7 T.C. 6 (1946)

A family partnership is not recognized for federal income tax purposes if family members do not contribute capital or services to the business, and the partnership is merely an attempt to reallocate income.

Summary

John Lang sought to recognize a family partnership for tax purposes, allocating income from his business, The Lang Co., among himself, his wife, and their four children. The Tax Court upheld the Commissioner's determination that the family members were not true partners because they did not contribute capital or services to the business. The court found that Lang's attempt to shift income was not a valid partnership for tax purposes, and all income was taxable to him.

Facts

John Lang operated The Lang Co., a machinery and equipment business. In 1941, Lang executed a partnership agreement purportedly conveying a one-sixth interest in the business to his wife and each of their four children. The agreement stipulated that Lang would manage the business for a salary, and profits would be shared equally. The children worked at the company at various times. Capital accounts were created for the wife and children reflecting their purported shares of the business's net worth. The wife and children, however, did not actively participate in the management of the business, nor did they contribute any capital to the business other than that received as purported gifts from the petitioner.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in John Lang's income tax, contending that all income from The Lang Co. was taxable to him. Lang petitioned the Tax Court, arguing for recognition of the family partnership. The Tax Court upheld the Commissioner's determination, finding no valid partnership for tax purposes.

Issue(s)

Whether the Commissioner erred in taxing all of the income of The Lang Co. to John Lang, or whether a valid family partnership existed such that the income should be allocated among Lang, his wife, and their children.

Holding

No, because the wife and children did not contribute capital or services to the business, and the purported partnership was merely an attempt to reallocate income for tax purposes.

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Court’s Reasoning

The Tax Court relied on precedent establishing that a family partnership is not recognized for tax purposes if family members do not genuinely contribute capital or services. The court found that the children’s work for the company was trivial and adequately compensated by wages, and the wife’s involvement was no different after the formation of the partnership than before. The court emphasized that the wife and children contributed nothing to the business except what they had simultaneously received by alleged gifts from the petitioner. The court noted that one of the children was only ten years old, and the oldest was eighteen, suggesting that Lang didn’t receive important advice from them when running the business. The Court found that based on these facts, no partnership existed between Lang and his family for income tax purposes.

Practical Implications

This case illustrates the importance of demonstrating genuine economic substance in family partnerships for tax purposes. To have a partnership recognized, family members must contribute either capital or services to the business. A mere reallocation of income without a corresponding contribution will not be respected by the IRS or the courts. This ruling emphasizes that intent to form a partnership is insufficient; there must be actual participation and contribution. Later cases have cited Lang to reinforce the principle that family partnerships will be closely scrutinized to prevent income shifting when there is no real economic change. The decision informs tax planning by highlighting the need for contemporaneous documentation of contributions and active participation of all partners.

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