North Carolina Central Law Review

Volume 2 | Issue 1 Article 14

4-1-1970

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Attribution and Beneficial Ownership Rules in Tax and Securities Laws: A Comparative Treatment and Analysis of Effectiveness

Today any corporate counsel who is "worth his weight in gold" cannot for one minute make decisions affecting his clients' securities without taking a long hard look at the vast rules and regulations that affect them under the Securities Acts[1] and the Internal Revenue Code.[2] In this paper I intend to analyze just how an individual, a partnership, corporation, trust and estate that dispose of its securities or other interests could be affected by the "beneficial" or "constructive" ownership rules under the Securities Exchange Act and the Internal Revenue Code. For corporate counsel, the effect and impact of these rules must be a matter of constant concern and as such must constantly endeavor to answer questions pertaining to who is a "beneficial owner" of the securities. Is a person the "beneficial owner" of securities held by other members of his family? Or is a partner the "beneficial owner" of securities held by his partnership? What about the securities that are held in trust or by the estate? Is the trust (or trustee for that matter) or estate the "beneficial owner" of the securities? Who is the "beneficial owner" of securities held by the corporation?[3]

To resolve these questions it would be necessary to examine them in light of the Federal Securities Act[4] and the Internal Revenue Code[5] in order to establish the applicability of the statutes, the prohibitions, and the liabilities which result through the existence of beneficial ownership.

Under the Revenue Code, stock ownership rules were originally de-

[1] SECURITIES ACT OF 1933, 48 Stat. 74, as amended, 17 U.S.C. §§ 77a-aa (1964) (hereinafter cited as SECURITIES ACT); SECURITIES EXCHANGE ACT OF 1934, 48 Stat. 881, as amended, 15 U.S.C. §§ 78a to hh-1 (1964) (hereinafter cited as EXCHANGE ACT); PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, 49 Stat. 838, as amended, 15 U.S.C. § 79 to 792-6 (1964); 15 U.S.C. §§ 77aaa-bbbb (1964); INVESTMENT COMPANY ACT OF 1940, 54 Stat. 789, as amended, 15 U.S.C. § 80a-1 to-52 (1964); INVESTMENT ADVISERS ACT OF 1940, 54 Stat. 847, as amended, 15 U.S.C. §§ 80b-1 to 21 (1964).

[2] INTERNAL REVENUE CODE OF 1964.

[3] For an excellent discussion of these questions see Feldman & Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 WESTERN RESERVE L.R. 1054 (1966) and Ringel, Surrey and Warren, *Attribution of Stock Ownership in the Internal Revenue Code*, 72 HARVARD L. REV. 209.

[4] See note 1 *supra*.

[5] See note 2 *supra*.

veloped to prevent tax avoidance through the "scheme of the incorporated pocketbook"[6] "and through transactions between members of a family and close corporations."[7] It has been suggested that "the assumption behind the rules are that, for practical purposes, persons or entities can control other persons or entities through close family relationship, stock ownership or otherwise."[8] Under the Exchange Act the rules were developed to prevent "the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information . . . to aid them in their market activities," and ". . . the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others."[9] One could readily conclude that the desired effect of both the Revenue Code and the Exchange Act is to curb the effect that control might have on profits by way of tax avoidance schemes and through the use of insider's information.

Determination of Beneficial Ownership

There are numerous guides for determining "beneficial ownership" under the Revenue Code[10] and the Exchange Act.[11] Under the Revenue Code the relationship necessary to effect "beneficial ownership" depends largely on the family relationship of the taxpayer to others in the business entity and the aggregate of this relationship which would effect con-

[6] H.R. Rep. No. 704, 73rd Cong. 2nd Sess. (1934) (CB1939-1) (part 2), (554,562).

[7] *Id.* at 571.

[8] *See* Loeb, *What Constitutes Ownership of Stock*, 21 NYU Institute on Fed. Taxation 417 at 419.

