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TAXATION - INCOME TAXATION OF STOCK DIVIDENDS

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TAXATION — INCOME TAXATION OF STOCK DIVIDENDS — In 1929 a stock dividend was paid to the holders of common stock in preferred stock of the dividend paying corporation, which had both common and preferred stock outstanding at the time the stock dividend was declared and paid. The taxpayer, as a holder of common stock, received his pro rata share of the dividend and subsequently within the same taxable year sold the preferred stock which he had so received as a dividend. *Held*, that under the Revenue Act of 1928, (1) the receipt of the stock dividend was not a taxable occasion, and (2) the basis of the stock received as a dividend was zero and that upon sale of such stock the entire proceeds were taxable. *Helvering v. Gowran*, (U. S. 1937) 58 S. Ct. 154.[1]

The Revenue Act of 1916 provided that a stock dividend should be treated as taxable income to the extent of its cash value.[2] In *Eisner v. Macomber*[3] it was held that a dividend in a corporation's own common stock paid on its outstanding common stock was not income within the Sixteenth Amendment to the Constitution, and hence was not within the power of Congress to tax. Thereafter Congress in the Revenue Act of 1921 provided "A stock dividend shall not be subject to tax."[4] The basis of this exemption is disclosed in the Senate and House reports on the bill, which upon Congressional enactment

[1] See also Helvering v. Pfeiffer, (U. S. 1937) 58 S. Ct. 159.

[2] 39 Stat. L. 756, § 2 (a) (1916).

[3] 252 U. S. 189, 40 S. Ct. 189 (1919).

[4] 42 Stat. L. 227, § 201 (d) (1921). The same provision was repeated in the Revenue Acts of 1924 and 1926, Section 201 (f) [43 Stat. L. 253 (1924) and 44 Stat. L. 9 (1925)] and the Revenue Acts of 1928, 1932 and 1934, Section 115 (f) [45 Stat. L. 791 (1926), 47 Stat. L. 169 (1932) and 48 Stat. L. 680 (1934)].

Compare, however, the Revenue Act of 1936, Section 115 (f) (1), which provides, "A distribution made by a corporation to its shareholders in its stock . . . shall not be treated as a dividend to the extent that it does not constitute income to the stockholder within the meaning of the Sixteenth Amendment to the Constitution." 49 Stat. L. 1648 (1936).

became the Revenue Act of 1921. The House report [5] states that the bill "modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in *Eisner v. Macomber*." In 1936 the Supreme Court's decision in *Koshland v. Helvering* [6] made it clear that *Eisner v. Macomber* did not hold or indicate that no stock dividend paid by a corporation in its own stock was taxable; it held merely that such a dividend was not constitutionally taxable where, because of its payment, "no severance of corporate assets was accomplished and the preexisting proportionate interest of the stockholders remained unaltered," [7] as for instance in the case of a stock dividend of a corporation's common stock on its common stock. The *Koshland* decision, moreover, went on to point out that where the stock dividend after distribution altered the proportional interest of the stockholder in the corporation, as where a holder of preferred stock received a dividend of common stock of the same corporation, the dividend was constitutionally subject to an income tax. In view of this history, the Commissioner of Internal Revenue urged in the principal case that the statutory exemption of stock dividends, namely, "A stock dividend shall not be subject to tax," should be interpreted to cover only such stock dividends as could not under the Constitution be taxed as income. On its face, the decision is the *Gowran* case flatly rejects this argument on the ground that the statute is perfectly clear and unambiguous. That this rejection of the commissioner's position is more apparent than real becomes clear in the Court's treatment of the second problem involved in the case, namely, the sale of the dividend stock by the recipient thereof. On this point it was held that in view of its history the stock dividend exemption could not "be taken as a declaration of congressional intent that the value of all stock dividends shall be immune from tax not only when received but also when converted into money or other property" [8] and that therefore, the cost of the dividend stock being zero, the entire proceeds thereof upon sale or exchange were taxable. Thus the Court in effect adopted the commissioner's contention that the statutory stock dividend exemption applied only to dividends not constitutionally taxable, adding, however, the proviso that in the case of a taxable dividend the tax was to be deferred until such time as the dividend was converted into money or other property, rather than at the time of its receipt. This holding was in the face of the taxpayer's argument that the basis of the dividend stock in his hands should be its value at the time he received it and that only the money received upon its sale in excess of that basis should be taxable income.[9] The decision represents, it is believed, a highly practical compromise between the desire not to violate the unambiguous statutory provision, and the desire to preserve the Government's revenue as much as possible in the face of the Congressional misunderstanding of the *Macomber* case. The technique of the decision was perhaps inspired by the so-called "tax free" reorganization pro-

[5] H. R. REP. 350, 67th Cong., 1st sess. (1921), p. 8. See similar statement in S. REP. 275, 67th Cong., 1st sess. (1921), p. 9.

[6] 298 U. S. 441, 56 S. Ct. 767 (1936).

[7] 298 U. S. at 444.

[8] 58 S. Ct. at 157.

[9] Compare Doyle v. Mitchell Bros., 247 U. S. 179, 38 S. Ct. 467 (1918).

visions of the revenue acts, which provide that the receipt of stock in certain corporate reorganizations, though constitutionally taxable, shall be exempt from tax, but that upon sale or exchange of such reorganization stock the proceeds thereof shall be taxed.[10]

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[10] See Revenue Act of 1936, 49 Stat. L. 1648, §§ 112, 113; MAGILL, TAXABLE INCOME 129 (1936).

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