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extended to the point, as applied to utterances, where there is clear and present danger[76] that such utterances unless restrained will deny the employees rights guaranteed by the Act.[77] From the words of one court it would appear that all speech by the employer is protected "unless the incidence of the evil apprehended is so imminent that it may befall before there is opportunity for full discussion."[78]

Undoubtedly, a privileged speech delivered to a captive audience under certain unusual circumstances and over objections of the employees might clearly constitute coercion and thereby lose its constitutional protection. But the Board's finding as a fact that a speech, regardless of its privileged nature standing alone, delivered to a captive audience thereby becomes coercive and ceases to be privileged seems an unwarranted denial of freedom of speech and a departure from the traditional interpretation of the First Amendment.

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Federal Income Taxation—Dividend Income—Accrual Accounting

In July, 1946, the Circuit Court of Appeals for the Seventh Circuit in the case of *Commissioner of Internal Revenue v. American Light and Traction Company*[1] held that a dividend declared in 1937 to stockholders of record at specified date in December, 1937, and payable in January, 1938, was taxable as income in 1938, when paid in 1938, *regardless of whether the stockholder was on an "accrual basis" or on a "cash basis."* The court concluded that the date of actual receipt, and not the date of declaration, determined the taxability of the income. The commissioner's contention throughout that the "record date" should be controlling brought no comment from the court other than that this was the first time such a theory had been urged.

The cases on this precise point are few. The decision in the principal case followed primarily that of *Tar Products Corp. v. Commissioner*[2] decided in September, 1942, which had overruled a Board of Tax

[76] The "clear and present danger" test as generally applied by the courts in freedom of speech cases was first used by Mr. Justice Holmes speaking for a unanimous court in *Schenck v. United States,* 249 U. S. 47 (1919). It has since been used in a series of important cases: Abrams v. United States, 250 U. S. 616 (1919) (Holmes, J., dissenting); Schaefer v. United States, 251 U. S. 466 (1920) (Brandeis, J., dissenting); Pierce v. United States, 252 U. S. 239 (1920) (Brandeis, J., dissenting); Gitlow v. People of New York, 268 U. S. 625 (1925) (Holmes, J., dissenting); Whitney v. California, 274 U. S. 357 (1927) (concurring opinion by Brandeis, J.); People v. Garcia, 37 Cal. App. (2d) 753, 98 P. (2d) 265 (1939); Cantwell v. Connecticut, 310 U. S. 296 (1940). For more recent cases see note 70 *supra.*

[77] 49 STAT. 449 (1935) 29 U. S. C. §151-166 (1940 ed.).

[78] Mr. Justice Brandeis in Whitney v. California, 274 U. S. 357, 377 (1927).

[1] 156 (F. (2d) 398 (C. C. A. 7th, 1946).

[2] 130 F. (2d) 866 (C. C. A. 3rd, 1942).

Appeals decision standing since 1927.[3] Because of the *Tar Products* decision, when the principal case arose in the Tax Court,[4] that court merely yielded to the decision of the circuit court of appeals and held contrary to its former views, refusing to discuss the relative merits of its own views and those of the circuit court of appeals.

In the two decisions placing all stockholders on the "cash basis" of accounting with respect to dividend income for tax purposes,[5] the courts relied heavily on the commissioner's interpretation of Code Section 115(a),[6] which is set out in Regulation 111[7] as follows: "A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands." This regulation was interpreted by both courts to apply alike to "cash basis" and "accrual basis" stockholders for two reasons. First, because it had for many years made no distinction between the two;[8] and second, because of the commissioner's non-acquiescence in the Board of Tax Appeals decision in 1927[9] which had allowed accrual of a dividend in the year of declaration.

