In the

Supreme Court of the United States

UNITED STATES,)
)
Petitioner,)
)
v.) No. 72-90
)
CHICAGO, BURLINGTON &)
QUINCY RAILROAD COMPANY)

Washington, D. C.
February 26, 1973

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Washington, D. C.

Monday, February 26, 1973

The above-entitled matter came on for argument at 10:04 o'clock a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM O. DOUGLAS, Associate Justice
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

RICHARD B. STONE, ESQ., Office of the Solicitor General, Department of Justice, Washington, D.C. for the Petitioner

RICHARD J. SCHREIBER, ESQ., 547 W. Jackson Boulevard, Chicago, Illinois 60606 for the Respondent

C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: The Court will hear arguments first this morning in No. 72-90, United States against Chicago, Burlington and Quincy Railroad.

Mr. Stone, you may proceed whenever you are ready.

ORAL ARGUMENT OF RICHARD B. STONE, ESQ.,

ON BEHALF OF THE PETITIONER

MR. STONE: Thank you, Mr. Chief Justice and may it please the Court:

This is a corporate income tax case here on a writ of certiorari to the United States Court of Claims. The sole issue presented in the Government's petition for certiorari is whether the respondent railroad is entitled to take depreciation deductions with respect to certain properties paid for by governmental agencies for the purpose of improving safety in traffic flow at highway-railroad intersections.

The issue is governed, as I shall explain, by provisions of the Internal Revenue Code of 1939 which are no longer applicable under the Internal Revenue Code of 1954. The resolution of this question of construction of the 1939 Code, however, will continue to affect tax returns filed for many future years, especially with respect to the railroad and utility industries because the relevant amendments to the 1954 Code do not apply to properties paid for as were those in issue here prior to 1954 and most of these properties have very long, useful lives, in some cases as many as 50 or 60 years.

The background of the properties with respect to which Respondent seeks depreciation deductions here is as follows:

Beginning in the early 1930's, Respondent and many other railroads entered into agreements with various state governments for construction of facilities to improve the safety and traffic flow conditions at highway-railroad intersections. The initial agreements between the railroads and the states provided that the states would substantially, though not entirely, reimburse the railroads for those facilities which it was the railroad's obligation to construct.

Shortly after these initial agreements were reached, Congress passed a series of statutes which authorized the Federal Government to pay at least part of the state's share of the construction costs of these facilities. This is set forth in the National Industry Recovery Act at 48 stat 195 section 203 and is a 1933 statute.

In the years following the initial agreements and the initial authorization of partial federal reimbursement of state expenses, the railroads, who presumably felt that these facilities designed to improve highway traffic conditions were tangential to the profitable operation of their railroad business, displayed great reluctance to share substantally in the construction costs and disputes between the railroads and the states were quite frequent over allocation of the costs.

In order to settle these disputes, Congress passed the Federal Highway Act of 1944 which was basically a stepped-up version of the prior act and this act authorized the Federal Government to reimburse the states for the entire costs of the facilities such as those at issue here, subject only to the limitation that to the extent that the railroad was deemed to receive direct benefit from these facilities, it should reimburse the Federal Government on a prorated basis up to a maximum of 10 percent of the cost of any particular facility.

The result was that the states initially absorbed all or most of the cost of the facilities for which they were reimbursed by the Federal Government and the railroads paid only so much as was deemed to reflect the benefit which the railroad derived from the facilites and this could in no event exceed ten percent of the cost.

Now, although there is some question as to whether Respondent or the states have title to the facilities under the terms of these agreements, the agreements do provide that Respondent is obligated to maintain the facilities "directly related to railroad use" such as railbridges and roadbeds and tracks and the states are correspondingly required to maintain the falilities directly related to motor vehicle use such as highway bridges and approaches.

The majority of the Court of Claims here appears to have assumed that the obligation to maintain these facilities includes the obligation to replace worn-out equipment. Judge Davis found that a questionable proposition but the Court of Claims appears to have found that Respondent had the obligation here to maintain and replace at least those facilities most directly related to railroad use.

And at this point I should point out that the government and Respondent appear to be in some disagreement as to precisely the type of facilities which Respondent seeks here to appreciate.

The Court of Claims did not make a specific finding as to what percentage of the facilities at issue here were of the type closely related to the railroad business and correspondingly what percentage were closely related to highway use and this would bear, for example, upon the question of whether Respondent was obligated to maintain and replace the facilities it seeks to depreciate, a question which, to be sure, we do not believe to be dispositive of this case.

The Court did find -- and this finding is at page 55A of our certiorari petition -- that about a million and a half of the somewhat more than $2 million of property at issue here was in the category of "highway undercrossings or highway overcrossings." We assumed, perhaps in some haste, that highway undercrossings and highway overcrossings refer to highway facilities over railroad tracks and concluded on that basis that at least 71 percent of the amount in controversy represented facilities in the category most directly related to highway use.

