14 T.C. 1094 (1950)

A family partnership will not be recognized for income tax purposes if the purported partners do not genuinely intend to presently conduct the enterprise together for a business purpose.

Summary

The Tax Court addressed whether the Commissioner erred in attributing partnership income to Vera Britz that she claimed was distributable to her mother and aunt under a partnership agreement. The court also considered whether a new partnership accounting period could be selected after Britz reacquired her aunt's interest in the business. The court held that the mother and aunt were not bona fide partners because they did not contribute to or participate in the business. The court further held that the partnership was not entitled to select a new accounting period, as there was no substantial change in the partnership's operation or control.

Facts

Vera Britz inherited a majority stake in Industrial Gas Engineering Co. from her husband and later formed a partnership with Joan Wagner. Britz then transferred portions of her partnership interest to her elderly mother and aunt, who were financially dependent on her and had no business experience. A formal partnership agreement was drafted to include Britz, William Wagner (Joan's brother), Britz's mother, and Britz's aunt. Britz continued to manage the business, while her mother and aunt played no active role. Britz later reacquired her aunt's partnership interest and then sought to establish a new fiscal year for the business.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Britz's income tax for 1944 and 1945, arguing that her mother and aunt were not bona fide partners and that the partnership could not change its accounting period. Britz petitioned the Tax Court for review.

Issue(s)

1. Whether the Commissioner erred in not recognizing Britz's mother and aunt as bona fide partners for income tax purposes.

2. Whether the partnership between Britz and William Wagner was entitled to select a new accounting period for tax purposes after Britz reacquired her aunt's interest and the partners entered into a new agreement.

Holding

1. No, because Britz's mother and aunt did not genuinely intend to join together

with Britz and Wagner in the present conduct of the enterprise for a business purpose.

2. No, because there was no substantial change in the partnership relations between Britz and Wagner that would justify a new accounting period.

Court's Reasoning

The court relied on *Commissioner v. Culbertson*, which stated that the key question is whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." The court found that Britz's mother and aunt had no abilities to contribute to the business, no capital except what Britz gave them, and no actual control over the income. The court noted that while Britz may have had benevolent motives, the elderly ladies did not participate in the conduct of the business, and Britz retained all responsibilities of ownership.

Regarding the accounting period, the court reasoned that the reacquisition of the aunt's interest did not substantially change the partnership between Britz and Wagner. The new agreement was similar to previous agreements. The court distinguished this case from *Rose Mary Hash*, where a new and distinct partnership was created. Furthermore, the court held that Wagner's minority at the time of the initial partnership agreement did not entitle the partnership to select a new accounting period once he reached adulthood, as he had ratified the partnership arrangement by accepting its benefits after becoming of age.

Practical Implications

This case reinforces the principle that family partnerships are subject to close scrutiny by the IRS to prevent income shifting for tax avoidance. The critical factor is whether all purported partners genuinely intend to conduct the business together. The case demonstrates that merely providing capital without active participation or control is insufficient to establish a bona fide partnership for tax purposes. Attorneys structuring partnerships, especially within families, must ensure that each partner has a real business purpose and actively participates in the enterprise to withstand IRS scrutiny. The decision also highlights the importance of maintaining consistency in accounting periods and obtaining IRS approval for changes unless a truly new partnership is formed.

