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Taxation--Federal Income Tax--Rights to Subscribe to Stock of Another Corporation as Taxable Gain

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reimbursement.[22] Such necessaries include necessary repairs to the dwelling, repairs to fences, necessary food and clothing and a common school education[23] but not a collegiate education,[24] or permanent improvements to the ward's estate.[25]

It seems to be the theory of the law that if an infant is the owner of property, real or personal, a guardian should be appointed who will act under bond. Although, in the principal case, the bank had apparantly acted in good faith it had not discharged its legal obligation. The case is consistent with all common law decisions and legislation relating to infants. They give real effect to the deeply-rooted policy of our law to protect infants.

—R. Doyne Halbritter.

Taxation — Federal Income Tax — Rights to Subscribe to Stock of Another Corporation as Taxable Gain. — The directors of the X corporation, a guaranty company, determined to organize the Y corporation, a fire insurance company, since the X corporation was not chartered to do such business. The X corporation's agents were to sell the new fire insurance policies. Of the capital stock of the Y corporation the board of directors of the X corporation resolved to purchase 50,000 shares at $40 per share, and further resolved that "rights" to purchase 25,000 of these should be issued pro rata to its common stockholders. The X corporation sent the rights to their shareholders, received the purchase price on the exercised rights and paid the money to the Y corporation. The Y corporation issued the certificates of stock directly to the subscribing purchasers. The rights were listed on the Baltimore Stock Exchange. The respondent received his pro rata share of the rights and exercised them. The petitioner assessed the fair market value on the date of receipt thereof at $1.02 per right, and claimed that this amount was a taxable gain to be included in the respondent's gross income. From a decision of the Board of Tax Appeals favoring the respondent,[1] the petitioner appealed. *Held,* the receipt of rights to subscribe to stock of

[22] Myers v. Myers, 47 W. Va. 487, 35 S. E. 868 (1901).
[23] Buskirk v. Sanders, *supra* n. 16.
[24] Campbell v. O'Neill, 69 W. Va. 459, 72 S. E. 732 (1911).
[25] Buskirk v. Sanders, *supra* n. 16.

[1] 28 B. T. A. 285 (1933).

another corporation was not a "dividend" within the revenue act.[2] *Helvering, Commissioner of Internal Revenue v. Bartlett.*[3]

A dividend is taxable income unless it is a dividend in capital stock of the same corporation[4] or in a corporation having substantially the same identity as the declaring corporation.[5] Rights to subscribe to stock of the same corporation are similarly nontaxable unless sold.[6] Dividends, however, may be payable either in cash or in anything of value. Property dividends may be distributed in bonds of the same corporation,[7] bonds of another corporation[8] or stock of another corporation.[9] Such dividends are treated like cash dividends and are taxable on receipt thereof at their fair market value.[10] Clearly the rights here were of value for they were being traded on the Baltimore Stock Exchange. The respondent in the instant case could do one of four things with the rights: (1) sell them, in which case it is admitted that there would be a taxable gain;[11] (2) allow them to lapse, which would be like a dividend declared in perishable goods which were allowed to perish but which would undoubtedly be taxable income; (3) reject the rights, which would be as impractical and unusual as refusing a gift of value; (4) exercise the rights, as was done in the present case. In this regard the court remarked that "no profit

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[2] 45 STAT. 822, 26 U. S. C. A. § 2115 (a) (1928). "*Definition of Dividend.* The term 'dividend' when used in this title . . . . means any distribution made by a corporation to its shareholders, whether in money or in any other property, out of its earnings or profits accumulated after February 28, 1913."

[3] 71 F. (2d) 598 (C. C. A. 4th, 1934). It is interesting to note a discrepancy in the briefs of the counsel and the decision of the court. The respondent owned 20,830 shares of the X corporation's capital stock. The petitioner asserts that the respondent exercised 36 rights at $1.02 per right, and calculates the aggregate value thereof as $21,246.60. Brief for Petitioner, 5, 6. The respondent states that he exercised 520 rights, which is probably correct since there were about 8,000 shareholders in the X corporation. Brief for Respondent, 5. The court, at page 598, states that there were 20,830 rights exercised. These errors, however, do not affect the substance of the decision.

[4] Towne v. Eisner, 245 U. S. 418, 38 Sup. Ct. 158 (1917); Eisner v. Macomber, 252 U. S. 189, 40 Sup. Ct. 189 (1920).

[5] Southern Pacific Co. v. Lowe, 247 U. S. 330, 38 Sup. Ct. 540 (1917); Weiss v. Stearn, 265 U. S. 242, 44 Sup. Ct. 490 (1923).

[6] Miles v. Safe Deposit Co., 259 U. S. 247, 42 Sup. Ct. 483 (1922).

[7] Doerschuck v. United States, 274 Fed. 739 (E. D. N. Y. 1921).

[8] Equitable Life Assurance Soc. v. Union Pacific R. R., 212 N. Y. 360, 106 N. E. 92 (1914).

[9] Peabody v. Eisner, 247 U. S. 347, 38 Sup. Ct. 546 (1917).

[10] Peabody v. Eisner, *supra* n. 9; Bartlett v. Commissioner of Internal Revenue, 71 F. (2d) 601 (C. C. A. 4th, 1934).

