1962

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Edward J. Hawkins Jr.
corporation, thereby avoiding a capital gain tax and having more capital available for investment, should not be overlooked. Those advantages should be weighed in the light of the type of investments the corporation will make, the amount of income the shareholders will receive, the income tax they will incur from year to year, and the possible necessity and the effect of larger dividends being paid from time to time. Frequently those advantages of continuing the corporation will be found to be very attractive.

PLANNING FOR TRANSACTIONS TO BE EFFECTED AFTER DEATH

VIII

TRANSACTIONS INVOLVING SALE OF BUSINESS INTEREST

Edward J. Hawkins, Jr.

The preceding articles in this series have dealt with the planning of transactions to be undertaken during the lifetime of our client, the hypothetical Mr. Jones. This article and the succeeding two articles will consider problems and transactions which will arise or take effect at or after Mr. Jones’ death but for which plans should be made while he is yet alive.

In the present article we shall consider plans for selling his interest to others after his death, first on the assumption that the family business is a corporation and then on the assumption that it is a partnership. The next article will consider problems involved in disposing of the business by legacies to relatives rather than by sale, and also the possibility of using legacies to facilitate redemptions of Mr. Jones’ stock by the corporation. The next succeeding article, which will conclude the series, will consider the administrative provisions which a will should contain where the testator owns various kinds of business interests.

PLANNING FOR THE DISPOSAL OF A CORPORATE INTEREST

The "Buy-Sell" Agreement

Agreements to sell stock at death must generally be made with persons already having an interest in the business either as shareholders or as employees. A complete outsider would be unlikely to enter into a binding commitment to purchase a business upon the happening of some unpredictable future event such as the death of Mr. Jones. If, however,
the buyer, Mr. Smith, already has an interest in the business he may not only be interested in buying Mr. Jones' interest at the latter's death, but in securing Mr. Jones' agreement to buy Mr. Smith's stock should Smith be the first to go. This results in the typical buy-sell agreement.¹

The advantages of entering into a buy-sell agreement during Mr. Jones' life are substantial. In several ways it prevents a sacrifice sale of the interest at his death: it assures a market for the stock at a fair price, it helps to assure continuity for the business, and it helps to solve any problems of liquidity which the estate might otherwise have. In addition, a buy-sell agreement, as compared to an immediate sale, can avoid income tax,² and may fix in advance the value of the stock for estate tax purposes. This fixing of the price permits and encourages the prospective purchaser to accumulate the necessary funds. Furthermore an agreement made during life is likely to be fairer to both parties since usually, if they are of approximately the same age, neither can be quite sure who will die first. From the company's viewpoint, such an agreement protects continuity of existence and of management and may even help to reduce exposure to the accumulated earnings tax. Also it can give younger men a great incentive by providing a clear expectation of acquiring the business, and acquiring it free from the control of inactive and inexperienced widows and orphans.

Corporate Redemptions Versus Purchase by Surviving Shareholder

In drafting a buy-sell agreement, the first question is whether the shares of the deceased or retiring shareholder are to be purchased by the surviving shareholder or redeemed by the corporation. Assume that Mr. Jones owns sixty per cent of the stock of the company and Mr. Smith owns forty per cent. If Mr. Jones dies, Mr. Smith's interest will increase to 100 per cent whether he purchases all of Mr. Jones' shares or whether the corporation redeems all of Mr. Jones' shares. However, in a number of other ways the effects of the two routes are quite different, giving some advantages to each.


If Mr. Jones is the sole stockholder of Jones Manufacturing Company he may still wish to enter into an agreement with certain employees of the company to permit them to buy his shares at death. Many of the factors to be discussed in reference to buy-sell agreements with other stockholders will also apply to agreements with employees owning no stock. However, it should be noted that in any case where an employee is given a right to purchase stock in exchange partly for his services the Regulations on "non-restricted stock options" may also be applicable. See Treas. Reg. § 1.421-6(a) (1) (1960) [hereinafter cited as Reg. §], as amended, T.D. 6481, 1960-2 CUM. BULL. 159.

