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Putnam v. Commissioner—The Reimbursable Outlay under the Tax Law

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COMMENT: PUTNAM v. COMMISSIONER — THE REIMBURSABLE OUTLAY UNDER THE TAX LAW

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Putnam v. Commissioner[1] is not a decision which is likely to alter pervasively the body of the income tax law. Nevertheless, because it disapproves the decisions of four Courts of Appeals,[2] because it crystallizes one hitherto uncertain doctrinal line, and because it may possibly suggest another, some analysis and appraisal may be warranted.

Mr. Putnam is a Des Moines lawyer. In 1946, with two associates he incorporated the Whitehouse Publishing Company. Each participant took one third of the shares of stock, but because Putnam contributed the greater part of the cash and property required to start the contemplated enterprise, his associates gave him their notes aggregating more than $8,000 to equalize participation. In the same year, the Company borrowed further funds from a bank, and Putnam signed a note therefor as co-maker. He also advanced funds to the corporation, and in 1947 procured further funds for the corporation by signing another note as co-maker with it. The enterprise did not prosper. In 1947, Putnam's claims against his fellow stockholders became worthless, and he took over their stock. In the same year, the Company ceased business and sold its remaining property. The proceeds were devoted to paying off, but only in part, the bank loans and Mr. Putnam's advances. The corporation remained in existence, but without assets. In 1948, Mr. Putnam paid off the remaining bank loans, with interest. It was the tax treatment of these payments, or the situation resulting from them, which gave rise to the issue decided by the Supreme Court.[3] The taxpayer contended that his payment of the guaranty gave rise to a fully deductible loss incurred in a transaction entered into for profit, permitted by §23(e) (2) of the Internal Revenue Code of 1939. The Commissioner argued that his loss was a short term capital loss arising from a worthless non-business debt, under §23(k) (4).

If, before they became worthless, Mr. Putnam had sold his stock in Whitehouse and his claim for the repayment of his loan to the corporation, all Revenue Acts beginning with that of 1924[4] would have classified the transaction as giving rise to a capital loss, subject to varying limitations as to deductibility. However,

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1. 352 U. S. 82 (1956), *aff'g Putnam v. Comm'r*, 224 F. 2d 947 (8th Cir. 1955).

2. *Fox v. Comm'r*, 190 F. 2d 101 (2d Cir. 1951); *Pollak v. Comm'r*, 209 F. 2d 57 (3d Cir. 1954); *Edwards v. Allen*, 216 F. 2d 794 (5th Cir. 1954); *Cudlip v. Comm'r*, 220 F. 2d 565 (6th Cir. 1955). For an appraisal of the significance of these decisions, see Holzman, *The Current Trend in Guaranty Cases: An Impetus to Thin Incorporation?*, 11 TAX L. REV. 29 (1955).

3. Litigation about the treatment of Mr. Putnam's worthless loans to his associates appears to have ended at the Court of Appeals level.

4. §208(c), Revenue Act of 1924.

had these transactions taken place before 1938, and had Mr. Putnam not sold, but rather waited until both his stock in the corporation and his claim for repayment of his loan became worthless, he could have taken ordinary deductions for, respectively, a loss in a transaction entered into for profit[5] and a bad debt.[6] 1938, however, marked the beginning of change. §23(g) (2) of the Revenue Act of that year provided that a loss arising from the worthlessness of shares of stock should be treated as a loss from a sale or exchange, *i.e.,* in this context, a capital loss. §23(k) (2) of the same Act imposed similar limitations on bad debt deductions, but only if the obligation was that of a corporation evidenced by an instrument with interest coupons or in registered form. Since Mr. Putnam's loan to Whitehouse was presumably not evidenced by an instrument of this formal nature, these limitations would not have prevented his taking an unrestricted deduction for a bad debt had the corporate obligation to repay his loan to it become worthless in 1938, or shortly thereafter.