Judge Davis appears to have assumed the same thing and I refer you in that connection to footnote two on page 48A of the petition.

Respondent now asserts in his brief that it is not claiming any highway structures here and that the items in its account six, which the Court of Claims described as highway undercrossings, are in fact, railroad bridges of some sort. In this connection, it cites the joint exhibit found at page 51 of the Appendix in which the items in account six are described simply as bridges.

Respondent claims that the bridges in this account are rail bridges and that in spite of the finding of the Court of Claims, it has not sought to depreciate any highway undercrossings or overcrossings.

Now, our examination of the record in this case including an inspection of the tax returns filed by Respondent does not provide a satisfactory answer to the question of whether the items in account six include highway crossings and, if so, to what extent and the litigation has I think quite rightfully not focused closely on this point.

We felt it desirable to bring this discrepancy between our reading of the Record and Respondent's assertion to the Court's attention , but for reasons which I shall refer to several times in the course of this argument, hopefully, our position is in no way dependent upon the answer to the question of whether the bulk of the facilities in question were directly related to highway use or rail use.

Q In that terminology, both highway overcrossing and highway undercrossing could refer to railroad structures. They wouldn't necessarily include highway structures.

MR. STONE: I think that's right. They could, Mr. Justice Rehnquist and in that connection, it may have been hasty of us to assume that it referred to highway structures. I believe Judge Davis assumed the same thing because in this footnote two on page 48A of the petition, he refers to the fact that three-quarters of the structures in question were those of the highway overcrossings or undercrossings and that part of the agreements between the states and the railroads included the condition that the railroads would not -- that the states would not have to pay for an easement with respect to those structures and I assumed that if there is any question involved with the state applying for or requiring an easement in order to make the construction, it would probably refer to a highway construction which it was the state's obligation to construct and not a rail construction. That isn't crystalclear either. In any event, we don't believe that this is at all dispositive of the issues in the case and I shall have occasion to explain why in the course of the argument.

I want to bring out one more bit of background to this case. In a series of events described at length in our brief and in the opinion of the Court of Claims, Respondent, as a condition to obtaining the permission of the Internal Revenue Service to change its basic depreciation accounting techniques, Respondent entered into a terms letter agreement with the Internal Revenue Service in which Respondent promised, among other things, that it would not take depreciation deductions with respect to properties that had been donated to it and so for years Respondent declined to claim depreciation deductions with respect to the assets at issue here.

Suddenly, in 1965, Respondent brought a lawsuit in the Court of Claims alleging that it overpaid its income tax for the Year 1955 and that is the year at issue here, when it failed to take depreciation deductions on these properties paid for by the government and the Court of Claims held by a margin of four to three, with Judge Davis dissenting vigorously, that Respondent was indeed entitled to include the value of these properties in its depreciation base and to take deductions though it had incurred no cost in the acquisition of these assets.

Q Mr. Stone, there are other cases backed up behind this one, aren't there, involving other railroads?

MR. STONE: Yes, there are, Mr. Justice Blackmun.

Q Do those cases have a terms letter wrinkle too, as this one does?

MR. STONE: I'm not sure whether all of them do, Mr. Justice Blackmun, but I'm told that the terms letter agreements were very widespread in the railroad industry. They were basically involved in the post-Second World War changes from retirement depreciation accounting and I'm told that that was such a widespread practice due to the fact there were such low retirements and high profits during the Second World War most railroads and most industries generally did their accounting on the basis of -- did their accounting on the basis of retirement but it became much more profitable after the war to do it on the basis of straight depreciation technique.

But I don't know specifically if there are any cases back up right now which do not involve the terms letter.

In deciding the issue in Respondent's favor, the Court of Claims held both that the depreciation deductions were allowable under the applicable provisions of the 1939 Code and that in addition, Respondent had not given up its right to take depreciation deductions on donated properties when it entered into these terms letter agreements.

It is our position that even if the 1939 Code allowed Respondent a depreciation deduction in these circumstances, which we certainly believe it did not, Respondent was precluded from taking these deductions as a result of the binding terms letter agreement it entered into. This is a question of contract interpretation essentially. It is quite thoroughly covered in our brief and I shall focus my attention in this argument on the primary question with respect to which we sought certiorari here which is whether Respondent is entitled under the terms of the 1939 Code to take deductions in these circumstances for the depreciation of properties in which it has incurred no costs.

The fundamental concept of the depreciation deduction -- and this is virtually an axiom -- since its inception has been that taxpayers deduct from taxable income that portion of their assets which is used up in earning that income. The deduction for depreciation is essentially an expense deduction. It is designed to reflect approximately that portion of the taxpayer's expense incurred in the purchase of its assets which is attributable to the production of income in any particular year.

Accordingly, both the 1939 and 1954 Internal Revenue Codes provide that the basis on which depreciation is allowed is the same as the basis for determining gain or loss in disposition of the property and, in most instances, this is the expense that the taxpayer has incurred in purchasing the asset which is, of course, the taxpayer's cost.

