## *Findley v. Commissioner, 13 T.C. 350 (1949)*

A partial bad debt deduction is only allowable in the year the debt is charged off on the taxpayer's books, but only to the extent the taxpayer demonstrates the debt is unrecoverable to the Commissioner's satisfaction.

### Summary

The taxpayer, Findley, sought a partial bad debt deduction for advances made to coal contractors. The Commissioner disallowed the deduction because Findley did not charge off the debt on his books until the following year. The Tax Court held for the Commissioner, stating that while a charge-off is required for a partial bad debt deduction, the taxpayer must also demonstrate to the Commissioner's satisfaction that a portion of the debt is not recoverable. The court emphasized that the worthlessness of the debt and the charge-off must occur in the same taxable year for the deduction. Because the court found the debt became worthless in 1949, the deduction was not allowed for 1948.

### Facts

Findley entered into two contracts with coal contractors, Wilkinson and Booth: a conditional sale agreement for mining equipment and an agreement where Findley advanced operating costs for coal stripping, to be repaid through credits from coal sales. Findley claimed a partial bad debt deduction for 1948 due to unrecovered advances. However, Findley did not charge off the debt on his books until April or May 1949, after terminating the coal stripping agreement and repossessing the equipment. The Commissioner disallowed the 1948 deduction.

### Procedural History

The case was heard in the United States Tax Court. Findley challenged the Commissioner's denial of the partial bad debt deduction. The Tax Court ruled in favor of the Commissioner.

### Issue(s)

1. Whether Findley could claim a partial bad debt deduction for 1948, despite charging off the debt in 1949.

2. Whether the advances to the coal contractors became partially worthless in 1948.

### Holding

1. No, because the partial bad debt deduction was not properly taken in the tax year 1948.

2. No, because the evidence did not establish the obligation had become partially

 

worthless in 1948.

## Court's Reasoning

The court relied on Section 23(k)(1) of the Internal Revenue Code (IRC), which governed bad debt deductions. The Court distinguished between wholly worthless debts, deductible in the year they become worthless, and partially worthless debts, where a deduction is allowed only up to the amount charged off during the taxable year and only if proven to the Commissioner that the debt is partially unrecoverable. The court noted that, "[T]he statute does not require that partial bad debts must be charged off or deducted in the year when the partial worthlessness occurs, or indeed in any other year prior to the time when the debt becomes wholly worthless." The Court found that the timing of the charge-off was critical for partial worthlessness. It emphasized that "partial worthlessness of an obligation must be evidenced by some event or some change in the financial condition of the debtor, subsequent to the time when the obligation was created, which adversely affects the debtor's ability to make repayment." It determined that the contractors' financial situation hadn't significantly changed in 1948 to indicate worthlessness and that, by April 1949, Findley terminated the agreement and repossessed the equipment, which was the triggering event for worthlessness. The court also pointed out that the purpose of the charge-off is to perpetuate evidence of the taxpayer's election to abandon part of the debt as an asset.

## Practical Implications

This case highlights the importance of proper timing and documentation when claiming partial bad debt deductions. Attorneys advising clients must ensure that:

- The debt is charged off during the taxable year in which partial worthlessness is claimed.
- There is clear evidence of events affecting the debtor's ability to repay, establishing partial worthlessness.
- Clients document all actions taken with respect to the debt.
- The client has proof that the debt is partially unrecoverable, which must be demonstrated to the Commissioner to justify the deduction.

This decision underscores that a deduction may be disallowed for bad debts that are only partially worthless, unless the taxpayer takes the proper steps in that particular year.

Later cases have continued to emphasize that the deduction is limited to the amount charged off within the taxable year.

 