16 T.C. 1056 (1951)

The sale of a partnership interest is generally treated as the sale of a capital asset, but this rule does not apply when the partnership is in a state of liquidation; in such cases, the transaction is viewed as an assignment of the partner's right to receive income, taxable as ordinary income.

Summary

Paul Trousdale, a partner in Housing Construction Co., sought to treat the sale of his partnership interest as a capital gain. The Tax Court determined that the partnership was in liquidation at the time of the sale because it had substantially completed its projects and was not pursuing new business. Trousdale assigned his interest, consisting primarily of accounts receivable, to third parties procured by Overland Housing's president, receiving cash and a promissory note. The court held that the gain from this transaction, exceeding Trousdale's original investment, was ordinary income, not capital gain, because it represented a discounted assignment of the right to receive income from services already rendered.

Facts

Paul Trousdale and Hyatt Dehn formed Housing Construction Company in 1943, each contributing $500 for a 50% interest. The partnership supervised defense housing projects for various construction companies. By early 1945, the partners decided to dissolve their relationship. The partnership had no liabilities, and its assets were $1,000 cash and $274,000 in accounts receivable. Trousdale initially offered to sell his interest to Dehn but, based on tax advice, sought a third-party buyer. Trousdale assigned his interest to three individuals procured by the president of Overland Housing, receiving $112,500 in cash and a promissory note, a discount from the face value of his share. Prior to the assignment, the partnership assigned its rights in future projects to Dehn.

Procedural History

The Commissioner of Internal Revenue determined that the gain from Trousdale's sale of his partnership interest was taxable as ordinary income, not capital gain. Trousdale contested this determination in the Tax Court.

Issue(s)

Whether the gain realized by Trousdale from the assignment of his partnership interest should be taxed as a capital gain or as ordinary income, given that the partnership was allegedly in a state of liquidation.

Holding

No, because the partnership was in a state of liquidation at the time of the

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assignment, and the transaction was essentially an assignment of the right to receive income for services already rendered, taxable as ordinary income.

Court’s Reasoning

The court reasoned that while the sale of a partnership interest is generally a capital transaction, this rule doesn’t apply when the partnership is in liquidation. The court found that Housing Construction Company was in liquidation because it had completed most of its projects and assigned future contracts to Dehn. The court emphasized that the

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