No. 11686.

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

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ESTATE OF HOMER LAUGHLIN, Deceased.

BEACH D. LYON, Administrator with the Will Annexed,

*Petitioner,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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## PETITIONER'S REPLY BRIEF.

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## PETITIONER'S REPLY BRIEF.

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Respondent, pursuant to leave of court granted February 2, 1948, withdrew his brief filed in October, 1947, and substituted a new brief, which takes positions differing in important respects from, and in part inconsistent with those taken in his former brief. It has therefore seemed desirable in the interest of clarity to file an entirely new reply brief, even though the argument herein contained necessarily parallels and in part duplicates that contained in the reply heretofore filed.

We shall give primary attention to the last brief filed by respondent, giving minimum heed to his former contentions. It is proper to note that in both his earlier and later arguments in this Court, he has devoted most of his attention to a point—that dealing with the effect of Sections 22(k) and 23(u) of the Internal Revenue Code—

which in the Tax Court he esteemed of so little worth as not to justify mention. It is perhaps no compliment to us that the Tax Court, unaided by respondent, came to his rescue regarding this matter. Fortified by this perhaps unexpected assistance, he now relies heavily upon the point that an estate is under no circumstances entitled to the benefits permitted to living taxpayers under the provisions of those sections.

## ARGUMENT.

### I.

### The Pertinent Provisions of the Internal Revenue Code Apply to and Support the Claimed Deduction.

We agree with respondent (Br. p. 8) that "the critical connection between Section 162(b) deductions and the basic alimony provisions is made by Section 171(b) of the Code" (quoted Pet. Op. Br. p. 8). We note respondent's concession (Br. p. 9) that if Ada Edwards Laughlin is a "wife" as described in Sections 22(k) and 171(a) of the Code (required therefore to include the present payments in her taxable income), then Section 171(b) makes her a "beneficiary specified in this supplement," that is, a Section 162(b) "beneficiary, payments to whom are proper deductions." We do not sponsor the proposition (see Resp. Br. p. 9) that "*all* payments to divorced wives by the estates of deceased ex-husbands are payments to Section 162(b) 'beneficiaries.'" We quite agree with respondent (pp. 9-10) that repayments by the estate to the wife, of a loan made by her, would not be deductible. The same rule would apply to debts generally . (See *Trust Estate of Thomas Lonergan,* 6 T.

C. 715, cited in respondent's earlier brief, p. 20.) The absence of any parallel between such cases and the present is obvious.

When we come to the *interpretation* of the "basic provisions" referred to by respondent (p. 10)—the so-called "alimony" provisions, in conjunction with Sections 162(b) and 171(b)—we part company with him. The use of the terms *estate or trust* in Section 171(b) was due to no inadvertence. Those terms are used several times by both the Senate and House Committees in reporting on these amendments. (For the Senate Committee Report, see 1942-2 C. B. 568-570, quoted in part, Pet. Op. Br. pp. 12-13; for the House Report, see 1942-2 C. B. 427-429.) Congress was fully cognizant of the fact that it was legislating regarding the "beneficiary" of an estate—a somewhat unusual use of language, but by no means unintelligible; producing in fact no ambiguity to an intelligent layman or anyone not having the lawyer's critical ear for the legally exact word.

Respondent *correctly* says (p. 12), that "the estate of Homer Laughlin owes Mrs. Laughlin a general obligation, or annuity." So did Homer Laughlin while living, and yet if the 1942 legislation had been passed before he died, he would have been entitled to deduct the $9600 payments. This argument, like that in respondent's former brief (p. 7) based on the "capital" nature of the payments, proves too much.

Respondent *incorrectly* says (p. 12) that this obligation is "in the nature of a substitute for dower rights which she gave up in the contract of April 1, 1924." Perhaps respondent was misled by a superfluous reference to "dower" in the Agreement between the Laughlins [R.

53 at 60], but the fact is there are no dower rights in California, and Mrs. Laughlin couldn't give up something she never had. At pages 6 and 7 of our opening brief, we called attention to the fact that property rights do not enter into this controversy. It was stipulated [R. 38]:

> "(15) Homer Laughlin, Jr., did not possess on April 1, 1924, or at any time thereafter during the continuance of the marriage between him and Ada Edwards Laughlin, any substantial amount of community property, his property consisting of property given to him by or inherited by him from his father, Homer Laughlin, Sr."

