6 T.C. 653 (1946)

Income from a personal service business is fully taxable to the individual providing the services, even if a family partnership is nominally established, when other family members contribute no significant services or capital.

Summary

William Harvey, a manufacturers' representative, attempted to shift income tax liability by forming a family partnership with his wife and son. The Tax Court determined that despite the formal partnership agreement, the income was fully taxable to Harvey because his wife and son did not contribute significant services or capital to the business. The court relied on the principles established in _Commissioner v. Tower_ and _Lusthaus v. Commissioner_, emphasizing that the critical factor is whether the partners genuinely intended to conduct business together.

Facts

William Harvey operated a manufacturers' representative business. In 1941, seeking to reduce his income tax burden, he executed a partnership agreement with his wife and his 20-year-old son. The agreement stipulated capital contributions from all three, with Harvey retaining sole control over business operations and finances. Harvey's wife had provided some secretarial assistance in the past, and his son worked in the office during summer breaks from college. The business continued to operate under the same name, and no new agreements were made with the companies Harvey represented. Funds of the business were kept in a joint savings and checking account of petitioner and his wife, as had been the case prior to the execution of the May 28, 1941, agreement.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Harvey, arguing that all income from the business was taxable to him, despite the purported family partnership. Harvey petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether the income from the Wm. G. Harvey Co. is fully taxable to William G. Harvey, despite the existence of a formal partnership agreement with his wife and son.

Holding

No, because the wife and son did not contribute significant services or capital, and there was no genuine intent to operate the business as a true partnership.

Court's Reasoning

The Tax Court emphasized that the formation of the family partnership did not alter the fundamental operation of the business. Harvey's professional qualifications, personal service, and contacts were the primary drivers of income. The court found that the wife's past contributions were minimal and the son's involvement was primarily for his future career development, rather than a genuine contribution to the partnership's current success. The court stated that "No capital not available for use in the business before was brought into the business as a result of the formation of the partnership." The court applied the principles from _Commissioner v. Tower_ and _Lusthaus v. Commissioner_, which require a genuine intent to conduct business as partners, sharing in profits and losses. Because this intent was lacking, and the other family members' contributions were insignificant, the court concluded that the income was properly taxable to Harvey alone.

Practical Implications

This case reinforces the principle that forming a family partnership solely for tax avoidance purposes is unlikely to be successful. Courts will look beyond the formal agreements to assess the true nature of the business relationship and the contributions of each partner. Attorneys advising clients on partnership formation must emphasize the importance of genuine contributions of capital, services, or expertise by all partners. Subsequent cases have continued to apply this principle, scrutinizing family partnerships to ensure they reflect true economic substance rather than mere tax planning strategies. This ruling highlights the need for careful documentation of each partner's contributions and the business purpose of the partnership.