As to the first reason, it appears that the regulation, in addition to having no binding effect,[10] is more susceptible to the interpretation that it applies only to a "cash basis" shareholder in order to prevent his turning his back on income available to him so as to postpone its receipt until the next year.[11] Moreover, the Revenue Act of 1921, Section 201(e), itself contained a similar provision, which was dropped from the 1924 Act, and upon a review of the legislative history of Section 201(e) it was determined that it in effect was to prevent a "cash basis" taxpayer from failing to report income unqualifiedly available to him, though not actually received. But since it was thought this was the rule which would be applied even in the absence of a statutory provision it was stricken from the Act.[12] It was thought, and reasonably so, that this provision in Section 201(e) inspired the above regulation.[13]

[3] The circuit court of appeals decision in the *Tar Products* case reversed the decision of the Board of Tax Appeals in 45 B. T. A. 1033 (1941), which had followed its earlier decision on the same point in *Campbell v. Commissioner*, 6 B. T. A. 60 (1927).

[4] 3 T. C. 1048 (1944).

[5] Cited *supra* notes 1 and 2.

[6] INTERNAL REVENUE CODE, §115(a), 26 U. S. C. A. §115(a).

[7] INCOME TAX REGULATIONS 111, §29.115-1.

[8] The Regulations have used substantially identical language since 1921.

[9] Campbell v. Commissioner, cited *supra* note 3.

[10] However, its long standing without any change by Congress might be deemed to give it the force and effect of law. See Helvering v. Reynolds Tobacco Co., 306 U. S. 110 (1939); Brown, *Regulations, Reenactment, and the Revenue Acts* (1941) 54 HARV. L. REV. 377.

[11] See John A. Brander, 3 B. T. A. 231 (1925).

[12] Cecil Q. Adams, 20 B. T. A. 243, 245 (1930); see also Mary Miller Braxton, 22 B. T. A. 128 (1931).

[13] 45 B. T. A. 1033, 1034, see note 3 *supra*.

In relying on the second reason the courts are holding the commissioner to his contention made nineteen years earlier, and in effect are giving more weight to the commissioner's opinion in the 1927 case than to that of the Board of Tax Appeals. Consequently the courts are reversing the authority which taxpayers have been following (or should have been), and are holding in accordance with the commissioner's former view, which he is here, in both cases, denouncing by asserting his belief to be in accord with the former authority which held that the dividend should be accrued by a shareholder properly reporting on the "accrual basis". Accordingly it seems that the second reason given by the court for its interpretation of the regulation is unsound.

In the application of the "single rule" the court in the principal case *(Commissioner v. American Light & Traction Co.)* states additional reasons. It says that it makes possible the checking of taxpayers' returns against the corporation record of disbursement. It must be conceded that the information return required by Code Section 148(a)[14] serves the practical purpose of aiding the commissioner to check the accuracy of shareholders' returns, but having the dividends reported on the information return included by "accrual basis" shareholders in one year and by "cash basis" shareholders in the next would not render the information worthless—at most it would merely require the commissioner to use each information return partly for one year and partly for the next.

Another reason given by the court is that application of the "single rule" will prevent variations in the tax paid where dividends are paid in kind and the value of the property fluctuates. However, it seems that there should be no substantial objection to such a situation; but on the contrary, it seems more desirable for the shareholder to report it in the manner in which he reports the rest of his income and disbursements, whether on the "cash basis" or "accrual basis," in order that the return will more properly reflect his gains for the period. Practically speaking, the tax paid by two shareholders on any particular dividend distribution would probably not be the same even though they reported the income in the same taxable year, and were holders of identical amounts of the stock, because they would be in different income brackets and would be affected differently by the same amount. But assuming for the sake of example that their total taxable net incomes are the same, that they are holders of an equal number of shares, and that tax rates applicable to the two years are the same, then the "accrual basis" shareholder would pay the same amount of tax on the dividend as the "cash basis"

[14] "Every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him." 26 U. S. C. A. 148 (a).

