

MANILA GAS CORPORATION, PLAINTIFF AND APPELLANT, VS. THE COLLECTOR OF INTERNAL REVENUE, DEFENDANT AND APPELLEE.

G. R. No. 42780. January 17, 1936

Ponente: MALCOLM, J.

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MALCOLM, J.:

This is an action brought by the Manila Gas Corporation against the Collector of Internal Revenue for the recovery of P56,757.37, which the plaintiff was required by the defendant to deduct and withhold from the various sums paid by it to foreign corporations as dividends and interest on bonds and other indebtedness and which the plaintiff paid under protest. On the trial court dismissing the complaint, with costs, the plaintiff appealed assigning as the principal errors alleged to have been committed the following:

"1. The trial court erred in holding that the dividends paid by the plaintiff corporation were subject to income tax in the hands of its stockholders, because to impose the tax thereon would be to impose a tax on the plaintiff, in violation of the terms of its franchise, and would, more- over, be oppressive and inequitable.

"2. The trial court erred in not holding that the interest on bonds and other indebtedness of the plaintiff corporation, paid by it outside of the Philippine Islands to corporations not residing therein, were not, on the part of the recipients thereof, income from Philippine sources, and hence not subject to Philippine income tax."

The facts, as stated by the appellant and as accepted by the appellee, may be summarized as follows: The plaintiff is a corporation organized under the laws of the Philippine Islands. It operates a gas plant in the City of Manila and furnishes gas service to the people of the metropolis and surrounding municipalities by virtue of a franchise granted to it by the Philippine Government. Associated with the plaintiff are the Islands Gas and Electric Company domiciled in New York, United States, and the General Finance Company domiciled in Zurich, Switzerland. Neither of these last mentioned corporations is resident in the Philippines.

For the years 1930, 1931, and 1932, dividends in the sum of P1,348,847.50 were paid by the plaintiff to the Islands Gas and Electric Company in the capacity of stockholders upon which withholding income taxes were paid to the defendant totalling P40,460.03 For the same years interest on bonds in the sum of P411,600 was paid by the plaintiff to the Islands Gas and Electric Company upon which withholding income taxes were paid to the defendant totalling P12,348. Finally for the stated time period, interest on other indebtedness in the sum of P131,644.90 was paid by the plaintiff to the Islands Gas and Electric Company and the General Finance Company respectively upon which withholding income taxes were paid to the defendant totalling P3,949.34.

Some uncertainty existing regarding the place of payment, we will not go into this factor of the case at this point, except to remark that the bonds and other tokens of indebtedness are not to be found in the record. However, Exhibits E, F, and G, certified correct by the treasurer of the Manila Gas Corporation, purport to prove that the place of payment was the United States and Switzerland.

The appeal naturally divides into two subjects, one covered by the first assigned error, and the other by the second assigned error. We will discuss these subjects and errors in order.

1. Appellant first contends that the dividends paid by it to its stockholders, the Islands Gas and Electric Company, were not subject to tax because to impose a tax thereon would be to do so on the plaintiff corporation, in violation of the terms of its franchise and would, moreover, be oppressive and inequitable. This argument is predicated on the constitutional provision that no law impairing: the obligation of contracts shall be enacted. The particular portion of the franchise which is invoked provides:

"The grantee shall annually on the fifth day of January of each year pay to the City of Manila and the municipalities in the Province of Rizal in which gas is sold, two and one-half per centum of the gross receipts within said city and municipalities, respectively, during the preceding year. Said payment shall be in lieu of all taxes, Insular, provincial and municipal, except taxes on the real estate, buildings, plant, machinery, and other personal property belonging to the grantee."

The trial judge was of the opinion that the instant case was governed by our previous decision in the case of *Philippine Telephone and Telegraph Co. vs. Collector of Internal Revenue* ([1933], 58 Phil., 639). In this view we concur. It is true that the tax exemption provision relating to the Manila Gas Corporation herein before quoted differs in phraseology from the tax exemption provision to be found in the franchise of the Telephone and Telegraph Company, but the ratio decidendi of the two cases is substantially the same. As there held and as now confirmed, a corporation has a personality distinct from that of its stockholders, enabling the taxing power to reach the latter when they receive dividends from the corporation. It must be considered as settled in this jurisdiction that dividends of a domestic corporation, which are paid and delivered in cash to foreign corporations as stockholders, are subject to the payment of the income tax, the exemption clause in the charter of the corporation notwithstanding.

For the foregoing reasons, we are led to sustain the decision of the trial court and to overrule appellant's first assigned error.

