REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

A. SORIANO CORPORATION,
OTHERWISE KNOWN AS ANSCOR,
Petitioner,

- versus - C.T.A. CASE NO. 3710

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
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D E C I S I O N

This petition seeks the review of respondent's decision assessing petitioner of withholding taxes on the redemption by petitioner of its common shares from the Estate of Don Andres Soriano and the cancellation and conversion of common shares into preferred shares of the Estate of Don Andres Soriano and Dona Carmen Vda. de Soriano which respondent considered as "essentially equivalent to a distribution of a taxable dividend" pursuant to Section 83(b) in relation to Sections 53 and 54 of the National Internal Revenue Code of 1939. Petitioner was assessed deficiency withholding taxes of P3,428,613.90 for the year 1968 and

P2,950,000.00 for the second quarter of 1969 inclusive of interests due thereon.[1]

Without presenting any evidence, respondent submitted this case for decision based on the pleadings and the BIR records.

The relevant material facts are as follows:

Petitioner, A. Soriano Corporation (ANSCOR for short), is a domestic corporation engaged in the business of managing its affiliate corporations under long-term management contracts. Among other things it acquires shares of stocks of other corporations for investment purposes and from time to time acts as an insurance and shipping agent. It is wholly owned and controlled by the family of Don Andres Soriano who are all non-resident American citizens.

Sometime in 1930, Don Andres Soriano organized A. Soriano y Cia, a predecessor of ANSCOR. At the time of its incorporation, A. Soriano y Cia had an authorized capital stock of P1,000,000.00 divided into 10,000 common shares at P100.00 par value per share. In 1937, Don Andres Soriano purchased and subscribed to 4,963 common shares coming from the original issue of 5,000 common shares.[2]

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[1]Exh. B, pp. 99-100, Folder I, BIR rec.; Exh. C, p. 215, Folder II, BIR rec.

[2]Exh. M, pp. 114-115, Folder III, BIR rec.; Exh. P, p. 46, Folder III, BIR rec.

When World War II broke out, the corporation suspended its operation. It was only on March 1, 1945 when it resumed its usual business operation. As of said date, Don Andres Soriano has a total shareholding of 4,971 common shares (inclusive of 8 shares in the name of 4 nominal stockholders with two shares each).

On September 12, 1945, the stockholders unanimously approved, in a special meeting, the proposed increase in the authorized capital stock from P1,000,000.00 to P2,500,000.00 divided into 25,000 commom shares at P100.00 par value per share.[3] The By-laws and the Articles of Incorporation were amended accordingly.

Meanwhile, the corporation issued only 10,000 common shares or P1,000,000.00 common stock from the increased P1,500,000.00 common stock. The stockholders of the corporation waived their pre-emptive rights to subscribe to these new issue of shares and allowed Don Andres Soriano to subscribe to the additional issue of 10,000 common shares for P1,000,000.00.

In October, 1945, Don Andres Soriano transferred 2,500 common shares to his two sons, Jose M. Soriano and Andres Soriano, Jr., divided

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[3]Exh. R-1, pp. 25-29, Folder III, BIR rec.

equally, each owning 1,250 common shares as their initial investment with A. Soriano y Cia. The total shareholdings of Don Andres Soriano after the transfer was 12,471 common shares (inclusive of 8 nominal shares).

In 1947, the corporation declared 100% stock dividends in favor of its stockholders on record. The corresponding stock dividends of 12,463 common shares were issued in favor of Don Andres Soriano.[4]

During a Special Meeting of the Board of Directors held on November 4, 1948, the Board approved the offer of Don Andres Soriano, then President and Chairman of the Board, to exchange his shareholdings in three other corporations managed by A. Soriano y Cia, namely: San Miguel Brewery, Philippine Oil Development Co., and Taysan Gold Mining Co., for 38,000 unissued common shares of A. Soriano y Cia.[5]

In December, 1949, the Board of Directors declared stock dividends in favor of its stockholders and by January, 1950, the corresponding 12,590 and 15,108 common shares were issued in the name of Don Andres Soriano as stock dividends.[6] Thereafter, the corporation continued

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[4]Exh. P-6, p. 43, Folder III, BIR rec.
[5]Exh. R, pp. 30-34, Folder III, BIR rec.
[6]Exh. P-8, p. 42, Folder III, BIR rec.; Exh. P-10, p. 41, Folder III, BIR rec.

to declare and issue stock dividends in favor of Don Andres Soriano up to December 20, 1963.

Don Andres Soriano died on December 30, 1964. At that time, he owned a total of 185,154 common shares (includes qualifying shares in the names of director-nominees) with 50,495 common shares (includes 21 common shares from nominees of Don Andres Soriano) coming from original issue and the balance thereof or P134,659 common shares from stock dividends.[7] These shares were acquired during the decedent's marriage with Dona Carmen M. Soriano.

The law says that the rights to the succession are transmitted from the moment of the death of the decedent.[8] Therefore, the rights of Dona Carmen Vda. de Soriano are made effective upon the death of her husband on December 30, 1964. The BIR examiners rightfully considered Dona Carmen Vda. de Soriano to be entitled to one-half of the total 185,154 common shares owned by her deceased husband or 92,577 common shares which represents her share in the conjugal partnership while the other half

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[7]Exh. J, pp. 255-261, Folder I, BIR rec.; Exh. J-2, p. 261, Folder I, BIR rec.; Exh. L, pp. 193-202, Folder I, BIR rec.; Exh. I-1, p. 216, Folder I, BIR rec.; ANSCOR Inter-Office Memorandum, pp. 265-269, Folder II, BIR rec.

