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Federal Income Tax on Exchange of Corporate Securities

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of public policy that have not even remote connection with a distinction between positive and negative decrees.[25]

In principle the threat of a tort or the threat (as in the New York case stated) of a breach of contract are indistinguishable from an act of suing abroad but injunctions have been issued in the former cases with much less attention to principle.[26] Indeed they have sometimes been issued without even making clear whether the tort enjoined involved the personal presence of defendant in the foreign state, in which case continued physical control must be renounced; or whether in that case a bond was required to be given; or of which state defendant was a citizen.[27] But such considerations—the bond; the fact that the decree (even if not directly enforced with coöperation of the foreign state) may possibly later be pleadable there as an equitable defense —affect only the decree's practicality. If equitably justified by the lack of other adequate remedy, that settles the point of jurisdiction; the possible futility of action can affect only discretion. And of course possible or even probable futility might not warrant inaction in a strong case, for almost all of equity's decrees represent mere expectations; decrees in rem alone being certainties. But here again, into these considerations of expediency it seems that the distinction between negative and positive decrees should not enter at all. The contemplated decree, no matter what its form, must be seen either to conflict or not to conflict with the sovereignty or the public policy of a neighbor state: the suggested distinction between decrees positive or negative in form can have no other effect than sometimes to tempt a court which knows it is violating the public policy or sovereignty of its neighbor to chance this in the one case (the injunction) where it would not in the other.

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CONSTITUTIONAL LAW—FEDERAL TAXATION—EXCHANGE OF SECURITIES IN CORPORATE REORGANIZATION AS INCOME.—[United States] A decision of interest to stockholders participating in corporate reorganizations between 1916 and 1923 is *Marr* v. *United*

25. If the injunction defendant is a citizen of the state of the suit enjoined, that state might assert theoretical power over him when abroad and resent the injunction proceeding; whereas it would naturally concede to the enjoining court jurisdiction over citizens of that court's state even when temporarily present in the state of the suit enjoined. This should affect the exercise of discretion. Apparently the cases do not show this distinction, perhaps because the doctrine of jurisdiction over absent citizens is growing weaker.

26. Cases are collected in Harv. L. Rev. 15:579, 23:390-91.

27. *Alexander* v. *Tolleston Club* (1884) 110 Ill. 65 is such a case (moreover the title to foreign land was involved, but this depended merely upon the construction of documents). Apparently the acts enjoined were the personal acts of the defendant in Indiana, although the contrary is often assumed in citations of the case (e. g. by Mr. Beale in Harv. L. Rev. 26:293; likewise in id. 31:646 and Cornell L. Quar. 5:423). Apparently the court claimed to control defendant while abroad because a citizen of Illinois (p. 77; compare *Harris* v. *Pullman* supra n. 1 pp. 26-27, and *Sercomb* v. *Catlin* supra n. 24). Compare *West U. Tel. Co.* v. *Atl. & Pac. Tel. Co.* (1868) 49 Ill. 90, 94.

States,[1] decided by the federal Supreme Court June 1, 1925. The Act of Sept. 8, 1916,[2] purported to tax as realized income stock dividends and any profit made on exchanges of corporate securities. Between 1920 and 1924, five cases were decided involving the power of Congress to do this under the Sixteenth Amendment, where the issue or exchange of securities effected merely a reorganization of an existing corporate enterprise.

In the first, *Eisner* v. *Macomber*,[3] new shares of stock in the identical corporation were issued to existing stockholders in the same proportions as their old holdings, so that, in the result, it was as if each former holder of two shares now had three. This was held to be no realization of the stockholder's interest and hence not taxable. Perhaps the best crucial test of a corporate stockholder's having "realized" a dividend, so as to make it taxable as income, is that as a result of the transaction he obtains a new interest in property differing either (1) in *kind* or (2) in *extent* from that which he had before. If a dividend be paid in cash or other property (including securities) previously owned by the corporation, the indirect and undivided interest which the stockholder previously had in such property as an owner of shares in the corporation has been now changed into a direct and separate personal interest of the shareholder, and the corresponding control of such property, before in the corporation, is now vested in the shareholder personally. His new interest differs in *kind* from the old one. Or, if he be given additional stock in the corporation, so that his present interest in it is larger than it was before, this is taxable as income, as differing in *extent* from his old interest, though of the same kind.

