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EDITORIAL

Lewis Gilbert Fisher

It is with a sense of heavy loss that we record the death of Lewis Gilbert Fisher. He died quite suddenly on March 5th at his home, which had been his birthplace sixty-eight years before, at Barrington near the city of Providence, Rhode Island. He had been in apparently good health to the very moment when he was stricken down by angina pectoris, and his passing was what he had wished it to be. The funeral services in the little Episcopal church in his native town were attended by most of the people in the community and by many representatives of accountancy from other states. Mr. Fisher was an outstanding member of his profession in Rhode Island and one of the eminent accountants of national reputation. Before the beginning of the American Institute of Accountants he was active and forward-looking and he played a very important part in accomplishing the success of the Institute. He was at various times a vice-president, member of the executive committee, chairman of the committee on state legislation. His tenure of office as a member of council was interrupted only by the year when he was vice-president. He was always present at annual and other meetings which it was possible for him to attend. Beyond these things he was ever a loyal advocate of high professional ethics and he practised what he preached. Most of all, however, he will be remembered as a staunch friend, an upright citizen, and a comrade altogether lovable. No one will fill his place in the affections of a multitude of friends. We shall miss him sorely.

Stock Dividends and Income

The question of the treatment of stock dividends by the recipient continues to excite a great deal of discussion and it is evident that there is a sufficient amount of difference of opinion to keep the question alive for some time to come. In the February issue of THE JOURNAL OF ACCOUNTANCY we commented at some length upon the general question and expressed the opinion that, in brief, a dividend in stock is not income while it remains stock. Naturally, it was expected that such a statement would evoke adverse comment. It is gratifying to find that it met with much approval, but it has never been the policy of this magazine to publish letters which praise what the magazine has contained. It does not seem quite the part of modesty or decorum to reproduce encomia. In the present instance, at any rate, we prefer to omit any commendation which has been received and to publish instead an adverse criticism. In selecting the letter which follows, we do so with mixed feelings, for the writer is one who was formerly chairman of the Institute's committee on publication and, therefore, had much to do with the editorial policy of the magazine. Furthermore, he is vice-president of one of the great companies which have followed the principle of making all distributions in the form of stock. We differ radically from some of the opinions which the letter contains, but respect profoundly the writer. The letter is long but well worth reading verbatim.

THE NORTH AMERICAN COMPANY
60 Broadway, New York

February 8, 1930.

Editor, *The Journal of Accountancy*,
DEAR SIR:

I have read the very interesting comments with regard to stock dividends which appeared in the editorials for February, 1930, and since you again refer to The North American Company as one of the conspicuous examples of companies making periodical distributions to stockholders in the form of stock dividends, I feel that I am, in a measure, privileged again to speak upon the subject. In doing this, may I take the liberty of referring, in some measure as to a text, to the last sentence but one of your editorials, which says, "It (accountancy) can no longer be restricted by the old boundaries of debit and credit."

Mr. Stagg's letter, from which you quote, refers very succinctly to the distinction which should be made between stock dividends of a periodical character and special stock dividends. He points out further that the leading tax case, upon which so much of the argument regarding stock dividends rests, dealt with a case involving a 50 per cent. stock dividend. I take it that Mr. Stagg's argument is that such a decision is not necessarily controlling in considering a periodical stock dividend and in this I am thoroughly in accord with him, as indeed I am with his entire letter.

I am not, however, equally in accord with some of the comments made in your editorials, or with the deductions which I think may reasonably be drawn from them, and, if I may be permitted to do so, I should like to take exception to them.

You say that even in circumstances wherein the distribution of a stock dividend does not flatten the price of the stock and the new shares have an immediate value in and of themselves without taking anything from the value of the older shares, you can not bring yourself to believe that a stock dividend is really income until it has been converted into cash. Is there not an inconsistency in this attitude? If a stock dividend is not income when it is received, how can it be changed into income by converting it into cash? If it is not income when it is received, what else can it be but capital? And when capital is converted from one form into another, it does not become income, although some part of it, representing a profit upon realization, may become income. This brings us back to the old idea of the proportionate ownership theory and the dilution of original cost upon receipt of a stock dividend, and we find ourselves where we were before we began to give consideration to the distinction between periodic stock dividends and special stock dividends. Happily that theory as applied to periodic stock dividends has been rather definitely discarded. We find that the law does recognize that a true stock dividend, which does not invade the original corpus, does itself, and not merely as to its proceeds or any part thereof, represent income. How then is it, if the stock dividend itself does actually constitute income, that it does not represent income when it is received, but only when it is converted into cash? Are we so ruled and governed by cash that we do not realize a gain by receiving anything else? I take it from your editorial, that your answer would be that what we received is only a part of what we had before, and yet the courts have ruled in several instances and the laws of several states hold otherwise.

