

**PHILIPPINE TELEPHONE & TELEGRAPH COMPANY, PLAINTIFF  
AND APPELLANT, VS. COLLECTOR OF INTERNAL REVENUE,  
DEFENDANT AND APPELLEE.**

*G.R. No. 35667. October 30, 1933*

Ponente: IMPERIAL, J.

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**IMPERIAL, J.:**

This is an appeal interposed by the plaintiff corporation, Philippine Telephone & Telegraph Company, from the decision of the Court of First Instance of Manila, the dispositive part of which reads as follows:

"For the foregoing reasons, the defendant is absolved from the complaint, and plaintiff is condemned to pay the defendant on the first counterclaim the sum of fifteen thousand fifty-seven pesos and fifty-nine centavos (P15,057.59) and on the second counterclaim the sum of forty-two thousand three hundred sixty pesos and eighty-two centavos (P42,360.82), making a total of fifty-seven thousand four hundred eighteen pesos and forty-one centavos (P57,418.41) with legal interest in each case from the date of the filing of defendant's counterclaim, on November 28, 1930.

"The plaintiff will pay the costs.

"Let judgment be entered accordingly. It is so ordered."

The plaintiff, a domestic corporation organized in accordance with the laws now in force, with its main office in the City of Manila, brought an action against the Collector of Internal Revenue to recover the sum of P30,421.65, which had been collected from it as income tax corresponding to the years 1927, 1928 and 1929 on the total sum of P1,014,055, which was paid and delivered by said appellant to the foreign corporations, Philippine Islands Telephone & Telegraph Company and Telephone Investment Corporation, in the form of dividends distributed by it in said years, and as shares dividends corresponding to the aforesaid foreign corporations as stockholders.

In his answer the appellee substantially admitted the facts above stated, but denied the right invoked by the appellant; and, as his first counterclaim, he sought to recover from it the sum of P15,057.59, this amount having been received by the appellant, which was then a foreign corporation and the biggest stockholder of the Philippine Islands Telephone & Telegraph Co., from the latter as annual dividends, which said Philippine Islands Telephone & Telegraph Co., having authority to engage in business and in fact engaged in business in the Philippines as a holder of the franchise created by Act No. 1368, failed to deduct, as it was its duty to deduct, as income tax for the years 1919, 1920 and 1921, from the earnings obtained in said years, amounting to P613,559.34; and as a second and last counterclaim the appellee sought to recover from the appellant the sum of P42,360.82, which the latter was bound to pay as income tax on the sum of P1,412,027.26, paid and delivered by it to the Philippine Islands Telephone & Telegraph Co. as dividends corresponding to the years 1923 to 1926, and from which said appellant had acquired at the beginning of the year 1923 the franchise granted by said Act.

The case was submitted for decision on the following:

## "STIPULATION OF FACTS

"The plaintiff and the defendant, by their undersigned attorneys, hereby stipulate and agree that the following are the facts of this case, and that judgment may be entered thereon.

"With respect to plaintiff's complaint the admitted facts are as follows:

" '1. Plaintiff is a domestic corporation duly organized and existing under the laws of the Philippine Islands with its principal office in the City of Manila therein, and the defendant is the Collector of Internal Revenue of the Philippine Islands.

" '2. Plaintiff was, during all the times set forth in the complaint, transacting the business of furnishing telephone service in the Island of Luzon, in the Philippine Islands, under and by virtue of a special franchise granted by the Philippine Commission in Act No. 1368, which it had duly acquired.

" '3. It is provided in section 5 of said Act No. 1368, the franchise under which the plaintiff is and has been transacting business, as aforesaid, among other things, that the grantees, their successors or assigns, should pay to the Insular Treasurer each year, two per centum (2%) of their gross receipts from the telephone, telegraph or other electrical transmission business transacted under said franchise, and that said percentage should be in lieu of all taxes on the franchise or earnings thereof.

" '4. During the years 1927, 1928 and 1929, as well as during the years prior thereto, the plaintiff corporation duly paid to the Insular Treasurer the full percentages corresponding to said years, under and in pursuance of the terms of the franchise referred to in the last preceding paragraph.

