



1952

Treasury Stock; A Corporate Anomaly

Harry Kotler

Follow this and additional works at: <https://engagedscholarship.csuohio.edu/clevstrev>

 Part of the [Business Organizations Law Commons](#)

How does access to this work benefit you? Let us know!

Recommended Citation

Harry Kotler, Treasury Stock; A Corporate Anomaly, 1(2) Clev.-Marshall L. Rev. 9 (1952)

This Article is brought to you for free and open access by the Law Journals at EngagedScholarship@CSU. It has been accepted for inclusion in Cleveland State Law Review by an authorized editor of EngagedScholarship@CSU. For more information, please contact library.es@csuohio.edu.

Treasury Stock; A Corporate Anomaly

by Harry Kottler*

I. "Treasury Stock" Defined.

The General Code of Ohio defines treasury shares as follows: "The term 'treasury shares' means shares issued and thereafter acquired by the corporation, and not retired or disposed of."¹

In the Act as originally passed, "treasury shares" were defined as "shares issued and paid for and thereafter acquired by the corporation, if not required to be cancelled." This definition was clarified in 1929 by omitting the words "and paid for" and the words "if not required to be cancelled." Explaining the omission of the words "if not required to be cancelled," the Corporation Committee said:

"The definition of treasury shares in the Act is not accurate in that it excludes shares which are required to be cancelled. This would keep a preferred share from being handled and classed as a treasury share, if by its terms it was required to be cancelled when redeemed. A corporation in order to obtain a settlement of a claim, or for any of the purposes permitted by Section 41, might lawfully acquire one of its preferred shares which was required to be cancelled upon redemption, and such a share, notwithstanding the requirement of cancellation, ought to be treated and handled as a treasury share until formally redeemed."²

* Mr. Kottler is a graduate of Western Reserve University (B. B. A., LL. B.) and is presently pursuing graduate study at the Law School of that university. A former naval officer during World War II, Mr. Kottler is associated in the general practice of law with the Cleveland firm of Daus and Schwenger.

¹ Ohio General Code Sec. 8623-2.

² Committee Report (January 5, 1929) 14. Until amended in 1939, Sec. 8623-39 distinguished between the "redemption" of shares subject to redemption and the "retirement" of treasury shares; and Sec. 8623-41 provided that redeemable shares purchased for the purpose of, or in anticipation of, redemption were to be carried on the books of the corporation as treasury shares until the "redemption" thereof was affected. Under the Act as amended in 1939, the distinction which formerly existed between "redemption" and "retirement" has been eliminated. See Sec. 8623-39. Shares subject to redemption issued and thereafter acquired by the corporation are by definition treasury shares and treated and handled in the same manner as other treasury shares, except that shares required by their express terms and provisions to be cancelled upon the acquisition thereof can not be reissued.

In 1939 the definition of treasury shares was changed by adding the words "and not retired or disposed of." The purpose of this addition was to make it clear that treasury shares cease to be such when retired, i.e., restored to the status of authorized and unissued shares—or when disposed of or reissued by the corporation, thus becoming issued and outstanding shares.

The definition of "to retire," which was added to this section by the 1939 change to implement the definition of treasury shares, is to be considered in connection with the provisions of Section 8623-39. Whenever a corporation acquires any of its own shares, such shares, even though the articles of the corporation require their cancellation or prohibit the reissue thereof, are not automatically retired, but action to that end must be taken by the board of directors or shareholders in conformity with the provisions of Section 8623-39.³ That is to say, a resolution must be adopted to retire those shares, and a report of such reduction of stated capital made to the Secretary of State. Whether or not, therefore, the corporation has the right to reissue or resell such shares of stock, until the redemption or retirement of such shares they are to be regarded as treasury shares.⁴

Other states, feeling a necessity for the spelling out of the distinction between "retirement" and "redemption" of shares of stock, have gone to some length to point out that so long as these shares remain subject to resale by the corporation or have not been barred from reissue by a prohibition against such reissue, they fall within the purview of the definition of treasury stock.⁵

"Treasury stock," then, appears to be best defined as the term applied to issued stock that has come into the hands of the cor-

³ 1 DAVIES, OHIO CORPORATION LAW 125.

