26 T.C. 115 (1956)

A corporate distribution to shareholders is considered a taxable dividend if it is made out of the corporation's earnings or profits, even if the distribution is characterized as a payment related to a prior capital reduction.

Summary

The case involves a dispute over whether cash distributions received by shareholders in 1948 were taxable dividends or a return of capital. A corporation had reduced its stated capital in 1936, crediting the difference to capital surplus, and subsequently transferred these amounts to shareholder accounts. The Tax Court held that the 1948 distributions were taxable dividends because the corporation had accumulated earnings and profits in excess of the distributions, thereby triggering the statutory presumption that the distribution came from those earnings. The court rejected the argument that the distributions were a nontaxable return of capital, emphasizing that the distributions were made out of earnings and profits, as defined by the Internal Revenue Code.

Facts

The Cleveland Towel Supply Co. was organized in 1928 with no-par common stock. In 1936, the corporation reduced its authorized capital from $50,000 to $2,500, transferring the $47,500 difference to a capital surplus account. In 1937, the corporation transferred the $47,500 from capital surplus to separate accounts for each common stockholder. The corporation made cash distributions to the stockholders in 1948. The Commissioner of Internal Revenue determined these cash distributions to the Millers were taxable dividends. The Millers argued that the distributions were a return of capital, not taxable dividends.

Procedural History

The Millers (Joseph and Rose Miller, and Samuel and Emma Miller) challenged the Commissioner's determination of income tax deficiencies in the U.S. Tax Court. The cases were consolidated. The Tax Court sided with the Commissioner, finding the distributions were taxable dividends, and the petitioners appealed to the Tax Court.

Issue(s)

1. Whether the cash distributions made by the Cleveland Towel Supply Co. to the Millers in 1948 were taxable dividends as defined by the Internal Revenue Code.

Holding

1. Yes, because the distributions were made out of the corporation's earnings and profits, as determined by the Internal Revenue Code, and are therefore considered taxable dividends.

Court’s Reasoning

The court applied the definition of a dividend provided in the Internal Revenue Code. Specifically, the court referenced 26 U.S.C. § 115(a), which defines a dividend as “any distribution made by a corporation to its shareholders, whether in money or other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year.