[9] Senate Comm. on Banking and Currency, *Stock Exchange Practices*, S. Rep. No. 1455, 73d Cong., 2d Sess. 6556 (1934).

[10] The Internal Revenue Code of 1954 uses the word "Constructive Ownership" instead of "Beneficial Ownership" as used in the Securities Exchange Act of 1934. However, the term "constructive ownership" as used in section 267(c), 318, 425 and 544 does not carry a uniform meaning except that they all refer to "stock," and benefits derived from "constructive ownership." For purposes of this article the word "beneficial" would be used throughout in lieu of "constructive" in reference to all such ownership under the Internal Revenue Code 1954.

[11] Exchange Act sec. 16(a) 48 Stat. 896 (1934), as amended, 15 U.S.C. § 78 p(a) (1964. "Every person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, . . . pursuant to section 12(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission."

trol or constitute "constructive ownership" directly or indirectly.[12] In order to effectuate "beneficial ownership" under the Exchange Act it would be necessary for the "beneficial owner" to own directly or indirectly more than 10 percentum of any class of any equity security or be a director or officer of the issuer of such securities.[13]

Family Attribution Rules

The determination of whether a person is the beneficial owner of securities held in the name of his spouse, minor children or other relations is significant in deciding whether such securities should be included in the reports filed by officers, directors and beneficial owners pursuant to Section 16(a).[14] Likewise, for the purposes of the provisions of Section 318, an individual shall be considered as owning the stock owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and his children, grandchildren, and parents.[15] The Commission has made no definite ruling as to whether a spouse who is legally separated from the individual under a decree of divorce or separate maintenance would still be considered a "beneficial owner" under Section 16(a).[16] I would imagine that if the circumstances are such where both spouses own stock in the company and legal provisions exist for separate maintenance or alimony there would be a determination of "beneficial ownership" since the Commission has taken the position that,

[12] Under sec. 267(b) and (e) Relationships once established are computed on the aggregate of 50 percent in value of the outstanding stock of which is owned. Sec. 544 is similar to sec. 267(c) except there is no percentage mentioned. Sec. 318 requires a 50 percent or more in value between individuals and corporations. However, if any of the shareholders of a corporation are so related that the stock owned by one person is attributed to another person under the rules of section 318 (applied without regard to the fifty percent limitation in section 318(a)(2)(c)), the related shareholder are considered as only one person solely for the purpose of determining the ten largest shareholders. Sec. 425 varies for different relationships from 5 percent to 95 percent.

[13] See note 11 *supra.*

[14] *See,* Securities Exchange Act Release No. 7824 (February 14, 1966).

[15] Sec. 318(a)(1)(A) 1954 Code.

[16] It has been suggested that "if special circumstances exist indicating that a person is not the beneficial owner of securities held in the name of members of his family, *e.g.,* the person is divorced or legally separated from his spouse and does not receive any benefits of ownership from the securities held by such spouse—or if he wishes advice as to whether he should report securities held by family members as being beneficially owned—he may write to the Securities and Exchange Commission, Washington, D.C. 20549, setting forth the relevant facts involved and request from the staff of the Commission an expression of opinion with respect to whether such securities should be reported as being beneficially owned." SEC Release No. 7824 (February 14, 1966).

"Generally a person is regarded as the beneficial owner of securities held in the name of his or her spouse . . . Absent special circumstances such relationships ordinarily result in such person obtaining benefits substantially equivalent to ownership, *e.g.*, application of the income derived from such securities . . . , to meet expenses which such person otherwise would meet from other sources, or the ability to exercise a controlling influence over the purchase, sale, or voting of such securities."[17]

