10 T.C. 357 (1948)

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A cash-basis taxpayer can deduct a loss under Section 23(f) of the Internal Revenue Code when it demonstrates an actual loss occurred during the taxable year, even if related to a bookkeeping error, where the taxpayer paid out funds and has no reasonable expectation of recovery.

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Summary

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First National Bank of Bellflower, a cash-basis taxpayer, experienced a discrepancy between its general and individual ledgers. An investigation revealed the discrepancy resulted from checks paid by the bank that were lost or returned before being charged to depositors' accounts. The bank deducted the unrecoverable amount as a loss. The Tax Court held that the bank could deduct the loss under Section 23(f) because the bank proved it actually paid out funds, the checks were lost, and the bank had no reasonable prospect of recovering those funds from its depositors during the tax year.

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Facts

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First National Bank of Bellflower (the Bank) operated on a cash basis. A discrepancy arose between the Bank's general ledger and the aggregate balances in its individual ledger, totaling approximately $2,100. Intensive investigation reduced the discrepancy to $1,726.50. The remaining discrepancy was attributed to lost or returned checks that had been paid by the Bank but not charged to the depositors' accounts. The Bank charged $1,726.50 to undivided profits and deducted it as a loss on its tax return.

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Procedural History

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The Commissioner of Internal Revenue disallowed the deduction, resulting in a deficiency assessment. The Bank petitioned the Tax Court for review of the Commissioner's determination.

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Issue(s)

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Whether a cash-basis bank can deduct as a loss under Section 23(f) of the Internal Revenue Code the amount of a discrepancy between its general ledger and individual ledgers when the discrepancy is attributable to checks that were paid but lost or returned before being charged to depositors' accounts.

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Holding

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Yes, because the bank demonstrated it actually sustained a loss during the taxable year when it paid out funds on the lost or returned checks and had no reasonable expectation of recovering those funds.

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Court's Reasoning

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The Tax Court emphasized that the stipulation that the general ledger was

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