In The Matter of the Petition of Mr. "A"

for a Declaratory Ruling

DOC #4102, Effective July 24, 1986

Pursuant to RSA 541-A:1, I-b., 541-A:2, I., (c), and Rev PART 209 of the New Hampshire Code of Administrative Rules, Mr. ..."A".... a resident and taxpayer subject to the provisions of RSA 77, having his principal place of residence at ...., has petitioned the Department of Revenue Administration for a declaratory ruling stating that certain stock dividends received were not taxable pursuant to the exemption language contained in RSA 77:4, II.

The Petitioner presents the following facts:

(1) Mr. "A" owned certain shares in the "M" Company.

(2) "M" Company offers to its shareholders a Dividend Reinvestment and Common Stock Purchase Plan which permits shareholders to receive dividend in stock, rather than in cash.

(3) Mr. "A" accepted the "M" Company offer for dividend reinvestment, and has received additional shares of stock as dividends from "M" Company pursuant to this contract.

(4) The stock received seems to qualify as "new stock" under the clause of RSA 77:4, II, which removes from taxation "other than stock dividends paid in new stock of the company issuing the same,"

The taxpayer's assertion that his "M" Company Dividends received in "M" Company stock is non-taxable under the language of RSA 77:4, II is wrong. The taxpayer has received income taxable within the definitional parameters of RSA 77.

The short reasoning to this conclusion is that the clear intent of the exclusionary clause of RSA 77:4, II "...other than stock dividends paid in new stock of the company issuing the same..." is that only "stock dividends" similar to those referenced by §305 (a) and limited by §305 (b) of the Internal Revenue Code are excluded from RSA 77:4. Exclusion does not mean exemption. This exclusion is narrowly prescribed by the words "paid" and "new stock", neither of which are conditions satisfied by the facts surrounding Mr. "A"'s petition. Mr."A" has "purchased", through an agent, "old stock" of "M" Company.

A more fully developed reasoning to this end will require analysis of the New Hampshire Constitution, several New Hampshire Supreme Court decisions, the Massachusetts statute from which the current RSA 77 was copied, several decisions of the Supreme Judicial Court of Massachusetts interpreting that predecessor statute before adoption of the New Hampshire statute, and a highly influential United States Supreme Court decision handed down just prior to adoption of the New Hampshire statute. This developed analysis follows in Parts A through F below:

A. THE CURRENT RSA 77 WAS "SUBSTANTIALLY" COPIED FROM AN EARLIER MASSACHUSETTS STATUTE.

That RSA 77 is substantially identical to the predecessor of Section 1 of Chapter 62 of the Massachusetts General Laws was the conclusion of our Supreme Court in one of the few cases raising questions about RSA 77.

"Since there are no decisions in this state determinative of the issue, we look to the Massachusetts cases inasmuch as our statute (RSA 77) was substantially copied from the original Massachusetts statute". Sagendorph v Marvin, 101 NH 79 (1957).

B. A "COPIED" STATUTE DICTATES CERTAIN INTERPRETATIONS THROUGH ITS NATURE AS A "COPIED" LEGISLATIVE ACT.

It is clear in this jurisdiction that when our legislature takes the wording of another state's statute as the basis of our own statute, then certain interpretations are presumptively accurate. In Mann v Carter, 74 NH 345 (1907), while examining the inheritance tax imposed by Chapter 40, Laws of 1905, our court said,

"Whatever ambiguity there may be in the language of the legislature in relation to this question disappears upon a consideration of the material circumstances under which the statute was passed. The quoted section is almost a literal copy of section 1, Chapter 15 of the Revised Laws of Massachusetts (Mass. Laws 1891, c. 425.), while the other sections of the act are substantially the same as the corresponding section of the Massachusetts Act. This coincidence is persuasive evidence of a practical re-enactment here of the foreign statute, and an adoption of the construction which the highest courts of that state had given to it. Parsons v Parsons, 67 NH 419, 420 (1891);Commonwealth v Hartnett, 3 Gray 450. The legislature is ordinarily presumed to have had in mind, when adopting the statutory language of another state, existing decisions of that state defining the extent and purpose of the statute, and to have used the identical language in the sense thus indicated."

C. ALTHOUGH "SUBSTANTIALLY COPIED" Sagendorph v Marvin, 101 N.H. 79 (1957) FROM MASSACHUSETTS, THE PORTION OF RSA 77 IN QUESTION IS NOT A COPIED PART.

