Securities and Exchange Commission PHILIPPINES

OFFICE OF THE GENERAL COUNSEL

02 October 2023

SEC OGC Opinion No. 23-14
Re: Prohibition on the Retention of Surplus Profits

BATINO LAW OFFICES
4F BMG Center, San Antonio St.
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ATTENTION: **ATTY. MA. CONSOLACION O. BELGADO**
ATTY. MA. PACITA K.F. BATINO
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Dear Attys. Belgado and Batino:

This refers to your letter dated 28 October 2021 which was received by this Office on 07 December 2021 and paid by the requestor on 20 December 2021, requesting for an opinion on the effect of the repeal of Section 29 of Republic Act (R.A.) No. 8424 or the National Internal Revenue Code (NIRC) by virtue of Section 8 of R.A. No. 11534 or the Corporate Recovery and Tax Incentives for Enterprises Act (CREATE) which deleted the improperly accumulated earnings tax (IAET).

Specifically, you are asking for an opinion on the following matters:

a) Whether or not the repeal of Section 29 of the NIRC has an effect on SEC Memorandum Circular (MC) No. 11, Series of 2008 or the Guidelines for the Determination of Retained Earnings Available for Dividend Declaration; and
b) Whether or not the Commission "still imposes fines and other penalties on corporations retaining surplus profits in excess of one hundred percent (100%) of their paid-in capital stock."

Prohibition on retaining profits

Section 4 of SEC MC No. 11, Series of 2008 prohibits the retention of profits in excess of the paid-in capital, to wit:

> Stock corporations are prohibited from retaining surplus profits in excess of one hundred (100%) percent of their paid-in capital stock, except:
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> a) when justified by definite corporate expansion projects or programs approved by the board of directors; or
> b) when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its consent, and such consent has not yet been secured; or
> c) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is need for special reserve for probable contingencies.[1]

[1] Section 4, SEC Memorandum Circular (MC) No. 11, Series of 2008 or the *Guidelines on The Determination of Retained Earnings Available for Dividend Declaration*, 05 December 2008.

The foregoing MC implements Section 43 of Batas Pambansa (B.P.) Blg. 68 or the Corporation Code which is substantially reproduced under now Section 42 of the R.A. No. 11232 or the Revised Corporation Code of the Philippines (RCCP), *viz.*:

> Section 42. Power to Declare Dividends – xxx xxx xxx
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> Stock corporations are ***prohibited from retaining surplus profits in excess of one hundred percent (100%) of their paid-in capital stock***, except:
>
> (a) when justified by the definite corporate expansion projects or programs approved by the board of directors; or
> (b) when the corporation is prohibited under any loan agreement with financial institutions or creditors, whether local or foreign, from declaring dividends without their consent, and such consent has not yet been secured; or
> (c) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is need for special reserve for probable contingencies.[2]

It is worthy to note that neither the repealing clause[3] nor the amendatory clause[4] of the CREATE Act ***expressly*** repealed Section 42 of the RCCP. The question then is whether or not there was an implied repeal of Section 42. As early as ***Antonio Mecano vs. Commission on Audit***, the Court laid down the rule on implied repeal:

> Repeal by implication proceeds on the premise that where a statute of later date clearly reveals an intention on the part of the legislature to abrogate a prior act on the subject, that intention must be given effect. Hence, before there can be a repeal, ***there must be a clear showing on the part of the lawmaker that the intent in enacting the new law was to abrogate the old one***. The intention to repeal must be clear and manifest; otherwise, at least, as a general rule, the later act is to be construed as a continuation of, and not a substitute for, the first act and will continue so far as the two acts are the same from the time of the first enactment.
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> There are two categories of repeal by implication. The first is where provisions in the two acts on the same subject matter are in an ***irreconcilable conflict***, The later act to the extent of the conflict constitutes an implied repeal of the earlier one. The second is if the later act ***covers the whole subject of the earlier one and is clearly intended as a substitute***, it will operate to repeal the earlier law.
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> ***Implied repeal by irreconcilable inconsistency takes place when the two statutes cover the same subject matter; they are so clearly inconsistent and incompatible with each other that they cannot be reconciled or harmonized; and both cannot be given effect, that is, that one law cannot he enforced without nullifying the other.***
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> The fact that a later enactment may relate to the same subject matter as that of an earlier statute is not of itself sufficient to cause an implied repeal of the prior act, since the new statute may merely be cumulative or a continuation of the old one. ***What is necessary is a manifest indication of legislative purpose to repeal***.[5] (Emphasis and underscoring supplied, citations omitted)

In the instant case, Section 42 of the RCCP and Section 8 of the CREATE Act are not in an irreconcilable conflict nor do they cover the same subject such that the later law was intended to substitute the provision of the older law.[6]

The imposition of the IAET, which was deleted under the CREATE Act, is ***separate and distinct*** from the prohibition to retain profits under Section 42 of the RCCP. The IAET is a ***penalty tax*** which discouraged tax avoidance through corporate surplus accumulation and compelled corporations to distribute earnings so that the said earnings by shareholders could, in turn, be taxed.[7] In contrast, Section 42 of the RCCP is a regulatory measure to encourage participation in the corporate vehicle by providing a framework by which stockholders can receive returns on their investments in the form of dividends, which is being implemented by the SEC MC No. 11, Series of 2008. Violation of Section 42 of the RCCP is meted an ***administrative penalty*** pursuant to Section 158 of the same law, where the SEC can impose general, extra-statutory obligations pursuant to authority properly delegated by Congress.[8]

