11 T.C. 298 (1948)

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A distribution to stockholders is considered a cash dividend, not a stock dividend, if the corporation’s resolution authorizes a cash dividend, dividend checks are issued, and stockholders are not legally bound to reinvest the dividends in new stock.

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Summary

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F. Brody & Sons Company sought to include $275,000 in its equity invested capital for excess profits tax purposes, arguing this sum represented cash received from a 1918 stock issuance. The Commissioner argued it was largely a stock dividend, not eligible for inclusion. The Tax Court held that the 1918 distribution was a cash dividend, and the stock was sold to stockholders for cash. The court reasoned the corporate minutes provided for a cash dividend and stockholders weren’t obligated to reinvest it in stock, therefore the full $275,000 could be included in equity invested capital.

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Facts

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Prior to June 6, 1918, F. Brody & Sons Co. had 1,000 outstanding shares of common stock. On June 6, 1918, stockholders voted to amend the articles of incorporation to allow for an additional $275,000 in common stock. The board of directors resolved to offer this new stock pro rata to existing shareholders. They also resolved to distribute accrued surplus and profits to shareholders. Checks were issued to stockholders on June 24, 1918, representing their pro rata share of the surplus. On the same day, stockholders wrote checks to the company totaling $275,000 for the new stock. The company’s records reflected the issuance of the new shares on June 24, 1918, and a certificate filed with the State of Iowa stated that the company received $275,000 in cash for the stock.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in F. Brody & Sons Co.’s excess profits tax liability for 1943, disallowing the inclusion of $275,000 in equity invested capital. The company petitioned the Tax Court for review.

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Issue(s)

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Whether the distribution made by petitioner to its stockholders in 1918 was a cash dividend or a stock dividend; and whether the stock simultaneously issued to them was sold for cash, such that the amount thereof should be included in petitioner’s equity invested capital.

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Holding

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Yes, the distribution was a cash dividend and the stock was sold for cash, because the corporate minutes provided for a cash dividend, checks were issued, and stockholders were not legally bound to use the dividend to purchase new stock. As such, the $275,000 could be included in the company’s equity invested capital.

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Court’s Reasoning

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The Tax Court distinguished this case from others where distributions were deemed stock dividends in disguise. The court emphasized the importance of the corporate resolutions, which clearly authorized a cash dividend. Crucially, stockholders were not obligated to reinvest their dividends in new stock. The court noted,

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