

Frederic A. Whittaker, 17 T.C. 1490 (1952)

When a partner assigns a partnership interest but retains a beneficial interest in a portion of the profits, that retained interest is not considered transferred and remains taxable to the original partner, not the assignee.

Summary

Whittaker acquired his mother-in-law's partnership interest, but she retained a 5% interest in the profits for life. The Tax Court addressed whether Whittaker could deduct the 5% profit share paid to his mother-in-law. The court held that the mother-in-law effectively retained a beneficial interest in that portion of the profits, making it taxable to her, not deductible by Whittaker. This decision hinged on the agreement's terms, which demonstrated her continuing interest and the son's accountability to her. The court viewed the arrangement as akin to a trust, with the son acting as a trustee for the mother's retained interest.

Facts

The taxpayer, Frederic A. Whittaker, acquired his mother-in-law's 20% partnership interest in a business. As part of the agreement, the mother-in-law was to receive 5% of the partnership profits for the remainder of her life. Whittaker sought to deduct the 5% share paid to his mother-in-law from his taxable income. The agreement stipulated that the son was to be accountable to the mother for the 5% interest.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Whittaker's income tax. Whittaker petitioned the Tax Court for a redetermination. The Tax Court reviewed the case, focusing on the interpretation of the agreement between Whittaker and his mother-in-law.

Issue(s)

1. Whether the 5% share of partnership profits paid to Whittaker's mother-in-law constituted a deductible expense for Whittaker, or whether it represented a retained beneficial interest taxable to the mother-in-law.

Holding

1. No, because the mother-in-law effectively retained a beneficial interest in the 5% of the business profits, and did not transfer that interest when she sold her remaining rights in the firm.

Court's Reasoning

The Tax Court reasoned that the arrangement was effectively a trust, with Whittaker acting as a trustee for his mother-in-law's retained 5% interest. The court emphasized that the mother-in-law retained a beneficial interest in the 5% of the business profits and did not transfer that interest. The court relied on precedent such as *Everett D. Graff*, 40 B. T. A. 920, stating that the transferor