

WISE & CO., INC., ET AL., PLAINTIFFS-APPELLANTS, VS. BIBIANO L. MEER, COLLECTOR OF INTERNAL REVENUE, DEFENDANT AND APPELLEE.

G.R. No. 48231. June 30, 1947

Ponente: HILADO, J.

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HILADO, J.:

This is an appeal by Wise & Co., Inc. and its co-plaintiffs from the judgment of the Court of First Instance of Manila in Civil Case No. 56200 of said court, absolving the defendant Collector of Internal Revenue from the complaint without costs. The complaint was for recovery of certain amounts therein specified, which had been paid by said plaintiffs under written protest to said defendant, who had previously assessed said amounts against the respective plaintiffs by way of deficiency income taxes for the year 1937, as detailed under paragraph 6 of defendant's special defense (Record on Appeal, pp. 7-10). Appellants made eight assignments of error, to wit:

"The Trial Court erred in findings:

"I. That the Manila Wine Merchants, Ltd., a Hong Kong corporation, was in liquidation beginning June 1, 1937, and that all dividends declared and paid thereafter were distributions of all of its assets in complete liquidation.

"II. That all distributions made by the Hongkong corporation after June 1, 1937 were subject to both normal tax and surtax.

"III. That income received by one corporation from another was taxable under the Income Tax Law, and that Wise & Co., Inc., was taxable on the distribution of its share of the same net profits on which the Hong Kong Company had already paid Philippine tax, despite the clear provisions of Section 10 of the Income Tax Law then in effect.

"IV. That the non-resident individual stockholder appellants were subject to both normal and additional tax on the distributions received despite the clear provisions of Section 5(b) of the Income Tax Law then in effect.

"V That Section 25 (a) of the Income Tax Law makes distributions in liquidation of a foreign corporation, dissolution proceedings of which were conducted in a foreign country, taxable income to a non-resident individual stockholder.

"VI. That Section 199 of the Income Tax regulations, providing that in a distribution by a corporation in complete liquidation of its assets the gain realized by a stockholder, whether individual or corporate, is taxable as a dividend is ineffective.

"VII. That the deficiency assessment was properly collected.

"VIII. That the refunds claimed by plaintiffs were not in order, and in rendering judgment absolving the Collector of Internal Revenue from making such refunds."

The facts have been stipulated in writing, as quoted verbatim in the decision of the trial court thus:

I

"That the allegations of paragraphs I and II of the complaint are true and correct.

II

"That during the year 1937, plaintiffs, except Mr. E. M. G. Strickland (who, as husband of the plaintiff Mrs. E. M. G. Strickland, is only a nominal party herein), were stockholders of Manila Wine Merchants Ltd., a foreign corporation duly authorized to do business in the Philippines.

III

"That on May 27, 1937, the Board of Directors of Manila Wine Merchants, Ltd., (hereinafter referred to as the Hongkong Company), recommended to the stockholders of the company that they adopt the resolutions necessary to enable the company to sell its business and assets to Manila Wine Merchants, Inc., a Philippine corporation formed on May 27, 1937, (hereinafter referred to as the Manila Company), for the sum of P400,000, Philippine currency; that this sale was duly authorized by the stockholders of the Hongkong Company at a meeting held on July 22, 1937; that the contract of sale between the two companies was executed on the same date, a copy of the contract being attached hereto as Schedule 'A'; and that the final resolutions completing the said sale and transferring the business and assets of the Hongkong Company to the Manila Company were adopted on August 3, 1937, on which date the Manila Company paid the Hongkong Company the P400,000 purchase price.

III

"That pursuant to a resolution by its Board of Directors purporting to declare a dividend, the Hongkong Company made a distribution from its earnings for the year 1937 to its stockholders, plaintiffs receiving the following:

Declared and Paid

June 8, 1937

Wise & Co., Inc.....

P7,677.82

Mr. J. F. MacGregor

2,554.86

Mr. N. C. MacGregor.....

2,369.48

Mr. C. J. Lafrentz

529.51

Mrs. E. M. G. Strickland.

2,369.48

Mrs. M. J. G. Mullins ...

21369 .48

P17,870.63

"That the Hongkong Company has paid Philippine Income tax on the entire earnings from which the said distributions were paid.

V

"That after deducting the said dividend of June 8, 1937, the surplus of the Hongkong Company resulting from the active conduct of its business was P74,182.12. That as a result of the sale of its business and assets to the Manila Company, the surplus of the Hongkong Company was increased to a total of P270,116.59.

"That pursuant to resolutions of its Board of Directors, and of its shareholders, purporting to declare, dividends, copies of which are attached hereto as Schedules 'B' and 'B-1', the Hongkong Company distributed this surplus to its stockholders, plaintiffs receiving the following sums on the following dates:

Declared
July 22,1937
Paid
August 4,1937

Declared
July 22,1937
Paid
October 28,1937

Wise & Co., Inc.....

P113,851.85

P2,198.24

Mr. J. F. MacGregor.....

37,885.20

731.48

Mr. N. C. MacGregor.....

35,137.03

678.42

Mr. C. J. Lafrentz.....

7,851.86

151.61

Mrs. E. M. G. Strickland .

35,137.03

678.42

Mrs. M. J. G. Mullins

35,137.03

678.42

P265,000.00

P5,116.59

"That Philippine income tax had been paid by the Hongkong Company On the said surplus from which the said distributions were made.

