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Correspondence: Stock Dividends

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Correspondence

Stock Dividends

Editor, The Journal of Accountancy:

SIR: A business decision of timely interest relative to stock dividends was handed down on February 1st by the appellate division of the New York supreme court, 1st department, in the *Matter of Megrue*, reversing a decree of the surrogate's court.

The facts before the court were briefly as follows:

John R. Megrue died October 8, 1910, possessed, among other assets, of 300 shares of the stock of the Standard Oil Co. of N. J., 100 shares of which, he directed in his will, should be held by his son, Enoch G. Megrue, in trust for his widow, Minnie Megrue, life beneficiary.

On September 1, 1911, in accordance with the decision of the United States supreme court in the Standard Oil case, the Standard Oil Co. of N. J. distributed to its stockholders stock in several subsidiaries, among which were the Prairie Oil & Gas Co. and the Ohio Oil Co., the trustee receiving his proportionate share.

In June, 1914, the United States supreme court handed down its decision in the so-called "pipe line cases," to which litigation the Prairie Oil & Gas Co. and the Ohio Oil Co. were parties.

By reason of this decision neither of these companies could longer engage in the pipe line business. Each company accordingly resolved that that part of its assets which constituted pipe line property be disposed of to another company to be organized, and that the stock of such new company be distributed pro rata to its own stockholders.

In conformity with these resolutions the pipe line property of the Prairie Oil & Gas Co. was sold to the Prairie Pipe Line Co. for the whole of its stock, and the pipe line property of the Ohio Oil Co. was sold to the Illinois Pipe Line Co. for the whole of its stock. The stock so received of such new companies was distributed among the stockholders of the Prairie Oil & Gas Co. and the Ohio Oil Co., the trustee receiving under this distribution of stock dividends about 27 shares of the former and about 20 shares of the latter company.

The life beneficiary claimed these 47 shares as income.

The trustee claimed that they were in no respect income or profits of the trust fund to which the life beneficiary might be entitled, but were part of the principal of the fund which should be held by him for the remainderman.

An epitome of the decision of the court, written by Judge J. Scott, follows:

... "When the trust fund was created the Standard Oil Co. of New Jersey owned all the capital stock of the Prairie Oil & Gas Co. and the Ohio Oil Co., and these constituted a part of the property or capital of said Standard Oil Co. The 100 shares of the latter company, which constituted the trust fund, represented and stood for a proportionate part of the capital and property of said Standard Oil Co. and consequently

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represented an equal proportionate part of the capital of the trust fund. When the Standard Oil Co. found it necessary to divest itself of the ownership of the subsidiary companies, it withdrew from its capital assets the stock of said subsidiary companies, and to this extent depleted its capital. The method it adopted for so divesting itself was to distribute the stock of the subsidiaries among its own stockholders, thus making good to them the depletion of its own capital caused by parting with the subsidiary shares. The corpus of the trust fund was not changed in any way. Before the distribution the shares of the Standard Oil Co. stock held by the trustee represented a proportionate part of all the assets of that company, including the stock and assets of the subsidiary companies. After the distribution, the trust fund held precisely the same interest, except that, so far as concerned the subsidiary companies, it held their stock directly and not by representation through the stock of the Standard Oil Co. To turn over now to the life beneficiary the stocks which have taken the place of the stocks of the subsidiary companies, as the decree appealed from proposes to do, would amount to handing over to her, as income, that which at the time the trust fund was set up constituted a part of the principal of that fund. . . . It is therefore quite immaterial that the stock of the subsidiary companies may have been acquired by the Standard Oil Co. out of surplus earnings which accrued prior to the creation of the trust fund. The controlling fact is that it had been acquired before the trust fund was set up and so constituted a part of the capital of the trust fund, as represented by the stock of the Standard Oil Co. when the trust was actually set up. . . . It follows that the decree appealed from should be reversed."

It is of interest to compare the above decision with those quoted by W. F. Weiss, C.P.A., in his article "*Dividends and the New Income Tax Law*" in the November, 1916, issue of THE JOURNAL OF ACCOUNTANCY, and with the comment thereon by John T. Kennedy in the January, 1917, issue and with the recent decision of the United States supreme court in *Towne vs. Eisner*, quoted in the *Income Tax Department* of THE JOURNAL for February, 1918.

Yours truly,

EDWARD H. MOERAN,

Member, American Institute of Accountants.

New York, February 15, 1918.

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