Heggestad v. Commissioner, 91 T. C. 778 (1988)

Commissions paid by a partner to his partnership for services rendered are included in the partner's distributive share of partnership income under the entity approach mandated by section 707(a) of the Internal Revenue Code.

Summary

Gerald Heggestad, a partner in Cross Country Commodities, a commodities brokerage firm, paid commissions to the partnership for trading commodities futures in his personal accounts. The IRS Commissioner included these commissions in Heggestad's distributive share of partnership income, leading to a tax deficiency. The U. S. Tax Court upheld the Commissioner's decision, ruling that under section 707(a) of the IRC, Heggestad's transactions with the partnership were to be treated as occurring with an entity separate from himself, thus including the commissions in his income. The court also determined that Heggestad's losses on Treasury bill futures were capital, not ordinary, losses, as they were not integral to the partnership's business.

Facts

Gerald Heggestad was a general partner in Cross Country Commodities, a commodities brokerage firm formed in 1978. The partnership acted as an associate broker, earning commissions from customers' commodities futures transactions. Heggestad also traded commodities futures for his personal accounts, paying commissions to the partnership for these trades. In 1979 and 1980, he incurred significant losses, including $85,360 on Treasury bill futures contracts. The partnership's returns included the commissions paid by Heggestad in calculating his distributive share of partnership income.

Procedural History

The IRS Commissioner issued a notice of deficiency to Heggestad for the tax years 1979 and 1980, determining that his distributive share of partnership income should include the commissions he paid to the partnership. Heggestad petitioned the U. S. Tax Court, which upheld the Commissioner's determination, ruling that the commissions were part of Heggestad's income under section 707(a) and that his losses on Treasury bill futures were capital losses.

Issue(s)

1. Whether $85,360 of losses incurred by Heggestad on the sale of Treasury bill futures contracts in 1980 were capital losses rather than ordinary losses.
2. Whether Heggestad's distributive share of partnership income from Cross Country Commodities includes commissions he paid to the firm on trades for his personal account.

Holding

1. Yes, because the Treasury bill futures contracts were not purchased as hedges or as an integral part of the partnership's brokerage business, and Heggestad had a substantial investment purpose in acquiring them.
2. Yes, because under section 707(a) of the IRC, transactions between a partner and his partnership are treated as occurring between the partnership and a non-partner, requiring the commissions paid by Heggestad to be included in his distributive share of partnership income.

Court's Reasoning

The court applied section 707(a) of the IRC, which mandates an entity approach for transactions between a partner and his partnership other than in his capacity as a partner. The court distinguished the case from *Benjamin v. Hoey*, which was decided under the 1939 Code and adopted an aggregate approach, noting that section 707(a) supersedes such precedent. The court reasoned that Heggestad's payment of commissions to the partnership for his personal trades was a transaction with the partnership as an entity, thus requiring inclusion of the commissions in his income. Regarding the Treasury bill futures losses, the court found that they were not integral to the partnership's business and were motivated by Heggestad's investment purpose, thus qualifying as capital losses.

Practical Implications

This decision clarifies that commissions paid by a partner to his partnership for services rendered are taxable income to the partner under the entity approach of section 707(a). Legal practitioners should ensure that such transactions are properly reported on partnership and individual tax returns. The ruling also reinforces the principle that losses from speculative investments in futures contracts are capital losses unless they are integral to the taxpayer's business. This case has implications for how partnerships and partners structure their transactions and report income, particularly in industries where partners may engage in business with the partnership. Subsequent cases have applied this ruling in similar contexts, emphasizing the importance of distinguishing between a partner's capacity as a partner and as an individual in transactions with the partnership.

