Opinion No. 19

PARTNERSHIP, Inheritance Tax—
INHERITANCE TAX—GOOD WILL,
Taxable—TAX, Inheritance—
PROPERY, Inheritance Tax.

Held: The partners agreed that good will should have no value in determining the interest of a deceased partner. The agreement could be enforced among the partners, thus depleting the deceased's estate. For taxation purposes, the agreement transferred a portion of decedent's estate to his partners, the transfer to take effect at or after death. It is thus taxable under Section 10400.1 (3). The surviving partners, having received the good will, it is taxable to them.

April 5, 1947

Mr. Sam D. Goza, Chairman
State Board of Equalization
State Capitol
Helena, Montana

Dear Mr. Goza:

You have presented the following question for my opinion:

Is the good will of a partnership taxable for inheritance tax purposes?

In this particular case, the deceased partner owned an interest in three separate partnerships, all doing business outside the state of Montana. He was a resident of Montana at the time of his death, August 15, 1945. He disposed of his estate by will.

On March 27, 1944, the decedent agreed with the other members of the three partnerships, among other things, that:

1. Surviving partners should have a right to purchase the share of a deceased partner.

2. No value sould be attributed to good will in determining the value of the interest of a deceased partner where acquisition made by remaining partners.

By statute in Montana, "good will" is defined and made property.

Section 6813, Revised Codes of Montana, 1935, provides:

> "The good will of a business is the expectation of continued public patronage, but it does not include a right to use the name of any person from whom it was acquired."

Section 6814, Revised Codes of Montana, 1935, provides:

> "The good will of a business is property, transferable like any other."

Cases in Montana ruling on the qualities of good will are scarce. However, in Wylie v. Wylie Permanent Camping Company, 57 Mont. 115, Page 119, 187 Pac. 279, it is characterized as an intangible asset. Again in Truzzolino Co. v. Woolworth Co., 108 Mont. 408, page 415, 91 Pac. (2d) 415, it is termed an intangible.

In New Jersey, the Court in, In Re Deutz's Estate, 149 Atl. 257, page 258, states:

"Good will of course is an asset." (Citing in re Hall, 99 N. J. Law 1, 125 Atl. 246, where good will was determined to be an asset of a partnership.)"

Greel v. Kelly, 36 Atl. (2d) 874, page 879, a later New Jersey case makes a similar statement to the effect that good will is an asset.

Thus by statute, good will is property, and property where it exists, is an asset of the business to which it attaches.

The agreement of the partners that no value should be attributed to good will in determining the value of a deceased partner's interest for purposes of acquisition by the survivors raises the question:

Can an agreement between partners fix the value of good will, which our law recognizes as property, so the good will is beyond the taxing power of the state?

That such an agreement is enforceable by the partners against each other is well established. In 44 A.L.R. 518, the California case of Rankin v. Newman (Philbrook v. Newman) 114 Cal. 635, 34 L.R.A. 265, 46 Pac. 742, among others, is cited.

However, whether such an agreement can circumvent the power of taxation of the state is an entirely different question. The New Jersey Court's apt language in In re Deutz's Estate, supra, answers the question in the negative.

> "An agreement between partners that there is no good will, or that it is of no value, may well be binding on the partners and their representatives, but it cannot preclude the state from taxing the actual value. In re Hellman (See) 172 N.Y.S. 671, affirmed 226 N. Y. 702, 123 N.E. 869; In re Halle's Estate, 103 Misc. Rep. 661, 170 N.Y.S. 898."

Other cases to the same effect from New York are cited in 144 A.L.R. 1141.

Our own Court, on another set of facts, in Farber v. Mid-Northern Oil Co., 100 Mont. 10, page 22, 45 Pac. (2d) 673, has cited the principle that:

> "A contract between individuals cannot have the effect of depriving the state of any power of taxation otherwise belonging to it."

See also Byrne v. Fulton Oil Co., 85 Mont. 329, 337, 338, 278 Pac. 514.

From the above, it would seem clear that the agreement of the partners cannot prevail against the power of taxation of the State of Montana.

The next question presented is that of the authority of the State of Montana to impose an inheritance tax on good will of a partnership. Section 10400.1 (3), Revised Codes of Montana, 1935, provides in part:

"A tax shall be and is hereby imposed upon any transfer of property, real, personal, or mixed, or any interest therein, or income therefrom in trust or otherwise, to any person, association, or corporation . . . in the following cases, except as hereinafter provided:

" . . . (3) In contemplation of death. When the transfer is of property made by a resident or by a nonresident when such nonresident's property is within the state, or within its jurisdiction, by deed, grant, bargain, sale or gift, made in contemplation of death of the grantor, vendor, or donor, or intended to take effect in possession or enjovment at or after such death. Every transfer by deed, grant, bargain, sale or gift, made within three years prior to the death of the grantor, vendor, or donor, of a material part of his estate, or in the nature of a final disposition or distribution thereof, and without a fair consideration in money or money's worth shall, unless shown to the contrary be deemed to have been made in contemplation of death within the meaning of this section."

