Disney v. Commissioner, 9 T.C. 967 (1947)

Going concern value associated with terminable and non-transferable franchises is not considered a distributable asset in corporate liquidation; furthermore, family partnerships formed primarily for tax benefits and lacking genuine spousal contribution of capital or services are not recognized for income tax purposes.

Summary

The petitioner, Mr. Disney, dissolved his corporation, which operated under automobile franchises from General Motors. The Tax Court addressed two key issues: first, whether the corporation's 'going concern value' constituted a taxable asset distributed to Disney upon liquidation, and second, whether a subsequent partnership formed with his wife was a valid partnership for federal income tax purposes. The court determined that the going concern value was not a distributable asset because it was inextricably linked to franchises terminable by and non-transferable from General Motors. Additionally, the court held that the family partnership was not bona fide for tax purposes as Mrs. Disney did not contribute capital originating from her or provide vital services to the business, with Mr. Disney retaining control. Consequently, the entire income from the business was taxable to Mr. Disney.

Facts

Prior to dissolution, Mr. Disney operated a corporation holding franchises from General Motors (GM) to sell Cadillac, La Salle, and Oldsmobile cars. These franchises were terminable by GM on short notice, non-assignable, and explicitly stated that goodwill associated with the brands belonged to GM. Before dissolving the corporation, GM agreed to grant new franchises to a partnership to be formed by Mr. Disney and his wife. Upon liquidation, the corporation distributed its assets to Mr. Disney. Subsequently, Mr. Disney and his wife formed a partnership, with Mrs. Disney contributing the assets received from the corporation. Mr. Disney continued to manage the business as he had before, and Mrs. Disney's involvement remained largely unchanged from her limited role during the corporate operation.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Mr. Disney's income tax. Mr. Disney petitioned the Tax Court to redetermine the deficiency. The Tax Court reviewed the Commissioner's determination regarding the inclusion of going concern value as a distributed asset and the recognition of the family partnership for tax purposes.

Issue(s)

1. Whether the 'going business' of the corporation, dependent on franchises terminable at will by the grantor, constitutes a recognizable asset (specifically,

going concern value or goodwill) that is distributed to the shareholder upon corporate liquidation and thus taxable.

2. Whether a partnership between husband and wife is valid for federal income tax purposes when the wife's capital contribution originates from the husband's distribution from a dissolved corporation, and her services to the partnership are not substantially different from her limited involvement prior to the partnership's formation.

Holding

1. No, because the going concern value was inherently tied to the franchises owned by General Motors, which were terminable and non-transferable, thus not constituting a distributable asset of the corporation in liquidation.

2. No, because Mrs. Disney did not independently contribute capital or vital services to the partnership, and Mr. Disney retained control and management of the business. Therefore, the partnership was not recognized for income tax purposes, and all income was attributable to Mr. Disney.

Court's Reasoning

Regarding the going concern value, the court reasoned that any goodwill or going concern value was inextricably linked to the franchises granted by General Motors. Because these franchises were terminable at will and non-assignable, and explicitly reserved the goodwill to GM, the corporation itself did not possess transferable going concern value as an asset to distribute. The court cited *Noyes-Buick Co. v. Nichols*, reinforcing that value dependent on terminable contracts is not a distributable asset in liquidation.

On the family partnership issue, the court relied heavily on the Supreme Court decisions in *Commissioner v. Tower* and *Lusthaus v. Commissioner*. The court emphasized that the critical question is "who earned the income," which depends on whether the husband and wife genuinely intended to operate as a partnership. The court found that Mrs. Disney did not contribute capital originating from her own resources, nor did she provide vital additional services to the business. Her activities remained largely unchanged after the partnership's formation and were similar to her limited involvement when the business was a corporation. The court noted, "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 was primarily a tax-saving arrangement without genuine economic substance, and therefore, the income was fully taxable to Mr. Disney because he remained the actual earner.

Practical Implications

This case clarifies that ‘going concern value’ is not always a separable asset for tax purposes, particularly when it is dependent on external, terminable agreements like franchises. It underscores the importance of assessing the transferability and inherent nature of intangible assets in corporate liquidations. For family partnerships, *Disney v. Commissioner* reinforces the stringent scrutiny applied by courts to determine their validity for income tax purposes. It highlights that merely gifting a partnership interest to a spouse is insufficient; there must be genuine contributions of capital or vital services by each partner. This case, along with *Tower* and *Lusthaus*, set a precedent for disallowing income splitting through family partnerships where one spouse, typically the wife in older cases, does not actively contribute to the business’s income generation beyond typical spousal or domestic duties. It serves as a cautionary example for tax planning involving family business arrangements, emphasizing the need for economic substance and genuine participation from all partners.

