



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
ESTATE OF JACK PASCHALL, DECEASED,)
AND OF GENELLE V. PASCHALL)

Appearances:

For Appellant: Norvald T. Ulvestad, Attorney at Law
For Respondent: W. M. Walsh, Assistant Franchise Tax
Commissioner; Burl D. Lack, Franchise
Tax Counsel; Mark Scholtz, Associate
Tax Counsel

O P I N I O N

These appeals are made pursuant to Section 19059 of the Revenue and Taxation Code (formerly Section 20 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner in denying the claims of the-Estate of Jack Paschall, Deceased, for refunds of personal income tax in the amounts of \$1,184.21 and \$26.09 for the taxable periods January 1, 1940, to September 18, 1940, and September 18, -1940, to December 31, 1940, respectively, and in denying the claims of Genelle V. Paschall for refunds of personal income tax in the amounts of \$37.17, \$201.14, \$447.30 and \$413.67 for the taxable years 1940, 1941, 1942 and 1943, respectively.

Jack Paschall died September 18, 1940, leaving his entire estate by will to his widow, Genelle v. Paschall, Until his death Mr. Paschall was a partner in the Paschall-Gist Company, a general insurance agency operated under an agreement entered into on April 1, 1938, between Mr. Paschall, Wooster Gist and June Paschall, the first two being active partners and the latter an inactive one. The firm had originally been started in 1909 as the McCuiston Company, the name being changed to Paschall-Jones Company in 1916. Then, on May 29, 1929, an agreement was drawn up between Mr. Paschall, June Paschall and Mr. Gist under which the latter became a partner on the payment of \$25,000 for a one-sixth interest, and the name of the Company was changed to Paschall-Jones-Gist Company. This continued until the formation of the Paschall-Gist Company partnership.

The agreement for the latter provided that its capital should consist of all assets of "the old co-partnership," i.e., the Paschali-Jones-Gist Company, including the cash reserve account, the accounts receivable and the rights and benefits under some general agency accident and life insurance contracts with the Pacific Mutual Life Insurance Company. It was also provided that

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Mr. Paschall and Mr. Gist were each to own 50% of the partnership assets; that all profits up to \$40,440 were to be shared as follows; 50% by Mr. Paschall, 27% by Mr. Gist, 23% by June Paschall; that all profits in excess of \$40,440 were to be shared 50% by Mr. Paschall and 50% by Mr. Gist; that all "losses or liabilities in excess of the assets" were to be borne equally by Mr. Paschall and Mr. Gist or solely by the survivor of them in the event one should die; and that the management of the business was to be in the hands of Mr. Paschal & and Mr. Gist or solely in the survivor.

The agreement further provided as follows:

"Upon the death of the inactive co-partner her estate or her heirs under her last Will and Testament or under the laws of succession of the State of California, whichever shall be applicable, shall be entitled to receive from the co-partnership her percentage of the profits as herein provided for a period of thirty-six (36) months, provided either or both active co-partners survive her and that period. At the expiration of thirty-six (36) months after the death of the inactive co-partner the per annum profits of the co-partnership up to \$40,440.00 shall be distributable on the basis of sixty-five (65%) percent to Jack Paschal-1 and thirty-five (35%) percent to Wooster Gist.

"Upon the death of an active co-partner the surviving active co-partner shall pay to his estate or to his heirs under his last Will and Testament or under the laws of succession of the State of California, whichever shall be applicable, an amount in cash equaling one-half of the cash reserve of the co-partnership at the time of his death, payable in cash, plus an amount equaling one-third of the accounts receivable of the co-partnership at the time of his death, payable at the rate of Two Hundred (\$200.00) Dollars per month without interest. For a period of thirty-six (36) months following the death of an active co-partner his estate or his heirs under his last Will and Testament or in accordance with the laws of succession of the State of California, whichever shall be applicable, shall be entitled to receive from the co-partnership the same percentage of the profits of the co-partnership which he was entitled to receive at the date of his death: The surviving active co-partner shall have sole control and direction of the policies, business, activities, and management of the co-partnership, and "shall become the sole owner of its capital, good will, and assets, subject only to his obligation to make the payments in this paragraph provided, At the expiration of thirty-six (36) months after the death

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"Of an active co-partner the annual profits of the co-partnership shall be distributable as herein provided on the basis of twenty-three (23%) percent to June Paschall and seventy-seven (77%) percent to the surviving active co-partner up to \$40,440.00, and thereafter one hundred (100%) percent to the surviving active co-partner."

