20 T.C. 511 (1953)

Expenses incurred while searching for a new business venture are not deductible as ordinary and necessary business expenses, expenses for the production of income, or losses from transactions entered into for profit, because the taxpayer is not yet engaged in a trade or business.

Summary

Morton and Agnes Frank traveled extensively to find a newspaper or radio station to purchase. They sought to deduct travel expenses and legal fees incurred during their search. The Tax Court held that these expenses were not deductible as ordinary and necessary business expenses because the Franks were not yet engaged in any trade or business. Furthermore, the expenses were not deductible as expenses for the production of income or as losses from transactions entered into for profit because the Franks were merely investigating potential businesses and had not yet entered into any transaction beyond preliminary investigation. This case establishes that pre-business investigation costs are generally non-deductible personal expenses.

Facts

Morton Frank, recently discharged from the Navy, and his wife Agnes, an attorney, embarked on a trip to investigate newspaper and radio properties across the United States. Their aim was to find a suitable business to purchase and operate. They traveled through several states, incurring travel and communication expenses. They also paid legal fees for services related to unsuccessful negotiations to purchase a newspaper in Wilmington, Delaware. Ultimately, in November 1946, they purchased a newspaper in Canton, Ohio.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Franks' income tax for 1946. The Franks petitioned the Tax Court for a redetermination, arguing that their travel expenses and legal fees were deductible as ordinary and necessary business expenses, expenses for the production of income, or losses from transactions entered into for profit. The Tax Court ruled against the Franks.

Issue(s)

Whether travel expenses and legal fees incurred while searching for a new business venture are deductible as: 1) ordinary and necessary business expenses under Section 23(a)(1) of the Internal Revenue Code; 2) expenses for the production of income under Section 23(a)(2) of the Internal Revenue Code; or 3) losses from transactions entered into for profit under Section 23(e)(2) of the Internal Revenue Code.

Holding

No, because the expenses were incurred before the taxpayers were engaged in any trade or business; no, because the expenses were incurred in an attempt to create a new income source rather than managing an existing one; and no, because the taxpayers did not enter into a transaction for profit that was later abandoned, but rather investigated potential transactions they ultimately declined to pursue.

Court's Reasoning

The court reasoned that the expenses were not deductible under Section 23(a)(1) because the Franks were not engaged in any trade or business at the time the expenses were incurred. The court stated, "The expenses of investigating and looking for a new business and trips preparatory to entering a business are not deductible as an ordinary and necessary business expense incurred in carrying on a trade or business." Citing *George C. Westervelt, 8 T.C. 1248*. The court also held that the expenses were not deductible under Section 23(a)(2) because they were incurred in an attempt to obtain income by creating a new interest, rather than in managing or conserving property held for the production of income. The court distinguished between expenses for producing income from an existing interest and expenses incurred in an attempt to obtain income by creating some new interest. Finally, the court held that the expenses were not deductible as losses under Section 23(e)(2) because the Franks did not enter into any transactions that were later abandoned. The court stated, "It cannot be said that the petitioners entered into a transaction every time they visited a new city and examined a new business property."

Practical Implications

This case clarifies that expenses incurred in searching for a new business are generally not deductible for income tax purposes. Taxpayers must be actively engaged in a trade or business to deduct related expenses. The ruling highlights the distinction between expenses incurred to maintain or manage an existing business and those incurred to start a new one. This decision impacts how individuals and businesses account for start-up costs, emphasizing the need to differentiate between deductible business expenses and non-deductible capital expenditures or personal expenses. Later cases have distinguished this ruling by focusing on whether the taxpayer's activities were sufficiently concrete to constitute engaging in a trade or business, or whether the expenses were truly investigatory in nature.

