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"KNOWN GENERALLY AS CORPORATE SECURITIES"

ALBERT S. ABEL*

SECTION 1801 of the Internal Revenue Code provides for a tax "on all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities." Language can hardly be imagined better calculated at once to require and to baffle construction as to what instruments other than corporate bonds, debentures, and certificates of indebtedness are subject to tax. Patently the provision does not admit of application according to its grammatical construction¹ for what corporation is there "with interest coupons" or what corporation "in registered form," as specified by the language quoted, and, if such could be found, who could reasonably suppose an intention to limit the operation of the legislation to such an odd creature? Again, the limitation to bonds, debentures, and certificates of indebtedness "issued by any corporation" seems clearly provided if anything is by this rhetorical hodgepodge; but if the limitation to instruments of corporate provenance is to apply throughout the entire section, why state it in the middle of the stream, and, on the other hand, if it is not, what effect shall be given to the second "issued by any corporation"?

Had the section been struck off at a given time by the hand and the mind of man, one would be driven to attribute its stylistic peculiarities to whimsy or to drink; but, coming as it has as a stage in an evolutionary process, some understanding of how it got that way (although not necessarily of what it means) can be gained from tracing its history. Appearing as set forth in the Revenue Act of 1926² and since, it replaced a section in the Revenue Act of 1924³ similar in all respects except that it taxed bonds, debentures, and certificates of indebtedness "issued by any person;"⁴ the narrowing was effected in conference at the instance of the Senate conferees⁵ and would seem to have contemplated that, as to those three classes of instruments, a corporate issuer was requisite to tax liability; what was intended as to those falling within the remainder of the section, nil constat. The provision of the Revenue Act of 1924, in its

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¹ See the somewhat plaintive recognition of the "obstacle" occasioned by "the presence of a grammatical error in the act of Congress" in Fidelity Trust Co. v. Lederer, 276 Fed. 51, 54 (E. D. Pa. 1921).
⁴ Italics supplied.
⁵ See United States v. Powell, 95 F. (2d) 752, 754 (C. C. A. 4th, 1938).
turn, was copied from that of the Revenue Act of 1921, which was identical with one in the Revenue Act of 1919, where, however, the provision had appeared with a companion section requiring stamp taxes to be annexed to "Bonds, indemnity and surety" without mention of corporations, which section was repealed by the Act of 1921. The Act of 1918 had for the first time added the clause relating to "all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities" to the provisions for taxing bonds, debentures, and certificates of indebtedness and, as to these latter, had imposed liability when they were "issued by any person" in contrast with the Revenue Act of 1917 which spoke in terms of their issue "by any person, corporation, partnership, or association."

Such has been the meandering course of this provision with the further complication that the section heading "Bonds of indebtedness" appearing in the Act of 1926 and theretofore was metamorphosed in the Internal Revenue Code to the present heading "corporate securities." All this rather tedious recital of the steps by which the present language developed serves well enough perhaps to dissipate any blame for its literary defects; but how far it discloses any consistent evolutionary pattern as an aid to construction is something else again. True, inference can be drawn as to what each several step was meant to accomplish; indeed they are extremely complaisant both individually and in the aggregate and will support a host of inferences of the most conflicting character. Of its history as of its grammar, one can make almost anything which, of course, means one can make almost nothing. Such situations are preeminently adapted to the technique of judicial construction of which this provision has received plenty.

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6 42 Stat. 303 (1921).
7 40 Stat. 1135 (1919).
8 "2. Bonds, indemnity and surety: On all bonds executed for indemnifying any person who shall have become bound or engaged as surety, and on all bonds executed for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and on all policies of guaranty and fidelity insurance, including policies guaranteeing titles to real estate and mortgage guarantee policies, and on all other bonds of any description, made, issued, or executed, not otherwise provided for in this schedule, except such as may be required in legal proceedings..."
10 See the discussion of statutory history in Lawyers' Mortgage Co. v. Anderson, 67 F. (2d) 889, 891, 892 (C. C. A. 2d, 1933).
11 They would seem also to be adapted to the technique of interpretative regulations; but of this, as will appear more fully, infra page 20, the provision has received little.
The United States Supreme Court has not yet spoken as to the meaning of section 1801; but its decision construing the very similar provision of the Revenue Act of 1919 in *Lederer v. Fidelity Trust Company* to hold railroad equipment trust certificates "instruments . . . known generally as corporate securities" and the trustee liable for a stamp tax on such certificates must be deemed and has been accepted as a direct authority on the meaning of section 1801. Counsel for the trustee had relied largely on the proposition that the phrase referred exclusively to instruments embodying or evidencing a debtor-creditor relationship between the corporation and the holder, a relationship not created by equipment trust certificates under which the holder's interest is analytically that of equitable owner rather than creditor, and on the threadbare generality that tax statutes are not to be extended by implication beyond the clear import of the language used. This approach was successful in the circuit court of appeals which apparently felt that Congress should put beyond the need for construction the tax liability of any instruments it desired to reach; but the Supreme Court took a less mechanical view, expressed in the somewhat cryptic opinion by Mr. Justice Holmes, who, after defining the issue as "whether the certificates are instruments issued &c, known generally as corporate securities" said

