18 T.C. 256 (1952)

To deduct a loss under Section 23(e)(2) of the Internal Revenue Code, the taxpayer must demonstrate that the transaction was entered into with a primary profit motive.

Summary

The petitioner, a life beneficiary of two trusts, purchased her son's remainder interests in those trusts. The son predeceased her, and she sought to deduct the cost of acquiring the remainder interests as a loss under Section 23(e)(2) of the Internal Revenue Code, arguing it was a transaction entered into for profit. The Tax Court denied the deduction, finding that her primary motive was to prevent the interests from being dissipated and to ensure they passed to her grandchildren, not to generate profit. Therefore, the transaction lacked the requisite profit motive for a loss deduction.

Facts

The petitioner was the life beneficiary of two trusts. Her son held the remainder interests, contingent on him surviving her; otherwise, the interests would pass to his issue.
The petitioner acquired her son's remainder interests through a series of transactions.
The son died before the petitioner.
The petitioner sought to deduct the total amount she spent acquiring the remainder interests as a loss on her income tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction claimed by the petitioner.
The petitioner appealed the Commissioner's decision to the Tax Court.

Issue(s)

Whether the petitioner's acquisition of her son's remainder interests in the trusts was a transaction entered into for profit, thus entitling her to a loss deduction under Section 23(e)(2) of the Internal Revenue Code.
Whether the death of the petitioner's son constitutes a "casualty" under Section 23(e)(3) of the Internal Revenue Code.

Holding

No, because the petitioner's primary motive in acquiring the remainder interests was to ensure they passed to her grandchildren, not to generate profit. Therefore, the transaction was not entered into for profit as required by Section 23(e)(2).

No, because the term “other casualty” refers to events similar in nature to a fire, storm, or shipwreck, and the death of the petitioner’s son does not fall within this category.

Court’s Reasoning

The court emphasized that the taxpayer’s motive is crucial in determining whether a transaction was entered into for profit, citing *Early v. Atkinson*, 175 F.2d 118, 122 (C.A. 4).
The court found that despite the arm’s-length nature of the transaction, the petitioner’s dominant intention was to prevent the remainder interests from being dissipated and to ensure they passed to her grandchildren. The court stated, “[W]e 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.”
The court distinguished between transactions conducted at arm’s length and those entered into for profit, noting that purchasing a house for personal occupancy, although an arm’s-length transaction, is not one entered into for profit.
Regarding the “other casualty” argument, the court stated that the term refers to events similar to a fire, storm, or shipwreck, citing *Waddell F. Smith*, 10 T.C. 701, 705.

Practical Implications

This case underscores the importance of establishing a profit motive when claiming loss deductions under Section 23(e)(2) of the Internal Revenue Code. Taxpayers must demonstrate that their primary intention in entering into a transaction was to generate profit, not personal benefit or estate planning.
The case clarifies that even arm’s-length transactions can be deemed not for profit if the underlying motive is personal rather than financial.
Attorneys advising clients on tax planning should carefully document the client’s intent and purpose behind transactions to support potential loss deductions. Contemporaneous records demonstrating a profit-seeking objective are crucial.
This ruling limits the scope of “other casualty” under Section 23(e)(3) to events similar to fires, storms, and shipwrecks, reinforcing a narrow interpretation of this provision. This principle is routinely applied in subsequent cases involving casualty loss deductions.