17 T.C. 854 (1951)

When stock is sold under an agreement where the seller retains title as security but dividends are credited to the purchase price, the dividends are constructively received by the buyer and taxable as ordinary income to the buyer, not the seller.

Summary

Hobson sold stock to Langdon, retaining title as security for the purchase price. The agreement stipulated that dividends paid on the stock would be credited against the purchase price. The Tax Court addressed whether dividends paid to Hobson during the payment period were taxable as ordinary income to Hobson or Langdon. The court held that the dividends were constructively received by Langdon and, therefore, taxable as ordinary income to Langdon. This was because Langdon held the beneficial interest in the stock and the dividends directly reduced his debt obligation.

Facts

Arthur Hobson owned 250 shares of Bradley-Goodrich, Inc. stock, initially acquired as security for a loan to Everett Bradley.
In 1943, Hobson agreed to sell these shares to George Langdon for $36,250.
The agreement stipulated Hobson would retain title to the stock until the full purchase price was paid.
Hobson was required to credit any dividends received on the stock against Langdon's purchase price.
Langdon made payments towards the stock purchase, and Hobson received dividends in 1943, 1944, and 1945 which were credited against the purchase price.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Hobson's income tax and Langdon's income and victory tax for the years 1943-1945, attributing the dividend income to each respectively.
Hobson and Langdon separately petitioned the Tax Court for redetermination.
The Tax Court consolidated the cases due to the identical income and issue involved.

Issue(s)

Whether dividends received by Hobson, as the record owner of stock, but credited against Langdon's purchase price under a sales agreement, constitute taxable income to Hobson or Langdon.

Holding

No, the dividends are taxable to Langdon because Langdon was the beneficial owner of the stock during the period in question, and the dividends reduced his purchase obligation. As the court noted, "We are of the opinion that the dividends paid Hobson belonged to and were constructively received by Langdon, constituting income to him."

Court's Reasoning

The court reasoned that while Hobson retained title to the stock, he did so merely as security for the purchase price.
The beneficial use of the stock, including the economic benefit of the dividends, was in Langdon, as the dividends reduced his debt.
The court emphasized that "taxation is not so much concerned with refinements of title as it is with actual command over the property taxed — the actual benefit for which the tax is paid." Quoting *Corliss v. Bowers*, 281 U.S. 376.
The court distinguished the case from situations where the seller retains full control and benefit of the stock. Here, Hobson's control was limited to securing payment, and the dividends directly benefitted Langdon.
The court dismissed Langdon's reliance on Regulations 111, section 29.147-8 concerning information returns for dividends, stating that the regulation cannot be used by one taxpayer against another when the true ownership of income is in controversy.

Practical Implications

This case clarifies the tax treatment of dividends paid during the pendency of a stock sale where title is retained as security.
It highlights that the economic substance of the transaction, rather than the mere form of title, dictates who is taxed on the dividend income.
When drafting stock sales agreements, parties should be aware that assigning the benefit of dividends to the buyer will likely result in the dividends being taxed as ordinary income to the buyer, even if the seller is the record owner of the shares.
This ruling informs how to structure agreements to achieve desired tax outcomes.
Subsequent cases will analyze similar transactions by focusing on who has the true beneficial ownership and control over the stock and its dividends during the period between the agreement date and the final transfer of title. See, e.g., *Moore v. Commissioner*, 124 F.2d 991, where the Tax Court's initial ruling was reversed on appeal based on similar principles.