5 T.C. 397 (1945)

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Losses from the sale of commodity futures contracts are considered capital losses, not ordinary business expenses, unless the contracts represent a true hedge against existing sales or inventory needs.

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Summary

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The Makransky case addresses whether a loss from the sale of wool tops futures contracts should be treated as an ordinary business expense or a capital loss for tax purposes. The partnership, engaged in manufacturing men's suits, purchased the contracts to secure a supply of wool during wartime uncertainty. When market conditions changed and the partnership sold the contracts at a loss, the Tax Court determined that the loss was a short-term capital loss, not a deductible business expense, because the futures contracts were not a hedge against current business needs but were speculative in nature.

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Facts

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S. Makransky & Sons, a partnership, manufactured men's suits. At the start of World War II, piece goods became scarce. The partnership bought futures contracts for wool tops, intending to take delivery and manufacture piece goods. The partnership planned to use the wool to create their fall line of clothing. Rumors arose that inferior Cape wool would be delivered under the contracts. Piece goods became more available. The partnership sold the futures contracts at a loss of $95,750.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the petitioners'

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income tax for 1941, disallowing a net operating loss carry-over from 1940 claimed by the partnership. The petitioners contested this adjustment, arguing the loss should be treated as an ordinary business expense.

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Issue(s)

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1. Whether the loss sustained by the partnership on the sale of wool tops futures contracts constitutes an ordinary business expense deductible from gross income.

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2. Whether the loss constitutes a short-term capital loss subject to the limitations of capital loss deductions.

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Holding

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1. No, because the purchase of the futures contracts was not a hedge against existing sales or inventory needs, and therefore the loss is not an ordinary business expense.

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2. Yes, because the wool tops futures contracts were considered capital assets, and the loss resulted from the sale of these assets held for less than 6 months.

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Court’s Reasoning

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The court reasoned that the wool tops futures contracts did not fall under the exceptions to the definition of

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