Further restrictions on bad debt deductions were developed in 1942. §124 of the Revenue Act of 1942 amended §23(k) of the Internal Revenue Code of 1939 by creating a new category, the non-business debt, and provided that in the case of an individual taxpayer, if a non-business debt became worthless, the loss resulting therefrom should be treated as a short term capital loss. This is the structure which has remained through the Internal Revenue Code of 1954.[7]

It therefore appears that at all times since 1942, Mr. Putnam's losses from his investment in stock of the Whitehouse Company and from his loans to that corporation would have given rise to capital losses rather than ordinary deductions.[8] To the business man or any layman, it would hardly appear surprising

5. §214(a)(5), Revenue Acts of 1924 and 1926; §23(e), Revenue Acts of 1926 through 1936.
6. §214(a)(7), Revenue Acts of 1924 and 1926; §23(j), Revenue Acts of 1928 and 1932; §23(k), Revenue Acts of 1934 and 1936.
7. See INT. REV. CODE OF 1954, §§165(g) and 166(d).
8. It should perhaps be noted that the treatment of the two is not quite identical. The worthless stock loss is long term or short term, depending upon the holding period. The loss is deemed to have taken place on the last day of the taxable year, which, by present statutory standards, will almost invariably make it a long term loss. The worthless non-business debt was classified by statute as a short term loss. The difference was highly significant in 1942, when short term losses could be used only to offset short term gains. It has relatively slight significance today. See INT. REV. CODE OF 1954, §§1201, 1211, 1222.

It is not self-evident that a stockholder's loan to a business corporation in which he is a principal, or the sole stockholder should be classified as a non-business debt. Such a conclusion, however, is strongly supported by *Dalton v. Bowers,* 287 U. S. 404 (1932) and *Burnet v. Clark,* 287 U. S. 410 (1932), arising in a different context under an earlier statute. It is directly supported by the decision in *Comm'r v. Smith,* 203 F. 2d 310 (2d Cir. 1953), *cert. den.,* 346 U. S. 816 (1953) (*but cf. Giblin v. Comm'r,* 227 F. 2d 692 (5th Cir. 1955)). In the *Putnam* case in the lower courts, Mr. Putnam sought to have his loans classified as business loans by contending that his publishing venture added to his law practise, but this claim was abandoned in the Supreme Court.

that Mr. Putnam's further loss in 1948, arising from fulfilling his guaranty[9] by payment of the corporation's debts, should be treated in the same fashion.

But it was not—as the business man or layman might have thought it would be—on any underlying similarity of Mr. Putnam's slightly variant forms of investment that the Supreme Court appeared principally to rely in reaching its decision. Rather, in holding that Mr. Putnam suffered a non-busines bad debt loss under §23(k) (4) (therefore a short term capital loss), and not an unrestricted loss in a "transaction entered into for profit" under §23(e), the Court appeared to base its decision on an analysis and elaboration of the doctrine of subrogation. Mr. Justice Brennan states it thus:[10]

> The familiar rule is that, *instanter* upon the payment by the guarantor of the debt, the debtor's obligation to the creditor becomes an obligation to the guarantor, not a new debt, but, by subrogation, the result of the shift of the original debt from the creditor to the guarantor who steps into the creditor's shoes. Thus, the loss sustained by the guarantor unable to recover from the debtor is by its very nature a loss from the worthlessness of a debt. This has been consistently recognized in the administration and the judicial construction of the Internal Revenue laws which, until the decisions of the Courts of Appeals in conflict with the decision below, have always treated guarantors' losses as bad debt losses.

The Courts of Appeals whose decisions were disapproved had not presented a fundamental challenge to this analysis of the guarantor's position, an analysis which appears to have received its original judicial sanction for tax purposes in Judge Learned Hand's opinion in *Shiman v. Comm'r.*[11] Rather, they had differentiated the situation where, at the time the guarantor paid the debt, the principal debtor was deceased and his insolvent estate closed,[12] or in the case of corporate debtors, heavily insolvent or bankrupt.[13] In doing so, they might have found—though they did not do so—useful analogies in the accepted treatment of other situations where the acquisition of unwanted or useless assets is deemed to warant differentiated handling.[14] The Supreme Court, however, rejected the distinction which they did take, and stated that the decisions adopting it "turn upon erroneous premises."[15] It reiterated its statement of the doctrine of subrogation, and held it applicable to convert losses in all cases where subrogation arose and the debtor

9. Mr. Putnam's position as co-maker on loans to the corporation is treated as that of a guarantor by the Court of Appeals, the Supreme Court, and herein.

