Michigan Law Review

Volume 35 | Issue 2

1936

CORPORATIONS - SIGNIFICANCE OF APPRECIATION AND CHANGING PRICE LEVELS IN CORPORATE DIVIDEND POLICIES

Kenneth K. Luce
University of Michigan Law School

Follow this and additional works at: https://repository.law.umich.edu/mlr

Part of the Business Organizations Law Commons, and the Securities Law Commons

Recommended Citation

Kenneth K. Luce, *CORPORATIONS - SIGNIFICANCE OF APPRECIATION AND CHANGING PRICE LEVELS IN CORPORATE DIVIDEND POLICIES*, 35 MICH. L. REV. 286 (1936).
Available at: https://repository.law.umich.edu/mlr/vol35/iss2/6

This Response or Comment is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

CORPORATIONS — SIGNIFICANCE OF APPRECIATION AND CHANGING PRICE LEVELS IN CORPORATE DIVIDEND POLICIES — The appreciation of assets and the legal and accounting problems involved are largely a product of constant fluctuation in the value of money, and to a lesser degree a product of actual rise in the relative value of isolated pieces of property. In the face of political events such as the devaluation of the dollar, and economic phenomena such as the rising price level which the country has experienced since 1933, such problems are of immediate concern to the accountant and lawyer. We must recognize at the outset that appreciation or depreciation in the price-

level sense are unrelated to depreciation in the sense in which the accountant uses the latter term. Depreciation in accounting is an amortization of the asset over its estimated life expectancy, and is figured usually upon an original-cost basis.[1] Its effect upon surplus available for dividends is mechanical, and results from the periodic arbitrary charge to depreciation expense. The problem here is much different. It concerns the effect upon surplus available for dividends of a rise in the monetary value of the corporate assets, which is due usually to a fluctuating price level. The writer will deal with fixed and current assets in order.

I.

The statutes dealing with the problem of dividends are general, and afford so little guide to decision that the courts have done really little more than render lip service to them. The several statutes usually contain one of two familiar tests for the legality of dividend declarations, and often these are found together in a single statute.[2] One test is that dividends may be declared only from surplus, negatively that dividends shall not be paid if the result is an impairment of capital. This is little more than a restatement of the common-law rule.[3] Surplus is usually defined as liabilities and capital stock deducted from assets.[4] An original interpretation of such statutes would say that unrealized appreciation recognized on the asset side of the balance sheet would be reflected in the surplus and would be available for dividends. At least the statutes announcing the surplus test do not prohibit such a result. The second familiar test is that dividends shall only be declared from net profits. The profits test would prohibit dividends from unrealized appreciation, at least if profits are defined in the accounting sense as current income. The courts and accountants have long denied that appreciation unrealized is profit in any

[1] 33 MICH. L. REV. 783 (1935).

[2] Ballantine and Hills, "Corporate Capital and Restrictions upon Dividends under Modern Corporation Laws," 23 CAL. L. REV. 229 at 238 (1935); Weiner, "Theory of Anglo-American Dividend Law: American Statutes and Cases," 29 COL. L. REV. 461 (1929).

[3] Branch v. Kaiser, 291 Pa. 543, 140 A. 498 (1928); Wittenberg v. Federal Mining & Smelting Co., 15 Del. Ch. 147, 133 A. 48 (1926); Guaranty Trust Co. v. Grand Rapids G. H. & M. Ry., (D. C. Mich. 1931) 7 F. Supp. 511.

[4] People of Colorado v. Great Western Sugar Co., (C. C. A. 8th, 1928) 29 F. (2d) 810; Uniform Business Corporation Act, § 24 (1932):

> "IV. No corporation shall pay dividends (a) in cash or property, except from the surplus of the aggregate of its assets over the aggregate of its liabilities, including in the latter the amount of its capital stock, after deducting from such aggregate of its assets the amount by which such aggregate was increased by unrealized appreciation in value or revaluation of fixed assets. . . ."

sense.[5] But the courts have generally disregarded the distinction between the two tests and have treated them as interchangeable.[6] And the legislatures have done likewise by frequently including both tests in a single statute.

A distinction prominent in the picture is that between realized and unrealized appreciation. There is considerable conflict as to exactly when appreciation is realized, but we shall adopt the general view that realization occurs when the appreciated asset is sold.[7] Prior to sale, the difference between the cost and market value of the asset is unrealized appreciation, assuming of course that the asset has risen in value.