shareholder, except where the value of the stock distributed as a dividend fluctuated between the record date and the date of receipt. But in view of the fact that the "acquisition value" to each shareholder would be the market value upon which he had paid tax, and that this value is the one upon which each would compute a gain or loss upon selling or otherwise disposing of the stock, the objection to the difference in the tax paid on the distribution would seem to lose much of its force.[15]

Another reason given by the court is that a dividend is not taxable unless paid out of earnings and the proportion of earnings to capital used in paying cannot be determined until the date of payment in many cases. As to this argument, it seems that it would be a rare situation indeed in which the proportion of earnings to capital would not be known by the paying corporation fairly close to the end of its operating year (whether calendar or fiscal), and in consequence that information would usually be available to the shareholders in ample time to record as non-taxable income that portion of their dividend income attributable to non-taxable distributions.[16]

Finally the court reasoned that the dividend might be subject to double taxation in the case of transfer of the stock from an "accrual

[15] Suppose that a dividend in the stock of another company is declared Decem-1, 1946, to stockholders of record December 15, 1946, payable January 10, 1947. Suppose that on the record date (December 15) the market value of the stock was $50, and by the payment date (January 10) the market value had fallen to $45. Under these conditions the shareholder on the "accrual basis" would be taxed on $50 and the shareholder on the "cash basis" on $45. Then suppose that both sold these stocks on February 15, 1947, at which time they received the current market value of $55 per share. Here the "accrual basis" shareholder who had been taxed on $50 would have a taxable short term capital gain of only $5, where the "cash basis" shareholder would have a taxable short term capital gain of $10. Thus it can be seen that the total tax to each shareholder would tend to equalize, and at the same time consistency in reporting income for tax purposes would be preserved.

It is conceivable that this equalization would not follow as closely in the case of a loss due to the sale in the example above, because of the maximum allowable deduction for a short term capital loss (INTERNAL REVENUE CODE §117(d)). But, conceding that in such cases the total tax of the two shareholders would not precisely equalize, nevertheless each taxpayer will more properly reflect his total taxable gains if he is required to report all income (and expense) in a consistent manner.

[16] Assuming for the sake of example that the declaring corporation operates on the basis of the calendar year, the shareholders would normally have until March 15 to file their returns, and certainly by the end of January the declaring corporation will have been able to determine the proportion.

If the declaring corporation and the shareholder were operating on years ending at different dates (say June 30, and December 31), the situation would be worse. However, the "single rule" cannot cure this situation because the shareholder's income will be taxable long before the end of the declaring corporation's year.

But in view of the state statutes requiring that dividends may be declared only from earnings (see 11 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §5329, and cases cited there in note 56) except in cases of liquidation, the likelihood that the determination of the taxable proportion of a dividend will present a major problem seems relatively slight.

basis" to a "cash basis" taxpayer between the record date and the date of payment. Here it seems that since the stockholder of record, who is the "accrual basis" stockholder in the court's example, would be the one to whom the dividend check would be sent, that the sale subsequent to the record date would have no effect, since this would ordinarily be an ex-dividend transfer. Of course, where the sale, by agreement of the parties, also transfers or assigns the dividend, the "accrual basis" stockholder would be taxed on the dividend which he had assigned to his vendee, but he would have received something by virtue of the sale in consideration of the assignment of the dividend, and the difference between the amount he received as consideration for the assignment and the amount of the dividend would be reported as interest expense (normally the dividend would be discounted); and the loss or gain on the stock itself would be reported as a capital gain or loss. The vendee "cash basis" stockholder should not be taxed because the dividend was not income to him, but merely the consideration moving to him in the contract, and for which he paid. Probably some small part of it would be interest income (in the same amount as the vendor's interest expense) and should be so reported. And so it can be seen that the courts' example of double taxation of one dividend would not materialize.

