6 T.C. 707 (1946)

Income from a partnership is taxed to those who earn it through their labor and control, not necessarily to those who are nominally partners; furthermore, real property purchased by wives using funds distributed from a partnership, without any restrictions, is not attributable to the husbands for income tax purposes.

Summary

Abe Schreiber and J.C. Shaprow, partners in Royalite Co., transferred partnership interests to their wives. The Commissioner of Internal Revenue argued the husbands should be taxed on the entire partnership income, while the Schreibers contended each partner (including the wives) should be taxed on only one-fourth of the income. The Tax Court held that the husbands maintained control of the business, making them liable for the full partnership income. However, the court also held that rental income from a building purchased by the wives with distributed partnership funds was taxable to the wives, not the husbands, as the wives had control over those funds without restriction.

Facts

In 1930, Schreiber and Shaprow formed a partnership, Royalite Co., using funds partially provided by their wives. In 1937, each partner conveyed a one-fourth interest in the partnership to his wife. In 1938, a formal partnership agreement was created, including the wives as partners. However, the husbands continued to manage the business, the wives only performing minor clerical tasks. Only the husbands could sign partnership checks. The wives used partnership distributions to purchase a building, which they then leased to the partnership as B & S Realty Co.

Procedural History

The Commissioner assessed deficiencies against the Schreibers, arguing they were taxable on one-half of the partnership income. The Schreibers petitioned the Tax Court, arguing they were only taxable on one-fourth. The Tax Court consolidated the cases. The Commissioner also argued that prior Board of Tax Appeals decisions regarding the 1937 tax year were res judicata. The Tax Court ruled in favor of the Commissioner regarding the partnership income, but against the Commissioner regarding the rental income.

Issue(s)

1. Whether the Commissioner erred in including all partnership income in the gross income of the petitioners, rather than attributing a portion to their wives?
2. Whether the Commissioner erred in including rental income from the B & S Realty Co. in the gross income of the petitioners?

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Holding

1. Yes, because the husbands continued to manage and control the business, the wives made no material contribution of services, and the capital contribution did not originate with the wives.
2. No, because the wives purchased the building in their own names with money distributed to them as their distributive share of the profits of the Royalite Co., and the income from the building was retained for their own use and benefit.

Court’s Reasoning

The Tax Court relied heavily on the Supreme Court’s decision in *Commissioner v. Tower*, emphasizing that the key issue is

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