Delp v. Commissioner, 6 T.C. 422 (1946)

An individual who is a party to an agreement to carry on a business and is entitled to receive a share of the net income from that business is considered a partner for federal income tax purposes and is taxable on that income.

Summary

The petitioner, Delp, contested the Commissioner's assessment, arguing that a portion of the business income attributed to him should have been taxed to his father, Charles Delp. Charles received a share of the business's net income pursuant to agreements designating him as having an interest in the business. The Tax Court held that Charles Delp was a partner in the business, S. Delp's Sons, and was therefore taxable on his share of the income. The court reasoned that Charles was a party to the agreement under which the business operated and received a portion of the net income, meeting the criteria for partnership status under the Internal Revenue Code.

Facts

The business of S. Delp's Sons was carried on under agreements between the petitioner and his siblings. Charles Delp, the petitioner's father, was also a party to these agreements. Pursuant to these agreements, Charles Delp was entitled to and did receive ¼ of the net income of the business in 1941.

Procedural History

The Commissioner determined a deficiency in the petitioner's income tax. The petitioner challenged this determination before the Tax Court, arguing that the Commissioner erred in including income that belonged to Charles Delp in the petitioner's gross income.

Issue(s)

Whether Charles Delp was a partner in the business of S. Delp's Sons for federal income tax purposes, such that the income he received should be taxed to him, and not to the petitioner?

Holding

Yes, Charles Delp was a partner in the business because he was a party to the agreement under which the business operated and was entitled to receive a share of the net income.

Court's Reasoning

The court relied on Section 3797 of the Internal Revenue Code, which defines a partnership broadly to include "a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on." The court noted that a common characteristic of a partnership is the mutual sharing of profits or losses. Because Charles Delp was a party to the agreement under which S. Delp's Sons operated and received ¼ of the net income, the court concluded that he was a partner and taxable on that income. The court stated, "Ordinarily a partnership exists where two or more persons contribute property or services or both for the carrying on of a business under a contract which provides that the profits shall be divided among them." The court found that the agreement between the petitioner, his siblings, and Charles Delp met this definition. Since Charles Delp was entitled to receive ¼ of the net income, the court held that the petitioner was not taxable on that portion of the income.

Practical Implications

This case clarifies the definition of a partnership for federal income tax purposes, particularly when family members are involved in a business. It emphasizes that a formal partnership agreement is not necessarily required; the key factor is whether an individual is a party to an agreement to carry on a business and shares in its profits. This case informs how similar situations should be analyzed by ensuring that the focus is on the economic reality of the arrangement rather than the formal labels assigned. Subsequent cases have relied on Delp to analyze whether an individual's involvement in a business and their entitlement to a share of its profits constitute partnership for tax purposes, regardless of blood relation or formal partnership agreement. Legal practitioners should use this ruling to guide businesses on how to correctly classify family members in business arrangements for tax purposes and ensure each party is taxed correctly.

