15 T.C. 190 (1950)

A partner’s share of profits from a separate business venture is taxable to the original partnership, not the individual partner, when the venture is conducted for the benefit of the original partnership and pursuant to a prior agreement among all partners.

Summary

In *Blades v. Commissioner*, the Tax Court addressed whether income from a construction company (Blades Construction Co.) was taxable to the decedent partner, Archie L. Blades, or to the original partnership, A.L. Blades & Sons. Blades formed a new partnership (Blades Construction Co.) utilizing the resources of his original partnership while his sons were in military service. The court held that because the new partnership was formed to benefit the original partnership, and the profits were transferred to it, the income was taxable to A.L. Blades & Sons, not to Archie L. Blades individually. The court also addressed and upheld the commissioner’s determination on an issue regarding income to the estate and disallowed deduction, due to lack of evidence by the petitioner.

Facts

Archie L. Blades and his two sons operated a construction business under the name A.L. Blades & Sons. The sons entered military service in 1941. In 1942, Blades formed a new partnership, Blades Construction Co., with six key employees from the original company to perform war-related construction at Sampson Naval Base. The agreement stipulated that Blades would contribute capital, secure additional capital if needed using his and the old partnership’s credit, and transfer existing war-related contracts to the new partnership. The sons were aware of the arrangement and understood Blades’ share of the new partnership’s profits would go to the original partnership. Blades Construction Co. used the office, personnel, and equipment of A.L. Blades & Sons. Fifty-eight percent of Blades Construction Co.’s profits were transferred to A.L. Blades & Sons and reported accordingly by Blades and his sons.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Archie L. Blades’ income tax for 1943 and against his estate for 1944, arguing that Blades’ share of the income from Blades Construction Co. was taxable to him individually. The Tax Court consolidated the cases. For the 1943 deficiency, the Tax Court ruled in favor of the petitioner (Blades’ estate), finding the income taxable to A.L. Blades & Sons. For the 1944 deficiency, the Tax Court ruled for the Commissioner, finding the petitioner failed to present any evidence to support its case.

Issue(s)

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1. Whether Archie L. Blades' share of the profits from Blades Construction Co. was taxable to him individually or to the A.L. Blades & Sons partnership.

2. Whether the Commissioner erred in taxing $6,000 to the estate of the decedent in 1944.

3. Whether the Commissioner erred in failing to allow a deduction of the cost of some cattle in 1944.

Holding

1. No, because the agreement among the partners, the use of the original partnership's resources, and the intent to benefit the original partnership meant that the income was earned by and taxable to A.L. Blades & Sons.

2. No, because the $6,000 was paid in accordance with the partnership agreement as distributable income, not a capital payment.

3. No, because the cost of cattle is a capital item, not a deduction from income, and no evidence was presented to show the Commissioner erred.

Court's Reasoning

The court reasoned that the Commissioner's reliance on the principle that one who earns income cannot escape tax by assigning it to another was misplaced. Here, Blades did not personally earn and then assign the income. Instead, there was a pre-existing agreement that the profits would go to the original partnership. The court emphasized the close relationship between the two partnerships, noting that Blades Construction Co. used the resources, personnel, and credit of A.L. Blades & Sons. The court stated: "He made an arrangement for the duration of the war under which the old partnership surrendered some of its rights and gave assistance to the new partnership with the understanding that a portion of the profits of the new partnership should belong, as earned, to the old partnership." The court found the arrangement was for the convenience of all parties involved, and it would be "unreal" to tax the income to Blades individually. Regarding the 1944 deficiency issues, the court found that the petitioner failed to present any evidence to support their contention that the Commissioner's determination was incorrect.

Practical Implications

Blades v. Commissioner illustrates that the IRS and courts will look beyond the formal structure of business arrangements to determine the true earner of income, but also respects clear agreements among partners. It emphasizes that when a business venture is undertaken for the benefit of an existing partnership and pursuant to a prior agreement, the income generated is taxable to the partnership, not the individual partner nominally involved in the new venture. This case provides guidance for structuring partnerships and related business ventures to ensure that

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income is taxed to the appropriate entity, avoiding potential tax deficiencies. It also serves as a reminder of the importance of presenting sufficient evidence to support claims made before the Tax Court.

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