

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. WILLIAM J. SUTTER AND THE COURT OF TAX APPEALS, RESPONDENTS.*G.R. No. L-25532. February 28, 1969*

Ponente: REYES, J.B.L., J.

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A limited partnership, named "William J. Suter 'Morcoin' Co., Ltd.", was formed on 30 September 1947 by herein respondent William J. Suter, as the general partner, and Julia Spirig and Gustav Carlson, as the limited partners. The partners contributed, respectively, P20,000.00, P18,000.00 and P2,000.00 to the partnership. On 1 October 1947, the limited partnership was registered with the Securities and Exchange Commission. The firm engaged, among other activities, in the importation, marketing, distribution and operation of automatic phonographs, radios, television sets and amusement machines, their parts and accessories. It had an office and held itself out as a limited partnership, handling and carrying merchandise, using invoices, bills and letterheads bearing its trade-name, maintaining its own books of accounts and bank accounts, and had a quota allocation with the Central Bank.

In 1948, however, general partner Suter and limited partner Spirig got married and, thereafter, on 18 December 1948, limited partner Carlson sold his share in the partnership to Suter and his wife. The sale was duly recorded with the Securities and Exchange Commission on 20 December 1948.

The limited partnership had been filing its income tax returns as a corporation, without objection by the herein petitioner, Commissioner of Internal Revenue, until in 1959 when the latter, in an assessment, consolidated the income of the firm and the individual incomes of the partners-spouses Suter and Spirig, resulting in a determination of a deficiency income tax against respondent Suter in the amount of P2,678.06 for 1954 and P4,567.00 for 1955.

Respondent Suter protested the assessment, and requested its cancellation and withdrawal, as not in accordance with law, but his request was denied. Unable to secure a reconsideration, he appealed to the Court of Tax Appeals, which court, after trial, rendered a decision, on 11 November 1965, reversing that of the Commissioner of Internal Revenue.

The present case is a petition for review, filed by the Commissioner of Internal Revenue, of the tax court's aforesaid decision. It raises these issues:

- (a) Whether or not the corporate personality of the William J. Suter "Morcoin" Co., Ltd. should be disregarded for income tax purposes, considering that respondent William J. Suter and his wife, Julia Spirig Suter, actually formed a single taxable unit; and
- (b) Whether or not the partnership was dissolved after the marriage of the partners, respondent William J. Suter and Julia Spirig Suter, and the subsequent sale to them by the remaining partner, Gustav Carlson, of his participation of P2,000.00 in the partnership for a nominal amount of P1.00.

The theory of the petitioner, Commissioner of Internal Revenue, is that the marriage of Suter and Spirig and their subsequent acquisition of the interests of remaining partner Carlson in the partnership dissolved the limited partnership, and if they did not, the fiction of juridical' personality of the partnership should be dis-regarded for income tax purposes because the spouses have exclusive ownership and control of the business; consequently, the income tax return of respondent Suter for the years in question should have included his and his wife's individual incomes and that of the limited partnership, in accordance with Section 45 (d) of the National Internal Revenue Code, which provides as follows:

"(d) Husband and wife. - In the case of married persons, whether citizens, residents or non-residents, only one consolidated return for the taxable year shall be filed by either spouse to cover the income of both spouses, - - - - -."

In refutation of the foregoing, respondent Suter maintains, as the Court of Tax appeals held, that his marriage with limited partner Spirig and their acquisition of Carlson's interests in the partnership in 1948 is not a ground for dissolution of the partnership, either in the Code of Commerce or in the New Civil Code, and that since its juridical personality had not been affected and since, as a limited partnership, as contradistinguished from a duly registered general partnership, it is taxable on its income similarly with corporations, Suter was not bound to include in his individual return the income of the limited partnership.

We find the Commissioner's appeal unmeritorious.

The thesis that the limited partnership, William J. Suter "Morcoin" Co., Ltd., has been dissolved by operation of law because of the marriage of the only general partner, William J. Suter, to the originally limited partner, Julia Spirig, one year after the partnership was organized is rested by the appellant upon the opinion of now Senator Tolentino in Commentaries and Jurisprudence on Commercial Laws of the Philippines, Vol. 1, 4th Ed., page 58, that reads as follows:

"A husband and a wife may not enter into a contract of general copartnership, because under the Civil Code, which applies in the absence of express provision in the Code of Commerce, persons prohibited from making donations to each other are prohibited from entering into universal partnerships. (2 Echaverri, 196) It follows that the marriage of partners necessarily brings about the dissolution of a pre-existing partnership. (1 Guy de Montella 58)"

The petitioner-appellant has evidently failed to observe the fact that William J. Suter "Morcoin" Co., Ltd. was not a universal partnership, but a particular one. As appears from Articles 1674 and 1675 of the Spanish Civil Code of 1889 (which was the law in force when the subject firm was organized in 1947), a universal partnership requires either that the object of the association be all the present property of the partners, as contributed by them to the common fund, or else "all that the partners may acquire by their industry or work during the existence of the partnership". William J. Suter "Morcoin" Co., Ltd. was not such a universal partnership, since the contributions of the partners were fixed sums of money, P20,000.00 by William Suter and P18,000.00 by Julia Spirig, and neither one of them was an industrial partner. It follows that William J. Suter "Morcoin" Co., Ltd. was not a partnership that spouses were forbidden to enter by Article 1677 of the Civil Code of 1889.

