

No. 3615.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

W. H. LAWRENCE,

Plaintiff in Error,

VS.

JUSTUS S. WARDELL, United States
Collector of Internal Revenue for the
First District of California,

Defendant in Error.

BRIEF FOR PLAINTIFF IN ERROR

Upon Writ of Error to the Southern Division of the
United States District Court of the Northern Dis-
trict of California, Second Division.

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STATEMENT OF THE CASE.

This is an action to recover \$2175.58 paid by plaintiff, under protest, to the defendant Collector as income tax and interest thereon. Plaintiff in Error and Defendant in Error were respectively Plaintiff and Defendant in the District Court and will be so designated in this brief.

The District Court sustained a general demurrer to the complaint. Plaintiff declined to amend and suffered a dismissal. Therefore, the allegations of the complaint are the facts of the case, and here, as in the District Court, the only question is whether the complaint states a cause of action.

Plaintiff, a citizen of the United States, was a resident of the Philippine Islands throughout the year 1918 and thereafter until March, 1919. In January, 1919, before leaving the Philippines, plaintiff there paid income tax of \$281.48, representing the full amount of tax upon his 1918 income computed in accordance with the Revenue Act of 1916, as amended by the Revenue Act of 1917. In March plaintiff established his residence in San Francisco, California, and in July was required by the defendant Collector to pay income tax upon his 1918 income computed in accordance with sections 210 and 211 of the Revenue Act of 1918, with credit for the amount paid in the Philippines. The payment was made under protest, and claim for refund was duly presented and was denied. (Printed Transcript, pp. 1-8.)

The case involves the interpretation of the Revenue Act of 1918 to determine whether sections 210 and 211 thereof apply to 1918 income of an American citizen residing in the Philippine Islands.

SPECIFICATION OF ERRORS.

Plaintiff in error specifies and relies upon three errors of the District Court, all of which involve the same question and need not, therefore, be argued separately:

(1) That the Court erred in holding and deciding that the complaint of the plaintiff herein does not state facts sufficient to constitute a cause of action against the defendant;

(2) That the Court erred in sustaining the demurrer of the defendant to the complaint of the plaintiff;

(3) That the Court erred in adjudging that the complaint of plaintiff be dismissed.

BRIEF OF THE ARGUMENT.

The Revenue Act of 1918 repealed the former income taxes *except* in Porto Rico and the Philippine Islands.

“Sec. 1400. (a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b):

“(1) The following titles of the Revenue Act of 1916:

“Title I (called ‘Income Tax’);

“* * *

“(3) The following titles of the Revenue Act of 1917:

“Title I (called ‘War Income Tax’);

“* * *

“Title XII (called ‘Income-Tax Amendments’).

“* * *

“(b) * * *

“Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 shall remain in force for the assessment and collection of the income tax in Porto Rico and the Philippine Islands, except as may be otherwise provided by their respective legislatures.”

This exception of the insular possessions was confirmed and emphasized by the specific requirement that every citizen and resident of the possessions should continue to make returns and payments under the Act of 1916.

“Sec. 261. That in Porto Rico and the Philippine Islands the income tax shall be levied, col-

lected, and paid in accordance with the provisions of the Revenue Act of 1916 as amended.

“Returns shall be made and taxes shall be paid under Title I of such Act in Porto Rico or the Philippine Islands, as the case may be, by (1) every individual who is a citizen or resident of Porto Rico or the Philippine Islands. * * *

“The Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands respectively.”

The new income taxes of the Act of 1918 were so imposed that they should take effect *pari passu* with the repeal of the old; they operated at once upon those affected by the direct repeal; in the possessions they came into force only as the former taxes were superseded by local income taxes imposed by the insular legislatures under their delegated authority. This was accomplished by establishing the new taxes of the 1918 Act “in lieu of” the old.

“Sec. 210. That, in lieu of the taxes imposed by subdivision (a) of section 1 of the Revenue Act of 1916 and by section 1 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax at the following rates:

“* * *

“Sec. 211. (a) That, in lieu of the taxes imposed by subdivision (b) of section 1 of the Revenue Act of 1916 and by section 2 of the Revenue Act of 1917, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax equal to the sum of the following:

“* * *”

It must be borne in mind that the "War Income Tax", Title I of the Revenue Act of 1917, did not extend to the insular possessions. For that reason it is not mentioned in sections 261 and 1400(b), *supra*, which maintain in force in the islands the income tax of the Act of 1916.

"Sec. 5. (of Title I of the Revenue Act of 1917). That the provisions of this Title shall not extend to Porto Rico or the Philippine Islands, and the Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands respectively."

