24 T.C. 1141 (1955)

A partnership agreement that provides for the surviving partner to receive the deceased partner's interest in the partnership upon death is a contractual arrangement, not an inheritance, which impacts the determination of the property's basis for tax purposes.

Summary

Rose Wasserman and her husband operated a retail dress store as a partnership. Their agreement stipulated that the surviving partner would inherit the deceased partner's share. Upon her husband's death, Rose claimed the inherited portion's basis should be determined by fair market value under the Internal Revenue Code. The Commissioner of Internal Revenue disagreed, asserting the acquisition was contractual, not testamentary. The Tax Court sided with the Commissioner, ruling that the partnership agreement controlled the transfer, not New Jersey inheritance law, thus affecting the basis calculation for tax purposes. The court emphasized the reciprocal obligations of the partnership agreement, deeming it a binding contract rather than a testamentary disposition.

Facts

Rose and Maurice Wasserman, husband and wife, formed a partnership to operate a retail dress store. The partnership agreement included a survivorship clause: upon either partner's death, the surviving partner would acquire the deceased partner's interest. Maurice died intestate in 1948, leaving Rose as his sole heir. Rose subsequently sold her interest in the business in 1949. The basis of the property sold became the subject of dispute.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Rose Wasserman's income tax. Rose challenged this determination, arguing that the basis of the property should be based on the fair market value at the time of acquisition, as provided under the Internal Revenue Code for inherited property. The case was heard by the United States Tax Court, which ruled in favor of the Commissioner.

Issue(s)

1. Whether Rose Wasserman acquired her deceased husband's interest in the partnership by inheritance under New Jersey law?

Holding

1. No, because Rose Wasserman acquired her deceased husband's interest in the partnership through the partnership agreement, not by inheritance.

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Court’s Reasoning

The court focused on whether the transfer was contractual or testamentary. The court cited the New Jersey case of *Michaels v. Donato*, which distinguished between contracts and wills. The court reasoned that the partnership agreement created a present, enforceable right, unlike a will, which is revocable and operates prospectively. The court emphasized that the partnership agreement’s survivorship clause was a binding contract, and the mutual obligations of the partners constituted sufficient consideration. The court stated, “If the instrument does invest him, in praesenti, with an irrevocable contractual interest in the property, it is not testamentary.” The court found that the partnership agreement was not a testamentary disposition, and that the survivor’s right to the deceased partner’s share was contractual, thus overriding any potential inheritance claims.

Practical Implications

This case highlights the importance of carefully drafting partnership agreements, especially survivorship clauses. Attorneys must advise clients that such clauses can have significant tax implications, determining how the property’s basis is calculated. The case establishes that the form of the agreement (contractual) dictates tax consequences over default inheritance rules. This impacts estate planning, business succession planning, and tax strategies for partners. Later cases follow this distinction; agreements should be reviewed to reflect current tax law. This case provides a precedent for similar factual scenarios, ensuring a partnership agreement will be interpreted as a contract and affect the basis of the inherited property.

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