⁴ *State Ex Rel. Page v. Smith*, 48 Vt. 266 (1876), where the court held that treasury stock is not automatically retired unless otherwise intended, but is rather a corporate asset and cannot be regarded as unissued stock. See also: *Commonwealth v. Boston & Albany R. R. Co.*, 142 Mass. 146, 7 N. E. 716 (1886). See also: 2 Ohio Atty. Gen's. Ops. 1322 (1916), where it is stated: "The purchase by a corporation of its own stock, which has been previously issued, subscribed and outstanding, does not restore such stock to the status of unissued stock. It continues to retain its character as subscribed, issued and outstanding stock."

⁵ Treasury shares are defined by a California statute (CAL. CIV. CODE, Sec. 278) as those shares which have been issued and thereafter acquired by the same corporation, but not retired or restored to the status of unissued shares.

A Missouri court has described them as "shares of stock belonging to and subject to sale by a corporation." *Maynard v. Doe Run Lead Co.*, 305 Mo. 356, 265 S. W. 94 (1924). This definition seems grossly inadequate in the light of the text discussion.

poration by purchase, donation or other means and which is not extinguished or destroyed either by the purchase or subsequent to it, with the directors having the right to sell and dispose of it again.⁶

II. *Legal Status of Treasury Stock.*

Strictly speaking, a corporation cannot become its own shareholder.⁷ That is to say, it obviously cannot have a proprietary interest in itself,⁸ and yet the corporation, upon the acquisition of its own shares, must know the legal status of such shares for a variety of purposes. Are they to be regarded as assets of the corporation, much as its machinery and equipment? Or are they merely choses in action, remaining in suspended animation until the assertion of some corporate right which revitalizes them and gives them force and personality?

There appears to be much disagreement as to the precise nature of the legal status of treasury shares. As stated by Judge Learned Hand in the *Kirschenbaum* case⁹: "The status of 'treasury shares' is in general not made clear in the books. Some courts treat them as though they were in suspended animation, existing, but existing only in a kind of Limbo. Other courts treat them as though they were retired."

On the other hand, Professor Ballantine contends they are in reality a new issue of securities. "Treasury shares," he says, "are indeed a masterpiece of legal magic, the creation of something out of nothing. They are no longer outstanding shares in the hands of a holder. * * * Their existence as issued shares is a pure fiction, a figure of speech, to explain certain special rules and privileges as to their reissue. * * * The truth is that treasury stock is merely authorized stock which may be reissued as fully paid without some of the restrictions upon an original issue of shares as to consideration and as to pre-emptive rights, if any."¹⁰

Since there appears to be little agreement as to the precise legal status of treasury shares,¹¹ and since this uncertainty has

⁶ 10 Ohio Jur. 243, Sec. 162.

⁷ 1 MORAVETZ, PRIVATE CORPORATIONS (2d Ed.) 114.

⁸ *Gustin v. Merrill*, 144 Mich. 498, 108 N. W. 408 (1906).

⁹ *Kirschenbaum v. Comm'r.*, 155 F. 2d 23 (2d Cir. 1946).

¹⁰ Ballantine, *The Curious Fiction of Treasury Shares*, 34 CAL. L. REV. 536, 537.

