11 T.C. 139 (1948)

Payments made to a deceased partner's widow, pursuant to a partnership agreement providing for such payments out of the surviving partner's income, are excludable from the surviving partner's gross income when the payments are not for the purchase of the deceased partner's interest.

Summary

The petitioner, a surviving partner, sought to exclude from his gross income payments made to his deceased partner's widow, as required by the amended partnership agreement. The Tax Court held that these payments were excludable from the surviving partner's gross income. The court reasoned that the payments were not intended as gratuities or as part payment for the purchase of the deceased partner's interest but were part of a profit-sharing arrangement benefiting the widow as a third-party beneficiary. The court emphasized the importance of examining the intent of the partners as evidenced by the agreement and surrounding circumstances.

Facts

Mayer and the petitioner were partners in a business. They amended their partnership agreement to provide that if one partner died, the surviving partner would make monthly payments to the deceased partner's widow for as long as she lived or the business continued. Upon Mayer's death, the petitioner made these payments to Mayer's widow. The partnership agreement stipulated that the payments were ostensibly for the use of the trade name, whether it was used or not. An independent audit determined the sum to be paid for the deceased partner's interest which the probate court recognized.

Procedural History

The Commissioner of Internal Revenue determined that the payments to the widow were not excludable from the petitioner's gross income. The petitioner appealed to the Tax Court. The Tax Court reviewed the case and ruled in favor of the petitioner, allowing the exclusion.

Issue(s)

Whether payments made by a surviving partner to the deceased partner's widow, according to the terms of their partnership agreement, are excludable from the surviving partner's gross income.

Holding

Yes, because the payments were part of a profit-sharing arrangement intended for the benefit of the widow and were not for the purchase of the deceased partner's

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interest in the business.

Court’s Reasoning

The court emphasized the importance of understanding the intent of the partners when they entered into the agreement. It considered the language of the agreement, surrounding circumstances, and parol testimony. The court found that the payments were not gratuities nor were they intended as payment for the deceased partner’s interest. The court dismissed the argument that payments were for the use of the trade name, stating that “no substantial meaning can be attributed to this provision in light of the agreement as a whole, the purposes sought to be accomplished, and the explanation of the ambiguity by petitioner.” The court cited cases such as *Bull v. United States*, 295 U.S. 247 (1935), and *Charles F. Coates*, 7 T.C. 125 (1946), to support the conclusion that such payments are excludable from the surviving partner’s gross income. The court characterizes the arrangement as something “* * * in the nature of a mutual insurance plan, the disadvantage of which each partner was willing to accept in consideration of a similar commitment for his benefit on the part of all other partners, * * *.” *Charles F. Coates*, 7 T. C. 125, 134.

Practical Implications

This case clarifies that payments to a deceased partner’s widow, mandated by a partnership agreement, can be treated as an exclusion from the surviving partner’s income rather than a deduction, provided they are part of a pre-arranged profit-sharing plan and not a disguised purchase of the deceased’s partnership interest. This distinction is critical for tax planning in partnerships. Attorneys drafting partnership agreements should clearly articulate the intent behind such payments to ensure the desired tax treatment. Later cases may distinguish *Mayer* based on specific wording of the partnership agreement and the factual context of the payments.

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