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[2] Section 42, Republic Act (R.A.) No. 11232 or the Revised Corporation Code of the Philippines (RCCP), 20 February 2019.
[3] Section 17, R.A. No. 11534 or Corporate Recovery and Tax Incentives for Enterprises Act (CREATE), 26 March 2021.
[4] Section 18, *ibid.*
[5] *Antonio Mecano vs. Commission on Audit (COA)*, G.R. No. 103982, 11 December 1992.
[6] See also *Rosario Valera vs. Mariano Tiuason, et. al.*, G.R. No. L-1276, 30 April 1948, *viz*:

> Endeavor should be made to ***harmonize*** the provisions of a law or of two laws so that each shall be effective. In order that one law may operate to repeal another law, the two laws must actually be inconsistent. The former must be so repugnant as to be irreconcilable with the latter act. Merely because a later enactment may relate to the same subject matter as that of an earlier statute is not of itself sufficient to cause an implied repeal of the latter, since the new law may be cumulative or a continuation of the old one.

[7] *Cyanamid Philippines Inc. vs. Court of Appeals (CA), et. al.* G.R. No. 108067, 20 January 2000.
[8] *Republic of the Philippines vs. Drugmaker's Laboratories Inc. and Terramedic Inc.*, G.R. No. 190837, 05 March 2014.

As the Court discussed in ***H. Villarica Pawnshop, et. al. vs. Social Security Commission***, if the law is clear, plain, and free from ambiguity, it must be given its literal meaning and applied without interpretation

> Basic is the rule of statutory construction that when the law is clear and unambiguous, the court is left with no alternative but to apply the same according to its clear language.
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> Parenthetically, the "plain meaning rule" or verba legis in statutory construction enjoins that ***if the statute is clear, plain and free from ambiguity, it must be given its literal meaning and applied without interpretation.*** This rule of interpretation is in deference to the plenary power of Congress to make, alter and repeal laws as this power is an embodiment of the People's sovereign will. Accordingly, ***when the words of a statute are clear and unambiguous, courts cannot deviate from the text of the law and resort to interpretation lest they end up betraying their solemn duty to uphold the law and worse, violating the constitutional principle of separation of powers.***[9]

The language of the RCCP and the intention to retain the prohibition on retention of profits beyond what is allowed therein are clear.

Considering that there is no express or implied repeal of Section 42, the rule remains, i.e. stock corporations are prohibited to retain surplus profits in excess of one hundred percent (100%) of their paid-in capital stock except in cases specifically enumerated therein.

Thus, as to your first question, the answer is in the *negative*. The repeal of Section 29 of the NIRC has no effect on the prohibition under SEC MC No. 11, Series of 2008 because the latter is ***not*** based on the NIRC but on the rule-making power of SEC under Section 143 of the Corporation Code [Now Section 179, RCCP[10]] and Section 5 of R.A. No. 8799 or the Securities Regulation Code (SRC)[11] in relation to Section 42 of the RCCP.

Power of the SEC to impose penalties

As to your second question, the answer is in the *affirmative*.

Section 158 of the RCCP provides the following rule:

> If, after due notice and hearing, the Commission finds that ***any provision of this Code, rules or regulations, or any of the Commission's orders*** has been violated, the Commission may impose any or all of the following sanctions, taking into consideration the extent of participation, nature, effects, frequency and seriousness of the violation:
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> (a) Imposition of a fine ranging from Five thousand pesos (₱5,000.00) to Two million pesos (₱2,000,000.00), and not more that One thousand pesos (₱1,000.00) for each day of continuing violation but in no case to exceed Two million pesos (₱2,000,000.00);
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> (b) Issuance of the permanent cease and desist order;
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> (c) Suspension or revocation of the certificate of incorporation; and
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> (d) Dissolution of the corporation and forfeiture of its assets under the conditions in Title XIV of this Code.[12]

Considering that Section 42 of the RCCP and, by extension, SEC MC No. 11, Series of 2008 are not yet repealed, the SEC may still impose penalties for violation of the foregoing subject to due notice and hearing as provided in Section 158 of the RCCP.[13]

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[9] *H. Villarica Pawnshop, et. al. vs. Social Security Commission, et. al.*, G.R. No. 7228087, 24 January 2018.

[10] Section 179, RCCP, *supra*.

> Section 179. Powers, Functions, and Jurisdiction of the Commission. — The Commission shall have the power and authority to:
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> (o) Formulate and enforce standards, guidelines, policies, rules and regulations to carry out the provisions of this Code; and
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[11] Section 5, R.A. No.8799 or the Securities Regulation Code (SRC), 19 July 2000.

> Section 5. Powers and Functions of the Commission. — 5.1. The Commission shall act with transparency and shall have the powers and functions provided by this Code, Presidential Decree No. 902-A, the Corporation Code, the Investment Houses Law, the Financing Company Act and other existing laws. Pursuant thereto the Commission shall have, among others, the following powers and functions:
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> (g) Prepare, approve, amend or repeal rules, regulations and orders, and issue opinions and provide guidance on and supervise compliance with such rules, regulations and orders;
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[12] Section 158, RCCP, *supra*.

[13] For queries on fines and penalties, please contact our Compliance and Monitoring Division of the Company Registration and Monitoring Department at crmd_publicassistance@sec.gov.ph. See also 2023 SEC Citizen's Charter which may be accessed through the SEC Website at www.sec.gov.ph.

It shall be understood that the foregoing opinion is rendered based solely on the facts, circumstances and documents disclosed/submitted and relevant solely to the particular issue raised therein. It shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts whether of similar or dissimilar circumstances.[14] If, upon further inquiry or investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

Very truly yours,

ROMUALD C. PADILLA
General Counsel

[14] Section 7, SEC MC No. 15-03, 16 December 2003.