ST. STEPHEN'S ASSOCIATION
and ST. STEPHEN'S CHINESE
GIRLS SCHOOL,
Petitioners,

- versus -

C.T.A.
CASE NO. 173

May 23, 1959

COLLECTOR OF INTERNAL REVENUE
Respondent.

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D E C I S I O N

The respondent assessed against the petitioners, the St. Stephen's Association (hereinafter referred to as the Association) and the St. Stephen's Chinese Girls School (hereinafter referred to as the School), donor's and donee's gift taxes on the sum of ₱9,252.48 which was allegedly received as gift by the School from the Association on January 20, 1950. Having failed to secure a reconsideration of the decision of respondent holding them liable for said gift taxes, petitioners elevated the case to this Court for review.

After trial and the submission of the case for decision, the question was raised as regards the jurisdiction of this Court to entertain the appeal. On this question, this Court held that the appeal was filed beyond the 30-day period prescribed in Section 11 of Republic Act No. 1125. Consequently, the appeal was ordered dismissed in our resolution of August 15, 1956. The case was elevated to the Supreme Court which held that the appeal was timely filed and the records were remanded to this Court for decision on the merits.

(See G. R. No. L-11238, August 21, 1958.)

While the case was pending consideration by this Court, specifically on August 27, 1958, respondent took steps to enforce collection of the taxes and penalties assessed against petitioners by distraint and levy. On September 10, 1958, petitioners filed an urgent motion to restrain respondent from executing the warrant of distraint and levy issued by the latter. Upon suggestion by this Court, to avoid unnecessary and protracted proceedings, petitioners filed a surety bond with the Bureau of Internal Revenue to secure payment of the entire amount involved. The surety bond filed with the Bureau of Internal Revenue having been approved by respondent, the urgent motion to restrain the collection of said taxes was withdrawn.

We will now, therefore, consider the case on the merits. The sole issue raised by the parties is whether or not the amount of ₱9,252.48 which was received by the School from the Association on January 20, 1950 is subject to the gift taxes assessed by respondent.

The facts have been correctly stated by counsel for petitioners, which we quote:

> "Sometime in 1903, Bishop Brent of the Protestant Episcopal Church of the United States of America in the Philippines founded the St. Stephen's Church (hereinafter called the Church) with the following objectives: (1) to attract all Chinese residents in the Philippines who had no place of worship, and (2) to convert the Chinese residents to Christianity. One major problem that confronted the Church was the bringing up of the children of its members in accordance with the precepts of Christianity. At that time, there was one school for Chinese boys which was called the Anglo-Chinese School, but there

was no school for girls. Fr. H. E. Studley, who was then the parish priest of the Church, conceived the idea of establishing a school for young Chinese girls for the following purposes: (1) to raise the educational standard of Chinese girls; (2) to bring Chinese girls into the Church; and (3) to provide Christian wives for young Chinese men, thus establishing Christian homes. With the help of the prominent members of the Church and the financial assistance extended by the Episcopal Church, the St. Stephen's Chinese Girls School (hereinafter called the School) was finally established.

"This School was wholly administered, maintained and supported by the Church. Enrollment was limited because of lack of rooms and facilities. More than that, the funds coming from the Department of Missions of the Protestant Episcopal Church of the United States of America were not sufficient. But there was a pressing need to enlarge the School because of the continued increase in the members of the Church. The leading members of the Church therefore organized and incorporated in 1931 the St. Stephen's Association (hereinafter called the Association) with this objective:

> 'To support and maintain school or schools wherein the arts, sciences and other studies embraced in a kindergarten, primary, intermediate, high-school and collegiate courses of instruction are taught to children of Chinese parentage or of Chinese descent.' (See Exhibit A-1)

"The Association took over the administration and management of the School from the Church. To solve the recurrent financial difficulties that faced the School, the Association solicited voluntary contributions from the members of the Church and the Chinese community. An aggregate amount of ₱50,000 was collected and this sum was earmarked as Endowment Fund for the School. This amount was deposited by the Association with the China Banking Corporation to earn interest. At times, certain sums were withdrawn from the bank and loaned to private individuals in order to earn higher interest. All interest earned by the Endowment Fund was turned over by the Association to the School as a School Fund. At present, the School Fund is one of the main sources of funds for the support of the School.

The interest earned by the Endowment Fund as of January 1, 1950 was ₱11,993.09.

