3 T.C. 1048 (1944)

For taxpayers using the accrual method of accounting, dividends are taxable in the year they are received, not the year they are declared.

Summary

American Light & Traction Co. (petitioner), an accrual basis taxpayer, received dividends in 1937 that were declared in December 1936, with record dates also in December 1936. The Commissioner of Internal Revenue argued the dividends were taxable in 1936. The Tax Court initially agreed with the Commissioner, citing its prior decision. However, it reversed course, yielding to the Third Circuit's decision in *Tar Products Corp. v. Commissioner*, which held that dividends are taxable when received, not when declared. The Tax Court also held that the petitioner could deduct Wisconsin privilege dividend taxes because the tax was imposed on the stockholder, not the corporation.

Facts

During December 1936, American Light & Traction Co. owned stock in several corporations that declared dividends.
The dividend declarations specified record dates in December 1936.
The dividends were payable in 1937, and American Light & Traction Co. actually received them in 1937.
The company used the accrual method of accounting.
Wisconsin corporations withheld and paid to the State of Wisconsin sums for the 2 1/2 percent privilege dividend tax imposed by section 3, chapter 505, Laws of 1935, as amended, of the State of Wisconsin

Procedural History

The Commissioner determined a deficiency in American Light & Traction Co.'s 1936 income tax.
The Commissioner argued that dividends declared in 1936 but paid in 1937 were taxable in 1936 because the company used the accrual method.
The Commissioner amended his answer to disallow a deduction for Wisconsin privilege dividend tax.

Issue(s)

1. Whether a taxpayer using the accrual basis is taxable in 1936 on dividends declared in 1936 and payable in 1937 to stockholders of record on dates falling in 1936.
2. Whether the taxpayer properly deducted the Wisconsin privilege dividend tax under Section 23(c) of the Revenue Acts of 1934 and 1936.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. No, because the dividends are taxable in the year they are received, not the year they are declared.
2. Yes, because the Wisconsin privilege dividend tax is imposed on the stockholder, not the corporation.

Court's Reasoning

Regarding the timing of dividend income, the Tax Court initially followed its own precedent but then yielded to the Third Circuit's decision in *Tar Products Corp. v. Commissioner*. The court recognized the importance of a clear and consistent rule, even if it disagreed with the Third Circuit's reasoning initially. The court stated, "We are convinced that the importance of the question lies in the promptness and certainty of the answer. Therefore, without discussing the relative merits of the opinion of the Circuit Court of Appeals and our own, we yield to the former." The court also noted the Fourth Circuit's apparent approval of the Third Circuit's decision.

Regarding the Wisconsin privilege dividend tax, the court relied on *Wisconsin Gas & Electric Co. v. United States*, which held that the tax is imposed on the stockholder. Therefore, the stockholder, not the corporation, is entitled to the deduction. The court acknowledged that its prior decision in *Montreal Mining Co.* was no longer to be followed on this point.

Practical Implications

This case clarifies the tax treatment of dividends for accrual basis taxpayers, establishing that dividends are taxable when received, providing certainty for tax planning. While the Tax Court initially favored taxing dividends when declared, this decision aligns with the principle that income is generally recognized when it is actually or constructively received. This case also has implications for state taxes, affirming that if a state tax is legally imposed on the shareholder, the shareholder is entitled to deduct it for federal income tax purposes. This principle extends beyond the specific context of the Wisconsin privilege dividend tax. Later cases will need to examine the specific provisions of any state tax to determine on whom the tax is actually imposed, following the precedent set by *Wisconsin Gas & Electric Co. v. United States*, as applied here.

© 2025 SCOTUSreports.com. All rights reserved.