If an asset has cost the taxpayer nothing, its gradual consumption represents no expense to him and there is ordinarily no reason to give him an expense deduction.

Now there are, to be sure, certain refinements of the general rule that the depreciation basis is the taxpayer's cost. In certain situations, for example, the tax laws have historically provided that a taxpayer to whom assets are transferred in certain well-defined types of transactions takes over the basis of the transferor rather than acquiring a new basis and this is known commonly as a "carry-over basis."

This is true, for example, where a taxpaper receives property in a transfer which the code characterizes as a gift.

There is also a carryover of the transferor's basis in many situations in which property is transferred to a corporation by its shareholders, for example. Section 358 of the Internal Revenue Code of 1954 provides a classic example of a carryover basis which is a carryover basis for property transferred to a corporation in a Section 351 transfer which is transfer in exchange for stock or securities in a corporation controlled by the transferors.

The reasons for providing a carryover basis in these situations are various and they are quite complex and would not fruitfully be explored in the context of this argument. But I would suggest that close analysis justifies the conclusion that these provisions do not really represent departures from the notion that basis is fundamentally a function of cost.

Rather, these special provisions reflect the legislative view that in certain circumstances, well-defined and for certain reasons, the purposes of the Code are most consistently and effectively carried out when the basis of an asset is unchanged in the hands of a transferee.

Or, if you will, when the cost basis of someone else within the transfee taxpayer is the most appropriate basis.

Now, what is the situation that you deal with here?

Section 113AAB of the 1939 Code provided that corporate taxpayers could take over their transferors basis, a carryover basis; in this case, to be sure, the assets we are dealing with are new and so the question is not one of whether it is a carryover basis or a taxpayer's cost basis because those are one and the same. The question is simply whether the taxpayer takes over any basis at all on these assets.

Section 113AAB provided that corporate taxpayers could take the transferor's basis including for purposes of depreciation in property transferred as "a contribution to capital" and that is the term we are dealing with here.

Ordinarily that term, "contribution capital" refers to transfer of money or other property to a corporation by a shareholder.

In this situation, the contribution to capital is quite logically considered a part of the shareholder's investment in his equity interest in the corporation and it is treated much the same way as consideration paid, for example, for the issuance of stock.

But the Internal Revenue Code of 1939 did not restrict the right to acquire a basis and, correspondingly, to depreciate assets donated as contributions to capital to assets donated by shareholders. It simply provided that the corporation acquired the transferors basis in a contribution to capital.

Consequently, it appears that the 1939 Code contemplated that non-shareholders could also make contributions to a corporation's capital and that the corporation could take over the transferors basis in these assets for depreciation purposes.

Significantly, by virtue of this Court's holding in

Edwards against Cuba Railroad at 268 U.S., a property transfer in these circumstances was held not to constitute income to the transferee corporation. Nonetheless, under the 1939 Code, corporate taxpayers who received donated assets which could be categorized as contributions to capital were able to take depreciation deductions with respect to these assets in which they had no investment and which they had received entirely free of income tax liability.

Congress changed the situation when it enacted the Internal Revenue Code of 1954. Section 362C of the current Code provides that contributions to capital made by non-wbareholders after June 1954 have a basis of zero for depreciation and other purposes in the hands of the transferees so that the basis is no longer carried over from the transferor.

But for cases such as this one which involved assets transferred before the application of the applicable date of Section 362, it is still necessary to inquire whether the transfering question can be classified as a contribution to capital within the meaning of Section 113 A8 of the 1939 Code.

Let me make it clear that we are not in any way whatsoever implying that Respondent should be deprived of a benefit which the 1939 Code provides to him. We are not attempting to make the amendments contained in Section 362 of the 1954 Code retroactive because they are explicitly made prospective in application only.

The specific issue in this case, however, is the definition of the term "contribution to capital" as used in Section 113AAB of the 1939 Code and that term is not defined in the Code. As I have indicated, it is a term ordinarily associated with transfers by shareholders or persons with underlying equity interests in a corporation.

The question in this case is, what does the term "contribution to capital" mean in the context of a transfer to a corporation by a nonshareholder?

With respect to this question, we believe that it is highly relevant to understand that the allowance of a depreciation basis in these circumstances was a departure from the traditional notion of depreciation as a reflection of expense, expense actually incurred as an asset is used up and we believe it is reasonable to conclude from the context that the term "contribution to capital" was not intended to apply to all transfers made to a corporation without immediately apparent consideration but that the term was intended to have a rather specific meaning and it is that meaning which we are attempting to cover here.

Indeed, we submit that the decisions of this Court rendered while Section 113AAB was still in effect have interpreted the term "contribution to capital" in the context of nonshareholder transfers in a very specific and limited way.

Essentially, we deal with two cases in which this Court specifically considered whether transfers of assets to a corporation by a nonshareholder constituted contributions to capital.

