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Taxation - Federal Income Tax - Purchase by Network of Corporation Producing Entertainer's Radio Show as Compensation to Entertainer

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TAXATION—FEDERAL INCOME TAX—PURCHASE BY NETWORK OF CORPORATION PRODUCING ENTERTAINER'S RADIO SHOW AS COMPENSATION TO ENTERTAINER—Prior to 1947, Jack Benny produced a complete radio show for his sponsor, American Tobacco Company. In January 1947 Amusement Enterprises was incorporated with Benny taking 60 percent of the stock and the remainder going to three of his business associates. Amusement contracted with American to produce a complete radio show, exclusive of Benny's services, to be broadcast over the NBC network on Sunday evenings. Benny signed a separate contract with American as the star of the show. Under the American-Benny contract American could make no change in the time of the broadcast or the network facilities without Benny's approval. In November 1948 the stockholders of Amusement sold their stock to the Columbia Broadcasting System[1] for $2,260,000, and, shortly after the sale, American and Benny agreed to transfer the show from NBC to CBS beginning January 2, 1949. On his return for 1948 Benny reported the gain derived from the sale as long-term capital gain. The Commissioner determined that $2,054,000 of the purchase price was taxable to him as ordinary income as compensation for his services.[2] *Held,* three judges dissenting, the entire amount paid by CBS to Amusement's stockholders was solely in payment for stock. *Jack Benny,* 25 T.C. 197 (1955).

While the sale of corporate stock is the classic "capital gain" transaction, in the principal case the Commissioner invoked the general rule of income tax law that substance rather than form governs the tax consequences which flow from any particular transaction.[3] He contended that the excess

[1] CBS actually purchased only 70% of the stock. The remaining 30% was taken by Columbia Records, Inc., a wholly-owned subsidiary of CBS. Principal case at 205.

[2] The $2,054,000 figure represented the full purchase price minus the book value of the stock. See note 5 infra. Since compensation for services is taxable to the one who performs the services rather than to the person who actually receives the money, Benny would be required to declare as his own income the full amount of the purchase price deemed to be compensation even though some of it went to the minority stockholders. Lucas v. Earl, 281 U.S. 111, 50 S.Ct. 241 (1930); Strauss v. Commissioner, (2d Cir. 1948) 168 F. (2d) 441.

[3] Commissioner v. Court Holding Co., 324 U.S. 331, 65 S.Ct 707 (1945). But the fact

of the purchase price over the book value of the stock was actually compensation paid to Benny either for his future services as an entertainer on the CBS network or for his "gentleman's agreement" not to exercise his veto power[4] to block a shift of the program from NBC to CBS. The question presented, therefore, was a factual one: was the transaction in substance as well as in form a transfer of capital assets? The court ruled that the entire purchase price was paid for stock, in spite of the fact that the evidence offered concerning the value of the individual assets of Amusement showed a market value far less than the amount paid for the stock.[5] The court took notice of the intense competition between NBC and CBS at the time of the sale and relied on that fact to explain the large price paid for Amusement's stock.[6] Admission of the fact that a prime consideration in the sale was to secure the services of Benny on CBS would seem to require an apportionment of at least part of the purchase price as payment for such services, if substance is to prevail over form. In substance, the transaction appears to be in large part a sale of services by an entertainer to a network eager to broadcast his radio show. The fact that Benny was under contract with his sponsor to perform the same services should not obscure the fact that such services had a real money value to the network which broadcast the show.[7] The network was willing to pay for these services by purchasing the corporation which produced the show at a price considerably in excess of its fair market value. While it is true that purchase of the corporation gave the network no contractual rights to Benny's services,[8] it precluded the sponsor of the show, for obvious practical considerations, from dealing with any other network for broadcasting facilities. And as to

that tax reduction or avoidance was the motive for the transaction will not, of itself, establish liability. Sun Properties v. United States, (5th Cir. 1955) 220 F. (2d) 171. See, generally, Finkelstein, "The Corporate Entity and the Income Tax," 44 YALE L. J. 436 (1935).

4 The 1947 American-Benny contract provided, in part: "No change shall be made in any way in the broadcasting time or facilities of the Program, including . . . the nationwide network of the National Broadcasting System . . . without BENNY'S approval." During negotiations leading up to the sale, Benny's agents refused to discuss either his future services or a possible exercise of the veto power. William Paley, CBS's president, testified that he took a "calculated risk" that Benny would assent to a change of networks when the deal was completed. Principal case at 202, 205, 209.

5 Book value of the stock at the time of the sale was $206,000. The principal asset of Amusement not reflected in the book value was the contract with American to produce the radio show. This contract had five and a half years to run at the time of the sale and had produced a net profit of $154,640 in the fiscal year ending September 30, 1948. Principal case at 205.

6 ". . . in addition to the assets of Amusement, there was an additional value which its stock had to CBS in that CBS's other broadcast periods on Sunday night would be more valuable with the Jack Benny Show as the 'kick-off program.'" Principal case at 210.

7 Ibid.

8 If Benny had been under contract to Amusement, rather than under a separate contract with the sponsor, Amusement would have been a personal holding company under I.R.C., §§542, 543.

Benny's veto power, the network could safely assume that he would not bite the hand which had just fed him more than a million dollars of capital gain. The refusal of the court to look beyond the form of the transaction is unfortunate. It should not be difficult for many radio and television stars to make arrangements identical with those involved in the instant case and thereby realize, out of transactions that are essentially sales of services, large sums of money at capital gain rates. In addition, amendment of the Internal Revenue Code to cover this situation may not be advisable. The aspect of the transaction which distinguishes it from an ordinary sale of stock is the fact that the network is paying a premium for the stock in order to get the services of the majority stockholder. Since the business practicalities involved in the purchase of the producing corporation by a network take the place of any contractual ties between such a stockholder and the network, a provision which would preclude the realization by entertainers of capital gains in exchange for services in this type of case might unduly restrict the application of capital gains provisions to bona fide sales of corporations formed to produce radio and television shows.

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