25 T.C. 94 (1955)

TONY MARTIN, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket No. 51062.

United States Tax Court.

Filed October 24, 1955.

J. Everett Blum, Esq., for the petitioner.

Joseph G. White, Esq., for the respondent.

The respondent determined a deficiency in income tax against petitioner for the calendar year 1949 in the amount of $4,506.62. Petitioner, by amended petition, claims an overpayment in an amount to be determined, if necessary, under a Rule 50 computation. The single question presented is whether a loss sustained by petitioner from an unpaid loan is to be deducted as a business bad debt or as a nonbusiness bad debt.

FINDINGS OF FACT.

The facts are partly stipulated and to the extent so stipulated are incorporated herein by reference.

Petitioner timely filed a joint Federal income tax return for the taxable year 1949 with the collector of internal revenue for the sixth district of California.

Petitioner, a cash basis taxpayer, has been engaged in business as an entertainer, including being a motion picture actor, nightclub performer, and singer on stage, screen, and radio, from 1932 to date, except for the period from January 2, 1942, to December 13, 1945, when he was a member of the Armed Forces of the United States. During all of this time Nat C. Goldstone represented petitioner as a theatrical agent. Prior to 1942, petitioner was very successful in his business.

As a consequence of circumstances undisclosed by the record petitioner in 1942, while serving with the Armed Forces, received some unfavorable publicity. After his honorable discharge from the service at the end of 1945, he returned to Hollywood to resume his career, only to find that the stigma of this earlier unfavorable publicity remained and that he was unable to secure any employment in motion pictures, other than that contracted for prior to 1942 and guaranteed to petitioner under then existing Federal laws (the so-called G.

I. Bill of Rights). Goldstone made substantial and extended efforts to secure movie and other entertainment work for petitioner, but the only employment that could be obtained for petitioner in the entertainment field was in nightclubs. In 1946, petitioner, under his previous contract arrangements with Loew's Inc., played in only one movie and was there required to sing only one song for which he was paid $47,250 in accordance with the terms of the contract. It did appear as though petitioner was to be given an opportunity to play another role but he was not finally cast in the role and did not play in the picture. Petitioner not only failed to secure this role but also was unable to obtain a renewal of his contract with Loew's Inc., despite Goldstone's offer to transfer petitioner's recording work to the MGM Record Company which had then just been formed.

At one point, Goldstone had induced Walter Wanger, a prominent motion picture producer, to consider petitioner for a part in a picture to be produced at Universal International (hereinafter referred to as U-I). Wanger enthusiastically supported petitioner for the role. However, under Wanger's partnership arrangement with U-I it had the right of approval of the cast of any pictures produced by it. Despite Wanger's efforts to secure U-I's approval of petitioner for the role, he was not so approved and the role went to another. The unfavorable publicity received by petitioner in 1942 played a significant part in the refusal of the motion picture industry heads to employ petitioner.

After these and other various unsuccessful efforts on the part of petitioner and Goldstone to obtain employment in Hollywood for petitioner, it was determined that it was necessary for petitioner to make a good motion picture if he were once again to achieve public acceptance and reestablish himself in the motion picture industry. Goldstone knew of an available property entitled "Pepe le Moko," based originally on a French novel, which he believed could be utilized for a dramatic motion picture with music. Previously, two dramatic motion pictures had been made from "Pepe le Moko," and each had been successful, resulting in Hedy Lamarr becoming a star and benefiting Charles Boyer substantially in his career. Petitioner, Goldstone, and others considered "Pepe le Moko" as good subject matter for a dramatic picture with music and, therefore, a good vehicle through which petitioner might rehabilitate his career and reestablish himself in the motion picture industry.

Goldstone acquired the rights to "Pepe le Moko," personally undertaking the expenses of options on the property and having a first draft of a screenplay written. He then attempted to dispose of this material as a "package," including petitioner as the leading man. One major studio offered to buy the property from Goldstone for a substantial profit, but they would not do so if required to take petitioner as the leading man. Goldstone's other efforts to dispose of the property were equally unsuccessful. Encouraged, nevertheless, by the seeming value placed on the property, Goldstone decided that the picture should be independently produced with petitioner as leading man.

