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[G. R. No. 17518. October 30, 1922]

FREDERICK C. FISHER, PLAINTIFF AND APPELLANT, VS. WENCESLAO TRINIDAD, COLLECTOR OF INTERNAL REVENUE, DEFENDANT AND APPELLEE.

D E C I S I O N

JOHNSON, J.:

The only question presented by this appeal is: Are the "stock dividends" in the present case "income" and taxable as such under the provisions of section 25 of Act No. 2833 ? While the appellant presents other important questions, under the view which we have taken of the facts and the law applicable to the present case, we deem it unnecessary to discuss them now.

The defendant demurred to the petition in the lower court The facts are therefore admitted. They are simple and may be stated as follows:

That during the year 1919 the Philippine American Drug Company was a corporation- duly organized and existing under the laws of the Philippine Islands, doing business in the city of Manila; that the appellant was a stoekohlder in said corporation; that said corporation, as a result of the business for that year, declared a "stock dividend;" that the proportionate share of said stock dividend of the appellant was P24,800; that the stock dividend for that amount was issued to the appellant; that thereafter, in the month of March, 1920, the appellant, upon demand of the appellee, paid, under protest, and involuntarily, unto the appellee the sum of P889.91 as income tax on said stock dividend. For the recovery of that sum (P889.91) the present action was instituted. The defendant demurred to the petition upon the ground that it did not state facts sufficient to constitute cause of action. The demurrer was sustained and the plaintiff appealed.

To sustain his appeal the appellant cites and relies on some decisions of the Supreme Court of the United States as well as the decisions of the supreme courts of some of the states of the Union, in which the question before us, based upon similar statutes, was discussed.

Among the most important decisions may be mentioned the following: *Towne vs. Eisner*, 245 U. S., 418; *Doyle vs. Mitchell Bros. Co.*, 247 U. S., 179; *Eisner vs. Macomber*, 252 U. S., 189; *DeKoven vs. Alsop*, 205 111., 309; 63 L. K. A., 587; *Kaufman vs. Charlottesville Woolen Mills*, 93 Va., 673.

In each of said cases an effort was made to collect an "income tax" upon "stock dividends" and in each case it was held that "stock dividends" were capital and not an "income" and therefore not subject to the "income tax" law.

The appellee admits the doctrine established in the case of *Eisner vs. Macomber* (252 U. S., 189), that a "stock dividend" is not "income" but argues that said Act No. 2833, in imposing the tax on the stock dividend, does not violate the provisions of the Jones Law. The appellee further argues that the statute of the United States providing for tax upon stock dividends is different from the statute of the Philippine Islands, and therefore the decision of the Supreme Court of the United States should not be followed in interpreting the statute in force here.

For the purpose of ascertaining the difference in the said statutes (United States and Philippine Islands), providing for an income tax in the United States as well as that in the Philippine Islands, the two statutes are here quoted for the purpose of determining the difference, if any, in the language of the two statutes.

Chapter 463 of an Act of Congress of September 8, 1916, in its title 1 provides for the collection of an "income tax." Section 2 of said Act attempts to define what is an income. The definition follows:

"That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, * * * which stock dividend shall be considered income, to the amount of its cash value."

Act No. 2833 of the Philippine Legislature is an Act establishing "an income tax." Section 25 of said Act attempts to define the application of the income tax. The definition follows:

"The term 'dividends' as used in this Law shall be held to mean any distribution made or ordered to be made by a corporation, * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, * * *. Stock dividend shall be considered income, to the amount of the earnings or profits distributed."

It will be noted from a reading of the provisions of the two laws above quoted that the

writer of the law of the Philippine Islands must have had before him the statute of the United States. No important argument can be based upon the slight difference in the wording of the two sections.

It is further argued by the appellee that there are no constitutional limitations upon the power of the Philippine Legislature such as exist in the United States, and, in support of that contention, he cites a number of decisions. There is no question that the Philippine Legislature may provide for the payment of an income tax, but it cannot, under the guise of an income tax, collect a tax on property which is not an "income." The Philippine Legislature cannot impose a tax upon "property" under a law which provides for a tax upon "income" only. The Philippine Legislature has no power to provide a tax upon "automobiles" only, and under that law collect a tax upon a *carreton* or bull cart. Constitutional limitations upon the power of the Legislature are no stronger than statutory limitations, that is to say, a statute expressly adopted for one purpose cannot, without amendment, be applied to another purpose which is entirely distinct and different. A statute providing for an income tax cannot be construed to cover property which is not, in fact, income. The Legislature cannot, by a statutory declaration, change the real nature of a tax which it imposes. A law which imposes an importation tax on rice only cannot be construed to impose an importation tax on corn.