Mr. Paschall's interest in the partnership was appraised for both California inheritance tax and Federal estate tax purposes in the amount of \$53,563.60, this consisting of the following:

One-half capital account (Cash reserve)	\$6,289.90
One-third accounts receivable	2,173.70
Decedent's share of other assets and good will	<u>45,000.00</u>
	\$53,463.60

Pursuant to the partnership agreement, Mr. Gist made payments to the Estate of Jack Paschall and, after distribution therein, to Genelle v. Paschall in the years 1940, 1941, 1942 and 1943 in amounts aggregating \$87,143.48, of which \$6,289.90 represented one-half of the cash reserve, \$2,173.70 one-third of accounts receivable and \$78,679.88 the stipulated percentage of business profits.

Taxes were computed and paid based on the inclusion of the \$78,679.88 in Appellants' gross incomes. Thereafter, claims for refunds were made on the ground that the partnership agreement provided for a sale of decedent's partnership interest to Mr. Gist as of the date of decedent's death, that the value of the interest was the figure of \$53,463.60 fixed for inheritance and estate tax purposes, that that amount was also the basis of the property under Section 9.3(a)(5) of the Personal Income Tax Act (now Section 17746 of the Revenue and Taxation Code), relating to inherited property, that the interest constituted a "capital asset" subject to Section 9.4(a)(b) of the Personal Income Tax Act (now Sections 17711 and 17712 of the Revenue and Taxation Code), and that, therefore, Appellants were liable for taxes only on a percentage of the difference between \$87,143.48 and \$53,463.60, i.e., on a portion of \$33,679.88.

The Commissioner did not accept the sale theory, but concluded that in view of former Section 16(d) of the Personal Income Tax Act, Article 16(d)-1 of the Regulations adopted with respect to that Section and the holding in Helvering v. Enright, 312 U.S. 636, the decedent's share of the partnership's renewable insurance contract commissions, earned before but not payable until after the decedent's death, was accruable as of the date of death in determining decedent's income for his last taxable period. The Commissioner valued the share at \$45,000, the figure at which it was appraised for inheritance and estate tax purposes, but deemed it to be community property and, accordingly, includible only up

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to \$22,500 in decedent's final return of income.

As for the amount in excess of \$22,500, the Commissioner has conceded that \$8,463.60 thereof, the aggregate of the appraisal of the cash reserve and accounts receivable items, represented a recovery of capital and, therefore, was not taxable to Appellants. He also granted that the \$22,500 accrued in the decedent's last return was not further taxable to Appellants, but rather was to be treated as property inherited by Mrs. Paschall. Everything over and above \$8,463.60 plus \$22,500, or \$30,963.60, was, however, in the Commissioner's opinion, income taxable to Appellants on the authority of Bull v. United States, 295 U.S. 247, holding that under a partnership agreement covering the activities of a personal service venture in which there is little or no capital investment or accumulation of tangible property and providing that upon the death of any partner his estate should continue to share in the income of the partnership as would the decedent himself had he survived, post-mortem partnership income distributed to the estate is taxable to it as ordinary income.

