It is fairly obvious that it is impossible to devise an income tax which is both just and simple. Simplicity is predicated upon a minimum of hard and fast rules which leave no room for the concessions to individual equities demanded by justice. The incompatibility between justice and simplicity does not mean, however, that either ideal must be abandoned entirely. Although it may not be feasible to construct a just and simple income tax, there should be a constant striving for the simplest law consistent with fairness. Complicated provisions of the tax law, which foster rather than mitigate injustice, are doubly damned, because they are both complex and unfair. The present method of taxing stock dividends and stock rights under the federal income tax falls squarely within this category.

STOCK DIVIDENDS

The most significant aspect of the present system of taxing stock dividends is not its remarkable complexity or even its manifest inequity. The significant thing is that this monstrosity is unnecessary. It is dictated by no constitutional mandate. It could be eliminated by adding one, or at the outside two, sentences to the Internal Revenue Code.

The basic pattern of the taxation of stock dividends is fairly clear, although some of the details may be obscure. The foundation cases are Eisner v. Macomber,1 Koshland v. Helvering,2 Helvering v. Sprouse,3

1. 252 U. S. 189 (1920).
2. 298 U. S. 441 (1936).
and Helvering v. Griffiths. Without reviewing pages of legal history, which would have been better blank, what happened is this.

In Eisner v. Macomber, the Supreme Court held that a stock dividend of common on common was not constitutionally taxable as income, because the dividend represented a capitalization of surplus, rather than a distribution of corporate profits to the stockholders. In Koshland v. Helvering, however, the Court explained that Eisner v. Macomber did not mean that no stock dividends are constitutionally taxable as income; a stock dividend which gives the stockholder a new interest in the corporation is income in the constitutional sense of the Sixteenth Amendment. Following the decision in Koshland v. Helvering, Congress, which after Eisner v. Macomber had provided that stock dividends should not be taxed as income, amended the law again to provide that stock dividends should be taxed as income to the extent to which they were constitutionally taxable. The question remained what stock dividends are and what stock dividends are not income in the constitutional sense. By accident or design Koshland v. Helvering did not make clear (1) whether an "income" stock dividend was simply a dividend in a different kind of stock than that on which the dividend was declared; or (2) whether it was a dividend which changed the proportional interests, or relative positions, of the stockholders in the corporation. Helvering v. Sprouse resolved the ambiguity in the Koshland case by holding that to be taxable as income a stock dividend must give the stockholders a different proportional interest in the corporation. Shortly, before the decision in the Sprouse case, however, the Court indulged in some startling reflections on Eisner v. Macomber.

In Helvering v. Griffiths the Government attempted to tax a stock dividend of common on common, contending that Eisner v. Macomber was decided incorrectly. The Government argued that all stock dividends are constitutionally taxable as income and should, therefore, be taxed under a statute which explicitly provides for the

5. Supra note 1.
6. Supra note 2.
7. § 201(d) of the Revenue Act of 1921, 42 Stat. 227 (1921), provided: "A stock dividend shall not be subject to tax. . . ." This provision was not changed until the Revenue Act of 1936, 49 Stat. 1652 (1936).
8. § 115(f)(1) of the Revenue Act of 1936, which is identical with the present INT. REV. CODE § 115(f)(1) expresses this negatively: "A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."
9. Supra note 3. See also Strassburger v. Commissioner, 318 U. S. 604 (1943), which was decided at the same time.
10. Supra note 4.
taxation of stock dividends which are income in the constitutional sense. Although a majority of the Court held that a common stock dividend declared upon common stock is not taxable as income, the opinion leaves small room for doubt that *Eisner v. Macomber* is wrong and that there is no constitutional prohibition against taxing any stock dividend as income.

The minority in *Helvering v. Griffiths* were in complete sympathy with the Government. They felt that *Eisner v. Macomber* was a mistake and that any kind of stock dividend is taxable as income under the Sixteenth Amendment. Moreover, they felt that all stock dividends are taxed under the present statute. The majority hedged. Although a careful reading of their opinion leaves the distinct impression that the majority felt that *Eisner v. Macomber* was decided erroneously and that all stock dividends are taxable as income, they refused to admit this explicitly. Instead, they said that a stock dividend of common on common was not taxable as income under the present statute, so there was no need to raise the constitutional issue. They reasoned that when Congress provided that stock dividends should be taxed to the extent they are constitutionally taxable, it had in mind the distinctions developed in *Eisner v. Macomber*; therefore, the majority in *Helvering v. Griffiths* concluded that the statute was not intended to tax and did not tax a dividend in the *Eisner v. Macomber* pattern. It is important to bear in mind, however, that any immunity which stock dividends presently possess derives from the construction of the existing statute. There is no longer constitutional immunity.

From the viewpoint of practical administration and elementary equity, the sheer asininity of the distinction between taxable and nontaxable stock dividends is patent. When a taxpayer receives a stock dividend the first problem with which he is confronted is whether or not it is taxable. Despite the Supreme Court's exposition in *Helvering v. Sprouse* and *Strassburger v. Commissioner* the problem is not as simple as it seems. Without undertaking an exhaustive examination, several illustrations will serve to point up the latent ambiguity in the different proportional interest test of the taxability of stock dividends.

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11. Justice Rutledge did not participate in the decision. The dissenters were Justices Douglas, Black and Murphy. The majority consisted of Chief Justice Stone and Justices Roberts, Reed, Frankfurter and Jackson.

12. The statement in the text may be colored by wishful thinking. A more cautious statement may be found in the conclusion to Professor Rottschaefer's article, *Present Taxable Status of Stock Dividends in Federal Tax Law*, 28 Minn. L. Rev. 106, 163 at 192 (1943): "It is fairly obvious ... that the likelihood is very great that *Eisner v. Macomber* will be overruled on the first opportunity."


14. See the discussion by Rottschaefer, *supra* note 12, from which most of the illustrations in the text are adapted.
It is generally assumed that a dividend of common on common is a nontaxable stock dividend.\textsuperscript{15} How far from the truth this assumption may be is revealed by the most casual analysis of the problem. A stock dividend may change the stockholders' proportionate interests because it effects a change in: (1) voting rights; (2) participation in profits; (3) priorities to assets on liquidation; or (4) proportionate ownership of the corporation. A common stock dividend on common stock might do any one or all four of these things.

