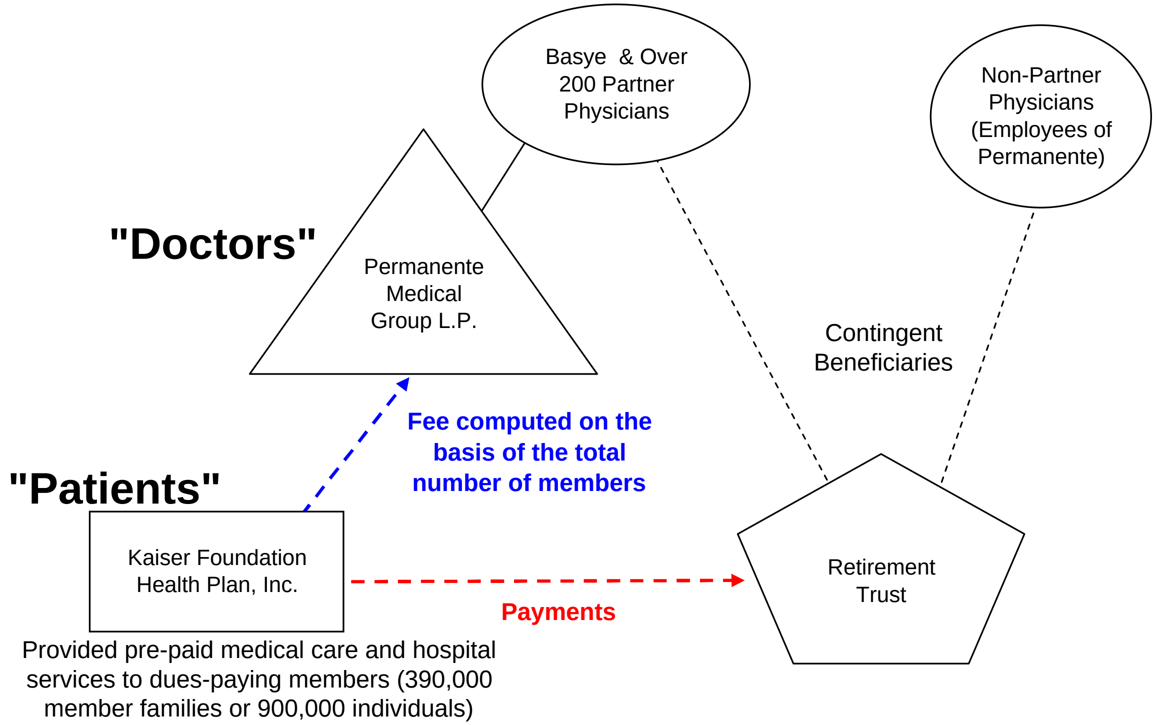
## U.S. v. Basye
## 410 U.S. 441 (1973)

# Partnership Attempt to Deflect Compensation to Retirement Plan



Basye and others, each of whom was a physician, were partners in a limited partnership known as Permanente Medical Group. Associated with the partnership were over 200 partner-physicians, as well as numerous nonpartner physicians and other employees. In 1959, Permanente entered into an agreement with Kaiser Foundation Health Plan, Inc., a nonprofit corporation providing prepaid medical care and hospital services to its dues-paying members. Pursuant to the terms of the agreement, Permanente agreed to supply medical services for the Kaiser members. In exchange for those services, Kaiser agreed to pay the partnership a "base compensation" composed of two elements. First, Kaiser undertook to pay directly to the partnership a sum each month computed on the basis of the total number of members enrolled in the health program. That number was multiplied by a stated fee, which originally was set at a little over $2.60. The second item of compensation--called for the creation of a program, funded entirely by Kaiser, to pay retirement benefits to Permanente's partner and nonpartner physicians.




A separate trust agreement establishing the contemplated plan was executed. Under this agreement Kaiser agreed to make payments to the trust at a predetermined rate, initially pegged at 12 cents per health plan member per month. Additionally, Kaiser made a flat payment of $200,000 to start the fund. The beneficiaries of the trust were all partner and nonpartner physicians who had completed at least two years of continuous service with the partnership and who elected to participate. The trust maintained a separate tentative account for each beneficiary. No physician was eligible to receive the amounts in his tentative account prior to retirement, and retirement established entitlement only if the participant had rendered at least 15 years of continuous service or 10 years of continuous service and had attained age 65. The trust agreement explicitly provided that no interest in any tentative account was to be regarded as having vested in any particular beneficiary. The agreement also provided for the forfeiture of any physician's interest and its redistribution among the remaining participants if he were to terminate his relationship with Permanente prior to retirement.

The Supreme Court held that the Permanente partner physicians were taxable on the payments to the retirement trust. This conclusion rested on two principles of income taxation. First, income is taxed to the party who earns it and that liability may not be avoided through an anticipatory assignment of that income. Second, partners are taxable on their distributive or proportionate shares of current partnership income irrespective of whether that income is actually distributed to them. There was no question that Kaiser's payments to the retirement trust were compensation for services rendered by the partnership under the medical service agreement. Nor was the receipt of these payments contingent upon any condition other than continuation of the contractual relationship and the performance of the perscribed medical services. The entity earning the income--whether a partnership or an individual taxpayer--cannot avoid taxation by entering into a contractual arrangement whereby that income is diverted to some other person or entity. Such arrangements, known to the tax law as "anticipatory assignments of income," have frequently been held ineffective as means of avoiding tax liability.