We are of the opinion that the position of the Commissioner should be sustained. To prevail, Appellants must establish that the partnership agreement provided for a sale of the interest of Jack Paschall for a consideration which included the \$78,679.88 paid Appellants from the profits of the partnership for the 36 months following his death. We are not convinced, however, that such was the case. The agreement does not use the term "sale" or any word of similar import in providing for the sharing of the partnership profits with the estate or heirs of a deceased partner and any intention to effect a sale must be inferred from the provisions of the agreement generally. While there are some provisions, e.g., those giving the surviving active partner sole control, direction and management of the partnership and vesting in him sole ownership of its capital, good will and assets, subject only to his obligation to make the payments mentioned and denying the estate or heirs any rights, interest or ownership in the partnership, the agreement as a whole does not, we believe, provide for a sale of the character urged by Appellants. It should be observed that the portion of the agreement above quoted provides that the surviving active partner shall pay to estate or heirs of a deceased active partner an amount based on the cash reserve and accounts receivable of the partnership, but that the estate or heirs shall receive from the partnership the same percentage of the profits of the partnership which the decedent was entitled to receive at the date of his death. This distinction as to the party from whom the payments were to be received by the estate or heirs gives support to the view that the consideration for the sale to the survivor, if in fact there was any sale at all, did not include the designated portion of the partnership profits. Furthermore, it should be noted that in the event of the death of the inactive partner, who was entitled to a portion of the partnership profits but who owned no capital interest in the partnership, her estate or heirs were entitled to receive from the partnership her specified portion of the partnership profits for

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a period of 36 months but no payment from the surviving partners based on the cash reserve and accounts receivable of the partnership.

We have concluded, accordingly, that irrespective of whether any sale was intended of the interest of a deceased active partner for a consideration based on the cash reserve and accounts receivable, the percentage payments are not properly to be regarded as consideration for any sale of that interest. We regard the provision for the percentage payments from the partnership to the estate and heir of Jack Paschall as a provision measuring the amount of partnership profits due him as compensation for services rendered to the partnership prior to his death and, accordingly, as ordinary income rather than the purchase price of his interest in the partnership (See Helvering v. Smith, 30 Fed. 2d 590). Our conclusion is based on such authorities as Bull v. United States, 295 U.S. 247, Darcy v. United States, 15 F. Supp. 251, Charles F. Coates, 7 T.C. 125, Richard P. Hallowell, 2nd, 39 B.T.A. 50, Gussie K. Barth, 35 B.T.A. 546, Walter T. Gudeon, 32 B.T.A. 100, although we realize that the factual situations presented therein may differ in some respect from that under consideration. Particularly pertinent in this connection, however, is Charles E. Coates, supra, wherein the fact that the partnership agreement provided that the estate of a deceased partner should continue as a member of the partnership for the period of five years (but have no voice in management) during which the estate was to share in partnership profits, was held not to be controlling. The real question, in the opinion of the Tax Court, was whether under the agreement the estates of the deceased partners were entitled to receive the income of the partnership apportioned to them, not as the proceeds of a sale or liquidation, but as income. Since we do not believe that the percentage of profit payments here in question were made to Appellants as consideration for a sale, the instant case is distinguishable from Pope v. Commissioner, 39 Fed. 2d 420, Benedict v. Price, 38 Fed. 2d 309, Hill v. Commissioner, 38 Fed. 2d 1105, Estate of George R. Nutter, 46 B.T.A. 35, Bravner C. Miller, 35 B.T.A. 487, and W. Frank Carter, 36 B.T.A. 60, cited by Appellants.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 19060 of the Revenue and Taxation Code, that the action of Chas. J. McColgan, Franchise Tax Commissioner, in denying the claims of the Estate of Jack Paschall, Deceased, for refunds of personal income tax in the amounts of \$1,184.21 and \$26.09 for the taxable periods January 1, 1940, to September 18, 1940, and September 18, 1940, to December 31, 1940, respectively, and in denying the claims of Genelle V. Paschall for refunds of personal

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income tax in the amounts of \$37.17, \$201.14, \$447.30 and \$413.67 for the taxable years 1940, 1941, 1942 and 1943, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of September, 1949, by the State Board of Equalization.

George R. Reilly, Chairman
J. H. Quinn, Member
J. L. Seawell, Member
Wm. G. Bonelli, Member

ATTEST. Dixwell L. Pierce, Secretary