Washington Law Review

Volume 72 | Number 3

7-1-1997

Kochanksky v. Commissioner: The Assignment of Income Doctrine, Community Property Law, and I.R.C. § 1041

Sarah Dods

Follow this and additional works at: https://digitalcommons.law.uw.edu/wlr

Part of the Taxation-Federal Commons

Recommended Citation

Sarah Dods, Notes and Comments, *Kochanksky v. Commissioner: The Assignment of Income Doctrine, Community Property Law, and I.R.C. § 1041*, 72 Wash. L. Rev. 873 (1997).
Available at: https://digitalcommons.law.uw.edu/wlr/vol72/iss3/5

This Notes and Comments is brought to you for free and open access by the Law Reviews and Journals at UW Law Digital Commons. It has been accepted for inclusion in Washington Law Review by an authorized editor of UW Law Digital Commons. For more information, please contact lawref@uw.edu.

Copyright © 1997 by Washington Law Review Association

KOCHANSKY v. COMMISSIONER: THE ASSIGNMENT OF INCOME DOCTRINE, COMMUNITY PROPERTY LAW, AND I.R.C. § 1041

Sarah Dods

Abstract: In *Kochansky v. Commissioner*, the Ninth Circuit held that an attorney was fully taxable on a contingent fee he agreed to split with his spouse at divorce, reasoning that the assignment of income doctrine requires that income be taxed to the person who earns it. This Note observes that in applying the assignment doctrine, the *Kochansky* court erred by failing to determine the extent of the spouse's community property interest in the contingent fee; community property income must be taxed one-half to each spouse, regardless of which spouse earns it, which spouse collects it, and when it is collected. This Note argues, moreover, that instead of applying any form of the assignment doctrine, the *Kochansky* court simply should have applied section 1041 of the Internal Revenue Code, under which each spouse would have been taxable on his or her share of the proceeds when collected. Many commentators have advocated such an approach, and the Tax Court has tentatively endorsed it in other cases.

The assignment of income doctrine requires that income be taxed to the person who earns it.[1] This doctrine is a fundamental principle of taxation. Equally fundamental, however, is the principle that community property income must be taxed one-half to each spouse.[2] Furthermore, section 1041 of the Internal Revenue Code, which governs transfers of property between spouses or former spouses incident to divorce, provides that in such transfers no gain or loss is recognized,[3] the property is treated as if acquired by gift,[4] and the transferee receives the transferor's basis in the property acquired.[5]

The issue presented in *Kochansky v. Commissioner*[6] was whether a contingent fee that two community property taxpayers had agreed to divide at divorce was taxable entirely to the spouse who earned it when both spouses eventually collected. The case thus called for an examination of how the assignment doctrine, community property law, and section 1041 interact. The Ninth Circuit considered only the assignment of income doctrine, holding that the fee was taxable entirely to the spouse who earned it.

1. Lucas v. Earl, 281 U.S. 111 (1930).
2. Poe v. Seaborn, 282 U.S. 101 (1930).
3. I.R.C. § 1041(a) (1994).
4. I.R.C. § 1041(b)(1).
5. I.R.C. § 1041(b)(2).
6. 92 F.3d 957 (9th Cir. 1996), *aff'g* 67 T.C.M. (CCH) 2665 (1994).

This Note observes that, under Ninth Circuit precedent regarding community property taxation, the *Kochansky* court incorrectly applied the assignment doctrine. This Note argues further that given the provisions and purposes of section 1041, the court should not have applied the assignment doctrine at all. Part I explains the facts of *Kochansky*, the court's analysis, and how other courts have rejected the assignment doctrine in the divorce context. Part II explains why a correct application of the assignment doctrine would have required a preliminary determination of the extent to which the contingent fee was community property and suggests how such a determination might have proceeded. Part III describes the operation of section 1041 and summarizes the Internal Revenue Service's and Tax Court's positions regarding section 1041's interaction with the assignment doctrine. Part IV argues that to effectuate Congress's purposes in enacting section 1041, to harmonize section 1041 with other areas of the tax law, and to prevent potential inequities to community property taxpayers, the assignment doctrine should not override section 1041. Finally, Part V asserts that section 1041 should have been applied in *Kochansky* and explains how such an approach would have worked.

I. *KOCHANSKY v. COMMISSIONER*

A. *Facts*

In September 1983, the McNarys retained Richard Kochansky, an Idaho attorney, to pursue a medical malpractice claim on a contingent fee basis.[7] Mr. Kochansky filed suit on behalf of the McNarys in October 1984. In July 1985, Mr. Kochansky and his wife divorced. Their property settlement provided that each spouse would relinquish his or her rights to the earnings of the other, except that the net proceeds of any contingent fee recovered from the McNary lawsuit would be divided equally.[8]

In late 1987, the McNarys settled their lawsuit.[9] The contingent fee was deposited in Mr. Kochansky's trust account, and after expenses were paid, a portion of the fee was disbursed to Mr. Kochansky's former wife pursuant to their property settlement.[10] Mr. Kochansky reported only the

7. Kochansky v. Commissioner, 67 T.C.M. (CCH) 2665, 2666 (1994).
8. *Id.*
9. *Id.*
10. *Id.* at 2666–67.

portion of the fee that he ultimately received, and the Commissioner assessed a deficiency against him for taxes on his former wife's portion[11] as well as various additions to tax.[12] Mr. Kochansky contested the deficiency and additions to tax, but the Tax Court concluded that the property settlement constituted an assignment of income ineffective to shift taxation and sustained the deficiency and additions to tax. The Ninth Circuit affirmed with respect to the deficiency but vacated the Tax Court's decision on the issue of additions to tax.[13]

B. The Ninth Circuit's Analysis

1. Lucas v. Earl *and Assignment of Income*

The Ninth Circuit agreed with the Tax Court that the assignment of income doctrine required the contingent fee to be taxable entirely to Mr. Kochansky.[14] The court relied on the landmark case *Lucas v. Earl*.[15] In *Earl*, a taxpayer had assigned half of his future income, including earnings, salaries, fees, and contractual rights, to his wife. The taxpayer argued that, accordingly, he was taxable only on one half of his income.[16] The U.S. Supreme Court rejected this argument, holding that although it was valid under state law, the contractual assignment of income was ineffective to shift taxation.[17] Justice Holmes explained:

> There is no doubt that the [income tax] statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.[18]

---

11. *Id.* at 2667.

12. *Id.* at 2668.

13. Kochansky v. Commissioner, 92 F.3d 957 (9th Cir. 1996).

14. *Id.* at 959.

15. 281 U.S. 111 (1930). The court also relied on *Helvering v. Eubank*, 311 U.S. 122 (1940) (holding that insurance agent remained taxable on future renewal commissions he had assigned).

16. *Earl*, 281 U.S. at 113.

17. *Id.* at 114–15.

18. *Id.*

The assignment doctrine that *Earl* established is undisputedly a first principle of taxation[19] and has long been heralded as necessary to protect progressivity and to preserve the tax base.[20] Courts have developed the doctrine over the years, often using Holmes's fruit-and-tree metaphor,[21] in which the "tree" represents income-producing property or a person, and the "fruit" represents any income the "tree" produces. Essentially, the doctrine requires that assignment of "fruit" is not effective for tax purposes without a corresponding transfer of the "tree" that produced it. Thus, when income produced by property is assigned, the assignment is effective only if an adequate interest in the income-producing property is also transferred.[22] Accrued income, often conceptualized as "ripened fruit," must be taxed to the transferor.[23] The line between income from property and income from personal services is not always clear,[24] but for purposes of the assignment doctrine, an employment contract is not considered income-producing property. In such circumstances the employee, not the contract, is considered the "tree" from which the income grows.[25]

---

19. *See, e.g.*, Commissioner v. Culbertson, 337 U.S. 733, 739–40 (1949). For a thorough discussion of the doctrine through its formative years, see Charles S. Lyon & James S. Eustice, *Assignment of Income: Fruit and Tree as Irrigated by the* P.G. Lake *Case*, 17 Tax L. Rev. 293 (1962).

20. *See* Boris I. Bittker, *Federal Income Taxation and the Family*, 27 Stan. L. Rev. 1389, 1401–03 (1975) (noting *Earl*'s reputation as guardian of progressivity, but criticizing *Earl*'s distinction between earned and investment income).

21. The metaphor has been an unhelpful one according to some commentators. *See, e.g.*, Michael J. Graetz & Deborah H. Schenk, *Federal Income Taxation: Principles and Policies* 506 (3d ed. 1995) (noting that fruit-and-tree metaphor "has given rise to a whole body of case law that has attempted to jam the facts into the metaphor").

22. *See, e.g.*, Harrison v. Schaffner, 312 U.S. 579 (1941) (holding that assignment of trust income for limited period of time was ineffective because income did not represent interest in trust corpus); Helvering v. Horst, 311 U.S. 112 (1940) (holding that gift of interest payments, without gift of underlying bond, was ineffective); Blair v. Commissioner, 300 U.S. 5 (1937) (holding that assignment of trust income for life was effective because income represented interest in trust corpus).

23. *See, e.g.*, Estate of Smith v. Commissioner, 292 F.2d 478 (3d Cir. 1961) (holding that gift of stock one day prior to distribution of dividends was ineffective to shift taxation on dividends).

24. *See, e.g.*, Siegel v. United States, 464 F.2d 891, 894 (9th Cir. 1972) (observing difficulty of distinguishing earned income and income from property when taxpayer used skill to create income-producing property, such as copyrighted works).