Chapter 269, Section 2(b) states:

(b) Dividends on shares in all corporations and joint stock companies organized under the laws of any state or nation other than this commonwealth, except national banks and except such foreign corporations as are subject to a tax upon their franchises payable to this commonwealth under the provisions of sections forty-three and fifty-two of Part III of chapter four hundred and ninety of the acts of the year nineteen hundred and nine, and acts in amendment thereof and in addition thereto.

RSA 77:4, II. states:

Dividends, other than stock dividends paid in new stock of the company issuing the same, on shares in all corporations and joint stock companies organized under the laws of any state, territory, or nation except New Hampshire state banks, trust companies, building and loan associations, credit unions, or national banks.

If these statutes are grammatically placed side-by-side, the following similarities and variances between them are apparent.

1. Both statutory excerpts begin with "Dividends";

2. The Massachusetts statute follows "Dividends" with linked adjectival phrases modifying directly and indirectly the opening word "Dividends". RSA 77, has similar linked adjectival phrases modifying "Dividends", but they do not directly follow the word they modify. RSA 77 has a unique independent clause placed immediately after "Dividends". The linked adjectival phrases are,

Massachusetts: "...on shares in all corporations and joint stock companies organized under the laws of any state or nation other than this commonwealth:

New Hampshire: "...on shares in all corporations and joint stock companies organized under the laws of any state, territory, or nation".

3. The Massachusetts statute follows the phrases in 2. above with an exemption which seems to accomplish much the same purpose as a similar exemption in the New Hampshire statute. The Massachusetts focus is on Massachusetts financial entities whereas the New Hampshire statute excluded New Hampshire financial entities. The parallel exemptionary language is:

Massachusetts: "...except national banks and except such foreign corporations as are subject to a tax upon their franchises payable to this commonwealth under the provisions of sections forty-three and fifty-two of Part III of chapter four hundred and ninety of the acts of the year nineteen hundred and nine, and acts in amendment thereof and in addition thereto."

New Hampshire: "... except New Hampshire state banks, trust companies, building and loan associations, credit unions, or national banks.

4. The significant difference between the statutes is the independent clause following "Dividends" found only in the New Hampshire statute; "...other than stock dividends paid in new stock of the company issuing the same," Very significantly, this is the clause at issue in this ruling request.

D. PRESENCE OF, AND GRAMMATICAL PLACEMENT OF THE NON-COPIED CLAUSE OF RSA 77:4, II COMPELS CERTAIN CONCLUSIONS.

Two things are immediately apparent with regard to the renegade clause of C (4) above, if ... other than stock dividends paid in new stock of the company issuing the same, ...

First, reasoning from its mere "presence", there seems to be a conscious effort by the New Hampshire legislature of 1923 to alter an element of the Massachusetts statute which would become part of the New Hampshire statute by reasoning similar to Sagendorph v Marvin, 101 NH 79 (1954) and the then recently decided Mann v Carter, 74 NH 345 (1907).

Second, its "grammatical placement" after "dividends" rather than along side the list of exemptions recited at C (3) above, tends to reveal an intent that the clause wants to remove certain "stock dividends" from the intended definition of "dividends". It places certain lostock dividends" outside the scope of "Dividends". It is a significant distinction that certain "stock dividends" are not an acknowledged "dividend" for which the legislature wished to grant an exclusion. C (3) type exemptions differ in degree from this type of property exclusion. This distinction is equivalent to the legislature stating that the independent clause shows items that are outside the class of property to be taxed, whereas the "except..." language clause shows items which are within the class of taxable property but which the legislature wished to grant an exemption for a public purpose. That is, not non-taxed, but non-taxable. An example of such a distinction would be if a tax were to be imposed equally on all motor vehicles; an exemption would remove motor boats and airplanes, whereas a statement that horse-drawn buggies are not taxable would be exclusionary language intending to place buggies outside the intended property definition of motor vehicles, even though arguments could be raised that a horse is a form of "motor" and a buggie a type of "vehicle".

1. ANALYSIS OF MASSACHUSETTS CASE LAW REVEALS A BROAD INTERPRETATION OF "DIVIDENDS". THE NEW HAMPSHIRE LEGISLATURE NARROWED THIS DEFINITION.

