REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

BATANGAS TRANSPORTATION COMPANY,
and LAGUNA TAYABAS BUS COMPANY,
Petitioners,

- versus - C.T.A. CASE NO. 71

COLLECTOR OF INTERNAL REVENUE,
Respondent.

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DECISION

This is an appeal from a decision of the respondent Collector of Internal Revenue assessing and demanding from the petitioners Batangas Transportation Company and Laguna Tayabas Bus Company the amount of ₱54,143.54, allegedly representing deficiency income tax and compromise for the years 1946, 1947, 1948 and 1949. However, before filing his answer to the petition for review, the respondent set aside his assessment of ₱54,143.54 and reassessed the alleged income tax liabilities of the petitioners at ₱148,890.14. In their reply to respondent's answer, the petitioners therefore ask this Court to consider their reply as an appeal from the said assessment of ₱148,890.14 based upon the same grounds as those alleged in their original petition.

It appears that the petitioners herein, the Batangas Transportation Company and the Laguna Tayabas Bus Company, are two distinct and separate corporations duly organized and existing under the laws of the Philippines, and are engaged in the business of land transportation by means of motor buses. The first was organized in 1918, and the second, in 1928, and each now has a fully paid-up capital of ₱1,000,000.00.

Before the last war they maintained separate head offices, the Laguna Tayabas Bus Company in San Pablo, Laguna, and the Batangas Transportation Company in Batangas, Batangas, as well as separate books, fleets, management, personnel, maintenance and repair shops, and other facilities. During the war and as a result thereof, both companies lost their respective properties, while their American officials were interned.

Sometime in April, 1945, the companies resumed operations when they acquired fifty-six (56) auto-buses from the United States Army. Half of these trucks were acquired by the Batangas Transportation Company, and the other half by the Laguna Tayabas Bus Company, being registered separately in their respective names.

Beginning March 1, 1947, after the resignation of Major Martin Olson as Manager of the Laguna Tayabas Bus Company, Mr. Joseph Benedict, Manager of the Batangas Transportation Company, was appointed manager of both corporations by their respective boards of directors. The office of the Laguna Tayabas Bus Company in San Pablo City was made the main office of both corporations. The placing of the two companies under the sole managership of Mr. Joseph Benedict was made by the President of both corporations, Mr. Max Blouse, under and by virtue of the authority granted by resolution of the Board of Directors of the Laguna Tayabas Bus Company on August 10, 1945 and ratified by the boards of the two corporations in their respective resolutions dated October 27, 1947.

According to the uncontradicted testimony of Mr. Benedict, the purpose of the joint management or the so-styled "Joint Emergency Operation" of the petitioners corporations by one management was to economize in overhead expenses. By means of this joint operation it appears that the petitioners have been able to save the salaries of one manager and one assistant manager, fifteen inspectors, special agents, and one set of office clerical force. In fact, the petitioners have been able to save at least ₱200,000.00 a year, or ₱100,000.00 each. (pp. 14-16, t.s.n.)

At the end of each calendar year, all gross receipts and expenses are determined and the net profit as of that date were transferred fifty-fifty (50-50) to the books of accounts of each corporation. (pp. 21-22, t.s.n.). Examiner Miguel Grafilo of the Bureau of Internal Revenue, who made a thorough investigation of the operation of the "Joint Emergency Operation," of the two companies, testified that the books of accounts as well as the reports of their auditors, Price, Waterhouse, White, Page & Company, show that one-half of the net profits of the joint management went to the Batangas Transportation Company and the other half to the Laguna Tayabas Bus Company. (pp. 49, 54, t.s.n.). Each corporation then prepared its own income tax return from this fifty percentum of the gross receipts and expenditures, assets and liabilities thus transferred to it from the "Joint Emergency Operation" and paid the corresponding income taxes thereon separately.

On the theory that the resources of the petitioners were pooled together in the "Joint Emergency Operation" and a joint venture was thus formed and organized, the Collector of Internal Revenue wrote a letter to the Laguna Tayabas Bus Company, informing the latter that there was due from it and the Batangas Transportation Company, the amount of ₱422,210.89 as deficiency income tax and compromise for the years 1946 to 1949, inclusive. Since the Collector of Internal Revenue caused to be distrained, seized, and advertised for sale all the rolling stock of the two corporations, the petitioners had to file a surety bond of ₱422,210.89 to guarantee the payment of the aforesaid income tax liability.

