MERGER AND CONSOLIDATION OF EXPIRING CORPORATIONS

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A. PRELIMINARY.

Between the years 1957 and 1960, no less than three big corporations were reported to have undertaken what supposedly were merger transactions before the expiration of their respective charters. One expiring corporation merged with a new corporation put up by it.[1] Another expiring corporation (parent corporation) merged with a subsidiary corporation purchased one or two years before the merger transaction, the subsidiary corporation having a longer corporate life than the expiring purchasing parent corporation.[2] The third expiring corporation merged with a corporation which used to be one of its departments.[3] The true identities of the corporations involved have been withheld for obvious reasons.

Clearly, the mergers *did not result* in the following: the raising of additional capital for expanded operation, more efficient operation,[4] simplification of the financial structure of the corporations involved, elimination of the unprofitable enterprise, liquidation or refund of urgent obligations, discharging of the unpaid dividends accumulated on preferred stocks, and reduction of the fixed charges.[5] Instead, the corporate transactions "enabled" the extension of the lives of the expiring corporations and the consequent "postponement" of the payment of the income tax due on stockholders' liquidating dividends [6] to a time when there will have been a change in substance or a realization in money.[7]

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[1] "A" (name of dissolved corporation) and "B" (name of new corporation.) The new corporation was incorporated by stockholders of the expiring corporation one day before the expiration of the term of the old corporation; the money used for incorporating the new company and its capital stock requirement was put up by the expiring company; and the new corporation did not start operation until after the merger. (Based on the records of the Securities & Exchange Commission.)

[2] "C" (name of dissolved corporation) and "D" (name of new corporation). The subsidiary corporation was wholly owned by the parent corporation; the set of officers of both corporations were the same; and the subsidiary corporation was treated as a branch in the books of the parent corporation before the merger. The new surviving corporation did not even have the capital stock to exchange for the assets of the expiring corporation. (*Ibid.*, Records of the Securities & Exchange Commission.)

[3] The "X" Case. Both corporations were owned by the same stockholders; and the stockholders' equities in both expiring and non-expiring corporations before and after the merger were the same.

[4] See Explanatory Note, H.B. No. 7235 (Rep. Act No. 1921), *infra*.

[5] These are the specific ends to be attained by corporate reorganization as provided in the Federal Internal Revenue Code. As will be shown in the discussion, Republic Act No. 1921 was closely patterned after the reorganization provisions of the Federal Internal Revenue Code.

[6] Act No. 1459, as amended otherwise known as the Philippine Corporation Law, limits corporate life to a *maximum* of 50 years (Sec. 6, par. 4), upon the expiration of which the corporation is forced to liquidate and required to file income tax return under Section 46 in relation to Section 78 of the National Internal Revenue Code.

[7] The deferment of recognition of gain or loss postpones the tax incidence of the transac-

This recent corporate mergers previously discussed were encouraged, if not compelled, by the approval of Republic Act No. 1921 on June 22, 1957, which amended section 35 of the National Internal Revenue Code, purportedly to regard certain corporate reorganizations as tax free.

B. THE LAW.

Republic Act No. 1921 amended Section thirty-five of the National Internal Revenue Code to read as follows:

> "Sec. 35. *Determination of gain or loss from the sale or other disposition of property.*—The gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, shall be determined in accordance with the following schedule: x x x
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> "(a) In the case of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen.
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> "(b) In the case of property acquired on or after March first, nineteen hundred and thirteen, the cost thereof if such property was acquired by purchase or the fair market price or value as of the date of the acquisition if the same was acquired by gratuitous title.
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> "(c) *Exchange of property*—
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> "(1) *General rule*: Except as herein provided, upon the sale or exchange of property, the entire amount of the gain or loss, as the case may be, shall be recognized.
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> "(2) *Exceptions*: No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation (a) a corporation which is a party to a merger or consolidation exchanges property solely for stock in a corporation which is a party to the merger or consolidation, (b) a shareholder exchanges stock in a corporation which is a party to the merger or consolidation solely for the stock of another corporation, also a party to the merger or consolidation, or (c) a security holder of a corporation which is a party to the merger or consolidation exchanges his securities in such corporation, a party to the merger or consolidation.
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> "(3) *Exchange not solely in kind:* (a) If, in connection with an exchange described in the above exceptions, a shareholder or a security holder receives not only stock or securities permitted to be received without recognition of gain or loss, but also money and/or other property, the gain, if any, but not the loss, shall be recognized but in an amount not in excess of the sum of the money and the fair market value of such other property received: *Provided*, That as to the shareholder, if the money and/or other property received has the effect of the distribution of a taxable dividend, there shall be taxed as a dividend to the shareholder an amount of the gain recognized not in excess of his ratable share of the undistributed earnings and profits of the corporation; the remainder, if any, of the gain recognized shall be treated as a capital gain.