[11] Miles v. Safe Deposit Co., *supra* n. 6 (rights to stock in the same corporation); Metcalf's Estate v. Commissioner, 32 F. (2d) 192 (C. C. A. 2d, 1929) (rights to stock in another corporation).

is realized upon a purchase''.[12] It should first be noted that a property dividend with a ready market value need not be realized upon before it is considered as giving rise to taxable income.[13] Furthermore, one who receives without cost a right of value, as did the respondent here, realizes a profit upon exercising it to the amount of the market value of the right, for without the right one would have to pay not only the purchase price of the share but also the price of the right.

In problems of taxation substance rather than form is the criterion for taxable gain.[14] The fact that the distribution was not called a dividend in the resolution is immaterial if in fact it was a dividend.[15] By its resolution the X corporation bound itself to purchase 50,000 shares. It could not retract. It also bound itself to distribute, pro rata, rights to 25,000 of these shares to its stockholders. Whether or not it distributed these rights, it was obliged to pay for the 50,000 shares. The X corporation itself distributed the rights, received and paid the purchase price to the Y corporation. The most reasonable interpretation of the act of the Y corporation in issuing the certificates of stock directly to the subscribers is that it was done to prevent duplication of work. The benefit, in substance a profit, accruing to the X corporation for the promotion of the new company and for its assets, good will,[16] which it transferred partially to the Y corporation, was expressed in part in the market value of the rights. This it passed on pro rata to its common stockholders. Hence, the respondent received by virtue of his ownership of stock an irrevocable[17] property in-

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[12] 71 F. (2d) 598, 600.

[13] N. 10, *supra.*

[14] Corliss v. Bowers, 281 U. S. 376, 378, 50 Sup. Ct. 336, 338 (1929); Tyler v. United States, 281 U. S. 497, 503, 50 Sup. Ct. 356, 359 (1929).

[15] Chattanooga Savings Bank v. Brewer, 17 F. (2d) 79 (C. C. A. 6th, 1927), *cert. denied,* 274 U. S. 751, 47 S. Ct. 764 (1927); Smith v. Moore, 199 Fed. 689, 697 (C. C. A. 9th, 1912); Spence v. Lowe, 198 Fed. 961, 965 (C. C. A. 8th, 1911).

[16] This transfer of assets, good will, is shown by the fact that the X corporation's agents were to sell the fire insurance policies in addition to the fidelity bonds. The ''X corporation'', the United States Fidelity and Guaranty Company, enjoyed very substantial good will at the time of the promotion in question, and it was, therefore, a very valuable asset. Confidence of the success of the enterprise is evidenced by the fact that the stock of the Y corporation was listed on the Baltimore Stock Exchange ''when issued'' at 76. N. Y. Times, Feb. 21, 1929.

[17] *Contra*: Bondy, J. in Cohn v. Cities Service Co., (S. D. N. Y. 1930) (unreported). But see comments in (1930) 39 YALE L. J. 1163; (1931) 4 So. CALIF. L. REV. 269, 282.

terest of value which was severed from the surplus and assets of the corporation and was, in effect, a property dividend.[18]

—WILLIAM H. WALDRON, JR.

VENDOR AND PURCHASER — RESCISSION OF CONTRACT — TENDER OF POSSESSION. — A contract for the sale of land provided that conveyance be made after payment of a specified part of the price. Time was stipulated to be of the essence. Defendant defaulted, plaintiffs rescinded the contract and sought recovery of the purchase money. No tender of possession was made but at the trial plaintiffs stated they were making arrangements to move. The lower court rendered judgment for the plaintiffs, which was reversed on the ground that restoration or an offer to restore possession was a condition precedent to an action for the purchase money. *Bey v. Kanawha Savings & Loan Ass'n.*[1]

The instant case involved a rather uncommon application of a principle established by a long line of decisions, both in England[2] and America,[3] with respect to restoring the *status quo* where there has been a rescission of a contract to convey land. The comparatively few decisions in point are in accord.[4]

It has been held in at least one jurisdiction that failure to tender reconveyance before commencing suit would not be ground

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[18] See Metcalf's Estate v. Commissioner, *supra* n. 11, in which rights to subscribe to stock in another corporation had been sold, the court termed such rights "dividend". The court in the present case attempts to distinguish that case on the ground that no assets of the parent company in the instant case were transferred to the new corporation. This distinction is more apparent than real since the parent corporation bought the stock with its surplus out of which dividends are presumably declared, and assets were transferred. See n. 16, *supra.*

[1] 174 S. E. 796 (1934).

[2] Hunt v. Silk, 5 East 449, 102 Eng. Reprint 1142 (1804). Contract for the lease of land in which plaintiff refused recovery because of technical defect in holding of premises two days over a ten day period, Lord Ellenborough says: "Now where a contract is to be rescinded at all, it must be rescinded in toto and the parties put in statu quo."

[3] MAUPIN ON MARKETABLE TITLE TO REAL ESTATE (3d ed. 1921) § 256.

[4] Cases dealing with breach of contract by defendant thus giving plaintiff right to rescind, yet recovery refused at law because of plaintiff's failure to re-deliver possession are: Weech v. Read, 208 Iowa 1083, 226 N. W. 768 (1929); Hayt v. Bentel, 164 Cal. 680, 126 Pac. 370 (1913); Beekhuis v. Palen, 76 Cal. App. 680, 245 Pac. 795 (1926); Martin v. Chambers, 84 Ill. 579 (1877); Gwynne v. Ramsey, 92 Ind. 414 (1883); Mellenthin v. Donovan, 168 Minn. 216, 209 N. W. 623 (1926); Hurst v. Means, 2 Swan (Tenn.) 594 (1853); Phelps v. Mineral Springs Heights Co., 123 Wis. 253, 101 N. W. 364 (1904).