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charges applicable thereon, such taxpayer should pay interest at the rate of 1% a month from the date his deficiency taxes were in the first instance due and collectible and not from the date of expiry of the period of extension granted.

ACCORDINGLY, the denial by the Court of Tax Appeals of the imposition of a 5% surcharge on the original deficiency estate and inheritance taxes assessed against the Cu Unjieng heirs is set aside; the Commissioner of Internal Revenue is hereby directed to collect a 5% surcharge on the original deficiency estate and inheritance taxes assessed against the Cu Unjieng heirs from April 23, 1959, taking into account the various payments made after that date in liquidation of the said deficiency estate and inheritance taxes. In all other respects, the judgment *a quo* is affirmed. No costs.

Makasiar, Esguerra, Muñoz Palma, and *Martin, JJ.*, concur.

Teehankee, J., is on leave.

FIRST DIVISION

[G.R. No. L-28398. August 6, 1975]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **JOHN L. MANNING, W.D. McDONALD, E.E. SIMMONS and THE COURT OF TAX APPEALS,** *respondents.*

SYLLABUS

1. TAXATION; INCOME TAX; TAX ON CORPORATIONS; CORPORATE EARNINGS OR PROFITS TAXABLE AS INCOME TO SHAREHOLDERS; CASE AT BAR.— The declaration by the respondents and Reese's trustees of MANTRASCO's alleged treasury stock dividends in favor of

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the former, brings, however, into clear focus the ultimate purpose which the parties to the trust instrument aimed to realize: to make the respondents the sole owners of Reese's interest in MANTRASCO by utilizing the periodic earnings of that company and its subsidiaries to directly subsidize their purchase of the said interests, and by making it appear outwardly, through the formal declaration of non-existent stock dividends in the treasury, that they have not received any income from those firms when, in fact, by that declaration they secured to themselves the means to turn around as full owners of Reese's shares. In other words, the respondents, using the trust instrument as a convenient technical device, bestowed unto themselves the full worth and value of Reese's corporate holdings with the use of the very earnings of the companies. Such package device, obviously not designed to carry out the usual stock dividend purpose of corporate expansion re-investment, *e.g.* the acquisition of additional facilities and other capital budget items, but exclusively for expanding the capital base of the respondents in MANTRASCO, cannot be allowed to deflect the respondents' responsibilities toward our income tax laws. The conclusion is thus ineluctable that whenever the companies involved herein parted with a portion of their earnings "to buy" the corporate holdings of Reese, they were in ultimate effect and result making a distribution of such earnings to the respondents. All these amounts are consequently subject to income tax as being, in truth and in fact, a flow of cash benefits to the respondents.

2. ID.; ID.; **ASSESSED ON INCOME RECEIVED FROM ANY PROPERTY, ACTIVITY OR SERVICE THAT PRODUCES INCOME; CASE AT BAR.**— The Commissioner erred in assessing the respondents the total acquisition cost (₱7,973,660) of the alleged treasury stock dividends in one lump sum. The record shows that the earnings of MANTRASCO over a period of years were used to gradually wipe out the holdings therein of Reese. Consequently, those earnings, which we hold, under the facts disclosed in the case at bar, as in effect having been distributed to the respondents, should be taxed for each of the corresponding years when payments were made to Reese's estate on account of his 24,700 shares. With regard to payments made with MANTRASCO earnings in 1958 and the years before, while indeed those earnings were utilized in those years to gradually pay off the value of Reese's holdings in MANTRASCO,

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there is no evidence from which it can be inferred that prior to the passage of the stockholders' resolution of December 22, 1958 the contributed equity of each of the respondents rose correspondingly. It was only by virtue of the authority contained in the said resolution that the respondents actually, albeit illegally, appropriated and partitioned among themselves the stockholders' equity representing Reese's interests in MANTRASCO. As those payments accrued in favor of the respondents in 1958 they are and should be liable, for income tax purposes, to the extent of the aggregate amount paid, from 1955 to 1958, by MANTRASCO to buy off Reese's shares. The fact that the resolution authorizing the distribution of the said earnings is null and void is of no moment. Under the National Internal Revenue Code, income tax is assessed on income received from any property, activity or service that produces income. The Tax Code stands as an indifferent, neutral party on the matter of where the income comes from.

