5 T.C. 732 (1945)

A partnership will not be recognized for federal income tax purposes if family members contribute neither capital nor services, and the original partners retain economic ownership and control.

Summary

Leonard Greenberg and William Arenson sought to divide partnership income with their wives to reduce their individual tax burden. The wives contributed no capital initially (paying later with partnership profits and gifts), performed minimal services, and the husbands retained control. The Tax Court held that the wives were not bona fide partners for tax purposes, emphasizing the lack of capital contribution, minimal services, and retained control by the husbands. The court focused on whether the parties actually carried on the businesses in partnership, finding that the arrangement primarily served to redistribute income within the family without substantive economic change.

Facts

Arenson owned the Toledo Machinery Exchange Co. (Exchange) as a sole proprietorship. Greenberg, Arenson's brother-in-law, worked for Exchange. They also operated L.W. Chuck Co. (Chuck) as an oral partnership with equal profit sharing. To give Greenberg an ownership stake in Exchange, and to reduce the tax burden, they drafted partnership agreements for both Exchange and Chuck, including their wives as partners, each with a 25% share. The wives contributed promissory notes, later paid with partnership profits and gifts from their husbands. The wives had little prior knowledge of the businesses, and while Mrs. Arenson occasionally assisted in the office, neither wife exerted control over the businesses' operations.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for 1941, arguing the wives were not legitimate partners. Greenberg and Arenson petitioned the Tax Court, contesting the Commissioner's determination. The Tax Court upheld the Commissioner's decision, finding the wives were not bona fide partners for tax purposes.

Issue(s)

Whether the wives of the petitioners were bona fide partners in Toledo Machinery Exchange Co. and L.W. Chuck Co. during 1941 for federal income tax purposes, such that the partnership income should be taxed one-fourth to each partner.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

No, because the wives contributed neither capital nor significant services to the partnerships, and the husbands retained economic ownership and control of the partnership properties and income.

Court’s Reasoning

The Tax Court reasoned that the wives brought no new capital into the businesses, as their contributions were derived from partnership profits and gifts from their husbands. They performed no significant services beyond minimal tasks they had occasionally done prior to the alleged partnership. Critically, the partnership agreements reserved control and management to the husbands. The court emphasized that while family partnerships are not automatically invalid, they are subject to heightened scrutiny. The court found the arrangement was designed primarily to redistribute income for tax purposes without a genuine change in the economic reality of the businesses. The court quoted *Burnet v. Leininger* stating that arrangements within families for the diversion of income “are always subject to careful scrutiny, and clear and convincing evidence is required to establish their bona fides.” The court emphasized that formalities alone (ledger accounts, notifications) do not validate a partnership for tax purposes, stating

© 2025 SCOTUSreports.com. All rights reserved.