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Taxation—Limited Partnership—Taxable as a Partnership or as a Corporation

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its existence, one line of cases holds that "order" refers to the intangible agreement. *Wagner-White Co. v. Holland Co-op Assn.*, 222 Mich. 58, 192 N.W. 552 (1923). The other line of cases holds that "order" refers to the writing. In *Kahn v. Schoen Silk Corp.*, 147 Md. 516, 128 Atl. 359 (1925), the seller's agent took an order for goods which the buyer did not sign. Later, the buyer wrote requesting partial cancellation of the order. The seller refused to cancel, wherefore the buyer wrote, "We are compelled to cancel our entire order." The court held that the letter incorporated the written "order" by reference. In *Louisville Asphalt Varnish Co. v. Lorick*, 29 S.C. 533, 8 S.E. 8 (1888), the defendant wrote, "Don't ship paint ordered through your salesman. We have concluded not to handle it." This was held to incorporate the unsigned written order. In *Knobel & Bloom v. Cortell-Markson Co.*, 122 Me. 511, 120 Atl. 721 (1923), the word "order" in "Please cancel the order given your representative, . . ." was found as a fact to refer to the written unsigned order. *Morris Furniture Co. v. Braverman*, 230 N.E. 346, 210 Iowa 946 (1930), held the word "order" in "Will you please hold our order of Sept. 17, until further notice?" referred to the writing.

Jones-Scott Co. v. Ellensburg Milling Co., 108 Wash. 73, 183 Pac. 113 (1919), the Washington case most nearly in point, held that a sufficient memorandum arose from the exchange of correspondence concerning a sale of wheat. Plaintiff had written two letters to defendant in which the terms of the sale had been set forth. Defendant's second reply letter concluded, "If you will give me time I will take the wheat bought from you in August." The Court said, "We think there can be no doubt that the letter refers to the contract mentioned . . ." by the plaintiff in its letters. It appears that the reference in the principal case is as direct a reference to the unsigned written contract as is the reference in the *Jones-Scott* case.

In view of the Court's admission that the use of the word "order" is a question of interpretation, it seems that "order" ought to be construed as a reference to the written "order" rather than a reference to the intangible order. The facts of this case do not present the slightest suggestion that fraud is being practiced by *P;* yet, the holding in the case permits the buyer to breach his contract and to use the statute of frauds as a shield to avoid liability to the seller. The courts have consistently said that they will not allow the defense of the statute of frauds when in so doing it becomes an instrument of fraud.

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Taxation — Limited Partnership — Taxable as a Partnership or as a Corporation. *A, B* and *C,* brothers, having for years operated their business as a general partnership and later as a corporation, formed a limited partnership under the Washington Limited Partnership Act of 1869, RCW 25.12.010 *et seq.* [RRS § 9966 *et seq.*], with themselves as general partners and their ten adult children as the limited partners. The articles of co-partnership provided: the management was to be vested in the general partners; upon the death or retirement of a general or limited partner, the remaining general partners were to have the right to continue the business; the interest of a limited partner was to be transferable only with the approval of the general partners; and the general partners were to have the right to admit additional limited partners upon the same footing as the original ones. The Commissioner of Internal Revenue contended that the enterprise constituted an "association" within the meaning of the Internal Revenue Code and was therefore taxable as a corporation. *Held:* Petitioner does not bear such a resemblance to an association or operate effectively as such to justify inclusion of it in that category for tax purposes. *Western Construction Co. v. CIR,* 14 T. C. 453, *Non-acquiesced,* 1950-2 CUM. BULL. 6, *aff'd without opinion,* 191 F. 2d 401 (C.C.A. 9th 1951).

The limited partnership, a hybrid between a corporation and a general partnership, has attracted few businessmen. When adopted, it was been attacked by the Commissioner as being, for tax purposes, a corporation. INTERNAL REVENUE CODE, § 3797 (a) (3) provides, "The term 'corporation' includes associations. . . ." Treas. Reg. 111, § 29.3797-5 (1942) asserts, "A limited partnership is classified for the purposes of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation." This note will discuss the characteristics of an association dealt with by the regulations and the decisions to determine what effect they have had in answering the question posed in the instant case.

The United States Supreme Court has pointed out six features indicative of an association: (1) sustained operation of the business for profit; (2) holding of title to property in the name of the business entity; (3) transferability of interests; (4) continuity of enterprise uninterrupted by death, insanity, or retirement of an owner; (5) centralized control and management in a representative capacity; and, (6) limited liability. *Morrissey v. CIR,* 296 U.S. 344 (1935) (business trust). Neither *Morrissey* nor the limited partnership cases have emphasized any single feature, but have considered all facets of the enterprise in determining its nature for tax purposes. Subsequent to *Morrissey,* the courts have held that not all of the above elements need be present for association status. *Pennsylvania Co., etc. v. U.S.,* 138 F. 2d 869 (C.C.A. 9th 1943) (trust).

