***22 T.C. 995 (1954)***

Under Washington community property law, a partnership interest acquired with funds borrowed on the separate credit of one spouse is considered that spouse's separate property, and any income derived from the interest is taxed to that spouse individually, even if the other spouse is aware of the partnership interest's existence.

**Summary**

The case involved Elsie Keil Mathisen, who claimed that her partnership interest in Western Construction Company and the income derived from it were community property, thus taxable equally to her and her then-husband. The IRS determined the interest was her separate property and taxed the income solely to her. The Tax Court upheld the IRS's determination, finding that because the funds used to acquire the partnership interest were borrowed on Elsie's individual credit, the interest was her separate property under Washington law, even though the husband knew of her involvement in the partnership. The court distinguished this situation from cases where community credit was used, which would have made the partnership interest community property.

**Facts**

Elsie Mathisen (formerly Keil) married Rudolph Keil in 1935 and resided in Washington, a community property state. In 1942, Western Construction Company was formed as a limited partnership where Elsie's father was a general partner and Elsie and her brother were limited partners. Elsie executed a $10,000 note to her father, which was not signed by Rudolph. Elsie then used the borrowed $10,000 to purchase her partnership interest. Later, the partnership was modified, and Elsie and her brother each executed new notes for $6,666.67, again without Rudolph's signature. Elsie and Rudolph filed separate income tax returns for the years in question, reporting the partnership income as community income. Elsie divorced Rudolph in 1946. The IRS determined deficiencies in Elsie's income tax, claiming the partnership income was her separate property.

**Procedural History**

The Commissioner of Internal Revenue determined income tax deficiencies against Elsie Mathisen for 1943 and 1944, based on the income from the Western Construction Company partnership. Elsie contested this determination in the United States Tax Court. The Tax Court upheld the Commissioner's assessment. A previous case, Western Construction Co., 14 T.C. 453, involving the general partners, was cited but deemed not binding on Elsie's individual tax liability.

**Issue(s)**

1. Whether Elsie Mathisen's partnership interest in Western Construction Company

was her separate property or community property under Washington law.

2. Whether the Tax Court's prior decision in the case involving Western Construction Co. barred the Commissioner from assessing the tax deficiency against Elsie under the principles of res judicata or collateral estoppel.

**Holding**

1. No, because the partnership interest was acquired with funds borrowed on Elsie's separate credit, it was her separate property, not community property.

2. No, because the prior case, Western Construction Co., did not involve Elsie's individual tax liability, so res judicata and collateral estoppel did not apply.

**Court's Reasoning**

The court focused on whether the funds used to acquire the partnership interest were community property or Elsie's separate property. Under Washington law, property acquired during marriage is presumed to be community property. However, the court found that the $10,000 loan taken out by Elsie from her father, without Rudolph's signature, was secured by her individual credit, not community credit. The court cited the case of *E.C. Olson*, 10 T.C. 458, where the court held that property purchased with funds borrowed on the separate credit of a spouse was that spouse's separate property. Because Rudolph did not sign the note, and there was no evidence of his consent or ratification of the borrowing sufficient to bind the community, the court concluded that the partnership interest was Elsie's separate property. The Court also determined that Elsie was not a party to the prior case and that her individual tax liability was not litigated there. Therefore, the decision in the *Western Construction Co.* case did not bar the current proceedings under the doctrines of res judicata or collateral estoppel.

**Practical Implications**

This case underscores the importance of how property is acquired in community property states, particularly when separate versus community credit is used. Attorneys should carefully examine loan documents and the involvement (or lack thereof) of both spouses when determining the character of property. This case provides guidance when a spouse uses their separate credit to acquire a partnership interest, which might be separate property, even if the other spouse is aware of the partnership. Practitioners must consider the implications of state community property law on federal tax liability. The distinction between separate and community property is critical in divorce proceedings and for estate planning purposes.