27 T.C. 755 (1957)

A cancellation of a debt owed to a shareholder by a financially troubled corporation, where the cancellation is made to improve the corporation's financial condition, is considered a contribution to capital, not a deductible expense or loss for the shareholder.

Summary

Leo Perlman, an officer and significant shareholder in an insurance company, cancelled the company's debt to him for unpaid salary. The company was in financial distress, with regulators expressing concern about its solvency. The court determined that Perlman's cancellation of the debt was a contribution to the company's capital, aimed at improving its financial standing and protecting his investment. Consequently, Perlman was not allowed to deduct the cancelled debt as a loss or expense on his taxes. The ruling highlights the importance of the taxpayer's intent and the economic reality of the transaction, particularly when a shareholder's actions benefit the corporation's financial health.

Facts

Leo Perlman was a key organizer, officer (Executive Vice President), and substantial shareholder (20-23.75%) of the Trade Union Accident and Health Association of America (later Union Casualty Co.). The company had minimal capital and surplus initially. Perlman had a five-year employment contract, which was later renewed. The company accrued Perlman's salary but paid him only a portion of it between 1943 and 1947. By 1950, the ratio of premiums written to capital and surplus was high, exceeding industry standards, and the New York Department of Insurance expressed concern. In response to this, the chief examiner requested that the unpaid compensation be

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