

**REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY**

SPECIAL FIRST DIVISION

SHINRYO (PHILIPPINES) CO., INC.,
Petitioner,

C.T.A. CASE NO. 7572

Members:

- versus -

ACOSTA, Chairperson
BAUTISTA, and
CASANOVA, JJ.

**COMMISSIONER OF INTERNAL
REVENUE,**

Respondent.

Promulgated:

JAN 20 2010; 10:07am 

X -----X

DECISION

BAUTISTA, J.:

This is a Petition for Review seeking the cancellation or setting aside of the Final Decision and Final Assessment issued against petitioner on November 27, 2006, which demand payment from petitioner of alleged Final Withholding Tax, Capital Gains Tax, and Donor's Tax deficiencies, detailed as follows:

DEFICIENCY FINAL WITHHOLDING TAX (FWT)	
Basic Tax Due	P 4,902,450.00
Add: Interest	4,085,211.59
Total Amount Due	P 8,987,661.59
DEFICIENCY CAPITAL GAINS TAX (CGT)	
Basic Tax Due	P 4,951,816.20
Add: Interest	4,209,043.77
Total Amount Due	P 9,160,859.97
DEFICIENCY GIFT/DONOR'S TAX	
Basic Tax Due	P 2,263,561.20
Add: Interest	1,924,027.02
Total Amount Due	P 4,187,588.22
GRAND TOTAL	P22,336,109.78

Petitioner Shinryo (Philippines) Co. Inc. (hereinafter referred to as "Shinryo Philippines") is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines under Securities and Exchange Commission (SEC) Registration No. 181090, engaged in the business of general construction. It holds office address at Rooms 403-406 One Corporate Plaza Building, 854 A. Arnaiz Avenue, Makati City. Petitioner is likewise registered with the Bureau of Internal Revenue as a Large Taxpayer.¹

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) empowered to perform the duties of said office including, among others, the power to issue deficiency tax assessments against taxpayers, and to decide assessment protests. He holds office at the 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City.

On October 17, 2001, Shinryo Corporation (hereinafter referred to as "Shinryo Japan") and Christian E. Cangco, both stockholders of Shinryo Philippines, executed a Deed of Exchange for the purpose of exchanging some of their respective stockholdings. The pertinent portions of said Deed of Exchange² are reproduced hereunder for ready reference, to wit:

"DEED OF EXCHANGE

KNOWN ALL MEN BY THESE PRESENTS:

This **Deed of Exchange** (the 'Agreement' for brevity) made and entered into this 17th day of October by and between:

SHINRYO CORPORATION, a foreign corporation duly organized and existing under the laws of Japan, with principal and business address at 2-4 Yotsuya, Shinjuku-ku, Tokyo, Japan, represented in this instance by its _____, CHIKARA OBA, and hereinafter referred to as '**Shinryo**';

CHRISTIAN E. CANGCO, of legal age, Filipino citizen, and with postal address at 28 Dao Street, Octagon

¹ Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Simplification of Issues, (JSFSI), docket, p. 111

² Exhibit "G"

Village, Pasig, Metro Manila, hereinafter referred to as '**Dr. Cangco**'.

WITNESSETH: That

WHEREAS, Shinryo and Dr. Cangco are stockholders of SHINRYO (PHILIPPINES) COMPANY, INC.

WHEREAS, both parties have mutually agreed to exchange their respective stockholdings, each free from all liens and encumbrances whatsoever.

NOW, THEREFORE, for and in consideration of the foregoing premises, Shinryo does hereby CEDE, TRANSFER and CONVEY unto Dr. Cangco its 900 Class 'A' Common Shares; and likewise, Dr. Cangco, in turn, does hereby CEDE, TRANSFER and CONVEY unto Shinryo his 900 Class 'B' Common Shares.

Each party warrants that: (1) their Shares have been validly issued, are fully paid, and non-assessable; (2) this Deed has been validly executed and enforceable in accordance with its terms; and (3) the shares are free and clear of all liens and encumbrances.

Furthermore, we hereby authorize the Corporate Secretary of **SHINRYO (PHILIPPINES) COMPANY, INC.** to make the corresponding transfer in the corporate books of the aforesaid subscription from our name to the other party.

IN WITNESS WHEREOF, the parties together with their two (2) instrumental witnesses, have hereunto signed this Agreement as of date first written at Makati City, Metro Manila, Philippines."

