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Principles Governing the Amounts Available for Distribution of Dividends*

By CHARLES B. COUCHMAN

Stockholders of corporations are a constantly increasing percentage of the people. One reason for becoming a stockholder is the expectation of receiving dividends from the corporation's profits. Dividends, therefore, are of primary interest to stockholders and to the officers of corporations. Principles governing the amounts that may or may not be paid deserve careful thought by all concerned. If the amounts paid out today are larger than they should be, the stockholder of today profits unduly at the expense of the stockholder of tomorrow. If the amounts paid out today are less than they should be, an undeserved benefit passes on to the stockholder of the future and the stockholder of the present suffers unduly.

The various agencies whose function it is to calculate such amounts have not yet reached a degree of skill that will enable them to make accurate determination. There are too many variable and indeterminate factors. Too much of prophetic vision is required to reduce the amounts to exact dollars. Nevertheless some progress has been made. Some pitfalls have been uncovered. Some erroneous methods have been so proved. It is well to summarize the principles that have been established so that advantage may be taken of them and also so that the way may be cleared for further progress.

Principles, to deserve such designation, must be of aid in the determination or expression of truth or must be for the benefit of

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parties concerned or the community as a whole. With regard to dividends, the parties at interest are the creditors and the stockholders, both of the present and of the future. The rights and interests of all, particularly of the commercial community, must be recognized in defining principles governing the distribution of dividends.

Dividends, other than so-called capital-stock dividends, are either a repayment of investment or a distribution of accumulated ownership in excess of investment, known as earnings or profit. It is with dividends representing distribution of such earnings or profit that the investing world is chiefly concerned. The determination of the amounts available for such distribution with regard to any corporation involves (1) the measurement of such earnings or profit, and (2) the limitations upon such distribution imposed by law, by economic conditions or by managerial policy.

Statutory law enters into the matter only for the purpose of determining and protecting the rights of each party directly concerned and of the community in general. Where matters arise, not contemplated or covered in the laws, the efforts of all parties must still be toward the determination and protection of the rights of the parties themselves and the community as a whole. To the extent that they fail in this, commercial enterprises in general and the efficiency of the community capital suffer.

Capital

The measurement of earnings or profits involves a proper separation of investment from accumulated ownership additional thereto. This requires an understanding of capital and its functions in business. In any consideration of capital, it is necessary to indicate very definitely the content and limitations intended by that term. In this discussion we are applying it to the assets of an individual or organization in excess of the amount necessary to liquidate liabilities to creditors.

No single and exact definition for this term is at present accepted in the economic, commercial and legal worlds. In its broadest usage, it applies to property utilized, not for direct consumption, but rather as an aid in the production of additional property. Such usage, therefore, practically includes all assets of a business, not only those directly owned but also those elements representing property advanced to others or receivable from others. In such a usage there is evidently a duplication, as property held by one organization, but owing to a second, would by such usage be included in the capital of each. The commercial world has attempted to eliminate such duplication by excluding from the capital of each organization that portion of the assets owed to other parties. A deduction, therefore, of the amount of liabilities of any commercial unit from the total assets of that unit leaves what is known as accounting capital, or, in more modern usage, "capital." This is in accordance with the content and limitation expressed above.

A and B have businesses in each of which exactly $10,000 of property is invested. A advances $3,000 of his property to B. A's investment in his business remains the same. In lieu of the property advanced he records a claim against B as an asset for the same amount so that his assets still total $10,000. B, on the other hand, now displays $13,000 of assets under his control, the property received from A being added to the property previously in his possession. An addition to the assets, properly shown by each, gives a total of $23,000 instead of the total of $20,000, which would have appeared prior to the advancing of value from one to the other. One can not say, however, that the combined capital of the two is now $23,000. Such a statement would imply the actual creation of capital by the simple maneuvre of one party lending to the other. Instead, the capital of each remains the same. That of A is expressed by the amount of his assets as he has no claims of creditors to deduct. That of B is represented by the $10,000 of assets in excess of the amount necessary to pay his creditors. The accounting definition and the economic definition of capital are therefore not greatly at variance.

