



## Tax Reduction Letter

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### Revenue Ruling 57-418

#### Section 165 Losses

July 1957

A loss, not compensated for by insurance or otherwise, sustained during a taxable year with respect to expenditures incurred in search of a prospective business or investment is deductible only where the transaction has actually been entered into and the taxpayer abandons the project. The loss is allowable only in the taxable year in which the project is abandoned.

I. T. 1505, C. B. I-2, 112 (1922), is revoked.

The issue involved in I. T. 1505, C. B. I-2, 112 (1922), and in the decision in *Charles T. Parker, v. Commissioner*, 1 T. C. 709, non-acquiescence C. B. 1943, 37, has been reconsidered in the light of the decisions in *Morton Frank et ux. v. Commissioner* 20 T. C. 511, and *Robert Lyons Hague v. Commissioner*, 24 B. T. A. 288.

I. T. 1505, *supra*, was based upon section 214 (a) (5) of the Revenue Act of 1921 and Article 141, Regulations 62. Section 214 (a) (5) corresponds to section 23 (e) (2) of the Internal Revenue Code of 1939 and to section 165 (c) (2) of the Internal Revenue Code of 1954. These sections allow deductions for losses sustained by an individual taxpayer during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business of the taxpayer.

In I. T. 1505, *supra*, a deduction of the expenses incurred in sending an agent to Europe to organize an export business was disallowed as an ordinary and necessary business expense (under section 214 (a) (1) of the 1921 Act). The reports of the agent were unfavorable and the idea of establishing the business was abandoned. The taxpayer's income consisted entirely of salaries and interest. While it was considered that the expenditure was not incurred in the taxpayer's trade or business, it was held that the transaction was entered into for profit, and that upon the abandonment of the enterprise any expenses incurred by the taxpayer in the course of the transaction became a loss which was deductible in the taxable year in which the enterprise was abandoned (under section 214 (a) (5) of the 1921 Act).

In the Frank case, the taxpayers were interested in purchasing and operating a newspaper or radio station. They incurred expenses for traveling, telephone, telegraph, etc., in their search for and investigation of business properties which they could purchase and operate. Various transactions were investigated and rejected. The taxpayers contended that the expenses should be allowed as nonbusiness losses. For a loss to be sustained during the taxable year with respect to expenditures incurred in search of a prospective business or investment, it is essential that the taxpayer abandon the project which was actually entered into for profit. The phrase "entered into for profit" has been construed to mean something more than carrying on negotiations to acquire a prospective business or investment. The court held in the Frank case, *supra*, that, since the

taxpayers refused to enter into transactions which they investigated, no abandonment occurred in the taxable year so as to give rise to a deductible loss.

In the Hague case, The United States Board of Tax Appeals denied a deduction under section 214 (a) (5) of the Revenue Act of 1926 for legal fees incurred in connection with prospective investments. The Board stated that the taxpayer had not entered into these transactions but, on the contrary, stayed out of them.

The Parker case is distinguishable on the facts from I. T. 1505, supra, and from the Frank and the Hague cases. In the Parker case, the taxpayer, after investigating a mining operation owned by another individual to determine whether it might be a suitable investment for himself, contributed cash and hired several men for about 30 days to rehabilitate the mining equipment and to operate the mine temporarily to determine whether further investment was warranted. The results of the temporary operation were unsatisfactory and the project was abandoned. The taxpayer never acquired any interest nor made any other investment in the property. The court held that the taxpayer sustained a deductible loss under section 23 (e) (2) of the 1939 Code in the taxable year in which the project was abandoned, because his activities in connection with the project were more than investigatory; he had actually entered into a transaction for profit which he later abandoned.

Accordingly, it is held that a loss, not compensated for by insurance or otherwise, sustained during a taxable year with respect to expenditures incurred in search of a business or investment is deductible only where the activities are more than investigatory and the taxpayer has actually entered into a transaction for profit and the project is later abandoned. The loss is allowable only in the taxable year in which the project is abandoned.

Pursuant to the authority contained in section 7805 (b) of the Internal Revenue Code of 1954, the principles stated herein will neither be applied to such losses sustained before September 23, 1957, nor to such losses sustained on or after September 23, 1957, where the search for a prospective business or investment began prior to September 23, 1957, but the taxpayer never actually entered into the transaction or the business venture.

Acquiescence has been substituted for nonacquiescence in the Parker case. See page 6.

I. T. 1505, C. B. I-2, 112 (1922), is revoked.