***Comm'r v. First State Bank of Stratford, 168 F.2d 1004 (1948)***

A corporation does not realize a taxable gain or loss when it distributes its own property as a dividend if the dividend declaration is, in reality, a declaration of a property dividend, even if the dividend is nominally declared in monetary terms.

**Summary**

The First State Bank of Stratford distributed shares of Warren Petroleum Corporation stock as a dividend. The IRS argued that the bank could not recognize a loss on this distribution because it was, in substance, a property dividend, not a cash dividend satisfied by property. The court agreed, holding that the dividend resolution, read as a whole, indicated an intent to distribute the Warren stock from the outset. Because the dividend was essentially a distribution of property rather than a cash dividend, the court ruled no taxable loss could be recognized by the bank. The case highlights the importance of interpreting corporate resolutions holistically to determine the nature of the dividend and its tax implications. The practical effect is that corporations must carefully draft dividend resolutions to ensure they are taxed as intended.

**Facts**

The First State Bank of Stratford's board of directors declared a dividend of $210,000 on common stock. The resolution specified that the dividend would be paid pro rata in shares of Warren Petroleum Corporation stock, valued at $21.25 per share, up to 5,800 shares; the remainder was to be paid in cash. The stipulated fair market value of the stock on the date of the dividend resolution was also $21.25 per share. The bank claimed a loss when distributing the stock, which had declined in value.

**Procedural History**

The Commissioner of Internal Revenue disallowed the loss claimed by the bank. The Tax Court agreed with the Commissioner. The Court of Appeals for the Fifth Circuit affirmed the Tax Court's decision.

**Issue(s)**

Whether the distribution of Warren Petroleum Corporation stock by First State Bank of Stratford was a transaction in which the bank realized a loss recognizable for tax purposes.

**Holding**

No, because the dividend was a property dividend from the outset, and the distribution did not result in a taxable loss.

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## Court’s Reasoning

The court relied on the principle that a corporation can realize a taxable gain or loss if it declares a cash dividend and satisfies the obligation by distributing property. However, if the dividend declaration is, in substance, a property dividend, no taxable gain or loss is realized. The court examined the dividend resolution and found it clearly indicated an intent to distribute shares of Warren stock from the outset. The resolution detailed a specific number of shares to be distributed at a specific value, and the court determined the bank’s obligation was tied to distributing those shares, not a fixed monetary amount. The court distinguished the case from situations where a definite monetary obligation is established, satisfied later by property distribution. The court referenced the General Utilities case to reinforce its position that the resolution must be read as a whole and that the actual substance of the transaction dictates the tax treatment.

The court stated that the resolution by the bank’s board was as follows:

“Resolved that there be paid out of the surplus or net profits of the Corporation a dividend of $210,000.00 on all the shares of common stock of the Corporation, said dividend to be payable immediately to holders of record of said stock at the close of business on December 21, 1948. Said dividend shall be payable pro rata in stock of Warren Petroleum Corporation to the extent of 5,800 shares of such stock of Warren Petroleum Corporation at a value of $21.25 per share adjusted by payment of cash to even shares, and the remainder of such dividend shall be payable in cash.”

The court said that “We find it difficult to perceive how the above resolution, read in its entirety, could be construed as obligating the corporation to distribute anything other than the 5,800 shares of stock referred to, valued at $21.25 per share, and the amount of cash necessary to bring the total distribution to $210,000.”

## Practical Implications

This case underscores the importance of how corporate resolutions are worded when declaring dividends. Corporations must clearly define the nature of the dividend: Is it a cash dividend to be satisfied with property, or a direct property dividend? This decision emphasizes that the substance of the transaction—the actual intent as reflected in the resolution—controls the tax consequences. The resolution must be unambiguous about the corporation’s obligation. If the corporation intends to distribute property directly, the resolution should not create a fixed monetary obligation that is later satisfied with property. This case has had lasting influence on tax planning for corporations making dividend distributions, particularly when using appreciated or depreciated assets. It means tax advisors need to carefully analyze the terms of any dividend declaration, especially the language used to describe the dividend payment. Subsequent cases have frequently cited the principle that dividend resolutions are interpreted as a whole, not piecemeal. It highlights the importance of expert tax law advice when making complex financial decisions.

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