The apparent disregard by the courts of the literal terms of the statutes in the formulation of the dividend law on appreciation finds its cause in the fact that the courts have adhered necessarily to accouning practice in dealing with the problem.[8] The accountant thinks of profit in terms of current revenues less expense, and has derived his earned surplus available for dividends solely from this source. He feels that unrealized appreciation in a fixed asset should not be recognized as profit unless the asset is sold. The reason is obvious. The rise in prices which created the unrealized surplus yesterday may be reversed on the morrow,[9] hence the generally accepted rule of law that unrealized appreciation is not profit and is not available for dividends, while realized appreciation can be paid out in cash dividends.[10] This rule is in harmony with the statutory profits test, but not at all with the surplus test which says that liabilities and capital stock de-

[5] Schmidt, "Is Appreciation Profit?" 6 ACCOUNTING REV. 289 (1931).

[6] Weiner and Bonbright, "Theory of Anglo-American Dividend Law: Surplus and Profits," 30 COL. L. REV. 330 (1930); Bank of Morgan v. Reid, 27 Ga. App. 123, 107 S. E. 555 (1921); Coleman v. Booth, 268 Mo. 64, 186 S. W. 1021 (1916); Goodnow v. American Writing Paper Co., 73 N. J. Eq. 692, 69 A. 1014 (1908).

[7] HATFIELD, ACCOUNTING 255 (1928).

[8] Southern California Home Builders v. Young, 45 Cal. App. 679, 188 P. 586 (1920).

[9] Southern California Home Builders v. Young, 45 Cal. App. 679 at 694, 188 P. 586 (1920): "Mere advance in value of property prior to its sale, or estimated profits on partially executed contracts do not constitute profits, because the fluctuations of the market and the uncertainty of the completion of such contracts may bring about a condition such as was found in the present case, where the estimated profits were in fact liabilities or direct losses. . . ."

[10] Kingston v. Home Life Ins. Co. of America, 11 Del. Ch. 258, 101 A. 898 (1917); Jennery v. Olmstead, 36 Hun (46 N. Y. S. Ct.) 536 (1885); REITER, PROFITS, DIVIDENDS AND THE LAW 70 (1926); Briggs, "Asset Valuation in Dividend Decisions," 9 ACCOUNTING REV. 220 (1934); HATFIELD, ACCOUNTING 282 (1928).

ducted from assets constitute surplus available for dividends.[11] Under the surplus test, recognition of appreciation in accounting for assets would result in an appreciation surplus available for dividends, since the surplus test does not necessarily include any requirement of realization. But accounting tradition has prevented the question from arising by refusing recognition to appreciation in asset accounting. In accounting for fixed assets the accountant proceeds on the assumption that cost gives book value.[12] Most corporations carry all assets at original cost without change except for the depreciation allowance.[13] Only a few have adopted reproduction cost as a basis for the valuation of assets, and they follow the sound accounting practice of crediting the appreciation to a special reserve and not to surplus available for dividends.[14] Accounting practice has for this reason given lawyers little opportunity to argue that under the statutory surplus test unrealized appreciation should be a basis for dividends. The decisions in the field generally speak in terms of the surplus test, but the test really applied is that dividends shall be declared only from profits realized in the usual course of business.[15]

The case law in the field is confusing due to the fact that the cases are decided under different statutes, and to the fact that many courts follow the statutory and common-law rules blindly without adequate understanding of what they mean. Many of the decisions concern cases of impairment of capital due to overcapitalization, or cases of fictitious writing up of assets,[16] and are therefore not good authority for a case where a rising price level has resulted in an actual

[11] Weiner and Bonbright, "Theory of Anglo-American Dividend Law: Surplus and Profits," 30 COL. L. REV. 330 at 341 (1930); "Is Appreciation Available for Dividends?" 5 ACCOUNTING REV. 1 at 15 (1930).

[12] GRAHAM AND KATZ, ACCOUNTING IN LAW PRACTICE 184 (1932).

[13] Weiner and Bonbright, "Theory of Anglo-American Dividend Law: Surplus and Profits," 30 COL. L. REV. 330 at 340 (1930).

[14] Fryxell, "Should Appreciation be Brought into the Accounts?" 5 ACCOUNTING REV. 157 (1930); GRAHAM AND KATZ, ACCOUNTING IN LAW PRACTICE 210 (1932); HATFIELD, ACCOUNTING 285 (1928); PATON, ACCOUNTING 368 (1934).

