STATE OF MAINE
SAGADAHOC, ss.

BUSINESS AND CONSUMER DOCKET
Location: West Bath
Consolidated Doc. Nos. BCD-WB-AP-09-32
BCD-WB-AP-09-33
BCD-WB-AP-09-34

DANIEL P. LUKER, ET AL,

Petitioners

v.

ORDER ON RESPONDENT'S MOTION FOR SUMMARY JUDGMENT

STATE TAX ASSESSOR,

Respondent

Before the court is the Motion of Respondent State Tax Assessor ("Assessor"), for summary judgment on Count I of each of the consolidated 80C petitions[1] of Simon C. Leeming and Alice Leeming, John M. Sullivan and Rhoda M. Sullivan, and Daniel P. Luker and Karen A. Slick (collectively, "Petitioners").[2]

FACTUAL BACKGROUND

Except where noted, the following facts are undisputed for the purposes of the instant Motion for Summary Judgment.

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[1] Each of the three consolidated petitions in this case initially alleged the same five causes of action: Improper Disregard of Corporation (Count I); Absence of Maine Source Income (Count II); Failure to Modify Apportionment Formula (Count III); General Claim of Error (County IV); and Abatement of Penalties (Count V). As to each petition, the parties have stipulated, as follows: (a) summary judgment may enter in favor of the Assessor on Counts II and III; and (b) summary judgment may enter in favor of Petitioners on Count V. *See* Case Management Conference Scheduling Order No. 1 at ¶ 3(a); and Joint Stipulation Regarding Counts IV and V of Petition, dated December 29, 2009 ("Joint Stipulation"). In addition, they have also stipulated that Count IV of each of the petitions shall be dismissed by the court with prejudice and without costs. *See* Joint Stipulation.

[2] The spouses of Daniel P. Luker, John M. Sullivan, and Simon C. Leeming are parties because Luker, Sullivan and Leeming filed joint tax returns. As will be outlined more fully, the income at issue, however, relates only to the efforts of Luker, Sullivan and Leeming and the partnership distributions paid to their professional corporations.

Preti Flaherty

From 2001 through the end of February 2004, the law firm of Preti, Flaherty, Beliveau, Pachios & Haley ("Preti Flaherty") was a Maine limited liability company ("LLC"). Stipulated Facts ¶ 1 (hereinafter "Stip. at ¶ __"). In 2001, the firm opened an office in Concord, New Hampshire (the "New Hampshire Office"). *Id.* at ¶ 2. While organized as an LLC, Preti Flaherty's operating agreement was set forth in a document entitled "Amended and Restated Operating Agreement of Preti, Flaherty, Beliveau, Pachios & Haley, Chartered, A Limited Liability Company" ("LLC Operating Agreement"). *Id.* at ¶ 30.

Effective March 1, 2004, Preti Flaherty changed its organizational structure to a limited liability partnership ("LLP") and was governed by a Partnership Agreement, which remained in effect from March 1, 2004 through December 14, 2004 (the "First Partnership Agreement"). Effective December 15, 2004, the First Partnership Agreement was updated and remains in effect (the "Updated Partnership Agreement"). *Id.* at ¶¶ 3, 50-51. *Id.* at ¶ 3. Whether as an LLC or an LLP, Preti Flaherty operated as a law firm in multiple states, including Maine and New Hampshire, since 2001. *Id.* at ¶ 4.

From 2001 to the present: (a) Preti Flaherty has maintained a permanent business presence in Portland, Maine, which has continuously served as its principal place of business; (b) Preti Flaherty has had income from business activity that was taxable both within Maine and in other jurisdictions, including New Hampshire; (c) all of Preti Flaherty's offices, including the New Hampshire Office, have been centrally managed and run as a single business entity based in Portland, Maine; (d) Preti Flaherty has had ultimate control over all hiring decisions related to the New Hampshire Office; (e) Preti Flaherty has provided administrative and support services to the New Hampshire Office, which shared the overhead costs of the Maine-based firm as a whole;

and (f) all of Preti Flaherty's clients, including clients for whom attorneys based in New Hampshire provided services, have been clients of the firm. *Id.* ¶¶ 7–12, 14–15. Included in the administrative and support services provided from Maine by Preti Flaherty are: information technology, billing, accounting, payroll, human resources, marketing, employment benefits, life insurance, health insurance, malpractice insurance and property and leasing. *Id.* at ¶ 13.

