6 T.C. 748 (1946)

A family partnership will not be recognized for tax purposes if family members do not contribute capital originating with them or substantial services to the business, and the business remains under the control of one family member.

Summary

Lewis Coleman Benson transferred a 48% interest in his auto parts business to his wife as trustee for their daughters and formed a partnership agreement making her an equal partner. Benson retained complete control of the business. The Tax Court held that all profits were taxable to Benson, as the arrangement lacked economic substance. The court emphasized that neither the wife nor the daughters contributed capital originating from them or substantial services, and Benson maintained exclusive control, indicating an attempt to reduce taxes by dividing income.

Facts

Lewis Coleman Benson operated an automobile parts business. In 1937, he separated the warehouse business from the retail sales business. By January 2, 1940, Benson executed trust deeds, transferring a 24% interest in the warehouse to his wife as trustee for each of his two daughters. Simultaneously, Benson and his wife (as trustee) entered a partnership agreement, proposing equal partnership. The agreement stipulated Benson would have sole management and control; his wife would not interfere. Benson continued managing both the warehouse and the sales agency, drawing a salary from the sales agency but not from the warehouse. His wife and daughters took no active part in the business.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies against Benson for 1940 and 1941, arguing that all profits from the warehouse should be taxed to him. Benson initially reported 52% of warehouse profits as his income, with his wife reporting 24% for each trust. The Commissioner initially allowed Benson to report $10,000 as compensation, but later sought to include all warehouse profits in Benson’s income. The Tax Court upheld the Commissioner’s determination.

Issue(s)

1. Whether a valid partnership existed between Benson and his wife (as trustee for their daughters) for tax purposes, such that the profits could be divided among them.

Holding

1. No, because the wife and daughters did not contribute capital originating with

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them or substantial services, and Benson retained complete control of the business.

Court’s Reasoning

The Tax Court relied on *Commissioner v. Tower, 327 U.S. 280 (1946)*, and *Lusthaus v. Commissioner, 327 U.S. 293 (1946)*. The court emphasized that the validity of a family partnership for tax purposes depends on whether the family members actually intend to carry on the business as partners. Quoting *Tower*, the court noted: “The question here is not simply who actually owned a share of the capital attributed to the wife on the partnership books… The issue is who earned the income and that issue depends on whether this husband and wife really intended to carry on business as a partnership.” Here, the court found the daughters’ capital interests were assigned via trust deeds simultaneously with the partnership agreement. Neither the wife nor daughters invested capital originating with them or contributed services. Benson retained exclusive management and control. The court concluded the arrangement was a tax avoidance scheme.

Practical Implications

This case illustrates the importance of economic substance over form in family partnerships for tax purposes. To be recognized, family members must contribute either capital originating with them or substantial services to the business. The individual claiming the partnership must relinquish real control. This case reinforces the IRS’s scrutiny of arrangements designed primarily to shift income within a family to minimize tax liability. Subsequent cases cite *Benson* to emphasize that mere paper transfers of ownership are insufficient; genuine economic activity and control are required for partnership recognition.

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