Capital, then, is not a single positive thing. Rather it is the difference between two things of opposite effect. It is a remainder —or rather, it is the measure of a remainder in which a certain fund of assets is the minuend and the claims of creditors are the subtrahend. The value of capital must depend upon the measure of these other two things.

The value of capital at any moment depends also upon conditions. Assets of a corporation continuing and expecting to continue according to the plans for which it exists may be worth one amount, and the capital may be determined by using that amount as a base. The assets of the same corporation facing dissolution or sale to another organization may be worth a far different amount. The capital as determined from this base may differ greatly from the capital as determined in the first instance.

Again, the amount of capital, being once determined at a particular instant, may change in the next. A sale for three dollars of that which cost in total two dollars adds a dollar to the capital. The breakage of a wheel or a slight turn of style or invention may decrease it. An overnight change in commercial affairs may add to it or subtract from it. It is as erratic as a homeless sheet of paper in a windy alley.

Capital can not be adjusted directly by all these flickering amounts. Thus, preferably, they are all accumulated in accounts over a period of time—some accounts favorable, some unfavorable—and, at the end of the period, all these accounts, each having accumulated during the period the total of some kind of effect, are all brought together—those showing increases of capital being offset against those showing decreases—and the net is amount added to or deducted from the capital. Thus profit is not only measured but also analyzed.

The assets resulting from profits are not tagged or earmarked, as some optimists fondly think, but instead are merged with the other assets of the corporation, as the assets contributed by stockholders and those advanced by creditors may be merged inextricably. As a result all assets must be measured and the liabilities deducted to determine the amount of accounting capital. Similarly, from this amount the portion representing original investment must be deducted to determine the amount of profit accumulated thereon. These measurements being duly made become a basic part of the accounting records, all changes being given effect therein as they occur. This measuring is at present indicated in terms of moneys. No allowance is made for variation in the effectiveness of the money units at various periods of time. This phase of the matter we desire to discuss later.

Let us first give consideration to the measurement of assets. This term is in such common usage that it is tossed about freely by all kinds of business men, used in a variety of business statements, discussed by congressmen and courts, and yet withal, despite the familarity with which it is treated by these various individuals, there is a sad lack of uniformity in their concepts with regard to it.

In its professional use, the term is gradually becoming more definite. All elements rightfully included in such professional definition may be divided into classes, the principles governing the measurement of each being recognized more fully as experience proves their truth.

The measurement of liabilities is simpler and is more definite than that of assets. It is the amount of moneys necessary to liquidate all claims of creditors at the date of measurement, so far as it may be determined.

If we would know accurately the increase of assets above the sum of the amounts advanced by proprietors and the amounts advanced by accrual to creditors, it is evident that we must maintain such a record that these increases may be accurately determined. We must, therefore, first, maintain a record of the amounts of assets so advanced as capital and advanced by creditors and, secondly, we must properly record the increase, with such proofs as will eliminate errors as far as possible. If this point be kept in mind it makes definite the methods which we must use in the recording of asset values. These methods vary with the character of the assets. For this purpose all assets of a corporation may be divided into five groups, as follows:

1. *Cash* includes money and items directly convertible into money by demand upon financial organizations. The measure of this group, so far as this country is concerned, is self-expressed to the extent that it consists of dollars. If all or any part of it consists of moneys of other countries these must be measured by the accepted ratios of exchange.

2. *Claims to be collected* include all legally enforceable claims upon other commercial units for definite amounts of money. This group is measured on the basis of the number of dollars expected to be realized therefrom.

3. *Assets to be sold*, not having as yet produced any profit, must be valued at what they have cost, less any loss due to decrease in market price. They may not be distributed at any higher amount without involving a negotiation equivalent to sale. Possible profit upon them must not enter into the records until sale or contract has actually created either cash or a legal claim for cash.

4. *Assets to be used*, which are intended to be of service in the creation of profit, should be valued at the amount of capital outlay which they represent, less such portion thereof as represents expired use—namely, amounts measuring the portion of

the service applicable to past periods which presumably has been recovered by charging the gross income of those periods.