As early as 1869, it was clear that Massachusetts could tax certain stock dividends, Leland v Hayden, 102 Mass 542 (1869), if the Legislature wanted to tax income. In Leland v Hayden the issue revolved around proper allocation of a stock dividend between a life tenant and the remainderman of a trust, where the dividend payor had purchased its own outstanding stock at less than par with "surplus income" and then distributed stock and cash to shareholders of record as a dividend. In deciding that this type of stock dividend was income the court states significantly;

This transaction wants the essential elements of a stock dividend as found in ordinary cases, and in the cases previously determined by this court. In those cases, new stock was created for the purpose of the dividend. Here no new stock was made, but a portion of the original stock, which had been already paid for in full to the corporation, and repurchased by it, was divided. This distinction is vital; for in the ordinary case, where the number of shares is increased, each share becomes a less proportion of the whole stock than it was before; so that, unless the new shares are added to the old in the hands of the trustee as capital, the original number of shares represents a smaller proportion of the whole corporate property than it did before the dividend; while, so far as the dividend now under consideration is concerned, the number of shares of the corporation is unaffected by it, and the trustee, by retaining only his original number of shares, retains the same fractional interest in the

whole corporation, its franchise and property, which he previously had, just as completely as he would do in the ordinary case by receiving the stock dividend and adding it to his capital. Leland v Hayden, 102 Mass 542, 546-547 (1869).

Thus, all dividends for trust purposes are not equal it seems. Leland type dividends are income, whereas "new stock" issued proportionally to all shareholders is arguably capital, in 1869. For our analysis of the New Hampshire statute with reference to the petitioner's request, we should note several facts:

(1) The Leland fact pattern is similar to the fact pattern presented with this ruling request.

(2) Without more analysis, Leland dividends would be within RSA 77 per the logic of the Sagendorph case and the Mann case.

(3) Leland distinguishes the facts of its case from a "new stock" fact pattern much like the exclusionary clause of RSA 77 within which the taxpayer wishes to place the facts of his ruling request.

Old trust based decisions like Leland, had potentially special significance for Massachusetts taxation theory because in 1916 Massachusetts adopted Constitutional Amendments for the express purpose of taxing income. New Hampshire, significantly, never followed Massachusetts. New Hampshire had previously amended its Constitution in 1903 to expand the authorized powers of the legislature to tax "other classes of property", NH Constitution, Part 2, Art. 6, which the Supreme Court of New Hampshire found to extend the class of taxable property to "income received".

There is a significant distinction that needs to be underscored here. An income tax and a property tax on income received are not equivalent concepts. This will be apparent when Eisner v Macomber, 262 US 188 (1919) is read next to Commissioner v Putnam, 227 Mass 522 (1917). In Conner v State, 82 NH 126, 128 (1925) our Supreme Court stated,

In the search for classifications of property to which the general provision in the amendment of 1903 could apply, the one that naturally and inevitably comes to mind is the receipt of income. The levy upon income was then a generally recognized method of taxation. Beyond any other that has been suggested, it is one to which the general description fitly applies. Unless the provision under consideration is to be wholly disregarded, the conclusion that it authorizes laying an income tax must be adopted.

Thus, in a rather awkward, but not fully harmonious manner, New Hampshire's legislature, like Massachusett's, is authorized to impose an income tax. But, for New Hampshire purposes, income must meet a constitutionally compelled "receipt of property" test. The "property received" could be net income (RSA 77-A), or gross income (RSA 77). This scope of taxation authority was clearly not extended to the New Hampshire Legislature before 1903 as Conner indicates at 127,

In 1903 a fundamental change was made in the people's grant of the taxing power. In the generation just preceding that time, the idea that the constitutional provision for contribution of "his share" by each taxable party meant a share determined by a common and unvarying method had been upheld and amplified in great detail and with a wealth of argument. Edes v Boardman, 58 NH 580; Morrison v Manchester, 58 NH 538; Bowles v Landaff, 59 NH 164; Gould v Raymond, 59 NH 260; Robinson v Dover, 59 NH 521; B.C. & M. Railroad v State, 60 NH 87; State v Express Co., 60 NH 219;Franklin Street Society v Manchester, 60 NH 342. It had been decided that the existing provisions of the constitution did not permit the laying of any inheritance tax. Curry v Spencer, 61 NH 624; Williams v State, 81 NH 341, 346. Whether any form of income tax was then allowable, or whether taxation other than that upon polls must be limited to a levy upon estates, as that term had been treated in the discussion of taxation problems in the various cases upon this subject, was generally considered to be at least a matter of doubt. Such a limitation had been judicially declared. State v Express Company, 60 NH 219, 236. "Taxation as understood here when the constitution was amended (1903) meant equal treatment to everyone and meant, when property was the basis or measure of the tax, a uniform rate, and it was also understood that equality and uniformity were essential characteristics of every process which could be included under the term taxation." Williams v State, 81 NH 341, 350.