For this purpose petitioner, Goldstone, and several others caused to be organized a corporation under the name of Marston Pictures, Inc., (hereinafter called Marston) with a total capital stock of $25,000, subscribed to in the following amounts: Petitioner, $6,250; Goldstone $13,750; others, $5,000. It was customary at that time in undertaking an

independent production to enter into a partnership arrangement with a major studio which would provide the physical facilities for production and defer its overhead, thereby making it possible for the independent producer to secure primary financing, in the form of a bank loan for a percentage of negative costs (the cost of making the picture), so-called first money. In such cases the independent producer, in the instant case Marston, is obliged to arrange for secondary financing, or so-called second money, which is the last money to go into the financing of the picture and also the last money to be finally repaid. With the aid of Rufus LeMaire of U-I, Goldstone was able to overcome the objections to engaging in any production with which petitioner would be associated, largely because of the personal financial undertakings of petitioner and Goldstone. Marston was thus able to enter into an arrangement with U-I for the production of a motion picture based on the "Pepe le Moko" property to be entitled "Casbah."

Marston obtained a loan from the Bank of America for the usual percentage of negative costs, in an amount of some $900,000. As is customary in this type of situation, U-I, on whose lot the picture was to be produced, was required to guarantee completion of the picture. No other endorsements were required by the bank.

The picture was first budgeted at about $1,200,000, of which the Bank of America was putting up some 70-odd per cent. Goldstone meanwhile had been assured that the second money would be forthcoming as soon as needed, and that the preproduction moneys put up personally by him would be returned immediately after all of the elements were put together (a practice customary in the industry). Goldstone, therefore, was permitted to engage people and to make other commitments, and production of the picture was commenced.

Shortly thereafter it became impossible to secure the release of moneys from England, accumulated there from the distribution and exhibition of motion pictures, and it was thought generally that other countries would also soon refuse to release such moneys. As a consequence of this blocking of English funds and the expectation that currencies in other countries would also be blocked, those persons who had previously made second money loans went out of that business completely and the so-called second money for "Casbah" was withdrawn. There being no written commitment on the part of those organizations from which the second money for "Casbah" was to be obtained, such money customarily being the last to be committed, petitioner, Goldstone, and the others had no legal recourse and there was no way to compel these groups to put up such moneys. The Bank of America, which was supplying the so-called first money, however, had already executed the necessary papers and was firmly committed to financing the production.

Faced with this situation, Goldstone having himself personally advanced certain moneys, production plans having been undertaken, and petitioner and Goldstone being of the opinion that it was extremely important and perhaps absolutely necessary to complete the picture if petitioner was to reestablish himself in the motion picture industry and rehabilitate his career, Goldstone, petitioner, Miller, petitioner's press agent, and a few others agreed to provide the required second money. The movie probably could not have been completed otherwise or the purpose for undertaking the production fulfilled. Production of the picture

was continued, petitioner deferring his entire salary and Goldstone also deferring any salary for his time and effort. Final production costs ran approximately $1,300,000.

To provide the so-called second money, petitioner loaned Marston $12,000, Goldstone loaned $41,500, and others loaned varying small amounts. These loans were evidenced by promissory notes executed by Marston to the several lenders, each dated August 1, 1947, and due and payable November 15, 1948, bearing interest at 6 per cent per year until due.

After completion of the picture it was released for general distribution. Petitioner made several personal appearances with the picture in order to stimulate successful showings. The picture, however, was not a financial success. Nevertheless, the picture benefited petitioner and in large measure reestablished petitioner and rehabilitated his career in the motion picture industry and in the entertainment field generally.

Marston had been organized to produce only one motion picture and has never produced or in any way participated in the production of a motion picture other than "Casbah."

Marston went into bankruptcy in 1949, and petitioner's loan thereto became worthless in that year.

Petitioner has never been engaged in the business of producing motion pictures or in investing in the production of motion pictures, nor has he ever been engaged in the business of promoting, organizing, financing, managing, or loaning moneys to corporations.

Petitioner sustained a loss from a bad debt proximately related to the conduct of his trade or business.

OPINION.

FISHER, *Judge:*

Petitioner contends that his loss upon a loan to Marston, which became worthless in 1949, constitutes a business bad debt, while respondent has determined that the loss incurred was from a nonbusiness bad debt. The ultimate issue is whether the loss resulting from the acknowledged bad debt was proximately related to the conduct of petitioner's business as an entertainer.