Preti Flaherty's equity and non-equity partners (or LLC members prior to 2004) have various voting rights under the applicable Partnership Agreement, receive firm distributions, as opposed to wages, and have always been distinguished from the firm's associates, who are employees of Preti Flaherty and receive wages. *Id.* at ¶¶ 22–23, 26.

Those partners or members have always been required to devote their professional efforts to serving Preti Flaherty and its clients and all fees charged by them are governed by the firm's rules and policies related to such fees for services. *Id.* at ¶¶ 24-25.

<u>The Lawyer–Petitioners</u>

On May 1, 2002, the Lawyer–Petitioners each joined Preti Flaherty as an LLC member.[3] *Id.* at ¶ 19. Sullivan and Luker joined as equity LLC members, while Leeming joined as a non-equity LLC member.[4] *Id.* at ¶ 20. The Lawyer–Petitioners also each individually signed on to and agreed to be bound, as LLC members, by the terms of the LLC Operating Agreement. *Id.* at ¶ 31.

In addition, effective May 1, 2002, both Sullivan and Luker, as a condition of their equity LLC membership, individually executed an agreement entitled Joinder Agreement To Limited Guaranty Dated October 22, 1999 ("Guaranty Agreement"), and agreed to "comply with and

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[3] Prior to joining Preti Flaherty, the Lawyer–Petitioners had each been partners in other New Hampshire law firms that, for tax purposes, did their business entirely in New Hampshire, which historically has not had an individual income tax. *Id.* at ¶¶ 27–28.

[4] Preti Flaherty has two classes of "partner" – equity and non-equity.

abide by all of the terms and conditions of the Limited Guaranty." *Id.* at ¶ 32. The Guaranty Agreement required all signatories and those joining the agreement to be individual guarantors, in the event of a Preti Flaherty default, of a commercial line of credit and two commercial notes with Key Bank totaling $1.9 million. *Id.* at ¶ 33.

From May 2002 to the present, the Lawyer–Petitioners have lived in New Hampshire and worked out of Preti Flaherty's New Hampshire Office. *Id.* at ¶ 27. During 2004 through 2006, other Preti Flaherty lawyers in Maine would occasionally work on matters originated and referred by the New Hampshire Office on New Hampshire-based matters. *Id.* at ¶ 17. During that same time period, Petitioners John M. Sullivan ("Sullivan"), Daniel P. Luker ("Luker") and Simon C. Leeming ("Leeming") (collectively the "Lawyer–Petitioners") would occasionally provide assistance to lawyers in the firm's Maine offices on Maine-based matters. *Id.* at ¶ 18.

<u>The 2002 and 2003 Tax Years</u>

In 2005, the Lawyer–Petitioners filed Maine individual income tax returns for 2002 and 2003, but only after Maine Revenue Services ("MRS") made a specific demand for such filings. *Id.* at ¶ 34. However, none reported any individual Maine income tax liability as a result of their LLC distributions for those years. *Id.* at ¶ 35. The Lawyer–Petitioners were each assessed for Maine income tax, interest and penalties for 2002 and 2003. *Id.* at ¶ 36. Those assessments were upheld on reconsideration by the Assessor and on appeal to the Maine Superior Court. *Id*. at ¶¶ 36-37; *see* Kennebec County Consolidated Docket Nos. AP-06-63, 64, 65, 66.

<u>The Formation of the PCs</u>

In December 2003, the Lawyer–Petitioners each formed New Hampshire professional corporations ("PCs") to hold their respective partnership interests in Preti Flaherty. *Id.* at ¶ 45. The PCs each bore the name of a Lawyer-Petitioner – John M. Sullivan, PC; Daniel P. Luker,

PC; and Simon C. Leeming, PC. *Id.* at ¶ 46. The Lawyer–Petitioners were advised in this endeavor by the accounting firm Berry Dunn McNeal & Parker ("Berry Dunn") and Ken Jones (of Berry Dunn) in connection with the formation of their PC's. *Id.* at ¶ 47. Berry Dunn has served as Preti Flaherty's accountant from 2001 through the present, with Ken Jones being Preti Flaherty's lead contact person for tax purposes since 2003. *Id.* at ¶¶ 38 & 39.

The PCs, when created, each became effective on January 1, 2004. *Id.* at ¶ 48. None of the PCs ever signed on to Preti Flaherty's LLC Operating Agreement, which agreement remained in effect through the end of February 2004. *See id.* at ¶ 49. However, effective March 1, 2004, the PCs, through their respective Lawyer–Petitioners, each signed on to the First Partnership Agreement and later to the Updated Partnership Agreement. *Id.* at ¶ 52.

Included in both the First Partnership Agreement and the Updated Partnership Agreement is the following "Entity Member" provision:

> Section K. Professional Corporations as Partners
>
> Notwithstanding the provisions of Sections H or J, with the consent of the Managing Partner, a Partner may transfer his or her interest in the Law Firm to a professional corporation, professional association, or similar entity of which such Partner is the sole stockholder or equity holder (an "Entity Member"). In such event, and in the case of any Partner who is an Entity Member at the time of admission, the provisions of this Agreement shall apply to the individual owning such Entity Member as appropriate.

Id. at ¶ 58.

The Lawyer–Petitioners each served as President, Treasurer and Secretary of their respective PCs during 2004 through 2006. *Id.* at ¶ 61. They were also the sole shareholders and sole directors of their respective PC's and the sole providers of legal services on behalf of their respective PCs. *Id.* at ¶¶ 62-63. The Lawyer–Petitioners and Preti Flaherty both understood that

the Lawyer–Petitioners were expected to provide the legal services to Preti Flaherty and its clients on behalf of the respective PCs. *Id.* at ¶ 64.

Apart from the legal services provided by the Lawyer–Petitioners, the PCs never employed any other attorneys, paralegals, legal secretaries or other full-time support staff in connection with their provision of legal services. *Id.* at ¶ 65. After forming their PCs, the Lawyer–Petitioners each continued to participate in some or all of Preti Flaherty's benefit plans, such as medical and dental plans, as well as profit sharing and 401(k) benefits to the Lawyer–Petitioners. *Id.* at ¶ 66. All of the PCs entered into arrangements whereby Preti Flaherty was designated a "co-employer" of the respective Lawyer–Petitioners for purposes of ongoing provision of profit sharing and 401(k) benefits to the Lawyer–Petitioners. *Id.* at ¶ 67.

All of the PCs identified the address of Preti Flaherty's New Hampshire Office as their sole business mailing address. *Id.* at 71. None had any office space separate and apart from the Lawyer–Petitioners' respective offices in the New Hampshire Office. *Id.* at ¶ 72. The PC's did not provide any extra insurance against malpractice on the part of the Lawyer–Petitioners that had not been provided by Preti Flaherty to the Lawyer–Petitioners. *Id.* at ¶ 73. The respective Lawyer-Petitioners, exclusively, used the assets of the PCs in their respective practice of law. *Id.* at ¶ 75.

<u>The Income at Issue</u>

During 2004 through 2006, the PCs, rather than the Lawyer–Petitioners, received partnership distributions from Preti Flaherty. *Id.* at ¶ 76. The distributions were apportioned to Maine based upon Preti Flaherty's Maine apportionment percentage for each respective year. *Id.* at ¶ 77. During 2004 and 2005, the amount of the Preti Flaherty equity partnership distributions paid to each of the PCs was determined, in part, based upon a three-year historical performance

of both the particular PC and of the Former Partner, when he was still individually a member of the firm. *Id.* at ¶ 78.

