

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of)
ESTATE OF IRVING GRANT THALBERG, DECEASED)

For Appellant: John B. Milliken, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise
Tax Commissioner; Burl D. Lack,
Franchise Tax Counsel; Mark Scholtz,
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code (formerly Section 19 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner on the protest of the Estate of Irving Grant Thalberg, Deceased, to a proposed assessment of additional tax in the amount of \$21,774.14 for the year ended December 31, 1938.

The question presented herein is whether a sum of \$198,866.96 received by the Estate during the year 1938 under a certain compromise agreement between the Estate, the surviving partners of a partnership in which the decedent was a member, Loew's Incorporated and Metro-Goldwyn Pictures Corporation represented income to the Estate or a distribution to it of a share of the decedent's capital interest in the partnership. The payment was received under the following circumstances:

On April 7, 1924, Louis B. Mayer Pictures, Incorporated, entered into an agreement with Metro-Goldwyn Pictures Corporation under which Louis B. Mayer, J. Robert Rubin and Irving Grant Thalberg were to perform personal services in the production of motion pictures for the latter corporation. In return, Metro-Goldwyn Pictures Corporation was to pay a specified weekly salary to each and, in addition, to pay to Louis B. Mayer Pictures, Inc., 20% of its net profits derived from pictures produced under their supervision.

On November 28, 1925; Louis B. Mayer Pictures, Inc., was dissolved, and on the same day Mayer, Rubin and Thalberg became associated as partners under the firm name of Louis B. Mayer Pictures for the purpose of carrying out the corporation's end of the contract of April 7, 1924, with Metro-Goldwyn Pictures Corporation. Among other things, the partnership agreement fixed the respective interests of the parties and specified a termination date. Subsequent modification of the agreement in these particulars resulted, as of September 14, 1936, the date of Thalberg's death, in a 36½% interest for Thalberg and in the selection of December 31, 1938, as the cessation date. The agreement also contained the following provisions:

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"15 - In the event of the death of any of the co-partners, the co-partnership may be continued by the remaining partners, and the assets then existing shall be divided in proportion to the interests of the co-partners, but there shall be continued to be distributed the pictures in which the co-partnership shall then be interested, and there shall be paid to the estate of the deceased partner his share of the proceeds derived by the partnership from the distribution of any such pictures then being distributed and any picture thereafter distributed in which the co-partnership is then interested and which has been more than one-half completed at the time of the death of the deceased partner. Any picture less than half completed shall be considered to be the property of the remaining co-partners and the estate shall have no interest therein. The share of the deceased partner in the proceeds derived from pictures distributed and to be distributed shall be paid to the estate of the deceased as and when received."

The contract of April 7, 1924, was amended thereafter to include another organization; Loew's Incorporated, of which Metro-Goldwyn Pictures Corporation was a subsidiary, as a party; to provide for paying the partnership 20% of the combined annual net profits of Loew's and its subsidiaries until December 31, 1938, and thereafter 20% of any net profits from the distribution after that date of all pictures produced under the supervision of the partners until December 31, 1938; end to stipulate for the payment to the partnership of a reduced percentage of the combined net profits of Loew's in the event that a partner should die prior to December 31, 1938.

Following Thalberg's death on September 14, 1936, a dispute arose between the Estate, the surviving partners, Metro and Loew's as to the extent of their interests under the various agreements mentioned and in order themselves to settle the questions involved and thereby avoid litigation, they entered into a compromise agreement on July 14, 1937. This agreement provided, in part, for the payment directly by Loew's to the Estate of a given percentage of the combined net profits of Loew's and its subsidiaries during the period from September 14, 1936, to December 31, 1938, and from January 1, 1939, of a given percentage of the net profits from the distribution after that date of pictures completed or more than half completed on December 31, 1938. The Estate expressly agreed that the payments to be made to it under the compromise agreement were to be in lieu of any other rights it had under the earlier agreements. In 1938, the Estate received the sum of \$198,866.96 pursuant to the compromise agreement.