" '5. Among the stockholders holding stock in the plaintiff corporation during the said years 1927, 1928 and 1929, and who received dividends from the plaintiff out of its operations under said franchise, were the Philippine Islands Telephone & Telegraph Company and the Telephone Investment Corporation, both of which said stockholders are foreign corporations domiciled in the United States, not engaged in business or trade within the Philippine Islands, and not having any office or place of business therein.

" '6. During the aforesaid years 1927, 1928 and 1929, plaintiff paid to the stockholder corporations mentioned in the last preceding paragraph, as dividends duly and lawfully declared by the plaintiff for said years the aggregate sum of P1,014,055 as follows:

Name of stockholder

1927

1928

1929

Total

P. I. Telephone and Telegraph Company

P286,600

P352,560

P358,495

P997,655

Telephone Investment Corporation

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6,600

9,800

16,400

Totals

286,600

359,160

368,295

1,014,055

" '7. The defendant, acting under the provisions of sections 9(b) and 13(f) of the Income Tax Law (Act No. 2833 as amended), levied and assessed against the plaintiff, and demanded of the latter the payment of the sum of P30,421.65 as income taxes on the aforesaid amount of P1,014,055, the dividends paid by the plaintiff as stated in paragraph 6 hereof, notwithstanding the tax exemption or commutation granted to plaintiff by its charter stated in paragraph 3 hereof.

" '8. On September 11, 1930, the plaintiff, having no other recourse in the matter and to avoid the distraint of its goods and the payment of fines and penalties, under duress, against its will, under due written protests, paid to the defendant the said sum of P30,421.65, the amount levied and assessed by defendant against the plaintiff as aforesaid.

" '9. Said payment mentioned in the last preceding paragraph was made under five separate protests. A copy of the first protest is set out in paragraph VIII of the complaint, and is hereby made a part hereof. The second protest is in all respects like the first, except that it is in connection with the tax on dividends for 1928 paid to the Philippine Islands Telephone & Telegraph Company, said tax being in the amount of P10,576.80. The third protest is in all respects like the first, except that it is in connection with the tax on dividends for 1928 paid to the Telephone Investment Corporation, said tax being in the amount of P198. The fourth protest is in all respects like the first, except that it is in connection with the tax on dividends for 1929 paid to the Philippine Islands Telephone & Telegraph Company, said tax being in the amount of P10,754.85. The fifth protest is in all respects like the first, except that it is in connection with the tax on dividends for 1929 paid to the Telephone Investment Corporation, said tax being in the amount of P294.

" '10. On September 13, 1930, the defendant, in a communication addressed to plaintiff's attorneys, overruled and denied each and all of plaintiff's protests.'

"With respect to the first counterclaim of the defendant, the admitted facts are as follows:

" '1. During the years 1919, 1920, 1921 and 1922, the Philippine Islands Telephone and Telegraph Company, a corporation, organized in the United States and duly authorized to transact business in the Philippine Islands, transacted the business of furnishing telephone service on the Island of Luzon under the franchise granted by Act No. 1368 of the Philippine Commission, hereinabove mentioned, which it had previously duly acquired.

" '2. During said years 1919, 1920, 1921 and 1922, the principal stockholder of the said the Philippine Islands Telephone & Telegraph Company was the Philippine Telephone & Telegraph Corporation, a non-resident

foreign corporation organized and existing in the United States.

" '3. During said years 1919, 1920, 1921 and 1922, the said Philippine Islands Telephone & Telegraph Company delivered to the said Philippine Telephone & Telegraph Corporation, as the latter's share in the yearly profits or dividends duly declared by the former for said years the aggregate sum of P613,559.34 as follows:

For the year 1919 .....

P334,919.38

For the year 1920 .....

109,764.86

For the year 1921 .....

40,410.00

For the year 1922 .....

128,4658.10

\_\_\_\_\_

Total

.....

613,559.34

=====

" '4. In delivering the amounts mentioned in the last preceding paragraph the Philippine Islands Telephone & Telegraph Company did not deduct and withhold therefrom and did not make return of the sum of P15,057.59 which amount is equivalent to a normal tax on the aforesaid sum of P613,559.34, as follows:

2% normal tax on .....

