1 T.C. 401 (1943)

For a corporation to claim a dividends paid credit under Section 27(a) of the Revenue Act of 1936, the dividend must be actually paid to the shareholders during the taxable year, not merely declared or credited on the books.

Summary

John H. Wheeler Co., a personal holding company, declared dividends in December 1936, payable on December 31, 1936. The resolution authorized the company to borrow the dividends back from the stockholders. The dividends were credited to a dividends payable account, and promissory notes were issued to the stockholders after the close of the year, dated December 31, 1936. The company claimed a dividends paid credit for 1936, which the Commissioner disallowed. The Tax Court upheld the Commissioner, holding that the dividends were not actually "paid" during the taxable year because the issuance of promissory notes after year-end did not constitute payment.

Facts

John H. Wheeler Co. declared a dividend on December 19, 1936, payable to shareholders of record on December 31, 1936. The resolution authorized management to borrow the dividends from stockholders. The company lacked sufficient cash to pay the dividend immediately. After the close of 1936, the company issued promissory notes to the stockholders, dated December 31, 1936, in the amount of the dividends. The company's books credited the dividends payable account as of December 31, 1936. Most of the stockholders were informed of the plan to issue promissory notes and agreed to it before the end of the year.

Procedural History

The Commissioner of Internal Revenue disallowed the dividends paid credit claimed by John H. Wheeler Co. on its 1936 tax return. The executors of John H. Wheeler's estate, along with other stockholders as transferees of the company's assets, petitioned the Tax Court for review.

Issue(s)

Whether the declaration of dividends in December 1936, the crediting of stockholders' accounts, and the issuance of promissory notes shortly after the close of the year constituted "payment" of dividends during the taxable year 1936, entitling the corporation to a dividends paid credit under Section 27(a) of the Revenue Act of 1936.

Holding

No, because the dividends were not actually paid to the shareholders during the

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taxable year 1936. The issuance of promissory notes after the close of the year does not constitute payment for the purpose of the dividends paid credit.

Court’s Reasoning

The court reasoned that Section 27(a) requires actual payment of dividends during the taxable year to qualify for the dividends paid credit. While payment need not be in cash and can include property or corporate obligations, the issuance of promissory notes after the close of the year did not constitute payment in 1936. The court distinguished cases where book credits were readily available to shareholders, emphasizing that here, the directors reserved the right to borrow back the dividends, indicating a lack of intent to make immediate payment. The court stated, “Section 27 requires more than the creation of a liability to pay.” The court rejected the argument that the stockholders’ reporting of their pro rata share of the company’s income fulfilled the purpose of the undistributed profits tax, stating that actual payment by the corporation in the taxable year is required. The court emphasized that tax deductions and credits are matters of legislative grace, and taxpayers must strictly comply with the statutory terms.

Practical Implications

This case clarifies that a mere declaration of dividends, or even the crediting of dividends to shareholder accounts, is insufficient to qualify for the dividends paid credit under the Revenue Act of 1936. To claim the credit, the corporation must demonstrate that the dividends were actually paid to the shareholders during the taxable year, either in cash, property, or through readily accessible credits. This case highlights the importance of contemporaneous documentation and actions demonstrating actual payment within the tax year. It also reinforces the principle that tax deductions and credits are narrowly construed, and taxpayers must strictly adhere to the statutory requirements to claim them. Later cases citing Wheeler emphasize the requirement of actual distribution or unconditional access to funds by shareholders within the tax year.

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