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tion. The collection of the tax or the allowance of the loss will be postponed as long as the interest of the shareholder remains in the business affected or until such time as the gain or loss is *actually* realized by the shareholder or by the acquiring corporation through the disposition of the property received in the transaction (MAGILL, TAXABLE INCOME, p. 74; PAUL, STUDIES IN FEDERAL TAXATION, pp. 4-6, 1940; Weis v. Stearns, 264 U.S. 242).

"(b) If, in connection with the exchange described in the above exceptions, the transferor corporation receives not only stock permitted to be received without the recognition of gain or loss, but also money and/or other property, then (1) if the corporation receiving such money and/or other property distributed it in pursuance to the plan of merger or consolidation, no gain to the corporation shall be recognized from the exchange, but (2) if the corporation receiving such other property and/or money does not distribute it in pursuance of the plan of merger or consolidation, the gain, if any, but not the loss, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not distributed.

"(c) If the taxpayer, in connection with the exchanges described in the foregoing exceptions, receives stock or securities which would be permitted to be received without the recognition of gain if it were the sole consideration, and as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability, then such assumption or acquisition shall not be treated as money and/or other property, and shall not prevent the exchange from being within the exceptions.

"(4) *Basis*: (a) The basis of the stock or securities received by the transferor corporation or its shareholder or security holder upon the exchange specified in the above exceptions shall be the same as the basis of the property, stock or securities exchanged, decreased by (1) the money received, and (2) the fair market value of the other property received, and increased by (a) the amount treated as dividend of the shareholder, and (b) the amount of any gain that was recognized on the exchange: *Provided*, That the property received as 'boot' shall have as basis its fair market value: *Provided, further*, That if the corporation or its shareholder or security holders received several kinds of stock or securities, the Collector of Internal Revenue is hereby authorized to issue rules and regulations for the allocation of the basis among the several classes of stock or securities. (b) The basis of the property transferred in the hands of the transferee shall be the same as it would be in the hands of the transferor, increased by the amount of the gain recognized to the transferor on the transfer.

"(5) *Definitions*: (a) The term 'securities' means bonds and debentures but not 'notes' of whatever class or duration.

"(b) The term 'merger' or 'consolidation' when used in this section, shall be understood to mean: (1) the ordinary merger or consolidation, or (2) the acquisition by one corporation of all or substantially all the properties of another corporation solely for stock: *Provided*, That for a transaction to be regarded as a merger or consolidation within the purview of this section, it must be undertaken for a *bona fide* business purpose and not solely for the purpose of escaping the burden of taxation: *Provided, further*, That in determining whether *bona fide* business purpose exists, each and every step of the transaction shall be considered and the whole transaction or series of transactions shall be treated as a single unit: *Provided, finally*, That in determining whether the property transferred constitutes a substantial portion of the property of the transferor, the term 'property' shall be taken to include the cash assets of the transferor.

"(c) The Collector of Internal Revenue is hereby authorized to issue rules and regulations for the purpose of determining the proper amount of transferred assets which meet the standard of the phrase 'substantially all' and for the proper implementation of this section."

1. NATURE OF EXEMPT TRANSACTIONS PROVIDED IN R.A. NO. 1921.

As thus worded, Republic Act No. 1921 refers only to (a) an ordinary merger; (b) consolidation; and (c) the acquisition by one corporation of all or substantially all the properties of another corporation solely for stock in pursuance of a plan of merger or consolidation.

Republic Act No. 1921, however, does not cover other forms of reorganization, namely: re-capitalization or mere change in identity, form or place of organization however effected. These *other* forms of reorganization, therefore, do not fall within the purview of Republic Act 1921. They will not derive any tax benefit from the law, if such can be enjoyed thereunder.

