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CURRENT DEVELOPMENTS IN TAXATION

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WHEN IS A PARTNERSHIP A TAXABLE ASSOCIATION?

In *Western Construction Company,* 14 T. C. No. 55, the Tax Court voted 8 to 7 to recognize a limited partnership, with the seven dissenting judges holding that although a limited partnership was formed exactly in accordance with a Washington state partnership law, certain characteristics rendered the limited partnership an association taxable as a corporation.

The Commissioner contended the partnership was taxable as an association because it continued for ten years, the general partners could admit additional limited partners, the management was vested in the general partners, death did not terminate the partnership so long as a general partner survived, and the partnership interests could be transferred.

The majority followed *Glensder Textile,* 46 BTA 176, but even though a limited partnership is formed strictly in accordance with state law, it may be taxable as an association. This trend should be watched closely.

PROPERTY SETTLEMENT AGREEMENT

The U. S. Supreme Court has granted certiorari in the *Harris* case, a Second Circuit case decided December 22, 1949, which involved the question of whether or not the transfer of property in connection with settling property rights in a divorce matter may be subject to gift tax. The decision in this matter can be very important and may clarify the confusion which followed the lower court's decision in this case.

CLOSED CORPORATION TRANSACTIONS

The decision in *Heat Bath Corporation,* 14 T. C., No. 41, demonstrates the necessity of having all business matters of a closed corporation reduced to writing by competent expert draftsmen whenever the rights of any of the controlling stockholders are involved. This is so because all such transactions will be subjected to the most careful scrutiny by taxing authorities, and any ambiguity or suspicious circumstances will be resolved against the stockholder. Complete minutes and carefully drawn instruments, on the other hand, will prevent unnecessary tax litigation.

SALARY PAID TO EMPLOYEE'S WIDOW

Under Regulation 111, Sec. 29.22 (a) 2, an employer is permitted to deduct a salary paid to the widow of an employee for a reasonable time after his death, and this salary has not been considered taxable income to the widow under I.T. 3329, issued in 1939. Now, the Bureau of Internal Revenue is about to hold that such payments constitute taxable income to the widow, but it has not yet determined whether to revoke the above regulation permitting deduction by the employer.

SALE OF ASSETS RECEIVED ON LIQUIDATION

In *U. S. v. Cumberland Public Service Company*, 70 S. C. 280, a taxpayer was successful in his contention that assets received in liquidation of a corporation were sold by the controlling stockholders and not by the corporation. This decision was reached even though negotiations regarding the sale had been entered into between the purchaser and the shareholders before the liquidation, and even though the directors had considered a sale and had refused to have the corporation enter into a sales contract.

The Commissioner steadfastly has contended that where sale negotiations precede the liquidation, the corporation will be held to have made the sale, even though the sale in fact was made by the shareholders after reecipt of the assets in liquidation. This position, of course, would result in a double tax, one being paid by the corporation on the profit received on the sale, and the other being paid by the shareholder on receipt of the assets in liquidation.

In the *Cumberland* case, however, what may be a new approach by the Supreme Court, namely a reference to the realities of the transaction, appears for the first time in many years. In this case the Commissioner's contention was denied, although the corporation attorney had advised the prospective purchaser that the directors of the corporation had determined that the corporation would not sell the assets in question, but that the two controlling stockholders were willing to enter into such contracts to become operative after the liquidation of the corporation.

The Court pointed out that whatever may be the motive for liquidation, Congress has imposed no tax on a corporation as a penalty for liquidation. Consequently, a corporation may liquidate or dissolve without subjecting itself to a corporate gains tax, even though a primary motive is to avoid the burden of corporate taxation.

The Court having found that the sale was made by the stockholders rather than the corporation after a genuine liquidation and dissolution, the fact that a major motive of the shareholders in liquidating the corporation was to reduce taxes was held to be immaterial. Thus, for the first time in many years "motive to reduce taxes" has been disregarded in a Federal income tax case.