[8]Article 777, New Civil Code.

belong to the Estate of the deceased, Don Andres Soriano.[9]

As of December 31, 1964, A. Soriano y Cia, now referred to as A. Soriano Corporation (ANSCOR), had its authorized capital stock increased to P20,000,000.00 divided into 200,000 common shares at P100.00 par value per share.[10] It was ascertained that of the 200,000 common shares issued, 53,000 common shares were original issues and 147,000 common shares represent stock dividends. Of the 53,000 common shares original issue, 50,495 common shares (includes 21 common shares from nominees of Don Andres Soriano) were registered in the name of Don Andres Soriano at the time of his death.[11]

A Special Proceeding (No. 5124) was filed by his two sons, Jose M. Soriano and Andres Soriano, Jr., in the Court of First Instance of Rizal for the probate of the last will and testament of their deceased father.[12] Both were appointed ancillary administrators for the purpose of liquidating the Estate of Don Andres Soriano in the Philippines. The Special Proceeding was terminated in November,

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[9]Exh. J, supra.
[10]Exhs. J and L; ANSCOR Inter-Office Memorandum, supra.
[11]Exhs. J-2, L and I-1, supra.
[12]Exh. J-3, pp. 2-6, Folder III, BIR rec.

1974 and the assets of the Estate of Don Andres Soriano in the Philippines were finally distributed to the heirs.

On July 2, 1965, Mr. Benjamin N. Tabios, then Acting Commissioner of Internal Revenue issued a certification to the effect that the Ancillary Administrators of the Testate Estate of Don Andres Soriano had already paid the Republic of the Philippines on June 30, 1965 a total of P2,789,063.94, representing full payment of the estate and inheritance taxes due on account of the transmission of the aforesaid estate to the heirs.[13]

On May 15, 1966, ANSCOR's authorized capital stock was increased from P20,000,000.00 (200,000 common shares) to P30,000,000.00 (300,000 common shares) with the same P100.00 par value per share. The reason for the increase, which was approved by the Securities and Exchange Commission on December 8, 1966, was to provide for additional capital due to the increase in the value of corporate assets.[14]

On July 15, 1966, ANSCOR declared 50% stock dividends. The Estate of Don Andres Soriano

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[13]p. 1, Folder III, BIR rec.

[14]Exh. J, pp. 255-261, Folder I, BIR rec.; Exh. L, pp. 193-202, Folder I, BIR rec.; ANSCOR Inter-Office Memorandum, pp. 265-269, Folder II, BIR rec.; Exh. D-2, pp. 270-287, Folder II, BIR rec.

received 46,290 stock dividends on December 16, 1966 making its total shareholdings to 138,867 common shares (92,577 + 46,290) as of December 31, 1967. Likewise, Dona Carmen Vda. de Soriano received 46,287 stock dividends. This made her total shareholdings equal to 138,864 common shares (92,577 + 46,287) with an original cost of P2,512,089.71.[15]

In a letter dated December 28, 1967, Dona Carmen Vda. de Soriano requested for a ruling from the United States Internal Revenue Service in Washington D.C. on the question of whether or not the exchange of a number of common shares in ANSCOR for the same number of preferred shares in the same company with the same par value of P100.00 would be interpreted as a tax avoidance scheme under Section 367 of the U.S. Internal Revenue Code of 1954. In its reply letter dated February 28, 1968, the U.S. Internal Revenue Service ruled that the proposed transaction is not in pursuance of a plan to avoid the Federal income taxes. It further held that the reclassification and exchange of common stock for preferred stock in the same company will qualify as a recapitalization and therefore a reorganization within the meaning of Section 368(a) (1) (E).

[15]Exhs. J and L; ANSCOR Inter-Office Memorandum, supra.

Moreover, no gain or loss will be realized by the shareholders from the exchange contemplated.[16]

On January 2, 1968, petitioner's Articles of Incorporation was amended to allow the re-classification of its 300,000 authorized common shares to be divided into 150,000 common shares and 150,000 10% preferred, cumulative and non-voting shares both at P100.00 par value per share.[17]

On March 31, 1968, the Estate of Don Andres Soriano actually exchanged 11,140 common shares (costing P759,882.85 based on the fair market value declared by the Estate of Don Andres Soriano for estate and inheritance tax purposes), instead of 11,134.5 common shares as earlier proposed, for 11,140 (valued at P1,114,000.00) 10% preferred cumulative shares at P100.00 par value per share. After the conversion of common to preferred shares, the common shares remaining from the Estate of Don Andres Soriano numbered only 127,727.

Likewise, Dona Carmen Vda. de Soriano exchanged all her 138,864 common shares (originally costing P2,512,089.71) for 138,860 preferred shares, at P100.00 par value per share, valued at P13,886,000.00.[18]

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[16]Exh. S, pp. 19-23, Folder III, BIR rec.
[17]Exhs. J, L, and D-2, supra.
[18]Exhs. J and L, supra.

Pursuant to a Board Resolution approved by its Directors in their meeting called on June 15, 1968, ANSCOR purchased, on June 30, 1968, in the United States some 28,000 common shares from the Estate of Don Andres Soriano at P100.00 par value amounting to P2,800,000.00. These shares were redeemed for the purpose of partially retiring (as treasury shares) the common shares held by non-resident stockholders in order to reduce the foreign exchange requirements of the corporation in the event it would declare cash dividends.[19]

On November 30, 1968, the stockholders approved in a Special Meeting the recommendation of the Board of Directors to increase the capital stock of the corporation from P30,000,000.00 divided into 150,000 preferred shares and 150,000 common shares both at P100.00 par value, to P75,000,000.00, divided into 150,000 preferred shares and 600,000 common shares at P100.00 par value.[20]

In November, 1969, ANSCOR again purchased in the United States another 80,000 common shares from the Estate of Don Andres Soriano at P125.00 per share costing P10,000,000.00 pursuant to Board

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[19] ibid.; Exh. R-2, pp.12-13, Folder III, BIR rec.; Exhs. E-1 and E-1-a, p. 48, Folder III, BIR rec.