5. *Items considered as assets* in the sense that they represent a capital expenditure but are not to be sold nor used nor collected—such as organization expense—if valued at the outlay which they represent and no portion of them is charged as expense or loss over the ensuing periods do not affect the amount of net profit. Any reduction in such amount representing original outlay results in a corresponding reduction of surplus or profits for purposes of distribution.

It may be noted from the above that profits are created normally only by sales or income represented by the first or second of the above groups. The amount of such sale or income is decreased by the used portions of the third and fourth groups. Any dividends therefrom presumably represent amounts which may be taken out of the corporate fund and distributed to stockholders without handicapping any of its activities and without reducing the fund which under the law is to be held for protection of creditors.

Protection to Creditors

If creditors are not properly safeguarded, the operation of credit is injured and the approach toward maximum efficiency of capital use—which is one of the goals of society—is delayed correspondingly. Similarly, if present stockholders are favored unduly, the corporation suffers with resultant loss to future owners, whether they be the same in personnel as at present or not. The present stockholders are deceived as to their true income. Their business judgment is handicapped in its functioning by being given false data from which to judge.

In order that the economic capital of the world may be used with any degree of efficiency, it is necessary that there be free movement of capital between organizations. If one commercial unit can use a certain amount of capital additional to its own, there must be some scheme whereby that amount may be advanced by those having such amounts available who will profit by such a loan of value. This involves the whole great scheme of credits whereby a form of coöperation between organizations is effected in the utilization of capital. Here is a theme that might be expanded indefinitely.

In order that one organization may be justified in thus advancing values to another, it must have some protection against shrinkage of the assets advanced and put under the control of the other party. Such security is usually obtained or sought by giving the one making the advance a general lien on all the assets of the debtor not previously and specifically pledged.

It is a well established fact in the economics of finance that a creditor can not advance values to any organization unless that organization has other values which may serve as a sort of collateral or guaranty of its ability to return to the creditor at maturity date the amount advanced. All assets are subject to shrinkage. The assets advanced by a creditor may shrink to such an extent that he is ill protected unless the debtor has other assets and the shrinkage will not affect his ability to pay his debts. The creditor automatically must have a lien upon the assets of the debtor. In the case of sole proprietorships and partnerships this lien may be applied through proper legal procedure whether the assets of the proprietorship remain in the business or are withdrawn. A partner may transfer certain assets from the partnership fund to his own fund, but the latter is still presumably accessible to the creditor if necessary for repayment of advances.

In the type of organization known as a corporation, the state builds a fence around the fund of assets. Creditors of the corporation can not cross this fence into the private fields of the individual stockholders save in certain cases not necessary to discuss in this argument. It is therefore evident that no creditor would advance a value to a corporation unless there were retained within the fence some assets of the proprietorship which would be subject to the creditor's lien in case of necessity. If corporation stockholders could withdraw all assets save those advanced by creditors there would be no such protective fund. The state, therefore, has so constructed the fence that not only is the creditor forbidden to cross it to reach the fields of the private stockholders, but, further, the private stockholder is forbidden to cross it for the removal of any assets of the corporation, save those in excess of the amount stipulated as a fund which must be maintained for the benefit of creditors. In the early forms of corporation this fund was the amount of the par value of the capital stock. This fund might be lost through business operation without the stockholders being compelled to replace it; but no part of it could be paid to the stockholders as dividends so long as the rights of creditors might be jeopardized thereby.

In order that this principle may be adhered to, it is necessary that accurate methods for measuring profits be used by corporations so that the amount of accumulated assets in excess of those represented by liabilities plus the amount of this fund as required by statute may be accurately determined. In the determination of the amount available for distribution to stockholders due attention must be given to this legal limitation.

Attention must be called to the effect which the reacquirement of stock may have upon this limitation. If treasury stock so reacquired is carried as an asset, there may be no evidence of the fact that a certain portion of the paid-in capital has been paid out again to stockholders and that the fund supposed to be maintained for the benefit of creditors has been correspondingly reduced.