². Under INT. REV. CODE OF 1954, § 1014 [hereinafter cited as CODE §], the basis of the shares in the hands of Mr. Jones' estate will step up (or down) to their fair market value at date of death or optional valuation date.
The advantages of a redemption by the corporation over a sale to the surviving shareholder include the following. (1) An individual shareholder can accumulate the funds necessary to purchase a decedent's stock only out of funds which have been taxed in his personal return, frequently in a high bracket. To the extent that the funds must be taken out of the corporation as dividends rather than as deductible compensation, they are subjected both to the corporate income tax and to the personal income tax. Funds accumulated by the corporation on the other hand are taxed only at the corporate rate, typically lower than that of the chief shareholders. (2) Since it is not known which of the owners will first retire or die, both Mr. Smith and Mr. Jones must accumulate funds for the buy-out of the other. If the corporate redemption route is chosen, on the other hand, the corporation need only accumulate enough funds to buy out the larger interest, since it will not have to buy out both. (The importance of this factor increases as the size of the largest single block decreases, but its importance is sharply decreased if the agreement is funded with insurance.) (3) Funds accumulated by the corporation for stock redemption are available for business purposes in the interim. (4) The accumulation of the funds needed for redemption by the corporation is easier to supervise and control than the accumulation of the necessary funds by the individual shareholders. (5) If a change in the plan is advisable when one of the shareholders dies, it is easier to shift from a corporate redemption arrangement to an inter-shareholder arrangement than vice versa.\(^3\)

The advantages of a sale from one shareholder to another as opposed to a corporate redemption include the following. (1) A stock redemption by the corporation may involve very adverse income tax consequences in certain cases, as will be discussed more fully below.\(^4\) (2) A purchase by the surviving shareholder steps up the tax base of his equity interest in the corporation whereas redemption by the corporation does not. (3) Funds accumulated by the corporation are subject to the claims of its creditors should the business encounter adversity.

Some but not all of the disadvantages of an inter-shareholder agreement can be avoided if both the right and duty to buy the decedent's shares is assigned to a trustee. The trustee can then purchase insurance on the lives of both shareholders, or can hold the funds necessary to purchase any one stock interest, such funds being furnished by the shareholders ratably. This permits supervision and control of the financing of the agreement and minimizes the cross-funding problem. In certain cases it might even be possible to make the accumulated funds available to the corporation on a loan basis.\(^5\)

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3. Cf., e.g., Holsey v. Commissioner, 258 F.2d 865 (3d Cir. 1958).
4. See pp. 337-38 infra.
5. Any use by the corporation of the funds accumulated in the hands of the trustee should
Provisions as to Stock Price

Another drafting problem in a buy-sell agreement is the provision for the price at which the shares are to be redeemed. Either a fixed price or a formula price can be used. A formula is much to be preferred, since a fixed price rapidly becomes obsolete as the business makes or loses money. A formula, on the other hand, leads to numerous accounting and valuation problems, including particularly problems as to the treatment of the intangible assets of the corporation. In addition, it should be noted that where funds are accumulated by the corporation to pay for the stock redemption, such funds will increase the net worth of the corporation and hence, ordinarily, the price which must be paid. However, when the accumulated funds are in readily identifiable form, such as insurance policies, it may be feasible by agreement of the parties to exclude specifically this asset from the computation. But if the accumulation becomes substantial this may prove quite disadvantageous for whichever shareholder becomes the decedent. The payment which he receives for his interest will not reflect the substantial increase in the corporation's net worth resulting from the accumulation which that shareholder has in part and in effect "paid for." If, to avoid this problem, the value of the insurance is included in the formula price, a choice is possible between including simply the cash surrender value at the moment before death or the face amount of insurance collectible the moment after death.

In drafting the provision as to stock value it should also be noted that if certain requirements are met the value so specified will govern the valuation of the stock for estate tax purposes. For this purpose, the agreement and the price must be fair and must constitute a "bona fide arms length business arrangement." Furthermore, the buyer must have a binding option to buy at the specified price when the decedent dies and probably at least a right of first refusal at the specified price during the decedent's lifetime.6

A factor of great importance is that provision should be made for periodic reopening of the agreement, and the client should be cautioned as to the necessity for such review. Even a formula price, to say nothing of a fixed amount price, can become grossly unfair as circumstances change. Furthermore, the tax law is constantly changing and an agreement which is satisfactory when drawn may become a catastrophe by the time the client dies. A possible example of such a "catastrophe" might be those agreements calling for stock redemption which were drawn before the enactment of the 1954 Code's stock attribution provisions.7

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7. CODE § 318.
Since it is possible to draw an agreement binding on widows and orphans which is not binding on the Internal Revenue Service, it is possible for the price received on the redemption of the decedent's stock to be less than the estate tax on the same stock, even aside from any income tax generated by treatment of the redemption as a dividend. In such a case, the effect of the buy-sell agreement is to wipe out the stock interest completely and impose an additional cash liability against the other property which the client thought he was leaving to his family.\(^8\) As estate planning this is inadequate.