To return now to our consideration of the Massachusetts case law and statute;

(1) It is clear, therefore, that Massachusetts case law considered the Leland type of stock dividend as income (for trust purposes) and upon passage of an income tax after the 1916 constitutional change a tax upon such income was authorized,

(2) Leland distinguished significantly the fact that "no new stock was created" in its facts, that is that "a portion of the original stock" was being distributed, and

(3) For trust purposes, the issuance of "new stock" dividends is a capital distribution under Leland.

The Massachusetts position on the income character of stock dividends in the specific context of a taxing statute was amplified and extended in Commissioner v Putnam, 227 Mass 522 (1917). Significantly, this decision, like Leland, preceded the adoption in 1923 of the New Hampshire Interest and Dividends tax, thus, it would come within the Sagendorph and Mann reasoning of the interpretive impact of "copied" statutes and their prior judicial interpretations.

In Putnam, it is clear that the newly adopted income tax powers of the Forty-fourth Amendment to the Massachusetts Constitution was controlling. The court cites it in full at page 534,

"Full power and authority are hereby given and granted to the General Court to impose and levy a tax on income in the manner hereinafter provided. Such tax may be at different rates upon income derived from different classes of property, but shall be levied at a uniform rate throughout the Commonwealth upon incomes derived from the same class of property. The General Court may tax income not derived from property at a lower rate than income derived from property, and may grant reasonable exemptions and abatements. Any class of property the income from which is taxed under the provisions of this article may be exempted from the imposition and levying of proportional and reasonable assessments, rates and taxes as at present authorized by the Constitution. This article shall not be construed to limit the power of the General Court to impose and levy reasonable duties and excises."

In Putnam, the stock dividend was an issuance of new stock. That is, Putnam is the distinguished fact pattern of the Leland decision. In looking at the broad grant to tax income in its Constitution, the Massachusetts Supreme Court states at page 536,

By the issuance of the stock dividend ... the stockholder now has evidence of a permanent interest in the corporate enterprise of which he cannot be deprived. It is a thing different in kind from the thing which the stockholder owned before. From the viewpoint of the stockholder, he has received in the form of dividend in stock a thing with which heretofore he could have no tangible dealings. The certificate for the new shares of stock representing the stock dividend may have a materially greater value than the less tactile right to a share in the accumulated profits which he 'had before. ...The thing of value which is taxed as income, namely the dividend in stock, did not come into his possession or right to possession until the year for which he is taxed. It is this thing of value which is taxable at the time when it comes into his right to possession. Edwards v Keith, 145 C.C.A. 298. Van Dvke v Milwaukee, 159 Wis. 460.

The inevitable conclusion of Putnam's expansion of Leland's scope of stock dividends as income, for a New Hampshire statute "copied" from the foreign statute upon which Putnam is based is that by the reasoning of Mann v Carter, 74 NH 345 (1907) and the latter Sagendorph v Marvin, 101 NH 79 (1954) that without modification in the New Hampshire statute the Putnam decision would bring into the scope of the Interest and Dividends tax all stock dividends. That is, that RSA 77 would consider a Putnam-type of "new stock" - stock dividend as "... a thing of value which is taxable, ..." in New Hampshire. Leland ("re-issued" treasury stock) and Putnam (new issued stock) would be indistinguishable and equally taxable under the New Hampshire statute. But the question would remain, are both of these types of stock dividends "property received" types of income under the New Hampshire Constitution? If the answer were negative, then the statute might have been impermissible in New Hampshire. Both types of dividends would be drawn into the New Hampshire statute by an

unmodified use of the Massachusetts statute's word "Dividend". That this did not occur is clear. Putnam's reasoning that, "from the viewpoint of the stockholder, he has received ... a thing ... of value which is taxed as income, ...It was blunted by RSA 77's "new stock" clause.

The New Hampshire legislature seems to have had in mind the differentiated Leland and Putnam reasoning when it inserted a phrase dealing with "new stock". The Leland distinction seems to be preserved and Putnam decision extinguished by the clause, "other than stock dividends paid in new stock of the company issuing the same,". That is, "stock dividends paid in new stock" are not Dividends in the sense that a horse and buggy is not a motor vehicle, not in the sense that motor boats could be intentionally exempt from a statute taxing all motor vehicles uniformly. They are excluded, not exempted.

2. THE GRAMMATICAL PLACEMENT OF THE CLAUSE, "OTHER THAN STOCK DIVIDENDS PAID IN NEW STOCK OF THE COMPANY ISSUING THE SAME," AS A MODIFIER OF "DIVIDENDS" (AN EXCLUSION) RATHER THAN ONE OF A SERIES OF EXEMPTIONS FROM TAX IS SIGNIFICANT IN ANALYSIS OF THE LEGISLATIVE INTENT BEHIND THE QUESTIONED CLAUSE.