The decedent's interest in the partnership was appraised for California inheritance tax purposes at a figure of \$1,100,000 and an inheritance tax was computed and paid thereon. Appellant maintains that the \$198,866.96 was merely a partial recovery by the Estate of the value of that interest; and that since the interest was taxed for inheritance tax purposes as a bequest,

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devise; or inheritance" all payments received thereon up to \$1,100,000 were excludible from gross income. As an alternative ground, it is urged that the payment was one made by Loew's as partial consideration for a purchase of decedent's partnership interest through the medium of the compromise agreement; that the basis of the interest for capital gains purposes was \$1,100,000, and that until all that amount, adjusted to the date of sale, was recovered or realized by the Estate none of the payments made by Loew's could be considered income to the Estate rather than a payment of capital.

The Commissioner contends that the case is analogous to and, therefore, governed by Bull v. United States, 295 U.S. 247, which held that under a partnership agreement covering the activities of a personal service venture in which there is no capital investment or accumulation of tangible property and providing that upon the death of any partner his estate shall continue to share in the income of the partnership as would have the decedent himself had he survived, post-death partnership income distributed to the estate is ordinary income to it and subject to taxation as such. It is our opinion that his position is well founded.

As in Bull v. United States, the partnership between Mayer, Rubin and Thalberg was obviously an arrangement for the rendition of personal services by them for and on behalf of Metro-Goldwyn Pictures Corporation and the latter's parent organization, Loew's Incorporated. The partners were not required to, and apparently never did, make any capital investment in the partnership and it does not appear that any property, aside from what was earned under the contract with Metro and Loew's, was ever acquired by the partnership. Moreover, the partnership agreement itself, as modified by the compromise and supplemental agreement of July 14, 1937, indicates quite plainly that the estate of a deceased partner was to share in post-death partnership income to substantially the same extent as the decedent himself. Since the decision in Bull v. United States, there have been numerous other cases affirming and reaffirming the principle laid down therein with respect to situations analogous to the one under consideration, among which are Darcy v. United States, 15 F. Supp. 251; Boston Safe Deposit and Trust Co. v. United States, 75 F. Supp. 884; K. Barth, _____, 35 B.T.A. 546; Charles F. Coates, 7 T. C. 123.

It appears that a payment of partnership post-death income to the estate of a deceased partner by the surviving partners pursuant to the partnership agreement will be treated as made towards the purchase by the survivors of the decedent's interest in the partnership, and hence as a recovery of capital by, and not income to, the estate, if (1) the agreement provides for a sale of the interest to the survivors, (2) the payment is made as consideration for the purchase of the interest by the survivors, and (3) the survivors in making the payment acquire a substantial capital interest in the partnership. W. Frank Carter, 36 B.T.A. 60; Estate of Miller, 38 B.T.A. 487; McClellan

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v. Commissioner of Internal Revenue, 117 Fed. 2d 988, sustaining 42 B.T.A. 124; Rabkin and Johnson, The Partnership Under the Federal Tax Laws, 55 Harv. L. Rev. 909, et seq. We find none of these factors present in the case at hand, however. Under our conception of the matter, accordingly, we are not concerned here with a sale or other disposition of the decedent's partnership interest or with the problem of the recovery of capital received by way of inheritance or otherwise.

Appellant also contends that the Commissioner's proposed deficiency assessment is invalid inasmuch as notice thereof was not mailed within three years of the date of the filing of its return for 1938 in accordance with Section 19 of the Personal Income Tax Act as amended in 1937, citing in support of its position the decision of the District Court of Appeal in Mudd v. McColgan, 77 A.C.A. 70. This contention must be rejected, however, in view of the Supreme Court's reversal of that decision (30 Cal. 2d 463) and its holding that the 1939 amendment of Section 19 (Stats. 1939, p. 2557), extending to four years the period for mailing a notice of a proposed deficiency, was applicable in a case in which, as herein, the three year period had not expired at the time of the amendment and the notice was mailed within four years.

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 18595 of the Revenue and Taxation Code, that the action of Charles J. McColgan, Franchise Tax Commissioner, on the protest of the Estate of Irving Grant Thalberg, Deceased, to a proposed assessment of additional personal income tax in the amount of \$21,774.14 for the year ended December 31, 1938, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of November, 1948, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
J. H. Quinn, Member
J. I. Seawell, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary