debtor who is unable to comply with the decree.[19] Where the constitutional provision excepts cases of fraud, the debtor who is able, but refuses to pay, has been deemed outside this constitutional protection.[20] If the debtor's non-compliance with a decree under a statute similar to § 793 is due to his honest inability to pay and is not a wilful refusal, his imprisonment would then, and only then, be in violation of the constitutional prohibition of imprisonment for debt.

In harmony with the increasing proportion of persons whose property consists of wages and salaries[21] is the growing trend toward the use of installment payments to satisfy judgment creditors. Similar methods are found in Massachusetts,[22] England,[23] and Nova Scotia,[24] and during the World War, Congress used this device in the temporary Soldiers' and Sailors' Civil Relief Act.[25] An analogous feature is the provision for payment by installments included in alimony decrees, generally with due regard to ability to pay.

Income Tax—Corporations—Interest Deduction and Hybrid Securities—[Federal]. —During the year 1929 the respondent corporation had "guaranteed stock" outstanding, which had been issued pursuant to the authority of the General Assembly of Virginia.[1] The guaranteed dividends on this issue are made payable whether earned or not, out of the general assets as well as out of the earnings. The holders share in the profits in excess of the guaranteed return on a parity with the common shareholders, and like the common shareholders have full voting privileges. The "guaranteed stock" is made a first lien as to principal and "interest" on all the defendant's assets, taking priority over both secured and unsecured creditors in case of default.

During 1929 the corporation paid to the holders of the "guaranteed stock" $34,835, the amount of the guaranteed dividend. The corporation also paid to these holders the sum of $25,213, the amount necessary to bring the payment up to 12% the rate at which dividends were paid to the holders of common stock. The corporations claimed both items as deductions for "interest paid" in computing its net income. The Board of Tax Appeals[2] disallowed the $25,213 deduction, holding that it occupied the status of an ordinary dividend, but allowed the $34,835. The action of the Board in allowing the $34,835 deduction was challenged by the Commissioner, and the sole question presented on appeal was whether the $34,835 is interest on indebtedness which is an authorized deduction in computing net income, or dividends on stock

[19] 3 Freeman, Executions pp. 2394–6 (3d ed. 1900); *Ex parte* Clarke, 20 N.J. Law 648 (1846); 41 Harv. L. Rev. 786 (1928); 37 Yale L. J. 509 (1928).

[20] Strode v. Broadwall, 36 Ill. 419 (1865); *In re* Jonas Concklin, 5 Ohio C.C. 78, 3 Ohio C. Dec. 40 (1890); *Ex parte* Clarke, 20 N.J. Law 648 (1846).

[21] 1 Recent Social Trends in the United States (Report of the President's Research Committee on Social Trends) c. VI (1933).

[22] Mass. Gen. Laws c. 224, § 16 (Ter. ed. 1932); see Ginsburg, The New Poor Debtor Law, 8 Boston U. L. Rev. 23 (1928).

[23] 32 & 33 Vict., c. 62, § 5 (2) (1869).

[24] Nova Scotia Rev. Stats., c. 232, § 29 (1923).

[25] 40 Stat. 440, 442 (§ 204) (1918), 50 U.S.C.A. 178 (1928).

[1] Va. L., 1855–1856, c. 130, 109; Va. L., 1865–1866, c. 210, 332–333.

[2] 33 B.T.A. 895 (1936).

which are not deductible under section 23(b) of the Revenue Act of 1928.[3] *Held*, affirmed; the deduction is allowable as interest. *Helvering v. Richmond, Fredericksburg and Potomac R. R. Co.*[4]

The ingenuity of corporate financiers has almost exhausted the possible combinations of the rights of creditors with the rights of stock holders.[5] One even meets such mongrel securities as perpetual income certificates of indebtedness[6] and mandatory dividend maturing preferred stock. These hybrid securities have frequently appeared in litigation on the question of the rights of their holders in relation to those of the general creditors of the corporation.[7] Thus, it is generally held that a corporation cannot issue preferred stock which will give the holders the rights of stockholders and also secure to them payment ahead of or on a parity with creditors.[8] Where, as in the instant case, the legislature has authorized the specific security,[9] questions based upon alleged considerations of policy for the protection of other investors or creditors are foreclosed.[10]

In tax cases the concrete question has been as to the rights of the corporation to deduct distributions to the holders of such hybrid securities as interest payments,[11] although cognate questions might be also raised under some of the Revenue Acts as to their taxation to the recipient.[12] It is clear that the taxing statute uses its own concepts and that a classification for the purposes of taxation need not be identical with one made for some other purpose.[13] But to the extent that a line between interest payments and dividends is settled as a matter of general business understanding or law one would expect the words in the tax statutes to be construed in the same sense,

[3] 45 Stat. 791 (1928), 26 U.S.C.A. § 23 (b) (1934).

[4] 90 F. (2d) 971 (C.C.A. 4th 1937).

[5] See, generally, Jones, Redeemable Corporate Securities, 5 So. Calif. L. Rev. 83 (1931); Hansen, Hybrid Securities: A Study of Securities Which Combine Characteristics of Both Stock and Bonds, 13 N.Y.U.L.Q. Rev. 407 (1936); Dewing, The Financial Policy of Corporations 43–127 (3d ed. 1934).

[6] Schachne v. Chamber of Commerce, 102 Misc. 197, 168 N.Y. Supp. 791 (1918).

[7] Warren v. King, 108 U.S. 389 (1883); Hamlin v. Toledo, St. L. & K.C. R. Co., 78 Fed. 664 (C.C.A. 6th 1897); 1 Cook, Corporations § 271 (7th ed. 1913); Ballentine, Corporations § 142 (1927).

[8] Note 7 *supra*. [9] Note 1 *supra*.

[10] Gordon's Executors v. Richmond, F. & P. R.R. Co., 78 Va. 501 (1884) (holding this very security to be legal); Heller v. Nat'l Marine Bank, 89 Md. 602, 43 Atl. 800 (1899).

[11] Arthur R. Jones Syndicate v. Commissioner, 23 F. (2d) 833 (C.C.A. 7th 1927); Wiggins Terminals Inc. v. United States, 36 F. (2d) 893 (C.C.A. 1st 1929); Elko Lamoille Power Co. v. Commissioner, 50 F. (2d) 595 (C.C.A. 9th 1931); Commissioner of Internal Revenue v. O. P. P. Holding Corporation, 76 F. (2d) 11 (C.C.A. 2d 1935); Commissioner of Internal Revenue v. Proctor Shop, 82 F. (2d) 792 (C.C.A. 9th 1936); Jewel Tea Co. Inc. v. United States, 90 F. (2d) 451 (C.C.A. 2d 1937).

[12] Previously it would have been to the benefit of the recipient of a fixed return to have it treated as a dividend because then it would be subject only to a surtax. Revenue Act of 1934 § 11, 22, 25; 48 Stat. 680 (1934); 26 U.S.C.A. § 11, 22, 25 (1934). But under the 1937 Act dividends are subject to both the normal tax and the surtax. Revenue Act of 1936, as amended by the Revenue Act of 1937 § 11, 22, 25; 50 Stat. — (1937); 26 U.S.C.A. § 11, 22, 25 (1937).

[13] Magill, Taxable Income 3–4 (1936).

except as otherwise required by important considerations in the administration of the tax law. Any line which permits tax advantages to be secured by arrangements or labels purely formal has obvious disadvantages.

In any case certain possible criteria can be readily dismissed. Thus the name given the security is apparently of little importance,[14] although where the implications of the terminology or forms chosen by the corporation operate against it, as they did in the instant case, courts might well decline to look further.[15] Again the presence or absence of voting rights should not be determining since business custom recognizes as unquestioned both non-voting stocks[16] and voting bonds.[17] Since the tax question is the narrow one of whether a particular distribution was an interest payment, attention may well be concentrated simply on the nature of the distribution. The usual interest charge is limited in amount, is not contingent upon the making of profits, and is recoverable by suit. Dividends on common stock lack all three of these characteristics. Between these extremes it seems generally agreed that the usual preferred stock dividends which have only one characteristic of an interest payment, *viz.* a maximum amount, are nevertheless dividends.[18] The troublesome case on this analysis is that of the income bond, the return on which is contingent upon profit, but is limited in amount and recoverable by suit.[19] This seems closer to the debt category and such payments have generally been understood as deductible.[20] Since the only difference between a preferred stock dividend and the return on an income bond is suability, this element would seem decisive. Under this test the distribution of the guaranteed dividend in the instant case is clearly an interest payment. There is danger, of course, that income bonds with a very long term may be used instead of stock as a tax avoidance device.[21] Preferred stocks with rights to force a declaration of earned dividends might be used for the same purpose unless there is added to the test the requirement that the security have a maturity date as to principal. In most cases, however, the ability to sue for principal, accompanies the ability to sue for return on principal.[22] In the instant case the absence of a fixed maturity is not significant since the principal could be sued for upon default in the guaranteed dividend.

It is arguable that the additional dividends paid out of profits in the instant case also represent interest. A rationale of the difference of interest and dividend payments

[14] Where corporation called investment stock merely to avoid usury statute, it was nevertheless allowed to treat distributions as interest. Arthur R. Jones Syndicate v. Commissioner. 23 F. (2d) 833 (C.C.A. 7th 1927).

[15] *Cf.*, Helvering v. Midland Mutual Life Ins. Co., 300 U.S. 216 (1937); noted, 4 Univ. Chi. L. Rev. 677 (1937).

[16] Ballentine, Corporations § 142 (1927).

[17] Hansen, *op. cit. supra* note 5, at 420 for citation of typical state statutes providing for giving bondholders a share in the management.

[18] Dewing, The Financial Policy of Corporations 43–67 (3d ed. 1934).

[19] Dewing, *op. cit. supra* note 18, at 110.

[20] Edwards v. Bay State Gas Co., 91 Fed. 946 (D.C. Del. 1898).

[21] Dewing, *op. cit. supra* note 18, at 76 (income bond maturing in 2862).

[22] But for an income bond without a maturity date, see, Schachne v. Chamber of Commerce, 102 Misc. 197, 168 N.Y. Supp. 791 (1918); for preferred stock with fixed redemption date, see, Jones, *op. cit. supra* note 5 at 98 n. 61.

in the taxing statutes is that Congress sought to tax only *net* income[23] and that interest as the cost of borrowed money is a normal business expense.[24] The corporation borrowed money from the holders of the hybrid securities by agreeing to pay not only a fixed return but also the share of their profits.[25] Both payments may consequently be said to represent the cost of the money borrowed.

The taxation cases reenforce the moral brought home so forcibly in the reorganization field: a simplified security structure is necessary if intelligent legal discrimination is to be made between various classes of investors.[26]

Insurance—Reformation of Reinsurance Policy for Variance from Terms of Binder Agreement—[Federal].—The plaintiff, having insured several buildings for another, sought reinsurance from the defendant. A binder was secured providing for reinsurance on all losses over $100,000 "on any one building." The plaintiff's broker, in preparing a suggested form for the final policy, substituted a provision of reinsurance coverage on the excess over $100,000 "on any one loss." An experienced employee of the defendant examined the form, concluded that it was satisfactory, and a policy based on that form was issued to the plaintiff. A loss occurred, amounting to substantially more than $100,000 on all of the buildings, but less than that amount on any one. The plaintiff brought suit on the policy. The defendant counterclaimed asking reformation, and judgment was given for the plaintiff. On appeal, *held* (one dissent), reversed. The policy should be reformed to the terms of the binder agreement. *Tokio Marine & Fire Ins. Co. v. National Union Fire Ins. Co.*[1]

The basis for the divergence between the majority and dissenting opinions was not clearly enunciated. The majority was of the opinion that the reinsurer had a right to "rely upon literal conformity" of the policy with the binder, while the dissenting justice stated that there was "no mistake whatever as to the terms of the policy." It would seem, however, that the decision should depend upon whether or not the parties intended that the agreement executed in the binder be embodied in the policy.

If, as the majority of the court tacitly assumed, the policy and binder were intended to be identical, then the result reached seems sound,[2] for the requirements for reformation are satisfied. Those requirements usually stated[3] are that there must be: (1) an

[23] There has been discussion of whether Congress could constitutionally tax gross income. Magill, Taxable Income c. 9 (1936).

[24] Old Colony R. Co. v. Commissioner, 284 U.S. 552, 560 (1932).

[25] Where the same purpose is achieved by giving a share of stock along with the bond, a distinction must be made for administrative convenience, since it is highly probable that the stock and the bond will become separated.

[26] Levi and Moore, Bankruptcy and Reorganization: A Survey of Changes, 5 Univ. Chi. L. Rev. 1, 7 (1937).

[1] 91 F. (2d) 964 (C.C.A. 2d 1937).

[2] Snell v. Ins. Co., 98 U.S. 85 (1878); Griswold v. Hazard, 141 U.S. 260 (1890); Phillipine Sugar Estates Development Co., Ltd., v. Government of Phillipine Islands, 247 U.S. 385 (1918); Skelton v. Fed. Surety Co., 15 F. (2d) 756 (C.C.A. 8th 1926). But see, Holmes v. Charlestown Mutual Fire Ins. Co., 10 Met. (Mass.) 211 (1845); Travelers Ins. Co. v. Henderson, 69 Fed. 762 (C.C.A. 8th 1895); 4 Page, Contracts § 2222 (2d ed. 1920).

[3] Malone, Reformation of Writings for Mutual Mistake of Fact, 24 Georgetown L. J. 613, 614 (1936).