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FIRST DIVISION

[G.R. No. 108576, January 20, 1999]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. THE COURT OF APPEALS, COURT OF TAX APPEALS AND A. SORIANO CORP., RESPONDENTS.

D E C I S I O N

AUSTRIA-MARTINEZ, J.:

Petitioner Commissioner of Internal Revenue (CIR) seeks the reversal of the decision of the Court of Appeals (CA)[1] which affirmed the ruling of the Court of Tax Appeals (CTA)[2] that private respondent A. Soriano Corporation's (hereinafter ANSCOR) redemption and exchange of the stocks of its foreign stockholders cannot be considered as essentially equivalent to a distribution of taxable dividends" under Section 83(b) of the 1939 Internal Revenue Act[3]

The undisputed facts are as follows:

Sometime in the 1930s, Don Andres Soriano, a citizen and resident of the United States, formed the corporation "A. Soriano Y Cia", predecessor of ANSCOR, with a P1,000,000.00 capitalization divided into 10,000 common shares at a par value of P100/share. ANSCOR is wholly owned and controlled by the family of Don Andres, who are all non-resident aliens.[4] In 1937, Don Andres subscribed to 4,963 shares of the 5,000 shares originally issued.[5]

On September 12, 1945, ANSCOR's authorized capital stock was increased to P2,500,000.00 divided into 25,000 common shares with the same par value. Of the additional 15,000 shares, only 10,000 was issued which were all subscribed by Don Andres, after the other stockholders waived in favor of the former their pre-emptive rights to subscribe to the new issues.[6] This increased his subscription to 14,963 common shares.[7] A month later,[8] Don Andres transferred 1,250 shares each to his two sons, Jose and Andres, Jr., as their initial investments in ANSCOR.[9] Both sons are foreigners.[10]

By 1947, ANSCOR declared stock dividends. Other stock dividend declarations were made between 1949 and December 20, 1963.[11] On December 30, 1964 Don Andres died. As of that date, the records revealed that he has a total shareholdings of 185,154 shares[12] - 50,495 of which are original issues and the balance of 134,659 shares as stock dividend declarations.[13] Correspondingly, one-half of that shareholdings or 92,577[14] shares were transferred to his wife, Doña Carmen Soriano, as her conjugal share. The other half formed part of his estate.[15]

A day after Don Andres died, ANSCOR increased its capital stock to P20M[16] and in 1966 further increased it to P30M.[17] In the same year (December 1966), stock dividends worth 46,290 and 46,287 shares were respectively received by the Don Andres estate[18] and Doña Carmen from ANSCOR. Hence, increasing their accumulated shareholdings to 138,867 and 138,864[19] common shares each.[20]

On December 28, 1967, Doña Carmen requested a ruling from the United States Internal Revenue Service (IRS), inquiring if an exchange of common with preferred shares may be considered as a tax avoidance scheme[21] under Section 367 of the 1954 U.S. Revenue Act.[22] By January 2, 1968, ANSCOR reclassified its existing 300,000 common shares into 150,000 common and 150,000 preferred shares.[23]

In a letter-reply dated February 1968, the IRS opined that the exchange is only a recapitalization scheme and not tax avoidance.[24] Consequently,[25] on March 31, 1968 Doña Carmen exchanged her whole 138,864 common shares for 138,860 of the newly reclassified preferred shares. The estate of Don Andres in turn, exchanged 11,140 of its common shares for the remaining 11,140 preferred shares, thus reducing its (the estate) common shares to 127,727.[26]

On June 30, 1968, pursuant to a Board Resolution, ANSCOR redeemed 28,000 common shares from the Don Andres' estate. By November 1968, the Board further increased ANSCOR's capital stock to P75M divided into 150,000 preferred shares and 600,000 common shares.[27] About a year later, ANSCOR again redeemed 80,000 common shares from the Don Andres' estate,[28] further reducing the latter's common shareholdings to 19,727. As stated in the board Resolutions, ANSCOR's business purpose for both redemptions of stocks is to partially retire said stocks as treasury shares in order to reduce the company's foreign exchange remittances in case cash dividends are declared.[29]