10. 352 U. S. at 85-6.

11. 60 F. 2d 65 (2d Cir. 1932).

12. *Fox v. Comm'r, supra,* note 2.

13. *Pollak v. Comm'r; Edwards v. Allen; Cudlip v. Comm'r, supra,* note 2. Meanwhile, the Tax Court had declined to follow the *Pollak* decision, *Peter Stamos,* 22 T. C. 885 (1954). These cases are set forth and analyzed by Kanter, 6 J. TAXATION 66 (1957), as well as by Holzman, *supra,* note 2.

14. *Cf., e.g.,* U. S. TREAS. REG. 118, §39.23(e)-2 (1953) and *N. W. Ayer & Son,* 17 T. C. 631 (1951); see also *Kimbell-Diamond Milling Co.,* 14 T. C. 74 (1950), *aff'd,* 187 F. 2d 718 (5th Cir. 1951).

15. 352 U. S. at 88.

was unable to reimburse the guarantor, into losses from worthless debts. Mr. Justice Harlan's dissent accepted the soundness of the differentiation made by the Courts of Appeals, and argued that it was unrealistic in such instances to fail to recognize that the guarantor-taxpayer's loss arose from his payment rather than from the worthlessness of his claim against the debtor.

What is the significance of the decision? Some appear to have seen in it an example of the elegant use of the legal craftsman's tools of analysis to reach a result deemed sound,[16] a result which does not make picayune differentiation of the case of the investor who lends his credit from that of the investor who lends his funds,[17] a result which, we have assumed, the businessman or layman might have expected when told of the tax treatment of Mr. Putnam's other investments. But is this all? It appears very possibly not. If subrogation is to be the basis of decision, a new crop of quirks and oddities, of perhaps picayune differentiations producing important differences in tax results, may be anticipated. A few examples may suffice.

Tribunals which have followed *Shiman* and have anticipated the *Putnam* reasoning have nevertheless differentiated the tax results in guaranty cases from those turning upon indemnity agreements, where no claim over arises after payment.[18] They have held that in such instances the loss arises from the indemnitor's payment, since there is no claim over to become worthless. This produces an unrestricted deduction for a loss or an expense rather than the capital loss to which the individual guarantor is restricted. The difference between guaranty and indemnity, between the presence and absence of subrogation in many instances, is at best elusive. Where the debtor is without assets, the financial difference to the guarantor or indemnitor is minimal. It may be questioned whether non-uniformity of tax results turning upon such shadowy differences is sound tax policy, unless compelled.

At least in some states, a partial guarantor is not pro tanto subrogated to the creditor's claim upon discharge of his guaranty obligation. In other states the rule is otherwise. The Tax Court, anticipating the *Putnam* reasoning, has felt impelled to reach differing tax results in such instances,[19] allowing an unrestricted deduction where there is no subrogation, and only a capital loss where local law gives the guarantor an immediate, if worthless, claim against the debtor. Despite

16. See Comment, *Current Law and Practise*, CCH FEDERAL TAXATION (Surrey and Warren, eds.) ¶1185 (1957).
17. See Stewart, J. dissenting in *Cudlip v. Comm'r*, 220 F. 2d 565, 572 (6th Cir. 1955).
18. *Howell v. Comm'r*, 69 F. 2d 447 (8th Cir. 1934), *cert. den.*, 292 U. S. 654 (1934); *Florence O. R. Lang*, 32 B. T. A. 522 (1935); *cf. United Gas Improvement Co. v. Comm'r*, 240 F. 2d 312 (3d Cir. 1956).
19. See, *e.g.*, *J. C. Bradford*, 22 T. C. 1057 (1954), *rev'd as to a separate issue*, 233 F. 2d 935 (6th Cir. 1956), differentiating *E. A. Roberts*, 36 B. T. A. 549 (1937).

the disclaimer of such purpose in Footnote 8 of the *Putnam* opinion,[20] is the emphasis upon subrogation not likely to produce not only tax differences between complete and partial guarantees, but also differences from state to state? Such kaleidoscopic tax results have not heretofore been thought desirable.

And what of the situation where the guarantor negotiates a settlement with the creditor, the debt remaining unpaid? The *Bradford*[21] case assimilated this to the partial guaranty, held subrogation unavailable under Tennessee law, and therefore allowed an unrestricted deduction arising from payment, rather than a capital loss from the worthlessness of the claim over.

Glancing through the literature on subrogation, one can hardly presume that the above examples exhaust the list of post-*Putnam* problems. Is it not time, perhaps, to question whether the tax law did not take a wrong turn in the *Shiman* decision, to question whether the significance of a claim for reimbursement, by subrogation or otherwise, should not be minimized rather than stressed in the interest of desirable tax administration?

Let us take the cases of two unfortunate taxpayers, A and B. A owns his home. It is completely destroyed by fire. He has a policy of fire insurance which covers the loss, but it develops that the insurance company is heavily insolvent, and he collects little or nothing on his policy. B also owns his own home. His house is slowly but completely destroyed by a colony of lethargic termites.[22] He has comprehensive insurance, including coverage for termite damage, but in the same insolvent insurance company, and he, too, recovers little or nothing.

What are the tax results? But for the insurance, A would have had an unrestricted deduction for a casualty loss, and B would have had no deduction. But now, if we focus upon the worthless claims against the insurance company, we deprive A of his deduction for a casualty loss and award him instead the restricted capital loss deduction for a worthless non-business debt. B, on the other hand, is blessed by fortune. By the same technique, the alchemy of a worthless claim against the insurance company converts his completely non-deductible loss into a deduction of at least substantial value.

What do these cases suggest? It must first be admitted that a court faced with them might refuse to focus upon the claim over and brush aside the reason-

20. 352 U. S. at 85.

21. *Supra*, note 19. See *Camp Mfg. Co.*, 3 T. C. 467 (1944). *Cf. Frank B. Ingersoll*, 7 T. C. 34 (1946), where the debtor had been discharged prior to the guarantor's payment.

22. It is specified that the destruction is slow and the termites lethargic so that even a generous reading of *Rosenberg v. Comm'r*, 198 F. 2d 46 (8th Cir. 1952) will not make it controlling; rather, B comes within the decisions in *United States v. Rogers*, 122 F. 2d 485 (9th Cir. 1941), *Fay v. Helvering*, 120 F. 2d 253 (2d Cir. 1941) and *Leslie C. Dodge*, 25 T. C. 1022 (1956).

ing of *Shiman* and *Putnam* simply as inapplicable in this context.[23] But these situations appear to suggest a fairly pervasive consideration. Not every outlay or loss of funds or property gives rise to a deduction under the income tax law. Congress has sharply differentiated the circumstances under which an outlay or loss gives rise to a deduction from those where none is allowed. By further classification it has differentiated the treatment of deductions arising in some circumstances from those arising in others. The suggestion seems obvious that it is the circumstances of the outlay which should be determinative in deciding whether there is a deduction, and, if so, of what type. To convert a non-deductible loss or expense into a deduction by virtue of the existence of a worthless claim for reimbursement gives at least the appearance of subverting the legislative classification. Let us consider the *Shiman* case, where the claim over first received significant judicial treatment. Mr. Shiman paid his brother-in-law's debts to his broker. The Board of Tax Appeals upheld the Commissioner in disallowing a deduction, pointing out that the outlay was "not in connection with the petitioner's trade or business, nor do we think that it arose from any transaction entered into for profit."[24] These reasons seem no less compelling if it is added that Mr. Shiman had earlier promised the brokers he would pay them.

It was on review that a new factor emerged as determinative. The promise to pay the brokers was an instrument called a guaranty. Thus, upon payment, a claim over against the brother-in-law arose. This subsequently proved worthless. Thus, Judge Hand concluded, subrogation converted the non-deductible outlay into a debt, which, when worthless, gave rise to a deduction,[25] then unrestricted and now a capital loss deduction. Does this conversion carry out the legislative classification which fairly clearly treated the expenditure as one giving rise to no deduction?

If the *Shiman* decision, and others like it, seem questionable, if it seems doubtful that outlays otherwise fully deductible or completely non-deductible should, by virtue of a worthless claim for reimbursement, be reduced to the common denominator of a capital loss for a non-business bad debt, what, then, is the function of the claim over, whether it arise by insurance, subrogation or otherwise? An answer seems reasonably apparent. It does, or should, determine

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23. If such a court insisted that A's case was squarely covered by the statute allowing deduction for "losses arising from fire . . . and not compensated for by insurance . . .", it might have difficulty if it attempted on this basis to differentiate Mr. Putnam's claim to equally literal coverage by the statute allowing deduction for "losses in any transaction entered into for profit . . . and not compensated for by insurance or otherwise." *Cf.* the case set forth in footnote 32, *infra.*

24. *David Shiman,* 21 B. T. A. 288 (1930).

25. *Shiman v. Comm'r,* 60 F. 2d 65 (2d Cir. 1932). For other instances in which emphasis on subrogation converted very questionable deductions into allowable bad debt deductions, see *Harold G. Trimble,* 6 T. C. 1231 (1946); *D. W. Pierce,* 41 B. T. A. 1261 (1940). See also *Kate Baker Sherman,* 18 T. C. 746 (1952).

arithmetically the ultimate amount of the loss, expense or outlay. It should determine the existence of loss or no-loss, expense or no-expense, only in the arithmetic sense that complete reimbursement may reduce the net outlay to zero. It should not classify the outlay, either directly or indirectly, for purposes of determining deductibility.

It appears that there is a substantial body of operative tax law, though not of language in judicial opinions, which supports this analysis. The very phrasing in the sections allowing deductions for losses and medical expenses[26] "not compensated for by insurance or otherwise," appears to suggest that the claim over may, if honored, reduce the amount of the otherwise allowable deduction. It hardly suggests that the claim over, if not realized upon, is to characterize the transaction for deduction purposes—by, for instance, converting a medical expense into a worthless non-business debt.[27]

But though the "not compensated for, etc." phrase does not appear in other sections, the operative tax law is much as though it had. By standards of the most stringent economy of phrasing, the "not compensated for, etc." might be deemed redundant, for outlays otherwise deductible under other sections do not give rise to deductions if made with the right or expectation of reimbursement which is subsequently honored.[28] In other words, it is the net outlay or loss in such instances which is deductible.[29] It is true that this might appear to produce trouble with the statute of limitations if the claim for reimbursement is not honored in a later year, and if one insists that the deduction arose only, if at all, in the year of outlay. But there is authority, and it appears sound, to meet this point. In casualty loss cases, where insurance coverage is disputed, the deduction for the amount of the coverage in dispute and ultimately not recovered has been held allowable as a casualty loss deduction in the later year of determination.[30]

26. INT. REV. CODE OF 1954, §§165 and 213; INT. REV. CODE OF 1939, §23(e) and (x).

27. One is intrigued by the possibility that the worthless claim against an insolvent insurance company or against a relative who had promised to reimburse the taxpayer for medical expenses might thus remove the percentage limitations and maximum contained in §213. Or, to reverse the situation, if a taxpayer guaranteed the medical expenses of a non-dependent relative, was called upon to make good his guaranty, and the relative later became unable to reimburse him, could the taxpayer by a bad debt deduction surmount not only the percentage and maximum limitations of §213, but also the fact that the medical deduction is allowed only for expenses of the taxpayer, his spouse, or a dependent?

28. See, *e.g., Henry F. Cochrane,* 23 B. T. A. 202 (1931). *Cf.* Magruder, J., concurring in *Friedman v. Delaney,* 171 F. 2d 269, 272, at 273-4 (1st Cir. 1948), and *cf. Island Petroleum Co. v. Comm'r,* 57 F. 2d 992 (4th Cir. 1932). It hardly needs statement that the reimbursement in such circumstances does not give rise to income. *Henry F. Cochrane, supra.*

29. The result may well be otherwise when reimbursement is not expected or owed when the outlay is made. *Cf. Findley v. United States,* 28 F. Supp. 715 (W. D. La. 1939).

