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TAXATION--INCOME TAX--FAMILY PARTNERSHIPS--APPLICATION OF THE TOWER-LUSTHAUS DOCTRINE

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TAXATION—INCOME TAX—FAMILY PARTNERSHIPS—APPLICATION OF THE TOWER-LUSTHAUS DOCTRINE—Respondent and his four sons formed a partnership in 1939. The sons contributed cattle and property purchased from respondent who accepted their notes in return. Subsequently, part of the notes were forgiven and part paid from shares of the firm proceeds. A firm bank account was opened on which all members could draw. It was planned that all the sons would render substantial services to the partnership. However, the plan was disrupted when the two eldest were called to military duty, and the two

minor sons continued their education. A partnership return was filed for 1940. The Commissioner determined a deficiency against the respondent, which the Tax Court[1] upheld on authority of the *Tower* and *Lusthaus* cases.[2] The circuit court of appeals reversed,[3] holding that the vital services required by the Tower-Lusthaus doctrine could be contributed presently or at a contemplated future time. On appeal, *held,* reversed. The intention to contribute capital or services sometime in the future is insufficient to establish a partnership for tax purposes. In addition, the Tax Court having erroneously applied an objective standard test not justified by the *Tower* and *Lusthaus* decisions, the case is remanded to it for a determination in accordance with this opinion. *Commissioner v. Culbertson,* 335 U.S. 883, 69 S.Ct. 1210 (1949).

In the course of the *Tower* opinion the Court stated, "If she [wife] either invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things she may be a partner. . . ."[4] The Tax Court has apparently seized upon this language as laying down an objective standard which family partnerships must meet if they are to receive tax recognition.[5] This approach, stemming from a selective culling of the *Tower* and *Lusthaus* opinions, has caused a departure from the fundamental doctrine therein formulated.[6] It ignores the vital thread interwoven throughout the opinions—that the courts should merely take the enumerated circumstances into consideration in determining whether the partners really intended a genuine union for partnership business purposes.[7] The principal case again stresses the ". . . bona fide intent

[1] W. O. Culbertson, Sr., 1947 P.H. T.C. Memo. Dec. ¶47,168.

[2] Commissioner v. Tower, 327 U.S. 280, 66 S.Ct. 532 (1946); Lusthaus v. Commissioner, 327 U.S. 293, 66 S.Ct. 539 (1946).

[3] Culbertson v. Commissioner, (C.C.A. 5th, 1948) 168 F. (2d) 979, noted in 47 MICH. L. REV. 595 (1949).

[4] Commissioner v. Tower, supra, note 2. The income splitting provisions of the 1948 Revenue Act, [P.L. 471, 80th Cong., 2d sess., c. 168, §301 (1948)], has lessened the importance of the family partnership as a tax avoidance device.

[5] Fletcher v. Commissioner, (C.C.A. 2d, 1947) 164 F. (2d) 182 at 183, where the court in discussing the Tower and Lusthaus opinions stated, "As we understand it, there are four conditions whose combined existence will make such a partnership 'unreal' when taxes are in question. . . ." Hougland v. Commissioner, (C.C.A. 6th, 1948) 166 F. (2d) 815; Gil Graber, 1948 P.H. Tax Ct. Memo. Dec. ¶48,001; Simons v. Commissioner, 7 T.C. 114 (1946); Tuttle and Wilson, "The Confusion on Family Partnerships," 9 GA. B.J. 353 (1947); and see Justice Rutledge's concurring opinion to the Tower case at page 292, note 2, supra.

[6] Vinson, C. J., stating in the principal case at 1214, "It ignores what we said is the ultimate question for decision, namely, 'whether the partnership is real within the meaning of the federal revenue laws' and makes decisive what we described as 'circumstances [to be taken] into consideration' in making that determination." And see Justice Frankfurter's concurring opinion at 1218; Mannheimer and Mook, "A Taxwise Evaluation of Family Partnerships," 32 IOWA L. REV. 436 (1947).

[7] See note 2, supra.

that they be partners in the conduct of the cattle business. . . ."[8] The emphasis is not on the setting down of an itemized objective standard, rather the emphasis must be on the real intent of the partners gained from all the circumstances. This bona fide intent doctrine, re-emphasized in this decision, is a clear limitation on the application of the *Tower* and *Lusthaus* cases. It will no longer be sufficient for the Tax Court to isolate the sources of capital contributions,[9] the amount and kind of services rendered,[10] and determine from those alone whether a partnership exists. Several divergent views represented by the concurring opinions indicate that all questions are by no means closed.[11] However, the instant decision has reduced each case to a question of fact to be determined on the issue of real intent to form a true business partnership.[12]

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[8] Principal case at 1217.

[9] Lowry v. Commissioner, (C.C.A. 6th, 1946) 154 F. (2d) 448; Herskovits, 1948 P.H. T.C. Memo. Dec. ¶48,090; Sandberg v. Commissioner, 8 T.C. 423 (1947).

[10] Robert H. Cole, 1948 P. H. Tax Ct. Memo Dec. ¶48,023; Irving Wenig, 1947 P.H. T.C. Memo. Dec. ¶47,338.

[11] Justices Black and Rutledge felt the Tax Court properly applied the Tower and Lusthaus cases but acquiesced in the court's opinion; Justice Burton believed a commitment to give future services to be a material consideration in determining partnership reality; Justice Jackson would permit the common law partnership concepts to control; and, Justice Frankfurter stated the Tower and Lusthaus cases simply follow the general rules of commercial partnerships.

[12] Internal Revenue Code §1141 (a) provides for review of Tax Court decisions by circuit courts of appeals in the same manner that equity appeals are reviewed. Therefore, the findings of fact are subject to scrutiny on appeal.