To take the simplest case, if a corporation had only one class of stock outstanding and that was voting common, a dividend in either voting or non-voting common would not change the stockholders proportionate interests and would not be taxable.\textsuperscript{16} Suppose, however, that A and B each own 50 per cent. of the stock and it is agreed that the dividend shall be distributed 60 per cent. to A and 40 per cent. to B.\textsuperscript{17} Since, the dividend changes their proportionate ownership of the corporation, it would appear to be taxable.

If a corporation has outstanding two classes of stock, voting and non-voting common, it has been held by the Supreme Court that a distribution to both classes of stockholders in non-voting common, does not change their proportionate interests and is not taxable.\textsuperscript{18} If, however, voting common were distributed to both classes of stockholders, the dividend would clearly change their proportional interests, since part of the voting power would pass from the holders of the voting common to the holders of the non-voting common. Apparently it has not been decided whether a mere change in voting rights, unaccompanied by any other change in the relations of the stockholders, is sufficient to make a stock dividend taxable. If it is, and it is hard to see why it should not be, the dividend of voting common, distributed to the holders of voting and non-voting common stock, would be a taxable stock dividend.

If, in addition to common stock, a corporation has preferred stock outstanding at the time it distributes a dividend of common stock to common stockholders, this may make the stock dividend taxable, even though it would not be taxable, if there were no preferred stock outstanding.\textsuperscript{19} If the preferred stock is entitled to vote, a distribution of

\textsuperscript{15} 2 C. C. H. Fed. Tax Rep., ¶835.015 (1947): "A distribution of common on common does not change the proportionate interests of the shareholders in the corporation. It merely divides the existing interest of the common shareholders into a greater number of shares without changing the proportion each holds to the total."

\textsuperscript{16} Helvering v. Griffiths, 318 U. S. 371 (1943).

\textsuperscript{17} A distribution to stockholders may be a dividend even though it is not in proportion to stock ownership. Lincoln Nat. Bank v. Burnet, 63 F. 2d 131 (App. D. C. 1933).

\textsuperscript{18} Helvering v. Sprouse, 318 U. S. 604 (1943).

\textsuperscript{19} Cf. the curious, and it would seem erroneous, oversimplification of the problem in 2 C. C. H. Fed. Tax Rep., ¶835.015 (1947): "If there is both preferred and
voting common to common stockholders alters the relations between 
the common and the preferred stockholders and would seem, therefore, 
to be a taxable stock dividend. If the preferred stock were entitled 
to participate in profits with the common after a specified dividend had 
been paid to common, a common stock dividend paid to common stock-
holders would also change the relations of the preferred and common 
stockholders and should be taxable.20 Again, if the preferred has a 
limited priority to assets on dissolution of the corporation and beyond 
that shares with common stock, a common stock dividend to common 
stockholders would seem to be taxable, because it changes the relations 
of the preferred and common stockholders with respect to the liquida-
tion of the corporation.

Another common assumption in connection with stock dividends 
is that a stock distribution to the sole stockholder of a corporation can-
not be taxable because it cannot change his proportional interest in the 
corporation.21 Suppose, however, that A owns all the stock in X 
Corporation. He agrees to have X Corporation distribute a stock 
dividend and to transfer this stock to B, who wishes to buy into the 
corporation. This is done. Will the dividend be taxable? If the 
dividend is regarded as part of the overall transaction by which B 
acquires an interest in the corporation, it will be taxable. There are 
supporting analogies for this point of view in the cases dealing with 
tax-exempt transfers to a controlled corporation.22 The question is of 
more than academic significance. If the stock dividend is taxable, 
A's income (assuming that the dividend stock is sold for its fair market 
value) will be ordinary income realized from a taxable dividend. If 
the stock dividend is not taxable, his profit will be realized in the form 
of a capital gain from the sale of the stock.23

common outstanding at the time of the dividend, a dividend to the common stockholder, 
payable in common stock, does not represent taxable income." A comparison of 
this quotation with the discussion in the text illustrates the rather considerable con-
fusion which still surrounds the taxation of stock dividends.

20. Consider, for example, a case suggested by Rottschaefer, supra note 12, at 122, 
123. Preferred stock is entitled to a dividend of $5 a share before any dividends are 
paid on common, and entitled to share profits equally with common after common has 
received a dividend of $6 per share. It would seem obvious that a dividend in common 
stock paid to the common stockholders, would increase their participation in profits 
and alter their relation to the preferred stockholders.

1939); Briggs-Darby Construction Co. v. Commissioner, 119 F. 2d 89 (C. C. A. 5th 
1941).
23. Suppose that A owns 1,000 shares of X Corporation common stock, the only 
stock outstanding. A paid $100,000 for the stock in 1930. The X Corporation has 
capital of $100,000 and earned surplus of $50,000. B wishes to buy one-third interest 
in X Corporation and makes a contract with A to buy this interest. Pursuant to the 
contract A has X Corporation issue him a 50 per cent. common stock dividend which 
he immediately transfers to B for $50,000, its fair market value. If the stock dividend 
is taxable, A realizes ordinary income of $50,000 from the dividend. If the dividend
It is generally assumed that a distribution in preferred stock to common stockholders is not taxable, if there is no preferred stock outstanding. If, however, the preferred stock carried voting rights and was distributed to holders of both voting and non-voting common, it would clearly change the relation of the holders of the voting and non-voting common as far as their voting rights were concerned, and would seem to be taxable.

Again, if preferred stock is outstanding, it is usually assumed that a distribution of preferred stock to common stockholders is a taxable stock dividend. Suppose, however, that the preferred stock distributed as a dividend to the common stockholders is convertible into common stock, which would not be taxable, if it were distributed directly, is this a taxable dividend? In Choate v. Commissioner, the Court held that rights to subscribe to preferred stock, which were issued to common stockholders, were taxable, when the corporation had other preferred stock outstanding, despite the fact that the preferred stock was convertible into common stock. The court declared: "We regard as immaterial the fact that the preferred stock here is convertible, at the election of the holder, into common stock". This seems inconsistent with a well known decision of the Board of Tax Appeals which held that the rights issued to stockholders to subscribe to bonds, which were convertible into stock, were to be treated as rights to subscribe to new stock. Illustrations of possible perplexities which may arise in determining whether a stock dividend is taxable or non-taxable might be multiplied. Clearly, the problem is far from simple.

Leaving the problem of whether or not a stock dividend is taxable as income, the taxpayer, who receives such a dividend, reaches the question of the basis of the stock dividend and the original stock, and

is nontaxable, the basis of the stock dividend is $33,333.33 and the only income which A realizes on the transaction is a long term capital gain from the sale of the stock of $8,333.34.