On October 22, 2001, the Board of Directors and Stockholders of Shinryo Philippines approved the declaration and distribution of stock dividends valued at P35,000,000.00 among its stockholders of record.³

In December 2003, respondent issued a Letter of Authority (LOA) No. 0062011 authorizing his revenue officers to examine or audit petitioner's books of account and other accounting records covering fiscal year ending September 30, 2002.⁴

Thereafter, respondent issued a Preliminary Assessment Notice⁵ (PAN) dated September 8, 2005, assessing petitioner for alleged Final Withholding Tax, Capital Gains

³ Docket, p. 261

⁴ Par. 3, Stipulation of Facts, JSFSI, docket, p. 112

⁵ Exhibit "A"



Tax, and Donor's Tax deficiencies for fiscal year ending September 30, 2002 and which was received by petitioner on November 23, 2005.

On December 7, 2005, petitioner filed its protest letter⁶, disputing the said PAN.

Petitioner then received on January 3, 2006 an undated Formal Letter of Demand and Assessment Notice⁷ from respondent, signed by Corazon C. Pangcog of the BIR Large Taxpayers Service, assessing petitioner the following tax deficiencies: (1) Final Withholding Tax in the amount of P8,987,661.59; (2) Capital Gains Tax in the amount of P9,160,859.97; and (3) Donor's Tax in the amount of P4,187,588.22.

On February 1, 2006, petitioner filed a Protest Letter to the Formal Letter of Demand and Assessment Notice⁸, refuting the alleged tax assessment on the following grounds: (1) prescription; (2) subject stock dividends are not subject to Final Withholding Tax; (3) petitioner is not a party to the Deed of Exchange of shares of stocks between stockholders; and (4) lack of factual and legal bases of the assessment.

Respondent issued the Final Decision on Disputed Assessment⁹ dated November 27, 2006, reiterating his stand that a stock dividend constitutes income subject to Final Withholding Tax, and that the period of limitation to assess and collect have not yet prescribed since there was fraud committed on the part of herein petitioner.

On February 7, 2007, petitioner filed the instant Petition for Review before this Court in order to prevent said decision from becoming final, executory, and demandable.

In his Answer filed on May 9, 2007, respondent interposed the following counter-arguments¹⁰:

***"The Right of Respondent to Assess
Petitioner the Subject Deficiency
Taxes has not yet Prescribed***

⁶ Exhibit "B"

⁷ Exhibit "C"

⁸ Exhibit "D"

⁹ Exhibit "E"

¹⁰ Docket, pp. 65-75

5. Petitioner avers that the right of respondent to issue the assessment herein has prescribed invoking Section 203 of the National Internal Revenue Code of 1997 (NIRC of 1997). Petitioner claims that respondent is given only a period of three years after the last day of filing of the return within which to make an assessment for deficiency taxes. However, respondent respectfully submits that the peculiar facts of this case deny the merit of petitioner's contention.
6. It is undisputed that in calendar year 2001, SHINRYO JAPAN received from petitioner, SHINRYO PHILIPPINES intercorporate dividends (stock dividends) valued at P35,000,000.00. Petitioner was then assessed for its failure to withhold the tax due from this transaction pursuant to Section 28 (B) (5) (b) in relation to Section 57 (A) of the NIRC of 1997. The merits of the assessment for the withholding tax deficiency is discussed in the immediate succeeding section and is hereby repleaded herein and made an integral part thereof.
7. It must be stressed that this amount sought to be collected from petitioner is not the tax itself. Logically, it would be ridiculous to collect the said tax from petitioner when no income flowed into its person and jurisprudence affirms the same. In the case of COMMISSIONER OF INTERNAL REVENUE vs. THE COURT OF APPEALS, COURT OF TAX APPEALS and A. SORIANO CORP.¹¹, it was provided:

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8. In instances of non-withholding of the tax, such as the case herein, the liability of the withholding agent becomes separate and distinct from the liability of the person on whom the tax is primarily imposed because the cause of action against the withholding agent is not for the collection of the tax but for the enforcement of the withholding tax provision of the NIRC of 1997. The same abovesited case provides:

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9. Clearer than day, in case of breach by the agent of his legal duty, he is assessed **not for the collection of income tax**. He is merely penalized for failure to comply with the withholding tax provision. Therefore, in case of such breach, and no income taxes were withheld by the agent, the agent is penalized. The tax cannot be collected from the agent because as stated in the above case, '(t)he agent is not liable for the tax as no wealth flowed into him – he earned no income.' The cause of action against the withholding agent is not the collection of the tax but for the enforcement of the withholding tax provision of the NIRC of 1997.

