Gordan v. Commissioner, 12 T.C. 791 (1949)

An unincorporated organization is taxed as a corporation only if it possesses salient characteristics, such as limited liability, centralized management, transferable interests, and continuity of life, that cause it to resemble a corporation more than a partnership.

Summary

The Tax Court addressed whether a theatrical production venture organized by Gordon should be taxed as a corporation or a partnership for the 1944 tax year. The Commissioner argued the venture resembled a corporation due to factors like centralized management and transferable interests. However, the court, emphasizing that the venture lacked corporate characteristics such as limited liability and free transferability of its main asset, the play rights, held that the venture should be taxed as a partnership, reversing the Commissioner's determination.

Facts

Gordon, an individual, secured production rights to a play. He solicited cash advances from associates to finance the production. In exchange for these advances, the associates received a percentage of the play's profits. Gordon retained title to the production rights, which were non-transferable according to his agreement with the authors. The associates were also liable for a percentage of any losses the production might incur.

Procedural History

The Commissioner of Internal Revenue determined that Gordon's theatrical production venture was taxable as a corporation under Section 3797 of the Internal Revenue Code and assessed tax deficiencies at corporate rates. Gordon contested this determination in the Tax Court.

Issue(s)

Whether Gordon's theatrical production venture should be classified and taxed as a corporation, or as a partnership, for federal income tax purposes.

Holding

No, because the venture lacked key corporate characteristics, such as limited liability for the associates and the free transferability of the venture's primary asset (the play's production rights).

Court's Reasoning

The court reasoned that while Section 3797 of the Internal Revenue Code expands the definitions of both "partnership" and "corporation" for tax purposes, the venture did not sufficiently resemble a corporation. Applying the principles from *Morrissey v. Commissioner*, the court considered characteristics such as continuity of life, centralized management, limited liability, and transferability of interests. The associates' advances were treated as loans contingently repayable from profits, and their liability was not limited. They were responsible for a percentage of the venture's losses, without any contractual limits on the amounts they could be required to contribute. The court emphasized that Gordon, as the holder of the non-assignable production rights, could not transfer his interest without terminating the venture, distinguishing his managerial role from that of a corporate officer. The court stated that "[t]he associates did not buy stock with their advances; they made loans, contingently payable out of petitioner's first profits if any. They acquired a right to a percentage of profits by guaranteeing to reimburse Gordon for a like percentage of losses."

Practical Implications

This case clarifies the criteria for distinguishing between partnerships and corporations for tax purposes, particularly for unincorporated organizations. It emphasizes that the substance of the arrangement, rather than its form, is determinative. The case highlights the importance of assessing the presence or absence of key corporate characteristics, such as limited liability, free transferability of interests, continuity of life, and centralized management, in determining the appropriate tax classification. Later cases have used this decision to analyze whether various unincorporated business ventures should be taxed as partnerships or as corporations, focusing on the specific characteristics of each entity.