25. Id. at 688, n. 12.
26. T. I. Hare Powel, 27 B. T. A. 55 (1932). This case was decided when the statute provided that no stock dividends should be taxed as income. The reasoning of the case, however, is that a right to subscribe to a convertible bond shall for tax purposes be treated as a right to subscribe to the stock into which the bond may be converted. This would seem to mean that under the present statute a right to subscribe to a bond which could be converted into stock, which would not be taxable as a dividend if distributed directly, would be a nontaxable stock right. See 1 C. C. H. Fed. Tax Rep. ¶ 68.29 (1947).
27. For example, if a stockholder receives a stock dividend which would not ordinarily be taxable, but is given his election to take cash instead of the stock, this is a taxable dividend. Int. Rev. Code § 115(f) (2). After a struggle (David Bruckheimer, 46 B. T. A. 234 (1942)) the Treasury has finally conceded that a stock dividend, which would not ordinarily be taxable, is not taxable because it is paid out of treasury stock and has amended its Regulations accordingly. U. S. Treas. Reg. III, § 29.115-7.
the related problem of the holding period of the stock dividend and the original stock. Of course, if the stock dividend is an income dividend, the fair market value of the dividend, to the extent that the corporation has taxable earnings or surplus, is taxed as income. The basis of the original stock is unchanged, and its date basis remains unchanged. The basis of the dividend stock is its fair market value at the time the dividend was distributed, and the holding period starts with the date of distribution.28

If the stock dividend is not a taxable dividend, the stockholder must apportion the basis of the old stock between the old stock and the dividend stock. This, of course, raises the question of how the apportionment is to be made. If the new stock is identical with the old stock, the apportionment is made by dividing the basis of the old stock by the total number of units of old and new stock. If the new stock is a different kind of stock than the old stock, apportionment is made on the basis of the respective market values of the old and new stock. In either case, since both old and new stock take as their bases a prorated part of the basis of the old stock, the date basis of both old and new stock is that of the original stock.29 It is not too clear just how different the old and new stock must be to require apportionment on the basis of respective market values. Presumably, they are sufficiently different if they have different market values.

28. In 1930 A purchased 100 shares of X Corporation preferred stock for $10,000. On March 1, 1947, he received a taxable dividend of 25 shares of preferred stock, which had a fair market value of $3,000. On June 1, 1947, A sold the original stock for $14,000 and the dividend stock for $3,500. The basis of the stock dividend was $3,000, its fair market value when the dividend was distributed, and the holding period for the dividend stock started with the distribution of the dividend. A, therefore, realized a short term capital gain of $500 on the sale of the dividend stock. The basis and date basis of the original stock remained unchanged, so A realized a long term capital gain of $2,000 (recognized gain $4,000) from the sale of the original stock.

29. Int. Rev. Code § 113(a) (19) (A); U. S. Treas. Reg. 111, § 29.113(a) (12)-1. A purchased 100 shares of X Corporation common stock in 1930 for $9,000. On March 1, 1947, the X Corporation distributed 50 new shares of common stock to A as a dividend on his X common stock. The X Corporation has only one class of stock outstanding. The basis of one share of the old stock and one share of the new stock is the cost of the original stock, $9,000, divided by the total number of shares of old and new stock, 150, or $60 a share. The holding period for both lots of stock starts with the holding period of the old stock.

If instead of issuing a dividend in common stock to A, X Corporation issued a dividend in preferred stock and A received a nontaxable dividend of 50 shares of new preferred stock having a fair market value of $3,000, and at this time, the fair market value of his common stock was $9,000, A's basis for the old and new stock would be determined as follows:

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\text{The basis of a share of the preferred would be determined by multiplying } 9,000 \text{ by } \frac{3,000}{12,000} \text{ and dividing the result by } 50 \text{ and would be } 45 \text{ a share. The holding period for both the common and preferred would start with the holding period of the common.}
\]
Obviously, the present method of taxing stock dividends is complicated. It may not be too complicated for effective administration. Complexity in the law, however, is justified only when it is necessary to achieve fair results. Complications which serve simply to confuse the taxpayer and the tax administrator, and to promote rather than mitigate discrimination, are indefensible. This is precisely what the present system of taxing stock dividends does.

The tax on stock dividends is collected from the stockholder. As far as the average investor is concerned, one stock dividend is just like another. He feels as rich or as poor, and, as a matter of fact, usually is just as rich or as poor, whether he gets a taxable or a nontaxable stock dividend. It is, of course, conceivable that a very large stockholder, who was contesting the control of a corporation, might be vitally concerned with whether a stock dividend changed his relative position in the corporation, and he might regard a dividend which strengthened his command as more valuable than one which left his relative position unchanged. Apart from the fact that the atypical situation should hardly be taken as the norm for the taxation of stock dividends, it is difficult to translate changes in the proportional interests of the stockholders into terms of taxability. Stock dividends are taxed as income because they represent a distribution of corporate profits. From the viewpoint of taxpaying ability and the receipt of something of value on the part of the taxpaying stockholder, it is difficult to see much reason in the distinction between taxable and nontaxable stock dividends. Suppose, for example, that X Corporation declares a dividend in non-voting common stock in favor of its common stockholders. Later X Corporation distributes a dividend in identical stock to its preferred stockholders. The common stockholder is not taxed upon his dividend. The preferred stockholder is. They have both, however, received exactly the same thing. Their respective abilities to pay a tax are in no way affected by whether their relative positions in the corporation

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30. It is also possible that since nontaxable stock dividends have obvious tax advantages and since a stock dividend to be nontaxable must leave the proportionate interest of the stockholders undisturbed, the overall effect of the distinction between taxable and nontaxable stock dividends on corporate management is to perpetuate the corporate status quo and retain the same group in control.


33. An interesting situation would arise if the corporation distributed one dividend in common stock to both its common and preferred stockholders. This would clearly change the proportionate interest of both classes of stock. However, the change would be adverse to the common stockholders and favorable to the preferred stockholders. If the preferred stockholders had not participated in the distribution, the dividend to the common stockholders would not have been taxable. Does it become taxable because of the detrimental change of position experienced by the common stockholders when the preferred stockholders are included in the distribution?
have been changed. Does the distinction which leads to taxing the preferred stockholder and exempting the common stockholder, when they both receive the same stock, make sense to anyone except a lawyer? 

There is some sense in not taxing any stock dividends as income. There is a lot of sense in taxing all stock dividends as income. There is little save nonsense in taxing some stock dividends as income and not taxing others.

