantiation for claimed deductions; taxpayers must demonstrate that expenses were actually incurred for a deductible purpose. Subsequent cases have cited Benningfield to reject similar tax-avoidance schemes, emphasizing the need for taxpayers to report income earned through their efforts and the potential consequences of negligence in tax planning.

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