19 T.C. 1046 (1953)

A taxpayer can deduct a loss under Section 23(e)(3) of the Internal Revenue Code when a contractor absconds with funds paid for construction, constituting a theft loss.

Summary

Thomas and Agnes Miller contracted with Landstrom to build a house, paying him $7,500. Landstrom abandoned the project after partial completion and disappeared. The Millers sought to deduct $3,627.36 as a theft loss under Section 23(e)(3) of the Internal Revenue Code. The Tax Court held that the Millers were entitled to deduct $2,500 as a loss due to Landstrom's felonious actions, as his absconding with the funds constituted a form of theft, even though the exact amount could not be precisely determined.

Facts

The Millers contracted with Landstrom on December 22, 1947, for the construction of a house for $11,340, later amended to include additional work for $3,384. The Millers paid Landstrom $3,500 upon signing the contract and $4,000 on February 11, 1948, totaling $7,500. Landstrom began work on February 18, 1948, but abandoned the job around April 26, 1948, and disappeared. The Millers filed a criminal complaint, and Landstrom was indicted for fraudulent conversion, a felony, but remained unapprehended.

Procedural History

The Commissioner of Internal Revenue disallowed the Millers' deduction of $3,627.36 for the loss incurred due to the contractor's abandonment. The Millers petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether the Millers are entitled to a deduction under Section 23(e)(3) of the Internal Revenue Code for a loss sustained when a contractor absconded with funds paid for construction of their house.

Holding

Yes, because Landstrom's actions constituted a form of theft under Pennsylvania law, entitling the Millers to a deduction for the loss, albeit in a reduced amount of $2,500 due to uncertainty regarding the exact amount Landstrom spent on the project.

Court's Reasoning

© 2025 SCOTUSreports.com. All rights reserved.

The court reasoned that Landstrom's absconding with the funds after only partially completing the work constituted a felonious act under Pennsylvania law. Even though the exact amount of the loss was difficult to ascertain, the court estimated the loss to be $2,500 based on the available evidence. The court distinguished the situation from one where the contractor had fully expended the funds on the project or where the value of the completed structure equaled or exceeded the amount paid. The court emphasized that Landstrom received the money as his own, and his felonious departure without settling accounts with the Millers was akin to theft or embezzlement. The court cited prior cases holding that embezzlement is sufficiently similar to theft to warrant a deduction under Section 23(e)(3).

Practical Implications

This case establishes that a taxpayer can deduct losses resulting from a contractor's theft of funds earmarked for construction. It clarifies that the deduction is not limited to cases of simple theft but extends to similar felonious acts like embezzlement or fraudulent conversion. When assessing such deductions, taxpayers must demonstrate that the contractor's actions were indeed felonious and that a genuine loss was sustained. While precise quantification of the loss is ideal, the court can estimate the loss based on available evidence, following the principle of Cohan v. Commissioner. This case is crucial for tax practitioners advising clients who have been victims of contractor fraud, helping them navigate the requirements for claiming a theft loss deduction.

© 2025 SCOTUSreports.com. All rights reserved.