(a) *Merger and consolidation.*

As applied to corporations, the terms "merger" and "consolidation" have well known legal connotations. While the result is practically the same in either event, there is this difference. In a "merger," one corporation *absorbs* the other and remains in existence while the other is *dissolved*. In a "consolidation," a *new* corporation is created *and the consolidating corporations are extinguished.* In either event, the *resulting* corporation acquires all the property, rights and franchises of the dissolved corporations and their stockholders become its stockholders.[8]

(b) *Acquisition of all or substantially all properties.*

The third form of reorganization to qualify as a tax-exempt transaction under Republic Act No. 1921 *must be made in pursuance of a plan of merger or consolidation,* wherein (a) a corporation is a *party to the merger or consolidation* exchanges property solely for stock in a corporation which is a party to the merger or consolidation; or (b) a shareholder exchanges stock in a corporation which is a *party to the merger or consolidation;* or (c) a security holder of a corporation which is *a party to the merger or consolidation* exchanges his securities in such corporation solely for stock or securities in another corporation.

[8] MONTGOMERY'S FEDERAL TAXES, CORPORATION AND PARTNERSHIP, 1946-47, p. 243.

2. PATTERNED AFTER THE FEDERAL INTERNAL REVENUE CODE.

These three forms of reorganization—merger, consolidation and acquisition by one corporation of all or substantially all the properties of another corporation solely for stock, have been closely patterned after the reorganization provisions of the Federal Internal Revenue Code of the United States.[9]

C. REASONS.

The reasons for providing non-recognition of gain or lose to these three forms of corporate reorganization transactions are stated in the Explanatory Note to House Bill No. 7235 (Now Republic Act No. 1921) as follows:

> "Under the present provisions of the Philippine Income Tax Law, the exchange of one piece of property for another is a taxable event, the rule being that the property received is considered as the equivalent of money in a sum equal to its fair market value at the time the exchange was made. There is no limitation to this rule except that which is found in the income tax regulations to the effect that the property received in order to be deemed as the equivalent of money must be essentially different from the property transferred. This essential differences must refer to the substance and not merely to the form of the properties exchanged. As to what is the determinative factor to indicate such a substantial difference, the law does not specify. However, it is certain that if a taxpayer transfers his stock in one corporation for the stock of another corporation, gain or loss shall be deemed realized in such a case to the extent of the difference of the par value or other basis of the stock transferred and the market value of the stock received. This rule was established in Ogan v. Meer, the only case which dealt directly on the exchange of stock for stock. As the court in that case held, when the stockholders of one corporation become the stockholders of the other, as a result of the transaction or exchange, they earned positive benefits and advantages and, therefore, the gain or loss should be included in the computation of the taxable income of the taxpayer.
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> "When the above rules are applied to exchanges incident to corporate combinations, their application will result in the imposition of tax or allowance of loss both on the corporate level as in the stockholders' level. Consider for instance this situation: Corporation X acquires all the assets of Corporation Y in return for the stocks of Corporation X, the assets transferred by Corporation Y having a basis of, say, ₱500,000.00 and a fair market value of ₱750,000.00. Under our present law the ex-

[9] Section 35 [c] [2] of the Internal Revenue Code, as amended by Republic Act No. 1921, was taken from Sections 354 and 361 of the Federal Internal Revenue Code of the United States, except that our Sec. 35 has eliminated the case where a shareholder or security holder exchanges his stock or security in one corporation for either stock or security in the same corporation, a party to the reorganization. Section 35 [a] [3] on exchanges not soley in kind was lifted from Section 356; Section 35 [b] [3] from Section 361 (b); Section 35 [c] [4] from Section 358 (a), (c) and Section 362, with the proviso, however, in Section 35 [c] [4] copied from Section 355 (b) of the Federal Internal Revenue Code.

change is definitely a taxable transaction, the property received and the property given being essentially different. If after receipt of the stock, Corporation Y, preparatory to its dissolution, distributes the stocks to its stockholders in exchange for its own outstanding shares, such a distribution will likewise be taxable under the rule established in the Ogan case.

"This method of Philippine income tax law in dealing with the problem of recognition of gain or loss from exchange of property in connection with corporate combinations is a deterrent factor in the economic development of the country. It discourages corporations from pooling their resources, thereby blocking one of the most important means thru which large concentrations of capital needed to finance the expansion of Philippine industries can be obtained. In other words, the present tax treatment of exchange of property under our law is a disincentive to business to combine and expand. Actually its net effect is to place corporations in what may be termed "a tax strait jacket" from which they could escape only at prohibitive cost.

