

**THOMAS H. WELCH, PETITIONER, v. COMMISSIONER OF INTERNAL
REVENUE, RESPONDENT.**

Docket Nos. 40852, 51929, 53119.

United States Board of Tax Appeals

25 B.T.A. 117

January 8, 1932, Promulgated

SYLLABUS:

In order to reestablish his credit and to secure customers for his individual business from among those who had been customers of a corporation of which he was an officer, petitioner partially reimbursed those who had sustained losses when the corporation was discharged in bankruptcy. *Held*, that such amounts may not be deducted as "ordinary and necessary expense."

COUNSEL:

Alexander E. Horn, Esq., and P. J. Coffey, Esq., for the petitioner.

C. H. Curl, Esq., for the respondent.

OPINION BY:

LANSDON

OPINION:

[*117] The respondent has asserted deficiencies in income taxes for the years 1924 to 1928, inclusive, in the respective amounts of \$235.46, \$1,051.60, \$419.70, \$546.83 and \$819.37. The single issue presented is whether, in the circumstances of these proceedings, the petitioner is entitled to deduct, as ordinary and necessary business expenses, certain amounts paid to reimburse creditors of a corporation for losses sustained when the corporation was discharged in bankruptcy.

FINDINGS OF FACT.

The petitioner is an individual residing in Minneapolis, Minnesota. During 1922 he was secretary of the E. L. Welch Company, a Minnesota corporation engaged in the grain business. Except for 10 shares of

stock owned by him, all the stock of E. L. Welch Company was owned by petitioner's father.

For several years prior to 1922 petitioner had been in close touch with the customers of E. L. Welch Company, having traveled [*118] through the territory for three or four months each summer making contacts with present and prospective customers. He handled all grain as it came into Minneapolis, and attended to grading and sale. Petitioner's father looked after the financial end of the business only.

On March 23, 1922, the E. L. Welch Company was adjudged an involuntary bankrupt. The petitioner was adjudged a voluntary bankrupt on August 5, 1922. In due course each was discharged from existing debts. Shortly thereafter, the petitioner entered into a contract with the Kellogg Company to purchase grain for it on a commission basis. In order to reestablish his standing and credit, and to revive new business contacts with former customers of the E. L. Welch Company, the petitioner determined, as far as he was able, to reimburse certain creditors of the E. L. Welch Company. Beginning in 1924, he made small payments to all of the numerous creditors, except two, by a special check which bore the following endorsement:

The payee of this check, by the endorsement hereof, accepts and agrees to apply the same on its claim against E. L. Welch Company, according to the terms of the letter of transmittal. It has nothing to do with present or future business relations with the maker of the check and is not to be considered as acknowledging any existing claim or renewing any barred claim against him.

From 1924 to 1928 the petitioner earned commissions and made payments to reimburse creditors of the E. L. Welch Company as follows:

Year	Commissions	Credits of E. L. Welch Co.
1924	\$18,028.20	\$3,975.97
1925	31,377.07	11,968.20
1926	20,925.25	12,815.72
1927	22,119.61	7,379.72
1928	26,177.56	11,068.25

On his income-tax returns for 1924, 1925 and 1926 the petitioner reported only the amount remaining from commissions earned after payments of the above amounts to creditors of the E. L. Welch Company. On his income-tax returns for 1927 and 1928, he reported the total commissions received and deducted the payments to creditors of the E. L. Welch Company. The respondent has added to income the payments for 1924, 1925 and 1926, and has disallowed the deductions taken in 1927 and 1928.

OPINION.

LANSDON: We think the respondent correctly disallowed the deductions claimed. If the payments relate at all to "carrying on a trade or business," they still may not be allocated as expense of any [*119] particular year. Doubtless petitioner more quickly reestablished his standing and credit and built up his new business by reimbursing those who had lost money through a corporation dominated by him and his father,

but we do not understand payments of such a nature to be ordinary and necessary business expenses.

In two recent decisions we have held that the payment of discharged obligations for the purpose of reestablishing credit resulted in the acquisition of an intangible capital asset, in the nature of good will, which had a probable life coextensive with the business. *Herbert Brush Manufacturing Co.*, 15 B.T.A. 673; and *A. Harris & Co.*, 16 B.T.A. 705. The latter case was reversed by the Circuit Court of Appeals for the Fifth Circuit in *Harris & Co. v. Lucas*, 48 Fed.(2d) 187, and the deduction claimed was allowed. The facts of the instant proceeding are distinguished from those of the *Harris* case. There, a mercantile establishment, which had been discharged from its debts in a compromise settlement, reimbursed its former creditors in an effort to reestablish its credit so that it could buy without having to pay cash for each order. Here, the bankrupt corporation is no longer in business and an individual is seeking to *build up* a business by reimbursing creditors of the corporation who have lost money.

Decision will be entered for the respondent.