VI

"That on August 19, 1937, at a special general meeting of the shareholders of the Hongkong Company, the stockholders by proper resolution directed that the company be voluntarily liquidated and its capital distributed among the stockholders; that the stockholders at such meeting appointed a liquidator to wind up the Hongkong Company's affairs; that the said liquidator duly paid off the remaining debts of the Hongkong Company and distributed its capital among the stockholders including plaintiffs; that the liquidator duly filed his accounting on January 12, 1938, and in accordance with the provisions of Hongkong Law, the Hongkong Company was duly dissolved at the expiration of three months from that date.

VII

"That plaintiffs duly filed Philippine income tax returns. That defendant subsequently made the following deficiency assessments against plaintiffs:

WISE & COMPANY, INC.

Net Income as per return.....

P87,649.67

Add : Deductions disallowed-Loss on

shares of stock in the Manila
Wine Merchants, Ltd., resulting
from the liquidation of said
firm.....

44,515.00

Income not declared:

Return of capital....

P51,185.00

Share of surplus

123,727.88

Total liquidating dividends received ..

P174,912.88

Less value of shares as per books.....

95,700.00

Profits realized on shares of stock in
the Manila Wine Merchants, Ltd.
resulting from the liquidation of the
said firm.....

P79,212.88

Accrued income tax as per return

5,258.98

Total

P216,636.53

Deduct accrued income tax

12,262.45

Net income as per Investigation

204,374.08

6% Normal tax.....

12,262.45

Less amount already paid.....

5, 258.98

Balance still due and collectible

7,003.47

J. P. MACGREGOR

Net income as per return.....

P47,479.44

Deduct: Ordinary dividends

6,307.92

Net Income as per investigation subject to
normal tax

Return of capital

P17,032.25

Share of surplus

41,171.52

Total liquidating dividends received.....

P58,203.77

Less cost of shares

17,032.25

Profit realized on shares of stock in the
Manila Wine Merchants, Ltd. resulting
from the liquidation of said firm.....

P41,171.52

Normal tax at 3 per cent

1,235.15

Additional tax due.....

549.59

Total normal and additional taxes

1,784.74

Less : Amount already paid

549 . 59

Balance still due and collectible

1,235.15

N. C. MACGREGOR

Net income as per return.....

P44,177.06

Deduct: Ordinary dividends.....

5,992.11

Net income as per investigation subject to normal tax :

Return of capital.....

P15,796.75

Share of surplus

38,184.95

Total liquidating dividends received.....

P53,981.70

Less cost of shares

15,796.75

Profit realized on shares of
stock in the Manila Wine Merchants, Ltd.
Resulting from the liquidation of the said firm

P38,184.95

Normal tax at 3 per cent.....

1,145.55

Additional tax due.....

483.54

Total normal and additional taxes

1,629.09

Less amount already paid

483.55

Balance still due and collectible

1,145.54

C. J. LAFRENTZ

Net income as per return

P 9,9778.18

Deducts Ordinary dividends

1,245.20

Net income as per investigation subject to normal tax:

Return of capital

P 3,530.00

Share of surplus

8,532.00

Total liquidating dividends received

P12,062.98

Less cost of shares

3,530. 00

Profits realized on shares of stock in the
Manila Vine Merchants, Ltd.
resulting from the liquidation of the said firm

P8,532.98

3 per cent normal tax due and collectible

255.99

MRS. E. M. G. STRICKLAND

Net income as per return

P 44,057.06

Deduct: Ordinary dividends

5,872.11

Net income as per investigation subject to normal tax:

Return of capital

P15,796.75

Share of surplus

38 , 184.95

Total liquidating dividends received

P53,981.70

Less cost of shares

15,796.75

Profit realized on shares of stock in the
Manila Wine Merchants Ltd. Resulting
from the liquidation of said firm

P38,184.95

Normal tax at 3 per cent

1,145.55

Additional tax due

481.14

Total normal and additional taxes

1,626.69

Balance still due and collectible

1,145.54

Net income as per return

P 44,057.06

Deduct: Ordinary dividends

5,872.11

Net income as per investigation subject to normal tax:

Return of capital

15,796.75

Share of surplus

38,184.95

Total liquidating dividends received

P53,981.70

Less cost of shares

15,796.75

Profit realized on shares of stock in
Manila Wine Merchants Ltd. resulting
from the liquidation of said firm.....

P38,184.95

Normal tax at 3 per cent.....

1,145.55

Additional tax due

481.14

Total normal and additional taxes

1,626.69

Less amount already paid

481.15

Balance still due and collectible

P1,145.54

VIII

"That said plaintiff duly paid the said amounts demanded by defendant under written protest, which was overruled in due course; that the plaintiffs have since July 1, 1939 requested from defendant a refund of the said mounts which defendant has refused and still refuses to refund.

IX

"That this stipulation is equally the work of both parties and shall be fairly interpreted to give effect to their intention that this case shall be decided solely upon points of law.

X

"The parties incorporate the Corporation Law and Companies Act of Hongkong, and the applicable decisions made thereunder, into this stipulation by reference, and either party may at any stage in the proceedings in this case cite applicable sections of the law and the authorities decided thereunder as though the same had been duly proved in evidence.

XI

"That the parties hereto reserve the right to submit other and further evidence at the trial of this case." (Record on Appeal, pp. 19-26).