Economic Limitations

In addition to legal limits upon the amount of accounting capital that may be distributed to stockholders there are practical economic limitations. Perhaps the first of these is the question of availability. Profit legally unhandicapped may not be available because of its nature or source or because of being impounded. If profits are in the form of receivables or inventories or other similar assets, there may be no satisfactory method of making distribution to stockholders.

Assets to be distributed evidently must be in a form that will permit physical removal from the fund of a corporation without handicapping that corporation's operations. Such assets may be created as the result of sales of commodities or service for an amount in excess of cost. These sales will result either in cash or in receivables ultimately convertible into cash. All this cash in excess of cost represents a realized profit and it is apparently only out of such realized profit that dividends are justifiable. Moreover the commodities or service sold must be such that the sale will not decrease the efficiency of the organization. To be available for dividends, therefore, assets must not be of a character which renders them necessary for the carrying on of the activities of the corporation. It is evident that no asset amount, merely created by appreciation of permanent assets, can be used in the payment of a dividend; nor should any such amount be allowed to appear as though it were a profit until actually realized. To encumber the figures, which are supposed to measure the amount of profit, with fictitious asset values merely beclouds one of the fundamental functions of profit-and-loss statements. On the other hand, the failure properly to recognize the expired portion of an outlay for such fixed assets would result in understating those costs which must first be subtracted from gross income before the amount available for distribution is determined.

Frequently corporations feel that their permanent assets have so increased in value because of the general trend of prices that they are justified in reducing to a minimum the amount of depreciation which they charge periodically against income. This understatement of the item depreciation results automatically in an overstatement of net income and, therefore, an overstatement of the amount of profit from which dividends may be declared. To pay out such an amount of income as dividends results in a distribution based upon an alleged increase in the value of a permanent asset and violates the principle which we have attempted to explain. Economically such a procedure is unsound. If carried to the extreme it would seriously handicap the activities of a corporation. The cost of fixed assets for use or service must therefore be construed as merely prepayments for such service. This prepayment must be distributed over the years of service in such a manner that at the expiration of the service there will have been withheld from gross income an amount known as depreciation which, together with the recoverable value or scrap or salvage value of the asset, will equal its original cost price. If a less amount is withheld, a portion of the original cost will not have been provided for and will have been merged with the net income and thereby have been added to surplus. If such surplus has been distributed to stockholders the organization will have violated the original legal limitations upon dividends discussed earlier in this article.

Corporations frequently find it necessary or desirable to retain a portion of otherwise available profits in order to meet the needs involved in expansion or provision of efficient facilities or to meet some liability or expected loss. The policy of conservatism dictates such withholding for the good of the organization and therefore for the good of its stockholders individually. To carry this policy too far, however, results in withholding from the individual stockholders that which is rightfully theirs. For the corporate officers to assume that by retaining assets they are really using them more advantageously for the benefit of the stockholders than the latter could use such assets if put into their possession smacks of corporate paternalism. Retaining funds in excess of proper needs is equivalent to compulsory re-investment. The economic rights of stockholders may be invaded by such action even though they may have no legal redress.

Directors of a corporation may be bound by contract to retain certain amounts of profits in order to comply with the sinking-fund requirements of bond issues. With regard to other amounts to be appropriated they have the legal right to use their discretion. Stockholders have a right, however, to be kept informed as to such appropriations, for they really represent the informal re-investment of an earning, without so much as the issuance of a certificate to identify it.

It is desirable to have all limitations with regard to profits expressed in the accounting records so that balance-sheets prepared therefrom may display the accounting capital in such a way that the observer will have some guide as to the amounts of surplus available for distribution as dividends. The legal limitation is usually expressed by the amounts of the capital-stock accounts if the stock has a par value. The economic limitations or those adopted as part of the policy of the corporation management may be expressed through accounts designated as surplus reserves or appropriations, such as "sinking fund reserve," "surplus appropriated for new factory" and "reserve for contingencies."

