Feldman v. Commissioner, 18 T.C. 1 (1952)

A family partnership will not be recognized for tax purposes if the parties did not intend in good faith and for a business purpose to conduct the business as a partnership, regardless of capital contributions from a donee.

Summary

The Tax Court addressed whether a family partnership, including a trust for the taxpayer's minor son, should be recognized for tax purposes. The court held that the partnership was not bona fide because the parties did not intend in good faith to conduct the business as a partnership. The key rationale was the lack of evidence that the trust's participation was motivated by a business purpose, separate from the taxpayer's personal objective to create an independent estate for his son. This ruling highlights the importance of demonstrating a genuine business purpose and intent when forming family partnerships for tax benefits.

Facts

Petitioner Feldman created a trust for his 13-year-old son and made the trust a partner in his clothing business, Brooks Clothes. The trust's stated purpose was to provide an independent estate for the son. The trust's income was to be accumulated until the son reached majority. The capital contributed to the trust was already used in the business. The father's salary remained relatively low compared to the business's overall earnings, which ranged from $200,000 to over $400,000 annually. The partnership agreement stipulated that the father, not the trust, would retain rights to purchase a partner's interest if they withdrew or died.

Procedural History

The Commissioner of Internal Revenue determined that the income allocated to the trust was taxable to the petitioner (Feldman). Feldman petitioned the Tax Court for a redetermination, arguing the validity of the partnership. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether the trust for the petitioner's minor son was a bona fide partner in Brooks Clothes, such that the income allocated to the trust should not be taxable to the petitioner.

Holding

No, because the parties did not intend in good faith and for a business purpose to conduct the business of Brooks Clothes in partnership with the trust for petitioner's minor son.

Court’s Reasoning

The court emphasized that while capital contribution from a donee is not essential for a valid partnership, mere legal title to capital acquired by gift is insufficient. The court considered the following factors: the trustee’s services were inseparable from his individual capacity as a partner, the son performed no valuable services, the effort to demonstrate a business purpose was limited to future anticipations, and the petitioner dominated the business. The court quoted *Commissioner v. Culbertson, 337 U.S. 733, 744*: “Unquestionably a court’s determination that the services contributed by a partner are not ‘vital’ and that he has not participated in ‘management and control of the business’ or contributed ‘original capital’ has the effect of placing a heavy burden on the taxpayer to show the bona fide intent of the parties to join together as partners.” The court found the stated motivation for the trust was “to provide an independent estate for my son Samuel Feldman,” a personal objective of petitioner which, could not have been of benefit even prospectively to the business of Brooks Clothes. The court noted that the partnership agreement retained control with the petitioner, as rights to purchase a partner’s interest did not pass to the trust.

Practical Implications

This case underscores that family partnerships designed to shift income to lower tax brackets will be closely scrutinized. The ruling emphasizes the importance of demonstrating a genuine business purpose beyond mere tax avoidance. To establish a valid family partnership, taxpayers must show that the family member contributes vital services, participates in management, or contributes needed capital to the business. Furthermore, this case highlights that the intent to conduct a business must be present during the tax years in question, not merely anticipated in the future. Later cases cite *Feldman* to emphasize the necessity of actual participation and a bona fide business purpose in family partnership arrangements. This case serves as a reminder that the absence of genuine business purpose can lead to the IRS disregarding the partnership for tax purposes.

