

GRANT, COLLECTOR, *v.* HARTFORD AND NEW HAVEN RAIL-ROAD COMPANY.

The expression "profits used in construction" (within the meaning of the one hundred and twenty-second section of the Internal Revenue Act of June 30, 1864, 13 Stat. 284) does not embrace earnings expended in repairs for keeping the property up to its normal condition, but has reference to new constructions adding to the permanent value of the capital; and when these are made to take the place of prior structures, it includes only the increased value of the new over the old, when in good repair.

ERROR to the Circuit Court of the United States for the District of Connecticut.

This action was brought by the Hartford and New Haven Railroad Company against Henry A. Grant, collector of internal revenue for the first district of Connecticut, to recover the sum of \$2,785.65 income tax, and \$139.28 penalty, paid to him under protest in January, 1868. The controversy arose upon the question of the company's income for the two fiscal years ending Aug. 31, 1867. During that period they expended from their earnings \$55,712.60, in constructing over the Farmington River at Windsor a new stone bridge, to be used in place of a wooden bridge which was deemed insecure; and they charged the amount to current expenses. The assessor of internal revenue for the district insisted that this sum should have been charged to account of construction, and was fairly to be regarded as "*profits used in construction*," within the meaning of the one hundred and twenty-second section of the act of June 30, 1864; and, therefore, he made a special assessment of the amount. The company having appealed to the commissioner of internal revenue without effect, this action was brought.

A jury having been waived, the cause was tried by the court, which found specially an agreed statement of facts. From this it appears that the amount charged to current expenses during each of the two years in question (including together the said sum of \$55,712.60) was not greater than the proper ordinary current expenses and depreciation of the entire property; and that the company returned the entire balance of their gross earnings over and above said expenses, in the shape of dividends and surplus, and paid the regular tax thereon.

Judgment having been rendered in favor of the company, the collector sued out this writ of error.

Argued by *Mr. Assistant Attorney-General Smith* for the plaintiff in error.

The "profit" of any business is the surplus remaining, after deducting from its gross receipts the necessary expenses of carrying it on, whether such surplus be retained in money or invested in addition to or improvement of the stock, or in other property.

The policy of Congress in the act which governs this case was to tax *all* gains and profits, whether divided or undivided. *Collector v. Hubbard*, 12 Wall. 17.

The stone bridge was an entirely new structure, a permanent improvement, for carrying on the business of the company. It was erected out of their profits, which were thus "used in construction," and not in repairs. Its total cost was properly assessed.

Mr. R. D. Hubbard for the defendant in error.

The profits of a railroad company cannot be claimed to be any thing more than the income remaining after satisfying a fair expense account.

The bridge was not intended to work an enlargement of the scope of the company's business. An unsafe structure was merely replaced by a better one.

The mere fact of its being more valuable adds nothing to the taxable or divisible profits of the company.

But the conceded facts render the preceding points wholly unnecessary.

The company charged no more for expenses and depreciation of their property in these two years than was "proper to cover such expenses and such depreciation."

The closest analogies to the question now under discussion have arisen under the construction of the English poor-law. By the Parochial Assessments Act (6 & 7 Will. IV. c. 96), rates for the relief of the poor in England and Wales are to be made upon an estimate of the *net annual value* of the several hereditaments rated thereunto,—that is to say, of the rent at which the same might reasonably be expected to let from year to year,—deducting therefrom the probable annual

average cost of the repairs, insurance, and other expenses (if any) necessary to maintain them in a state to command such rent. Under this act the railway companies are chargeable. We submit that this law provides for no deduction which an honest railway management ought not to make before counting its profits. In getting at the net annual value of the several properties, the English courts hold, that a "percentage on the gross receipts for annual depreciation of stock beyond ordinary annual repairs," is to be made before coming at the taxable income (*Reg. v. Grand Junction Ry. Co.*, 4 Ad. & E. n. s. 18); that another deduction is to be made, of "an annual sum per mile, for the renewal and reproduction of the rails, sleepers," &c. (*id.*; *Reg. v. G. W. Ry. Co.*, 15 Q. B. 1085); and that the company is entitled to deduction of a fair percentage for depreciation, reproduction, &c., although the amount has not been actually expended (*Reg. v. Lond., Bright., & So. C. Ry. Co.*, and several other cases following, reported in 15 Q. B. 313.)

MR. JUSTICE BRADLEY delivered the opinion of the court.

The company having returned the entire balance of their gross earnings over and above current expenses, in the shape of dividends and surplus, for the period in question, and paid the regular tax thereon, we do not see why this was not a full compliance with the law. The object of the law was to impose a tax on net income, or profits, only; and that cannot be regarded as net income, or profits, which is required and expended to keep the property up in its usual condition proper for operation. Such expenditure is properly classed with repairs, which are a part of the current expenses. If a railroad company should make a second track when they had but a single track before, this would be a betterment or permanent improvement, and, if paid out of the earnings, would be fairly characterized as "profits used in construction." The works of the company would have an additional value to what they had before, with an increased capacity for producing future profits. This kind of expenditure is what Congress meant to reach, when, in the one hundred and twenty-second section referred to, it imposed a tax not only on the dividends of every railroad, canal,

and turnpike company, but also on "all profits of such company carried to the account of any fund, or used for construction."

The counsel for the government insists that this bridge was a betterment, because it was much more valuable than the old wooden bridge. But the assessor did not include the excess merely: he assessed the whole expenditure bestowed upon the new bridge, without making any allowance for the old one. His idea seems to have been, that all earnings used in new constructions are made taxable by the act, without reference to betterments, or to their being substituted for other constructions. Indeed, his assessment is not for "*profits* used in construction," but for "*earnings* used in constructing new Windsor Bridge, \$55,712.60." In this view he was decidedly wrong. Earnings expended on a new structure may or may not be profits. Whether they are or not depends on other things to be taken into the account besides the mere fact of such expenditure. Had the assessment been merely for the increased value of the new bridge over the old one when in good repair, the case might have admitted of very different consideration.

Judgment affirmed.

HORNOR *v.* HENNING ET AL.

The act of Congress (16 Stat. 98), under which certain corporations are organized in the District of Columbia, contains a provision, that, "if the indebtedness of any company organized under this act shall at any time exceed the amount of its capital stock, the trustees of such company assenting thereto shall be personally and individually liable for such excess to the creditors of the company." *Held*, 1. That an action at law cannot be sustained by one creditor among many for the liability thus created, or for any part of it, but that the remedy is in equity. 2. That this excess constitutes a fund for the benefit of all the creditors, so far as the condition of the company renders a resort to it necessary for the payment of its debts.

ERROR to the Supreme Court of the District of Columbia.

The plaintiff in error, who was plaintiff below, had judgment against him on demurrer to his declaration. The substance of the declaration is, that he is a creditor of the Washington City Savings-Bank; that the bank had incurred an indebtedness of \$850,000 in excess of the amount of its capital stock, with the