¹¹ G.R. No. 108576, January 20, 1999

10. Such position is buttressed by Section 251 of the NIRC of 1997 which provides:

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It is clear that in addition to other penalties provided under the NIRC of 1997, the withholding agent shall be liable to **a penalty** equal to the total amount of tax not collected and remitted. Hence, since the liability of the withholding agent (petitioner herein) is a penalty, then the period of limitation provided in Section 203 of the NIRC of 1997 finds no application. The said provision prescribed a limitation only as to the assessment and collection **of taxes, not penalties.**

11. As to the deficiency capital gains tax and donor's tax assessments, contrary to petitioner's submission that respondent has only a period of three years within which to assess the petitioner for the subject transactions, respondent is actually entitled to a prescriptive period of 10 years due to the exceptional circumstance attendant in this case. Here, it was clearly determined that while petitioner filed internal revenue tax returns and actually paid minimal taxes due on the transaction on behalf of both parties, it failed to declare and pay the legally required Donor's Tax due on the transaction. Furthermore, petitioner also substantially underdeclared the Capital Gains Tax due from the same. It paid the amount of P27,325.30 when the correct amount should have been P4,051,816.20. In other words, it paid less than one percent (1%) of the Capital Gains Tax due. Such action/omission of petitioner falls within the ambit of Section 248 (B) of the NIRC of 1997, to wit:

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12. Being a matter falling under the above provision, the applicable period to assess in this case is ten (10) years from the discovery of this falsity or omission as provided by Section 222 of the NIRC of 1997, to wit:

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Based on the foregoing, it becomes crystal clear that petitioner's assertion that respondent is only entitled to a period of three (3) years from the last day for filing a return as required by law, to assess the applicable taxes does not find application in this case.

13. More correctly, in this case, the date when the Preliminary Assessment Notice (PAN) was issued is deemed as the date of discovery of the fraud, falsity or omission since it clearly documents the preliminary findings and gives an indication, by this positive action, of the determination pursuant to Section 248 (B) of the NIRC of 1997 made by respondent. Here the PAN was issued on 8 September 2005. Thus respondent has ten (10) years from such date to make an assessment. Within such period, or on 3 January 2006,



the Assessment and Formal Letter of Demand was issued by respondent. Without a doubt the assessment was issued within the period provided by law.

Petitioner's Declaration of Stock Dividends is Subject to Final Withholding Tax

14. It is undisputed that SHINRYO JAPAN is a non-resident foreign corporation. It is also undisputed that in calendar year 2001, SHINRYO JAPAN received from petitioner, SHINRYO PHILIPPINES, intercorporate dividends (stock dividends) valued at P35,000,000.00.
15. Ordinarily, stock dividends being merely transfers of surplus to capital account, are not taxable. However, in this case, respondent found that there has been a change in the proportional interest of SHINRYO JAPAN, different from that which his former stockholding represented. Accordingly, Section 252 of Revenue Regulations No. 2 finds application in present case, thus:

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As defined above, the stock dividend received by SHINRYO JAPAN, was found to have resulted in a change in its proportional interest in SHINRYO PHILIPPINES. Thus, it constitutes taxable intercorporate dividend income subject to the final tax on intercorporate dividends under Section 28 (B) (5) of the NIRC of 1997.

16. As provided by Section 28 (B) (5) of the NIRC of 1997, the tax imposed thereunder shall be collected and paid in accordance with Section 57 (A) of the NIRC of 1997, which provides:

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17. Indubitably, SHINRYO PHILIPPINES, as the payor/withholding agent in the subject transaction, is liable for the taxes it was supposed to withhold from the intercorporate dividends it had given to SHINRYO JAPAN. Since it failed to discharge its statutory obligations, it is assessed a penalty equal to the amount of taxes it was liable to remit.

***The Assessment for Deficiency
Capital Gains Tax and Donor's
Tax on the Exchange of Shares
of Stocks is Proper in all Respects***

18. Petitioner posits that it is not the proper party to be assessed the deficiency taxes due on the exchange of shares between its stockholders, SHINRYO JAPAN and Mr. Christian Cangco, petitioner being a separate juridical entity from SHINRYO JAPAN (sic). This contention cannot hold water.



