***Robert E. Imel and Nancy J. Imel v. Commissioner of Internal Revenue, 61 T. C. 318; 1973 U. S. Tax Ct. LEXIS 12; 61 T. C. No. 34 (November 29, 1973)***

The case establishes the criteria for distinguishing between business and non-business bad debts and clarifies the deductibility of losses from guarantor payments under the Internal Revenue Code.

**Summary**

Robert Imel, a bank officer, sought to deduct losses from a personal loan and a payment made as a guarantor of a loan to his stepfather-in-law. The court held that the $5,000 loss from the personal loan was a non-business bad debt deductible as a short-term capital loss, not an ordinary business loss, because Imel's lending activities did not constitute a separate business and the loan was not proximately related to his employment. The $30,000 payment as a guarantor was not deductible under section 166(f) since the loan proceeds were not used in the borrower's trade or business. However, legal and travel expenses incurred to settle the guarantor liability were deductible under section 165(c)(2) as losses in a transaction entered into for profit.

**Facts**

Robert Imel, vice president and trust officer at Citizens Bank & Trust Co. in Pampa, Texas, made a $5,000 loan to his stepfather-in-law, W. E. Pritchett, to fund an option to purchase stock in an insurance company. Pritchett used the funds to acquire an interest in National Fraternity Life Insurance Co. Imel also signed as a guarantor on a $100,000 note for Pritchett to purchase more stock in the same company. When National Fraternity went bankrupt, Imel paid $30,000 to settle his guarantor liability and incurred $5,980. 50 in legal and travel expenses to negotiate the settlement.

**Procedural History**

Imel and his wife filed a petition with the United States Tax Court challenging the Commissioner's determination of deficiencies in their federal income taxes for 1965 and 1968. The court reviewed the deductibility of Imel's losses under sections 166 and 165 of the Internal Revenue Code.

**Issue(s)**

1. Whether the $5,000 loss Imel sustained in 1968 on the worthlessness of a debt owed by Pritchett is deductible as a business or non-business bad debt under section 166?
2. Whether the $30,000 payment Imel made in 1968 to settle his liability as a guarantor of a $100,000 note is deductible under section 166(f)?
3. Whether section 166 exclusively determines the deductibility of the $30,000 loss?
4. Whether legal and travel expenses incurred by Imel to obtain a settlement of his liability as a guarantor are deductible under section 165(c)(2)?

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## Holding

1. No, because the $5,000 loan was not proximately related to Imel's trade or business, it is treated as a non-business bad debt subject to short-term capital loss treatment.
2. No, because the proceeds of the $100,000 loan were not used in the trade or business of the borrower, the $30,000 payment is not deductible under section 166(f).
3. Yes, because the $30,000 loss resulted from the worthlessness of a debt, section 166 exclusively determines its deductibility, and it cannot be deducted under section 165(c)(2).
4. Yes, because the legal and travel expenses were incurred in a transaction entered into for profit, they are deductible under section 165(c)(2).

## Court's Reasoning

The court applied the dominant motivation test from United States v. Generes to determine that Imel's loan to Pritchett was not proximately related to his employment but rather to his investment in the bank, thus classifying it as a non-business bad debt. For the guarantor payment, the court relied on Whipple v. Commissioner to conclude that the loan proceeds were used for investment, not in a trade or business, thus not qualifying for deduction under section 166(f). The court also found that the $30,000 loss was exclusively governed by section 166, following Putnam v. Commissioner, which established that a guarantor's loss is a bad debt loss if it results from the worthlessness of a debt. However, the court allowed the deduction of legal and travel expenses under section 165(c)(2), citing Marjorie Fleming Lloyd-Smith and Peter Stamos, as these expenses were incurred in a transaction entered into for profit.

## Practical Implications

This decision clarifies the criteria for distinguishing between business and non-business bad debts, emphasizing the importance of the dominant motivation behind the loan. It also limits the deductibility of losses from guarantor payments under section 166(f) to cases where the loan proceeds are used in the borrower's trade or business. Practitioners should note that while a guarantor's loss may not be deductible as a business bad debt, related legal and travel expenses might still be deductible under section 165(c)(2) if the guaranty was made in a transaction entered into for profit. This case has been cited in subsequent rulings to determine the deductibility of losses and expenses in similar contexts.

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