30. *Comm'r v. Harwick,* 184 F. 2d 835 (5th Cir. 1950).

And the Supreme Court, in an embezzlement loss case, has observed,[31] "The theft occurs, but whether there is a loss may remain uncertain. One whose funds have been embezzled may pursue the wrongdoer and recover his property wholly or in part." It can hardly be thought to have implied that a deduction for a worthless debt would arise in the later year.[32]

The Supreme Court has in another context reached what in substance is the same result in dealing with reimbursed outlays. In *Detroit Edison Co. v. Comm'r*,[33] the Court held that where a public utility company had constructed lines to serve new customers with an agreement that these customers would reimburse it for the cost of construction, as they did, the company had a zero basis in the lines for purpose of computing the depreciation deduction.[34]

If, then, it is proper to net the outlay or loss where partial or complete reimbursement is expected and made, is there any reason to treat the claim for reimbursement as separate and apart when it is not honored? Is there any reason to allow the failure of the claim for reimbursement to change the entire character of the outlay, from non-deductible to deductible, from an ordinary loss or expense to a capital loss? The structure of the Internal Revenue Code hardly suggests that this is either wise, desirable or compelled. There is little in our experience to suggest that judges or administrators cannot determine the characterizing facts which Congress has chosen to differentiate. It may be significant that where the guarantor is a corporate taxpayer, so that it makes no difference whether the deduction arises from the claim over as a worthless debt or from the outlay as a business expense or loss, opinion writers appear to discuss the matter with fair consistency in terms of the outlay, without mention of the claim over resulting in a worthless debt.[35]

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31. *Alison v. United States*, 344 U. S. 167, 170 (1952).

32. That application of the *Shiman-Putnam* reasoning might, however, produce this result is suggested by the varying language of the opinions in *George M. Still, Inc.*, 19 T. C. 1072 (1953), *aff'd*, 218 F. 2d 639 (2d Cir. 1955). In that case officers of the taxpayer corporation misappropriated the proceeds of certain sales. When their embezzlement was discovered before the end of the tax year they promised to make restitution. They apparently did so in subsequent years. In disallowing a deduction for embezzlement in the year of misappropriation, Judge Raum for the Tax Court appears to proceed on the idea that reimbursement would, and did, diminish the amount of the loss. But the Court of Appeals, in its Per Curiam opinion of affirmance, spoke of the promise as a "contract obligation which accrued within the taxable year." On this analysis, subsequent inability to enforce the promise would produce a worthless debt deduction. *Spring City Foundry Co. v. Comm'r*, 292 U. S. 182 (1934). *Cf. Lewellyn v. Electric Reduction Co.*, 275 U. S. 243 (1927).

33. 319 U. S. 98 (1943).

34. This analysis, though it does not appear to be the one adopted by the Court, may explain the otherwise anomalous result in *Edwards v. Cuba R. Co.*, 268 U. S. 628 (1925).

35. See, *e.g.*, *Camp Mfg. Co.*, 3 T. C. 467 (1944); *Standard Oil Co. of New Jersey*, 11 T. C. 843 (1948), *modifying* 7 T. C. 1310 (1946); *Robert Gaylord, Inc.*, 41 B. T. A. 1119 (1940).