After some exchange of communications between the petitioners and the respondent, the latter wrote a letter dated January 8, 1955, informing the former that after crediting the overpayment made by them of their alleged income tax liabilities for the aforesaid years, pursuant to the doctrine of equitable recoupment, the income tax due from the "Joint Emergency Operation" for the years 1946 to 1949, inclusive, is in the total amount of ₱54,143.54. The petition for review is an appeal from this assessment, but, as stated above, the respondent set aside his assessment of ₱54,143.54 and reassessed the alleged income tax liabilities of the petitioners at ₱148,890.14. The last mentioned amount is what we are now called to pass upon in review.

Before proceeding further, mention should be made of the decision of our Supreme Court in the case of Cesar Reyes, et als. vs. Max Blouse, et als., G.R. No. L-4420, May 19, 1952. This was an action instituted by the plaintiffs as minority stockholders of the Laguna Tayabas Bus Company to restrain its Board of Directors composed of the defendants from carrying out a resolution approved by approximately 92-1/2% of the stockholders, authorizing said Board of Directors to take the necessary steps to consolidate the properties and franchises of the Laguna Tayabas Bus Company with those of the Batangas

Transportation Company. Among others, the Supreme Court found that:

> "To the foregoing we may add the following: the Laguna Tayabas Bus Co. and the Batangas Transportation Co. are pre-war corporations organized in 1928 and 1918, respectively. They ceased operating during the war. In April, 1945, they resumed operations, and pursuant to the authority granted by the respective Board of Directors, the two companies were jointly operated under a single management. In view of the success of this joint operation, it was strongly recommended that it be continued and made permanent. For this purpose a meeting of the stockholders was called, and the disputed resolution was approved. And this resolution was approved because the stockholders found that with the consolidation, the two companies would enjoy the services of the same technical men, would invest much less in the purchase of spare parts, would effect savings in running one machine shop, instead of two, would employ less personnel, and in general, both companies would effect a substantial economy in men, materials and operation expenses. The merger or consolidation has been voted upon by two-thirds vote of the stockholders. Their action is decisive. They have acted having in view only the best interests of both companies. It is not fair to allow a small minority to undo or set at naught what they have done. The remedy of the appellants is to register their objection in writing and demand payment of their shares from the corporation as provided for in section 28-1/2 of the corporation law."

Furthermore, in the first portion of paragraph 4 of the petition for review, the petitioners allege:

> "4. <u>In order to economize in overhead expenses</u>, it was decided by the boards of directors of both corporations to maintain only one principal office for both under the management of Mr. Benedict. This management was styled 'Joint Emergency Operation.' Each corporation retained ownership of its properties, franchises, and equipment and of the income therefrom, subject to the control and disposition of its own board of directors."

And in paragraph 3 of his answer, the respondent avers:

> "e. That he admits the allegation in paragraph 4 thereof to the effect that the Batangas Transportation Company and the Laguna Tayabas Bus Company prepared their own income tax returns, but

denies specifically the allegation that the 'Emergency Joint Operation' established by the petitioners herein has for its purpose the economizing of their overhead expenses, and states that said 'Emergency Joint Operation' is a new and distinct corporation. . . "

The petitioners presented the testimony of their manager Joseph Benedict as to the purpose of placing the two corporations under a joint management. (pp. 13-16, t.s.n.). The respondent having failed to introduce evidence to the contrary, and there being no reason to doubt the testimony of Mr. Benedict, the stated purpose, namely, economy in overhead expenses, should therefore be considered as duly established without contradiction.

The only question in this case is whether or not the "Joint Emergency Operation" or joint management is a new and distinct corporation liable to income tax under the provisions of section 24 of the National Internal Revenue Code, separately and independently from its members, the petitioners herein. The law which defines the word <u>corporation</u> as contemplated by said section 24, is section 84 (b) of the same Code, which reads as follows:

"SEC. 84. Definitions.—When used in this Title—

x x x x

"(b) The term 'corporation' includes partnerships, no matter how created or organized, joint-stock companies, joint accounts (cuentas en participacion), associations or insurance companies, but does not include duly registered general copartnerships (compañias colectivas)."

As stated above, the term "corporation" used in the income tax law, embraces not only the ordinary corporation organized under the corporation law (Act 1459) but also those organizations enumerated therein.

