8 T.C. 431 (1947)

Payments made by a taxpayer to satisfy oral guarantees of a corporation's debt, even if the guarantees are technically unenforceable due to the statute of frauds or statute of limitations, are deductible as losses incurred in a transaction entered into for profit under Section 23(e) of the Internal Revenue Code.

Summary

Abraham and Louis Greenspon, former owners of a corporation, orally guaranteed loans to their company. After the corporation entered receivership and was liquidated, the Greenspons made payments in 1942 to their brother-in-law, Kronick, fulfilling their guarantees. The Tax Court addressed whether these payments were deductible as bad debts or losses. The court held that the payments were deductible as losses under Section 23(e) because they arose from a transaction entered into for profit, notwithstanding potential legal defenses like the statute of frauds or bankruptcy discharge.

Facts

Abraham and Louis Greenspon owned and managed Jos. Greenspon's Sons Iron & Steel Co. Loans were made to the corporation between 1928 and 1931 by Isador Kronick and Missouri Bag Co. The Greenspons orally guaranteed these loans. The corporation entered receivership in 1931 and was liquidated in 1938 without paying creditors. In 1932, the Greenspons formed a new corporation with capital from Kronick. In 1942, they entered a written agreement to repay Kronick for the old corporation's debts they had guaranteed and made payments to Missouri Bag Co.

Procedural History

The Commissioner of Internal Revenue disallowed deductions claimed by the Greenspons for payments made to Kronick and Missouri Bag Co. The Greenspons petitioned the Tax Court for review of the Commissioner's determination. The Tax Court consolidated the cases and addressed the deductibility of these payments.

Issue(s)

Whether payments made by the Greenspons in 1942 and 1943 to satisfy oral guarantees of a corporation's debt, which might be unenforceable under the statute of frauds or statute of limitations, are deductible as bad debts under Section 23(k) or as losses under Section 23(e) of the Internal Revenue Code.

Holding

No, the payments are not deductible as bad debts; Yes, the payments are deductible as losses under Section 23(e), because the losses were the proximate result of transactions entered into for profit, and waiving potential legal defenses does not

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preclude deductibility.

Court’s Reasoning

The court reasoned that while the oral guarantees might have been unenforceable under the Missouri statute of frauds or because the statute of limitations had run, these were personal defenses that the Greenspons could waive. The court cited Francis M. Camp, 21 B.T.A. 962, stating that “if a taxpayer chooses to waive his personal defenses and perform a contract, the Commissioner can not object.” The court also noted that Abraham’s bankruptcy discharge was a personal defense that could be waived, and a new promise could revive the debt. The court found that the payments were not deductible as bad debts because the old corporation had been liquidated, precluding any debt from arising from the old corporation to the petitioners. However, the court held that the payments were deductible as losses under Section 23(e) because they were incurred in transactions entered into for profit. The court cited R.W. Hale, 32 B.T.A. 356; Marjorie Fleming Lloyd-Smith, 40 B.T.A. 214; and Carl Hess, 7 T.C. 333 for this proposition.

Practical Implications

This case clarifies that taxpayers can deduct payments made to honor business-related obligations, even if those obligations are not legally enforceable due to defenses like the statute of frauds or limitations. It emphasizes that the critical factor for deductibility as a loss under Section 23(e) is whether the underlying transaction was entered into for profit. This ruling is relevant for analyzing the deductibility of payments made under guarantees, endorsements, or other contingent liabilities. It also highlights the importance of documenting the business purpose behind such transactions. Later cases may distinguish this ruling based on the specific facts and circumstances, such as the absence of a clear business purpose or the presence of personal motivations overriding the profit motive.

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