The legalistic basis for the distinction between taxable and nontaxable stock dividends is that in order to be taxable under the Sixteenth Amendment income must be realized, and income is not realized by a stock dividend which does not give the stockholder a new proportional interest in the corporation. One of the curious aspects of the legal mind is its eagerness to objectify purely subjective phenomena. There is, of course, not a single word in the Sixteenth Amendment requiring a gain to be realized before it becomes income in the constitutional sense. The doctrine of realization is a pure figment of the judicial imagination. The only rational basis for it is a sort of intuitive feeling that the bird in the hand is more important than two in the bush. It is obvious that it would be unfair to tax paper profits which may never be reduced to the taxpayer’s possession. It would be both unfair and administratively impractical to tax fluctuations in value as income, or to treat them as deductible losses. Realization, as far as it has any meaning, indicates the point at which a gain or a loss becomes sufficiently fixed and definite to justify taking it into consideration for income tax purposes. It is not an objective reality which can be touched or smelled or photographed; it is merely a vague canon of convenience to expedite the fair and effective administration of the income tax. Realization means just what the courts say it means. It has no independent existence apart from the judicial mind. Although it is commonly said that income is taxable because it is realized, this phrasing, like the usual way of stating many legal doctrines, puts the cart before the horse. Realization is simply a judicial tag for a result, not a reason for a result. A gain is realized, because it is held to be taxable. It is not taxable, because it is realized.

When realization was blown up to the dignity of a constitutional mandate, and it was held that income must be realized to be taxable under the Sixteenth Amendment, what this really meant was that the Courts decided that they, rather than Congress, should be the final arbiters of when it is fair and wise to impose an income tax. It may

34. Particularly in view of the possibility that if both dividends had been combined into a single distribution, both the preferred and the common stockholders might have been taxed upon the dividend. See note 33 supra.
well be argued that the Courts overstepped the bounds of judicial propriety in taking away from Congress the power to determine what may fairly be taxed as income, and that the doctrine of realization as a canon of constitutionality was a breach of judicial good manners and self-restraint. Without going into that, however, it would seem apparent that where there is legitimate and reasonable doubt as to whether a particular item should be taxed as income, the courts should defer to Congressional judgment. This is precisely what they failed to do in connection with stock dividends.

It is true that a stock dividend does not give the stockholder anything which he did not possess before the dividend, as far as his total assets are concerned. But this is equally true of a cash dividend. If a taxpayer pays $150 for a share of stock, which represents ownership of $100 of the corporation's capital and $50 of its surplus, and the next day the corporation distributes a cash dividend of $50 to him, he has exactly what he had before as far as his total assets are concerned. The change in his position which justifies taxing the cash dividend as income lies in the fact that the cash he receives is severed from the risks of the corporate business. When a stockholder gets a stock dividend, the investment represented by the new stock is still subject to the hazards of the corporate business. However, the stockholder now has the means of withdrawing that part of his investment by selling the dividend stock. It is not unreasonable to argue that stock dividends should not be taxed as income until they are converted into cash. On the other hand, the distribution of a stock dividend clearly affords a convenient point at which to impose an income tax from the angle of effective administration. Whether or not it is a fair time to tax is a sufficiently controversial question to be properly left to the judgment of the legislature.

There might have been some small justification for overruling the decision of Congress to tax stock dividends as income, if it had been held that no stock dividends were taxable. However, there certainly has never been any excuse for the distinction between taxable and non-taxable stock dividends. The only sensible reason for not taxing a stock dividend as income is that, until the dividend is sold, the investment represented by the dividend remains subject to the hazards of the corporate enterprise. This is equally true, however, of a stock dividend which gives the stockholder a new proportional interest in the corporation. There is not the remotest connection between the problem of whether a stock dividend reduces profits to the stockholder's possession, so that they may be taxed effectively and fairly, and the question of whether the dividend changes the proportional interests of the stock-
holders. It is not difficult to see how the courts became so bemused with the concept of realization that they lost all touch with reality and evolved the distinction between taxable and nontaxable stock dividends. But, although the distinction between taxable and nontaxable stock dividends can be explained as an illustration of the curious complexities of the legal mind, that does not mean that it can be justified.

Of course, a nontaxable stock dividend is not really tax-exempt, because the gain from the dividend will be taxed when the original stock and the stock dividend are sold, unless the stocks depreciate to a point where no gain is realized on their subsequent sale. It is far from obvious, however, why certain stockholders are preferred over others by deferring the tax on the gain from a nontaxable stock dividend. Moreover, the doctrine of nontaxable stock dividends really does more than postpone the stockholder’s tax liability. A taxable stock dividend is fully taxed as ordinary income. In the case of a nontaxable stock dividend, taxable gain is not realized until the original stock, whose basis is reduced by the dividend, or the stock dividend is sold. Even when both are sold so that the gain is fully realized, it will usually be realized in the form of a long-term capital gain, only half of which is included in taxable income.35

The practical effect of the distinction between taxable and nontaxable stock dividends is to establish a discrimination, which has no foundation in taxpaying ability, against the stockholder who is unfortunate enough to receive a taxable stock dividend. The complexities of taxing stock dividends serve no just purpose. They have no sound economic basis. They lead to unwarranted and outrageous discrimination. If they were forced upon us by constitutional mandate, we might acquiesce in them as something which had to be endured. It seems manifest, however, from the Supreme Court’s opinion in Helvering v. Griffiths36 that all stock dividends can constitutionally be taxed as income. A single sentence added to the Code explicitly taxing stock dividends as income, whether or not they follow the pattern of Eisner v. Macomber36 would put a definite termination to the unhappy situation which started with that case and place the taxation of stock dividends upon a just and rational basis.

**Stock Rights**

The taxation of stock rights is, if anything, more confused and complicated than the taxation of stock dividends. The difficulties here

35. See note 23 supra.
36. Caution should be exercised in amending the Code to make abundantly clear the Congressional intention of taxing all stock dividends, and not merely those which the Supreme Court thought were taxable at some past date.
stem again from *Eisner v. Macomber*, with an added wrinkle derived from *Palmer v. Commissioner*.37

**Nontaxable Stock Rights**

The distinction between nontaxable and taxable stock dividends applies to stock rights. Since a stock dividend which gives the stockholder no new proportional interest is not taxable as income, a stock right to acquire such stock is not taxable as income, either upon its receipt or its exercise.38 When the right, or new stock acquired through the exercise of the right, is sold, there will be taxable gain or loss. The basis for computing such gain or loss in the case of the right is a part of the basis of the stock, in connection with which the right was issued, equal to the ratio between the fair market value of the right and the fair market values of the original stock and the right at the time the right was issued.39 The basis of stock acquired by the exercise of the right is the basis of the right plus the cost of exercising the right.40 The basis of the old stock in connection with which the right was issued is, of course, the portion of the stock's original basis which remains after allocating part of the original basis to the right. By a more or less arbitrary provision of the statute the time of holding a right, when the right is sold, starts with the date basis of the original stock;41 while the time of holding new stock acquired through the exercise of the right starts with the date when the right was exercised.42 The date basis of the original stock, of course, remains unchanged.