The respondent does not and cannot claim that the "Joint Emergency Operation" is a corporation organized under the Corporation Law, hence the issue is limited to whether the said "Joint Emergency Operation" comes within the purview of the other organization included in the foregoing definition. Applying the statutory definition of the term "Corporation" to the joint emergency operation or joint management, there can be no question that it is not a partnership as the same is defined by our laws. Even if the term is given a broad non-technical significance and includes within its purview any medium for the transaction of profit-seeking activities, the "Joint Emergency Operation" still lacks the essential characteristics of a partnership, defined under Act 1767 (New Civil Code, Art. 1665, Span. Civil Code). This is because there was no contribution to a common fund and no property of the petitioners was ever transferred to the joint management. The companies retained ownership and ultimate control of their respective properties, the joint emergency operation being confined only to acts of management. Furthermore, there would be serious doubts of the legal capacity of these corporations to operate in partnership, there being no express authority under our Corporation Law (Act 1459) to such effect.

> "Unless the authority is expressly conferred, as a general rule, the management of a corporation cannot bind it to continue in a partnership relation with another, as this is considered to involve too great a delegation of the power of management exercised by the board of directors. The general manager or officers of a corporation would have to obey the orders of the board of directors but each partner is co-equal in the management of the firm unless otherwise agreed. As the Tennessee Supreme Court has said: 'the whole policy of the law creating and regulating corporations looks to the exclusive management of the affairs of each corporation

> by the officers provided for or authorized by its charter. This management must be separate and exclusive, and any arrangement by which the control of the affairs of the corporation should be taken from its stockholders and the authorized officers and agents of the corporation would be hostile to the policy of our general incorporation acts'". (Ballantine, Corporations, 1946 Ed. pp. 234-235, citing Mallory v. Hanaur Oil-Workers, 86 Tenn. 598, 8 SW 396 and Hosher-Platt Co. v. Miller, 238 Mass. 518, 131 N.E. 310).

For the same reasons, we hold that the "Joint Emergency Operation" cannot be embraced by the terms "joint-stock company or a joint account (cuenta en participacion)." The "Joint Emergency Operation" was not organized primarily for the purpose of carrying on business and making profits; and no capital stock, was contributed by the petitioners nor did they receive transferable shares of stock. For even greater reasons, this arrangement of "joint management" cannot be classified as an insurance company, for it is obvious that even the minor essentials of an insurance company are not present.

Considering that the "Joint Emergency Operation" is not a partnership, joint stock company, joint account (cuenta en participacion) nor insurance company, the question at bar therefore is narrowed down, to whether it is an "association" within the purview of the definition of "corporation" under section 84 (b), N.I.R.C. cited <u>supra</u>. This question appears to be of first impression. In passing, it is well to observe that our section 84 (b) is identical to section 3797 (a) (3) of the United States Internal Revenue Code of 1939, and in this respect, resort may be made to American authorities on the concept of "association" as embraced within the term "corporation" for income tax purposes.

According to a general recognized treatise on income taxation (Mertens, Law of Federal Income Taxation, 1943 Ed. Vol. 7A, Sec. 43.10, p. 801), jurisprudence establish three concurring essential tests for determining whether a particular organization is taxable as an association which are as follows:

> "If (1) two or more individuals are associated together in a joint enterprise (2) for the carrying on of a business for profit and (3) the enterprise has substantial resemblance to a corporation, it falls within the provisions of the income tax statutes as an association taxation as a corporation. All of these elements are essential, no one of them standing alone being sufficient to characterize an organization as an association taxable as a corporation." (Mertens, cited supra.)

In applying the foregoing tests to the case at bar, the issue will ultimately be one regarding the determination as to whether or not, the "joint emergency operation" of the petitioners has a resemblance to a corporation. This question has been raised in the leading American case of Morrissey v. Commissioner (1935, 296 U.S. 344, 80 L. ed. 563), which involved a trust sought to be treated as an association and taxable as a corporation. The entity in question was created to develop a large tract of land by constructing and operating golf courses, club houses, etc., and to conduct incidental business, including the purchase, operation and sale of properties. The powers of management and control thereof were vested in the trustees, who were authorized to add to their number and to designate their successors. However, they were without power to bind the beneficiaries, and all persons dealing with the trust were required to look to the trust property for payment or indemnity. Transferable common preferred share certificates were issued, representing beneficial interests with described rights and priorities. The trustees were empowered to convene the shareholders to make reports and to receive recommendations, but the stockholders' votes were purely advisory. The death of a trustee or beneficiary had no effect upon the life of the trust which was to continue for twenty-five years unless sooner terminated by the trustees.