Finally, if the price becomes unfair, and this is discovered at a time when it is relatively clear which stockholder will be the first to die or retire, it may be a difficult matter to have the price amended if provision for this was not made in advance. A buy-sell agreement is not merely, or even primarily, a tax device, but a valid and binding business contract.

**Tax Treatment of Redemption of Decedent's Stock**

If the decedent's stock is to be redeemed by the company rather than sold to other shareholders, the redemption will be taxed under the same rules as those applicable to a redemption from a living stockholder,\(^9\) subject to three major differences.

The first peculiarity in redemption from an estate is the added advantage of qualifying for capital gain treatment. For either a living shareholder or the estate of a decedent the capital result is much to be preferred over dividend treatment. This is especially true as to a decedent shareholder since stock held by a decedent will have a basis stepped up to the fair market value at date of death or optional valuation date. Thus, there will be no tax liability at all if the redemption is treated as a sale of the stock, except to the extent that the stock appreciates from the date of death or optional valuation date to the date of redemption.

**The Effect of the Attribution Rules**

A second distinction in the case of redemption from an estate is that the attribution rules become even more difficult to live with. Whether a redemption qualifies for capital gains treatment generally depends upon the extent of the relative reduction in the particular shareholder's stock interest, and frequently the reduction is insufficient because of the "attribution" to the shareholder of the unredeemed stock of other persons. Among

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8. Even if the redemption is treated as a sale of the stock rather than as a dividend and hence results in a capital loss, such loss may nevertheless be nondeductible by virtue of the interpretation given section 267 (that section which deals with transactions between related taxpayers). See Estate of Ruth Hanna, 37 T.C. No. 9 (October 20, 1961), and note 17 infra.  
9. For a discussion of these rules see Kohn, Redemption of Shares, 12 WES. RES. L. REV. 310 (1961).
living persons such attribution is usually by reason of family relationship (as provided in section 318(a)(1)), and this type of attribution is inapplicable in certain cases of complete termination of interest. If the shareholder is a living person, complete termination of interest may thus be achieved even if some of the remaining stock is held by members of his family. This result obtains whenever the conditions of section 302(c)(2) can be satisfied. But where the stock is being redeemed from a decedent shareholder's estate a different statutory scheme must be faced. By virtue of section 318(a)(2)(A), stock held by any of the beneficiaries of an estate is attributed to the estate. This type of attribution applies whether there would otherwise be a complete termination of interest or not. The exemption from attribution provisions of section 302(c)(2) does not apply to the attribution from an estate or trust to its beneficiaries or vice versa. Therefore the redemption of the decedent's stock from his estate will not amount to a complete termination of the estate's interest in the business and may accordingly fail to qualify for capital gains treatment.

The problem created by attributions from the beneficiaries to the estate has been aggravated by two rulings. The first ruling is to the effect that as long as an estate is open, which it would be if it were participating in a stock redemption, the residuary legatees still constitute beneficiaries within the meaning of section 318(a)(2)(A), even though the assets retained in the estate are only sufficient to pay creditors, and it is substantially certain that nothing further will be paid to the legatee in question.

The second ruling which complicates the problem is to the effect that section 302(c)(2), even as to family attribution, relates only to the last step of the attribution. That is, if A is the wife of B and B is a beneficiary of C's estate, A's stock will be attributed to the estate even though, had the redemption been from B himself, A's stock would not have been attributed to him because of section 302(c)(2).