The petitioner asks us to look through the form of the arrangement and give it a somewhat different meaning. The respondent on

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14 The court reporter thus summarizes the argument of counsel for respondent taxpayer, 267 U. S. 17, 19, 20: "The equipment certificate here taxed is not a certificate of indebtedness or a corporate security. It is not the obligation of a corporation to pay money owing by it, nor does it evidence an indebtedness secured on the property of a corporation. It is a mere declaration of trust and defines the holder's ownership of the equipment leased to the railroad company and the extent of his interest in the moneys to be received as rental therefor. Neither the railroad company nor the trust company is indebted to the certificate holders . . . The certificate is merely the evidence of the holder's equitable ownership of an undivided interest in the equipment leased to the railroad company and the rentals payable therefor. How, then, can such muniments of title be termed "corporate securities"?" (Italics supplied.)
15 Id. at 20.
16 *Fidelity Trust Co. v. Lederer*, 289 Fed. 1009, 1012 (C. C. A. 3d, 1923). ("It will thus be seen that, when the transaction is viewed as a whole, as must be the case, and the certificate in question measured from that standpoint, no indebtedness is involved or obligation incurred by the trustee to the holder, but it is simply a certificate of the holder's right to proportionate participation in a rental when paid . . . It would seem that Congress, had it intended taxing (car trust certificates), would have so covered them by specific designation, or by proper generic description, as to leave no question of its intent.")
the other hand says in the language of United States v. Isham...

"whatever upon its face (the instrument) purports to be, that it is for the purpose of ascertaining the stamp duty." We are content to adopt the respondent's rule for this case, as upon any rule the result seems to us clear.

As a matter of common speech, to which the statute refers, we have no doubt that these instruments would be known as corporate securities. They would be called so more accurately than some other documents which we believe also would be known generally by that name. Their purpose, as stated in the agreement of the trustee with the railroad, is to secure payment to the holder with interest. They do nothing else. We do not regard the precise limits of the Trust Company's undertaking as important. If it were only to collect and pay money received by the Company under the secured contract of the Railroad it would be a security for money payment. But the counsel for the Company seemed not prepared to argue that the Company could not put the money received from the Railroad into its general account without a breach of trust, and give the certificate holder cash or a check for his interest or principal. But be the undertaking greater or less, the security better or worse, we cannot regard these certificates as anything but corporate securities by general understanding and in fact.18

Somewhere in this language and in the significant silences of this opinion, the lower federal courts have to find virtually19 all the guidance from higher authority available for the construction of the provision. There has been little administrative assistance. While Regulation 71 in its original form devoted twenty-one sections to the elucidation of section 1801, most of them were concerned with what should be deemed "bonds" or "certificates of indebtedness" and only two20 dealt with the amorphous "instruments, however termed . . . known generally as corporate securities." One21 so categorized the equipment trust certificates which were the subject of suit in Lederer v. Fidelity Trust Company. The other22 dealt similarly with "business property investment bond(s),"

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18 Id. at 21, 22, 45 S. Ct. 207, 69 L. ed. 495.
19 True, there have been denials of certiorari in certain other cases arising under the section, almost invariably without specification of the grounds for denial, however; and he would be a bold man indeed who attempted to erect much of a structure of reasoning on implications from such action. Cf. Griswold, Book Review (1935) 48 Harv. L. Rev. 1037, 1038.
20 Two others declare that certificates of deposit in banks and instruments representing an assignment of interest in a bond secured by a mortgage are not taxable, thus inferentially holding transactions of the type specified not to be "known generally as corporate securities."
21 U. S. Treas. Reg. 71, art. 13 (1932) ("Car trust certificates on the so-called Philadelphia plan are 'corporate securities,' within the meaning of the Act, and are subject to payment of the stamp tax on bonds of indebtedness.")
22 U. S. Treas. Reg. 71, art. 16 ("A business property investment bond wherein it is certified that the holder thereof is the owner of an interest in certain specified property, legal title to which has previously been conveyed to a trustee, and whereby the corporation issuing the same agrees to manage the property and
thus accepting as to them the result of the majority of lower federal court holdings. The later revision of the Regulation makes even briefer reference to the matter, its contribution (if such it can be called) being limited pretty much to an uninformative paraphrase of the statutory piracyscope. So little influence, indeed, has administrative regulation and in this field that in only two instances has any reference to it in the opinions been found. There may be few places left in our present intricately meshed tax system for judicial development of doctrine by case law; but here, it would seem, we have one of them.