APPEARANCES OF COUNSEL

Solicitor General Antonio P. Barredo, Solicitor Lolita O. Gal-lang and *Special Attorney Virgilio J. Saldajena* for petitioner.

Manuel O. Chan for private respondents.

D E C I S I O N

CASTRO, *J.*:

This is a petition for review of the decision of the Court of Tax Appeals, in CTA case 1626, which set aside the income tax assessments issued by the Commissioner of Internal Revenue against John L. Manning, W.D. McDonald and E.E. Simmons (hereinafter referred to as the respondents), for alleged undeclared stock dividends received in 1958 from the Manila Trading and Supply Co. (hereinafter referred to as the MANTRASCO) valued at ₱7,973,660.

In 1952 the MANTRASCO had an authorized capital stock of ₱2,500,000 divided into 25,000 common shares; 24,700 of

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these were owned by Julius S. Reese, and the rest, at 100 shares each, by the three respondents.

On February 29, 1952, in view of Reese's desire that upon his death MANTRASCO and its two subsidiaries, MANTRASCO (Guam), Inc. and the Port Motors, Inc., would continue under the management of the respondents, a trust agreement on his and the respondents' interests in MANTRASCO was executed by and among Reese (therein referred to as OWNER), MANTRASCO (therein referred to as COMPANY), the law firm of Ross, Selph, Carrascoso and Janda (therein referred to as TRUSTEES), and the respondents (therein referred to as MANAGERS).

The trust agreement pertinently provides as follows:

"1. Upon the execution of this agreement the OWNER shall deposit with the TRUSTEES, duly endorsed and ready for transfer Twenty-Four Thousand Seven Hundred (24,700) shares of the capital stock of the COMPANY, these shares being all shares of the capital stock of the COMPANIES belonging to him . . .

"2. Upon the execution of this Agreement the MANAGERS shall deposit with the TRUSTEES, duly endorsed and ready for transfer, all shares of the capital stock of the COMPANIES belonging to any of them.

"3. (a) The OWNER and the MANAGERS, and each of them, agree that if any of them shall at any time during the life of this trust acquire any additional shares of stock of any of the COMPANIES, or of any successor company, or any shares in substitution, exchange or replacement of the shares subject to this agreement, they shall forthwith endorse and deposit such shares with the TRUSTEES hereunder and such additional or other shares shall become subject to this agreement; shares deposited by the OWNER and shares received by the TRUSTEES as stock dividends on, or in substitution, exchange or replacement of, such shares so deposited under this agreement being MANAGERS' SHARES.

"(b) All shares deposited under paragraphs 1, 2 and 3(a) hereof shall, during the life of the OWNER, remain in the name of and shall be voted by the respective parties making the deposit . . .

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"4. (a) Upon the death of the OWNER and the receipt by the TRUSTEES of the initial payment from the company purchasing the OWNER'S SHARES, the TRUSTEES shall cause the OWNER'S SHARES to be transferred into the name of such company and such company shall thereupon transfer such shares into the name of the TRUSTEES and the TRUSTEES shall hold such shares until payment for all such shares shall have been made by the company as provided in this agreement.

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"(c) The TRUSTEES shall vote all stock standing in their name or the name of their nominees at all meetings and shall be in all respects entitled to all the rights as owners of said shares, subject, however, to the provisions of this agreement of trust.

"(d) Any and all dividends paid on said shares after the death of the OWNER shall be subject to the provisions of this agreement.

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"5. (b) It is expressly agreed and understood, however, that the declaration of dividends and amount of earnings transferred to surplus shall be subject to the approval of the TRUSTEES and the TRUSTEES shall participate to such extent in the affairs of the COMPANIES as they deem necessary to insure the carrying out of this agreement and the discharge of the obligations of the COMPANIES and each of them and of the MANAGERS hereunder.