It would seem at first glance that the SEC should take the position of the Internal Revenue Service[18] and exempt a spouse that is legally separated from the individual under a decree of divorce or separate maintenance from registering as a beneficial owner, but it should also be noted that although a report includes the holdings of other members of the family of the person filing reports, a person may avail himself of the privilege granted by Rule 16a-3 and disclaim that such report is an admission of beneficial ownership of any securities included in the report. Another consideration would be that the Revenue Code is looking strictly at the profit or income derived through the relationship and seeing that such income is properly allocated rather than the manipulations through a controlling influence which would primarily concern the SEC. However, under other provisions of the Act, liabilities attach because of the realization of a profit.[19] It is this profit which has motivated the abuse of inside information and thus caused the enactment of Section 16(b).[20] Whether section 16(b) is necessary to give section 16(a) effect is doubtful since it seems that 16(a) is itself a deterrent to the misuse of inside information through the publicity which attaches to the reports.[21]

Section 318(a)(5)(b)[22] provides that stock constructively owned by an individual by reason of ownership by a member of his family shall not be considered as owned by him for purposes of making another family member the constructive owner of such stock under section 318(a)(1). For example, if F and his two sons, A and B, each owns one-third of the stock of a corporation, under section 318(a)(1), A is treated as owning constructively the stock owned by his father but is not treated as owning

[17] *Id.*

[18] Sec. 318(a)(1)(A)(i) 1954 Code.

[19] Section 16(b) provide that profits realized by persons required to report pursuant to Section 16(a) from the purchase and sale, or sale and purchase, of any equity security, whether or not registered, of the issuer, within a period of less than six months inure to and are recoverable by or on behalf of the issuer.

[20] EXCHANGE ACT, Sr. 16(b), 48 Stat. 896 (1934), as amended 15 U.S.C. § 78 p (1964).

[21] Feldman & Teberg, note 3 at 1065, *supra.*

the stock owned by B. Section 318(a)(5)(B) prevents the attribution of the stock of one brother through the father to the other brother, an attribution beyond the scope of section 318(a)(1) directly. Using the same example as above, would the results be the same under the family rules of section 16(a) of the Exchange Act? If both A and B were minors there is no doubt that the beneficial ownership rules would apply even if they were held in a revocable trust by F since a person . . . is regarded as the beneficial owner of securities held in the name of . . . minor children . . . , even though he does not obtain therefrom the . . . benefits of ownership, if he can vest or revest title in himself at once, or at some future time.[23] However, assuming the converse that A and B were adults living apart and maintaining separate homes from F, would the result be the same under section 16(a)? A person also may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement, or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership. It could be assumed that if a pooling contract[24] or agreement existed between F, A and B, they would come squarely within the Act and would be subject to the reporting requirements under 16(a) and the "insider" liabilities of 16(b).

The Rule as to Partnerships and Partners

Perhaps the case that most clearly points out the significance of the attribution rules as they relate to partnerships and their partners is the case of *Blaw v. Lehman.*[25] In that case the petitioner, a stockholder in a corporation with stock registered on a national securities exchange, sued under section 16(b) of the Exchange Act to recover, on behalf of the corporation from one of its directors and a partnership of which he was a member, "short-swing" profits realized by them on the purchase and sale by the partnership of stock of the corporation within a period of less than six months. Petitioner alleged that the partnership had "deputized" the director to represent its interests on the corporation's board of directors and that by reason of his inside information, he had caused the partnership to purchase the stock of the corporation. Held: the partnership was neither an officer nor a 10% stockholder of the corporation, and

[22] Reg. §§ 1.318-4(b) 1954 Code.
[23] Exchange Act Release No. 7824 (February 14, 1966).
[24] *Id.*
[25] 286 F.2d 786 (2d Cir. 1960), *aff'd* 368 U.S. 403 (1962).