In the *Tar Products* case[17] upon which the decision of the principal case is based, the facts were for practical purposes the same; however, in that case the commissioner was contending that the dividend should constitute taxable income to the distributee on the "accrual basis" in the year of declaration; without mention of record date. In dealing with the question as placed before it, the court, it is submitted, properly held that the date of declaration of a dividend would not be a convenient date on which to compel a taxpayer to accrue it. However, the court went on to say "for he will never receive it unless he is also a shareholder upon the date when the books close, and that date is wholly subject to the corporation's convenience, not that of either the government or taxpayer." Such reasoning overlooks the effect of a record date. Once the record date is stated, and known, then the distributee can be determined regardless of when the corporation closes its books, or whether it closes them at all. Had the commissioner urged upon the court in that case that the dividend should be accrued by the "accrual basis" stockholder on the *record* date, it seems that the court's reasoning would have been more clearly shown to be unsound.

It is a fundamental concept in accounting that in order to accurately reflect the position of a business, the income must be allocated to the period when earned.[18] It would seem to follow that where a definite

[17] Cited *supra* note 2.
[18] See KESTER, ADVANCED ACCOUNTING (3d rev. ed. 1933), p. 183.

debtor-creditor relationship arises conclusively, the period when earned would be determined for purposes of accruing. The courts have divided on the question of whether a corporate debt arises upon declaration of a dividend or whether it arises upon the record date.[19] The federal courts seem to favor the latter.[20] Under either view it can be seen that the debtor-creditor relationship does arise, with an absolute right in the shareholder-creditor, at the latest, no later than the record date; and it seems that under any view it would be proper to accrue dividend income as of the record date.[21]

It must be admitted that under the decision of the principal case, there would be no accounting burden placed upon the "accrual basis" shareholder in compelling him for tax purposes to report dividend income on a "cash basis"; it would merely be an item of an accounting adjustment for purposes of filing the tax return. And it may be argued that once this procedure is established that each year will balance out the next in as far as the tax burden itself is concerned. However, it is nevertheless true that in order to accurately and properly reflect the income for a period, each item of income must be placed where the right to it arose, and not the time of actual receipt.[22] The basic idea under the accrual system is that the books shall immediately reflect obligations and expenses definitely incurred and income definitely earned, regardless of whether payment has been made or is due. The word "accrue" does not mean that the item is due in the sense of being then payable. The accrual system wholly disregards due dates.[23]

It has been argued that it would be impossible for stockholders to accrue dividend income in the year of declaration, because very few stockholders have reliable information as to when the declaration is made.[24] This argument is based on an excerpt from an accounting handbook published in 1920,[25] and it should be called to mind that such information is much more readily available in 1946 than in 1920.[26] Also

[19] *Declaration date:* Ford v. Snook, 240 N. Y. 624, 148 N. E. 732; Beattie v. Gidney, 99 N. J. Eq. 207, 132 Atl. 652; Western Securities Co. v. Silver King Mining Co., 57 Utah 88, 113, 192 Pac. 664; Notes (1938) 27 GEORGETOWN L. J. 74; Notes (1924) 38 HARV. L. REV. 245.

Record date: Smith v. Tacker, 133 Cal. App. 351, 24 P. (2d) 182; Richter & Co. v. Light, 97 Conn. 364, 116 Atl. 600; Ford v. Ford Manufacturing Co., 222 Ill. App. 76, 84; Nutter v. Andrews, 246 Mass. 224, 142 N. E. 67.

See also Annotation 72 A. L. R. 982.

[20] Sharp v. Commissioner, 91 F. (2d) 802 (C. C. A. 3d, 1937); Buchanan v. National Savings & Trust Co., 23 F. (2d) 994 (App. D. C. 1928).

[21] See PATON, ADVANCED ACCOUNTING (1941), p. 193.

[22] Spring City Foundry Co. v. Commissioner, 292 U. S. 182 (1934).

[23] Brown Co., 8 B. T. A. 112 (1927); *see also* Patrick McGuirl, Inc. v. Commissioner, 74 F. (2d) 729 (C. C. A. 2d, 1935).

