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Income Tax--Sale of Unidentified Securites--Determination of Taxable Gain (John A. Snyder v. Commissioner of Internal Revenue, 54 F.2d 57 (3rd Cir. 1931))

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that the retirement of corporate bonds at a discount does not create assessable gain. In the instant case, which is a reversal upon both logical and statutory [6] grounds of the position taken by the Board, the Supreme Court has pointed out that its decision in the *Bowers* case was prompted by the equitable consideration that the transaction, as a whole, resulted in a loss to the debtor.[7] Similar reasons of equity will undoubtedly influence the Supreme Court to uphold the Board in its contention, likewise founded upon the *Bowers* case, that the cancellation of the indebtedness of an insolvent firm by agreement of creditors does not make for taxable income.[8] The significance of the present case lies rather in the indication of the applicability of equitable principles in determining taxable profits than in any explanation of the scope of a definition.

J. L.

INCOME TAX—SALE OF UNIDENTIFIED SECURITIES—DETERMINATION OF TAXABLE GAIN.—During 1924 and 1925, petitioner had been dealing on margin in the stock of the United Gas Improvement Company. In the latter year, his margin repeatedly fell below the agreed percentage and sales of the stock were thereupon made by his brokers. The petitioner, in his 1925 tax returns, set off these sales against his 1925 purchases, thereby showing a loss. The Commissioner of Internal Revenue, claiming that such sales should be set off against the earliest 1924 purchases, declared a taxable profit. Upon affirmance of the Commissioner's ruling by the Board of Tax Appeals, the case was brought by the taxpayer to the Circuit Court of Appeals. *Held*, that the amount of profit or loss resulting from the sale of unidentified securities is determined by charging such

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[6] U. S. Treas. Reg. 62, Art. 545 (1) (c) (applying to 1921 Rev. Act): "If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year." See Art. 544 (1) (c) of Reg. 45 (Revenue Act of 1918); Art. 545 (1) (c) of Reg. 65 (Revenue Act of 1924); Art. 545 (1) (c) of Reg. 69 (Revenue Act of 1926); Art. 68 (1) (c) of Reg. 74 (Revenue Act of 1928).

[7] In his dissenting opinion in the National Sugar Mfg. Co. case, *supra* note 4 at p. 578, Mr. Sternhagen declared, "* * * but the court was undoubtedly influenced to a substantial extent by the equitable consideration that, at the time the tax was sought to be imposed, 'the result of the whole transaction was a loss, and the fact that the borrowed money was lost, and that the excess of such loss over income was more than the amount borrowed.' The opinion concludes with the statement that 'the mere diminution of loss is not gain, profit or income.' This is far from saying that the diminution of liability in a going business is not gain, and I can not believe that the Supreme Court intended to have its decision so understood."

[8] Simmons Gin Company v. Comm., 16 B. T. A. 793 (1929); Progress Paper Co. v. Comm., 20 B. T. A. 234 (1930).

sale against the earliest purchase of the stock. *John A. Snyder* v. *Commissioner of Internal Revenue,* 54 F. (2d) 57 (C. C. A. 3rd, 1931).

The Federal Revenue Acts declare that the taxable income or deductible loss resulting from the sale of personal property is to be determined by comparison of the selling price with the cost, statutorily termed the basis.[1] In the simplest form of transaction, the formula is mechanically applicable, but in the more complex dispositions of property, the determination of the basis often presents special difficulties.[2] Where, as in the instant case, an unidentified portion of a stock issue is sold, the consistently maintained position of the government has been that the basis is the cost to the seller of the earliest purchase of the stock.[3] Under no circumstances may the average cost of all the stock be employed as the basis.[4] But where securities upon which a stock dividend has been declared are sold, an exception to the rule against averaging is presented.[5] This deviation from the rule is explainel by the courts upon the theory that the distribution of a stock dividend merely substitutes a larger number of shares for a smaller without effecting any alteration of the recipient's interest in the corporation.[6] In the instances of the acquisition of securities by bequest[7] or gift,[8] the difficulties pre-

[1] Sections 111(a) and 113, Rev. Act of 1928; sections 202(a) and 204(a), Rev. Act of 1926. See Merchants' Loan and Trust Company v. Smietanka, 255 U. S. 509, 41 Sup. Ct. 386 (1921); Walsh v. Brewster, 255 U. S. 536, 41 Sup. Ct. 392 (1921); U. S. v. Siegel, 52 F. (2d) 63 (C. C. A. Mo. 1931).

[2] See Klein, Federal Income Taxation (1929) chapters 13 and 26.