The characteristic feature of the equipment trust is the establishment of a specific res (consisting of railroad rolling stock), the proprietorship interest in which is evidenced by a number of instruments (entitled equipment trust certificates) in amounts conveniently adapted to investment purposes, which are marketed among a group of persons not otherwise sustaining any special business relationship with one another and not proposing to engage in any common enterprise except the receipt of income from the res, which is and which it is contemplated will continue to be used by others, subject to a contract yielding a regular return to the certificate holders. The formation of the income yielding contracts, the distribution of the proprietorship interest by marketing

distribute the proceeds in a certain manner, is not subject to tax as a bond, debenture, or certificate of indebtedness, but is subject to tax as a certificate of interest in property issued by a corporation. But cf. the provisions of U. S. Treas. Reg. art. 56(h) quoted infra note 23. U. S. Treas. Reg. 71, art. 55 (1942) ("Issues subject to tax. Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration, and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called. The following are examples of corporate instruments taxable upon issue: . . . (e) Equipment trust certificates. (f) Scrip-dividend certificates. (g) Any of the obligations described in section 1801, issued on or after October 22, 1942, by any receiver, trustee in bankruptcy, assignee, or other person, having custody of property, or charge of the affairs, of any corporation.")

Id. art 56 ("Issues not subject to tax. In addition to the various issues specifically exempt under section 1608, as to which see Subpart J, the following are examples of instruments not taxable upon issue: (a) An instrument issued by an individual. . . . (h) A business property investment certificate wherein it is certified that the holder thereof is the owner of an interest in certain specified property, legal title to which has previously been conveyed to a trustee, and whereby the issuing corporation agrees to manage the property and distribute the proceeds. However, such an instrument is subject to the issue tax imposed by section 1802(a) . . ")

23 U. S. Treas. Reg. 71, art. 55 (1942) ("Issues subject to tax. Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration, and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called. The following are examples of corporate instruments taxable upon issue: . . . (e) Equipment trust certificates. (f) Scrip-dividend certificates. (g) Any of the obligations described in section 1801, issued on or after October 22, 1942, by any receiver, trustee in bankruptcy, assignee, or other person, having custody of property, or charge of the affairs, of any corporation.")

the certificates, and all the managerial details of receiving and distrib-
uting the income and supervising the arrangements with the railroad on
the one hand and the certificate holders on the other are undertaken by
a corporate intermediary, usually styled a trustee, compensated for such
services by marketing commissions, managerial commissions, or both.
The plan is devised to make costly equipment immediately available to
the railroad without a pledge of its general credit or the assumption of
liabilities other than those nominally attributable to current use, to per-
mit individuals with available funds to invest them in a curious sim-
ulacrum of entrepreneurship largely stripped (or believed to be
stripped) of the risk of fluctuating return, characteristic of that status
in its more usual form of partnership or of corporate stockholding, and
to enable the intermediary to preserve and cultivate advantageous fin-
ancing relations with the railroad on the one hand and the certificate
holders on the other, to be remunerated for its services, and at the same
time to undertake no liabilities except those arising from its general
obligations as fiduciary.25

Such a plan, while of obvious advantage to railroads, is not limited
in its appeal to that single situation. Given a group of potential investors
who want concurrently the postulated security of principal which at-
taches to ownership and the assurance of a level effortless income return
which is lacking with the orthodox forms of proprietorship, a res homo-
genous enough and large enough to invite the splitting of ownership into
a number of standard and easily marketable portions, and a financial
institution unable or unwilling to commit its own funds indefinitely as
advances on account of such res but willing to serve as sponsoring inter-
mediary and manager, of such prestige among investors that, in reliance
on its sponsorship and management, without any specific assumption of
liability by it, they are willing to advance the value of the res in return
for fractional ownership shares therein, an arrangement analogous to the
equipment trust is a perfectly natural development. The peculiarity of
the resultant enterprise is that it engenders claims arising out of the
activity of the sponsoring institution which involve no element of stock-
holding in that or any other corporation nor yet in any undertaking by
it to repay the amount invested; so that the corporation which generates
the investment and which continues to exercise management has issued
neither stock, bonds, debentures, or anything which can strictly be called
corporate indebtedness.

25 For a comprehensive pioneer study of the car equipment trust device, see
The conditions supposed have been most frequently presented, aside from the car equipment trust, in connection with mortgage participation schemes. This type of arrangement, although it has by now attained a considerable age and degree of standardization, has received but little methodical consideration in legal literature and that usually in consideration with the position of investors\(^{26}\) rather than that of the institution distributing the participation certificates and undertaking managerial functions. It presents all the financial attributes noted in the preceding paragraphs, however, and, subject to statutory and judicial limitations,\(^{27}\) has had a fairly widespread use as an investment outlet, especially in flush times. Issues of such participation certificates were not uncommon in the late '20s, resulting in the decision of stamp tax liabilities in the unhappier '30s; and it may be expected that this experience is about to repeat itself, so that those tax determinations are of current importance.

