



TERRITORY OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
HONOLULU

45

November 18, 1942

OPINION NO. 1827

TAXATION, PUBLIC WELFARE TAX:

Distributions of earned surplus, made in liquidation of a corporation, are subject to public welfare tax.

SAME, SAME:

The distributions subject to public welfare tax are not limited to the profit arising after the stockholder receives back his investment in the stock.

Honorable William Borthwick
Tax Commissioner
Territory of Hawaii
Honolulu, T. H.

Dear Sir:

Attention: Mr. Earl Fase

Your letter of October 30 requests our opinion as to the taxability, under the Public Welfare Tax Law, of distributions of earned surplus of Hawaiian Sugar Company, made in liquidation of the company. The distributions were made and received by the stockholders in 1941 and 1942.

Originally this tax law defined "dividends" as meaning "dividends as defined in the territorial income tax

law" which was:

"(4) Dividends. The term 'dividend' when used in this Act means any distribution, whether in money or in other property, made by a corporation, national banking association, insurance company, association or joint stock company, to its shareholders or holders of an interest therein on account of the ownership of such shares or interests;" (Act 44, Second Sp. S.L. 1932).

Subsequently the income tax law definition of the term "dividends" was amended by Act 120 (Ser. A-45) L. 1935, but Act 252 (Ser. A-42) L. 1939 amended the welfare tax law to eliminate the reference to the income tax law for a definition. The original definition of dividends quoted above was set forth in the welfare tax law.

Although the definition fails to specify that the distribution, to be a dividend, must be made out of earnings or profits (as does the amended definition in the income tax law) an opinion letter of this office of July 6, 1934, No. 18, interpreted the statute as not taxing disbursements of capital, particularly as territorial law prohibits payments of dividends from capital except upon compliance with certain statutory requirements in connection with a reduction in the capital stock. Your proposed assessment follows this principle; it confines the tax to distributions of accumulated surplus and does not impinge on distributions of capital.

In our opinion letters of February 5, 1940, Nos. 138 and 141, we pointed out that "this definition including as

it does any distribution * *, applies also to distributions in liquidation, in the absence of a specific provision that distributions in liquidation shall be treated as something else", citing: Falk v. Wisconsin Tax Commission, 259 N. W. (Wis.) 624; Hope Inv. Co. v. Wisconsin Tax Commission, 259 N. W. (Wis.) 628; Larson v. Wisconsin Tax Commission, 288 N. W. (Wis.) 250; Frank Darrow, 8 B.T.A. 276; Philetus W. Gates, 9 B.T.A. 1133; Phelps v. Commsr., 54 F. (2d) 289, cert. den. 285 U.S. 558; James Dobson, 1 B.T.A. 1082; A.B. Mickey & Sons, 3 B.T.A. 173. As to the income tax law, we were of the opinion that by Section 2033-2 (b) R.L. 1935, the legislature had provided for different treatment of distributions in liquidation, but as to the welfare tax there was nothing to take the case out of the general rule that this definition of "dividend" includes distributions in liquidation, and accordingly such distributions are subject to welfare tax. Hawaiian Sugar Company has submitted arguments against the application of this conclusion, as follow:

a. That the amount received by the stockholders should be treated as a payment in exchange for the stock, citing federal Regulations 103, Sec. 19.115-5.

This regulation is based upon Section 115 (c) I.R.C. Prior to the enactment of the statutory provision the federal authorities held that a distribution in liquidation should not be treated as a payment in exchange for the stock.

b. That the tax is levied upon the stockholder with respect to the receipt of the dividend and there can be no tax if there is no income realized by the stockholder i.e. he must first receive back his investment in the stock.

Assuming that the contention that the tax is on the receipt of the dividend is correct, nevertheless the conclusion urged does not follow. The welfare tax is on gross receipts, not net income. The argument assumes that the liquidation is to be treated the same as a sale or exchange of the stocks and that the "dividend" is limited to the profit arising from such sale or exchange, which is not the case. See paragraph "a" supra.

The contention that the question whether or not a distribution in liquidation is capital should be determined from the standpoint of the person receiving the distribution was considered and rejected in Boston Safe Deposit and Trust Co. v. Commissioner, 10 N.E. (2d) 105 (Mass. 1937). This was a tax on the recipient of the distribution. The Court held that it would determine the classification of the distribution according to the source from which it was paid, and not on the basis of whether or not the shareholder had received more than he paid in.

c. That the differentiation between payments from capital and payment from surplus is insubstantial, because surplus can be converted into capital at any time through the issuance of a stock dividend.

This contention is answered by the cases which hold that redemption of stock issued as part of a continued unified plan to distribute surplus will be treated the same as if the stock had not been issued. 1 Paul and Mertens Law of Federal Income Taxation, Sec. 8.109. Moreover, the statute does not specifically exempt distributions of capital, and whether or not the implied exemption should be allowed in the event of a capitalization of earned surplus need not be considered at this time.

d. That the capital gain provision, which this office has ruled exempts such distributions from payment of income tax, also applies to the public welfare tax by reason of Section 14 of the Public Welfare Tax Act, which incorporates provisions of the income tax law not inconsistent with the provisions of the Public Welfare Tax Act.

This section does not incorporate the exemption provisions of the income tax law. The Public Welfare Tax Act contains its own provisions as to what shall be taxed and what shall be exempted from tax. See Bishop v. Hill-, Circuit Ct., 1st Cir., L. No. 14486, Sept. 12, 1934.

e. That it is doubtful that the legislature intended to tax any dividends paid from surplus earned prior to the effective date of the Act in 1933.

This contention again assumes that the trans-

action is to be viewed as a sale or exchange of the stock in which the tax falls only on the profit from the transaction, and, further, that the basis for determining the profit is the value of the stock on the effective date of the tax act. None of these considerations is present. Since the tax is on dividends, the time when the corporation earned the profits from which the dividends are paid is immaterial. Van Dyke v. City of Milwaukee, 146 N.W. 812 (Wis. 1914); Lynch v. Hornby, 247 U.S. 339, 1918.

Respectfully,

Rhoda V. Lewis

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Deputy Attorney General

APPROVED:

Garner Anthony
Attorney General.