Under section 23 (k) (1), a bad debt incurred in a trade or business is deductible in full in the taxable year in which it becomes worthless, while all other bad debts constitute nonbusiness bad debts and are treated as short-term capital losses in accordance with section 23 (k) (4). The respondent's regulations, Regulations 111, section 29.23 (k)-6 (derived from H. Rept. No. 2332, 77th Cong., 2d Sess., p. 76; 1942-2 C. B. 431), provide, in pertinent part, as follows:

A non-business debt is a debt, other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business and other than a debt evidenced by a security

as that term is defined in section 23 (k) (3). The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23 (e) is "incurred in trade or business" under paragraph (1) of that section.

The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but *is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a non-business debt for the purpose of this section.* [Emphasis supplied.]

There cannot be any serious doubt that petitioner, during 1949, was individually engaged in a trade or business, specifically, that of being an entertainer, including, in the instant case, being a motion picture actor, nightclub performer, and singer on stage, screen, and radio. See *Olivia de Haviland Goodrich,* 20 T. C. 323 (1953); *William Lee Tracy,* 39 B. T. A. 578 (1939); *Reginald Denny,* 33 B. T. A. 738 (1935). Petitioner has been so engaged in his trade or business from 1932 to date, except for a few years during World War II when he was a member of the Armed Forces.

The only issue, therefore, in determining the business or nonbusiness character of the bad debt in question is whether there existed in the instant case the requisite proximate relation of the bad debt loss to the conduct of the taxpayer's business. Such question is one of fact to be decided upon the particular circumstances involved in each case. *Samuel Towers,* 24 T. C. 199 (1955); *Robert Cluett, 3rd,* 8 T. C. 1178 (1947). The evidence shows that we have accordingly found as a fact that the $12,000 loss sustained by petitioner in 1949 from a bad debt was incurred in his trade or business and constituted a business bad debt deductible in that year in accordance with section 23 (k) (1). Our reasons for so finding are set out below.

It should be noted at the outset that petitioner does not contend that he was in the business of producing motion pictures or in any business consisting of investing in and financing of the production of motion pictures. Nor does he contend that he was engaged in a business of promoting, organizing, managing, financing, or loaning moneys to corporations for the purpose of producing motion pictures or for any other purpose. Petitioner, therefore, does not attempt to come within the scope of the so-called promoter cases, such as *Weldon D. Smith,* 17 T. C. 135 (1951), revd. (C. A. 2, 1953) 203 F. 2d 310; *Henry E. Sage,* 15 T. C. 299 (1950); and *Vincent C. Campbell,* 11 T. C. 510 (1948). The record indicates quite clearly that exclusive of his relationship to the Marston enterprise petitioner has never produced or financed the production of a motion picture, or in any way engaged in the production of a motion picture, except as he was employed to act and sing, which employment represented the conduct of his own business as an entertainer. The bad debt

loss in issue must, therefore, be proximately related to the conduct of petitioner's business as an entertainer which involves mainly rendering his personal talent services to others.

Petitioner in his argument respects fully the separateness of the business of the corporate entity from that of its stockholders, *Burnet* v. *Clark,* 287 U. S. 410 (1932); *Omaha National Bank* v. *Commissioner,* (C. A. 8, 1950) 183 F. 2d 899, and does not argue that the corporate form should be ignored. In essence, he argues that the primary reason for producing the motion picture "Casbah" was the promotion again or protection and saving of his career and business. He points out that completion of the motion picture was essential to accomplishment of this objective and that the movie could not have been completed had not petitioner and the others loaned additional moneys to Marston. Petitioner concludes that in such circumstances the loss from worthlessness of the debt was proximately related to the conduct of and incurred in petitioner's trade or business.

We agree with petitioner's conclusion. The loan which here gave rise to the bad debt in issue was not contemplated at the time of organization of the enterprise. It appeared to everyone at that time that all the necessary financing was available to Marston to complete and distribute the movie "Casbah." But after commencing production, the so-called second money which had been promised was withdrawn and additional financing which was necessary to complete production could only be obtained from petitioner, Goldstone, and a few others interested in the production, individually. This was done primarily with a view to the necessity of so completing the picture if petitioner was once again to be able to achieve a measure of public acceptance and thus rehabilitate his career. At least such motivation must be considered as petitioner's primary purpose even if Goldstone or the others were more interested in personally protecting the investment they had already made in the production.