P334,919.38

P6,698.39

3% normal tax on .....

109,764.86

3,292.95

3% normal tax on .....

40,410.00

1,212.30

3% normal tax on .....

128,465.10

3,853.96

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613,559.34

15,057.59

Totals

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" '5. At the beginning of the year 1923 the plaintiff purchased and acquired all the assets, liabilities and franchises of the said Philippine Islands Telephone & Telegraph Company, and has since, during all the time covered by the complaint, been operating a telephone system on the Island of Luzon under the franchise granted by Act No. 1368 of the Philippine Commission, as aforesaid.

" '6. The defendant has demanded of plaintiff the payment of the said sum of P15,057.59 but the plaintiff refuses to pay the same, alleging as a reason for its refusal that it is exempt from the payment of said normal

tax amounting to P15,057.59 by virtue of the tax exemption or commutation provided for in section 5 of its franchise, Act No. 1368 of the Philippine Commission.'

"With respect to the second counterclaim of the defendant, the admitted facts are as follows:

" '1. At the beginning of the year 1923, the plaintiff purchased and acquired from the Philippine Islands Telephone & Telegraph Company, a corporation organized in the United States and authorized to transact business in the Philippine Islands, the latter's franchise granted by Act No. 1368 of the Philippine Commission, and all property appertaining thereto; and since then during all the period of time covered by the complaint the plaintiff has been operating a telephone system on the Island of Luzon.

" '2. After thus transferring its property and franchise to the plaintiff as aforesaid, the said Philippine Islands Telephone and Telegraph Company ceased to do business in the Philippine Islands and became a non-resident foreign corporation, and a majority stockholder in the plaintiff corporation.

" '3. During the years 1923 to 1926, the plaintiff delivered and paid over to the Philippine Islands Telephone & Telegraph Company, then a non-resident foreign corporation, and a stockholder in plaintiff corporation, as aforesaid, as its share in the yearly dividends or profits duly declared by plaintiff for the said years, the aggregate sum of P1,412,027.26, as follows:

1923 .....

P317,377.26

1924]

1925] .....

751,450.00

1926 .....

343,200.00

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1,412,027.26

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" '4. In making delivery of the amounts mentioned in the last preceding paragraph, the plaintiff did not deduct and withhold from the said sum of P1,412,027.26 and did not make return of the sum of P42,360.82, which the latter amount is equivalent to a normal tax on the said aggregate sum of P1,412,027.26, as follows:

3% normal tax on .....

P317,377.26

P9,521.32

3% normal tax on .....

751,450.00

22,543.50

3% normal tax on .....

343,200.00

10,296.00

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1,412,027.26

42,360.82

"Totals

.....

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" '5. The defendant has made demand upon the plaintiff for the payment of the aforesaid sum of P42,360.82, but plaintiff has refused to pay defendant the said sum, alleging, as a reason for its refusal, that it is exempt from the payment of said normal tax amounting to P42,360.82 by virtue of the tax exemption or commutation provided for in section 5 of its franchise, Act No. 1368, of the Philippine Commission.'

"Manila, P. I., February 2, 1931.

"DEWITT, PERKINS & BRADY

"Attorneys for plaintiff

"By \_\_\_\_\_

"601 Nat. City Bank Bldg.

"DELFIN JARANILLA

"Attorney-General

"Attorney for defendant

"By:

\_\_\_\_\_

"Assistant Attorney"

On the foregoing facts we are of the opinion that the only question submitted for our determination is whether the appellant is bound to pay said taxes in view of the exemption granted in its favor by section 5 of Act No. 1368 of the Philippine Commission establishing said franchise.

However, before we proceed with the discussion of the legal aspect of the case, as above stated, we must first determine the law upon which the appellee bases his right to collect the income tax in question, and also whether the dividends of a domestic corporation, which are distributed and delivered to foreign corporations, are subject to said tax.

