As a result of the Court's decision, the Commissioner no longer possesses the authority under section 482 to reallocate income to a subsidiary which has not in fact received the prohibited funds.

Another example of a potential abuse encouraged by the majority can arise where "captive insurance companies" are involved.[42] In a typical situation of this sort, a finance company establishes a subsidiary life insurance company that issues customer policies in connection with the parent's business. The subsidiary then charges excessive premiums on this business and succeeds in diverting a portion of the parent's income to it.[43] At the time of the passage of the Life Insurance Company Tax Act for 1955,[44] Congress was concerned about this problem and was advised that under section 482 the Commissioner had power to prevent such diversion by reallocating income.[45] The holding of the Court in *First Security Bank* seems to ignore this congressional concern.

In sum, *First Security Bank* can be said to encourage the formation of subsidiaries that will absorb the parent's income obtained from illegal sources and will be taxed at lower rates than would the parent on income diverted by the parent to the subsidiaries. The Commissioner's power to reallocate income to effectuate the purposes of section 482 is no longer an effective weapon against such practices. The majority's reliance on the actual receipt of income is at odds with the assignment of income cases as well as with section 61(a) and section 482 as previously interpreted, both of which incorporate the doctrine that income is taxed to the true earner thereof.[46] Finally, the Court's linkage of illegality with nontaxability resurrects the *Wilcox* "claim of right" doctrine and makes it available in cases of intercorporate transfers of income. The revitalization of the *Wilcox* rule with respect to controlled corporations may be expected to stimulate corporate formation of tax protectorates.

HARRIS J. BELINKIE

Federal Income Taxation—Section 165(a)—Losses: Corporate Loss Deduction Denied on Sale of Realty Because Property Was Not Held for Use in Trade or Business—*International Trading Co.*[1]—Petitioner, a brewery supply business[2] in Wisconsin, purchased thirteen

[42] 405 U.S. at 425 n.14 (dissenting opinion).

[43] Id. If the subsidiary charges excessive premiums on the parent's life insurance policies, the latter thereby obtains a greater "ordinary and necessary" business deduction under § 162(a) and thus reduces its taxable income. The subsidiary then reports the excessive premiums in its income for that year.

[44] Act of March 13, 1956, Pub. L. No. 429, 70 Stat. 36, as amended by the Life Insurance Company Tax Act of 1959, Act of June 25, 1959, Pub. L. No. 86-69, 73 Stat. 112, as amended, 26 U.S.C. § 801 et seq. (1970).

[45] 405 U.S. at 425 (dissenting opinion).

[46] See text at notes 19 and 39 supra.

[1] 57 T.C. 455 (1971).

[2] In addition petitioners "held real estate and collected rents therefrom." Id. at 456.

acres of land at Beaver Lake, Wisconsin, in 1944. For the next five years petitioner expended more than four hundred thousand dollars to construct and furnish a lavish residence and some small houses on the lake property. From 1948 to 1950 petitioner received rental income from certain individual stockholders and from four related companies for use of the property. In 1950 petitioner attempted to sell the property. It was eventually sold at public auction, in 1957, for $144,500. As of the date of sale the adjusted basis of the asset was $447,167, leaving an uncompensated loss after sale of $302,667. Petitioner claimed an ordinary loss on the sale of the property in 1957, but it was disallowed.[3] In 1959, during which year petitioner realized its first capital gains, petitioner did not attempt to claim the loss as a capital loss, even though corporate capital losses are allowable to the extent of capital gains.[4] In 1960 and 1961, however, petitioner did attempt to deduct a carryover loss,[5] claiming the loss from the sale of the Beaver Lake property as a capital loss under section 165.[6] The Commissioner denied petitioner's deductions, asserting that petitioner had not established that any capital loss from the sale should be available to petitioner for carryover to those years. As a result, the Commissioner determined that a tax deficiency existed for the fiscal year 1960.[7] Moreover, as a result of petitioner's attempt to amend its original claim and apply a portion of the loss to 1959, a tax deficiency was issued for that year as well.[8] A majority of the tax court HELD: Petitioner cannot take a loss deduction under section 165 and thus is not entitled to a capital loss carryover for the fiscal years 1959 and 1960. The loss, the court ruled, was not allowable under section 165(a) because the property which was owned and subsequently sold by petitioner was not held by it for use in its trade or business.