Under the agreement, binding upon the partners, the good will has no value among the partners. In Thompson v. Flynn, 95 Mont. 484, 493, 494, 27 Pac. (2d) 505, where a partner dies:

"Title to the property does not devolve upon either the heirs nor the personal representative of the deceased partner, but remains in the surviving partner until the partnership business is settled up, when it becomes the duty of such survivor to account to the personal representative for, and turn over to the estate, the balance due."

Similarly, see White v. Prahl, 94 Mont. 345, page 349, 22 Pac. (2d) 620; Mares v. Mares, 60 Mont. 36, page 53, 199 Pac. 267.

By the agreement, the decedent's share of the good will remains in the surviving partners' hands, is not accounted for to the personal representative, and is not turned over to the representative as a part of the balance due. In other words, the estate of the deceased is depleted by the amount of the value of the deceased's share of the good will. The agreement, in effect, withholds from the representative and gives to the surviving partners at the time of decedent's death, the decedent's share of the good will.

It would seem that such a transaction would come within subsection (3) of Section 10400.1, Revised Codes of Montana, 1935, as a gift to the surviving partners "intended to take effect in possession or enjoyment at or after such death . . ."

Estate of Oppenheimer, 75 Mont. 186, page 199, 243 Pac. 589:

"Stripped of all unnecessary verbiage, as applied to the facts before us, the statute clearly requires the imposition of the tax 'when the transfer is of property made by a resident intended to take effect in possession or enjoyment at or after . . . death,' and independent of the decisions of other courts in the construction of language employed in similar statutes of other states, we have heretofore held, and we think correctly, that, where the transfer of property is not to take effect in possession or enjoyment until after the death of the transferor or, whether in contemplation of death or not, it is subject to the tax. (In re Estate of Schuh, 66 Mont. 50, 212 Pac. 516.)"

By operation of law the surviving partners retain the partnership property upon the death of the decedent. By operation of the agreement, the estate of the deceased partner has no right to an accounting for the value of the good will. Thus, the surviving partners benefit under the agreement to the amount the estate of the decedent is depleted—the amount of the decedent's share of the value of the good will.

Before discussing the matter of who shall bear the tax, the nature of our inheritance tax should be determined. Our court has stated in many cases that it is a tax upon the right or privilege of receiving property, and not upon the property of the deceased. Among those cases are:

> In re Powell's Estate, 110 Mont. 213, 218, 222, 101 Pac. (2d) 54; In re Clark's Estate, 105 Mont. 401, 74 Pac. (2d) 401; State ex rel. Davis v. State Board of Equalization, 104 Mont. 52, 58, 64 Pac. (2d) 1057.

Clearly, the people receiving the good will in this case are the surviving partners. It follows that they must bear the tax, and that the representatives of the decedent should not be taxed for that which the legatees did not receive. This rule is established in the case of In re Powell's Estate, supra, page 219 in the following language:

> "Each specific share, interest or legacy passing upon the death of a decedent must bear its proportionate part of the inheritance tax, and the share of one beneficiary cannot be used in paying the tax charged against that of another."

Taxation of intangible property by the state of the decedent's domicile, although the evidence of the property is without the boundaries of the state (decedent's interest in a partnership outside the state) was held proper in Blodgett v. Silberman, 277 U. S. 1, 48 S. Ct. 410, 72 L. Ed. 74.

Methods of evaluation of good will for inheritance tax purposes are contained in 144 A.L.R. 1141. In general, the method is as follows: The average net profit over a period of years is computed, and the value determined by multiplying the average net profits by the number of years purchase. (The latter is an arbitrary figure of from three to five years over which it is deemed reasonable to expect the good will to continue as an asset.)

Anticipating that the question of consideration may be raised and that it may be argued that the mutual promises of the parties are sufficient to remove the transfer from the operation of subsection (3), Section 10400.1, Revised Codes of Montana, 1935, I cite the following as the view of the court: (Estate of Oppenheimer, 75 Mont. 186, 201, 243 Pac. 589)

> "It was never intended by the lawmakers when enacting the inheritance statute, to permit the owner of an estate falling within its provisions to continue in possession and enjoyment of all of his property and the rents and income therefrom during his lifetime, secure in the knowledge that upon advent of death, the legislative intent could be effectually circumvented . . . clearly, a gift or transfer for a valuable consideration must be in praesenti in order to escape the tax. A deceased person can have but one estate, and all property owned by him at the time of his death, including gifts made by him which are not to become effective until after his death, is taxable. The tax imposed is upon the right to transfer not upon the estate."

To sumarize: The partners agreed that good will should have no value in determining the interest of a deceased partner. The agreement could be enforced among the partners, thus depleting the deceased's estate. For taxation purposes, the agreement transferred a portion of decedent's estate to his partners, the transfer to take effect at or after death. It is thus taxable under Section 10400.1 (3). The surviving partners, having received the good will, it is taxable to them.

Sincerely yours,
R. V. BOTTOMLY,
Attorney General