From 2004 through 2006, all profits, losses and distributions to Preti Flaherty partners were governed by the Partnership Agreements. None of the Lawyer–Petitioners ever entered into any written employment agreements with their respective PCs. *Id.* at ¶ 97. There is no written documentation between any of the Lawyer–Petitioners and their respective PCs reflecting any negotiations, employment terms, or discussion of salaries, bonuses, or job expectations or requirements or setting forth how the Lawyer–Petitioners would be paid compensation or in what capacity. *Id.* at ¶¶ 98-99. The amount of compensation that the Lawyer–Petitioners ultimately paid themselves for any given year was, in large part, a function of the total amount of distributions paid to their respective PCs by Preti Flaherty. *Id.* at ¶ 101. The Lawyer–Petitioners each attempted to have their respective PCs pay them the approximate equivalent of the Preti Flaherty distributions to their respective PCs, less expenses, as compensation for their respective services and to pay out all of the PCs income as compensation or as expenses, in order to minimize the taxable income remaining in the respective PCs for income tax purposes. *Id.* at ¶¶ 102 & 104. The PCs deducted all payments to the Lawyer–Petitioners as a cost of doing business for Maine income tax purposes. *Id.* at ¶ 105.

On November 16, 2006, Elaine Corrow of MRS sent Sullivan, Luker and Leeming identical letters explaining both MRS' view that the PCs were each formed as an attempt to avoid Maine individual income taxes, and MRS' intention to disregard the PCs and recognize the Lawyer–Petitioners as having received the distributions from Preti Flaherty. *Id.* at ¶ 106. The Assessor notified the Lawyer–Petitioners by letters dated November 14, 2006 that, despite their

formation of PCs to hold their partnership interests, the Assessor believed that they still had individual income tax liabilities. *Id*. at ¶ 107.

The Lawyer–Petitioners each wrote Preti Flaherty identical, single-sentenced letters dated December 27, 2006 resigning as partners and withdrawing from Preti Flaherty effective December 31, 2006. *Id*. at ¶ 108. No formal firm vote was taken in connection with the withdrawals of the PCs. *Id*. at ¶ 109.[5] The Lawyer–Petitioners each signed employment agreements with Preti Flaherty effective January 1, 2007 and, beginning on that date, became employees of Preti Flaherty working in its New Hampshire Office. *Id*. at ¶¶ 110-111.

The Lawyer–Petitioners and their spouses either did not file Maine income tax returns for 2004 and 2005 or filed such tax returns but showed no, or very little, Maine income tax liability. *See id.* at ¶¶ 117, 125, & 132. The Assessor issued assessments dated February 7, 2007 for income taxes, interest and penalties for years 2004 and 2005 ("Assessments") against the Sullivans, Luker/Slick, and the Leemings. *Id*. at ¶ 133. The income involved in the Assessments is related entirely to the partnership distributions paid by Preti Flaherty to each of the PCs. *Id*. at ¶ 134. By letters dated September 17, 2007 ("Reconsideration Decisions") the Assessor denied the Petitioners' respective requests for reconsideration of their Assessments. *Id*. at ¶ 136.

DISCUSSION

I. Standard of Review

Although this matter comes before the court on the petitions for judicial review pursuant to M.R. Civ. P. 80C, the court's review in this case is governed by 36 M.R.S. §151 which "provides that the Superior Court 'shall conduct a de novo hearing and make a de novo determination of the merits of the case.'" *Foster v. State Tax Assessor*, 1998 ME 205, ¶ 7, 716

[5] Under the terms of the LLC Operating Agreement and the Partnership Agreements, the withdrawal of a partner requires a mandatory 30-day notice as well as a requirement for an accounting and payments to withdrawing partners for capital accounts, profits and shares of fees. *Id*. at ¶ 55.

