

Reorganizations and Other Exchanges in Federal Income Taxation (Book Review)

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REORGANIZATIONS AND OTHER EXCHANGES IN FEDERAL INCOME TAXATION.
By Robert N. Miller, Homer Hendricks, Ewing Everett. New York:
Ronald Press Co., 1931, pp. 448.

Several decades ago when there was a crying need for additional sources of revenue, it was a simple matter to seize upon income as an available source. Not so simple was it, however, to determine what is income. Congress, as the mouthpiece of the sovereign will of the people, could make legislative pronouncements as to what is meant by income, but Congress could not speak with finality¹ if its pronouncements aroused such a controversy as could be heard by that ultimate authority, the Supreme Court of the United States.

Take, for example, the question of stock dividends. Are stock dividends income? Congress in no uncertain language pronounced stock dividends income.² But taxpayers disagreed with Congress and when the Supreme Court of the United States was called upon to decide the controversy, it spoke, hesitantly (five to four), though also in no uncertain language,³ saying that stock dividends were not income.

The importance of this decision lay not merely in the fact that the Treasury Department would be deprived immediately of considerable revenue, nor in the fact that corporations could now accumulate huge surpluses, and then cause them to disappear through the devise of the stock dividend into the hands of stockholders without any immediate loss to the latter in the way of taxes, but also that the corporation would not be hampered in its growth, as business boomed and the corporation kept changing its spots to keep pace with the growing prosperity.

It was therefore a bit of a shock to the prosperous business community when the Supreme Court of the United States, in considering the Reorganization cases,⁴ failed to apply the logic of its own stock dividend decision to what seemed to be an analogous situation. This time it was Congress that came to the rescue of the Corporation. Said Congress in effect, "The Court shall not interfere with the prosperity of the country; that prosperity depends upon the

¹ *Eisner v. Macomber*, 252 U. S. 189, 206, 40 Sup. Ct. Rep. 189 (1920): "It becomes essential to distinguish between what is and what is not 'income' . . . Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution."

² Revenue Act of 1916: "The net income of a taxable person shall include gains, profits, and income derived, . . . also from interest, rent, dividends . . . provided that the term 'dividends' . . . shall be held to mean any distribution . . . whether in cash or in stock of the corporation . . . *which stock dividend shall be considered income, to the amount of its cash value.*" See note 1 *supra*, 212.

³ "We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction."

⁴ *U. S. v. Phellis*, 257 U. S. 156, 42 Sup. Ct. Rep. 63 (1921); *Rockefeller v. U. S.*, 257 U. S. 176, 42 Sup. Ct. Rep. 68 (1921); *Cullinan v. Walker*, 262 U. S. 134, 43 Sup. Ct. Rep. (1923); *Weiss v. Stearn*, 265 U. S. 242, 44 Sup. Ct. Rep. 490 (1924).

right of the business community to grow and expand with a minimum, that is, there shall be no interference on the part of the government in the guise of tax collector." And so the Reorganization provisions of the Revenue Act of 1924,⁵ bolstered up by the famous preliminary Gregg Memorandum,⁶ corrected the Court's unexpected wandering away from the straight and narrow path of business prosperity.

The purpose of the Reorganization Provisions was to enable corporations to reorganize, that is, recapitalize, merge, consolidate, break up into subsidiary corporations, and otherwise effect the numerous "sleight of hand" changes in its capital structure (that the country is now unhappily well aware of) without involving itself in taxable gain. Riding on a wave of prosperity, such changes were unquestionably accompanied by tremendous profits. In fact the profits were out of all proportion to the requirements of sound business, and hence the present effects of these too easily manufactured profits.

Perhaps the restraining hands of the tax collector might have prevented the too rapid growth of the super-structures evolved out of corporate reorganizations. Instead, Congress permitted transfers and exchanges to go merrily on without an immediate recognition of the resultant gain. The gain was there, but the realization of it was allowed to be deferred into the indefinite future. That meant that the tax collector might collect his tithe when taxes were at a minimum, or he might never collect his due if the taxpayer realized his gain at a time when such gain could be offset by a loss, or again the gain might be deferred to the end of taxpayer's days, when the gain would no longer be one subject to an income tax.

The reorganization provisions of the Revenue Acts are in many respects the most important provisions in the tax law. They are the most technical in the law and certainly the most difficult to comprehend without a careful and thorough study. It had long been the hope of tax practitioners among accountants and lawyers that some outstanding members of these professions would present to the public some meritorious commentary on the Reorganization Provisions. Happily, the first such commentary has now appeared in the concerted efforts of three able lawyers who had the courage to attack the most difficult problems presented in the tax law. Even though there is no basis of comparison with any other book, this being the first major work on the subject, it is possible to say that the present offering is noteworthy and commendable. Each provision of the law has been subjected to a most careful analysis. The meaning is made clear through the interpretations of the courts, the decisions of the Board of Tax Appeals, the Treasury Regulations, legislative commentaries, comparison with similar provisions in earlier acts, as well as the authors' own able and independent reflections. The method employed is primarily that of the lawyer who builds up his case precedent by precedent. Notes and references are copious and the collation of all the references in the indexes at the end of the book indicates the tremendous task that the authors dared to face, as well

⁵ Sections 201, 203, 204 especially.

⁶ An unofficial statement prepared by A. W. Gregg for the use of the House Ways and Means Committee with reference to the Reorganization Provisions of the proposed Revenue Bill of 1924.

as the scholarly accomplishment of what must have appeared at the outset insuperable.

That the authors had a proper background and adequate understanding of their subject is evident in their discussion in Part I of the nature of income and realization of income. That the work is thorough is evident from the fact that the authors do not limit their discussions merely to the reorganization provisions of the law, but devote a major section of the book, Part III, to a discussion of the basis for subsequent gain or loss after the transfer or exchange has taken place. Included in the latter discussion it is noted that the authors do not omit comment on Involuntary Conversions,⁷ Losses on Wash Sales,⁸ and miscellaneous related topics,⁹ such as Filing Returns, Book Entries, Tax Board Petitions, Changing from Accrual to Instalment Basis, etc. Appendix A presents five Illustrative Reorganization Problems and Appendix C quotes important excerpts from the unofficial Gregg statement.

When the book first came to the writer's attention, there was not a little disappointment over the fact that the collaborators did not include a trained accountant. In the administration of the income tax law the debt to the science of accounting has been pretty well established and acknowledged, and in the writer's opinion a proper understanding of the reorganization provisions of the tax law is almost impossible without a thorough knowledge of the principles of accounting. That the authors of this book have succeeded so well without the collaboration of an accountant is further evidence of the excellence of their efforts. It is the hope of the writer that the next effort in this direction will be made by the accountancy profession (working either alone or in collaboration with the lawyer). The accountant certainly has much to offer towards the clarification of income tax laws.

In the meantime, the tax practitioner is fortunate in having the able work of Messrs. Miller, Hendricks, and Everett to guide him through the mazes of the Reorganization Provisions.

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FEDERAL INCOME TAXATION—1931 CUMULATIVE SUPPLEMENT.

In a sense it is no longer necessary to review Dr. Klein's book on "Federal Income Taxation." The long awaited major work appeared in 1929 and was well received both by the legal and accounting professions. Today no tax library is without this book.

The reception accorded the basic text undoubtedly encouraged the author to continue his labors and the result was the 1930 Supplement, which brought

⁷ Chapter 14.

⁸ Chapter 15.

⁹ Chapter 22.