

**W. C. OGAN AND BOHOL LAND TRANSPORTATION CO., PLAINTIFFS
AND APPELLANTS, VS. BIBIANO L. MEER, COLLECTOR OF INTERNAL
REVENUE, DEFENDANT AND APPELLEE.***G.R. No. 49102. May 30, 1949*

Ponente: PERFECTO, J.

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On May 5, 1936, W. C. Ogan and the Bohol Land Transportation Company owned, respectively, 100 and 200 shares of stock of the Central Motor Supply Company, Inc., which had a capital stock of P300,000 divided into 3,000 shares with par value of P100 each, and had no other assets except the shares of stock it acquired from the Motor Service Company, Inc., another corporation capitalized at P300,000 divided into 3,000 shares at P100 each.

On December 31, 1935, the Central Motor Supply Co., Inc., owned 1,763 shares of stock of the Motor Service Co., Inc., valued at P304,600, and in February, 1936, purchased 232 shares for P58,000. On May 5, 1936, the Motor Service Co., Inc., declared a stock dividend of 50 per cent in favor of its stockholders, of which 1,000 shares were issued to the Central Motor Supply Co., Inc., so that on said date this corporation owned 2,995 shares of stock of the other. The five directors of the Central Motor Supply Co., Inc., owned one share each of the five remaining shares of the Motor Service Co., Inc., of which they were at the same time directors.

On May 5, 1936, it was resolved at the stockholders' meeting of the Central Motor Supply Co., Inc., that the 2,995 shares of stock which it acquired from the Motor Service Co., Inc., should be transferred to the stockholders of the Central Motor Supply Co., Inc., in exchange for an equivalent number of shares of the stock of this corporation, while the remaining five shares of the Central Motor Company, Inc., would be retained and held by its directors.

Pursuant to this resolution, the 2,995 shares of stock of the Central Motor Supply Co., Inc., were withdrawn from its stockholders, were converted into treasury stock and were correspondingly replaced share for share with the stock of the Motor Service Co., Inc., and the stockholders of the Central Motor Supply Co., Inc., were then registered as the stockholders of the Motor Service Co., Inc., for an equal number of shares which they previously owned in the Central Motor Supply Co., Inc. As a result of the transaction, W. C. Ogan and the Bohol Land Transportation Company acquired, respectively, 100 and 200 shares of stock of the Motor Service Company.

The par value of each share of the Central Motor Supply Co., Inc., was P100 while the market value of each share of the Motor Service Co., Inc., on May 5, 1936, was P166.66. The stockholders of the Central Motor Co., Inc., invested the sum of P100 for each share of this corporation and, as the market value of each share of the Motor Supply Co., Inc., on May 5, 1936 was P166.66, the difference of P66.66 in the value of each share in the two corporations was reckoned by defendant as the profit realized per share out of the transaction and collected upon it the corresponding income tax, now the subject of this litigation.

The above recital of facts is based on the findings made by the trial court in its decision rendered on July 31, 1941. Plaintiffs-appellants made the following assignments of error:

"I

"The lower Court erred in not holding that appellants did not realize any income by virtue of the transaction of May 5, 1936.

"II

"The lower Court erred in not holding that the transaction of May 5, 1936, was not an "Exchange of one piece of property for another" within the meaning of section 2(c), paragraph (3), of Act No. 2S33, as amended.

"III

"The lower Court erred in not holding that the transaction of May 5, 1936, was merely a simplification of intercorporate relations between a parent corporation and a subsidiary company which could not entail the realization of either loss or gain to the stockholders."

Interpretation and application of the provisions of section 2 (c), paragraph 3 of Act No. 2833 as amended by Act No. 2926, referring to taxable income in relation with section 2 (a) of said Act, are involved in this litigation. Said pertinent provisions of law read as follows:

"SEC. 2 (c) The gain or loss sustained from the sale or other disposition of property, real or personal or mixed, shall be determined in accordance with the following schedule:

"(3) In the case of the exchange of one piece of property for another, the property received in exchange shall be considered as equivalent of money in a sum equal to its fair market value on the date of which the exchange was made."