To a court sitting in California, we need not emphasize the fact that Homer Laughlin's property, being separate, was his to dispose of as he saw fit.[1] In so far as respondent's position rests on the contrary assumption, it falls by its own weight.

Respondent argues (p. 12) that Homer Laughlin's obligation having outlasted his life, it is not an "alimony" or "support" obligation; that therefore (in effect), the payments made pursuant to it do not come within Section 22(k) at all. At the risk of repetition, let us reexamine the facts of the present case in the light of Section 22(k) in an effort to ascertain whether the case fits the statutory requirements.

First, we have a "wife," Ada Edwards Laughlin, "who is divorced * * * from her husband under a decree

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[1]Probate Code, Section 20, as it read in 1932, when Homer Laughlin died:

> §20. Who May Make Will: [Separate Property: Soundness of Mind: Age]. Every person of sound mind, over the age of eighteen years, may dispose of his or her separate property, real and personal, by will.

of divorce"; second, we have "periodic payments" received "in discharge of * * * *a legal obligation which because of the marital or family relationship,* is imposed upon *or incurred by* such husband under such decree *or under a written instrument incident to such divorce.*"

The obligation incurred by Homer Laughlin conforms to these requirements, and there is no other requirement. Respondent in implying that the payments must be strictly for "alimony," reads something into the statute that isn't there. Congress, presumably with intent, used neither the word alimony nor support (except as to support of minor children).[2] Recognizing that the husband's obligation might be different from, perhaps broader than alimony, Congress refused to place such a limitation upon it, specifying merely that the obligation be caused by the marital relationship (as here), that it be *imposed upon* the hus-

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[2]Section 6 of Public Act No. 1, 76th Congress, approved February 10, 1939, provides:

> Sec. 6. The arrangement and classification of the several provisions of the Internal Revenue Title have been made for the purpose of a more convenient and orderly arrangement of the same, and, therefore, no inference, implication or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion thereof, nor shall any outline, analysis, cross-reference, or descriptive matter relating to the contents of said Title be given any legal effect:

The heading "Alimony, etc., Income," to Section 22(k) seems to be "descriptive matter," not to be given any legal effect. Irrespective of this, it is well established as a matter of the general law of statutory construction that although the title to an act may be looked at in case of "ambiguity" (there is none here), it "will not limit the plain meaning of the text" (*Maguire v. Commissioner,* 313 U. S. 1, 9, 85 L. Ed. 1149, 61 S. Ct. 789; *Strathearn Steamship Co. v. Dillon,* 252 U. S. 348, 64 L. Ed. 607, 40 S. C. 350).

band (by a court, for example), or *be incurred* by him under a decree or written instrument (both are present here).

This is sufficient to distinguish *Parker v. Parker,* 193 Cal. 478, 225 Pac. 477, cited by respondent, and similar cases. In fact, that case, upholding as it does the legality in California of the kind of obligation, not strictly for alimony, that is here presented, is an authority for, rather than against the petitioner.

We confess our inability to see the relevancy of respondent's argument, pages 14 to 16, to the effect that the construction he contends for "will be consistent with the treatment accorded to separation agreement obligations under the estate and gift tax laws." To begin with, the claimed consistency is not manifest. Under state law, a promissor such as Homer Laughlin is bound by his promise, regardless of whether the federal taxing authorities, weighing his support obligation in their own special scales, decide that he has obligated himself to pay too much, and has therefore made a gift as to the excess. The existence here of a valid and enforceable obligation is not in dispute. If such an obligation were lacking, the Court's time would not be taken up with this controversy. We do not understand respondent to say that he could deny Homer Laughlin, if living, a full deduction because, in respondent's opinion, Laughlin had agreed to pay too much. Sections 22 (k) and 23 (u) contain or suggest no such limitation and we suggest none can be implied.