This note will attempt to show that the tax court erred in ruling that the corporation must have used property in its trade or business in order to deduct a loss on the sale of that property under section 165(a). It is submitted, rather, that section 165(a) does not require

[3] Id. at 457.

[4] See Int. Rev. Code of 1954, § 1211(a).

[5] A capital loss carryover is permitted:

> If for any taxable year a corporation has a net capital loss, the amount thereof shall be a short-term capital loss—
>
> (A) in each of the 5 succeeding taxable years . . . to the extent such amount exceeds the total of any net capital gains (determined without regard to this paragraph) of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year.

Int. Rev. Code of 1954, § 1212(a)(1), as amended, Pub. L. No. 91-172, § 512(a) (1969). It should be noted that section 1212 does not allow a deduction for any loss not otherwise deductible under section 165 or some other deduction provision. Section 1212 merely details how allowable capital losses may be deducted.

[6] Although under the general rule of section 165(a) all capital losses are deductible, section 165(f) specifically limits them to the extent allowed in sections 1211 and 1212.

[7] Unexplainably the Commissioner did not issue a deficiency for 1961.

[8] 57 T.C. at 457. For the fiscal years 1959, 1960 and 1961, International claimed capital loss carryovers of $118,583, $165,097 and $163,587 respectively.

that losses, to be deductible, must arise out of a corporation's trade or business.[9]

The tax court began its examination by determining whether or not the Beaver Lake property was held by petitioner for use in its trade or business. The Commissioner claimed that the property was neither used in petitioner's trade or business nor held for the production of income. In this connection, the court examined an earlier case involving the same property, *International Trading Co. v. Commissioner (International I)*.[10] There the Seventh Circuit had determined that the Beaver Lake property was held primarily for the benefit of International's stockholders and that it had little or no business use. At issue was the question of whether a portion of International's claimed deductions for depreciation and maintenance expenses were allowable. The Commissioner had disallowed a portion of the deduction for maintenance expenses and depreciation claimed by International under the predecessors of section 162(a)[11] and section 167(a)(1).[12] The Commissioner permitted only a deduction for expenses of an amount equivalent to the gross rents received by International from its stockholders and included by International in its gross income.[13] The remainder was disallowed because the property was held "primarily for the personal benefit of the stockholders and had little or no business use."[14] The circuit court held that the property was not used in International's trade or business or held for the production of income.[15]

In dealing with the instant *International* case, however, the tax court could not designate the *International I* decision as controlling or rely on it as sufficient grounds for disallowing deduction of the claimed section 165(a) loss. *International I* had disallowed the claimed depreciation deduction because petitioner failed to meet the explicit "trade or business" requirement of section 167. Section 165, however, does not specifically require that the property meet a "trade or business" test. It is primarily that difference which required the tax court in the instant case to inquire into the meaning of section 165 and which gives rise to the issues presented by this decision.

[9] See text at notes 56-67 infra, where it is argued that in 1962 Congress adopted an exception to the general rule of section 165(a), when it passed section 274 which disallows corporate losses if the property involved was used as an entertainment, amusement or recreational facility.

[10] 275 F.2d 578 (7th Cir. 1960).

[11] Int. Rev. Code of 1939, § 23(a)(1)(A). The provision allows as a deduction all the ordinary and necessary expenses incurred in carrying on a trade or business.

[12] Int. Rev. Code of 1939, §§ 23(*l*)(1)-(2). The provision allows as a depreciation deduction, the exhaustion of property used in the trade or business.