In both of these two cases, the Court tested the assets in question in terms of the donative intent of the transferor, specifically in terms of whether the transferors intention was to increase the corporation's capital, whether he was making a contribution to the corporation's capital.

Thus, in the Detroit Edison case, decided in 1943 at 319 U.S., the taxpayer was a utility company which claimed depreciation deductions with respect to electric power lines which its customers had been required to pay for in order to induce the company to provide its services in that neighborhood. The Court held that the taxpayers customers had not contributed these assets to taxpayers capital.

Justice Jackson said at 319 U.S. 102, "It overtaxes imagination to regard that the farmers and other customers who furnished these funds as makers either of donations or contributions to capital. The payments were to the customer the price of service."

Then, in 1950, seven years after Detroit Edison, the Court decided the second case construing the term "contribution to capital" in the context of nonshareholder transfers and that case is the Brown Shoe Company case decided at 339 U.S. In that case and it is a fairly standard model for a whole group of cases, community citizen groups which were intending to induce the taxpayer to locate its operations in that community for the purpose of generating economic benefit to the community donated factory buildings and other assets for use in the construction of the taxpayers basic new plant facilities. The use of the assets was unrestricted except that they were to be used in the taxpayer's business at that location for a specified period of time.

The Court in that case noted that the intent of the community groups was immediately to add assets to taxpayer's working capital without imposing restrictions and the Court held that the transfers, and I quote, "Manifested a definite purpose to enlarge the working capital of the company" end of quote for which reason the Court distinguished the Detroit Edison case where the transfers had been made by customers in compensation for service and held that the transfers constituted depreciable contributions to capital under the 1939 Code.

Now, where does this case fit in the spectrum between Detroit Edison, where the Court found that the donations were intended as payment for services rather than as contributions to enlarge the taxpayer's capital and Brown Shoe where the Court held that the donations made to induce taxpayer to locate its plant in a particular area were intended to increase the taxpayer's capital.

The Court of Claims in this case recognized that the governmental agencies which contributed to the highway-railroad facilities at issue -- or let us more properly say, which paid for the facilities at issue -- did not intend to enlarge Respondent's working capital in any way.

Well, the Court specifically found that, quote, "The facilities were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow." That finding is at page 57A of the petition.

The Court found further that the transferors were motivated entirely by considerations of highway safety and convenience and that they gave no consideration to Respondent's need for capital.

Nonetheless, the Court held that the instant case was controlled by Brown Shoe rather than by Detroit Edison and that transfers were contributions to capital. Its reasons, and they are amplified by Taxpayer in its brief, reflect in our view incorrect interpretation of these two cases and an excessively broad reading of the term "contribution to capital."

To begin with, both the Court of Claims and Respondent seize upon the reference in Detroit Edison to the fact that the power lines were contributed by taxpayer's customers in order to attain taxpayer's services. They seize upon this language and in spite of the Court's emphasis on Detroit Edison on the lack of intention to enlarge the company's working capital, they would restrict the application of that holding to situations where the properties in question are paid for as compensation for services. They set up an either/or test.

Conversely, the Court of Claims and Respondent would read Brown Shoe, and this is nearly incredible in view of the language of that case, not to require a finding of intent to enlarge taxpayer's capital.

Under their argument, a transfer to a corporation without obvious consideration constitutes a contribution to capital unless it can be categorized as compensation for services. This is a very broad conception of the term contribution to capital. It is rather cleverly contrived to fit the facts of this case in which the assets were clearly, as the Court of Claims found, not donated with intention of enlarging or contributing to taxpayer's capital but in which the transfers also cannot be categorized as payment for services.

We simply do not see how this conclusion can be reconciled with the opinions in these cases or, indeed, with the whole statutory scheme governing the depreciation and the production and, indeed, there is a vital aspect of the case bearing quite specifically on this question of intention which is ignored by the Court of Claims altogether but which makes it even clearer perhaps than in the Detroit Edison case that no contribution has been made to taxpayer Respondent's capital.

In Detroit Edison, the power lines which the taxpayer's customers donated to it, though they were not, to be sure, transferred with the intention of expanding the company's capital, were at least assets which were directly beneficial and relevant to the taxpayer's business, assets which in fact made substantial addition to the taxpayer's corporate capital.

Here in this case, as the Court found, the assets were only tangentially related to Respondent's business. The contribution was worth very little to the extent that there was any at all. Though an increased safety at highway railroad crossings is a goal that no one presumably would oppose, it is not especially relevant to the profitability of the railroad business, a fact which is doubtless reflected in the railroad company's constant resistance to sharing in the cost of these facilities.

This resistance is what resulted in Congress' authorization of total federal reimbursement for the facilities subject to the ten percent maximum pay-back by the railroads and, indeed, this is perhaps the most significant fact in the case. To the extent that Respondent was deemed to benefit to receive any tangible benefit from the construction of the facilities in issue here, he was required to pay for them. Nothing was contributed. Whatever the Respondent was deemed to have benefitted from, he paid for.