2. In support of its second assignment of error, appellant contends that, as the Islands Gas and Electric Company and the General Finance Company are domiciled in the United States and Switzerland respectively, and as the interest on the bonds and other indebtedness earned by said corporations has been paid in their respective domiciles, this is not income from Philippine sources within the meaning of the Philippine Income Tax Law. Citing sections 10 (a) and 13 (e) of Act No. 2833, the Income Tax Law, appellant asserts that their applicability has been squarely determined by decisions of this court in the cases of *Manila Railroad Co. vs. Collector of Internal Revenue* (No. 31196, promulgated December 2, 1929, not reported), and *Philippine Railway Co. vs. Posadas* (No. 35766, promulgated October 30, 1933 [58 Phil., 968]), wherein it was held that interest paid to non-resident individuals or corporations is not income from Philippine sources, and hence not subject to the Philippine income tax. The Solicitor-General answers with the observation that the cited decisions interpreted the Income Tax Law before it was amended by Act No. 3761 to cover the interest on bonds and other obligations or securities paid "within or without the Philippine Islands." Appellant rebuts this argument by "assuming, for the sake of the argument, that by the amendment introduced to section 13 of Act No. 2833 by Act No. 3761 the Legislature intended that interest received by non-residents is to be considered income from Philippine sources and so is subject to tax," but with the necessary sequel that the amendatory statute is invalid and unconstitutional as being beyond the power of the Legislature to enact.

Taking first under observation the last point, it is to be observed that neither in the pleadings, the decision of the trial court, nor the assignment of errors, was the question of the validity of Act No. 3761 raised. Under such circumstances, and no jurisdictional issue being involved, we do not feel that it is the duty of the court to pass on the constitutional question, and accordingly will refrain from doing so. (*Cadwallader-Gibson Lumber Co. vs. Del Rosario* [1913], 26 Phil., 192; *Macondray & Co. vs. Benito and Ocampo*, p. 137, ante; *State vs. Burke* [1912], 175

Ala., 561.)

As to the applicability of the local cases cited and of the Porto Rican case of *Domenech vs. United Porto Rican Sugar Co.* ([1932], 62 F. [2d], 552), we need only observe that these cases announced good law, but that each case must be decided on its particular facts. In other words, in the opinion of the majority of the court, the facts at bar and the facts in those cases can be clearly differentiated. Also, in the case at bar there is some uncertainty concerning the place, of payment, which under one view could be considered the Philippines and under another view the United States and Switzerland, but which cannot be definitely determined without the necessary documentary evidence before us.

The approved doctrine is that no state may tax anything not within its jurisdiction without violating the due process clause of the constitution. The taxing power of a state does not extend beyond its territorial limits, but within such limits it may tax persons, property, income, or business. If an interest in property is taxed, the situs of either the property or interest must be found within the state. If an income is taxed, the recipient thereof must have a domicile within the state or the property or business out of which the income issues must be situated within the state so that the income may be said to have a situs therein. Personal property may be separated from its owner, and he may be taxed on its account at the place where the property is although it is not the place of his own domicile and even though he is not a citizen or resident of the state which imposes the tax. But debts owing by corporations are obligations of the debtors, and only possess value in the hands of the creditors. (*Farmers Loan Co. vs. Minnesota* [1930], 280 U. S., 204; *Union Refrigerator Transit Co. vs. Kentucky* [1905], 199 U. S., 194; *State Tax on Foreign-held Bonds* [1873], 15 Wall, 300; *Buck vs. Beach* [1907], 206 U. S., 392; *State ex rel. Manitowoc Gas Co. vs. Wis. Tax Comm.* [1915], 161 Wis., Ill; United States Revenue Act of 1932, sec. 143.)

These views concerning situs for taxation purposes apply as well to an organized, unincorporated territory or to & Commonwealth having the status of the Philippines.

Pushing to one side that portion of Act No. 8761 which permits taxation of interest on bonds and* other indebtedness paid without the Philippine Islands, the question is if the income was derived from sources within the Philippine Islands.

In the judgment of the majority of the court, the question should be answered in the affirmative. The Manila Gas Corporation operates its business entirely within the Philippines. Its earnings, therefore, come from local sources. The place of material delivery of the interest to the foreign corporations paid out of the revenue of the domestic corporation is of no particular moment. The place of payment even if conceded to be outside of the country cannot alter the fact that the income was derived from the Philippines. The word "source" conveys only one idea, that of origin, and the origin of the income was the Philippines.

In synthesis, therefore, we hold that conditions have not been provided which justify the court in passing on the constitutional question suggested; that the facts while somewhat obscure differ from the facts to be found in the cases relied upon, and that the Collector of Internal Revenue was justified in withholding income taxes on interest on bonds and other indebtedness paid to non-resident corporations because this income was received from sources within the Philippine Islands as authorized by the Income Tax Law. For the foregoing reasons, the second assigned error will be overruled.

Before concluding, it is but fair to state that the writer's opinion on the first subject and the first assigned error herein discussed is accurately set forth, but that his opinion on the second subject and the second assigned error is not accurately reflected, because on this last division his views coincide with those of the appellant. However, in the interest of the prompt disposition of this case, the decision has been written up in accordance with instructions received from the court.