1. The first assignment of error.— Appellants maintain that the amounts received by them and on which the taxes in question were assessed and collected were ordinary dividends; while upon the other hand, appellee contends that they were liquidating dividends. If the first proposition is correct, this assignment would be well taken; otherwise, the decision of the court upon the point must be upheld.

It appears that on May 27, 1937, the Board of Directors of the Manila Wine Merchants, Ltd., (hereafter called the Hongkong Co.) recommended to the stockholders of said company "that the Company should be wound up voluntarily by the members and the business sold as a going concern to a new Company incorporated under the laws of the Philippine Islands under the style of 'The Manila Wine Merchants, Inc.'" (Annex "A" defendant's answer, Record on Appeal, p. 12), and that they adopt the resolutions necessary to enable the company to sell its business and assets to said new company (hereafter called the Manila Company) organized on that same date, for the price of P400,000.00, Philippine currency; that the sale was duly authorized by the stockholders of the HongKong Co. at a meeting held on July 22, 1937; and that the contract of sale between the two companies was executed on the same day, as appears from the copy of the contract, Schedule A of the Stipulation of Facts (par.

III, Stipulation of Facts, Record on Appeal, pp. 19-20). It will be noted that the Board of Directors of the Hongkong Co., in recommending the sale, specifically mentioned "a new Company incorporated under the laws of the Philippine Islands under the style of 'The Manila Wine Merchants, Inc.,'" as the purchaser, which fact shows that at the time of the recommendation, the Manila Company had already been formed, although on the very same day; and this and the further fact that it was really the latter corporation that became the purchaser should clearly point to the conclusion that the Manila Company was organized for the express purpose of succeeding the Hongkong Co. The stipulated facts would admit of no saner interpretation.

While it is true that the contract of sale was signed on July 22, 1937, it contains in its paragraph 4 of the express provision that the transfer "till take effect on and from the first day of June, One thousand nine hundred and thirty-seven, and until completion thereof, the Company shall stand possessed of the property hereby agreed to be transferred and shall carry on its business in trust for the Corporation" (Schedule A of Stipulation of Facts, Record on Appeal, p. 15). "The Company" was the Hongkong Company and "the Corporation" was the Manila Company, For "the Company" to carry on the business in trust for "the Corporation," it was necessary for the latter to be the owner of the business. It is plain that the parties considered the sale as made as on and from June 1, 1937—for the purposes of said sale and transfer, both parties agreed that the deed of July 22, 1937, was to retroact to the first day of the preceding month.

The cited provision could not have served any other purpose than to consider the sale as made as of June 1, 1937. If it had not been for this purpose, if the intention had been that the sale was to be effective upon the date of the written contract or subsequently, said provision would certainly never have been written, for how could the transfer or sale take effect as of June 1, 1937 if it were to be considered as made at a later date?

The first distribution made after June 1, 1937, of what plaintiffs call ordinary dividends but what defendant denominates liquidating dividends, was declared and paid on June 8, 1937 (Stipulation, Paragraph IV, Record on Appeal, p. 20). It will be recalled that the recommendation of the Board of Directors of the Hong Kong Company, at their meeting on May 27, 1937, was first of all "that the company should be wound up voluntarily by the members" (Record on Appeal, p. 12), and in pursuance of that purpose, it was further recommended that the Company's business be sold as a going concern to the Manila Company (*ibid.*) Complying with the Companies Ordinance 1932 for companies registered in Hongkong for the voluntary winding up lay members, a Declaration of Solvency was drawn up and duly signed before the British Consul-General in Manila by the same directors, and said declaration was returned to Hongkong for filing with the Registrar of Companies (*ibid.*). Both recommendations were in due course approved and ratified. The later execution of the formal deed of sale and the successive distributions of the amounts in question among the stockholders of the Hong Kong Company were obviously other steps in its complete liquidation. And they leave no room for doubt in the mind of the Court that said distributions were not in the ordinary course of business and with intent to maintain the corporation as a going concern—in which case they would have been distributions of ordinary dividends—but after the liquidation of the business had been decided upon, which makes them payments for the surrender and relinquishment of the stockholders' interest in the corporation, or so-called liquidating dividends.

More than with the distribution of June 8, 1937, is this true with those declared on July 22, 1937, and paid on August 4 and October 28, 1937, respectively (Stipulation of Facts, par. 5, Record on Appeal, p. 21). The distributions thus declared on July 22, 1937, and paid on August 4 and October 28, 1937, were from the surplus of the Hongkong Company resulting from the active conduct of its business and amounting to P74,182.12, which surplus was augmented to a total of P270,116.59 as a result of the sale of its business and assets to the Manila Company (*ibid.*). In both Schedules B and B-1 of the Stipulation of Facts (Record on Appeal, pp. 16-18), being minutes of directors' meetings of the Hongkong Co., where authorization and instruction were given to declare

and pay in the form of "dividends" to the shareholders the amounts in question, it was specifically provided that the surplus to be so distributed be that resulting after providing for return of capital and necessary or various expenses, as shown in the balance sheet prepared as of June 1, 1937, and in the reconstructed balance sheet of the same date presented by the company's auditors, it having been resolved in Schedule B-1 that "any balance remaining to be distributed when final liquidator's account has been rendered and paid" (Record on Appeal p. 18; italics supplied). It thus becomes more evident that those distributions were to be made in the course or as a result of the Hongkong Company's liquidation and that said liquidation was to be complete and final. And although the various resolutions above mentioned speak of distributions of dividends when referring to those already alluded to, "a distribution does not necessarily become a dividend by reason of the fact that it is called a dividend by the distributing corporation." (Holmes Federal Taxes, 6th edition, 774)

"The ordinary connotation of liquidating dividend involves the distribution of assets by a corporation to its stockholders upon dissolution." (Klein, Federal Income Taxation, 253-254).