So long as Title I of the Revenue Act of 1916 remained "in force for the assessment and collection of the income tax in * * * the Philippine Islands" (sec. 1400(b), *supra*), it applied to citizens of the United States there resident. This is clear from section 261, *supra*, which requires "every individual who is a * * * resident of * * * the Philippine Islands" to make return and pay tax in the Philippines under the Act of 1916. It further appears from the fact that "the assessment and collection of the income tax in * * * the Philippine Islands" under the Act of 1916 included such assessment and collection against Americans there resident.

The Revenue Act of 1916 extended the income tax to all citizens, residents and local income of the insular possessions, but assigned to the insular governments all the revenues collected in their respective territories, in deference, no doubt, to principles set out in our Declaration of Independence. Perhaps it might

have been more logical to allocate the revenues between the United States and the possessions in accordance with the source of income; but this method would have been cumbersome. Substantial justice with simplicity was achieved by allocation according to the place of collection, which depended on the residence of the taxpayer. So, a resident of New York enjoying Philippine income made his whole return and payment in New York, and his tax went to the Treasury of the United States. On the other hand, a resident of Manila, whether an American citizen or other, there paid his tax on his income of every origin, and the proceeds went to the Philippine government. The principle is illustrated by the ruling that a corporation conducting its principal business in an insular possession should be deemed there resident and should there pay income tax, although incorporated in one of the States (T. D. 2090, Dec. 14, 1914).

“Sec. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a non-resident alien, including interest on bonds, notes, or other interest bearing obligations of residents, corporate or otherwise.”

“Sec. 15. That the word ‘State’ or ‘United States’ when used in this title shall be construed to include any Territory, the District of Colum-

bia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions."

"Sec. 23. That the provisions of this title shall extend to Porto Rico and the Philippine Islands: Provided, That the administration of the law, and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general governments thereof, respectively; * * *"

The point to be emphasized is that under the Revenue Act of 1916 the Philippine government collected and retained the income taxes of citizens of the United States residing in the Philippines.

To provide increased revenues for war purposes Congress adopted the Revenue Act of 1918 with its greatly augmented rates of income tax. But, even in the emergency, it was evidently deemed improper to tax the dependencies for the benefit of the sovereign, and if the new taxes were assigned, like the old, to the insular governments they would prove disproportionate to ordinary requirements. The obvious course was to leave the Act of 1916 in force in the insular possessions, withholding the Act of 1918 from those territories. The power conferred in the Act of 1917 was continued by section 261 of the Act of 1918, whereby the possessions might modify the income tax to meet their own needs, and, if they saw fit, to give financial assistance in the prosecution of the war. If the Act of 1916 had been repealed entirely, the insular possessions, which had not yet exercised their

power to establish their own income taxes, might have been seriously embarrassed. Controlled by such reasons Congress in the Revenue Act of 1918 defined the United States to exclude the insular possessions,

“Sec. 1. That when used in this Act * * * the term ‘United States’ when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.”

And left the income tax of the Act of 1916 in force in the possessions, “except as may be otherwise provided by their respective legislatures.” No provision was made for distinct taxation of citizens of the United States residing in the possessions, but it appears that Congress contemplated a repeal by the insular legislatures of the Act of 1916, which would, of course, bring into operation upon resident Americans the new taxes “in lieu of” those so superseded.

In the Philippine Islands the Act of 1916 remained in force until January 1, 1920, and therefore applied to income of 1918, excluding in that territory the operation on income of 1918 of sections 210 and 211 of the Revenue Act of 1918. This appears from paragraph VI of the complaint (printed transcript, p. 3), admitted by demurrer. Probably the Court is not concluded by this admission, but may judicially notice whether or not an Act of Congress has been repealed by the Philippine Legislature under delegated power. It will be found that there is no pertinent Philippine legislation except Act No. 2833, approved March 7, 1919. This Act, which provides a complete scheme of income taxes for the Philippine Islands, is effective

January 1, 1920 (sec. 34); it "supersedes" the Income Tax Title of the Revenue Act of 1916 as amended by Title XII of the Revenue Act of 1917 (sec. 20).

So, plaintiff's 1918 income, by reason of his Philippine residence, was subject to tax under the Revenue Act of 1916 by virtue of sections 261 and 1400(b) of the Revenue Act of 1918. And, consequently, such income was not subject to the taxes of sections 210 and 211 of the Revenue Act of 1918, which could not apply "in lieu."

The defendant Collector was evidently misled by provisions of "Regulations 45" of the Treasury Department.

