5 T.C. 482 (1945)

A taxpayer cannot deduct from their gross income any portion of a worthless debt owed to an entity other than the taxpayer, even if the taxpayer is a beneficiary of that entity.

Summary

The petitioner, a distributee of his father's estate, claimed a deduction for a worthless debt in 1941. The debt was owed by Edward G. King to the partnership of Chauncey & Co., which had been dissolved by the petitioner's father's death. The petitioner argued that because he was entitled to two-thirds of the balance owed to his father's estate by the new firm (successor to the old partnership), he should be able to treat King as his debtor. The Tax Court denied the deduction, holding that the debt was an asset of the partnership, not of the petitioner, and that a taxpayer cannot deduct a worthless debt owed to someone else.

Facts

C. Edgar Anderson was a partner in Chauncey & Co. He died on October 1, 1939, dissolving the partnership. The surviving partners continued the business under the same name. The new partnership's books showed an indebtedness to C. Edgar Anderson's estate. Edward G. King owed a debt to the original Chauncey & Co. When King was expelled from the Stock Exchange in 1941 and his debt became worthless, the petitioner (C. Edgar Anderson's son and a legatee) sought to deduct a portion of the debt on his personal income tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether the petitioner, as a distributee of his father's estate, can deduct a portion of a worthless debt owed to a partnership in which his father was a partner, where the debt became worthless after the father's death and dissolution of the original partnership.

Holding

No, because the debt was an asset of the partnership, not of the petitioner, individually. A taxpayer cannot deduct a worthless debt owed to someone else.

Court's Reasoning

The court reasoned that the credit balance due from Edward G. King was an asset of

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Chauncey & Co. The court cited *Guggenheim v. Helvering*, which held that under New York partnership law, a deceased partner's executors have no interest in the firm's assets, but only the right to an accounting. Therefore, the petitioner was not King's creditor in 1941 and could not deduct any part of King's debt to Chauncey & Co. that became worthless. The court emphasized the basic principle that a taxpayer cannot deduct a worthless debt owed to someone other than the taxpayer.

The court distinguished *Lillie V. Kohn*, where residuary legatees *were* allowed to deduct a loss on a note. In that case, the note was effectively vested in the legatees because the estate's debts and legacies had been paid, and the maker of the note was indebted to *them*.

Practical Implications

This case reinforces the principle that deductions for worthless debts are generally limited to situations where the debt is directly owed to the taxpayer claiming the deduction. Attorneys should advise clients that indirect interests in debts, such as through partnerships or estates, may not be sufficient to support a deduction for a worthless debt. When evaluating potential deductions for worthless debts, legal practitioners must carefully trace the ownership of the debt and ensure that the taxpayer claiming the deduction is the actual creditor. This decision highlights the importance of understanding partnership law and the distinction between a partner's interest in a partnership and direct ownership of the partnership's assets.

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