The Supreme Court of the United States held that the trust was taxable as an "association" within the purview of the term "corporation" in income taxation, and in its decision stated among others, that:

> "While it is impossible in the nature of things to translate the statutory concept of 'association' into a particularity of detail that would fix the status of every sort of enterprise or organization which ingenuity may create, the recurring disputes emphasize the need of a further examination of the congressional intent. x x x x x
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> "The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity. The resemblance points to features distinguishing associations from partnerships as well as from ordinary trusts. As we have seen, the classification cannot be said to require organization under a statute, or with statutory privileges. The term embraces associations as they may exist at common law. Hecht v. Malley (265 U.S. 144). We have already referred to the definitions, quoted in that case, showing the ordinary meaning of the term as applicable to a body of persons united without a charter 'but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise.' These definitions, while helpful, are not to be pressed so far as to make mere formal procedure a controlling test. The provision itself negatives such a construction. Thus unincorporated joint-stock companies have generally been regarded as bearing the closest resemblance to corporations. But, in the revenue acts, associations are mentioned separately and are not to be treated as limited to 'joint-stock companies,' although belonging to the same group. While the use of corporate forms may furnish persuasive evidence of the existence of an association, the absence of particular forms, or of the usual terminology of corporations, cannot be regarded as decisive. x x x x x

> "What, then, are the salient features of a trust--when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains--which may be regarded as making it analogous to a corporate organization? A corporation, as an entity, holds the title to the property embarked in the corporate undertaking. Trustees, as a continuing body with provision for succession, may afford a corresponding advantage during the existence of the trust. Corporate organization furnishes the opportunity for a centralized management through representatives of the members of the corporation. The designation of trustees, who are charged with the conduct of an enterprise,--who act 'in such the same manner as directors'--may provide a similar scheme, with corresponding effectiveness. Whether the trustees are named in the trust instrument with power to select successors, so as to constitute a self-perpetuating body, or are selected by, or with the advice of, those beneficially interested in the undertaking, centralization of management analogous to that of corporate activities may be achieved. An enterprise carried on by means of a trust may be secure from termination or interruption by the death of owners of beneficial interests and in this respect their interests are distinguished from those of partners and are akin to the interests of members of a corporation. And the trust type of organization facilitates, as does corporation organization, the transfer of beneficial interests without affecting the continuity of the enterprise, and also the introduction of large numbers of participants. The trust method also permits the limitation of the personal liability of participants to the property embarked in the undertaking.
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> "It is no answer to say that these advantages flow from the very nature of trusts. For the question has arisen because of the use and adaptation of the trust mechanism. The suggestion ignores the postulate that we are considering those trusts which have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking, --trusts that thus satisfy the primary conception of association and have the attributes to which we have referred, distinguishing them from partnerships. In such a case, we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that the income of the enterprise should be taxed in the same manner as that of corporations." (pp. 356-360). (underscoring supplied.)

In a later case (Commissioner of Internal Revenue v. Rector & Davidson, (1940) 11 F. 2d 332), involving the question whether a syndicate constituted a partnership or an association within the concept of "corporation" for income tax purposes, the Circuit Court of Appeals summarized succinctly the five salient features of a 'corporation'" as contemplated by the Income Tax Law following the Morrissey decision, as follows:

> "(1) title to the property held by the entity, (2) centralized management, (3) continuity uninterrupted by deaths among the beneficial owners, (4) transfer of interest without affecting the continuity of the enterprise, and (5) limitation of the personal liability of participants." (p. 333)

In another case (Wabash Oil & Gas Association vs. Commissioner of Internal Revenue (1947) 160 F. 2d Series 658), the Circuit Court of Appeals, citing the case of Morrissey vs. Commissioner, supra, as authority, held that in determining whether an "association" can be properly classified as a "corporation" for income tax purposes, the basic problem is whether the salient features of the organism created as the medium for carrying on a business venture makes it analogous to a conventional corporation.

In the light of the doctrine laid down by the United States Supreme Court in the Morrissey case and the other aforecited cases, it is essential that the entity or association must have substantially the salient features of a corporation to be taxable as a "corporation". Considering that our revenue law is based upon the United States Tax Code, it is clear to us and we so hold, that the real criterion to be applied when the question is raised as to whether an association should be taxable as a "corpofation" under the income tax law, is whether it substantially resembles in purpose, general form and mode of operations an ordinary corporation.

