Stock Dividends as Income

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STOCK DIVIDENDS AS INCOME

In the case of *Towne v. Eisner*, the United States Supreme Court has recently held that under the Income Tax Law of 1913, the stock dividends received by a shareholder during the year 1914 could not be taxed upon their full par value, where the corporate surplus thus distributed all accrued prior to January 1, 1913. The Treasury Department subsequently announced that the decision is not applicable to the Income Tax Law of 1916. It is the purpose of this article to review the case of *Towne v. Eisner,* and then to discuss the soundness of the position taken by the Secretary of the Treasury. Thus two general questions are presented. The first is, "Can the decision of the Supreme Court in the *Towne Case* be upheld?" The second is, "Is that section of the Income Tax Law of 1916 that states that stock dividends are income and taxable, constitutional?" These questions will be dealt with in order.

I

CAN THE CASE OF TOWNE V. EISNER BE UPHELD?

It is believed that this question must be answered in the affirmative. It is to be remembered that the corporate surplus that was transferred to capital and distributed among the shareholders during the year 1914 was all earned prior to January 1, 1913. The income tax law of 1913 required that the "gains, profits and income" must have accrued after March 1, 1913, if they were to be taxed as income for the calendar year. Giving the words "gains and profits" their broadest interpretation, it cannot be said that the shareholders receiving these stock dividends had at that moment anything of value,—any gain or profit—which they did not have on March 1, 1913, before the transfer from undivided surplus to capital was made, other than, perhaps, some slight advantage growing out of the fact that their shares of stock had an increased marketability which was due to the fact that the original shares of stock had been replaced by several of a lower par value. In the

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1 Letter of Commission, dated Jan. 10, 1918, addressed to Collectors of Internal Revenue.
2 245 W. S. 418, decided by the United States Supreme Court, Jan. 7, 1918.
3 See the article "Corporate Earnings as 'Gains, Profit and Income,' as Depending upon the Time of their Accrual" by Robert M. Drysdale and Maurice C. McGiffin, 16 Mich. L. Rev. 232.
Towne Case the Supreme Court was not called upon to determine whether or not such an increase in value arising out of the better marketability of the shares of stock was income and taxable as such. The narrow question presented was whether or not the plaintiff shareholder had received gains, profits or income in the amount of $417,450. Clearly he had not, and the decision of the district court was properly reversed.

II

IS THAT PROVISION OF THE INCOME TAX LAW OF 1916, WHICH DECLARES THAT STOCK DIVIDENDS ARE INCOME AND TAXABLE, CONSTITUTIONAL?

It is submitted that this question, too, must be answered in the affirmative.

Prior to the Sixteenth Amendment, there was no constitutional provision dealing specifically with the power to tax incomes. It has been held, however, that Congress always had the power to levy income taxes under the authority conferred upon Congress by sec. 8 of Article I "to lay and collect taxes, duties, imposts and excises," as a part included in the whole. The Constitution contains a further requirement that all direct taxes shall be apportioned. Mr. Justice Fuller in Pollock v. Farmers' Loan & Trust Company, at page 557, aptly summed up the constitutional taxation requirements as follows:

"In the matter of taxation, the constitution recognizes two great classes of direct and indirect taxes, and lays down two rules by which their imposition must be governed, namely, the rule of apportionment as to direct taxes, and the rule of uniformity as to duties, imposts and excises."

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4 Constitution, Article I, Section 8, provides:
"The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States."

5 Constitution, Art. I, Section 2, Clause 3, provides:
"Direct taxes shall be apportioned among the several states * * * according to their respective numbers."

7 Constitution, Art. I, Section 9, Clause 4, provides:
"No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken."

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In 1894, an act was passed, laying a tax on incomes from all classes of property and other sources of revenue, which was not apportioned, and which therefore was of course assumed to come within the classification of excises, duties and imposts, which were subject to the rule of uniformity, but not to the rule of apportionment. The constitutional validity of this law was challenged on the ground that it did not fail within the class of excises, duties and imposts, but was direct in the constitutional sense, and was therefore void for want of apportionment. The Supreme Court, in the case of Pollock v. Farmers' Loan & Trust Company had this question presented to it and held that the law was unconstitutional because, in the substance of things, it was direct on property in a constitutional sense, since to burden an income by a tax was, from the point of substance, to burden the property from which the income was derived, and thus accomplish the very thing which the provision as to apportionment of direct taxes was adopted to prevent.