[20] Exh. R-3, pp. 9-11, Folder III, BIR rec.

Resolution approved by its Directors during their meeting held on October 30, 1969. The same purpose was cited by the Board as in the initial purchase of 28,000 common shares from the Estate of Don Andres Soriano in 1968, that is, to reduce the foreign exchange requirements of the corporation in the event it would declare cash dividends.[21]

Sometime in 1972, the Bureau of Internal Revenue issued Letter of Authority No. 72881 NA dated June 1, 1972 authorizing its revenue examiners to examine the books of accounts of petitioner-ANSCOR.[22] An examination was conducted and a memorandum report dated January 2, 1973 was submitted by the revenue examiners to the Chief of the Services & Misc. (Audit) Division.[23] On the same date, petitioner was invited for an informal conference to enable petitioner or any of its duly authorized representative to go over the findings of the Bureau's examiners. Instead of accepting the invitation, petitioner's representative and counsel, Atty. Demosthenes B. Gadioma, requested on several occasions for an extension of time within which to submit the necessary documents in support of his client's side of the proposed assessment.

[21]Exh. R-4, pp. 7-8, Folder III, BIR rec.; Exhs. J and L, supra.
[22]Exh. A, p. 136, Folder II, BIR rec.
[23]pp. 148-158, Folder II, BIR rec.

The Bureau, on the other hand, gave petitioner up to May 14, 1973 to submit the necessary documents.[24]

In a letter dated May 14, 1973, Atty. Gadioma informed the Bureau that ANSCOR availed of the tax amnesty under Presidential Decree Nos. 23 and 157. This was verified by the Bureau to be true as shown in the BIR records.[25]

Meanwhile, petitioner was informed thru a letter, dated December 5, 1973, sent by Mr. Largion A. Najera, Chief, Services and Misc. (Audit) Division that respondent had issued a memorandum dated April 5, 1973, stating that all those who have availed of the tax amnesty under Presidential Decree No. 23, as amended, are exempt from investigation.[26]

This notwithstanding, on April 3, 1974, petitioner still received from respondent a letter dated March 29, 1974 informing it that the tax amnesty under Presidential Decree Nos. 23 and 157 does not cover Sections 53 and 54 (now Sections 50(a), as amended by Executive Order Nos. 37 and 51, respectively) of the National Internal Revenue Code insofar as the withholding tax liability on

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[24]p. 173, Folder II, BIR rec.

[25]Exh. A-2, p. 175, Folder II, BIR rec.; Exh. A-3, p. 244, Folder II, BIR rec.

[26]Exh. A-1, p. 117, Folder I, BIR rec.

taxable dividends of the Estate of Don Andres Soriano and Dona Carmen de Montemar Vda. de Soriano are concerned.[27]

On April 4, 1974, petitioner received from respondent 1968 deficiency assessment for withholding tax-at-source amounting to P3,428,613.90, computed as follows:[28]

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Total taxable dividends income of Dona Carmen de Montemar Vda. de Soriano and the Estate of Don Andres Soriano	P 14,528,027.44
Withholding tax due thereon (20%)	P 2,905,605.00
Add: 1/2 % mo. int. fr. 4-16-69 to 4-16-72	523,008.90
TOTAL AMOUNT DUE AND COLLECTIBLE	P 3,428,613.90

The total taxable dividend of the Estate of Don Andres Soriano and Dona Carmen Vda. de Soriano for 1968 amounting to P14,528,027.44 is itemized below per computation of the Bureau's examiners, to wit:[29]

	Estate of Don Andres	Dona Carmen
Preferred shares issued	P1,114,000.00	P13,886,000.00
Less: Cost of common shares cancelled	759,882.85	2,512,089.71
Income realized from conversion	P 354,117.15	P11,373,910.29

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[27]pp. 179-180, Folder II, BIR rec.
[28]Exh. B, pp. 99-100, Folder I, BIR rec.
[29]Memo.-Report of Examiners dated April 2, 1974, p. 104, Folder I, BIR rec.

1968 Income realized from conversion:		
Estate of Don Andres Soriano	P	354,117.15
Dona Carmen de Montemar Vda. de Soriano		11,373,910.29
1968 redemption of 28,000 common shares of the Estate of Don Andres Soriano		2,800,000.00
Total 1968 taxable dividends income of Dona Carmen de Montemar Vda. de Soriano and the Estate of Don Andres Soriano		P 14,528,027.44

On May 7, 1974, respondent issued another deficiency assessment against petitioner this time for the 2nd quarter of 1969 in the amount of P2,950,000.00, inclusive of interest, computed as follows:[30]

2nd Quarter of 1969

Redemption of stocks from the Estate of Don Andres Soriano considered as equivalent to a distribution of taxable dividend (80,000 @ P125.00)	P 10,000,000.00
Withholding tax-at-source due thereon	P 2,500,000.00
Add: 1/2% mo. int. fr. 4-16-70 to 4-16-74	450,000.00
TOTAL AMOUNT DUE & COLLECTIBLE	P 2,950,000.00

Petitioner filed its protest on the first assessment on April 18, 1974 and the second assessment was protested on June 11, 1974.[31] A supplemental memorandum dated June 8, 1979 was later filed by petitioner with respect to the 1968

[30]Exh. C, p. 215, Folder II, BIR rec.
[31]Exh. D, pp. 118-122, Folder I, BIR rec.; Exh. D-1, pp. 221-229, Folder II, BIR rec.

and 1969 (2nd quarter) deficiency assessments issued by respondent.[32]

On December 11, 1983, petitioner received respondent's decision dated November 4, 1983 denying its protest and at the same time reiterating the payment of the total amount of P6,378,613.90.[33]

Hence, this petition for review.