25. *See, e.g.*, Hall v. United States, 242 F.2d 412 (7th Cir. 1957) (rejecting taxpayer's argument that employment contract was income-producing property that effectively could be assigned to wife). Attempts to assign the "tree" by assigning services in kind are similarly ineffective. *See, e.g.*, Vnuk v. Commissioner, 621 F.2d 1318 (8th Cir. 1980) (holding that taxpayers who assigned their lifetime services to family trust were taxable on their earnings because taxpayers, not trust, retained control over services); Vercio v. Commissioner, 73 T.C. 1246 (1980) (same).

The "fruit" in *Kochansky* was the contingent fee, and the court's analysis suggests several possibilities for the "tree." The court concluded that regardless of what the "tree" was, the assignment was ineffective. If the "tree" was the McNarys' claim, the assignment was ineffective because Mr. Kochansky did not own the claim and therefore could not have assigned it.[26] If the "tree" was Mr. Kochansky's law practice, the assignment was ineffective because Mr. Kochansky did not transfer any part of his law practice.[27] Stressing that the contingent fee was compensation for personal services, however, the court concluded that "[i]n terms of the tree-fruit analogy, 'there was no tree other than [the taxpayer] himself.'"[28] Accordingly, because Mr. Kochansky did not transfer himself, his assignment of part of the contingent fee was held ineffective to shift taxation.[29]

2. *Assignments of Uncertain or Contingent Income*

Nonetheless, Mr. Kochansky argued that the assignment was effective on the principle that when an income right is uncertain, doubtful, or contingent, assignment of that right will be effective to shift taxation.[30] When this principle is applied to an assignment of an interest in a legal claim or contingent fee, the assignment's effectiveness generally turns on the level of uncertainty at the time of transfer, whether consideration is exchanged, and whether the assignment is between family members.[31] These factors were significant to the court's analysis in *Jones v. Commissioner*,[32] the case upon which Mr. Kochansky primarily relied.

In *Jones*, a taxpayer assigned his legal claim in exchange for $10,000 and the assignee's promise to bear the risks and expense of pursuing the claim.[33] The *Jones* court held that the assignment was effective.[34] The

26. Kochansky v. Commissioner, 92 F.3d 957, 959 (9th Cir. 1996).

27. *Id.*

28. *Id.* (quoting Hall v. United States, 242 F.2d 412, 413 (7th Cir. 1957)).

29. *Id.*

30. *Id.* at 958 (citing Jones v. Commissioner, 306 F.2d 292, 301 (5th Cir. 1962)); Cold Metal Process Co. v. Commissioner, 247 F.2d 864, 872–73 (6th Cir. 1957); Dodge v. United States, 443 F. Supp. 535, 538 (D. Or. 1977)); *see also* Commissioner v. Timken, 141 F.2d 625 (6th Cir. 1944) (holding that assignment was effective when debtor was in default at time of assignment); Wellhouse v. Tomlinson, 197 F. Supp. 739 (S.D. Fla. 1961) (holding that assignment was effective when debtor's legal obligation to pay was questionable at time of assignment).

31. *See, e.g.*, Doyle v. Commissioner, 147 F.2d 769 (4th Cir. 1945) (holding that gratuitous, intra-family assignment of claim proceeds, made when recovery was practically assured, was ineffective).

32. 306 F.2d 292 (5th Cir. 1962).

33. *Id.* at 294.

court based its holding on several factors it had culled from the major assignment of income cases: the extent to which control of the claim passed to the assignee; whether the transfer was gratuitous or for valuable consideration; how soon the assignment occurred before collection of the income; whether the assignment was at arm's length or between family members; whether there was a legitimate non-tax-avoidance purpose for the assignment; and to what extent the prospect of recovery was uncertain at the time of the assignment.[35] The Ninth Circuit did not adopt these factors in *Kochansky* because it distinguished *Jones* on its facts.[36] In *Jones*, the taxpayer transferred his own claim along with his entire business and relinquished control over both upon assignment. In *Kochansky*, however, the taxpayer did not own the claim and did not relinquish any control over it upon assignment.

Nevertheless, examination of the *Jones* factors might have drawn the *Kochansky* court's attention to some of the reasons why assignment principles are less appropriate in the context of divorce than in other circumstances. Because the parties are parting, for example, the assignor at divorce does not stand to retain control over income as does the assignor in a traditional intra-family assignment. The U.S. Supreme Court has concluded that for tax purposes, divorcing spouses may be said to act at arm's length,[37] and that when property is transferred at divorce for a relinquishment of marital rights, the exchange is not gratuitous but is made for valuable consideration.[38] When consideration is exchanged for an income right in an arm's length transaction, however, the assignor is taxed on the consideration received, and the assignee is taxed on the income collected that exceeds his or her cost.[39] Had this principle been applied in *Kochansky*, Mr. Kochansky would have been taxable at divorce on the consideration he received for assigning part of the contingent fee,[40] precisely the approach to divorce taxation that Congress

34. *Id.* at 301.

35. *Id.* at 301–02 (citations omitted).

36. Kochansky v. Commissioner, 92 F.3d 957, 959 (9th Cir. 1996).

37. United States v. Davis, 370 U.S. 65, 72 (1962).

38. *Id.* at 69 n.6.

39. *See, e.g.*, Cotlow v. Commissioner, 22 T.C. 1019 (1954), *aff'd*, 228 F.2d 186 (2d Cir. 1955); *see also* Schulze v. Commissioner, 46 T.C.M. (CCH) 143, 146 (1983) (approving principle in context of divorce); Wilkinson v. United States, 304 F.2d 469, 472 (Ct. Cl. 1962) (approving principle in context of partial sale of contingent fee). The principle is inapplicable if the true nature of the transaction is a loan. *Compare* Mapco Inc. v. United States, 556 F.2d 1107 (Ct. Cl. 1977) (assignment recast as loan) *with* Estate of Stranahan, 472 F.2d 867 (6th Cir. 1973) (assignment not recast as loan).

40. *See infra* note 112.

rejected in enacting, and the Tax Court has rejected in interpreting, section 1041.[41]

Finally, assignment of an income right at divorce can serve a legitimate purpose unrelated to tax avoidance: to effectuate an equitable division of the couple's property. In cases involving taxpayers not subject to section 1041, other courts have rejected the assignment doctrine in the divorce context for this reason. In *Kenfield v. United States*,[42] for example, the Tenth Circuit held that a partner in a real estate partnership was not taxable on future partnership earnings that were assigned to his wife at divorce, even though he retained full control over the partnership interest, with the former wife's only participation being receipt of the income.[43] Stressing that a divorce settlement constitutes a division of co-owned property and is not a voluntary transfer susceptible of manipulation for tax avoidance purposes, the court concluded that the assignment doctrine was inapplicable.[44] Similarly, in *Schulze v. Commissioner*,[45] the Tax Court considered a couple who agreed in connection with their divorce to share the proceeds of the husband's pending legal claim.[46] The Tax Court relied on the factors set forth in *Jones* to hold that the husband was not taxable on the proceeds disbursed to his former wife, stressing that the assignment was not gratuitous and was made for the legitimate purpose of effectuating an equal division of property at divorce.[47]

Thus, in both *Kenfield* and *Schulze*, the assignment doctrine was not applied even though the assignee spouse was given little or no control over the income right that was assigned, and at least part of the income assigned was earned by the assignor.[48] The assignments were given effect because they were not gratuitous, were not wholly voluntary, and were made for the purpose of equitably dividing marital property. In

41. *See infra* text accompanying notes 99–101.

42. 783 F.2d 966 (10th Cir. 1986).

43. *Id.* at 967. Although the settlement's language literally assigned earnings, the court reasoned that it must have operated to divide the partnership interest as marital property and therefore must have granted the former wife a partnership interest. *Id.* at 967–69. The court dismissed Treasury regulations governing the degree of control necessary for partnership status as a mere "response to the evasionary assignment-of-income transfers . . . taxpayers have attempted over the years." *Id.* at 970.

44. *Id.* at 970.

45. 46 T.C.M. (CCH) 143 (1983).

46. *Id.* at 144.

47. *Id.* at 146.

48. *Id.* at 144; *Kenfield*, 783 F.2d at 967.

Kochansky, the taxpayer attempted to make a similar argument based on Idaho's community property law.[49] Perhaps mindful of the complications that applying community property principles in *Kochansky* would have entailed, the Ninth Circuit refused to consider this argument.[50]

II. TAXATION OF COMMUNITY PROPERTY INTERESTS IN CONTINGENT FEES

A. *Taxation of Community Income*

Applying community property principles in *Kochansky* would have entailed significant complications under long-established rules governing community property taxation. Although the Ninth Circuit stated that the "ancient precedent" of *Lucas v. Earl*[51] controlled *Kochansky*,[52] a similarly ancient precedent controls *Earl*'s application to the taxation of community property income. In *Poe v. Seaborn*[53] and its companion cases,[54] the U.S. Supreme Court held that community property spouses

---

49. Kochansky v. Commissioner, 92 F.3d 957, 959 (9th Cir. 1996); Appellant's Brief at 6–10 (No. 94-70747). Kochansky's community property argument differs from the analysis in this Note. Kochansky argued that the right to the contingent fee was community property owned equally by each spouse at divorce, and when divided at divorce, the right to one half of the fee became the separate property of each, and accordingly, each spouse was taxable on the income generated by that separate property after divorce. The Ninth Circuit rejected similar reasoning in *Johnson v. United States*, 135 F.2d 125, 127–28 (9th Cir. 1943). Had the *Kochansky* court found that each spouse's community interest was equivalent to one half of the net contingent fee, no assignment would have occurred, and each would have been taxable on the half collected. Although such a finding would have simplified the case, it would not have reflected Idaho law, under which the community had no interest in the fee to the extent it was earned after divorce, even though a contingent contractual right to the fee was acquired during marriage. *See* Shill v. Shill, 765 P.2d 140, 143 (Idaho 1988) [*Shill II*] (holding that increase in value of contingent pension plan attributable to post-divorce labor was not community property).

