



R.G. Manabat & Co.

Determining the Tax Treatment of Liquidating Dividends

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It can be said that our substantive law as well as court decisions are consistent with regard to the tax treatment of liquidating dividends.

The dissolution of a corporation signifies the cessation of its existence. Section 117 of the Corporation Code of the Philippines provides that a corporation formed or organized under the provisions of the Code may be dissolved voluntarily or involuntarily. As to voluntary dissolution, the Code provides for three modes namely:

1. File an application for issuance of certificate of dissolution with the Securities and Exchange Commission (SEC) in case there are no creditors who will be affected;
2. File a formal petition for dissolution with the SEC, with due notice and hearing, in case there are creditors who will be affected; or
3. Shortening of corporate term by amendment of the Articles of Incorporation.

On the other hand, a corporation may be dissolved involuntarily by the SEC upon filing of a verified complaint and after proper notice and hearing on grounds provided by existing laws, rules and regulations. Regardless of the mode of dissolution, once all the corporate debts have been satisfied, the remaining corporate assets shall be distributed to the stockholders as liquidating dividends. The issuance of said dividend can also be akin to a return on investment. In other words, liquidating dividend refers to the distribution of assets by a corporation to its stockholders upon dissolution.

In the early case of *Wise & Co., Inc. vs. Meer*, our Supreme Court has settled already the issue regarding the tax treatment of liquidating dividends. The Court held that "where a corporation, etc. distributes all its assets in complete liquidation or dissolution, the gain realized or loss sustained by the stockholder is a taxable income or a deductive loss as the case may be, in effect treated such distributions as payments in exchange for the stock or share." This pronouncement of the Court was reiterated in the case of *Fernando vs. Spouses Lim* where the Court held that "on the part of the stockholder, any gain or loss is subject to tax, while on the part of the liquidating corporation, no tax is imposed on its receipt of the shares surrendered by the stockholder or transfer of assets to said stockholder because said transaction is not treated as sale." Simply put, liquidating dividends shall be treated as taxable on the part of the stockholder recipient and not of the distributing corporation.

Despite these Supreme Court decisions, the tax treatment of liquidating dividends still became an issue in the Court of Tax Appeals (CTA) En Banc case of *Commissioner of Internal Revenue vs. Premium Leisure Corp.* where the Bureau of Internal Revenue (BIR) imposed a Capital Gains Tax (CGT) on the liquidating dividends received by one of the stockholders. One of the arguments of the BIR is that imposition of CGT under Section 27 (D) (5) of the Tax Code is proper as there was presumed gain from the disposition of property considered as capital asset.

In resolving the case, the CTA En Banc discussed the ruling made by the Court in Division where the latter held that imposition of CGT is improper because mere distribution of liquidating dividends of a corporation should not be treated as sale for purposes of the imposition of CGT. The Court in Division further held that CGT is a final tax on the gain from the sale of property considered as capital asset. Hence, there must be profit or gain from the sale, exchange or disposition of real property before one can be liable for said tax. In other words, CGT shall not be imposed in case there is no sale, disposition or conveyance of real property or no income was derived from said transaction.

However, it is CTA En Banc's view that the imposition of CGT is improper not because of the absence of sale, disposition or conveyance of real property or absence of income from said transaction but because it is subject to ordinary income tax as expressly provided under the Tax Code. Section 73 (A) of the Tax Code provides that any gain derived or any loss sustained by the stockholder from its receipt of liquidating dividends shall be treated as taxable income or deductible loss, as the case may be. The said tax treatment was echoed by Section 8 of Revenue Regulations No. 06-2008 where it states that the capital gain or loss derived from such transaction shall be subject to regular income tax rates in case of individual taxpayers or to corporate income tax rate in case of corporations.

To further support this view, the CTA En Banc also cited the cases of *Wise & Co., Inc. vs. Meer and Fernando vs. Spouses Lim* where the CTA En Banc explained that our Supreme Court had treated the surrender of shares by stockholders in exchange for assets distributed by the dissolved corporations as sale by the stockholder of its shares to the dissolved corporation and any gain derived by said stockholder from such transaction is subject to income tax.

As a final note, it can be said that our substantive law as well as court decisions are consistent with regard to the tax treatment of liquidating dividends. Thus, it is imperative that we apply them accordingly so we can avoid conflicting interpretations moving forward.

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