7 T.C. 333 (1946)

Payments made to satisfy a personal guarantee given in connection with the sale of stock can be deductible as a loss incurred in a transaction entered into for profit, even if the guarantee was made to a family member.

Summary

Carl Hess sold stock to his sister and guaranteed her against loss. When the company went bankrupt, he made payments to her to honor that guarantee. The Tax Court held that these payments were deductible as a loss incurred in a transaction entered into for profit under Section 23(e)(2) of the Internal Revenue Code. The court reasoned that the original stock sale was a transaction entered into for profit, and the guarantee was directly connected to that transaction. The court rejected the Commissioner's arguments that the debt was discharged in bankruptcy and that the payments were gifts.

Facts

In 1925, Carl Hess sold his sister, Reta Lerner, 50 shares of preferred stock in Parisian Co. for $5,000. He orally guaranteed her against any loss for 10 years, confirming it in writing shortly after. In 1930, Hess sold Lerner 200 shares of Class B common stock for $1,000, again providing a similar guarantee. Parisian Co. entered bankruptcy in 1933, rendering the stock worthless. Hess filed for bankruptcy in 1933 and did not list Lerner as a creditor. After bankruptcy, Hess promised Lerner he would repay her when he could afford it and started paying her interest. In 1941, Hess paid Lerner $1,100 towards the principal.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Hess's 1941 income tax, disallowing the $1,100 deduction claimed for the payment to his sister. Hess petitioned the Tax Court for review. The Tax Court ruled in favor of Hess, allowing the deduction.

Issue(s)

Whether the $1,100 paid by Hess to his sister in 1941, pursuant to his guarantee against loss on stock he sold to her, is deductible as a loss (1) incurred in trade or business, or (2) incurred in a transaction entered into for profit under Section 23(e) of the Internal Revenue Code.

Holding

No as to whether the loss was incurred in trade or business; Yes, as to whether the loss was incurred in a transaction entered into for profit, because the original sale of stock to Lerner was a transaction entered into for profit, and the guarantee was

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directly related to that transaction, making the subsequent payment deductible as a loss under Section 23(e)(2).

Court’s Reasoning

The court dismissed the argument that the debt was discharged in bankruptcy because Hess made a new promise to pay Lerner after filing for bankruptcy. While the promise was conditional on his ability to pay, it was a valid condition and sufficient to revive the debt. Citing *R.W. Hale, 32 B.T.A. 356*, the court reasoned that the transaction began when Hess acquired the stock, marking the inception of a

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