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TAXATION — INCOME TAX — PROFIT ON SALE OF SECURITIES — IDENTIFICATION OF SHARES SOLD — The taxpayer ordered his broker to sell certain shares of stock purchased in March, 1929, which were on deposit at a bank. He then ordered the bank to deliver a thousand shares from certificates numbered 80250 to 80258 inclusive, and 80264. It does not appear whether the instructions were written or oral. The bank, however, delivered by mistake certificates from another lot which had a considerably lower cost basis and had been held as collateral since 1925. The Board of Tax Appeals concluded that the shares delivered to the broker as represented by the certificates were the shares actually sold by the petitioner, and computed the taxable gain upon the basis of the cost of those shares rather than on the cost of the shares which the petitioner intended to sell and had instructed the broker to sell. On appeal, *held*, the order of the Board of Tax Appeals should be affirmed, for in the situation herein presented the certificates were the best means of identification available. *Davidson v. Commissioner*, (U. S. 1938) 59 S. Ct. 43, affirming (C. C. A. 8th, 1938) 94 F. (2d) 300.

When shares of corporate stock are sold and the identity of the lots can-

not be determined, the regulations [1] provide that the stock sold shall be charged against the earliest purchases of such stock for the purpose of ascertaining the cost upon which the taxable gain is computed. The validity of the regulation was sustained in *Helvering v. Rankin*,[2] but the Supreme Court further held that where the shares sold could be identified, the "first in, first out" rule was inapplicable. Until recently, the only method of identifying the shares of stock purchased was by means of the certificates transferred, but the Court in the *Rankin* case clearly indicated that a designation of the securities as those purchased on a certain date for a stated price was also a satisfactory method of identification. This decision gave rise to a new problem, namely, conceding that both methods of identification are acceptable, in a situation where the certificates delivered in consummation of a sale do not represent the same shares as described in the instructions to the broker—which method will be controlling? Apparently contrary to the result reached by the Circuit Court of Appeals for the Eighth Circuit and confirmed by the Supreme Court in the principal case, the judges of the Second Circuit in *Miller v. Commissioner* [3] have held that the written instructions to the broker, specifying the price paid and the date on which the particular lot was purchased, were controlling in determining the identity of the shares sold where the certificates delivered did not correspond to the stock designated by the instructions. The difference between the views expressed by the courts in these two cases lies not in their approach to the law, but rather in their divergent views of the consideration given by brokers to stock certificates. The court in the *Miller* case was strongly impressed by the evidence that for many purposes, brokers use stock certificates interchangeably,[4] and give them only secondary consideration because of their fungible nature.[5] Consequently, when faced with a choice between uncontroverted instructions to a broker which have previously been held a valid method of identification, and certificates of stock which have been so commingled that none were traceable to any particular purchase,[6] the Court logically based its decision on the more reliable evidence. However, it must be remembered that the instructions of the taxpayer have been recognized as a method of identification only where the stock was purchased on margin and certificates were not delivered to the buyer, or in the situation where the certificates themselves have lost their identity by mergers and new issues.[7] Such circumstances were present in both the *Rankin* and *Miller* cases, and the rule there stated must be limited to the facts presented. The situation involved in the principal case, where the certificates were directly

[1] TREAS. REG. 94, art. 22 (a)-8 (1936).

[2] 295 U. S. 123, 55 S. Ct. 732 (1935).

[3] (C. C. A. 2d, 1935) 80 F. (2d) 219.

[4] Howbert v. Penrose, (C. C. A. 10th, 1930) 38 F. (2d) 577, 68 A. L. R. 820 at 827. Here the intention was not even communicated, but there were additional factors, other than the book entries made by himself, which strongly supported the taxpayer's intention.

[5] Richardson v. Shaw, 209 U. S. 365, 28 S. Ct. 512 (1908).

[6] In Miller v. Commission, (C. C. A. 2d, 1935) 80 F. (2d) 219, it clearly appears that at least as to the block of stock purchased on March 6, the certificates were so commingled that none were traceable to their respective purchases.

[7] In Helvering v. Rankin, 295 U. S. 123, 55 S. Ct. 732 (1935), it was expressly stated that no certificates were delivered to the buyer at any time.

traceable to the stock, differs materially from the facts upon which the doctrine of the *Rankin* and *Miller* cases was predicated, and consequently the rule there developed was properly refused application. Under these circumstances, as was decided by the Supreme Court, the certificates alone must determine the identity of the shares sold. It should be noted that the problem arising here is not to be analyzed in the same manner as the case where a taxpayer has certificates in his own possession, and after designating a particular lot by instruction, transfers to his broker certificates indicating a different block of stock.[8] Under these facts, the courts proceed upon the theory that the taxpayer's intention is evidenced by two obviously contrary acts, and hence may properly conclude that the last act was indicative of the final purpose of the taxpayer. This theory does not underlie the decision in the instant case because the intent of the taxpayer herein is undisputed. The principle here followed is merely that the taxpayer's liability is determined by what was done by himself through his agent, rather than by what he intended to do. Although this result may seem unduly harsh in some situations, still the position of the taxpayer is not wholly unfortunate for he always has recourse for damages against his agent, who in most instances is a financially responsible concern.

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[8] See Horner v. Commissioner, (C. C. A. 3d, 1934) 72 F. (2d) 407 (in this case not only did the taxpayer deliver the certificates himself, but at the time of sale he had not yet acquired the shares which according to his allegations were transferred in the sale); Vawter v. Commissioner, (C. C. A. 10th, 1936) 83 F. (2d) 11, wherein the court expressly declined to decide the case where delivery of the certificate was made by the agent rather than the taxpayer; Curtis v. Commissioner, (C. C. A. 8th, 1937) 89 F. (2d) 736 (the court here intimated its decision in the principal case); Cole v. Helburn, (D. C. Ky. 1933) 4 F. Supp. 230. See also, Davidson v. Commissioner, (C. C. A. 8th, 1938) 94 F. (2d) 303.