It is true that the statute in question provides for an income tax and contains a further provision that "stock dividends" shall be considered income and are therefore subject to income tax provided for in said law. If "stock dividends" are not "income" then the law permits a tax upon something not within the purpose and intent of the law.

It becomes necessary in this connection to ascertain what is an "income" in order that we may be able to determine whether "stock dividends" are "income" in the sense that that word is used in the statute. Perhaps it would be more logical to determine first what are "stock dividends" in order that we may more clearly understand their relation to "income." Generally speaking, stock dividends represent undistributed increase in the capital of corporations or firms, joint stock companies, etc., etc., for a particular period. They are used to show the increased interest or proportional share in the capital of each stockholder. In other words, the inventory of the property of the corporation, etc., for a particular period shows an increase in its capital, so that the stock theretofore issued does not show the real value of the stockholder's interest, and additional stock is issued showing the increase in the actual *capital*, or property, or assets of the corporation, etc.

To illustrate: A and B form a corporation with an authorized capital of P10,000 for the

purpose of opening and conducting a drug store, with assets of the value of P2,000, and each contributes P1,000. Their entire assets are invested in drugs and put upon the shelves in their place of business. They commence business without a cent in the treasury. Every dollar contributed is invested. Shares of stock to the amount of P1,000 are issued to each of the incorporators, which represent the actual investment and entire assets of the corporation. Business for the first year is good. Merchandise is sold, and purchased, to meet the demands of the growing trade. At the end of the first year an inventory of the assets of the corporation is made, and it is then ascertained that the assets or capital of the corporation on hand amount to P4,000, with no debts, and still not a cent in the treasury. All of the receipts during the year have been reinvested in the business. Neither of the stockholders have withdrawn a penny from the business during the year. Every peso received for the sale of merchandise was immediately used in the purchase of new stock—new supplies. At the close of the year there is not a centavo in the treasury, with which either A or B could buy a cup of coffee or a pair of shoes for his family. At the beginning of the year the assets were P2,000 and at the end of the year they were P4,000, and neither of the stockholders have received a centavo from the business during the year. At the close of the year, when it is discovered that the assets are P4,000 and not P2,000, instead of selling the extra merchandise on hand and thereby reducing the business to its original capital, they agree among themselves to increase the capital issued and for that purpose issue additional stock in the form of “stock dividends” or additional stock of P1,000, each, which represents the actual increase of the shares or interest in the business. At the beginning of the year each stockholder held one-half interest in the capital. At the close of the year, and after the issue of the said stock dividends, they each still have one-half interest in the business. The capital of the corporation increased during the year, but has either of them received an income? *It is not denied, for the purpose of ordinary taxation, that the taxable property of the corporation at the beginning of the year was P2,000, that at the close of the year it was P4,000, and that the tax rolls should be changed in accordance with the changed conditions in the business. In other words, the ordinary tax should be increased by P2,000.*

Another illustration: C and D organized a corporation for agricultural purposes with an authorized capital stock of P20,000 each contributing P5,000. With that capital they purchased a farm and, with it, one hundred head of cattle. Every peso contributed is invested. There is no money in the treasury. Much time and labor was expended during the year by the stockholders on the farm in the way of improvements. Neither received a centavo during the year from the farm or the cattle. At the beginning of the year the assets

of the corporation, including the farm and the cattle, were P10,000, and at the close of the year an inventory of the property of the corporation is made, and it is then found that they have the same farm with its improvements and two hundred head of cattle by natural increase. At the end of the year it is also discovered that, by reason of business changes, the farm and the cattle both have increased in value, and that the value of the corporate property is now P20,000 instead of P10,000 as it was at the beginning of the year. The incorporators instead of reducing the property to its original capital, by selling off a part of it, issue to themselves "stock dividends" to represent the proportional value or interest of each of the stockholders in the increased capital at the close of the year. There is still not a centavo in the treasury and neither has withdrawn a peso from the business during the year. No part of the farm or cattle has been sold and not a single peso was received out of the rents or profits of the capital of the corporation by the stockholders.

Another illustration: A, an individual farmer, buys a farm with one hundred head of cattle for the sum of P10,000. At the end of the first year, by reason of business conditions and the increase of the value of both real estate and personal property, it is discovered that the value of the farm and the cattle is P20,000. A, during the year, has received nothing from the farm or the cattle. His books at the beginning of the year show that he had property of the value of P10,000. His books at the close of the year show that he has property of the value of P20,000. A is not a corporation. The assets of his business are not shown therefore by certificates of stock. His books, however, show that the value of his property has increased during the year by P10,000. Can the P10,000, under any theory of business or law, be regarded as an "income" upon which the farmer can be required to pay an income tax? Is there any difference in law in the condition of A in this illustration and the condition of A and B in the immediately preceding illustration? Can the increase of the value of the property in either case be regarded as an "income" and be subjected to the payment of the income tax under the law?