**Taxable Stock Rights**

The line of demarcation between nontaxable and taxable stock rights is determined by whether or not the stock or property called for by the right would be taxable as a dividend, if it were distributed directly. This means, of course, that the same uncertainties which arise in ascertaining whether a stock dividend is taxable exist in the case of stock rights. Moreover, if a stock right calls for property or stock which would be a taxable dividend, if it were distributed directly, so that the right is a "taxable" stock right, there is considerable un-

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37. 302 U. S. 63 (1937).
39. U. S. Treas. Reg. 111, §29.22(a)-8. The basis of the stock is allocated between the stock and the rights according to their respective values by the same method which is employed in allocating the basis of the old stock between old and new stock, when a nontaxable stock dividend in a different kind of stock is distributed. Note 29 *supra*, second paragraph.
42. *Int. Rev. Code* § 117(h)(6).
TAXATION OF STOCK DIVIDENDS AND RIGHTS

certainty as to how such rights are taxed. Originally, the Treasury took the position that taxable stock rights were a form of dividend which were taxable to the extent of their fair market value when they were received. This theory, however, received a serious set-back in Choate v. Commissioner,43 a decision by the Circuit Court of Appeals for the Second Circuit. In that case, Judge Frank who delivered the opinion held that no income is realized upon the mere receipt of a stock right, even though the right calls for property or stock which would be taxable as income, if it were distributed directly.44 When the right is exercised, Judge Frank said, taxable income is realized to the extent of (1) the "spread" at the time the right was issued, or (2) the "spread" at the time the right was exercised, whichever is lower. The "spread" is the difference between the fair market value of the property acquired by exercising the right and the cost of exercising the right.45 For example, if a stockholder receives a right to buy one share of stock for the right and $100, and the fair market value of the stock is $125 when the right is issued and $150 when it is exercised, the "spread" when the right is issued is $25; the spread when it is exercised is $50; and under Choate v. Commissioner, the taxable income realized by exercising the right is $25.

The opinion in Choate v. Commissioner made two points. First, no income is realized from the receipt of a taxable stock right. Second, when the right is exercised income may be realized, but it is limited to the lower of the spread existing at the time the right is issued or at the time when the right is exercised. Both of these propositions purported to be derived from the Supreme Court's decision in Palmer v. Commissioner.46

In Palmer v. Commissioner, a corporation issued rights to its stockholders to purchase stock in another corporation. At the time the rights were issued the fair market value of the stock did not exceed the cost of exercising the rights, although when the rights were exercised the stock had increased in value and its fair market value was in excess of the cost of exercising the rights. The Board of Tax Appeals found as a fact, which the Supreme Court said was sustained by the evidence, that the corporation in issuing the rights intended

43. 129 F. 2d 684 (C. C. A. 2d 1942).
44. The rights in this case were distributed to common stockholders and were rights to purchase preferred stock, which was convertible into common stock. Other preferred stock was outstanding at the time the rights were distributed. Judge Frank ignored the conversion privilege and treated the rights as taxable rights to purchase preferred stock. See the discussion of the case on this point supra, p. 152.
45. Note that the rights may acquire an independent market value different from the spread. It is the spread, however, rather than the independent market value of the right, which determines the amount of taxable income realized upon the exercise of the right.
46. 302 U. S. 63 (1937).
merely a sale to its stockholders and did not intend to distribute a dividend. Relying upon this finding, the Supreme Court held that there was merely a sale, and that no income was realized either upon the receipt of the rights or their exercise.

As far as the decision in the Palmer case goes, the Supreme Court held merely that where a corporation issues stock rights with the intention of selling stock to its stockholders, rather than with the intention of distributing a dividend, no income is realized either upon the receipt or the exercise of the rights. However, the language of the case went beyond the bare decision and indulged in certain reflections as to the taxability of stock rights generally. Among other things the Court said: "The mere issue of rights to subscribe and their receipt by stockholders, is not a dividend. No distribution of corporate assets or diminution of the net worth of the corporation results in any practical sense. Even though the rights have a market or exchange value, they are not dividends within the statutory definition... They are at most options or continuing offers, potential sources of income to the stockholders through sale or the exercise of the rights. Taxable income might result from their sale, but distribution of the corporate property could take place only on their exercise." 47

Certainly this language is subject to a legitimate inference that the receipt even of a "taxable" stock right does not result in the realization of income. But despite Judge Frank's modest disclaimer, that he was merely a "judicial moon" reflecting the light of the Supreme Court, he generated a little independent illumination (or, at least, some heat), when he held in Choate v. Commissioner that the income realized from the exercise of a stock right is limited to the lower of the spread existing either at the time the right was issued or at the time it was exercised. Palmer v. Commissioner does not touch the point directly. Judge Frank reasoned that the income derived from the exercise of a right could not exceed the spread at the time it was exercised, because this represents the maximum distribution of corporate profits to the stockholder. On the other hand, he said that it could not exceed the spread when the rights were issued, because this is all the corporation intends to distribute. His reasoning on this last point may be vulnerable. Apparently the Treasury thinks that it is, because the latest General Counsel's Memorandum 48 on the subject takes the position that income is realized upon the exercise of a stock right to the extent of the spread at the time the right is exercised, without regard to whether this is greater or less than the spread at the

47. Id. at 71.
time the right is issued. Judge Frank's limitation on the amount of taxable income derived from the exercise of a stock right to the spread at the time the right was issued not only involves the debatable proposition that the amount of a dividend is determined by what a corporation intends to distribute, rather than what it actually does distribute; but it seems a dubious interpretation of the corporate intention. When a corporation issues stock rights to its stockholders, it would seem that what it intends to distribute is the stock, rather than the difference between the fair market value of the stock at the time the rights are issued and the cost of exercising the rights. This interpretation of corporate intention is, moreover, peculiarly persuasive if you start from the premise that corporate profits can be distributed only by the exercise, rather than the issue of stock rights.