There has been no contention by petitioner that the organization and financing of a corporation to produce a motion picture might conceivably constitute an element of or facet of the conduct of his business as an entertainer,[1] but only that while such was not within the scope of the normal conduct of his business, in the circumstances of this case, when it became necessary to make the loan to Marston to complete the picture which might and subsequently did serve to save petitioner's business and rehabilitate his career, such loan was business connected and even crucial to the ultimate carrying on of that business. We think it evident from the record that investment in the production of a motion picture by a corporation or otherwise was not a normal part of petitioner's business activity as an entertainer. But we think it is also clear that at the point it became necessary to supply additional funds to the corporation to complete the picture, production of which had been undertaken in the first instance to rehabilitate petitioner's career and reestablish him in the motion picture industry as an entertainer and to promote and save that career, such advances as were made by petitioner were made in connection with his business and were proximately related to the conduct of that business as the exigencies of the situation required. We do not consider this loan as an ordinary and necessary expense of petitioner's business since it clearly was neither an expense (being a loan to be repaid) nor a normal part of that business, but only that the loan and the loss sustained upon the worthlessness

thereof was incurred in the carrying on of petitioner's business and was essential to the carrying on of that business.

While there are no cases involving precisely the circumstances here involved, we think that our view is supported largely by *Robert Cluett, 3rd, supra,* and *Stuart Bart,* 21 T. C. 880 (1954), and that *Putnam* v. *Commissioner,* (C. A. 8, 1955) 224 F. 2d 947, affirming a Memorandum Opinion of this Court and *W. A. Dallmeyer,* 14 T. C. 1282 (1950), are readily distinguishable.

In *Cluett,* the taxpayer's business consisted of acting as the floor member for various partnerships at the New York Stock Exchange. In this connection he owned a seat on the Exchange. Petitioner sold a fractional accretion to his Exchange seat and accepted in part payment certain promissory notes. A portion of this indebtedness became worthless in 1943 after the buyer became bankrupt. We held that the loss sustained was from a business bad debt, indicating that the debt and loss therefrom arose in the course of petitioner's business, which involved owning an Exchange seat, and that a sale of the accretion thereto was necessary if the taxpayer was to realize any benefit therefrom. It was clear, however, that such was not a usual or common event in the conduct of the taxpayer's business, but was, nevertheless, incident thereto.

The *Bart* case, decided on the authority of *Cluett,* is perhaps more like the instant case. There the taxpayer was engaged in business as an advertising agent. A certain corporate publication was one of petitioner's clients. Through that relationship petitioner had obtained other clients, some of whom advertised in the aforementioned publication. At certain times petitioner made loans to the publication in an effort to retain it as a client on a profitable basis and also to hold onto other clients' advertising in the publication. We concluded that the loss incurred upon the loans which subsequently became worthless was a business bad debt incurred in the conduct of the taxpayer's trade or business and related thereto.

The crucial tests underlying our decision in *Bart* are brought out clearly in the *Putnam* case. There the taxpayer was a practicing attorney. He made loans to clients to engage in a publishing venture which ultimately was not successful. It was held that the losses incurred were from nonbusiness bad debts and not business bad debts because they were not proximate to or incurred by the taxpayer in his business as an attorney. It was pointed out that it was not in any way essential to his law practice (business) for the taxpayer to make such loans, while in *Bart* it does appear to have been so for his business, and, again unlike the situation in *Bart* that the particular publishing business was not directly or even closely connected with the taxpayer's practice of law.

The *Dallmeyer* case is similarly distinguishable in that there was no proximate relation between the acquisition of and loss upon certain unsecured notes from the bank of which the taxpayer was chief executive and his business as chief executive, such acquisition and loss having been a consequence of only a moral responsibility he felt and not a part of the conduct of his business activity.

In the light of the foregoing, we hold that petitioner is entitled to a deduction in 1949 for a loss from a business bad debt.

In view of our conclusion, it is unnecessary to consider petitioner's argument based on the recent decision in *George J. Schaefer,* 24 T. C. 638 (1955), and we merely indicate that the circumstances in the two cases are materially different from each other.

Decision will be entered under Rule 50.

[1] See *Commissioner* v. *Stokes' Estate,* (C. A. 3, 1953) 200 F. 2d 637, affirming a Memorandum Opinion of this Court, where the taxpayer was considered to have been engaged individually in the business of exploiting patents sometimes through the media of a corporation established to do so, and *Dalton* v. *Bowers,* 287 U. S. 404 (1932), relied on in the instant case by respondent, where the Supreme Court had earlier reached an opposite conclusion upon the facts of that case, holding that the taxpayer there was not engaged in such a business of exploiting his inventions through corporations organized for that special purpose and forming a complete and comprehensive enterprise of which the corporation was but a part.