But it is contended by plaintiff s that as of August 4, 1937 the Hongkong Company "had taken no steps toward dissolution or liquidation and still retained on hand liquid assets in excess of its capitalization." They also assert that it was only on August 19, 1937, that said company took the first corporate steps toward liquidation (Appellants' Brief, pp. 9-10). The fact, however, is that since July 22, 1937, when the formal deed of sale of all the properties, assets, and business of the Hongkong Company to take Manila Company was made, it was expressly stipulated that the sale or transfer shall take effect as of June 1, 1937. As already indicated, the transfer of what was sold, like the sale itself, was, by the mutual agreement of the parties, considered as made on and from that date, and that, if thereafter and until final completion of the transfer, the Hongkong Company continued to run the business, it did so in trust for the new owner, the Manila Company. In the case of *Canal-Commercial T. & S. Bk. vs. Comm'r* (63 P. Fed. [2d], 619, 620) it was held that:

"* * * The determining element therefore is whether the distribution was in the ordinary course of business and with intent to maintain the corporation as a going concern, or after deciding to quit with intent to liquidate the business. Proceedings actually begun to dissolve the corporation or formal action taken to liquidate it are but evidentiary and not indispensable. *Tootle vs. Commissioner* (C. C. A. 58 [2d], 576.) The fact that the distribution is wholly from surplus and not from capital, and therefore lawful as a dividend is only evidence. In *Hellmich vs. Hellman*, ad *Tootle vs. Commissioner*, supra the distribution was wholly from profits yet held to be one in liquidation * * *." (Italics supplied)

In the case at bar, when in the deed of July 22, 1937, by authority of its stockholders, the Hong Kong Company thru its authorized representative declared and agreed that the aforesaid sale and transfer shall take effect as of June 1, 1937, any distributions from its assets to those same stockholders made after June 1, 1937, altho before July 22, 1937, must have been considered by them as liquidating dividends; for how could they consistently deem all the business and assets of the corporation sold as of June 1, 1937, and still say that said corporation, as a going concern, distributed ordinary dividends to them thereafter?

In *Holmby Corporation vs. Comm'r*. (83 Fed. [2d], 548-550), the court said:

"* * * The fact that the distributions were called 'dividends' and were made, in part, from earnings and profits, and that some of them were made before liquidation or dissolution proceedings were commenced, is not controlling. * * * The determining element is whether the distributions were in the ordinary course of business and with intent to maintain the corporation as a going concern, or after deciding to quit and with intent to liquidate the business * * *." (Italics supplied).

The directors or representatives of the Hongkong Company or the Manila Company, or both, could of course not convert into ordinary dividends what in law and in reality were not such. As aptly stated by Chief Justice Shaw in

Comm. vs. Hunt, (38 Am. Dec. 354-355),

"The law is not to be hoodwinked by colorable pretenses. It looks at truth and reality through whatever disguise they may assume."

The amounts thus distributed among the plaintiffs were not in the nature of a recurring return on stock—in fact, they surrendered and relinquished their stock in return for said distributions, thus ceasing to be stockholders of the Hongkong Company, which in turn ceased to exist in its own right as a going concern during its more or less brief administration of the business as trustee for the Manila Company, and finally disappeared even as such trustee.

"The distinction between a distribution in liquidation and an ordinary dividend is factual; the result in each case depending on the particular circumstances of the case and the intent of the parties. If the distribution is in the nature of a recurring return on stock it is an ordinary dividend. However, if the corporation is really winding up its business or recapitalizing and narrowing its activities, the distribution may properly be treated as in complete or partial liquidation and as payment by the corporation to the stockholder for his stock. The corporation is, in the latter instances, wiping out all or part of the stockholders' interest in the company * * *". (Montgomery, Federal Income Tax Handbook [1938-1939] 258; italics supplied).

It is our considered opinion that we are not dealing here with "the legal right of a tax-payer to decrease the amount of what otherwise will be his taxes, or altogether avoid them, by means which the law permits" (St. Louis Union Co. vs. U. S., 82 Fed. [2d], 6l), but with a situation where we have to apply in favor of the government the principle that the "liability for taxes cannot be evaded by a transaction constituting a colorable subterfuge" (6l C. J. 173), it being clear that the distributions under consideration were not ordinary dividends and were taxable in the manner, form and amounts decreed by the court below.

2. The second assignment of error.— In disposing of the first assignment of error, we held that the distributions in the instant case were not ordinary dividends but payments for surrendered or relinquished stock in a corporation in complete liquidation, sometimes called liquidating dividends. The question is whether such amounts were taxable income. The Income Tax Law, Act No. 2833, Section 25 (a), as amended by Section 4 of Act 3761, inter alia stipulated:

"Where a corporation, partnership, association, joint-account, or insurance company distributes all of its assets in complete liquidation or dissolution, the gain realized or loss sustained by the stockholder, whether individual or corporation, is a taxable income or a deductible loss as the case may be." (Italics supplied).

