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Income Taxation--Corporate Bonds Distributed as Dividends Repurchased at Less than Par (Commissioner of Internal Revenue v. Rail Joint Co., 61 F.2d 751 (2d Cir. 1932))

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In *Burnet* v. *Clark*[19] the Court said:

> "The respondent was employed as an officer of the Corporation; the business which he conducted for it was not his own. There were other stockholders and in no sense can the corporation be regarded as his alter ego or agent. He treated it as a separate entity for taxation, made his own personal return and claimed losses through dealings with it. He was not regularly engaged in endorsing notes or buying and selling corporate securities. The unfortunate endorsements were no part of his ordinary business but occasional transactions intended to preserve the value of his investment in capital shares.
>
> "A corporation and its stockholders are generally to be treated as separate entities. Only under exceptional circumstances—not present here—can the differences be disregarded."

Therefore it appears that where corporations are used to conduct a business the person claiming net loss through loans made to such corporation or through loss of value of stock must not be an agent of the corporation or an officer therein. In the *Washburn* case the taxpayer was not entitled to any reimbursements from the corporation except expenses actually incurred in connection with the management of the corporations.

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INCOME TAXATION—CORPORATE BONDS DISTRIBUTED AS DIVIDENDS REPURCHASED AT LESS THAN PAR.—In 1914 the taxpayer, a New York corporation, approved an appraisal of its assets which added $3,000,000 to its surplus account. It then declared a dividend payable in bonds, and issued and distributed among its stockholders its own debenture bonds of a face value of $2,000,000. During the taxable years 1926 and 1927, some of these unmatured bonds were purchased by the corporation at less than their face value. The bonds so purchased were cancelled, and the difference between the purchase price and the face value was credited to surplus. The Board of Tax Appeals ruled that the corporation did not realize a taxable gain in the amount of such difference in the years when the bonds were purchased and retired On appeal to the Supreme Court the respondent relied on *United States* v. *Kirby Lumber Co.*,[1]

[19] *Supra* note 17.

[1] 284 U. S. 1, 52 Sup. Ct. 4 (1931); (1932) 6 ST. JOHN'S L. REV. 415. (A corporation purchased and retired some of its own bonds for less than their par value, which it had received for them when issued. *Held,* the corporation realized within the year an accession to income.)

a Supreme Court decision handed down subsequent to the Board's decision. *Held,* affirmed. *Commissioner of Internal Revenue* v. *Rail Joint Co.,* 61 F. (2d) 751 (C. C. A. 2d 1932).

The Court in this case was confronted with two decisions of the Supreme Court, *Bowers* v. *Kerbough-Empire Co.,*[2] and the more recent case of *United States* v. *Kirby Lumber Co.,*[3] but did not base its decision on either one. The Court conceded that "the purchase and retirement of the bonds in the two years in question resulted in decreasing the corporation's liabilities without a corresponding decrease in its assets," [4] but denied that by discharging a liability for less than its face the debtor necessarily receives a taxable gain.[5] It was pointed out that the corporation never received any increment to its assets, since the retirement of the bonds at less than par merely meant that the corporation paid less than it promised to pay, and in paying dividends the corporation does not receive any property.[6] The Court conceded that if the accrual basis were used instead of a cash basis of accounting the result might be different.[7]

It is submitted that the principal case is not inconsistent with the *Kirby Lumber Co.*[8] case, and might have followed the *Kerbough-Empire Co.*[9] case in reaching its decision.[10] The difficulty in these cases arises from a failure of adequate definition of the term income, the principal case and other recent decisions [11] indicating "that the Supreme Court may now be ready to discard the conceptual approach," [12] adopted in the case of *Eisner* v. *Macomber,*[13] and to proceed on the basis of taking the words " 'accession to income' in their plain popular meaning as they should be taken." [14]

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[2] 271 U. S. 170, 46 Sup. Ct. 449 (1926). (Plaintiff repaid a loan in marks, at a time when marks had greatly depreciated, the amount of the depreciation, however, being less than the losses sustained on the entire transaction. *Held,* the difference, resulting from the depreciation, was not taxable as income.)

[3] *Supra* note 1.

[4] Commissioner v. Rail Joint Co., 61 F. (2d) 751, 752 (C. C. A. 2d, 1932).

[5] See REVENUE ACT OF 1926, §213 (44 Stat. 23 [26 U. S. C. A. §94]); KOBLER, FEDERAL INCOME TAXES 1927 (1927) 46; KLEIN, FEDERAL INCOME TAXATION (1930) 130.

[6] Compare U. S. v. Oregon Washington R. & N. Co., 251 Fed. 211 (C. C. A. 2d, 1918); Commissioner v. Simmons Gin Co., 43 F. (2d) 327 (C. C. A. 10th, 1930).

[7] *Cf.* Aluminum Castings Co. v. Rontzahn, 282 U. S. 92, 51 Sup. Ct. 11 (1930); (1931) 5 ST. JOHN'S L. REV. 296; Harrow, *The Supreme Court on Accounting Methods* (1929) 15 A. B. A. J. 607, 611.

[8] *Supra* note 1.

[9] *Supra* note 2.

[10] But *cf.* Note (1932) 20 CAL. L. REV. 441, 446, the writer stating that it does not seem possible to distinguish the two cases.

[11] For a discussion of these cases see Note (1932) 45 HARV. L. REV. 1072.

[12] *Ibid.* at 1077.

[13] 252 U. S. 189, 207, 40 Sup. Ct. 189, 193 (1919).

[14] Mr. Justice Holmes, in U. S. v. Kirby Lumber Co., *supra* note 1, at 3, 52 Sup. Ct. at 4.