[15] Jennery v. Olmstead, 36 Hun (46 N. Y. S. Ct.) 536 (1885); Hyams v. Old Dominion Copper Mining & Smelting Co., 82 N. J. Eq. 507, 89 A. 37 (1913); Peters v. United States Mortgage Co., 13 Del. Ch. 11, 114 A. 598 (1921); Weiner and Bonbright, "Theory of Anglo-American Dividend Law: Surplus and Profits," 30 COL. L. REV. 330 at 335 (1930).

[16] Southern California Home Builders v. Young, 45 Cal. App. 679, 188 P. 586 (1920); Coleman v. Booth, 268 Mo. 64, 186 S. W. 1021 (1916); Irving Trust Co. v. Gunder, 152 Misc. 83, 271 N. Y. S. 795 (1934). 1 OHIO B. A. REP., SUPP. No. 2.,p. 65 (1928): "The problem to be settled lies in the field of legal accountancy and cannot be determined from reported decisions for the reason that the decisions are in hopeless confusion and conflict and are based upon different statutes."

appreciation of assets. The common-law and accounting view that unrealized appreciation of fixed assets is not a basis for cash dividends has been generally accepted by statutes and recent decisions.[17]

2.

The rule that dividends cannot be paid from unrealized appreciation has been applied generally to current as well as to fixed assets.[18] This is unfortunate because it ignores the obvious distinction which the element of liquidity draws between the two. Professor Paton has said that there is reason for giving recognition in the income account to appreciation in liquid assets such as bonds and stocks. In the case of appreciated liquid assets income has in a sense been realized.[19] In a few cases unrealized appreciation of current assets has been recognized in the accounts as income.[20] Even though the rule for fixed assets is generally applied to current assets, it must be recognized that there is less reason for it, and that as a matter of fact the rule is not as invariably applied to current assets. One departure is the commonly accepted accounting rule that current assets will be valued at cost or market, whichever is lower. This rule will recognize in the accounts a fall but not a rise in value.

3.

Accountants have proceeded traditionally on the theory that what the stockholder invests in corporate capital is dollars, and upon liquidation he will get back the same number of dollars that he invested regardless of a possible change in the purchasing power of those dollars in the meantime. This fundamental approach has led the accountant to adhere to the original-cost method of accounting for fixed assets, and to see little reason to adopt reproduction cost except in the case

[17] Southern California Home Builders v. Young, 45 Cal. App. 679, 188 P. 586 (1920); Irving Trust Co. v. Gunder, 152 Misc. 83, 271 N. Y. S. 795 (1934); Uniform Business Corporation Act, § 24 (1932); Ohio Code (Throckmorton 1930), § 8623-38, Ohio Ann. Gen. Code (Page Perm. Supp. 1935), § 8623-38.

[18] Jennery v. Olmsted, 36 Hun (46 N. Y. S. Ct.) 536 (1885); Hill v. International Products Co., 129 Misc. 25, 220 N. Y. S. 711 (1925); Hastings v. International Paper Co., 187 App. Div. 404 at 419, 175 N. Y. S. 815 (1919): "This sum . . . does not represent actual profits as the materials have not been turned into money."

[19] PATON, ACCOUNTING 624 (1934).

[20] Hutchinson v. Curtiss, 45 Misc. 484, 92 N. Y. S. 70 (1904); Meserve v. Andrews, 106 Mass. 419 at 422 (1871), where the following dictum is found: "The profit and loss of trade in merchandise is not confined to that which results from sales. Depreciation or advance in value of the stock unsold must also be taken into account. . . ."

of the regulated industry where the rate base furnishes a standard for the determination of income.[21]

There is another theory of accounting for capital which is expressed by the statement that what the stockholder invests is purchasing power, and upon liquidation he should receive back an equal amount of purchasing power which may be a more or less number of dollars than his original investment, depending upon the direction in which the price level has moved in the interim. This approach is in conformity with value as understood by the economist. Whether the accountant should adopt this economic concept of value in preference to the dollar concept is fundamental and controversial.[22] The fact remains that he has not. It should be clear that to measure the capital assets of a corporation upon a purchasing power rather than a dollar basis would dictate the use of reproduction-cost accounting. It should also be clear that on the purchasing power basis the rise in dollar value of the corporate assets resulting from a general rise in the price level is not unrealized appreciation, but capital. And any payment to stockholders out of this appreciation in dollar value will therefore be a payment out of capital. Also on the purchasing power basis the only possible unrealized appreciation in an asset is a rise in value which occurs independently of any movement of the general price level, and which is due to economic or social factors affecting it alone. In this section the writer will assume this purchasing power concept of value as the proper basis for accounting for capital, and with this in view will