¹¹ For a further expansion of some thoughts on this subject, see: "The Legal Status of Treasury Shares," 85 U. PA. L. REV. 622 (1937); "Effect of a Purchase by a Corporation of its Own Shares," 41 HARV. L. REV. 657 (1928).

given rise to many troublesome problems to which the decided cases do not supply clear answers, the Ohio Corporation Act has attempted to clarify their legal status for various purposes. While any attempt by the legislature to spell out the status of such shares in every contingency is undoubtedly a vast aid, it must needs leave to conjecture those anomalous situations which are left undefined by the Code. So far as the Code has gone in this direction, it has at least removed any ambiguities as to the status of treasury shares in the specific situations which it purports to cover. It provides that treasury shares shall be deemed to be outstanding for the purpose of computing a corporation's stated capital and for the purpose of determining franchise taxes under the provisions of Section 5498; but under Section 8623-41, Ohio General Code, treasury shares may not be treated as assets for the purpose of computing the excess of assets available for dividends or the purchase of shares or the making of other distributions to shareholders.

· When or whether treasury shares are to be treated as assets of the corporation appears to be a vexing problem. Courts appear to speak loosely of treasury shares as "assets" or "property." On the other hand, a much quoted dictum of Judge Hand in the *Borg* case¹² expresses a quite contrary view. There seems, however, to be a tendency toward acceptance of the "asset" concept.¹³ And yet they are not assets in the sense of having a value upon liquidation, and consequently provide no margin of protection to creditors of the corporation. Their value would completely disappear at the very time when most needed by creditors, i.e. upon bankruptcy.

Moreover, if treasury shares are to be regarded as assets, then by merely restricting each purchase to the amount of the surplus and by then using the acquired shares to indicate a continuation of the same surplus, a corporation could continue to purchase its own shares indefinitely and thus "bail out" all of the shareholders at the expense of the creditors. It is for this reason that the Ohio Corporation Act has rejected the "asset" concept, and spelled out in detail the legal status of treasury shares for specific purposes.

The "asset" concept was adopted by the Ohio Supreme Court, however, in *North High Realty Co. v. Evatt*,¹⁴ where the question

¹² *Borg v. International Silver Co.*, 11 F. 2d 147 (2d Cir. 1935).

¹³ 85 U. PA. L. REV. 622-8 (1937).

¹⁴ 143 Ohio St. 231, 54 N. E. 2d 783 (1944).

was presented as to whether treasury shares were to be considered as issued and outstanding for the purpose of determining the franchise tax due. In holding that treasury shares were assets of the company and, ergo, amenable to the tax the court said:

“The purchase by such corporation of its own shares which had been previously subscribed, issued and outstanding does not restore such shares to the status of unissued shares. Such shares continue to retain their character as subscribed, issued and outstanding shares.”

Other jurisdictions have adopted the same rule. In *Knickerbocker Importation Company v. State Assessors*,¹⁵ a statute of New Jersey provided for assessment of a corporate franchise tax on the issued and outstanding capital stock of the corporation. Appellant corporation acquired one-third of its capital stock in consideration for the transfer of one-third of the corporate assets taken from its accumulated surplus. The corporation contended that the stock thus acquired by it was not subject to taxation on the ground that the qualities of debtor and creditor were united in the corporation and that the obligation was thus extinguished. The court held, however, that the transaction did not effect a cancellation of the stock so as to reduce the capital stock for purposes of corporate franchise taxation, since it constituted treasury stock, which was considered as issued and outstanding capital stock within the meaning of the franchise tax law because they had not been formally retired or cancelled as required by law for the reduction of capital stock.¹⁶

In spite, then, of all efforts to fix the precise legal status of treasury shares, no overall principle can be laid down. They remain an anomaly, subject to varying concepts in different situations, depending, it would seem, upon a philosophy of expediency in the case at hand, and upon the equities which appear to inhere in a given circumstance.

III. *Pre-emptive Rights of Shareholders as to Treasury Stock.*

It is generally held that stockholders of a corporation have no pre-emptive right to subscribe to a pro rata share of treasury

¹⁵ 74 N. J. L. 583, 65 Atl. 913 (1907).

