Sargent v. Commissioner, 93 T. C. 572 (1989)

In tax law, professional athletes are considered employees of the sports team, not their personal service corporations, when the team exercises significant control over their services.

Summary

In Sargent v. Commissioner, professional hockey players formed personal service corporations to contract their services to the Minnesota North Stars. The court held that the players were employees of the team, not their corporations, due to the team's extensive control over the players' activities. This control included determining game schedules, player participation, and strategy. Consequently, income received by the corporations from the team was taxable to the players under the assignment of income doctrine or section 482 of the Internal Revenue Code. The decision underscores the importance of control in determining employer-employee relationships for tax purposes.

Facts

Gary Sargent and Steven Christoff, professional hockey players, established personal service corporations (Chiefy-Cat and RIF Enterprises) to contract their services to the Northstar Hockey Partnership, owners of the Minnesota North Stars. Sargent and Christoff entered into employment agreements with their respective corporations, which then contracted with the team. The team controlled game schedules, player participation, and strategy, while the players were subject to fines for non-attendance at mandatory training camps. The team provided uniforms and equipment, and the players were not considered employees for the NHL Players' Pension Plan purposes.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the players' federal income taxes, asserting that income paid to their corporations should be taxable to them. The case was heard by the United States Tax Court, which consolidated related cases and issued a decision that the players were employees of the team, not their corporations.

Issue(s)

1. Whether Sargent and Christoff were employees of the Northstar Hockey Partnership or their personal service corporations.
2. Whether the amounts received by the personal service corporations for the players' services were taxable to the players under section 61 or section 482 of the Internal Revenue Code.

Holding

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1. No, because the Northstar Hockey Partnership exercised significant control over the players' services, making them employees of the team.
2. Yes, because under the assignment of income doctrine or section 482, the income received by the corporations was allocable to the players as they were the true earners of the income.

Court's Reasoning

The court applied common law principles to determine that the team, not the personal service corporations, was the employer due to its control over the players' activities. The court highlighted the team's authority over game schedules, player participation, and strategy, which negated any meaningful control by the corporations. The decision was grounded in the assignment of income doctrine from *Lucas v. Earl* and section 482, which allow the reallocation of income to the true earner. The court rejected the players' argument that their individual talents constituted control, emphasizing the team nature of hockey. A dissenting opinion argued that the majority disregarded the corporations' separate existence without a finding of sham, contrary to precedent.

Practical Implications

This decision impacts how professional athletes and other service providers structure their income through personal service corporations. It reinforces that the entity exercising control over the service is likely the employer for tax purposes, potentially limiting tax planning strategies involving such corporations. The ruling may influence future cases involving the taxation of income earned through corporate intermediaries in service industries. It also led to legislative changes with the enactment of section 269A, aimed at addressing similar tax avoidance schemes. Subsequent cases have considered this ruling when determining employer-employee relationships in the context of personal service corporations.

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