Thus far, the main issue to be resolved is whether or not petitioner is liable for the deficiency withholding tax-at-source for the years 1968 and the second quarter of 1969 amounting to P3,428,613.90 and P2,950,000.00, respectively, on the basis of the findings of the examiners holding: (1) the redemption of 28,000 common shares in 1968 and 80,000 common shares of the Estate of Don Andres Soriano in 1969; and (2) the conversion and cancellation of 11,140 common shares of the Estate of Don Andres Soriano and 138,865 common shares of Dona Carmen Vda. de Soriano into preferred shares in 1968, as "essentially equivalent to a distribution of taxable dividend" under Section 83(b) in relation to Sections 53 and 54 of the National Internal Revenue Code of 1939.

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[32]Exh. D-2, pp. 270-287, Folder II, BIR rec.
[33]Exh. D-3, p. 266, Folder I, BIR rec.

Aside from the main issue above-mentioned, two corollary issues present itself and if answered in the affirmative would render the main issue moot.

The first corollary issue is whether or not petitioner is excused from any withholding taxes liability under Sections 53 and 54 after having availed of the tax amnesty as provided by Presidential Decree No. 23, as amended by Presidential Decree No. 67.

Second, whether the withdrawal of the letter of authority previously issued by respondent deprived the revenue examiners report of any validity, thereby rendering the contested deficiency assessments, which was based on said report, null and void.

On the first corollary issue, petitioner maintains that its payment of the tax amnesty for the untaxed income earned prior to 1972 under Presidential Decree No. 23, as amended, clears petitioner from all investigation, whether civil or criminal, insofar as the taxable years 1968 and 1969 are concerned.

Respondent on the other hand averred that the withholding taxes as provided under Sections 53 and 54, are not covered by Presidential Decree No. 23, as amended.

We agree with respondent. Petitioner's availment of the tax amnesty under Presidential Decree No. 23 does not cover its liability for withholding taxes. Section 1 of Presidential Decree No. 23, as amended, insofar as pertinent reads as follows:

> "SECTION 1. 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 of 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:
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> xxx xxx xxx" (Underscoring Ours.)

The taxpayer, who can avail of the tax amnesty which the law (Presidential Decree 23) speaks of, refers to one who is necessarily the earner of the untaxed income or wealth. Thus, as correctly put by respondent, the "withholding tax agent, in this case the petitioner, or the person required by law to withhold the tax due on income realized by another person is, obviously, not the earner of that income."[34] By the very nature of the withholding tax the liability to withhold the income of another belongs to the withholding agent. Petitioner has a duty to withhold taxes due on dividends income earned by its stockholders. Therefore, the declaration made by petitioner-taxpayer (earner of income) of untaxed income prior to 1972 and its availment of the tax amnesty under Presidential Decree No. 23, as amended, refers only to income earned and not to its liability as a withholding agent, who under Sections 53 and 54 of the National Internal Revenue Code (1939) is required to withhold the tax due on the income earned by another person. Hence, Sections 53 and 54 are not covered by the protections and immunities granted by Presidential Decree No. 23, as amended.

Anent the second corollary issue, petitioner maintains that the cancellation and revocation of the letter of authority made the findings of the revenue examiners without legal basis. Thus, the decision of respondent, based on the investigative

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[34]Respondent's Memorandum, p. 141, CTA rec.

report of his revenue examiner on a cancelled letter of authority, is null and void.

Respondent averred that the cancellation and revocation of the letter of authority did not take effect insofar as the withholding tax liability of petitioner is concerned since the tax amnesty proviso of Presidential Decree No. 23, as amended, do not apply to withholding taxes. Furthermore, the issuance of the demand letter to petitioner constitutes a revalidation of the letter of authority.

We find the letter dated March 29, 1974 sent by respondent to petitioner informing the latter that Section 53 of the National Internal Revenue Code is not covered by the amnesty as provided in Presidential Decree No. 23, as amended, and the assessment letter dated April 4, 1974 all together revalidated the letter of authority previously cancelled it appearing from the records that the deficiency assessment letters sent were for the withholding tax deficiency for 1968 and 1969.

The liability for withholding tax is not covered by the tax amnesty decree (P.D. 23). Hence, the letter of authority is not deemed cancelled insofar as the withholding tax aspect is concerned.

We now go to the main issue of whether the petitioner is liable under Section 83 in relation to Section 53 of the National Internal Revenue Code.

Respondent posits that the redemption of 28,000 and 80,000 common shares in 1968 and 1969, respectively, from the Estate of Don Andres Soriano as well as the cancellation and conversion of 11,140 common shares of the Estate of Don Andres Soriano and 138,865 common shares of Dona Carmen Vda. de Soriano into preferred shares in 1968 have caused the realization of income to these stockholders where the shares cancelled or redeemed previously form part of stock dividends within the purview of "essentially equivalent to a taxable dividend" pursuant to Section 83(b).