"As already stated, the School was established in 1917 but it was incorporated only in 1932 in view of the provisions of Section 3 of Act No. 2706 to the effect that any private school should incorporate under the provisions of Act No. 1459 (Corporation Law) in order to be recognized by the Government. After the incorporation of the School, the administration of its affairs devolved upon its board of trustees. However, the administration and control over the Endowment Fund remained with the Association. Hence, it was expressly stated in paragraph 7 of the Articles of Incorporation of the School (Exhibit C):

> 'Seventh - That the amount of money to be used in the maintenance of said school shall be such sums that may be received from St. Stephen's Association, the Department of Missions of the Protestant Episcopal Church in the United States of America, tuition fees, or from the public thru donations, bequest, gift, endowment, or other sources.' (Exhibit C-2, Underscoring supplied)

"The members of the board of trustees of the School are elected from the members of the board of trustees of the Association. Any vacancy in the board of the School is filled by a majority vote of the members of the board of trustees of the Association. All acts of the School's board of trustees are subject to control by the board of trustees of the Association. (See Exhibits C-1 and D-1) The treasurer of the School performs the duties designated to him by the treasurer of the Association. (Art. IV, Sec. 4, By-Laws of School) In reality, therefore, the affairs of the School continued to be managed and conducted by the Association.

"On January 20, 1950, the Association delivered to the School a China Banking Corporation Check No. VB-42301 in the amount of ₱9,252.48 as School Fund. This amount was part of the ₱11,993.09 earned by the Endowment Fund as of January 1, 1950. The balance of ₱2,740.61 was retained by the Association for the future use of the School. The transfer was entered on page 1 of the journal (Exhibit F-1) and page 59 of the ledger (Exhibit G-1) of the Association. Receipt of

> this amount was also entered by the book-keeper of the School, Mr. Jaime Hizo, on January 21, 1950, on page 49 of the School's ledger (Exhibit E-1). The account on page 49 of the School's ledger (Exhibit E-1) is captioned 'Gifts, Donations - Received'. During the routine inspection of the books of the School by one of the examiners of the Bureau of Internal Revenue, the examiner came across this particular entry on page 49 of the School's ledger. Because the account on this page is designated 'Donations, Gifts - Received,' respondent assessed against petitioners in his Assessment Notice No. GA-3008-50, dated October 15, 1950, the amounts of ₱98.70 and ₱699.07 as donor's and donee's gift taxes plus surcharges and interests." (Pp. 1-4, Memorandum for Petitioners, March 24, 1956.)

There is no dispute that the Association was organized primarily to operate and maintain the School through voluntary contributions. The Association accumulated the amount of ₱50,000.00 through voluntary contributions for the support of the School. This amount was deposited with the China Banking Corporation and was earmarked as Endowment Fund. As of January 1, 1950, said deposit earned interest in the sum of ₱11,993.09. On January 20, 1950, the sum of ₱9,252.48 was given by the Association to the School, the said amount having been taken from the interest earned by the Endowment Fund.

Respondent contends that although the donations made by the various contributors to the Endowment Fund of the Association are not taxable and that the amount of ₱9,252.48 was given by the Association to the School "in compliance of the Association's avowed purpose and objective to support and maintain" the School, the said amount was a gift by the Association to the

School and is subject to both donor's and donee's gift taxes. We quote from the decision of respondent of July 11, 1955:

> "We are aware of the fact that the sum of ₱9,252.48 received in 1950 by the St. Stephen's Chinese Girls' School from the St. Stephen's Association was derived from funds obtained by the latter by means of contributions from persons who sympathized with the purpose and objectives of the said association. We deliberately omitted mentioning the aforesaid fact in our letter to you dated April 6, 1955 in view of the finding of this Office that the said contributions, while they constitute gifts or donations by the contributors to the Association, are severally exempt from the donor's and donee's gift taxes. Also, we do not deny that the transfer of the sum of ₱9,252.48 may be considered a compliance of the Association's avowed purpose and objective to support and maintain schools established for children of Chinese parentage or descent. But we maintain, as we have previously intimated, that the said transfer has the quality of a gift even if we should admit and consider the alleged special relationship between the Association and the School." (Exh. 7, page 47, B.I.R. records; emphasis supplied.)

It is admitted that the sum of ₱9,252.48 was derived by the Association from funds obtained by it by means of contributions from persons who sympathized with its purpose and objective of maintaining and supporting the School, and that the transfer of said amount to the School was made in compliance with such purpose and objective. Under these facts, we are of the opinion that the transfer by the Association to the School of the sum of ₱9,252.48 was not a transfer by way of gift. The said amount formed part of the trust fund which the Association was under obligation to give to the School. The various contributors to the Endowment Fund of the Association gave their contributions not for the support and maintenance of the Association but of the School. Accordingly, when the Association transferred to the School an amount taken from the Endowment Fund, the transfer was not a gift by the Association to the School; it was a gift by the various contributors to the School.] And respondent himself admits that "the gifts or donations by the contributors to the Association, are severally exempt from the donor's and donee's gift taxes." (See decision of respondent dated July 11, 1955, quoted above.)

