

EL HOGAR FILIPINO, PLAINTIFF AND APPELLEE, VS. JAMES J. RAFFERTY, COLLECTOR OF INTERNAL REVENUE, DEFENDANT AND APPELLANT.*G.R. No. 11861. April 01, 1918*

Ponente: JOHNSON, J.

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The appellee is a "building and loan association" duly and regularly organized under the laws of the Philippine Islands (Act No. 1459, sections 171-174). The only question presented by this appeal, is whether or not it is a "domestic building and loan association organized and operated exclusively for the mutual benefit of its members." If it is, then it is relieved from the necessity of paying the income tax by virtue of the express provisions of paragraph G of the Act of Congress of October 3, 1913, and the judgment of the lower court must be affirmed. If it is not such a building and loan association, then it is not entitled to the exemption under the law, and the decision of the lower court must be reversed.

This action was brought to recover, from the Collector of Internal Revenue, moneys which had been paid, by the plaintiff under protest, as income tax. The plaintiff alleged that, inasmuch as it was a "building and loan association" it was exempt from the payment of the income tax under the Act of Congress of October 3, 1913. (Public Laws, vol. 9, p. 509.) Upon the issue presented the lower court decided that the appellee was a "building and loan association" and, therefore, was exempt from the payment of the income tax, and ordered the Collector of Internal Revenue to pay back the amount paid under protest, with costs.

The plaintiff alleged that it was a mutual building and loan association duly organized under the laws of the Philippine Islands (Act No. 1459, sections 171-174) ; that it was organized for the following purposes: "(a) The accumulation of the savings of its stockholders, (b) The repayment to said stockholders of their accumulated savings and the profits thereof upon presentation and surrender of their stocks, (c) The encouragement of industry, frugality, and homebuilding among its stockholders, (d) The loaning of its funds and the funds borrowed for the purpose, to its stockholders on the security of the unencumbered real estate and the pledge of the shares of capital stock owned by the stockholders as collateral security; and (e) The borrowing of money under the credit of the corporation and the issuing of bonds or other documents guaranteeing the existence of such obligations;" that the defendant is the Collector of Internal Revenue of the Philippine Islands; that it was compelled by the defendant, on the 24th day of April, 1914, to pay, as income tax, the sum of P2,579.88 for the year 1913, and on the 8th day of June, 1915, to pay the further sum of P3,871.66 as income tax for the year 1914; that both of said payments were made under protest; that said protest was based upon the ground that, by virtue of a provision of paragraph G of the Act of Congress of October 3, 1913, it was relieved from the necessity of paying the income tax; that under and by virtue of the provisions of articles 43 and 44 of its by-laws all loans which it made were limited to the members of the association; that the issuance of preferred and special shares is to aid and further the purposes for which said association was organized; that the ruling of the defendant upon the protest of the plaintiff is arbitrary, unjust and illegal—making a distinction where the law makes none. The plaintiff prayed that the court render a

judgment declaring that it was a "building and loan association organized and operated for the mutual benefit of its members" and therefore exempt from the payment of the income tax and that the defendant should be compelled to return to it the sum of P6,451.54, together with whatever other remedy which the facts in justice and equity entitle it to.

On the 21st day of August, 1915, the defendant, through the Attorney-General, answered the complaint of the plaintiff. The defendant admitted some of the facts of the complaint, denied generally others and interposed a special defense, and prayed that the court render a decision declaring that the plaintiff was not a "building and loan association" organized exclusively for the "mutual benefit of its members."

After issue joined in the manner above indicated by the petition and answer, the parties, on the 15th day of November, 1915, entered into the following stipulation of facts:

"(1) That the defendants admits that the plaintiff corporation is organized in accordance with the laws of the Philippine Islands and inscribed in the Division of Archives of the Executive Bureau, but reserves the right to discuss, as a legal point, the propriety or impropriety of the plaintiff institution's being called 'mutual.'

"(2) The plaintiff, on other hand, admits the facts alleged in the defendant's answer, and further admits having published the printed report of the activities of the corporation during 1914 which is now presented as Exhibit B of the defendant, but reserves the right to discuss the materiality, pertinency, and relevancy of the said exhibit as evidence."

On the 26th day of November, 1915, the parties entered into an additional stipulation of facts as follows:

"The parties stipulate, as supplementary to what was agreed upon on the day of the trial, that the contract of January 11, 1911, referred to in article 92 of the by-laws, Exhibit A of the defendant's answer, is that which, together with what is attached hereto to form an integral part of the statement of facts agreed upon by the parties, was previously and subsequently connected therewith.