Further doubt is cast upon the soundness of Judge Frank's position in Choate v. Commissioner by the case of Commissioner v. Smith, which, although it involved an option given an employee to purchase stock, rather than a stock right, has very disturbing implications on the subject of taxing stock rights. In Commissioner v. Smith a corporation gave an employee an option to buy stock in another corporation. At the time the employee received the option the fair market value of the stock did not exceed the cost of exercising the option, or in other words, there was no spread when the option was extended to the employee. When the employee exercised the option later, however, the stock had increased in value and there was a spread,—the fair market value of the stock exceeded the cost of exercising the option. The Supreme Court held that the employee realized income from the exercise of the option to the extent of the difference between the fair market value of the stock which he received, at the time he received it, and the cost of exercising the option.

The distinction between Palmer v. Commissioner, where it was held that no income was realized from the exercise of a stock right, when there was no spread at the time the right was issued, and Commissioner v. Smith, where it was held that income was realized from the exercise of a stock option given an employee, when there was no spread at the time the option was received by the employee, is simple enough, although the implications of the distinction are somewhat appalling. In Commissioner v. Smith the Supreme Court relied upon a finding by the Tax Court to the effect that the option given the employee was intended as compensation. Since, it was found as a fact that compensation was intended, the court held that the difference between the cost of acquiring the stock and the fair market value of

49. 324 U. S. 177 (1945).
the stock was income. In the Palmer case the Board of Tax Appeals found that in issuing the stock rights the issuing corporation did not intend to distribute a dividend, but intended a sale to its stockholders. Relying upon this finding the Supreme Court held that there was no dividend but merely a sale. In Choate v. Commissioner Judge Frank in dealing with the intention angle in Palmer v. Commissioner said that the intention of the corporation to make a sale or to distribute a dividend was to be determined objectively, rather than subjectively, and the intention to make a sale or distribute a dividend would be conclusively presumed from the fact that there was no spread, or there was a spread, when a stock right was distributed. This inference from Palmer v. Commissioner hardly seems borne out by Commissioner v. Smith, since in that case there was no spread at the time the stock option was given the employee, but the Supreme Court still sustained a finding by the tax court to the effect that the option was intended as compensation for services.

Commissioner v. Smith raises still further difficulties when it is read in connection with Palmer v. Commissioner. The Court said in Commissioner v. Smith: "It of course does not follow that in other circumstances not here present the option itself, rather than the proceeds of its exercise, could not be found to be the only intended compensation." 50 The other circumstances which the Court apparently had in mind were a situation where the option, unlike the option in Commissioner v. Smith, had value at the time it was received by the employee. In such a situation the Court intimates that the receipt of the option itself might constitute income, and if the parties intended the receipt of the option to be compensation, the amount of income realized by receiving and exercising the option would be limited to the spread at the time the option was received. Of course, the Court did not say in Commissioner v. Smith that this is the law. It said merely that it might be the law. If it is the law, and there is any correlation between stock rights and options to buy stock given to employees, it is obvious that the taxation of stock rights is still further confused.

If the receipt of an option to buy stock, which is given to an employee, may constitute income, if the option has value when it is received, does this mean that the receipt of a stock right may constitute income, where there is a spread at the time the right is received? This would be consistent with the decision in Palmer v. Commissioner because the stock right in that case had no value when it was received. However, it is clearly inconsistent with the language of Palmer v. Commissioner, to the effect that no income is realized from a stock

50. Id. at 182.
right until it is exercised. The same judge delivered the opinions in both *Commissioner v. Smith* and *Palmer v. Commissioner*, and in *Commissioner v. Smith* he cited the *Palmer* case with apparent approval. It is unlikely that anything said in *Commissioner v. Smith* was intended to intimate that the receipt of a stock right results in the realization of income, even though there is a spread when the right is received. It is probably important to bear in mind that stock rights under the present statute are apparently taxed, if they are taxed at all, as a dividend or a distribution of corporate profits. *Palmer v. Commissioner* did not say that the receipt of a stock right might not result in a realization of income. It said that the receipt of a stock right could not be a dividend because it did not distribute the corporate profits. It seems likely that if the Supreme Court is pressed upon the point, it will say that the receipt of a stock option by an employee may result in a realization of income by the employee because he has received something of value. However, the receipt of a valuable stock right is not taxable as income under the present statute, not because it may not be income in the constitutional sense, but because the present statute only taxes stock rights when they constitute dividends, and the receipt of a stock right, which does not distribute corporate profits, is not a dividend.

It is noteworthy that in stating that the receipt of a valuable option to purchase stock by an employee might be income, the Court in *Commissioner v. Smith* also said that the "option itself", might be "found to be the only intended compensation." This seems to mean that if the spread at the time the stock option is given to the employee is less than the spread when the option is exercised, the income derived from the option would be limited to the spread at the time the employee received the option. This is not precisely the same limitation as that suggested by Judge Frank in connection with stock rights, because the income realized from the employee's option to buy stock is limited to the spread at the time the option is received. Apparently he would still receive income to this extent, even though the option later became less valuable and the spread at the time he exercised it was lower than the spread at the time when he received it. Moreover, it is doubtful whether it lends any support to Judge Frank's contention that the income from a stock right, when the right is exercised, cannot in any case exceed the spread when the right is issued. The situation envisaged in *Commissioner v. Smith* where income from the receipt of an employee's option is limited to the spread when the option is received, is one where the receipt of the option or in the Court's words, "the option itself" is intended to constitute the income. In the case of
stock rights, it is not the right itself, but the exercise of the right which is "intended" to constitute the taxable dividend. It would seem to follow that in any situation where the exercise of a stock right, as distinguished from the receipt of the right, constitutes income, the amount of income realized by the exercise of the right will be determined by the spread when the right is exercised, rather than the spread when it is received.

Of course, there really is no law on the taxation of taxable stock rights, unless one chooses to adopt the theory that law is discovered rather than made, and say that there is law which has not been discovered. From a practical point of view, however, there are as yet no definite rules governing the taxation of taxable stock rights. At best, there are doubts and possibilities.