Each of the foregoing illustrations, it is asserted, is analogous to the case before us and, in view of that fact, let us ascertain how lexicographers and the courts have denned an "income." The New Standard Dictionary, edition of 1915, defines an income as "*the amount of money coming to a person or corporation within a specified time whether as payment for services, interest, or profit from investment.*" Webster's International Dictionary defines an income as "the receipts, salary; especially, the annual receipts of a private person or a corporation from property." Bouvier, in his law dictionary, says that an "income" in the federal constitution and income tax act, is used in its common or ordinary meaning and not in its technical or economic sense. (146 Northwestern Reporter, 812.) Mr. Black, in his law

dictionary, says: "An income is the return *in money* from one's business, labor, or capital invested ; gains, profit, or private revenue." "An income tax is a tax on the yearly profits arising from property, professions, trades, and offices."

The Supreme Court of the United States, in the case of Gray vs. Darlington (82 U. S., 63), said in speaking of income that mere advance in value in no sense constitutes the "income" specified in the revenue law as "income" of the owner for the year in which the sale of the property was made. Such advance constitutes and can be treated merely as an increase of capital. (*In re Graham's Estate*, 198 Pa., 216; *Appeal of Braun*, 105 Pa., 414.)

Mr. Justice Hughes, later Associate Justice of the Supreme Court of the United States and now Secretary of State of the United States, in his argument before the Supreme Court of the United States in the case of Towne vs. Eisner, *supra*, denned an "income" in an income tax law, unless it is otherwise specified, to mean cash or its equivalent. It does not mean choses in action or unrealized increments in the value of the property, and cites in support of that definition, the definition given by the Supreme Court in the case of Gray vs. Darlington, *supra*.

In the case of Towne vs. Eisner, *supra*, Mr. Justice Holmes, speaking for the court, said: "Notwithstanding the thoughtful discussion that the case received below, we cannot doubt that the dividend was capital as well for the purposes of the Income Tax Law.* * * 'A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished and their interests are not increased. * * * The proportional interest of each shareholder remains the same. * * *' In short, the corporation is no poorer and the stockholder is no richer than they were before." (*Gibbons vs. Mahon*, 136 U. S., 549, 559, 560; *Logan County vs. U. S.*, 169 U. S., 255, 261.)

In the case of Doyle vs. Mitchell Bros. Co. (247 U. S., 179), Mr. Justice Pitney, speaking for the court, said that the act employs the term "income" in its natural and obvious sense, as importing something distinct from principal or capital and conveying the idea of gain or increase arising from corporate activity.

Mr. Justice Pitney, in the case of Eisner vs. Macomber (252 U. S., 189), again speaking for the court, said: "An income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a *sale* or conversion of capital assets."

For bookkeeping purposes, when stock dividends are declared, the corporation or company

acknowledges a liability, in form, to the stockholders, equivalent to the aggregate par value of their stock, evidenced by a "capital stock account." If profits have been made by the corporation during a particular period and not divided, they create additional bookkeeping liabilities under the head of "profit and loss," "undivided profits," "surplus account," etc., or the like. None of these, however, gives to the stockholders as a body, much less to any one of them, either a claim against the going concern or corporation, for any particular sum of money, or a right to any particular portion of the asset, or any share unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for that purpose. The dividend normally is payable in money and when so paid, then only does the stockholder realize a profit or gain, which becomes his separate property, and thus derive an income from the capital that he has invested. Until that is done the *increased assets belong to the corporation* and not to the individual stockholders.

When a corporation or company issues "stock dividends" it shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution, in money or in kind, should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone said realization, in that the fund represented by the new stock has been transferred from surplus to assets, and no longer is available for actual distribution. The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations resulting from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, the stockholder by virtue of the stock dividend has in fact received nothing that answers the definition of an "income." (Eisner vs. Macomber, 252 U. S., 189, 209, 211.)

The stockholder who receives a stock dividend has received nothing but a representation of his increased interest in the capital of the corporation. There has been no separation or segregation of his interest. All the property or capital of the corporation still belongs to the corporation. There has been no separation of the interest of the stockholder from the general capital of the corporation. The stockholder, by virtue of the stock dividend, has no separate or individual control over the interest represented thereby, further than he had before the stock dividend was issued. He cannot use it for the reason that it is still the property of the corporation and not the property of the individual holder of the stock

dividend. A certificate of stock represented by the stock dividend is simply a statement of his proportional interest or participation in the capital of the corporation. For bookkeeping purposes, a corporation, by issuing stock dividend, acknowledges a liability in form to the stockholders, evidenced by a capital stock account. The receipt of a stock dividend in no way increases the money received by the stockholder nor his cash account at the close of the year. It simply shows that there has been an increase in the amount of the capital of the corporation during the particular period, which may be due to an increased business or to a natural increase of the value of the capital due to business, economic, or other reasons. We believe that the Legislature, when it provided for an "income tax," intended to tax only the "income" of corporations, firms, or individuals, as that term is generally used in its common acceptance; that is, that the income means money received, coming to a person or corporation for services, interest, or profit from investments. We do not believe that the Legislature intended that a mere increase in the value of the capital or assets of a corporation, firm, or individual, should be taxed as "income." Such property can be reached under the ordinary form of taxation.