Partial source of the foregoing provision was Section 201 (c) of the U. S. Revenue Act of 1918, approved February 24, 1919, providing:

"Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for the stock or share, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits. "

It is a familiar rule of statutory construction that the judicial construction attached to the sources of statutes adopted in a jurisdiction are of authoritative value in the interpretation of such local laws. The Supreme Court of the United States has had occasion to construe certain pertinent parts of the Federal Revenue Act above mentioned on February 20, 1928, when it decided the case of Hellmich vs. Hellman (276 U. S. 233; 72 Law ed. 544). The case involved the recovery of additional income taxes assessed against the plaintiffs under the Federal Revenue Act of 1918 and paid under protest. And its determination hinged around the construction of parts of said act after which those of our own law now under discussion were patterned. Justice Sanford said:

"The question here is whether the gains realized by stockholders from the amounts distributed in the liquidation of the assets of a dissolved corporation, out of its earning or profits accumulated since February 28, 1913, were taxable to them as other 'gains or profits', or whether the amounts so distributed were 'dividends'

exempt from the normal tax.

"Section 201 (a) of the act defined the term 'dividend' as 'any distribution made by a corporation * * * to its shareholders * * * whether in cash or in other property * * * out of its earnings or profits accumulated since February 28, 1913 * * *.' Section 201 (c) provided that 'amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.'"

Our law at the time of the transactions in question, in providing that where a corporation, etc. distributes all its assets in complete liquidation or dissolution, the gain realized or loss sustained by the stockholder is a taxable income or a deductible loss as the case may be, in effect treated such distributions as payments in exchange for the stock or share. Thus, in making the deficiency assessments under consideration, the Collector, among other items, made proper deduction of the "value of shares" or "cost of shares" in the case of each individual plaintiff, assessing the tax only on the resulting "profit realized." (Stipulation, par. VII, Record on Appeal, pp. 22-25); and of course in case the value or cost of the shares should exceed the distribution received by the stockholder, the resulting difference will be treated as a "deductible loss".

In the same case the Supreme Court of the United States made the following quotation, which is here relevant, from Treasury Regulations 45, Art. 1548:

"* * * So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder, or over its fair market value as of March 1, 1913, if acquired prior thereto, is a taxable profits. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock." (72 Law ed. 546).

The Income Tax Law of the Philippines in force at the time defined the term, "dividend" in Section 25(a), as amended, as "any distribution made by a corporation * * * out of its earnings or fits accumulated since March 1, 1913, and payable to its shareholders whether in cash or other property." This definition is substantially the same as that given to the same term by the U. S, Revenue Act of 1918 quoted by Justice Sanford in the passage above inserted.

Plaintiffs contend that defendant's position would result in double taxation. A similar contention has been adversely disposed of against the taxpayer in the Hellmich case in these words:

"The gains realized by the stockholders from the distribution of the assets in liquidation were subject to the normal tax in like manner as if they had sold their stock to third persons. The objection that this results in double taxation of the accumulated earnings and profits is no more available in the one case than it would have been in the other. See *Merchants' Loan & T. Co. vs. Smietanki*, 255 U. S. 509; 65 Law. ed., 751; 15 A. L. R. 1305; 41 Sup. Ct. Rep., 386; *Goodrich vs. Edwards*, 255 U. S. 527, 65 Law ed., 758, 41 Sup. Ct. Rep. 390. When, as here, Congress has clearly expressed its intention, the statute must be sustained even though double taxation results. See *Patton vs. Brady*, 184 U. S. 608, 46 Law ed., 713; 22 Sup. Ct. Rep. 493; *Cream of Wheat Co. vs. Grand Forks County*, 253 U. S. 325, 330, 64 Law ed. 931, 934; 40 Sup. Ct. Rep. 558." (*Hellmich vs. Hellman*, supra, 72 Law ed. 547.)

It should be borne in mind that plaintiffs received the distributions in question in exchange for the surrender and relinquishment by them of their stock in the Hongkong Company which was dissolved and in process of complete liquidation. That money in the hands of the corporation formed a part of its income and was properly taxable to it

under the then existing Income Tax Law. When the corporation was dissolved and in process of complete liquidation and its shareholders surrendered their stock to it and it paid the sums in question to them in exchange, a transaction took place, which was no different in its essence from a sale of the same stock to a third party who paid therefor. In either case the shareholder who received the consideration for the stock earned that much money as income of his own, which again was properly taxable to him under the same Income Tax Law. In the case of the sale to a third person, it is not perceived how the objection of double taxation could have been successfully raised. Neither can we conceive how it could be available where, as in this case, the stock was transferred back to the dissolved corporation.