There is one economic limitation upon profit distribution with which everyone is familiar, and yet it is continually and persistently ignored in business records. That is the fluctuating power of the money unit. One dollar today is considered on the records the same as one dollar of twenty years ago. A corporation that invested $100,000 then shows an accounting capital of $150,000 now and we say it "has accumulated $50,000 of profits." Perhaps it has accumulated no profits at all. Perhaps the equipment and working capital it has today are even less efficient than those it had at first. No part could be distributed without actually distributing that which is the equivalent of original investment. Such a distribution would in reality be a liquidating dividend and not a profit dividend.

If the investment of the stockholders of a corporation is sufficient for all its operating needs, any earnings above this amount, after allowing for taxes, for depreciation and for other portions of expired investment, should be available for distribution to the stockholders. Theoretically this is correct, but practically it can seldom be followed. An amount of capital sufficient for the needs of a business one year is seldom sufficient for its needs the following year. More or less of the profit must be retained in order that business may be developed and efficiency of operation be increased. Because of the constantly decreasing effectiveness of the monetary dollar the number of dollars in effective representation must be continually increased as each part of the equipment is replaced. The replacement to produce equal effectiveness requires a greater number of dollars than did the old part which was removed. As a result it is seldom true that an organization having a net investment of $100,000 in 1913 and also $100,000 in 1923 has held its own, save for the dividends that may have been distributed. To express this differently, if the organization has paid out all values during this period over and above those measured by 100,000 of dollars it has actually distributed a portion of its original capital. There are exceptions, but in many cases the truth of this statement is evident. If the organization in 1923 owns the identical assets that it owned in 1913 the fluctuation in the measuring content of the dollar does not affect their condition. If the assets in 1923 differ from those owned in 1913 and consist of assets whose price has greatly increased in that ten-year period, it is self-evident that the effectiveness of assets costing $100,000 at the latter date would be much less than that of assets costing a similar amount in 1913.

This is an element frequently overlooked by corporations and, for that matter, by accountants. Whether or not the business world is ready to accept a modification in the systems of accounting which have prevailed in the past, we are considerably in doubt. Whether or not the accounting profession is able to offer a practical method of overcoming the difficulty is a still more doubtful matter. Whether or not the future will bring forth a practical solution remains to be seen. Meantime the problem is one vitally affecting the economic structure of commerce and one not wholly to be ignored.

No-Par Stock

The introduction of capital stock without par value brings new complications. It is doubtful if there has yet been a sufficient legal interpretation of the relation of no-par stock to the protection of creditors. States authorizing the issuance of capital stock with no par value usually require designation of a certain amount per share which must measure assets withheld from distribution. Usually, however, this amount per share is very small. It would seem that creditors of corporations whose capital stock consists entirely of the no-par issue would be greatly concerned with this item. Assume a corporation authorized to issue 100,000 shares of no-par stock with a nominal value of five dollars a share required under the statute. If this stock be issued for, say, an average of $20 a share so that capital stock appears on the balance-sheets at $2,000,000, the question arises to what extent creditors should be influenced by that figure in the granting of credits. If the directors choose to distribute to the stockholders a portion of this $2,000,000, still maintaining the fund of $500,000 required by the state, have they violated the rights of creditors? Have the creditors any recourse under our present laws? To express this differently, is it proper to construe any amount paid in for no-par stock, in excess of the nominal value as indicated in the statute controlling the corporation, as paid-in surplus, the same as amounts paid in excess of the par value of stock whose certificates express such par value on their face?

The introduction of no-par stock into the realm of business is so recent and the problems resulting therefrom in many cases have been so unexpected that it is not astonishing that many principles have not yet reached a satisfactory development either in law or in practice. There is as yet little uniformity even in the methods of recording its issuance and its reacquisition. Many of the methods in use fail to give effect to facts necessary to a proper consideration of the question of dividends.

