4 T.C. 330 (1944)

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A taxpayer seeking a special tax credit for debt retirement or dividend restrictions must demonstrate strict compliance with the statutory conditions, and restrictions must be explicitly stated within the contract itself, not implied from external factors.

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Summary

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Securities Co. sought tax credits under the Revenue Act of 1936 for restrictions on dividend payments and for setting aside earnings to discharge debt. The Tax Court denied the credits. It found that while the debt was incurred before the statutory deadline, the contract did not explicitly prohibit all dividends, only those not payable in stock, and the sinking fund requirements didn't mandate using current year's income. The court also addressed the proper year for claiming credit for debt retirement, holding it's the year of purchase, not surrender, of the notes. Finally, it held Stores, as the surviving corporation in a merger, was liable as a transferee for Securities Co.'s tax deficiencies.

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Facts

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Securities Co. had a collateral trust agreement executed in 1928, restricting dividend payments. In 1936, a new agreement extended the debt maturity, reduced interest, and modified sinking fund terms. In its tax returns, Securities Co. claimed credits for dividend restrictions and amounts set aside to retire debt under the 1928 agreement. The company also purchased some of its own notes and surrendered them to the trustee. Stores was the surviving corporation after a merger with Securities Co.

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Procedural History

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The Commissioner of Internal Revenue disallowed the tax credits claimed by Securities Co. and determined a deficiency in surtax. The Commissioner also determined that Stores was liable as a transferee for Securities Co.'s tax deficiencies. Securities Co. and Stores then petitioned the Tax Court for a redetermination. The Tax Court upheld the Commissioner's disallowance of certain credits but adjusted the credit for debt retirement and found Stores liable as a transferee.

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Issue(s)

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1. Whether Securities Co. is entitled to tax credits under Sections 26(c)(1) and 26(c)(2) of the Revenue Act of 1936 for restrictions on dividend payments and setting aside earnings to discharge debt.r
2. Whether Securities Co. is entitled to credit for the year 1937 under section 351 (b) (2) (B) of the Revenue Act of 1936 for amounts used to retire indebtedness.r
3. Whether Stores is liable for the deficiencies found with interest, as transferee.

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Holding

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1. No, because the contract did not explicitly prohibit all dividends, and the sinking fund requirements did not mandate using the current year's income.r
2. No, in part, because the date of purchase, not the date of surrender to the trustee, controls the year in which credit can be taken; thus, the court adjusted the credit amount.r
3. Yes, because the distribution to the stockholders of Securities, and the assumption of liabilities by Stores, imposed a legal and equitable liability upon the transferee.

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Court's Reasoning

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The court reasoned that tax credit statutes require strict construction and exact compliance. Regarding dividend restrictions, the contract allowed dividends payable in stock, meaning it didn’t explicitly prohibit all dividends, even though the company argued it couldn’t practically issue more stock. The court stated it could not

