American Liberty Oil Co. v. Commissioner, 127 F.2d 264 (5th Cir. 1942)

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To claim a tax credit under Section 26(c)(2) of the Revenue Act of 1936 for earnings required to be paid in discharge of a debt, a corporation must demonstrate a written contract executed before May 1, 1936, which explicitly mandates the use of earnings to satisfy a debt, and that the debt was incurred before April 30, 1936.

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Summary

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American Liberty Oil Co. sought a tax credit for undistributed profits based on a purported contract to pay off debt. The Fifth Circuit denied the credit, finding the agreement with the bank was not a binding contract executed before the statutory deadline and that the debt was incurred after the deadline. The court emphasized strict adherence to the statute's requirements for such credits, noting the initial agreement was conditional and did not bind the bank or the company until later. Additionally, the company's attempt to change its inventory valuation method without permission was rejected.

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Facts

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Three individuals planned to unify oil-gathering systems and needed financing. They corresponded with a bank in late 1935 regarding a $1,250,000 bond issue. The bank's commitment was conditional, requiring full completion and acceptance of the construction program by June 30, 1936. American Liberty Oil Co. was involved in this project. The conditions were met on June 18, 1936, and the loan was finalized. The company also sought to change its inventory valuation method for tax purposes in 1938.

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Procedural History

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American Liberty Oil Co. claimed a tax credit, which the Commissioner denied. The Board of Tax Appeals upheld the Commissioner's decision. The Fifth Circuit Court of Appeals reviewed the Board's decision.

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Issue(s)

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1. Whether the correspondence between the company's promoters and the bank constituted a written contract executed before May 1, 1936, as required by Section 26(c)(2) of the Revenue Act of 1936, entitling the company to a tax credit.r
2. Whether the debt discharged by the loan proceeds was incurred before April 30, 1936, as required by the statute.r
3. Whether the company was entitled to change its method of valuing inventories in 1938 without the Commissioner's permission.

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Holding

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1. No, because the bank's commitment was conditional and did not become a binding contract until June 18, 1936, after the statutory deadline. The court stated that "the terms of the bank's letter of December 13. 1935, constituted an offer of an unilateral contract, and the acceptance by petitioner's promoters was merely an authentication of the terms of the offer. The contract was 'executed,' within the meaning of that word as used in the statute, upon performance of the conditions precedent on June 18, 1936."r
2. No, because the debt to the bank was a new debt incurred on June 18, 1936, after the statutory deadline, when the loan was finalized and the prior debts were discharged. The court reasoned that "The latter debts were fully discharged and satisfied out of the proceeds of the bank's loan, and a new debt, owing to another and different creditor, in a different amount, and upon entirely different terms and conditions, was incurred after April 30. 1936."r
3. No, because the company had already elected to use the cost method in prior years and could not change without obtaining the Commissioner's permission.

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Court's Reasoning

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The court reasoned that the bank’s initial commitment was conditional and did not create a binding contract until the conditions were met in June 1936. Therefore, the contract was not