"(c) The TRUSTEES shall designate one or more directors of each of the COMPANIES as they shall consider advisable and corresponding shares shall be transferred to such directors to qualify them to act.

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"8. (a) Upon the death of the OWNER, the COMPANIES or any one or more of them shall purchase the OWNER'S SHARES; it being the intent that any of the COMPANIES shall purchase all or a proportionate part of the OWNER'S SHARES . . .

"(b) The purchase price of such shares shall be the book value of such share computed in United States dollars . . .

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"(d) All dividends paid on stock that had been OWNER'S SHARES, from the time of the transfer of such shares by one or more

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of the COMPANIES to the TRUSTEES as provided in Article 4 until payment in full for such OWNER'S SHARES shall have been made by each of the COMPANIES which shall have purchased the same, shall be credited as payments on account of the purchase price of such shares and shall he a prepayment on account of the next due installment or installments of such purchase price.

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"12. The TRUSTEES may from time to time increase or decrease the unpaid balance of the purchase price of the shares being purchased by any COMPANY or COMPANIES should they in their exclusive discretion determine that such increase or decrease would be necessary to carry out the intention of the parties that the Estate and heirs of the OWNER shall receive the fair value of the shares deposited in Trust as such value existed at the date of the death of the OWNER. . .

"13. Should the said COMPANIES or any of them be unable or unwilling to comply with their obligations hereunder when due, the TRUSTEES may terminate this agreement and dispose of all the shares of stock deposited hereunder, whether or not payment shall have been made for part of such stock, applying the proceeds of such sale or disposition to the unpaid balance of the purchase price:

"(a) If, upon any such sale or disposition of the stock, the TRUSTEES shall receive an amount in excess of the unpaid balance of the purchase price agreed to be paid by the COMPANIES for the OWNER'S SHARES such excess, after deducting all expenses, charges and taxes, shall be paid to the then MANAGERS.

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"17. Until the delivery to him of the shares purchased by him, no MANAGER, shall sell, assign, mortgage, pledge, transfer or in anywise encumber or hypothecate such shares or his interest in this agreement.

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"19. After the death of the OWNER and during the period of this trust the COMPANIES shall pay no dividends except as may be authorized by the TRUSTEES. Dividends on MANAGER'S SHARES shall, so long as they shall not be in default under this agreement, be paid over by the TRUSTEES to the MANAGERS. Dividends on OWNER'S SHARES shall be applied in liquidation of the COMPANIES' liabilities hereunder as provided in Article 8(d).

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"26. The TRUSTEES may, after the death of the OWNER and during the life of this trust, vote any and all shares held in trust, at any general and special meeting of stockholders for all purposes, including but not limited to wholly or partially liquidating or reducing the capital of any COMPANY or COMPANIES, authorizing the sale of any or all assets, and election of directors . . .

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"28. The COMPANIES and each of them undertake and agree by proper corporate act to reduce their capitalization, sell or encumber their assets, amend their articles of incorporation, reorganize, liquidate, dissolve and do all other things the TRUSTEES in their discretion determine to be necessary to enable them to comply with their obligations hereunder and the TRUSTEES are hereby irrevocably authorized to vote all shares of the COMPANIES and each of them at any general or special meeting for the accomplishment of such purposes.x x x"

On October 19, 1954 Reese died. The projected transfer of his shares in the name of MANTRASCO could not, however, be immediately effected for lack of sufficient funds to cover initial payment on the shares.

On February 2, 1955, after MANTRASCO made a partial payment of Reese's shares, the certificate for the 24,700 shares in Reese's name was cancelled and a new certificate was issued in the name of MANTRASCO. On the same date, and in the meantime that Reese's interest had not been fully paid, the new certificate was endorsed to the law firm of Ross, Selph, Carrascoso and Janda, as trustees for and in behalf of MANTRASCO.