50. *Kochansky*, 92 F.3d at 959.

51. 281 U.S. 111 (1930).

52. *Kochansky*, 92 F.3d at 958.

53. 282 U.S. 101 (1930) (applying Washington's community property law). *Seaborn* was decided only eight months after *Earl* and profoundly shaped our tax system by spurring enactment of the joint return. *See generally* 3 *Mertens Law of Federal Income Taxation* § 19.02 (1988) (describing state reactions to *Seaborn*, unsuccessful Congressional proposals for overruling it, and eventual enactment of joint return in 1948). For an overview of tax issues related to various states' community property systems, see Fred F. Murray, *Problems of Taxation of the Income of Spouses in the Context of Divorce and Separation*, Community Prop. J., July 1987, at 20.

54. Soon after *Seaborn*, the U.S. Supreme Court held that other states' community property laws yielded the same income tax consequences. *See* United States v. Malcolm, 282 U.S. 792 (1931) (California); Bender v. Pfaff, 282 U.S. 127 (1930) (Louisiana); Hopkins v. Bacon, 282 U.S. 122 (1930) (Texas); Goodell v. Koch, 282 U.S. 118 (1930) (Arizona). The Service recognized Idaho, as well as Nevada and New Mexico, as community property states for tax purposes in 1930.

are each taxable on half of the couple's aggregate community income, regardless of which spouse actually labored to produce the income. The *Seaborn* Court distinguished *Earl* in that Mr. Earl's earnings would have been his own property absent the contractual arrangement with his wife.[55] In *Seaborn*, on the other hand, community property law mandated that the husband's earnings were the property of the community, not the husband, even though the husband had labored to earn them.[56] Later, the Court applied *Seaborn*'s reasoning to confirm that a taxpayer's community property tax liability on his or her former spouse's earnings during marriage was not absolved by divorce.[57]

Not long after *Seaborn*, the Ninth Circuit considered *Seaborn*'s relationship to the assignment of income doctrine when a taxpayer assigns community property income rights to her husband at divorce. In *Johnson v. United States*,[58] a wife agreed in a divorce settlement to assign her community property interest in legal fees owed to her attorney husband by certain clients. Under *Seaborn*, the wife possessed a vested property right in the husband's earnings for tax purposes,[59] and she would have been subject to tax on half the fees had no assignment occurred. Furthermore, under the assignment of income cases, a taxpayer could not shift tax liability by assigning an income right to another taxpayer.[60] Applying these principles, the *Johnson* court concluded that the wife's relinquishment of her community property rights in the fees through the divorce settlement constituted an assignment of income of the kind contemplated by the assignment of income cases.[61] Therefore, the court held that the wife remained taxable on half of the fees.[62]

Mim. 3853, X-1 C.B. 139 (1930). *See generally* 3 Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates, and Gifts* ¶ 76.1 (2d ed. 1991).

55. *Seaborn*, 282 U.S. at 117.

56. *Id.*

57. United States v. Mitchell, 403 U.S. 190 (1971). Legislation enacted to afford relief to such spouses only applies in limited circumstances. *See* I.R.C. § 66 (1994); Bittker & Lokken, *supra* note 54, at ¶ 76.4.

58. 135 F.2d 125 (9th Cir. 1943).

59. *Id.* at 129 (citing *Seaborn*, 282 U.S. at 111).

60. *Id.* at 128 (citing Harrison v. Schaffner, 312 U.S. 579 (1941); Helvering v. Eubank, 311 U.S. 122 (1940); Helvering v. Horst, 311 U.S. 112 (1940)).

61. *Id.*

62. *Id.* at 130. The result in *Johnson* was not so inequitable as it may appear, because the husband had agreed to pay his wife's tax liability for the years in which she was taxable on the fees. *Id.* at 127. However, *Johnson*'s potentially harsh impact is apparent: the greater the community interest in uncollected community income one spouse relinquishes at divorce, the larger his or her eventual tax liability grows.

Accordingly, *Johnson* mandates that when community property taxpayers divorce in the Ninth Circuit, a spouse's assignment of a community income right will not shift tax liability on that income right, regardless of who earned the income and who ultimately collects it.

B. Community Property Interests in Contingent Fees

The *Kochansky* court's application of the assignment doctrine without regard to community property rights in the contingent fee is inconsistent with *Johnson*, because to the extent that Ms. Kochansky possessed a community property interest in the fee proceeds she received, no assignment of income occurred. Accordingly, if the assignment doctrine was to be applied at all, *Kochansky* required a preliminary determination of whether, and to what extent, the contingent fee was community property.

The Ninth Circuit refused to consider community property law in *Kochansky* on the grounds that the issue was first raised on appeal[63] and that facts had not been developed to support the existence of a community interest in the fee.[64] The fundamental principle of community property law in Idaho as elsewhere, however, is that each spouse possesses an undivided one-half interest in income earned by his or her spouse during marriage.[65] Determining the value of the community interest in the fee may have required additional factual findings,[66] but determining the existence of any community interest in the fee was purely a matter of Idaho law.[67]

---

63. Kochansky v. Commissioner, 92 F.3d 957, 959 (9th Cir. 1996). The court cited *United States v. Kimball*, 896 F.2d 1218 (9th Cir. 1990), *vacated in part on reh'g*, 925 F.2d 356 (1991), to support its refusal to consider the community property issue. However, *Kimball* presents three exceptions to the general rule against considering issues first raised on appeal, one of which is when review of the issue is necessary to preserve the integrity of the judicial process. *Id.* at 1219. In *Kochansky*, community property analysis was necessary to preserve the integrity of the judicial process, because such analysis was necessary to reconcile *Kochansky* with the Ninth Circuit's precedent in *Johnson v. United States*, 135 F.2d 125 (9th Cir. 1943).

64. *Kochansky*, 92 F.3d at 959.

65. *See, e.g.*, Idaho Code § 32-906 (1983 & Supp. 1995); Poe v. Seaborn. 282 U.S. 101 (1930); *see generally* William Q. de Funiak & Michael J. Vaughn, *Principles of Community Property* § 1 (2d ed. 1971).

66. *See infra* text accompanying notes 77–78.

67. Accordingly, the issue of whether a community property interest existed also fell within another of *Kimball*'s exceptions to the general rule against reviewing issues first raised on appeal. *See Kimball*, 896 F.2d at 1219. This question could have been decided according to Idaho precedent or certified to the Idaho Supreme Court. *See* Commissioner v. Estate of Bosch, 387 U.S. 456 (1967); Idaho App. R. 12.1(a).

The Supreme Court of Idaho has upheld a decision that an attorney's hourly fees earned during marriage were community property,[68] but it has not specifically considered whether and to what extent contingent fees earned partially during marriage and partially after divorce are community property. Two Idaho Supreme Court decisions indicate, however, that such fees would be characterized as community property to the extent they were earned during marriage. In *Shill I*[69] and *Shill II*[70] the Idaho Supreme Court considered whether and to what extent spouses possess a community property interest in a contingent, non-vested pension plan earned by one spouse during marriage, but collected after divorce. *Shill I* established that a contingent, non-vested pension earned by one spouse is community property divisible at divorce.[71] The primary holding in *Shill I* was not that such an interest existed, but that when dividing such a plan at divorce, courts should look not to cash-surrender value, but to the present worth of future payments, taking all the various contingencies affecting value into account.[72] *Shill II* established that, although proper valuation must take contingencies into account, any increase in the pension's value attributable to the earning spouse's labor after divorce is not considered community property.[73]

Like the contingent, non-vested pension plan in *Shill I*, the fee in *Kochansky* represented a contingent, non-vested right to future income attributable in part to labor performed during marriage and in part to labor performed after divorce. As in *Shill I*, events only partly within the employee spouse's control influenced whether, when, and how much income was ultimately collected.[74]

---

68. Smith v. Smith, 860 P.2d 634, 643 (Idaho 1993). The *Smith* court also upheld the trial court's valuation of the attorney's accounts receivable, implying that the accounts receivable were also community property. *Id.* at 640.

69. Shill v. Shill, 599 P.2d 1004 (Idaho 1979) [*Shill I*].

70. Shill v. Shill, 765 P.2d 140 (Idaho 1988) [*Shill II*].

71. *Shill I*, 599 P.2d at 1007. *Shill I* accords with the law of other community property states. *See, e.g.*, Van Loan v. Van Loan, 569 P.2d 214 (Ariz. 1977); Brown v. Brown, 544 P.2d 561 (Cal. 1976); LeClert v. LeClert, 453 P.2d 755 (N.M. 1969); Cearley v. Cearley, 544 S.W.2d 661 (Tex. 1976); Wilder v. Wilder, 85 Wash. 2d 364, 534 P.2d 1355 (1975).

72. *Shill I*, 599 P.2d at 1007–08. The *Shill I* court observed that a court may award a lump sum according to the pension's present value or may reserve jurisdiction to divide the pension if and when it becomes due. *Id.* at 1008, 1010.

73. *Shill II*, 765 P.2d at 148.