The original issue of no-par stock may be carried upon the records of a corporation (1) at the amount of the accounting capital applicable to such stock, or (2) at the value of the assets for which it was issued or (3) at the amount representing the statutory minimum of the state under whose non-par stock laws the stock was issued. Under the second and third methods surplus accounts must be used to absorb any excess of capital accumulated above the amounts expressed by the capital stock. The first method, although seeming to conform closely to the original idea back of the law creating stock without par value, still fails to satisfy the commercial world. It measures in one account the capital applicable to the stock of no par value, whereas portions of that capital may differ greatly from each other as to source and as to availability for distribution. Economic principles necessitate a separation of the amounts measuring values contributed by proprietors to a corporation from those amounts measuring values accumulating to the credit of the proprietors as a result of corporate operation. This separation should be indicated upon the accounting records.

The second method indicated above provides for such separation. The amount expressed as no-par capital stock indicates the value of the assets received by the organization from the stockholders. Additional amounts accruing to the owners of stock are displayed in a separate account or accounts. The latter accounts are presumed to represent surplus available for dividends unless some portions thereof have been appropriated to meet expected needs for expansion, liabilities or unusual losses.

The third method apparently has little justification. Under such a method any amounts paid in for stock of no par value in excess of the minimum amount per share stipulated under the no-par stock statute would appear as a sort of paid-in surplus or would be merged in the general surplus. Under the latter treatment no separation is made between values contributed and other values earned by the corporation.

Methods of recording no-par stock that is reacquired by the issuing corporation vary even more than the methods of recording original issue and are dependent somewhat upon those methods. If the original issue is recorded at the minimum required by statute, as discussed under the third method above, presumably the reacquired stock should be recorded in like manner. Any amount paid for such stock in excess of the amount per share at which it is recorded will evidently represent a decrease of surplus. If the amount per share of surplus so paid out is in excess of the amount per share applicable to the remaining outstanding shares it would seem that the rights of the remaining stockholders have been injured. Also, if this amount is in excess of the amount paid in as part of the purchase price of such shares when originally issued, it is evident that a certain portion of accumulated profit has been paid out to the holders of these shares. Unless the accounting records have separated amounts paid in for stock from later surplus from earnings they will fail to indicate that earned surplus has been paid out to the owners of these shares.

Such a failure would violate accounting principles, economic principles and perhaps legal principles.

If the original issue of no-par stock has been recorded at the value of the assets for which it was issued, as noted in the second method above, the reacquired stock should presumably be so recorded as properly to offset such entry. Two methods are used in the attempt to accomplish this purpose. Under one the reacquired stock is entered at the price originally paid in for the identical shares when issued. Under the other method the reacquired shares are recorded at the average price which has been paid in for all shares of the same class of stock, without attempting to identify the amount paid in for the particular shares reacquired.

To illustrate this point simply, assume that a corporation authorized to issue 2,000 shares of no-par stock issues the first 1,000 at $10 a share and begins operations. The possibilities of profit are developed to such an extent that at a later date 1,000 additional shares are issued for $20 a share. If the capital-stock account be carried at the values for which the stock is issued it will now appear with a balance of $30,000. If 500 shares are reacquired they may be recorded at $15 a share, this being the average of the stock outstanding at that date. Or they may be identified as being a part of the first 1,000 or a part of the second 1,000 and therefore be recorded at $10 a share or at $20 a share, as the case may be. Any excess paid for such reacquired shares above the price at which they are recorded as treasury stock subtracts from the surplus of the corporation. Conversely, any excess of the price at which they are recorded as treasury stock over the price paid for their reacquisition adds to the surplus of the corporation. The remaining stockholders are therefore vitally affected, not only by the price paid for the reacquisition of stock but also by the method of recording the purchase. The principle to be used in making the record must evidently be one that will result in compliance with the principles of law and of economics governing the relations of stockholders to the corporation. It must also result in a proper display of the true interests of stockholders and the surplus rightfully available for distribution to them.

