Seed v. Commissioner, 52 T. C. 880 (1969)

Losses from transactions entered into for profit are deductible under Section 165(c)(2) even if the venture is abandoned before full realization.

Summary

In Seed v. Commissioner, the Tax Court held that expenses incurred by Harris Seed in a failed attempt to establish a savings and loan association were deductible as losses from a transaction entered into for profit under Section 165(c)(2) of the Internal Revenue Code. The petitioners, along with others, took extensive steps to secure a charter, including legal and financial preparations and public solicitations for stock. Despite two denials by the state commissioner, the court ruled that these efforts constituted a substantive transaction, not merely a preliminary investigation, thus allowing the deduction of the incurred losses.

Facts

In late 1962, Harris Seed joined a group of businessmen in Santa Barbara, California, to form a savings and loan association in Goleta. They employed legal and financial professionals, conducted an economic survey, and solicited public investment. The group made two applications for a charter, both of which were denied by the state's savings and loan commissioner. After the second denial on July 15, 1964, the group abandoned the venture. Seed had expended $1,566. 82 on the project and sought to deduct these expenses as a loss on his 1964 tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction, leading Seed to petition the U. S. Tax Court. The case was submitted under Rule 30 based on stipulated facts, with the sole issue being the deductibility of the loss under Section 165(c)(2).

Issue(s)

1. Whether expenses incurred in an unsuccessful attempt to establish a savings and loan association constitute a deductible loss under Section 165(c)(2) of the Internal Revenue Code?

Holding

1. Yes, because the activities undertaken by the petitioners were substantive and constituted a transaction entered into for profit, not merely a preliminary investigation.

Court's Reasoning

The court determined that the petitioners' actions went beyond mere investigation, involving a joint venture with clear steps towards establishing a profitable business. The court emphasized that the term 'transaction' in Section 165(c)(2) encompasses activities with substance and a profit motive, even if they do not result in a permanent business. The court cited Charles T. Parker, where similar preliminary operations were deemed sufficient for a deductible loss. The court distinguished this case from Morton Frank, where the taxpayer's actions were deemed merely investigative. The court also noted the petitioners' commitment to purchasing stock, which distinguished their efforts from mere exploration of opportunities.

Practical Implications

This decision clarifies that losses from business ventures that do not come to fruition can be deductible if they involve substantive steps towards establishing a profit-driven enterprise. Taxpayers can claim deductions for expenses incurred in abandoned ventures, provided they demonstrate a clear profit motive and substantive engagement in the venture. This ruling may encourage entrepreneurs to pursue business opportunities more aggressively, knowing that they can offset losses against income if the venture fails. Subsequent cases have followed this precedent, reinforcing the principle that 'transaction' under Section 165(c)(2) includes significant preparatory steps towards a business venture.

