1953 Tax Ct. Memo LEXIS 95

A loss is deductible under Section 23(e)(2) of the Internal Revenue Code only if the transaction was entered into for profit; the taxpayer's motive in acquiring the asset is crucial to determining whether the transaction meets this requirement.

Summary

Frances B. Watkins sought to deduct as a loss the amount she spent acquiring her son's remainder interests in two trusts. Watkins was the life beneficiary of the trusts, and her son's interest would only vest if he outlived her. He did not. The Tax Court denied the deduction, finding that Watkins's primary motive for acquiring the remainder interests was to ensure they passed to her grandchildren, not to generate a profit. The court emphasized that while Watkins might have been able to sell the interests, her intent was never to do so.

Facts

Frances B. Watkins was the life beneficiary of two trusts. Her son held a remainder interest in these trusts, contingent on him surviving her. If he predeceased her, the remainder would go to his issue (Watkins's grandchildren).
Watkins purchased her son's remainder interests. Her son died before Watkins, meaning his remainder interest never vested.
Watkins claimed a loss deduction on her tax return for the amount she spent acquiring the remainder interests.

Procedural History

Watkins claimed a deduction on her federal income tax return. The Commissioner of Internal Revenue disallowed the deduction. Watkins petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether Watkins is entitled to a loss deduction under Section 23(e)(2) of the Internal Revenue Code for the amount she spent to acquire her son's remainder interests, given that the son predeceased her and the interests never vested in her estate; specifically, whether the purchase of the remainder interest was a "transaction entered into for profit".
Whether the death of the petitioner's son constitutes a casualty loss within the meaning of Section 23(e)(3) of the Internal Revenue Code.

Holding

No, because Watkins's primary motive in acquiring the remainder interests was not to generate a profit but to ensure the assets passed to her grandchildren.
No, because the death of a son is not an event similar in character to a fire, storm,

or shipwreck, which are the types of events contemplated by Section 23(e)(3).

Court's Reasoning

The court focused on Watkins's intent when she acquired the remainder interests. It found that she intended to keep the interests within her family and pass them on to her grandchildren, not to sell them for a profit. The court stated, "Although she no doubt could have sold these interests, we are satisfied that she never intended to do so, and that her only intention was to prevent them from being sold or otherwise dissipated and to make them part of her estate so that she could transfer them to her grandchildren at her death."

Even though the transactions were "arm's length," the court emphasized that this didn't automatically make them "for profit." Buying a house for personal use is an arm's length transaction, but it's not for profit. The court distinguished the case from situations where a speculative profit motive exists, stating, "Petitioner's contention that these remainder interests had a speculative value from which she might have derived a profit is wholly irrelevant on the facts of this case. The point is that such speculative possibility played no part whatever in her motive in acquiring these interests."

The court also dismissed the argument that her son's death was a casualty, stating that "The term 'other casualty' has been consistently treated as referring to an event similar in character to a fire, storm, or shipwreck."

Practical Implications

This case illustrates the importance of taxpayer intent when determining whether a transaction qualifies as one "entered into for profit" for loss deduction purposes. It clarifies that even an arm's-length transaction can be considered personal if the primary motive is non-economic, such as preserving assets for family.

Attorneys should advise clients to document their intent and purpose when entering into transactions that could potentially generate a loss, particularly when dealing with family members or assets with sentimental value.

This case serves as a reminder that the "other casualty" provision under Section 23(e)(3) is narrowly construed to include events similar in nature to those specifically listed (fire, storm, shipwreck), and does not extend to events like death, even if it results in a financial loss.