Mr. Justice Pitney, in the case of *Eisner vs. Macomber*, *supra*, said in discussing the difference between "capital" and "income": "That the fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs; the latter as the outlet stream, to be measured by its flow during a period of time." It may be argued that a stockholder might sell the stock dividend which he had acquired. If he does, then he has received, in fact, an income and such income, like any other profit which he realizes from the business, is an income and he may be taxed thereon.

There is a clear distinction between an extraordinary cash dividend, no matter when earned, and stock dividends declared, as in the present case. The one is a disbursement to the stockholder of accumulated earnings, and the corporation at once parts irrevocably with all interest thereon. The other involves no disbursement by the corporation. It parts with nothing to the stockholder. The latter receives, not an actual dividend, but certificate of stock which simply evidences his interest in the entire capital, including such as by investment of accumulated profits has been added to the original capital. They are not income to him, but represent additions¹ to the source of his income, namely, his invested capital. (*De- Koven vs. Alsop*, 205 111., 309; 63 L. R. A., 587.) Such a person is in the same position, so far as his income is concerned, as the owner of a young domestic animal, one year old at the beginning of the year, which is worth P50 and, which, at the end of the year, and by reason of its growth, is worth P100. The value of his property has increased, but has

he had an income during the year ? It is true that he had taxable property at the beginning of the year of the value of P50, and the same taxable property at another period, of the value of P100, but he has had no income in the common acceptance of that word. The increase in the value of the property should be taken account of on the tax duplicate for the purposes of ordinary taxation, but not as income for he has had none.

The question whether stock dividends are income, or capital, or assets has frequently come before the courts in another form-in cases of inheritance. A is a stockholder in a large corporation. He dies leaving a will, by the terms of which he gives to B during his lifetime the "income" from said stock, with a further provision that C shall, at B's death, become the owner of his share in the corporation. During B's life the corporation issues a stock dividend. Does the stock dividend belong to B as an income, or does it finally belong to C as a part of his share in the capital or assets of the corporation, which had been left to him as a remainder by A? While there has been some difference of opinion on that question, we believe that a great weight of authorities hold that the stock dividend is capital or assets belonging to C and not an income belonging to B. In the case of *D'Ooge vs. Leeds* (176 Mass., 558, 560) it was held that stock dividends in such cases were regarded as *capital* and not as *income*. (*Gibbons vs. Mahon*, 136 U. S., 549.)

In the case of *Gibbons vs. Mahon*, *supra*, Mr. Justice Gray said: "The distinction between the title of a corporation, and the interest of its members or stockholders in the property of the corporation, is familiar and well settled. The ownership of that property is in the corporation, and not in the holders of shares of its stock. The interest of each stockholder consists in the right to a proportionate part of the profits whenever dividends are declared by the corporation, during its existence, under its charter, and to a like proportion of the property remaining, upon the termination or dissolution of the corporation, after payment of its debts." (*Minot vs. Paine*, 99 Mass., 101; *Greeff vs. Equitable Life Assurance Society*, 160 N. Y., 19.)

In the case of *DeKoven vs. Alsop* (205 111., 309; 63 L. R. A., 587) Mr. Justice Wilkin said: "A dividend is defined 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.'"

There is a clear distinction between an extraordinary cash dividend, no matter when earned,

and stock dividends declared. The one is a disbursement to the stockholders of accumulated earning, and the corporation at once parts irrevocably with all interest therein. The other involves no disbursement by the corporation. It parts with nothing to the stockholders. The latter receives, not an actual dividend, but certificates of stock which evidence in a new proportion his interest in the entire capital. When a cash dividend is declared and paid to the stockholders, such cash becomes the absolute property of the stockholders and cannot be reached by the creditors of the corporation in the absence of fraud. A stock dividend, however, still being the property of the corporation, and not of the stockholder, it may be reached by an execution against the corporation, and sold as a part of the property of the corporation. In such a case, if all of the property of the corporation is sold, then the stockholder certainly could not be charged with having received an income by virtue of the issuance of the stock dividend. Until the dividend is declared and paid, the corporate profits still belong to the corporation, not to the stockholders, and are liable for corporate indebtedness. The rule is well established that cash dividends, whether large or small, are regarded as "income" and all stock dividends, as capital or assets. (Cook on Corporations, Chapter 32, sees. 534, 536; Davis vs. Jackson, 152 Mass., 58; Mills vs. Britton, 64 Conn., 4; 5 Am. and Eng. Encycl. of Law, 2d ed., p. 738.)