¹⁶ The same result was reached in *State v. Stewart Bros. Cotton Co.*, 193 La. 16, 190 So. 317 (1939).

stock,¹⁷ and the Ohio Corporation Act, in dealing with pre-emptive purchase rights, expressly provides that, unless the articles otherwise provide, treasury shares shall not be subject to pre-emptive rights.¹⁸ Prior to the adoption of the Act in Ohio, the general rule in respect of the right of existing shareholders to subscribe to a new increased issue of stock was held to apply to treasury stock.¹⁹

The reason for the denial of the pre-emptive right to treasury stock is usually based on the ground that the shareholders proportionate interest is determined by the original authorized issue, and is not, therefore, affected by reissues.²⁰ It has been suggested, however, that all exceptions to the pre-emptive rule are arbitrary, necessitated by the courts' desires to break down a rule which they have found too inflexible for modern corporate needs.²¹

In support of a shareholder's pre-emptive right, it may be said that it is the only sure protection against a dilution of his interest, even though the courts have shown an inclination to protect him from a breach of their fiduciary duty by the directors. But it is often difficult to prove that directors were acting fraudulently, and it is too expensive a procedure for the small stockholder to bring a suit without certainty of recovery.

There is, however, a fundamental principle which underlies the rule negating the pre-emptive right as to treasury shares, that is, that where there is bad faith or a breach of the directors' fiduciary duties, the stockholders may assert their legal and equitable remedies provided for in such circumstances. Thus, directors may not, by a secret purchase of treasury stock, the sale of which is exclusively in their control, (a) increase their

¹⁷ *Borg v. International Silver Co.*, 11 F. 2d 147 (2d Cir. 1935); *Crosby v. Stratton*, 17 Colo. App. 212, 68 Pac. 130 (1902); 1 U. OF CHI. L. REV. 645-7; *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 78 N. E. 1090 (1906); 13 Am. Jur. Sec. 311, Sec. 189.

¹⁸ Ohio General Code Sec. 8623-25.

¹⁹ In *Sachs v. Randolph Desk Co.*, 3 O. L. Abs. 525, the court held that where a corporation, through its directors, seeks to sell any portion of its treasury stock, reasonable opportunity must be afforded to present stockholders to acquire a pro rata portion of it; and, therefore, a resolution of the board of directors which authorizes sale of treasury stock to strangers is null and void if no reasonable opportunity is given a stockholder to purchase his pro rata share thereof, and the corporation and its directors will be enjoined from transferring the stock, or rights by virtue of it, and the stock was decreed to be surrendered to the corporation to be cancelled and refund made to the purchaser.

²⁰ "Treasury Stock," 36 YALE L. J. 1181 (1927).

²¹ BERLE & MEANS, *THE MODERN CORPORATION* (1st Ed. 1932).

voice in the control of the corporation, (b) increase their proportionate share of the surplus, or (c) obtain the stock at an inadequate price.²²

Thus, in *Elliott v. Baker*,²³ the Supreme Court of Massachusetts, while recognizing the general rule of no pre-emptive right to treasury shares, held that if, however, there is a contest for control of a corporation, it would not permit the directors, in pursuance of a pre-arranged agreement between them and a third person, for the purpose of ousting of the leader of the opposing faction, issue treasury stock to such third person, without giving the stockholders equal opportunity to purchase the stock, notwithstanding that the stock so issued was turned in to the company by a stockholder, to be disposed of for the corporation's benefit in such way and for such price and purpose as the directors might determine. The court ordered cancellation of the certificate and the return of the shares to the treasury of the company.²⁴

In *Hammer v. Werner*,²⁵ the plaintiffs were shareholders in the American Metal Company which held 1685 of its own shares as treasury shares. Defendants, directors of the company, without offering the other shareholders an opportunity to subscribe for a pro rata share of the treasury stock, purchased the shares themselves at a price of \$70.00 per share. These shares were subsequently sold at \$661.00 per share. The court, in a vigorous decision, held that the plaintiffs could recover their damages, and the court stated that the plaintiffs, being stockholders of the company, had at least an equal pre-emptive right to purchase treasury shares with the directors of the company.