The Supreme Court at one time may have considered that a guarantor's deduction, if any existed, arose from the fact and circumstances of the outlay. At least three of the four Courts of Appeals whose decisions were disapproved in *Putnam* so stated their understanding of *Eckert v. Burnet.*[36] That decision, followed in *Helvering v. Price*,[37] held that a cash basis guarantor who had given his own notes when called on by the creditor, could not take a deduction prior to paying the notes. The Supreme Court in *Putnam,* however, indicated that the significance of *Eckert* was that the cash basis taxpayer could not "charge off" the worthless debt owed him until he had paid his own note. This reasoning has the appearance of plausibility, for of course a taxpayer's bad debt deduction is limited by his basis in the claim he holds.[38] And it might reasonably be assumed that a cash basis taxpayer who had paid out nothing for a claim had, as yet, no basis—or a basis of zero. But there is a perhaps unperceived difficulty here. In *Crane v. Comm'r,*[39] the Supreme Court held that a cash basis taxpayer could begin to take full depreciation on property for which she had not paid, and for which she was not even obligated to pay. If this is so, it is not immediately apparent why a cash basis taxpayer who had acquired a note, bond or other claim for money on credit could not take a bad debt deduction if that claim became worthless even before he had paid for it. *Crane* and *Eckert* appear to be able to co-exist in a completely rational universe only if, as the Courts of Appeals understood it, the latter meant that a guarantor's deduction, if any, arose from his payment.

But in making a reasoned analysis of tax problems, one would hesitate to rely very heavily on the dubious decision in *Crane.*[40] Quite apart from *Crane,* the considerations earlier advanced appear to suggest that one serves legislative purpose and its factual classifications by looking to the occasion and circumstances of the guarantor's outlay in determining whether he has a deduction, and if so, into what statutory category it is to fall. His claim over may reduce its amount, but should hardly serve as a universal solvent to change its character.

It is not suggested that the above analysis of the tax position of a guarantor or other taxpayer with a claim for reimbursement will eliminate or immediately solve all difficulties. It may well be objected that the guarantor who has paid the creditor does have a claim for money against the debtor, and that to deny it bad debt classification when it becomes worthless is to fly in the face of the statute. This, of course, is the reasoning of the decisions from *Shiman* through *Putnam,* and one can not gainsay that it is possible. But there are at least two answers.

36. 283 U. S. 140 (1931). See *Pollak v. Comm'r,* 209 F. 2d 57, 59 (3d Cir. 1954); *Edwards v. Allen,* 216 F. 2d 794, 797 (5th Cir. 1954); *Cudlip v. Comm'r,* 220 F. 2d 565, 568-9 (6th Cir. 1955).

37. 309 U. S. 409 (1940).

38. INT. REV. CODE OF 1954, §166(b); INT. REV. CODE OF 1939, §23(i).

39. 331 U. S. 1 (1947).

40. *Cf.* Magruder J., concurring in *Parker v. Delaney,* 186 F. 2d 455 (1st Cir. 1950).

First, not every worthless claim for money gives rise to a bad debt deduction under the statute.[41] Second, and more important, we frequently have to make choice between possible classifications under the Internal Revenue Code as well as under other statutes. Given two or more possible alternatives, we should clearly make the choice which appears the more consistent with the comprehensive legislative scheme. Since, as has been pointed out, classification which looks to the circumstances of the outlay seems more nearly consistent with the larger pattern of the Internal Revenue Code than a classification which focuses upon the unsatisfied claim for reimbursement and thereby reduces both fully deductible and non-deductible outlays to the common denominator of a restricted deduction for a worthless debt, the meritorious choice appears to be the former.

It may also be objected, as Judge Stewart objected in *Cudlip v. Commr,*[42] that had Mr. Shiman and Mr. Putnam made loans, or even borrowed money to make loans, the one to his brother-in-law and the other to his corporation, a bad debt loss would clearly result when the loan became uncollectable. Then, it will be said, the analysis herein requires what will be termed an unrealistic differentiation between the man who lends his money and the man who lends his credit. Passing for a moment a special factor in the case of Mr. Putnam, it must be admitted that there is force in the observation. Yet it is little more than a rephrasing of the objection first above considered. The answers are similar. First, not dissimilar differentiations have been required elsewhere.[43] Second, this is a product of the larger choice which appears the more consistent with the comprehensive statutory pattern. And third, with respect to the intra-family loan and the non-profit-motivated guaranty, where the difference in tax results would be greatest, it can not seem unfortunate that the taxpayer who wishes to get a bad debt deduction if the debtor becomes unable to pay, should be required to conform to the statute and make a loan to his needy relative or friend, rather than risk the possibility of having a non-deductible outlay if called on to perform a guaranty obligation. Congress may some day bring the intra-family or friendly loan within §267, but until it does, it hardly seems unfortunate to insist that §166 be met literally if an intra-family or non-profit transaction is to give rise to a deduction.