Thereafter, on February 25, 1913, the Sixteenth Amendment became effective. It provides:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

On October 13, 1913, the Internal Revenue Act of 1913 was passed. This act was held to be constitutional in the case of Brushaber v. U. P. Ry. Co., where the history outlined above is set forth more in detail. From the opinion in the Brushaber Case, the following propositions may be deduced:

(a) Congress has power to levy taxes on all properties and upon all incomes.
(b) Direct taxes on property, other than income taxes, must be apportioned.
(c) In all cases, indirect taxes must be uniform.
(d) By virtue of the Sixteenth Amendment, income taxes need not be apportioned, and this is true even though such income taxes, in their substance, are direct taxes imposed because of the ownership of property, either real or personal.

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8 28 Stat. at L. 599, Chap. 349.
It is thus apparent that Congress could tax a corporation on its capital stock as well as upon its income, and likewise could tax an individual on his share of the capital stock in a corporation, as well as on his income derived therefrom. Congress therefore has the power to tax stock dividends. The Internal Revenue Act of 1916 does not apportion the taxes according to any census or enumeration. The section of the Act of 1916 which is under consideration must be upheld if this is an indirect tax, because clearly there is geographical uniformity, and that is the only kind of uniformity required by the constitution.12

However, it is expressly stated by the Supreme Court in the Brushaber Case that the Sixteenth Amendment does not do away with the requirement of apportionment of direct taxes, in any case other than that of an income tax. Therefore this tax is only invalid if in the first place it is not an income tax, and if in the second place, it is a direct tax. What, then, was the meaning of the word "income," as used in the Sixteenth Amendment?

In 1912 the leading dictionaries defined "income" as the annual receipts, gains, profits or emoluments derived from capital invested.13 Income is commonly thought of as being money only. It is more correct to say that it is usually measured in terms of money, but that gains, profits and income are actually synonymous. It would seem, therefore, that a shareholder has received income, under these definitions, when the corporation has accumulated a surplus within a given year, whether or not this surplus has been transferred to cap-

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13 Definitions of "income":

The Century Dictionary and Cyclopedia: "That which comes in to a person as payment for labor or services rendered in some office, or as gain from lands, business, the investment of capital, etc.; receipts or emoluments regularly accruing, either in a given time, or, when unqualified, annually; the annual receipt of a person or a corporation; revenue."

The Oxford Dictionary: "That which comes in as the periodical product of one's work, business, lands, or investment (considered in reference to its amount, and commonly expressed in terms of money); annual or periodical receipts accruing to a person or corporation; revenue."

The New Standard Dictionary: "The amount of money coming to a person or corporation within a specified time or regularly (when unqualified, annually), whether as payment for services, interest, or profit from investment; revenue."

Webster's New International Dictionary: "That gain or recurrent benefit (usually measured in money) which proceeds from labor, business or property; commercial revenue or receipts of any kind, including wages or salaries, the proceeds of agriculture or commerce, the rents of houses, or the return on investments. * * * Synonyms: Gain, profit, proceeds, interest, emoluments, produce."

Worcester's Dictionary: "Gain derived from any business or property; produce, profit, revenue."
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ital stock or distributed in stock dividends. To illustrate: Take a corporation with a fully paid capital stock of $1,000, consisting of 1,000 shares of stock, held by 1,000 shareholders, each share of an approximate value of $1.00. Suppose that this corporation accumulates a surplus of $1,000 during the year 1917. Then each shareholder, at that time, has something that is worth more than one dollar if he chooses to sell his share of stock. Can it be said that no gain or profit has accrued to him during the year of 1917 merely because he chooses to retain his share in the expectation that it may become more valuable during the next year? If it be assumed that income—gains and profits—need not be money or cash, but only need be measured in terms of money or cash, it would appear that an individual shareholder has received income during a given calendar year if in that year his share of stock has increased in value. It is not the declaration of a stock dividend that gives him this profit, but the fact that his undivided share in the corporate enterprise has increased in worth. It is thus conceivable that an individual shareholder receives income—something in the form of a gain or profit—in exact proportion to the increase in value of the capital he has invested. Whether or not Congress will take it upon itself to tax such income before a stock or cash dividend has been declared is a different question. But it is submitted that a cash dividend, a stock dividend, or an undivided surplus of a corporation may be termed the income of a shareholder under the definition of income as laid down by the leading dictionaries.