[13] The Seventh Circuit indicated that the Commissioner's allowance of a setoff of maintenance expenses and depreciation to the extent of income received from the property had no reasonable basis and should therefore not have been made. 275 F.2d at 587. The Commissioner's treatment of International appears similar to the treatment afforded by section 183(b)(2) to individuals and to Subchapter S corporations whose activities are not engaged in for profit.

[14] 17 CCH Tax Ct. Mem. 521, 531 (1958), aff'd, 275 F.2d 578 (7th Cir. 1960).

[15] 275 F.2d at 588.

The *International* court held, as had the Seventh Circuit in *International I*, that the Beaver Lake property was not used in petitioner's trade or business or held for the production of income during the years after 1950, when no rental income was received on the property.[16] With respect to the years 1948-1950, however, when certain amounts of rents were received, the tax court noted that there might have been at least some ground for finding a business use of the Beaver Lake property had there been evidence sufficient to indicate whether or not rental income exceeded expenses for those years.[17] Such a demonstration, the court reasoned, "might mark the property as being held for some business purpose at least in those early years."[18] The tax court, then, apparently looked for the existence of some profit in order to determine whether or not the property was held for a business purpose. When it failed to find an actual profit, the court concluded, as had the *International I* court before it, that the property was not held by petitioner for use in its trade or business.

In reaching this conclusion the court did not appear to consider the meaning of "trade or business" as established in other contexts by case law. The case law interpreting the "trade or business" limitation requires that "the activities must be entered into and carried on in good faith for the *purpose* of making a profit."[19] It can be concluded, then, that the "trade or business" limitation requires neither the production of an actual profit nor even a reasonable expectation of profit, but rather "the existence of a substantial profit motive."[20] It is submitted that the tax court misapplied the "trade or business" test by requiring that petitioner produce an actual profit in order to be entitled to a loss deduction.

After determining the nonbusiness use of the Beaver Lake property, the tax court narrowed its inquiry to the central issue: whether a corporation could deduct a loss under section 165(a) for property which it owned but did not hold for use in its trade or business. Petitioner contended that the explicit terms of section 165(a) required the allowance of the claimed loss deduction. This argument was based on the fact that the corporate loss deduction granted by section 165(a) is subject only to the two requirements that the loss be sustained in the taxable year and that it not be compensated for by insurance or otherwise: "There shall be allowed as a deduction *any* loss sustained during

[16] 57 T.C. at 459.

[17] It is interesting to note that if the payors of the fair rental value had been unrelated third parties rather than shareholders, depreciation, maintenance expenses and a section 165(a) loss deduction would probably have been allowed.

[18] 57 T.C. at 459.

[19] 5 J. Mertens, Law of Federal Income Taxation § 28.31, at 131 (rev. ed. 1969) (emphasis added). See Lamont v. Commissioner, 339 F.2d 377 (2d Cir. 1964); Hirsch v. Commissioner, 315 F.2d 731, 736 (9th Cir. 1963); Doggett v. Burnet, 65 F.2d 191, 194 (D.C. Cir. 1933).

[20] 5 J. Mertens, Law of Federal Income Taxation § 28.31, at 131 (rev. ed. 1969). See Hirsch v. Commissioner, 315 F.2d 731, 736 (9th Cir. 1963); White v. Commissioner, 227 F.2d 779, 780 (6th Cir. 1955).

the taxable year and not compensated for by insurance."[21] Traditionally, then, if a loss existed and if the amount and the year of loss could be determined, a corporation was accorded the benefit of the loss deduction without any questions relating to the employment of that property in the corporate trade or business.[22] The Treasury regulations develop the same requirements, stipulating that in order to be entitled to a loss deduction, a corporation must show that the loss is (1) fixed by a closed transaction, (2) identified by recognized events and (3) sustained during the year claimed.[23] If the corporation complies with these requirements it is entitled to the deduction as a matter of right.[24]

