Characterization of Partnership Property Upon the Death of One of the Partners

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INTRODUCTION

The purpose of this comment is to highlight some of the problems concerning the characterization of partnership property upon the death of a partner and the dissolution and liquidation of the partnership.

The characterization of partnership property is important in order to determine whether a surviving spouse will be entitled to dower in the interest owned by the deceased husband and to determine those persons who will be entitled to the decedent's interest in the partnership property.

The problem of what constitutes partnership property, while pertinent to the above question, is outside the scope of this comment. Rather, this comment will concentrate on a survey of the divergent views, and an interpretation of Florida's position in this controversy. An attempt will also be made to illustrate some of the practical aspects which the Florida practitioner will encounter if the Florida legislature were to adopt the Uniform Partnership Act.

Much of the confusion in this area of the law has resulted from the basic conflict as to whether the partnership constitutes an entity or an aggregate. The entity theory provides that a partner owns a share in the business organization, which, like shares of stock in a corporation, is personal property. On the other hand, the aggregate theory does not recognize the partnership as a legal entity capable of holding title to property. As the aggregate of individuals own partnership assets as tenants in common, the title to such property descends as any other realty that the decedent might have owned.

ENGLISH VIEW

It is a general principle of partnership law that, in the absence of an agreement to the contrary, the death of one partner will cause the dissolution of the partnership.
Prior to 1890, the English decisions were in conflict as to whether partnership realty was converted into personalty for all purposes, or whether it retained its true character as realty upon the dissolution of the partnership. In the leading case of Darby v. Darby, the court carefully reviewed the earlier cases and concluded that partnership property was to be regarded in equity as converted into personalty. Under this theory, the conversion is not only for the purpose of discharging the partnership debts, but retains that character for descent and distribution of the deceased partner's remaining interest.

The doctrine of "out and out" conversion is said to have developed from the peculiar English law of primogeniture, which excluded all but the eldest male child from inheriting the property of the deceased father. This doctrine also sought to remedy the hardship created by the rule exempting real property, in the hands of the heir, from all but the specialty debts of the deceased.

According to one authority, the English rule seems to be based upon the principle "that a share of a partner is nothing more than his proportion of the partnership assets after they have been turned into money and applied in liquidation of the partnership debts . . . ."

With the enactment of the Partnership Act of 1890, all doubt which had existed in regard to this problem was removed. In effect, the act provided for the "out and out" conversion of all real property held by the partnership into personalty. However, it was recognized that the rule of "out and out" conversion would apply only in the absence of any intention to the contrary, either express or implied, between the partners.

Proponents of the English rule have claimed that this theory provides for simplicity of administration in the winding up of the partnership. It has also been stated that the English view allows for a closer adherence to the intentions of the partners.

Therefore, it is well established that the rule in England provides

8. Ibid.
10. Partnership Act, 1890, 53 & 54 Vict. c. 39 § 22. "Where land or any heritable interest therein has become partnership property, it shall, unless the contrary intention appears, be treated as between the partners (including the representatives of the deceased partners) and also as between the heirs of a deceased partner and his executors, or administrators, as personal or movable and not as real or heritable." (Emphasis added.)
11. Ibid.
that on the death of a partner his share in the partnership property is to be treated as personalty, and not as realty, in the winding up of partnership affairs and as to those who claim the interest of the deceased partner.

**American Rule**

The majority of American jurisdictions have failed to adopt the strict English rule of "out and out" conversion. Instead, in the absence of a statute to the contrary they have adopted a modified rule of *pro tanto* equitable conversion. These courts have held that the doctrine of equitable conversion is recognized only so far as it is necessary to effectuate the payment of partnership debts and to adjust the equities between the parties. Once this is accomplished, the property resumes its former character as real estate and is distributed to the heirs at law or devisees of the deceased partner.\(^{15}\) This rule has also been stated in the alternative; that on the

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death of a partner, the deceased partner's share of the firm's real estate vests in his heirs at law, subject to a trust created in favor of the surviving partner to satisfy any outstanding partnership obligations. However, it is a well recognized exception to the above rule that the distribution of partnership property may be controlled by an express or implied agreement between the partners.