The Effect of Section 303

A third distinction between redemption from an estate and redemption from a living stockholder is the availability to an estate of section 303. Under this section redemptions are treated as capital transactions

10. Id. at 315.
11. CODE § 302(c)(2)(A).
12. Rev. Rul. 60-18, 1960-1 CUM. BULL. 145. Under this ruling and Regulation section 1.318-3(a)(1955) attribution to and from a specific legatee may terminate before the estate is closed.
to the extent that the price paid for the stock does not exceed the sum of the state and federal death taxes plus the amount of funeral and administration expenses.\textsuperscript{15} The section applies, however, only where stock in the corporation (or stock in two or more seventy-five per cent owned corporations) constitutes either thirty-five per cent of the decedent's gross estate or fifty per cent of his taxable estate, and where the redemption takes place before the expiration of ninety days from the end of the period of limitations for the assessment of federal estate taxes.

The possibility of using section 303 is an important factor to consider in planning the estate of any business owner such as Mr. Jones. If its use is possible, all choices between gifts of stock and gifts of property other than stock must be made with an eye to the effect of the gift in enabling Mr. Jones' estate to meet the percentage requirements of the section.

In planning for the use of section 303 a number of technical points should also be born in mind. For example, the redemption need not be from the estate. Provided that the stock was included in the decedent's gross estate for federal estate tax purposes, it may be redeemed from whoever owns it during the period in question, for example, the donee of a gift in contemplation of death or a relative to whom the stock was distributed from the estate in compliance with a specific legacy. This means that it is necessary to consider any redemptions that are likely to be made from beneficiaries of the decedent. The protection of section 303 is applied on a first-come-first-served basis, and redemption from others who have received the decedent's stock may exhaust the shelter of section 303 before the estate's own stock is reached.\textsuperscript{16}

A further set of problems relates to the effect of stock valuation on section 303. Because section 303 applies only when the stock constitutes a certain percentage of the estate, the valuation provided in a buy-sell agreement may control whether or not section 303 will apply at all to

\textsuperscript{15} The amount received from the redemption need not be used to pay the items listed. Also, provided that the administration expenses were allowable as estate tax deductions, they may be included in the computation even though in fact they were deducted on the estate's income tax return. Rev. Rul. 56-449, 1956-2 CUM. BULL. 180.

\textsuperscript{16} A qualification of the above rule is that section 303 does not follow stock into the hands of a vendee, or a donee of a beneficiary of the estate, or of the beneficiary of a "specific monetary bequest." Reg. § 1.303-2(f) (1955). This again raises a planning problem. If for any reason it is preferable to distribute the stock to the decedent's widow and redeem from her rather than from the estate, is it advisable to avoid the use of a marital deduction formula using the word "amount"? Where the widow receives the stock as part of a fraction of the estate which rises and falls with fluctuations in the value of the estate, she is clearly covered by section 303. If, however, she is entitled to an amount which does not fluctuate but is no greater and no less than the marital deduction regardless of fluctuations in the value of the estate after the date of death or the optional valuation date, Revenue Ruling 56-270, 1956-1 CUM. BULL. 325 holds that the satisfaction of the bequest is a taxable transaction giving rise to gain or loss, and hence it may be a transaction which cuts off the protection of section 303. See, however, Reg. § 1.663(a)-(b)(1) (1956).
the decedent's estate. This in some cases simply means that the buy-sell agreement price formula should take this factor into account. In other cases it may mean that any advance specification of price may be disadvantageous, and that perhaps the estate will wish to seek a higher value than would have been agreed to in advance. Furthermore, where the stock is closely held and the redemption is in effect under the control of the beneficiaries of the estate, the absence of a prearranged price would appear to leave room for the use of artificial prices.

For a clear example of the artificial price problem, assume an estate owning 100 per cent of the stock of the corporation, divided into 10,000 shares. The estate tax return, using values at date of death, reported the stock at $50 per share, for a total value in the estate of $500,000. Death taxes and administration expenses were $100,000. The company then plans a redemption two or three years after the date of death. It is clear that the company is going to pay $100,000 to the estate and therefore the question becomes: How many shares should the estate give the company? From a business viewpoint the answer is immaterial, since the estate will still own 100 per cent regardless of the number of shares redeemed. From a tax viewpoint, however, the number of shares redeemed would seem to determine the basis to be applied against the $100,000 received. The more shares turned in, therefore, the lower the capital gain or the greater the capital loss to the estate, but the less basis remaining to be handed on to the beneficiaries of the estate. Thus, the parties may be inclined to set the redemption price, and accordingly the number of shares to be turned in, according to these tax considerations and might prefer to be unhampered by prior agreements specifying a price.

