Friedman v. Commissioner, 34 T.C. 456 (1960)

The tax court addressed the deductibility of interest on loans used to purchase bonds, charitable contributions of those bonds, and amortization of bond premiums in a case involving a sophisticated tax avoidance scheme.

Summary

In *Friedman v. Commissioner*, the U.S. Tax Court considered whether a taxpayer could deduct interest expenses, charitable contributions, and bond premium amortization related to a bond purchase scheme. The court determined that the taxpayer could deduct interest expenses and the value of the bonds contributed to charity, but not the bond premium amortization. The court relied on prior rulings and the specific facts of the transaction, where the taxpayer, at the advice of a financial advisor, purchased bonds with borrowed funds, assigned them to a charity, and then had the charity sell the bonds. The Commissioner disallowed the deductions, arguing that the transactions lacked economic substance. The court, however, found the transactions legitimate.

Facts

Sadie S. Friedman, the taxpayer, was a widow involved in charitable endeavors and received a salary as treasurer of a company. Her brother, Dewey D. Stone, advised her to purchase callable bonds selling at a premium and donate them to the Sadie S. and Nathan H. Friedman Fund, Inc. to take advantage of tax benefits. With Stone's guidance, Friedman purchased Piedmont and Jacksonville bonds using a loan. The bonds were then assigned to the Friedman Fund, which sold them shortly thereafter. The entire process was orchestrated by a financial advisor, M. Eli Livingstone, who also arranged loans for the bond purchases from Lake View Trust and Savings Bank. The Friedman Fund then sold the bonds to Livingstone. Friedman sought deductions for interest expenses on the loan, the charitable contribution of the bonds, and bond premium amortization.

Procedural History

The Commissioner of Internal Revenue disallowed Friedman's claimed deductions for interest, charitable contributions, and amortization. Friedman petitioned the U.S. Tax Court to review the Commissioner's determination.

Issue(s)

1. Whether Friedman was entitled to deduct interest expenses under I.R.C. § 163.

2. Whether Friedman was entitled to deduct a charitable contribution under I.R.C. § 170.

3. Whether Friedman was entitled to deduct amortization of bond premium under

I.R.C. § 171.

Holding

1. Yes, because the court followed the precedent in L. Lee Stanton, 34 T.C. 1, where interest deductions were allowed in similar bond purchase scenarios.

2. Yes, because the contribution to the charity was allowed under I.R.C. § 170.

3. No, because following precedent set by Maysteel Products, Inc., 33 T.C. 1021, and Fabreeka Products Co., 34 T.C. 290, the claimed deductions for amortization of bond premium were disallowed.

Court’s Reasoning

The court relied heavily on prior cases, particularly *L. Lee Stanton* and *Fabreeka Products Co.*, which addressed similar fact patterns involving bond transactions. The court found that the interest payments were deductible because Friedman had a legitimate loan to finance the purchase of the bonds. The court distinguished this from a sham transaction where the taxpayer lacked any real economic risk. The court also found the contribution to charity legitimate. However, the court disallowed the amortization of bond premiums, consistently with its prior decisions in *Maysteel Products, Inc.* and *Fabreeka Products Co.* The court’s decision highlighted that the interest deductions were allowable while bond premium amortization was not. The court noted the specific wording in the