In determining whether the business is an association, the courts, in not only the limited partnership cases, but other cases as well, have largely ignored the *Morrissey* requirements that the business must be one conducted for profit and that title to the property must be held in the entity. While the former element has always been implicitly present, the absence of the latter has not prevented the courts' finding association status. *CIR v. Fortney Oil Co., etc.,* 125 F. 2d 995 (C.C.A. 6th 1943) (oil leases).

A controlling factor in determining the nature of the business for tax purposes is the fluidity of ownership. Under the Uniform Limited Partnership Act, the interest of a limited partner is assignable without interrupting the enterprise, and the assignor may, under certain conditions, make this assignee a substituted limited partner. RCW 25.08.190 [REM. SUPP. 1945 § 9975-19]. The Tax Court has held without exception that though similar to the rights of a stockholder this is not determinative of association status since the limited partner has the power to transfer his interest without giving his assignee the rights of a substituted limited partner. *Glensder Textile Co. v. CIR,* 46 B.T.A. 176 (1946); *Taywal, Ltd. v. CIR,* 1942 P-H BTA-TC Memo. Decisions ¶ 42421. The merits of this argument are debatable since the owner of corporation stock has the same power to limit the rights of his transferee. An influencing factor in the decision of both of these cases was the absence of any evidence of ownership in the partnership other than the articles of co-partnership, the importance being that the parties did not contemplate a convenient transferability of their partnership interests such as is usually sought in corporate ownership. While the instant case accords with the prior decisions, the provisions of the contract here involved which required "approval of the General Partners" for the transfer of a limited partner's interest present a more persuasive argument for partnership status.

Continuity of enterprise uninterrupted by the death, insanity or retirement of an owner is a prominent indicium of a corporation. *Morrissey v. CIR, supra;* Treas. Reg. 111, § 29.3797-5 (1942). Under the Uniform Limited Partnership Act, such incapacity

of a general partner will *ipso facto* dissolve the partnership unless the general partners continue the business under a right reserved in the certificate or with the consent of all the remaining members. RCW 25.08.200 [REM. SUPP. 1945 § 9975-20]. In the instant case, the general partners had reserved such a right. But, as the court said in the *Glensder* case, this is only a "contingent continuity," a continuity operative only upon the exercise of a reserved right or with the consent of all the members. This is not the automatic continuity of existence that is incident to a corporation. *Accord, Taywal, Ltd. v. CIR, supra.* A contrary result has been reached under the corresponding Ohio statute where the business continues despite the death or bankruptcy of any partner. *Giant Auto Parts, Ltd. v. CIR,* 13 T.C. 307 (1949).

While the limited partnership traditionally possesses centralized control and management, the management does not act purely in a representative capacity. *Glensder Textile Co. v. CIR, supra.* Under the Uniform Limited Partnership Act, RCW 25.08.090 [REM. SUPP. 1945 § 9975-9], and the facts of the instant case, the general partners are not subject to domination by the limited partners in the same way that the directors of a corporation are controlled by the stockholders. However, "if . . . the general partners [are] not men with substantial assets risked in the business, but [are] mere dummies without real means acting as the agents of the limited partners, whose investments made possible the business, [and who are empowered to direct its operations], there would be something approaching the corporate form of stockholders and directors." *Glensder Textile Co. v. CIR, supra* (dictum). *Cf. Wabash Oil & Gas Association v. CIR,* 160 F. 2d 658 (C.C.A. 1st 1942).

Possibly the most persuasive argument for association status is the limited liability of the limited partners. The analogy, nevertheless, is not complete because the general partners, the persons in control of the business, do not have limited liability. Even the limited partners will be exposed to general liability if they take ". . . part in the control of the business." RCW 25.08.070 [REM. SUPP. 1945 § 9975-7]. The Ohio limited partnership has been taxed as a corporation because, *inter alia, all* of the partners have limited liability. *Giant Auto Parts, Ltd. v. CIR, supra.* However, where the other association factors have been present, the enterprise has been taxed as a corporation though none of the owners had limited liability. *Bert v. Helvering,* 92 F. 2d 491 (App. D.C. 1937) (syndicate).

Of collateral significance are the orthodox formal indicia of a corporate enterprise. In the instant case, the limited partners held no meetings, elected no officers, received no certificates or other evidence of ownership; nor did the firm have by-laws, keep minute books or have a seal. While the absence of these forms and procedures is not fatal, their presence is persuasive that there is an association. *Morrissey v. CIR, supra.*

In view of the judicial treatment of the cases, it appears that the limited partnership formed under the Uniform Limited Partnership Act or similar statutes should receive more serious consideration from the businessman, as a method of conducting business with some of the advantages of corporations but without being subject to corporate tax rates. However, it is difficult to predict how many association features an enterprise can adopt while retaining, for tax purposes, a partnership status. While the Commissioner has announced non-acquiescence to the instant decision, it is submitted that his arguments have little merit. In any event, before advising his client, the attorney should give serious attention to the reduction in income taxes through the use of the limited partnership; for if a limited partnership similar to the Western Construction Co. is created, the taxpayer may receive a deficiency notice necessitating an appeal to the Tax Court where he should win.

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