Brandschain v. Commissioner, 80 T. C. 746 (1983)

Retirement payments from a partnership are subject to self-employment tax if the retired partner performs any services for the partnership.

Summary

Joseph Brandschain, a retired partner of a law firm, received retirement payments from the firm's current earnings. He also continued to work as a labor arbitrator, turning over his fees to the firm as per the partnership agreement. The IRS determined these retirement payments were subject to self-employment tax. The U. S. Tax Court held that since Brandschain performed services for the firm, his retirement payments did not qualify for the exclusion under section 1402(a)(10) of the Internal Revenue Code, emphasizing that any services rendered by a retired partner disqualify retirement payments from the self-employment tax exclusion.

Facts

Joseph Brandschain was a retired partner of the law firm Wolf, Block, Schorr & Solis-Cohen. He continued to serve as a labor arbitrator after his retirement, earning fees which he turned over to the firm. In 1976 and 1977, he worked as an arbitrator for 10 and 34 days, respectively, earning $4,750 and $16,295. The firm's partnership agreement required retired partners to contribute all income from professional services to the firm's earnings. Brandschain received retirement payments of $39,000 in 1976 and $43,000 in 1977, which he reported on his income tax return but did not subject to self-employment tax.

Procedural History

The IRS determined deficiencies in Brandschain's self-employment tax for 1976 and 1977. Brandschain petitioned the U. S. Tax Court, which assigned the case to Special Trial Judge John J. Pajak. The court adopted Pajak's opinion, holding that Brandschain's retirement payments were subject to self-employment tax.

Issue(s)

1. Whether retirement payments received by a retired partner from current earnings of a partnership qualify for exclusion from self-employment tax under section 1402(a)(10) of the Internal Revenue Code if the retired partner performs any services for the partnership.

Holding

1. No, because the retired partner must render no services with respect to any trade or business carried on by the partnership during the taxable year to qualify for the exclusion.

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Court’s Reasoning

The court applied section 1402(a)(10) of the Internal Revenue Code, which excludes retirement payments from self-employment tax only if the retired partner renders no services with respect to any trade or business of the partnership. The court found that Brandschain’s arbitration work constituted services for the firm, as evidenced by his obligation to turn over arbitration fees to the firm under the partnership agreement. The court emphasized the legislative intent that the exclusion applies only to fully retired partners who perform no services. It rejected Brandschain’s argument that his arbitration work was not a trade or business of the firm, citing prior cases that included similar activities as partnership income. The court also noted that the firm continued to hold Brandschain out as an arbitrator, further indicating his services were part of the firm’s business.

Practical Implications

This decision clarifies that any service performed by a retired partner, even if minimal, disqualifies retirement payments from the self-employment tax exclusion under section 1402(a)(10). Law firms and partnerships must carefully structure retirement plans to ensure that retired partners do not perform any services. This ruling impacts the tax planning of retired partners and may influence how partnerships draft their agreements regarding retirement payments. It also serves as a precedent for future cases involving the self-employment tax status of retirement payments from partnerships.

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