***9 T.C. 976 (1947)***

A taxpayer is not required to deduct for partial worthlessness of a debt in each year that partial worthlessness occurs, but may wait until further worthlessness occurs and deduct the total partial worthlessness at the later date.

**Summary**

The E. Richard Meinig Co. (Petitioner) sought to deduct a partially worthless debt from Meinig Hosiery Co. (Hosiery) in 1939. The Commissioner of Internal Revenue (Commissioner) disallowed a portion of the deduction, arguing that the debt became worthless prior to 1939. The Tax Court addressed whether the taxpayer must deduct for partial worthlessness each year it occurs or can wait and deduct the total partial worthlessness later. The Tax Court held that the taxpayer could wait and deduct the total partial worthlessness at a later date, even if part of it occurred in a prior year.

**Facts**

Petitioner and Hosiery were closely related companies. From 1925 to 1938, Petitioner loaned money to Hosiery and had various accounts with them. By September 22, 1931, the net debit balance was $385,195.02, and by March 4, 1938, it was $640,774.38. Hosiery experienced financial difficulties, and on September 22, 1931, Petitioner agreed to subordinate its claim to a bank loan to Hosiery. On March 4, 1938, Hosiery filed for reorganization under Section 77-B of the Bankruptcy Act and was later found to be insolvent. In 1939, Petitioner estimated a minimal recovery and wrote off $615,143.40 as a partially worthless debt.

**Procedural History**

The Commissioner disallowed $385,195.02 of the Petitioner's claimed deduction for 1939, asserting the debt became worthless before that year. The Tax Court reviewed the Commissioner's determination regarding the deductibility of the debt.

**Issue(s)**

Whether a taxpayer must deduct for partial worthlessness in each year when some partial worthlessness develops, or whether the taxpayer may wait until further worthlessness occurs and deduct the total partial worthlessness at the later date?

**Holding**

No, because a taxpayer can wait until a later date and deduct the entire partial worthlessness at that time, even though a part of it may have occurred in a prior year.

**Court's Reasoning**

The Commissioner argued that the debt existing at the time of the subordination resolution in 1931 was a separate debt that became worthless either in 1931 or 1938, thus precluding a deduction in 1939. The court rejected this argument, finding no justification for dividing the debt into two separate debts. The court emphasized that the accounts between the Petitioner and Hosiery continued uninterrupted, and there was no agreement to treat the amount due in 1931 as a separate debt. The court stated that the petitioner had only one cause of action against the debtor for the entire amount due on March 4, 1938. The court reasoned that because the Commissioner recognized some partial worthlessness in 1939 by allowing a portion of the claimed deduction, he could not disallow the remainder by claiming that a larger portion became worthless in a prior year. The court emphasized that the indebtedness never became entirely worthless before 1939, and a taxpayer is not required to deduct for partial worthlessness in each year it occurs.

### Practical Implications

This case provides clarity on the timing of deductions for partially worthless debts. It establishes that taxpayers have some flexibility in deciding when to claim a deduction for partial worthlessness. A taxpayer can choose to wait until a later year when additional worthlessness occurs and deduct the total partial worthlessness at that time. This ruling is beneficial for taxpayers who may not want to claim a deduction in an earlier year due to various tax planning considerations. Later cases will apply this ruling when determining the appropriate year for taking deductions on partially worthless debts, particularly when financial difficulties span multiple tax years. However, it’s crucial that the debt is not entirely worthless in prior years to utilize this provision.