T.C. Memo. 1948-270

For federal tax purposes, a wife is not considered a bona fide partner in her husband's business if she does not contribute capital originating from her, substantially contribute to the control and management of the business, or perform vital additional services.

Summary

The Tax Court addressed whether Mrs. Gray was a legitimate partner in Martin H. Kay & Associates for federal tax purposes, and whether $8,000 paid to Mr. Gray by Todd & Brown constituted taxable income. The court held that Mrs. Gray was not a bona fide partner because her contribution was a temporary arrangement, and she did not contribute vital services or management to the partnership. The court also found that the $8,000 was reimbursement for expenses and not taxable income to Mr. Gray.

Facts

Martin Gray, the petitioner, was a partner in Martin H. Kay & Associates. To improve the partnership's financial appearance for securing a War Department contract, Mrs. Gray assigned securities and cash to the partnership. There was an understanding that these assets would be returned to her. Mrs. Gray did not actively participate in the management or operations of the partnership. After the War Department rejected the partnership's contract proposal, the contract was awarded to Todd & Brown, Inc., which then entered into a profit-sharing arrangement with Martin H. Kay & Associates. Todd & Brown reimbursed Mr. Gray $8,000 for expenses he incurred while negotiating the government contract.

Procedural History

The Commissioner of Internal Revenue determined that Mrs. Gray was not a bona fide partner and that the income distributed to her was taxable to Mr. Gray. The Commissioner also argued that the $8,000 reimbursement was taxable income to Mr. Gray. Mr. Gray appealed to the Tax Court.

Issue(s)

1. Whether Mrs. Gray was, for federal tax purposes, a bona fide partner in the firm of Martin H. Kay & Associates.

2. Whether the $8,000 paid to Mr. Gray in 1941 by Todd & Brown as reimbursement for expenses incurred in connection with his negotiations to secure the Government contract represents taxable income to him.

Holding

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1. No, because Mrs. Gray's assignment of securities was a temporary arrangement and she did not substantially contribute to the partnership's management or operations.

2. No, because the $8,000 was a reimbursement for expenses incurred and paid, not income.

Court's Reasoning

Regarding the partnership issue, the court applied the principles established in *Commissioner v. Tower* and *Lusthaus v. Commissioner*, which require a wife to either invest capital originating with her, substantially contribute to the control and management of the business, or perform vital additional services to be considered a partner for tax purposes. The court found that Mrs. Gray's assignment of securities was essentially a loan, as they were intended to be returned to her. The court emphasized that the assets

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