[21] "Is Appreciation a Depreciating Element?" 5 ACCOUNTING REV. 1 at 44 (1930); DEWING, THE FINANCIAL POLICY OF CORPORATIONS, 3d ed., 492, 514 (1934). At page 513, Dewing says:

> "Consequently, in spite of the theoretical acknowledgment by accountants that the economic value of physical structures changes with the price level, no attempt is made to reflect this change in the income account. With the exception of inventories, and perhaps certain easily appraised assets such as bonds and listed stocks, the accountant is satisfied with a money-cost maintenance of value rather than a money purchasing power maintenance of value."

[22] See generally, Sweeney, "How Inflation Affects Balance Sheets," 9 ACCOUNTING REV. 275 (1934); SWEENEY, STABILIZED ACCOUNTING (1936); Wasserman, "Accounting Practice in France during the period of Monetary Inflation (1919-1927)," 6 ACCOUNTING REV. 1 (1931); Castenholz, "The Accountant and Changing Monetary Values," 6 ACCOUNTING REV. 282 (1931); and Sweeney, "Maintenance of Capital," 5 ACCOUNTING REV. 277 at 286 (1930) where it is said:

> "The basis for maintenance probably most often in harmony with the customary fundamental purpose of economic activity is maintenance of absolute *general* purchasing power, i.e., maintenance of general real capital or simply 'real capital.' It, alone, continually measures capital and income in such a way as to facilitate realization of the usual goal of economic effort, namely, increase of general purchasing power, and thus materially assists accounting to realize its main purpose of accurately distinguishing between capital and income."

examine the original-cost and reproduction-cost methods of valuation in order to determine which one gives most accurate effect to the common-law rules against declaring dividends out of unrealized appreciation and out of capital.

Suppose the *X* corporation is capitalized at $100,000, and that this is invested in fixed assets with a life expectancy of twenty years. If we assume the use of the straight-line method of depreciation, the fixed asset figure will be reduced to $75,000 by the allowance for depreciation at the end of five years. Also assume the market value of the assets to be equal to the book value. If a fifty per cent rise in the price level occurs at the end of five years the market value of the assets will be at that time $112,500. Clearly the assets are worth no more in real value after than they were before the rise in prices, because the appreciation is caused solely by a change in the value of money. And this change will affect the monetary value of all commodities in the same degree as it does the assets of *X* corporation. The $37,500 rise in monetary value of the assets of *X* corporation is appreciation under the dollar concept of accounting, but it is capital under the purchasing power concept. Under either concept it seems that a payment of $37,500 in dividends today would be equivalent to a dividend out of capital of $25,000 before the rise in prices. Such a payment would be forbidden under the dollar concept by the rule forbidding declaration of dividends out of unrealized appreciation, and under the purchasing power concept by the rule forbidding declaration of dividends out of capital. Assuming the *X* corporation uses original cost and does not revalue, the balance sheet at the end of the five year period will appear as follows:

Assets			Equities	
Cash		$ 10,000	Liabilities	$ 5,000
Receivables		10,000	Capital Stock	100,000
Inventory		15,000	Earned surplus	5,000
Fixed Assets	$100,000			
Less: Reserve for depreciation	25,000			
Total		75,000		
		$110,000		$110,000

If the management maintains the assets at original cost as shown, the depreciation charge will remain at $5,000 annually. The situation then is one in which all items in the income accounting except depreciation are being computed in terms of the current inflated prices, while depreciation continues to be computed with reference to prices before

the inflation. In other words, the annual depreciation expense is not being figured as high as it should be relative to the other figures in the income accounts. The result is that annual net income is inflated.[23] Assume that this annual income is carried to surplus and paid out in dividends. Fifteen years after the assumed rise in the price level the original $100,000 in assets will be amortized, and other assets will have taken their place.[24] The balance sheet will then appear:

Assets		Equities	
Cash	$ 10,000	Liabilities	$ 10,000
Receivables	10,000	Capital Stock	100,000
Inventory	10,000	Earned Surplus	20,000
Fixed Assets*	100,000		
	$130,000		$130,000

*Replacements

But in view of the rise in prices there should be assets amounting to $150,000, or the corporation does not have the real, purchasing power value in fixed assets that it should have. What has happened to the missing $50,000 in assets? Obviously it has been paid out in dividends through the inflated income account. The leakage has resulted from the depreciation charge being relatively too low. Clearly the use of original cost has led here to paying dividends out of capital, defined as purchasing power.