In the second place, respondent is asking here for a consistency which is often lacking in the operation of the revenue laws. For example, a person who by reason of the death of a decedent acquires the right to receive an

amount which would have been income if received by the decedent, is taxable on the amount as though it were income to him (§ 126, I. R. C.), although obviously it is a legacy or inheritance.[3] A man who distributes portions of his property among his family, who thereupon embark the same property in a partnership with the donor, makes valid, taxable gifts; but the law does not always give them recognition for income tax purposes.[4] Similiarly, under the doctrine of *Helvering v. Clifford,* 309 U. S. 331, a grantor may remain taxable on the income from transferred property, but nevertheless incur a gift tax on the transfer.[5] He may remain taxable on the income from transferred property, but *not* be liable for a gift tax on the income paid over to the beneficiaries pursuant to the terms of the same transfer.[6] A "gift" for estate or gift tax purposes may be a "purchase" for income tax purposes.[7] There is no provision more inconsistent with ordinary concepts of what constitutes income than that we are now considering, under which payments admittedly out of capital are considered and taxed as income (Reg. 111, Sec. 29.22(k)-1(a), last paragraph).

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[3]*Cf. Hazel Kirk Carlisle,* 8 T. C. 563, 568, aff'd., C. C. A. 6, Feb. 3, 1948.

[4]*Commissioner v. Tower,* 327 U. S. 280, 90 L. Ed. 670 (1946); *Lusthaus v. Commissioner,* 327 U. S. 293, 90 L. Ed. 679 (1946).

[5]*Commissioner v. Prouty,* 115 F. (2d) 331, 25 A. F. T. R. 986 (C. C. A. 1, 1940); *Commissioner v. Beck's Estate,* 129 F. (2d) 243, 29 A. F. T. R. 809 (C. C. A. 2, 1942).

[6]*Commissioner v. Hogle,* ...... F. (2d) ...... (C. C. A. 10, Dec. 26, 1947).

[7]*Farid-Es-Sultaneh v. Commissioner,* 160 F. (2d) 812 (C. C. A. 2, 1947).

On page 16, respondent, referring to the $800 per month payments made by Homer Laughlin during his lifetime, says:

> "* * * They are therefore deductible, whether made by the husband, or from estate or trust funds, by the payor, and are includible in the wife's return, under the new alimony provisions. Internal Revenue Code, Sections 22 (k), 23 (u) and 171 (b)."

As to this, query: What is meant by payments made "from *estate* * * * funds"? How could the *living* husband have an "estate" from which the payments could be made? Congress could hardly have contemplated such an absurdity. If respondent means what he seems to say, we needn't go any further.

Respondent's next statement, paragraph (b), page 16, states a general conclusion which we shall not attempt to repel here, as our entire argument runs contrary to the conclusion that the "annuity" payments made by the Laughlin estate are not *"related to* the husband's support obligation," and are consequently not deductible. On the contrary, we contend that the payments are made "in discharge of * * * a legal obligation which *because of the marital* * * * *relationship* is imposed upon or incurred by the husband." Homer Laughlin, in agreeing to pay $800 per month, was not acting solely out of kindness of heart. He "incurred" this liability "because of the marital relationship." We have already sufficiently adverted to respondent's attempt to whittle down this broad language to make it fit into a narrow concept or purely "support" or "alimony" obligations. This argument, like respondent's former argument, now discarded, based on the "capital" nature of the expenditures, proves too much. It would tend to prove that

Homer Laughlin would not have been entitled to deduct the $300 per month which would have been payable [R. 54] in the event of Mrs. Laughlin's remarriage—a position which seems clearly untenable.

We are not unduly disturbed by the "practical results" referred to in respondent's brief, page 17, if petitioner's position is sustained. In particular, the suggestion, page 17, that denial of the deduction will create pressure for settlement of the matter as between the estate and the annuitant, is not impressive in a case where the estate and the annuitant struggled along for some ten years after Homer Laughlin's death in 1932 without benefit of deduction (none being allowed by law) and without a "settlement." We submit that the number of cases of this kind is relatively small; and further, that this species of encumbrance on estate administration must necessarily be contemplated by those who become parties to such arrangements.

