21 T.C. 625 (1954)

Proceeds from the sale of stock subscription rights, taxed as ordinary income, are considered dividends for the purposes of a dividends received credit.

Summary

Tobacco Products Export Corporation (taxpayer) received stock subscription rights from Philip Morris & Co. Ltd., Inc. The taxpayer sold these rights and reported the proceeds as capital gains. The Commissioner of Internal Revenue determined the proceeds were taxable as ordinary income. The Tax Court addressed whether the taxpayer was entitled to a dividends received credit under I.R.C. § 26(b) on the proceeds. The court held that, even though the proceeds from the sale of stock rights were taxed as ordinary income and not a dividend, the proceeds should be treated as dividends for the purpose of calculating the dividends received credit.

Facts

Philip Morris & Co. Ltd., Inc. offered its common stockholders transferable rights to subscribe to its preferred stock. The taxpayer, a common stockholder, received and subsequently sold these rights for $12,685.23. The Commissioner determined that the proceeds from the sale of the rights were taxable as ordinary income. The taxpayer did not contest this determination.

Procedural History

The Tax Court initially ruled, in the Commissioner’s favor, that the taxpayer was not entitled to a dividends received credit. The taxpayer successfully petitioned for a rehearing to introduce further evidence on the dividends received credit. The Tax Court considered the application of the dividends received credit in light of the newly presented evidence, ultimately reversing its initial stance.

Issue(s)

Whether the taxpayer is entitled to a dividends received credit under I.R.C. § 26(b) on the proceeds received from the sale of stock rights.

Holding

Yes, because the court held that, even though the proceeds from the sale of stock rights were taxed as ordinary income, the taxpayer could apply the dividend received credit for tax purposes.

Court’s Reasoning

The court recognized that the sale of stock rights generated ordinary income, not dividends, according to prior rulings. However, the court distinguished between the

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characterization of the income for taxability and its classification for dividend credit purposes. The court relied on the principles established in *Palmer v. Commissioner*, where the mere issuance of rights did not constitute a dividend. However, since the rights were sold, and the proceeds were taxable as ordinary income, the court decided that for the purpose of determining the dividends received credit, the proceeds from the sale should be treated as a dividend. The court found no disagreement over the taxability of the stock rights proceeds as ordinary income, but there was a controversy over whether they are to be treated as a dividend for tax purposes and allowed as part of the dividends received credit. “We are of the opinion that the proceeds of the sale of the stock rights in the present case, concededly being taxable as ordinary income, constitute dividends for purposes of dividends received credit.”

Practical Implications

This case highlights the nuanced distinction between classifying income for tax purposes and classifying it for the application of tax credits. It suggests that even when the initial characterization of income is not as a dividend, for specific tax benefits (like the dividends received credit for corporations), the source or nature of the income can be considered a dividend. Lawyers should carefully analyze the specific tax code sections, the nature of the underlying transaction, and relevant case law to determine if a dividend received credit is available.

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