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Taxation -- A Trust Res as a Member of a Partnership

court's position[17] including Supreme Court decisions,[18] yet the court denies that there is any Supreme Court authority in point.[19] Of those cases cited as being contra to this position, *Pennsylvania R.R. v. St. Louis, Alton & T. H. R.R.*[20] is anomalous in holding that the plaintiff was not a corporation of the second state but only licensed therein, which fact indicates the necessity of examining the corporate history. In such a situation Judge Goodrich, himself, states that there would be no problem.[21] Again, he says that the Supreme Court has not considered the problem since 1912,[22] although, in fact, the Supreme Court denied certiorari in 1936.[23]

The rationale of the court's opposition to the general rules seems to lie in the statement that the plaintiff need only cross over into New York in order to get federal diversity jurisdiction. This appears unnecessary in view of the fact that there is actually only one operating road regardless of the number of charters it possesses.[24] The writer believes this idea is fundamental to the court's decision and indicates its desire to have the majority rule reversed. Judge Kaufman arrived at the same result in New York in 1950.[25] If this case is appealed it will surely be reversed under the great weight of authority unless it and the New York case represent a new trend.

TAXATION—A TRUST RES AS A MEMBER OF A PARTNERSHIP

Plaintiff, member of a partnership, created a trust for the benefit of his son and daughter from a portion of his share of the partnership. The indenture of trust named plaintiff and two others as trustees and provided that, as to the trustees and beneficiaries, a trust and not a partnership was created. The indenture further provided that the trustees should not be personally liable as partners in the firm. The plaintiff seeks a refund of federal income taxes alleging that the trust res created is a valid member of the partnership for federal income tax purposes. *Held*, a trust res cannot be a member of a partnership for federal income tax purposes. *Hanson v. Birmingham*, 92 F. Supp. 33 (N.D. Iowa 1950).

A membership of a partnership at Common Law must meet the following essential requirements: (1) the ability to contract,[1] (2) the assumption

17. *Id.* at 105, n.4.
18. *Ibid.*
19. *Id.* at 107.
20. 118 U.S. 290 (1886).
21. 185 F.2d 104, 107.
22. *Ibid.*
23. Town of Bethel v. Atlantic Coast Line R.R. 81 F.2d 60 (4th Cir. 1936), *cert. denied*, 298 U.S. 682 (1936).
24. 185 F.2d 104, 105.
25. Lucas v. New York Central R.R., 88 F. Supp. 536 (S.D.N.Y. 1950).

1. Kasch v. Comm'r, 63 F.2d 466 (5th Cir. 1933), *cert. denied*, 290 U.S. 644 (1933).

of the fiduciary relationship of principal and agent,[2] and (3) the assumption of unlimited liability.[3] Prior to the enabling act a married woman could not be a valid partner;[4] nor could a bank[5] or a corporation.[6] An executor or administrator may, under certain circumstances,[7] become a partner of a firm in which his decedent was a member. However, if he does so, he becomes personally liable and, in effect, a new partnership is created.[8] The existence of a partnership for tax purposes is commonly tested by the application of the following tests: (1) contribution of capital and/or rendition of valuable services,[9] (2) control of the business,[10] (3) good faith and intent of the grantor,[11] and (4) validity of a partnership under state law.[12]

A trust relationship contains three distinct elements: (1) a trustee, (2) a beneficiary, and (3) a trust res.[13] The trustee possesses no power to bind either the beneficiaries or the trust estate.[14] His contracts are personal ones, binding only upon himself.[15] As a general rule he cannot delegate his duties or contractural powers.[16] Unbridled discretion in this respect usually negatives the existence of a trust.[17] In contrast to the strictly limited powers of the trustee, a partner possesses virtually unlimited ability to bind either the partnership or the other partners. Despite the manifest incompatibility of the two relationships a number of courts have arbitrarily decided that the trustee,[18] and the beneficiaries,[19] and in dicta have intimated that even the trust res[20] could be valid members of a partnership for income tax purposes. These decisions have given rise to a trust-partnership relation unknown to Common Law.