Even granting that the transfer of ₱9,252.48 by the Association to the School was a gift within the meaning of the Gift Tax Law, is the Association, a corporate legal entity, subject to the donor's gift tax? Respondent claims that it is subject to the tax, citing Paul, Fed. Estate & Gift Taxation, Vol. II, p. 964. Petitioners alleged that only individuals are liable, citing Section 108 of the Revenue Code, which provides:

> "Sec. 108. Imposition of tax. - (a) There shall be levied, assessed, collected, and paid upon the transfer by any individual, resident or nonresident, of property by gift, a tax, computed as provided in section 109.
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> "(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." (Emphasis supplied.)

Section 108 of the Revenue Code was copied from the Federal Gift Tax Law of the United States. The law specifically imposes the donor's gift tax only on individuals. This provision has been interpreted by the U. S. Treasury Department to mean that where a corporation makes a gift, the gift is deemed, for purposes of the Gift Tax Law, to have been made by the individual stockholders and not by the corporation.] The U. S. Treasury regulations implementing the Gift Tax Law enumerates examples of taxable gifts, among which is the following:

> "(1) Transfer of property by a corporation to B is a gift to the latter from the stockholders of the corporation. If B himself is a stockholder, the transfer, not being a distribution from earnings or in liquidation to which B is entitled as a stockholder, is a gift to him from the other stockholders." [Sec. 86.2, Regulations 108, U. S. Treasury Department; Par. 126,131, P-H Federal Taxes (1955)./

This interpretation finds justification in the provision that the tax shall apply whether the gift is direct or indirect. Where a corporation makes a donation, the same is deemed to have been made by the stockholders indirectly through the corporation. In such case, the corporation is not required to file a return or to pay the gift tax. The stockholders are the ones required to file donor's gift tax returns in respect of their individual shares in the donation. [1] (See Joseph P. Crockett, The Federal Tax System of the United States, A Survey of Law and Administration, page 78.)

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For the requirements for the filing of donor's gift tax returns, see Section 115, Rev. Code.

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It is clear, therefore, that the Association is not subject to the donor's gift tax on the transfer by it to the School of the sum of ₱9,252.48. Neither may the members of the Association be held liable to the tax it appearing that the share of each in the donation did not exceed ₱1,000.00.[1] (See 1st indorsement dated December 20, 1954 of Examiner Rinaldo P. Lopez, page 12, B.I.R. records.)

We now come to the taxability of the School, the recipient of the sum of ₱9,252.48. Whether the donation is treated as gifts of the individual members of the Association or as gifts of the persons who contributed to the Endowment Fund of the Association, it appears that each contributor gave not more than ₱1,000.00. Under the law, gifts by an individual donor to a donee not exceeding ₱1,000.00 are not subject to the donor's and donee's gift taxes. (Sec. 112, Rev. Code.)

For purposes of the donee's gift tax, where gifts are made by two or more donors in favor of the same donee, the gifts made by each donor are considered separately from the gifts of the other donors and are entitled to separate exemptions. For this reason, the law requires that separate returns be filed by the donee covering gifts received from each individual donor. [Sec. 115(b), Rev. Code.] Therefore, the School,

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[1] Effective September 15, 1950, donations or gifts in favor of educational institutions irrespective of amount are not subject to the donor's gift tax, pursuant to section 4 of Republic Act No. 579.

as recipient of the gifts of the individual contributors to the Endowment Fund of the Association or of the individual members of the said Association who gave not more than ₱1,000.00 each, is not subject to the donee's gift tax in respect of the sum of ₱9,252.48 received by it from the Association.

Included in the assessment is the sum of ₱20.00 as "compromise penalty" for failure of petitioners to file donor's and donee's gift tax returns. We have consistently held that the imposition by respondent of "compromise penalties" is unauthorized and illegal. (U.S.T. v. Coll. of Int. Rev., C.T.A. No. 10, Sept. 10, 1956, affd. on this point in G. R. Nos. L-11274 & L-11280, Nov. 28, 1958.)

FOR THE FOREGOING CONSIDERATIONS, the decision appealed from is reversed. Accordingly, respondent is hereby ordered to release and cancel the surety bond filed by petitioners to guarantee payment of the questioned assessment. No costs.

SO ORDERED.

Manila, May 23, 1959.

ROMAN M. UMALI
Associate Judge

I CONCUR:

MARIANO NABLE
Presiding Judge

Associate Judge Augusto M. Luciano did not take part.