According to respondent, petitioner is liable to withhold the tax on dividends earned by its non-resident stockholders under Section 53(b). Failure of petitioner to withhold the tax gave rise to the 1968 and 1969 deficiency withholding tax assessment subject matter of the instant petition for review.

Petitioner insists that its purchase of 108,000 common shares from the Estate of Don Andres Soriano and the conversion of common shares to preferred shares is not within the purview of "essentially equivalent to the distribution of a taxable dividend" under Section 83(b) for the following reasons: (1) almost 50% of the stocks purchased by petitioner are shares coming from original issues; (2) that although the remaining balance of the stocks purchased came from stock dividends still Section 83(b) does not apply here there being no motive to evade or avoid the income tax considering the long period of time since these stocks were redeemed and there being a legitimate business purpose for the purchase of said shares; (3) that the purchase by ANSCOR of its own shares resulted in partial liquidation whereby capital gains is attributable to the seller, therefore, the corresponding duty to withhold any income tax is not present; and (4) the reclassification of shares from common to preferred does not fall under Section 83(b) for the same reason that there was a legitimate business purpose for the conversion and that no magnificent change had occurred from the move to convert these shares it being of the same quantity, par value and market value except that preferred shareholders would be deprived of their voting rights in exchange for the preference in case of liquidation.

Section 83(b) of the National Internal Revenue Code (1939) was copied from Section 115(g) of the United States Internal Revenue Code of 1939, the pertinent provision of which reads as follows:

> "Sec. 83. Distribution of dividends or assets by corporations. - (a) Definition of dividends. - x x x
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> (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, that 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." (Underlining supplied.)

It is clear from the above-quoted provision that the redemption or cancellation of stock by a corporation refers only to stock dividends. Furthermore, such redemption or cancellation of stock dividends must be at such a time and in such manner as to constitute the transaction as one which is essentially equivalent to the distribution of a taxable dividend.

Thus, where the corporation redeems or cancel stocks other than stock dividends said provision does not apply.

The deficiency assessments issued by respondent refer to the alleged withholding taxes due from petitioner on account of its redemption of 28,000 and 80,000 common shares of the Estate of Don Andres Soriano in 1968 and 1969, respectively, as well as the cancellation or conversion of 11,140 common shares of the Estate of Don Andres Soriano into 11,140 preferred shares and 138,865 common shares of Dona Carmen Vda. de Soriano to 138,860 preferred shares in 1968.

(1) Redemption of 28,000 and 80,000 common shares of the Estate of Don Andres Soriano in 1968 and 1969, respectively.

We must first determine the <u>source</u> of the shares redeemed by petitioner. If the shares redeemed came from shares of original issue then the redemption of these shares would not be treated as a dividend distribution but as a return of investment since Section 83(b) applies only to stock dividends cancelled or redeemed.

There is no dispute that 50,495 common shares of the Estate of Don Andres Soriano are original issues.[35] Petitioner was able to prove from the evidence submitted that all of the 50,495 common shares redeemed from the Estate of Don Andres Soriano came from original issues.[36] It is evident that the 28,000 common shares redeemed in 1968 came from original subscriptions. Therefore, since this 28,000 common shares do not form part of the stock dividends issued to Don Andres Soriano, then Section 83(b) does not apply. Parenthetically, the alleged realized income of the Estate of Don Andres Soriano on the 28,000 common shares redeemed by petitioner on which withholding of tax thereon should have been made does not lie.

With respect to the 80,000 common shares of the Estate of Don Andres Soriano which petitioner redeemed in 1969 in the United States, 22,495 of these common shares came from original issue and 57,505 common shares from stock dividends previously issued to Don Andres Soriano. As to the 22,495 common shares purchased by petitioner, We adopt the same ruling as in the 28,000 common shares purchased in 1968 it appearing that the 22,495 common shares also came from the original

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[35]Exh. I-1, p. 216, Folder I, BIR rec.; Exh J-2, p. 261, Folder I, BIR rec.; Exh. N-1, pp. 259-262, Folder II, BIR rec.

[36]Exh. N, p. 263, Folder II, BIR rec.; Exh. N-1, supra.

issue of 50,495 common shares. Understandably, Section 83(b) does not apply. As earlier opined this refers only to the cancellation or redemption of 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.

How about the 57,505 common shares purchased by petitioner or that portion of the 80,000 common shares which formed part of stock dividends? Would these shares purchased forming part of stock dividends be equivalent to a distribution of taxable dividend under Section 83(b)?

There are no clear cut criteria nor a definite yardstick to determine if Section 83(b) would be applicable. Often times each case must be decided on its own particular facts and circumstances.

The United States Courts have come up with a somewhat comparable listing of the "judicial criteria" which have proven useful in coming to a conclusion as to whether Section 83(b) is applicable. Some recognized criteria developed by the courts include the following: the presence or absence of a real business purpose; whether the action was initiated by the corporation or by the stockholders; the amount of earnings and profits available for the declaration of a regular dividend and the corporation's past record with respect to the payment of dividends; whether the distribution resulted in any substantial change in ownership and control or in a contraction of corporate operations; continued profitable operations; the effect of the distribution as compared with the declaration of a regular dividend; and any special circumstances existing at the time of a distribution.[37]

The factor of lapse of time between issuance and redemption was also held important since the test of whether or not the redemption and distribution are "essentially equivalent to a taxable dividend" depend on the "time" and "manner" of redemption. In selected cases in the United States, it was ruled that the lapse of time between issuance and redemption such as a matter of days or a period of up to 2 years were deemed to be