74. For example, in *Shill I* the employee spouse could have died, changed jobs, or been discharged before the pension vested, and he could have influenced the amount and timing of the payments by continuing to work after the date of first vesting. *Shill I*, 599 P.2d at 1008.

Applying the Idaho court's reasoning in *Shill I* and *Shill II* to *Kochansky* yields the conclusion that a community property interest in the contingent fee existed at the time of divorce, but the extent of this interest was limited to the proportion of the fee that was earned during marriage. All community property states that have considered the issue have adopted this approach,[75] and at least one court has specifically relied on the analogy to contingent, non-vested pensions in reaching this conclusion.[76] The courts generally have reasoned that a contractual right, although contingent on future events, is property divisible at divorce, and that the extent of the community's interest in this property is ascertainable by reference to the percentage of hours the attorney spouse worked on the claim during marriage.

Valuation under this approach usually requires reserving jurisdiction until the contingent fee is collected or the case closed, because the ratio of the community interest to the non-community interest cannot be ascertained until that time. To determine the extent of the community's interest, the total fee collected is multiplied by the ratio of hours the spouse worked on the claim during marriage to the total hours the spouse worked on the claim, with possible weight given to other relevant factors and appropriate offsets for costs.[77] Thus, determining the community property interest in the contingent fee in *Kochansky* would have required

75. *See* Garrett v. Garrett, 683 P.2d 1166 (Ariz. App. 1983); *In re* Kilbourne, 232 Cal. App. 3d 1518 (Cal. Ct. App. 1991) (partially published decision); Waters v. Waters, 170 P.2d 494 (Cal. Ct. App. 1946); Due v. Due, 342 So. 2d 161 (La. 1977); *In re* Marriage of Estes, 84 Wash. App. 586, 929 P.2d 500 (1997); Weiss v. Weiss, 365 N.W.2d 608, 613 (Wis. Ct. App. 1985); *cf.* Commissioner v. King, 69 F.2d 639 (5th Cir. 1934) (holding that contingent fee collected after wife's death was community property under Texas law and taxable as such); Buck v. Rogers, 709 S.W.2d 283 (Tex. App. 1986) (holding that attorney spouse's fraudulent failure to disclose community property interests in contingent fees at divorce entitled former spouse to one half of proceeds under terms of property settlement). *But cf.* Harris v. Harris, 765 S.W.2d 798 (Tex. App. 1989) (holding that contingent fee contract owned by law partnership was not susceptible to characterization as community or separate property, although spouse's partnership interest could be characterized as community property). *See generally* Kenneth L. Hickman, *The Classification of Contingent Fee Contracts as Community or Separate Property*, 37 La. L. Rev. 1190 (1977) (discussing classification and division of contingent fee contracts as community property under Louisiana's Civil Code).

Non-community property states have reached mixed results, but a number have concluded that contingent fees are marital property to the extent earned during marriage. *Compare In re* Marriage of Vogt, 773 P.2d 631 (Colo. Ct. App. 1989), Lyons v. Lyons, 526 N.E.2d 1063 (Mass. 1988), *and* Metzner v. Metzner, 446 S.E.2d 165 (W. Va. 1994), *with* Goldstein v. Goldstein, 414 S.E.2d 474 (Ga. 1992), *In re* Marriage of Zells, 572 N.E.2d 944 (Ill. 1991), *In re* Marriage of Tietz, 605 N.E.2d 670 (Ill. App. Ct. 1992), Musser v. Musser, 909 P.2d 37 (Okla. 1995), *and* Beasley v. Beasley, 518 A.2d 545 (Pa. Super. Ct. 1986).

76. *Garrett*, 683 P.2d at 1169.

77. *Id.* at 1172–73.

factual findings concerning the number of hours Mr. Kochansky spent on the McNary lawsuit while married, the number of hours he spent on it overall, and possibly the nature and quality of his work at various stages of representation.[78] Such a determination was necessary in *Kochansky*, even though the spouses had long since agreed how they would actually divide the fee, if the assignment doctrine was to be applied in a manner consistent with *Johnson*.[79] This fact-intensive calculation would have been unnecessary, however, had the *Kochansky* court simply applied section 1041.

III. SECTION 1041 AND THE ASSIGNMENT OF INCOME DOCTRINE

A. *The Operation of Section 1041*

Section 1041 governs all transfers of property between spouses, and between former spouses if the transfer is incident to divorce.[80] Section 1041 provides that the transferor will recognize no gain or loss at transfer, that the property transferred will be treated as if acquired by the transferee by gift, and that the transferee will take the transferor's basis in the property received.[81] The Treasury Regulations emphasize that the carryover basis rule applies "[i]n all cases."[82]

Gift treatment entails the application of section 102, under which a cash payment from one spouse to the other is simply non-taxable.[83] When property other than cash is transferred, the transferee is similarly not taxable on the property when it is received, but is taxable on income

---

78. Another approach would be to value the community's interest by equating it with the reasonable value of the services rendered during marriage, but this valuation may bear little or no relation to the fee recovered, especially in cases where no fee is recovered. Valuing the contingent fee by this method would probably be impermissible because it is analogous to valuing a pension by reference to its cash surrender value at divorce, a method the Idaho court rejected in *Shill I*. *See supra* note 72.

79. The *Garrett* court observed that taxation of the fee would be governed by *Johnson v. United States*, 135 F.2d 125 (9th Cir. 1943), under which each spouse would be taxable on his or her community property share of the fee upon collection. *Garrett*, 683 P.2d at 1171.

80. Neither opinion and none of the parties' appellate briefs mention § 1041, but the section is mandatory and applies to all transfers pursuant to property settlements executed after July 18, 1984. Temp. Treas. Reg. § 1.1041-1T(f) (1984).

81. I.R.C. § 1041 (1994).

82. Temp. Treas. Reg. § 1.1041-1T(d)A-11. Basis is adjusted, however, to the extent that liabilities exceed basis when property is transferred in trust. I.R.C. § 1041(e).

83. I.R.C. § 102(a) (1994). If the cash payment is alimony, it is taxable to the payee and deductible by the payor unless the spouses designate otherwise. *See* I.R.C. §§ 71, 215 (1994).

generated by the property[84] and on any gain realized when the property is later sold or exchanged. Gain or loss at this time is determined by reference to the basis carried over from the transferor at the time of transfer.[85] When a transferee spouse receives an interest in an item of uncollected income rather than the cash equivalent of that interest, section 1041 should therefore operate to treat the interest as if acquired by gift, and the transferee should take the transferor's basis in that interest. Accordingly, the transferee should be taxable by reference to this basis when the property is later exchanged for cash or other property. When the deferred income item has a zero basis, the transferee should be fully taxable when he or she collects. Section 1041's conflict with the assignment of income doctrine in such circumstances is apparent, but the conflict has not been resolved by the Service or the courts.

B. *The Service's Position*

The Service has taken inconsistent positions concerning section 1041's conflict with the assignment of income doctrine. It first considered the issue in a 1987 Revenue Ruling concerning a transfer of U.S. savings bonds pursuant to a divorce settlement.[86] The Service held that the deferred interest that had accrued on the bonds was taxable to the transferor, with the simple explanation that recognition of accrued income in such circumstances will simply be treated as a matter distinct from recognition of gain.[87] The ruling did not examine the purposes behind section 1041 or how the assignment doctrine interacts with other nonrecognition provisions.[88]

The Service also has taken various positions on the issue in private letter rulings[89] concerning deferred compensation.[90] For example, in a

84. I.R.C. § 102(b)(1).

85. I.R.C. § 1041(b)(2).

86. Rev. Rul. 87-112, 1987-2 C.B. 208. *But cf.* Cofield v. Koehler, 207 F. Supp. 73 (D. Kan. 1962) (declining to tax husband on accrued interest on savings bonds transferred at divorce because transfer effectuated partition of jointly owned property).

87. Rev. Rul. 87-112. In determining that the basis of the bonds in the transferee's hands would be adjusted to reflect the gain recognized by the transferor, the Service analogized the transfer to a gift of an installment obligation. The analogy is inopportune, however, given the operation of § 453B(g), which excludes inter-spousal transfers of installment obligations from the usual tax treatment of gifts or other dispositions of installment obligations. *See infra* text accompanying notes 129–30.

88. *See infra* text accompanying note 141.

89. The Service does not consider itself bound by private letter rulings in dealings with taxpayers other than the party to whom issued. I.R.C. § 6110(j)(3) (1994). Nevertheless, the U.S. Supreme

ruling later reversed by the Tax Court, the Service concluded that when a taxpayer exchanged community property rights to her former husband's future retirement income for cash, the cash was immediately taxable to her.[91] Observing that taxation follows community property rights under *Seaborn* and *Johnson*, the Service characterized her exchange of rights for cash as an assignment in which she was taxable on the consideration received.[92] In at least two other rulings, the Service has declined to express an opinion on the issue.[93]

Other rulings indicate a different approach. In one ruling, the Service took the position that where cash payments were exchanged for community property rights to unspecified business "benefits," the payments were non-taxable to the transferee.[94] The Service implied that, had the spouses simply agreed that the non-earner spouse would retain an ownership interest in half of the benefits rather than taking a cash equivalent at divorce, each spouse would have been taxable as he or she collected.[95] The Service endorsed a similar position in a technical advice memorandum concerning a stock redemption at divorce.[96] In that situation, the husband transferred stock in the family corporation to his wife at divorce, and the corporation immediately redeemed the stock pursuant to the divorce decree. But for section 1041, the husband would have been treated as having redeemed the stock himself and would have

Court has cited private letter rulings as evidence of inconsistent interpretation by the Service. *See, e.g.*, Rowan Cos. v. United States, 452 U.S. 247, 261 n.17 (1981).

