Harvey v. Commissioner, 20 T.C. 105 (1953)

For federal income tax purposes, a partnership is not recognized if the grantor retains excessive control over a trust's participation in the business or if the trustee fails to act independently.

Summary

The case involves the question of whether a husband, his wife, and two trusts for his children were partners for federal income tax purposes. The Tax Court held that the wife was a legitimate partner, as she contributed services and capital to the business. However, it found that the trusts were not partners because the husband retained significant control over the trusts, and the trustee did not act independently. The court emphasized the business purpose behind the partnership and examined the substance of the arrangements, not just the form.

Facts

The taxpayer, Harvey, formed a partnership with his wife to improve the credit rating of his business, The Harvey Co. He assigned a portion of the business interest to his wife and created trusts for his two children, assigning interests to the trusts as well. The partnership agreement was amended to reflect the changes in ownership. While the wife actively contributed to the business, the trustee for the children's trusts was an employee of the business and did not act independently as a partner. Harvey retained significant control over the trusts, including the power to remove the trustee and direct the sale of the trust interests.

Procedural History

The Commissioner of Internal Revenue determined that the trusts were not valid partners, and the taxpayer brought a case before the Tax Court, challenging the determination. The Tax Court sided with the Commissioner on the issue of the trusts' partnership status, and the decision was made under Rule 50.

Issue(s)

1. Whether the wife was a valid partner in the business for federal income tax purposes.

2. Whether the trusts established for the children qualified as partners in the business for federal income tax purposes.

Holding

1. Yes, because the wife contributed both capital and services to the partnership, and the arrangement served a legitimate business purpose.

2. No, because the husband retained excessive control over the trusts, and the trustee did not act independently.

Court's Reasoning

The court first addressed whether the wife was a legitimate partner. It found that she contributed services to the business through her work in advertising and management, and also provided some capital from independent sources. The court emphasized that there was a legitimate business purpose behind forming the partnership, namely to improve the company's credit rating. The court then turned to the issue of the trusts. The court considered "the activities of the trustee and the extent of the grantor's control over the trusts." The court determined that the trustee, who was also an employee of the business, did not participate in the business as a representative of a partnership interest. Moreover, Harvey retained significant control over the trusts, including the power to remove the trustee and direct the sale of the trust interests. The court concluded that

