Harkness v. Commissioner, T.C. Memo. 1958-4 (1958)

A family partnership is valid for tax purposes only if the parties, acting with a business purpose, genuinely intended to join together in the present conduct of the enterprise, contributing either capital or services.

Summary

The Tax Court addressed whether a valid partnership existed between Harkness, Sr., his wife, and their two children for the 1943 tax year concerning the United Packing Co. Harkness, Sr., had converted his sole proprietorship into a partnership, purportedly to ensure his son and son-in-law would join the business after their military service. The court found that the children did not contribute substantial capital or services, nor did they actively participate in the business's management during 1943. Therefore, the court concluded that a bona fide partnership did not exist for tax purposes, and the income should be taxed to Harkness, Sr., and his wife.

Facts

Harkness, Sr., owned and operated United Packing Co. as a sole proprietorship. In late 1942, he decided to convert the business into a partnership, including his son, Harkness, Jr., and his daughter, Harriet Colgate, as partners. Harkness, Jr., was in the Army since January 1942, and Harriet accompanied her husband, also in the Army, across the country. Neither child contributed substantial new capital; Harriet used a promissory note paid from company profits, and Harkness, Jr., used a small credit owed by his father and a promissory note. The partnership agreement stipulated that Harkness, Sr., would manage the business and the children would not be required to devote time to it unless agreed upon.

Procedural History

The Commissioner of Internal Revenue determined that the net income of United Packing Co. was community income to Harkness, Sr., and his wife, as no bona fide partnership existed. The Harknesses petitioned the Tax Court for a redetermination, arguing a valid partnership existed. The Tax Court reviewed the evidence and determined that no valid partnership existed for tax purposes.

Issue(s)

Whether a valid partnership existed between Harkness, Sr., his wife, and their two children for the 1943 tax year, such that the income from United Packing Co. should be taxed according to partnership shares.

Holding

No, because the children did not contribute substantial capital or vital services to

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the business, nor did they actively participate in its management, indicating a lack of intent to presently conduct the enterprise as partners.

Court's Reasoning

The court relied on the Supreme Court's decision in *Commissioner v. Culbertson*, emphasizing that the key question is whether the parties, acting with a business purpose, intended to join together in the present conduct of the enterprise. The court found that the purposes motivating the partnership's formation showed no expectation that the children would contribute substantially. Harkness, Sr.'s primary motive was to secure the future services of his son and son-in-law after the war. The court also noted the absence of substantial capital contributions from the children, referencing *Lusthaus v. Commissioner* and *Commissioner v. Tower*, which highlight capital contribution as a significant factor. The partnership agreement gave Harkness, Sr., complete control over the business. The court concluded that Harkness, Sr., dominated the business as before, and the children acquiesced in that control. As the Supreme Court said in *Commissioner v. Culbertson*, "The intent to provide money, goods, labor, or skill sometime in the future cannot meet the demands of §§ 11 and 22 (a) of the Code that he who presently earns the income through his own labor and skill and the utilization of his own capital be taxed therefor."

Practical Implications

This case underscores the importance of demonstrating genuine intent and present participation in a business enterprise when forming a family partnership for tax purposes. It clarifies that merely providing capital or services in the future is insufficient. Attorneys advising clients on family partnerships should emphasize the need for all partners to actively contribute to the business's management and operations. Subsequent cases have cited Harkness to illustrate the scrutiny family partnerships face and the necessity of proving actual participation and control, not just nominal ownership. The case highlights the continuing relevance of *Culbertson* in evaluating the validity of partnerships.

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