90. The Service's position on transfers of IRAs illustrates such inconsistency. *Compare* Priv. Ltr. Rul. 94-22-060 (Mar. 14, 1994) (ruling that transfer of IRA between spouses was taxable notwithstanding § 1041), *and* Priv. Ltr. Rul. 88-20-086 (Feb. 25, 1988) (same) *with* Priv. Ltr. Rul. 89-29-046 (Apr. 25, 1989) (ruling that transfer of interests in spouses' IRAs was non-taxable under § 1041 as informed by legislative intent). *See generally* Deborah A. Geier, *Form, Substance, and Section 1041*, 60 Tax Notes 519 (July 26, 1993).

91. Priv. Ltr. Rul. 88-13-023 (Dec. 29, 1987), *rev'd*, Balding v. Commissioner, 98 T.C. 368 (1992); *see infra* text accompanying notes 99–102.

92. Priv. Ltr. Rul. 88-13-023 (citing Poe v. Seaborn, 282 U.S. 101 (1930); Johnson v. United States, 135 F.2d 125 (9th Cir. 1943); Veit v. Commissioner, 8 T.C. 809 (1947)).

93. Priv. Ltr. Rul. 96-15-026 (Jan. 2, 1996); Priv. Ltr. Rul. 88-42-072 (July 29, 1988).

94. Priv. Ltr. Rul. 91-23-053 (Mar. 13, 1991).

95. *Id.* The Service stated:

> The instrument executed in Year B did not give Wife title to one-half of Husband's Benefits in Business [B]. Rather, in consideration for Wife's community property interest, the instrument required Husband to pay Wife the cash equivalent of one-half of the benefits. Accordingly, the payments are transfers of property between an individual and a former spouse, incident to divorce, and are non-taxable under § 1041 of the Code.

Id.

96. Tech. Adv. Mem. 90-46-004 (July 20, 1990).

been taxable on the proceeds. The Service taxed the wife, however, reasoning that in enacting section 1041:

> Congress gave taxpayers a mechanism for determining which of the two spouses will pay the tax upon the ultimate disposition of the asset. The spouses are thus free to negotiate between themselves whether the "owner" spouse will first sell the asset, recognize the gain or loss, and then transfer to the transferee spouse the proceeds from that sale, or whether the owner spouse will first transfer the asset to the transferee spouse who will then recognize gain or loss upon its subsequent sale.[97]

The Service's approach in these situations suggests that spouses considering the division of an income item at divorce should be free to determine the tax consequences of their settlement by the form of transaction they choose.

C. *The Tax Court's Position*

The Tax Court has tentatively rejected the assignment doctrine in the context of divorce, reasoning that applying the doctrine thwarts Congress's purposes in enacting section 1041. The Tax Court first considered the issue when it reviewed the Service's attempt to tax an assignor spouse on consideration received in exchange for community property income rights.[98] The Tax Court reversed this Service ruling in *Balding v. Commissioner*.[99] The *Balding* court agreed that a former wife's relinquishment of community property rights to her husband's future retirement pay constituted an assignment of income, observing that outside the marital context, it would have little trouble taxing her on the consideration she received.[100] The court concluded, however, that the legislative purposes behind section 1041 rendered this aspect of the assignment of income doctrine inapplicable and, accordingly, refused to tax the wife on this consideration.[101] The court declined to decide whether, as *Johnson* requires, she would be taxable on her community

97. *Id.* This concept of "private ordering" characterizes the Code's treatment of alimony under §§ 71 and 215, which allow spouses to designate whether support payments will be deductible to payor and taxable to payee, or non-deductible to payor and non-taxable to payee.

98. Priv. Ltr. Rul. 88-13-023 (Dec. 29, 1987). *See supra* text accompanying notes 91–92.

99. 98 T.C. 368 (1992).

100. *Id.* at 370 (citing Commissioner v. P.G. Lake, Inc., 356 U.S. 260 (1958)).

101. *Id.* at 373.

property portion of the retirement pay when her former husband eventually collected it.[102]

The Tax Court again considered the interaction of the assignment doctrine with section 1041 in *Berger v. Commissioner*.[103] In *Berger*, a husband transferred his interest in a family business, including certain sales contracts and receivables, to his wife at divorce. The husband argued that no part of the income accrued at the point of transfer was taxable to him. The court noted that subjecting section 1041 to the assignment doctrine had been sharply criticized on the grounds that this position can cause misattribution of income and uncertainty in marital property negotiations.[104] In *Berger*, however, the husband had actually received economic benefits from the accrued income, in the form of draw payments and payments of expenses, prior to transfer.[105] Thus, the court concluded that misattribution of income was not a concern and taxed a certain amount of the accrued income to the husband.[106] The court did not hold, however, that the assignment doctrine overrides section 1041. Instead, the court held that in the peculiar factual circumstances of this case, section 1041 did not trump the clear reflection of income rule.[107] *Berger* suggests that the Tax Court considers uncertainty and misattribution of income legitimate reasons not to apply the assignment doctrine to section 1041, and that instead, the Tax Court will apply other, more flexible tax rules to reach fair results in appropriate circumstances.

---

102. *Id.* at 373 n.8. The court stated:

> We do not here deal with the tax consequences to petitioner of retirement payments made by the Government on account of Balding's retirement. *Cf.* Johnson v. United States, 135 F.2d 125 (9th Cir. 1943). Accordingly, we have no occasion to consider whether the assignment of income doctrine would require petitioner's share of those retirement payments to be taken into petitioner's income as paid by the Government to Balding, notwithstanding petitioner's lack of entitlement to such payments.

Id.

103. 71 T.C.M. (CCH) 2160 (1996).

104. *Id.* at 2178.

105. *Id.*

106. *Id.*

107. *Id.* at 2177. This rule requires that a taxpayer's method of accounting clearly reflect income. The Service is given broad discretion under I.R.C. § 446 (1994) in determining whether a taxpayer's method of accounting clearly reflects income and if not, what accounting method is required to do so. *See generally* 2 *Mertens Law of Federal Income Taxation* § 12.15–18 (1990).

IV. THE ASSIGNMENT DOCTRINE SHOULD NOT OVERRIDE SECTION 1041

A. *Legislative Purposes of Section 1041*

Many tax scholars and practitioners have noted the uncertain relationship between the assignment doctrine and section 1041, and they have nearly unanimously concluded that the doctrine should not override section 1041.[108] Their primary objection has been that subjecting section 1041 to the doctrine undermines Congress's express purposes in enacting section 1041. Section 1041 was enacted as part of the Deficit Reduction Act of 1984[109] with the express purpose of overturning the prior rules of divorce taxation[110] established by *United States v. Davis*.[111] Under *Davis*, transfers of appreciated property to a spouse or former spouse in exchange for the relinquishment of marital rights triggered immediate gain recognition to the transferor.[112] The transferee reported no income or

108. *See, e.g.*, Carlyn S. McCaffrey & Melissa G. Salten, *Structuring the Tax Consequences of Marriage and Divorce* § 604 (Little, Brown Tax Practice Series 1995) (criticizing application of doctrine); Michael Asimow, *The Assault on Tax-Free Divorce: Carryover Basis and Assignment of Income*, 44 Tax L. Rev. 65, 84–112 (1988) (arguing comprehensively against application of doctrine); Geier, *supra* note 90 (arguing against application of doctrine; stressing spouses' freedom to determine tax consequences through form of transfer); Roland L. Hjorth, *Divorce, Taxes, and the 1984 Tax Reform Act: An Inadequate Response to an Old Problem*, 61 Wash. L. Rev. 151, 165–66 & n.68 (1986) (describing argument for inapplicability; suggesting use of tax indemnification agreements); Michael J.R. Hoffman & Kenneth N. Orbach, *Assignment of Income and Divorce*, 23 Tax Adviser 601 (1992) (arguing against application of assignment doctrine); John A. Miller, *Federal Income Taxation and Community Property Law: The Case For Divorce*, 44 Sw. L.J. 1087, 1121–30 (1990) (noting inequities of applying doctrine in community property context); Walter H. Nunnallee, *The Assignment of Income Doctrine as Applied to Section 1041 Divorce Transfers: How the Service Got It Wrong*, 68 Or. L. Rev. 615 (1989) (arguing comprehensively against application of doctrine); Gary C. Randall, *Transfers to Spouses or Incident to Divorce: Section 1041 and Planning Considerations*, Q 165 A.L.I.-A.B.A. Video L. Rev. Study Materials 61, 66–67 (1988) (noting community property issues); Nancy J. Brown, Comment, *Domestic Relations Tax Reform*, 20 Gonz. L. Rev. 251, 261–62 (1984/85) (noting community property issues; arguing doctrine inapplicable); Warren P. Kean, Note, *Federal Income Tax Consequences of Dissolving the Marital Community Upon Divorce*, 44 La. L. Rev. 1823, 1829 n.43 (1984) (predicting doctrine would not apply; noting community property issues; suggesting private tax agreements). *But cf.* Leon Gabinet, *Section 1041: The High Price of Quick Fix Reform in Taxation of Interspousal Transfers*, 5 Am. J. Tax Pol'y 13, 21–26 (1986) (suggesting situation of potential abuse; noting differences from other nonrecognition contexts).

109. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 421, 98 Stat. 793 (1984) (codified as amended at 26 U.S.C. § 1041 (1994)).