If the *X* corporation revalues its assets when the rise in prices occurs, the following journal entry will be necessary:

Fixed Assets	$50,000	
Reserve for depreciation		$12,500
Reserve for revaluation		37,500

[23] GRAHAM and KATZ, ACCOUNTING IN LAW PRACTICE 210 (1932); Sweeney, "Stabilized Depreciation," 6 ACCOUNTING REV. 165 at 167 (1931): "Ordinary accounting fails, in periods of fluctuating prices, to preserve real capital and charge profit and loss with the correct amount of depreciation because it neglects to treat figures measured in inwardly unlike, though superficially similar, monetary units as though they were outwardly expressed in heterogeneous money. . . ."

[24] Of course, capital replacements will be made at current prices. If made gradually they will check the declaration of dividends because surplus will thus be reinvested in the business. Hence gradual replacements will result in a lagging correspondence between the dollar and the real value of the assets. However, the writer assumes that surplus is paid out in dividends as it is accumulated, and that no capital replacements are made until the end of the fifteen-year period.

The balance sheet will appear:

Assets			Equities	
Cash		$ 10,000	Liabilities	$ 10,000
Receivables		10,000	Capital Stock	100,000
Inventory		20,000	Reserve for revaluation	37,500
Fixed Assets	$150,000		Earned surplus	5,000
Less: Reserve for depreciation	37,500			
Total		112,500		
		$152,500		$152,500

Each year the depreciation charge will be $7,500, in line with the same prices by which other items in the income accounts are measured. The assets will be amortized on the basis of current prices, and assets at the end of the period will equal $150,000 while the Reserve for Revaluation item amounting to $37,500 will still stand on the equity side of the balance sheet.

The use of the special reserve account retains the appreciation as capital equity in the business and avoids its diversion into earned surplus through an inadequate depreciation charge. Valuation is thus adjusted to correlate real values to the change in the value of money. Should the corporation transfer the Reserve for Revaluation item to Earned Surplus and pay it out in dividends, a court adopting the purchasing power concept would no doubt condemn such action as paying dividends out of capital.[25] But such action would leave the same result as is reached when original-cost accounting is used. The only difference is that in the former case the diversion of purchasing power capital, or unrealized appreciation, to earned surplus is apparent on the face of the accounts. When original-cost accounting is used it is hidden behind an inadequate depreciation charge. In either case failure to recognize that changes in the value of money do not affect the real value of assets results in the payment of dividends out of the purchasing power contributed originally by the stockholders. And

[25] GRAHAM and KATZ, ACCOUNTING IN LAW PRACTICE 190 (1932). Following the dollar concept the accountant of today will periodically transfer a part of the Revaluation Surplus to Earned Surplus as fast as the appreciation on the asset side of the balance sheet is periodically absorbed into operating costs, along with the depreciation charged against the original cost of the plant. Hence at the end of the period the dollar value of the assets will be the same as if original cost had been used. Arriving at the same point by either road, the accountant of today concludes that the trouble involved in the use of reproduction cost is a waste of time except for the small advantage gained thereby in the evening out of periodical income.

there is reason to the statement that this is really the capital of the corporation.[26]

The writer recognizes that reproduction-cost accounting is difficult to apply in a practical business world. For this reason it is only possible at the most to maintain valuation in rough correspondence to long-term fluctuations in the price level. Undoubtedly this consideration stands in the way of making real value instead of dollar value the basis of corporate accounting. The difficulty of applying reproduction cost is clearly a very considerable practical justification for the refusal of modern accounting to depart from original cost or to recognize appreciation until it is realized. The point is simply that substitution of reproduction-cost accounting and the purchasing power concept of value for original-cost accounting and the dollar concept would result in giving real practical effect to the policy of the law forbidding payment of dividends from capital.

4.

Contrary to the decisions concerning cash dividends, the courts and many statutes permit declaration of stock dividends from unrealized appreciation of fixed assets.[27] The reason for a different rule in the case of share dividends is that share dividends are not a disbursement of property. They are instead a capitalization of surplus, and have only the effect of diluting the shares as they existed before. When a corporation has recognized appreciation in a special reserve account, it can safely declare stock dividends and capitalize the appreciation only if it can justifiably make the assumption arbitrarily made in the last section, namely that the price level is going to remain indefinitely at the point to which it has risen. Such an assumption does not square with monetary conditions as they are. The corporation which capitalizes unrealized appreciation by declaring a stock dividend when prices are high will find itself with a corresponding impairment when

[26] Wasserman, "French Enterprise under Inflation: A Balance Sheet Analysis," 9 ACCOUNTING REV. 130 (1934), where the writer says that inflation forced the use of reproduction cost in France during the period from 1919 to 1926.