But the ordinary stock dividend changes his interest neither in kind or extent. If he owns, for instance, 100 shares of stock in a corporation with 1000 shares, whose value as a going concern is $200,000, he has a stockholder's indirect and undivided interest and control in this (as to *kind*), amounting to 1/10 of the capital assets—with a present value of $20,000 (as to *extent*). If a 100 per cent stock dividend is declared, he will now have 200 shares out of 2000, with the same indirect and undivided interest and control, amounting as before to 1/10 of the capital assets—still valued at $20,000. He has received no new property interest of any kind from the corporation—his old property interest is merely restated in smaller units of value, much as if it were valued before in dollars and now in cents (100 times as many). There is just one practical difference. His interest is now legally transferable on the books of the corporation in smaller units of actual value than before. This often gives it a wider investment market, thus increasing its ready salability and sometimes (consequently) its net sale value. Giving this new quality to his old interest, otherwise unchanged, does not however seem to be sufficient to amount to a

1. (1925) 45 Sup. Ct. 575.
2. (1916) 39 St. L. 756-7 c. 463 tit. 1 sec. 1-2.
3. (1920) 252 U. S. 189.

"realization" of the old interest—the turning of it into something else—which is necessary to make any part of it taxable as "income" under the Sixteenth Amendment. If a state statute, for instance, made legal the transfer on the corporate books of fractional shares of the stock of its domestic corporations, it could scarcely be claimed that this at once made the owners of such stock liable to an income tax on the excess of the present value of such stock above its cost to them. The effect of an ordinary stock dividend seems no different. The decision in *Eisner* v. *Macomber,* then, seems fundamentally sound.

Then followed four cases in which, in the process of corporate reorganizations, new corporations were formed, the securities of which were distributed to the old stockholders. In *United States* v. *Phellis*[4] a New Jersey corporation with $30,000,000 par value of common stock had accumulated undivided profits so that its common stock was worth $795 a share. A new Delaware corporation was formed, to which the New Jersey corporation sold all of its business and assets, receiving therefor $60,000,000 par value of six per cent debenture stock and $60,000,000 par value of common stock of the Delaware company. The New Jersey company used $30,000,000 of the debenture stock to retire its own outstanding bonds and preferred stock, kept $30,000,000 of the debenture stock in its own treasury (the dividends from which were divided among its stockholders as received), and distributed the $60,000,000 of Delaware common stock among its stockholders at the ratio of two shares of Delaware for each one of the New Jersey company. The old New Jersey stock was now worth $100 a share and the new Delaware stock was worth $347.50 a share, so that each former holder of a share of New Jersey common (then worth $795) now had one share of New Jersey common (worth $100) and two shares of Delaware common (worth $695) so that the value of his holdings was not altered and it was still all in stock giving a control of exactly the same assets and business as before in exactly the same proportions for each stockholder, but partly in a new corporation of another state. The Delaware common stock was held to be realized income and taxable.

In *Rockefeller* v. *United States*[5] a Kansas oil company doing both a producing and a piping business formed a new Kansas corporation to do the piping part of its business, and transferred to it all of its pipe-line property in exchange for all the stock of the new company. This new piping company stock was distributed among the stockholders of the original Kansas company in proportion to their holdings. The same procedure was followed by an Ohio oil company which completed a similar reorganization with a new Ohio piping company. In each case the original company had an undivided surplus worth more than the value of its pipe lines or the stock of the new company. It was held that the new

4. (1921) 257 U. S. 156.
5. (1921) 257 U. S. 176.

piping company stock was realized income in each case. The stockholders get new actual exchangeable assets transferred to them for their separate use in part realization of their former undivided and contingent interest in the entire surplus of the old corporation.

In *Cullinan* v. *Walker*[6] the stock of a Texas oil company (engaged both in producing and piping), which was originally capitalized at $100,000, became worth about $6,000,000. The corporation was dissolved and one-half of its assets were transferred to a new Texas oil-producing company, and one-half to a new Texas oil-piping company. Each new company gave $1,500,000 of its bonds and $1,500,000 of its stock for the transfer. All of the stock of the two new companies was transferred to a third new Delaware corporation for $3,000,000 of its stock, and then the Delaware stock (worth $3,000,000) and the bonds of the two new Texas companies (worth $1,500,000 each) were distributed to the stockholders of the original Texas company in proportion to their holdings. The entire distribution (stocks and bonds) was held to be realized income, the stock on the ground that the Delaware corporation was a holding company and could sell all of the stock of the two Texas corporations (thus disposing of the entire interest in the original enterprise) without affecting the rights of its stockholders, which the original Texas corporation could not do—and so the stockholders had acquired a new and different interest for their old one.