We are, in fact, brought to the second point to which I take exception, namely, your analogy between a stockholder receiving stock dividends and a man owning a piece of land which increases in value. I realize, of course, that all analogies are dangerous and should not be construed too literally if they are in any way helpful in throwing light upon a discussion. This particular analogy, I believe, does not serve that purpose. May I try to amplify your illustration a little in ways which I believe will make it serve better as an analogy?

First, let us suppose that the land which the man buys for $1,000 is rather unproductive and that his means are very limited.

He may have a thousand acres and out of them he finds that one hundred are suitable for fairly intensive cultivation. On this one hundred acres he proceeds to grow a little wheat and perhaps some soy beans, or any other crop which a good agriculturalist would consider advantageous to the land, and with these crops he provides natural fertilizer and seed so that next year he can cultivate two hundred acres and so on. After a few years his thousand acres are productive and in cultivation, and he finds that they are worth $10,000. I do not believe the most orthodox even of those who still are restricted by the old boundaries of debit and credit would say that this man had not realized a profit every year, even though he might not have sold a dollar's worth of his crops. They would no doubt compute his profits very conservatively. They might even advise him that he was not subject to any income tax; but I venture to say that not one of them would so far belittle his efforts as to deny that he could take unto himself the meager pleasure of measuring his progress from year to year in dollars and cents on his ledger. They might not give him credit for $9,000 of profit; they might not even give him credit for the value of his own labor. I am almost sure they would tell him that his personal effort would only be paid for from the neck down and that he had contributed nothing beyond the services of a day laborer to the value which he had created. Perhaps they are right, because we are making use of your analogy, which treated of a kind of property to start with of which no part could be realized without sacrificing a part of what was specifically there in the first instance, namely, the land. To that extent, therefore, the analogy is still not a true one, because a company like The North American Company is constantly creating new values which did not exist before, even in the germ, and the stock which is issued against those values is both separate and separable from the original stock, except to the extent that that which gives such additional stock a value in excess of the steel, bricks, mortar and day-laborers' wages which went to create the tangible property that has now been converted into earning power, may be regarded as being inherent in the original stock. To this extent it is equally true that there is something approaching a pound of needles in a pound of fine grade steel. It requires only a little genius to get them out.

May I make use of your analogy in a second way which also, I think, renders it more applicable to the argument? Supposing the purchaser of the real estate finds that he has bought a plot with a building on it so constructed that several more stories can be added to it when desired. He operates this building at a profit and reinvests all of the profits in the construction from time to time of additional stories. No one will question that he has made a profit, even a taxable profit.

It is only if he has taken the precaution upon the acquisition of the property, in either of the forms into which I have twisted your analogy, to form a corporation to own and operate his property that he is found, on the theory to which I take exception, to have deprived himself of any income. Even if he issues stock dividends from year to year, representing the additional tangible property and earning power which he has created, he is presumed not to have realized any income unless he sells the stock. To hold this opinion appears to me to involve the torturing of the principle of realized profit within unreasonably narrow limits. Cash, which is only the shuttle, is raised to a dignity greater than the looms, the power plant and the structures of industry. To receive a stock certificate representing a share in a growing enterprise is to realize nothing, but to exchange that stock certificate for cash, which is itself useless until it is reinvested, is made the test of a realized gain.

In either of these hypothetical cases it would, of course, be easy to show that the additional values created by the reinvestment of the earnings were largely in excess of the cost of the tangible units added to the property. Additional invested capital, however, does not always produce equally generous results, otherwise we should not be willing to pay more for one security than for another.