"Art. 1131. *Income tax in Porto Rico and Philippine Islands.*—In Porto Rico and the Philippine Islands the Revenue Act of 1916, as amended, is in force and the Revenue Act of 1918 is not. See also section 1400 of the statute.
* * *

"Art. 1132. *Taxation of individuals between United States and Porto Rico and Philippine Islands.*—(a) A citizen of the United States who resides in Porto Rico, and a citizen of Porto Rico who resides in the United States, are taxed in both places, but the income tax in the United States is credited with the amount of any income, war profits and excess profits taxes paid in Porto Rico. See section 222 of the statute and articles (of the regulations) 381-384. * * * The same principles apply in the case of the Philippine Islands."

As applied to the Philippines, Article 1132, *supra*, is correct for taxation of income of 1919 affected by *Philippine* taxes; it is erroneous for taxation of income of 1918 subject to the taxes of the Revenue Act of

1916. The error, whether in the Regulations or in their interpretation by defendant, arises from a misunderstanding of section 222 of the Act of 1918.

“Sec. 222. (a) That the tax computed under Part II of this title shall be credited with:

“(1) In the case of a citizen of the United States, the amount of any income, war-profits, and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States. * * *”

Obviously, this section contemplates two returns of the same income by a citizen of the United States, one in the United States under sections 210 and 211, and another in an insular possession. But if the return in the possession, here referred to, were the return under the Act of 1916 there remaining in force, there would be a conflict between section 222 and the inference from sections 210, 211, 261 and 1400(b) that the operation of the tax of 1916 excludes the operation of the tax of 1918. To contend that the 1918 tax is effective “in lieu of” the 1916 tax while the latter still persists would be as paradoxical as to assert inheritance from a living ancestor.

“Direct repeal would be no stronger, as it is expressly enacted that the increased duties and rates of duty shall be imposed in lieu of the duties heretofore imposed by law.” (*Gossler v. Goodrich*, 10 Fed. Cas. 836, 839.)

“‘In lieu of’ means in place of the thing modified by the quoted phrase.” (*Hendricks v. Thomas*, 242 Fed. 37, 42.)

The apparent conflict disappears and the Act is left wholly congruous if the reference in section 222 to "taxes paid * * * to any possession" is confined to such taxes imposed by the legislature of the possession under its delegated power. On January 1, 1920, the local statute superseded in the Philippines the Act of 1916 and thus left room for the operation upon United States citizens there resident of the taxes of sections 210 and 211 "in lieu of" those so repealed; resident Americans thereafter pay the local income tax to the Philippine Islands, and also pay to the United States the income tax of 1918, taking the corresponding credit under section 222.

This construction is not only required to harmonize the statute, but is compelled by the terms of section 222. It will be noted that the credit is not only for income taxes, but also for war-profits and excess-profits taxes. As no Act of Congress has ever extended war-profits and excess-profits taxes to the insular possessions nor to Americans residing therein, the reference in that respect could have been applicable only to such taxes imposed by local authority. The grouping of the possessions with foreign countries supports the idea of taxes imposed by other authority than that of Congress. The use of the preposition *to* in the phrase, "to any possession," negatives the possibility that the taxes of the Act of 1916 were in contemplation, for those taxes were paid *to* the United States even though *in* a possession, and none the less because Congress saw fit to allot the insular collections to the insular governments. Under the Act of 1916 the taxpayer in Manila and the taxpayer in San

Francisco paid income taxes under the same authority—that of the United States—and discharged the same obligation—to the United States. In section 261, where the reference is to the Act of 1916, Congress uses discriminatingly the phrase “*in the Philippine Islands.*”

The conclusive proof is in the interpretation which Congress, in another section of the Revenue Act of 1918, puts upon the clause, “taxes paid * * * to any possession of the United States.”

“Sec. 214. (a) That in computing net income there shall be allowed as deductions: * * *

“(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war profits and excess-profits taxes allowed as a credit under section 222; * * *”

So it appears that the “taxes allowed as a credit under section 222” are “taxes * * * imposed * * * *by the authority* of * * * possessions,” and the description is made more impressive by contrast with the preceding class of such taxes “imposed by the authority of the United States,” a class which does include the income taxes of the Revenue Act of 1916.

Construed as Congress intended it, section 222 fits perfectly into the general purpose of the Revenue Act of 1918 for which plaintiff contends: that the two Acts of Congress should be mutually exclusive; that so long as the Act of 1916 applied in any case, the Act of 1918 should not come into operation.

Applying these principles to the facts set out in the complaint it appears: that plaintiff's 1918 income was taxable in the Philippine Islands in accordance with the Revenue Act of 1916, and, therefore, was not taxable under sections 210 and 211 of the Revenue Act of 1918. It follows that defendant's exaction of payment from plaintiff was unlawful and erroneous; that the demurrer to the complaint should have been overruled, and that the judgment of dismissal of the District Court should be reversed.

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