In *Weiss* v. *Stearn*[7] an Ohio corporation with $5,000,000 par value capital stock was dissolved. A new Ohio corporation with the same powers as the old one, but with $25,000,000 authorized capital, was formed and took over the old assets, paying the old Ohio stockholders $7,000,000 cash and $12,500,000 in stock of the new Ohio corporation (amounting to $150 cash and $250 stock for each $100 par value share in the old Ohio company). This was held to be realized income only as to the $150 cash received for each old share—not as to the $250 of new stock, which left each stockholder with just one-half of his former undivided interest in the old corporation, now represented by the new one with the same powers and assets. It was just the same as if one-half of the old stock had been paid for in cash and then a true four hundred per cent stock dividend had been issued to the holders of the other half.

In the principal case[8] the stockholders of a New Jersey corporation, having $15,000,000 par of seven per cent voting preferred stock and $15.000.000 par of common stock, exchanged their holdings for $20,000,000 par of six per cent non-voting preferred stock and $75,000,000 par of common stock in a new Delaware corporation to which was transferred all of the assets and liabilities of the New Jersey corporation, which was then dissolved. The

6. (1923) 262 C. S. 134.
7. (1924) 265 U. S. 242.
8. *Marr* v. *United States* (1925) 45 Sup. Ct. 575.

transfer of the preferred stock was made on the basis of 1—1/3 shares of Delaware for each one of New Jersey, and of the common stock 5 shares of Delaware for each one of New Jersey. All of the new Delaware stock was held to be realized income, on the grounds (1) that the Delaware corporation had rights and powers different from those of the New Jersey company, so that its stock was an essentially different thing from the New Jersey stock; and (2) that the securities received were substantially different in character from the old ones: the preferred stock differing in rate of dividend, voting power, and capital value of its prior lien on the corporate assets, and the common stock in its subjection to a larger absolute amount of preferred stock and a heavier annual dividend charge thereon. "The case at bar is not one in which after the distribution the stockholders have the same proportional interest of the same kind in essentially the same corporation."[9] Four judges (Van Devanter, McReynolds, Sutherland, and Butler) dissented upon the ground that the case fell within *Weiss* v. *Stern*, *supra*, saying:

"The practical result of the things done was but the reorganization of a going concern. The business and assets were not materially changed, and the stockholder received nothing actually severed from his original capital interest—nothing differing in substance from what he already had. *Weiss* v. *Stearn* did not turn upon the relatively unimportant circumstance that the new and old corporations were organized under the laws of the same state, but upon the approved definition of income from capital as something severed therefrom and received by the taxpayer for his separate use and benefit. Here stockholders got nothing from the old business or assets except statements of their undivided interests, and this, as we carefully pointed out, is not enough to create taxable income."[10]

The problem involved in these cases is susceptible of a variety of reasonable solutions of differing degrees of liberality. *Eisner* v. *Macomber*[11] (stock dividend in identical corporation of same kind of shares already held—not income) is correct on any view, and its principle might have been limited strictly to this exact situation, excluding even a case like *Weiss* v. *Stearn*[12] where the business and assets of corporation A are transferred to corporation B (of the same state and with like powers) and the stockholders of A get stock in B of the same sort and in the same proportions as their holdings in A; for corporation B is literally and technically a different entity from A, and so stock in it may be said to be a different interest. The difference here, however, is merely formal, and so there is good sense in holding the new stock not income.

Rockefeller v. *United States*[13] (division of assets of old corporation between new corporations which carry on different parts

9. 45 Sup. Ct. at 577.
10. 45 Sup. Ct. at 577.
11. (1920) 252 U. S. 189.
12. (1924) 265 U. S. 242.
13. (1921) 257 U. S. 176.

of old business—new stock received for old is income) is readily distinguishable. The stockholder in the old corporation had an undivided interest in a combined oil producing and transporting business. He could not deal with nor dispose of his interest in these businesses separately, if he wished. The new stock enabled him to do this. It was a substantially different kind of an interest from the old combined business interest.