If the ownership of the property represented by a stock dividend is still in the corporation and not in the holder of such stock, then it is difficult to understand how it can be regarded as income to the stockholder and not as a part of the capital or assets of the corporation. (Gibbons vs. Mahon, supra.) The stockholder has received nothing but a representation of an interest in the property of the corporation and, as a matter of fact, he may never receive anything, depending upon the final outcome of the business of the corporation. The entire assets of the corporation may be consumed by mismanagement, or eaten up by debts and obligations, in which case the holder of the stock dividend will never have received an income from his investment in the corporation. A corporation may be solvent and prosperous today and issue stock dividends in representation of its increased assets, and tomorrow be absolutely insolvent by reason of changes in business conditions, and in such a case the stockholder would have received nothing from his investment. In such a case, if the holder of the stock dividend is required to pay an income tax on the same, the result would be that he has paid a tax upon an income which he never received. Such a conclusion is absolutely contradictory to the idea of an income. An income subject to taxation under the law must be an actual income and not a promised or prospective income.

The appellee argues that there is nothing in section 25 of Act No. 2833 which contravenes the provisions of the Jones Law. That may be admitted. He further argues that the Act of

Congress (XL S. Revenue Act of 1918) expressly authorized the Philippine Legislature to provide for an income tax. That fact may also be admitted. But a careful reading of that Act will show that, while it permitted a tax upon income, the same provided that income shall include gains, profits, and income derived from salaries, wages, or compensation for personal services, as well as from interest, rent, dividends, securities, etc. The appellee emphasizes the "income from dividends." Of course, income received as dividends is taxable as an income, but an income from "dividends" is a very different thing from a receipt of a "stock dividend." One is an actual receipt of profits; the other is a receipt of a representation of the increased value of the assets of a corporation.

In all of the foregoing arguments we have not overlooked the decisions of a few of the courts in different parts of the world, which have reached a different conclusion from the one which we have arrived at in the present case. Inasmuch, however, as appeals may be taken from this court to the Supreme Court of the United States, we feel bound to follow the same doctrine announced by that court.

Having reached the conclusion, supported by the great weight of authority, that "stock dividends" are not "income," the same cannot be taxed under that provision of Act No. 2833 which provides for a tax upon income. Under the guise of an income tax, property which is not an income cannot be taxed. When the assets of a corporation have increased so as to justify the issuance of a stock dividend, the increase of the assets should be taken account of by the Government in the ordinary tax duplicates for the purposes of assessment and collection of an additional tax. For all of the foregoing reasons, we are of the opinion, and so decide, that the judgment of the lower court should be revoked, and without any finding as to costs, it is so ordered.

Araullo, C. J., Avanceña, Villamor, and Romualdez, JJ., concur.

CONCURRING

STREET, J.,

I agree that the trial court erred in sustaining the demurrer, and the judgment must be reversed. Instead of demurring the defendant should have answered and alleged, if such be the case, that the stock dividend which was the subject of taxation represents the amount of earnings or profits distributed by means of the issuance of said stock dividend; and the case should have been tried on that question of fact.

In this connection it will be noted that section 25 (a) of Act No. 2833 of the Philippine Legislature, under which this tax was imposed, does not levy a tax generally on stock dividends to the extent of the par of the stock nor even to the extent of its value, but declares that stock dividends shall be considered as income to the amount of the earnings or profits distributed. Under this provision, before the tax can be lawfully assessed and collected, it must appear that the stock dividend represents earnings or profits distributed; and the burden of proof is on the Collector of Internal Revenue to show this.

The case of *Eisner vs. Macomber* (252 U. S., 189; 64 L. ed., 521), has been cited as authority for the proposition that it is incompetent for the Legislature to tax as income any property which by nature is really capital- as a stock dividend is there said to be. In that case the Supreme Court of the United States held that a Congressional Act taxing stock dividends as income was repugnant to that provision of the Constitution of the United States which requires that direct taxes upon property shall be apportioned for collection among the several states according to population and that the Sixteenth Amendment, in authorizing the imposition by Congress of taxes upon income, had not vested Congress with the power to levy direct taxes on property under the guise of income taxes. But the resolution embodied in that decision was evidently reached because of the necessity of harmonizing two different provisions of the Constitution of the United States, as amended. In this jurisdiction our Legislature has full authority to levy both taxes on property and income taxes; and there is no organic provision here in force similar to that which, under the Constitution of the United States, requires direct taxes on property to be levied in a particular way.

