***Sandberg v. Commissioner, 8 T.C. 423 (1947)***

A family partnership will not be recognized for tax purposes if the wife contributes neither capital originating separately with her nor vital services of a managerial or controlling nature to the business; however, income from property held as tenants by the entirety is divided equally between husband and wife for tax purposes, regardless of whether one spouse contributed more labor to improve the property.

**Summary**

The petitioner, Sandberg, sought to recognize a partnership with his wife for tax purposes to split income. The Tax Court examined whether the wife contributed capital or vital services to the business. The court held that the alleged partnership was not valid for tax purposes because Mrs. Sandberg did not contribute separate capital or vital services. However, the court also addressed how income from properties held as tenants by the entirety should be taxed, ruling that it should be split equally between the spouses, irrespective of the husband's labor contributing to the property's improvement. The court rejected the Commissioner's attempt to attribute more income to the husband due to his personal services.

**Facts**

Sandberg claimed a partnership with his wife existed since their marriage in 1925, later formalized in a 1941 agreement. He argued his wife contributed to the business, but the Tax Court found: Mrs. Sandberg contributed no capital originating separately with her. Her services were limited to answering phones, some cleaning, and occasional input on design choices. Titles to properties were often held as tenants by the entirety. Sandberg primarily managed and performed the construction work on the properties.

**Procedural History**

The Commissioner of Internal Revenue challenged the validity of the partnership for tax purposes and sought to adjust the income reported by Mr. and Mrs. Sandberg. The Tax Court reviewed the Commissioner's determination.

**Issue(s)**

1. Whether a valid partnership existed between Sandberg and his wife for tax purposes.
2. Whether the income from properties held by Sandberg and his wife as tenants by the entirety should be divided equally for tax purposes, or whether a deduction should be made for the value of Sandberg's personal services in improving the properties.

**Holding**

 

1. No, because Mrs. Sandberg did not contribute capital originating separately with her or vital services of a managerial or controlling nature.
2. Yes, the income should be divided equally because under Oregon law, as tenants by the entirety, both spouses have an equal estate, and the husband's labor in improving the property inures to the benefit of the joint estate.

**Court's Reasoning**

The court relied on *Commissioner v. Tower*, 327 U.S. 280 (1946), and *Lusthaus v. Commissioner*, 327 U.S. 293 (1946), stating that a family partnership requires the wife to contribute either capital or vital services. Mrs. Sandberg's contributions were deemed minor and related to typical spousal interests rather than vital business functions. Regarding the tenancy by the entirety, the court cited I.T. 3743, 1945 C.B. 142, which dictates that income from such properties can be split equally in Oregon. The court reasoned that the wife has a vested interest in the property, and the husband's labor on the property benefits the joint estate. The court distinguished the situation from cases where personal service income is assigned, noting that Sandberg received no direct monetary compensation for his services; his services created other property of which his wife was an equal owner.

**Practical Implications**

This case illustrates the stringent requirements for recognizing family partnerships for tax purposes. It emphasizes the need for the spouse to contribute either separate capital or vital services. It also clarifies that income from properties held as tenants by the entirety is generally divided equally between spouses, even if one spouse contributes more labor to improve the property. This provides a predictable framework for tax planning in states recognizing tenancy by the entirety. It limits the IRS's ability to reallocate income based on unequal contributions to jointly owned property. Later cases have cited Sandberg to underscore the importance of demonstrating genuine capital or service contributions to establish a valid family partnership for tax purposes.

 