Seltzer v. Commissioner, T.C. Memo. 1951-125 (1951)

A partner is liable for income tax on their distributive share of partnership income, regardless of agreements made after the partnership interest was earned or arrangements regarding the handling of those funds, unless it's proven they did not receive said income.

Summary

This case concerns the tax liability of a woman, Seltzer, on income from a partnership she held with her husband. The Commissioner determined Seltzer was taxable on her full distributive share of the partnership income. Seltzer argued that she was dominated by her husband and used as a tool to evade income tax on income that belonged to him. The Tax Court held that Seltzer was liable for the tax on her share of the partnership income because she was a partner and agreements with her husband did not relieve her of this liability, especially because there was no clear evidence showing she did not receive her share of the income.

Facts

Seltzer was an equal partner with Fred Morelli in an ice rink business starting in April 1942. In January 1944, a new partnership was formed where Seltzer held a one-fourth interest. Seltzer testified that her husband required her to sign an agreement to deposit her partnership income into a joint account before he would allow the new partnership agreement to become effective. The Commissioner determined that Seltzer was liable for tax on her full distributive share of the partnership income. Seltzer and her husband divorced, and there was a property settlement agreement.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Seltzer's income tax. Seltzer petitioned the Tax Court for a redetermination. The Tax Court reviewed the evidence and the Commissioner's determination.

Issue(s)

1. Whether Seltzer is liable for income tax on her distributive share of the partnership income, despite her claims of being dominated by her husband and an agreement to deposit her income into a joint account.
2. Whether Seltzer received income in 1944 from the sale of her one-fourth interest in the partnership.

Holding

1. Yes, because Seltzer was a partner and agreements made after a partnership interest has been earned do not relieve a partner of income tax on their share of the

income already earned. Additionally, she failed to show clear and convincing evidence that she did not receive her full distributive share.
2. No, because Seltzer was on a cash basis and did not actually receive the note or any part of the $15,000 during 1944. Thus she was not required to report any gain in 1944 based on her husband's obligation to pay her in the future.

Court's Reasoning

The Court reasoned that Section 182 of the Internal Revenue Code dictates that each partner's net income includes their distributive share of the partnership income, whether or not it is actually distributed. Agreements made after a partnership interest is earned do not relieve a partner of income tax on their share of the income already earned, citing *Helvering v. Horst*. While Seltzer claimed she was dominated by her husband and used as a tool to evade taxes, the evidence did not substantiate that she was forced into the earlier partnership or that the agreement relieved her from income tax on her 25% share of the new partnership's income. She drew checks on the joint account, indicating control. Furthermore, the Court found that Seltzer did not receive the $15,000 or the note during 1944. Since she was on a cash basis, she was not required to report any gain in 1944 based on her husband's promise to pay her at some future time.

Practical Implications

This case clarifies that a partner cannot avoid tax liability on their distributive share of partnership income simply by entering into agreements with others regarding how that income is handled. The critical factor is whether the partner actually earned the income as a partner. Taxpayers cannot use marital agreements as a means of evading income tax liability on partnership income. The case underscores the importance of clear and convincing evidence when attempting to dispute the Commissioner's determination of tax liability. This decision highlights the application of the cash basis accounting method. It emphasizes that income is taxed when it is actually or constructively received, not merely when there is a promise of future payment.