It results, under the statute here in force, there being no constitutional restriction upon the action of the law-making body, that the case before us presents merely a question of statutory construction. That the problem should be viewed in this light, in a case where there is no restriction upon the legislative body, is pointed out in *Eisner vs. Macomber*, supra, where in the course of his opinion Mr. Justice Pitney refers to the cases of *the Swan Brewery Co. vs. Rex* ([1914] A. C, 231), and *Tax Commissioner vs. Putnam* (227 Mass., 522), as being distinguished from *Eisner vs. Macomber* by the very circumstance that in those cases the law-making"body, or bodies, were under no restriction as to the method of levying

taxes. Such is the situation here.

DISSENTING

OSTRAND, J., with whom concurs **MALCOLM, J.**,

In its final analysis the opinion of the court rests principally, if not entirely, on the decision of the United States Supreme Court in the case of Eisner vs. Macomber (252 U. S., 189), a decision which, for at least two reasons, is entirely inapplicable to the present case.

In the first place, there is a radical difference between the definition of a taxable stock dividend given in the United States Income Tax Law of September 8, 1916, construed in the case of Eisner vs. Macomber, and that given in Act No. 2833 of the Philippine Legislature, the Act with which we are concerned in the present case. The former provides that "stock dividend shall be considered income, to the amount of *its cash value*;" the Philippine Act provides that "Stock dividend shall be considered income, to the amount of the *earnings or profits distributed*." The United States statute made stock dividends based upon an advance in the value of the property or investment taxable as income whether resulting from earnings or not; our statute makes stock dividends taxable only to the amount of the earnings and profits distributed, and stock dividends based on the increment in the inherent value of the property are not considered income and are not taxable. Though the difference would seem sufficiently obvious, we will endeavor to make it still clearer by borrowing one of the illustrations with which the opinion of the court is provided. The court says:

"A, an individual farmer, buys a farm with one hundred head of cattle for the sum of P10,000, At the end of the first year, by reason of business conditions and the increase of the value of both real estate and personal property, it is discovered that the value of the farm and the cattle is P20,000. A, during the year has received nothing from the farm or the cattle. His books at the beginning of the year show that he had property of the value of P10,000. His books at the close of the year show that he has property of the value of P20,000. A is not a

corporation. The assets of his business are not shown therefore by certificates of stock. His books, however, show that the value of his property has increased during the year by P10,000. Can the P10,000, under any theory of business or law, be regarded as an 'income' upon which the farmer can be required to pay an income tax? Is there any difference in law in the condition of A in this illustration and the condition of A and B in the immediately preceding illustration? Can the increase of the value of the property in either case be regarded as an 'income' and be subjected to the payment of the income tax under the law?"

I answer no. And while the increment if in the form of a stock dividend would have been regarded as income under the United States statute and taxed as such, it is *not* regarded as income and cannot be so taxed under our statute because it is *not* based on *earnings* or *profits*. That is precisely the difference between the two statutes and that is the reason the illustration is not in point in this case, though it would have been entirely appropriate in the *Eisner vs. Macomber* case. It is also one of the reasons why that case is inapplicable here and why most of the arguments in the majority opinion are beside the mark.

But let us suppose that A had sold the products of the farm during the year for P10,000 over and above his expenses, and had invested the money in buildings and improvements on the farm, thus increasing its value to P20,000. Why would not the P10,000 earned during the year and so invested in improvements still be income for the year? And why would not a tax on these earnings be an income tax under the definition given in *Black's Law Dictionary*, and quoted with approval in the decision of the court, that "An income tax is a tax on the yearly profits arising from the property, professions, trades, and offices?" There can be but one answer. There is no reason whatever why the gains derived from the sale of the products of the farm should not be regarded as income whether reinvested in improvements upon the farm or not and there is no reason why a tax levied thereon cannot be considered an income tax.

Moreover, to constitute income, profits, or earnings need not necessarily be converted into cash. *Black's Law Dictionary* says—and I am again quoting from the decision of the court—"An income is the return in money from one's business, labor, or capital invested; gains, profit, or private revenue." As will be seen in the secondary sense of the word, income need not consist in money; upon this point there is no divergence of view among the lexicographers. If a farmer stores the grain produced upon his farm without selling, it may none the less be regarded as income.

In the *Eisner vs. Macomber* case, the United States Supreme Court felt bound to give the word "income" a strict interpretation. Under article 1, paragraph 2, clause 3, and paragraph 9, clause 4 of the original Constitution of the United States, Congress could not impose direct taxes without apportioning them among the States according to population. As it was thought desirable to impose Federal taxes upon incomes' and as a levy of such taxes by apportionment among the States in proportion to population would lead to an unequal distribution of the tax with reference to the amount of taxable incomes, the Sixteenth Amendment was adopted and which provided that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The United States Supreme Court therefore says in the *Eisner vs. Macomber* case:

"A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts.