it could not be held liable as a director under §§ 16(a).[26] In the earlier case of *Rattner v. Lehman*,[27] the Court took the position that a partnership could be a director (and thus a beneficial owner) under the Act, but a partner-director must be "deputized" to act on behalf of his partnership before 16(b) liability will apply to the entity itself. The SEC has taken the position that "the director of a company issuing an equity security, who is a partner in a partnership which holds any equity securities of the company, must file reports with respect to the holdings of the partnership in such equity securities to the extent of his pro-rata interest in the partnership. If the partnership owns more than 10% of any class of equity security of the company, the individual partners are not required to file the reports unless such partners are directors or officers of the issuer or have an interest, through the partnership, in addition to that which each of them would otherwise be a direct or indirect beneficial owner, of more than 10% of any class of equity security of the issuer."[28] Thus, a partner who is subject to section 16(a) is required to report all the securities held and traded by his partnership.[29] Section 16 is not concerned primarily with the partner's relationships with his other partners, but specifically his relationship to the corporation as a shareholder, director or officer, and whether there are benefits to be derived by the other partners through this relationship.[30]

Under partnership law each partner is considered a co-owner of an undivided interest in all partnership property, therefore he would in effect be the beneficial owner of all securities held by the partnership. However, this is not the case under section 16, for he is allowed to trade freely in his own account and at the same time use the aggregate of his holdings in the partnership to gain inside information.[31]

Sections 267, 318, 425, and 544 provide without significant difference that stock owned directly or indirectly by or for a partnership shall be considered as owned proportionately by its partners.[32] The transactions under these sections are generally governed by section 707 for the purposes of which the partnership is considered to be an entity separate from the partners.[33] Nor is an individual's constructive owner-

[26] *Id.* at 409-413.
[27] 193 F.2d 564 (2d Cir. 1952).
[28] 17 C.F.R. 241. 1965 at para. 26, 045.
[29] SEC Exchange Act Release No. 4754 (Sept. 24, 1952).
[30] Feldman & Teberg, *supra* note 3 at 1078.
[31] *Id.* at 1078-79.
[32] Sec. 267(c)(2), 318(a)(2)(A), 425(d)(2), 544(a)(I) Rev. Code 1954.
[33] Reg. 1.267 (b)-(1), (b)(1).

ship, under section 267(c)(2) or (3), of stock owned directly or indirectly by or for a member of his family, or by or for a partner, to be considered as actual ownership of such stock, and the individual's constructive ownership of the stock is not to be attributed to another member of his family or to another partner.[34] For example, where community property was invested by the husband in a partnership, the wife, who under the laws of the State of Washington, has a vested interest in the community property equal to that of her husband, is not precluded from deducting in her separate return one-half of her husband's share of a partnership loss resulting from the sale of assets by the partnership to a corporation in which the husband owned, directly or indirectly, more than 50% of the stock. However, the wife does not own, directly or indirectly, 50% of the stock of a corporation.[35] Under section 267(c)(1), attribution of stock can be made to a partner only if he already owns, directly or indirectly, other stock in the same corporation, and the partner's ownership may be attributed to a member of his family or to his partner.[36] None of the sections specify the proportion of the partners' shares. However, attribution does not occur if the aggregate amount of stock owned by the partner and his relationship is below 50% of the outstanding stock. Section 707(b) would then be applied as the measuring stick to determine the partner's interest in capital or profits. It would not be possible to reach this result through section 318(a) since there is no provision for direct attribution between partners and "sidewise" attribution has been removed.[37] For example, if A owns 65 shares of P corporation and B owns 10, the shares constructively owned by the partnership are not again to be attributed to A and B. However, assuming that A owned 20% of P and B owned 80% and there were 100 shares outstanding with the partnership owning 25 of these shares, A would own another 5 shares (20% of 25) since the 25 shares would be owned directly by the partnership and similarly, B would own another 20 shares (80% of 25).

