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Report of the Special Committee on Stock Dividends New York Stock Exchange

New York Stock Exchange. Special Committee on Stock Dividends

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IN the requirements for the listing of investment trusts recently promulgated by the Stock Exchange, a provision was incorporated to the effect that investment trusts should not include stock dividends in their income accounts. In recent weeks, the wisdom of this ruling has been the subject of discussion between the Stock Exchange and representatives of many companies affected by its operation, and a special committee has been looking into the question of stock dividends from the point of view of the Exchange with a view to clarifying the issues involved.

Based on the report of this committee to the Governing Committee, the following statement of position is made: The interest of the Stock Exchange in the method by which companies account for stock dividends arises out of its consistent policy of attempting to obtain, in connection with corporate returns, such a clear disclosure of the relevant facts as will enable the investor to properly appraise the listed securities in which he is interested.

The stock dividend has, in late years, become an important instrument in the financial policy of American corporations, and there can be little doubt that its use is still in the early stages of development. In particular is it of value to corporations in growing industries requiring the use of large additional amounts of capital, as it permits them in some measure to obtain this capital in the simplest manner from their own stockholders, and, at the same time, permits these stockholders, if they are so inclined, to realize upon their share of current or past earnings so capitalized.

Coincident with the development of the stock dividend, there has taken place the development of the less than $100 par and of the no par value stock, together with the practice of having large capital or paid in surpluses; and these relatively new conceptions have led with increasing frequency to the corporate practice of partial or complete recapitalization through the form of so-called "split-ups."

As a matter of definition from the point of view of the Exchange, a true stock dividend represents the capitalization, in whole or in part, of past or current earnings; while a split-up has not of necessity any relation to earnings and may mean nothing more than a change in the form in which ownership in an existing situation is expressed.

Accounting practice, in striving to adapt itself soundly to these important developments in corporate procedure, has not yet reached the point where a mere perusal of the year's accounts will suffice to reveal to the average investor in what manner he has been affected by action taken during the year in the matter of stock dividends. On this account, it is felt that the Exchange is justified in seeking to obtain wherever possible for the benefit of the investor such supplementary information as may assist him to a correct understanding of the accounts themselves.

Applications for listing which involve questions relating to stock dividends will be considered in the light of the foregoing. In view of the large and constantly increasing number of listings on the Exchange, either originating in stock dividends or involving questions that have to do with stock dividends, an effort will be made to obtain for the investor such information as may place him in the position to determine in connection with stock dividends received by him, to what extent they constitute true stock dividends representing the capitalization of current or past earnings, and to what extent, if at all, they represent merely split-ups involving an expression in a new form of what was already his. In any event, it is felt that the individual investor should make such independent investigations as seem desirable in order to be quite sure that he understands in each instance how he has been affected by the declaration of a stock dividend.

When stock dividends are received by investment trusts, holding companies or other corporations, the manner in which these dividends are accounted for by the receiving company presents a problem somewhat different from that attending the accounting for the payment of stock dividends by the declaring company. Current practice varies all the way from the policy of ignoring stock dividends in their entirety in the income account of receiving companies, to the policy of taking them into the income account whether they have been realized upon or not at the full market value on the date received.

Uniform accounting practice today seems to favor as sound procedure the ignoring of stock dividends in the income account of receiving companies. However, it has been urged on behalf of investment trusts, holding companies and others, with what seems to us to be some measure of justification, that a technical interpretation of the nature of stock dividends may operate to hamper management in the adopting of perfectly reasonable and proper dividend programs of their own, whether in cash or in stock, and may even under certain circumstances force them as recipients, for technical reasons, to realize upon stock dividends which for business reasons they would have preferred to hold.

It may be that accounting practice will undergo certain modifications in the light of these new tendencies, but it is too early to form an opinion as to the direction that this modification is apt to take. It is possible that a schedule of all stock dividends received will suggest itself as a desirable addition to the annual report of investment trusts, holding companies and others; or, conceivably, a new departure in accounting theory may permit the inclusion of stock dividends in some form or other in the income accounts of receiving companies.

At the present time, it appears as if the Exchange could go no further than to take the position that it will raise no objection to the method by which investment trusts, holding companies and others account for stock dividends received by them and not realized upon, provided there is the fullest disclosure of the procedure adopted, and provided that these are not included in the income accounts of the receiving companies at a greater dollar value per share than that at which they have been charged to income account or earned surplus account by the paying companies. The manner in which receiving companies account for stock dividends received by them and realized upon during the period under review is a matter which the committee will pass on in connection with each specific instance.

Richard Whitney,
Frank Altschul,
Roland L. Redmond,
J. M. B. Hoxsey,

September 4, 1929.

Recommended to the Governing Committee by a joint meeting of the Law Committee and the Committee on Stock List, held September 9th, 1929.

Ashbel Green, Secretary.

Adopted by the Governing Committee, September 11, 1929.

Ashbel Green, Secretary.

Investment Trusts

(Continued)

I—Survey *(Concluded)*

A SECOND practice relative to the receipt of stock dividends is to assign a value at market, and to credit that amount to income. This practice has been followed by one of our important investment trust clients.

The ordinary procedure of this client on selling securities is to take profits on the basis of the average book value of all shares held. If shares received into investment account as stock dividends were sold, the utilization of the average book value basis would result in taking into income not only the market value of the shares at date of receipt, but also a sales profit corresponding to the amount by