Shevenell & Sons, Inc. v. Commissioner, 12 T.C. 943 (1949)

A stock dividend of common stock on common stock, distributed before March 1, 1913, is not considered a distribution of earnings and profits for the purpose of calculating equity invested capital under Section 718 of the Internal Revenue Code.

Summary

Shevenell & Sons sought to include stock dividends, distributed before 1913, in its equity invested capital for excess profits tax purposes. The Tax Court held that these pre-1913 stock dividends (common on common) do not represent a distribution of earnings and profits under Section 718 of the Internal Revenue Code. Because such dividends were not considered taxable income to the recipient, they do not increase the equity invested capital of the corporation, as they did not reduce earnings and profits available for later distribution.

Facts

Shevenell, a Kentucky corporation, distributed common stock dividends to its common stockholders between 1898 and 1909. At the time of each distribution, the company's earnings and profits exceeded the par value of the stock issued. The company transferred amounts from its earnings and profits account to its capital stock account to reflect these dividends. In 1941, Shevenell wrote down its capital stock account and credited a portion of the reduction to its undivided profits account.

Procedural History

Shevenell included the pre-1913 stock dividends in its computation of equity invested capital for excess profits tax purposes. The Commissioner of Internal Revenue disallowed this inclusion, determining that the dividends were not includible in equity invested capital and should be restored to accumulated earnings and profits. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether stock dividends, paid before March 1, 1913, are considered distributions of earnings and profits under Section 718(a)(3)(A) of the Internal Revenue Code, and therefore includible in the computation of equity invested capital.

Holding

No, because a stock dividend of common stock on common stock does not constitute a distribution of earnings and profits within the meaning of the statute, irrespective of whether it was distributed before or after the enactment of the Sixteenth Amendment.

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Court’s Reasoning

The Court reasoned that Section 718 of the Internal Revenue Code allows inclusion of stock distributions in equity invested capital only to the extent they are considered distributions of earnings and profits. Referring to the House Ways and Means Committee report, the court noted that taxable stock dividends are included in invested capital because they represent a reinvestment of earnings. However, stock dividends that were not taxable to the distributee are not deemed to reduce earnings and profits and are already reflected in accumulated earnings and profits. Citing *Eisner v. Macomber, 252 U.S. 189 (1920)*, the court emphasized that a dividend of common on common does not constitute the receipt of income by the stockholder; it is merely a bookkeeping adjustment. The court also noted that the restoration of a portion of the stock dividends to undivided profits in 1941 indicated that the earnings were not irrevocably transferred to capital. The court distinguished cases involving state law and deficit corporations, emphasizing that Congress fixed its own rules for applying the statute.

Practical Implications

This case clarifies that the tax treatment of stock dividends, specifically common stock on common stock, impacts the calculation of equity invested capital for excess profits tax purposes. The key takeaway is that stock dividends that were not considered taxable income to the recipient (because they did not reduce the company’s earnings and profits), even if distributed before 1913, do not increase the corporation’s equity invested capital. This decision provides guidance on how to treat stock dividends in similar situations, emphasizing the importance of determining whether the distribution effectively transferred value to the shareholder and reduced the corporation’s retained earnings.

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