Winkler v. Commissioner, T.C. Memo. 1949-099

A loss on the sale of personal property, such as jewelry, is not deductible as a capital loss unless the property was purchased in connection with a trade or business or with the expectation of making a profit.

Summary

Eli Winkler and his wife claimed a capital loss deduction on their joint tax return after selling jewelry for significantly less than its original cost. The Tax Court disallowed the deduction, holding that the loss was not incurred in a trade or business or in a transaction entered into for profit. The court emphasized that deductions are a matter of legislative grace and must fall within the specific provisions of Section 23(e) of the Internal Revenue Code, which governs loss deductions for individuals. Because the jewelry was purchased for personal use and not for profit-making purposes, the loss was not deductible.

Facts

The Winklers purchased jewelry. They later sold the jewelry for $18,500 less than its cost. The Winklers claimed a long-term capital loss of $9,250 on their joint tax return. The Winklers conceded the purchase was not made in connection with trade or business or with an expectation of making a profit therefrom.

Procedural History

The Commissioner of Internal Revenue disallowed the capital loss deduction claimed by the Winklers. The Winklers petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination, finding the loss to be nondeductible because it did not arise from a transaction within the petitioners' trade or business and was not for profit.

Issue(s)

Whether a loss incurred on the sale of personal jewelry, not connected with a trade or business or entered into for profit, is deductible as a capital loss under the Internal Revenue Code.

Holding

No, because Section 23(e) of the Internal Revenue Code allows deductions for losses sustained by individuals only if the losses are (1) incurred in a trade or business, (2) incurred in a transaction entered into for profit, or (3) the result of a casualty, and the loss from the sale of personal jewelry does not fall into any of these categories.

Court's Reasoning

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The court reasoned that deductions are a matter of legislative grace and are permitted only when specifically granted by statute. Section 23(e) of the Internal Revenue Code specifically outlines the types of losses that individuals can deduct. Since the loss from the sale of the jewelry was not incurred in a trade or business, nor was it a transaction entered into for profit, it does not meet the requirements for deductibility under Section 23(e). The court stated that “there is no provision in the Code which can be construed to permit the deduction of a capital loss which would not be deductible as an ordinary loss if the property involved were not a capital asset.” The court distinguished this case from investments such as securities, noting that jewelry is not ordinary investment property and does not generate income. The court emphasized that the real test for deductibility is whether the property was purchased with the expectation or intention of deriving a profit, which was not the case here.

Practical Implications

This case clarifies that losses on the sale of personal-use property are generally not deductible for income tax purposes. It reinforces the principle that deductions are a matter of legislative grace and that taxpayers must demonstrate that their losses fall within the specific provisions of the Internal Revenue Code to be deductible. This case is often cited to illustrate the distinction between personal losses and deductible losses incurred in a trade or business or for investment purposes. It highlights the importance of establishing a profit motive when acquiring property if a taxpayer wishes to deduct a loss upon its sale. Later cases have applied this ruling to deny deductions for losses on the sale of other types of personal assets, reinforcing the principle that personal consumption is distinct from business or investment activities for tax purposes.

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