The appellee invokes in support of his authority sections 9 (par. b) and 13 (par. f) of Act No. 2833, as amended otherwise known as Income Tax Law, which reads as follows:

"Sec. 9. (a) \*\*\*\*\*

"(b) All persons, corporations, joint-stock companies, partnerships, joint accounts (cuentas en participacion), associations, insurance companies, and general copartnerships (compañías colectivas), in whatever capacity acting, including lessees or mortgagors of personal property, trustees acting in any trust capacity, executors,

administrators, receivers, conservators, employers, and all officers and employees of the Government of the Philippine Islands having the control, receipt, custody, disposal, or payment of interests, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident alien individual, other than income derived from dividends or net profits subject to the tax established in subsection (a) of section ten are hereby authorized and required to deduct and withhold from such annual or periodical gains, profits, and income such sum as will be sufficient to pay the normal tax thereon, and shall make return thereof on or before March first of each year, and, on or before the time fixed by law for the payment of the tax, shall pay the amount withheld to the officer of the Government of the Philippine Islands authorized to receive the same; and they are each hereby made personally liable for such tax, and they are each hereby indemnified against every person, corporation, joint-stock company, partnership, joint-account (cuenta en participacion), association, or insurance company, or demand whatsoever by reason of the payment of the said tax."

"Sec. 13. \*\*\*\*\*

"(f) Likewise, all the provisions of this Law relating to the tax required to be deducted and withheld and paid to the officer of the Government of the Philippine Islands authorized to receive the same from the income of non-resident alien individuals from sources within the Philippine Islands shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies, partnerships, joint-accounts (cuentas en participacion), associations, and insurance companies by nonresident alien firms, corporations, joint-stock companies, partnerships, joint-accounts (cuentas en participacion), associations, and insurance companies, not engaged in business or trade within the Philippine Islands and not having any office or place of business therein."

In the light of the provisions of said sections there seems to be no question that the dividends of a domestic corporation, which are paid and delivered in cash to foreign corporations as stockholders, are subject to the payment of said tax.

"An ordinary dividend on corporate stock, paid in money or its equivalent, and representing a distribution to stockholders of profits of the corporation, as distinguished from a stock dividend representing a capitalization of profits or of an increase in the value of corporate assets, and from distributions of capital and liquidating dividends, is in- Come of the recipients, within the meaning of a statute imposing a tax upon incomes, and accordingly is taxable as such, unless specifically exempted or excepted by the statute; and the taxability of a dividend is not affected by the fact that the profits out of which it is declared have in whole or in part accrued to or been accumulated by the corporation during a long period of time or even before taxes on incomes were imposed by law, since corporate profits first become income of the stockholders when they are distributed as dividends." (61 C. J., pp. 1572, 1573 and cases cited therein.)

The same rule applies to dividends which are paid and delivered to the stockholders in the form of stock dividends:

"Except where a statute imposing a tax upon incomes otherwise specifically provides<sup>1</sup>, it has been held that a stock dividend in the ordinary sense, being a dividend on corporate stock paid in newly issued stock of the corporation, as distinguished from one paid in treasury stock or in stock of a subsidiary or other corporation, is income, within the meaning of the statute, and so is subject to taxation thereunder, whether it represents earnings or profits of the corporation or an increase in the value of corporate assets, although on the latter point there is also authority to the contrary." (61 C. J., 1573 and cases therein cited.)

In the cases of *Posadas vs. Warner, Barnes & Co.*, and *Posadas vs. Menzi* (73 Law. ed., 339 et seq.) the Supreme Court of the United States, among other things, said:

"\* \* \* 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. \* \* \*."

Reference is herein made to said cases, coming from this court, only for the purpose of showing that if stock dividends are subject to income tax, a fortiori the dividends paid and delivered in cash to stockholders should be subject thereto.

We shall now proceed with the consideration of the main question. The appellant vigorously contends that it is exempted from the payment of said tax, by virtue of the provisions of section 5 of Act No. 1368, which reads as follows:

"Sec. 5. The grantees, their successors or assigns, shall be liable to pay the same taxes on their real estate, buildings, and personal property exclusive of the franchise as other persons or corporations are now or hereafter may be required by law to pay. The grantees, their successors or assigns, shall further pay to the Insular Treasurer each year, within ten days after the audit and approval of the accounts as prescribed in section four of this Act, two per centum of all gross receipts of the telephone, telegraph, or other electrical transmission business transacted under this franchise by the grantees, their successors or assigns, and the said percentage shall be in lieu of all taxes on the franchise or earnings thereof."

