6 T.C. 682 (1946)

A taxpayer cannot avoid income tax liability by assigning income to family members through sham partnership agreements when the taxpayer maintains control over the business and the family members contribute neither capital nor substantial services.

Summary

Ed. Dubinsky Durwood, a theater owner, attempted to distribute profits to his wife, son, and daughter through "operating agreements," treating them as partners. The Tax Court held that these agreements were shams because Durwood retained complete control over the business, and his family members did not contribute capital or substantial services. Therefore, the income credited to his wife, son, and daughter was taxable to Durwood. The court also held that the assessment of deficiencies for 1938 and 1939 was not barred by the statute of limitations because Durwood omitted more than 25% of gross income from his returns.

Facts

Durwood operated several movie theaters and previously shared profits with his brothers under operating partnership agreements. In 1938, he entered into an "Operating Agreement" with his brothers and son, Stanley, to operate his theaters, allocating profits. In 1940, he included his wife, Celia, in a similar agreement, and in 1941, he added his daughter, Marjorie. Under these agreements, Durwood remained the general manager with full authority and control. He also leased theaters to his wife and son, but without receiving any consideration in return. Durwood's wife and children invested no capital and their roles did not substantially change the business operations.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Durwood's income tax for 1938-1941, arguing that the income allocated to his family members should be taxed to him. Durwood petitioned the Tax Court, contesting the deficiencies. The Tax Court ruled in favor of the Commissioner, upholding the deficiencies. Durwood also argued that the statute of limitations barred assessment for 1938 and 1939, but the court rejected this argument due to a waiver and a substantial omission of income.

Issue(s)

1. Whether the amounts of profits allocated to Durwood's wife, son, and daughter under the operating agreements are taxable income to him under Section 22(a) of the Revenue Act of 1938 and the Internal Revenue Code.

2. Whether the assessment and collection of deficiencies for 1938 and 1939 are barred by the statute of limitations.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. No, because Durwood did not intend to carry on business as a partnership with his wife, son, and daughter, and he maintained complete control over the business while they contributed neither capital nor significant services.

2. No, because Durwood omitted more than 25% of his gross income for those years, and he signed a waiver extending the limitation period for 1938.

Court’s Reasoning

The court reasoned that the operating agreements were not bona fide partnerships because Durwood retained complete control over the business, and his family members did not contribute capital or substantial services. The court cited *Commissioner v. Tower*, emphasizing that the key issue is

© 2025 SCOTUSreports.com. All rights reserved.