The major fact difference between the car equipment trust and the mortgage participation lies in the character of the res which consists as to the former of rolling stock, as to the latter of pooled mortgages on realty. In both, "ownership" interests in the res are split into shares of standard denominations which are serially issued to investors desiring to participate. The issuing and managing institution characteristically has a rather more intimate relation to the res in the mortgage participation plan, to the extent that it, usually either through a subsidiary or through its parent financial corporation, will have initially acquired the constituent mortgages as part of its own investment portfolio. Such mortgages are then transferred either in a block or by designation in a transaction between parent and subsidiary or, if the parent-subsidiary device is not employed, are made subject to a declaration of trust pari passu with the distribution of participation certificates to investors. Under established variations, such certificates represent sometimes an undifferentiated fractional interest in the pooled mortgages, sometimes a fractional interest in specific constituent mortgages as to which the investors might and occasionally do exercise a degree of discriminating choice; on the latter side, the arrangement shades into outright mortgage assignment, which indeed the financing institution sometimes offers prospective investors as an alternative option to mortgage participation. Some form of mortgage guarantee by itself or mortgage insurance by an authorized independent insurer may be offered as a further assurance to investors; or there may be

\(^{26}\) I Glenn Mortgages (1943) §7; Loring, A Trustee's Handbook (Shattuck's rev. 1940) §60.  
\(^{27}\) The best discussion of this phase of mortgage participations is found in Note, Legality of Mortgage Participations as Trust Investments (1932) 41 Yale L. J. 455.
no such provision and, indeed, the financing institution may expressly absolve itself from any liability for principal or interest except as they are received. Besides the intangible advantages from extending its financial influence and connections in the community, the institution frequently profits by providing for distribution to the investors of slightly less sums than those paid by the mortgagors as interest, the balance being retained as a managerial commission.

That car equipment trust certificates should be held taxable, upon the most perfunctory consideration, as "instruments... known generally as corporate securities" in the single case arising with respect to them under the current Act will perhaps not astonish even those most easily amazed, in the light of Lederer v. Fidelity Trust Company and Article 55(e) of Treasury Regulation 71. It might well be assumed that a like result would as easily be reached as to instruments issued under mortgage participation arrangements in view of the essential identity between them and car equipment trusts pointed out above so far as concerns the substantial rights and relative position of the parties. That is, indeed, the result achieved after deliberation in the greater number of cases where the problem has arisen. However, the course of decision has not been unanimous and authority exists in which the issuance of participating certificates has been held not to give occasion for the payment of the stamp tax. Differentiating circumstances were thought to exist as a result of the investor's power of selection among mortgages and of detailed provisions in the contract expressed by the certificate. Pretermitting consideration of the logical validity of these suggested differentiations, it can be said nevertheless that there are few, if any, of the supposed differentiating features which could not equally be found in issues elsewhere held subject to tax. The central fact to be noted is that instruments distributed

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29 Supra note 23.
under mortgage participation schemes have been generally though not unanimously deemed taxable on the ground that they are "known generally as corporate securities," thus putting them on the same tax footing as the nearly parallel equipment trust certificates.

Attractive engraving and elaborate phraseology combined with a nebulous proprietorship have no doubt proved a potent lure for investment hungry funds; but the proprietorship can be left out and a direct promise of the issuer substituted without greatly lessening the appeal to the classic widow-and-orphan market. There has resulted a proliferation of instruments which present in each instance the question whether the paper can be said to be "known generally as corporate securities," hence taxable. The issuer, a corporation engaged in the business of advancing funds to others—"managing investments," if you please—desires to induce a continuing flow to itself of outside capital, to permit it to enlarge its loans and obtain a return by the differential between the interest it receives and that which it pays out. Technical considerations of financing procedure, arising from the short term character of the underlying security, a desire for greater discretion and greater diversity as to available types of security, and the like, militate against the creation of a floating proprietorship interest (a device indeed which seems to have been largely confined to car equipment trusts and mortgage participations and which is ill-adapted to securing funds for investment in heterogeneous or fluctuating securities). The alternative is an issue of instruments bearing the direct promise of the issuer, coupled sometimes with a reference to the existence of a trust to secure repayment but not purporting to give the purchaser any direct proprietary interest in the res or in any specific part of it. Frequently the instrument will bear some such resounding title as "special interest contract," "special annuity contract," "collateral trust secured thrift agreement," "accumulative instalment certificate," or the like; but in each case it is in essence the issuer's promise to repay in a manner specified the sum advanced plus interest. While a corporate obligation, its dissimilarities from orthodox bonds, debentures, and certificates of corporate indebtedness are too many and too great to permit classification under those heads for tax purposes.

As the general although not invariable tendency in connection with the mutations from corporate stock represented by car equipment and mortgage participation certificates was seen to be to hold them taxable as "known generally as corporate securities," so it seems to be also as to
these aberrant corporate obligations. In one case, where an automobile finance company marketed "notes" secured by its holdings of automobile paper, thus in effect obtaining funds by a distributed discount of its aggregate holdings of such paper, the court felt that such "notes" might fairly be said to be "known generally as corporate securities," although it thought them non-taxable on formal grounds because they were not issued with coupons or in registered form. The typical transaction, however, involves an instalment investment plan and an instrument by which the issuer undertakes, in the event of a series of payments by investors, to repay after a certain time a stated principal sum in excess of the amounts received or to make a series of income payments. *Willcuts v. Investors Syndicate* and *National Thrift Corporation v. Welch* held the "accumulative instalment certificates" and "collateral trust secured thrift certificates," respectively, issued pursuant to such a scheme to be instruments "known generally as corporate securities" and taxable; and this in the *Investors Syndicate* case although it affirmatively appeared that there was no obligation assumed by the issuer at the time of issue, such obligation being postponed until eighteen months had elapsed or the purchaser had paid the second instalment on the contract. The only clearly opposing authority is *Fidelity Investment Association v. United States*, in which substantially similar paper was found not to be within the statutory description. While the instruments in *City Bond & Finance Company v. Welch* were also held non-taxable, the investors in that case paid their instalments in contemplation of eventually getting title to named securities, not in return for the issuer's undertaking to repay; and the instruments in suit embodied rather a highly formalized method for notation of receipt of partial payments on the purchase price than any pledge either of the issuer's general credit or of a trust fund.