Judgment affirmed, with the costs of this instance assessed against the appellant.

Hull, Vickers, Imperial, Butte, and Recto, JJ., concur.

CONCURRING AND DISSENTING OPINION

VILLA-REAL, J.:

I concur with the majority decision regarding the disposition of the second error, but dissent as to its disposition of the first error. In my opinion, the exemption clause to be found in the charter of the plaintiff is broader in scope than that to be found in the charter of the Philippine Telephone and Telegraph Company, thus making inapplicable the decision of this court in the case of Philippine Telephone and Telegraph Co. vs. Collector of Internal Revenue (58 Phil., 639).

CONCURRING IN PART AND DISSENTING IN PART:

ABAD SANTOS, J.:

I am of opinion that the first assignment of error should be sustained, and the judgment below reversed in that respect.

The franchise held by the appellant corporation contains a stipulation by the Government to the effect that the payment by the corporation to the entities named in the franchise of two and one-half per centum of its gross receipts, shall be in lieu of all taxes, except taxes on the real estate, buildings, plant, machinery and other personal property belonging to the corporation. The dividends paid by the appellant corporation to its stockholders were a part of its earnings and as such not subject to tax under the terms of the franchise. The franchise in this case is a contract, the obligation of which can not be impaired.

I agree with the majority of the court that the second assignment of error should be overruled, and the judgment affirmed in that particular. Section IS (e) of Act No. 2833, as amended by Act No. 8761, expressly provides for the imposition of a tax " * * * upon the income derived from interest upon bonds and mortgages, or deeds of trust, notes, or oilier interest-bearing obligations of a domestic or resident foreign corporation, * * * " The income derived from the interest on bonds and other indebtedness of the appellant corporation, is clearly within the purview pf the statute. The power of the legislature to impose such a tax must be recognized. As stated by Justice Bradley in United States vs. Erie R. Co, (106 U. S., 327; 27 Law. ed., 151, 153): " * * * The tax laid upon their bonds was intended to affect the owners of the bonds, and whilst the companies were directed to pay it, they were authorized to retain the amount from the installments due to the bondholders, whether citizens or aliens. The objection that Congress had no power to tax non-resident aliens, is met by the fact that the tax was not assessed against them personally, but against the rem ithin the jurisdiction of the United States, with certain exceptions not necessary to be noted. The money due to non-resident bondholders in this case was in the United States—in the hands of the company—before it could he transmitted to London, or other place where the bondholders resided. Whilst here it was liable to taxation. Congress, by the internal revenue law, by way of tax, stopped a part of the money before its transmission, namely: 5 per cent of it. Plausible grounds for levying such a tax might be assigned. It might be said that the creditor is protected by our laws in the enjoyment of the debt; that the whole machinery of our courts and the physical power of the government are placed at his disposal for its security and collection."

DISSENTING OPINION

AVANCEÑA, C. J., :

I do not agree with the majority opinion with respect to the appellant's second assignment of error, which in my opinion should be sustained. The question involved in this error has been clearly decided by this court in the case of Manila Railroad Co. vs. Collector of Internal Revenue (G. R. No. 31196, promulgated December 2, 1929, not report- ed). In said case it was held that interest on bonds purchased outside the Philippine Islands by non-residents of the Islands cannot be considered derived from sources within the Islands. The amendment of the law introduced by Act No. 3761 as to the place of payment of interest does not affect the aspect of the question raised in this error if the interest on which the tax in the present case has been collected is not derived from sources within the Islands, as it is not so in fact, in accordance with the doctrine laid down in said case of Manila Railroad Co. vs. Collector of Internal Revenue.

DISSENTING OPINION

GODDARD, J.:

The tax exemption and commutation clause in the plain- tiffs franchise provides that:

"The grantee shall annually on the 5th day of January of each year pay to the City of Manila and to the municipalities in the Province of Rizal in which gas is sold, two and one-half per centum of the gross receipts within said city and municipalities, respectively, during the preceding year. Said payment shall be in lieu of all taxes, Insular, provincial and municipal, except taxes on the real estate, buildings, plant, machinery, and other personal property belonging to the grantee"

This franchise is a contract between the Government and the grantees thereof, whose rights have been acquired by the plaintiff corporation. In Manila Railroad Co. vs. Rafferty (40 Phil., 224, 230), this court held that "* * * Once granted, a charter becomes a private contract * * *." Article 1091 of the Civil Code provides that "Obligations arising from contract shall have the force of law between the contracting parties and must be performed in accordance with their stipulations." It follows that as the plain- tiff corporation has paid to the City of Manila and to the municipalities of Rizal, where gas is sold by it, the franchise tax stipulated in the contract, the Government has no legal right to impose another tax on its earnings.