"In addition to its discouraging effect, the present income tax rule on exchanges of property is also detrimental to the revenue needs of the Government because, whereas it tends to discourage successful corporations to combine, it tends to encourage such transactions in those cases where the possibility of deductible loss is apparent.

"Another objectionable feature of the Philippine method is its being unrealistic. More often than not, exchanges involved in corporate combinations do not result in a substantial alteration in the interest of those who own the business affected by the transaction before it was reformed. Usually in such cases there was no change except as to the form of the muniment representing the interest of the owners. When, therefore, the Government imposes a tax on the supposed gain or when it allows the deduction of the supposed loss, what the government actually does is to tax what are often referred to as 'paper profits' and to allow the deduction of 'paper losses.'

"As early as 1947, the joint *Philippine-American Commission* suggested that the Philippine income tax rule on exchanges of property be changed. The reason of the Commission in suggesting the change was this—

> 'Two corporations may find that their business may be more efficiently operated as one corporation. If the interest of the individual remains in the business, the tax law can aid these business adjustments by regarding the new as the old, so that the tax will be payable, not at the time of the readjustment, but at the time of the disposition of the property or interest in ordinary course. Such aid would appear to be needed in the rehabilitation of Philippine industries.'

"In order to eliminate the obstacles to necessary business readjustments, and in order to prevent taxpayers in taking imaginary losses, and to remove in our law what is considered to be economically unsound technical construction of gains, it is proposed that Section 35 (c) of the National Internal Revenue Code be amended." [10]

[10] Congressional Record, Vol. IV, No. 58, pp. 2041-2042.

D. THE PROBLEMS.

The passage of Republic Act No. 1921 on June 22, 1957,[11] now called the "reorganization statute," has brought in its wake questions involving not only the taxability, but even the legality of certain corporate reorganizations which have been basically patterned after those provided in the Federal Internal Revenue Code. To concretize, these questions which have emerged are the following:

1. Whether Republic Act No. 1921 *authorizes* merger, consolidation and acquisition by one corporation of all or substantially all the properties of another corporation solely for stock in pursuance of a plan of merger or consolidation;

2. Whether our Corporation Law and other existing laws authorize such corporate reorganizations as defined in Republic Act No. 1921; and

3. Whether American jurisprudence on these corporate reorganizations is applicable in this jurisdiction.

E. DISCUSSION.

1. REPUBLIC ACT NO. 1921 DOES NOT AUTHORIZE MERGER, CONSOLIDATION AND ACQUISITION OF PROPERTIES PURSUANT TO A PLAN OF MERGER OR CONSOLIDATION.

Republic Act No. 1921 is *not* a law which expressly authorizes merger, consolidation or acquisition of the properties of another corporation pursuant to a plan of merger or consolidation. It merely assumes that these corporate reorganizations may be made under our Corporation Law or other enabling acts, and for the purpose sets the rules for non-recognition of gains or losses involved in these transactions. The reasons are as follows:

(a) Merger, consolidation and acquisition by one corporation of all or substantially all the properties of another corporation, like other *corporate powers,* must be *derived from the law of the cor-*

[11] In 1957, the reorganization provisions of the Federal Internal Revenue Code, from which Republic Act No. 1921 has been closely patterned, were subjected to *severe re-examination* because of a new high of mergers reported by the Federal Trade Commission. The most widely publicized recent proceeding has been the decision of the Federal Supreme Court condemning du Pont's acquisition of General Motors stocks as a violation of the Federal anti-trust laws, accompanied by a host of federal actions seeking to enjoin or dissolve mergers. (United States v. Eil. du Pont de Nemours & Co., 353 U.S. 589 [1957]). Presumably, these recent developments have caused certain authorities to realize that these forms of corporate re-organization—all of which may be referred to simply as mergers—is "a favored child of the tax law" and the tests of income realization effect in this area is *wholly inconsistent* with the rest of the Tax Code; and that taxing these transactions would not impede economic growth, but their continued tax exemption may be promoting undesirable concentration of wealth, economic power and monopoly. The Attorney General's suit to enjoin the proposed merger of Bethlehem Steel & Youngstown Steel & Tube Co., Silberman, in *The Coming Assaults of Pijwen,* Fortune, June, 1957, p. 142 at 143, reports that the Department of Justice and the Federal Trade Commission have suits pending seeking dissolution of 28 other mergers, and that at least 12 other proposed suits are under consideration. Hellerstein, Jerome R., *Mergers, Taxes and Realism*, 71 HARV. L. REV. 257 (1957).

