Blum v. Commissioner, 5 T.C. 702 (1945)

Section 24(b)(1)(A) of the Internal Revenue Code disallows deductions for losses from sales or exchanges of property, directly or indirectly, between members of a family, even if the sale is bona fide.

Summary

The Tax Court held that a taxpayer could not deduct a loss from the sale of a partnership interest to his brother, because Section 24(b)(1)(A) of the Internal Revenue Code disallows deductions for losses from sales between family members. The court rejected the argument that the statute should not apply to bona fide sales, finding the language of the statute unambiguous. The court also addressed the proper allocation of costs when a business is acquired and assets are subsequently sold piecemeal.

Facts

Nathan Blum and his brother, Louis Blum, operated a business as partners. On November 1, 1940, Louis sold his interest in the partnership to Nathan. During November and December 1940, Nathan, now the sole proprietor, continued to operate the business and sold some of the assets. On his tax return, Louis claimed a loss from the sale of his partnership interest to Nathan. Nathan also faced scrutiny regarding the allocation of costs to assets sold after he acquired the business.

Procedural History

The Commissioner of Internal Revenue disallowed Louis's deduction for the loss sustained on the sale of his partnership interest. The Commissioner also determined that Nathan had realized additional income from the sales of assets after acquiring the business. Both Louis and Nathan Blum petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court consolidated the cases.

Issue(s)

1. Whether Section 24(b)(1)(A) of the Internal Revenue Code precludes the deduction of a loss sustained on the sale of a partnership interest to a brother.
2. Whether the Commissioner properly allocated the cost basis of assets sold by Nathan Blum after acquiring the business.

Holding

1. Yes, because the language of Section 24(b)(1)(A) is broad and admits of no exception for bona fide sales between family members.
2. Yes, because the Commissioner acted reasonably in allocating Nathan Blum's cost proportionately to the separate assets of the business in the ratio of cost to book value.

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Court’s Reasoning

Regarding the disallowance of the loss, the court emphasized the clear and unambiguous language of Section 24(b)(1)(A), which states that “no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly, * * * between members of a family.” The court acknowledged that Congress’s intent was to prevent sham transactions designed to create artificial losses for tax purposes, but the language Congress chose was broad enough to cover even bona fide transactions. The court stated: “That language is so broad as to admit of no exception.” The court refused to create an exception by judicial legislation.

As for the allocation of costs, the court found the Commissioner’s method reasonable and the taxpayer failed to suggest a more appropriate method. The court cited precedent holding that when property is acquired as a whole for a lump sum and then sold in parts, the cost basis must be allocated over the several units, and gain or loss is computed on the disposition of each part. The Court rejected the taxpayer’s vague and unsupported statements challenging the Commissioner’s determinations regarding accounts receivable and inventory turnover.

Practical Implications

Blum v. Commissioner illustrates the broad scope of Section 24(b)(1)(A) and similar provisions designed to prevent tax avoidance through related-party transactions. Attorneys must advise clients that losses from sales to family members will be disallowed, regardless of the legitimacy of the transaction. This case emphasizes the importance of clear statutory language and the limited role of courts in creating exceptions. It also underscores the need for taxpayers to maintain accurate records to support their cost basis and allocation methods when disposing of assets acquired in bulk. Later cases have consistently applied the rule in *Blum*, reinforcing the disallowance of losses in related-party sales, even when a genuine economic loss has been sustained.

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