Lucia Chase Ewing v. Commissioner, 20 T.C. 216 (1953)

To deduct losses under Section 23(e)(2) of the Internal Revenue Code, the taxpayer must demonstrate that their primary motive for entering into the transaction was to generate a profit, not for personal pleasure or to promote a charitable endeavor.

Summary

Lucia Chase Ewing, a principal dancer and devotee of ballet, sought to deduct sums advanced to The Ballet Theatre, Inc., a corporation she controlled, as either worthless debts or losses incurred in a joint venture. The Tax Court denied the deductions. The court found that the advances, contingent on the ballet company earning profits, did not constitute a debt. Further, the court determined that Ewing's primary motive in funding the ballet was not profit-driven but to support and promote the art form, disqualifying the losses from deduction under Section 23(e)(2) of the Internal Revenue Code.

Facts

Ewing, a principal dancer, advanced significant funds to The Ballet Theatre, Inc., a corporation she controlled, for ballet productions during the 1941-1942 and 1942-1943 seasons. These advances were made indirectly through High Time Promotions, Inc. (her wholly-owned corporation) in 1942 and directly in 1943. Repayment was contingent upon The Ballet Theatre, Inc., generating profits during those seasons. The ballet company sustained losses, and Ewing's advances were not repaid. Ewing had a long history of funding ballet, consistently incurring losses. The advances were entered as "loans" on the Ballet Theatre's books.

Procedural History

Ewing initially claimed the advances as worthless debt deductions under Section 23(k) of the Internal Revenue Code. She later amended her petition, arguing for a deduction under Section 23(e)(2) as a loss incurred in a joint venture. The Tax Court ruled against Ewing, disallowing the deductions.

Issue(s)

1. Whether the advances to The Ballet Theatre, Inc., constituted a deductible worthless debt under Section 23(k) when repayment was contingent on the company earning profits.

2. Whether Ewing's advances to The Ballet Theatre, Inc., constituted a deductible loss under Section 23(e)(2) incurred in a transaction entered into for profit, considering her primary motive.

Holding

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1. No, because a debt, within the meaning of Section 23(k), does not arise when the obligation to repay is subject to a contingency that has not occurred.

2. No, because Ewing's primary motive was not to earn a profit but to support ballet as an art form, disqualifying the loss deduction under Section 23(e)(2).

Court's Reasoning

The court reasoned that the advances did not constitute a debt because repayment was contingent on the ballet company earning profits, a condition that was never met. Citing *Evans Clark, 18 T.C. 780*, the court emphasized that a debt requires an unconditional obligation to repay. Regarding the joint venture argument, the court found no evidence of intent to form a joint venture; the agreements referred to the advances as loans and explicitly disavowed any partnership. The court also emphasized that Ewing bore the losses, and the Ballet Theatre, Inc., received additional assets. Critically, the court analyzed Ewing's primary motive under Section 23(e)(2), stating, "[N]o loss is deductible under this provision if the taxpayer engaged in the transaction merely or primarily for pleasure such as farming for a hobby, or primarily for such other purposes devoid of profit motive or intent, such as promoting charitable enterprises…" Given her long-standing devotion to ballet, consistent losses, limited attention to business management, and the terms of the agreements, the court concluded that Ewing's primary motive was to support ballet, not to generate profit. The court noted, "[T]he profit motive must be the 'prime thing.'"

Practical Implications

This case underscores the importance of demonstrating a primary profit motive when claiming loss deductions under Section 23(e)(2). It clarifies that even if a taxpayer hopes for a profit, a deduction will be disallowed if their dominant intent is personal pleasure, charitable contribution, or another non-profit objective. This case serves as a cautionary tale for taxpayers who subsidize activities they enjoy. Later cases have cited *Ewing* to emphasize the need for a clear and demonstrable profit-seeking purpose, especially in cases involving hobbies or activities closely aligned with personal passions. It clarifies that continuous losses are a significant factor when determining a taxpayer's true intention and that the terms of any agreement should reflect an arm's length transaction, particularly when dealing with controlled entities.

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