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say that the violator is negligent *per se,* for which holding it has ample precedent.[15] The question then left to be answered would be whether the violation was the proximate cause of the injury. The court should, in answering this question, determine at the outset, by interpretation of the statute involved, whether the injured party belongs to the class of persons which the statute was designed to protect and whether the injury which has occurred is one of the sort which the statute was designed to prevent. If the court finds that the answer to either of these questions is in the negative, it should rule, as a matter of law, that the violation was not the proximate cause of the injury. If the court finds that the injured person is a member of the class of persons which the statute was designed to protect and that the injury which has occurred is of the sort which the statute was designed to prevent, there remain two questions; namely, whether the party violated the statute and whether the act of the party which violated the statute actually caused the injury of which complaint is made. If more than one inference can reasonably be drawn as to the answer to either of these two questions, it should be submitted to the jury for their finding as to which inference should be drawn.

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Taxation of Income—Dividends in Kind—Corporation's Liability

In a recent case[1] before the Circuit Court of Appeals for the Fifth Circuit, the taxpayer corporation held certain notes which had been charged off as wholly worthless and deducted as bad debts in previous income tax returns. In 1942, when it became apparent that some of the notes could be collected, the notes were declared as a dividend in kind and distributed to the stockholders. No value was placed on the notes by the corporation. The commissioner determined that the amount collected by the stockholders on the dividend notes was taxable as income to the corporation. The Tax Court reversed the commissioner, holding that a corporation does not realize income by its distribution of a dividend in kind.[2] The circuit court of appeals reversed the Tax Court. It held that the amount collected on the notes was income to the extent of the tax benefit received on account of the deductions previously allowed and was taxable to the corporation under the assignment of expectant income theory.

The taxpayer and the Tax Court relied on *General Utilities & Operating Co. v. Helvering*[3] for the proposition that a corporation does

[15] See note 6 *supra.*

[1] Commissioner v. First State Bank of Stratford, 168 F. 2d 1004 (C. C. A. 5th 1948).

[2] First State Bank of Stratford, 8 T. C. 831 (1947).

[3] 296 U. S. 200 (1935).

not realize income by its distribution of a dividend in kind. In that case the corporation had bought stock of another corporation which increased in value, and the corporation had a chance to sell it at a great profit. Rather than make the sale itself, it distributed the stock as a dividend in kind to its stockholders who in turn made the sale. The Supreme Court held that the corporation derived no taxable gain from the transaction.

The cases involving the tax consequences to the corporation of its distribution of a dividend in kind have tended to divide into two classes. 1. Where the dividend is declared in a specific amount of money and paid in kind, then the difference between the cost of the property in the corporation's hands and the amount of the dividend declared is taxable to the corporation, since it is using the property to pay off a debt.[4] 2. Where the dividend is declared in kind and paid in kind the difference between the cost and the present market value is not a gain or loss to the corporation.[5] The Supreme Court has never made this distinction even though in the *General Utilities* case the director's resolution read that "a dividend in the amount of $1,071,426.25 . . . is hereby declared . . . payable in the Common Stock of The Islands Edison Company. . . ." The commissioner contended that since the dividend was declared in a specific amount of money a debt was created which was paid off by the securities, but the Supreme Court did not discuss the point. The distinction does not seem to be justified because it makes the tax consequences depend upon the form of the director's resolution rather than upon any actual gain to the corporation.

In this type of case the purpose of the corporation in declaring a dividend in kind of property which has appreciated in value usually is to avoid the double taxation attendant upon the normal procedure of the corporation making a profit on the sale of the property and then distributing the profit to its shareholders.[6] Some courts have said that the purpose to avoid a tax does not establish tax liability,[7] but the circuit court of appeals in the *General Utilities* case[8] upheld the tax on the corporation on the theory that the whole scheme was contrived for the sole purpose of avoiding the tax and for this reason the sale was, in

[4] Bacon-McMillan Veneer Co., 20 B. T. A. 556 (1930); Callanan Road Improvement Co., 12 B. T. A. 1109 (1928).

[5] Commissioner v. Columbia Pacific Shipping Co., 77 F. 2d 759 (C. C. A. 9th 1935); First Sav. Bank of Ogden v. Burnet, 53 F. 2d 919 (App. D. C. 1931).

[6] In both the instant case and the *General Utilities* case the minutes of the director's meeting clearly showed that the purpose of the dividend in kind was to avoid tax consequences.

[7] *E.g.*, Gregory v. Helvering, 293 U. S. 465 (1935); United States v. Isham, 17 Wall. 496 (U. S. 1837); Chisholm v. Commissioner, 79 F. 2d 14 (C. C. A. 2d 1935).

[8] Helvering v. General Utilities & Operating Co., 74 F. 2d 972 (C. C. A. 4th 1935).

effect, made by the corporation.[9] The Supreme Court reversed on this point because it had not been raised in the Tax Court and thus could not be raised for the first time on appeal. So this approach might still be open to create tax liability even under the *General Utilities* doctrine.

