21 T.C. 382 (1953)

Distributions of common stock on common stock are not includible in equity invested capital for the purpose of excess profits tax calculations, whereas cash dividends reinvested in stock are includible.

Summary

The Geo. W. Ultch Lumber Co. disputed the Commissioner of Internal Revenue's determination of its excess profits tax liability for 1944 and 1945. The primary issue was the calculation of the company's equity invested capital, specifically concerning whether certain stock issuances and a subsequent stock surrender increased or decreased this capital. The Tax Court held that stock distributions representing dividends of common on common stock before March 1, 1913, did not qualify for inclusion in equity invested capital, while later distributions, which were essentially cash dividends reinvested in stock, did. Additionally, the court determined that a proportional surrender of stock by shareholders did not increase the company's equity invested capital.

Facts

Geo. W. Ultch Lumber Co. was formed in 1906. Between 1908 and 1910, the company issued additional shares of stock. These issuances were in the form of stock dividends and also involved cash payments by shareholders in exchange for additional shares. In 1941, shareholders proportionally surrendered some of their shares back to the company. The company calculated its invested capital for excess profits tax purposes, including these stock transactions. The Commissioner disagreed with these calculations.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the company's excess profits tax for 1944 and 1945, based primarily on adjustments to the equity invested capital calculation. The case was brought before the United States Tax Court, which reviewed the Commissioner's adjustments. The Tax Court issued a decision addressing the issues, which was subject to a Rule 50 computation, to determine the exact amount of the deficiencies.

Issue(s)

1. Whether the par value of stock issued before March 1, 1913, should be included in equity invested capital under section 718 of the Internal Revenue Code.

2. Whether the company's equity invested capital increased in 1941 when stockholders surrendered shares to the company proportionally.

3. Whether the Commissioner properly computed the company's accumulated

earnings and profits by accruing and subtracting the 1944 excess profits tax deficiency from the beginning of 1945.

Holding

1. No, stock issued prior to March 1, 1913, as a stock dividend of common on common, is not included in equity invested capital.

2. No, the proportional surrender of stock by shareholders did not increase the company's equity invested capital.

3. Yes, the Commissioner correctly computed the accumulated earnings and profits by accounting for the 1944 tax deficiency.

Court's Reasoning

The court looked to Section 718 of the Internal Revenue Code to define equity invested capital. The court distinguished between stock dividends and what it considered cash dividends. The court found that the first issuance of stock on January 25, 1908, was a stock dividend of common on common stock, and relied on the *Owensboro Wagon Co.* case for the principle that these are not includible in equity invested capital. The court held that subsequent issuances were, in effect, reinvestments of cash dividends. "Each of the dividend resolutions of May 14, 1908, January 23, 1909, and January 11, 1910, expressly provided for the manner in which the dividend therein declared was to be paid." The court reasoned that since there were cash distributions, even if the stockholders used the cash to buy more stock, it was to be considered as money paid in. The court also found that the proportional surrender of stock didn't change the corporation's capital, as the shareholders' interests remained the same.

Practical Implications

This case provides clear guidance on calculating equity invested capital for tax purposes, particularly during the excess profits tax era. It reinforces the importance of distinguishing between true stock dividends and cash dividends, even if cash is subsequently reinvested in the corporation. The case illustrates how the form of the transaction is crucial. For tax practitioners, the case highlights: the importance of meticulously reviewing stock issuance records and related shareholder transactions; the need to consider the impact of pre-1913 stock distributions; and the principle that proportional stock surrenders generally do not impact invested capital. This case should inform tax planning strategies related to corporate capital structure and dividend policies and how those choices affect tax calculations. It is also important to note the court's reliance on *Owensboro Wagon Co.*, which provides an important precedent to understand how the courts interpret the Internal Revenue Code.