19. It is admitted that SHINRYO JAPAN is a non-resident foreign corporation, duly licensed and existing under the laws of Japan. SHINRYO PHILIPPINES, on the other hand, is a domestic corporation, duly licensed under the laws of the Philippines. Thus, their respective juridical personalities may be concluded to be distinctly identifiable. But this does not relieve petitioner, SHINRYO PHILIPPINES, from any tax liability.
20. Granting without conceding, that the deficiency capital gains taxes and donor's taxes should be collected from the parties to the exchange, there are certain acts that estop petitioner from denying liability. By its actions, petitioner held itself out to the world as one authorized to pay the taxes due on the exchange of the shares.
20. SHINRYO PHILIPPINES was authorized by SHINRYO JAPAN and Mr. Christian Cangco to act as their agent to legally effect their exchange of shares and make the corresponding transfer in the corporate books. This is evidenced by the Deed of Exchange dated 17 October 2001. Petitioner's acceptance of this authority/agency is also betrayed by its subsequent actions. SHINRYO PHILIPPINES filed the corresponding Capital Gains Tax and Documentary Stamp Tax returns governing this transaction and paid the miniscule amounts of P27,325.30 and P675.00, respectively. The returns, dated 5 November 2001, were executed, filed and paid by SHINRYO PHILIPPINES thru its own President, on behalf of the seller and buyer, in the Land Bank of the Philippines, Atrium-Makati Branch.
21. By holding itself out to the world that it is authorized to pay the taxes due on the exchange of shares, petitioner cannot at the same time, deny liability for paying the wrong amount for one type of tax and its omission to pay another. Such a ratiocination would be hard to swallow because presenting oneself as authorized to pay taxes due on a certain transaction necessarily includes the duty to pay the correct taxes. It cannot attach validity to the action it undertook yet deny the validity of the consequences of the same. It cannot boldly hold itself out as one authorized and responsible for a transaction yet cut and run when the going gets rough and a deficiency assessment is issued. 'A party cannot, in the course of litigation or in dealings in pais, be permitted to repudiate his representations, or occupy inconsistent positions, or in the letter of Scotch law, to approbate or reprobate.'¹²
22. The deficiency capital gain tax herein was lawfully assessed based on Section 28 (B) (5) (c) of the NIRC of 1997 to wit:

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On petitioner's conjecture that the exchange of the shares of stock is not subject to the above tax as there was no gain realized from the

¹² Magdalena Estate, Inc. vs. Myrick, 71 Phil. 344



said transaction and merely a paper transaction, it is the respondent's position that there was a taxable gain realized from this transaction. The shares of stocks exchanged were of different classes, with different par values. Moreover, it is not a mere paper transaction which does not result in the flow of wealth. On the contrary, SHINRYO JAPAN received 900 class B shares in exchange for the 900 class A shares it disposed of. It is not disputed that the class B shares have greater par value than class A shares. Hence, tax may be imposed on the net capital gains realized from the exchange.

23. As to petitioner's denial of their liability for Donor's tax on the ground that there exists no donative intent, the NIRC provides that:

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As earlier mentioned, the par value of Class B shares was greater than the par value of the Class A shares. The consideration given is inadequate for the value of shares received. The transaction is therefore a proper subject of Donor's Tax.

24. Finally, it is well-settled rule in taxation that assessments are *prima facie* presumed correct and made in good faith. The taxpayer has the duty of proving otherwise, and in the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed."

After trial on the merits, this case was submitted for decision on January 20, 2009, taking into consideration petitioner's Memorandum filed on October 28, 2008 and respondent's Memorandum filed on December 10, 2008.

The parties stipulated the following issues¹³ for this Court's resolution:

- "1. Whether or not the right of respondent to assess has already prescribed.
2. Whether or not petitioner is liable for deficiency Final Withholding Tax Assessment for the fiscal year ending 15 January 2002.
3. Whether or not petitioner is liable for deficiency Donor's Tax Assessment for the fiscal year ending 15 January 2002.
4. Whether or not petitioner is liable for deficiency Capital Gains Tax Assessment for the fiscal year ending 15 January 2002."



¹³ Docket, pp. 113-114

Declaration of stock dividends is not subject to final withholding tax.

In 2001, Shinryo Japan received from petitioner intercorporate dividends. Petitioner contends that the stock dividends it declared and distributed to its stockholder Shinryo Japan are not subject to income tax. Since it is not subject to income tax, consequently, it is not subject to Final Withholding Tax. Petitioner also argues that although Section 28(B)(5)(b) of the National Internal Revenue Code (NIRC) of 1997 imposes a tax on intercorporate dividends received by a non-resident foreign corporation, the same is not applicable to the circumstances of the present case. Section 28(B)(5)(b) applies to cash and/or property dividends and not to stock dividends as it does not constitute an income collected and paid to its non-resident foreign corporation stockholder.

