Standard Oil Co. v. Commissioner, 7 T.C. 1310 (1946)

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Payments made under a guaranty agreement are not deductible as ordinary and necessary business expenses or losses if the guarantor has a reasonable expectation of reimbursement from the primary obligor, even if no active steps are taken to pursue that reimbursement.

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Summary

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Standard Oil sought to deduct payments made under a guaranty agreement as ordinary business expenses or losses. The company had guaranteed dividends on preferred stock issued by Export Corporation, a company formed to promote export trade. When Export failed to fully cover a dividend payment, Standard Oil, as a guarantor, paid its share. The Tax Court denied the deduction, reasoning that Standard Oil had an implied right to reimbursement from Export, making the payment akin to a loan rather than an expense or loss. The court emphasized that the possibility of reimbursement, not the likelihood of it, determined deductibility.

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Facts

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Standard Oil and three other companies formed Export Corporation under the Webb Act to boost export sales.

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Export acquired Anglo American, another company, by exchanging Export's preferred stock for Anglo's stock.

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Standard Oil and the other companies guaranteed the dividends and par value of Export's preferred stock.

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Export paid dividends for several years, but in 1936, it couldn't fully cover a dividend payment. Standard Oil paid its guaranteed share, totaling $764,914.24.

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Standard Oil then sought to deduct this payment as a business expense or loss.

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Procedural History

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Standard Oil deducted the payment on its 1936 tax return.

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The Commissioner of Internal Revenue disallowed the deduction.

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Standard Oil appealed to the Tax Court.

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Issue(s)

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Whether payments made by Standard Oil under its guaranty of Export Corporation's preferred stock dividends are deductible as ordinary and necessary business expenses or losses under Section 23 of the Revenue Act of 1936.

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Holding

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No, because Standard Oil, as guarantor, had an implied right to reimbursement from Export Corporation, the primary obligor, for the dividend payments it made under the guaranty agreement; therefore, the payment is not deductible as an ordinary and necessary business expense or a loss.

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Court’s Reasoning

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The court reasoned that a guaranty is a secondary obligation, meaning the guarantor has recourse against the primary obligor (Export in this case). The court cited legal precedent, including *Howell v. Commissioner*, which affirmed the principle that “in the case of suretyship or guaranty there is an implied agreement on the part of the principal debtor to reimburse his surety or guarantor.”

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Even though there was no express agreement for reimbursement, the court found an implied agreement existed. Citing *Island Petroleum Co. v. Commissioner*, the court stated,