In 1973, after examining ANSCOR's books of account and records, Revenue examiners issued a report proposing that ANSCOR be assessed for deficiency withholding tax-at-source, pursuant to Sections 53 and 54 of the 1939 Revenue Code,[30] for the year 1968 and the second quarter of 1969 based on the transactions of exchange and redemption of stocks.[31] The Bureau of Internal Revenue (BIR) made the corresponding assessments despite the claim of ANSCOR that it availed of the tax amnesty under Presidential Decree (P.D.) 23[32] which were amended by P.D.'s 67 and 157.[33] However, petitioner ruled that the invoked decrees do not cover Sections 53 and 54 in relation to Article 83(b) of the 1939 Revenue Act under which ANSCOR was assessed.[34] ANSCOR's subsequent protest on the assessments was denied in 1983 by petitioner.[35]

Subsequently, ANSCOR filed a petition for review with the CTA assailing the tax assessments on the redemptions and exchange of stocks. In its decision, the Tax Court reversed petitioner's ruling, after finding sufficient evidence to overcome the prima facie correctness of the questioned assessments.[36] In a petition for review, the CA, as mentioned, affirmed the ruling of the CTA.[37] Hence, this petition.

The bone of contention is the interpretation and application of Section 83(b) of the 1939 Revenue Act[38] which provides:

> "Sec. 83. Distribution of dividends or assets by corporations. –
>
> (b) *Stock dividends* – A stock dividend representing the transfer of surplus to capital account shall not be subject to tax. However, if a corporation *cancels or redeems stock issued as a dividend at such time and in such manner as to make the distribution and cancellation or redemption, in whole or in part, essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock shall be considered as taxable income to the extent it represents a distribution of earnings or profits accumulated after March first,* nineteen hundred and thirteen." (Italics supplied).

Specifically, the issue is whether ANSCOR's *redemption* of stocks from its stockholder as well as the *exchange* of common with preferred shares can be considered as "essentially equivalent to the distribution of taxable dividend," making the proceeds thereof taxable under the provisions of the above-quoted law.

Petitioner contends that the exchange transaction is tantamount to "cancellation" under Section 83(b) making the proceeds thereof taxable. It also argues that the said Section applies to *stock dividends* which is the bulk of stocks that ANSCOR redeemed. Further, petitioner claims that under the "net effect test," the estate of Don Andres gained from the redemption. Accordingly, it was the duty of ANSCOR to withhold the tax-at-source arising from the two transactions, pursuant to Section 53 and 54 of the 1939 Revenue Act.[39]

ANSCOR, however, avers that it has no duty to withhold any tax either from the Don Andres estate or from Doña Carmen based on the two transactions, because the same were done for legitimate business purposes which are (a) to reduce its foreign exchange remittances in the event the company would declare cash dividends,[40] and to (b) subsequently "filipinized" ownership of ANSCOR, as allegedly envisioned by Don Andres.[41] It likewise invoked the amnesty provisions of P.D. 67.

We must emphasize that the application of Sec. 83(b) depends on the special factual circumstances of each case.[42] The findings of facts of a special court (CTA) exercising particular expertise on the subject of tax, generally binds this Court,[43] considering that it is substantially similar to the findings of the CA which is the final arbiter of questions of facts.[44] The issue in this case does not only deal with facts but whether the law applies to a particular set of facts. Moreover, this Court is not necessarily bound by the lower courts' conclusions of law drawn from such facts.[45]

AMNESTY:

> We will deal first with the issue of tax amnesty. Section 1 of P.D. 67[46] provides:
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> "I. In all cases of voluntary disclosures of previously untaxed income and/or wealth such as earnings, receipts, gifts, bequests or any other acquisitions from any source whatsoever which are taxable under the

> National Internal Revenue Code, as amended, realized here or abroad by any *taxpayer*, natural or juridical; the collection of all internal revenue taxes including the increments or penalties or account of non-payment as well as all civil, criminal or administrative liabilities arising from or incident to such disclosures under the National Internal Revenue Code, the Revised Penal Code, the Anti-Graft and Corrupt Practices Act, the Revised Administrative Code, the Civil Service laws and regulations, laws and regulations on Immigration and Deportation, or any other applicable law or proclamation, are hereby condoned and, in lieu thereof, *a tax of ten (10%) per centum on such previously untaxed income or wealth* is hereby imposed, subject to the following conditions: (conditions omitted) [Emphasis supplied].

The decree condones "the collection of all internal revenue taxes including the increments or penalties or account of non-payment as well as all civil, criminal or administrative liabilities arising from or incident to" (voluntary) disclosures under the NIRC of previously untaxed income and/or wealth "realized here or abroad by any taxpayer, natural or juridical."