I take it everyone agrees that Respondent is entitled to depreciate any portion of these assets which it may have had to pay for. The agreements specified, as I have said earlier, that this benefit was not to exceed ten percent of the cost of the facilities and this is presumably a reflection of the party's judgment, of the legislative judgment that the facilities were not financially important to the railroads.

Indeed, testimony before the Court of Claims Hearing Commissioner -- and I point specifically to page 76 of the Appendix -- indicated that the railroads frequently asserted in arguing how much of the cost they would have to bear that the benefit they enjoyed amounted really to only one or two percent of the cost, total cost of the facilities and it did not seem to matter for this purpose whether the facilities were of a type directly related to rail use or the type directly related to highway use.

In sum, these assets with respect to which Respondent seeks depreciation now, were neither transferred in consideration of Respondent's services, as in Detroit Edison, nor were they contributions to Respondent's capital as in Brown Shoe. The railroads and the governmental agencies here have merely apportioned among themselves the costs of improving traffic flow at highway-railroad intersections.

Their respective shares of these costs reflect the relative benefit that the railroads and the government representing the people respectively derive from the assets.

In the case of the railroad, this is not much benefit and other railroads don't pay much but neither can it be said that these governmental agencies, in absorbing the share of the costs which reflects the public's interests in these assets, it cannot be said that they have contributed or donated that share of the costs to Respondent's capital.

Essentially, it may be helpful to think in terms in which Respondent and these agencies are simply like any two persons who share a cost together in proportions which reflect their respective interests in an asset. Two adjoining landowners, for example, may decide to construct a fence or dig a well together. They might find it convenient to locate the fence or the well on one side or the other of their property line. Presumably their apportionment of the cost of this asset will reflect their respective uses of the facilities.

The landowner on whose side of the line the well is dug or the fence erected has certainly not received a donation from his neighbor and cannot include his neighbor's cost in his depreciation basis.

This is essentially, we believe, the nature of the case here.

We would add, finally, that the great emphasis placed in Respondent's brief on the fact that it was obligated to maintain some -- or, it argues, all of the facilities. It may or may not be true that it has this obligation but it is irrelevant to the question of depreciability and irrelevant to the question of whether this is a contribution to capital because -- I'll say relevant, the question is certainly not dependent upon it. Depreciation, as is well-known, is an expense deduction for a current expense. It is not an anticipation of a future expense and a cost which the taxpayer has never incurred..

The taxpayer cites in this regard certain cases in which it is unclear who has made the underlying investment in an equity asset and in those cases it has been relevant to inquire who has the maintenance obligation in so far as that sheds evidence on the question of who is the underlying owner or has the underlying cost basis in the asset. But the mere obligation to undertake a speculative future expense is not under any circumstances to give rise to a depreciation deduction.

For these reasons, we believe that this decision ought to be reversed.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Stone.

Mr. Schreiber.

ORAL ARGUMENT OF RICHARD J. SCHREIBER, ESQ.,

ON BEHALF OF THE RESPONDENT

MR. SCHREIBER: Mr. Chief Justice and may it please the Court:

We feel that the significant difference in the factual apporach taken by Petitioner and Respondent is decisive of the outcome of this case. We submit that the obligation of replacement of these facilities is the critical factor in the determination as to whether or not Respondent is entitled to these depreciation deductions.

The finding of the Court below is clear that Respondent had this obligation in connection with the 173 facilities that we are talking about here today.

Now, what are these facilities? They are simply railroad bridges, rail crossing protective devices that are located on Respondent's rightofway which it has the obligation to maintain and to replace.

Now, we say we have the lagal obligation of replacement of these facilities. In addition, we have a very real practical obligation because the rail bridge over the public highway is a vital link in our transportation system. If we are furnishing common carrier service to the public, each one of these locations is essential to that operation. Therefore, we feel that there is a definite need to set up a depreciation reserve both from an accounting standpoint in order to anticipate replacement and from the very real practical situation of replacing these bridges as they became inoperable and needed replacement.

Q In the Detroit Edison case, did the utility company have the obligation to maintain and, if necessary, replace those power lines, or doesn't that appear in the opinion?

MR. SCHREIBER: I don't believe it appears, Mr. Justice Stewart, but I think it probably could be assumed that if they wanted to continue in business that they would have to replace this facility although it was not part of the agreement between the prospective customer and the Detroit Edison Company.

Q But the lines became the property of the utility company of Detroit Edison.

MR. SCHREIBER: Yes, they did, Mr. Justice.

Q And presumably they had the same obligations as your client does in this case, didn't they?

In any event, the Court didn't put any weight on that at all. Didn't even mention it.

MR. SCHREIBER: Not in the Detroit Edison case, Mr. Justice, but we feel that the legal obligation and the practical obligation of replacement that we have makes our case more persuasive for justifying a claim for depreciation deductions on 113 AAB than the Brown Shoe case.