[24] See dissenting opinion of Smith, Tar Products Corp. v. Commissioner, cited *supra* note 3.

[25] MONTGOMERY'S INCOME TAX PROCEDURE (1920), p. 450.

[26] The larger newspapers devote whole sections to stock reports, and declarations of dividends with the record dates are quoted therein. The declarations of divi-

it should be noted that this argument is aimed at not requiring an accrual of the dividend income as of the *date of declaration*—a proposition with which the writer here agrees—but they are not considering the accrual as of the *record date.* And in support of this very proposition the accounting authority referred to above as supporting the compulsory "cash basis" view,[27] in commenting upon the 1927 decision,[28] recognizes the record date as controlling.[29] It should be further noted that, assuming the information is not always immediately available, it is not necessary to know of the directors' action at once in order to accrue the income. Certainly the sooner the better, but it is simple and common to accrue items long after they have arisen, but in time to get them in the financial statements for the period.

A somewhat analogous situation to that in issue here, is the problem arising upon the death of a stockholder, i.e., *is the dividend income taxable as income to the decedent or to his estate?* In discussing the proper accounting procedure applicable to this situation Professor Finney says, "dividends declared prior to decedents death are part of the corpus, even though not collected, and those declared afterwards are income to the estate."[30] This accounting authority is placing the emphasis upon the declaration date which is earlier than the accrual date urged in this article (except where declaration date and record date are the same day), but the same principle is involved—that of allocating the income to the proper period. The United States Supreme Court recently partially settled this question by determining that the date of accrual of the dividend income was not the declaration date.[31] The court there expressly[32] did not decide whether the controlling date should be the record date or the payment date; however, its clear analysis of the situation placed the record date as the date at which all elements were present which are necessary for a propr accrual, *i.e.,* the payor, the amount, and the payee. With this view of the arising of a complete debtor-creditor relationship, it seems highly probable that the Supreme Court would hold the record date to be the proper date for recognition of dividend income by a shareholder on the "accrual basis." Considering that possibility, it is regrettable that the commissioner did not ask for *certiorari* in the principal case.

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dends by the more closely held corporations may never reach newsprint, but there the shareholders are practically in constant touch with the corporation and would normally be well informed. Also, any shareholder whose business enterprise is large enough to justify accounting on the "accrual basis" (normally an individual would be on the "cash basis") will easily be able to make it a point to know the declaration and record dates of dividends on the stock he holds.

[27] See note 24 *supra.* [28] See note 3 *supra.*

[29] MONTGOMERY'S INCOME TAX PROCEDURE (1920), p. 294.

[30] H. A. FINNEY, PRINCIPLES OF ADVANCED ACCOUNTING (1946), p. 474.

[31] Estate of Putnam v. Commissioner of Internal Revenue, 324 U. S. 393 (1945).

[32] *Id.* at 398.

It appears from a practical point of view, and from the standpoint of making the law follow a natural course in allowing proper accounting procedure, that the record date should control the point at which an "accrual basis" shareholder must accrue his dividend income. A shareholder reporting all other income, and all disbursements, on an "accrual basis" cannot, even for tax purposes, properly and accurately reflect his income for a period so long as his dividend income is taxable as though he were on the "cash basis."

It might be noted in closing that the holding in the principal case is not objectionable to "accrual basis" shareholders having dividends declared to stockholders of record on a date in 1946 and to be paid in 1947. With the "prospects" of lowered taxes for 1947, it is highly desirable for everyone to postpone income until 1947, while at the same time accruing as many expenses as possible for 1946. Should the tax reductions not materialize for 1947, it would seem safe to say that at least they will not be higher. However, this holding, though causing possible bright outlooks for the present, may conceivably, when the situation is reversed, cause an equal amount of hardship.

But under either situation, it is the consistency and logic of properly reflecting income that is to be desired, and it is submitted that the holding of the principal case denies both when it places an "accrual basis" shareholder, for tax purposes, partially upon a "cash basis."

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