Cullinan v. *Walker*[14] is distinguishable on several grounds. The bonds there received in place of the old stock were of course an entirely different kind of security, constituting a debt instead of a power of control of property, and being a charge on assets prior to the new stock. The combined oil producing and piping business of the old corporation was split into two separate corporate enterprises, as in the *Rockefeller* case, but the stock of both new companies was held by a single Delaware company, whose stock was transferred to the old stockholders. It was thus not immediately possible for a Delaware stockholder to exercise any personal control over his interest in either of the new corporate businesses separately, as he could in the *Rockefeller* case, and hence it was arguable that his new stock interest was not substantially changed or severed from the old one. But the argument of the court held it substantially a new interest because the Delaware corporation would be able to sell all of the stock in the two Texas corporations without realizing any income that belonged individually to the stockholders, while this could not be done by the former stockholders of the original Texas corporations. That is, a holding company can deal so differently with the stock of its subsidiaries from what the original stockholders in those subsidiaries can, without producing taxable income to any individual, that the holding company stock is necessarily a different thing from the stock of its subsidiaries. This, too, is a logical, though not a liberal, view of the matter.

The *Phellis* case[15] seems distinguishable from *Weiss* v. *Stearn* only on the ground that the new Delaware corporation, to which the assets and business of the New Jersey corporation were transferred, was a corporation of another state and presumably of substantially different powers from its New Jersey predecessor, so that its stock was really different from that of the New Jersey company. This ground was also relied upon in the *Marr* case here under discussion. It may be doubted whether being chartered in another state is alone sufficient to produce this result, if there is proof that the old and new corporations have substantially similar powers, duties, and incidents. It may even be questioned whether it is necessary that they have the same "incidents," in so far as these do not deal with corporate powers and duties as such, but only with the application to the corporation or its stockholders of rules of law unconnected with corporate activities, such as liability to state

14. (1923) 262 U. S. 134.

15. *United States* v. *Phellis* (1921) 257 U. S. 156.

inheritance taxes, and so forth. But the *Marr* case may be thought consistent with all of its predecessors upon the grounds given by the court: (1) the new preferred securities had different fiscal qualities from the old ones; and (2) it was likely that the new Delaware corporation had different powers and duties from the New Jersey one.

JAMES PARKER HALL.

EVIDENCE—SPONTANEOUS STATEMENTS—DETERMINATION OF ADMISSIBILITY.—[Missouri] A recent case[1] presents an interesting question on the practice involved in determining the admissibility of an alleged spontaneous statement.

Plaintiff sued the receiver of the street railway company, claiming that while she was a passenger on one of its cars, the conductor opened the doors on the platform before the car came to a stop, and that it was stopped with a sudden and unusual jerk, which caused her to lose her balance and fall from the car to the street.

Mrs. McGowan, a witness for the plaintiff, testified that she was sitting in the lobby of a hotel in front of which the accident happened, and saw the plaintiff fall, and that she immediately ran out to the car and reached the plaintiff about the same time that the conductor got to her, and that the latter then stated that he opened the door too soon.

The conductor denied making the statement, and he and several passengers testified that Mrs. McGowan did not get beyond the curb until the plaintiff had been picked up and assisted by the conductor and a young man to the sidewalk.

If the witness' version of the matter should be accepted, the alleged statement of the conductor was made so soon after the accident that it might fairly be considered spontaneous and therefore admissible under that exception to the hearsay rule.[2]

If the conductors' denial should be accepted, there was of course no statement at all, spontaneous or otherwise.

If the version of the other witnesses, to the effect that Mrs. McGowan did not reach the scene of the accident until the plaintiff had been picked up and assisted to the sidewalk, should be accepted, then an appreciable amount of time must have elapsed, and a statement by the conductor could hardly be regarded as spontaneous.[3]

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1. *Rosenzweig* v. *Wells* (Mo. 1925) 273 S. W. 1071.
2. *Prior* v. *Payne* (Mo.) 263 S. W. 982.
3. *Luby* v. *Ry.* 17 N. Y. 131; *Ry.* v. *O'Brien* 119 U. S. 299; *Ruschenburg* v. *Ry.* 161 Mo. 70.

In the opinion, *State* v. *Martin* (124 Mo. 514) is cited, where statements of the wounded man were admitted though made after the lapse of several minutes. The time element is not necessarily fatal to the admission of a statement as spontaneous where the condition of the declarant is such as to make it improbable that he could have thought it over: *Hill* v. *Comm.* (Va.) 2 Grat. 594; *People* v. *Del Vermo* 192 N. Y. 470. In the principal case the conductor had not been injured, so that there was nothing to suspend his power of reflection.