"SEC. 2 (a). Subject only to such exemptions and deductions as are hereinafter allowed, the taxable net income of a person shall include gains, profits, and income derived from salaries and wages or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, business, trade commerce, sales or dealings in property, whether real or personal growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profits, or gains, profits and income derived from any source whatever."

The controversy centers on whether plaintiffs realized taxable income as stockholders of the Central Motor Supply Co., upon their acquisition of the shares of stock of the Motor Service Co., Inc., through exchange share for share with the stock of the Central Motor Supply Co., Inc., on March 5, 1936. Defendants' contention is to the effect that as the stockholders of the Central Motor Supply Co., Inc., acquired their shares at a cost of TWO per share, the difference between the market value of P166.66 per share of the Motor Service Co., Inc., and the cost per share of the Central Motor Supply Co., Inc., is taxable income for which the plaintiffs-appellants should pay the sum of P599.94 and P799.92, respectively, in accordance with section 2 (e), paragraph 3 of Act No. 2833 as amended by Act No. 2926.

Appellants contend in their brief that they did not realize any income by virtue of the transaction of May 5, 1946, alleging that on that day, the value of their holdings in the Central Motor Supply Co., Inc., the alleged parent corporation, was P166.66 a share. They argue that on May 5, 1936, the Motor Service Co., Inc., the subsidiary company, was worth P499,980 net. Inasmuch as this company had 3,000 shares outstanding, it was, therefore, worth the quantity of P499,980 divided by 3,000, or P166.66 each share. The parent corporation possessed on May 5, 1946, no assets other than the 3,000 shares of stock of the subsidiary company and, consequently, the assets of the parent corporation were also worth P499,980 net on that date. Since the parent corporation had 3,000 shares outstanding, each of these must have been worth on May 5, 1936, the amount of P499,980 divided by

3,000, or P166.66 each share, and, therefore, appellants could not have possibly realized any income from a transaction where their shares of stock in the parent corporation worth P166.66 per share were exchanged for an equal number of shares in the subsidiary company, valued likewise at P166.66 per share on the date of the exchange.

The whole structure of appellants' argument is premised on the assumption that on May 5, 1936, the value of their holdings in the Central Motor Supply Co., Inc., the parent corporation, was P166.66 a share, when, as a matter of fact, it appears that the shares of the Central Motor Supply Co., Inc., cost its stockholders only P100 a share. According to the findings made by the trial court, the Central Motor Supply Co., Inc., had a capital stock of 300,000 shares with par value of P100 each.

Vicente O. Jose, examiner of the Bureau of Internal Revenue, testified that he examined the books of the Central Motor Co., Inc., and of the Motor Service Co., Inc., in February, 1938, and he found out that on May 5, 1936, the value of each share of stock of the Motor Service Co., Inc. for the Central Motor Supply Co., Inc., was P100 each, and this testimony was fully accepted and agreed upon by appellant.

"R. Segun este report, el valor de la accion de la Motor Service Company para la Central Motor Supply Company es P100 cada accion.

"P. Sobre que hechos ha basado usted para sentar esa conclusion?

"Sr. Agrava:

Nosotros aceptamos como cierta la alegacion en la ultima contestacion del testigo y, por tanto, el companero no puede repreguntar al mismo sobre el particular.

"Juzgado:

"Hagase constar." (11)

"R. El valor de cada accion de la Motor Service Company a la Central Motor Supply Company, es P100.

"P. Diga usted, sobre que ha basado usted para sentar esa opinion?

"Sr. Agrava: "Admitimos que es cierto, por lo que pueda valer, el testimonio del testigo en relacion a la ultima pregunta.