Applying the above test to the "Joint Emergency Operation" or joint management of the petitioners, it will readily be seen that it does not meet the aforesaid doctrine of resemblance to a corporation form of organization. The outstanding characteristics of a conventional corporation are entirely lacking in the said "Joint Emergency Operation." The title to the properties of the petitioners was never vested in the enterprise, for as a matter of fact, in the findings above, the companies retained ownership and ultimate control of their respective properties. In law or in fact it had no capacity to hold and dispose of property as a unit nor the ability to sue and be sued. While the purpose of the joint emergency operation was for centralized management, there is no provision for the continuity in its life since the withdrawal by or dissolution of the corporations involve, would work a termination of its existence, besides the fact that there was no bar to any such withdrawal. It is also significant that there was no stock issued, no provision for succession was agreed upon, and no limitation of personal liability of the petitioners was entered into. Clearly, we find that the "Joint Emergency Operation" involved in this case is wanting in the essential features of an association and does not qualify to the rule of resemblance to a corporate form of organization nor could it be said to be analogous to a conventional corporation.

While there may be some divergence of view as to the minimum features and degree of resemblance sufficient to treat an association taxable as a corporation, we see no necessity to consider this question in the present case because the "Joint Emergency Operation" involved, does not have the semblance of a corporation in the method, mode and form of procedure in the conduct of its affairs.

We believe that to protect the revenues of the government a person vested with the right to receive income should not be allowed to escape the tax due thereon by any means which ingenuity may create, and procures the payment thereof to another (Commissioner vs. Sunnen (1948) 333 U.S. 591, citing Harrison vs. Schaffner, 312 U.S. 579). However, it is fundamental that in income taxation, the tax should be borne primarily, in the absence of statutory provision to the contrary, by those who earn or otherwise have the right to receive it and enjoy its benefits when paid. (Helvering vs. Horst (1940) 311 U.S. 112). Applying these concepts here, we find that we cannot see any basis to justify collection of the income tax in question. The evidence on record shows that the "Joint Emergency Operation" constituted by the petitioners, by which they could economize overhead expenses, had no income of its own, nor had received any benefit. All that the "Joint Emergency Operation" did was to manage the Batangas Transportation Company and the Laguna Tayabas Bus Company. Although there are indications to show that it was the recipient of income, the "Joint Emergency Operation" was only serving as a conduit or transmitter of such income to the petitioners. If we are to follow the theory of the respondent, it would result in the imposition of a tax on income payable by a person other than the owner of the property or investment from which the income is derived.

There is no merit in the contention of the respondent that in the light of the decision of our Supreme Court in the case of Cesar Reyes vs. Max Blouse, <u>supra</u>, the "Joint Emergency Operation" of the petitioners is a corporation distinct and separate from the Laguna Tayabas Bus Company and the Batangas Transportation Company. That case was brought by Cesar Reyes and other minority stockholders of the Laguna Tayabas Bus Company against Max Blouse and other members of the Board of Directors of the corporation to restrain the said board from carrying out a resolution approved by about 92.5% of the stockholders in a meeting held on July 20, 1947. The said resolution authorized the Board of Directors to take the necessary steps to consolidate the properties and franchises of Laguna Tayabas Bus Company with those of the Batangas Transportation Company. While the Supreme Court held that the resolution in question did not seek to dissolve the Laguna Tayabas Bus Company but merely to transfer its assets to a new corporation in exchange for its corporate stocks, the evidence on record do not show that the new corporation proposed by the resolution had been actually organized. Neither does it appear that "Joint Emergency Operation" or joint management of the petitioners is the same corporation or entity proposed. On the contrary, Mr. Joseph Benedict testified that the new corporation contemplated in the resolution has not yet been organized pending the result of this case (pp. 36-37, t.s.n.). The respondent having failed to introduce proofs to prove his allegation, and there being no reason to doubt the testimony of Mr. Benedict, we would rather believe that the "Joint Emergency Operation" of the petitioners is not a new corporation distinct and separate from the Laguna Tayabas Bus Company and the Batangas Transportation Company.

We are, therefore, of the opinion and so hold that the "Joint Emergency Operation" or joint management of the petitioners Batangas Transportation Company and Laguna Tayabas Bus Company is not a corporation within the contemplation of section 84 (b) of the National Internal Revenue Code much less a partnership, association or insurance company, and therefore hold that the same is not subject to the income tax under the provisions of section 24 of the same Code, separately and independently from the petitioners.

WHEREFORE, the decision of the respondent Collector of Internal Revenue assessing and demanding from the petitioners the payment of the amount of ₱54,143.54 and/or the amount of ₱148,890.14 is hereby reversed without special pronouncement as to costs.

SO ORDERED.

Manila, Philippines, August 11, 1955.

MARIANO NABLE
Presiding Judge

I concur:

AUGUSTO M. LUCIANO
Associate Judge