The former Chief Justice of the Spanish Supreme Court, D. Jose Castan, in his *Derecho Civil*, 7th Edition, 1952, Volume. 4, page 546, footnote 1, says with regard to the prohibition contained in the aforesaid Article 1677:

"Los conyuges, segun esto, no pueden celebrar entre si el contrato de sociedad universal, Pero 8 podran constituir sociedad particular? Aunque el punto ha sido muy debatido, nos inclinamos a la tesis permisiva de los contratos de sociedad particular entre esposos, ya que ningun precepto de nuestro Codigo los prohíbe, y hay que estar a la norma general segun la que toda persona es capaz para contratar mientras no sea declarado

incapaz por la ley. La jurisprudencia de la Direccion de los Registros fue favorable a esta misma tesis en su resolucion de 3 de febrero de 1936, mas parece cambiar de rumbo en la de 9 de marzo de 1943."

Nor could the subsequent marriage of the partners operate to dissolve it, such marriage not being one of the causes provided for that purpose either by the Spanish Civil Code or the Code of Commerce.

The appellant's view, that by the marriage of both partners the company became a single proprietorship, is equally erroneous. The capital contributions of partners William J. Suter and Julia Spirig were separately owned and contributed by them before their marriage; and after they were joined in wedlock, such contributions remained their respective separate property under the Spanish Civil Code (Article 1396):

"The following shall be the exclusive property of each spouse:

(a) That which is brought to the marriage as his or her own; - - - - -."

Thus, the individual interest of each consort in William J. Suter "Morcoin" Co., Ltd. did not become common property of both after their marriage in 1948.

It being a basic tenet of the Spanish and Philippine law that the partnership has a juridical personality of its own, distinct and separate from that of its partners (unlike American and English law that does not recognize such separate juridical personality), the bypassing of the existence of the limited partnership as a taxpayer can only be done by ignoring or disregarding clear statutory mandates and basic principles of our law. The limited partnership's separate individuality makes it impossible to equate its income with that of the component members. True, section 24 of the Internal Revenue Code merges registered general co partnerships (compañías colectivas) with the personality of the individual partners for income tax purposes. But this rule is exceptional in its disregard of a cardinal tenet of our partnership laws, and can not be extended by mere implication to limited partnerships.

The rulings cited by the petitioner (Collector of Internal Revenue vs. University of the Visayas, L-13554, Resolution of 30 October 1964, and Koppel (Phil.), Inc., vs. Yatco, 77 Phil. 504) as authority for disregarding the fiction of legal personality of the corporations involved therein are not applicable to the present case. In the cited cases, the corporations were already subject to tax when the fiction of their corporate personality was pierced; in the present case, to do so would exempt, the limited partnership from income taxation but would throw the tax burden upon the partners-spouses in their individual capacities. The corporations, in the cases cited, merely served as business conduits or alter egos of the stock-holders, a factor that justified a disregard of their corporate personalities for tax purposes. This is not true in the present case. Here, the limited partnership is not a mere business conduit of the partner-spouses; it was organized for legitimate business purposes; it conducted its own dealings with its customers prior to appellee's marriage, and had been filing its own income tax returns as such independent entity. The change in its membership, brought about by the marriage of the partners and their subsequent acquisition of all interest therein, is no ground for withdrawing the partnership from the coverage of Section 24 of the tax code, requiring it to pay income tax. As far as the records show, the partners did not enter into matrimony and thereafter buy the interests of the remaining partner with the premeditated scheme or design to use the partnership as a business conduit to dodge the tax laws. Regularity, not otherwise, is presumed.

As the limited partnership under consideration is taxable on its income, to require that income to be included in the individual tax return of respondent Suter is to overstretch the letter and intent of the law. In fact, it would even conflict with what it specifically provides in its Section 24: for the appellant Commissioner's stand results in equal treatment, taxwise, of a general copartnership (compañía colectiva) and a limited partnership, when the code plainly differentiates the two. Thus, the code taxes the latter on its income, but not the former, because it is in the case of compañías colectivas that the members, and not the firm, are taxable in their individual capacities for any dividend or share of the profit derived from the duly registered general partnership (Section 26, N. I. R. C.;

Arañas, Anno. & juris. on the N.I.R.C., As Amended, Vol. 1, pages 88-89).

But it is argued that the income of the limited partnership is actually or constructively the income of the spouses and forms part of the conjugal partnership of gains. This is not wholly correct. As pointed out in *Agapito vs. Molo*, 50 Phil. 779, and *People's Bank vs. Register of Deeds of Manila*, 60 Phil. 167, the fruits of the wife's parapherna become conjugal only when no longer needed to defray the expenses for the administration and preservation of the paraphernal capital of the wife. Then again, the appellant's argument erroneously confines itself to the question of the legal personality of the limited partnerships which is not essential to the income taxability of the partnership since the law taxes the income of even joint accounts that have no personality of their own.^[1] Appellant is, likewise, mistaken in that it assumes that the conjugal partnership of gains is a taxable unit, which it is not. What is taxable is the "income of both spouses" [section 45 (d)] in their individual capacities. Though the amount of income (income of the conjugal partnership vis-a-vis the joint income of husband and wife) may be the same for a given taxable year, their consequences would be different, as their contributions in the business partnership are not the same.

The difference in tax rates between the income of the limited partnership being consolidated with, and when split from the income of the spouses, is not a justification for requiring consolidation; the revenue code, as it presently stands, does not authorize it, and even bars it by requiring the limited partnership to pay tax on its own income.

For the foregoing reasons, the decision under review is hereby affirmed. No costs.

Concepcion, C.J., Dizon, Makalintal, Zaldivar, Sanchez, Castro, Fernando, Capistrano, and Teehankee, JJ., concur.

Barredo, J., did not take part.

[1] *V. Evangelista vs. Collector of Internal Revenue*, 102 Phil. 140; *Collector vs. Batangas Transportation Co.*, 102 Phil. 822.

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