The case of Farrington vs. Tennessee (95 U. S., 679; 24 Law. ed., 558), is almost in exact parallel with the case at bar. The facts of that case were as follows: The Union and Planters' Bank of Memphis was duly organized under the charter granted by the Legislature of Tennessee, by two Acts, respectively dated March 20, 1858, and February 12, 1869. Since its organization it continued doing a regular banking business. Its capital subscribed and paid in amounted to \$675,000, divided into 6,750 shares of \$100 each. Farrington, the plaintiff in error, was the owner of 150 shares, of the value of \$15,000.

The tenth section of the charter of the bank declared:

"That 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, a stockholder of the bank, 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 plaintiff in error denied the right of the State and County to impose these taxes. He claimed:

- (1) That the 10th section of the charter was a contract between the State and the Bank;
- (2) That any other tax than that therein specified was expressly forbidden; and
- (3) That the revenue laws imposing the taxes in question impaired the obligation of the contract.

The Supreme Court of Tennessee adjudged the taxes to be valid and the plaintiff in error thereupon removed the case to the Federal Supreme Court for review.

In upholding all of the contentions of the plaintiff in error, and pronouncing invalid the taxes involved as impairing the obligation of the contract created by the franchise, the United States Supreme Court said:

"This case turns upon the construction to be given to the 10th section of the charter of the bank. * * *

* * * * *

"When this charter was granted, the State might have been silent as to taxation. In that case, the power would have been unfettered. (Bk. vs. Billings, 4 Pet., 514.) It might have reserved the power as to some things, and yielded it as to others. It had the power to make its own terms or to refuse the charter. It chose to stipulate for a specified tax on the shares, and declared and bound itself that this tax should be 'in lieu of all other taxes.'

"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 decree of the Supreme Court of Tennessee is reversed and the case will be remanded, with directions to enter a decree in favor of the plaintiff in error." (Farrington vs. Tennessee, 95 U. S., 679; 24 Law. ed., 560, 561.)

That case, it will be observed, is almost in exact parallel with the case at bar. Both cases deal with tax commutation provided for in a franchise granted by the State. In both cases the State covenanted that the tax specified in the franchise should be in lieu of all other taxes. In both cases the additional tax which the tax authorities sought to impose was a revenue tax. In both cases the tax provided for in the franchise was paid by the corporation, and the tax which the authorities attempted to collect were imposed on the stockholders. In the Farrington case the provision in the Federal Constitution that "No State shall * * * pass any * * * law impairing the obligation of contracts" was applied; in this case the provision of our Organic Law that "no law impairing the obligation of contracts shall be enacted" is involved. It will be observed, further, that in the Farrington Case the franchise was granted to a corporation, yet the court held that the commutation provision of the franchise extended to the individual stockholders. In the case at bar, while the plaintiff, the present owner of the franchise, is a corporation, the original grantees were natural persons; hence there is more reason for holding in the present case that the commutation provision in the franchise granted by the Philippine Government should extend to the

stockholders of plaintiff corporation.

The Farrington Case, decided in 1878, was by a divided court. Eighteen years later—in 1896—the State of Tennessee sought to have the decision in that case reviewed, on the ground that the court did not consider the other portions of the charter which, according to the State, were material. The Supreme Court—this time unanimously—declined to reverse its view as expressed in the Farrington decision, saying.

"We do not think under the circumstances that we ought now to come to a different conclusion upon the question of exemption from that which was arrived at by this court in the Farrington Case. As the whole charter was then before the court, we are not prepared to say that its force was misunderstood, or that there was an omission by the court to consider all the language of the exemption clause simply because a portion of it is omitted in the quotation from the record made in the opinion therein delivered. We are not inclined, therefore, to overrule or distinguish the Farrington Case, and we must now hold that the charter clause of exemption limits the amount of tax on each share of stock in the hands of the shareholder, and that any subsequent revenue law of the state which imposes an additional tax on such shares in the hands of shareholders, impairs the obligation of the contract, and is void. This compels us to reverse the judgments herein against the shareholders." (Bank of Commerce vs. Tennessee, 161 U. S., 134; 40 Law. ed., 645, 648.)

The doctrine of the Farrington Case is now the settled rule of the highest court of the United States. The first assignment of error should therefore be sustained.

As to the second assignment of error I concur with the dissenting opinion of the Chief Justice for the reasons set forth therein. Consequently that assignment of error should also be sustained.

The trial court erred in not holding that interest received by a non-resident corporation, outside of the Philippine Islands, is not income from Philippine sources and so not subject to income tax.

In view of the above I am of the opinion that the appealed decision should be reversed and another entered by this court, ordering the defendant to pay the plaintiff the sum of P40,460.03, the amount of withholding taxes paid on account of interest on bonds and other indebtedness, or a total of P56,757.37.

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