Here again we notice a certain flexibility in the tax rules and the varying results that could be achieved by eliminating attribution as it

[34] Reg. 1.267(c)-(1)(3).
[35] Rev. Rul. 121, 1953-2 Cum. Bull. 209.
[36] Reg. 1.267 (c)-(1)(3).
[37] Pub. No. 88-554 eliminated "sidewise" attribution from the constructive ownership of stock rules effective August 31, 1964, the date of the law's enactment. It provides that when stock is attributed to a partnership, estate, trust or corporation from a partner, shareholder or beneficiary, this stock is not again to be attributed to another partner, beneficiary or shareholder.

applies "indirectly." Under the same example as above, the effect under the Exchange Act, section 16(a), would be to attribute the shares to both partners and the partnership. And this would result if A, B and the partnership owned 10% or more.[38]

The Rule as to Corporations

So far we have talked about the "beneficial ownership" of securities through relationship of consanguinity and the more formal relationships of partners and partnership, but what about that "legal animal" called the corporation? Is it capable of influencing the kind of control that has been discussed? Can a corporation beneficially own securities of another corporation? If so, could the corporation's beneficial ownership of these securities be imputed to other persons, for example, its officers, directors, shareholders or the family relationship previously discussed? The answer to all these questions is obviously "yes" if they meet the test of "control."

The term "control" is defined in SEC Exchange Act, Rule 12b-2(f), to mean "the possession directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise."[39] The term "person" as it relates to "control" refers to "every person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of any security (other than an exempted security) which is registered . . ."[40], and the word "person" should be construed to cover any individual or corporation, including any holding company, holding stock of the registered company,"[41] and "every person who is . . . a director or an officer of the issuer of such security, . . ."[42]

Generally, it can be simply stated that the articles of incorporation and bylaws of a corporation represent a contract of the relationship between the corporation and its shareholders, and "a person also may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement, or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership."[43]

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[38] *See* note 28, *supra.*

[39] SEC Exchange Act Rule 126-2(f), 17 C.F.R. Sec. 240.12b-2(f) (rev. ed. 1964).

[40] SEC Exchange Act of 1934 Sec. 16(a).

[41] SEC Exchange Act Release No. 34-21, October 1, 1934.

[42] SEC Exchange Act. Sec. 16(a).

[43] SEC Exchange Act Release No. 34-7793, 17 C.F.R. 241.7793. Note: The

In *Blaw v. Mission Corporation*,[44] the court held that the Mission Corporation, which controlled the Mission Development Company, was the beneficial owner of all the securities of Tide Water Associated Oil Company held by Development for purposes of determining whether Mission Corporation was the "beneficial owner" of more than ten percent of Tide Water. Of Mission, which owned sixty percent of the outstanding stock of Development, the court stated: "There can be no doubt that Mission, by virtue of its absolute control of Development, was indirectly the owner of all Tide Water stock held by Development and was therefore an insider . . ."[45] Likewise in *Stella v. Graham-Paige Motors Corporation*,[46] it was decided that in a transaction involving the acquisition by a corporation of more than 10 percent of the stock in another corporation, the acquiring corporation becomes a "beneficial owner" of the selling corporation on the date on which it incurred an irrevocable liability to take and pay for the stock. Therefore, in reporting his holdings, a person would have to include all securities held by a controlled corporation in which he has "control" whether by securities held (directly or indirectly), or by corporate position for the purposes of section 16(a).[47]

All four attribution sections (267, 318, 425, 544) provide that stock owned by a corporation will be attributed proportionately to the shareholders in that corporation.[48] However, only section 318(a)(2)(c) states how the proportion is to be determined.[49] "The ownership attributed is proportionate to the interest in the corporation rather than 100 percent as in attribution among members of the family."[50] Under the family attribution rules of section 318(a), an individual is deemed to own all the stock which is owned directly or indirectly by or for his spouse (other than one who is legally separated) and his children, grandchildren, and parents. But section 318(a)(2)(c) limits the attribution of stock owner-

word "person" as used in this section of the article relates to an individual or corporation as implied from its context.

[44] 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954).

[45] Blaw v. Mission Corp., 212 F.2d 77, 80 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954).