(1) With the Treasury acquiescing, at least temporarily, in the position of Choate v. Commissioner to the effect that no income is realized upon the receipt of stock rights, it is reasonably clear that the receipt of a stock right will not be taxed as income. It may be well to bear in mind, however, that the only really solid foundation for Choate v. Commissioner, or the recent General Counsel's Memorandum, is the somewhat vague dictum in Palmer v. Commissioner.\footnote{Palmer v. Commissioner and Commissioner v. Smith are not enlightening. They could probably be construed to uphold either result. If the language of those cases is followed literally, it would be possible to say that it is all a matter of subjective intention, and depending upon the intention of the corporation to make a true sale, to distribute a dividend in the amount of the spread at the time the right was issued, or to distribute a dividend in the amount of the spread at the time the right was exercised, there will, upon the exercise of the right, be no income, or income to the extent of the spread when the right was issued, or income to the extent of the spread when the right was exercised.}

(2) It is not at all clear under what circumstances income will be realized from the exercise of a taxable stock right; nor, if income is realized, how the amount of such income will be measured.

If there is a spread both at the time the right is issued and the time it is exercised, Choate v. Commissioner holds that income is realized upon the exercise of the right, but that it is limited to the lower spread. The Treasury's position is also that income is realized upon the exercise of the right, however, according to the Treasury the amount of income is determined by the spread at the time the right is exercised.\footnote{G. C. M. 25063, 1947-1 Cum. Bull. 45.}  

\footnote{Supra, p. 160.}  

\footnote{Supra, p. 160.}
If there is no spread at the time the right is issued, but there is a spread when it is exercised, *Choate v. Commissioner* holds, and the result in *Palmer v. Commissioner* is consistent with the holding, that no income is realized from the exercise of the right. It is possible to argue from *Palmer v. Commissioner*, however, that if it is found as a fact that the corporation intended a dividend, then there will be income when the right is exercised to the extent of the spread at that time. Such a conclusion could also, of course, derive support from the reasoning in *Commissioner v. Smith*.

If there is no spread at the time the right is issued and no spread when it is exercised, it is very hard to see any theory which would justify holding that there is income either at the time the right is issued or at the time it is exercised.

If there is a spread when the right is issued, but no spread when the right is exercised, it seems clear that no income would be derived from the receipt or exercise of the stock right, if the only theory on which it can be taxed under the statute is that of a dividend, since there is no distribution of corporate profits. Presumably a corporation cannot distribute a dividend by an intention to do so unaccompanied by actual distribution. Even though an intention might be found to distribute a dividend by issuing the rights, it is doubtful if this intention would weigh against the fact that no distribution was actually made.

Whether a stock right is a taxable or a nontaxable right, and, if it is taxable, when and to what extent it is taxable, are, of course, only some of the problems which arise in connection with the taxation of taxable stock rights. If instead of exercising a taxable stock right, the stockholder sells the right, he realizes income. Since the right is in the nature of income, no part of the basis of the old stock is allocated to the right, but it takes a basis of zero. The zero basis follows, of course, only on the assumption that no income is realized upon the receipt of the right. If the basis of the right is zero, all of the proceeds of the sale of the right are income. However, the question arose in *Gibson v. Commissioner* whether this is ordinary income or a capital gain. In *Gibson v. Commissioner* the right was sold for an amount in

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54. 133 F. 2d 308 (C. C. A. 2d 1943). The corporation in this case had only common stock outstanding. Rights were issued to the stockholders to subscribe to a new issue of preferred stock, which was convertible into common stock. Although the Court treated the rights as taxable, it seems clear that they were not taxable, and would not have been taxable, even if there had been no conversion privilege. See Helvering v. Sprouse and Strassburger v. Commissioner, 318 U. S. 604 (1943). The case differs from *Choate v. Commissioner*, 129 F. 2d 686 (C. C. A. 2d 1942), in that in the *Choate* case when the rights to subscribe to the convertible preferred stock were issued to the common stockholders, the corporation had another issue of preferred stock outstanding.
excess of the spread at the time the right was issued. Under *Choate v. Commissioner*, which was decided by the same Circuit, if the right had been exercised, the taxable income realized from the exercise of the right could not have exceeded the spread at the time the right was issued. Consequently in *Gibson v. Commissioner* the proceeds of the sale of the right were divided into two parts: (1) an amount equal to the spread at the time the right was issued; and (2) the excess over this amount. For some reason the Commissioner and the taxpayer agreed that the excess over the amount of the spread was taxable as a capital gain. The only question in issue was how the amount equal to the spread should be taxed. The Court held that this was taxable as ordinary income, because it was in lieu of the income which would have been realized on the exercise of the right, which would, of course, have been taxed as ordinary income. Although its position is somewhat ambiguous, the Treasury seems to feel that the entire proceeds from the sale of a taxable stock right are taxable as ordinary income.\(^55\) If part of the proceeds from the sale of the right should be treated as a capital gain, the holding period of the right, which would determine whether the gain was short or long-term, would start with the date when the right was acquired, since it is a taxable right.

If a stockholder exercises a taxable right, he will realize gain or loss upon the subsequent sale of the original stock or the new shares acquired by the exercise of the right. Since the right is taxable or "in its nature" income, no part of the basis of the old stock will be allocated to the new stock, and the basis and date basis of the old stock will remain unchanged. The basis of the new stock will be the cost of exercising the right to acquire the new stock plus any income realized by exercising the right.\(^56\) The holding period for the new stock starts with the date the stock right is exercised.\(^57\)

It is manifest that the present system of taxing stock rights splits some fine legal hairs. If it is a headache for the lawyer, and it certainly should be, think what it must be for the average laymen. Visualize the laymen's thoughts about people who invent these professional pitfalls. As far as the average investor is concerned one stock right looks just like another. They are traded in the same way on the exchange. Just as in the case of the taxpayer who gets a stock dividend, one stock dividend looks like another, so from an economic point of view (or for that matter any point of view, except a highly legalistic one) one stock right resembles another. From a practical viewpoint, the only effect of the distinction between taxable and non-

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TAXATION OF STOCK DIVIDENDS AND RIGHTS

The simple and rational way to tax stock rights would be to treat them as a form of taxable dividend and to tax them to the extent of their fair market value when they are received. If the right is sold, this should be treated like the sale of a taxable stock dividend. The basis of the right would be its fair market value, which was returned as income when the right was received, and any gain or loss realized upon the sale would be a capital gain or loss. The holding period to determine whether there was a long or short term gain or loss would start with the date the right was received.

If the right is exercised, no gain or loss will be realized upon its exercise, because the receipt of the right has already resulted in the realization of taxable income. The basis of the stock acquired through the exercise of the right will be the cost of exercising the right plus the fair market value of the right returned as income. The time of holding the new stock for the sake of convenient administration should start at the date when the right was exercised.