If the legal definitions of income, which were pronounced by the Supreme Court prior to the Sixteenth Amendment, are also consistent with the principles above laid down then we must say that Congress could state that stock dividends received by a shareholder were income and taxable as such. It is only necessary to say that the Supreme Court believed that a corporate undivided surplus or the stock dividend received by an individual shareholder could be termed his income. The question then to be decided is whether or not Congress intended that it should be so considered.

There are several United States Supreme Court decisions defining income. One of the earliest is the case of Brainard, Collector, v. Hubbard. This was a suit to recover back money paid by plaintiff, under protest, as a tax on his income for the year 1864 under the Income Tax Law of 1864. Plaintiff was a shareholder in a corporation and was taxed on his proportional share of the corporate undivided surplus that had accrued during the year 1864.

14 12 Wall. 1, 20 L. Ed. 272, decided in 1871.
Plaintiff contended that his interest in such corporate profits was not legally subject to any such assessment and levy as it appeared that the corporation had invested the profits in part in real estate, machinery and raw materials proper for carrying on the business, and that the same remained so invested at the time the duties were assessed and collected. Part only of the profits of that year were so invested, and it was that part of the same which was not included in the dividends of the year, and which plaintiff refused to add to the list he delivered to the assessor, and which was the subject of controversy. The Supreme Court held that plaintiff had no right of action, inasmuch as no appeal had been taken seasonably; and that even though this had been done, still plaintiff had been taxed properly because his share in the undivided corporate profits was income and taxable as such. The court interpreted the act and found a clear intention on the part of Congress to tax such income as plaintiff's own gains and profits, and then held that those profits were income. 16

Here then is a clear statement by the Supreme Court of the United States to the effect that a shareholder's interest in the undivided annual profits of a corporation was to be considered as income when the Congress evidenced an intention to tax such income. If the corporate surplus which is invested in real estate and machin-

16 13 Stat. at L. 381.
17 At 277 of 30 L. Ed. the court says:

"Decided cases are referred to in which it is held that a stockholder has no title for certain purposes to the earnings, net or otherwise, of a railroad prior to the dividend being declared, and it cannot be doubted that those decisions are correct as applied to the respective subject-matters involved in the controversies. Minot v. Payne, 99 Mass., 106; Goodwin v. Hardy, 57 Me., 145. Grant all that; still it is true that the owner of a share of stock in a corporation holds the share with all its incidents, and that among those incidents is the right to receive all future dividends, not then divided. Profits are incident to the share to which the owner at once becomes entitled provided he remains a member of the corporation until a dividend is made. March v. Railroad, 43 N. H. 520. Regarded as an incident to the shares, undivided profits are property of the shareholder, and as such are the proper subject of sale, gift or devise. Undivided profits invested in real estate, machinery or raw material, for the purpose of being manufactured, are investments in which the stockholders are interested, and when such profits are actually appropriated to the payment of the debts of the corporation, they serve to increase the market value of the shares, whether held by the original subscribers or by assignees. But the decisive answer to the proposition is that Congress possesses the power to lay and collect taxes, duties, imposts and excises, and it is as competent for Congress to tax annual gains and profits before they are divided among the holders of the stock as afterwards, and it is clear that Congress did direct that all such gains and profits, whether divided or otherwise, should be included in estimating the annual gains, profits or income liable to taxation under the provisions of that Act. Annual gains and profits, whether divided or not, are property, and, therefore, are taxable." (Italics ours.)
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ery constitutes income of the shareholders, then clearly a stock dividend would be no different. And the intention of Congress in the Act of 1916 is unmistakable.37

The next decision is that of Bailey v. N. Y. C. & H. R. R. Company.18 In this case the Supreme Court again stated that the earnings of the company belonged to the shareholders. The case is no authority on its facts, because the tax was levied against the corporation, but it is important to be familiar with its holding in view of the later language of the Supreme Court when discussing this decision in the case of Gibbons v. Mahon.19 The Bailey Case has language to the effect that corporate earnings belong to the shareholders. If this is so, then corporate earnings are alike corporate income and the income of the shareholders. Each has received a profit arising out of capital invested. The corporate profit is money. The shareholder's profit is something of value that can be turned into money.

