Harvey v. Commissioner, 21 T.C. 1020 (1954)

A valid partnership for federal income tax purposes requires a good faith intention among partners to join together in a business enterprise, along with the contribution of capital or services; the grantor's control over a trust can negate a finding of a valid partnership interest held by the trust.

Summary

The case of *Harvey v. Commissioner* concerns the determination of whether a valid partnership existed for federal income tax purposes between the petitioner, his wife, and trusts established for his children. The Tax Court held that a partnership existed with the petitioner's wife because she contributed both capital and services and demonstrated a good faith intent to be a partner. However, the court determined that the trusts were not valid partners because the trustee was an employee and the petitioner retained extensive control over the trusts, including the power to remove and appoint trustees, and direct business operations. The court focused on the substance of the arrangements to determine the existence of a valid partnership, emphasizing the intent of the parties and the contributions of capital and services.

Facts

The petitioner, Mr. Harvey, sought to improve the credit rating of his business, The Harvey Co. He formed a partnership with his wife, Dorothea S. Harvey, who contributed services in advertising and management and also contributed independent funds which were used in the business. Harvey assigned one-tenth interests in the business to trusts for each of his children, with James M. Todd as trustee. Todd was an employee of the company. Harvey retained significant control over the trusts and the business operations. The business books were kept on a partnership basis, and Dorothea S. Harvey's capital account was credited with her share of the net profits and she paid income tax on this gain.

Procedural History

The Commissioner of Internal Revenue determined that neither Mrs. Harvey nor the trusts were partners. The petitioner challenged this determination in the Tax Court.

Issue(s)

1. Whether a valid partnership for federal income tax purposes existed between the petitioner and his wife.
2. Whether the trusts for the petitioner's children were valid partners in the business for federal income tax purposes.

Holding

1. Yes, because there was a good faith intent to be partners, with Dorothea

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contributing services and capital to the business.
2. No, because the trustee's role was limited, and the petitioner retained excessive control over the trusts' interests in the business.

Court's Reasoning

The court analyzed the substance of the partnership arrangements, not merely the form, to determine their validity for tax purposes. For the partnership with Mrs. Harvey, the court found a genuine intent to form a partnership, supported by her active involvement in the business, contribution of services and independent funds. The court looked at her work in advertising and management and also considered that the business was operated on a partnership basis, she paid taxes as a partner, and the credit organizations recognized her as a partner.

Regarding the trusts, the court focused on the trustee's lack of independent action and the petitioner's significant control over the trusts. The court found that the trustee was an employee and did not participate in the business as a representative of the trusts' interests, and that the petitioner had the power to remove and appoint trustees, control trust investments, and direct the sale of trust interests. The court stated that the trustee

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