

**FINLEY J. GIBBS, ETC., ET AL., PLAINTIFF AND PETITIONER,
ALLISON J. GIBBS AND ESTHER K. GIBBS, INTERVENORS AND
PETITIONERS, VS. COLLECTOR OF INTERNAL REVENUE AND COURT
OF TAX AP...**

G.R. Nos. L-14166 and L-14320. April 28, 1962

Ponente: CONCEPCION, J.

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CONCEPCION, J.:

These are two (2) appeals one by the plaintiff and the plaintiffs-intervenors and the other by the Government, from a decision of the Court of Tax Appeals, hereafter referred to as the lower court, promulgated on February 28, 1958, the dispositive part of which reads:

"IN VIEW OF THE FOREGOING, the decision appealed from is modified and the defendant Collector of Internal Revenue is hereby ordered to refund to the plaintiff the sum of P5,381.88, as computed in Annex 'A' hereof, with interest at the legal rate from date of payment. Without special pronouncement as to costs."

as amended by a resolution of said lower court, dated July 25, 1958, the concluding paragraph of which is as follows:

"WHEREFORE, our decision of February 28, 1958 is modified in the sense that the delinquency interest of one-half (1/2) of one (1%) percent should be computed on the deficiency taxes only from July 1, 1954 to July 30, 1954, and the defendant Collector of Internal Revenue is hereby ordered to refund to plaintiff the sum of P9,387.54 as computed in Annex 'A' hereof, with interest at the legal rate from the date of payment. Without special pronouncement as to costs."

On September 25, 1950, Allison J. Gibbs and his wife Esther K. Gibbs, hereinafter referred to as trustors, executed five (5) separate documents each, entitled "Deed of Sale and Declaration of Trust", whereby the respective trustors transferred, sold and assigned, in trust, 53,000 shares of stock of the Lepanto Consolidated Mining Co., in favor of each one of their five (5) children, namely, Johnson Kelly Gibbs, Allison De France Gibbs, Candace Gibbs, Douglas Fletcher Gibbs and Reginald Kelley Gibbs, in consideration of the sum of P26,227.70, to be paid "on or before December 23, 1950, by selling, mortgaging, hypothecating, or pledging part or all of the corpus of the trust." The market value of said 53,000 shares on September 25, 1950 was P34,980.00

The terms and conditions of the ten (10) deeds of trust were identical. Instituted trustee, without bond, in said ten (10) deeds, was Finnley J. Gibbs, a brother of trustor Allison J. Gibbs, who, as attorney-in-fact of the former, accepted the trust, in his (Finnley J. Gibbs') name, for and on behalf of the aforementioned beneficiaries. The trust was to terminate upon the respective beneficiary reaching the age of 35. If the beneficiary died before reaching that age, leaving legitimate issue, the trust would continue, but for the benefit of the latter, and the full distribution and termination of the trust with respect to such issue would be effected not later than 20 years after the death of said beneficiary. If the beneficiary died before reaching the age of 35 leaving no legitimate issue, the trustee would turn over the trust corpus or the remainder thereof and any accumulated income, share and share alike, to

the other beneficiaries or children of the trustors.

On October 24, 1950, the trustors gave notice to the then Collector of Internal Revenue, hereafter referred to as defendant, of the execution of the ten (10) deeds of trust and requested a ruling on whether or not gift taxes were due thereon. Soon thereafter, or on December 14, 1950, defendant assessed a donee gift tax of P75.04 on each of the beneficiaries in said trust agreements, or a total of P750.40 and a donor gift tax of P774.04 on each of the trustors, or P1,548.08 for both. These assessments were based upon the difference between said market value of the shares of stock and the stipulated consideration for the transfer thereof. On December 22, 1950, defendant revised his assessment of the donor gift tax by increasing it from P774.04, P842.84 for each trustor, or a total of P1,685.68. The next day, the donee gift taxes were, also, increased, from the aforementioned total sum of P750.40 to P7,856.90.

Within the period fixed by law, or on May 15, 1951, said donor and donee gift taxes in the sum of P1,685.68 and P17,856.90, respectively, were paid. Subsequently, the refund of P17,106.50, representing the difference between the amount of the first assessment (P750.40) for donee gift taxes and that of the second assessment thereof (P17,856.90), was demanded, but the demand was, on August 23, 1951, turned down by the defendant. The trustee appealed to the Secretary of Finance. Before the latter could pass upon the appeal, however, the Board of Tax Appeals was created by Executive Order No. 401 of the President of the Philippines. The pertinent records were then forwarded to said Board. Alleging fear of expiration of the two-year period for the refund of said sum of P17,106.50, on May 12, 1953, the trustee instituted Civil Case No. 19541 of the Court of First Instance of Manila against the defendant for the recovery of such amount.

