21 T.C. 155 (1953)

A loss from the sale of property will be disallowed for tax purposes if the sale is deemed to be indirectly between members of a family, even when title is taken as tenants by the entirety with a family member and another party.

Summary

Julius Stern sought to deduct a loss on the sale of his former residence. He sold the property to his son-in-law and daughter, with title conveyed to them as tenants by the entirety. The Tax Court disallowed the loss under Section 24(b) of the Internal Revenue Code, which prohibits deductions for losses from sales between family members. The court reasoned that because the daughter received a full ownership interest as a tenant by the entirety, the sale was indirectly to a family member, regardless of the son-in-law's involvement.

Facts

Petitioner Julius Stern owned a residence he used until 1947 when he moved and listed it for sale. Unsuccessful in selling, he rented it to his son-in-law, Dr. Guttman. Later, Stern sold the house to Dr. Guttman and his wife (Stern's daughter) Claire Guttman, taking title as tenants by the entirety. Stern claimed a loss on the sale for tax purposes. The IRS disallowed the deduction, arguing the sale was indirectly to a family member.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the income tax of Julius and Ellen Stern for the taxable year 1948. The Sterns contested the deficiency in the Tax Court regarding the disallowance of the loss on the sale of the residence.

Issue(s)

1. Whether the sale of property by the petitioner, with title taken by his daughter and son-in-law as tenants by the entirety, constitutes a sale "directly or indirectly" to a member of his family under Section 24(b) of the Internal Revenue Code, thus disallowing the loss deduction.

Holding

1. Yes. The Tax Court held that the sale was indirectly to the petitioner's daughter, a family member, because as a tenant by the entirety, she received full ownership interest in the property. Therefore, the loss deduction is disallowed under Section 24(b).

Court's Reasoning

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The court focused on the legal nature of tenancy by the entirety under Pennsylvania law, stating that each tenant owns the whole, not just a part. Quoting *Gallagher's Estate*, the court emphasized that in tenancy by the entirety, each spouse is seized "*per tout et non per my*, i. e., of the whole or the entirety and not of a share, moiety, or divisible part." Because the daughter obtained full ownership as a tenant by the entirety, the court reasoned the sale was effectively to her, a family member explicitly listed in Section 24(b). The court distinguished cases where sales were made to excluded individuals merely as nominal parties to mask sales to family members, noting that even without such nominalism, the statute's purpose of preventing tax avoidance within families would be frustrated if losses were allowed in this scenario. The court stated, "It does not necessitate the allowance of the present loss where to do so would likewise frustrate the legislative purpose." The court also noted the difficulty in ascertaining the bona fides of intra-family sales losses, which is a reason for the automatic disallowance rule.

Practical Implications

Stern v. Commissioner clarifies that the "indirectly" provision of Section 24(b) can extend to situations where family members gain full property rights through legal constructs like tenancy by the entirety, even if non-family members are also involved in the transaction. For tax practitioners, this case serves as a reminder that the substance of a transaction, particularly in family sales, will be scrutinized over its form. It highlights that losses can be disallowed even when a sale is not directly and solely to a family member if the family member acquires a significant ownership interest. This ruling impacts how tax advisors must counsel clients on property transfers within families, emphasizing the need to consider all forms of ownership and control when evaluating potential loss disallowances.

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