Respondent contends that although ordinarily stock dividends are not taxable since they represent mere transfers of surplus to capital account; however, if there is a change in the proportional interest of stockholders compared to what the former stocks represented, then the stock dividends become taxable.

Section 28(B)(5)(b) of the NIRC of 1997 provides that:

"SEC. 28. Rates of Income Tax on Foreign Corporations. -

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(B) Tax on Nonresident Foreign Corporation. —

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(5) Tax on Certain Incomes Received by a Nonresident Foreign Corporation. -

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(b) Intercompany Dividends. - A final withholding tax at the rate of fifteen percent (15%) is hereby imposed on the amount of cash and/or property dividends received from a domestic corporation, which shall be collected and paid as provided in Section 57 (A) of this Code, subject to the condition that the country in which the nonresident foreign corporation is domiciled, shall allow a credit against the tax due from the nonresident foreign corporation taxes deemed to have

been paid in the Philippines equivalent to twenty percent (20%) for 1997, nineteen percent (19%) for 1998, eighteen percent (18%) for 1999, and seventeen percent (17%) thereafter, which represents the difference between the regular income tax of thirty-five percent (35%) in 1997, thirty-four percent (34%) in 1998, and thirty-three percent (33%) in 1999, and thirty-two percent (32%) thereafter on corporations and the fifteen percent (15%) tax on dividends as provided in this subparagraph;" (*Emphasis supplied*)

While Section 28(B)(5)(b) of the NIRC of 1997 imposes a tax on intercorporate dividends received by a non-resident foreign corporation, such does not apply in the instant case as it speaks only of cash and/or property dividends. The same does not include stock dividends declared by a domestic corporation, since they do not constitute income collected and paid to its non-resident foreign corporate stockholder.

In BIR Ruling (DA-077-98) dated March 12, 1998, the BIR defined dividends as follows:

"1. Dividends comprise any distribution, whether in cash or other property, in the ordinary course of business, even though extraordinary in amount, made by a domestic or resident foreign corporation to the stockholders out of its earnings or profits (Sec. 250, Income Tax Regulations)."

Petitioner's position finds further support in the case of **Commissioner of Internal Revenue vs. The Court of Appeals, Court of Tax Appeals and A. Soriano Corp.**¹⁴, wherein it was held by the Supreme Court that stock dividend is not taxable, thus:

"(S)pecifically, 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. So that the mere issuance thereof is not yet subject to income tax as they are nothing but an 'enrichment through increase in value of capital investment.'** As capital, the stock dividends postpone the realization of profits because the 'fund represented by the new stock has been

¹⁴ G.R. No. 108576, January 20, 1999

transferred from surplus to capital and no longer available for actual distribution.' 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.' It means cash or its equivalent. It is gain derived and severed from capital, from labor or from both combined - so that to tax a stock dividend would be to tax a capital increase rather than the income. **In a loose sense, stock dividends issued by the corporation, are considered unrealized gain, and cannot be subjected to income tax until that gain has been realized. Before the realization, stock dividends are nothing but a representation of an interest in the corporate properties. As capital, it is not yet subject to income tax.** It should be noted that capital and income are different. Capital is wealth or fund; whereas income is profit or gain or the flow of wealth. The determining factor for the imposition of income tax is whether any gain or profit was derived from a transaction.

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The issue of taxable dividend may arise only once a subscriber disposes of his entire interest and not when there is still maintenance of proprietary interest." (*Emphasis supplied*)

The above jurisprudence was an interpretation of Section 73(B) of the NIRC of 1997, as amended, which states as follows:

"SEC. 73. Distribution of Dividends or Assets by Corporations. —

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(B) Stock Dividend. — 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 that it represents a distribution of earnings or profits." (*Emphasis supplied*)

Moreover, respondent in BIR Ruling No. 009-04 affirmed the same treatment of stock dividends in this wise:

"However, stock dividends whether of the same class or different are not income. The reason is that there is no distribution of the assets of the corporation. The stock dividends create only a change in the composition of the stockholders' equity, that is, a transfer from retained earnings to capital stock."



Contrary to the allegation of respondent, petitioner managed to prove that there was no change in the proportionate interest of the stockholders prior to and after the declaration of stock dividend, as evidenced by the analysis¹⁵ of the capital structure of petitioner before and after the declaration of stock dividends.

