32 T.C. 869 (1959)

Under Section 23(r)(1) of the 1939 Internal Revenue Code, the deductibility of dividends paid by a savings and loan association depends on when the dividends are withdrawable on demand, regardless of when they are credited or paid.

Summary

The U.S. Tax Court addressed whether a savings and loan association could deduct dividends declared in 1951 and 1952 for the purpose of calculating its 1952 tax liability. The court found that the timing of dividend deductibility hinged on when the dividends were withdrawable on demand by shareholders, not when they were declared or credited. The court determined that the 1951 dividends were not withdrawable until 1952, making them deductible in 1952. Conversely, the 1952 dividends were withdrawable in 1952, therefore also deductible in 1952. This case clarifies the application of Section 23(r)(1) regarding dividend deductions for savings and loan associations, emphasizing the importance of withdrawal availability.

Facts

Hancock County Federal Savings and Loan Association of Chester (the "Petitioner") was a federal savings and loan association that operated on a calendar year and cash basis. Its first year of federal income tax liability was 1952. The association declared and paid semi-annual dividends to both investment and savings shareholders. For dividends declared on December 31, 1951, the Petitioner did not allow withdrawals or payment until January 2, 1952. In 1952, the Petitioner changed its policy to allow shareholders to withdraw dividends on demand on December 31, 1952. The IRS disallowed the deduction for the December 31, 1951 dividends, arguing they were not deductible in 1952. The IRS also contended that the 1952 dividends were not withdrawable until January 1, 1953, and therefore not deductible in 1952.

Procedural History

The Commissioner of Internal Revenue (the "Commissioner") determined deficiencies in the Petitioner's income tax for 1952 and 1953. The Petitioner contested the disallowed deductions in the U.S. Tax Court. The Tax Court considered the case and issued a decision for the Petitioner.

Issue(s)

1. Whether the dividends declared on December 31, 1951, were deductible in 1952 under Section 23(r)(1) of the 1939 Code.

2. Whether the dividends declared on December 31, 1952, were deductible in 1952 under Section 23(r)(1) of the 1939 Code.

Holding

1. Yes, because the court found that, in accordance with the Petitioner's policy, the December 31, 1951, dividends were not withdrawable on demand until January 2, 1952.

2. Yes, because the court determined that, based on the resolution of the board of directors, the December 31, 1952, dividends were available and withdrawable by shareholders on December 31, 1952.

Court's Reasoning

The court's reasoning centered on the interpretation of Section 23(r)(1) of the 1939 Internal Revenue Code, which allowed deductions for dividends paid by savings and loan associations. The court emphasized that the deductibility of dividends depended on when they were withdrawable on demand, not the date of declaration, or payment. The court cited Regulation 111, section 29.23(r)(1), which stated that amounts credited as dividends as of the last day of the taxable year which are not withdrawable by depositors or holders of accounts until the business day next succeeding are deductible in the year subsequent to the taxable year in which they were credited.

For the 1951 dividends, the court found that the Petitioner's consistent policy of not allowing withdrawals until the first business day of the following year meant the dividends were not withdrawable on demand until January 2, 1952. As a result, the court determined that the 1951 dividends were deductible in 1952.

Regarding the 1952 dividends, the court pointed to the board's resolution, which specified the dividends were payable as of the opening of business on December 31, 1952. The dividends were available for withdrawal and were paid on that day. Therefore, the court held the 1952 dividends were deductible in 1952.

The court distinguished this case from *Citizens Federal Savings & Loan Assn. of Covington*, where the savings shareholders could receive credit in their passbooks on December 31, 1951. Here, the evidence showed that the savings shareholders' dividends for the last six months of 1951 were not withdrawable on demand before January 2, 1952.

The court explicitly noted that the date on which dividends can be demanded and withdrawn determined the taxable year in which the dividends are deductible, regardless of when the dividends are credited or paid.

Practical Implications

This case is a critical precedent for savings and loan associations and other financial institutions, clarifying the timing of dividend deductions for tax purposes. It emphasizes the importance of policies and procedures regarding the availability of dividend withdrawals. Tax attorneys and accountants advising savings and loan associations must carefully examine the specifics of their dividend policies, including when dividends are considered available for withdrawal. The court's focus on the date of withdrawal, rather than the date of declaration or payment, provides a clear rule for determining the proper tax year to deduct dividends.

The case's interpretation of 'withdrawable on demand' underscores the necessity for clear documentation of withdrawal policies. It also stresses the importance of consistent application of these policies. This case reinforces that the language used in board resolutions and in communications with shareholders must accurately reflect the reality of when dividends become accessible. Subsequent cases that have addressed dividend deductions in savings and loan associations continue to cite *Hancock County* for its clear articulation of this key principle.