It is clear, then, that although it is generally held that shareholders have no pre-emptive rights as to treasury shares, the shareholders may have such a right, or at least certain remedies, when the resale of treasury shares redounds to their pecuniary disadvantage or is used by the directors to acquire an unconscionable advantage over some of them.

²² *Treasury Stock and Its Relation to Earned Surplus*, 3 BROOKLYN L. R. 337-9.

²³ 194 Mass. 518, 80 N. E. 450 (1917).

²⁴ See also: *Dunn v. Acme Auto & Supply Co.*, 168 Wis. 128, 169 N. W. 297 (1918).

²⁵ 239 App. Div. 38, 265 N. Y. S. 172 (1933).

IV. *Voting Rights of Treasury Stock.*

In accord with the established common-law principle, the Ohio Corporation Act²⁶ expressly forbids a corporation from voting, directly or indirectly, upon any stock issued by it. The rule appears to have been generally adopted in other jurisdictions.²⁷ The underlying theory is not that the voting power is lost, but that it is withdrawn to effect equal distribution of the voting power among the stockholders, and to prevent the directors from perpetuating their control of the company.

Since a corporation cannot vote its own shares, the device of pledging the stock to third persons has been attempted with varying degrees of success. In general, it has been held that since a corporation has no right to vote its own stock held by it, it cannot by agreement, as pledgor, confer upon the pledgee the right to vote. At least one Ohio court has declined to accept this rule.

The Superior Court of Cincinnati, in *Allen v. Lagerberger*,²⁸ held that the pledgees of stock in a corporation of which the corporation was itself pledgor, might vote the stock at an election, if by the contract to pledge it was intended that the pledgees should vote, and the right to vote was conferred for a consideration inuring to the benefit of all of the shareholders, and the mere fact that it might have been expected that the pledgees would vote for the existing management of the corporation would be no ground for setting aside the contract, if they gave full value for the collateral with power to vote; in other words, if the pledgees were not bound by any collusive agreement between them as directors, secured by parting with the rights of the company to support the existing board, their preference in the matter, growing out of confidence in the management, even if known to those managers at the time of the transfer, did not indicate a fraud upon the rights of the stockholders.

The court declared that the inability of the company to vote arose in fact from the equal distribution of the power to vote among the shareholders, and that, therefore, there was no reason why, under a pledge, by express contract, the right to vote might not be transferred, if transferred for a consideration inuring to the benefit of all the stockholders. *Quare*: Whether the court

²⁶ Ohio General Code Sec. 8623-52.

²⁷ 90 A. L. R. 318. and cases cited.

²⁸ 10 Ohio Dec. Repr. 341, 20 Bull. 368 (1888). And see 5 FLETCHER, CYCLOPEDIA OF CORPORATIONS 150 Sec. 2041.

would have so held had not the stockholders been stifled in their voting by the equal distribution of shares?

Under a New Jersey statute analogous to that of Ohio, it was held in *Thomas v. International Silver Co.*²⁹ that treasury shares pledged by the corporation to secure a loan can not be voted. "The right," the court said, "which the law gives to the pledgor to empower the pledgee to vote thereon is limited to such pledgors as are themselves possessed of the right to vote on the stock which they own, and * * * the pledgees in this case held the stock subject to the same disqualification, so far as the power to vote thereon is concerned, as that which the statute imposes on the pledgor."

It should be pointed out, however, that in the *Allen* case, the court found no evidence of bad faith on the part of the directors in making the pledge, while the court in the *Thomas* case noted that the pledge was in fact made not to secure a loan but to enable the directors to vote the treasury shares. In spite of the language used by the courts, then, it would appear that the guiding principle in determining whether or not a pledgee may vote treasury shares does not depend upon the rules of statutory construction, but rather upon the good or bad faith of the directors in making such a pledge.