In marked contrast to the general terms of section 165(a), section 165(c) provides that deductible losses of an *individual* are restricted to "(1) losses incurred in a trade or business; (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and (3) losses of property not connected with a trade or business, if such losses arise . . . from . . . [a] casualty . . . ."[25] Both the title heading of section 165(c) and basic tax theory indicate that these limitations are not applicable to corporations. The title heading of section 165(c) explicitly limits applicability of that section to individuals.[26] Current tax theory finds the same limitation. As one authority has stated: "The restrictions of § 165(c) are not applicable to corporations, presumably on the theory that all corporate transactions arise in trade or business."[27]

The petitioner in *International* argued that since 165(a) lacked the specific limitations set forth in 165(c), the former subsection must be construed to allow the deduction of *any* loss sustained by a corporation: that is, a trade or business requirement should not be read into section 165(a). The tax court, however, rejected this literal approach

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21 Int. Rev. Code of 1954, § 165(a) (emphasis added).

22 S. Surrey & W. Warren, Federal Income Taxation 338-39 (1960 ed. with 1961 Supp. integr.); 5 J. Mertens, Law of Federal Income Taxation § 28.05 (rev. ed. 1969). See Richard R. Riss, Sr. v. Commissioner, 56 T.C. 388, rev'd, 57 T.C. 469 (1971). In the earlier decision the court stated: "[I]f our analysis of the 1954 statute is correct, it would seem that, without regard to the use to which the items in question were put while held by [taxpayer], the losses experienced by [taxpayer] as a result of their disposition were clearly deductible under section 165 of the Code." 56 T.C. at 415.

23 Treas. Reg. § 1.165-1(b) (1972). See Lee, Losses on Depreciable Property under Section 165 of the Internal Revenue Code of 1954, 10 How. L.J. 1, 2 (1964).

24 Id.

25 Int. Rev. Code of 1954, § 165(c). See Fleischer, The Tax Treatment of Expenses Incurred in Investigation for a Business or Capital Investment, 14 Tax L. Rev. 567, 588 (1959).

26 The section is captioned "Limitation on Losses of Individuals." Int. Rev. Code of 1954, § 165(c).

27 B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders § 5.03, at 5-6 (3d ed. 1971). In the first *Richard R. Riss, Sr.* decision, the Tax Court stated: "unlike the treatment accorded to individual taxpayers under section 165(c) of the Code, wherein losses are limited to three categories one of which is losses 'incurred in a trade or business,' no equivalent section exists for losses sought by corporations." 56 T.C. at 414.

and chose instead to analyze the statutory history of section 165(a) to determine whether or not petitioner's interpretation was valid.[28]

The first appearance of the corporate loss deduction in federal tax law was in the Act of 1894,[29] which also imposed the first general income tax. Section 32 of that Act provided:

> that there shall be assessed, levied, and collected, . . . a tax of two per centum annually on the net profits or income above actual operating and business expenses, including expenses for materials purchased for manufacture or bought for resale, *losses*, and interest on bonded and other indebtedness of all banks, . . . and all other corporations, companies, or associations doing business for profit in the United States, no matter how created and organized, but not including partnerships.[30]

After the 1894 income tax was declared unconstitutional,[31] Congress passed the Act of 1909, which imposed upon organizations incorporated for profit an excise tax on the privilege of doing business measured by the net income of the corporation.[32] A corporate deduction for losses was allowed to the extent that "all losses [were] actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property. . . ."[33] Then, in 1913, after ratification of the Sixteenth Amendment, the excise tax on the privilege of doing business was abandoned in favor of a tax imposed directly on corporate net income.[34] The 1913 provision for the allowance of losses[35] was identical to that in the 1909 Act, and was retained substantially unchanged in the Internal Revenue Code of 1939.[36] Finally, when the Code was restructured in 1954, all of the loss provisions of the 1939 Code were gathered into Section 165.[37] The Senate Finance Committee explained that this change affected not the substance but merely the structural arrangement of the loss provisions.[38]

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[28] See 57 T.C. at 459-61.