A.2d 1012, 1014 (quoting 36 M.R.S. § 151). The Petitioners, as the taxpayers, bear the burden of proof. 36 M.R.S. § 151.

In this case, the Assessor has moved for summary judgment under M.R. Civ. P. 56. Rule 56(c) provides that summary judgment is warranted if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." M.R. Civ. P. 56(c)). For purposes of summary judgment, a "material fact is one having the potential to affect the outcome of the suit." *Burdzel v. Sobus*, 2000 ME 84, ¶ 6, 750 A.2d 573, 575. "A genuine issue of material fact exists when there is sufficient evidence to require a fact-finder to choose between competing versions of the truth at trial." *Lever v. Acadia Hosp. Corp.*, 2004 ME 35, ¶ 2, 845 A.2d 1178, 1179. If ambiguities in the facts exist, they must be resolved in favor of the non-moving party. *Beaulieu v. The Aube Corp.*, 2002 ME 79, ¶ 2, 796 A.2d 683, 685.

II. Whether the Distributions to the Lawyer–Petitioners' PCs May Be Attributed to the Lawyer–Petitioners, Individually, for Maine Income Tax Purposes.

In support of its contention that the distributions from Preti Flaherty to the PCs was income to the Lawyer–Petitioners, individually, for Maine income tax purposes, the Assessor claims that it may either disregard the corporate structure of the PCs or simply "impute" the PCs' income to the Lawyer–Petitioners pursuant to various legal principals, including the Assignment of Income Doctrine.[6]

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[6] The Assessor also relies on two other legal principals: the sham transaction doctrine and the common law doctrine of piercing the corporate veil.

Under the sham transaction doctrine as it is posited by the Assessor, the corporate form of the PC is disregarded if the PC (1) lacks economic substance; or (2) has no business purpose other than tax avoidance. As one court has explained, "a transaction ceases to merit tax respect when it has no

A. The Assignment of Income Doctrine

The assignment of income doctrine is based on federal[7] income tax law and is used to determine the true earner of the income at issue. The doctrine was first recognized by the United States Supreme Court in *Lucas v. Earl*, 281 U.S. 111 (1930). In that case, the Court held that income from a husband-taxpayer's legal practice was taxable to him, even though he and his wife had entered into a valid contract under state law to split all income earned by each of them. In so holding, the Court stated:

> There is no doubt that the [Federal 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.

Id. 281 U.S. at 114-15.

Since 1930, the doctrine has evolved with different courts developing different tests in order to better guide its application. One such test, and the one the Assessor asks this court to

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'economic effects other than the creation of tax benefits." *UPS of Am. v. Comm'r*, 254 F.3d 1014, 1018 (11th Cir. 2001) (internal citations omitted).

Somewhat similarly, under the Maine common law doctrine known as "piercing the corporate veil," "although corporations are separate legal entities with limited liability, courts may disregard the corporate entity if the party seeking that relief establishes that: a corporation's shareholder "abused the privilege of a separate corporate identity; and (2) an unjust or inequitable result would occur if the court recognized the separate corporate existence." *State v. Weinschenk*, 2005 ME 28, ¶ 19, 868 A.2d 200, 207 (internal citations and quotation marks omitted).

Notwithstanding the parties' arguments regarding the applicability of these other doctrines, because this court concludes that the Assessor's motion may be decided on the basis of the assignment of income doctrine alone, it does not reach the Assessor's arguments regarding sham transactions and piercing the corporate veil.