Q Your point is that exactly the same obligation might have existed in the Detroit -- for all we know, did exist in the Detroit Edison case and yet the Court didn't, as I say, find that -- if it were true -- find it persuasive at all.

MR. SCHREIBER: No, because of the overriding consideration that the payments from the prospective customers in Detroit Edison --

Q Were part of the cost of services.

MR. SCHREIBER: Right.

Q Or part of the price of services.

MR. SCHREIBER: Yes, that is correct.

Q Rightly or wrongly, the court doesn't seem, in other words, in either case, neither the Detroit Edison nor Brown Shoe to have considered the factor that you are now talking about as dispositive either way. Isn't that true, in Brown Shoe the Court laid stress on the fact that the purpose who gave the assets was to benefit Brown Shoe and indirectly, therefore, to benefit the community. Isn't that right?

MR. SCHREIBER: We feel that the teaching of the Brown Shoe case was that the contributions made by the local citizen groups to the Brown Shoe Company to benefit the public at large --

Q Right.

MR. SCHREIBER: -- in other words, to create additional job opportunities.

Q In the community through Brown Shoe.

MR. SCHREIBER: Yes. And the means they used to achieve this publis purpose was to make these contributions to the working capital of the taxpayer. We feel that that is strictly analagous to the factual situation we have here. The primary purpose of the Federal Aid Highway Act was to benefit the public at large by enlarging the network of highways and also to increase safety at these intersections between highways and railroads.

Now, the means that the government chose to use to reach this laudable objective was to make these contributions to this taxpayer in order to benefit the public but in so doing, did so by contributing to our working capital.

In fact, I might enlarge on that just a bit. The agreements between the Respondent and -- it was the local or state governmental unit -- provided for the construction of these railroad bridges and these rail crossing protective devices and subsequent to that, the Respondent taxpayer was then reimbursed in cash through the Federal Aid Highway Program.

So the initial expenditure was out of Respondent's working capital to fund the construction of these projects and then this cash that went to the construction of these facilities was reimbursed directly into Respondent's working capital.

Q Mr. Schreiber, I'm not sure it is important or even relevant, but in recent times, at least, spur tracks off a railroad yard running into industry pick up their freight have been constructed at the cost -- by the railroad but at the cost of the industry.

What do the railroads do about that? Do they claim depreciation on those spur tracks?

MR. SCHREIBER: Well --

Q Industry tracks?

MR. SCHREIBER: The industry tracks, if the payment is made initially by the prospective customer without any right of reimbursement, that money would never appear in Respondent's accounts because it is assumed that they -- the prospective customer is paying for that right to have the track in there to serve his business.

Q Isn't that quite a bit like Detroit Edison?

MR. SCHREIBER: That is more like Detroit Edison than the instant fact situation, yes, Mr. Chief Justice.

Q How would you distinguish it? Tell me how you think that is distinguishable, in what respect, from your case.

MR. SCHREIBER: The spur track situation? It is different because there the prospective customer is making a payment in order to obtain services that might not otherwise be available to it. Unless there is a legal obligation on the Respondent to construct facilities, it is within its discretion as to whether or not it will do so and that is comparable to the Detroit Edison case.

Here, Mr. Chief Justice, we have a situation where this Respondent railroad had a preexisting legal obligation to construct these facilities in accordance with the laws of the states in which we operate. The state regulatory commissions did, and frequently did, issue orders requiring railroads to construct these types of facilities on their property.

Generally, that was done as a result of a petition from residents of a local community. If they wanted a signal light or a crossing gate at a particular location in their town, they would go down to the State Public Service Commission and, as a result of the proceedings there, we were frequently ordered, as the record below indicates, to construct these facilities. So there was a preexisting legal obligation on Respondent to construct these facilities which distinguishes it from the situation in Detroit Edison case and from the situation in regard to the spur track.

Q When a spur track is constructed, who owns it? Who has title to it?

MR. SCHREIBER: The title would be dependent on whether or not the track was sold on the prospective customer's property or whether it was on railroad right-of-way. If it was on railroad right-of-way, the title, legal title would assume to be in the railroad. But if it was on, as most of the siting tracks for serving customers at plant facilities are located within that particular plant facility area --

Q Some part of it is always on the right-of-way of the railroad, is it not?

MR. SCHREIBER: Probably the lead-in, Mr. Chief Justice, would be in order to get into the property line. It would have to be.

Q But the railroads don't claim any depreciation for that part.

MR. SCHREIBER: Well, the prospective company would only be paying for the track that is located on its property. In other words, the side track up to a door in the side of its building in order to serve that particular company. The -- what we call a "turn-out" from the rail track off the railroad right of way to the property line of the plant, would be our cost. And, of course, the --

Q What happens if 50 years from now the viaduct on such and such a road collapses and just wears out and several of them wear out and Burlington says, we can't afford to build it, to rebuild it and the government says, okay, we'll do like we did before. We'll give you the money.