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34 Id. at 983 ("I would say, without deciding the point, that these instruments might well be termed generally 'corporate securities'").
35 Id. at 984.
36 57 F. (2d) 811 (C. C. A. 8th, 1932).
37 55 F. (2d) 1077 (S. D. Cal. 1931).
38 79 Ct. Cl. 769, 5 F. Supp. 19 (1933).
39 In *Willcuts v. Investors Syndicate* and in *National Thrift Corp. v. Welch*, the promise was to repay a sum certain, representing the amount of the instalments paid in plus interest accruals, whereas in *Fidelity Investment Ass'n v. United States*, the promise was for a series of "interest" or "annuity" payments, being the earnings on account of a principal sum calculated as in the earlier two cases; but no point of this difference in the manner of repayment is made in any of the cases and it is believed that nothing turns on it. In other respects the contracts are not distinguishable in substance.
40 79 F. (2d) 969 (C. C. A. 9th, 1935).
The element of the procurement of funds from the investment seeking public through a public distribution has been present in all cases thus far considered. Normally it will be present and its presence may perhaps lend weight to the conclusion that the instruments involved are "known generally as corporate securities;" but there is no evident reason for deeming its absence conclusive against that consequence. Whenever a corporation proposes to obtain a line of credit from a bank under an arrangement contemplating the issue or reissue of the borrower's corporate paper, to notice one frequent situation, the problem is potentially present. The reports disclose only two cases where it has been passed on judicially—with divergent if not actually conflicting results. Bellefield Company v. Heiner presented the situation where, as a condition to procuring the requested line of credit, the corporation conveyed all its real property to a trustee to hold as mortgage security and, as the line of credit was used, endorsed to the bank the borrower's "collateral mortgage notes" made to itself as payee in the same amount as the bankable notes by which it utilized the credit extension. The court, in an intrinsically unsatisfactory opinion wholly consistent with the Third Circuit's penchant against taxability, held that such "collateral mortgage notes" were not taxable since they were to be deemed "notes" and not "bonds" under the formal rules distinguishing those two classes of instruments; nothing is said in the opinion regarding their possible taxability as instruments known generally as corporate securities. A somewhat different situation and a far different judicial approach are revealed in Royal Loan Company v. United States. There the corporation applying for a line of credit from a bank already had outstanding in the hands of individuals a number of its notes; the bank as a condition to extending the requested credit required that the antecedent notes be

41 Compare Wisconsin Public Service Corp. v. United States, 40 F. Supp. 327 (E.D. Wis. 1941) (holding subject to tax as "bonds . . . issued by any corporation" a single "temporary bond" in the sum of $7,500,000 pledged, together with a mortgage to secure a bank loan, pending contemplated issue of a series of "permanent bonds" of like amount and covering the same obligation whenever the securities market should become more favorable for offerings).


43 There were in fact two banks which joined in extending a line of credit on a mutually satisfactory basis; but this fact variation would seem to be immaterial.

44 The applicable statute was the Revenue Act of 1924, 43 Stat. 333 (1924) in which the provisions taxing instruments "known generally as corporate securities" appeared, although under a section heading "Bonds." The court does not venture, naturally, upon a rationale that the text of the statute is to be disregarded in favor of the section catchlines; at the same time, while quoting the statutory language, 25 F. (2d) 561, the court entered upon no analysis of the terms but discussed only the stigmata of bonds and notes respectively.

made and kept subordinate to the bank's claim; the creditors assenting, that result was accomplished by calling in the outstanding notes and issuing in exchange serial notes registered with the bank and transferable by change of registry; and this serial note issue, the Court of Appeals for the Eighth Circuit held, was composed of "instruments . . . known generally as corporate securities." There are obvious dissimilarities of fact in the two cases, notably the circumstances that the instruments in the Bellefield case were intended to be given and were given to the bank extending the line of credit whereas in the Royal Loan case they were given existing creditors as a device to assure the priority of the bank's claim; but in the essentials of lack of public distribution, general character of the financing scheme (procurement of a line of bank credit), and the formal expression of the resultant obligation in promissory notes, they are identical.