"It is also agreed upon that after the lapse of the first year from and after the date of the organization of the corporation, and after the contract of January 11, 1911, had thereby become inoperative, Mr. Melian has continued as manager of said corporation at the compensation fixed in article 87 of the by-laws, to which compensation the sum of twelve thousand pesos (P12,000) per annum was added by the Board of Directors in compliance with the provisions of paragraph 2 of same article, but deducting from said amount of P12,000 what is collected during the year as entrance fees of the stockholders.

"The parties pray the court to approve this supplementary agreement, and to take in account, in deciding the case, the documents which accompany the same."

Upon said stipulation of facts and the argument of the respective counsel, the Honorable Simplicio del Rosario, on the 24th day of March, 1916, rendered a very carefully prepared opinion in which he discussed the nature and character of the plaintiff association and reached the conclusion that it was "a mutual building and loan association" and, as such, was exempt from the payment of the income tax under said Act of Congress, and rendered a judgment in its favor and against the defendant for the sum of P6,451.54.

From that decision the defendant appealed and made the following assignments of error:

"The court erred:

"(1) In finding that, in spite of the different classes of stock issued by plaintiff, it is included in the exemption established by the Act of Congress approved October 3, 1913, in favor of 'domestic building and loan associations * * * organized and operated exclusively for the mutual benefit of their members.'

"(2) In finding that in spite of the participation of the founder of the plaintiff institution and his heirs and of its board of directors to the extent of the percentages fixed by the by-laws, plaintiff is included in the above-mentioned exemption.

"(3) In rendering judgment in favor of plaintiff and against defendant."

The provisions of the Act of Congress of October 3, 1913, so far as they affect the question before us, are as follows:

Paragraph A, subdivision 1, of Section II of the Act of Congress of October 3, 1913:

"That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of one per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere."

Paragraph B of subdivision 2 reads in part as follows:

"That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent dividends, securities or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, * * *."

Paragraph G (a) is in part as follows:

"That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year; Provided, however, That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare: * * *."

It is admitted that El Hogar Filipino was organized under the provisions of Act No. 1459 in accordance with the provisions of said law. Act No. 1459, under the head of "Building and Loan Corporations" or Associations, defines the purposes and objects of such corporations or associations.

Section 171 provides that "All corporations whose capital stock is required or is permitted to be paid in by the stockholders in regular, equal, periodical payments and whose purpose is to accumulate the savings of its stockholders, to repay to said stockholders their accumulated savings and profits upon surrender of their stock, to encourage industry, frugality, and home building among its stockholders, and to loan its funds and funds borrowed for the purpose to stockholders on the security of unencumbered real estate and the pledge of shares of capital stock owned by the stockholders as collateral security, shall be known as building and loan corporations, and the words 'mutual building and loan association' shall form part of the name of every such corporation."

Section 172 provides:

"The articles of incorporation shall state the purposes of the corporation as set forth in section one hundred and seventy-one."

Section 173 provides:

"Any person may become a stockholder of any building and loan corporation by subscribing for one or more shares therein and signing the by-laws of the corporation, following his signature with his postoffice address."

Section 174, as amended by Act No. 2092, provides:

"The capital stock of such corporations shall be paid in by the stockholders in regular, equal, periodical payments, known as dues, at such times and in such amounts as shall be provided in the by-laws of the corporation. The dues on each share of stock subscribed for by a stockholder shall continue to be paid by the stockholder to the corporation until the share has been duly withdrawn, cancelled, or forfeited, or until the share has reached its matured value; that is to say, when the dues paid on each share and the net earnings thereof, in accordance with the by-laws, shall amount to the par value of the share, but such corporation may issue and sell at par, for cash, paid-up or investment stock, and may pay to the holders of such shares a rate of interest or dividend to be fixed by the board of directors of the corporation, which shall be expressed in the stock shares and shall not participate further in the profits or accretions of the corporation. Such paid-up or investment stock may be surrendered by the holder at any time upon the giving of ninety days' notice to the corporation, or such briefer notice as the corporation may fix, and upon such surrender the holder will be entitled to receive only the amount of principal invested together with the accrued interest or earned dividend fixed by the board of directors and expressed in the stock shares.. The capital stock shall consist of the proceeds of such paid-up or investment stock and of such accumulated dues together with the earnings and profits of the corporation, and shall in no case exceed ten million pesos."