As has been a long established rule in New Hampshire that a true exemption from tax like the clause, "except New Hampshire state banks, trust companies, building and loan associations, credit unions, or national banks." must meet the equality tests of Article 12, Part 1 of the New Hampshire Constitution (Y.W.C.A. v Portsmouth, 89 NH 40 (1937)) and must be reasonable related to the legislative protective powers Article 5, Part 2 of the New Hampshire Constitution (Opinion of the Justices, 82 NH 561 (1927)) such as the protection of property, health, comfort and lives of the citizens (Town of Canaan v Enfield Village Fire District, 74 NH 517 (1908)). If the phrase in question were truly an exemption, then the clear requirement that the legislature grant exemptions as it determines the scope of taxable property, that is, with strict attention to equality, exempting "whole classes of property", Opinion of the Justices, 76 NH 609 (1913), would subject the, phrase, "other than stock dividends paid in new stock of the company issuing the same," to equality scrutiny . Could we equitable exempt Leland-type stock dividends but not Putnam-type stock dividends? How can a distinction be drawn between stock dividends "paid in new stock" and other types of stock dividends without violating the "whole class" rule? Additionally, to what public purpose could we attribute the needed exclusion?

The grammatical placement of the phrase "other than stock dividends paid in new stock of the company issuing the same," helps us answer these questions. It implies that such dividends are not taxable, because they are constitutionally outside the larger, clearly definable class of property, i.e., "dividends." Only Leland "Dividends" are within the class of taxable property, not Putnam "Dividends". Putnam "Dividends" are not dividends that are simply not taxed by legislative exemption. They are not taxable property. They are not properly within the parameters of an equal, proportional tax on a defined class of property.

Between the 1917 decision of the Massachusetts Supreme Judicial Court in Commissioner v Putnam, 227 Mass 522 (1917) and the 1923 passage of New Hampshire's Interest and Dividends Tax, the United States Supreme Court, in 1919, handed down a landmark tax case on federal income tax facts which resolved the taxability of stock dividends issue for federal purposes on United States Constitutional grounds, Eisner v Macomber, 262 US 188 (1919). The critical passages of that decision are at 262 U.S. 188, 209-212 (1919):

For bookkeeping purposes, the company acknowledges a liability in form to the stockholders equivalent to the aggregate par value of their stock, evidenced by a "capital stock account." If profits have been made and not divided they create additional bookkeeping liabilities under the head of liprofit and loss," "undivided profits," surplus account," or the like. None of these, however, gives to the stockholders as a body, much less to any one of them., either a claim against the going concern for any particular sum of money, or a right to any particular portion of the assets or any share in them unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose. The dividend normally is payable in money, under exception circumstances in some other divisible property; and when so paid, then only (excluding, of course, a possible advantageous sale of his stock or winding-up of the company) does the stockholder

realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested.

In the present case, the corporation had surplus and undivided profits invested in plant, property, and business, and required for the purposes of the corporation, amounting to about $xx,xxx,xxx, in addition to outstanding capital stock of $xx,xxx,xxx. In this the case is not extraordinary. The profits of a corporation, as they appear upon the balance sheet at the end of the year, need not be in the form of money on had in excess of what is required to meet current liabilities and finance current operations of the company. Often, especially in a growing business, only a part, sometimes a small part, of the years profits is in property capable of division; the remainder having been absorbed in the acquisition of increased plant, *equipment, stock in trade, or accounts receivable or in decrease of outstanding liabilities. When only a part is available for dividends, balance of the year's profits is carried to the credit of undivided profits, or surplus, or some other account having like significance. If thereafter the company finds itself in funds beyond current needs it may declare dividends out of such surplus or undivided profits; otherwise it may go on for years conducting a successful business, but requiring more and more working capital because of the extension of its operations, and therefore unable to declare dividends approximating the amount of its profits. Thus the surplus may increase until it equals or even exceeds the par value of the outstanding capital stock. This may be adjusted upon the books in the mode adopted in the case at bar - by declaring a "stock dividend." This, however, is no more than a book adjustment, in essence not a dividend but rather the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company, but profits so far absorbed in the business as to render it impracticable to separate them for withdrawal and distribution. In order to make the adjustment, a charge is made against surplus account with corresponding credit to capital stock account, equal to the proposed "dividend"; the new stock is issued against this and the certificates delivered to the existing stockholders in proportion to their previous holdings. This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its out- standing liabilities; it affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing capital stock" at the expense of *"surplus"; it does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share.

A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.