[29] Act of Aug. 27, 1894, ch. 349, 28 Stat. 509.

[30] Act of Aug. 27, 1894, ch. 349, § 32, 28 Stat. 509 (emphasis added).

[31] See Pollack v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895).

[32] Act of Aug. 5, 1909, ch. 6, 36 Stat. 11.

[33] Act of Aug. 5, 1909, ch. 6, § 38, 36 Stat. 11.

[34] Act of Oct. 3, 1913, ch. 16, 38 Stat. 114.

[35] Act of Oct. 3, 1913, ch. 16, § II(G)(b), 38 Stat. 114.

[36] Int. Rev. Code of 1939, § 23(f).

[37] Int. Rev. Code of 1954, § 165.

[38] S. Rep. No. 1622, 83d Cong., 2d Sess. (1954), U.S. Code Cong. & Ad. News 4833 (1954). The Report stated:

> Rules for the treatment of losses contained in various subsections of section 23 of the 1939 Code have been brought together in this section.
>
> The general rule for losses of individuals (sec. 23(e)) and the rule for corporations (sec. 23(f)) become subsections (a) and (c). The reference to the

This review of the statutory history of section 165(a) led the court to conclude that it was "simply assumed [by Congress] that losses by corporations would arise out of its trade or business."[39] Only because such an assumption could not be made with respect to individuals, the court concluded, were the explicit trade or business limitations placed by Congress in section 165(c) and omitted from section 165(a). In short, an implied trade or business requirement must be read into the latter section. It is submitted that although the court was correct when it concluded that all corporate transactions were presumed by Congress to arise from a trade or business, it erred when it went further and concluded that section 165(a) has an implied trade or business requirement. If in fact Congress had intended that a "trade or business" requirement be implied into section 165(a), then Congress should have enacted a casualty loss provision to allow a corporation to deduct losses of *nonbusiness* assets lost in a casualty. That is, if the court's conclusions as to congressional intention were correct, then casualty losses of corporate nonbusiness assets would not have been deductible under 165(a), and Congress would have had to provide elsewhere for their deduction. The fact that Congress did not make such a provision, while it made provision for individuals' deduction of nonbusiness casualty losses,[40] indicates that it did not intend that the nonbusiness limitation placed on individuals be placed on corporations as well. Moreover, it is highly unlikely that Congress would have explicitly placed a nonbusiness limitation on individual losses while intending but not placing the same limitation on corporate losses. In fact, as will shortly be shown, when Congress did decide to enact such a provision in 1962, it made the provision explicit.[41] Hence it would appear that Congress never intended that a nonbusiness limitation be read into section 165(a).

To buttress its conclusion that Congress intended a trade or business requirement in section 165(a), the court employed arguments arising from three other code provisions. These arguments, discussed in the remainder of this note, are principally based upon Section 167, Section 172, and Section 274 of the Code.

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basis for determining the amount of any loss (sec. 23(i)) is now subsection (b). The treatment of wagering losses (sec. 23(h)) is contained in subsection (d). The reference to capital losses (sec. 23(g)(1)) is now subsection (f). No substantive change is made by this rearrangement.

Id.

[39] 57 T.C. at 461. In support of its conclusion, the court cited Surrey and Warren, supra note 22, at 338, where the authors state that corporations are "presumed to be carrying on a business for profit," and A. Parker, Deductions and Credits 76 (rev. ed. 1967), where it is stated that "[t]he requirement that the loss must arise from a transaction entered into for profit, or be incurred in a trade or business does not require proof in the case of corporate taxpayers. It is presumed that any transaction entered into by a corporation is either for profit or in connection with a trade or business."

[40] Int. Rev. Code of 1954, § 165(c)(3).

[41] See text at 132-34 infra.