110. H.R. Rep. No. 98-432, pt. 2, at 1491–93 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1134.

111. 370 U.S. 65 (1962).

112. *Id.* at 74. The transferor's gain was measured by the difference between the transferor's basis and the value of the property the transferor acquired. If this "property" consisted of a relinquishment of the other spouse's marital rights, these rights were presumed equal in value to the fair market

gain on the transaction[113] and took a basis in the transferred property equal to its fair market value at the time of transfer.[114] These rules did not apply to approximately equal divisions of community property,[115] to divisions of jointly-held property,[116] and in some common law states, to equitable divisions of marital property.[117] Thus, the taxation of property divisions at divorce was often unclear, varied significantly from state to state, and resulted in considerable controversy and litigation.[118] *Davis* often caused a harsh and unexpected tax burden because divorcing spouses either were unaware of the *Davis* rule or mistakenly believed that their property was jointly owned.[119] *Davis* was particularly unpopular because a divorce transfer not only generated no cash with which to pay the tax liability, but, in effect, depleted the transferor's net wealth.[120] Finally, *Davis* struck when spouses were already suffering emotional and financial strain. *Davis* probably "whipsawed" the government, because although much *Davis* gain went unreported by transferors, transferees would use the property's fair market value at transfer to compute gain upon a later sale of the property.[121]

Congress enacted section 1041 to correct these problems,[122] and the Treasury supported Congress's decision.[123] In overturning the *Davis* rule,

value of the property the transferor transferred, under the principle established in *Philadelphia Park Amusement Co. v. United States*, 126 F. Supp. 184, 189 (Ct. Cl. 1954). *Davis*, 370 U.S. at 72.

113. *See Davis*, 370 U.S. at 73 n.7.

114. Under the principle of *Philadelphia Park Amusement Co.*, the transferee's basis in the property received was determined by equating the value of his or her marital rights with the fair market value of the property he or she received. *Id.* at 73; *see also supra* note 112.

115. Community property settlements were taxable, however, to the extent that separate property was exchanged. *See* Carrieres v. Commissioner, 552 F.2d 1350 (9th Cir. 1977).

116. *See* Rev. Rul. 74-347, 1974-2 C.B. 26; Rev. Rul. 81-292, 1981-2 C.B. 158.

117. *Compare, e.g.*, Imel v. United States, 523 F.2d 853 (10th Cir. 1975) (holding Colorado equitable distribution statute created species of common ownership such that division was non-taxable) *with* Wiles v. Commissioner, 499 F.2d 255 (10th Cir. 1974) (holding Kansas equitable distribution statute did not create species of common ownership; division taxable).

118. H.R. Rep. No. 98-432, pt. 2, at 1491 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1134 (citing Bosch v. United States, 590 F.2d 165 (5th Cir. 1979); *Imel*, 523 F.2d 853; *Wiles*, 499 F.2d 255; Wallace v. United States, 439 F.2d 757 (8th Cir. 1971); Collins v. Commissioner, 412 F.2d 211 (10th Cir. 1969); McKinney v. Commissioner, 64 T.C. 263 (1975)).

119. H.R. Rep. No. 98-432, at 1491.

120. *See* Laurie L. Malman, *Unfinished Reform: The Tax Consequences of Divorce*, 61 N.Y.U. L. Rev. 363, 387 n.118 (1986).

121. H.R. Rep. No. 98-432, at 1491–92 (discussing *Davis* and "whipsaw" concept).

122. *Id.* at 1492. For citations to contemporary bar studies regarding taxation under *Davis*, see Asimow, *supra* note 108, at 66 n.4; Malman, *supra* note 120, at 386 n.116.

123. *Treasury Statement on H.R. 3475 Before House Ways and Means Committee* (July 25, 1983), *reprinted in* 4 Tax Mgmt. Primary Sources (BNA) 263 (1986). Objecting to *Davis*'s harsh

Congress intended to provide uniform tax treatment of property settlements regardless of variations in state property laws,[124] to reflect the policy that spouses are to be treated as a single economic unit,[125] to reduce whipsaw to the government,[126] and to make the tax laws as unintrusive as possible with respect to relations between spouses.[127]

Congress has also evidenced its intent concerning transfers of property between spouses and former spouses through a number of other Code provisions. The consistent theme of these provisions is that the assignment doctrine should not apply to such transfers.[128] For example, when installment obligations are sold, transferred, or otherwise disposed of, the disposition normally triggers recognition of gain to the transferor.[129] When installment obligations are transferred pursuant to section 1041, however, no gain recognition is triggered, and the transferee simply steps into the tax position of the transferor.[130] Similarly, assignment of income principles codified by the grantor trust provisions[131] are inapplicable in the context of divorce.[132] Likewise, transfers of IRAs pursuant to divorce or separation instruments are not subject to assignment of income principles that usually require such transfers to be treated as taxable distributions.[133] Additionally, Congress rejected assignment principles in the divorce context when it enacted the Retirement Equity Act (REA) in 1984,[134] under which retirement payments are taxable to a non-earning spouse receiving them if he or she

---

consequences, the tax disparities state property law yielded under *Davis*, and the whipsaw *Davis* probably caused, the Treasury emphasized that § 1041 would be mandatory, posed no significant threat of revenue loss, and would apply to *all* transfers of property incident to divorce. *Id.*; *see also* Temp. Treas. Reg. § 1.1041-1T(a) A-2 (1984) (§ 1041 applies to "any" transfer of property between spouses or former spouses).

124. *See* H.R. Rep. No. 98-432, at 1491.

125. *Id.*

126. *Id.* at 1491–92.

127. *Id.* at 1492.

128. *See generally* Asimow, *supra* note 108, at 100–04; Nunnallee, *supra* note 108, at 637–38.

129. I.R.C. § 453B(a) (1994).

130. I.R.C. § 453B(g).

131. *See* I.R.C. §§ 673–77 (1994).

132. I.R.C. § 682(a) (1994) provides that in the case of alimony trusts, the recipient spouse will be taxable on the trust income notwithstanding control or reversionary interests retained by the grantor spouse.

133. I.R.C. § 408(d)(6) (1994).

134. Pub. L. No. 98-397, §§ 204-07, 98 Stat. 1445–50 (1984) (codified as amended in scattered sections of 26 U.S.C.).

received an interest in the plan in a qualified domestic relations order.[135] Finally, section 1041 overrides the income-triggering depreciation recapture rules of sections 1245 and 1250,[136] and unless the transfer is in trust,[137] section 1041 overrides the loan assumption gain rules, which normally trigger income to the extent liabilities exceed basis.[138]

B. Inapplicability of the Assignment Doctrine to Section 351 Transfers

Many commentators have suggested that section 351 provides a good model for resolving the conflict between section 1041 and the assignment of income doctrine.[139] Like section 1041, section 351 provides for nonrecognition of gain or loss in certain transfers of property.[140] Accordingly, like section 1041, section 351 directly conflicts with the assignment doctrine when the property transferred is an interest in uncollected income.

This conflict was resolved in *Hempt Bros. v. United States*.[141] In *Hempt*, a partnership transferred its accounts receivable to a controlled corporation in exchange for stock pursuant to section 351. When the corporation later collected the receivables, the partnership asserted that it and not the corporation was the proper taxpayer, arguing that income must be taxed to those who earn it. The court reasoned that in the absence of section 351, the partnership would have been taxable on the value of the stock at the time of transfer as consideration received for an assignment of income.[142] Taxing the partners on the value of this consideration, however, would have in effect rendered section 351

---

135. I.R.C. §§ 401(a)(13)(A)–(B), 414(p) (1994); *see, e.g.*, Priv. Ltr. Rul. 88-37-013 (June 7, 1988). It is arguable that because REA only applies to certain plans, Congress intended the assignment doctrine to apply to all other items of deferred compensation transferred between spouses or former spouses. However, it is also arguable that Congress's intent in enacting REA was simply to reject the assignment doctrine in the specific context before it. *See* Asimow, *supra* note 108, at 104.

136. H.R. Rep. No. 98-432, pt. 2, at 1492 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1134; *see also* I.R.C. §§ 1245 (b)(1), 1250(d)(1) (1994).

137. I.R.C. § 1041(e) (1994).

138. *Compare* Temp. Treas. Reg. § 1.1041-1T(d) (1984) *and* Priv. Ltr. Rul. 96-15-026 (Jan. 2, 1996) *with* Crane v. Commissioner, 331 U.S. 1 (1947).

139. *See, e.g.*, Asimow, *supra* note 108, at 88–89; Hoffman & Orbach, *supra* note 108, at 602; Hjorth, *supra* note 108, at 166 n.68; Nunnallee, *supra* note 108, at 630; Brown, *supra* note 108, at 261–62.

140. Section 351 provides that no gain or loss is recognized when property is transferred to a controlled corporation solely in exchange for stock of the corporation. I.R.C. § 351(a) (1994).

141. 490 F.2d 1172 (3d Cir. 1974); *see also* Rev. Rul. 80-198, 1980-2 C.B. 113 (confirming inapplicability of assignment doctrine to § 351 transfers absent tax evasion).

