***31 T.C. 346 (1958)***

To deduct a loss under Internal Revenue Code § 23 (e)(2), a taxpayer must prove that the transaction resulting in the loss was entered into primarily for profit, and that the taxpayer personally expected to profit directly from the transaction.

**Summary**

The case concerns the deductibility of a claimed loss resulting from a stock exchange. George Arata exchanged stock in Snyder & Black for worthless stock in Salers, Inc. Arata argued that he entered into the transaction to secure the services of Salers' personnel for Snyder & Black, thus increasing his profits. The Tax Court held that the loss was not deductible because Arata's primary motive was not profit, and any profit would have indirectly benefited him. The court emphasized that the anticipated profit from the transaction, was too contingent and remote to justify a deduction under § 23(e)(2).

**Facts**

George Arata was president and director of Snyder & Black, a corporation engaged in the advertising business, and also of a wholly owned subsidiary. He also held positions in other corporations, including Coca-Cola bottling companies. In 1953, Arata exchanged 765 shares of Snyder & Black stock (worth $50 per share) for 765 shares of Salers, Inc., stock, which had become worthless. The value of Snyder & Black stock was estimated at $68 per share at the time of trial. He claimed a loss deduction of $38,250 on his 1953 tax return, arguing that the loss was incurred in a transaction for profit under I.R.C. § 23(e)(2). The IRS disallowed the deduction.

**Procedural History**

The IRS disallowed the loss deduction claimed by the Aratas. The Aratas petitioned the United States Tax Court, challenging the IRS's determination. The Tax Court reviewed the facts and legal arguments, ultimately ruling in favor of the IRS and upholding the deficiency determination. The case was not appealed.

**Issue(s)**

1. Whether Arata's loss from the stock exchange was deductible as a loss incurred in trade or business under I.R.C. § 23(e)(1).

2. Whether Arata's loss from the stock exchange was deductible as a loss incurred in a transaction entered into for profit under I.R.C. § 23(e)(2).

3. Whether the Aratas were liable for additions to tax under I.R.C. § 294 (d) (1) (A) and 294 (d) (2).

**Holding**

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1. No, because Arata was not in the trade or business of financing corporations, and even if he were, the transaction was not part of that business.

2. No, because Arata failed to establish that his primary motive for the stock exchange was profit, and he did not directly expect profit from the transaction.

3. Yes, because the Aratas did not present any evidence to contest the additions to tax.

**Court's Reasoning**

The court first addressed whether the loss could be deducted as a loss incurred in trade or business under § 23 (e)(1). The court found that Arata was not in the business of financing corporations, and that even if he was, the stock exchange was not a part of that business. Next, the court addressed whether the loss could be deducted as a loss incurred in a transaction entered into for profit under § 23 (e)(2). The court emphasized that the taxpayer's motive must primarily be profit, and the taxpayer needs to have a reasonable expectation of profit. Arata's claimed motive was to secure services, resulting in increased value of Snyder & Black stock. The court found the evidence insufficient to establish that Arata's primary motive was profit and that he could directly expect profit from the exchange, and denied the deduction. The court noted that the benefit to Arata would have been indirect and contingent on the increased profits of Snyder & Black. The court also sustained the IRS's determination on additions to tax, as Arata offered no evidence to challenge it.

**Practical Implications**

The case highlights the stringent requirements for deducting losses under I.R.C. § 23(e)(2). It underscores the importance of documenting the taxpayer's primary profit motive and reasonable expectation of direct profit from the transaction. Attorneys advising clients on similar stock transactions must thoroughly investigate and present evidence of the taxpayer's intent, including detailed records of the transaction and the potential financial benefits. The Arata case serves as a caution to the necessity of proving a direct and non-speculative profit motive, as the court will scrutinize whether the taxpayer's actions are consistent with an investment strategy and are not motivated by personal benefit. This case also makes clear that a taxpayer will not be allowed to deduct losses from activities that primarily benefit a related entity or another party.

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