Coming to your example of the two stockholders, A and B, each of whom received a stock dividend on October 1, 1929, when the market price of the stock was $100, and who find later that the value of the stock has gone down to $10 a share, I personally maintain that their income in the first instance was $100 in each case, and that the one who left his income invested in the shares of stock suffered a loss of $90 just as positively as if he had sold his dividend stock and reinvested the proceeds in some equally desirable security which similarly developed at a later date the tendencies of a great character in *Paradise Lost*. Let us turn the example another way. Supposing the dividend stock had been issued at some earlier date, and that by October 1st, the stockholder who kept his stock found that it was worth $200, would you say that his income was twice that of the man who sold his stock immediately upon receipt for $100? This, it seems to me, would be an unusual way of looking at the matter.

It was my understanding that the discussion has got beyond the point as to whether a true periodic stock dividend is or is not income upon its receipt. That it is income upon receipt appears to be accepted in most quarters generally regarded as endowed with a certain degree of authority to speak for the community. I think that everyone recognizes that stock dividend income falls into a special classification which must not be merged without specification with other income. It is undesirable that it should. There is, after all, a certain degree of assurance to a stockholder in reading an income statement to know that that part at least of the income is reinvested in securities which have proved themselves to be sound and productive. The rest of the income, which is unfortunately received in cash, may not fare so well when it is reinvested. The stockholder will scrutinize the balance-sheet with some anxiety to see what has been done with it, and the balance-sheet often will not afford him the information he most wishes to have; but of the stock dividend income he can feel assured.

The real question at the present time is the value at which stock dividends should be taken into income, and, as your editorial indicates, this is still so much under discussion that it would be trespassing too far upon your columns and your good nature to attempt to go into that question in this letter.

Yours sincerely,

HERBERT C. FREEMAN.

Other Opinions Are Invited

This letter is welcome, not only because of Mr. Freeman's criticisms of comments which have appeared in these pages, but also because it affords an opportunity for continuing discussion of a most important question. In referring to the statement that we did not believe a stock dividend was income until it had been converted into cash, Mr. Freeman seems to imply that we admitted that the whole of the income would be income as soon as the dividend stock had been realized. But the next succeeding sentence in our comments reads as follows: "Furthermore, as one correspondent asks, when the stock is sold why should not part or all of the proceeds be treated as a reduction of cost or book value of original holdings, upon which the stock dividend was based." It would be interesting to pursue the discussion further, but before attempting to do so we invite further expression of opinion on the important questions involved. It is hoped that members of the profession who agree or differ with Mr. Freeman's views will give expression to their opinions.

International Double Taxation

An important conference on the subject of double taxation was held in the city of Washington on February 14th, when about 150 men, representing various interests, were present. At the request of the secretary of the treasury, the president of the American Institute of Accountants appointed two representatives, Joseph E. Sterrett, member of the executive committee, and Charles R. Trobridge, chairman of the committee on federal legislation. The question which was the cause of calling the conference was one of vital importance to many corporations and many taxpayers. As an illustration of the extent to which double taxation sometimes goes, the following instance was cited: A company which owned the majority of stock of a French corporation would have to pay the following taxes in France: first, a tax of 15 per cent. on the profits of the French corporation; second, a tax of 18 per cent. on all dividends distributed by the French corporation, and, third, a tax of 18 per cent. on the proportion of the dividends distributed by the parent company considered to be applicable to the earnings of the French subsidiary. It was pointed out that most European countries tax dividends, but France is the only one at present which attempts to tax dividends distributed by corporations owning stock in a French corporation. Other examples of the imposition of double taxation were adduced by delegates, and it was the unanimous opinion that something should be done to relieve the present condition. Dr. Thomas S. Adams described the proposals for relief and stated that most countries seemed to favor a proposed convention which would provide that tax should be levied only at the place of residence of the taxpayer. On this theory a non-resident alien of the United States would not be taxed on any interest or dividends from sources within the United States or on book and patent royalties from sources within the United States or from casual business profits from such sources. He would, however, be taxed on mining royalties and income from real estate within the United States, and on compensation for personal services rendered in the United States and from business income when a permanent establishment is maintained in the United States. The difficulties of determining a fair allocation of profits on income derived from sources partly within and partly without the United States were emphasized. E. C. Alvord, special assistant to the secretary of the treasury, also discussed the proposed legislation. He summarized the provisions as follows: In the case of non-resident aliens three classes of income would be subject to tax in the United States: (1) business income earned through permanent establishments in the United States, (2) income from personal services in the United States, and (3) income from real property in the United States, that is, from rents, royalties and profits. George O. May, another member of the double taxation committee of which Dr. Adams is chairman, addressed the meeting on the subject of basis of allocation and apportionment. He hoped that the attitude of the treasury department would be liberal. Mark Graves, of the New York state tax commission, and many representatives of various industries spoke, but the meeting adjourned without passing any formal resolution. It was called for the purpose of discussion and it is expected that as a result of the deliberations which took place there will be a substantial advance toward settlement of the complex question of double taxation. In such a question as this accountants must play an important part.