3. The third assignment of error.— In view of what has been said in our consideration of the second assignment of error, the third can be briefly disposed of. Having held that the distributions involved herein were not ordinary dividends but payments for stock surrendered and relinquished by the shareholders to the dissolved corporation, or so-called liquidating dividends, we have the road clear to declaring that under section 25 (a) of the former Income Tax Law, as amended, said distributions were taxable alike to Wise and Co., Inc. and to the other plaintiffs. We hold that both the proviso of section 10 (a) of said Income Tax Law and Section 198 of Regulations No. 81 refer to ordinary dividends, not to distributions made in complete liquidation or dissolution of a corporation which result, in the realization of a gain as specifically contemplated in Section 25 (a) of the same law, as amended, which as aforesaid expressly provides for the taxability of such gain as income, whether the stockholder happens to be an individual or a corporation. By analogy, we can cite the following additional passages from the *Hellmich* case:

"The controlling question is whether the amounts distributed to the stockholders out of the earnings and profits accumulated by the corporation since February 28, 1213, were to be treated under section 201 (a) as 'dividends,' which were exempt from the normal tax; or, under section 201 (c) as payments made by the corporation in exchange for its stock, which were taxable 'as other gains or profits.' "

"It is true that if section 201 (a) stood alone its broad definition of the term 'dividend' would apparently include distributions made to stockholders in the liquidation of a corporation—although this term, as generally understood and used, refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock. (See *Lynch vs. Hornby*, 247 U. S. 339, 344-346; and *Langstaff vs. Lucas* [D. C.] 9 Fed. [2d], 691, 694.)

"However, when section 201 (a) and section 201(c) are read together, under the long-established rule that the intention of the lawmakers is to be deduced from a view of every material part of the statute (*Kohlsaat vs. Murphy*, 96 U. S. 153, 159; 24 Law. ed., 846) we think it clear that the general definition of a dividend in section 201 (a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distributions should be governed by section 201 (c), which, dealing specifically with such liquidation, provided that the amounts distributed should 'be treated as payments in exchange for stock,' and that any gain realized thereby should be taxed to the stockholders 'as other gains or profits.' This brings the two sections into entire harmony, and gives to each its natural meaning and due effect. * * *" (*Hellmich vs. Hellman*, *supra*, italics supplied.)

4. The fourth assignment of error.— Under this assignment it is contended by the non-resident individual stockholder appellants that they were not subject to the normal tax as regards the distributions received by them and involved in the instant case. They "reported these distributions as dividends from profits on which Philippine income tax had been paid * * *." (Appellants' brief, p. 21). They assert that the distributions were subject only to the additional tax; whereas the Collector contends that they were subject to both the normal and the additional tax. After what has been said above, it hardly needs stating that the manner and form of reporting these

distributions employed by said appellants could not, under the law, change their real nature as payments for surrendered stock, or so-called liquidating dividends, provided for in section 25(a) of the then Income Tax Law. Such distributions under that law were subject to both the normal and the additional tax therein provided for.

"* * * loosely speaking, the distribution to the stockholders of a corporation's assets, upon liquidation, might be termed a dividend; but this is not what is generally meant and understood by that word. As generally understood and used, a dividend is a return upon the stock of its stockholders, paid to them by a going corporation without reducing their stockholdings, leaving them in a position to enjoy future returns upon the same stock * * *. In other words, it is earnings paid to him by the corporation upon his invested capital therein, without wiping out his capital. On the other hand, when a solvent corporation dissolves and liquidates, it distributes to its stockholders, not only any earnings it may have on hand, but it also pays to them their invested capital, namely, the amount which they had paid in for their stock, thus wiping out their interest in the company * * *." (Langstaff vs. Lucas, 9 Fed. [2d] 691, 694).

5. The fifth assignment of error.— This assignment is made in behalf of those appellants who were non-resident alien individuals, and for them it is in effect said that if the distributions received by them were to be considered as a sale of their stock to the Hongkong Company, the profit realized by them does not constitute income from Philippine sources and is not subject to Philippine taxes, "since all steps in the carrying out of this so-called sale took place outside the Philippines." (Appellants' brief, p. 26). We do not think this contention is tenable under the facts and circumstances of record. The Hongkong Company was at the time of the sale of its business to the Manila Company as of June 1, 1937, doing business in the Philippines, and the Manila Company was a domestic corporation domiciled and doing business also in the Philippines. Schedule A of the Stipulation of Facts (Record on Appeal, p. 13) declares, among other things, that the Hongkong Company was incorporated for the purpose of carrying on in the Philippine Islands the business of wine, beer, and spirit merchants and the other objects set out in its memorandum of association. Hence, its earnings, profits, and assets, including those from whose proceeds the distributions in question were made, the major part of which consisted in the purchase price of the business, had been earned and acquired in the Philippines. From aught that appears in the record it is clear that said distributions were income "from Philippine sources."

6. The sixth assignment of error.— Section 199 of Regulations No. 81, deleting immaterial parts, reads:

"SEC. 199. Distributions in liquidation.— In all cases where a corporation * * * distributes all of its property or assets in complete liquidation or dissolution, the gain realized from the transaction by the stockholder * * * is taxable as a dividend to the extent that it is paid out of earnings or profits of the corporation * * *. If the amount received by the stockholder in liquidation is less than the cost or other basis of the stock, a deductible loss is sustained."

This regulation would seem to support the contention that the distributions in question, at least those proceeding from sources other than the earnings or profits of the dissolved corporation, were not taxable. Placing the above-quoted section of Regulations No. 81 side by side with Section 25 (a) of the amended Income Tax Law then in force, we notice that while the regulation limits the taxability of the gain realized by the stockholder "to the extent that it is paid out of earnings or profits of the corporation," section 25 (a) of the law, far from so limiting its taxability, provides that the gain thus realized is a "taxable income"—under the law so long as a gain is realized, it will be a taxable income whether the distribution comes from, the earnings or profits of the corporation or from the sale of all of its assets in general, so long as the distribution is made "in complete liquidation or dissolution". The regulation makes the gain taxable as a dividend, while the law makes it a taxable income. An inevitable conflict between the two provisions seems to exist, and in such a case, of course, the law prevails.

