14 T.C. 251 (1950)

When a partnership sells some of its assets, the gain or loss is determined at the partnership level, and the character of the gain (capital or ordinary) depends on the nature of the assets sold, not whether the partners intended to sell their individual partnership interests.

Summary

The Hatch family, operating as a partnership (Hatch Chevrolet Co.), sold most of its assets to Chase, retaining a few assets and the partnership name. The Tax Court addressed whether the sale should be treated as a sale of partnership assets, as the Commissioner argued, or as a sale of the individual partners' interests, as the Hatches contended. The court held it was a sale of partnership assets. Thus, the gain attributable to the sale of non-capital assets (like inventory and accounts receivable) was taxable as ordinary income, not capital gains. The court emphasized that the partnership continued to exist after the sale and that the assets were never distributed to the partners individually prior to the sale.

Facts

The Hatch family (Herbert, Juanita, and Herbert Jr.) formed a partnership, Hatch Chevrolet Co., to sell and service automobiles. In 1944, the partnership sold most of its assets to King M. Chase via an "Agreement of Sale" and a "Bill of Sale." The assets included were all of the partnership's assets except the General Motors franchise, two automobiles, a substantial amount of cash, and the partnership name. Chase also assumed some, but not all, of the partnership's liabilities. The check from Chase was made payable to the Hatches as co-partners, and deposited into the partnership account. The assets were not distributed to the individual partners before the sale.

Procedural History

The partnership reported the gain from the sale as a long-term capital gain. The Commissioner recharacterized a portion of the gain as ordinary income, arguing it arose from the sale of non-capital assets. The Hatches petitioned the Tax Court, arguing they had sold their individual partnership interests, which were capital assets.

Issue(s)

Whether the sale of the majority of a partnership's assets should be treated as a sale of partnership assets, resulting in ordinary income for the sale of non-capital assets, or as a sale of the individual partners' partnership interests, resulting in capital gains.

Holding

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No, because the transaction was structured as a sale of assets by the partnership, the partnership continued to exist after the sale, and the assets were never distributed to the partners prior to the sale. The gain is thus recognized at the partnership level, and the character of the gain depends on the nature of the assets sold.

Court's Reasoning

The court emphasized that the Hatches, "as co-partners transacting business under the firm name and style of HatchChevrolet Company," executed the sale agreement and bill of sale. The check for the purchase price was made payable to the partnership, not the individual partners. Critically, the assets sold were not distributed to the partners individually before being sold to Chase. The partnership continued to exist after the sale, holding onto certain assets and liabilities. The sale was reported on the partnership's tax return as a sale of assets. The court stated, "The stipulated facts show that the partners made no effort to sell and Chase did not buy their individual interests in the partnership or any part of those interests, but, on the contrary, the subject of the sale was a part of the partnership assets subject to a part of the partnership liabilities." Therefore, the gain had to be assessed at the partnership level. Some of that gain came from inventory and accounts receivable which were not capital assets and the gains were therefore ordinary income.

Practical Implications

Hatch clarifies that the form of a transaction matters when determining the tax consequences of a sale involving a partnership. If partners intend to sell their partnership interests to achieve capital gains treatment, they must structure the transaction accordingly. A simple sale of partnership assets, even if it comprises most of the partnership's holdings, will be treated as such, with gains or losses determined at the partnership level. This decision underscores the importance of careful planning and documentation in partnership transactions to achieve the desired tax outcomes. Later cases cite *Hatch* for the proposition that intent alone is insufficient; the transaction must reflect that intent. This affects how attorneys advise clients and how transactions are structured.

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