5 T.C. 94 (1945)

A partnership will not be recognized for income tax purposes if it is determined that the primary purpose of its formation was tax avoidance and the alleged partners do not genuinely contribute capital or services to the business.

Summary

Jacob DeKorse and Louis Koppy, previously operating a tool and die business as a corporation, dissolved the corporation and purportedly formed a partnership with their wives and Koppy's minor son. The Tax Court addressed whether the profits from the business should be taxed entirely to DeKorse and Koppy, or whether portions should be taxed to their wives and son as partners. The court held that the wives and son were not bona fide partners, and the income was taxable to DeKorse and Koppy in proportion to their original ownership interests because the arrangement lacked economic substance and was primarily for tax avoidance.

Facts

DeKorse and Koppy operated the Koppy-DeKorse Tool & Die Co. as a corporation. In 1941, after discussions with their attorney and accountant, they dissolved the corporation to form a partnership with their wives, Helen DeKorse and Ella Koppy, and Koppy's 15-year-old son, Arthur Koppy. The stated intent was to save on taxes. Corporate assets were distributed to each of the five individuals, and a partnership agreement was drafted and signed. Ella Koppy worked for the company and received regular compensation; Arthur Koppy worked occasionally and was also paid. Helen DeKorse performed no services for the company.

Procedural History

The Commissioner of Internal Revenue determined that all earnings of the company for 1941 were taxable to DeKorse and Koppy. DeKorse and Koppy petitioned the Tax Court for a redetermination. The Tax Court consolidated the proceedings. The Commissioner amended the answer to claim increased deficiencies, based on recomputation of gains from the corporate dissolution.

Issue(s)

1. Whether the profits of the Koppy-DeKorse Tool & Die Co. for the period March 1 to December 31, 1941, are entirely taxable to petitioners DeKorse and Koppy, or whether portions are taxable to their wives and son as partners.
2. Whether Louis Koppy is taxable on the earnings of his minor son, Arthur, for 1940 and 1941.

Holding

1. No, because the wives and son were not bona fide partners, and the

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arrangement lacked economic substance beyond tax avoidance.
2. Yes, because Arthur was not legally emancipated, and under Michigan law, a parent has a right to the earnings of a minor child who is not emancipated.

Court's Reasoning

The court reasoned that the primary purpose of forming the partnership was to reduce taxes. While tax avoidance is not inherently illegal, the court scrutinized whether the partnership arrangement was genuine and of substance. The court found that the formation of the partnership did not bring any new capital into the business, nor did it procure the services of any of the alleged new partners beyond what they were already doing as employees. Helen DeKorse contributed no services, and Ella and Arthur Koppy's services were compensated. The court emphasized that DeKorse and Koppy maintained complete control of the business.

The court cited *Mead v. Commissioner*, noting the importance of actual contribution to capital or services by the partners. The court concluded, "Viewing the transactions here as a whole, we think that what the petitioners intended to do was not to make out and out gifts of the assets of the business to their wives and Arthur Koppy, but was to give them portions of the income from the business so as to avoid income tax liability thereon, a thing not countenanced by our income tax laws."

Regarding Arthur Koppy's earnings, the court noted that under the applicable regulations, a parent must report a minor child's earnings unless the child is emancipated. Because Arthur was not emancipated and Louis Koppy continued to provide him support, Arthur's earnings were taxable to his father.

Practical Implications

DeKorse v. Commissioner demonstrates the importance of economic substance in partnership arrangements, especially when family members are involved. The case reinforces that simply assigning income to family members to reduce tax liability is insufficient; there must be genuine contributions of capital or services and a real transfer of ownership. This case influences how tax advisors counsel clients forming family partnerships. Later cases refer to *DeKorse* when evaluating the legitimacy of partnerships, focusing on factors like capital contributions, services rendered, control exercised, and the overall intent behind the partnership's formation. This case is a reminder that tax benefits cannot be the sole or primary driver behind business structures; a legitimate business purpose and real economic activity are required.

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