[3] Art. 39 of Reg. 69, Rev. Act of 1926: "When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain"; Towne v. McElligott, 274 Fed. 960 (S. D. N. Y. 1921); Executors of Skinner v. Eaton, 34 F. (2d) 575 (D. C. Conn. 1929); Howbert v. Penrose, 38 F. (2d) 577 (C. C. A. 10th, 1930). See Appeals of George W. Megeath *et al.,* 5 B. T. A. 1274 (1927); David Stewart v. Commissioner of Int. Rev., 17 B. T. A. 604 (1929); Western Bank and Trust Co. v. Comm. of Int. Rev., 19 B. T. A. 401 (1930).

[4] See Klein, *op. cit. supra,* at p. 346.

[5] Appeal of Fuller, 4 B. T. A. 992 (1926); George L. DeBlois *et al.* v. Comm. of Int. Rev., 12 B. T. A. 1138 (1928).

[6] See cases, *supra* note 5; Towne v. Eisner, 245 U. S. 418, 38 Sup. Ct. 158 (1918); Towne v. McElligott, *supra* note 3. In Appeal of Cowden, 3 B. T. A. 816 (1926) at p. 817, the court says, "The only result of the declaration and distribution of the stock dividend was that each of the taxpayers, in common with all other stockholders, had a larger number of shares evincing his ownership of unchanged interest in the assets of the corporation. It follows, therefore, that the cost of each share, either before or after the distribution of the stock dividend, must be found by dividing the cost of all by the whole number of shares involved." See 1 Cum. Bull. 30; 2 Cum. Bull. 26.

[7] Section 113(a) (5), Rev. Act of 1928; Section 204(a) (5); Brewster v. Gage, 25 F. (2d) 915 (W. D. N. Y. 1927). See Moser v. Comm. of Int. Rev., 12 B. T. A. 672 (1928).

[8] Section 113(a) (4) Rev. Act of 1928; section 204(a) (4) Rev. Act of 1926.

sented are met by the governmental ruling that the fair market value at the time of acquisition shall constitute the basis. The decision in the present case is a lucid exposition of the logic inherent in a ruling which, at first glance, may appear somewhat arbitrary.

J. L.

ESTATE TAX, TENANCY BY THE ENTIRETY.—Appellee sought to recover Federal Estate taxes paid upon thirteen items of property, real and personal, held by the testator and his wife as tenants by the entirety. As to those items of property held upon tenancies by the entirety created after the effective date of the Revenue Act of 1924, it was conceded that the tax was rightfully assessed; but as to those items of property held upon tenancies by the entirety created after the Revenue Act of 1916 and before the effective date of the Revenue Act of 1924, it was contended that the statute is arbitrarily retroactive. The government argued that the tax is laid upon rights devolving upon the wife at the death of her husband after the passage of the act, and that the statute is therefore not applied retroactively. *Held,* The tax was validly assessed. *Phillips* v. *Dime Trust & Safe Deposit Co.,* 283 U. S. 795, 52 Sup. Ct. 46 (1931).

The Supreme Court has recently held that the interest of the surviving tenant may be subjected to an estate tax,[1] reasoning that "The death of one of the parties to the tenancy became the generating source of important and definite accessions to the property rights of the other."[2] Disregarding the common law fiction of husband and wife unity it is at once apparent that the surviving tenant whose rights had formerly been hedged in on all sides has now acquired sole proprietorship of the property.

A transfer tax levied on a donor in respect to absolute gifts made *inter vivos* has been held to be invalid.[3] Here technical title, power to recall, and beneficial use and enjoyment had all passed out of the settlor prior to the enactment of the applicable taxing sections. But, where the settlor reserves the right during his life to alter the terms of the trust,[4] or to revoke the trust[5] the tax has been held not to be retroactive within the condemnation of the Fifth

[1] Tyler v. U. S., 281 U. S. 497, 50 Sup. Ct. 356 (1930); (1930) 5 ST. JOHN'S L. REV. 135.

[2] *Supra* note 1, at p. 504, 50 Sup. Ct. at 359.

[3] Nichols v. Coolidge, 274 U. S. 531, 47 Sup. Ct. 710 (1927); Blodgett v. Holden, 275 U. S. 142, 48 Sup. Ct. 105 (1927); Untermyer v. Anderson, 276 U. S. 440, 48 Sup. Ct. 353 (1928); Coolidge v. Long, 282 U. S. 582, 51 Sup. Ct. 306 (1931).

[4] Saltonstall v. Saltonstall, 276 U. S. 260, 48 Sup. Ct. 225 (1927).

[5] Reinecke v. Northern Trust Co., 278 U. S. 339, 49 Sup. Ct. 123 (1928); (1929) 42 HARV. L. REV. 833.