Being concerned only with the true character and effect of such a dividend when lawfully made, we lay aside the question whether in a particular case a stock dividend may be authorized by the local law governing the corporation, or whether the capitalization of profits may be the result of correct judgment and proper business policy on the part of its management, and a due regard for the interests of the stockholders. And we are considering the taxability of bona fide stock dividends only.

We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of

profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction.

The New Hampshire Legislature could not have been unmindful of this decision when adopting the Interest and Dividends Tax in 1923. Critical importance must have been attached to the language at page 211.

The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit;

Given the New Hampshire Constitution 1903 Amendment to Part 2, Article 5 allows taxation of "property received" as a "class of property", if stock dividends are not "received property", then stock dividends are not taxable property. They are not within the allowance class of property and thus need not be exempt. They are constitutionally excluded. The United States Supreme Court was not ignorant of the Putnam line of reasoning which would tax as income what that Court would not allow the United States to tax. it distinguished Putnam at 262 U.S. 188,216, 217 (1919):

In Tax Commissioner v Putnam (1917) 227 Mass. 522, 116 N.H. 904, L.R.A. 1917F, 806, it was held that the Forty-Fourth amendment to the Constitution of Massachusetts, which conferred upon the Legislature full power to tax incomes, "must be interpreted as including every item which by any reasonable understanding can fairly be regarded as income" (227 Mass. 526, 531, 116 N.E. 911, L.R.A. 1917F, 806):

"In essence the thing which has been done is to distribute a symbol representing an accumulation of profits, which instead of being paid out in cash is invested in the business, thus augmenting its durable assets. In this aspect of the case the substance of the transaction is no different from what it would be if a cash dividend had been declared with the privilege of subscription to an equivalent amount of new shares."

We cannot accept this reasoning. Evidently, in order to give a sufficiently broad sweep to the new taxing provision, it was deemed necessary to take the symbol for the substance, accumulation for distribution, capital accretion for Its opposite; while a case where money is paid into the hand of the stockholder with an option to buy new shares with it, followed by acceptance of the option, was regarded as identical in substance with a case where the stockholder receives no money and has no option. The Massachusetts court was not under an obligation, like the one which binds us, of applying a constitutional amendment in the light of other constitutional provisions that stand in the way of extending it by construction.

Simply stated, the United States Supreme Court says that the Federal Constitution will not permit the Federal Government to go as far as the Massachusetts Constitution would permit the Massachusetts Legislature to go. This matrix of decisions affects New Hampshire because we have not adopted a Massachusetts "income tax" even though much of our statute echoes the Massachusetts statute.

We have a tax similar to that imposed in Massachusetts, but, it is a tax assessed on "property received." Consequently, we follow the United States Supreme Court's determination that the Mrs. Macombers of the world have not "received property", or in other words that the "income" in the Massachusetts sense of the word is not taxable under our statute because it is not "property received", Conner v State, 82 NH 126 (1925). Additionally, our statute itself mandates that interpretations of its scope must conform with the United States Supreme Court reasoning because RSA 77:2, (1923) states;

Conformity to Laws. It is the intention of this chapter, and it shall be construed, anything contained herein to the contrary notwithstanding, not to impose any tax upon any income in violation of the constitution of the United States or in violation of any constitutional federal laws, or in violation of the constitution of this state, or in violation of any contractual obligations of exemption from taxation established prior to May 4, 1923, by the state or any of its political subdivisions or by the United States, which may not be impaired lawfully hereby.

Thus (1) due to the United States Supreme Court's reading of the Sixteenth Amendment's prohibition of taxing "stock dividends" in the Macomber fact pattern as violative of a "receipt of property" principle and (2) because the New Hampshire Supreme Court approved RSA 77 on the same "receipt of property" analysis, and (3) because RSA 77:2 specifically adopts federal analysis instead of Massachusetts law, therefore, the Eisner v Macomber case seems intended to govern RSA 77:4, 11. (See: Opinion of the Justices, 77 NH 610 (1915)).

Additionally:

The proposed act (Interest and Dividends Tax) rests upon the same principle, taxing the corpus to the corporate trustee or legal owner, the profits paid over to the equitable owner into whose hands they have come. The only change in existing law is the selection of money received during the year, instead of money on hand, as the measure of the property to be taxed. "To establish the rules by which each individual's just and equal proportion of a tax shall be determined is a task of much difficulty, and a very considerable latitude must be left to the legislature on the subject." This determination rests "in the sound discretion of the legislature ... Within the limits of this discretion, as to the selection of proper subjects for taxation ... the authority of the legislature is without question supreme. (Opinion of the Court, 4NH 565, 570.")