Lack of acceptance of the English rule has been based upon the obvious differences embodied in the general inheritance laws of the United States. In Williams v. Dovell, it was stated that the reason for the adoption of the American rule was that:

in this country the law of primogeniture does not prevail, and there is no exemption of real estate from liability for simple contract debts, but real estate left by an ancestor is an asset for the payment of all debts. Thus there is no necessity for an absolute conversion to justify a fiction that would deprive partnership real estate of its descendible quality.

It has also been stated that the American rule commends itself for its simplicity and results in a closer adherence to the intentions of the parties.

An apparent exception to the general American rule is found when the only business of the partnership is real estate. In this case, land owned by the partnership is considered to be personalty for all purposes, including descent and distribution. This conclusion is based upon a presumed or an expressed intention between the parties.

1915; contra, Mattson v. Wagstad, 188 Wis. 560, 206 N.W. 865 (1926). In Lynch v. Kentucky Tax Comm'n, supra, the court held that partnership property located in North Carolina descended as personalty and therefore was taxable in Kentucky.


18. Williams v. Dovell, 202 Md. 351, 96 A.2d 484 (1953); Darrow v. Calkins, 154 N.Y. 503, 49 N.E. 61 (1897). "Courts pointed out, time and again, that after all firm debts are paid and land still remains, the land need not be sold; the land can readily go to whoever normally gets land on death of an owner or co-owner; hence, there is no need to view partnership realty as personalty beyond the necessities of carrying on firm business and paying firm debts." LATTY, INTRODUCTION TO BUSINESS ASSOCIATIONS—CASES AND MATERIALS 545 (1951).


20. Id. at 355, 96 A.2d at 486.


22. Lenow v. Fones, 48 Ark. 557, 4 S.W. 56 (1887).


25. Patrick v. Patrick, 71 N.J. Eq. 347, 63 Atl. 848 (Ch. 1906).
The Uniform Partnership Act, (hereinafter referred to as the act), was approved by the National Conference of Commissioners on Uniform State Laws in 1914. As of the present date, the act has been adopted in thirty nine states.

The purpose of the act is first, to state the law in simple, clear language; second, to render clear any existing uncertainties in the law; third, to introduce beneficial changes into the law.

One change which the act seems to make in the existing law is in reference to the nature of a partner's interest in the partnership. Section 26 of the act states: “A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.”

Although the act sought to create uniformity and clarity:

It is certainly arguable that Section 26 was merely intended to declare that the partnership property is personalty for the purpose of working out the rights of partnership creditors and of the partners inter se, and should not affect the former law for the purpose of declaring the respective rights of those interested in the estate of the deceased partner.

Several states have had the opportunity to interpret this provision of the act, and while there has not been unanimity of interpretation, the majority of the states have held that the act calls for the adoption of the English rule of “out and out” conversion.

Professor William Draper Lewis, the draftsman of the act, stated that this provision reversed the rule established in Shearer v. Shearer which has been followed in the majority of American jurisdictions. Professor Lewis stated that the main problem in the application of this doctrine

27. See appendix A.
33. 98 Mass. 107 (1867).
34. Lewis, The Uniform Partnership Act, 24 Yale L.J. 617, 637 (1915).
exists in a case in which, although:

the partnership agreement provides for the continuation of the business after the death of one of the partners, it is not possible to ascertain whether the real estate will or will not be sold for the payment of debts or to supply money for the carrying on of the business. Therefore, it may be impossible to determine whether the heir of the deceased partner inherits a fraction of the partner's interest in the partnership until several years after the death of his ancestor, and the ultimate determination depends, not on any principle of law or justice, but on the whim of the surviving partners.35

This problem is avoided when the interest is converted into personalty and the deceased partner's interest in the firm property is paid in cash.