Ordinarily an instrument expressing the promissory obligation of an individual will not be one which is commonly regarded as a corporate security. The rate of tax is, moreover, so slight that avoidance of documentary stamp tax liability will rarely move a corporation to indulge in elaborate hocus-pocus to mask its operations as those of individuals, although conceivably if other business advantages are in equipoise, such tax avoidance might be just enough of a makeweight to determine the preferred procedure. Still, for divers reasons of varying legitimacy, there has been a growing practise in real estate financing particularly of employing "straw men," who, for record purposes, stand as the promisors upon whose undertakings lenders rely in advancing funds on the security of real property. In such cases, is the series of notes or bonds signed by the straw man under which funds are advanced to the corporation (which moreover will ordinarily by contract of guaranty or other collateral agreement have placed its credit behind the loan) properly describable as instruments "known generally as corporate securities?"

46 The opinion extends the customary professional courtesy of attempting to distinguish the Bellefield case on the ground that that decision had gone off on the lack of registry or interest coupons, see 154 F. (2d) 558; but while those formal details were alluded to in the Bellefield case, see 25 F. (2d) 562, it was at an intermediate state of the discussion and the conclusion was rested on a classification of the instruments as "notes" rather than "bonds," partly but only partly because of the interest coupon-registry angle.

47 Cf. National Commercial Title & Guaranty Co. v. Kelly, 39 F. Supp. 339 (D. N. J. 1941) (holding not subject to tax mortgages by individuals to corporation upon their subsequent assignment to other holders coupled with corporate guaranty); Mutual Building & Savings Association v. Wilkinson, 8 F. (2d) 183 (E.D. Wis. 1925) (instrument given by borrower-member of building and loan association to the association held not taxable under Revenue Act of 1917).

On this issue the two reported cases⁴⁰ are in square disagreement. Whatever one's final judgment as to the appropriate result, it is well to note that this is merely one special technique by which outside funds are made available to and for the purposes of the corporation hovering ostentatiously in back of the straw man.

The fortuitous circumstance that the issuer was an individual has misled courts in a few cases⁴⁰ involving receivers' certificates to suggest it as a reason for rejecting the contention that the certificates were taxable. Aside from the fact that a "straw man" and a receiver normally are both natural persons, however, they have little in common nor has either one very much likeness institutionally to an individual entrepreneur. Only by yielding to an arid verbalism does one seem compelled to hold the situations to be identical or even significantly comparable. The receiver and his certificate are exemplars rather of a fairly extensive group of issuers and issues, namely, those connected with the liquidation or reorganization of down-at-the-heel corporations.

Up to this point, we have been interested in the paper of golden dreams—the instrument by which financial genius come to blossom in a management corporation has been going to make everyone rich or at least comfortably secure by getting the use of his money. But there is also the cold gray dawn of the morning after. The corporation has flourished; investors have confided their funds to it; then it falls on evil days and, either voluntarily or by governmental direction, confesses its inability to repay, at least at once and in full. To salvage as much as possible, a receiver is appointed by the appropriate court or creditors get together and designate a protective committee or the corporation itself turns over its assets to a trustee for creditors or to a successor corporation established to aid in orderly liquidation. As evidence of the interests of the old creditors, statements are given them of the balance to their credit with contingent promises of payment; or, if the corporation is a public utility obliged to continue its service, trustees' certificates in satisfaction of accruing claims or receivers' certificates to obtain working capital for day to day operation are issued pursuant to court authorization. Very generally courts have held such evidences of claims against stricken corporations not to be subject to the documentary stamp tax, whether issued by natural per-

sons\textsuperscript{51} or by corporations,\textsuperscript{52} by receivers,\textsuperscript{53} trustees,\textsuperscript{54} creditors' committees,\textsuperscript{55} successor corporations,\textsuperscript{56} or the original corporation,\textsuperscript{57} and whether the instruments are certificates for the balance of loans and investments theretofore entrusted to the corporation,\textsuperscript{58} for currently accruing operating expenses,\textsuperscript{59} or for funds borrowed to meet such expenses.\textsuperscript{60}

In so doing, they have furthered the spirit of legislative\textsuperscript{61} and administrative\textsuperscript{62} exemptions from taxation expressly accorded in a somewhat


\textsuperscript{53} United States v. Powell, 95 F. (2d) 752 (C. C. A. 4th, 1938).

\textsuperscript{54} Stewart v. Moore, 43 F. Supp. 331 (N.D. Ohio 1940); In re Follansbee Brothers Company, 42 F. Supp. 448 (W.D. Pa. 1940).

\textsuperscript{55} Cf. In re Follansbee Brothers Company, 42 F. Supp. 448 (W.D. Pa. 1940) (point raised by petition but not passed on because moot).


\textsuperscript{57} Sterling v. United States, 26 F. Supp. 488 (D. Md. 1939).


\textsuperscript{59} Stewart v. Moore, 43 F. Supp. 331 (N.D. Ohio 1940).

\textsuperscript{60} United States v. Powell, 95 F. (2d) 752 (C. C. A. 4th, 1938).