"Treasury Department cannot impose or exempt from income taxes, and regulations purporting to exempt from taxation income specifically taxed would be void.

"* * * * *

"Any erroneous interpretation of revenue act by regulation of Treasury Apartment would not estop government from asserting tax on an income, though taxpayer had been misled by such interpretation, and by it induced to expose property to taxation." (Langstaff vs. Lucas, 9 Fed. [2d] 691).

7 and 8. The seventh, and eighth assignments of error. — In view of what has been said above, these two assignments need no separate treatment.

For the foregoing considerations, the judgment appealed from will be affirmed with the costs of both instances against the appellants. Sp Ordered.

Moran, C. J. , Parás, Feria, Pablo, Perfecto, Bengzon, Briones, Hontiveros, Padilla, and Tuazon, JJ., concur.

RESOLUTION ON MOTION FOR RECONSIDERATION'

July 28, 1947

HILDO, J.:

Plaintiffs and appellants have filed a motion for reconsideration dated July 10, 1947. After carefully considering said motion, which make particular reference to appellants' fifth assignment of error, the Court does not consider the arguments therein adduced tenable. Stripped to their bare essentials, the movants' contentions are summarized in the following propositions found on pages 3-4 of their motion, to wit:

Since appellants J.F. MacGregor, N. C. MacGregor, C.J. Lafrentz, E. M. G. Strickland, and Mrs. M. J. G. Mullins were all non-resident aliens and since the court has held that the transaction in this case amounted to a sale or exchange of their shares in a foreign corporation, which sale or exchange took place entirely outside of the Philippines Islands, it follows that they have not derived income from Philippine sources and are not subject to the taxes which have been collected from them by defendant.

"* * * * *

"* * * On the other hand if the income results from the sale or exchange of the shares in question then the non-resident alien stockholders who converted their shares abroad have received no income from Philippine sources and are not subject to any tax whatsoever on their profits from the transaction."

Leaving aside the other portions of the above-quoted proposition as sufficiently covered in the Court's decision, let us direct attention to those parts thereof wherein it is pretended that the transaction took place "entirely outside the Philippine Island" or "abroad."

In the minutes, Schedule B of the stipulation of facts (Rec. on Appeal, pp. 16-17), it appears that on July 22, 1937, an extraordinary meeting of shareholders of the Manila Wine Merchants, Ltd. was held and in said meeting, among other things, it was resolved that the Directors of said company "be authorized and instructed to declare and pay in the form of dividend to the shareholders the amount of any surplus existing after the above-referred to sale has been consummated. This surplus, after providing for return of capital and necessary expenses, as shown in the Balance Sheet prepared as of June 1, 1937, after giving effect to the sale transaction above-referred to, amounts to approximately P270,000." While Schedule B does not state the place where the meeting was held, Schedule B-1 of the same stipulation of facts (Record on Appeal, pp. 17-18) furnishes us the information that it was held in Manila. Schedule B-1 in this connection says:

"Sale of Company: In accordance with resolution passed at an Extraordinary Meeting of Shareholders held in

Manila (underscoring supplied) on July 22, 1937, at 3 o'clock, the Directors of the Manila Wine Merchants Ltd., were authorized to sell the Company as a going concern in accordance with sale agreement presented at the Meeting."

Later in the same Schedule B-1 we find that the declaration of dividends authorized in the previous meeting, as stated in the minutes Schedule B, was made by the Board of Directors of the same Manila Wine Merchants, Ltd., of whose meeting on that same date, July 22, 1937, Schedule B-1 constitutes the minutes. The pertinent parts of the minutes of said meeting read as follows:

"Dividend: The second matter before the Meeting was the question of declaring a dividend to enable a distribution in cash to be made, the dividend to be the entire amount standing at surplus after providing for return of capital and various expenses in accordance with reconstructed balance sheet as at June 1, 1937 presented by our auditors.

"* * * * *

"Resolved that as after the Manila Wine Merchants Ltd. has been sold for the stipulated sum of P400,000 and money received, there will be after providing for return of capital, payment of income tax and other charges, a sum of approximately P270,000 standing at surplus account, a dividend is now hereby declared in amount covering the entire balance remaining at surplus account after the concern has been wound up, and we hereby authorize the distribution of P265,000 as and when funds are available, any balance remaining to be distributed when final Liquidator's account has been rendered and paid."

Again, while the minutes Schedule B-1 do not reveal the place where that board meeting was held, the fact stated therein that it was held on July 22, 1937, the self-same date of the holding of the extraordinary meeting of shareholders referred to in the minutes Schedule B, at 3 o'clock (presumably p. m.), "as recorded in Schedule B-1, clearly shows that the said board meeting was held also in Manila, and not in Hongkong or elsewhere abroad, for J. F. MacGregor and E. Heybrook, both of whom appear in both Schedules B and B-1 to have participated in both meetings, could not, so far as the record discloses, very well be in Manila and Hongkong or elsewhere abroad on that same date. There is no showing, nor is it even pretended, that these two gentlemen after the meeting held in Manila on July 22, 1937, at 3 o'clock, took an airplane or other mode of conveyance, as fast or faster, and hurried to Hongkong or elsewhere abroad and attended the other meeting that very same day. Indeed, that both meetings must have been held in Manila would seem to be the only natural and logical supposition from the fact that the Manila Wine Merchants, Ltd., was admittedly conducting its business in said city and the Philippines in general (Schedule A, Rec. on Appeal, p. 13). It seems clear, therefore, that the dividends in question were declared in the Philippine Islands.

