

C. PEREZ RUBIO, PLAINTIFF AND APPELLEE, VS. COLLECTOR OF INTERNAL REVENUE, DEFENDANT AND APPELLANT.

G. R. No. 30855. January 20, 1930

Ponente: MALCOLM, J.

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MALCOLM, J.:

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Uncomplicated by questions of fact, the appeal in this case again submits for decision the legal question of whether a stock dividend may lawfully be taxed as income of the stockholder.

The original Income Tax Law for the Philippines was the Revenue Act of September 8, 1916, which was expressly extended to the Philippines by the Congress of the United States (12 Public Laws, pp. 251 et seq.). In section 2 (a) of this law, it was provided that the term "dividends" shall be held to mean "any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of its cash value." The Congress altered its policy with reference to the Philippines in the War Revenue Act of October 3, 1917, section 5, the Revenue Act of February 24, 1919, section 261, and the Revenue Act of November 23, 1921, section 261, by delegating its power to the Philippine Legislature (40 U. S. Stat. at L., pp. 300, 1057; 42 U. S. Stat. at L., p. 227). The last mentioned Act included the provision "That in * * * the Philippine islands the income tax shall be levied, assessed, collected, and paid as provided by law prior to the passage of this Act. The *** Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in * * * the Philippine Islands, * * *."

In pursuance of express authority, the Philippine Legislature enacted an Income Tax Law on March 7, 1919, by placing Act No. 2833 on the statute books. The law levied a flat rate on the incomes of corporations and a graduated rate on the incomes of individuals. Among other things, it provided that "the taxable net income of a person shall include gains, profits, and income derived from" various sources including "dividends * * * or gains, profits and income derived from any source whatever" (sec. 2 [a]). Then in section 25 (a) of the same law, the Legislature included the following: "The term 'dividends' as used in this Law shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company. Stock dividend shall be considered income, to the amount of the earnings or profits distributed." (Italics inserted.)

The Corporation Law, as ratified by the Congress, authorizes a corporation to issue stock for "profits earned by it, but not distributed among its stockholders or members." (Sec. 16, as amended by Act No. 3518, sec. 9.) On the other hand, section 28 of the Philippine Organic Act, the Act of Congress of August 29, 1916, provides "That all franchises or rights granted under this Act * * * shall forbid the declaring of stock or bond dividends." A further limitation of a general nature is that found in section 3, paragraph 16, of the Organic Act, to the effect "That the rule of taxation in said Islands shall be uniform."

There arose in connection with the Revenue Act of September 8, 1916, which, it will be recalled, was the Act of Congress extended to the Philippine Islands, the case of *Eisner vs. Macomber* ([1920], 252 U. S., 189). It was held in the Supreme Court of the United States by a vote of five to four that Congress was given no power by the Income Tax Amendment to the Federal Constitution to tax, without apportionment, as income of a stockholder in a corporation, a stock dividend made lawfully and in good faith against accumulated profits earned by the corporation since the adoption of such amendment. Thereafter in the Philippines, the case "of *Fisher vs. Trinidad* ([1922], 43 Phil., 973) considered the question of whether stock dividends are taxable as income under the provisions of the local law, Act No. 2833. It was held by a divided court that stock dividends cannot be so taxed. Subsequently, the cases of *Warner, Barnes & Co. vs. Posadas*, No. 24037, and *Menzi vs. Posadas*, No. 23499, [1] involving much the same question, were submitted. In the meantime, the make-up of the Supreme Court having changed and one member being disqualified, there resulted an evenly divided court. Eventually the two cases were shifted to the First Division, and there, with one dissent, stock dividends were once more held not subject to the income tax. These cases were taken to the United States Supreme Court on writs of certiorari, and in that court it was said that the respondents suggest no ground on which the judgments of the lower court can be sustained, and accordingly the judgments were reversed. (*Posadas vs. Warner, Barnes & Co.*; *Posadas vs. Menzi* [1929], 278 U. S. 588.)

While the two cases above-mentioned were under consideration in the United States Supreme Court, four new cases involving an identical question were initiated in the Court of First Instance of Manila. All of them had to do with the receipt by four individuals of stock dividends from the Luzon Stevedoring Co., Inc., and with the levy on these stock dividends by the Collector of Internal Revenue of the corresponding income tax. The decisions in the lower court naturally respected the decisions of this court, and so gave judgments in favor of the respective plaintiffs. On appeal, the submission of the four cases was suspended, awaiting the pronouncements of the United States Supreme Court in the *Warner, Barnes & Co.* and *Menzi* cases. The higher court having spoken in those cases, the instant case and its companion cases are ready for decision.

Plainly, our first duty is to determine if the decisions of the Supreme Court of the United States in the *Warner, Barnes & Co.* and *Menzi* cases are conclusive of the case at bar.

In the *Warner, Barnes & Co.* case, the higher court had to deal with a corporation which was subject to a flat tax rate under the Income Tax Law. It was definitely held (1) that the provision of the Philippine statute was "substantially like that * * * which was held invalid in *Eisner vs. Macomber*;" (2) that the decision in *Eisner vs. Macomber* was not controlling; (3) that, as to corporations, the rule of uniformity was not transgressed;" (4) that the title of the Philippine Income Tax Law was sufficient; and (5) that, although a stock dividend is a "form of property," nevertheless the Philippine Legislature may lay a tax upon the advantage resulting¹ to recipients from the allotment of stock dividends. The court, through Justice Butler, in part, said:

"The petitioner admits that, strictly speaking, a stock dividend is not income. But he insists, and respondent concedes, that, in the absence of constitutional restriction, such dividends may be taxed. And the parties agree that the tax in question is within the scope and intent of the statute.