We refer now to the "incidental notes" to the government's main argument, pages 17 to 21.

1. *Uniformity.*—We make no contention opposed to the uniform operation of the statute.

2. *Taxability of Mrs. Laughlin.*—Ada Edwards Laughlin is, we submit, taxable on the $9600 payments, and by reason of Section 22 (k) of the Code. That is the whole point of the present case.[8] Naturally, Mrs. Laughlin is not concluded by the decision here, and no judgment can be rendered which will affect her, except

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[8]The respondent concedes that Mrs. Laughlin would be taxable if Homer Laughlin were alive. (Resp. Br. p. 16.) No adequate reason is suggested why his death should convert taxable income into a non-taxable receipt.

indirectly and as a precedent. Every decision the Court hands down affects numerous people in that way and to that extent.

We question the statement in Note 3, page 19, of respondent's brief, to the effect that "the estate obligation results from a gift to Mrs. Laughlin as of April 1, 1924." Mrs. Laughlin received no gift in 1924; what she got was a promise to pay money in discharge of an obligation then imposed upon or incurred by her husband. Unless Homer Laughlin was bound by that promise, we have no case.

3. *Section 162 (d).*—(Resp. Br. p. 19.) We are in agreement with the concessions made, as far as they go.

4. *Reg. 111, Sec. 29.23(u)-1.*—(Resp. Br. p. 20.) We endeavored—with no notable success so far as the Tax Court is concerned—to reconcile Section 29.22(k)-1 (a) and 29.23(u)-1 of respondent's regulations. The Tax Court (R. 110; p. 44 of 8 T. C.) says the last cited regulation is "apparently in conflict with what petitioner contends." The government (p. 20) now concedes the inapplicability of Section 29.23(u)-1, rendering it unnecessary for the Court to consider the argument advanced in our opening brief (pp.10-11), relating to this subject matter.[9]

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[9]In his earlier brief, page 13, respondent said that our effort "to construe this Regulation as inapplicable to the case where the estate of the deceased husband makes the payments, strains common sense. Actually, taxpayer's contention is that this Regulation is invalid for conflict with Section 171(b) of the Code." Respondent now says (Br. p. 20) that "the government places no reliance upon the above provision and submits that it is not relevant to the present question * * *." Since we are unable to draw a distinction between what is "not relevant" and what is "inapplicable," we assume this amounts to a recession from respondent's former position and from his characterization of the position we took.

## II.

## The Estate Tax Deduction.

As pointed out in our opening brief (p. 16), the estate tax deduction with which we are now charged is somewhat illusory. Passing that point, and assuming that the estate had, or should have had a deduction in some amount on account of Ada Edwards Laughlin's claim, we believe there are two answers to respondent's contention: First, the payment of *this kind of a debt* gives the right to a deduction. This is admittedly so in *inter vivos* transactions. We believe the same result to be required as to payments by decedents' estates, the requirements of Sections 22 (k), 162 (b), 162 (d) (1), and 171 (b) being satisfied. Second, the statute expressly permits this kind of "duplication" of deductions, just as it permits sums paid to a divorced wife out of capital to be treated as deductions to the payor and income to the payee.

Section 162 (e), referred to in respondent's brief, page 22, is not apropos here for the reasons, first, that this statute, enacted in 1942, is prospective in its application, inapplicable to the estate of a man then ten years deceased. The section shows on its face (by its reference to filing a waiver of the right to have the items in question allowed as deductions under Section 812 (b)) that it can apply only prospectively, to cases where such waiver is possible.[10]

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[10]The above construction is supported by Section 161(b), Revenue Act of 1942. Referring to Section 162(e), I. R. C., added by Section 161(a) of the Act, Section 161(b) says:

> "(b) Taxable Years to Which Amendment Applicable.—The amendment made by subsection (a) in so far as it relates

In the second place, Section 162 (e) cannot have the effect of disallowing as a deduction items expressly made deductible from the estate's income under the provisions of Sections 162 (b), 162 (d) (1) and 171 (b). If, as we believe, we are entitled to a Section 162 (b) deduction, we don't need a Section 23 deduction, and Section 162 (e), which refers only to the latter type of deduction doesn't apply. Supplement E (Sections 161 to 172) provides a code relative to deductions of estates and trusts,

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to section 23(a)(2) shall be applicable with respect to the same taxable years and the same revenue laws as the amendments made by section 121 (relating to non-trade or non-business deductions) of this Act; and the other provisions shall be applicable to taxable years beginning after December 31, 1941."