Furthermore, Section 252 of Revenue Regulations No. 2 categorically provides that dividend which represents the transfer of surplus to capital account is not subject to income tax; except if there is a change in the interest of the stockholders after the stock dividend declaration as compared to the interest before the declaration of stock dividend, to wit:

"SECTION 252. *Stock dividends.* — A stock dividend which represents the transfer of surplus to capital account is not subject to income tax. However a dividend in stock may constitute taxable income to the recipients thereof notwithstanding the fact that the officers or directors of the corporation (as defined in Section 84) choose to call such distribution as a stock dividend. The distinction between a stock dividend which does not, and one which does, constitute income taxable to the shareholder is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholders after the distribution is essentially different from his former interests. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stockholdings represented. **A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old — the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.**" (*Emphasis supplied*)

Based on the afore-quoted provision, a stock dividend may be taxable only if it alters the proportionate interest of the shareholders after the declaration of stock dividend as compared to the interest before the stock dividend declaration. Below is the computation of the proportional interests of the stockholders of petitioner before and after the declaration of stock dividends, to wit:¹⁶

¹⁵ Exhibit "V"

¹⁶ Exhibits "V" and "W"



Stockholders	Shares Held		Percentage	
	Before	After	Before	After
CLASS "A" Par Value: P100				
Shinryo Corporation	5,070	16,900	30.73%	30.73%
Christian E. Cangco	9,870	32,900	59.82%	59.82%
Koichi Kikawada	15	50	0.09%	0.09%
Luz D. Cangco	15	50	0.09%	0.09%
Mely I. Espinosa	15	50	0.09%	0.09%
Masao Hirano	15	50	0.09%	0.09%
	15,000	50,000		
CLASS "B" Par Value: P9,000.00				
Shinryo Corporation	1,500	5,000	9.09%	9.09%
Christian E. Cangco				
	1,500	5,000		
TOTAL NO. OF SHARES	16,500	55,000	100.00%	100.00%

It can be deduced from the above table that there was no proportionate increase in Shinryo Japan's percentage of stocks before and after petitioner's declaration of stock dividends. It is still at 30.73 for Class "A" stocks and 9.09% for Class "B" stocks. Stated differently, due to the lack of change in the proportionate interest in petitioner despite the stock dividend declaration, the stock dividends so declared do not constitute taxable income subject to Final Withholding Tax.

Petitioner is not subject to Capital Gains Tax and Donor's Tax for not being privy to the Deed of Exchange of shares of stocks between its stockholders and for having a separate and distinct personality from its stockholders.

On the issue of whether or not petitioner has to pay Capital Gains Tax and Donor's Tax on the exchange of shares of stock between Shinryo Japan and Christian E. Cangco, both stockholders of petitioner, the Court finds that petitioner is not liable to pay the same on the simple reason that petitioner is not a party to the said transaction as shown in the Deed of Exchange. And pursuant to the provision of the Corporation Code and numerous



jurisprudence¹⁷, petitioner, being a juridical person, "is invested by law with a separate personality, separate and distinct from that of the persons composing it as well as from any other legal entity to which it may be related."¹⁸

At this point, it must be emphasized that Shinryo Japan is only a stockholder of petitioner Shinryo Philippines as clearly indicated in the General Information Sheet duly filed before the SEC for fiscal years ending September 30, 2002¹⁹ and September 30, 2003²⁰. Likewise, the testimony²¹ of Mr. Hideaki Sakai, the President of Shinryo Japan has proven that Shinryo Japan, whose principal place of business is in Tokyo, Japan, is distinct and different from Shinryo Philippines. On the other hand, Shinryo Philippines is a domestic corporation organized and existing under the laws of the Philippines as evidenced by its SEC registration²². Consequently, the one that should be made liable are the parties to the Deed of Exchange, namely; Shinryo Japan and Christian E. Cangco.

As to the alleged deficiency Donor's Tax amounting to P4,187,588.22 plus interest, Section 98 of the NIRC of 1997, as amended, is the one applicable, which reads as follows:

"SEC. 98. Imposition of Tax. —

(A) There shall be levied, assessed, collected and paid upon the transfer by any person, resident or nonresident, of the property by gift, a tax, computed as provided in Section 99.

(B) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible."

