2 T.C. 124 (1943)

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A corporation with a deficit in accumulated earnings and profits may be entitled to a tax credit if it is legally prohibited from paying dividends due to that deficit, but restrictions on dividend payments must be legally binding, and payments on running accounts require specific evidence to qualify as debt retirement.

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Summary

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Senior Investment Corporation contested deficiencies in income tax and personal holding company surtax. The Tax Court addressed whether the corporation was entitled to credits for restrictions on dividend payments or as a deficit corporation under the Revenue Act of 1936, as amended by the Revenue Act of 1942. The court held that restrictions in the amended charter and stock certificates didn't qualify for credits under Section 26(c)(1). However, the court found that because Michigan law prohibited dividend payments due to accumulated deficits, the corporation was entitled to credits under Section 26(c)(3). The court disallowed deductions for payments on running accounts, as the payments weren't shown to have been applied to pre-1934 indebtedness.

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Facts

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Senior Investment Corporation (petitioner) was a Michigan corporation and personal holding company of Fred J. Fisher. In 1933, a reorganization occurred, creating a Delaware corporation, Senior Corporation, to which the petitioner transferred assets. The petitioner amended its charter, restricting dividend payments until a specific deficit was eliminated. The petitioner claimed credits on its 1936 and 1937 tax returns due to these dividend restrictions and sought to deduct payments made to Senior Corporation as debt retirement.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in income tax and personal holding company surtax for the years 1935, 1936, and 1937. The petitioner contested these deficiencies, arguing it was entitled to certain credits and deductions. The Tax Court addressed the issues after the petitioner withdrew certain assignments of error and the respondent confessed error regarding a loss deduction.

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Issue(s)

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1. Whether, under Section 26(c)(1) or Section 26(c)(3) of the Revenue Act of 1936, the petitioner is entitled to credits equal to its adjusted net income in determining its undistributed profits tax for 1936 and 1937?

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2. Whether, under Section 351(b)(2)(B) of the Revenue Acts of 1934 and 1936, and Section 355(b) of the Revenue Act of 1936, the petitioner is entitled to deduct from its adjusted net income for 1935, 1936, and 1937 amounts allegedly paid on an indebtedness incurred before January 1, 1934, in determining its personal holding company surtax?

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Holding

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1. No, for Section 26(c)(1) because the amended charter and stock certificates are not considered “written contracts” under the statute. Yes, for Section 26(c)(3) because Michigan law prohibited dividend payments due to the corporation’s accumulated deficit.

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2. No, because the payments made to the Senior Corporation were not proven to be specifically used to retire indebtedness incurred before January 1, 1934.

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Court’s Reasoning

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Regarding Section 26(c)(1), the court followed the Sixth Circuit’s precedent, holding that a charter amendment and stock certificates do not constitute a

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