Schneer v. Commissioner, 97 T. C. 643 (1991)

A partner's income from services performed individually can be treated as partnership income if earned after joining the partnership and if the services are similar to the partnership's business.

Summary

Stephen Schneer, a lawyer, received referral fees from his former employer, Ballon, Stoll & Itzler (BSI), after becoming a partner at Bandler & Kass (B&K) and later Sylvor, Schneer, Gold & Morelli (SSG&M). These fees were for clients Schneer referred to BSI while an associate there. The IRS argued Schneer earned the fees before joining B&K and SSG&M, making the subsequent assignment to these partnerships invalid under the assignment-of-income doctrine. The Tax Court, however, held that most of the fees were earned after Schneer joined B&K and SSG&M, and thus could be treated as partnership income under the partnerships' agreements, provided the services were similar to those of the partnerships' business.

Facts

Stephen Schneer was an associate at BSI, where he earned a salary plus a percentage of fees from clients he referred to the firm. Upon leaving BSI in February 1983, Schneer became a partner at B&K, and later at SSG&M in August 1985. Post-departure, BSI continued to pay Schneer his share of referral fees, which he turned over to B&K and SSG&M per partnership agreements. These agreements stipulated that all legal fees received by partners were to be treated as partnership income. Most of the fees in question were earned after Schneer's departure from BSI, with Schneer consulting on these matters while a partner at B&K and SSG&M.

Procedural History

The IRS issued notices of deficiency for Schneer's 1984 and 1985 tax years, asserting that the referral fees should be taxed to Schneer individually under the assignment-of-income doctrine. Schneer petitioned the U. S. Tax Court, which heard the case and ruled in favor of Schneer, except for $1,250 of fees earned in 1984 before his partnership with B&K.

Issue(s)

1. Whether the referral fees received by Schneer from BSI were taxable to Schneer individually or to the partners of B&K and SSG&M in their respective shares.

Holding

1. No, because most of the fees were earned after Schneer joined B&K and SSG&M, and the services were similar to those performed by the partnerships.

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Court’s Reasoning

The court analyzed the case using the all-events test, determining that the fees were not earned until after Schneer left BSI, as they were contingent on the performance of services by BSI and Schneer’s potential consultation. The court rejected the IRS’s argument that the fees were earned prior to Schneer’s departure, citing the necessity of services being performed post-departure. The court also reconciled the assignment-of-income doctrine with the principle that partners can pool their income by treating the partnership as an entity for tax purposes when the income relates to services similar to the partnership’s business. The court emphasized that the partnership agreements allowed for the fees to be treated as partnership income, except for $1,250 in 1984, which was earned before Schneer joined B&K. The court also noted the absence of any intent to avoid taxation through the partnerships, supporting the treatment of the fees as partnership income.

Practical Implications

This decision clarifies that income from services performed by a partner individually can be treated as partnership income if those services are similar to the partnership’s business and are earned after the partner joins the partnership. Legal professionals should ensure that partnership agreements clearly stipulate the treatment of such income. This ruling impacts how partnerships structure their agreements and how attorneys manage income from prior engagements. It also influences how the IRS audits partnership income, focusing on the timing of when services are performed and the similarity of those services to the partnership’s business. Subsequent cases, such as *Brandschain v. Commissioner*, have applied this principle, affirming that income from services similar to the partnership’s business can be pooled and taxed at the partnership level.

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