9 T.C. 1168 (1947)

A taxpayer does not sustain a deductible loss under Section 23(e)(3) of the Internal Revenue Code merely because a portion of their income is received in foreign currency at an official exchange rate, even if a more favorable 'free' rate exists; the key issue is how to accurately report gross income in U.S. dollars.

Summary

S.E. Boyer, a U.S. Army officer stationed in Europe during World War II, received part of his salary in British pounds and French francs at the official, controlled exchange rates. He claimed a tax deduction for the difference between the official rates and the more favorable 'free' market rates, arguing he sustained a loss. The Tax Court denied the deduction, holding that being paid in foreign currency at the official rate does not automatically create a deductible loss. The court emphasized that the core issue is the proper valuation of income received in foreign currency for U.S. tax purposes.

Facts

From 1942 to 1945, S.E. Boyer served as an officer in the U.S. Army in England and France.
He received a salary and allowances, a portion of which he withdrew overseas in British pounds and French francs.
These withdrawals were made at the official, controlled exchange rates: $4.035 per pound and $0.02 per franc.
The 'free' market exchange rates were approximately $2.75 per pound and $0.0085 per franc.
Boyer used the foreign currency for his living expenses and entertainment.

Procedural History

Boyer claimed deductions on his 1943, 1944, and 1945 income tax returns for the difference between the official and free exchange rates.
The Commissioner of Internal Revenue disallowed these deductions, resulting in income tax deficiencies.
Boyer petitioned the Tax Court to review the Commissioner's determination.

Issue(s)

Whether the petitioner sustained a deductible loss under Section 23(e)(3) of the Internal Revenue Code when he received a portion of his military compensation in foreign currency at official exchange rates that were less favorable than 'free' market rates?

Holding

No, because the mere fact that the petitioner was paid for his services in part in foreign currency at the official rate does not automatically mean that he sustained a statutory loss.

Court's Reasoning

The court reasoned that the crux of the matter was not a deductible loss, but rather how to properly calculate and report gross income received in foreign currency in terms of U.S. dollars. "The principle is established that, where one has received a part of his income in foreign currency, it must be reported for taxation in terms of United States money." The court found that Boyer had not proven that he could not redeem his pounds and francs at the full official rate when leaving Britain and France, respectively. Therefore, using the official exchange rates to report his income in dollars was appropriate. The court implied the taxpayer had not demonstrated an actual economic loss, because there was no evidence he could not exchange the currency back at the official rate. Section 23(e)(3) of the Internal Revenue Code allows for deduction of losses sustained during the taxable year, but the court found that in this instance no such loss occurred.

Practical Implications

This case clarifies that receiving income in foreign currency, even at potentially unfavorable official exchange rates, does not automatically entitle a taxpayer to a deductible loss. Taxpayers must demonstrate an actual economic loss. The primary focus should be on accurately converting foreign currency income into U.S. dollars for tax reporting purposes. Subsequent cases and IRS guidance would likely require taxpayers to use the most accurate and readily available exchange rate (potentially the official rate, unless proven to be unreflective of actual value) when reporting income received in foreign currency. This case highlights the importance of proper documentation and evidence to support any claimed loss related to foreign currency transactions.

