25 T.C. 1045 (1956)

A partner must include their distributive share of partnership income or loss in their gross income for the relevant tax year, regardless of whether they have actually received the income; and, a partner may deduct certain partnership expenses if they are required to pay them out of their own funds per the partnership agreement.

Summary

This case concerns the tax treatment of a partner’s distributive share of partnership income and expenses. The court held that a partner must report their share of partnership income in the year the partnership earns it, regardless of when the partner actually receives the funds. Additionally, the court addressed the deductibility of partnership expenses paid by a partner out of pocket. Klein argued that he could deduct the expenses he paid, which the court allowed because they were in accordance with the amended partnership agreement. The court’s ruling reinforces the principle that partners are taxed on their share of partnership income and losses as they accrue, and that specific partnership agreements determine which expenses a partner can deduct.

Facts

The case involves a dispute between the executors of Nadeau and Klein regarding the distribution of partnership income from the Glider Blade Company. The amended partnership agreement specified how the distributive shares of the partners were to be determined, including a provision for Klein to receive 5% of partnership sales in addition to a share of the net income. Klein claimed he did not receive the 5% of sales until after a settlement with Nadeau’s estate, while the executors contended that Klein’s share should have been included in his gross income for the years the partnership earned it. Klein also sought to deduct unreimbursed travel and entertainment expenses he paid on behalf of the partnership. The court noted that Klein had not been reimbursed for these expenses, which arose from his acquiescence in Nadeau’s position that Klein bear such partnership expenses.

Procedural History

The case began with a dispute over the proper tax treatment of partnership income and expenses. The Commissioner of Internal Revenue assessed a deficiency against Klein. Klein challenged the Commissioner’s determination in the Tax Court.

Issue(s)

1. Whether Klein should have included the allowance for 5% of partnership sales in his gross income for the tax years the income was earned by the partnership, irrespective of when it was actually received by him?

2. Whether Klein was entitled to deduct unreimbursed travel and entertainment expenses paid on behalf of the partnership?

Holding

1. Yes, because the relevant provisions of the Internal Revenue Code require partners to include their distributive share of partnership income in their gross income, regardless of the timing of actual distribution.

2. Yes, because the partnership agreement effectively required Klein to bear these expenses, making them deductible from his individual gross income to the extent they were ordinary and necessary business expenses.

Court’s Reasoning

The court applied Sections 181, 182, and 188 of the Internal Revenue Code of 1939, which collectively mandate that partners report their distributive share of partnership income or loss in their individual tax returns, irrespective of distribution. The court emphasized that the distributive share is determined by the partnership agreement. The court cited prior case law stating that the

