9 T.C. 68 (1947)

A bank's loss from a "wash sale" of securities is not deductible under Section 118(a) of the Internal Revenue Code, even though Section 117(i) allows banks to deduct certain security losses as ordinary losses.

Summary

Merchants National Bank sold railroad bonds at a loss and, on the same day, purchased substantially identical bonds. The Tax Court addressed whether the bank could deduct the loss, considering both Section 118(a), which disallows losses from wash sales, and Section 117(i), which allows banks to deduct certain security losses as ordinary losses. The court held that Section 118(a) applied, disallowing the deduction, and that Section 117(i) did not create an exemption from the wash sale rule for banks.

Facts

On March 8, 1935, Merchants National Bank purchased $10,000 of Central Railroad of New Jersey bonds for $9,700. On January 30, 1942, the bank sold these bonds for $1,519.96. On the same day, January 30, 1942, the bank purchased $11,000 of Central Railroad of New Jersey bonds for $1,567.50. The bonds purchased had the same security, maturity date, and interest rate as the bonds sold and were considered substantially identical. The bank was not a dealer in securities; it held the bonds for investment purposes.

Procedural History

The Commissioner of Internal Revenue disallowed the bank's claimed loss of $8,180.04 from the bond sale. The bank petitioned the Tax Court for a redetermination of the deficiency, arguing that Section 117(i) of the Internal Revenue Code allowed the deduction despite the wash sale rules.

Issue(s)

Whether a bank can deduct a loss from the sale of securities when it purchased substantially identical securities on the same day, considering the interplay between Section 118(a) (wash sale rule) and Section 117(i) (bank security losses).

Holding

No, because Section 118(a) prohibits the deduction of losses from wash sales, and Section 117(i) does not create an exception for banks from this rule.

Court's Reasoning

The court reasoned that Section 118(a) of the Internal Revenue Code explicitly

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disallows loss deductions in wash sale situations. The court emphasized that this prohibition had been in place since the 1921 Revenue Act. The bank argued that Section 117(i), enacted in 1942, which treats certain security losses of banks as ordinary losses, superseded or created an exception to the wash sale rule. However, the court rejected this argument, stating, “There is nothing in the report indicating that Congress intended to exempt banking corporations from the provisions of section 118.” The court interpreted both sections as coordinate, with Section 117(i) defining how deductible losses from security sales by banks should be treated, and Section 118(a) determining when such losses are not deductible in the first place. Since the sale was a wash sale, the loss was not deductible, regardless of Section 117(i).

Practical Implications

This case clarifies that banks are not exempt from the wash sale rules under Section 118(a) of the Internal Revenue Code, even with the enactment of Section 117(i). This means that when analyzing security sales by banks, practitioners must first determine if the transaction constitutes a wash sale. If so, the loss is not deductible, regardless of whether Section 117(i) would otherwise classify the loss as an ordinary loss. The case highlights the importance of considering all relevant code sections and interpreting them harmoniously. It reinforces the principle that specific provisions like Section 117(i) do not automatically override general prohibitions like the wash sale rule in Section 118(a) unless Congress explicitly states such an intention. This case has been cited in subsequent tax cases involving the deductibility of losses in various financial transactions and serves as a reminder that tax rules must be read in their totality.

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