This reasoning was reaffirmed by the Opinion of the Justices, 81 NH 552 (1923) and in Conner v State, 82 NH 126, 129 (1925),

In the search for classifications of property to which the general provision in the amendment of 1903 could apply, the one that naturally and inevitably comes to mind is the receipt of income. The levy upon income was then a generally recognized method of taxation. Beyond any other that has been suggested, it is one to which the general description fitly applies. Unless the provision under consideration is to be wholly disregarded, the conclusion that it authorizes laying an income tax must be adopted.

Just as it is clear that the majority decision by Mr. Justice Pitney in Eisner v Macomber compelled a redrafting of the Internal Revenue Code at §305 (a), so is it also clear that Mr. Justice Brandeis, who argues in dissent, in the same case, assured the narrow reading of Macomber and the adoption of §305 (b) of the Internal Revenue Code. In what essentially amounts to a form over substance argument, Mr. Brandeis urges that not all "stock dividends" are necessarily non-income. All stock dividends" do not fail the "receipt of property" test even though Mrs. Macomber's could conceivable be found, as the majority did, to fail the test.

Mr. Brandeis' concern was that common usage of "stock dividend" had two applications; (1) the "simple method" utilized by Standard Oil Company of California with Mrs. Macomber, and (2) the "more complicated method" utilized by Standard Oil Company of Kentucky. Mr. Brandeis wanted to make sure that readers of the Eisner v Macomber decision did not take it too far. He stated:

It is conceded that if the stock dividend paid to Mrs. Macomber had been made by the more complicated method pursued by the Standard Oil Company of Kentucky; that is, issuing rights to take new stock pro rata and paying to each stockholder simultaneously a dividend in cash sufficient in amount to enable him to pay for this pro rata of new stock to be purchased - the dividend so paid to him would have been taxable as income, whether he retained the cash or whether he returned it to the corporation in payment for his pro rata of new stock. But it is contended that, because the simple method was adopted of having the new stock issued direct to the stockholders as paid-up stock, the new stock is not to be deemed income, whether she retained it or converted it into cash by sale. 252 US 188, 225; 40 S.Ct 189, 199

And then again Mr. Brandeis states,

Suppose that a corporation having power to buy and sell its own stock, purchases, in the interval between its regular dividend dates, with moneys derived from current profits, some of its own common stock as a temporary investment, intending at the time of purchase to sell it before the next dividend date and to use the proceeds in paying dividends, but later, deeming it inadvisable either to

sell this stock or to raise by borrowing the money necessary to pay the regular dividend in cash, declares a dividend payable in this stock; can any one doubt that in such a case the dividend in common stock would be income of the stockholder and constitutionally taxable as such? See Green v Bissell, 79 Conn. 547, 65 Atl. 1056, 8 L.R.A. (N.S.) 1011, 118 Am. St. Rep. 156, 9 Ann, Cas. 287; Leland v Hayden, 102 Mass. 542. 252 US 188, 228; 40 S.Ct 189,200.

Mr. Brandeis wants to distinguish between a stock dividend that is purchased from one that is a "payment". The "payment" of a stock dividend, at least in the narrow facts of Mrs. Macomber, is not income. It is only "payment" in stock that does not increase the percentage ownership in the corporation that Eisner v Macomber deals with. We should remember that the stock dividend in Leland was purchased, it should be recalled, whereas the stock dividend in Putnam was "paid".

RSA 77:4, 11 seems to pick up Mr. Justice Brandeis' concern with payment" versus "purchase". it says,

"other than stock dividends paid in new stock of the company issuing the same,"

Thus, this clause inserted after "dividends" in RSA 77:4, II was clearly intended to forestall the application of the Putnam decision. (The focus here being on how the Massachusetts case law will integrate with the New Hampshire statute). From another analytical perspective, (The focus here being on how the U.S. Supreme Court's analysis will integrate with the New Hampshire statute) The clause intends to clarify the definition of "dividend" in light of (1) the Macomber decision, (2) the Brandeis dissent, and (3) the mandate of RSA 77:2.

New Hampshire's statute can be shown to respect, albeit narrowly, the reasoning of Mr. Justice Pitney. He stated,

Here we have the essential matter: not a gain accruing to capital; not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value, proceeding from the property, severed from the capital, however invested or employed, and coming in, being "derived" ... that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal - that is income derived from property. Nothing else answers the description.

The same fundamental conception is clearly set forth in the Sixteenth Amendment - "incomes, from whatever source derived" - the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution.

