

Rockefeller Vs. United States

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Appeal No. : 257 U.S. 176

Appellant : Rockefeller

Respondent : United States

Judgement :

Rockefeller v. United States - 257 U.S. 176 (1921)

U.S. Supreme Court Rockefeller v. United States, 257 U.S. 176 (1921)

Rockefeller v. United States

Nos. 535, 536

Argued October 11, 12, 1921

Decided November 21, 1921

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ERROR TO THE DISTRICT COURT OF THE UNITED STATES

FOR THE SOUTHERN DISTRICT OF NEW YORK

SYLLABUS

1. Where the stockholders of a corporation, which is engaged in producing, buying, and selling crude petroleum and in transporting it through its pipelines, form a new corporation to which the pipeline property is conveyed by the old corporation and in consideration therefor and as part of the transaction all the capital stock of the new corporation, of par value equal to the valuation of the property so conveyed, is distributed among such stockholders *pro rata*, either by being issued to them directly or by being first

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issued to the old corporation and then so distributed, and the old company possesses such a surplus that the transaction leaves its capital unimpaired and requires no reduction of its outstanding issues, the shares so received by the stockholders are a dividend within the meaning of the Income Tax Act of October 3, 1913, c. 16, 38 Stat. 166, and income within the meaning of the Sixteenth Amendment. P. [257 U. S. 182](#) . *United States v. Phellis, ante*, [257 U. S. 156](#) .

2. Such a distribution of shares, whatever its effect upon the aggregate interests of the stockholders, constitutes, in the case of each individual, a gain in the form of actual, exchangeable assets transferred to him from the old company for his separate use, in partial realization of his former indivisible and contingent interest in the corporate surplus -- in substance and effect a dividend of profits by the corporation, and individual income of the shareholder. P. [257 U. S. 183](#) .

274 F. 952 affirmed.

Error to judgments of the district court sustaining income tax assessments under the Income Tax Law of October 3, 1913, and the Sixteenth Amendment. In No. 535, the action was by the United States, to collect the tax, against the plaintiff in error Rockefeller. In No. 536, the plaintiffs in error, having paid the tax under protest, sued the collector to recover the amount with interest.

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MR. JUSTICE PITNEY delivered the opinion of the Court.

These two cases were argued together, turn upon like facts, and may be disposed of in a single opinion. They involve the legality of certain income taxes assessed against the plaintiff in error in the one case, and against the testator of plaintiffs in error in the other, under the income tax provisions of the Act of October 3, 1913, c. 16, 38 Stat. 114, 166, 167, by reason of certain distributions of corporate stocks received by the respective taxpayers under the following circumstances: in and prior to the year 1914, the Prairie Oil & Gas Company, a corporation of the State of Kansas, was engaged in producing, purchasing, and selling crude petroleum, and transporting it through pipelines owned by the company in the States of Kansas and Oklahoma and elsewhere. At the same time, the Ohio Oil Company, a corporation of the State of Ohio, was engaged in producing and manufacturing petroleum and mineral oil and transporting the same through pipelines owned by it in the States of Ohio, Indiana, Illinois, and Pennsylvania. In the month of June, 1914, it was judicially determined by this Court (*The Pipe Line Cases*, [234 U. S. 548](#)), that with respect to the transportation business, these companies were common carriers in interstate commerce, subject to the Act to Regulate Commerce as amended by Act of June 29, 1906, c. 3591, 34 Stat. 584, and as such subject to the supervision of the Interstate Commerce Commission. By Act of September 26, 1914, c. 311, 38 Stat. 717, the remainder of their business became subject to the supervision of the Federal Trade Commission. In order to avoid a probable conflict of federal authority in case the combined business of production and transportation should continue to be carried on as theretofore, it was in each case, upon advice of counsel, determined that the pipeline property should be owned and operated by a separate corporation. In the