[7] *See Williams v. State Tax Assessor*, 2002 ME 172, ¶ 13, 812 A.2d 245, 248 ("The Assessor's audit power includes the authority to interpret the applicable federal tax provisions and ensure that the taxpayer reports a federal adjusted gross income figure that comports with federal law") (citing, *inter alia*, 36 M.R.S. §§ 141 & 5121; and *Specktor v. Comm'r of Revenue*, 308 N.W.2d 806, 808 (Minn. 1981) (holding the state tax commissioner has the authority to bring a taxpayer's reported federal adjusted income into compliance with federal law notwithstanding the federal government's failure to make a similar adjustment)). *Id.* at fn. 4.

apply, is that adopted by the United States Tax Court in *Johnson v. Comm'r*, 78 T.C. 882, 891 (1982), *aff'd without published opinion*, 734 F.2d 20 (9th Cir. 1984).

Under the *Johnson* test, so-called, a corporation or other entity is deemed to have earned income for income tax purposes only if two conditions are both met: (1) the service provider (here, each Lawyer–Petitioner) is an employee of the corporation (here, each Lawyer–Petitioner's PC) and the corporation has the means to effectively control the employee's performance of the services in some meaningful sense; and (2) a contract or similar arrangement exists between the corporation and the individual or entity using the services (here, Preti Flaherty) recognizing that the corporation has the authority to direct or control the performance of the services. *See id.* at 891. According to the Assessor, Petitioners cannot meet either prong of the *Johnson* control test and, thus, it appropriately assigned the PCs' income to each of the Lawyer–Petitioners.

In opposition, Petitioners and Amici Curiae (the "Amici") both argue that the *Johnson* test should not be applied in this case and that adoption of the Assessor's position runs counter to well-established principles of corporate law pursuant to which the separate identity of corporate entities must be respected. They assert that, rather than applying *Johnson*, the court should instead employ the standard outlined by the United States Supreme Court in *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943) and further developed in the years since that decision. They explain that under the *Moline Properties* test, so-called, a corporation will be respected for tax purposes if either: (1) the corporation has a business purpose that is the equivalent of a business activity; or (2) it actually carries out business activities. According to Petitioners and the Amici, the PCs at issue in this case were formed for a legitimate business purpose, namely to provide legal services. Therefore, they contend that the PCs satisfy the *Moline Properties* test

and the Assessor should not be permitted to use the Assignment of income doctrine and *Johnson* to essentially disregard the PCs' separate corporate form. In the alternative, Petitioners contend that they satisfy both prongs of the *Johnson* test.

After reviewing case law on the evolution and application of the assignment of income doctrine as well as the motion record in this case, the court concludes that the assignment of income doctrine as articulated in *Johnson* does not run counter to *Moline Properties*. Rather, the analytical framework articulated in *Johnson*, was expressly formulated to reconcile the "separate corporate entity" principles that lie at the heart of *Moline Properties* with the principle, outlined in *Lucas v. Earl*, that, as a general matter, income must be taxed to the one who earns it. As the court explained in *Johnson*, when tasked with determining which party is the "true earner" of income in the corporate setting, the more refined inquiry relates not just to who "turned the spade or dribbled the ball" but, also, which party effectively exercised control over the earning of the income. *Johnson*, 78 T.C. at 891.[8] In this way, the assignment of income doctrine as it is applied under the *Johnson* test respects the separate corporate form so long as it is the corporation, rather than the individual, that controls the services provided and the income derived from those services such that the corporation may truly be deemed the "true earner." Accordingly, because the court concludes that the *Johnson* test adequately balances the two competing principles of *Lucas v. Earl* and *Moline Properties* and represents a well-reasoned

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[8] Since *Johnson* was decided, the United States Supreme Court has also explained that the assignment of income doctrine is intended to attribute income to the person or entity that maintains control over the income at issue. *See Comm'r v. Banks*, 543 U.S. 426, 434 (2005). ("In an ordinary case attribution of income is resolved by asking whether a taxpayer exercises complete dominion over the income in question. . . . In the context of anticipatory assignments, however, the assignor often does not have dominion over the income at the moment of receipt. In that instance the question becomes whether the assignor retains dominion over the income-generating asset, because the taxpayer 'who owns or controls the source of the income, also controls the disposition of that which he could have received himself and diverts the payment from himself to others as the means of procuring the satisfaction of his wants.'") *Id.* (quoting *Helvering v. Horst,* 311 U.S. 112, 116-117, 85 L. Ed. 75, 61 S. Ct. 144 (1940)) (other citations omitted).

approach to upholding the integrity of the income tax system, the court agrees with the Assessor that the test is applicable in this case.