Section 167 Argument

In order to implement effectively its section 167 argument, the court applied the rule of "sensible construction."[42] This rule states that it will always be presumed that Congress intended exceptions to be implied into the letter of a statute when necessary to avoid "injustice, oppression, or an absurd consequence."[43] The tax court felt that this "rule of sensible construction" should be applied here as it was by the Supreme Court in *Helvering v. Owens*.[44] In *Owens* the taxpayer had sustained a casualty loss to his automobile. The issue presented to the Court was whether the tax basis for determining the amount of a loss sustained by injury to personal property, for which there is no annual depreciation allowance, should be cost or cost less accumulated depreciation—adjusted basis. The Court employed the adjusted basis to determine the casualty loss even though a strict construction of the casualty loss provision would seem to have required the use of a cost basis.[45] The *Owens* Court ruled that the casualty loss should be limited "so that it [the loss deduction] may not exceed cost, and in the case of depreciable non-business property may not exceed the amount of the loss actually sustained in the taxable year, measured by the then depreciated value of the property."[46]

The tax court reasoned that application of the "rule of sensible construction" as it was used in *Owens* would necessitate the disallowance of the loss deduction upon sale of the Beaver Lake property. The court believed that such disallowance was necessary to avoid what the court considered to be an otherwise inevitable and undesirable consequence—the frustration of the purposes of section 167, the depreciation deduction provision, which allows a deduction only for depreciation of property used in the taxpayer's trade or business or held for the production of income.[47] That frustration, the court feared, would result in a case where a depreciation deduction was denied to a corporation because the property involved had failed to meet the

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[42] United States v. Kirby, 74 U.S. (7 Wall.) 482 (1868).

[43] Id. at 486. The Court noted:

> The common sense of man approves the judgment mentioned by Puffendorf, that the Balognian law which enacted, "that whoever drew blood in the streets should be punished with the utmost severity," did not extend to the surgeon who opened the vein of a person that fell down in the street in a fit.

Id.

[44] 305 U.S. 468 (1939).

[45] Since a loss deduction taken under the casualty loss provision is taken on non-business property not subject to a depreciation deduction, the casualty loss provision would seem to require application of the cost basis rather than the adjusted basis in determining the amount of the loss.

[46] 305 U.S. at 471.

[47] Int. Rev. Code of 1954, § 167(a). This section permits the deduction of: a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

> (1) of property used in the trade or business, or
> (2) of property held for the production of income.

requirements of section 167. The corporation, after selling the same property, would still be allowed a *full* loss deduction under section 165(a) if that provision imposed no trade or business test.[48] The *International I* court had denied a claimed depreciation deduction for the structural improvements made to the Beaver Lake property.[49] If a full loss deduction were now allowed on the same property, that allowance would give to petitioner benefits equal to, or more than, those arising from a depreciation deduction. Such a result would frustrate the purposes of section 167. Therefore, the court concluded, it must deny the loss.

One dissenting member of the tax court, Judge Tannenwald, rejected this conclusion. He suggested that petitioners be granted a *partial* loss deduction rather than a *full* loss deduction. Such a loss would be limited to the "difference between the proceeds of sale and the original cost less depreciation, albeit nondeductible depreciation."[50] Imposing such a limit would avoid frustration of section 167 and at the same time follow the rationale used by the *Owens* Court. There, the Court actually granted a partial casualty loss deduction.[51] It is submitted that the tax court failed to consider the possibility that a *partial* loss deduction could be allowed without frustrating section 167. The majority of the tax court had considered only the issue of whether a *full* loss deduction would frustrate section 167.[52]

Section 172 Argument

The tax court also feared that section 172 would be frustrated if petitioner were allowed a full loss deduction.[53] Section 172 permits a deduction for net operating loss carryovers and carrybacks.[54] A net operating loss is defined in section 172(c) as "the excess of the deductions allowed by this chapter over the gross income."[55] Thus, a cor-

[48] 57 T.C. at 462.

[49] 17 CCH Tax Ct. Mem. at 531-32.