In the instant case tax liability was imposed in a more direct manner. It has frequently been held that one who assigns future income is taxable for that income.[10] "The fruit is not to be attributed to a different tree from that on which it grew."[11] The reasoning behind these cases is that one who earns and has control over the disposition of income enjoys it and realizes it in the statutory sense as much when he assigns it to another as when he actually receives it. If the income is assigned in payment of an existing obligation or in return for other economic gain, it is obvious that the assignor realizes the income.[12] But even if the taxpayer makes a gift of the future income, it is still taxable to him.[13]

The notes represented possible future income since they had been charged off as worthless and deducted as bad debts on former income tax returns.[14] As stated by the court, "When the tax benefit for a bad debt is obtained, the debt loses its nature as capital and becomes representative of that portion of the taxpayer's income which was not taxed."[15] Thus any money collected on the notes by the corporation would be income and when they were distributed as dividends in kind to the stockholders the corporation was assigning future income, and the amount collected on the notes was properly taxable to the corporation.[16]

[9] *Cf.* S. A. MacQueen Co. v. Commissioner, 67 F. 2d 857 (C. C. A. 3d 1934) (corporation sold property to stockholder at a price less than its value. Stockholder then sold property and distributed the profit that he made on the sale to the other stockholders according to their holdings. *Held:* profit made on the sale by the stockholder is taxable to the corporation.).

[10] *E.g.,* Helvering v. Horst, 311 U. S. 112 (1940) (interest coupons assigned); Helvering v. Eubank, 311 U. S. 122 (1940) (commissions on renewal premiums assigned); Lucas v. Earl, 281 U. S. 111 (1930) (future salary assigned).

[11] Helvering v. Horst, *supra* note 10.

[12] Old Colony Trust Co. v. Commissioner, 276 U. S. 716 (1929); Lembcke v. Commissioner, 126 F. 2d 940 (C. C. A. 2d 1942); *see* Raybestos-Manhattan, Inc. v. United States, 296 U. S. 60, 64 (1935).

[13] *E.g.,* Helvering v. Horst, 311 U. S. 112 (1940); Commissioner v. Sunnen, 68 S. Ct. 715 (1948); Harrison v. Schaffner, 312 U. S. 579 (1941); Helvering v. Clifford, 309 U. S. 331 (1940).

[14] *E.g.,* St. Louis Refrigerating & Cold Storage Co. v. United States, 162 F. 2d 394 (C. C. A. 8th 1947); Helvering v. State Planters Bank and Trust Co., 130 F. 2d 44 (C. C. A. 4th 1942); National Bank of Commerce v. Commissioner, 115 F. 2d 875 (C. C. A. 9th 1940). INT. REV. CODE §22(b)(12) excludes from gross income the amount collected on the bad debts to the extent that the previous deductions did not result in a reduction of the taxpayer's tax.

[15] Commissioner v. First State Bank of Stratford, 168 F. 2d 1004, 1008 (C. C. A. 5th 1948).

[16] The dissent in the instant case insisted that if there were any tax liability it should be measured by the market value of the notes rather than the amount actually collected. For the purposes of this note it will be assumed that the majority decided this point correctly.

This point would also raise the corollary question of how the dividend would

Could the rule as to assignment of future income be properly applied to situations of the *General Utilities* type, where stock of another corporation which has appreciated in value is distributed as a dividend in kind? The rule has never been applied to gifts of property which has appreciated in value.[17] Thus the court in the instant case drew a distinction between this and the *General Utilities* case. Here the dividend consisted of charged-off notes, representing income, while there the dividend was of appreciated stock, a capital asset.

However, it is doubtful if this distinction should exist in the case of a corporation distributing a dividend in kind. In the case of a gift by an individual, Congress has provided that the basis of the property for the purpose of determining the taxable gain to the donee upon the sale of the property by the donee shall be the same as if the property were in the hands of the donor or the last owner who did not receive the property by gift.[18] Thus any appreciation in the value of the property while in the hands of the donor is taxable to the donee when he makes a sale. As long as this is the policy of Congress it would not seem to be desirable to attempt to tax the appreciation to the donor also. No analogous situation exists in the case of a corporation distributing a dividend in kind. There the property received as a dividend is taxable income to the stockholder at the market value of the property at the time the stockholder received it.[19] In case of a future sale of the property by the stockholder the basis of the property is the value at which it was taxable as income to him.[20] Therefore the appreciation which took place while the property was in the hands of the corporation is not taxed[21] and there would seem to be no good reason why that appreciation should not be taxed to the corporation.

Moreover, it would seem that the corporation realizes the income as much when the dividend is of appreciated stock of another corporation

be taxed to the shareholder. Would the amount realized on the notes be taxed as income as collected or would the notes be taxed at their fair market value at the time of distribution with any excess of amount collected over fair market value treated as capital gain?

[17] People v. Wendell, 196 App. Div. 613, 188 N. Y. Supp. 510 (3d Dept. 1921) is the only case found where it was attempted to tax the donor for the appreciation in value of property given away.

[18] INT. REV. CODE §113(a)(2); Taft v. Bowers, 278 U. S. 470 (1929). This section also provides that for the purpose of determining loss the basis shall be the same as for determining gain or the fair market value of the property at the time of the gift, whichever is lower.

[19] INT. REV. CODE §115(j); Commissioner v. Wakefield, 139 F. 2d 280 (C. C. A. 6th 1943); Golden State Theater & Realty Corp. v. Commissioner, 125 F. 2d 641 (C. C. A. 9th 1942).

[20] John H. Cook, 38 B. T. A. 651; *cf.* Commissioner v. Timken, 141 F. 2d 625 (C. C. A. 6th 1944).

[21] Of course the property is taxed at its appreciated value as income to the stockholder, but as a somewhat similar proposition a gift of property is subject to a gift tax at its appreciated value.

as when it is of charged-off notes. In both cases the corporation has earned the income and has control over its disposition. Since the primary purpose of the corporation is to make profit for its stockholders it can hardly be said that the corporation does not enjoy the benefit of the difference between cost and present market value when it distributes a dividend in kind of appreciated stock of another corporation to its stockholders. It would seem that a corporation should not be allowed to escape its normal tax burdens by declaring such dividends in kind, and by applying the principle of the instant case to the *General Utilities* case it would seem that a different result could be reached there.

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