On December 22, 1958, at a special meeting of MANTRASCO stockholders, the following resolution was passed:

"RESOLVED, that the 24,700 shares in the Treasury be reverted back to the capital account of the company as a stock dividend to be distributed to shareholders of record at the close of business on December 22, 1958, in accordance with the action of the Board of Directors at its meeting on December 19, 1958 which action is hereby approved and confirmed."

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On November 25, 1963 the entire purchase price of Reese's interest in MANTRASCO was finally paid in full by the latter, On May 4, 1964 the trust agreement was terminated and the trustees delivered to MANTRASCO all the shares which they were holding in trust.

Meanwhile, on September 14, 1962, an examination of MANTRASCO's books was ordered by the Bureau of Internal Revenue. The examination disclosed that (a) as of December 31, 1958 the 24,700 shares declared as dividends had been proportionately distributed to the respondents, representing a total book value or acquisition cost of ₱7,973,660; (b) the respondents failed to declare the said stock dividends as part of their taxable income for the year 1958; and (c) from 1956 to 1961 the following amounts were paid by MANTRASCO to Reese's estate by virtue of the trust agreement, to wit:

Year	Liabilities	Amounts Paid
1956	₱ 5,830,587.86	₱2,143,073.00
1957	5,317,137.86	513,450.00
1958	4,824,059.28	493,078.58
1959	4,319,420.14	504,639.14
1960	3,849,720.14	469,700.00
1961	3,811,387.69	38,332.45

On the basis of their examination, the BIR examiners concluded that the distribution of Reese's shares as stock dividends was in effect a distribution of the "asset or property of the corporation as may be gleaned from the payment of cash for the redemption of said stock and distributing the same as stock dividend." On April 14, 1965 the Commissioner of Internal Revenue issued notices of assessment for deficiency income taxes to the respondents for the year 1958, as follows:

	J.L. Manning	W.D. McDonald	E.E. Simmons
Deficiency Income Tax	₱1,416,469.00	₱ 1,442,719.00	₱1,450,434.00

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Add 50% surcharge*	723,234.50	721,359.50	25,217.00
1/2% monthly interest from 6-20-59 to 6-20-62	260,364.42	259,689.42	261,078.12
TOTAL AMOUNT DUE & COLLECTIBLE:	₱2,430,067.92	₱2,423,767.92	₱2,436,729.12

The respondents unsuccessfully challenged the foregoing assessments and, failing to secure a favorable reconsideration, appealed to the Court of Tax Appeals.

On October 30, 1967 the CTA rendered judgment absolving the respondents from any liability for receiving the questioned stock dividends on the ground that their respective one-third interest in MANTRASCO remained the same before and after the declaration of stock dividends and only the number of shares held by each of them had changed.

Hence, the present recourse.

All the parties rely upon the same provisions of the Tax Code and internal revenue regulations to bolster their respective positions. These are:

A. *National Internal Revenue Code*

"SEC. 83. *Distribution of dividends or assets by corporations* — (a) *Definition of Dividends* — The term 'dividends' when used in this Title means any distribution made by a corporation to its shareholders out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in money or in other property.

"Where a corporation distributes all of its assets in complete liquidation or dissolution the gain realized or loss sustained by the

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* The 50% surcharge was imposed pursuant to Section 72 of the National Internal Revenue Code, while the 1/2% interest was assessed under Section 51(d) of the said Code.

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stockholder, whether individual or corporate, is a taxable income or deductible loss, as the case may be.

"(b) *Stock dividend.* — A stock dividend representing the transfer of surplus to capital account shall not he 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 accumulated after March first, nineteen hundred and thirteen."

B. *B.I.R. Regulations*

"SEC. 251. *Dividends paid in property.* — Dividends paid in securities or other property (other than its own stock), in which the earnings of the corporation have been invested, are income to the recipients to the amount of the full market value of such property when receivable by individual stockholders . . .

