Schreiber v. Commissioner, 6 T.C. 707 (1946)

The income from a purported family partnership will be taxed to the dominant partner(s) who actually control the business and generate the income, even if formal partnership agreements exist under state law.

Summary

The Tax Court addressed whether income from a family partnership should be taxed entirely to the husbands or split between the husbands and wives. The husbands had gifted partnership interests to their wives. The court held that the income was taxable solely to the husbands because they continued to manage and control the business without material contribution from the wives, and the wives' capital contribution did not originate with them. The court emphasized the lack of genuine intent to operate the business as a true partnership, focusing on who actually earned and controlled the income. The court found that real estate purchased by the wives with distributions from the partnership was not taxable to the husbands.

Facts

Petitioners, the Schreibers, operated a business selling electrical fixtures. In 1930, the business was purchased with some money from the wives. In 1937, each husband gave his wife an interest in the business, and they formed a partnership under Michigan law. The husbands continued to manage and control the business. The wives did not materially contribute services, and the capital contributions did not originate with the wives. The wives were not permitted to draw checks on the partnership account. The wives used their share of the Royalite Co. profits to purchase a building in their own names, which was then leased to the partnership.

Procedural History

The Commissioner of Internal Revenue determined that all partnership income should be included in the gross income of the husbands. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the income from the partnership is taxable only to the husbands, or whether it should be split between husbands and wives?

2. Whether the income from the real estate purchased by the wives with partnership distributions is taxable to the husbands?

Holding

1. No, because the husbands retained control and management of the business, the wives did not materially contribute, and the capital contributions did not originate

with the wives, indicating a lack of genuine intent to operate as a true partnership.

2. No, because the wives received the money as their own, invested it in the building, and retained the income for their own use and benefit. The building was not a partnership asset.

Court's Reasoning

The court relied on *Commissioner v. Tower*, 327 U.S. 280 (1946), which held that the key issue is "who earned the income" and whether there was a "real intention to carry on business as a partnership." The court found that the husbands continued to manage and control the business, the wives made no material contribution of services, and the capital contribution did not originate with the wives. The court noted that compliance with state partnership law is not conclusive for federal tax purposes. The court also distinguished the partnership's business (selling electrical fixtures) from real estate, concluding that a building purchased with distributed partnership income would not become a partnership asset unless explicitly included in the partnership agreement. The court reasoned, "We do not think that the wives had the requisite 'command of the taxpayer over the income which is the concern of the tax laws,' as said in the *Tower* case." Regarding the real estate, the court emphasized that the wives received partnership profits "without any strings attached to the use of the money."

Practical Implications

This case, along with *Commissioner v. Tower* and *Lusthaus v. Commissioner*, illustrates the IRS and courts' scrutiny of family partnerships to prevent income shifting for tax avoidance. It highlights that merely forming a partnership under state law is insufficient; the parties must genuinely intend to operate as partners, with each contributing capital or services. Subsequent cases applying this principle require careful examination of the partners' roles, contributions, and control over the business. This case teaches tax attorneys to thoroughly document each partner's active participation and capital contribution to support the validity of a family partnership for tax purposes. It also confirms that assets distributed from a partnership to individual partners are treated as belonging to those partners, especially when reinvested for personal benefit.