\textsuperscript{61} With respect to insolvent banks and trust companies, assessment of taxes having the effect of diminishing the assets available to satisfy claims of depositors was forbidden and restoration of all sums paid on account of such taxes was directed by the Act of March 1, 1879, 52 STAT. 579, which was, in United States v. Sterling, 106 F. (2d) 178 (C. C. A. 4th, 1939) and in United States v. Consolidated Gas Electric Light & Power Co., 108 F. (2d) 609 (C. C. A. 4th, 1940) made the express ground of affirmance of decisions, see cases cited supra note 53, exempting transactions from the documentary stamp tax, without passing on the District Court's view that the instruments were not "known generally as corporate securities." Subsequent to the transactions out of which the claimed tax liability in those cases arose, the statutory provisions as to the documentary stamp tax were amended to exempt securities transactions in connection with the reorganization of railroads under Section 77 of the National Bankruptcy Act and corporate reorganizations under Section 77B of said Act. see 44 STAT. 1474 (1933), 48 STAT. 919 (1934), which provisions have been later amended and somewhat broadened to apply to railroad and corporate reorganizations and to transactions pursuant to orders of the Securities and Exchange Commission under section 11(b) of the Public Utility Holding Company Act, see 56 STAT. 959 (1942), the provisions now appearing as Internal Revenue Code, §1808 (e), (f). Simultaneously with the more recent amendment, §1801, Internal Revenue Code, was amended by adding a provision that "Obligations described in this section issued by any receiver, trustee in bankruptcy, assignee, or other person, having custody of property or charge of the affairs, of any corporation, shall, for the purposes of this chapter, be deemed to be issued by the corporation," a provision which seems aimed at preventing the accrual of any immunity on account of the circumstance that the formal obligor is an individual, without otherwise affecting the question of the character of the instrument itself.

\textsuperscript{62} For a summary of pertinent administrative regulations, see the discussion in United States v. Sterling, 106 F. (2d) 179 (C. C. A. 4th, 1939) and in United States v. Powell, 95 F. (2d) 754 (C. C. A. 4th, 1938). The portion of Regulation 71 currently in effect and relevant is set forth supra, note 23.
special and limited group of cases and have on occasion purported to be applying such legislation or regulations, as indeed they may on occasion have been doing. However that may be, the contrast between the prevalent tendency to tax instruments of miscellaneous types used by operating financial corporations to tap sources of funds for purposes of business expansion and the even more general agreement on exemption of instruments used to facilitate the liquidation or reorganization of ailing enterprises is marked.

Thus ends the examination of the results of the cases. In rough profile, they present a picture of liability whenever the instruments, whatever their form and whatever the technical legal status of the corporation with reference to them, were calculated to induce a flow of funds or a grant of credit to a corporation so as to enable it to enlarge its own operations (ordinarily in the financing field) and of non-liability whenever they served some other purpose, such as acknowledgment of sums due for claims arising out of prior or current transactions or receipts for part payment of a purchase price. To phrase the matter yet more simply, it is a question of contrast between investment and non-investment instruments. True, on no situation is their judicial unanimity; but it is perhaps significant that, aside from one Court of Claims decision, all of the cases exempting issuance of investment paper from the documentary stamp tax have been decisions arising in the Third Circuit—a Circuit whose view on this specific issue of "instruments . . . known generally as corporate securities" was rejected by the United States Supreme Court in Lederer v. Fidelity Trust Company. In this Circuit, it may further be noted, there is, except for one late case involving a car equipment trust certificate and so squarely governed by Lederer v. Fidelity Trust Company, no instance where eccentric investment paper spawned by corporations has been held to be "known generally as corporate securities." Moreover, the marked bias of the Circuit is—or

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perhaps it would be fairer to say was until recently—to give a restrictive construction in stamp tax cases generally, so that, not only in Lederer v. Fidelity Trust Company but also in Raybestos Manhattan Company v. United States, the United States Supreme Court disapproved doctrines entertained in that Circuit in favor of exemptions from the documentary stamp tax. Upon an inspection of the results, one seems therefore to see a general concurrence on the investment character of the instrument as the principal criterion of taxability under the "known generally" clause, opposed only by a special Third Circuit jurisprudence stubbornly resistant to taxability beyond the ambit of bonds, debentures, and certificates of indebtedness technically delimited.

There has been no discussion of the legal doctrine proclaimed in support of the results and none is proposed. Its absence traces to no conviction that such materials are valueless, either generally (indeed, for some purposes, such as that of persuasion, they are immensely important) or in this specific matter (indeed, animated and excellent doctrinal discussion is found in some of the opinions). But the writer if firmly convinced that opinions are but the navigational buoys of the law which, while designed and useful as channel markers to aid counsel in safely steering his client's cause through the shoal waters of tax law, should always be used with the caution that

In taking bearings, it must be borne in mind that the buoys are floating guides and while they are restricted by their anchor chains to the minimum movement consistent with the rise and fall of the tide in the locality in which they are placed, they are not absolutely

67 296 U. S. 60, 56 S. Ct. 63, 80 L. ed. 44 (1935), affirming 80 Ct. Cl. 809, 10 F. Supp. 130 (1935). The opinion by Mr. Justice Stone opens with the statement, "In this case we granted certiorari to review a judgment of the Court of Claims, to settle a doubtful point of federal law, of importance in the administration of the revenue acts, and to resolve a conflict of the decision below with that of the Court of Appeals for the Third Circuit in MacLaughlin v. Westmoreland Coal Co., 73 F. (2d) 1004, affirming 8 F. Supp. 963..." Affirmance of the Court of Claims decision necessarily involved rejection of the Third Circuit rule that under the circumstances presented, not here material to be discussed, there was no liability on account of the documentary stamp tax.