Meanwhile, or on December 28, 1951, the trustors, by five (5) separate documents each, had created ten (10) additional and separate trusts, each involving 22,400 shares of stock of the same mining company, in favor of each of the aforementioned beneficiaries, for the stipulated consideration of P17,430, to be paid by the trustee within 120 days after the transfer of said stock has been effected in the books of the mining company. In all other respects, the terms and conditions of this second set of deeds of trust are identical to those of the first set. Admittedly, the market value of said 22,400 shares was then P19,264.00.

These additional deeds of trust impelled the defendant to assess, on April 8, 1952, a donor gift tax of P304.42 on each trustor, or a total of P608.84 for both trustors, and a donee gift tax of P36.69, on each of the beneficiaries, or a total of P366.90. These amounts were paid on May 15, 1952, within the statutory period therefor.

Holding that gift taxes are leviable on the full market value of all the shares of stock thus placed in trust instead of upon the difference between said market value and the stipulated considerations—on June 16, 1954, defendant assessed additional donor gift taxes in the sums of P5,093.71 on each trustor, or a total of P10,187.42, for the ten (10) trusts created on September 25, 1950, and P8,788.78, on each trustor, or a total of P17,577.56 for the trusts created on December 28, 1951. Additional donee gift taxes were, likewise, assessed in the sum of P12,040.30 for the ten (10) additional trusts created on December 28, 1951. The corresponding assessment notices demanded that these three (3) sums be paid on or before June 30, 1954. Upon request of the taxpayers, they were given an extension up to July 31, 1954, on which date said sums were paid under protest. Thus, the amounts paid under protest for the two (2) sets of trusts in question aggregate P56,911.78, itemized as follows:

Donee gift taxes on the trusts created on September 25, 1950

P17,106.50

Donor gift taxes on the trusts created on September 25, 1950

10,187.42

Donee gift taxes on the trusts created on December 28, 1951

12,040.30

Donor gift taxes on the trusts created on December 28, 1951

17,577.56

Total

P56,911.78

In the meantime, or on June 16, 1954, Republic Act No. 1125, creating the Court of Tax Appeals, had been approved and become effective. Pursuant to section 22 of said Act, the records of Civil Case No. 19541 of the Court of First Instance of Manila were, on August 26, 1954, forwarded to the Court of Tax Appeals. In October, 1955, the trustors intervened in the case as plaintiffs-intervenors. In their complaint in intervention they prayed for the refund of the additional donor gift taxes paid by them in the aggregate sum of P27,764.98, with interest and attorney's fees. In July, 1956, the trustee amended his complaint to include therein the claim for refund of the aggregate sum of P56,911.78 specified above. In due course, thereafter, the Court of Tax Appeals rendered its aforementioned decision, which on motion for reconsideration was amended as adverted to above. Hence, these appeals, one by the trustee (plaintiff) and the trustors (plaintiffs-intervenors), G. R. No. L-14166, and another by the defendant, G. R. No. L-14320.

The main issue raised in the first appeal is whether the gift taxes on the transfer of the shares of stock aforementioned should be based on the full market value of said shares of stock at the time of the respective transfers thereof or only upon the difference between said market value and the consideration, stipulated in the trust agreements. The defendant adhered to the first alternative, which the Court of Tax Appeals, likewise, adopted, upon the ground that the stipulated consideration were—except as to the aggregate sum of P52,277.00 allegedly paid by the trustee in June 1953—in effect, simulated.

Indeed, the stipulated consideration of P262,277.00, for the transfer of the 530,000 shares of stock involved in the first set of deeds of trust were to be paid, pursuant thereto, "on or before December 23, 1950, by selling, mortgaging, hypothecating or pledging part or all of the corpus of the trust". On December 2, 1950, the Central Bank granted plaintiff's application for license to sell, assign or encumber said shares of stock. Yet nothing was done to pay the stipulated consideration on the date set therefor. What is more, the trustors did not demand payment of, or do anything to collect, said consideration.

It is true that on June 15, 1953, or about three and a half years (3 1/2) after the latter had become due, Allison J. Gibbs, as one of the trustors and as attorney-in-fact for the trustee, as well as the other trustor, his wife, Esther K. Gibbs, executed ten (10) documents entitled "Compromise Agreement", stating that the parties had agreed to suspend and defer payment of the sum of P26,277.70 stipulated in each of the first ten (10) trust agreements, and to liquidate the obligation to make said payment as follows: (a) the trustee would pay P5,227.70 on or before June

30, 1953; and (b) the balance of P21,000.00 would be paid on or before the 21st birthday of the respective beneficiaries or the date of termination of the trust, whichever date came first. The trustee and the trustors have, likewise, introduced in evidence, ten (10) promissory notes of the trustee, for said sum of P21,000, allegedly executed in compliance with said compromise agreements.

