

Weiss Vs. Stearn

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Court : US Supreme Court

Decided On : May-26-1924

Appeal No. : 265 U.S. 242

Appellant : Weiss

Respondent : Stearn

Judgement :

Weiss v. Stearn - 265 U.S. 242 (1924)

U.S. Supreme Court Weiss v. Stearn, 265 U.S. 242 (1924)

Weiss v. Stearn

Nos. 262 and 263

Argued April 30, 1924

Decided May 26, 1924

265 U.S. 242

CERTIORARI TO THE CIRCUIT COURT OF APPEALS

FOR THE SIXTH CIRCUIT

SYLLABUS

Pursuant to an agreement, the stockholders of an Ohio corporation deposited with a trustee their certificates for all its capital stock (\$5,000,000), and other parties deposited \$7,500,000; the depositors organized a new Ohio corporation with authorized capital stock of \$25,000,000, and powers like those of the old corporation; the new corporation took over the property, assets and business of the old one, assuming its contracts and liabilities, and delivering certificates for all its stock to the trustee, in payment, and carried on the business under the old management; the old corporation was dissolved; the trustee delivered half of the new stock and the whole \$7,500,000 to the old stockholders *pro rata*, and the other half of the new stock to the other depositaries, so that each owner of old stock received cash, and also shares of new stock representing an interest in the corporate property and business half as large as he had before.

HELD

(1) That the new stock received by the old stockholders, unlike the money, was not the proceeds of a sale, but represented part of the same capital investment as their old shares, without any segregated gain taxable as income under the Revenue Act of 1916. P. [265 U. S. 252](#) .

(2) The transaction amounted to a financial reorganization under which each stockholder retained half his interest and disposed of the remainder. P. [265 U. S. 254](#) .

(3) Questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants. *Id.*

(4) When applying the Sixteenth Amendment and income tax laws enacted under it, the courts must regard matters of substance, and not of mere form. *Id.*

285 F. 689 affirmed.

Page 265 U. S. 243

Certiorari to judgments of the circuit court of appeals affirming judgments recovered by the respondents in the district court in their actions to recover money paid under protest as income taxes.

Page 265 U. S. 251

MR. JUSTICE Mc REYNOLDS delivered the opinion of the Court.

Respondents brought separate actions to recover money which they alleged petitioner unlawfully demanded of them as income tax. The question for our decision is this: did they, by the transactions hereinafter detailed, dispose with profit of all or, as they maintain, of only half their interests in the National Acme Manufacturing Company, within the income provisions, Revenue Act of 1916 (c. 463, 39 Stat. 756, 757). Both courts below upheld their claims and gave judgments for appropriate refunds.

Under a definite written agreement the following things were done:

(A) Respondents and other owners delivered duly indorsed certificates representing the entire capital stock (\$5,000,000) of the National Acme Manufacturing Company, incorporated under laws of Ohio -- the old corporation -- to the Cleveland Trust Company, as depository. Messrs. Eastman, Dillon & Co. deposited \$7,500,000 with the same trust company. Representatives of both classes of depositors thereupon incorporated in Ohio the National Acme Company -- the new corporation -- with \$25,000,000 authorized capital stock and powers similar to those of the old corporation. Pursuing the definite purpose for which it was organized, the new corporation purchased and took over the entire property, assets, and business of the old one, assuming all outstanding contracts and liabilities, and in payment therefor issued to the trust company its entire authorized capital stock. It continued to operate the acquired business under the former management, and the old corporation was dissolved.

Page 265 U. S. 252

(B) The trust company delivered to Eastman, Dillon & Co. certificates for half the new stock -- \$12,500,000. To the owners of the old stock -- to each his *pro rata* part -- it delivered certificates representing the remaining half, together with the \$7,500,000 cash received from Eastman, Dillon & Co. The owner of each \$100 of old stock thus received \$150 cash, also \$250 of new stock, representing an interest in the property and business half as large as he had before. Prior to the specified transactions, his interest in the enterprise was 100/5,000,000; thereafter, it became 250/25,000,000, or 50/5,000,000.

The collector ruled that each old stockholder sold his entire holding, and assessed respondent accordingly for resulting profits. Adopting a different view, the courts below held that he really sold half for cash and exchanged the remainder, without gain, for the same proportionate interest in the transferred corporate assets and business.

We agree with the conclusion reached below. The practical result of the things done was a transfer of the old assets and business, without increase or diminution or material change of general purpose, to the new corporation, a disposal for cash by each stockholder of half his interest therein, and an exchange of the remainder for new stock representing the same proportionate interest in the enterprise. Without doubt, every stockholder became liable for the tax upon any profits which he actually realized by receiving the cash payment. If, by selling the remainder, he hereafter receives a segregated profit, that also will be subject to taxation.

Petitioner relies upon *United States v. Phellis*, [257 U. S. 156](#) , and *Rockefeller v. United States*, [257 U. S. 176](#) ; also *Cullinan v. Walker*, [262 U. S. 134](#) , which followed them. As the result of transactions disclosed in the *Phellis* and *Rockefeller* cases, certain corporate assets not exceeding accumulated surplus were segregated and passed to individual stockholders. The value of the segregated thing

so received was held to constitute taxable income. Cullinan's gain resulted from a dividend in liquidation actually distributed in the stock of a holding company incorporated under the laws of a foreign state, not organized for the purpose of carrying on the old business, and which held no title to the original assets.

Eisner v. Macomber, [252 U. S. 189](#) , gave great consideration to the nature of income and stock dividends. It pointed out that, within the meaning of the Sixteenth Amendment, income from capital is gain severed therefrom and received by the taxpayer for his separate use; that the interest of the stockholder is a capital one, and stock certificates but evidence of it; that, for purposes of taxation, where a stock dividend is declared, the essential and controlling fact is that the recipient receives nothing out of the company's assets for his separate use and benefit. The conclusion was that,

"having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

Applying the general principles of *Eisner v. Macomber*, it seems clear that, if the National Acme Manufacturing Company had increased its capital stock to \$25,000,000, and then declared a stock dividend of 400 percent, the stockholders would have received no gain -- their proportionate interest would have remained the same as before. If, upon the transfer of its entire property and business for the purpose of reorganization and future conduct, the old corporation had actually received the entire issue of new stock and had then distributed this *pro rata* among its stockholders, their ultimate rights in the enterprise would have continued substantially as before -- the capital assets would have remained unimpaired, and nothing would have gone therefrom to any stockholder for his separate benefit. The value of his holdings would not have changed, and he would have retained the same essential rights in respect of the assets.

We cannot conclude that mere change for purposes of reorganization in the technical ownership of an enterprise, under circumstances like those here disclosed, followed by issuance of new certificates, constitutes gain separated from the original capital interest. Something more is necessary -- something which gives the stockholder a thing really different from what he theretofore had. *Towne v. Eisner*, [245 U. S. 418](#) ; *Southern Pacific Co. v. Lowe*, [247 U. S. 330](#) ; *Gulf Oil Corp. v. Lewellyn*, [248 U. S. 71](#) . The sale of part of the new stock and distribution of the proceeds did not affect the nature of the unsold portion; when distributed, this did not in truth represent any gain.

Considering the entire arrangement, we think it amounted to a financial reorganization under which each old stockholder retained half of his interest and disposed of the remainder. Questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants, and, when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder, we must regard matters of substance, and not mere form.

Affirmed.

MR. JUSTICE HOLMES and MR. JUSTICE BRANDEIS dissent on the ground that the case falls within the rule declared in *Cullinan v. Walker*, [262 U. S. 134](#) .

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