

1561.

APPROVAL, NOTES OF WILMOT VILLAGE SCHOOL DISTRICT, STARK COUNTY, OHIO—\$1,224.00.

COLUMBUS, OHIO, September 14, 1933.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.

1562.

APPROVAL, NOTES OF STOW TOWNSHIP RURAL SCHOOL DISTRICT, SUMMIT COUNTY, OHIO—\$14,442.00.

COLUMBUS, OHIO, September 14, 1933.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.

1563.

APPROVAL, NOTES OF UNION RURAL SCHOOL DISTRICT, UNION COUNTY, OHIO—\$3,758.00.

COLUMBUS, OHIO, September 14, 1933.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.

1564.

DIVIDEND—LIQUIDATING DIVIDEND OR DISTRIBUTION OF CAPITAL BY CORPORATION NOT INCOME YIELD—EFFECT OF EXCESS VALUATION OF ASSETS THEREON—AUTHORITY OF TAX COMMISSION TO COMPEL PRODUCTION OF EVIDENCE AND DETERMINE NATURE OF TAXABLE PROPERTY DISCUSSED.

SYLLABUS:

1. *A liquidating dividend or distribution of capital by a corporation to its stockholders is not income yield, within the meaning of that term as defined in Section 5389, General Code.*

2. *When the board of directors of a corporation declares a dividend payable from the surplus of the company it is to be presumed that such board of directors determines that the conditions at that time existed which would comply with the provisions of Section 8623-38, General Code, and the mere fact that at a later date the board of directors decided that certain assets of the company were carried on*

the books at a figure so excessive that the dividend could not have been legally declared by reason of the requirements of Section 8623-38, General Code, is not sufficient to rebut the presumption of good faith on the part of the directors, and does not change the nature of such distribution from dividends to liquidating dividends to such an extent as to change the manner of assessing the tax on the capital shares of such corporation in the hands of its shareholders from productive investments to unproductive investments.

3. *The Tax Commission, by virtue of the provisions of Sections 1465-12 to 1465-17, General Code, has the equivalent power to compel the production of evidence concerning and to determine the nature of taxable property as is possessed by courts of common pleas in matters within their jurisdiction, and therefore is not bound by the nomenclature of assets as designated on the books of the taxpayer.*

COLUMBUS, OHIO, September 15, 1933.

The Tax Commission of Ohio, Columbus, Ohio.

GENTLEMEN:—I am in receipt of your request for my opinion, which reads, in so far as material, as follows:

“It appears that the Far Hills Holding Company declared dividends at a time when the books of the company disclosed a surplus sufficient in amount. It appears, however, that at the time the actual value of the stocks held by the Far Hills Holding Company were so depreciated on the market that there was in fact no surplus, but a deficit. Such being the case, it is contended that the dividends were illegal and in any event, liquidating dividends.

We request your formal opinion concerning the right of the commission to go into the question of the legality of dividends under the above circumstances.”

For the purpose of clarity, I might state briefly the facts which in part formed the basis of my earlier informal opinion issued under date of June 23, 1933, to which you refer in your request.

During the calendar year 1931, the Far Hills Holding Company had issued and outstanding one hundred thousand non par shares having a declared value as shown by the balance sheet of the company of \$10,515,672.00. It further appears that no reserves whether for contingent losses, depreciation, obsolescence or otherwise, were set up on the books of the company; that on December 31, 1930 dividends amounting to \$350,000.00 were declared, payable on January 7, 1931; that on June 6, 1931 dividends amounting to \$25,000.00 payable on June 15, 1931 were declared; that on July 8, 1931, dividends amounting to \$50,000.00 payable July 13, 1931 were declared.

For the purposes of this opinion, I am assuming that the dividends in question were paid on the dates declared to be payable. In other words, during the year 1931, dividends amounting to \$425,000.00 were paid to stockholders. I am further informed that Mr. P. was the sole owner of the shares of stock of the Far Hills Holding Company. The dividends in question, in so far as the records of the company were concerned, were paid from surplus. However, it further appears that subsequent to the payment of such dividends an evaluation of the corporate assets was made, and it was thereupon determined that the book value of the assets was excessive. In other words, during the year 1932, it was determined that the remaining assets of the corporation after the declaration of the

dividends, was \$1,589,129.53 and that the liabilities of the company other than those to shareholders, as such, amounted to \$1,566,908.12 or that the net worth of the company was \$22,221.41, whereas, the stated capital of the company was \$10,515,672.00.

In my informal opinion above referred to, I held that a liquidating dividend was not income yield, within the meaning of that term as defined in Section 5389, General Code, which in substance, defines income yield, with reference to shares of stock, as the amount of cash dividends separately charged and paid during the year.

By reason of the foregoing statement of facts, it is contended that the dividends declared and paid during the year 1931, were liquidating dividends or return of capital to the shareholders, and by reason of such fact, could not be used as the measure of tax on the shares of stock of Mr. P.

If the hypothesis or assumptions of such contention were to be admitted, I would not be inclined to differ with the taxpayer, by reason of the holdings of the court with reference to liquidating dividends. See *Wilberding vs. Miller*, 90 O. S. 38, Syl. 2; *State vs. Bank*, 11 Ohio 94; *Larwell vs. Burk*, 19 O. C. C. 513; *Mobile Nav. Co. vs. Tenn.* 153 U. S. 486.