These did not merit, however, full faith and credence from the Court of Tax Appeals, which regarded such agreements, as well as said-promissory notes, as a mere device to avoid and evade payment of the corresponding gift taxes. Considering that the trustee is a brother of trustor Allison J. Gibbs; that the ten (10) cash payments of P5,277.70 each, referred to in the compromise agreements aforementioned, were seemingly made to trustors Esther K. Gibbs and Allison J. Gibbs by the latter as attorney-in-fact of the trustee, his brother Finley J. Gibbs; that there was absolutely no consideration for the release of the trustee from the obligation to pay P26,227.70 on or before December 23, 1950, under each of the deeds of trust executed on September 25, 1950; that the promissory notes adverted to above bear no date and were not executed before any witness; and that the date of maturity therein set is so distant, in relation to the due dates under said deeds of trust, we find no justification for disturbing the conclusion reached by the lower court. In fact, said conclusion is borne out by the following circumstances:

- In answer to the following question propounded by a Judge of said court

"If the trusts were created for the benefit of your children and as you said, one of the consequences of which was your love and affection for your children, what need was there for you to impose this burden of requiring them to pay for those shares?"

trustor Allison J. Gibbs answered:

"Well, there were tax considerations involved, Your Honor. I have not only to think of the Philippine tax problems but also the United States tax problems. I very carefully went into the whole matter before my wife and I decided on doing what we did. I studied and came to the conclusion that we could not afford to make an outright gift of these shares, that the taxes that would result not only to the Philippine government but to the United States government would be too big for us to shoulder, considering the fact that we also are letting off our control of transfers of our right into these substantial portion of our assets. We could not have afforded to do it. It calls by way of future interest under the United States gift tax laws for payment of gifts taxes. We were allowed an exemption both—for both my wife—for each of my wife and myself of \$30,000.00 under the United States Federal gift tax law. But these gifts, had they been accepted * * * had they been made 100% * * * rather, these transfers had they been made without any consideration would have been taxable 100% at the market value on that date. That would have resulted on a tremendous tax both to the Philippine Government and to the United States Government. We could not afford to pay those taxes, and that is fundamentally one reason for fixing the price that we did fix which was premised upon our cost."

- The deeds of trust state that the purpose thereof is "to establish an endowment for the support, maintenance, care, health, higher education and travel of the beneficiary and the launching of his career after he becomes of age". These purposes would be materially impaired, if not entirely defeated, if the beneficiaries were to pay the stipulated consideration aggregating P262,277, under the first set of deeds of trust, and P174,300 under the second set, or a total of P436,577. If we deduct this sum from the aggregate market value of all the shares of stock in question—which is P542,440—the net value of the whole trust would be reduced to P105,863 and the net value of the aggregate trust for each beneficiary would be no more than P21,172.60. And, if as the trustee and the trustors maintain, the taxes under consideration (P56,911.78) should be deducted from the corpus of the trust, the net value of the aggregate trust for each beneficiary would be further reduced to P9,790.244. Certainly, this amount, as well as the aforementioned sum of P21,172.60 could hardly be sufficient for the "support, maintenance, care, health, higher education and travel" of each beneficiary and "the launching of his career after he has become of age".

- The trustors are financially well off. When the first set of deeds of trust were executed (September 25, 1950), their assets in the Philippines and United States were worth P1,500,000.00 and P500,000.00 respectively, at the rate of P2.00 to a \$1.00. If the trustors were earnestly concerned, as they seemingly were, in providing ample funds to assure the support, maintenance, care, health, higher education and travel of their children and the launching of their career after they had become of age, the trustors would not have really meant to require them to pay the consideration stipulated in the trust agreements. The subsequent acts of the trustors showed that they did not intend to collect said consideration. As the lower court had correctly observed:

"* * * We assume that the trustors were indeed serious about the purpose of the trusts. With this in mind, we cannot conceive how the purpose of the trust may readily and liberally be achieved if the trust were to be burdened by such onerous monetary consideration. Without the consideration, the purpose or purposes of the trusts could have been more readily obtained. Consequently, we feel constrained to treat the monetary considerations of the trusts as an intended superfluity, if not subtlety, to becloud the donative intent of trustors.'