The first case to construe this provision of the act was Wharf v. Wharf.36 The court, after careful consideration, held "that the legislative intention was to adopt the English rule . . . ."37 In reaching this conclusion, the court reasoned that the provision stating that partnership land shall not be subject to dower, curtesy, and allowances to heirs, applies to property of a partner after his death.38 Also, upon the death of a partner, his partnership interest vests in the surviving partner, except that when the deceased is the last surviving partner, his interest vests in his legal representative.39 Further, a partner's interest in the partnership is his share of the profits and surplus, and it is personal property.40 Finally, when the dissolution is caused by the death of a partner, each partner, as against his co-partners, and all persons who may claim through them, may have his share of the partnership property applied to discharge the existing liabilities. Any surplus will be used to pay the net amount owing the respective partners.41 The courts have continued to adhere to this reasoning, and have reached the same conclusion.42

In New Jersey, the court has failed to adopt the English rule, even though the act has been adopted.43 In a per curiam decision the Appellate Division recently stated that the conversion only applies so long as the necessity for it exists. Therefore, after partnership debts have been fully paid, partnership realty will descend to the deceased partner's heirs.44

35. Ibid.
36. 306 Ill. 79, 137 N.E. 446 (1922).
37. Id. at 86, 137 N.E. at 449.
38. Uniform Partnership Act § 25(2)(e).
41. Uniform Partnership Act § 38(1).
42. See cases cited note 32 supra.
44. Id. at 382, 67 A.2d at 353. In commenting about this case, the Florida
Thus, there is some doubt still existing as to the question of the conversion of partnership property, although it would appear to this writer that the intent of the act was to unequivocally adopt the English rule.

**FLORIDA**

Florida partnership law consists of case law and a few statutes relating to certain specific areas. It has been suggested on several occasions that Florida adopt the Uniform Partnership Act in order to bring about a clarification and uniformity in the law.45

The Florida position on this particular subject, while not recent, is quite clear. Two early cases subscribed to the majority American view of *pro tanto* conversion.46 This view appears to have been recently codified by the legislature.47 The statute provides that when a person dies owning an interest in a partnership it is the duty of the surviving partner to liquidate the business and pay over to the deceased partner's estate all balances due. Naturally, this provision is only applicable in the absence of an agreement to the contrary between the partners.48 As of the present date, this statute has not been construed by the Florida courts.

It has not been determined precisely what is meant by the term "an agreement providing otherwise."49 It has been recommended that such an agreement be in writing,50 and naturally it should attempt to specify, in as much detail as possible, the rights and liabilities of the parties so as to eliminate the necessity of court interpretation.

If the legislature were to adopt the act it is evident that this and other principles of Florida law would be abrogated. This is made manifest in the light of a recent Florida case51 in which it became necessary for the court to determine the character of partnership property owned by a Florida resident, but located in two states that had adopted the act. The result reached on this issue was significant in resolving the question of
whether the intestate's widow was entitled to dower in this partnership property. If the court found that the situs characterized the land as realty, the act would apply to bar the widow's dower rights, but, if the situs characterized the land as converted into personalty, Florida law would apply and the widow would be entitled to her dower rights in the property.

The court concluded that the partnership property was personalty under the act, as interpreted by the courts of those states,\(^5\) and that Florida provides for a widow's dower rights in personal property.\(^6\) As the widow's right to share in personalty is to be controlled by the law of the state of the decedent's domicile at the time of his death,\(^7\) the county judge had jurisdiction to assign dower to the widow.\(^8\)

Although the result reached on the issue of characterization of the partnership property was in accord with the general interpretation of the act, the Florida court, in allowing dower to attach, reached a result contrary to the express provisions of the act.\(^9\)

In order for the entire act to have applied in a case such as this, it would have been necessary for it to have been adopted in Florida as well as to have been the law of the situs of the property. This would produce the uniformity in result which the commissioners sought through the introduction of this legislation.

