6 T.C. 1027 (1946)

A taxpayer on the cash basis can deduct losses from joint ventures or guarantees only in the year of actual payment, not merely upon giving a promissory note, unless the taxpayer was a direct owner of the underlying asset.

Summary

Bramer and two associates formed a syndicate to trade stock. Bramer later guaranteed another associate's stock purchase. The Tax Court addressed whether Bramer, a cash-basis taxpayer, could deduct payments made in 1941 related to losses from these ventures. The court held that Bramer could not deduct the 1941 payment related to the syndicate's stock losses because the losses were sustained and deductible in prior years. However, Bramer could deduct the 1941 payment related to his guarantee of the other associate's stock purchase, as that loss was realized only upon payment.

Facts

In 1929, Bramer, Foster, and Frank formed a syndicate to buy and sell International Rustless Iron Corporation stock. Foster and Frank secured a loan to purchase 60,000 shares, using the stock and other securities as collateral. Bramer signed the joint note but contributed no cash or collateral. The syndicate sold some shares in 1930, incurring a loss. In 1935, the remaining shares were sold at a further loss. Bramer gave a promissory note in 1935 to cover his share of the syndicate's losses. In 1941, Bramer made a payment on this note and claimed it as a deduction.

Separately, in 1929, Foster purchased 5,000 shares of the same stock and Bramer agreed to share equally in profits or losses. Bramer gave Foster a promissory note in 1930 for his share of the losses. In 1941, Bramer paid the balance due on this note and claimed a deduction.

Procedural History

Bramer deducted payments made in 1941 related to the two sets of stock losses on his 1941 tax return. The Commissioner of Internal Revenue disallowed the deduction related to the syndicate losses but disallowed the deduction related to the guaranteed stock purchase. Bramer petitioned the Tax Court for redetermination of the deficiency.

Issue(s)

1. Whether Bramer, a cash-basis taxpayer, could deduct in 1941 a payment made on a note representing his share of losses from a stock trading syndicate that occurred in prior years?

2. Whether Bramer, a cash-basis taxpayer, could deduct in 1941 a payment made to

cover his share of losses from another individual's stock purchase, where Bramer had guaranteed against losses?

Holding

1. No, because Bramer's loss from the syndicate was sustained in prior years when the stock was sold and the loss determined, not when he paid off his note. However, he can deduct the portion of the payment that constitutes interest.

2. Yes, because Bramer's loss from guaranteeing Foster's stock purchase was sustained when he made the payment to Foster, as Bramer had no ownership of the underlying stock.

Court's Reasoning

Regarding the syndicate, the court reasoned that Bramer was a part owner of the stock and that the losses were sustained when the stock was sold by the bank. The court cited *J.J. Larkin, 46 B.T.A. 213*, noting the principle that losses are deductible in the year sustained, not when a note given to cover the loss is paid. The court stated, "We are of the opinion that the respondent is correct in his contention that the petitioner sustained deductible losses of one-third of the net losses sustained by the syndicate on the sales of shares of Rustless stock by the bank in 1930 and 1935. The petitioner was as much an owner of one-third of those shares as either of the other members of the syndicate."

Regarding the guaranteed stock purchase, the court held that Bramer's loss was sustained when he made the payment to Foster because he never owned the stock. The court cited *E.L. Connelly, 46 B.T.A. 222*, stating, "His out-of-pocket loss was when he made his settlement with Foster. The deduction of a loss by the petitioner had to be deferred until the payment was made."

Practical Implications

Bramer clarifies the timing of loss deductions for cash-basis taxpayers involved in joint ventures and guarantees. It highlights that losses are generally deductible when sustained, which, in the case of joint ventures, is when the underlying asset is sold. For guarantees, the loss is deductible when the payment is made to cover the guaranteed obligation, provided the taxpayer did not have ownership rights in the underlying asset. This case informs tax planning by emphasizing the need to accurately track the timing of losses in these types of arrangements to ensure proper deductibility in the correct tax year. This case is often cited in situations where the timing of a loss deduction is at issue, particularly when promissory notes or guarantees are involved.