Questions and Answers to be Published

Since the establishment of the library and bureau of information of the American Institute of Accountants it has been the custom of the librarian to issue from time to time, but not at stated intervals, bulletins containing questions and answers which have passed through the library. These bulletins have met with cordial reception and have served a most useful purpose. The questions which are selected for publication are usually those which have a general interest, and an effort has been made to avoid publication of questions which would probably concern only a small number of readers. Out of the thousands of questions which are answered each year by the library, the great majority can be answered without reference outside the bureau of information, but when complex or highly technical questions arise which have not been the subject of any written discussion, it is the practice to refer such questions to a committee of three or more practising accountants whose experience renders them capable of answering. As most of our readers know, the identity of the questioner and the personnel of the committee which replies are not divulged. The one who asks has no idea who answers and those who answer do not know who propounded the question. In this way it is possible to encourage a freedom of expression which might not be possible if the identity of the parties were known. The importance of these questions and answers has increased with the years and it has seemed desirable that some means should be provided which would give them wider circulation. Accordingly, it has been decided to abandon for the time being the custom of publishing special bulletins by the library and to include in THE JOURNAL OF ACCOUNTANCY representative questions and answers in a special department devoted to that purpose. The department will probably not appear every month but whenever there are questions which seem to be of general interest and the replies are available, we hope to publish them for the general information of readers. It is the rule of the bureau of information that questions propounded by members of the Institute are to be answered if possible. Persons who are not members can not expect to have all their questions settled for them, and there is no desire to encourage a general questioning attitude, but if readers have problems which they are totally unable to solve they may be submitted and it will rest with the committee to decide whether or not they should be answered. Let it be understood that this service is primarily and chiefly for members of the Institute. Questions of taxation will not be answered and persons who desire to receive accounting counsel should not address their questions to the Institute but to some public accountant in whom they have confidence.

The Lustrum of Wisdom

A correspondent, who has been reading editorial notes which appeared in THE JOURNAL OF ACCOUNTANCY recently on the subject of employment for men of middle age or older, sends us a clipping from a metropolitan newspaper which he regards, with apparent justice, as an indication that this is the age of youth. The clipping contains advertisement for an accountant or an office manager: "The man we want should be between 25 and 30 and possess outstanding executive ability. He must have broad experience in modern accounting methods, business, finance, cost and productive control systems, office management, etc. The job requires initiative, vision and the ability to get results." One sees at a glance that this must be a good man, but the point which distresses our correspondent is the age limit. He feels that a man who had had broad experience and had outstanding executive ability might not always be found within that narrow lustrum which ends on the boundary of that antique world which marches with thirty years. It might be possible to find the sort of man required if he had begun early. For example he might have taken up the question of executive control in primary school and as he advanced through the mature processes of secondary education he might have achieved that broad experience in modern accounting methods, business, finance, etc., which would qualify him to occupy the capacious chair which seems to be vacant. Between the ages of twenty and twenty-five he might have acquired a thoroughly competent knowledge of all the questions which distress the business world and then, having reached the end of that first quarter century, he might for a period of five years devote himself to directing the conduct of modern business. Our correspondent is all wrong—very wonderful men can be found between the boundaries which the advertisement sets. And, really, those of us who comment upon such subjects may be a little jaundiced in our views. There is not one of us who wouldn't be glad to go back to those expansive years if we could. Such people as we are crabbed, old critics, who are not really sufficiently appreciative of what younger men may do. The men who inserted the advertisement knew better.