Section 14 of the same Act, containing some reference to the same subject, reads as follows:

"Sec. 14. The grantees may transfer, sell, or assign this franchise to any corporation formed, organized, or existing under the laws of the Philippine Islands or of any State of the United States and such corporation shall have the right to buy and to own said franchise. Any corporation to which this franchise is sold, transferred, or assigned shall be subject to the corporation laws of the Philippine Islands now existing or hereafter enacted and shall be subject to all the terms, conditions, restrictions, and limitations of this franchise as fully and completely and to the same extent as if the franchise had been originally granted to said corporation."

It is contended that the exemption provided by law includes all taxes to be paid by the appellant on all of its earnings from the business for which the franchise was granted, with the exception of the 2 per cent fixed by it. If this contention is correct there is no doubt that the dividends delivered by the appellant and those which are the subject matter of the counterclaims are exempted from the payment of income tax. We hold, however, that such interpretation of the law is untenable. As the law clearly provides, the exemption only relates to the income and earnings of the franchise and it should not be construed as including those which cease to belong to the franchise or to the corporation holding it, for they have been delivered to its stockholders as their own. The law did not exempt from the payment of said tax those dividends paid and delivered to stockholders, because they ceased to be the property of the corporation and became of the stockholders; and evidently it was not the intention of the Philippine Commission to extend such privilege to parties other than the original holders of the franchise and their grantee.

It is a well known principle that the States of the Union possess full authority to collect an income tax from individuals and corporations, in the absence of any constitutional prohibition, and that the exemptions are to be given strict interpretation. The Philippine Legislature has the same authority and may levy taxes on income in the absence of any prohibition or limitation in the Organic Law, and the same rule of construction must be adopted. In the instant case the exemption is evidently limited, and we find no justification for extending it to dividends received by the stockholders of a corporation after they have become their exclusive property.

"Since taxation is necessary to the existence and continuance of government, there are no implied exemptions from its burdens, and a relinquishment of such right by the state will not be presumed, unless a deliberate purpose to relinquish it appears. (Trimble vs. City of Seattle, 116 P., 647; 64 Wash., 102, judgment affirmed 34

S. Ct., 218; 231 U. S., 683; 58 Law. ed., 435.)" (Am. Dig., 2d Dec, Vol. 21, p. 604.)

The appellant, in its endeavor to show that the dividends received and delivered to it are included in the exemption, invokes the ruling in the case of *Farrington vs. Tennessee* (95 U. S., 679). In order to determine whether or not the doctrine laid down in said case is applicable, we quote herein the facts and reasoning given in the decision, to wit:

"The Union and Planters' Bank of Memphis was duly organized under a charter granted by the Legislature of Tennessee, by two acts, bearing date respectively on the 20th of March, 1858, and the 12th of February, 1869. Since its organization, it has been doing a regular banking business. Its capital stock subscribed and paid in amounts to \$675,000, divided into six thousand seven hundred and fifty shares of \$100 each. Farrington, the plaintiff in error, was, throughout the year 1872, the owner of one hundred and fifty shares, of the value of \$15,000.

"The tenth section of the charter of the bank declares 'that the said company shall pay to the State an annual tax of one half of one per cent on each share of the capital stock subscribed, which shall be in lieu of all other taxes.'

"The State of Tennessee and the county of Shelby claiming the right, under the revenue Laws of the State, to tax the stock of the plaintiff in error, assessed and taxed it for the year 1872. It was assessed at its par value. The tax imposed by the State was forty cents on the \$100, making the State tax \$60. The county tax was \$1.20 on the \$100, making the county tax \$180.