As stated in the above provision, the person liable to donor's tax is the party who owns the property and who, with donative intent, transfers the same to another to effect

¹⁷ Western Agro Industrial Corporation, *et al.* vs. Hon. Court of Appeals, *et al.*, G.R. No. 82558, August 20, 1990; Tan Boon Bee & Co Inc. vs. Jarencio, 163 SCRA 205; Yutivo and Sons Hardware Company v. Court of Tax Appeals, 1 SCRA 160; Emilio Cano Enterprises, Inc. v. Court of Industrial Relations, 13 SCRA 290

¹⁸ Tan Boon Bee & Co Inc. vs. Jarencio, 163 SCRA 205, citing Yutivo and Sons Hardware Company v. Court of Tax Appeals, 1 SCRA 160

¹⁹ Exhibit "I"

²⁰ Exhibit "J"

²¹ Exhibit "L"

²² Exhibit "H"

inter vivos or during the lifetime of the donor and the donee, who accepts the same.²³ In the case of petitioner, it is neither the owner of the shares allegedly being donated nor a party to the alleged donation; hence, petitioner is not liable.

The right of respondent to assess and collect the alleged tax deficiencies of petitioner has already prescribed.

Pursuant to Section 203 of the NIRC of 1997, respondent has three years, counted from the date of actual filing of the return or from the last date prescribed by law for the filing of such return, whichever comes later, to assess a national internal revenue tax. Section 203 is hereunder quoted for easy reference, to wit:

"SEC. 203. Period of Limitation Upon Assessment and Collection. – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

In the case of the deficiency Capital Gains Tax assessment, records show that Shinryo Japan and Christian E. Cangco filed Capital Gains Tax Returns and paid the corresponding Capital Gains Tax on November 5, 2001²⁴ and November 19, 2001²⁵, respectively, pertaining to the Deed of Exchange²⁶ of shares of stock entered into by and between Shinryo Japan and Christian E. Cangco on October 17, 2001. Therefore, respondent had until November 19, 2004 within which to issue an assessment for deficiency Capital Gains Tax on the said exchange. Since the Formal Letter of Demand and

²³ Article 725, Civil Code of the Philippines; *Heirs of Sevilla vs. Sevilla, et al.*, G.R. No. 150179, April 30, 2003

²⁴ Exhibits "P" and "Q"

²⁵ Exhibits "T" and "U"

²⁶ Exhibit "G"



Assessment Notice were received by petitioner only on January 3, 2006, respondent's right to assess petitioner for Capital Gains Tax on the said exchange has already prescribed.

Likewise, the assessments for deficiency Final Withholding Tax and Donor's Tax were issued outside of the three-year prescriptive period.

Section 2.58(A)(2)(a) of Revenue Regulations No. 2-98 provides that the return for FWT is to be filed and payment should be made within ten (10) days after the end of each month for final taxes withheld during the months of January until November, while the return and payment for final taxes withheld for the month of December shall be made on or before January 25 of the following year. The alleged deficiency FWT pertains to the stock dividends declared by petitioner on October 21, 2001. Assuming that petitioner is required to file a return and pay the corresponding FWT on the said transaction, respondent had until November 12, 2004,²⁷ which is three years from the last day to file the return for the month of October 2001, within which to assess petitioner of deficiency FWT.

As regards the Donor's Tax, Section 103(B) of the NIRC of 1997, as amended, mandates that the return must be filed within thirty (30) days after the gift is made and the tax due thereon be paid at the time of filing. The alleged deficiency Donor's Tax pertains to the Deed of Exchange dated October 17, 2001. Thus, respondent's right to assess petitioner of deficiency Donor's Tax ended on November 17, 2004.

While Section 222 of the NIRC of 1997 provides for certain exceptions as to the period of limitation, *viz.*, in case of false or fraudulent return with intent to evade tax or failure to file a return, such is not attendant in this case to warrant extension of the prescriptive period to ten (10) years.

In the case of petitioner's alleged deficiency Final Withholding Tax, Section 252 of Revenue Regulations No. 2 provides that stock dividend which represents the transfer of surplus to capital account is not subject to income tax except if there is a change in the

²⁷ November 10, 2001 being a Saturday



interests of the stockholders after the stock dividend as compared to the interests before the stock dividend.