"SEC. 252. *Stock dividend.* — 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 shareholders 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 change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from the former interest. 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 certificate plus the old representing the same proportionate interest in the net assets of the corporation as did the old."

The parties differ, however, on the *taxability* of the "treasury" stock dividends received by the respondents.

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The respondents anchor their argument on the same basis as the Court of Tax Appeals; whereas the Commissioner maintains that the full value (₱7,973,660) of the shares redeemed from Reese by MANTRASCO which were subsequently distributed to the respondents as stock dividends in 1958 should be taxed as income of the respondents for that year, the said distribution being in effect a distribution of cash. The respondents' interests in MANTRASCO, he further argues, were only .4% prior to the declaration of the stock dividends in 1958, but rose to 33 1/3% each after the said declaration.

In submitting their respective contentions, it is the assumption of both parties that the 24,700 shares declared as stock dividends were treasury shares. We are however convinced, after a careful study of the trust agreement, that the said shares were not, on December 22, 1958 or at anytime before or after that date, treasury shares. The reasons are quite plain.

Although authorities may differ on the exact legal and accounting status of so-called "treasury shares,"[1] they are more or less in agreement that treasury shares are stocks issued and fully paid for and re-acquired by the corporation either by purchase, donation, forfeiture or other means.[2] Treasury shares are therefore issued shares, but being in the treasury they do not have the status of outstanding shares.[3] Consequently, although a treasury share, not having been retired by the corporation

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[1] See Henry W. Ballantine, "The Curious Fiction of Treasury Shares," 34 California Law Review, 536-542; George H. Hills, "Model Corporation Act," 48 Harvard Law Review at pp. 1364 and 1373. According to Judge Learned Hand in Kirchenbaum vs. Commissioner (155 F 2d 23): "The status of 'treasury shares' is in general not made perfectly clear in the books. Some courts treat them as though they were, so to say, in suspended animation — existing, but existing only in a kind of limbo; other courts treat them as though they were retired."

[2] *Bronson vs. Bagdad Copper Corp.*, 151 A 2d 677; State *ex rel Weeds vs. Bechtel,* 56 NW 2d 173; Thompson and Thompson, *Commentaries on the Law of Corporations* (3rd ed.), Secs. 3446 *et seq.*

[3] Thompson and Thompson, *ibid.*, section 3444; *Fuller vs. Krogh,* 113 NW 2d 25.

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re-acquiring it, may be re-issued or sold again, such share, as long as it is held by the corporation as a treasury share, participates neither in dividends, because dividends cannot be declared by the corporation to itself,[4] nor in the meetings of the corporation as voting stock, for otherwise equal distribution of voting powers among stockholders will be effectively lost and the directors will be able to perpetuate their control of the corporation,[5] though it still represents a paid-for interest in the property of the corporation.[6] The foregoing essential features of a treasury stock are lacking in the questioned shares. Thus,

(a) under paragraph 4(c) of the trust agreement, the trustees were authorized to vote all stock standing in their names at all meetings and to exercise all rights "as owners of said shares" — this authority is reiterated in paragraphs 26 and 28 of the trust agreement;

(b) under paragraph 4(d), "Any and all dividends paid on said shares after the death of the OWNER shall be subject to the provisions of this agreement;"

(c) under paragraph 5(b), the amount of retained earnings to be declared as dividends was made subject to the approval of the trustees of the 24,700 shares;

(d) under paragraph 5(c), the choice of corporate directors was delegated exclusively to the trustees who were also given the authority to transfer qualifying shares to such directors; and

(e) under paragraph 19, MANTRASCO and its two subsidiaries were expressly prohibited from paying "dividends except as may be authorized by the TRUSTEES;" in the same paragraph mention was also made of "dividends on OWNER'S

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[4] *Claplin vs. Commissioner of Internal Revenue*, 136 F 2d 298; *Gearhart vs. Standard Steel Car Co.*, 72 A 699.