May the withholding agent, in such capacity, be deemed a taxpayer for it to avail of the amnesty? An income taxpayer covers all persons who derive taxable income.[47] ANSCOR was assessed by petitioner for deficiency withholding tax under Section 53 and 54 of the 1939 Code. As such, it is being held liable in its capacity as a withholding agent and not in its personality as a taxpayer.

In the operation of the withholding tax system, the withholding agent is the payor, a separate entity acting no more than an agent of the government for the collection of the tax[48] in order to ensure its payments;[49] the payer is the taxpayer – he is the person subject to tax impose by law;[50] and the payee is the taxing authority.[51] In other words, the withholding agent is merely a tax collector, not a taxpayer. Under the withholding system, however, the agent-payor becomes a payee by fiction of law. His (agent) liability is direct and independent from the taxpayer,[52] because the income tax is still impose on and due from the latter. The agent is not liable for the tax as no wealth flowed into him – he earned no income. The Tax Code only makes the agent personally liable for the tax[53] (c) 1939 Tax Code, as amended by R.A. No. 2343 which provides in part that "xxx Every such person is made personally liable for such tax xxx."53 arising from the breach of its legal duty to withhold as distinguish from its duty to pay tax since:

> "the government's cause of action against the withholding agent is not for the collection of income tax, but for the enforcement of the withholding provision of Section 53 of the Tax Code, compliance with which is imposed on the withholding agent and not upon the taxpayer." [54]

Not being a *taxpayer*, a withholding agent, like ANSCOR in this transaction, is not protected by the amnesty under the decree.

Codal provisions on withholding tax are mandatory and must be complied with by the withholding agent.[55] The taxpayer should not answer for the non-performance by the withholding agent of its legal duty to withhold unless there is collusion or bad

faith. The former could not be deemed to have evaded the tax had the withholding agent performed its duty. This could be the situation for which the amnesty decree was intended. Thus, to curtail tax evasion and give tax evaders a chance to reform, [56] it was deemed administratively feasible to grant tax amnesty in certain instances. In addition, a "tax amnesty, much like a tax exemption, is never favored nor presumed in law and if granted by a statute, the terms of the amnesty like that of a tax exemption must be construed strictly against the taxpayer and liberally in favor of the taxing authority."[57] The rule on *strictissimi juris* equally applies.[58] So that, any doubt in the application of an amnesty law/decree should be resolved in favor of the taxing authority.

Furthermore, ANSCOR's claim of amnesty cannot prosper. The implementing rules of P.D. 370 which expanded amnesty on previously untaxed income under P.D. 23 is very explicit, to wit:

> "Section 4. *Cases not covered by amnesty. – The following cases are not covered by the amnesty subject of these regulations:*
>
> xxx xxx xxx
>
> (2) Tax liabilities with or without assessments, on withholding tax at source provided under Sections 53 and 54 of the National Internal Revenue Code, as amended;[59]

ANSCOR was assessed under Sections 53 and 54 of the 1939 Tax Code. Thus, by specific provision of law, it is not covered by the amnesty.

TAX ON STOCK DIVIDENDS

General Rule

Section 83(b) of the 1939 NIRC was taken from Section 115(g)(1) of the U.S. Revenue Code of 1928.[60] It laid down the general rule known as the 'proportionate test'[61] wherein stock dividends once issued form part of the capital and, thus, subject to income tax.[62] Specifically, the general rule states that:

> "A stock dividend representing the transfer of surplus to capital account shall not be subject to tax."

Having been derived from a foreign law, resort to the jurisprudence of its origin may shed light. Under the US Revenue Code, this provision originally referred to "stock dividends" only, without any exception. Stock dividends, strictly speaking, represent capital and do not constitute income to its recipient.[63] So that the mere issuance thereof is not yet subject to income tax[64] as they are nothing but an "enrichment through increase in value of capital investment."[65] As capital, the stock dividends postpone the realization of profits because the "fund represented by the new stock has been transferred from surplus to capital and no longer available for actual distribution."[66] Income in tax law is "an amount of money coming to a person within a specified time, whether as payment for services, interest, or profit from investment."[67] It means cash or its equivalent.[68] It is gain derived and severed from capital,[69] from labor or from both combined[70] - so that to tax a stock