Section 23(a)(2), referred to in the foregoing excerpt, added by Section 121 of the 1942 Act, provides for deductibility of the following:

"(2) Non-Trade or Non-Business Expenses.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

This provision was made retroactive generally, as follows (Section 121(e), 1942 Act):

"* * * * * * * * * * *

"For the purposes of the Revenue Act of 1938 or any prior Revenue Act the amendments made to the Internal Revenue Code by this section shall be effective as if they were a part of such Revenue Act on the date of its enactment."

The above shows that Congress had the question of retroactivity in mind; and that it could have contemplated the applicability of Section 162(e) only where the estate tax matter was still open and the question of deductions undetermined.

allowing some deductions *additional* to those granted to individuals. Section 171 (b) contains no mention of Section 23 (u). It refers only to a Section 22 (k) "wife," and says, in effect, that distributions from an estate or trust to such a "wife" are deductible. This is a particular provision relative to this particular subject matter.

To construe this provision in accordance with respondent's contention would be to permit the general provision to govern the particular, contrary to a familiar canon of statutory construction (*Townsend v. Little,* 109 U. S. 504, 512, 27 L. Ed. 1012; *Virginian Railway Co. v. System Federation No. 40,* 300 U. S. 515, 563, 81 L. Ed. 789). The construction would, we submit, constitute a departure from the intent of Congress, which is to regard an estate, during the period of its administration, as a continuing entity, governed as to income taxes by rules comparable to those which obtain in the case of trusts, as to which Supplement E establishes a special and (except as it includes other sections by reference) a complete code.

Section 162 (e), we submit, refers to those claims against an estate whose entire income tax effect is determinable *in limine, not to recurring obligations such as the Ada Edwards Laughlin claim.* The fact that the claims referred to are those deductible in determining the estate tax—a definite and non-recurring event—seems to confirm this.

The fact that it is impossible under given circumstances to comply with a prescribed condition furnishes some indication that the condition is not intended to apply to those circumstances. In the present case, the estate tax return was due March 27, 1934 [R. 32]. For the taxpayer, making its 1942 return on March 15, 1943, to have filed a waiver of its right to a deduction on an estate tax return filed almost nine years before, would have been a little ridiculous. Congress plainly never contemplated a gesture so futile, and one so incapable of becoming in any manner effective.

The Commissioner, in 1939, claimed an estate tax deficiency of $5,954.94 on the theory that his earlier allowance of a deduction for the commuted value of the Ada Edwards Laughlin claim was erroneous [R. 69-71]. The income tax deficiency resulting from the disallowance of the $9600 as a deduction is $7,077.09 *for the year 1942 alone* [R. 119]. Assuming a comparable amount to be involved for the remaining years of Ada Edwards Laughlin's life, it is manifest that petitioner is paying a big price for the small tax benefit received by the estate some fifteen years ago. If the equities of the case enter into the picture at all, it would seem that petitioner should at most be charged with only $5,954.94. It might be difficult to find technical justification for such a result. But it would eliminate in a rational manner the "double deduction" of which respondent complains.

## Conclusion.

From the confusion of the present debate, one luminous fact emerges. Ada Edwards Laughlin is a "wife," the "beneficiary" of an "estate," as those terms are used in Section 171 (b) or those terms have no meaning in that context. In two tries in this Court, respondent has brought forward no adequate explanation of this language. Unless Ada Edwards Laughlin is a "wife" who is the "beneficiary" of an "estate," within the meaning of Section 171(b), that particular part of the statute seems to have no significance. It will require something more than a decision of the Tax Court, bolstered by the respondent's interested though somewhat belated support, to convince us that Congress made so futile a gesture.

We respectfully submit that the decision of the Tax Court should be reversed.

Respectfully submitted,

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