Markwardt v. Commissioner, 64 T. C. 989 (1975); 1975 U. S. Tax Ct. LEXIS 75

A shareholder cannot deduct a loss incurred by a corporation, even if the loss results from the worthlessness of an asset acquired by the corporation through the shareholder's purchase of its stock.

Summary

Edwin Markwardt purchased all the stock of Top-Mix Concrete, Inc. , believing he had acquired a covenant not to compete from the seller, Homer Harrell. When Harrell reentered the concrete business, Markwardt claimed a loss on his personal taxes due to the covenant's worthlessness. The U. S. Tax Court ruled that any covenant not to compete would be an asset of Top-Mix, not Markwardt personally. Therefore, Markwardt could not deduct the loss, as it was sustained by the corporation, not him as a shareholder. Additionally, the court declined to consider a new theft loss claim raised after the trial.

Facts

Edwin Markwardt purchased all the stock of Top-Mix Concrete, Inc. from Homer Harrell and others in March 1965. Markwardt claimed that Harrell orally promised not to compete with Top-Mix after the sale, but Harrell later started a competing business. A jury found that Harrell had promised not to compete and that Markwardt relied on this promise, but a Texas court held the covenant unenforceable. Markwardt then claimed a loss on his 1968 personal tax return due to the covenant's worthlessness, which the IRS disallowed.

Procedural History

Markwardt sued Harrell for breach of the alleged covenant, but the Texas court ruled in Harrell's favor. Markwardt then filed a petition with the U. S. Tax Court to deduct the loss on his personal taxes. The Tax Court heard the case and ruled for the Commissioner, finding that any covenant was a corporate asset, and thus, the loss could not be deducted by Markwardt personally.

Issue(s)

1. Whether Edwin Markwardt could deduct a loss on his personal tax return due to the worthlessness of an alleged covenant not to compete acquired through his purchase of Top-Mix stock.

2. Whether Markwardt could raise a new issue of a theft loss deduction after the trial.

Holding

1. No, because the covenant, if it existed, would be an asset of Top-Mix, not Markwardt personally, and losses are personal to the taxpayer sustaining them.

2. No, because an issue raised for the first time on brief will not be considered, and a motion to raise a new issue after the trial is untimely under Tax Court rules.

Court's Reasoning

The court applied the rule that losses are deductible only by the taxpayer who sustains them, not by others. It reasoned that if a covenant existed, it would be an asset of Top-Mix, not Markwardt personally, and thus any loss from its worthlessness would be the corporation's, not Markwardt's. The court also noted that Markwardt treated the covenant as a corporate asset on tax returns, further supporting its conclusion. On the theft loss issue, the court held that new issues cannot be raised for the first time on brief or after the trial without consent of the opposing party, citing Rule 41(b) of the Tax Court Rules of Practice and Procedure.

Practical Implications

This decision clarifies that shareholders cannot deduct losses on their personal taxes for assets that belong to the corporation, even if they purchased the corporation's stock with the expectation of acquiring those assets. It emphasizes the importance of properly structuring business transactions to achieve desired tax results. The ruling also underscores the procedural requirement of raising all issues before or during the trial, not afterward. Subsequent cases have applied this ruling to similar situations where shareholders attempted to claim deductions for corporate losses.