poration's existence and be based on a statutory authorization. The right may exist by virtue of the *general law* authorizing the *formation* of corporations or by special *enabling* acts which deal mainly with corporate *reorganizations.*[12]

> "Statutes authorizing consolidation, merger and other fundamental changes in the charter contract are based upon the reserved power to alter and amend the charter contract as to existing corporations." [13]

Republic Act No. 1921, being merely amendatory to the National Internal Revenue Code, is a *regulatory* measure providing for the *assessment* and *collection* of a tax and the *enforcement* of all forfeitures, penalties and fines connected therewith.[14] It is neither a *general law* authorizing the formation of corporations nor a *special enabling act which deals mainly with corporate reorganizations.* It cannot, therefore, be properly directed at corporate or even quasi-corporate forms of organization, much less authorize them. These corporate matters can only be provided for by *corporation laws,* or the *charters of corporations.*

> "The primary purpose of *corporation laws is not regulatory.* They are *enabling acts* to authorize businessmen to organize and to operate their business with the advantages of the corporate mechanism. x x x They provide the legal frame and *financial structure* of the intricate device by which business can be carried on and in which the combined energies and the capital of the managers and of many investors may work together. They deal with the *internal affairs* of the organization, the content of the articles of incorporation, *the right of the shareholders*, the powers and liabilities of directors, the authorized number and variety of the shares, the holding of meetings, *restrictions on corporate finance, such as* the withdrawal of funds by way of dividends and share purchases, the corporate records, *the authorization of organic changes such as amendments, sale of entire assets, merger and consolidation, and dissolution and winding up.*" [15]

And if these organic corporate changes are accomplished through an independent statute, such statute must apply generally to corporations already in existence, or specially adapted to a particular case. In the latter case, however, such ratifying acts are generally equivalent to *original authorization,* and, therefore, must likewise be *enabling and not merely regulatory acts.*

> "The primary grant of authority to consolidate is in the *act of incorporation or the charter of the company.* In the absence of constitutional

[12] BALLENTINE, LAW OF CORPORATIONS, pp. 41-42.
[13] BALLENTINE, *ibid.*, p. 684
[14] Cf. Sec. 3, National Internal Revenue Code.
[15] BALLENTINE, *ibid.*, pp. 41-42. (*underscoring* supplied).

restriction it may be given in the statute by virtue of which the corporation *was organized* whether that is a *special act of incorporation or a general act under which all corporations of the same kind are chartered.* But the authority may also be given in a *general act* antecedent to, or contemporaneous with the charter, and having no especial relation thereto. In other words, the legislature may authorize corporate consolidation either by charter or independent statute. The authority may be granted by statute passed after the corporation has been organized, when neither in their charters nor in any statute in force when they were created was any such authority conferred. It may be either by an act *applying generally to corporations already* in existence, or by *special statute adapted to a particular case.* Moreover, just as the legislature may validate the unauthorized organization of a corporation, such ratifications generally being equivalent to *original authorization,* so, also may an unauthorized consolidation be validated." [16]

(b) The latest enacted statutes in the several states (of the United States) which *permit* corporations to consolidate apply to various kinds of corporations and authorize them to consolidate under varied conditions subject to sundry limitations, and by *diverse methods of procedure.*[17] In fact, *a distinguishing feature of a merger and consolidation statute* is that it *prescribes the procedure* to be observed in the consummation of merger, consolidation and acquisition of corporate properties and assets.[18] The significant *omission* in Republic Act No. 1921 of the procedure to be followed in the consummation of the corporate reorganizations defined therein is another clear indication that Congress never intended to consider said law as a "reorganization statute" sufficient in itself to provide for *organic corporate changes* in the framework of existing corporations.

(c) In the United States, the authority to merge or consolidate is granted to American corporations *not* by virtue of the Federal Income Tax Code provisions, *but* by explicit provisions in the Uniform Business Corporation Act of the United States and the respective corporation laws of the majority of the states patterned after the said Uniform Business Corporation Act.[19] Even the Federal Income

[16] BALLENTINE, *ibid.*, p. 42.

[17] Am. Jur., *ibid.*, p. 1089.

