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# Income Tax--Assignment of Right to Renewal Commissions on Certain Life Insurance Policies--To Whom Taxable and When

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words to have their proper legal meaning in the absence of any contrary intention appearing in the instrument"<sup>5</sup>

Even though the parties used the word "abatement" which was used in the A.A.A. act, it is submitted that this strict construction was not reasonable. The contract provided that if an increase were required by law, the increase would be added to the purchase price. It seems reasonable to infer from this that the abolition of the tax as directed by law was within the contemplation of the parties. Cognizance might also have been taken of the general uncertainty in regard to the constitutionality of the A.A.A. at the time of the formation of the contract, and of the seller's insistence that independently of the alleged contract price funds be provided to meet a tax increase. All of these considerations tend to show a contractual relation which would allow recovery.

However, this strict construction might be justified on the ground of "letting the profit lie where it falls". As restitution was not allowed the retailer and consumer would not receive the return of the tax which was passed to them; thus, why should the wholesaler be allowed the unearned profit.

J. GRANVILLE CLARK

**INCOME TAX—ASSIGNMENT OF RIGHT TO RENEWAL  
COMMISSIONS ON CERTAIN LIFE INSURANCE  
POLICIES—TO WHOM TAXABLE  
AND WHEN**

A life insurance agent after termination of successive agencies assigned in 1924 and in 1928, respectively, all his right to and interests in three contracts entitling the assignor to renewal commissions, if any, on certain life insurance policies. In 1933 the assignee collected renewal commissions in the amount of \$15,612.79. The Supreme Court *held* for "the reasons stated" in the *Horst Case*<sup>1</sup> that commissions paid to the assignee were income of the assignor in 1933.<sup>2</sup> In the *Horst Case* an owner of bonds clipped negotiable interest coupons from the bonds and gave the latter to his son who collected in the same year the interest as it matured. Considering the *Horst Case* and the *Eubank Case* together, the reasoning of the Court in the latter decision, the instant case, appears to be as follows: First, the purpose of Congress as expressed in the Revenue Act<sup>3</sup> is to

<sup>5</sup> 12 Am. Jur. 760; and see note 4 *supra*.

<sup>1</sup> *Helvering v. Horst*, — U. S. —, 85 L. Ed. 99, 61 S. Ct. 144 (1940).

<sup>2</sup> *Helvering v. Eubank*, — U. S. —, —, 85 L. Ed. 104, 105, 61 S. Ct. 149, 150 (1940).

<sup>3</sup> The Revenue Act of 1932 provided that gross income included ". . . income derived from . . . compensation for personal service, of whatever kind and in whatever form paid . . .; also from interest . . ." 26 U. S. C. A. Internal Revenue Act of 1932, sec. 22; 1940 ed. p. 487.

tax the income to him who earns it. Second, income is taxed to the "earner" who makes his returns on the cash basis when it is "derived" or—to use the language of the courts—"realized" by him. And third, the assignor in the principal case realized compensation for personal services in the year his assignee received the renewal commissions. There was a dissent by three of the Justices as to the third point. In effect, the dissenters were of the opinion that "realization" coincided with the assignment, or that the assignee was vested with property and was the one to be taxed.<sup>4</sup>

The Justices in the instant case do not state explicitly whether in their opinion the assignment was a sham. The opinion of the Board of Tax Appeals, however, contains the statement "that this is not a case of income attributable to an assignor or settlor by reason of application of the income for his use or benefit."<sup>5</sup> If, nevertheless, the assignee is only the assignor's agent for collection of the renewal commissions then no doubt could be raised as to the correctness of the finding of the majority. The case, however, is not so simple where there is a bona fide, outright, irrevocable assignment of uncollected earnings for past services. The Court does not say whether the same result would follow in the case of a sale that is obtained in the case of a gift. Significant is the fact that the majority opinion in the instant decision is based on the assumption that the assignment was gratuitous. The instruments of assignment, which are set out at length in the opinion of the Board of Tax Appeals,<sup>6</sup> contain recitals of consideration; but counsel for the taxpayer produced no evidence showing actual consideration was received by or was owing to the assignor; neither did they explain the use of the word "trustee" after the name and address of the assignee in some of the instruments.<sup>7</sup> Furthermore, counsel for the taxpayer briefed and argued the case as if the assignments were voluntary. Were it not, therefore, for the statement that for "the reasons stated" in the *Horst Case* the commissions collected by the assignee were taxable to the assignor in the year of receipt by the former, one might readily conclude that this is no more than a case of agency. In the *Horst Case* there was a gift of interest coupons, and the donor kept the bonds—the property. The latter decision could be justified on the principle that the owner

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<sup>4</sup>— U. S. —, —, 85 L. Ed. 104, 106, 61 S. Ct. 149, 151 (1940). Notice the following excerpt: "The general principles approved in *Blair v. Commissioner of Internal Revenue*, 300 US 5, 81 L. Ed. 465, 57 S. Ct. 330, and applied in *Helvering v. Horst*, are controlling and call for affirmation of the judgment under review." In the *Blair Case* an income beneficiary of a trust assigned his right to the income, and the Court said the assignee obtained a property right in the trust and was subject to the income tax. The *Horst Case* held that the owner of coupon bonds was the owner of the source of the interest and should be taxed on the interest collected by the assignee.