MR. SCHREIBER: You mean in regard to the possible reconstruction of the bridges and of crossing signal protection devices?

Well, if that were to be the case, and of course we certainly hope it won't be the case in connection with the taxpayer, that would be a situation that would have to be determined at that time. But as of today, we have that --

Q Well, could the government deduct from what they give you how much you've depreciated in those last 50 years?

MR. SCHREIBER: Could they -- Mr. Justice, I -- I don't have the answer to that question as to whether they could or not. If, by congressional action --

Q Would it be fair for them to do that?

MR. SCHREIBER: From the standpoint and perspective of fairness, it might very well be fair and reasonable if at some future date, due to a collapse of a particular railroad, the obligation was placed back on the government to replace these facilities to offset the depreciation deductions claim. However, if that situation --

Q By that time, all that money is gone.

MR. SCHREIBER: Pardon me?

Q Right? By that time, all that depreciation money that you got back is gone now, isn't it? 50 years from now?

MR. SCHREIBER: Well, it's gone in the sense that it was available to the taxpayer but if in your situation the taxpayer railroad is becoming bankrupt, it wouldn't have any taxable income so it wouldn't be able to achieve any benefit from the deduction.

Q Well, I didn't mean bankrupt, I meant it was scooting along as it was in the '60's.

MR. SCHREIBER: Well, as long as it is still viable --

Q Well, you had to go to the Federal Government to get the money, didn't you? And you weren't bankrupt. Am I right?

MR. SCHREIBER: This -- the Federal Aid Highway Act of 1933 and the subsequent amendments thereto were provided for the primary purpose of benefitting the public by enlarging the highway network and also to provide these safety facilities at high --

Q Why, is the taxpayer taking money for depreciation benefitting the public?

MR. SCHREIBER: The taxpayer claiming his legitimate right to depreciation deductions is exercising the right that's provided by statute.

Q But he isn't benefitting the public, is he?

MR. SCHREIBER: But the project itself had the primary purpose to benefit the public, although that is true. As I've indicated before, the question is the means that were utilized to achieve this primary purpose.

Q You, I guess, started to say something else in response to my question. Continue.

MR. SCHREIBER: In regards to the track itself, the track is a nondepletiable item from the standpoint of straight-line depreciation so therefore the depreciation on the tracks is -- is not an issue here. It is only those items that we claim are entitled to straightline depreciation.

Q Railroad tracks are not depreciable?

MR. SCHREIBER: Under straightline depreciation. They are under retirement accounting, Mr. Justice.

Q I see.

MR. SCHREIBER: Now, we submit that the issue here involves clearly and simply a question of the proper statutory construction of Section 113 of the 1939 Internal Revenue Code.

Now, the section we are relying upon is Section 113 A8B which provides for the transferee to assume the basis of the transferor on payments made by shareholders as paid in surplus or from any other person as spelled out in the regulations and in the statute itself.

Now, this distinguishes the situation furthermore from the Detroit Edison case because under Section 113A8B, there is no necessity for a requirement of donative intent as there would be under Section 113A2, which is the gift provision and permits the donee to acquire the donor's basis. The donative intent only is of significance in connection with an interpretation of 113A2.

Now, as I have indicated previously, we feel that this case is controlled by this Court's 1950 decision in the Brown Shoe case.

Now, the logic and the rationale of this Court's decision in the Brown Shoe case is equally applicable in connection with our case. The facts are parallel. The primary intent was to benefit the public at large, both in Brown Shoe and in this case.

Secondly, the payments in the Brown Shoe case and in this case were not payments for goods or services to be rendered as they were in the Detroit Edison case.

Finally --

Q Wasn't there the difference that in Brown Shoe perhaps the industry would not have come into the area at all except for the contribution?

MR. SCHREIBER: That is correct, Mr. Chief Justice that --

Q Is that true here?

MR. SCHREIBER: That is not the same factual situation here because we had this preexisting legal obligation to construct these facilities, yes, sir.

Q So you didn't have any option about it that Brown Shoe had?

MR. SCHREIBER: That's why we feel, Mr. Chief Justice, that the facts in this case are more persuasive to justify a claim under Section 113 A8B.

Brown Shoe Company agreed to maintain this new facility or to renovate a facility within that community only for an initial period of ten years. Now, at the expiration of that ten-year period, Brown Shoe Company could pick up and move on and, conceivably they did.

Here, we had the obligation of replacement on a continuing basis if we intended to continue an operation as an interstate railroad.

That, as I was indicating, is the distinguishing characteristics, we feel, between Detroit Edison on the one hand and Brown Shoe and the factual situation in this case on the other hand.

Now, I'll just mention briefly in Petitioner's argument, as part of the overall revision of the 1954 Internal Revenue Code, Section 362C was added to apply a zero basis to these types of contributions but to do so on a prospective fashion only as to those facilities constructed subsequent to June 22, 1954 and the facilities that we are talking about here today, these rail bridges, these rail crossing safety devices, were all constructed prior to the cut-off date provided for in Section 362C of the 1954 Code.