[5] Howard L. Oleck, *Modern Corporation Law,* Vol. 3 (Bobbs-Merrill Co., Inc.: Indianapolis), Section 1664 at p. 708.

[6] Thompson and Thompson, *ibid.*, quoting *Wood, Modern Business Corporations*, p. 119. See also 41 Harvard Law Review 660, and 48 Harvard Law Review 1364 *et seq.*; also Oleck, *ibid.*, sections 1661 *et seq.*, pp. 705-709.

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SHARES" which shall be applied to the liquidation of the liabilities of the three companies for the price of Reese's shares.

The manifest intention of the parties to the trust agreement was, in sum and substance, to treat the 24,700 shares of Reese as absolutely outstanding shares of Reese's estate until they were fully paid. Such being the true nature of the 24,700 shares, their declaration as treasury stock dividend in 1958 was a complete nullity and plainly violative of public policy. A stock dividend, being one payable in capital stock, cannot be declared out of outstanding corporate stock, but only from retained earnings:[7]

Of pointed relevance is this useful discussion of the nature of a stock dividend:[8]

"'A stock dividend always involves a transfer of surplus (or profit) to capital stock.' Graham and Katz, *Accounting in Law Practice*, 2d ed. 1938, No. 70. As the court said in *United States vs. Siegel,* 8 Cir., 1931, 52 F 2d 63, 65, 78 ALR 672: 'A stock dividend is a conversion of surplus or undivided profits into capital stock, which is distributed

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[7] See section 16, Philippine Corporation Law (Act 1459, as amended); also *Nielson & Co., Inc. vs. Lepanto Consolidated Mining Co.*, L-21601, Dec. 18, 1968 (resolution on motion for reconsideration), 26 SCRA 540, 567; Meigs & Johnson, *Accounting: The Basis for Business Decisions*, 2d ed., 1967 (McGraw-Hill Book Co., New York), pp. 541-544.

[8] *Bass vs. Commissioner of Internal Revenue,* 129 F 2d 300: "It is possible for a corporation to pay out a taxable dividend by means of a distribution of its own, stock to shareholders without increasing its stated capital. Thus, the corporation might use a portion of its surplus earnings to make purchases of its own stock, and might later distribute this treasury stock to the remaining stockholders as a dividend. No increase of capital is involved, since there is merely a reissue of existing paid-up shares. Such a distribution of treasury stock would not be a stock dividend within the ordinary meaning of that term. Accepting to the full the authority of *Eisner v. Macomber,* 1920, 252 US 189, 40 S Ct 189, 64 L ed 521, 9 ALR 1570, such a distribution would nevertheless seem to be quite clearly a distribution out of corporate earnings or profits taxable as income to the shareholders in the amount of the market value of the shares when received by the shareholders. For the present purposes it is the same as if the corporation had used accumulated earnings to buy any other property — say, the stock of another corporation — and had distributed such substituted property in specie as a dividend to its share holders."

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to stockholders in lieu of a cash dividend.' Congress itself has defined the term 'dividend' in No. 115(a) of the Act as meaning any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits. In *Eisner v. Macomber,* 1920, 252 US 189, 40 S Ct 189, 64 L Ed 521, 9 ALR 1570, both the prevailing and the dissenting opinions recognized that within the meaning of the revenue acts the essence of a stock dividend was the segregation out of surplus account of a definite portion of the corporate earnings as part of the permanent capital resources of the corporation by the device of capitalizing the same, and the issuance to the stockholders of additional shares of stock representing the profits so capitalized."