142. 490 F.2d at 1176–77.

inapplicable to a transfer of property within its provisions. The court's method of resolving this conflict was to ascertain a controlling congressional mandate.[143] The court concluded that Congress's mandate in enacting section 351 was to facilitate the incorporation of ongoing businesses.[144] To effectuate this mandate, the court held that the assignment doctrine did not apply to section 351 transfers. It held that the partnership was not taxable on the consideration it received and that the corporation, rather than the partnership, was taxable on the income from the accounts receivable.[145]

One commentator has suggested that because the theoretical reason for nonrecognition under section 351 is continuity of interest, which is not the reason for nonrecognition under section 1041, the assignment doctrine should apply to section 1041.[146] However, although nonrecognition under section 1041 is not based on continuity of interest, at least in the case of transfers incident to divorce, continuity of interest is only one reason justifying non-application of the doctrine. The *Hempt* court's reasoning was not that continuity of interest alone justifies non-application of the assignment doctrine to a nonrecognition provision, but rather, that in determining whether the assignment doctrine should apply, the foremost concern must be to preserve Congress's objectives in enacting the provision. If applying the doctrine thwarts these objectives, the doctrine should not be applied.

In another case involving a conflict between the assignment doctrine and congressional policy, *Rubin v. Commissioner*,[147] the Second Circuit disregarded the assignment doctrine to honor the policy recognizing a corporation as a taxable entity distinct from its shareholders.[148] Given the importance of this policy, the assignment doctrine was considered an inappropriately blunt tool for dealing with potential tax avoidance issues:

> Resort to "common law" doctrines of taxation . . . may occasionally be useful in connection with 'transactions heavily freighted with tax motives' which cannot be satisfactorily handled in other ways

143. *Id.* at 1177.

144. *Id.*

145. *Id.* Like § 1041, § 351 only defers taxation, as latent gain remains taxable if the stock or property later is sold. *See id.* at 1178.

146. Gabinet, *supra* note 108, at 24.

147. 429 F.2d 650 (2d Cir. 1970).

148. *Id.* at 653.

> [citation omitted], but they have no place where, as here, there is a statutory provision adequate to deal with the problem presented.[149]

The *Rubin* court considered section 482 to be a better tool for dealing with potential tax avoidance issues because it permits sensitivity to the circumstances of each case, including the hardship of imposing tax liability on income a taxpayer did not receive.[150] *Rubin* suggests that if section 1041 presents a potential for tax avoidance when income items are transferred, statutory or judicial tools more sensitive than the assignment doctrine should be used to remedy this problem. The *Berger* court's use of the clear reflection of income rule on the facts of that case offers one example of how other anti-tax-avoidance doctrines may be used to curb potential abuse without resort to blanket application of the assignment doctrine.[151]

C. *Unfavorable Results of Applying the Assignment Doctrine to Section 1041 Transfers*

Commentators have also argued that applying the assignment doctrine to section 1041 does not serve the doctrine's purposes and may even frustrate them.[152] The doctrine's manifest purposes are to safeguard progressivity and protect the tax base. Given the operation of the joint return, however, transfers during marriage do not achieve tax reduction as they once might have.[153] Similarly, transfers incident to divorce do not present a substantial threat of tax avoidance, as they are characterized by involuntariness, relinquishment of control over the economic benefits of the income involved, and the improbability of frequent manipulation and repetition by taxpayers.[154] Additionally, applying the assignment doctrine at divorce magnifies the doctrine's anti-progressive preference for

---

149. *Id.*

150. *Id.* at 653–54.

151. *See supra* text accompanying notes 103–07. The *Berger* court's approach is consistent with how courts have approached § 351, which trumps the assignment doctrine but, in some circumstances, may be trumped by the clear reflection of income rule. Berger v. Commissioner, 71 T.C.M. (CCH) 2160, 2178 (citing Palmer v. Commissioner 29 T.C. 154 (1957), *aff'd*, 267 F.2d 434 (9th Cir. 1959)).

152. *See, e.g.*, Asimow, *supra* note 108, at 104–09; Nunnallee, *supra* note 108, at 636–41.

153. *See* I.R.C. § 6013 (1994).

154. Because they share these characteristics, as well as an element of personal tragedy, divorce transfers have been analogized to death transfers, to which the tax law refuses to apply the assignment doctrine, even when the result is an obvious tax benefit. Nunnallee, *supra* note 108, at 644.

investment income over earned income.[155] Couples whose assets consist largely of investment property may easily shift future tax liability at divorce by transferring the underlying property at divorce. If the assignment doctrine overrides section 1041, however, couples whose assets consist largely of deferred income items will be less able to shift tax liability at divorce.

More importantly, as was the case in *Hempt*,[156] applying the assignment doctrine to section 1041 transfers thwarts Congress's objectives in permitting nonrecognition for such transfers. Applying the assignment doctrine in *Kochansky* illustrates why this is especially so in the case of community property taxpayers. Had the assignment doctrine been applied in the form that requires an assignor to be taxed on consideration received in exchange for an income right, the court first would have had to determine the extent of the community's interest in the fee, because transfer only occurred to the extent that Ms. Kochansky did not already possess a community property interest in the fee. Mr. Kochansky would have been taxable at the time of divorce on the consideration he received for transferring the interest in the fee that was not already Ms. Kochansky's community property. At the time of divorce, however, it would have been practically impossible to determine the extent of the community interest in the fee, unless Mr. Kochansky could have forecast the number of hours he would spend on the lawsuit after divorce and the amount that would be collected. Next, it would have been necessary for the court to determine which property served as consideration for the portion of the fee that was assigned. If this consideration consisted of a relinquishment of marital rights, its value would have been presumed to equal the value of the income right assigned.[157] Valuation of the contingent fee at the time of divorce, however, might have borne little or no relation to the amount ultimately collected—especially if the claim yielded no recovery. Had the spouses agreed that Mr. Kochansky would collect the entire fee, determining Ms. Kochansky's tax liability would have presented similar difficulties; in that case, Ms. Kochansky would have been taxable at divorce on whatever consideration she received in exchange for her community interest in the fee. It would thus have been necessary to determine the extent of Ms. Kochansky's community interest in the fee, specify the

155. *See* Bittker, *supra* note 20, at 1403.

156. Hempt Bros. v. United States, 490 F.2d 1172 (3d Cir. 1974); *see supra* text accompanying notes 141–46.

157. *See supra* note 112.

consideration exchanged for this interest, and value that consideration as of the time of divorce. In effect, this approach would have reinstated the *Davis* rule and certainly would not have fostered the simple, consistent form of divorce taxation Congress intended, as the Tax Court has recognized.[158]

Instead of applying this form of the assignment doctrine, the *Kochansky* court purported to tax the assignor on the income when it was ultimately collected by the assignee. In applying this form of the assignment doctrine to community property taxpayers, however, the Ninth Circuit was bound by *Johnson*. Applying the doctrine as *Johnson* requires would also thwart section 1041's purposes. Such an approach would have necessitated a preliminary determination of the community interest in the fee because each spouse would have been taxable on that portion of the fee representing his or her community property interest regardless of who collected it. Because some portion of the fee was earned after divorce, Ms. Kochansky's community interest necessarily would have been less than half of the fee, and accordingly, she would have been taxable on some amount less than she collected.

Alternatively, had the Kochanskys agreed that the entire fee would go to Mr. Kochansky, the Service would have been entitled to tax Ms. Kochansky on her community share when Mr. Kochansky eventually collected. If Ms. Kochansky had transferred her community interest merely for a relinquishment of Mr. Kochansky's marital rights, she would have generated no cash with which to pay this unexpected tax liability. Had she transferred her interest for other property, she would have generated no cash to pay the tax liability until she sold the property, at which time she would have incurred a second tax liability on any latent gain. If the Kochanskys had agreed that Mr. Kochansky would pay his former wife's community property tax liability on the fee when he collected it, as the spouses in *Johnson* agreed, a determination of the extent of the community's interest in the fee would still have been necessary to determine Ms. Kochansky's tax liability on the fee. Such an agreement would have yielded an anti-progressive result if Ms. Kochansky's rate differed from Mr. Kochansky's. The Kochanskys could also have agreed that Ms. Kochansky would reimburse Mr. Kochansky for the taxes he paid if the Service determined he was

---

158. *See supra* text accompanying notes 91–92 and 99–102.

taxable on the entire fee notwithstanding *Johnson*. This agreement also would yield anti-progressive results if the spouses' rates differed.[159]

Thus, applying the assignment of income doctrine as *Johnson* requires does not achieve Congress's purposes in enacting section 1041. Unless both spouses' counsel are particularly adept at tax calculations,[160] *Johnson* can easily impose a severe hardship on community property spouses. Tax indemnification agreements can temper this hardship for those who secure them, but such agreements can produce anti-progressive results. Furthermore, taxpayers who relinquish a community interest in their spouse's deferred earnings at divorce are unlikely to voluntarily report income as their former spouse later collects. Meanwhile, transferee spouses would be entitled to exclude that portion of the income representing their former spouse's community interest.

When Congress expressed a desire to make the tax laws "as unintrusive as possible with respect to relations between spouses," it had in mind a broad, simple rule under which spouses could easily determine, by the structure of their property settlement, who would bear the latent tax burdens of the marital assets distributed at divorce, regardless of variations in state property law.[161] Applying the assignment doctrine to section 1041 increases the complexity of negotiations at divorce and the potential for harsh results to taxpayers and whipsaw to the government.

V. APPLYING SECTION 1041 IN *KOCHANSKY*

Section 1041 governs all transfers of property between spouses, and between former spouses if the transfer is incident to divorce[162] and

159. The Kochanskys in fact agreed that if Mr. Kochansky were taxable on the entire fee, Ms. Kochansky would pay him an amount equal to the refund to which she would be entitled had she not claimed the amount as income. Kochansky v. Commissioner, 67 T.C.M. (CCH) 2665, 2666 (1994). The progressivity of this agreement, at least as far as Mr. Kochansky was concerned, also would depend on whether his wife's rate differed from his own.

