***1942 Tax Ct. Memo LEXIS 147***

A wife can be a bona fide partner in a business for tax purposes, even if she contributes limited services, provided she owns a capital interest and the partnership is a legitimate business endeavor.

**Summary**

The Tax Court addressed whether a husband was taxable on the portion of partnership income allocated to his wife. The Commissioner argued the wife's entry into the business was solely for tax avoidance, lacking a bona fide partnership interest. The court found the wife was a legitimate partner, having invested capital, been recognized as a partner by all members, and having the right to withdraw funds. Her limited involvement in day-to-day operations and the initial use of some funds for household expenses did not negate her status as a bona fide partner. Thus, the husband was not taxable on his wife's share of the partnership income.

**Facts**

Petitioner and his father were partners in a peanut butter business. The father later brought his daughter and seven sons into his oil business. Subsequently, a new peanut butter partnership was formed, with the petitioner holding a one-quarter interest, his wife a one-quarter interest, and the father's oil business the remaining half. The wife purchased her partnership interest from her husband using a note, which was largely paid off with profits from the new partnership. The partnership agreement recognized her capital contribution, and she had authority to draw checks from the partnership account.

**Procedural History**

The Commissioner determined that the husband was liable for income tax on the portion of the partnership income allocated to his wife. The husband challenged this determination in the Tax Court.

**Issue(s)**

Whether the petitioner's wife was a bona fide partner in J. D. Johnston, Jr. Co. for federal income tax purposes, such that the income attributed to her should not be taxed to the petitioner.

**Holding**

Yes, because the wife invested capital in the partnership, was recognized as a partner by the other members, and had the right to control her share of the profits, establishing a bona fide partnership despite her limited services.

**Court's Reasoning**

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The court emphasized that the wife contributed capital to the partnership, evidenced by her investment and the partnership agreement. The other partners acknowledged her status by signing the agreement and operating the business accordingly. While the wife's services were limited, the court noted that the partnership agreement did not require active participation from all partners to share in the profits. The court distinguished the case from those involving arrangements solely between husband and wife where the income was predominantly derived from the husband's personal services. Here, the wife's income flowed from her capital investment, not her husband's efforts. Even the fact that some partnership withdrawals were used for household expenses did not negate her partnership status, as she had the right to spend her funds as she saw fit. The court cited *Kell v. Commissioner* and *Commissioner v. Olds* as examples where family members were legitimately partners despite limited direct involvement in the business operations.

**Practical Implications**

This case clarifies that a family member can be a legitimate partner in a business for tax purposes even if they do not actively participate in daily operations. The key factors are a real capital investment, recognition by other partners, and control over their share of the profits. It impacts how family partnerships are structured and viewed by the IRS. It suggests that the presence of capital contribution and genuine intent to operate as a partnership are more important than the level of services provided by each partner. Later cases applying this ruling would likely focus on scrutinizing the validity of the capital contribution and the extent of control exercised by the purported partner.

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