68 In fairness to the Third Circuit, one should observe that all the restrictive constructions of the statute were prior to the decision in Ladner v. Penroad Corporation, 97 F. (2d) 10 (C. C. A. 3d, 1938) reversing 21 F. Supp. 575 (E.D. Pa. 1937) and cert. denied 505 U. S. 618, 59 S. Ct. 78, 83 L. ed. 394 (1938), in which the Circuit Court of Appeals used language favoring a broad construction of the statute and reached a result making for taxability. Since then, interpretation of the statute has not been before the court, so that one may if optimistically inclined regard the case as a harbinger of a new attitude toward stamp tax problems.

69 The opinions in Motter v. Bankers' Mortgage Co., 93 F. (2d) 778 (C. C. A. 10th, 1937), Willcuts v. Investors Syndicate, 87 F. (2d) 811 (C. C. A. 8th, 1938) and Royal Loan Co. v. United States, 61 F. Supp. 436 (E.D. Mo. 1945) contain particularly illuminating discussions. The devotees of doctrinal discussion will at any rate find this article affords them a comprehensive check list of the materials.
accurate marks. If landmarks are available they should not be disregarded, even though one or more buoys may be relatively close. What then has observation of the fixed landmarks of case results indicated as the probable true position with respect to taxability, under section 1801, of unorthodox instruments of corporate parentage?

Briefly these propositions, it is believed:

(1) Car equipment trust certificates are taxable;

(2) So are mortgage participation certificates (if the structure of the present Treasury Regulation 71 is considered as indicating a contrary result, the courts may and indeed should disregard the Regulation pro tanto);

(3) So is any other instrument issued serially in convenient conventional denominations as a part of a scheme for inducing investors to supply funds or credit for projected corporate operations;

(4) But no instrument not falling within the description of clause (3)—of which clauses (1) and (2) are but special instances—is, within the statutory contemplation, an instrument "known generally as (a) corporate security.

(5) Whether an instrument purports to be the obligation of a corporation or of an individual, functioning as receiver, assignee, or

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70 DUTTON, NAVIGATION AND NAUTICAL ASTRONOMY (7th ed. 1942) 170.
71 Also governing as to INT. REV. CODE, §3481, which imposes a companion tax on account of transfer "of legal title to any of the instruments mentioned or described in section 1801 and of a kind the issue of which is taxable thereunder . . ."
72 See the language of art. 56 (h), quoted supra note 23.
73 In the words of Willbur, Circuit Judge, concurring in Welch v. Kerckhoff, 84 F. (2d) 300 (C. C. A. 9th, 1936), in a decision involving another aspect of the documentary stamp tax, "The statute having provided for the tax the regulations of the Treasury Department could not relieve the transferee of the obligation imposed by the statute:" cf. United States v. Powell, 95 F. (2d) 754 (C. C. A. 4th, 1938). Note that the current provision of the Regulations and the immediately preceding one, quoted supra note 22 are diametrically opposed, so that either the Department acted beyond its statutory authority in promulgating one or the other or else the statutory language, conceiving that it would allow both results, is wholly meaningless and inoperative. On the basis of the authorities discussed in this article, it is submitted that the first formulation was the correct one which the Department should restore or the courts retain.

74 Unless the instrument have the formal characteristics referred to, it would not be similar to any of those which have been held taxable and probably in common understanding would not be regarded as a corporate security. It is also highly probable that the instrument must have been issued with interest coupons attached or, alternatively, in registered form or both. Instruments issued with interest coupons apparently present too clear a case and have not come before the courts; but there has been much obscure disagreement as to what provisions bring the registry provision into play. Compare the terms and conditions set out with respect to the instrument in Willcuts v. Investors Syndicate, 57 F. (2d) 811 (C. C. A. 8th, 1932) with those of the instruments in General Motors Acceptance Corporation v. Higgins, 60 F. Supp. 979 (S.D. N.Y. 1945).
otherwise, is immaterial, except as noted in clause (6). As to all instru-
ments not covered by the exception, the tests for taxability depend on
the nature of the instrument and the transaction in the manner stated
in the first four clauses. 75

(6) Instruments issued in connection with certain railroad or
corporate reorganizations or in effectuating orders of the Securities and
Exchange Commission under section 11(b) of the Public Utility Holding
Company Act are exempt on account of the nature of the transaction, 76
whatever the character of the instrument or the issuer.

75 Accordingly it would seem that a situation such as that involved in United
States v. Powell, 95 F. (2d) 752 (C. C. A. 4th, 1938), cited supra note 61, would
not now be exempt from the tax unless it could be brought within the provisions
of section 1808 (c).
76 Int. Rev. Code, §1808 (e), (f).