19 T.C. 1072 (1953)

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A taxpayer cannot claim a deduction for an embezzlement loss if, during the same taxable year the embezzlement is discovered, the embezzler promises restitution, creating a reasonable expectation of recovery.

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Summary

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George M. Still, Inc. failed to report cash sales on its original tax returns after two officers withheld proceeds. The company argued that this omission was offset by an embezzlement loss deduction. The Tax Court held that no deductible loss occurred because the officers promised restitution during the same taxable year, creating a reasonable expectation of recovery, which they fulfilled the following year. Furthermore, the court held that filing an amended return and paying the additional tax did not preclude the IRS from assessing fraud penalties where the original return was fraudulent.

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Facts

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George M. Still, Inc. was a wholesale oyster and clam dealer. Two of its officers, Nancy Milliken (vice president) and Michael Weissman (secretary), withheld proceeds from cash sales, causing sales to be understated on the company's books. The president, Sidney Still (Nancy's father), discovered this before the end of the fiscal year. Milliken and Weissman promised to return the funds. The original tax returns, prepared by an accounting firm, did not include these sales. The officers later made restitution in October 1946.

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Procedural History

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The company filed original tax returns that did not reflect the cash sales. Amended returns were later filed, disclosing the additional sales and paying the associated taxes. The Commissioner of Internal Revenue determined a deficiency in tax and additions to tax for fraud. The Tax Court reviewed the Commissioner's determination.

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Issue(s)

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1. Whether the petitioner was entitled to an embezzlement loss deduction to offset the unreported income, given the officers' promise of restitution.

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2. Whether the subsequent filing of an amended return and payment of additional tax barred the Commissioner from assessing fraud penalties.

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3. Whether the Commissioner presented clear and convincing evidence of fraud with intent to evade tax.

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Holding

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1. No, because the officers promised restitution during the taxable year the embezzlement was discovered, creating a reasonable expectation of recovery.

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2. No, because a taxpayer cannot avoid fraud penalties by filing an amended return and paying the tax due after filing a fraudulent original return.

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3. Yes, because the company’s officers knowingly failed to report income on the original returns with the intent to evade tax.

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Court’s Reasoning

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Regarding the embezzlement loss deduction, the court distinguished this case from others where such deductions were allowed, noting that in those cases, there was no indication of likely restitution. The court emphasized that section 23 (f) of the Internal Revenue Code allows deductions for “losses sustained during the taxable year and not compensated for by insurance or otherwise.” The court found the promise of restitution significant: “In these circumstances, it seems clear to us that the unauthorized withdrawals did not constitute ‘losses’ which were ‘not compensated for by insurance or otherwise.’” The court cited Charles D. Whitney, stating,

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