Goldberg v. Commissioner, T.C. Memo. 1947-267

Losses from the sale of personal assets, even real property, are not attributable to a taxpayer's trade or business for net operating loss deduction purposes if the property was not acquired, held, or sold in the course of that business.

Summary

The petitioner, a lawyer and real estate investor, sought to deduct a loss from the sale of a Fifth Avenue property as a net operating loss carry-back. The Tax Court disallowed the deduction, finding that although the petitioner was in the real estate business, the Fifth Avenue property was a personal residence inherited from his mother and not held as part of his real estate business. The court determined that the loss was a personal capital loss, not a business loss, and therefore not eligible for net operating loss treatment. The court also addressed deductions for entertainment expenses, allowing a portion related to a club used for client meetings but disallowing vague and unsubstantiated claims.

Facts

The petitioner was engaged in the business of buying and selling real estate in a joint venture until 1939.

He inherited the Fifth Avenue property from his mother in 1927; it had been her personal residence.

The petitioner and his siblings initially formed a partnership to manage and liquidate the inherited property, including the Fifth Avenue residence.

In 1937, the petitioner bought out his siblings' shares of the Fifth Avenue property, intending to sell it, but struggled to find a buyer.

He rented the property but the income was insufficient to cover expenses.

The petitioner finally sold the Fifth Avenue property in 1945 at a significant loss.

He attempted to deduct this loss as a net operating loss carry-back to reduce his taxes for 1943 and 1944.

Procedural History

The petitioner brought this case before the Tax Court to contest the Commissioner's determination that the loss on the sale of the Fifth Avenue property was not deductible as a net operating loss.

Issue(s)

1. Whether the loss incurred from the sale of the Fifth Avenue property in 1945 is

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attributable to the operation of the petitioner's trade or business for the purpose of calculating a net operating loss under Section 122 of the Internal Revenue Code.

2. Whether the petitioner substantiated claimed deductions for traveling and entertainment expenses related to his law business for the years 1942-1944.

Holding

1. No, because the Fifth Avenue property was not acquired, held, or sold by the petitioner in the course of his real estate business; it was a personal residence inherited from his mother and dealt with separately from his business activities.

2. Yes, in part. The petitioner substantiated entertainment expenses related to the "Bankers Club" to a reasonable estimate of $500 per year for 1942-1944, but failed to adequately substantiate other claimed entertainment expenses.

Court's Reasoning

The court reasoned that to deduct a loss as a net operating loss, it must be attributable to the taxpayer's trade or business. For losses from the sale of real property, the trade or business must be that of buying and selling real estate.

The court found that while the petitioner was in the real estate business, the Fifth Avenue property was a personal inheritance, not a business asset. The court stated, "*Far from sustaining petitioner's position, the evidence indicates that, while the petitioner was engaged in the business of buying and selling real property, the Fifth Avenue property was not acquired, held or sold by him in the course of such business.*"

The property was inherited, initially managed in a family partnership for liquidation, and then purchased by the petitioner personally, separate from his real estate business venture. His dealings with the property were distinct from his business operations.

Regarding entertainment expenses, the court applied the *Cohan v. Commissioner* rule, allowing a reasonable estimate for expenses at the Bankers Club due to credible testimony, but disallowed other vague and unsubstantiated claims.

Practical Implications

This case clarifies that losses on the sale of personal assets, even by taxpayers engaged in related businesses, are not automatically deductible as business losses for net operating loss purposes. Taxpayers must demonstrate a clear connection between the asset and their trade or business. The intent and context of acquiring, holding, and disposing of the property are crucial factors.

For legal practice, this case highlights the importance of meticulously documenting

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the business purpose of asset acquisition and disposition, especially for taxpayers with both business and personal dealings in similar asset types. It reinforces the distinction between personal investments and business assets for tax purposes. Later cases applying this principle often focus on the taxpayer's intent and the nature of the asset's use in determining whether a loss is business-related.

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