160. Additionally, if the property settlement must be fashioned by a court, it is unlikely to perfectly account for future tax consequences. *See generally* Roland Hjorth, *The Effect of Federal Tax Consequences on Amount of Property Allocated to Spouses in State Court Dissolution Proceedings*, 24 Fam. L.Q. 247 (1990) (observing that generally state courts do not take federal tax consequences into account when valuing assets at divorce).

161. H.R. Rep. No. 98-432, pt. 2, at 1492 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1134.

162. I.R.C. § 1041(a) (1994). A transfer of property is incident to divorce if it occurs within one year after the date on which the marriage ceases, or is related to the cessation of the marriage. I.R.C. § 1041(c). A transfer of property is treated as related to the cessation of a marriage if the transfer is pursuant to a divorce or separation instrument and occurs not more than six years after the date on which the marriage ceases. Temp. Treas. Reg. § 1.1041-1T(b) A-7 (1984).

occurred after July 18, 1984.[163] The Kochanskys were divorced on July 23, 1985.[164] Accordingly, section 1041 applied in *Kochansky* if an interest in a contingent fee was "property" and if such property was "transferred" between the Kochanskys.

Section 1041 offers no indication that an interest in a contingent fee would not be considered property under its provisions. The section does not define property,[165] and the regulations do not limit the term's scope.[166] Additionally, decisions in related contexts indicate that a contingent fee interest is property for the purposes of section 1041. As the *Hempt* court observed in concluding that accounts receivable are property for the purposes of nonrecognition under section 351, the word "property" generally has a broad reach in tax law.[167] Additionally, in a decision prior to the enactment of section 1041, the Tax Court treated a spouse's community interest in accounts receivable as property when she transferred that interest at divorce.[168] The Tax Court has also held a contingent fee interest to be property for estate tax purposes.[169] Finally, courts in the community property states have concluded that contingent fee interests are not only property, but property that may be divided or transferred between spouses at divorce.[170]

The Kochanskys' property settlement operated to transfer this property when the agreement was executed. The Tax Court has stated that the usual connotations of the term "transfer" are to apply for the

---

163. Temp. Treas. Reg. § 1.1041-1T(f).

164. *Kochansky*, 67 T.C.M. (CCH) at 2666. Transfers pursuant to instruments in effect on or before July 18, 1984, however, are not subject to § 1041 absent an election by the spouses. Temp. Treas. Reg. § 1.1041-1T(f). The Tax Court's opinion implies that the property settlement was executed at the time of the Kochanskys' divorce in 1985. In any case, the settlement could not have been in effect on or before July 18, 1984, because it refers to the case number of a lawsuit filed on October 19, 1984. *Kochansky*, 67 T.C.M. (CCH) at 2666.

165. One commentator has proposed that the definition of property for the purposes of § 1041 should be based on the existence of tax basis, even if that basis is zero, as is the case with service-generated income rights such as contingent fee interests. *See* Gabinet, *supra* note 108, at 20, 25.

166. *See* Temp. Treas. Reg. § 1.1041-1T(a) A-4 (providing that § 1041 governs transfers of property, whether real or personal, tangible or intangible).

167. Hempt Bros. v. United States, 490 F.2d 1172, 1175 (3d Cir. 1974) (citing E.I. DuPont de Nemours v. United States, 471 F.2d 1211, 1218–19 (Ct. Cl. 1973)); *see supra* text accompanying notes 141–45. An attorney's interest in a contingent fee has been denied treatment as property for the purposes of securing capital gains preferences, *see* Wilkinson v. United States, 304 F.2d 469, 473–75 (Ct. Cl. 1962), but an asset may be viewed as property although not as a capital asset, *see Hempt*, 490 F.2d at 1175; *see also* Asimow, *supra* note 108, at 109 n.198.

168. Showalter v. Commissioner, 33 T.C.M. (CCH) 192 (1974).

169. Estate of Curry v. Commissioner, 74 T.C. 540 (1980).

170. *See* cases cited *supra* note 75.

purposes of section 1041.[171] Under this view, the Tax Court held that a valid settlement dividing community property interests operated to transfer property as of the date of the settlement, even though the divorce was not finalized until six months later.[172] The Tax Court has also stated that in determining when transfer occurs for the purposes of section 1041, all the surrounding circumstances are relevant, but generally transfer is complete upon the earlier of the passage of legal title or the passage of equitable title.[173] This view also yielded a determination that a section 1041 transfer occurred upon the execution of a property settlement.[174]

In *Friscone v. Commissioner*,[175] the Tax Court considered a property settlement which, like the Kochanskys' settlement, did not speak of legal title, but rather, awarded each spouse a percentage of future income. In *Friscone*, the settlement awarded each spouse a portion of the proceeds from the sale of certain stock[176] and provided that each spouse would bear tax liability on his or her share of these proceeds.[177] The court held that the settlement operated to transfer the stock and that the spouse to whom it was transferred was taxable on the proceeds with reference to a carryover basis under section 1041. The court reasoned that although the settlement did not pass legal title to the stock, it transferred equitable title by granting the right to share in the sale proceeds and imposing a contractual duty to share in the corresponding tax liability.[178] The Kochanskys' settlement similarly provided that each spouse would be entitled to a certain share of the proceeds of the contingent fee and that

---

171. Harrington v. Commissioner, 67 T.C.M. (CCH) 3060, 3061 (1994).

172. *Id.* at 3061.

173. Berger v. Commissioner, 71 T.C.M. (CCH) 2160, 2173–75 (1996). Equitable title passes when the benefits and burdens of ownership shift. *Id.*

174. *Id.*; *see supra* text accompanying notes 103–07. *Cf.* Godlewski v. Commissioner, 90 T.C. 200 (1988) (holding that transfer of legal title by deed accomplished transfer before property agreement was finalized until five days later).

175. 71 T.C.M. (CCH) 2837 (1996).

176. *Id.* at 2838. *Friscone* involved a stock redemption in a close corporation according to the terms of a divorce decree. Such redemptions have engendered much controversy on the issue of whether the stock has been transferred to a third party "on behalf of" a spouse for the purposes of § 1041. *See supra* text accompanying note 96–97; Arnes v. United States, 981 F.2d 456 (9th Cir. 1992); Praegitzer v. Commissioner, 73 T.C.M. (CCH) 2018 (1997); Blatt v. Commissioner, 102 T.C. 77 (1994); Hayes v. Commissioner, 101 T.C. 593 (1993); *see generally* Thomas Monaghan, Note, *Corporate Redemption in the Context of Martial Dissolutions: I.R.C. § 1041 and* Arnes v. United States, 68 Wash. L. Rev. 923 (1993). In contrast to such cases, the transfer in *Kochansky* involved no transfer of property to a third party.

177. *Friscone*, 71 T.C.M. (CCH) at 2839.

178. *Id.*

each would bear tax liability on his or her share of the proceeds.[179] Accordingly, even if the settlement did not transfer legal title to the contingent fee, it passed equitable title and accomplished transfer under the Tax Court's analysis in *Friscone.*[180]

Of course, the Kochanskys' property settlement only transferred property to the extent that Ms. Kochansky obtained an interest larger than her existing community property interest in the fee. Even so, determining each spouse's tax liability under this approach would have been relatively simple. To the extent that the settlement transferred an interest to Ms. Kochansky, she received this interest as a non-taxable gift and took Mr. Kochansky's zero basis in it. Determining the extent of her community property interest would have been unnecessary, because Ms. Kochansky's basis in the community interest she already possessed was also zero. Accordingly, she would have been taxable on the entire amount that she collected, regardless of what proportion of the proceeds were community property. Even if no portion of the contingent fee had been community property, the tax results would have been identical, for in that case, Ms. Kochansky would have taken Mr. Kochansky's zero basis in the entire interest transferred to her at divorce. In either case, Mr. Kochansky would have been taxable only upon the proceeds from the interest that he retained, and neither spouse would have been taxable on money the other actually received.

VI. CONCLUSION

In *Kochansky v. Commissioner*, the Ninth Circuit applied the assignment of income doctrine in contravention of established principles of community property taxation, including principles established by the Ninth Circuit in *Johnson v. United States*. Had the Ninth Circuit applied the assignment doctrine in the manner *Johnson* requires, however, the tax consequences of divorce to community property taxpayers would have

179. Kochansky v. Commissioner, 67 T.C.M. (CCH) 2665, 2666 (1994).

180. Because the contingent fee proceeds, after passing to an escrow company, passed through Mr. Kochansky's trust account in the process of reaching Ms. Kochansky, it is arguable that a transfer governed by § 1041 occurred when Mr. Kochansky disbursed Ms. Kochansky's share to her, rather than through the operation of the Kochanskys' property settlement. Under this view, that portion of the proceeds which was not already Ms. Kochansky's community property would be treated as a non-taxable gift to her under § 1041. However, to the extent that the proceeds were her community property, no transfer could have occurred, as she already owned them. To this extent, Ms. Kochansky would have remained taxable on them. Thus, not only does this view not accord with *Friscone*, it necessitates a complicated determination of community property interests in the fee at the time of divorce.

been unnecessarily complex and potentially harsh. Instead of applying the assignment of income doctrine at all, the *Kochansky* court should have applied section 1041 of the Internal Revenue Code. Such an approach would have harmonized treatment of section 1041 with other Code provisions related to divorce and with the nonrecognition provisions of section 351. More importantly, this approach would have provided a fair, simple, and uniform rule for taxpayers trying to structure an equitable division of their property at divorce.