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Taxation—Federal Income Tax—Interest in Law Partnership as a Capital Asset

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law factor of the mixed issue may be readily separable. In this light it is worth noting that in three of these cases the court was *reversing* the Board to find *for* the claimant; in the fourth (*Martin* v. *Plaut*) the Court of Appeals was faced with an affirmed finding from below so that only questions of law *could* be considered. And it is generally held in compensation that inferential facts are just as "factual" for review purposes as are evidentiary ones, E.g. *Gordon* v. *New York Life Ins. Co.,* 300 N. Y. 652, 90 N. E. 2d 898 (1950) (extreme case).

The bare result of the principal decision is not noteworthy, considering the prior "heart" cases, but the technique or review employed is significant, its express adoption being highlighted by the failure of the court to cite even one precedent for substantive authority. The courts are not thus abdicating their decisive role as regards legal questions; rather they are placing increased reliance on the agency, and properly so, considering the remedial and largely non-political nature of compensation and the record of honest administration achieved by the Board. Objectively considered, the decision means at least that *within* the substantive limits defined by existing case law the Board's conclusion on the "accident" issue will control; very likely it means that the same view will be taken when the Board ventures into uncharted areas *beyond* those limits, a result to be welcomed. The limited review applied here may be a concomitant of the emphasis on casual relation already noted. The decision is not surprising as there has been a growing tendency of the courts to discuss all types of compensation issues in "fact" terms. This case, however, presents the desirable review process in full form, worthy of careful consideration and wide application.

Robert B. Fleming

TAXATION — FEDERAL INCOME TAX — INTEREST IN LAW PARTNERSHIP AS A CAPITAL ASSET

Max Swiren, member of a Chicago law firm, acquired by a series of purchases a 30% interest in the partnership for a net total outlay of some $18,000. In 1944 he valued the interest at about $43,000, of which $35,000 represented his allocable share of unpaid fees, billed and unbilled. Swiren sold his interest that year for $40,000. In filing his income tax return for 1944, on a cash receipt basis, he reported as capital gain the sale price less his investment. The Commissioner of Internal Revenue contended that the amount received was ordinary income. The Tax Court, after allowing taxpayer to recover his capital investment tax-free, held that so much of the remaining consideration as represented unpaid fees was ordinary income. On appeal, the United States Court of Appeals reversed (2-1), holding that the partnership interest was a capital asset and the gain a capital gain. *Swiren* v. *Commissioner,* 183 F. 2d 656 (7th Cir. July 1950), *cert. denied* 340 U. S. 912, 71 S. Ct. 293 (Jan. 1951).

Here, for the first time, an interest in a professional partnership was held to be a capital asset for income tax purposes. There are conflicting views as to the manner in which partnerships are treated: whether to treat them as an entity separate from their members, or as a joint ownership by the member partners in all of the firm's assets. If a partnership is to be treated as an entity, then a partnership interest can be treated as a capital asset within the definition of § 117 of the Internal Revenue Code, and any gain or loss realized upon its sale is to be characterized as a capital gain or loss. If it is to be treated as a joint ownership, then upon the sale of a partnership interest an interest is sold in each and every asset of the partnership in which event the sale of a partnership interest should result in the same tax treatment as the sale of a sole proprietorship. See *Williams* v. *McGowan,* 132 F. 2d 570 (2d Cir. 1945). Thus each asset of the partnership would have to be classified as to whether it was a capital asset or not and if a capital asset its holding period determined; in addition, the cost basis of each would have to be computed, together with the portion of the total purchase price allocable to it. The bookkeeping problems would be great in any case, and in many partnerships almost insuperable.

The Internal Revenue Code does not limit itself to a single theory of law in its treatment of partnerships. See Brooks, *The Strange Nature of the Partnership Under the Income Tax Law,* 5 TAX L. REV. 35 (1949). The partnership is treated as an entity without regard to its owners in its business operations, but once the partnership casts its accounts and determines the profit or loss for the particular accounting period, then the individual partners—not the partnership—are taxed on their respective distributive shares, whether or not the profits have been distributed. It is in large measure due to this dual concept of a partnership, as a separate entity for some purposes and a joint ownership for others, that tax problems as in the instant case have arisen.

Swiren v. *Commissioner,* the principal case, follows a line of cases in the Tax Court and the Courts of Appeals holding that, for purposes of the federal income tax laws at least, a sale of a partnership interest is a sale of an interest in a separate entity and that such interest is a capital asset. These decisions all dealt with trading partnerships. Unnecessary complications in this field arose because of the inconsistent positions taken by the Commissioner in his attempts to protect the revenue. Thus, when a claim was made that the sale of a partnership interest resulted in a capital gain rather than an ordinary one, the Commissioner contended that such income was ordinary and thus taxable in full. *H. R. Smith* v. *Commissioner,* 10 T. C. 398, *aff'd,* 173 F. 2d 470 (5th Cir. 1949), *cert. denied,* 338 U. S. 818; *United States* v. *Landreth,* 164 F. 2d 340 (5th Cir. 1947); *Commissioner* v. *Shapiro,* 125 F. 2d 532 (6th Cir. 1942). But where the sale resulted in a loss, the Commissioner switched his position arguing that the loss was a capital loss, instead of ordinary; he was as success-

ful in this latter argument as he was unsuccessful in the former. *McClellan* v. *Commissioner,* 117 F. 2d 988 (2d Cir. 1941); *Stilgenbauer* v. *United States,* 115 F. 2d 283 (9th Cir. 1940); *Estate of Lowenstein,* 12 T. C. 694 (1949). At the present time, then, the courts recognize a partnership as something separate and distinct from the members, and an interest therein as a capital asset within the definition of § 117 of the Code. Thus it readily follows that a sale of that interest constitutes the sale of a capital asset and that the holding period is measured from the date of acquisition of the partnership interest and not from the time when the partnership assets were acquired. *Commissioner* v. *Lehman,* 165 F. 2d 383 (2d Cir. 1948), *cert. denied,* 334 U. S. 819.