"In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income/ as the term is there used; and to apply the distinction as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

That, in the absence of the peculiar restrictions placed by the Constitution upon the taxing power of Congress, the decision of the court might have been different is clearly indicated by the following language:

"Two recent decisions, proceeding from courts of high jurisdiction, are cited in

support of the position of the Government.

“Swan Brewery Co. vs. Rex ([1914] A. C, 231), arose under the Dividend Duties Act of Western Australia, which provided that ‘dividend’ should include ‘every dividend, profit, advantage, or gain intended to be paid or credited to or distributed among any members or directors of any company,’ except, etc. There was a stock dividend, the new shares being allotted among the shareholders pro rata; and the question was whether this was a distribution of a dividend within the meaning of the act. The Judicial Committee of the Privy Council sustained the dividend duty upon the ground that, although ‘in ordinary language the new shares would not be called a dividend, nor would the allotment of them be a distribution of a dividend/ yet, within the meaning of the act, such new shares were an ‘advantage’ to the recipients. *There being no constitutional restriction upon the action of the lawmaking body, the case presented merely a question of statutory construction, and manifestly the decision is not a precedent for the guidance of this court when acting under a duty to test an act of Congress by the limitations of a written Constitution having superior force.*

“In Tax Commissioner vs. Putnam ([1917], 227 Mass., 522), it was held that the 44th Amendment to the constitution of Massachusetts, which conferred upon the legislature full power to tax incomes, ‘must be interpreted as including every item which by any reasonable understanding can fairly be regarded as income’ (pp. 526, 531); and that under it a stock dividend was taxable as income. * * * Evidently, in order to give a sufficiently broad sweep to the new taxing provision, it was deemed necessary to take the symbol for the substance, accumulation for distribution, capital accretion for its opposite; while a case where money is paid into the hand of the stockholder with an option to buy new shares with it, followed by acceptance of the option, was regarded as identical in substance with a case where the stockholder receives no money and has no option. *The Massachusetts court was not under an obligation, like the one which binds us, of applying a constitutional amendment in the light of other constitutional provisions that stand in the way of extending it by construction.*”

The Philippine Legislature has full power to levy taxes both on capital or property and on income, subject only to the provision of the Organic Act that “the rule of taxation shall be uniform.” In providing for the income tax the Legislature is therefore entirely free to employ

the term "income" in its widest sense and is in nowise limited or hampered by organic limitations such as those imposed upon Congress by the Constitution of the United States. This is the second reason why the rule laid down in *Eisner vs. Macomber* has no application here.

The majority opinion in discussing this question, says:

"There is no question that the Philippine Legislature may provide for the payment of an income tax, but it cannot, under the guise of an income tax, collect a tax on property which is not an 'income.' The Philippine Legislature cannot impose a tax upon 'property' under a law which provides for a tax upon 'income' only. The Philippine Legislature has no power to provide a tax upon 'automobiles' only, and under that law collect a tax upon a *carreton* or bull cart. Constitutional limitations upon the power of the Legislature are not stronger than statutory limitations, that is to say, a statute expressly adopted for one purpose cannot, without amendment, be applied to another purpose which is entirely distinct and different. A statute providing for an income tax cannot be construed to cover property which is not, in fact, income. The Legislature cannot, by a statutory declaration, change the real nature of a tax which it imposes. A law which imposes an importation tax on rice only cannot be construed to impose an importation tax on corn."

These assertions while in the main true are, perhaps, a little too broadly stated; much will depend on the circumstances of each particular case. If the Legislature cannot do the things enumerated it must be by reason of the limitation imposed by the Organic Act, "That no bill which may be enacted into law shall embrace more than one subject, and that subject shall be expressed in the title of the bill." Similar provisions are contained in most State Constitutions, their object being to prevent "log-rolling" and the passing of undesirable measures without their being brought properly to the attention of the legislators. Where the prevention of this mischief is not involved, the courts have uniformly given such provisions a very liberal construction and there are few, if any, cases where a statute has been declared unconstitutional for dealing with several cognate subjects in the same Act and under the same title. (Lewis' *Sutherland on Statutory Construction*, 2d ed., pars. 109 *et seq.*; *Government of the Philippine Islands vs. Municipality of Binalonan and Roman Catholic Bishop of Nueva Segovia*, 32 Phil., 634.) Certainly no income tax statute would be declared

unconstitutional on that ground for treating stock dividends as income and providing for their taxation as such.

