1 T.C. 345 (1942)

A corporation is not entitled to a tax credit for restrictions on dividend payments under Section 26(c)(1) or (2) of the Revenue Act of 1936 based on agreements that do not expressly prohibit or mandate specific dividend actions during the taxable year.

Summary

Gehring Publishing Co. and its subsidiaries, Ahrens Publishing Co. and Restaurant Publications, Inc., sought tax credits for restrictions on dividend payments under the Revenue Act of 1936. The companies argued that agreements with creditors and voting trustees restricted their ability to pay dividends. Ahrens Publishing Co. also contested an increase in income due to the settlement of a debt for less than its full amount. The Tax Court denied the credits, finding that the agreements did not meet the strict requirements of the statute, and ruled that Ahrens did not realize taxable income from the debt settlement, following the precedent set in *Hirsch v. Commissioner*.

Facts

Ahrens Publishing Co. experienced financial difficulties in 1933, leading its stockholders to create a voting trust managed by three trustees, including major creditors. On April 1, 1933, Ahrens entered into an agreement with creditors, promising to pay 60% of its net profits annually to creditors in exchange for an extension on liabilities. On May 12, 1933, the voting trustees agreed not to pay any dividends without unanimous consent. In 1928, Ahrens had purchased stock in Hotel World Publishing Co. at a high price, and the stock's value subsequently declined. In 1937, a settlement was reached with the Bohn estate (seller) to accept $6,200 less than the outstanding balance for the Hotel World Publishing Co. stock.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against Gehring Publishing Co., Ahrens Publishing Co., and Restaurant Publications, Inc. for the years 1936 and 1937. The deficiencies stemmed from the denial of credits for restrictions on dividend payments and, in the case of Ahrens, from the determination of additional income due to debt settlement. The cases were consolidated, and the taxpayers petitioned the Tax Court for review.

Issue(s)

1. Whether the petitioners are entitled to credits under Section 26(c)(1) of the Revenue Act of 1936 for restrictions on dividend payments due to the creditors' agreement and the voting trustees' agreement.
2. Whether the petitioners are entitled to credits under Section 26(c)(2) of the Revenue Act of 1936 because the creditors' agreement required a portion of

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earnings and profits to be paid in discharge of a debt.
3. Whether Ahrens Publishing Co. realized taxable income from the settlement of a debt for less than its full amount in 1937.

Holding

1. No, because the agreement between the voting trustees was merely a declaration of policy and not a contract executed by the corporations, and because the creditors' agreement did not expressly deal with the payment of dividends as required by the statute.
2. No, because the agreement only required payments after the close of each calendar year, meaning there was no contractual requirement to pay or irrevocably set aside earnings and profits within the taxable year.
3. No, because the settlement effectively reduced the purchase price of the stock, aligning the case with precedents such as *Hirsch v. Commissioner*.

Court's Reasoning

The Tax Court reasoned that Section 26(c)(1) requires a written contract executed by the corporation before May 1, 1936, that expressly deals with the payment of dividends. The court found that the creditors' agreement of April 1, 1933, did not explicitly address dividend payments. The trustees' agreement, a letter dated May 12, 1933, was deemed merely a declaration of policy, not a binding contract executed by the corporations. The court emphasized that the trustees retained the power to declare dividends with unanimous consent, independent of the creditors' agreement. Regarding Section 26(c)(2), the court noted that the creditors' agreement required payments only after the close of each calendar year. This meant there was no contractual obligation to pay or set aside earnings within the taxable year, as required for the credit. The court followed the Supreme Court's decision in Helvering v. Ohio Leather Co., which held that voluntary payments do not qualify for the credit. Finally, regarding the debt settlement, the court distinguished the case from United States v. Kirby Lumber Co. and similar cases, finding that the settlement effectively reduced the purchase price of the stock. The court stated, "the net result of the settlement in 1937 was in substance a reduction of the purchase price of the Hotel World Publishing Co. stock from $ 40,000 to $ 33,800."

Practical Implications

This case underscores the strict interpretation of tax statutes, particularly regarding credits and deductions. It highlights the importance of clear and unambiguous language in contracts intended to restrict dividend payments for tax purposes. To secure tax credits under Section 26(c)(1) or (2) of the Revenue Act of 1936 (and similar provisions in later tax laws), corporations must demonstrate a binding contractual obligation, executed before the statutory deadline, that expressly restricts dividend payments or mandates specific actions regarding earnings within the taxable year. Subsequent cases have cited *Gehring Publishing* for the

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proposition that agreements among trustees or shareholders, without a direct contractual obligation on the corporation, are insufficient to qualify for dividend restriction credits.

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