Building and loan associations are of recent origin. Their nature, character and mode of operation are matters of recent growth and development. Endlich is considered a leading authority upon such associations. He says in section 1 of his work "On Building Associations:"

"The building association is an institution in modern society. Its plan was designed to meet the wants, and accommodate itself to the peculiarities, of men, whose little earnings can be only slowly raised to an effective bulk. As a corporation, it is the creature of legislative policy, and not of legislative caprice. In its essential plan and nature, it is the same alj over the world, springing from the same considerations, ministering to the same necessities, achieving the same results. The similarity existing between the statutes and usages relating to building associations in the various States and countries is neither accident nor simply imitation. It is at once the evidence and the recognition of identical requirements of society in the various communities."

In section 7, Endlich, in discussing the primary designs and general operation of building associations, says:

"The idea which first gave rise to the institution of building associations, which furnished their ostensible and legitimate *raison d'être*, and which secured to them their popularity and their, in many respects, exceptionally favored position before the law, is that of enabling persons belonging to a class whose earnings are small, and with whom the slowness of the accumulation discourages the effort, to become, by a process of gradual and compulsory savings, either at the end of a certain period, or by anticipation of it, the owners of homesteads. The operation of the scheme may be easily understood."

Thornton and Blackledge, in their work "On Building and Loan Associations," at page 6, say:

"Societies, known as building, loan fund, and savings associations, are now recognized as important factors in the social and economic development of this country. The controlling idea is the massing of the separate earnings of wage-workers, and the savings of persons of small means, in such a manner as to aid them in procuring homes. It is the organization of thrift and self-help; a practical application of the maxim that in 'union there is strength.' The effect of such a movement is to dignify the home; to foster morality, and to make thoughtful, wise, and responsible citizens. It is for such reasons that the law and the courts, where such associations have been properly conducted, have looked upon them with favor. Whether they shall retain the favorable estimation of legislatures and courts will depend in large measure upon the wise forecast and determined purpose of those who control such institutions. Those departures from the original idea, intended to enhance the profits of investors, without in any degree aiding those who are endeavoring to build homes, have been, and in the future probably will be, severely censured by the courts."

The defendant-appellant contends: (a) that because the plaintiff, under its by-laws, issues three classes of stock, and (b) that because it has fixed a certain charge against its annual profits in favor of the founder of said association, it is, therefore, not a "building and loan association organized for the mutual benefit of its members" and is not such a building and loan association as is contemplated by the exemptions of the said Act of Congress.

The plaintiff issues three classes of stock: (a) preferred (articles 12-16 of by-laws) ; (b) special (articles 17-21 of by-laws) ; and (c) ordinary (articles 22-23 of by-laws). Each stockholder enjoys certain fixed and well-defined privileges under said by-laws according to the class of his stock. Does that fact destroy the mutual character of the association?

"Mutual benefit" does not necessarily mean equal benefit. It may mean reciprocal support, aid, or assistance. Reciprocal benefits may be mutual, even though not equal. One stockholder, by loaning money to the association, may greatly benefit another class of stockholders who are borrowers of money from the association. While the resulting benefits may not be equal they are reciprocal and therefore mutual.

In the case of *Herold vs. Park View Building and Loan Association* (210 Fed. Rep., 577, 582) it was held that a building and loan association which issued both prepaid and installment stocks, the former being entitled to a fixed dividend payable only out of the earnings of the association, was entitled to the exemption under the law on the ground that, in operation, there would be but a small class of privileged stockholders with rights superior to their fellows, and all would stand on a footing of substantial equality, which was all that the law intended. Looking at the subject from as many points of view as possible, we are persuaded that Congress intended the word "mutual" to mean "substantially equal," and that a building association is organized and operated for the "mutual benefit" of its members when they share in the profits on substantially the same footing.

The principal objection urged against treating the defendant association as a "building and loan association" seems to be that, under its charter and by-laws, it is authorized to borrow money and issue different classes of stock. It has been held in numerous cases that the power to borrow money and to issue different classes of stock, or the exercise of that power, does not deprive such association of its character as "building and loan association."

(Manship v. New South Building and Loan Association, 110 Fed. Rep., 845, 852; Central Building, Loan and Savings Co. v. Bowland, 216 Fed. Rep., 526; Burt v. Rattle, 31 Ohio St., 116; People v. Preston, 140 N. Y., 549, 553; 24 L. R. A., 57.)