The court, in the instant case, reasoned that since the conception of a trust as a partner is completely foreign to the fundamental definition of a

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2. Schumann-Heink v. Folsom, 328 Ill. 321, 195 N.E. 250 (1927).
3. Francis v. McNeal, 228 U.S. 695 (1913).
4. DeGraum v. Jones, 23 Fla. 83, 6 So. 925 (1887).
5. Merchants' Nat. Bank of Cincinnati v. Wehrmann, 202 U.S. 295 (1906).
6. Kasishki v. Baker, 146 F.2d 113 (10th Cir. 1944), *cert. denied*, 325 U.S. 856 (1945).
7. City Nat. Bank v. Stone, 131 Mich. 588, 92 N.W. 99 (1902) (provided for by decedent's will); McGrath v. Cowen, 57 Ohio St. 385, 49 N.E. 338 (1898) (contract between surviving partner and administratrix).
8. *Ibid.*
9. Comm'r v. Towers, 327 U.S. 280 (1946).
10. Earp v. Jones, 131 F.2d 292 (10th Cir. 1942), *cert. denied*, 318 U.S. 764 (1943).
11. Comm'r v. Culbertson, 337 U.S. 733 (1949).
12. Doll v. Comm'r, 149 F.2d 239 (8th Cir. 1945), *cert. denied*, 326 U.S. 725 (1945).
13. RESTATEMENT, TRUSTS § 2 (1935).
14. Taylor v. Davis, 110 U.S. 330 (1883), cited with approval in Greenough v. Tax Assessors, 331 U.S. 486, 494 (1947).
15. *Ibid.*
16. 2 SCOTT, TRUSTS §§ 175, 176 (1939).
17. Ponzelino v. Ponzelino, 238 Iowa 201, 26 N. W.2d 330 (1947).
18. Sherer v. Comm'r, 3 T. C. 776 (1944); Oakley v. Comm'r, 24 B.T.A. 1082 (1931).
19. Rose v. Comm'r, 65 F.2d 616 (6th Cir. 1933).
20. *See* Thompson v. Riggs, 175 F.2d 81, 82 (8th Cir. 1949).

partnership, it ought not be so considered for income tax purposes. Furthermore, the indenture in the present case does not conform to the rules of partnership in the state of Iowa.[21] Many courts hold validity under state law controlling although the Supreme Court has not as yet ruled on this particular point.[22] Much of the present conflict is attributed to the failure on the part of the various courts to properly analyze existing federal statutes. The court here does not feel that either the legislature or the Supreme Court ever intended to create a partnership for income tax purposes where none existed either under state law or under the Common Law.

At the present time there seems to be no hard and fast rule for determining whether a trust-partnership will be upheld for tax purposes or not. The cases are conflicting and as yet the Supreme Court has failed to hand down a definite ruling on this particular point. The instant case presents a well reasoned and exhaustive opinion which, if followed, will go far in clearing up the present trust-partnership controversy.

TAXATION — EQUAL PROTECTION — DISCRIMINATION AGAINST FOREIGN CORPORATIONS

Under a Michigan statute[1] a tax was assessed against plaintiff, an Ohio corporation doing business in Michigan as a foreign corporation, on intangible assets that were acquired from the doing of business in Michigan and removed from the state before the statute was passed, but had neither been physically present nor invested in Michigan since. The statute contained an exemption for intangible property owned by a domiciliary of Michigan that was situated in a foreign state and taxed by that state. Plaintiff owned and operated some mines in Michigan, but its executive offices and other assets were situated in other states. Plaintiff paid the tax under protest and sued for a refund. *Held*, for Plaintiff on grounds that such an application of the statute is unconstitutional under the Fourteenth Amendment to the Constitution. *Cleveland-Cliffs Iron Co. v. Michigan*, 45 N.W.2d 46 (Mich. 1950).

A state is not bound to admit foreign corporations,[2] and it won't be considered as a denial of "equal protection"[3] if the state does refuse to admit them[4] or puts onerous conditions on admission.[5] But once a foreign corporation has been domesticated, having fulfilled all conditions precedent

21. Hanson v. Birmingham, 92 F. Supp. 33 (N.D. Iowa 1950).
22. Zander v. Comm'r, 173 F.2d 624 (5th Cir. 1949); Comm'r v. Tenny, 120 F.2d 421 (1st Cir. 1941).

1. MICH. STAT. ANN. §§ 7.556(1), 7.556(12).
2. Paul v. Virginia, 8 Wall 168 (U.S. 1868).
3. U.S. CONST. AMEND. XIV, § 1.
4. Paul v. Virginia, *supra* note 2.
5. Lincoln Nat. Life Ins. Co. v. Read, 325 U.S. 673 (1945); Montgomery Ward & Co. v. Warner, 312 Mich. 117, 20 N.W.2d 127 (1945).