[50] 57 T.C. at 468. Compare Treas. Reg. § 1.165-7(b)(1) (1972) which rules that when dealing with the measurement of casualty losses

> the amount of loss to be taken into account for the purposes of section 165(a) shall be the lesser of either—
>
> (i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or
>
> (ii) The amount of the adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved.

But see Nulex, Inc. v. Commissioner, 30 T.C. 769 (1958).

[51] See text at note 46 supra.

[52] In addition Judge Tannenwald suggested that the *Owens* rule could be applied to limit the loss to the "difference between the proceeds of sale and the fair market value of the property on the date of sale." 57 T.C. at 468. Since the fair market value on the date of sale would be equal to the proceeds of sale, subtracting one from the other would produce a zero loss. Id.

[53] 57 T.C. at 462.

[54] Int. Rev. Code of 1954, § 172(b).

[55] Int. Rev. Code of 1954, § 172(c).

poration that wished to determine its net operating loss would include among the "deductions allowed by this chapter" a depreciation deduction under section 167. Since the depreciation deduction had been disallowed on the property involved in the instant case, petitioner would not have been allowed to include an amount equal to this depreciation, in its determination of a net operating loss. Now, the court argued, if a full capital loss deduction were allowed upon sale of the same property, which deduction *would* be includible in the determination of a net operating loss, petitioners would in fact be given the benefit of the disallowed depreciation deduction—thus frustrating section 172.

This reasoning, which led the tax court to conclude that section 172 would be frustrated should a loss deduction be allowed under section 165(a), was parallel to the reasoning the court used in its section 167 argument. It is submitted that the tax court was mistaken in failing to consider the possibility that a *partial* loss deduction could be allowed without frustrating section 172, just as it erred in failing to follow Judge Tannenwald's suggestion that deduction of a partial loss would not frustrate section 167. That is, the apparent inconsistency between sections 172 and 165(a) could be resolved by applying Judge Tannenwald's formula. Petitioner's loss would then be limited to the difference between the property's sales price and its original cost, less an amount equal to the depreciation that was *not* deductible under section 167.

Section 274 Argument

Although section 274[56] is not applicable to the years for which the Commissioner issued a deficiency statement,[57] that provision was examined by the tax court to determine whether petitioner should be granted the loss deduction it claimed under section 165(a).[58] The court concluded that subsection (g) of section 274, together with its legislative history, clearly required that losses on the sale of a nonbusiness entertainment or recreational facility be disallowed under section 165(a). Subsection (g) provides:

> (g) Treatment of Entertainment, Etc., Type Facility.—For purposes of this chapter, if deductions are disallowed . . . with respect to any portion of a facility, such portion shall be treated as an asset which is used for personal, living, and family purposes (and not as an asset used in the trade or business).[59]

Congress gave a "technical explanation" of 274(g) which described the results that that section was intended to achieve:

[56] Int. Rev. Code of 1954, § 274.

[57] The deficiency statements were issued for the years 1959 and 1960. 57 T.C. at 457. Section 274, however, did not become effective until Dec. 31, 1962. Int. Rev. Code of 1954, § 274.

[58] 57 T.C. at 462-63.

[59] Int. Rev. Code of 1954, § 274(g).

> To the extent that expenses and other items with respect to a facility are disallowed . . . that portion of the facility is to be accorded the *treatment provided under present law to an asset used exclusively for personal, living, and family purposes*. Thus, the portion of a facility so treated will not be subject to depreciation, and losses incurred on the sale of such portion will not be deductible.[60]

The tax court argued that Congress, in promulgating section 274, was not "altering the meaning of section 165(a)."[61] That is, the addition of section 274 in 1962 did not mean that *for the first time* Congress was refusing to permit a corporation to deduct losses arising from the sale of property not used in its trade or business: section 274 was not to be interpreted as a refutation of the court's theory that section 165(a) had *always* imposed an implied requirement that the property involved be used in the corporation's trade or business. To support this argument the court pointed to the phrase "under present law," used in the committee report, as proof that the law had not changed from what it had been prior to 1962.[62] Thus the court concluded that Congress had always considered losses on the sale of corporate entertainment or recreational facilities non-deductible under section 165(a).[63]