With respect to the first prong of *Johnson* (i.e., employment and control), the Assessor disputes that the Lawyer–Petitioners were employees of their respective PC's. However, even if such a relationship might be found to exist, the Assessor more strongly contends that the PCs did not have the power to control the Lawyer–Petitioners in the rendition of services in any meaningful sense. *See also Johnson*, 78 T.C. at 891; and *Arnold v. Comm'r*, T.C. Memo. 2007-168, 2007 Tax Ct. Memo LEXIS 169.

Contrarily, Petitioners argue that they have satisfied the first prong of *Johnson* by virtue of the fact that the Lawyer-Petitioners were employees of their PCs. In support, Petitioners note that courts in other jurisdictions have held that the existence of an employment contract is itself sufficient evidence of control. As Petitioners correctly explain, some courts have determined that the existence of an employment contract between a corporation and its service-provider employee is sufficient to satisfy the first prong of *Johnson*. *See e.g. Haag v. Comm'r*, 88 T.C. 604, 612 (1987);[9] *Sargent v. Comm'r*, 929 F.2d 1252, (8th Cir. 1991). Thus, Petitioners ask the court to extend that logic and conclude that by establishing the existence of an "employment relationship" a party sufficiently establishes the requisite "control" by the PC and thus satisfies the first prong of *Johnson*, even in the absence of an express employment contract.

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[9] In *Haag*, the employment contract at issue provided:

> 1. EMPLOYMENT
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> (a) The Corporation hereby employs the Employee to perform professional services on behalf of the Corporation and to render such services as are necessary for the Corporation to operate and maintain an establishment for . . . the practice of medicine.
>
> . . .
>
> (d) The Employee agrees to devote his entire time, attention, knowledge and skill to such employment and shall at all times maintain and enhance the reputation of the Corporation, its shareholders and employees and the profession, generally.

Id.

Notwithstanding *Haag*, and the other cases where an employment contract has been deemed dispositive of control, courts have also concluded that although "contract terms are important in determining whether a personal service corporation is to be recognized as the true employer of the individual service provider, [] the mere existence of such terms in a contract is insufficient when the reality of the relationship is otherwise." *See e.g. Leavell v. Comm'r*, 104 T.C. at 154 (1995) (citing *Professional & Executive Leasing, Inc. v. Comm'r*, 89 T.C. 225, 233 (1987), *affd*. 862 F.2d 751 (9th Cir. 1988)); and *Arnold v. Comm'r.*, T.C. Memo. 2007-168, 2007 Tax Ct. Memo LEXIS 169. According to the Tax Court in *Leavell,* to determine "control" based solely on the existence of a written contract would elevate form over substance. *Id.* Instead, the better approach is to look at the relationship of the parties to determine who has "the right to control the manner and means by which the individual service provider renders the services for which compensation is being paid." *Id.*

Notwithstanding this split of authority regarding the significance of employment contracts the facts in the above-cited cases are distinguishable from the instant case in at least one significant respect. Here, there was no employment contract between the Lawyer–Petitioners and their respective PCs. Whether the existence of an employment agreement may be sufficient evidence or even definitive proof of control in some cases, the court declines to make the leap in logic urged on it by Petitioners. In the court's view, the absence of an employment agreement outlining the extent to which a purported "employee" is controlled by his or her purported "employer" necessitates an examination of other indicia of the nature of the parties' relationship. As the Law Court has previously explained, *albeit* in a different legal context, an employment relationship exists:

> [w]henever one person stands in such a relation to another that he may control the work of the latter …. The essential elements are … control and direction … of the employment …, and … the right to employ … and … discharge …. If these elements are wanting, the relationship does not exist. Conversely it does exist when these named elements are present . . ..