What was the legal effect of that declaration? Paragraph V of the stipulation of facts (Rec. on Appeal, pp. 20-21) states that, pursuant to these Resolutions, "the Hongkong Company (the same Manila Wine Merchants, Ltd.) distributed this surplus to its stockholders, plaintiffs receiving (underscoring supplied) the following sums on the following dates" (then follow plaintiffs' names with the respective amounts in Philippine pesos received by them on the dates stated). It is not stated that they received their dividends in Hongkong or other foreign money. And in their own brief (p. 25) they say that the payments or distributions thus received by them, as a result of the liquidation and sale of said company, "were included as gross income in their Philippine income tax returns". This fact further tends to show that those payments or distributions were received in the Philippine Islands, either by plaintiffs personally or through their proxies or agents. Besides, in paragraph V of the stipulation of facts (Rec. on Appeal, p. 21) it appears that the dividends or distributions pertaining to these individual plaintiffs as well as that pertaining to their co-plaintiff Wise and Co., Inc., were paid on the same dates, namely, August 24, 1937, and October 28, 1937; and it being undisputed that Wise and Co., Inc. was domiciled and had its principal office in

Manila (complaint, par. I, Rec. on Appeal, p. 2), in. which city it was presumably paid, it would seem obvious that the concomitant payments thus made to the other plaintiffs were likewise effected in the same place, whether the individual plaintiffs acted personally or through proxies or agents. It should also be remembered that while the "registered office" of the Manila Wine Merchants, Ltd. was situated in the colony of Hongkong (Schedule A, Rec. on Appeal, p. 13), the fact is that the only business for which it was incorporated was the wine, beer, and spirit business, which had been and was being conducted exclusively within the Philippine Islands, and from the record we deduce that it had also an office in Manila where, so far as the record discloses, the payments were made. Finally, the fact that payment was made in Philippine pesos would strongly corroborate the conclusion that it was made in this country—if it had been made in Hongkong or elsewhere abroad, the reasonable assumption is that it would have been made in Hongkong dollars or in the currency of such other place abroad.

"* * * However, where a corporation has not only declared a dividend but has specifically appropriated and set apart from its other assets a fund out of which the dividend is to be paid, such action constitutes the assets to set apart a trust fund in the hands of the corporation for the payment of the stockholders to the exclusion of other creditors. * * *" (18 C. J. S., p. 1115; *italics supplied.*)

"As between, successive owners of shares of stock in a corporation, the general rule is that dividends belong to the persons who are the owners of the stock at the time they are declared, without regard to the time during which the dividends were earned, and this is true although the dividends are made payable at a future date." (18 C. J. S., 119, sec. 470 [a]; *italics supplied.*)

"There is no controversy about the legal proposition that- dividends declared belong to the owner of the stock at the time the dividend is declared." (*Livingstone County Bank vs. First State Bank*, 136 Ky., 546, 554, cited in footnote 36, p. 818, 14 C. J.; *italics supplied.*)

"The moment the dividend is declared, it becomes then separate and distinct from the stock and the dividend falls to him who is proprietor of the stock of which it was theretofore incident.

"The doctrine is that a dividend is considered parcel of the mass of corporate property until declared and therefore incident to and parcel of the stock up to the time it is declared; and before its declaration, will pass with the sale or devise of the stock. Whosoever owns the stock prior to the declaration of a dividend, owns the dividend also." (*McLaren vs. Crescent Planning Mill Co.*, 117 Mo. A., 40, 47, cited in note 36, p. 818, 14 C. J.; *italics supplied.*)

In *De Koven vs. Alsop* (205 111., 309; 63 L. R. A., 587), the court said:

"A dividend is denned as 'a corporate profit set aside, declared, and ordered by the directors to be paid to the stockholders on demand or at a fixed time. Until the dividend is declared, these corporate profits belong to the corporation, not to the stockholders, and are liable for corporate indebtedness.'" (*Italics supplied.*)

We are fully satisfied from the facts and data furnished here by the parties themselves that the dividends in question were paid to plaintiffs, personally or thru their proxies or agents, in the Philippines. But aside from this, from the moment they were declared and a definite fund specified for their payment (all surplus remaining "after providing for return of capital and various expenses") — and all of this was done in the Philippines—to all legal intents and purposes they earned those dividends in this country. From the record we deduce that the funds and assets of the Manila Wine Merchants, Ltd., from which those dividends proceeded, were in the Philippines where its business was located. So far as the record discloses, its liquidation was effected in terms of Philippine pesos, indicating that it was made here. And this in turn would lead to the deduction that the funds and assets liquidated were here.

Motion denied. So ordered.

Moran, C. J., Paras, Feria, Pablo, Perfecto, Bengzon, Briones, Hontiveros, Padilla, and Tuason, JJ., concur.

Motion denied.

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