19 T.C. 1180 (1953)

A corporation is not entitled to a dividends received credit for dividends received from a cooperative that was tax-exempt at the time the dividend was declared and paid from tax-exempt earnings, even if the cooperative's tax-exempt status changed after the dividend payment.

Summary

Tazewell Service Company sought a dividend received credit for dividends received from Illinois Farm Supply Company, a cooperative. The Tax Court denied the credit. The court reasoned that because Illinois Farm Supply Company was tax-exempt when the dividend was declared and paid from earnings accrued during its tax-exempt period, the dividend did not qualify for the credit. The court emphasized that the purpose of the dividend received credit is to prevent double taxation, which was not applicable here since the distributing corporation was tax-exempt.

Facts

Tazewell Service Company (Petitioner), an Illinois corporation, received dividends from Illinois Farm Supply Company. Illinois Farm Supply Company was an agricultural cooperative that had been granted tax-exempt status under Section 101(12) of the Internal Revenue Code. On July 30, 1947, Illinois Farm Supply Company declared a dividend payable to stockholders of record on August 31, 1947, and paid on September 30, 1947. Petitioner received $859.50 on October 1, 1947. Illinois Farm Supply Company filed a tax return for the year ending August 31, 1948, indicating it would no longer seek tax-exempt status due to changes in its operations after August 31, 1947.

Procedural History

Petitioner filed a tax return for the fiscal year ended October 31, 1947, reporting income from dividends. It later filed a claim for a refund, arguing it was entitled to a dividends received credit. The Commissioner of Internal Revenue (Respondent) disallowed the claim and determined a deficiency. The Petitioner then appealed to the Tax Court.

Issue(s)

Whether the petitioner is entitled to a dividends received credit under Section 26(b)(1) of the Internal Revenue Code for dividends received from a cooperative that was tax-exempt at the time the dividends were declared and paid from tax-exempt earnings.

Holding

No, because the dividends were declared and paid by a corporation that was tax-

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exempt at the time of declaration and payment, and the dividends were paid out of earnings on which no tax had been paid.

Court's Reasoning

The court reasoned that the status of the distributing corporation at the time the dividend was declared and became a fixed liability is determinative of the recipient's right to a dividends received credit. The court stated, "In other words it is the nature and character of the dividend, not the date it was received, which is important." The court looked to the purpose of Section 26(b)(1), which is to eliminate double taxation on intercorporate dividends. Since the Illinois Farm Supply Company was exempt from taxation when the dividends were declared and paid, and no federal income tax was ever paid on the earnings from which the dividends were distributed, allowing the credit would be contrary to the intent of the statute. The court noted that the first indication of a change in the Illinois Farm Supply Company's operations was in its tax return for the fiscal year ending August 31, 1948, indicating changes *subsequent* to August 31, 1947.

Practical Implications

This case establishes that the tax status of the distributing corporation at the time a dividend is declared and becomes a liability is critical in determining eligibility for the dividends received credit. Attorneys advising corporations on tax matters must consider the source of the dividend and the tax status of the distributing entity when the dividend liability was created. Subsequent cases may distinguish this ruling if the facts show that the distributing corporation's tax-exempt status was questionable at the time of dividend declaration. The case highlights the importance of documenting the timing and nature of changes in a cooperative's operations that could impact its tax-exempt status.

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