[46] (D.C.N.Y., 1955) 132 F. Supp. 100 *aff'd* (CA-2, 1956) 232 F.2d 299. This decision will be discussed under the section on "Options."

[47] *See*, Feldman & Teberg, note 3 at 1081, *supra*.

[48] Rev. Code. Sec. 267(c)(1), 318(a)(2)(c)(i), 425(d)(2), 544(a)(1).

[49] "From Corporations.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation."

[50] *See*, Ringel, Survey and Warren, *supra* note 3.

ship from a corporation to its shareholders to circumstances where a shareholder owns directly or indirectly more than 50 percent in value of the stock of the corporation. For example, in applying the family attribution rule of section 318(a), suppose that H, an individual, his wife, W, and his son, S, each owns one-third of the stock of the Green Corporation. For purposes of determining the amount of stock owned by H, W, or S under section 318(a)(2)(c), the amount of stock held by the other members of the family shall be aggregated in applying the 50 percent requirement of such section. H, W, or S, as the case may be, is for this purpose deemed to own 100 percent of the stock of the Green Corporation. However, when the individuals are unrelated, *e.g.*, A and B, unrelated individuals, own 70 percent and 30 percent, respectively, of the stock of corporation M, A, B, and corporation M all own stock of corporation O. Since B owns less than 50 percent in value of the stock of corporation M, neither B nor corporation O is owned by the other. However, for purposes of certain sections of the Code, such as sections 304 and 856(d),[51] the 50 percent limitation of section 318(a)(2)(c) and (3)(c) is disregarded or is reduced to less than 30 percent. For such purposes, B constructively owns his proportionate share of the stock of corporation O owned indirectly by corporation M, and corporation M constructively owns the stock of corporation O owned by B.[52]

Generally, transfers of stock to a corporation controlled by the transferor and exchanges of property solely for stock in one corporation by another when the transferor corporation controls 80% or more of the transferee corporation immediately after the transfer is considered a tax free exchange under the Code. However, when the unwary taxpayer might have benefited from these provisions of the Code the tax rules cannot control actions under section 16 of the Exchange Act. Assuming that we are dealing with a registered corporation under section 12 of the Exchange Act and A exchanges 100 shares of A corporation for 200 shares of B corporation which is equal to 10% of B's outstanding shares, A thus becomes a "beneficial owner" under the Act and would be liable for section 16(b) violations if it proceeded to sell within a six-month period. Under the Code the exchange would have been tax free. However, if the same transaction took place pursuant to a merger or consoli-

[51] Sec. 304 deals with redemptions through use of related corporations and section 856(d) deals with rents from real property to real estate investment trust where there is more than a 10 percent interest held by the individual or corporation.

[52] Treas. Reg. 1.318-2.

dation it would be exempt from section 16(b) of the act provided that prior to the merger or consolidation the corporation owned 85 percent or more of the equity securities of all other corporations involved in the merger or consolidation.[53] However, the exemption is not available to an officer, director or stockholder who should make a purchase or sale of a security in any corporation involved in the merger or consolidation.[54]

Options

In computing the percentage of securities outstanding that a person would beneficially own under the Exchange Act, options to acquire securities are to be included in the aggregate of such person's holdings, but it is doubtful that such options could be used in computing the percentage of the class owned by any other person.[55] However, it would seem that a firm commitment would be necessary on the part of an officer, director or stockholder to acquire the option and satisfy whatever conditions might exist prior to consummation.[56] Relying on Release No. 116 the court in *Stella v. Graham-Paige*[57] stated that "the date when a purchaser becomes a 'beneficial owner' is that on which he incurred an irrevocable liability to take and pay for the stock 'when his rights and obligations became fixed.' "[58] This has been criticized as not deterring

[53] Exchange Act Release No. 34-8177 (October 10, 1967), "A merger within the meaning of this rule shall include the sale or purchase of substantially all the assets of one company by another in exchange for stock which is then distributed to the security holders of the company which sold its assets."