In the latest utterance of the Treasury it is stated that no loss is recognized when a stock right is allowed to lapse. This is, of course, the logical corollary of the position that no gain is realized upon the receipt of the right. If, however, gain is to be realized upon the receipt of the right, it would only be fair to allow a loss when the right is allowed to lapse. Since the income realized upon the receipt of the right will be taxed as ordinary dividend income, the loss realized upon the lapse of the right should be an ordinary loss.

A possible objection to taxing the fair market value of stock rights as income, when the rights are distributed, might be urged on the ground that it leaves a loophole for tax avoidance. Since income is realized upon the receipt of the right, rather than upon the exercise of the right, no income would be realized if a corporation issued rights, which had no fair market value when they were issued, because the

58. Otherwise the part of the stock referable to the right would have as its date basis the date on which the right was received and the part referable to the subscription price would take as its date basis the date the rights were exercised and there might be a difficult problem of apportionment when the stock was sold.

59. G. C. M. 25063, 1947-1 Cum. Bull. 45. This does not apply, of course, to stock rights which were purchased by the taxpayer. If purchased rights are allowed to lapse, there is a deductible loss. G. C. M. 25063, moreover, involved taxable stock rights. It might be argued that since a nontaxable stock right is treated as a return of capital, at least, to the extent of allocating to it part of the basis of the original stock, the lapse of a nontaxable right would result in a deductible loss, to the extent of the basis of the right. On the other hand, it can be argued with perhaps equal plausibility, that no part of the basis of the stock is allocable to the nontaxable right, until the right is sold or exercised, and, therefore, no deductible loss occurs on the lapse of such a right.
cost of exercising the right equalled or exceeded the fair market value of the stock called for by the right, even though the value of the stock might greatly exceed the cost of exercising the right when it was exercised. There are several answers to this objection. One is that it does not seem that a tax would be imposed in this situation even under the present system of taxing the exercise of stock rights rather than their receipt. However, an adequate short answer seems to be that the possibilities of tax avoidance by this means seem very slight—the situation is not typical—and if any serious tax avoidance materialized it can be dealt with by an explicit statutory exception at that time.

There is a simple, fair and economically sound method of taxing stock rights, which can easily be substituted for the present chaotic system, if it can be dignified with the label of a system. The only possible excuse for failing to adopt some such simple and equitable method at the next session of Congress is that there is some constitutional impediment. Is there any such impediment? There does not appear to be, although there are two Supreme Court decisions which require some consideration.

If *Eisner v. Macomber* were still law, it would doubtless be necessary to draw a distinction between taxable and nontaxable stock rights analogous to the distinction between taxable and nontaxable stock dividends. It probably would not be feasible to treat as income stock rights which call for stock which could not be taxed as income, if it were distributed directly. As far as the Constitution is concerned, however, all stock dividends are now taxable. It follows that all stock rights are constitutionally taxable as income.

Conceding, however, that all stock rights are taxable as income, the problem posed by *Palmer v. Commissioner* still remains as to the time at which income from a stock right may be taxed as income. Is income realized when the right is received or only when the right is exercised? Obviously the problem is not susceptible of solution by any scrutiny of the text of the Sixteenth Amendment. It is almost inconceivable, however, that the present Supreme Court would hold that there is any constitutional prohibition against taxing stock rights as income when they are received. The fact that *Commissioner v. Smith* strongly hinted that an option to purchase stock given to an employee as compensation for his services might be taxed when the employee received the option would seem to show that the Supreme

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61. At least, if you regard the law as a matter of guessing what the next decision on the point in question will be, this seems to be a fair inference from *Helvering v. Griffiths*, 318 U. S. 371 (1943).
Court realizes that the receipt of a valuable stock right may be taxed as income. Stock rights have a market value. They are as definite and tangible a form of wealth as a share of stock. It is true that the value of a stock right lies in the fact that it gives the stockholder an opportunity to obtain something of value. But on any realistic analysis this is true of any property which is embraced under the legal category of choses in action. The value of a share of stock—or a bond lies not in the certificate of stock or the engraving on the bond, but in the hope that the stock will pay dividends, and the bond will return interest and principal. Surely a valuable option or opportunity is property and income in a constitutional sense. The fact that a stock right may become valueless if it is allowed to lapse does not alter the fact that something of value is received when the right is issued. Since the stock right will become valueless if it is allowed to lapse, a statute which undertakes to tax the receipt of stock rights as income, should, as a matter of equity, make provision for an offsetting deduction, if this event occurs. But the possibility that this event will occur is no reason for not taxing the receipt of the right as income. Whether or not there is income in the constitutional sense when a valuable stock right is received must be tested by what happens at the time of the receipt, rather than by what may happen later. It would be just as logical to say that a stock dividend could not be treated as income, because the stock might later become worthless, as it would be to say that the receipt of a valuable stock right could not be taxed as income, because the right might subsequently lapse and become worthless.

The only thing which stands in the way of holding that the receipt of a valuable stock right is income in the constitutional sense is some of the language in *Palmer v. Commissioner.*

*Commissioner v. Smith* shows, however, that the receipt of a valuable option to purchase stock may be income. If anything is certain about *Palmer v. Commissioner,* it is that that case did not say that the receipt of a valuable stock right is not income in a constitutional sense. In the *Palmer* case the Court was concerned with construction, not with constitutionality. Moreover, the Court addressed itself solely to the question of whether the receipt of a stock right constituted a dividend as that term was defined in the statute. The Court reached the conclusion that it was not a dividend by adhering very closely to the statutory definition of a dividend as a distribution of corporate profits. The only reason to consider *Palmer v. Commissioner* in connection with the proposal to tax the receipt of valuable stock rights as income is to make sure that


63. *Supra,* p. 162.
in drafting the appropriate amendments to the Code Congress' intention to tax the receipt of stock rights, regardless of whether or not the receipt of the rights fits into the statutory concept of a taxable dividend, is clearly specified.

The present system of taxing stock dividends and stock rights is a monument to legal deviousness rather than to legal common sense. It is complicated, cumbersome and fraught with pitfalls and uncertainties. It is unjust and discriminatory. Above all it is unnecessary. With the downfall of *Eisner v. Macomber*, the way has been cleared for a simple and rational method of taxing stock dividends and stock rights. From any point of view, except that of the lineal descendants of the medieval conveyancers, the receipt of stock dividends and stock rights represent income. That is the way they should be taxed.