V. *Resale and Reissuance of Treasury Shares.*

Unless the articles of the corporation provide otherwise, treasury shares may be disposed of for such considerations as the board of directors may fix.³⁰ The requirement that stock must not be issued for an amount less than its par value, except where the corporation is financially embarrassed and in need of additional capital, or where an amount is discounted as part of the cost of underwriting, does not apply to treasury stock.³¹ However, in disposing of treasury shares and in fixing the amount of consideration therefor, the directors have a broad discretion, but, as in the case of an original issue of shares, it is manifestly clear that they are bound to act fairly and fix an amount of consideration which is reasonable under the circumstances,³² and the sale

²⁹ 72 N. J. Eq. 224, 73 Atl. 833 (1907).

³⁰ Ohio General Code Sec. 8623-19.

³¹ 10 Ohio Jur. 544, Sec. 407; 4 THOMPSON, CORPORATIONS 51, Sec. 3436 (2d Ed.)

³² See note 25, *supra*.

of such shares for a nominal consideration is clearly to be treated as void and subject to rescission in an action by the shareholders.³³

Where treasury shares are resold at less than their cost to the corporation, its surplus is thereby reduced by an amount equal to the difference between cost and the resale price; but where such shares are sold for more than cost to the corporation, the amount of such excess constitutes surplus, which, under the provisions of the Ohio Corporation Act,³⁴ must be separately shown on the balance sheet.³⁵

The board of directors may, if it chooses, cause treasury shares to be reissued by the declaration of a dividend. Such a dividend does not, however, constitute a share dividend in the usual sense of the term. Since stated capital was not reduced when the treasury shares were purchased by the corporation, consequently, stated capital is not increased when the shares are reissued in payment of dividend. The effect of a dividend paid in treasury shares is permanently to reduce surplus by the amount thereof which was appropriated or ear-marked when the treasury shares were purchased by the corporation. The transaction is, therefore, viewed from that position, in many respects similar to the payment of a cash dividend. Since, however, the proportionate interests of the shareholders remain the same as it was prior to the declaration of the share dividend, it is in reality a maintenance of the status quo with respect to their relative equities and does not enrich them as would a cash dividend.

Oftentimes the corporation, in reselling treasury shares is required to enter into an agreement to repurchase such shares from the buyer. By the weight of authority, such an agreement by a corporation, entered into at the time of the sale of its stock, whereby the corporation undertakes, at the option of the purchaser, to repurchase the stock or take the certificates back and return the consideration paid, in certain contingencies, is not ultra vires the corporation and is enforceable against it.³⁶

In *Dickinson v. Zubiata Mining Co.*³⁷ such a contract was held valid where the contract of sale which had been entered

³³ *Stramann v. North Baltimore Waterworks Co.*, 8 Ohio C. C. 89, 4 Ohio C. Dec. 339.

³⁴ Ohio General Code Sec. 8623-38.

³⁵ 1 Davies, op. cit., p. 708.

³⁶ 101 A. L. R. 179 et seq., and cases cited. See also: *Oklahoma Natural Gas Co. v. Douglas*, 170 Okla. 28, 39 P. (2d) 578 (1934); *Oklahoma Natural Gas Co. v. Hudson*, 170 Okla. 291, 39 P. (2d) 585 (1934); *Wilson v. Torchon Lace & Merc. Co.*, 167 Mo. App. 305, 149 S. W. 1156 (1912).

³⁷ 11 Cal. App. 656 (1909).

into was accompanied by an agreement, embodied in a written contract entered into contemporaneously with the sale, whereby the corporation agreed that it would refund the money paid for the stock, if, after examination of the properties of the company, the purchasers were not satisfied.