\* \* \* \* \*

"The shares of the capital stock are usually represented by certificates. Every holder is a cestui que trust to the extent of his ownership. The shares are held and may be bought and sold and taxed like other property. Each share represents an aliquot part of the capital stock. But the holder cannot touch a dollar of the principal. He is entitled only to share in the dividends and profits. Upon the dissolution of the institution, each shareholder is entitled to a proportionate share of the residuum after satisfying all liabilities. The liens of all creditors are prior to his. The corporation, though holding and owning the capital stock, cannot vote upon it. It is the right and duty of the shareholders to vote. They in this way give continuity to the life of the corporation, and may thus control and direct its management and operations. The capital stock and the shares may both be taxed, and it is not double taxation. The bank may be required to pay the tax out of its corporate funds, or be authorized to deduct the amount paid for each stockholder out of this dividend. (Ang. & A. Corp., secs. 556, 557; *Bank vs. State*, 9 Yerg. [Tenn.], 490; *Van Allen vs. Assessors*, supra; *Bradley vs. People*, 4 Wall., 459; 71 U. S., XVIII, 433; *Queen vs. Arnaud*, supra; *Bank vs. Commonwealth*, 9 Wall., 353; 76 U. S., XIX, 701; *State vs. Branin*, 3 Zab. [N. J.], 484; *M'Culloch vs. Maryland*, 4 Wheat, 316.)

\* \* \* \* \*

"There is no question before us as to the tax imposed on the shares by the charter. But the State has by her revenue law imposed another and an additional tax on these same shares. This is one of those 'other taxes' which it had stipulated to forego. The identity of the thing doubly taxed is not affected by the fact that in one case the tax is to be paid vicariously by the bank, and in the other by the owner of the share himself. The thing thus taxed is still the same, and the second tax is expressly forbidden by the contract of the parties. After the most careful consideration, we can come to no other conclusion. Such, we think, must have been the understanding and intent of the parties when the charter was granted and the bank was organized. Any other view would ignore the covenant that the tax specified should be 'in lieu of all other taxes.' It would blot those terms from the context, and construe it as if they were not a part of it."

The inapplicability of the principles enunciated in that case becomes readily apparent by taking into consideration:

(a) that the exemption established by the State of Tennessee was of a general character, whereas the exemption contained in section 5 of Act No. 1368 is clearly limited, and (b) that in said case the tax was levied on 150 shares of the banking corporation, while in the instant case the same was levied and assessed upon dividends delivered to corporate stockholders, it being evident, therefore, that the two cases, are not in pari materia.

The foregoing considerations, made in connection with the merits' of the appellant's complaint, may be reiterated and applied with equal force to the appellee's counterclaims. The dividends in question, at the time they were paid and delivered by the appellant, as well as when they were received by it, were subject to the payment of income tax, and we are convinced that the court a quo correctly applied the law on the point at issue.

For the foregoing reasons, the decision appealed from is affirmed, with costs against the appellant. So ordered.

Avanceña, C. J., Street, Malcolm, Villa-Real, Hull, and Butte, JJ., concur.

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## DISSENTING

### ABAD SANTOS, J.:

As I view it, this case is important not only because of the amount involved, but because it affects the faith and credit of the Government of the Philippine Islands. It seems too clear to require any citation of authorities that Act No. 1368 is a contract between the Government, on the one hand, and the grantees of the franchise, their successors or assigns, on the other. Under the contract it was agreed that, in lieu of all taxes on the franchise or earnings thereof, the grantees, their successors or assigns should pay to the Government two per centum of the gross receipts of the business transacted under the franchise. The Government has thus pledged to exempt the holders of the franchise from the payment of any taxes on such franchise or earnings thereof. There is no dispute on this point.

The specific question involved in this appeal is whether such exemption applies to dividends declared and distributed by the appellant corporation among its stockholders. Counsel for the appellant contend that it does, while counsel for the appellee maintains that it does not. In determining the extent of the exemption, it is well to bear in mind the purpose thereof, which was to invite and encourage the investment of capital for the establishment and maintenance of the telephone, telegraph, or other electrical transmission systems in the Island of Luzon. Viewed in this light, it is, I think, fair to conclude that it was the intention of the contracting parties to have the exemption redound to the benefit of those who would actually risk their capital in the proposed enterprise. In other words, the exemption was intended to confer substantial benefits not to any artificial person, such as a corporation, but to real, natural persons, such as those who compose a stock corporation—its stockholders. That is, in my opinion, the nature of the obligation of the contract created by Act No. 1368, which can neither be impaired by subsequent legislation, nor circumvented by resorting to a legal fiction.

I am of opinion that the judgment appealed from should be reversed.

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