The declaration by the respondents and Reese's trustees of MANTRASCO's alleged treasury stock dividends in favor of the former, brings, however, into clear focus the ultimate purpose which the parties to the trust instrument aimed to realize: to make the respondents the sole owners of Reese's interest in MANTRASCO by utilizing the periodic earnings of that company and its subsidiaries to directly subsidize their purchase of the said interests, and by making it appear outwardly, through the formal declaration of non-existent stock dividends in the treasury, that they have not received any income from those firms when, in fact, by that declaration they secured to themselves the means to turn around as full owners of Reese's shares. In other words, the respondents, using the trust instrument as a convenient technical device, bestowed unto themselves the full worth and value of Reese's corporate holdings with the use of the very earnings of the companies. Such package device, obviously not designed to carry out the usual stock dividend purpose of corporate expansion reinvestment, e.g. the acquisition of additional facilities and other capital budget items, but exclusively for expanding the capital base of the respondents in MANTRASCO, cannot be allowed to deflect the respondents' responsibilities toward our income tax laws. The conclusion is thus ineluctable that whenever the companies involved herein parted with a portion of their earnings "to buy" the corporate holdings of Reese, they were in ultimate effect and result making a distribution of such earnings to the respondents. All these amounts

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are consequently subject to income tax as being, in truth and in fact, a flow of cash benefits to the respondents.

We are of the opinion, however, that the Commissioner erred in assessing the respondents the total acquisition cost (₱7,973,660) of the alleged treasury stock dividends in one lump sum. The record shows that the earnings of MANTRASCO over a period of years were used to gradually wipe out the holdings therein of Reese. Consequently, those earnings, which we hold, under the facts disclosed in the case at bar, as in effect having been distributed to the respondents, should be taxed for each of the corresponding years when payments were made to Reese's estate on account of his 24,700 shares. With regard to payments made with MANTRASCO earnings in 1958 and the years before, while indeed those earnings were utilized in those years to gradually pay off the value of Reese's holdings in MANTRASCO, there is no evidence from which it can be inferred that prior to the passage of the stockholders' resolution of December 22, 1958 the contributed equity of each of the respondents rose correspondingly. It was only by virtue of the authority contained in the said resolution that the respondents actually, albeit illegally, appropriated and partitioned among themselves the stockholders' equity representing Reese's interests in MANTRASCO. As those payments accrued in favor of the respondents in 1958 they are and should be liable, for income tax purposes, to the extent of the aggregate amount paid, from 1955 to 1958, by MANTRASCO to buy off Reese's shares.

The fact that the resolution authorizing the distribution of the said earnings is null and void is of no moment. Under the National Internal Revenue Code, income tax is assessed on income received from any property, activity or service that produces income.[9] The Tax Code stands as an indifferent, neutral party on the matter of where the income comes from.[10]

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[9] *Republic vs. De la Rama*, 18 SCRA 866; *Alexander Howden and Co. Ltd. vs. Collector of Internal Revenue*, 13 SCRA 601.

[10] See Mertens, *Law of Federal Income Taxation*, Vol. I, Sec. 6A. 13, p. 71; Alexander's Federal Income Tax Handbook (24th edition) Sec. 810, p. 240.

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Subject to the foregoing qualifications, we find the action taken by the Commissioner in all other respects — that is, the assessment of a fraud penalty and imposition of interest charges pursuant to the provisions of the Tax Code — to be in accordance with law.

ACCORDINGLY, the judgment of the Court of Tax Appeals absolving the respondents from any deficiency income tax liability is set aside, and this case is hereby remanded to the Court of Tax Appeals for further proceedings. More specifically, the Court of Tax Appeals shall recompute the income tax liabilities of the respondents in accordance with this decision and with the Tax Code, and thereafter pronounce and enter judgment accordingly. No costs.

Makasiar, Esguerra, Muñoz Palma, and *Martin, JJ.*, concur.

Teehankee, J., is on leave.

FIRST DIVISION

[G.R. No. L-29432. August 6, 1975]

JAI-ALAI CORPORATION OF THE PHILIPPINES, *petitioner, vs.* **BANK OF THE PHILIPPINE ISLANDS,** *respondent.*

SYLLABUS

COMMERCIAL LAW; NEGOTIABLE INSTRUMENTS LAW; FORGED SIGNATURE; EFFECT OF; CASE AT BAR.— Section 23 of the Negotiable Instruments Law (Act 2031) states that — "When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any