Finally, on May 15, 1950, the General Counsel of the Bureau of Internal Revenue, confronted by these consistent decisions, issued G. C. M. 26379, holding that the sale of a partnership interest should be treated as the sale of a capital asset. He was careful, however, to exclude sales in "form and appearance" only, where the "substance" of the transaction was a distribution of past earnings. He seized upon the distinction declared by the courts in the few cases dealing with professional partnerships. *Hervering* v. *Smith,* 90 F. 2d 590 (2d Cir. 1937); *McAfee* v. *Commissioner,* 9 T. C. 720 (1947); cf. *Doyle* v. *Commissioner,* 102 F. 2d 86 (4th Cir. 1939), (dealing with the sale of an interest in a single fee). In those cases, emphasis was laid on the underlying assets of the partnerships, the bulk of which, in the case of a professional partnership, must of necessity consist of uncollected fees. The courts reasoned that since these fees would eventually have become ordinary income, any payments made for giving up an interest in them represented the partner's share of past earnings, and thus ordinary income. See *McClellan* v. *Commissioner,* 117 F. 2d 998 (2d Cir. 1941).

Valid arguments may exist for the treatment of every sale of a partnership interest as giving rise to ordinary income. However, in view of the frequent holdings that an interest in some partnerships is a capital asset, there can be no valid reason for denying such treatment to one type of partnership and allowing it to another. If a partnership interest is something separate, it has that status regardless of the underlying assets comprising the partnership. The further distinction that what the retiring partner receives in a professional parnership is a share of past earnings should not exist. Receivables and cash make up a part of the assets of a trading partnership; yet in cases dealing with sales of interests in such partnerships, the courts have never attempted to segregate such assets. See *H. R. Smith,* (10 T. C. 398) *supra,* where cash, notes and accounts receivable constituted approximately 42% of the total assets. In the decision, this fact was not even considered by the Tax Court.

When the appellate courts, despite the Commissioner's opposition, declared

that the sale of a trading partnership interest was the sale of a capital asset, the Commissioner frequently petitioned the Supreme Court for certiorari in order to get a final adjudication on the subject. Certiorari was denied each time. This consistent refusal has been construed to signify that the Supreme Court refuses to disturb the lower court decisions. See *United States* v. *Shapiro,* 178 F. 2d 459, 461 (8th Cir. 1949). The refusal of the Court to grant certiorari in the *Swiren* case could also be viewed in the same light which ,if true, means that the Supreme Court sees no distinction between trading partnerships and professional partnerships. But see Mr. Justice Frankfurter's strong statement that denial of certiorari implies no approval of lower court decisions, *Maryland* v. *Baltimore Radio Show,* 338 U. S. 912, 917-920 (1950).

Since the Commissioner of Internal Revenue may continue to attack the sale of interests in professional partnerships, the form of the transaction may be important. Care should be taken so that all facts point to the sale of an interest, rather than to a termination of the partnership.

Henry Wojcicki

CONFLICT OF LAWS—DEVISE OF FOREIGN REALTY — RENVOI EXPRESSLY ADOPTED

Testator, a naturalized American citizen, died while domiciled in New York, leaving real property in his native Switzerland. His devise of this property was valid by New York internal law, but invalid in part by Swiss internal law, because of compulsory heirship in near relatives. The realty was sold and proceeds transmitted to New York. *Held:* The devise is valid. Decedent Estate Law § 47, in referring the question of validity of a devise to the law of situs, means all of that law, including its principles of conflict of laws. Swiss conflict law would in this case refer validity to the internal law of decedent's nationality. The proceeds are to be distributed as the realty would have been, i.e. by New York internal law. *In re Schneider's Estate,* 96 N. Y. S. 2d 652, *on reargument,* 100 N. Y. S. 2d 371 (Surr. Ct. 1950).

When a forum has decided that some aspect of the case should be dealt with in view of the law of a particular foreign jurisdiction, it may refer to the purely internal, domestic law of that jurisdiction; or, in the interest of uniformity of decision, i.e. to reach the same result which other courts, including the foreign court, would reach, it may refer to all of the law of the foreign jurisdiction, incuding its principles of conflict of laws. If it makes the broader reference, it adopts the so-called "renvoi" theory.

Renvoi has not suffered for lack of interest on the part of legal writers. Those who oppose it focus their arguments upon the difficulty which may be encountered in ascertaining a foreign conflict rule, and upon the possibility that these problems are more theoretical than real, and that, in any event, the to the conflict rule of some other jurisdiction which in turn refers to the conflict rule of the forum, with supposedly endless reference and re-reference. See, e.g., Cormack, *Characterization, Localization and Preliminary Question in the*