Finally, while this analysis clearly questions the result in *Shiman,* does it question the result in *Putnam?* By no means does it necessarily do so.

It has been suggested herein that the guarantor or other taxpayer with an unsatisfied claim for reimbursement should take a deduction, if he has one at all, only by reason of the circumstances which give rise to his outlay or loss. This

41. *Cf., e.g., Katherine J. Hanes,* 2 T. C. 213 (1943); *W. Thomas Menefee,* 8 T. C. 309 (1947); *Milton Bradley Co. v. United States,* 146 F. 2d 541 (1st Cir. 1944); *Lewellyn v. Electric Reduction Co.,* 275 U. S. 243 (1927).
42. 220 F. 2d 565, 572 (6th Cir. 1955).
43. *Bridgeport Hydraulic Co.,* 22 T. C. 215 (1954). See *Great Western Power Co. v. Comm'r,* 297 U. S. 543 (1936).

substantially means, to quote Judge Stewart,[44] that "the taxpayer who becomes a guarantor . . . for a reason other than to make a profit (and not in his trade or business), will be able to take no deduction at all if he pays on the guaranty and can collect nothing from the original debtor." It was fairly clearly because the *Fox* and *Pollak* decisions had foreshadowed just such a result in the circumscribed field of their applicability, that Congress gave carefully limited relief in the form of §166(f) of the 1954 Code.[45]

But Mr. Putnam claimed that his guaranty was given in a "transaction entered into for profit," and that therefore he should be entitled to a loss deduction without capital restrictions. His claim and the classification of his transaction might be sound if we went no further into the facts. But we must remember that Mr. Putnam was first a principal, and later the sole stockholder of the Whitehouse Publishing Company. Under these circumstances there is sound reason for treating his payment of the corporation's debts as a contribution to capital which would result in an added capital loss from the worthlessness of his stock.[46]

It may have been with a sense that this was the ultimately sound result that Mr. Justice Brennan ended his opinion in *Putnam v. Comm'r*, as follows:[47]

> The loss he sustained when his stock became worthless, as well as the losses from the loans he made directly to the corporation, would receive capital loss treatment; the 1939 Code so provides as to non-business losses both from worthless stock investments and from loans to a corporation, whether or not the loans are evidenced by a security. It is clearly a "fairer reflection" of Putnam's 1948 taxable income to treat the instant loss similarly. There is no real or economic difference between the loss of an investment made in the form of a direct loan to a corporation and one made indirectly in the form of a guaranteed bank loan. The tax consequences should in all reason be the same, and are accomplished by §23(k)(4).

In absence of a showing that it made a difference in dollar result whether Mr. Putnam had a capital loss under §23(g)(2), as the analysis suggested herein would produce, or a short term capital loss under §23(k)(4), one may well accept the result in *Putnam* while questioning the route by which it appears primarily to have been reached.

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44. 220 F. 2d 565, at 572. There are a few other possibilities, such as a guaranty of medical expenses of a spouse or dependent.

45. S. Rep. No. 1622, 83d Cong., 2d Sess. 200 (1954). The *Putnam* analysis, on the other hand, reduces the entire significance of §166(f) to its second parenthetical clause.

46. *Comm'r v. Estate of Murphy*, 229 F. 2d 569 (6th Cir. 1956), *aff'g* 22 T. C. 242 (1954); *Comm'r v. Adam, Meldrum & Anderson Co.*, 215 F. 2d 163 (2d Cir. 1954); *Interstate Transit Lines v. Comm'r*, 130 F. 2d 136 (8th Cir. 1942), *aff'd*, 319 U. S. 590 (1943); *Estate of Hayne*, 22 T. C. 113 (1954); Rev. Rul. 619, 1955-2 Cum. Bul. 52; *Cf. Johnson v. Comm'r*, 233 F. 2d 752 (4th Cir. 1956).

47. 352 U. S. 82, at 92-3.