Stating that a contract made by a corporation for the repurchase of its stock from an original subscriber would be against public policy, ultra vires and unenforceable, the Supreme Court of Washington in *Simonds v. Nolan*³⁸ held that this rule did not apply where the stock agreed to be purchased had been regularly subscribed and paid for at the time of the organization of the company, and donated or given back to it by those who had subscribed and paid for it, so that the corporation might use the stock for its benefit. In the course of its opinion, the court said:

“When stock subscribed and fully paid for is turned back to the corporation, which the corporation has the power to resell, and regarding such sale it can make such agreement as the dictates of sound business judgment may demand. If this company had sold some other assets, for example a piece of machinery, with an agreement to repurchase it, there could be no question but what the agreement could be enforced and would not be ultra vires. The treasury stock in this case differed in no respects from the machinery in the supposititious case.”

The court further observed that the distinction between a contract to repurchase capital stock originally issued, and one to repurchase treasury stock is not observed by some courts, but it stated that it perceived strong and convincing arguments in favor of such a distinction.³⁹

VI. Accounting For Treasury Stock.

In accounting practice, treasury shares have enjoyed a status no less ambiguous than in law.⁴⁰ Upon corporate balance sheets they have appeared as current assets, investment assets, unclassified assets, deductions from earned surplus, etc. They have been variously valued at cost of acquisition, original price issued for, par or stated value, market value and a fractional portion of capital stock value. The earliest method of dealing

³⁸ 142 Wash. 423, 253 P. 638 (1927).

³⁹ Cf. *Ophir Consolidated Mines Co. v. Brynteson*, 143 F. 829 (CCA 7th, 1906); *Mulford v. Torrey Exploration Co.*, 45 Colo. 81, 100 Pac. 596 (1909); *Royal Glue Co. v. Lange*, 40 App. D. C. 9 (1913), involving treasury stock, in which the decision giving effect to the agreement is not based on the treasury character of the stock.

⁴⁰ Hills, *Stated Capital and Treasury Shares*, 57 J. OF ACCOUNTANCY 202 (1934).

with them was to represent them as assets, which may give a false impression of the legal fund available for dividends and the purchase of shares. A more recent method, to list them as a deduction from capital stock, is also liable to misrepresent the true situation, unless it is somehow indicated that the stated capital, which is not a fund, but a legal requirement, has not been reduced. Therefore, a third method has been advocated, involving a deduction from earned surplus, or combined capital and earned surplus, and a valuation at cost of acquisition. Whatever method is used, it should be made clear so that creditors will know their status.

The Federal Securities and Exchange Commission, in its Instruction Book, Form A-2, suggests that it is preferable to show treasury stock as a deduction from capital stock or from either the total of capital stock and surplus, or from surplus, at either par or cost as the circumstances require.⁴¹ However, the methods prescribed by the S E C are open to some criticism. To carry treasury shares as a deduction from stated capital, it has been suggested, is necessarily (a) a misrepresentation that surplus has not been reduced, or (b) in case there is not sufficient surplus to absorb the reduction, an admission of illegal reduction of stated capital or (c) a representation that stated capital has been legally reduced.⁴² A requirement that treasury shares be purchased only from surplus is a requirement that such shares be not carried as an asset nor as a reduction from stated capital.

Mr. Davies, in his work on Ohio corporations, asserts that treasury shares should be shown as a deduction in the net worth section and not carried as an asset. "It should be observed," he states, "that the practice of showing treasury shares which have been purchased out of surplus as a deduction from stated capital or as an unallocated reduction of stated capital and surplus * * * results in an overstatement of the amount of surplus legally available for dividends and the purchase of shares * * * a purchase of shares renders unavailable for dividends or for the purchase of additional shares a portion of surplus equal to the cost of the treasury shares, and the balance sheet should clearly reflect this result."⁴³

⁴¹ S. E. C. Reg. S-X, Rule 3.16 provides: "Acquired shares (treasury stock), if significant in amount, shall be shown separately as a deduction from capital shares, or from the total of capital shares and surplus, or from surplus, at either par or stated value, or cost, as circumstances require."

