13 T.C. 529 (1949)

A wife can be recognized as a partner in a family partnership for tax purposes if she made a valid capital contribution, and the partners genuinely intended to carry on the business together.

Summary

Edward Theurkauf sought a redetermination of a deficiency in his income tax, arguing his wife should be recognized as a partner in their business, F.A. Marsily & Co. The Tax Court found that Mrs. Theurkauf made a valid capital contribution to the partnership following a complete and irrevocable gift of stock from her husband. Because the partners intended to operate a bona fide partnership, Mrs. Theurkauf was recognized as a partner for tax purposes. The court distinguished this case from *Commissioner v. Tower*, emphasizing the unconditional nature of the stock transfer to Mrs. Theurkauf.

Facts

Mr. Theurkauf owned a corporation, F.A. Marsily & Co., where capital was a crucial factor. In 1936, he decided to dissolve the corporation and form a partnership. Prior to this, he gifted one-half of the corporate stock to his wife, Frances, intending a complete and irrevocable transfer with no conditions attached. Subsequently, the corporation was liquidated, and its assets were transferred to a newly formed partnership consisting of Mr. and Mrs. Theurkauf, and two employees. The employees made no capital contributions. In 1941, this partnership dissolved due to one employee's financial issues, and a new partnership was formed with the Theurkaufs and one employee. Mrs. Theurkauf never rendered any services to the partnership.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Mr. Theurkauf's income tax for 1944, based on the determination that Mrs. Theurkauf's share of the partnership income should be attributed to him. Mr. Theurkauf petitioned the Tax Court for a redetermination.

Issue(s)

Whether Frances G. Theurkauf should be recognized as a partner in the partnership of F. A. Marsily & Co. for income tax purposes in 1944.

Holding

Yes, because Mrs. Theurkauf made a valid capital contribution to the partnership, and the partners genuinely intended to carry on the business together.

Court's Reasoning

The court distinguished this case from *Commissioner v. Tower*, where the stock transfer to the wife was conditional. Here, Mr. Theurkauf made an unconditional gift of stock to his wife, giving her full ownership. Therefore, her subsequent contribution of those assets to the partnership was a valid capital contribution. The court relied on *Commissioner v. Culbertson*, which emphasized that if partners join together in good faith, agreeing that each contribution of services or capital is valuable, that is sufficient for partnership recognition. The court found that the partners intended to operate a bona fide partnership. The court stated, "If, upon a consideration of all the facts, it is found that the partners joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient." The court noted that the active partners received salaries commensurate with their services, further supporting the bona fide nature of the partnership.

Judge Disney dissented, arguing the majority overemphasized the capital contribution while neglecting that the gift to Mrs. Theurkauf occurred after the decision to change the business structure. The dissent emphasized that, per *Tower* and *Culbertson*, income must be taxed to the one who earns it, and the court failed to adequately consider Mrs. Theurkauf's lack of participation in the business.

Practical Implications

This case clarifies that an unconditional gift of capital followed by its contribution to a partnership can establish a valid family partnership for tax purposes. The key is demonstrating a genuine intent to conduct a business as partners. It distinguishes situations where the transfer of assets is merely a tax avoidance scheme without a real shift in economic control. Later cases applying this ruling would focus on the intent of the parties, the validity of the transfer, and the proportionality of compensation for active partners before profit distribution.

