

IN THE MATTER OF THE TESTATE ESTATE OF EMIL MAURICE BACHRACH, DECEASED.

G.R. No. L-2659. October 12, 1950

Ponente: OZAETA, J.

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OZAETA, J.:

Is a stock dividend fruit or income, which belongs to the usufructuary, or is it capital or part of the corpus of the estate, which pertains to the remainder man? That is the question raised in this appeal.

The deceased E. M. Bachrach, who left no forced heir except his widow Mary McDonald Bachrach, in his last will and testament made various legacies in cash and virilled the remainder of his estate as follows:

"Sixth: It is my will and do herewith bequeath and devise to my beloved wife Mary McDonald Bachrach for life all the fruits and usufruct of the remainder of all my estate after payment of the legacies, bequests, and gifts provided for above; and she may enjoy said usufruct and use or spend such fruits as she may in any manner wish."

The will further provided that upon the death of Mary McDonald Bachrach, one half of all his estate "shall be divided share and share alike by and between my legal heirs, to the exclusion of my brothers."

The estate of E.M. Bachrach, as owner of 103,000 shares of stock of the Atok-Big Wedge Mining Co., Inc., received from the latter 54,000 shares representing 50 per cent stock dividend on the said 103,000 shares. On June 10, 1948, Mary McDonald Bachrach, as usufructuary or life tenant of the estate, petitioned the lower court to authorize the Peoples Bank and Trust Company, as administrator of the estate of E. M. Bachrach, to transfer to her the said 54,000 shares of stock dividend by endorsing and delivering to her the corresponding certificate of stock, claiming that said dividend, although paid out in the form of stock, is fruit or income and therefore belonged to her as usufructuary or life tenant. Sophie Seifert and Elisa Elianoff, legal heirs of the deceased, opposed said petition on the ground that the stock dividend in question was not income but formed part of the capital and therefore belonged not to the usufructuary but to the remainderman. And they have appealed from the order granting the petition and overruling their objection.

While appellants admit that a cash dividend is an income, they contend that a stock dividend is not, but merely represents an addition to the invested capital. The so-called Massachusetts rule, which prevails in certain jurisdictions in the United States, supports appellants' contention. It regards cash dividends, however large, as income, and stock dividends, however made, as capital. (*Minot vs. Paine*, 99 Mass. 101, 96 Am. Dec. 705.) It holds that a stock dividend is not in any true sense any dividend at all since it involves no division or severance from the corporate assets of the subject of the dividend; that it does not distribute property but simply dilutes the shares as they existed before; and that it takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders.

On the other hand, the so-called Pennsylvania rule, which prevails in various other jurisdictions in the United States, supports appellee's contention. This rule declares that all earnings of the corporation made prior to the

death of the testator stockholder belong to the corpus of the estate, and that is earnings, when declared as dividends in whatever form, made during the lifetime of the usufructuary or life tenant are income and belong to the usufructuary or life tenant. (Earp's Appeal, 28 Pa. 368.)

"* * * It is clear that testator intended the remainder men should have only the corpus of the estate he left in trust, and that all dividends should go to the life tenants. It is true that profits realized are not dividends until declared by the proper officials of the corporation, but distribution of profits, however made, is dividends, and the form of the distribution is immaterial." (In re Thompson's Estate, 262 Pa. 278; 105 Atl. 273, 274.)

In *Hite vs. Hite*, (93 Ky. 257, 20 S.W. 778, 780), the Court of Appeals of Kentucky, speaking thru its Chief Justice, said:

"* * * Where a dividend, although declared in stock, is based upon the earnings of the company, it is in reality, whether called by one name or another, the income of the capital invested in it. If it is but a mode of distributing the profit. If it be not income, what is it? If it is, then it is rightfully and equitably the property of the life tenant. If it be really profit, then he should have it, whether paid in stock or money. A stock dividend proper is the issue of new shares paid for by the transfer of a sum equal to their par value from the profit and loss account to that representing capital stock; and really a corporation has no right to declare a dividend, either in cash or stock, except from its earnings; and a singular state of case—it seems to us, an unreasonable one—is presented if the company, although it rests with it whether it will declare a dividend, can bind the courts as to the proper ownership of it, and by the mode of payment substitute its will for that of the testator, and favor the life tenants or the remainder-men, as it may desire. It cannot, in reason, be considered that the testator contemplated such a result. The law regards substance, and not form, and such a rule might result not only in a violation of the testator's intention, but it would give the power to the corporation to beggar the life tenants, who, in this case, are the wife and children of the testator, for the benefit of the remainder-men, who may perhaps be unknown to the testator, being unborn when the will was executed. We are unwilling to adopt a rule which to us seems so arbitrary, and devoid of reason and justice. If the dividend be in fact a profit, although declared in stock, it should be held to be income. It has been so held in Pennsylvania and many other states, and we think it the correct rule. *Earp's Appeal*, 23 Pa. St. 368; *Cook, Stocks & S.* sec 554 * * * "

We think the Pennsylvania rule is more in accord with our statutory laws than the Massachusetts rule. Under section 16 of our Corporation Law, no corporation may make or declare any dividend except from the surplus profits arising from its business. Any dividend, therefore, whether cash or stock, represents surplus profits. Article 471 of the Civil Code provides that the usufructuary shall be entitled to receive all the natural, industrial, and civil fruits of the property in usufruct. And articles 474 and 475 provide as follows:

"Art. 474. Civil fruits are deemed to accrue day by day, and belong to the usufructuary in proportion to the time the usufruct may last.

"Art. 475. When a usufruct is created on the right to receive an income or periodical revenue, either in money or fruits, or the interest on bonds or securities payable to bearer, each matured payment shall be considered as the proceeds or fruits of such right.

"When it consists of the enjoyment of the benefits arising from an interest in an industrial or commercial enterprise, the profits of which are not distributed at fixed periods, such profits shall have the same consideration.

"In either case they shall be distributed as civil fruits, and shall be applied in accordance with the rules prescribed by the next preceding article."

The 108,000 shares of stock are part of the property in usufruct. The 54,000 shares of stock dividend are civil fruits of the original investment. They represent profits, and the delivery of the certificate of stock covering said

dividend is equivalent to the payment of said profits. Said shares may be sold independently of the original shares, just as the offspring of a domestic animal may be sold independently of its mother.

The order appealed from, being in accordance with the above-quoted provisions of the Civil Code, is hereby affirmed, with costs against the appellants.

Moran, C.J., Paras, Feria, Pablo, Bengzon, Tuason, Montemayor, and Reyes, JJ., concur.

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