U.S. Fidelity and Guar. Co. v. Rosso, 521 A.2d 301, 304 (Me. 1987) (citations and internal quotation marks omitted).

In this case, because there is no written contract evidencing the PCs' right to employ, control and discharge the Lawyer–Petitioners, the nature of their relationship must be evidenced, if at all, in some other way. On this record, there is evidence that the Lawyer-Petitioners were characterized as employees on tax returns and on certain other corporate documents.[10] However, Petitioners have produced no evidence going to the discrete element of "control," which, as noted above, the court considers a central component of the assignment of income analysis.[11]

To the contrary, the statements of fact establish that the Lawyer–Petitioners, in their individual capacities, are subject to some measure of control by Preti Flaherty by virtue of Paragraph K of the Partnership Agreements as well as their obligation to personally guaranty Preti Flaherty's financial obligations to Key Bank pursuant to the Guaranty Agreement. Further, under the Partnership Agreements, fees charged by Preti Flaherty partners were subject to approval by the Managing Partner of Preti Flaherty and it was Preti Flaherty, alone, that provided various administrative and support services to the PCs/Lawyer–Petitioners in New Hampshire.

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[10] The court has reviewed Petitioner's arguments and record citations relating to the transfer of the Former Partner's interests to the PCs, the fact that Lawyer–Petitioners were paid as W-2 employees, and that the Lawyer–Petitioners performed legal services *on behalf* of the PCs. *See* Opp. at 18 (citing Def.'s Supp. S.M.F. ¶¶ 98-102, 130; and Pls.' A.S.M.F. ¶¶ 183, 201, 224).

[11] The court notes that under the multi-part common law tests for establishing employment status, characterizations of individuals as either employees or independent contractors for tax withholding purposes is not necessarily dispositive on the issue of employment status and control. *See e.g. Northeast Ins. Co. v. Soucy*, 1997 ME 106, ¶ 26, 693 A.2d 1141, 1145.

Additionally, Preti Flaherty "had ultimate control over all hiring decisions related to the New Hampshire Office" from 2001 through the present.

In the face of these undisputed facts, and in the absence of record evidence demonstrating that the PCs had or exercised any meaningful control over the Lawyer–Petitioners, their services, or their income, the court finds no evidentiary support for Petitioners' claim that the PCs, rather than the individual attorneys, were the "true earners" of the income at issue here. Therefore, the court concludes that the Assessor appropriately invoked the assignment of income doctrine in this case and properly considered the distributions to the PCs as income to the Lawyer–Petitioners, individually.

DECISION

Pursuant to Rule 79(a) M.R. Civ. P., the Clerk is directed to enter this Order on the Civil Docket by a notation incorporating it by reference and the entry is

A. Respondent's Motion for Summary Judgment on Count I of each of the petitions in this consolidated action is GRANTED, and judgment is entered in favor of Respondent on Count I of each of the petitions.

B. Pursuant to the stipulations of the parties:

(1) Respondent's Motion for Summary Judgment on Counts II and III of each of the petitions in this consolidated action is GRANTED, and judgment is entered in favor of Respondent on those counts;

(2) Pursuant to the Joint Stipulation of the parties, Count IV of each of the petitions in this consolidated action is DISMISSED, with prejudice and without costs to any party;

(3) Pursuant to the Joint Stipulation of the parties, Respondent's Motion for Summary Judgment on Count V of each of the petitions in this consolidated action is DENIED; and

(4) Pursuant to M.R. Civ. P. 56(c), summary judgment is rendered against Respondent and Judgment is entered in favor of Petitioners on Count V of each of the petitions, and this matter is remanded to the State Tax Assessor for further proceedings consistent with this Order, including the waiver or

abatement of the penalties imposed against Petitioners for the years 2004 and 2005.

Date: January 22, 2010

s/Thomas E. Humphrey
Chief Justice, Superior Court