13 T.C. 1020 (1949)

A wife can be a bona fide partner in her husband's business for federal income tax purposes, even if her capital contribution originated as a gift from him, provided the gift was absolute, she has control over the capital, and the partnership is formed with a genuine business purpose.

Summary

John Morris gifted cash and securities to his wife, Edna, who then invested it as a limited partner in his brokerage firm. The Tax Court addressed whether Edna was a bona fide partner for tax purposes, or if the income should be taxed to John. The court held that Edna was a bona fide partner because the gifts were irrevocable, she had control over the funds, and the partnership served a valid business purpose, distinguishing it from arrangements lacking economic substance. This case clarifies the circumstances under which family members can be recognized as legitimate partners in a business, even when capital originates from intra-family gifts.

Facts

John Morris, a general partner in Gude, Winmill & Co., gifted shares of stock and cash to his wife, Edna, totaling approximately $80,000. He told her she was to have absolute control of the securities and money, as he wanted to interest her in their management because she would undoubtedly inherit a substantial estate from him. Edna sold the securities and, with the cash gift, invested $80,000 as a limited partner in Gude, Winmill & Co. The partnership agreement stipulated she would receive 6% interest on her investment plus 2% of the profits. Edna maintained separate bank accounts, and her partnership income was used for her personal expenses, gifts, and investments. As a limited partner, Edna was precluded from providing services to the firm and rendered none of any consequence.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against John Morris, arguing that the partnership income attributed to Edna should be taxed to him. Morris petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether Edna Morris was a bona fide partner in the brokerage firm of Gude, Winmill & Co. for federal income tax purposes, such that her share of the partnership income was taxable to her, or whether the income was taxable to her husband, John Morris.

Holding

Yes, Edna Morris was a bona fide partner because the gifts from her husband were

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absolute and irrevocable, she had control over her capital, and the partnership served a valid business purpose, demonstrating a genuine intent to conduct business as a partnership.

Court's Reasoning

The Tax Court relied on *Commissioner v. Culbertson*, emphasizing that the critical question is whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." The court found that John made an absolute gift to Edna without retaining control. Edna used the income for her own purposes, not to discharge John's family obligations. The court noted that limited partnerships are a common method of financing brokerage houses. While John was a dominant partner, admitting Edna as a partner required the approval of all ten general partners. Importantly, John's share of the profits actually increased after Edna joined the firm. The court distinguished *Hitchcock*, where the donor retained too much control over the gifted assets. Here, Edna had unfettered control, and her income was used at her discretion, indicating a genuine partnership.

Practical Implications

Morris v. Commissioner provides guidance on establishing the legitimacy of family partnerships for tax purposes. It confirms that gifted capital can be the basis for a bona fide partnership interest if the gift is complete and the donee exercises control over the assets and income. This case emphasizes the importance of demonstrating a real business purpose and economic substance in family partnerships. Attorneys advising clients on structuring family business arrangements should ensure that gifts are structured to avoid any retained control by the donor, that the donee has the ability to manage and dispose of the gifted property, and that the partnership serves a legitimate business function, not just tax avoidance. Later cases have cited *Morris* to illustrate the importance of assessing the totality of the circumstances to determine the true intent of the parties in forming a partnership.

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