14 T.C. 1272 (1950)

For a family partnership to be recognized for income tax purposes, all parties must, in good faith and with a business purpose, intend to join together in the present conduct of the enterprise, contributing either capital or services.

Summary

Russell and Ruth Giffen formed a limited partnership, Russell Giffen & Co., including their four minor children as limited partners. The Tax Court addressed whether the children were bona fide partners for federal income tax purposes. The court held that the children were not valid partners because there was no genuine intent for them to presently conduct the enterprise, contribute capital originating with themselves, or provide services. The court further held that the income should be calculated based on the partnership's fiscal year, not the Giffens' individual calendar year.

Facts

Russell and Ruth Giffen, a married couple, built a successful farming business. To potentially minimize taxes and provide for their children's future, they formed a limited partnership, Russell Giffen & Co., with Russell as the general partner and Ruth and their four minor children as limited partners. The children's capital contributions were derived from gifts from their parents. The partnership agreement granted Russell full management control, and the children did not participate in the business operations. Profits allocated to the children were largely retained in the business.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Giffens' income taxes, arguing that the partnership was ineffective for allocating income to the children. The Giffens petitioned the Tax Court, contesting the Commissioner's assessment. The Tax Court consolidated the cases. The Tax Court ruled in favor of the Commissioner, determining that the children were not bona fide partners and upheld the calculation of income based on the partnership's fiscal year.

Issue(s)

1. Whether the Giffens' four children were bona fide partners in the limited partnership of Russell Giffen & Co. for federal income tax purposes.
2. If the children are not recognized as partners, whether the income of Russell Giffen & Co. should be calculated on the basis of the partnership's fiscal year or the Giffens' individual calendar year.

Holding

1. No, because the children did not genuinely intend to presently conduct the enterprise, contribute capital originating with themselves, or provide services.
2. The income should be calculated on the basis of the partnership's fiscal year because the partnership between Russell and Ruth Giffen was valid, and the children's status as partners was the only issue.

Court's Reasoning

The court relied on *Commissioner v. Culbertson, 337 U.S. 733 (1949)*, stating that the key is "whether, considering all the facts…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 the children performed no services, contributed no independent capital, and had no control over the business. The gifts to the children were conditioned on the property remaining in the business under Russell's control. The court emphasized the lack of a business purpose for including the children in the partnership, noting that it primarily served tax avoidance. Since Russell and Ruth Giffen were conceded as valid partners the partnership's fiscal year was valid for tax purposes.

Practical Implications

Giffen v. Commissioner highlights the importance of demonstrating a genuine intent and economic reality in family partnerships for tax purposes. It reinforces the principle that merely assigning income to family members without a real contribution of capital or services will not shift the tax burden. Legal professionals should advise clients to ensure that all partners actively participate in the business and contribute either capital originating from themselves or substantial services. This case is a reminder that the IRS and courts will scrutinize family partnerships to prevent tax avoidance schemes and that a clear business purpose, beyond tax savings, is essential for recognition.

