Frances Cokes v. Commissioner of Internal Revenue, 91 T. C. 222 (1988)

A working interest owner in an oil and gas venture is subject to self-employment tax as a partner in a partnership, even if they are not actively involved in the business.

Summary

Frances Cokes inherited a 42. 29% working interest in an oil and gas unit in Indiana. The Tax Court determined that the working interest owners constituted a partnership, making Cokes's income from the venture subject to self-employment tax. The decision hinged on the definition of a partnership under the Internal Revenue Code, which includes joint ventures like this one. Despite Cokes's lack of active participation, the court found her income from the partnership was taxable as self-employment income because the partnership was engaged in a trade or business.

Facts

Frances Cokes inherited a 42. 29% working interest in the Rogers Unit, an oil and gas unit in Posey County, Indiana, from her husband Hubert Cokes. The working interest owners, including Cokes, entered into a unitization agreement and a unit operating agreement with T. W. George as the operator. After George's death, the T. W. George Trust continued to operate the unit. Cokes received income from the unit and paid her share of the expenses. Other working interest owners included H. S. Barger, Amalie Barger, Glantz, and R. W. Kuzmich. The agreements stipulated that the working interest owners were not partners, but the court found otherwise.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Cokes's federal individual income taxes for the years 1980, 1981, and 1982, claiming that her income from the Rogers Unit was subject to self-employment tax. Cokes petitioned the United States Tax Court to dispute these deficiencies. The Tax Court, in a decision entered on August 15, 1988, ruled in favor of the Commissioner, holding that Cokes was a partner in a partnership and liable for self-employment tax on her income from the Rogers Unit.

Issue(s)

1. Whether Frances Cokes's income from her working interest in the Rogers Unit for the years 1980, 1981, and 1982 is subject to self-employment tax under section 1401 of the Internal Revenue Code.

Holding

1. Yes, because Cokes was a member of a partnership, or a joint venture taxable as a partnership, and her distributive share of the partnership's trade or business income

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is subject to self-employment tax under section 1402(a) of the Internal Revenue Code.

Court’s Reasoning

The court relied on the broad definition of a partnership under section 7701(a)(2) of the Internal Revenue Code, which includes joint ventures. The court found that the Rogers Unit working interest owners constituted such a partnership or joint venture. Despite the unit operating agreement’s provision that the owners were not partners, the court held that this did not change the legal status of the arrangement for tax purposes. The court cited *Bentex Oil Corp. v. Commissioner* as precedent, where similar joint ownership of oil and gas leases was treated as a partnership. The court also distinguished *DiPortanova v. United States*, which was not relevant to the partnership question. The court noted that Cokes’s lack of control and passive role did not change her status as a partner for tax purposes.

Practical Implications

This decision clarifies that owners of working interests in oil and gas ventures must consider their tax liability for self-employment taxes, even if they do not actively participate in the business. Practitioners should advise clients that the form of the agreement (e. g. , a clause stating no partnership exists) does not necessarily determine tax treatment. The decision also affects how similar cases involving joint ventures in other industries should be analyzed. Subsequent cases have followed this ruling, reinforcing that income from a working interest in a partnership is subject to self-employment tax unless specific statutory exemptions apply.

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