[37]1 Mertens 304-305, see Giles v. Bullock, 26 TC 276 (1956); Herbert E. Pliner, TC Memo 1961-218; Himmel v. Comm., 338 F2d 815 (CA 2d, 1964), citing Mertens text; Salvatori v. U.S., 66-2 USTC 9670 (DCSD Cal, 1966); Estate of Arthur F. Hinrichsen, TC Memo 1966-271; Levin v. Comm., 385 F2d 521 (CA 2d, 1967), citing Mertens text, affg 47 TC 258 (1966); Howard P. Blount, 51 TC 1023 (1969), affd 425 F2d 921 (CA 2nd, 1969).

essentially equivalent to the distribution of a taxable dividend.[38]

However, in some instances the time intervening between issuance and redemption if in excess of 2 years were deemed to be not equivalent to a dividend.[39]

Likewise, the courts have also ruled that "the statute does not provide that every cash redemption of shares shall be treated per se as a dividend, but only those which because of some circumstance of time and manner are in fact the essential equivalent of a dividend."[40] The reason advanced for this is if stocks issued as stock dividends are redeemed and are taxed as dividends to the full

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[38]1 Mertens 305, see: Adler v. Commissioner of Internal Revenue, 77 F2d 733 (CCA 5th, 1935) 2 years; Robinson v. Commissioner of Internal Revenue, 69 F2d 972 (CCA 5th, 1934), 2 months; Stanley Goldstein, BTA Memo Op Dkt 91426 (1939), affd 113 F2d 363 (CCA 7th, 1940), 9 months; Arthur M. Godwin, 34 BTA 485, a matter of days.

[39]1 Mertens 305; see: Commissioner of Internal Revenue v. Cordingley, 78 F2d 118 (CCA 1st, 1935) and Commissioner of Internal Revenue v. Quackenbos, 78 F2d 156 (CCA 2d, 1935), 8 years; Commissioner of Internal Revenue v. Champion, 78 F2d 513 (CCA 6th, 1935), 6 years; Commissioner of Internal Revenue v. Ahlborn, 77 F2d 700 (CCA 3d, 1935), 11 years; Commissioner of Internal Revenue v. Brown, 69 F2d 602 (CCA 7th, 1934), 2 years 5 months; Bona Allen, Jr., 41 BTA 206, 9 years; William Swindells, 44 BTA 336, 5 months to 2 years; Alfred E. Fuhlage, 79 F2d 998 (CCA 8th, 1935), 9 years; James A. Connelly, 30 BTA 331, 1 to 5 years; Robert R. Meyer, 27 BTA 44, 3 years; Alfred A. Laun, 26 BTA 764, 3 to 4 years.

[40]Commissioner of Internal Revenue v. Brown, supra.

amount paid for then it would in effect impose on such stocks an undisclosed lien, and this would be extremely unfair to intervening purchasers who bought such stocks after the stock dividend had been issued. Such purchasers would find on the redemption of the stocks that a large part of their capital investment was taxed as income.[41] Settled is the view that sums paid in retirement of stock are not taxable as dividends, unless the retirement was made in pursuance of a plan formed at the time when the stock was originally issued, or as a cloak for the distribution of earnings.[42]

Often times, We have resorted to the United States decisions in connection with the construction of Philippine tax laws.[43] It is a rational rule of statutory construction that a statute adopted from another state or country will be presumed to be adopted with the construction placed upon it by the courts of that state or country before its adoption. Such construction is regarded as of great weight, or at least persuasive, and will generally be followed if found

[41]Commissioner of Internal Revenue v. Cordingley, supra.

[42]Commissioner of Internal Revenue v. Cordingley, supra, citing Comm. v. Babson, 70 F2d 304 (CCA 7th, 1934) and Comm. v. Brown, supra.

[43]Osorio v. Posadas, 56 Phil. 748; Wise v. Meer, 78 Phil. 655.

reasonable, and in harmony with justice and public policy, with other laws of the adopting jurisdiction on the subject.** Considering that Section 83(b) of the National Internal Revenue Code was patterned after Section 115(g) of the United States Internal Revenue Code (1939), decisions of the United States courts construing similar laws are entitled to great weight and have persuasive effect in interpreting Section 83(b).

In the case at bar, this Court reached at the following findings and observations:

1. The purpose of redeeming 28,000 and 80,000 common shares in 1968 and 1969, respectively, was to reduce the number of shareholdings of non-resident stockholders in order to minimize the outflow of foreign exchange which will be incurred by the corporation in case it declares cash dividends in the future. Petitioner's Board of Directors envisioned this scenario in the event ANSCOR would declare cash dividends, where the non-resident stockholders would receive the foreign exchange equivalent of their cash dividends. In order to save on the cash outflow of foreign exchange from the country, the

**Cu v. Republic of the Philippines, 89 Phil. 473.

Board of Directors resolved to purchase the shares of these non-resident stockholders.[45]

2. The shares redeemed from the Estate of Don Andres Soriano was part of the plan to implement the desire of the late Don Andres Soriano to Filipinize the corporation and spread ANSCOR's equity ownership to the Filipino employees of ANSCOR as well as to Filipino employees of corporations managed by ANSCOR having for its purpose their improvement as well as their social and economic well-being.[46]

This plan was implemented in 1972 and 1973 when the Executors of the Estate of Don Andres Soriano offered 45,000,000 common shares, 75% hereof to Filipino employees of ANSCOR and its affiliate companies and 25% to other interested Filipinos in general.[47]

3. At the time the 80,000 common shares were redeemed in November, 1969, almost 6 years have lapsed from the time ANSCOR declared stock dividends on December 20, 1963 and the period of redemption.