⁴² Hills, *Model Corporation Act*, 48 HARV. L. REV. 1334 (1935).

⁴³ 1 DAVIES, OHIO CORPORATION LAW 711-2.

The Ohio Corporation Act does not undertake to specify how treasury shares shall be carried on the books of the corporation, but in result, at least, the treatment it accords treasury shares upon a determination of the excess of assets available for dividends follows approved accounting practice. The Act provides that "in the determination of the excess of the corporation's assets over its liabilities plus stated capital, for the purpose of declaring and paying a dividend, purchasing its own shares or making any other distribution to shareholders, treasury shares shall not be considered as an asset of the corporation."⁴⁴ They must, however, be included among its outstanding shares for the purpose of determining stated capital.⁴⁵

While the accounting practices with respect to the method of treating treasury shares seems to vary rather widely,⁴⁶ it is essential that the method adopted clearly indicate to creditors and others relying on the balance sheet the precise position which the corporation has taken.

In one respect, at least, accounting practice seems fairly uniform; that is, that surplus arising from the sale of treasury shares is to be treated as capital surplus.⁴⁷

VII. *Tax Aspects of Treasury Stock.*

From 1920 to 1934 the Treasury Regulations specifically provided that for the purpose of the federal income tax no gain or loss was realized by a corporation from the purchase or sale of its own shares, but in 1934, the Regulations were changed to require the recognition of gain or loss on such transactions.⁴⁸ The current Treasury Regulations provide:

"Whether the acquisition or disposition by a corporation of its own capital stock give rise to taxable gain or deductible

⁴⁴ Ohio General Code Sec. 8623-41.

⁴⁵ Ohio General Code Sec. 8623-37.

⁴⁶ For a detailed discussion of the various methods of accounting for treasury shares and the effect upon surplus and stated capital, see: 13 TEX. L. REV. 442, 454 (1935); 20 CHI-KENT L. REV. 115, 129 (1941).

⁴⁷ Opinion of Chief Accountant of S E C, Accounting Release No. 6 of May 10, 1938; Marple, *Capital Surplus and Corporate Net Worth*; Rankin, *Treasury Stock: A Source of Profit and Loss*, 15 ACCTG. REV. 71 (1940); Musselman, *On the Nature of the Gain on Treasury Stock*, 70 J. OF ACCOUNTANCY 104 (1940).

⁴⁸ For cases involving the application of the amended Regulation, see *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 59 Sup. Ct. 423, 83 L. Ed. 536 (1939); *E. R. Squibb & Sons v. Helvering*, 98 F. 2d 69 (2d Cir. 1938); *Comm'r. v. S. A. Woods Mach. Co.*, 57 F. 2d 635 (1st Cir. 1932); See also Notes: 37 MICH. L. REV. 1351; 39 COLUM. L. REV. 716 (1939).

loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of the stock.

“But if the corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.”⁴⁹

VIII. *Conclusion.*

Treasury shares and their incident problems are of comparatively recent origin. It is signally characteristic of their youth, therefore, that neither their precise legal status nor definitive concepts can be attached to them. Certainly it may be expected that the gamut of legal wisdom will be searched before a series of forceful precedents can be established by which to fix their status. They are an anomaly, since it has thus far appeared that they have been subjected to a doctrine of expediency, a doctrine of ascertaining their position and consequences only from the point of view of the specific problem at hand. They are assets for one purpose, but not assets for another. They are treated as existing for one purpose, but non-existent for another. They appear, reappear and disappear. They have a fluidity which is uncommon in corporate law, where certainty, precision and definiteness are the keynotes. Because they offer to a corporation a singularly tempting opportunity to represent the corporation's financial status in any way the directors may desire, for this reason creditors and stockholders must carefully scrutinize any transactions involving them. It may well be expected, in the light of the uncertainty of their nature, that transactions involving treasury shares will be the subject of much litigation.

⁴⁹ Reg. 103, Sec. 19.22 (a)-16.