It should be noted that if Florida were to adopt the act, and if the courts were to follow the majority interpretation of "out and out" conversion, even though the characterization of real property would change to personalty, the distributees of an intestate partner's property would be unaffected. This is because of the fact that a Florida statute provides that property of the intestate, whether real or personal, shall be distributed to a certain class of takers.\(^5\) Thus, whether the property is characterized as personalty or realty it still will be distributed to the same individuals in a case of intestacy.

An entirely different situation would be encountered when the deceased partner dies testate and devises all his realty to A and bequeaths all his personalty to B. If the realty included partnership realty of a substantial nature it would result in B's receiving the cash value of this partnership realty. This may produce a result contrary to the intention of the testator. Thus, it becomes necessary for the draftsman of a will to inform the testator of this possibility and to express his actual intent so as to avoid the above result. The indicated situation might be remedied by leaving all partnership property and any realty owned to A and all per-


\(^{54}\) In re Binkow's Estate, 120 So. 2d 15, 19 (Fla. App. 1960).

\(^{55}\) Ibid.

\(^{56}\) Uniform Partnership Act § 25(2)(e).

sonalty other than partnership property to B.

Perhaps the most significant conflict that would arise with the adoption of the act is the exclusion of the surviving widow’s dower rights to partnership property owned by the deceased husband. This would abrogate a policy provision very familiar to Florida jurisprudence.58

The elimination of the widow’s dower rights would, however, produce a simplification of one aspect of the law. It would no longer be necessary to have the partner’s wife join in a conveyance of partnership realty in order for the partnership to convey title free from the wife’s dower rights.59 Obtaining the wife’s signature often places an undue restriction upon the partnership business.

The act would also allow a partnership to take or convey title to realty in the name of the partnership.60 This does away with any confusion which might exist when there has been a conveyance by a partner of partnership property in the name of the partnership. So long as the subscribing partner is apparently carrying on the partnership business in the usual manner61 and the party with whom he is dealing has no knowledge of a lack of authority, he can convey legal title to the land.

CONCLUSION

It is quite apparent that the interpretations of this facet of partnership law have been far from uniform. While it is difficult to conclude which view of the two discussed would prove the most advantageous when it becomes necessary to distribute a deceased partner’s share of the partnership’s real property, it is submitted that the English view is the better of the two. The basic reasons behind this conclusion are that this view tends to provide for greater simplicity of administration on the part of the surviving partner in settling with the decedent’s estate, and it facilitates the continuation of the partnership business.62

This is just one area of partnership law which is in need of reform in Florida. The adoption of the act would also:

fill in the many large gaps now causing confusion and uncertainty in our partnership law. In addition, such a move would set up a workable pattern of law, comparable to our corporation and limited partnership statutes, for the important and complex but much neglected form of business organization known as the ordinary partnership. The attorney could advise his clients with much less hesitation and legitimate doubt about various phases of their partnership business than he can today. Finally, our judiciary

58. FLA. STAT. § 731.34 (1959).
59. FLA. STAT. §§ 693.02, 731.34 (1959). Inchoate dower rights constitute an incumbrance upon the land which will render it unmarketable. See BOYER, FLORIDA REAL ESTATE TRANSACTIONS § 14.09 (1960).
60. UNIFORM PARTNERSHIP ACT §§ 8(3), 10.
61. UNIFORM PARTNERSHIP ACT § 9(1).
would benefit greatly through being able to utilize the vast body of decisions in those jurisdictions, now a majority, that have already adopted the UPA. 63

The Uniform Partnership Act has gone through a careful screening process in which representatives from all states have had the opportunity to participate. Over the years it has undergone, and withstood, the rigorous test of application by many sister states. The act has also attained a substantial uniformity of judicial interpretation among the adopting states. It is hoped that adoption of the act will result in the solution of some of these problems in Florida's partnership law and perhaps bring a renewed interest in the use of this practicable form of business association.

Marvin S. Maltzman

APPENDIX A

States That Have Adopted the Uniform Partnership Act and Where It May Be Found*


* Subsequent to the writing of this paper Connecticut passed the act. Conn. Pub. Acts 1961, No. 158.—Ed.