Can a stock dividend, considering its essential character, be brought within the definition? 252 US 188, 207-208; 40 S.Ct 188, 193

And;

Thus, from every point of view we are brought irresistibly to the conclusion that neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, or the accumulated profits behind it, as income of the stockholder. The Revenue Act of 1916, in so far as it imposes a tax upon the stockholder because of such dividend, contravenes the provisions of article 1, §2, cl.3, and article 1, §9, cl.4, of the Constitution, and to this extent is invalid, notwithstanding the Sixteenth Amendment. 252 U.S. 188, 197; 40 S.Ct 188, 197.

Thus, the clause questioned in this ruling request,

"other than stock dividends paid in new stock of the company issuing the same,"

is clearly an attempt to balance substantial and competing legal forces at odds over tax policy at the turn of the 20th Century. Not all stock dividends are non-dividends. Only dividends "paid" (Brandeis dissent), "in new stock of the company issuing the same" (Leland without the Putnam corrollary because of Macomber), are excluded from taxable property.

E. ADDENDUM OF ADDITIONAL FACTS

The following additional facts were gathered independent of Mr. "A"'s Declaratory Ruling request from the Prospectus: "M" Company - Dividend Reinvestment and Common Stock Purchase Plan, April 15, 1986. They pull into clearer factual focus, the analytical application of RSA 77:4, II to Mr."A"'s circumstances.

On Page 1 the Prospectus reads:

Each participant in the Plan who is an existing shareholder of record (each such participating shareholder is referred to in this Prospectus as a "shareholder participant") may:

- have cash dividends on all or a portion of his or her shares of Stock automatically reinvested (but, if fewer than all of his or her shares, not less than the dividends on 25 shares, and, in any event, dividends on all shares of Common Stock held under the Plan); or

- continue to receive cash dividends on shares of Stock, but invest in the Company by making optional cash payments of not less than $10, up to $10,000 per year in the aggregate; or

- invest both cash dividends, or a portion thereof, and any such optional cash payments of not less than $10, up to $10,000 per year in the aggregate for optional cash payments.

A shareholder participant may make his or her optional cash payments by authorizing the Company to draw funds against his or her bank account.

On Page 2, the Prospectus reads:

Effective April 1, 1986, the price of shares of Common Stock purchased with either reinvested dividends or optional cash payments will be the average price of such shares purchased from time to time on the open market by an agent designated for such purpose (the "Designated Agent") for distribution to the accounts of participants in the Plan. (The price of shares of Common Stock purchased with optional cash payments received by the Company prior to April 1, 1986 will continue to be as described in the Plan Prospectus Supplement dated January 17, 1986.)

On Page 3 and 4, the Prospectus reads:

DESCRIPTION OF THE PLAN

The Company is offering holders of record of its Stock, as well as customers and employees of the Company who are residents of (state) the opportunity to own shares of the Company's Common Stock under the Plan. Full investment of funds is possible under the Plan because it permits fractions of shares, as well as full shares, to be credited to a participant's account. The Plan was first made available to existing shareholders of record and eligible employees of the Company in June 1978 and in June 1982 was made available to customers and employees of the Company who reside in (state). Shares of Common Stock purchased under the Plan have heretofore been drawn from the Company's authorized but unissued shares registered for issuance and sale under the Plan. However, the Company anticipates discontinuing the issuance of such shares on or about April 1, 1986. Upon such discontinuance, the Designated Agent will commence purchasing shares of Common Stock on the open market for the accounts of participants in the Plan. (See Questions 12 and 16 below.) In light of this and other changes in the Plan, this Prospectus should be studied carefully.

The following is a question and answer statement of the provisions of the Plan.

1. What is the purpose of the Plan?

The purpose of the Plan is to provide shareholders and employees and _________ service customers of the Company who reside in (state), with a simple and convenient method of investing cash dividends or making optional cash payments, or both, to purchase shares of Common Stock of the Company.

No portion of the "M" Company Prospectus could be found to support the "paid". or "new issue" analysis necessary for application of the exclusion in RSA 77:4, II. All additional data confirmed a "purchase" or "old issue" by plan participants.

F. CONCLUSION

Mr. "A" has received a taxable dividend from "M" Company because he has not been "paid" this dividend in stock, he purchased it by contract, and because the stock received was not "new stock", it was old stock purchased on the open market, not issued newly for the purpose of the stock dividend in question. In view of the foregoing representations and specifically based upon an analysis of them, the Department of Revenue Administration finds that Mr. "A" has received "Dividends" taxable under RSA 77:4, II when he received certain shares in the "M" Company pursuant to the "M" Company Dividend Reinvestment and Common Stock Purchase Plan.

Everett V. Taylor, Commissioner