[54] Exchange Act Release No. 34-8177 (Oct. 10, 1967). The release does not state whether the stockholder would have to be an insider (a 10% holder of equity securities), but it could be assumed that this would have to be the case.

[55] "In determining for the purpose of Section 16(a) of the Act whether a person is the beneficial owner, directly or indirectly, of more than ten percent of any class of equity securities, such person shall be deemed to be the beneficial owner of securities of such class which such person has the right to acquire through the exercise of presently exercisable option, . . . The securities subject to such options, held by a person shall be deemed outstanding for the purpose of computing, . . ., the percentage of outstanding securities of the class owned by such person but shall not be deemed outstanding for the purpose of computing the percentage of the class owned by any other person . . . Exchange Act Release No. 34-8325 (July 8, 1968)."

[56] ". . . an officer, director or stockholder is to be deemed to have acquired beneficial ownership of a security at the time when he takes a firm commitment for the purchase thereof, and to divest himself of such beneficial ownership at the time when he takes a firm commitment for the sale thereof. If it is necessary that certain conditions be satisfied prior to the consummation of the purchase or sale, and if it is uncertain whether such conditions will be satisfied, then it would appear that the officer, director or stockholder would not acquire beneficial ownership." SEC Exchange Act Release No. 116, March 9, 1935.

[57] 104 F. Supp. 957 (S.D.N.Y. 1952), 132 F. Supp. 100 (D.C.N.Y., 1955) *aff'd as modified*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. 831 (1956).

[58] *Id.* at 301.

the speculative activities of the option holder, thus allowing him to obtain a controlling influence. It is suggested that if exercise of the option is subject to a contingency or condition beyond the control or discretion of the optionee, the speculation cannot occur.[59]

If a person has an option to aquire stock, the stock is considered as owned by him, for the purpose of applying the constructive ownership rules of section 318(a) of the Code. However, under section 424 of the Code relating to restricted stock options it is necessary that the optionee be an employee of the granting corporation, its parent or subsidiary at the time of exercise, and the option price has to be at least 85 percent of the fair market value of the stock on the date of grant. In order to qualify as a restricted stock option, the optionee, at the time of grant, cannot own over 10 percent of the total combined voting power of all classes of stock of the employer corporation or its parent or subsidiary where the price is less than 110 percent of the fair market value of the stock subject to the option and is not exercisable after the expiration of 10 years from the date of grant.[61]

Under the Code, income is precluded to the optionee at the time of grant and at the time of exercise with one exception where the fair market value of the stock on the date of grant is greater than the option price. Under the Exchange Act market value of the stock is not to be considered, but rather that the optionee has a firm commitment to acquire the stock before it is attributed to him.

TRUST

It is clear that the underlying premise of beneficial ownership under the Exchange Act is the ability on the part of a person to buy and sell or vote the securities and by virtue of this he has sufficient benefits to make him a beneficial owner. A trustee would thus come within the premise stated above; for if he did not, "stockholders of relatively large holdings could create trusts for their benefit, and thus avoid the liability imposed by the statute."[62] Beneficial ownership of a trust's securities under rule 16a-8[63] exists under three circumstances "(1) . . . where either the trustee or members of his immediate family have a vested interest in the income or corpus of the trust, (2) the ownership of a vested beneficial interest in a

[59] Feldman & Teberg, *supra* note 3 at 1086.
[61] Treas. Reg. 1.424-2.
[62] Park & Tilford v. Schulte, CCH Fed. Sec. L. Rep. 90336 (S.D.N.Y. 1945), *aff'd*, 160 F.2d 984 (2d Cir. 1947), *cert. denied*, 332 U.S. 761 (1947).
[63] 17 C.F.R. §§ 240.16a-8(a) (1)-(3) (rev. ed. 1964).