In the famous case of Gibbons v. Mahon, the term "income" was again defined. But a reference to the facts of the case again shows that the Supreme Court was deciding what income might be, and not what income must be. It was here held that as between life tenant and remainderman, where a clear intention to give stock dividends to the remainderman is shown, this intention will be followed. The court reasons that stock dividends are usually thought of as capital. It was to be presumed that the testator intended that the usual presumption was to be followed, and that the life tenant should not take if the corporation declared a stock dividend rather than a cash dividend. But it is submitted that the decision goes off on the intention of the testator rather than the necessary, as distinguished from the usual, meaning of income. Suppose that the bequest had read "All income is to go to the life tenant, and stock dividends are to be considered as income." Would not the Supreme Court have held that the stock dividends were to go to the life tenant as the testator intended? When the general law applicable to

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37 Act of Sept. 8, 1916, part 1, sec. 2:

"Sec. 2. * * * (a) the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, * * * and payable to its shareholders, whether in cash or in stock of the corporation, * * * which stock dividend shall be considered income, to the amount of its cash value."

18 22 Wall. 604, 22 L. Ed. 840, decided in 1875. Here the Income Tax Law of 1864 was again before the Supreme Court. The narrow question presented to the court was whether or not certain "interest certificates" issued to the stockholders were "dividends in scrip" which were taxable to the corporation under the law of 1864. The court found that said "interest certificates" bore all the attributes of "dividends in scrip" and held them to be taxable.

The method of approach is, who in justice is entitled to this benefit? The party intended by the testator. Then it is often said by way of dictum, "The life tenant is entitled to this dividend; therefore it is income." But the courts do not say, "This is income; therefore it goes to the life tenant regardless of the intention of the testator." In the Gibbons Case, counsel for the life tenant cited the case of Bailey v. Railway. The Supreme Court stated that a different rule could well apply as between life tenant and remainderman, and between the government and one sought to be taxed. From this it

20 There are at least three distinct rules, on the authorities, for determining whether the life tenant or the remainderman shall take a stock dividend. In substance, Mr. Cook in his treatise on Corporations, 6th ed., chap. XXXIII, states the rules as follows: The majority of American courts follow the Pennsylvania Rule, which proceeds on the theory that the court, in disposing of stock or property dividends, as between life tenant and remainderman, may properly inquire as to the time when the fund out of which the extraordinary dividend is to be paid was earned and accumulated, and also as to the method of accumulation. If it is found to have accrued or been earned before the life estate arose, it is held that the remainderman takes, without reference to the time it is declared or made payable. But when it is found that the fund, out of which the dividend is paid, accrued or was earned, not before, but after the life estate arose, then it is held that it belongs to the tenant for life. (Earp's Appeal, 28 Pa. St. 368, Wiltbank's Appeal, 69 Pa. St. 256.) The courts in these jurisdictions will also take into consideration the custom and regularity of the corporation in accumulating its surplus, inasmuch as the testator may be presumed to have expected the corporation to continue its accumulation of a surplus or to provide for improvements out of profits. (Spooner v. Phillips, 62 Conn. 65; Hite v. Hite, 93 Ky. 257; Van Doren v. Olden, 19 N. J. Eq. 176.) The rule which prevails in Massachusetts, and at least in three other states, is sometimes called "the rule in Minot's case." It regards cash dividends, whether large or small, as income, and stock dividends, whenever earned and however declared, as capital. Cash dividends, in these jurisdictions, belong to the tenant for life and stock dividends to the corpus (Minot v. Faine, 99 Mass. 101). As the rule works a hardship in many instances, it is not rigidly adhered to, but the court, in deciding whether the distribution is a stock or cash dividend, may consider the actual and substantial character of the transaction, and not its nominal character merely. (Leland v. Hayden, 102 Mass. 542.) In England, an ordinary, regular, usual cash or stock or property dividend belongs to the life tenant, while an extraordinary cash or stock or property dividend belongs to the corpus of the trust (Witts v. Steere, 13 Ves. Jr. 365; Norris v. Harrison, 2 Madd. 268). The court says, at page 527 of 34 L. Ed.:

"In Bailey v. New York Cent. & H. R. R. Co., 89 U. S. 22 Wall. 664, cited for the plaintiff, the point decided was that certificates, issued by a railroad corporation to its stockholders as representing earnings which had been used in the construction and equipment of its road, and payable, at the option of the company, with dividends like those paid on the stock, were within that provision of the Internal Revenue Laws, which enacted that any railroad company 'that may have declared any dividend in script or money due or payable to its stockholders,' 'as part of the earnings, profits, income or gains of such company, and all profits of such company carried to the account of any fund, or used for construction, shall be subject to and pay a tax of five per centum on the amount of all such' 'dividends or profits, whenever and wherever the same shall be pay-
appears that the *Gibbons Case* is in no wise inconsistent with the proposition here contended for, viz.: Income, when used in a statute taxing the shareholders of a corporation, in both its popular and legal sense, has a different meaning than is ordinarily the case.

