Capital-Stock Stamp Tax Hallucinations

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By Edmund M. Meyer

The issuance of capital stock of no face or par value is now authorized by a number of states in the union. Much has been written regarding the advantages, disadvantages and methods of recording it in the books and showing it in the balance-sheet. Congress has recognized it by providing a *special* tax on its issuance and transfer. The term special tax is used, as the tax on non-par-value stock differs materially from that on stock with a par value, although from a casual reading of the revenue acts it would appear that the tax was intended to be the same.

The revenue acts of 1921 and 1924 provide for a stamp tax on capital stock as follows:

With par value:

- Original issue—5 cents on each $100 of face value or fraction of the certificate.
- Transfers—2 cents on each $100 of face value or fraction of each certificate.

Non-par value:

- Original issue—5 cents a share unless the actual value is more than $100 a share, in which case the tax is 5 cents for each $100 of actual value or fraction thereof; if the actual value is less than $100 a share, then the tax is 1 cent for each $20 of actual value or fraction thereof.
- Transfers—2 cents a share, regardless of value.

The treasury department has ruled on the above under articles 2 (a & b) and 10 (a, b & c) of regulations 40. Under date of August 17, 1923, the department held that the transfer tax on shares of non-par value stock is 2 cents a share (16149a Prentice-Hall tax service).

From a casual reading of the law and regulations it would appear that full justice and equity results; e. g., where one corporation issues stock of $100 par value a share and another issues non-par value stock for $100 a share, the tax on the original issue would be 5 cents a share and on transfers 2 cents a share in each instance.

In industrial enterprises the usual value for a share of stock is $100 regardless of whether it has a par value or not. However, in the mining industry, especially metal mines in the northwest, stock is issued with a par value of ten cents to one dollar a share. Most mining companies that have capital stock with a par value issue the entire amount of authorized stock in payment of mining claims. In order to obtain funds for prospecting and development, the party receiving the stock donates the major portion of it back to the company for working capital. Such stock, being treasury stock and having been fully paid for, can then be sold by the company for less than its par value.

As most mining claims are merely prospects, the company obtains funds for development by selling stock for a fraction of its par value, often for one and two cents a share. As development shows increasing quantities of ore or larger values, the price of the stock is increased to future investors. It is not at all uncommon for a mining company to issue its treasury stock at prices ranging from 1 cent to 25 cents a share.

In order to circumvent the fallacy of issuing the entire capital stock for the claims and the promoter donating back most of the stock for resale at less than par, the state of Washington recently passed a law providing for non-par value stock. Under this law the Prudent Silver Mining company was organized with an authorized capital of 6,000,000 shares of non-par value stock. To date this company has sold its non-par value stock at from 1 cent to 25 cents a share, according to the stage of development of the properties.

Now, what is the *special* tax on the original issuance of this non-par-value stock? The law and regulations provide and the department has so held that the tax is 1 cent a share if the actual value of the share is $20 or less. Following is a summary of the tax:

	Amount received by company	Stamp tax	Per cent of tax to capital
1,000 shares sold for 1 cent	$ 10	$10	100%
1,000 shares sold for 2 cents	20	10	50%
1,000 shares sold for 5 cents	50	10	20%
1,000 shares sold for 10 cents	100	10	10%
1,000 shares sold for 25 cents	250	10	4%

Rather amusing, but wait. Some of this stock has been resold, transferred, for ½, 1, 2 and 3 cents a share. The tax on such transfers, according to the never-to-be-sufficiently-censored tax laws, is 2 cents a share, regardless of values, as follows:

	Amount received by seller	Stamp tax	Per cent of tax to S. P.
1,000 shares sold for ½ cent	$ 5	$20	400%
1,000 shares sold for 1 cent	10	20	200%
1,000 shares sold for 2 cents	20	20	100%
1,000 shares sold for 3 cents	30	20	67%

The tax is imposed upon the seller. How can sales be made under the above conditions?

The Hypotheek Mine stock has a par value of 10 cents a share and is being resold at from 1 to 2 cents a share. The tax on the original issue, if sold for par, is 5 cents for 1,000 shares and 2 cents for the transfer of 1,000 shares as against $10 and $20 for Prudent stock of non-par value.

The following summary and comparisons of the tax on the stock of the two companies will show the absurdity of the law and present interpretations of the department:

	Amount received	Tax
Prudent stock (non-par)		
Original Issue:		
1,000 shares at 10 cents	$100	$10
Transfers:		
1,000 shares at ½ cent	5	20
1,000 shares at 1 cent	10	20
1,000 shares at 2 cents	20	20
1,000 shares at 3 cents	30	20
Hypotheek stock (par 10¢ a share)		
Original issue:		
1,000 shares at 10 cents	100	.05
Transfers:		
1,000 shares at 1 cent	10	.02
1,000 shares at 2 cents	20	.02
1,000 shares at 3 cents	30	.02

The Hypotheek can sell 1,000 original shares for $100, the par value, with a tax of only 5 cents; but the Prudent must pay a tax of $10 for 1,000 shares sold for $100. If the holder of Prudent stock desired to sell for 1 cent a share, he would have to pay 2 cents a share tax; in other words, it would cost him 1 cent to dispose of the stock by way of sale. Let us carry the comparisons a little further. The tax on the transfer of 1,000 shares of Prudent stock is 200% of the tax on the original issue at 10 cents; while on Hypotheek stock the tax on transferred stock is only 40% of the tax on the original issue. The tax on the transfer of 1,000 shares of Prudent stock is $20 as against 2 cents for Hypotheek.

Is it conceivable that congress intended to penalize non-par-value stock in this manner? Would the courts permit such confiscation and the resulting inability of mining companies to operate in a manner permitted by state laws? I doubt it. Is the commissioner right in his interpretations of the law? I have a letter dated August 6, 1924, signed R. M. Estes, deputy commissioner, confirming the department's present attitude as above outlined.

Now some may ask, "Why not sell the stock for $100 a share instead of a few cents?" That is not practical. In order to enlist the aid of capital for the development of a hole in the ground, the small investor must be attracted. He will invest small amounts in the early stages of development and is entitled to more benefits than one who invests after the showings of ore or values increase. Many investors during the development stages invest with the sole idea of selling their stock at increased prices.

Regardless of reasons for selling mining stocks for a few cents a share, the fact remains that, under the present interpretations of the law by the department, no company can sell non-par-value stock for a small price a share, as the stamp tax will result in 100% confiscation of the capital. Nor can stock of non-par value be resold for a few cents a share.