<sup>5</sup> *Eubank v. Commissioner of Internal Revenue*, 39 B. T. A. 583, 588 (1939) (Statement made on the state of the pleadings.)

<sup>6</sup> *Id.* at 584–586.

<sup>7</sup> *Id.* at 588.

of the property is the "earner" of the interest; and it can be distinguished from an irrevocable assignment of the right to compensation for services rendered in that the assignor in the latter case retains nothing whereas in the former the assignor retains the bonds—the property itself.

It is not disputed that the purpose of Congress was to tax compensation derived from personal services as income to the "earner". Such construction, moreover, is entirely consistent with the literal definitions of the words employed in the Revenue Act.

The earner of income who makes his tax return on the cash basis is taxed when the income is "realized". Ordinarily compensation for personal services is collected by the earner and is taxed in the year of receipt.<sup>8</sup> Where the taxpayer does not receive money or tangible property himself but *derives economic gain* by having an obligation of his paid,<sup>9</sup> realization has been said to occur "when the last step is taken by which he obtains the fruition of the economic gain."<sup>10</sup> In the *Horst Case* the Court asserted that: "The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it."<sup>11</sup> If this test were applied to the principal case the result would be contra; that is, the assignor exercised his power of disposition of the income when he assigned his right to the renewal commissions in 1924 and 1928, hence realization occurred at the date of the assignment rather than in the year the transferee collected the commissions.

Where the earner collects the commissions himself, realization occurs at date of payment;<sup>12</sup> but where the earner assigns his right to receive payment for services rendered,<sup>13</sup> or to be rendered if he

<sup>8</sup> See *Helvering v. Horst*, — U. S. —, —, 85 L. Ed. 99, 101, 61 S. Ct. 144, 146 (1940).

<sup>9</sup> *Old Colony Trust Co. v. Commissioner of Internal Revenue*, 279 U. S. 716, 73 L. Ed. 918, 49 S. Ct. 499 (1929).

<sup>10</sup> *Helvering v. Horst*, — U. S. —, —, 85 L. Ed. 99, 101, 61 S. Ct. 144, 146 (1940).

<sup>11</sup> *Id.* at —, 102, and 147-148, respectively.

<sup>12</sup> *Woods v. Lewellyn*, 252 Fed. 106 (CCA 3rd, 1918); *Workman v. Commissioner of Internal Revenue*, 41 F. (2d) 139 (CCA 7th, 1930); cf. *North American Oil Consolidated v. Burnet*, 52 S. Ct. 613, 286 U. S. 417, 76 L. Ed. 1197 (1932); see *Platt v. Bowers*, 13 F. (2d) 951 (D. C., S. D., N. Y., 1926); *R. & L., Inc., v. Commissioner of Internal Revenue*, 84 F. (2d) 721 (CCA 5th, 1936).

<sup>13</sup> *Platt v. Bowers*, 13 F. (2d) 951 (D. C., S. D., N. Y., 1926) (Surrender contractual right for consideration); *Hall v. Burnet*, 54 F. (2d) 443 (C. A., D. C., 1931) (Assignment of contractual interest in renewal commissions). *Contra*: *Bishop v. Commissioner of Internal Revenue*, 54 F. (2d) 298 (CCA 7th, 1931) (Income *per se* can not be assigned; but had the husband assigned the contract as well as the right to renewal commissions on certain policies the opinion suggests that the assignor might not have been subject to the tax); *Stokes v. Collector of Internal Revenue*, 22 B. T. A. 1386 (1931).

receives consideration therefor<sup>14</sup> he realizes the income in the year of the assignment. An analogous situation occurs upon the assignment of patent royalties,<sup>15</sup> or upon the sale of the patent itself.<sup>16</sup> A patent or a right to royalties from the use of it represents to the inventor compensation for personal services; and should the inventor sell his patent or assign his right to royalties the date of realization would be the time of the transfer.<sup>17</sup> The results in the patent cases are due to the fact that patents or royalty rights for the use of the same are treated as property.<sup>18</sup> The dissent in the principal case was on the ground that since the assignor retains no interest and has no further services to perform, the assignee of a contractual right to renewal commissions obtains a property right by virtue of the assignment. The decision of the Circuit Court of Appeals was based upon the same reasoning.<sup>19</sup> To say that the right of the assignor to renewal commissions on policies written is "property" is to assume the question. And it is to be noted that no cases were cited which held such right to be property. But, in effect, the dissent is simply saying that the assignor "realized" all the economic gain he would ever receive from his services as agent when he made the assignment. Whatever the assignor received for the assignment was income.<sup>20</sup>

It is submitted that the assignor of a vested right to renewal commissions, if there are renewals, "realizes" compensation for past services as of the date of the assignment; and that it *should be immaterial*, so far as the time of realization is concerned, whether or not the "earner" received consideration for the transfer. It is thought that a donor-assignor receives nothing tangible in the year of

<sup>14</sup>First Nat. Bank v. Commissioner of Internal Revenue, 107 F. (2d) 141 (CCA 6th, 1939) (Salesman received note for amount to be paid him should he consummate a certain sale; he discounted the note before consummation of the sale. Held: Income was realized on discounting the note.)