The case of *Logan County v. United States*, is likewise one dealing with the nature of stock dividends. That case merely holds that where a tax is assessed and collected upon the undivided surplus of a corporation, it will not be presumed that the tax so collected was upon the individual shareholders' undivided interests where the shareholders in question were municipal corporations, and hence not subject to the tax. It does not hold that the undivided corporate surplus cannot be held to be the income of the individual shareholders when the Congress has designated it as such, but only that the tax collectors shall not be presumed to have levied a tax on this income of the individuals where they had no power to do so, and it is possible to say that the tax was merely upon the corporate property.

able, and to whatsoever party or person, the same may be payable." Acts of June 30, 1864, chap. 173, sec. 122 (13 Stat. 284): July 13, 1886, chap. 184, sec. 9 (14 Stat. 138, 139). *The question at issue was not between the owners of successive interests in particular shares, but between the corporation and the government, and depended upon the terms of a statute carefully framed to prevent corporations from evading payment of the tax upon their earnings.* (Italics ours.)

22 169 U. S. 255, 42 L. Ed. 737, 18 Sup. Ct. Rep. 361. This case also arose under the Income Tax Law of 1864. Plaintiff was seeking a refund of taxes assessed and collected on the theory that no tax could be laid against municipal corporations. The collector had previously assessed and collected from the corporation in which plaintiff municipal corporation was a shareholder, a tax on its undivided surplus. Thereafter the corporation declared a stock dividend, said stock dividend being less by the amount of the tax previously imposed on the undivided surplus than would otherwise have been the case. The act provided that a duty of five per cent. should be laid on stock dividends, the deduction to be made by the corporation.

Held, the stock dividends were not taxed, but the only tax levied was against the surplus belonging to the corporation. But the court expressly held that the United States could tax a stock dividend where the shareholder was not a municipal corporation, saying, at page 739 of 42 L. Ed.: "By the provisions of the internal revenue act of 1864 (13 Stat. at L. 223, chap. 173, sec. 122), a stock dividend was subject to a tax of five per cent. * * *" "Under this plain provision of the statute it is perfectly clear that the stock dividend in question was a proper subject of taxation. But, as already mentioned, there is no finding that any such tax has been paid, and, of course, none that any deduction on its account was ever made from any dividend due the county. On the contrary, from the findings that have been made, it appears that the only tax which has been paid was paid by the railroad company upon its undistributed surplus at a time when such fund was its own absolute property."

It is not to be denied that there is language to the effect that until a cash dividend is declared, no income accrues to the shareholders. But it is also to be noticed that the case of Brainard v. Hubbard, supra, is not referred to, and thus presumably not overruled, in view of the fact that the cases are distinguishable.
It will be well now to summarize what has been said thus far:

1. The Internal Revenue Act of 1916 lays a tax on all stock dividends received by corporate shareholders. This tax is not apportioned, and therefore is void if, in the first place, it is not an "income" tax, as that word is used in the Sixteenth Amendment, and if, in the second place, it is a direct tax.

2. To determine the meaning of the word "income," as used in the Sixteenth Amendment, the current use of the word at the time the Sixteenth Amendment was enacted must be looked at, together with all definitions that the Supreme Court of the United States had previously given, and the language of the preceding income tax laws.
   
   a. The leading dictionaries in 1912 defined "income" as a gain or profit derived from capital invested. It is consistent with this definition to say that "income," as thus defined, includes the undivided profits or surplus of a corporation, whether or not a stock dividend has been declared.

   b. The case of Gibbons v. Mahon and all other cases dealing with the respective rights of life tenant and remaindermen in the last analysis appear to go off on a different ground from that of the distinction between capital and income, and are therefore not controlling authorities in this discussion.