The potential complication of an intentional resort to artificial prices by the taxpayer has been matched by the resort to an artificial price by the Commissioner. In a ruling on section 303 it has been held, in effect, that in computing gain or loss to the estate the redemption price per share shall be measured by "the net assets of the corporation applicable to the common stock at the time of the sale," rather than by the price specified by the parties. This ruling has not been tested in court and is completely without statutory authority. However, it was probably intended to be simply a measure of the fair market value of the company's stock. Thus the ruling may be interpreted to mean that the redemption

17. As the result of a recent decision, a serious problem exists as to the deduction of capital losses incurred by an estate upon the sale of the decedent's stock to the corporation. Although section 267 (dealing with transactions between related taxpayers) does not by its terms relate to sales from an estate to a corporation, the stock held by an estate may be deemed to have been sold by the beneficiaries of the estate. In this case section 267 will apply to the transaction. See Estate of Ruth Hanna, 37 T.C. No. 9 (October 20, 1961).
shall be deemed to have been undertaken at the fair market value of the stock at the time of redemption. Such a position is defensible, although probably so far as administrative application, judicial enforcement, and statutory authorization are concerned, it should primarily be regarded as a weapon against sham and deliberately artificial values rather than as authority for the Commissioner to second-guess a bona fide effort of the parties to determine actual fair market value.

The preceding comments, of course, are limited to the tax treatment of the estate or other beneficiary. Whether the corporation also faces accumulated earnings tax problems from a stock redemption program is beyond the scope of this article.

Planning for the Disposal of a Partnership Interest

The discussion so far has assumed that Mr. Jones' business interest consists of stock in a corporation. If, instead, he owns an interest in a partnership, the planning for the disposal of that interest will follow a different line of analysis. It is true that many of the advantages of planning in advance for the disposal of the business interest and of entering into a binding buy-sell agreement apply to partnerships as well as to corporations. Indeed, there may even be more opportunities for advance tax planning in the partnership situation. However, when we move beyond these generalities, we find ourselves dealing with a completely different group of statutory sections which apply only to partnerships.

The partnership sections distinguish three possible routes for disposal of Mr. Jones' interest: liquidation of the entire partnership, sale or exchange of his interest to another individual, and liquidation of his interest by the continuing partnership. The planning process must begin with a choice between these three routes.

Liquidation of the Entire Partnership

Under the Uniform Partnership Act, a partnership is technically ended by the death of one of the partners. However, for tax purposes a partnership is not terminated unless (a) no part of the business continues to be carried on by any of the partners in partnership form, or (b) unless

19. For detailed discussion of this subject, see Herwitz, Stock Redemptions and the Accumulated Earnings Tax, 74 Harv. L. Rev. 866 (1961).
20. Code §§ 701-71. No brief discussion can do more than skim the surface of Subchapter K. For a more complete analysis, see Willis, Handbook of Partnership Taxation (1957). Note also that legislative revision of Subchapter K in the near future is not unlikely.
23. Such a liquidation would be governed by section 736 to the extent applicable and otherwise by sections 731-35. See also section 753.
within a twelve month period there is a sale or exchange of fifty per cent or more of the partnership interest.\textsuperscript{25} The mere transfer of a fifty-one per cent interest from Mr. Jones to his executor would not terminate the partnership since in such a case there would be no "sale or exchange." Nor would there be a termination where Mr. Jones' fifty-one per cent interest was liquidated by the surviving partners since here again there would have been no sale or exchange. In addition, even where termination has been achieved through a sale of Mr. Jones' interest to the surviving partners (either because his interest exceeded fifty per cent of the partnership or because there was only one surviving partner), the tax treatment of the sale would not be determined by the provisions relating to liquidation of a partnership interest but rather by the provisions of section 741 relating to transfers of interest in a partnership.\textsuperscript{28} For these reasons, the liquidation of the entire partnership route must be limited to the liquidation of the partnership by means of a distribution of its assets among the partners, including Mr. Jones' estate. Such a procedure is cumbersome and at best will be available only where the surviving partner or partners do not as a business matter wish to continue the business in partnership form. However, where this course is practicable it may well be advantageous from a tax viewpoint.

