14 T.C. 1366 (1950)

A reasonable addition to a bad debt reserve under Section 23(k)(1) of the Internal Revenue Code depends on the nature of the business, general business conditions, past experience, the amount of the existing reserve, and all other relevant factors; a formula that works in some years may be inappropriate in others.

Summary

Mill Factors Corporation, engaged in the factoring business, disputed the Commissioner's determination of a reasonable addition to its bad debt reserve for 1942. The Tax Court upheld the Commissioner's allowance, finding that while past experience is important, the economic conditions of the tax year, including wartime prosperity and decreased receivables, justified the lower addition. The court emphasized that a bad debt reserve is an estimate of future losses based on conditions at the time of the estimate, and Mill Factors did not demonstrate a reasonable expectation of losses exceeding the amount allowed.

Facts

Mill Factors Corp. was in the factoring business, purchasing accounts receivable and making loans to textile companies. They primarily dealt with the textile industry. Their activities consisted of loans secured by inventory and the purchase of accounts receivable without recourse. Mill Factors maintained a reserve for bad debts, charging losses and crediting recoveries to it.

Procedural History

Mill Factors filed its 1942 federal income tax return and claimed a deduction for an addition to its bad debt reserve. The Commissioner determined a deficiency, allowing a smaller deduction than claimed. Mill Factors petitioned the Tax Court, arguing for a larger deduction.

Issue(s)

Whether the Commissioner erred in determining that $21,573.17 was a reasonable addition to Mill Factors Corporation's reserve for bad debts for the year 1942, when Mill Factors claimed it was entitled to a deduction of $164,475.34.

Holding

No, because the amount of a reasonable addition to a bad debt reserve depends on the specific facts of the business and economic conditions prevailing during the tax year, and Mill Factors did not demonstrate that it reasonably expected probable losses justifying a larger addition than what the Commissioner allowed.

Court's Reasoning

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The court applied Section 23 (k) (1) of the Internal Revenue Code, which permits a deduction for a reasonable addition to a reserve for bad debts at the Commissioner’s discretion. The court considered Mill Factors’ past experience, but emphasized that past experience is not the sole determining factor. It cited Black Motor Co., <span normalizedcite="41 B.T.A. 300

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