<sup>15</sup>See Nelson v. Ferguson, 56 F. (2d) 121 (CCA 3rd, 1932), writ of certiorari denied 286 U. S. 565, 76 L. Ed. 1297, 52 S. Ct. 646.

<sup>16</sup>See Saunders v. Commissioner of Internal Revenue, 29 F. (2d) 834 (CCA 3rd, 1928).

<sup>17</sup>See Saunders v. Commissioner of Internal Revenue, n. 16; see Nelson v. Ferguson, n. 15 (Assignee of profits from exploitation of patent, not the assignor, was subject to income tax on the profits subsequent to the assignment.)

<sup>18</sup>See United States v. Dubilier Condenser Corporation, 53 S. Ct. 554, —, 289 U. S. 178, 187, 77 L. Ed. 114, — (1933) ("A patent is property and title to it can pass only by assignment.")

<sup>19</sup>Eubank v. Commissioner of Internal Revenue, 110 F. (2d) 737 (CCA 2nd, 1940); ". . . when a taxpayer who makes his income tax return on a cash basis assigns a right to money payable in the future for work already performed, we believe that he transfers a property right, and the money, when received by the assignee, is not income taxable to the assignor." *Id.* at pp. 738-739; Helvering v. Eubank, — U. S. —, —, 85 L. Ed. 104, 106, 61 S. Ct. 149, 151 (1940).

<sup>20</sup>Helvering v. Eubank, — U. S. —, —, 85 L. Ed. 104, 106, 61 S. Ct. 149, 151 (1940): "Whatever the assignor receives as consideration may be his income . . ."

the assignment for which he can be taxed; but *quære*, does he receive anything in the year the donee collects the commissions out of which he can pay the tax? The assignor has exercised his power of disposition of the income irrespective of whether he receives consideration for the assignment. In the case of a gift, a present value may be given this contractual right upon the basis of statistics even though the exact amount of the commissions can not be determined now. The Wisconsin Court upon the decease of an agent assigned a present value to the decedent's right to renewal commissions, if any, on certain policies.<sup>2</sup> Where consideration is received, the assignor would be taxed on the amount thereof; and the assignee would pay income tax on the commissions collected in excess of the purchase price.

CLARENCE CORNELIUS

### HUSBAND AND WIFE—CONVEYANCE IN FRAUD OF MATERIAL RIGHTS OF THE WIFE

In contemplation of marriage, Tom Martin transferred to his sister all of his personal property amounting to approximately \$30,000. There was evidence that the sister gave to Tom such sums as he should from time to time require and that the transfer was made for the purpose of depriving the wife of any rights she might acquire as a result of the prospective marriage. Upon the death of Martin, his wife brings an action seeking to have the sister declared a trustee for the \$30,000 and claiming \$15,000 as her interest under Kentucky Statute 2132 which provides: ". . . survivor shall have an absolute estate in one-half of the surplus personalty left by such decedent." It was held that the transfer of the personal property to the sister was a fraud on the marital rights of the wife, and the sister is declared to be a constructive trustee of the amount received by her. *Martin v. Martin*, 282 Ky. 411, 138 S. W. (2d) 509 (1940).

The theory by which the court decided the case, raising a constructive trust, is a remedy afforded by courts of equity for fraud.<sup>1</sup> It does not arise out of an express or implied agreement of the parties, but arises by operation of law, and may in fact be exactly contra to any intention of the parties. It is a remedy imposed under circumstances which render it unconscionable for the holder of the legal title to enjoy the beneficial interest in the property.<sup>2</sup> The fraud may be actual or implied or in a number of cases the courts have discovered a constructive trust<sup>3</sup> where it is felt that the donor held property unjustly from one truly and equitably entitled to it although perhaps he may never have had any legal estate therein.<sup>4</sup>

<sup>2</sup> *Herzberg v. Wisconsin Tax Commission*, 194 Wis. 126, 215 N. W. 936 (1927).

<sup>1</sup> 3 *Scott on Trusts*, (1939) 2313.

<sup>2</sup> *Pomeroy, Equity Jurisprudence*, (4th ed. 1918) 2404.

<sup>3</sup> 3 *Scott on Trusts*, (1939) 2314.

<sup>4</sup> *Supra*, note 2.