   c. There appears to be no direct decision on the point in question by the Supreme Court, but there are three dicta, one of which states squarely that for the purposes of an income tax law, the undivided corporate surplus may be taxed as the shareholders' income. If this be true, then a stock dividend may be so taxed, as its only effect is to re-assign the respective interest which each shareholder has in this undivided surplus. The dicta in the other two Supreme Court decisions are in no wise conflicting with this when the facts of the cases under which they arose are considered.

   d. A dictum in the case of Gibbons v. Mahon is to the effect that a different rule may apply when the question is between the government and one questioning a tax, and when it is between life tenant and remainderman.

   e. Every income tax law has used the words "gains and profits" as synonymous with income, and the Act of 1864 stated that stock dividends and the corporate undivided surplus were to be taxed as income of the shareholders.
(f) The recent case of Towne v. Eisner states nothing in conflict with these conclusions.

(3) Every presumption is in favor of the constitutionality of an Act of Congress. It is therefore not necessary to say that the "income" of a shareholder always includes his pro rata interest in the corporate undivided surplus, but only that the word "income," as used by the Supreme Court prior to the Sixteenth Amendment, may consistently under facts parallel to those now in question, be so construed.

(4) That provision of the Internal Revenue Act of 1916 which defines stock dividends as income, is constitutional, because "income," as defined by the leading dictionaries, by Congress, and by the Supreme Court prior to the Sixteenth Amendment may consistently include the profit or gain of a stockholder of a corporation arising out of the enhancement of the value of his interest in the corporate enterprise, which flows from the corporate earnings. There is no necessity, therefore, to inquire whether or not this is a direct tax. It is believed that it is, when the substance of things is considered.

This appears to be a proper solution on principle. To hold otherwise would be to defeat the purposes of the Act. The shareholders, who are often the ones who vote a stock dividend, could themselves always defer the collection of a just tax on their earnings till the crisis had passed and the law had been repealed. It is no answer to say there is double taxation, because the same double taxation exists in the case of a cash dividend, and furthermore, there is no constitutional inhibition against double taxation. Nor can it be said that the Act does not purport to tax the undivided corporate surplus, because it does—when a stock dividend is declared. That time is taken as the most convenient to determine the amount of gains or profits the shareholders have received in a given calendar year. Furthermore, Section 3 of the Act\textsuperscript{23} taxes the corporate undivided surplus when the Secretary of the Treasury believes that an attempt is being made to avoid the Act. It may be argued that even though an undivided corporate profit may be thought of as the income of the shareholders, when this is transferred to capital stock, it thereupon ceases to be income and is no longer taxable; and that this is especially true when the shareholders themselves have no word in such transfer and no control over it. But the answer is, that once the thing is ascertained as being subject to the income

\textsuperscript{23} Act of Sept. 8, 1916, part I, sec. 3:
tax, it matters not what is done with it afterwards." Nor does it make any difference that the one taxed has no power over the fund so subject to the tax, because he receives his benefit if it is put to a corporate use.

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24 H. R. H. The Nizam State Ry. Co. v. Wyatt, (1890), 24 Q. B. D. 598. Here a corporation was contesting the collection of an income tax. 16 and 17 Vict. c. 34 imposed duties on gains and profits according to five schedules. Schedule C was as follows:

"Schedule C. For in respect of all profits arising from interest, annuities, dividends and shares of annuities, payable to any person, body politic or corporate." * * *

The corporation had a contract whereby it was bound to apply one per cent. of an annuity to be received from the Nizam of Hyderabad to trustees to form a sinking fund for the redemption of the debenture capital. The company claimed to deduct the amount put into the sinking fund, claiming it could not be income inasmuch as they had no power over it. The court held that this part of the annuity was subject to the tax, saying, through Hawkins, J., at page 556:

"It seems to me that the application of the money has not so very much to do with the matter. The money paid by the Nizam is paid as income and in the company's hands is income, which they are bound to apply, no doubt, to payment of their just liabilities to shareholders, and debenture holders, and to a sinking fund. But it is income prepaid, which has to be applied and appropriated in the interests of the company. I cannot regard it as other than income supplied by the Nizam under his contract, and when it comes into the hands of the company it is, I think, in the same condition as income earned, subject only to this difference, that it does not rest with the directors to decide whether a sinking fund shall be created or not, but there is an obligation on them to create a sinking fund imposed by the contract under which the income is supplied. * * *"