Corn Exchange National Bank and Trust Co. v. Commissioner, 1947 Tax Ct. Memo LEXIS 74 (T.C. 1947)

A taxpayer can deduct a loss under Section 23(f) of the Internal Revenue Code when the loss is sustained during the taxable year, even if the specific cause of the loss is an unidentified bookkeeping error, provided the taxpayer demonstrates the actual loss with sufficient evidence.

Summary

Corn Exchange National Bank sought to deduct a loss due to discrepancies between its individual and general ledgers. Despite exhaustive efforts, the bank could not pinpoint the exact cause of the $1,726.50 discrepancy, but the Tax Court found the loss resulted from missing or returned checks paid by the bank but not charged to depositors' accounts. The court held that the bank sustained a deductible loss under Section 23(f) because it demonstrated that it had made cash payments it could not recover, and charging the loss against undivided profits evidenced the bank's judgment that the loss was irrecoverable in the taxable year. The Commissioner argued that the Bank could not claim a loss until a depositor withdrew more than entitled, but the court rejected this.

Facts

During June 1943, the petitioner, Corn Exchange National Bank, discovered a discrepancy of approximately $2,100 between its individual ledger (containing depositors' accounts) and its general ledger. The bank investigated the discrepancy, reducing it to $1,726.50 by identifying and correcting mathematical and mechanical errors in the individual ledger. The bank's investigation confirmed the deposit side of the ledger was correct. Despite further investigation, the remaining discrepancy could not be traced to any specific error or transaction. The bank's records were complete except for the canceled checks already returned to depositors. The bank charged off the remaining discrepancy against its undivided profits account.

Procedural History

The Commissioner of Internal Revenue disallowed the bank's deduction of $1,726.50 as a loss sustained during the taxable year. The Corn Exchange National Bank then petitioned the Tax Court for a redetermination of the deficiency. The Tax Court reviewed the case. Decision would be entered under Rule 50.

Issue(s)

Whether the petitioner sustained a deductible loss under Section 23(f) of the Internal Revenue Code for the taxable year due to the unidentified discrepancy between its individual and general ledgers.

Holding

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Yes, because the evidence showed that the discrepancy resulted from actual cash payments made by the bank for checks that were lost or returned before being charged to the depositors' accounts, constituting a real economic loss sustained during the taxable year.

Court's Reasoning

The Tax Court reasoned that while a mere charge-off to balance books is insufficient for a loss deduction, this case differed because the bank demonstrated an actual loss. The stipulation regarding the balanced general ledger eliminated it as a source of error. The court inferred that the remaining discrepancy was due to lost or returned checks paid by the bank. The court emphasized that the bank made actual cash payments that it could not recoup because it lost the evidence (the checks) necessary to charge the depositors' accounts. The court distinguished this situation from cases where the taxpayer merely seeks to deduct a bookkeeping entry without demonstrating an actual economic outlay. The court found the charge-off against undivided profits significant as it evidenced the bank's judgment of an irrecoverable loss, supported by the facts. The court stated, "The loss or return of the checks rather than the charge made against petitioner's undivided profits account was the event which fixed the petitioner's actual loss under the statute, and closed the transaction beginning with its payment of the checks."

Practical Implications

This case clarifies that a taxpayer can deduct a loss even if the precise cause is unknown, provided sufficient evidence demonstrates an actual economic outlay that the taxpayer cannot recover. It distinguishes between a mere bookkeeping adjustment and a real loss. The case highlights the importance of establishing that the taxpayer parted with assets and has little prospect of recovery. This ruling is essential for banks and other financial institutions dealing with numerous daily transactions, as it provides a framework for deducting losses stemming from unidentified errors. It also emphasizes the evidentiary burden on the taxpayer to demonstrate the fact and amount of the loss.

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