7 T.C. 1186 (1946)

A family partnership will not be recognized for federal income tax purposes where it lacks a genuine business purpose, the contributing partner provides no essential services or capital, and the primary motivation is tax avoidance.

Summary

Edward P. Fletcher sought to reduce his income tax liability by forming a partnership with his sister, Helen, in his existing oil business. Fletcher transferred $50,000 of his capital account to Helen but retained control of the business operations. Helen provided no services to the company. The Tax Court ruled that the partnership was not bona fide for tax purposes, finding that it lacked a legitimate business purpose and was primarily intended to shift income to reduce Fletcher's tax burden. The court emphasized that Helen's contribution was essentially a gift and that she did not actively participate in the business's management or operations.

Facts

Edward P. Fletcher operated the Fletcher Oil Co. as a sole proprietorship. In late 1940, Fletcher discussed giving his sister, Helen, $50,000 and one-third of the business's income. In July 1941, Fletcher and Helen executed a written agreement establishing a partnership. The agreement stated that Fletcher transferred $50,000 of his capital account to Helen, making her a one-third partner. Helen did not contribute any new capital or services to the business, and Fletcher remained the general manager with final say over cash withdrawals. Fletcher filed a gift tax return for the $50,000 transfer. Helen was a full-time secretary and used the money to help support their mother. Fletcher did not need new capital for his business.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Fletcher's 1941 income tax, arguing that all of the Fletcher Oil Co.'s income was taxable to him, not just two-thirds. Fletcher petitioned the Tax Court, claiming the partnership with Helen should be recognized for tax purposes.

Issue(s)

Whether a partnership formed between a brother and sister, where the sister contributes no new capital or services and the primary purpose is to reduce the brother's income tax liability, is a bona fide partnership that should be recognized for federal income tax purposes.

Holding

No, because the partnership lacked a genuine business purpose and was primarily

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motivated by tax avoidance, as the sister contributed no essential services or capital, and the brother retained control of the business.

Court’s Reasoning

The Tax Court found the arrangement was not a bona fide partnership, distinguishing it nominally from cases involving husband-wife partnerships but finding the substance similar to cases where the arrangement was designed to reallocate income within a family. The court noted that Helen contributed no new capital but received a

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