trust, and (3) the ownership of securities as a settlor of a trust in which the settlor has the power to revoke the trust without obtaining the consent of all the beneficiaries."[64] In determining whether a person is the beneficial owner, directly or indirectly, of more than 10 percent of any class of any equity security, the interest of such person in the remainder of a trust shall be excluded.[65] Further exemptions are granted under section 16a-8(b) of the Act to persons with a vested beneficial interest and to settlors with a power to revoke (1) where less than twenty percent in market value of the securities held by such trust consists of equity securities, and (2) where the ownership, acquisition, or disposition of such securities by the trust is made without prior approval by the settlor or beneficiary.[66]

Section 267(c), 318 and 544 provide that stock owned, directly or indirectly, by or for an estate or trust, is attributed proportionately to each beneficiary.[67] But of the three sections only section 318 provides for attribution to the settlor or other substantial owner or beneficiary of the trust except where such beneficiary's interest in the trust is a remote contingent interest.[68] Only section 318 provides the proportion in which attribution is to be computed. It states that stock owned, directly or indirectly, by or for a trust shall be considered as owned by its beneficiaries in proportion to their actuarial interest.[69] It has also been held under the so-called Clifford trusts that a husband who declared himself trustee of certain securities, and paid his wife the income accruing during the period, but retained the right to accumulate income and the complete control over the principal fund plus a reversion of the corpus at the end of the term, may properly be found the owner of the fund.[70] The court further stated that this was in reality but one economic unit.[71] However, we could not arrive at the same results under section 267 and 544 since they do not provide for attribution to the settlor or other substantial owner of the trust.

In the trust situation we can notice a distinct difference in the treatment of a settlor/beneficial owner between the Exchange Act and the

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[64] *Id.*

[65] 17 C.F.R. §§ 240. 16a-8(f) (rev. ed. 1904) as amended by Release No. 34-7525 effective March 8, 1965.

[66] 17 C.F.R. §§ 240.16a-8(b) (rev. ed. 1964).

[67] Rev. Code Sec. 267(c)(1), 318(a)(2)(B), 544(a)(1).

[68] Rev. Code. Sec. 318(a)(3)(B)(1) Reg. 1.318-3(b).

[69] Rev. Code Sec. 318(a)(2)(B)(1).

[70] Helvering v. Clifford, 309 U.S. 331 (1940).

[71] *Id.* at p. 335.

Code in that under the former, a twenty percent interest (computed as to market value) must exist in equity securities, and under the latter, attribution is 100 percent rather than proportionate. However, under the Exchange Act an exemption exists when the ownership, acquisition, or disposition of such securities by the trust is made without prior approval by the settlor or beneficiary of a revocable trust. Under section 318, retention of the power to revoke alone would be sufficient to cause all of the stock to be attributed to the settlor even without a reversionary interest.[72]

Conclusion

It can be generally concluded that the main difference in premise between the "attribution" and "beneficial" ownership rules under the Securities Exchange Act and Internal Revenue Code is that the Act is primarily concerned with prohibiting the manipulation of various stock transactions through effective control of persons in control within the meaning of the Act, whereas under the Code, the main concern is with proper allocation of income to the persons to be benefited thereby. Therefore, it would be rather presumptious to criticize the many inconsistencies that exist between both the Act and the Code for determining beneficial ownership inasmuch as they are designed to effect different purposes. The various rules within themselves and as applied to particular circumstances within their respective settings do assume the existence of what in reality might not exist. For example, under both the Code and the Act it is assumed that a relative living under the same roof or through a close family relationship could control other persons or entities, through stock ownership or otherwise. However, the Act does offer a solution in this stiuation through the use of a disclaimer clause in registering the beneficial interest. There is no such provision under the Code.

The desired effect of both the Securities Exchange Act of 1934 and the Internal Revenue Code of 1954 is to curb the effect that control might have on profits by the use of insider's information and by way of tax avoidance schemes.

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[72] See; Ringel, Surrey and Warren, *supra* note 3.