It is submitted, however, that the court's conclusion is erroneous. As the court itself established, it had always been "assumed that losses by corporations would arise out of its trade or business."[64] In 1962, however, Congress finally acknowledged *explicitly* that a corporation could have assets not held for use in its trade or business. Thereafter, under section 274, corporate entertainment and recreational facilities were "to be accorded the [same] treatment provided under present law to an asset used exclusively for personal, living and family purposes."[65] It is submitted that the phrase "treatment provided under present law" in the congressional committee report was not, as the court believed, a reference to section 165(a) as it then existed. Rather, it should be interpreted as referring to that treatment provided for assets used by an *individual* for his personal, living and family purposes. Such assets are never subject to depreciation,[66] and losses incurred on the sale of such assets are never deductible.[67]

It is submitted, therefore, that 1962 *did* mark a dramatic change on the part of Congress in its conception of corporate personality. Only with the passage of section 274 was a corporation to be treated as

[60] S. Rep. No. 1881, 1962-3 Cum. Bull. 881 (emphasis added).

[61] 57 T.C. at 463.

[62] When the phrase *under present law* is used in the technical explanation of section 274(g), it refers to the law as it existed prior to the enactment of section 274.

[63] 57 T.C. at 463.

[64] Id. at 461.

[65] S. Rep. No. 1881, 1962-3 Cum. Bull. 881.

[66] Int. Rev. Code of 1954, § 167(a).

[67] Int. Rev. Code of 1954, § 165(c).

capable of having a personal nature. Thus, for the first time, a corporate loss deduction may be denied if it arises from a corporate activity that does not meet congressional expectations.

This interpretation of the significance of the 1962 changes is supported by the treatment that Congress provided in section 274(f) for corporate recreational facilities lost in a casualty. Realizing that a corporation must be protected if a non-deductible recreational facility were lost in a casualty, Congress allowed the corporation to deduct such a loss "without regard to its connection with his [the taxpayer's] trade or business."[68] The language of the subsection adds that this provision should be applied to a taxpayer which is not an individual, as if it were an individual,[69] a point underlined by the Treasury regulations: "Thus, if a corporation sustains a casualty loss on an entertainment facility used in its trade or business, it could deduct the loss even though the facility was not used primarily in furtherance of the corporation's trade or business."[70] It is submitted that these statements reveal congressional recognition that corporations had never before needed a casualty loss provision for non-trade or -business property. This recognition in turn indicates that prior to 1962 section 165(a) permitted a deduction for all losses sustained on such property by a corporation.

It would appear that *all* corporate losses, including those sustained on property not used in the trade or business, were deductible before the passage of section 274. Hence the tax court should have allowed petitioner the benefit of the loss deduction which it claimed under section 165(a). While it is admitted that after 1962, section 274 would disallow losses from the sale of entertainment or recreational facilities, petitioner should have been given the benefit of the law as it existed prior to that time.

Conclusion

There appears to be no substantial ground for the tax court's refusal to grant the loss deduction. The tax court's fear that both the depreciation deduction and the capital loss carryover deduction provisions would be frustrated, should petitioner be granted a loss deduction, were hollow fears. The tax court's conclusion that section 274 required the result that section 165(a) contain a business requirement appears unsupported by either fact or reason. This court decision denies a loss deduction which should have been allowed and fails to recognize that not until 1962 did Congress decide that a corporation can have personal characteristics and so limit the hitherto expansive application of section 165(a).

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[68] Int. Rev. Code of 1954, § 274(f).
[69] Int. Rev. Code of 1954, § 274(f).
[70] Treas. Reg. § 1.274-6 (1963).