A liquidation of the type described will be non-taxable to the partners except to the extent of cash received. Furthermore, the cash received will produce gain (taxable as capital gain) only to the extent that it exceeds the recipient partner's basis for his entire interest.\textsuperscript{27} Such excess over basis is unlikely in the case of the decedent's estate, since the basis of a partnership interest steps up at death. The provisions of section 751, relating to the realization of ordinary income on substantially appreciated inventory and unrealized receivables do not apply where there has been a distribution to a partner of his own proportionate share of such items rather than a distribution of this property in payment for the partner's interest in the partnership.\textsuperscript{28} However, this "section 751 property" does retain a special character in the hands of the distributee partner in that any gain or loss from the subsequent sale of such property by the distributee is considered "gain or loss from the sale of property other than a capital asset."\textsuperscript{29} But where a proportionate share of partnership inventory is held by the estate of a decedent distributee, Congress has indicated\textsuperscript{30} that such property may be increased or decreased in basis in

\textsuperscript{25} \textsc{Code} § 708(b).
\textsuperscript{26} Reg. § 1.741-1(b) (1956).
\textsuperscript{27} \textsc{Code} § 731(a).
\textsuperscript{28} Reg. § 1.751-1(b) (ii) (1956).
\textsuperscript{29} \textsc{Code} § 735(a).
the same manner as any other property owned by the decedent. For this reason sales by the estate of this substantially appreciated inventory interest should produce little if any taxable income. With respect to unrealized receivables held by the decedent distributee's estate, it again may be possible, through proper tax planning, to achieve a complete or partial avoidance of ordinary income tax on such items.\(^{31}\)

**Sale or Exchange of the Partnership Interest**

The second possible route for the disposal of a partnership interest is the sale or exchange of the interest to the surviving partners or to outsiders who are to be admitted to the partnership. This route has several tax and non-tax disadvantages.\(^{32}\) One practical problem encountered where a surviving partner rather than an outside party purchases the partnership interest of the decedent relates to the reallocation of partnership income among the remaining partners. To the extent the partnership income is derived from personal services the rights to such income presumably will be and should be divided among the surviving partners in accordance with their opinion as to the relative value of the services of each. The fact that one surviving partner has paid money to the estate of the decedent partner would presumably not be considered sufficient reason to increase the payor's interest in future income by the full percentage interest of the decedent.

From a tax standpoint, the price received for the partnership interest would be taxed as capital gain to the extent it exceeded the basis of the partnership interest, stepped up to its value at date of death. The gain on that part of the purchase price attributable to the unrealized receivables or substantially appreciated inventory would be taxed as ordinary income.\(^{33}\) However, it would again appear that the basis of the partnership interest would step up at date of death to the extent that it related to the inventory, whether substantially appreciated in value or not, and again at least a possibility exists of the same result as to realized receivables.\(^{34}\) Finally, to the extent that the payment exceeded the value of the identifiable assets and constituted a payment for good will, or simply an agreed bonus in the nature of mutual insurance, capital gain treatment would again appear applicable.\(^{35}\)

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31. See the argument to this effect in WILLIS, HANDBOOK OF PARTNERSHIP TAXATION 392-94 (1957), and in Recommendation 19 (relating to section 753) of the REVISED REPORT ON PARTNERS AND PARTNERSHIPS FROM THE ADVISORY COMMITTEE ON SUBCHAPTER K (December 31, 1957).

32. See the vigorous argument against this route in Griswold & Kidder, Planning for Retirement or Death, 29 U. CIN. L. REV. 1, 7-10 (1960).

33. CODE §§ 741, 751.

34. See notes 30 and 31 supra, and accompanying text.

35. At least two technical problems may be raised by the use of this route. In some circumstances it will cause an undesirable bunching of income. Also, the election which is necessary
Liquidation by the Continuing Partnership

The third route for disposal of a partnership interest is the liquidation of the interest by the continuing partnership. The characteristic of this route is that a large part of the liquidating payment seems at first glance to be taxable as ordinary income to the distributee, to wit, the entire excess of the payment over the price of the partner's interest in partnership assets, plus that part of the price of such assets which relates to unrealized receivables and goodwill. On the other side the surviving partners may reduce their ordinary income payments by the amount which is to be taxed as income to the distributee partner. This benefit will accrue more readily where, as in this case, there has been a liquidation of the retiring partner's interest rather than a purchase of that interest by the continuing partnership.