It is clear also, from the legislative history of Section 362C, that it was intended to overcome the effect of the Brown Shoe case but to do so in a prospective fashion only.

Congress had it within its discretion to apply this revision of the Code provided for in Section 362C both in a retroactive manner -- if it deemed it prudent and advisable -- or in a prospective manner. They chose to do it in a prospective fashion only.

Now, the Commissioner and the government are coming into Court here and saying that regardless of what the Congressional intent was, this '54 Code revision should now be applied retroactively to factual situations that Congress specifically excluded when it amended the Code.

Now, I think it is clear that as a general principle of law that no retroactive effect is to be given to a statutory amendment unless it is explicitly required by the terms and conditions of that statutory amendment. Here, the case is quite to the contrary that it was to operate prospectively only.

Therefore, we assert that our rights to these depreciation deductions have matured exclusively under Section 113 of the 1939 Code and, specifically, Section A8B.

Finally, I'd just like to touch briefly on the so-called "terms letter defense" of Petitioner which we have been faced with throughout the trial of the case in the Court of Claims and on appeal to the Court below.

Petitioner asserts that certain illustrative language out of the so-called "mimeo 58 guidelines" is a bar to our claim for depreciation deductions in this case. Briefly, what transpired here is that in 1944, pursuant to a request by the taxpayer for a changeover in method of depreciation accounting from retirement accounting, straight-line depreciation accounting, revised -- or schedules were submitted to the Internal Revenue Service and an offer of a terms letter agreement to consent to this change-over in accounting was sent to the taxpayer.

Included in that terms letter in 1945 was the document that has been referred to "mimeo 58 guidelines."

It is our position, number one, that mimeo 58 guidelines were never a part of the terms letter agreement between REspondent and the Commissioner. They were not incorporated either by reference or otherwise into the terms letter offer between Respondent and Commissioner.

Then, upon receipt of the terms letter offer from the Commissioner, Respondent replied with a qualified acceptance indicating that in the event that any of the terms and conditions should be changed by statutory amendment, by the operation of law or otherwise, that the taxpayer would not be precluded from the benefits of such changes.

Now, considering the status of the law in regards to these depreciation deductions in 1945, it is clear why these were not included in the schedule submitted by Respondent to the Commissioner of Internal Revenue.

In 1943, this Court decided the Detroit Edison case and subsequent to that decision, the Commissioner began to disallow depreciation deductions to the Brown Shoe Company based on the Detroit Edison case. That is what initiated the lawsuit by the Brown Shoe Company to be allowed to claim these depreciation deductions and that issue was resolved by this Court in 1950. So from the period from 1943 to 1950, it was the position of the Commissioner and the government that nobody was entitled to any depreciation deductions on contributions to capital similar to those at issue in Brown Shoe and here.

Therefore, it would have been a meaningless act for us to, as a result of a request for change-over in accounting, raise the issue when that was the current understanding of the Commissioner and the government.

The terms letter itself and the mimeo 58 both specifically were qualified to indicate that depreciation was to be in accordance with Section 113 of the 1939 Internal REvenue Code in the regulations issued thereunder.

Therefore, once it became clear as a result of this Court's decision in the Brown Shoe case that contributions of this nature were properly depreciable, it effected a change in the terms and conditions of the terms letter agreement between Respondent and Commissioner and justified our claim for depreciation deductions, even if the mimeo 58 guidelines could be considered as even partially incorporated into the terms letter offer from the Commissioner to Respondent.

Finally, in conclusion, Respondent would like to assert it's a very simple, factual situation we are dealing with here in this case. What we are talking about are railroad bridges, rail safety facilities that are directly related to the operation of plaintiff's railroad; that we have the legal and practical obligation of replacement of these facilities if, as we do, continue to desire to stay in business as an interstate railroad.

Further, the government should not be allowed, as a result of this litigation, to apply a statutory amendment in a retroactive fashion when Congress, although it had it within its discretion to do so, failed to do so.

And, finally, we assert that the so-called terms letter defense cannot be successfully used to defeat a valid claim of this taxpayer on the substantive issue of its entitlement to depreciation deductions when the illustrative language relied upon by Petitioner is included in a mimeo 58 guideline enclosure to the terms letter agreement which is qualified by providing that all applicable sections of the 39 Code will govern the situation in regard to depreciation and when Respondent's acceptance of the terms letter agreement was so qualified to preserve its legal rights to contest the legitimacy of these depreciation deductions in a proper form by a timely claim for refund which is precisely what Respondent did successfully, both in the Trial Court and before the Court of Claims on review.

If there are no further questions, thank you, Mr. Chief Justice and the Court.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Schreiber.

Thank you, Mr. Stone.

The case is submitted.

(Whereupon, at 10:59 o'clock a.m., the case was submitted.)