13 T.C. 897 (1949)

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A taxpayer cannot deduct a loss under Section 23(e) of the Internal Revenue Code if there is a reasonable prospect of reimbursement from another source, such as a trust obligated to indemnify the taxpayer.

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Summary

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Charles D. Whitney, sole trustee of a trust, sought to deduct a payment he made to settle a lawsuit arising from an accident involving a trust employee. The Tax Court denied the deduction, finding Whitney failed to prove the loss was not compensated by insurance or otherwise. Because Whitney, as trustee, had a right to indemnification from the trust assets for the settlement payment, and he didn't prove the trust lacked sufficient assets to reimburse him, the loss was not deductible. The court emphasized that deductions are allowed only for actual, realized losses, and Whitney hadn't shown he couldn't recover his outlay.

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Facts

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Whitney was the sole trustee of the Whitney Worsted Trust, which was liquidating the assets of Whitney Worsted Co. An employee of the trust, driving a company truck, caused an accident that resulted in a death. The deceased's estate sued both the employee and the company. The company's insurer paid its policy limit of $5,000. Whitney, on advice of counsel that he might be personally liable, settled the suit against the employee for $2,750 and incurred $200 in attorney fees.

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Procedural History

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Whitney claimed a $2,950 deduction on his 1944 income tax return, representing

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the settlement payment and attorney's fees as a casualty loss. The Commissioner of Internal Revenue disallowed the deduction, leading to Whitney's petition to the Tax Court. The Tax Court upheld the Commissioner's determination.

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Issue(s)

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1. Whether Whitney could deduct the $2,950 payment as a loss incurred in a trade or business under Section 23(e)(1) of the Internal Revenue Code.

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2. Whether Whitney could deduct the $2,950 payment as a loss incurred in a transaction entered into for profit, though not connected with a trade or business, under Section 23(e)(2) of the Internal Revenue Code.

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Holding

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1. No, because the employee was working for the Whitney Worsted Trust, not Whitney individually, at the time of the accident.

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2. No, because Whitney failed to show that the payment was a loss "not compensated for by insurance or otherwise," as required by the statute.

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Court's Reasoning

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The court rejected Whitney's initial claim of a casualty loss under Section 23(e)(3), noting it only applied to losses of property. Turning to Sections 23(e)(1) and (2), the court found that even if Whitney's textile activities constituted a trade or business, the employee was acting on behalf of the trust, not Whitney personally. More critically, the court emphasized that a trustee has a right to indemnify himself from trust assets for liabilities incurred due to an employee's negligence during proper trust administration. Quoting from Scott on Trusts, the court stated that a trustee is entitled to indemnity out of the trust estate if the liability was incurred in the proper administration of the trust and the trustee was not personally at fault. Because Whitney didn't prove the trust lacked sufficient assets to reimburse him, he failed to demonstrate an actual, realized loss. The court stated, "It is a startling proposition that a taxpayer may, for reasons of his own, decline to enforce a valid claim against a responsible concern and then assert that he has sustained a business loss which the Government should share."

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