* * * * *

"Fisher vs. Trinidad merely decided that 'stock dividends' are not taxable as 'income' under the act. Petitioner does not combat that view or claim that such distributions do constitute income. The Philippine Legislature has power to lay a tax in respect of the advantage resulting to recipients from the allotment and delivery of such dividend shares, (Swan Brewing Co. vs. Rex [1914], A. C, 231-P. C.) Respondent rightly concedes that, there being no constitutional restriction, such dividends may be taxed and that the statute discloses a purpose to tax them. The decision of this court in Eisner vs. Macomber rested on constitutional provisions not applicable to the Philippine Islands."

In the Menzi case, the court had before it an individual who had received a dividend in stock. This court had held that, as stock dividends do not constitute income, the tax is on property and that therefore the specified graduated rates violate the rule of uniformity. The higher court dismissed the point with this observation: "But the record does not disclose the rate at which the tax was assessed or show any facts to support the suggestion that the required equality was lacking. In other respects, this case is the same as No. 251."

The decision in Eisner vs. Macomber, supra, and the decision in Warner, Barnes & Co. vs. Posadas, supra, contain sign posts consisting of references to other decisions which clearly point the way. Swan Brewing Co. vs. Rex ([1914],

A. C, 231) is mentioned in both cases. This was a case which arose in Australia and subsequently came before the Privy Council, which held that a stock dividend representing accumulated profits was taxable like an ordinary cash dividend. The United States Supreme Court refers to the English case in Eisner vs. Macomber by saying "There being no constitutional restriction upon the action of the law making body, the case presented merely a question of statutory construction." In the Warner, Barnes & Co. decision the case of Swan Brewing Co. vs. Rex, supra, is cited in support of the statement that the Philippine Legislature possesses power to tax stock dividends.

Another case, which was discussed in Eisner vs. Macomber, supra, was that of Tax Commissioner vs. Putnam ([1917], 227 Mass., 522), in which the Supreme Court of Massachusetts held that a stock dividend was taxable as income. Discussing this case, the United States Supreme Court stated: "The Massachusetts court was not under an obligation, like the one which binds us, of applying a constitutional amendment in the light of other constitutional provisions that stand in the way of extending it by construction."

In Massachusetts, it may be said parenthetically, it was subsequently necessary for the legislative body to declare that stock dividends are exempted from the income tax in order to surmount the obstacle raised by the decision of the State Court. (See Lanning vs. Trefry [1924], 142 N. E., 829.) New York had the same experience for after the Supreme Court had held stock dividends to be taxable under the local law, pending consideration by the Court of Appeals, the New York Legislature amended the law by providing that stock dividends when received by a share holder shall not be subject to tax. (See People vs. Gilchrist [1925], 211 N. Y. S., 679; People vs. Gilchrist [1926], 243 N. Y., 173; Equitable Trust Co. vs. Prentice [1928], 250 N. Y., 1.)

It cannot be gainsaid that the Philippine Islands in its tax status is closely akin to the status of Australia and of a state in the American Union. Proceeding within the confines of express and general authority, the Philippine Legislature deemed it wise to classify stock dividends as income. Except for the alleged breach of the uniformity rule, merely a question of statutory construction is accordingly involved. Such question of statutory construction disappears, however, since the Philippine Legislature has as plainly and unequivocally evinced the purpose to tax stock dividends as language is able to express itself.

What has been said by the United States Supreme Court would appear to relieve us from all necessity of discussing appellee's first proposition, that stock dividends are property and not income, and hence that the tax here in question is a property and not an income tax. Whatever the true quality of stock dividends may be, the local Legislature has made its own definition of income, and has included in that definition stock dividends. The Legislature had that right. It is the sole judge of the propriety of taxation and of the subjects of taxation. The legislative classification should be respected. For the purposes of the law, there is no sound basis for distinguishing stock dividends from cash dividends. (Note Opinion of the Justices [1915], 77 N. H., 611; *Glasgow vs. Rowse* [1869], 43 Mo., 479.)

As to appellee's second proposition, it is hardly incumbent upon the court to consider seriously the arguments centering on the want of uniformity of the Income Tax Law 'as affecting stock dividends, in view of the attitude taken by the United States Supreme Court in the *Warner, Barnes & Co.* and *Menzi* cases. Indeed the challenge goes further than stock dividends for it impugns the whole scheme of graduated taxes on incomes. But the United States Supreme Court has held the 1913 statute constitutional, overruling, among other things, objections to its constitutionality because the rate of the tax was progressive (*Brushaber vs. Union Pacific Railroad Co.* [1915], 240 U. S., 1). Obviously, an income tax is a tax at an arbitrary rate. Inequalities in taxation are inevitable, but such inequalities in the operation of a tax law will not invalidate it. In the Philippine Income Tax Law, all persons are treated alike as far as they are similarly circumstanced. Should the graduated income tax levied on the stock dividend of an individual be found to violate the uniformity rule, the result would be that the stock dividend would not be liable to the tax when received by an individual, but would be when received by a corporation. Such an anomalous distinction was never intended and cannot be sustained. Concede that a stock dividend is strictly speaking not income, and still we fail to discern any failure in uniformity.

The decisions in the *Warner, Barnes & Co.* and *Menzi* cases govern the case at bar. The *Menzi* case is exactly the *Rubio* case. The pleadings, the facts, and the applicable legal provisions are identical. If *Menzi* was subject to the tax, *Rubio* and others similarly situated must likewise be subject to the tax. Like in the *Menzi* case, the record does not show any facts to support the suggestion that the required equality was lacking. We propose to enforce the law as it stands. Judgment will be reversed and the complaint will be dismissed, without costs in either instance.

Street, Villamor, Ostrand, Johns, Romuldez and Villa-Real, JJ., concur.

[1] Both promulgated December 17, 1927, not reported.

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