"Juzgado: Hagase constar." (12)

On the other hand, the parties entered into the following agreement at the trial:

CONVENIO

"Las partes convienen en que el precio en el mercado de las acciones de la Motor Service Company, en 5 de Mayo de 1936, era a P166.66." (10)

There can be no question, therefore, that with the exchange of shares made on May 5, 1936, plaintiffs earned as profits the difference of P66.66 per share—the difference between the market value per share of the Motor Service Company, Inc., and the value per share of the Central Motor Supply Company, Inc., to its stockholders. The exchange falls within the purview of the above quoted provision of section 2 (e), paragraph 3, of Act No. 2833 as amended by Act No. 2926, because plaintiffs exchanged their property (shares of stock of the Central Motor Supply Company, Inc., valued at P100 per share) for another property (the shares of stock of the Motor Service Co., Inc.) which property thus received should be "considered as equivalent of money in a sum equal to its fair market value on the date of which the exchange was made," that is, at the rate of P166.66 per share.

Appellants contend that the transaction of May 5, 1936, was not an exchange of one piece of property for another, because the Motor Service Co., Inc., is owned 100 per cent by the Central Motor Supply Co., and the stockholders of the latter are the beneficial and real owners of the share of stock and of the property of both entities, and that the two concerns should be viewed as forming a single unit, the transaction of May 5, 1936 being merely a simplification of corporate relations between a parent corporation and a subsidiary company. They contend that a singleness in business propositions exists and the separate identities of the two corporations should be disregarded, and that we should look through the forms to see the realities and consider as if the subsidiary company did not exist, and that the fiction of corporate entity may be disregarded where one corporation is organized and controlled and its affairs are so conducted that it is, in fact, a mere instrumentality or adjunct of another corporation. They also alleged that the identities of both parent corporation and subsidiary company should be looked upon as if merged into one company. It is further contended that the replacement of shares of stock of the former with shares of stock of the latter did not involve a taxable exchange and that what was accomplished really in the transaction of May 5, 1936, was a formal, not a substantial, exchange of what were merely the evidences of the same property, because the shares of stock of the parent corporation represented exactly the same physical assets represented by the shares of stock of the subsidiary company and, after the exchange, a stockholder of the Central Motor Co., Inc., owned exactly the same thing that he already owned before his aliquot part of the physical assets of the Motor Service Co., Inc., became his, and, therefore, no exchange of two distinct pieces of property took place; in other words, there was an exchange of certificates but not of interest.

Appellants' arguments are all based on subtleties that cannot stand the realities involved in this case. Aside from the fact stated in the appealed decision to the effect that there is no allegation or evidence on record to show that the Motor Service Co., Inc., was and is a subsidiary of the Central Motor Supply Co., Inc.,—a fact that, for the purposes of the controversy, has no importance—there is no dispute that the two corporations are different from each other, each having distinct legal personalities, and one cannot be identified with the other, both having different rights and responsibilities under the law, and the stockholders in the Central Motor Co., Inc. (the so-called parent company), by the mere fact of being stockholders thereof, do not become stockholders of the Motor Service Co., Inc. (the so-called subsidiary company), nor enjoy the rights and privileges of the same. When the stockholders of one corporation become the stockholders of the other, as a result of a transaction of exchange, they earn positive benefits and advantages, such as the right to vote their stocks at the stockholders' meetings of the second corporation, and, in the present case, they profited by the difference of share values at the rate of P66.66 per share. There cannot be any question that there was in the transaction of May 5, 1936, an exchange of one property with another.

Plaintiffs have no cause of action for the recovery of the sums they paid under protest as income tax for the year 1936 in connection with those transfers, and the trial court did not err in dismissing the complaint. The appealed decision is affirmed with costs against appellants.

Paras, Pablo, and Bengzon, JJ., concur.

Feria, Tuason, and Reyes, JJ., concur in the result.

PARAS, J.:

I certify that the Chief Justice voted for the affirmance.

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