The ordinary income treatment to both parties of payments under this route may be advantageous if the tax bracket of the party to whom it is taxed is lower than the tax brackets of the survivors from whose returns it is eliminated. However, if desired, the parties can avoid such ordinary income treatment, as to both the decedent's estate and the surviving partners, simply by stating in the partnership agreement that all or part of the payment which would without the agreement constitute ordinary income shall instead constitute payment for goodwill.

The statutory pattern again may permit the elimination of some or all of the tax on the decedent's share of unrealized receivables. A payment under section 736(a) is income in respect of a decedent by virtue of the specific provision to that effect in section 753. However, it may be that the ordinary income attributed to the decedent's estate may be accompanied if the purchaser is to receive a tax benefit corresponding to the tax burden on the seller involves serious mechanical problems. See Griswold & Kidder, Planning for Retirement or Death, 29 U. CINC. L. REV. 1 (1960).

36. This route is governed in part by section 736, which refers to the liquidation of the interest of a retiring partner or a deceased partner. There is no express statement in the Code or Regulations as to whether this section does or does not apply to liquidation of the entire partnership, but the statutory pattern and the normal usage of the language employed would seem to bar such application.

37. Some believe that section 736 applies, or should apply, only to a series of payments over more than one year made in money. See Griswold & Kidder, Planning for Retirement or Death, 29 U. CINC. L. REV. 1 (1960); 2 CASNER, ESTATE PLANNING 1644 (1961). These requirements were contained in Proposed Regulation section 1.736(a) (2), 21 Fed. Reg. 3500 (1956). They are not contained in the statute and were omitted in the final Regulations. Congress may in fact have intended section 736 to cover lump sum payments. S. REP. No. 1622, 83d Cong., 2d Sess. 98 (1954).


39. CODE § 736(b) (2) (B). The figure for goodwill arrived at by the parties will generally be respected if it is in the area of reasonableness. Reg. § 1.736-1(b) (3) (1956). Care must be exercised, if the partnership has elected to make basis adjustments under section 743, lest the same result be reached inadvertently without any agreement. To the extent that the partnership is found to have goodwill, and a basis adjustment for this is made at death in respect to the decedent's interest, ordinary income treatment is again inapplicable under the cited Regulation.
by a capital loss in the same amount. More startling yet is the possibility that, by making the optional basis adjustment and allowing the receivables to be received in the partnership, ordinary income tax to either the decedent's estate or to the surviving partners may be avoided.

CONCLUSION

The above description of the choice of routes which Mr. Jones must make, together with the choices as to optional basis adjustments and as to whether or not a payment for goodwill should be specified, covers only some of the more basic factors to be considered. In addition, problems of income-bunching, choice of taxable year, incorporation of the partnership, and assignability of various kinds of partnership interests may be quite important in any particular case. Substantially more experience with the 1954 Code provisions, together with the probable statutory refinements of these provisions, will be necessary before there will be a generally accepted planning pattern comparable to that which has been developed in the corporate field.

40. See the discussion in WILLIS, HANDBOOK OF PARTNERSHIP TAXATION 392 (1957), which considers this possibility.

41. HEARINGS ON ADVISORY GROUP RECOMMENDATIONS ON SUBCHAPTER C, J, AND K OF THE INTERNAL REVENUE CODE BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 86th Cong., 1st Sess. 81 (1959). It may be that the same result could be achieved under Regulation section 1.736-1 (b) (2) (1956) without waiting for the receivables to be collected. This Regulation excludes from ordinary income, payments for unrealized receivables to the extent of the partnership basis for such receivables, "including any special basis adjustment for them to which such partner is entitled."

42. The liquidation of the partner's interest, route three in the discussion above, may avoid the bunching of income, since the partnership's income from the end of its last complete taxable year to the date of death is not included in the decedent's final return. On the other hand, this may have the effect of transferring income from a joint return to a fiduciary's return. To avoid that result the designation of the partner's widow as successor in interest, in part or in whole, may be advisable. See the discussion of these matters in Griswold & Kidder, Planning for Retirement or Death, 29 U. CINC. L REV. 1, 15-18 (1960).