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case of the Ohio company, an added reason for segregation lay in the fact that, by a section of the Ohio General Code, its entire gross receipts, including those derived from business other than transportation, were subject to an annual assessment of 4% chargeable against the gross receipts of companies engaged in

the transportation business. For these reasons, the stockholders of the Prairie Oil & Gas Company caused a corporation to be organized under the laws of the state of Kansas, by the name of the Prairie Pipe Line Company, to which all the pipeline property of the Prairie Oil & Gas Company was transferred in consideration of the issue and delivery of the entire capital stock of the new company, to be distributed *pro rata* to the stockholders of the Prairie Oil & Gas Company. And similarly, the stockholders of the Ohio Oil Company caused a corporation to be formed under the laws of that state, by the name of the Illinois Pipe Line Company, to which all the pipeline property of the Ohio Oil Company was transferred in consideration of the issue to it of the entire capital stock of the new company, which was to be distributed at once by the oil company to its stockholders *pro rata*. These arrangements were carried out in like manner in both cases, except that, in the case of the Kansas companies, the stock of the pipeline company was issued directly to the stockholders of the oil company, whereas in the case of the Ohio companies, the pipeline company issued its stock to the oil company, but, in the same resolution by which the contract was made, an immediate distribution of the new stock among the oil company's stockholders was provided for, and in fact it was carried out. The aggregate valuation of the Prairie pipelines was \$27,000,000, that of the Ohio pipelines \$20,000,000, and the total capitalization of the respective pipeline companies equalled these amounts.

In each case, the oil company had a surplus in excess of the stated value of its pipelines and of the par value of

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the total stock of the corresponding pipeline company, so that the transfer of the pipelines and the distribution of the stock received for them left the capital of the respective oil companies unimpaired, and required no reduction in their outstanding issues.

Messrs. Rockefeller and Harkness, respectively, were holders of large amounts of the stock of both the Prairie and the Ohio oil companies, and, in the distributions, each received an amount of stock in each of the pipeline companies proportionate

to his holdings in the oil companies. This occurred in the year 1915. Neither Mr. Rockefeller nor Mr. Harkness nor the latter's executors sold any of the stock in the pipeline companies.

Income tax assessments for the year 1915 were imposed upon Messrs. Rockefeller and Harkness based upon the value of the stocks thus received as dividends, and these assessments are in question in the present suits, both of which were brought in the District Court of the United States for the Southern District of New York, one by the United States against Mr. Rockefeller, the other by the executors of Mr. Harkness against the Collector. In each case, the facts were specially pleaded so as to present the question whether the distribution of the stocks of the pipeline companies among the stockholders of the oil companies constituted, under the circumstances, dividends within the meaning of the Act of 1913, and income within the meaning of the Sixteenth Amendment. In each case, a final judgment was rendered sustaining the assessment, and the judgments are brought here by direct writs of error under 238, Judicial Code, because of the constitutional question.

Under the facts as recited, we deem it to be too plain for dispute that, in both cases, the new pipeline company shares were in substance and effect distributed by the oil company to its stockholders -- as much so in the case of the Kansas company, where the new stock went directly

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from the pipeline company to the stockholders of the oil company, as in the case of the Ohio company, where the new stock went from the pipeline company to the oil company and by it was transferred to its stockholders. Looking to the substance of things, the difference is unessential. In each case, the consideration moved from the oil company in its corporate capacity; the new company's stock issued in exchange for it was distributed among the oil company's stockholders in their individual capacity, and was a substantial fruit of their ownership of stock in the oil company, in effect a dividend out of the accumulated surplus.

The facts are in all essentials indistinguishable from those presented in *United States v. Phellis*, ante, [257 U. S. 156](#) . In these cases, as in that, regarding the general effect of the entire transactions resulting from the combined action of the mass of stockholders, there was apparently little but a reorganization and financial readjustment of the affairs of the companies concerned -- here a subdivision of companies, without immediate effect upon the personnel of the stockholders, of much difference in the aggregate corporate activities or properties. As in the *Phellis* case, the adoption of the new arrangement did not of itself produce any increase of wealth to the stockholders, since whatever was gained by each in the value of his new pipeline stock was at the same moment withdrawn through a corresponding diminution of the value of his oil stock. Nevertheless the new stock represented assets of the oil companies standing in the place of the pipeline properties that, before had constituted portions of their surplus assets, and it was capable of division among stockholders as the pipeline properties were not. The distribution, whatever its effect upon the aggregate interests of the mass of stockholders, constituted in the case of each individual a gain in the form of actual exchangeable assets transferred to him from the oil company

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for his separate use in partial realization of his former indivisible and contingent interest in the corporate surplus. It was in substance and effect, not merely in form, a dividend of profits by the corporation, and individual income to the stockholder.

The opinion just delivered in *United States v. Phellis* sufficiently indicates the grounds of our conclusion that the judgment in each of the present cases must be

Affirmed.

MR. JUSTICE CLARKE took no part in the consideration or decision of these cases.

MR. JUSTICE VAN DEVANTER and MR. JUSTICE Mc REYNOLDS dissent.