Some organizations reacquiring capital stock of no par value carry it on their records as treasury stock at the amount paid for it. The effect of this is to distort the ratio of surplus to capital stock outstanding. If the reacquisition has resulted in any addition to or deduction from surplus, as discussed above, such changes should be indicated in the surplus account. Further, a deduction of the amount of treasury stock from the amount of stock issued gives the value at which the outstanding shares are carried by the corporation. This amount should represent a portion of the assets not available for distribution to stockholders. That the method is illogical may be demonstrated by illustrations. Assume that the corporation referred to above, whose 2,000 shares of no-par-value stock were originally issued for $30,000, accumulated an earned surplus of $75,000, and found it desirable to reacquire some of this stock. Further assume that the corporation was justified in paying $50 a share for 500 shares reacquired. If this treasury stock was recorded at the amount of the purchase price, $25,000, the effect would be to indicate a net value of only $5,000 representing capital stock outstanding as follows:

Capital stock, no-par value:	
2,000 shares issued	$30,000
Less 500 shares reacquired	25,000
1,500 shares outstanding	$5,000
Surplus	75,000
Total capital and surplus	$80,000

Such a method of recording is evidently absurd. If there were an earned surplus of $75,000, note what the effect would be in the various methods of recording this treasury stock. If the stock were identified as having been originally issued at $10 a share and were so recorded at reacquisition the effect would be:

Capital stock, no-par value:	
2,000 shares issued	$30,000
Less 500 shares reacquired	5,000
1500 shares outstanding	$25,000
Surplus	55,000
Total capital and surplus	$80,000

If the stock were identified as having been issued at $20 a share and were so recorded when reacquired, the effect would be:

Capital stock, no-par value:	
2,000 shares issued	$30,000
Less 500 shares reacquired	10,000
1500 shares outstanding	$20,000
Surplus	60,000
Total capital and surplus	$80,000

If the reacquired stock were recorded at the average price per share of the stock outstanding prior to repurchase, the effect would be:

Capital stock, no-par value:	
2,000 shares issued	$30,000
Less 500 shares reacquired	7,500
1500 shares outstanding	$22,500
Surplus	57,500
Total capital and surplus	$80,000

An analysis of the amount paid in for the remaining outstanding stock and of the relation of surplus to the remaining stockholders discloses that that method is most just whereby the reacquired stock is recorded at the exact amount for which it was originally issued. Owing to the complication arising if stocks are transferred frequently, such identification may at times be impracticable. In such cases recording the reacquired stock at an amount per share determined as being the average cost per share of the outstanding stock prior to the reacquisition seems the nearest to accomplishment of the desired purpose. This is too brief an article to enable one to carry through the analyses to prove this contention.

No method can meet the needs of commerce that does not provide for correct determination of earned surplus and the effects upon surplus of any repurchase of capital stock.

Summary

Presumably stockholders of a corporation are entitled to a distribution of all profits above amounts necessarily withheld for purposes which we have discussed.

It is for the good of the community as a whole as well as for the good of the individual that wealth not needed for consumption should be utilized in producing more wealth and, further, that such increase of wealth should be made available to its true owner with the minimum of delay. Profits retained by a corporation above the amounts necessary for preserving its commercial and financial integrity are the equivalent of a reinvestment of capital by the stockholder without his individual consent. While the declaration of a dividend from profits in excess of the limitations discussed is left to the discretion of the board of directors, the presumption must be that their duty to stockholders is to make such declaration. Failure to do so deprives the stockholder of the control of wealth that has properly accrued to him and to which he is properly entitled.

To summarize, profit distributions may be made by corporations from assets accumulating to their ownership in excess of amounts necessary to liquidate liabilities and amounts received as investment from stockholders, subject to the following restrictions:

First: legal limitations intended to protect creditors.

Second: practical limitations due to the non-availability of sufficient assets in a form suitable for distribution.

Third: limitations imposed because of contract whereby certain amounts of profit must be temporarily appropriated to uses other than distribution, such as the liquidation of bond issues.

Fourth: limitations imposed because of economic conditions whereby amounts additional to original investment must be retained by the corporation to provide for uninterrupted continuity of operations and undiminished efficiency.

Title to all assets representing profits above these limitations should be passed promptly to the stockholder by periodic dividends so that he may use his own judgment as to the proper utilization of wealth accrued to him as the result of his investment which he may desire to use for his own good or for that of others or to re-invest in the same or in some other enterprise.