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[45]Exh. M-1, pp. 97-108, Folder III, BIR rec.

[46]Exhs. M-1 and M-2, Administrative Hearings conducted on April 26, 1980 and May 20, 1980, pp. 85-108, Folder III, BIR rec.

[47]Exhs. O and O-1, p. 121, Folder III, BIR rec.

4. The stocks redeemed were not retired or put out of circulation but were placed in the name of ANSCOR as treasury shares for the purpose of re-issuing them in the future to the employees and officers of ANSCOR and other affiliate corporations managed by petitioner.

In summary therefore, an examination of the purpose for the redemption would show that there was no intention on the part of petitioner to avoid or evade the tax on "dividend equivalence" under Section 83(b) of the National Internal Revenue Code. The "essentially equivalent to a dividend" provision was evidently aimed at the capitalization of earnings which had no fair business object and were intended merely to evade the payment of taxes.[4a]

Adequate evidence were presented by petitioner showing proof of a valid corporate purpose for the redemption of its own shares, such as:

(a) its desire to limit the stock interest of its non-resident stockholders by the acquisition of their stocks in order to save on foreign exchange requirement in case cash dividends would be declared and remitted abroad; and

[4a]Commissioner of Internal Revenue v. Quackenbos, 78 F2d 156, (CCA 2d, 1935)

(b) the objective of the late Don Andres Soriano to Filipinize the corporation thru the distribution of its shares to Filipino employees of ANSCOR and its affiliates and to the public in general.

Thus, redeemed shares are the equivalent of dividends if and only if the shares were not issued for genuine business purposes.[49] Furthermore, Section 41 of the Corporation Code (1980) mandates the power of a corporation to purchase or acquire its own shares for a legitimate corporate purpose(s), provided, it has unrestricted earnings to cover the said purchase and that its capital is not thereby impaired and provided further, that the conditions of corporate affairs warrant it.[50] There being a valid corporate purpose for the redemption, there is, therefore, sufficient justification for the redemption to exclude it from the purview of an "essentially equivalent to a taxable dividend" provision. However, this factor alone is not controlling although it may be relevant and at times considered to be a critical factor in determining the applicability of Section 83(b).

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[49]Patty v. Helvering, 98 F2d 717 (CCA 2d, 1938); De Nobili Cigar Co. v. Commissioner of Internal Revenue, 143 F2d 436 (CCA 2d, 1944)

[50]see SEC Opinion, Feb. 27, 1976.

Moreover, the distribution and redemption of stock dividends were not made at the same time nor at a time close to each other as to make them one transaction.[51] The issuance of new common stocks in 1963 was due to the declaration of stock dividends, but the redemption of common shares in 1969, though forming part of stock dividends, was not made at such time in such manner as to make the transaction essentially equivalent to a distribution of dividend since over 6 years have lapsed after it was issued and before the redemption was effected.

Redemption under Section 83(b) connotes something other than repurchase; it includes the idea of a surrender of shares by a stockholder and a retirement of that which he surrenders. Conceivably the reason may be found in the fact that the corporation's acquisition of the stock with a view of reissuing it indicates that there was no intention on its part to permanently distribute part of its surplus. The characteristics of a sale may be thought to predominate over the characteristics of a distribution in partial liquidation.[52] A true

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[51]Huntoon v. Commissioner of Internal Revenue, 14 BTA 459.

[52]Alpers v. Commissioner of Internal Revenue, 126 F2d 58.

redemption of stock occurs when it is called and retired.[83]

Petitioner did not retire the stocks purchased from the Estate of Don Andres Soriano instead it placed them in its treasury as live assets to be disposed of as it should thereafter determine in this case to be distributed to its employees in the near future or more particularly in 1973 when the intent to Filipinize materialized.

In view of the findings arrived at by this Court, We can fairly conclude that Section 83(b) of the National Internal Revenue Code does not apply to the redemption of 28,000 and 80,000 common shares in 1968 and 1969, respectively. Hence, no obligation on the part of petitioner was created in order to withhold the tax from the Estate of Don Andres Soriano.

(2) Conversion of 11,140 common shares of the Estate of Don Andres Soriano and 138,864 common shares of Dona Carmen Vda. de Soriano into preferred shares in 1968.

The conversion of 11,140 common shares of the Estate of Don Andres Soriano and 138,864 common shares of Dona Carmen Vda. de Soriano into 11,140 and 138,860 preferred shares, respectively, with

[83]Commissioner of Internal Revenue v. Snite, 177 F2d 819.

the same par value were considered by respondent as "essentially equivalent to a distribution of taxable dividend" under Section 83(b) since the bulk of the stocks cancelled came from stock dividends resulting from a taxable income on the part of petitioner's stockholders which created on its part a liability to withhold the tax due thereon.