The argument in favor of the taxpayer is probably based upon the theory that the dividends were illegally declared; that is, the records of the company were not set up in such manner that the board of directors could determine whether or not a dividend could be declared from surplus as would meet the requirements of Section 8623-38, General Code. The pertinent part of such section reads:

"(a) A corporation may declare dividends payable in cash, shares, or other property out of the excess of the aggregate of its assets less the deduction hereinafter required over the aggregate of its liabilities plus stated capital.

(b) In computing the excess of the assets, deductions shall be made for depletion, depreciation, losses, and bad debts. In computing the excess of assets for the purpose of determining the fund available for a dividend payable otherwise than in shares of a corporation deduction shall also be made for the unrealized appreciation, if any, appearing on its books unless the amount thereof shall have been transferred to or included in stated capital. If its articles so provide, a corporation whose business consists substantially of the exploitation of wasting assets, may pay dividends without making deduction for the depletion of such assets resulting from lapse of time or from the consumption or sale of such assets incidental to their exploitation.

(c) No corporation shall declare or pay a dividend in cash or other property when there is reasonable ground for believing that it is unable or, by the payment of the dividend, may be rendered unable to satisfy its obligations and liabilities.

(d) Whenever a dividend is paid, in whole or in part, out of other than earned excess of assets appearing on the books of the corporation at the time of the declaration of such dividend, the shareholders receiving such dividend shall be notified as to its source."

It is an elemental rule that courts should not presume that business men act in an illegal manner in the conduct of the affairs of the corporation. The presumption therefore is that at the time the dividends in question were declared

the board of directors made deductions for depletion, depreciation, losses and bad debts, as required by the statute above quoted and that all other terms and requirements of such section were complied with by the board of directors, and such presumption can only be overcome by clear and convincing evidence.

From the facts submitted along with your request, it appears that the assets of the company consisted of certain federal farm loan bonds, liberty bonds and certain shares of stock in other corporations, which items were carried on the books of the company at the cost price to the company, which price as to certain stocks owned by the company was decidedly in excess of the market value of the stocks on the 31st day of December, 1931.

While I realize that under ordinary circumstances, the market value of shares of stock should correspond with the actual value; that is, ordinarily a commodity is worth that sum at which a willing seller who is not obliged to sell, will enter into a sales agreement with a purchaser who is not obliged to purchase the commodity; yet by reason of the chaotic condition which existed in the stock market during the years 1931, 1932 and 1933, I am unable to say that the quoted market price is or is not the actual value of shares of stock. For instance, during such period many shares of stock which were dividend paying and having a par value of \$100.00 were quoted on the market as having little or no value. To state it another way, in a great number of instances the quoted price represented sales made by an owner who was compelled to sell to a purchaser who was afraid to buy, and such psychological status was reflected in the quoted price.

While I am herein laying down no rule concerning the proper method to be used by corporation issuers of stock in fixing the value of such assets to the corporation, it would appear that since the board of directors of the Far Hills Holding Company were bound by the provisions of Section 8623-38, General Code, to determine whether or not a surplus existed in the assets of such corporation at the time of the declaration of the dividends in question and did declare the dividends as payable from surplus such finding of the board of directors should not be disturbed in the absence of clear and convincing evidence of bad faith or fraud on the part of such board of directors. The mere fact that at a subsequent date the board of directors in the use of their discretion determined that certain of the assets were carried on the books of the company at an excessive figure does not appear to me to be sufficient evidence to overcome the presumption as to the legality of such dividends.

While I have to some extent commented upon the method by which the dividends in question were declared as having evidential value in determining whether or not the dividend was or was not a liquidating dividend, yet I do not intend to rule that the Tax Commission has no authority to accept additional evidence or even to make its own investigation for the purpose of determining the exact nature of any taxable asset. Sections 1465-12 to 1465-17, General Code, give to the Tax Commission the equivalent power as to the production of evidence in such matters as is possessed by a court of common pleas as to the production of evidence in matters within their jurisdiction. It would therefore appear that the Tax Commission has ample evidence to investigate into and power to determine the nature of taxable assets.

In specific answer to your inquiry it is my opinion that:

(1) A liquidating dividend or distribution of capital by a corporation to its stockholders is not income yield, within the meaning of that term as defined in Section 5389, General Code.

(2) When the board of directors of a corporation declares a dividend payable from the surplus of the company it is to be presumed that such board of

directors determines that the conditions at that time existed which would comply with the provisions of Section 8623-38, General Code, and the mere fact that at a later date the board of directors decided that certain assets of the company were carried on the books at a figure so excessive that the dividend could not have been legally declared by reason of the requirements of Section 8623-38, General Code, is not sufficient to rebut the presumption of good faith on the part of the directors and does not change the nature of such distribution from dividends to liquidating dividends to such an extent as to change the manner of assessing the tax on the capital shares of such corporation in the hands of its shareholders from productive investments to unproductive investments.

(3) The Tax Commission, by virtue of the provisions of Sections 1465-12 to 1465-17, General Code, has the equivalent power to compel the production of evidence concerning and to determine the nature of taxable property as is possessed by courts of common pleas in matters within their jurisdiction, and therefore is not bound by the nomenclature of assets as designated on the books of the taxpayer.

Respectfully,
 JOHN W. BRICKER,
Attorney General.

1565.

APPROVAL, NOTES OF BERGHOLZ VILLAGE SCHOOL DISTRICT, JEFFERSON COUNTY, OHIO—\$4,365.00.

COLUMBUS, OHIO, September 15, 1933.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.

1566.

APPROVAL, BONDS OF WHITE EYES TOWNSHIP RURAL SCHOOL DISTRICT, COSHOCTON COUNTY, OHIO—\$17,000.00.

COLUMBUS, OHIO, September 15, 1933.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.