In this connection it might be profitable to relate the story of the young man who entered business in Germany as a nail merchant at the beginning of the post-war inflation period. He began with one hundred marks, which he invested in a stock of nails. Upon selling out he reinvested one hundred marks in another stock of nails, and spent what he received above one hundred marks as profit. He repeated this process a number of times. His last one hundred marks brought him one very cheap nail which at least served as a peg upon which he hung himself.

[27] Ohio Code (Throckmorton 1930), § 8623-38; Ohio Ann. Gen. Code (Page Perm. Supp. 1935), § 8623-38; Uniform Business Corporation Act, § 24 (1932); Northern Bank & Trust Co. v. Day, 83 Wash. 296, 145 P. 182 (1915); State ex rel. Gentry v. Bray, 323 Mo. 562, 20 S. W. (2d) 56 (1929).

prices fall. Whether the stock dividend should be used to freeze the capital structure is a business question which should be resolved only with a full realization of its possible consequences. It is submitted that the appreciation reserve set up to recognize appreciation of fixed assets should not necessarily be capitalized, but might better be kept as capital surplus available to absorb a future fall in the monetary value of the assets. Really the only case in which the stock dividend should be used to capitalize appreciation is where the appreciation consists of a real rise in the value of the assets due to permanent economic changes and not to movement of the price level.[28]

It is the conclusion of the writer that corporate income in a period of rising prices is deceptive, and that the amount of deception varies directly with the violence of the rise in prices. This is because the failure of modern accounting to take account of appreciation in the monetary value of corporate assets causes part of the economic wealth which the stockholders originally invested in the business to be diverted into the income account. If this diversion of capital into corporate income is not detected, and the income is unthinkingly paid out entirely in dividends, the result is inevitably an impairment of corporate capital. And the psychology present in a boom period often leads to rash dividend policies with the ultimate result that corporate wealth, supposedly devoted to production, becomes an added source of fuel for the inflation already in progress. The tendency then is for the real economic wealth of society to be diverted into consumption and added stock market inflation. The writer has pointed out that adoption of reproduction-cost accounting would halt the causes of deception at their source by preventing diversion of capital into income. However, the practical objections to reproduction-cost accounting are countless. Many small businesses cannot afford the appraisal and accounting expense involved in frequent revaluation. Appraisals are often little more than guesswork. Difficulties arise over how often revaluation should occur. In view of such obstacles, it is quite safe to say that it will be a long time before reproduction cost is adopted on any considerable scale. The really important thing is that lawyers, accountants, and business executives should recognize the problem, because reproduction-cost accounting is not the only method of avoiding the pitfalls involved. Real capital can also be maintained intact by following a conservative dividend policy, and by ploughing a consid-

[28] "Is Appreciation a Depreciating Element," 5 ACCOUNTING REV. 1 at 44 (1930): "For real appreciation—that founded upon social and industrial progress and not merely on shifting price levels—the stock dividend method is probably the most logical treatment even though it would simply amount to a thinning out of the stockholder's equity."

erable portion of the income appearing on the books in boom periods back into the business. It is submitted that recognition by business executives of the connection between price level appreciation and dividend policy will do much to remove corporate capital from the list of sources from which inflation derives its fuel. And recognition of the problem in the business world will lead ultimately to its recognition in the law.

Regardless of whether the purchasing power or the present-day dollar concept of accounting for corporate capital is followed, the application of the rule that unrealized appreciation is not to be used as a basis for dividends is bound to have a salutary effect in preventing impairment of corporate capital. The rule is justifiable. Under present-day accounting procedure it prevents any deliberate payment of dividends from unrealized appreciation, whether the latter be real, doubtful, or fictitious. Undoubtedly it is sufficient to prevent most of the unjustified dividend policy at which it is aimed. The only question is whether or not the rule should be extended in its application for the purpose of maintaining intact the real as well as the dollar investment of the stockholder. This could be accomplished either by adoption of reproduction cost in accounting, or by legal condemnation of rash dividend policies in periods of rising prices.

Kenneth K. Luce