53-SBE-014

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the l-latter of the Appeal

of

JOSEPH T. MALOUF

Appearances:

For Appellant: G. Fred Skaff, Attorney at Lae

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 19060 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Joseph T. Malouf for refunds of personal income tax in the amounts of $522.76 and $12.11 for the years 1945 and 1946, respectively, and in the amount of $425.39 for the period from January 1, 1947, to June 30, 1947. By agreement of the parties the appeal was submitted for decision without oral hearing.

Appellant, at the time of his marriage in 1930, was the sole stockholder of Joseph Malouf, Inc., a corporation engaged in the business of manufacturing ladies' apparel, Thereafter his wife, Aneesa Malouf, purchased a part of the stock of the corporation and became a director and vice-president, They dissolved Joseph Malouf, Inc. in 1937, and formed a partnership, Joseph Malouf Company, in which Appellant owned a 72 percent interest and his wife owned a 28% interest.

On January 3, 1944, Appellant and his wife entered into an agreement stating that they and their two children, Jo-Ann Malouf and Donald W. Malouf, were forming a limited pa rtnership. At the time of the agreement the ages of the children were approximately eight and six years, respectively. The agreement stated that Appellant and his wife were contributing $32,000 each, for which they would receive a 32 percent interest and would be general partners, and that the children were each contributing $18,000, for which they would each receive an 18 percent interest, and would be limited partners. It provided that the children were to share in the losses as well as the profits. The 'agreement also stated that Appellant would seek appointment as guardian of the minor children with reference to their interests in the business. Appellant was to manage and control the business.

A gift of the specified capital interest was made to each child and gift taxes were paid thereon. These gifts were unconditional, irrevocable and absolute. Appellant states that his purpose in giving the children interests in the business was to create security for the children. He filed in the Superior Court of the State of California in and for the County of San Mateo petitions to be appointed as guardian of the children, and was so appointed on April 3, 1944. On that same day the limited partnership agreement was signed by Appellant and his wife and by Appellant as guardian of the children. Apparently the assets of the general partnership, Joseph Malouf Company, were then transferred to the limited partnership, Joseph Malouf Company.

For the taxable periods involved herein the limited partnership filed partnership returns reporting each of the children as having an 18 percent share of the partnership profits. The children reported these amounts on their individual returns.

On March 18, 1947, Appellant and his wife organized a corporation entitled Wearpruf Corporation, and on June 30, 1947, the limited partnership, Joseph Malouf Company, was dissolved, On July 1, 1947, a new partnership, Joseph Malouf Investment Company, was formed. This was apparently the successor of a partnership of the same name in which Appellant had had a 90 percent interest and his wife a 10 percent interest; In the new partnership Appellant had a 61 percent interest, his wife a 15 percent interest, and each of the children a 12 percent interest. It appears that after the dissolution of the limited partnership its assets were distributed to Wearpruf Corporation and to Joseph Malouf Investment Company. Thereafter Wearpruf Corporation continued the business of manufacturing ladies' apparel.

On March 30, 1945, Appellant, as guardian of the children, filed in the Superior Court petitions for allowance for expenses of education and maintenance of the children, alleging that the sum of $1,500 per annum would be required for the support, maintenance, and incidental expenses of each child and that Appellant was financially unable to spend said amounts for their education and maintenance. An order authorizing Appellant to expend that amount per annum for the aforesaid purposes for each child was approved by the Court on April 16, 1945. It authorized the payments to commence as of January 1, 1945. Appellant did not exercise his authorization to expend any of these moneys during the years maintenance has no material significance in determining the tax status of the income. At his sole discretion, he could retain profits for use in the business, or make distribution of them to aid in discharging his general family obligations.

We do not agree with Appellant's contention that a limited partnership is entitled to special consideration. Such a partnership will be given effect for tax purposes if it meets the necessary factual requirements, but it "must pass through the mill of scrutiny" the same as any other family partnership; Roughan v. Commissioner, 198 Fed. 2d 253. Furthermore, as stated by the Court, "it can be argued that the very nature of a limited partnership, in that it prohibits the limited partners from engaging in the conduct of the business, makes the taxpayer's case even weaker."

While we may assume that the transfer of capital to the children constituted valid and irrevocable gifts, the mere title in a purported partner of capital acquired by gift is insufficient to establish the validity of a family partnership. Feldman v. Commissioner, 186 Fed. 2d 87. From a careful consideration of all of the evidence bearing on the question, we have concluded that the arrangement between Appellant, his wife, and their two children did not meet the test of a bona-fide partnership for the current conduct of the business.

Appellantrelies heavily on the case of Theodore D. Stern, 15 T.C. 521, in support of his position. In that case the principal stockholder in a corporation transferred some of his stock to four separate trusts, one for his wife and one for each of his three sons, naming himself as trustee of each trust. He then dissolved the corporation and continued the business as a limited partnership in which he was a general partner and the trusts were limited partners. At the time the partnership was formed the eldest son had entered military service, the second son was at college, and the third son was in high school. The wife had rendered valuable services to the business for many years and apparently continued to render those services during the taxable period involved therein. The eldest son was already in the business and the two younger boys had also contributed services to the business for several years.

The trustor's puspose in making the three transfers for the benefit of the boys was to give them an inducement to return to and stay in the business after the war and after their educations had been completed. His principal purpose in making the transfer for the benefit of his wife was to recognize the services which she performed for the business and to provide for her support in case he died, The Tax Court held that there was real intent to carry on the business as partners and recognized the validity of the partnership. In our opinion this case is clearly distinguishable on the facts from the instant appeal and, accordingly, cannot be regarded as authority in the determination herein.

Other cases cited by Appellant, i.e., Thomas v. Juarez, 93 Cal. App. 2d 846; Commissioner v. Culbertson, supra; Arnold v. Green, 186 Fed. 2d 18; Crossley v. Campbell, 184 Fed. 2d 639; Greenberger v. Commissioner, 177 Fed. 2d 990; Trapp V. Jones, 87 Fed. Supp. 415, affirmed on partnership point, 186 Fed. 2d 951; Middlebrook v. Commissioner, 13 T.C. 385, are also distinguishable on the facts.

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 the Franchise Tax Board in denying the claims of Joseph T. Malouf for refunds of personal income tax in the amounts of $522.76 and $12.11 for the years 1945 and 1946, respectively, and in the amount of $425.39 for the period from January 1, 1947, to June 30, 1947, be and the same is hereby sustained.

-Done at Sacramento, California, this 21st day of July, 1953, by the State Board of Equalization,

Wm. G. Bonelli, Chairman

J. H. Quinn, Member

Geo. R. Reilly, Member

Paul R. Leake, Member

______, Member

ATTEST: Dixwell L. Pierce, Secretary