Reverting to the question of the nature of income, it is argued that a stock certificate has no intrinsic value and that, therefore, even if it is based on earnings instead of increment in capital it cannot be regarded as income. But neither has a bank check or a time deposit certificate any intrinsic value, yet it may be negotiated, or sold, or assigned and it represents a cash value. So also does a stock certificate. A lawyer might take his fee in stock certificates instead of in money. Would it be seriously contended that he had received no fee and that his efforts had brought no income?

Some of the members of the court agree that stock dividends based on earnings or profits may be taxed as income, but take the view that in an action against the Collector of the Internal Revenue for recovering back taxes paid on non-taxable stock dividends, the plaintiff need not allege that the stock dividends are not based on earnings or profits distributed, but that the question of the taxability or non-taxability of the stock dividends is a matter of defense and should be set up by the defendant by way of answer.

I think this view is erroneous. If some stock dividends are taxable and others are not, an allegation that stock dividends in general have been taxed is not sufficient and does not state a cause of action. The presumption is that the tax has been legally collected and the burden is upon the plaintiff both to allege and prove facts showing that the collection is unlawful or irregular. (Code of Civil Procedure, sec. 334, subsecs. 14 and 31.)

The judgment appealed from should be affirmed.

DISSENTING

JOHNS, J.,

We have studied and analyzed with care the able and exhaustive majority opinion written by

Mr. Justice Johnneon.

In the final analysis, the question involved is whether the words "which stock dividend shall be considered income, to the amount of its cash value" are to be construed as meaning the same thing as the words "stock dividend shall be considered income, to the amount of the earnings or profits distributed," as the majority opinion says. The first is an Act of Congress defining what is a stock dividend, and that the word dividend shall be construed as income to the amount of its cash value. It is upon that construction and that definition that the majority opinion is founded. That is the definition of the words as used in an Act of Congress. The other is an Act defining the meaning of the words by the Legislature of the Philippine Islands, and it says: "Stock dividend shall be considered income, to the amount of the earnings or profits distributed."

It is true, as the majority opinion says, that in enacting the Income Tax Law of the Philippine Islands, the Legislature had before it the Act of Congress. But it is also true that by the Act of the Philippine Legislature "Stock dividend shall be considered income, to the amount of the earnings or profits distributed." One law is founded upon the actual cash value of the stock and the other is founded upon distributed earnings and profits.

Much is said in the textbooks and by the numerous decisions cited in the majority opinion as to the meaning of the word income, and the decisions in the United States are founded upon the meaning of that word, as it is used in the Act of Congress, and to the effect that the word is to be construed in its usual and ordinary meaning. But assuming that to be true, it must also be conceded that the Legislature of the Philippine Islands has a legal right to define the meaning of the word "income" by a legislative act, and when its meaning is defined by legislative act, it is the duty of the courts to follow that definition regardless of whether it is the usual and ordinary meaning of the word, and therein lies the distinction between the two acts and the reason why the authorities cited in the majority opinion are not in point. Act No. 2833 of the Philippine Legislature specifically says that "Stock dividend shall be considered income, to the amount of the earnings or profits distributed." The Act of Congress is founded upon the "cash value of the stock," and the Act in question is founded upon "the amount of the earnings or profits distributed."

Here, then, we have the meaning of the words defined in the legislative act, and it is very apparent that the purpose and intent of the legislative act was to avoid the meaning and construction of such words which is now given to them in the majority opinion. The Legislature had the power to define the meaning of the words, did define them, and it is the

duty of the courts to follow and adopt the meaning and definition of the words given to them in the legislative act.

As pointed out in the opinion of Mr. Justice Street, the constitutional limitations upon the legislative power for taxation purposes, which exist in the United States, does not exist in the Philippine Islands. There is no organic law here similar to the provisions of the Constitution of the United States which require direct taxes on property to be levied in a specific way, in other words, the restrictions and limitations placed on the power to levy an income tax under the Constitution of the United States do not exist in the Philippine Islands.

Hence, it must follow that the authorities cited in the majority opinion are not in point in the instant case. They are founded upon different language, different organic powers, different conditions, and the different meaning of the same words as defined in the different legislative acts. The Philippine Legislature had a legal right to define the meaning of the words "dividend" and "income," and it expressly says "Stock dividend shall be considered income, to the amount of the earnings or profits distributed." In the instant case, the earnings and profits of the corporation were distributed among the existing stockholders of the company upon a pro rata basis, and they were made exclusively out of "distributed earnings and profits." The declaring of the dividend was a matter in the sole discretion of the stockholders, but when such a dividend is made from and out of "earnings or profits distributed," it then becomes and is an income within the meaning of Act No. 2833, and should be subject to an income tax.

For such reason, I dissent.