4 T.C. 1001 (1945)

When a partnership agreement stipulates continuation for a fixed period after a partner's death, the deceased partner's share of partnership income up to the date of death is taxable to the decedent, while income earned after death is taxable to the estate.

Summary

The Estate of Hunt Henderson sought to reduce its tax liability by offsetting partnership losses incurred before Henderson's death against partnership income earned after his death. The Tax Court ruled against the estate, holding that partnership income attributable to the decedent's interest up to the date of death is taxable to the decedent, and the income earned after death is taxable to the estate. This decision clarified the application of Section 126 of the Internal Revenue Code regarding income in respect of decedents and the proper allocation of partnership income when a partnership continues after a partner's death according to the partnership agreement.

Facts

Hunt Henderson, a resident of Louisiana, was a partner in a sugar refining business. The partnership agreement stipulated that the firm would continue for one year following the death of any partner. Henderson filed his income tax returns on a cash basis, while the partnership used an accrual basis. Henderson died on June 21, 1939. The partnership incurred losses from January 1 to June 21, 1939, and generated income from June 22 to December 31, 1939.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Henderson's estate. The estate initially contested the assessment. Following the Revenue Act of 1942, the estate sought to apply its provisions retroactively via an election. The Tax Court initially entered a memorandum finding. After a motion for further hearing and reconsideration was filed by the petitioners, the Tax Court issued a supplemental finding of fact and opinion.

Issue(s)

Whether the partnership income distributable to decedent's estate for the period after his death should be reduced by the partnership losses attributable to the decedent's interest therein for the period before his death, given the partnership agreement's provision for continuation after death.

Holding

No, because the partnership losses incurred before Henderson's death are properly

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includible in his final income tax return, while the income earned after his death is taxable to his estate without reduction for those prior losses.

Court’s Reasoning

The court reasoned that under the Revenue Acts prior to 1934, the income of a partnership attributable to the interest of a partner who dies, calculated up to the time of his death, was ordinarily to be included in the taxable income of the deceased partner. The court emphasized that this remains true even if the partnership agreement stipulated that the business would continue after a partner’s death. Citing Louisiana law and partnership principles, the court noted that an agreement to continue the partnership after a partner’s death effectively creates a new partnership. The court stated, “We construe the partnership agreement in this case to be equivalent to an agreement that the business of the partnership shall be carried on for one year after the death of any partner.” Thus, the losses incurred before Henderson’s death were “properly includible in respect of the taxable period in which falls the date of his death.”

Practical Implications

This case provides clarity on how to treat partnership income and losses when a partner dies and the partnership continues. It highlights the importance of the partnership agreement in determining the tax consequences. It confirms that even with a continuation agreement, the decedent’s final tax return must include their share of partnership income or losses up to the date of death. Practitioners should advise clients to carefully draft partnership agreements to clearly define the tax implications of a partner’s death, taking into account relevant state laws governing partnerships. The Henderson case remains relevant for interpreting Section 126 and similar provisions in current tax law.

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