T.C. Memo. 1952-270

For a family member to be recognized as a partner in a business for tax purposes, the parties must have a genuine intent to conduct the enterprise as partners, considering factors such as capital contribution, control over the business, and distribution of profits.

Summary

Hugh Jackson sought to recognize his wife, Ada, as a partner in the Ray Jackson and Sons partnership for the tax years 1943 and 1944. The Tax Court upheld the Commissioner's determination that Ada was not a partner, finding insufficient evidence of a genuine intent to form a partnership. The court emphasized that stricter proof is required for partnerships between family members. The court found that Ada's alleged capital contribution (a used car), lack of control over the business, and the nature of her profit sharing (in lieu of support) did not demonstrate a bona fide partnership. The property settlement agreement, executed during divorce proceedings, further undermined the claim, specifying that Ada's interest was solely a property interest.

Facts

The Ray Jackson and Sons partnership was initially formed by Hugh Jackson and his father, Ray. Hugh claimed that in 1939, his wife, Ada, contributed a used car to the partnership, making her a partner. However, partnership tax returns from 1939-1942 did not list Ada as a partner. In 1943, Hugh and Ada executed a property settlement agreement as part of their divorce, which stated Ada received a two-ninths interest in the partnership, but only as a "property interest" in lieu of marital support. A separate "partnership agreement" was also drafted recognizing Ada's two-ninths interest.

Procedural History

The Commissioner of Internal Revenue determined that Ada Jackson was not a partner in Ray Jackson and Sons for the tax years 1943 and 1944. Hugh Jackson petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether Ada Jackson was a bona fide partner in the Ray Jackson and Sons partnership for the tax years 1943 and 1944, entitling Hugh Jackson to treat her share of partnership income accordingly.

Holding

No, because the evidence failed to demonstrate that Ada Jackson, Hugh Jackson, and Ray Jackson genuinely intended to join together as partners in the conduct of the

© 2025 SCOTUSreports.com. All rights reserved.

business. Additionally, the capital of the partnership in 1943 did not represent an outgrowth of any capital allegedly contributed by Ada in 1939.

Court's Reasoning

The court emphasized that the burden of proof rests on the person asserting the existence of a partnership, and stricter proof is required in cases involving family members. Applying the standard set forth in *Commissioner v. Culbertson, 337 U.S. 733*, the court assessed 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 noted several factors undermining Hugh's claim. Ada was not listed as a partner in prior tax returns. Her alleged capital contribution was a used car of limited value. The 1943 property settlement agreement specifically limited her interest to a "property interest only" in lieu of marital support, indicating she would share in profits only when distributed and lacked control over undistributed earnings. Ada's testimony revealed a lack of understanding of the business and minimal participation in its affairs. The court also observed that no capital account was opened in Ada's name and that her withdrawals from the partnership were significantly less than Hugh's. The Court noted, "Ownership and control over profits while they remain undistributed constitutes one test of whether a person is a partner."

Practical Implications

This case reinforces the principle that family partnerships are subject to heightened scrutiny by tax authorities. It highlights the importance of demonstrating a genuine intent to operate as partners, with factors such as capital contribution, control over the business, sharing of profits and losses, and the conduct of the parties all being considered. Agreements must reflect economic reality and the partners' true intentions. The case serves as a cautionary tale for taxpayers seeking to use family partnerships solely for tax avoidance purposes. Later cases have cited *Jackson* to emphasize the need for objective evidence to support the existence of a bona fide partnership, particularly within families, as well as the importance of a true sharing in profits and losses, rather than a mere assignment of income.

© 2025 SCOTUSreports.com. All rights reserved.