- The corpus of the trust was never totally or partially sold, hypothecated or encumbered. Instead, after December 7, 1950, when the Central Bank authorized the conversion of the shares of stock covered by the first set of trust agreements from resident stocks to non-resident stocks, the corresponding cash dividends and stock dividends declared by the mining company were sent directly to the trustee in the United States, thus enabling the trustors to create dollar assets in the United States. The testimony of trustor Allison J. Gibbs on this point is illuminating. We quote:

"JUDGE LUCIANO

If, as you said, one of the purpose of imposing a consideration on the trustee in your favor and that of your wife, was to protect the interest of both you and your wife, why is it that when these dividends were declared by the Lepanto Consolidated Mining Company, and were so declared, you did not collect the consideration from these dividends to offset the stipulated consideration in the series of trust agreements?

"A

Because that would defeat the very objectives for which we created the trusts and at least, one of the objectives was to transfer as much as possible of our Philippine assets to the United States in the form of dollars so as to create dollar assets in the United States on which our children could rely under the trust indentures'. In fact, that was the prime basis upon which I secured the eventual licensing by the Central Bank of the transactions. In fact, I told the Central Bank if they did not license it on the basis on which I had proposed which I considered absolutely legal, that I would find some other way of accomplishing the objective. If necessary, I would leave the Philippine Islands and become a resident of the United States. And, in that instance, under their regulations, there could be no question that all of my assets in the Philippines which were earning dividends would be entitled to have the dividends remitted to the United States. They saw the logic of my reasoning and they finally agreed on the transaction of issuing the license, XL-530 on December 2, 1950, Exhibit 3-2, plaintiff. There has been no question from the very beginning of one of the prime purposes of this transaction—it was to create a dollar estate for our children in the United States, premised upon our conviction that Lepanto Consolidated Mining Company was going to pay dividends and that the Central Bank regulations would allow the remittance of dividends to non-resident stockholders."

The trustors could have easily collected the stipulated consideration or part of it from said dividends, yet they did not do so—they even saw to it that the dividends were sent to the United States.

In connection with the trust agreements executed on December 28, 1951, the trustee, represented by his attorney-in-fact, Allison J. Gibbs, and the latter, as one of the trustors, as well as his wife, trustor Esther K. Gibbs, executed on July 15, 1953, another set of deeds, entitled "Compromise Agreement", stating that the trustee

thereby resold, retransferred and reassigned to the trustor the 22,400 shares covered by each of said trust agreements, for and in consideration of the sum of P19,264 to be paid by the trustors by crediting to the trustee the sum of P17,430, the consideration stipulated in each one of said trust agreements, thereby leaving a balance of P1,843 to be paid to the trustee upon the trustors' repossession of the corresponding stock certificates.

The main reason given in said compromise agreements for the provisions thereof is the alleged inability of the trustee to sell, mortgage, hypothecate, or pledge the said shares of stock or otherwise deal with third parties with a view to raising funds for the payment of the consideration stipulated in the trust agreements, pending registration of the transfer of said stock in the books of the mining company, in view of the conditions—not described in the compromise agreements—imposed by the Central Bank for the issuance of a license authorizing said transfer, which—according to the compromise agreements—are rightly unacceptable to the trustee.

This reason is clearly artificial. The stock involved in the trust agreements of September 25, 1950 were so transferred. Still no payment was made thereon. Moreover, the trustee could have authorized the trustors to sell, mortgage, hypothecate or otherwise dispose of said stock to raise the necessary funds, if the intent was really that the stipulated consideration be paid. Indeed, as attorney in-fact for the trustee, trustor Allison J. Gibbs, with the ample powers that his acts revealed he had, could have simply granted such authority to himself and his wife, Esther K. Gibbs, as trustors. Considering that one of the prime objectives of the trustors in executing the trust agreements was "to transfer as much as possible of our Philippine assets to the United States in the form of dollars", it is understandable that they did not wish the stock in question to be disposed of in the Philippines, for this would surely defeat the accomplishment of said objectives. At the same time, it is apparent that the reason given in said compromise agreements for the execution thereof is not true.

It may not be amiss to note, also, that the compromise agreements affecting the trusts constituted on December 28, 1951, virtually revoked said trusts, contrary to the explicit provision in the trust agreements, to the effect that the trusts therein established are "irrevocable".

Another factor that affects adversely the credence and weight due to all of the compromise agreements is that the same were made with knowledge of the fact that the defendant was already investigating whether the stipulated consideration was real or fictitious and entertaining the idea of asceicing the corresponding gift taxes on the basis of the full market value of the stock involved.