As correctly illustrated by petitioner in Exhibit "V", there had been no change in the interests before and after the declaration of the subject stock dividends. Petitioner's stockholders still maintained their proportionate interest prior to and after the stock dividend declaration, as shown below:

Stockholders		Shares Held		Percentage	
		Before	After	Before	After
Class "A" Par Value: P100					
	Shinryo Corporation	5,070	16,900	30.73%	30.73%
	Christian E. Cangco	9,870	32,900	59.82%	59.82%
	Koichi Kikawada	15	50	0.09%	0.09%
	Luz D. Cangco	15	50	0.09%	0.09%
	Mely I. Espinosa	15	50	0.09%	0.09%
	Masao Hirano	15	50	0.09%	0.09%
		15,000	50,000		
Class "B" Par Value: P9,000.00					
	Shinryo Corporation	1,500	5,000		
	Christian E. Cangco				
		1,500	5,000		
TOTAL NO. OF SHARES		16,500	55,000		

Apparently, petitioner is not liable to withhold any FWT on the stock dividends it declared on October 21, 2001. Accordingly, it was correct on the part of petitioner not to file any FWT Return on the said transaction.

Regarding the Capital Gains Tax assessment, records indicate that Shinryo Japan and Christian E. Cangco, the parties to the subject exchange transaction, filed the corresponding CGT Returns and paid the taxes due thereon. Respondent failed to establish that such Returns were false or fraudulent as contemplated under Section 222 of the NIRC of 1997.

Anent the Donor's Tax Assessment, it must be pointed out that Shinryo Japan and Christian E. Cangco filed Capital Gains Tax and Documentary Stamp Tax Returns, and paid



the corresponding CGT and DST.²⁸ The Supreme Court in the case of **Commissioner of Internal Revenue vs. Goodrich Philippines, Inc. et al.**²⁹, ruled that:

"For the purpose of safeguarding taxpayers from any unreasonable examination, investigation or assessment, our tax law provides a statute of limitations in the collection of taxes. Thus, the law on prescription, being a remedial measure, should be liberally construed in order to afford such protection. As a corollary, the exceptions to the law on prescription should perform be strictly construed.

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Furthermore, the fact that private respondent sold its real property for a price less than its declared fair market value did not by itself justify a finding of false return. Indeed, private respondent declared the sale in its 1974 return submitted to the BIR. Within the five-year prescriptive period, the BIR could have issued the questioned assessment, because the declared fair market value of said property was of public record. This it did not do, however, during all those five years. Moreover, the BIR failed to prove that respondent's 1974 return had been filed fraudulently. Equally significant was its failure to prove respondent's intent to evade the payment of the correct amount of tax.

Ineludibly, the BIR failed to show that private respondent's 1974 return was filed fraudulently with intent to evade the payment of the correct amount of tax. Moreover, **even though a donor's tax, which is defined as 'a tax on the privilege of transmitting one's property or property rights to another or others without adequate and full valuable consideration,' is different from capital gains tax, a tax on the gain from the sale of the taxpayer's property forming part of capital assets, the tax return filed by private respondent to report its income for the year 1974 was sufficient compliance with the legal requirement to file a return.** In other words, **the fact that the sale transaction may have partly resulted in a donation does not change the fact that private respondent already reported its income for 1974 by filing an income tax return."** (*Emphasis supplied*)

Since respondent failed to demonstrate clearly that petitioner had filed a fraudulent return with the intent to evade tax, or that it had failed to file a return at all, the three-year prescriptive period applies; hence, the period for issuance of assessment had already prescribed.

Inasmuch as respondent's right to assess had already lapsed and petitioner has sufficiently proven that it is not liable to pay Final Withholding Tax, Capital Gains Tax, and

²⁸ Exhibits "N", "O", "P", "Q", "R", "S", "T", and "U"

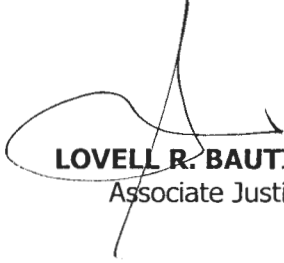
²⁹ G.R. No. 104171, February 24, 1999



Donor's Tax, the cancellation of Assessment Notice Nos. LTDO-122-WF-00004, LTDO-122-CG-2002-00001, and LTDO-122-DN-2002-00001, respectively, is in order.

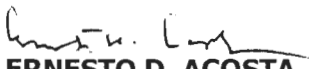
WHEREFORE, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, the Final Decision and Final Assessment issued on November 27, 2006, assessing petitioner for deficiency Final Withholding Tax, Capital Gains Tax, and Donor's Tax are hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.



LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:



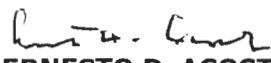
ERNESTO D. ACOSTA
Presiding Justice



CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.



ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division