Disney v. Commissioner, 17 T.C. 7 (1951)

Goodwill intrinsically tied to non-transferable franchises is not considered a distributable asset in corporate liquidation; family partnerships formed primarily for tax avoidance and lacking genuine economic substance will not be recognized for income tax purposes.

Summary

In *Disney v. Commissioner*, the Tax Court addressed whether goodwill associated with automobile franchises was a distributable asset in corporate liquidation and whether a family partnership was valid for income tax purposes. The court held that goodwill tied to non-transferable franchises was not a distributable asset because it was contingent on the franchise agreements. Furthermore, the court found that a partnership formed between a husband and wife, where the wife contributed no capital or vital services and the partnership was primarily for tax reduction, lacked economic substance and was not a valid partnership for tax purposes. The husband remained liable for the entire income.

Facts

Eugene W. Disney was the sole owner of a corporation engaged in selling Cadillac, La Salle, and Oldsmobile cars under franchises from General Motors Corporation (GM). These franchises were terminable by GM on short notice, non-assignable, and explicitly reserved the goodwill to GM. Prior to corporate dissolution, GM agreed to grant new franchises to a partnership to be formed by Disney and his wife. Upon liquidation, Disney received the corporation’s assets, and he and his wife formed a partnership to continue the automobile business. The Commissioner determined that Disney received goodwill as a liquidating dividend and that the partnership was not bona fide, attributing all partnership income to Disney.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Eugene W. Disney, arguing that he received undistributed corporate earnings in the form of goodwill and that the income from the partnership should be attributed solely to him. Disney petitioned the Tax Court to redetermine the deficiency.

Issue(s)

1. Whether the corporation possessed distributable goodwill as an asset upon liquidation, considering the nature of its automobile franchises.
2. Whether a valid partnership for federal income tax purposes was formed between Eugene W. Disney and his wife.

Holding

1. No, because the goodwill was inherently tied to franchises owned and controlled by General Motors, and these franchises were non-transferable and terminable, thus not constituting distributable goodwill of the corporation.
2. No, because the partnership lacked economic substance, the wife contributed no capital or vital services, and the primary motivation was tax avoidance; therefore, the partnership was not recognized for income tax purposes.

Court's Reasoning

Regarding Goodwill: The court reasoned that the corporation's goodwill was inextricably linked to the GM franchises, which were personal, non-assignable, and terminable by GM. Quoting *Noyes-Buick Co. v. Nichols*, the court emphasized that such goodwill "ceased as something out of which the corporation could use or derive profit when the franchises were terminated." The advance agreement by GM to grant franchises to the partnership did not alter the fact that the corporation itself had no transferable goodwill. The court concluded, "Thus the good will, if any, was bound to the franchises and ceased as something out of which the corporation could use or derive profit when the franchises were terminated."

Regarding Partnership: The court applied the principles from *Commissioner v. Tower* and *Lusthaus v. Commissioner*, focusing on whether the partnership was formed with a genuine intent to conduct business as partners. The court found that Mrs. Disney did not contribute capital originating from her, nor did she provide vital additional services to the business beyond what she had done when it was a corporation. Tax avoidance was a significant motive. The court stated, "But when she does not share in the management and control of the business, contributes no vital additional service, and where the husband purports in some way to have given her a partnership interest, the Tax Court may properly take those circumstances into consideration in determining whether the partnership is real." The court concluded that the partnership lacked economic reality and was merely an attempt to assign income, thus the entire income was taxable to Mr. Disney.

Practical Implications

Disney v. Commissioner clarifies that goodwill dependent on external, non-transferable contracts, like franchises, is not a distributable asset for corporate liquidation purposes. This case is crucial for tax planning related to corporate dissolutions involving franchise-dependent businesses. It also reinforces the scrutiny family partnerships face under tax law, particularly when formed after income is already being generated and where one spouse's contribution is minimal. The decision emphasizes that for a partnership to be recognized for tax purposes, it must have genuine economic substance beyond tax reduction, with each partner contributing capital or vital services and sharing in control and management. Later cases applying *Tower* and *Lusthaus* continue to examine the reality of family partnerships based on factors like capital contribution, services rendered, and control exercised by each partner.