The trustee and the trustors maintain that the lower court erred in not deducting the amount of the donor gift taxes from the value of the property subject to the donee gift taxes, in view of the provision of the trust agreements to the effect

"In addition to the forgoing, the TRUSTEE shall pay out of the property and/or the gross income of the trust estate all income, estate, gift, succession or inheritance taxes, if any, payable by the VENDOR, TRUSTEE or BENEFICIARY by reason of this trust."

We find no merit in this pretense. The question as to who shall pay any given tax and what shall be the basis thereof are determined by law, the operation of which can not be affected by the provisions of a contract to which the Government is not a party. This, of course, is without prejudice to the right, if any, of a party to the trust agreements to demand reimbursement from the other party. But such right of reimbursement is independent of, and foreign to, the right and duty of the defendant to collect the taxes in the manner and under the conditions prescribed by law.

The appeal taken up by the defendant refers to the interest chargeable on the amounts representing the taxes in question, and the interest on the sum to be refunded by the Government.

In its resolution of June 25, 1958, the Court of Tax Appeals held that interest of one-half (1/2) of one (1%) percent should be charged on the deficiency taxes only from July 1, 1954 to July 30, 1954, because the defendant had demanded payment on or before June 30, 1954, of the deficiency donor gift taxes—amounting to P10,187.42 and P17,577.56—assessed on the first and the second set of trust agreements, respectively, and the deficiency donee gift taxes of P12,040.30, assessed on the second set of trust agreements. The defendant maintains that said interest should be charged from the 15th day of May following the calendar year in which the gifts in question had been made, for section 116 of the Tax Code provides;

"The gift taxes imposed by sections one hundred nine and one hundred ten of this Chapter shall be due and payable on or before the fifteenth day of May following the close of the calendar year and shall be paid by the donor or donee, as the case may be, to the Collector of Internal Revenue or to the treasurer of the province, city or municipality of which the donor or the donee is a resident."

Upon the other hand, section 118(b) of the same Code, on which the lower court relied, reads:

"In case an extension for the payment of a deficiency is granted, there shall be collected, as a part of the taxes, interest on the part of the deficiency the time for payment of which is so extended, at the rate of six per centum per annum for the period of the extension." (Italics supplied.)

At this juncture, it should be noted that the taxes assessed on the basis of the difference between the market value and the consideration were paid within the period fixed by law, or on May 15, 1951, as regards the trusts created in 1950, and on May 15, 1952, as regards the trusts constituted in 1951. Even the donor gift taxes, under a revised assessment, and the deficiency donee gift taxes due on the first set of trusts were paid in due time (May 15, 1951). With respect to the deficiency donor gift taxes on the two sets of trust agreements and the deficiency donee gift taxes assessed on the second set of trust agreements, the defendant demanded payment thereof on or before June 30, 1954. Had these assessments been paid on that date, no interest whatsoever would have been due thereon. It is but fair and just, therefore, that interest be charged only for the period of the extension secured for the payment of the last assessments, pursuant to section 113(b). In support of the theory that interest is due, not only for said period of extension, but, also, from the fifteenth day of May of the year following that in which the trust had been constituted, defendant cites section 119(b) (2) of the Tax Code, according to which:

"If the part of the deficiency the time for payment of which is extended is not paid in accordance with the terms of the extension, there shall be collected, as a part of the taxes, interest on such unpaid amount at the rate of one per centum a month from the date the same was originally due until it is paid."

This provision applies only when the taxes are not paid within the extension granted by the Collector or Commissioner of Internal Revenue. It is inapplicable to the case at bar, for the taxes involved herein were paid within said extension of time.

It is urged by the defendant that the Government should not be required to pay interest on the amount refundable to the trustee and the trustors. The matter of payment of interest on sums collected by way of taxes, which the Government is subsequently sentenced to refund to the taxpayer, depends upon whether or not the collection of said sums is manifestly unwarranted (*Collector of Internal Revenue vs. Convention of the Philippine Baptist Churches, et al.* 110 Phil., 711; 61 Off. Gaz. [14] 2007 (Resolution); *Collector of Internal Revenue vs. Sweeney*, 106 Phil., 59; 57 Off. Gaz., [7] 1221; *Collector of Internal Revenue vs. St. Paul's Hospital, etc.*, L-12127, May 21, 1959). In the case at bar, it is clearly not so, in the light of the attending circumstances. Hence, the amount refundable by the Government, pursuant to the decision appealed from, should draw no interest, and said decision should be modified accordingly.

Thus modified, said decision should be, as it is hereby affirmed, in all other respects, without pronouncement as to

costs. It is so ordered.

Bengzon, C. J., Padilla, Bautista Angelo, Reyes, J. B. L., Paredes, and Dizon, JJ., concur.

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