Leavell v. Commissioner, 104 T. C. 140 (1995)

Income from personal services must be taxed to the individual who performs the services, even if a personal service corporation (PSC) is used, if the service recipient has the right to control the manner and means of the services.

Summary

Allen Leavell, a professional basketball player, formed a personal service corporation (PSC) to manage his basketball and endorsement services. Despite an agreement between Leavell and his PSC, and a contract between the PSC and the Houston Rockets, the Tax Court ruled that Leavell was an employee of the Rockets. The court focused on the Rockets' control over Leavell's services, evidenced by the personal guarantee Leavell provided and the detailed control stipulated in the NBA contract. This case highlights the importance of genuine control by a PSC over an individual's services to avoid income reallocation to the individual under the assignment of income doctrine.

Facts

Allen Leavell, a professional basketball player, formed a personal service corporation (Allen Leavell, Inc.) in 1980 to manage his basketball and endorsement services. Leavell agreed to provide his services exclusively to the corporation, which then contracted with the Houston Rockets using an NBA Uniform Player Contract. However, the Rockets required Leavell to personally guarantee his services, indicating their direct control over him. The contract detailed extensive control over Leavell's basketball activities and personal conduct. The Rockets paid the corporation, which then paid Leavell a salary, but the IRS sought to include these payments in Leavell's personal income.

Procedural History

Leavell filed a petition with the U. S. Tax Court challenging the IRS's determination of a deficiency in his 1985 federal income tax. The Tax Court, after reviewing the case, ruled in favor of the IRS, determining that the payments made by the Rockets to Leavell's corporation were taxable to Leavell personally. The court's decision was influenced by the reversal of a similar case, *Sargent v. Commissioner*, by the Eighth Circuit Court of Appeals.

Issue(s)

1. Whether the income paid by the Houston Rockets to Allen Leavell's personal service corporation for his basketball services should be included in Leavell's gross income?

Holding

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1. Yes, because the Rockets had the right to control the manner and means by which Leavell's basketball services were performed, making him their employee, not his corporation's.

Court's Reasoning

The Tax Court applied the assignment of income doctrine, focusing on the control over Leavell's services. The court determined that the Rockets, not the PSC, controlled Leavell's basketball activities, as evidenced by the NBA contract's detailed requirements and Leavell's personal guarantee. The court rejected the PSC's control based on the lack of meaningful control over Leavell's services, aligning with the Eighth Circuit's reversal of *Sargent*. The court emphasized that the PSC's control was illusory given the Rockets' direct control over Leavell's performance. The court also considered policy implications, noting that allowing PSCs to control services without genuine authority could undermine tax principles.

Practical Implications

This decision reinforces that for a PSC to be recognized as the recipient of income from personal services, it must genuinely control the manner and means of those services. It impacts how athletes and other professionals structure their service arrangements through corporations, requiring careful consideration of control elements in contracts. The ruling may deter the use of PSCs for tax deferral if genuine control cannot be established. Subsequent cases, such as those involving other professional athletes, have cited Leavell to assess the legitimacy of PSCs. The decision also underscores the importance of contractual terms that reflect actual control dynamics, influencing how legal practitioners draft and negotiate such agreements.

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