Respondent relied on the report of his examiners finding the conversion of stocks from common to preferred created an entirely different right and privilege resulting in a substantial change in the equity of its stockholders. Cash dividends were declared from the time preferred shares were issued on March 31, 1968 to December 31, 1971 on the basis of the total value of the preferred shares. It even recognized the total value of the preferred shares issued as its indebtedness in favor of preferred shareholders since the dividends paid to them were claimed as an interest expense. Petitioner also obligated itself to redeem the preferred shares at par value.[34]

Other factors considered by respondent's examiners were: petitioner is owned by a single family; the conversion was not pro-rata among its

[34]Respondent's Memorandum, pp. 152-153, CTA rec.; Examiners' Report, p. 21, Folder I, BIR rec.

stockholders; there was no distribution of cash dividends in favor of common shareholders; petitioner continue to operate with a profit; and last but not the least, the accumulated surplus earnings of petitioner before and after the conversion was tremendous.[33]

Petitioner on the other hand maintains that the conversion was merely a reclassification of its capital structure. The stockholders received equal number of preferred shares in exchange for their common shares with the same par value of P100.00 per share. The composition of petitioner's assets remain to be the same. There was only a cancellation of the certificate evidencing ownership in common stock in lieu of another certificate evidencing ownership in preferred stock. Furthermore, the United States Internal Revenue Service of Washington D.C. issued a ruling on this matter regarding the contemplated exchange of common to preferred shares in the same corporation as one that would qualify as a recapitalization or a reorganization.

However, respondent contends that the above ruling was based on incomplete facts. Petitioner did not mention that prior to the recapitalization

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[33]Ibid.

of the 300,000 common shares outstanding, into 150,000 common and 150,000 preferred shares, its capital structure was a combination of stocks originally purchased and stock dividends issued to stockholders. Cash dividends were not declared since 1945, when it resume its business operation due to World War II, until the date of recapitalization in 1968. The book value (absent the fair market value) as of December 31, 1967 or prior to the exchange in March, 1968 was P141.92 per common share.

We find for the petitioner.

The vital question to be determined is whether a gain or profit had been realized by the stockholders concerned from the exchange or conversion of the common shares of stock to preferred shares of stock, as compared to realizable gain, in order to subject petitioner from the withholding of tax due thereon.

It is worthy to note that the persons responsible in the management of ANSCOR are the two sons of Don Andres Soriano, namely, Andres Soriano, Jr. and Jose M. Soriano, who prior to the reclassification owned only 23,000 common shares while the majority of the stocks were owned by the Estate of Don Andres Soriano (including that of his wife). For this reason the Board of Directors decided to reclassify the 300,000 common shares into 150,000 common shares and 150,000 preferred shares, which was later approved by the Securities and Exchange Commission, in order to give greater shares of stock of the active managers (Jose M. Soriano and Andres Soriano, Jr.) of the corporation thereby reducing the risk of being over turned by the vote of Dona Carmen Vda. de Soriano (their mother) who owns majority of the stocks in ANSCOR. With the conversion, Dona Carmen Vda. de Soriano would loose her right over the management of the corporation in exchange for some preferred rights in the distribution of dividends and assets upon liquidation.[58] The purpose to reclassify was therefore a valid one.

More or less the same number of common shares were exchange for the same number of preferred shares with the same par value per share. In general, the rights and privileges of a common stockholder is the same as that of a preferred stockholder except that holders of preferred shares are entitled to certain preferences such as payment of dividends or the distribution of assets of a corporation in case of its dissolution or such

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[58]Exh. M-2, pp. 88-89, Folder III, BIR rec.

other preferences as may be stated in the articles of incorporation which are not violative of the Corporation Code in exchange for their voting rights.[37] As a result of restrictions upon other classes of stock with respect to voting rights, the common stock may, as to those classes, have preference in the matter of management.[38] The law provides that "Except as otherwise provided by the articles of incorporation and stated in the certificate of stock, each share shall be in all respects equal to every other share."[39] This means that all stocks enjoy equal rights and privileges. Therefore, the findings of respondent's examiners that the conversion created entirely different rights and privileges resulting in very substantial change in the equity of the stockholder have no legal nor factual basis to stand on.

Before the common shares of Dona Carmen Vda. de Soriano were actually converted into preferred shares, she requested for a ruling from the Internal Revenue Service of Washington D.C., regarding the tax consequence of the exchange which ruled: that the proposed transaction was not in pursuance to a plan to avoid Federal Income Taxes;

[37]Sec. 6, par. 2, Corporation Code.
[38]18 Am. Jur. 2d, 741.
[39]Sec. 6, par. 5, Corporation Code.

that the reclassification will classify as a recapitalization or a reorganization; no gain or loss will be recognized by the stockholders; and the basis for the exchange will be the same. The fact that some of the common shares converted came from stock dividends is of no consequence because no gain was realized from the transaction. The stocks of petitioner were merely reclassified into two - common and preferred. Only the certificate of stocks evidencing ownership was changed whereby the certificates evidencing ownership in common stock was cancelled and a new certificate this time evidencing ownership in preferred stock was issued for the same number of shares originally owned and with the same par value per share.

The "dividend equivalence" contemplated by Section 83(b) must necessarily have some logical relation to the conventional form, notion and effect of a dividend.[60] In the instant case, the stockholders, the Estate of Don Andres Soriano and Dona Carmen Vda. de Soriano, did not receive, as is required, any "net beneficial income" nor any "realized income" by reason of the exchange. Therefore, Section 83(b) does not apply to the cancelled and converted common shares to preferred

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[60]Commissioner of Internal Revenue v. Snite, supra.; 1 Mertens 298.

shares. Thus, there is no liability to withhold on the part of petitioner there being no taxable dividend to speak of.

WHEREFORE, premises considered, the presumption of prima pacie correctness of the assessments issued by the respondent having been overcome by sufficient and convincing evidence presented by petitioner, the decision appealed from is hereby reversed.

Without pronouncement as to cost.

SO ORDERED.

Quezon City, Metro Manila, July 4, 1991.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

ALEX Z. REYES
Presiding Judge

ERNESTO D. ACOSTA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ALEX Z. REYES
Presiding Judge
Court of Tax Appeals