Judge Lurton (later an Associate Justice of the Supreme Court of the United States) in the case of Wilson v. Parvin (119 Fed. Rep., 652, 658), in discussing the effect upon building and loan associations of their issue of different kinds of stock says:

"It is said, in some of the cases which deal with the scheme of such associations, that such shares are inconsistent with the mutuality of such organizations by introducing the mere investor as a factor, and that the loans made by such companies to installment members would be usurious, but for the supposed mutual contribution of all to the fund thus loaned and the equal participation of all, including the borrowing members, in the contributions arising from interest, premium, dues, and fines. It is also said that the scheme of such association only contemplates the payment of members in advance out of the fund resulting from the small periodical payments from all the shareholders alike, and that there is in fact no lending or borrowing, but that the notes taken and the mortgage given by an advance member are only to secure the periodical payments due from him until his stock is matured and his note and mortgage thereby cancelled. * * *

"In order to 'advance members' there must be a fund out of which they may be advanced. The slow accumulations from subscribers paying only two dollars per share each month was doubtless found unsatisfactory to those it was intended to assist in the acquisition of homes by the aid of such companies. * * * The object in permitting these investment shares was plainly to assist those members of such associations who needed loans or advance to aid in procuring homes by inducing contributions from a special class of members who might be tempted by the promise of receiving as a dividend a larger return upon their money than otherwise admissible." (Herold v. Park View Building and Loan Association, 210 Fed. Rep., 577, 582; Central Building, Loan and Savings Co. v. Bowland, 216 Fed., Rep. 526; Eversmann v. Schmitt, 53 Ohio St., 174, 184; 29 L. R. A., 184.)"

A building and loan association is an organization created for the purpose of accumulating a fund by the monthly subscription, or savings of its members, to assist them in building or purchasing for themselves dwellings or real estate, by loaning to them the requisite money from the funds of the society. To all particular intent it may be said to be to enable a number of associates to have and invest their savings to mutual advantage, so that, from time to time, any individual among them may receive, out of the accumulation of the pittances which each contributes periodically, a sum, by way of loan, wherewith to build or pay for a home, and ultimately making it absolutely his own by the payment of such small amounts from time to time. (Rhodes v. Missouri Savings & Loan Co., 173 111., 621, 629; 42 L. R. A., 93.)

The appellee was organized in accordance with the provisions of the law for the creation of building and loan associations. It has complied with every requirement of the law. It has done nothing forbidden by the law. Everything which it has done, so far as the record shows, has been done in the furtherance of the primary object of building and loan associations generally, which was for the mutual benefit of its members. Our conclusion, therefore, upon the first assignment of error is that the issuance of different classes of stock does not destroy the mutuality required of such associations by the Act of Congress; that the appellee is a building and loan association organized for the mutual benefit of its members.

The appellant argues that inasmuch as said association has made a fixed charge upon its earnings that fact destroys the mutuality required by the Act of Congress in order to be regarded as a building and loan association such as are relieved from the necessity of paying the income tax. While the record does not clearly show why the members of the association willingly promised to pay to its founder a certain percentage of the dividend, it may be

fairly presumed that such promise was made by virtue of his special ability, experience and information regarding building and loan associations. They evidently desired an experienced man, a man versed in the enterprise upon which they were entering. They evidently desired to have a man who was able, by reason of his experience, etc., to insure the success of their association. They evidently believed, or otherwise they would not have given their consent to said charge, that the founder was able to guarantee the financial success of the association and could, therefore, without burden, sustain said charge. There is nothing in the law which prohibits them from employing agents, clerks and assistants for any number of years. If the members of the association or the board of directors, under proper authority, decide to employ an agent or a clerk or any of their employees for the whole period of their natural lives there is nothing in the law which prohibits them from so doing. Neither is there anything in the law which prohibits the association from pensioning a faithful employee who has rendered valuable services to the association if they so desire. If an employee or agent of the association should, by diligence and ability, greatly increase the profits, the members could well afford to pay him a stipend covering one or more years, depending upon what they thought his services, in fact, were really worth. We do not believe that the agreement to pay to the founder a fixed percentage of the profits has the effect of destroying the mutuality of the association.

For all of the foregoing reasons, we are of the opinion and so decide that El Hogar Filipino is a building and loan association organized exclusively for the mutual benefit of its members and is, therefore, exempt from the payment of the income tax. Therefore, the judgment of the lower court is hereby affirmed, with costs of this instance. So ordered.

Arellano, C. J., Araullo, and Street, JJ., concur.

Torres, J., did not take part.

Carson, and Malcolm, JJ., dissent.

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