[18] BAKER AND CARY, CORPORATIONS, CASES AND MATERIALS. 1959 ed., p. 1468. The Uniform Business Corporation Act of the United States *recognizes* merger and consolidation between two corporations. The act provides with *considerable detail* as to the method in which the merger or consolidation may be brought about, and its effects. In general, the essential steps involve (1) the negotiation and approval of an agreement of merger or consolidation by the boards of directors of the constituent companies and the drafting of formal agreement for the purpose in accordance with the statute applicable; (2) the submission of the agreement, either in full or in substance, to the shareholders for their approval and the giving of the required majority of votes in favor of the agreement upon lawful notice of a shareholders meeting; (3) the execution of the formal agreement by the proper corporate officers with the formal certificates of one authorization and the filing of the agreement so duly certified with the Secretary of State or other designated officials. Statutes differ greatly as to the shareholder vote or consent required for the approval and authorization of an agreement of merger or consolidation (Ballentine, *ibid.*, pp. 684-685).

[19] BALLENTINE, *ibid.*, pp. 35, 44-45, 47.

Tax Regulations, in defining the terms statutory merger or consolidation, states that such merger or consolidation must be made *"pursuant to the corporation laws* of the United States or a State or Territory of the District of Columbia." No such provision can be found in the Philippine Corporation Law, and Republic Act No. 1921 admittedly based merely on the non-recognition provisions of the Federal Internal Revenue Code cannot by itself confer that authority.

2. OUR CORPORATION LAW (ACT NO. 1459) DOES NOT AUTHORIZE MERGER OR CONSOLIDATION OF CORPORATIONS OR ACQUISITION OF CORPORATE PROPERTY PURSUANT TO A PLAN OF MERGER OR CONSOLIDATION.

Corporations have the right and the power to consolidate *only by the consent and authority of the legislature.* This consent to a valid consolidation must be *clearly* and *distinctly* expressed; it is *never implied* and exist only by virtue of *plain legislative enactment.*[20] The reason is that "a corporation has no natural rights and capacities, such as an individual or an ordinary partnership, and if a power is claimed for it, the words giving the power, or from which it is necessarily implied, must be found in the charter of the law of its creation; *otherwise, such power does not exist.*"[21]

In the *absence* of an express statutory authorization, any attempt on the part of a corporation to consolidate or merge would be *ultra vires.*[22] And, such an attempted merger or consolidation cannot even result in the creation of a corporation *de facto.* The rule which a *de jure* corporation might be created, is applicable to *de facto* mergers and consolidations in that there can be a *de facto* corporation only when there is a law under which *a de jure corporation may be organized.* Hence in the case of any such attempted merger or consolidation, its validity may be questioned even in a collateral proceeding.[23]

(a) *No express provision in our Corporation Law.*

Nowhere in our Corporation Law (Act No. 1459) is there such a clear, distinct, plain and express conferment of the authority to the corporations to merge or consolidate.

Section 17½, 18 and 28½ of our Corporation Law cannot be resorted to as sources of authority for corporate merger, consolidation or acquisition by one corporation of the property of another

[20] Am. Jur., *ibid*, pp. 1087-1089; 15 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATION, 27 (Permanent ed.).

[21] National Home Building and Loan Asso. v. Home Saving Bank, 181 Ill. 35, 64 N.E. 619.

[22] 15 FLETCHER, *op. cit., supra* note 20, at 211-213.

[23] Clearwater v. Meredith, I Wall. 25 (U.S.), 17 L.Ed. 604.

corporation solely for stock pursuant to a plan of merger or consolidation.

(1) *Section 17½*—

Section 17½, it is true, authorizes a corporation organized under the Corporation Law to invest its funds in any other corporation or business under certain conditions. *But* such authorization to invest *does not* go so far as to include that of subscribing for stock in the incorporation of another corporation.[24]

(2) *Section 18*—

Section 18 authorizes a corporation to amend its articles of incorporation. *But* among the matters which can not be amended is *the extension of corporate life beyond that fixed by the articles of incorporation.*[25]

(3) *Section 28½*—

Section 28½ authorizes a corporation, by action taken at any meeting of its board of directors, to sell, exchange, lease or otherwise dispose of all or substantially all of its property and assets, including its goodwill for such considerations, which may be money, stock, bonds, or other property or considerations. *But* "a simple sale of its property by one corporation to another is to be distinguished from a merger or a consolidation, and particularly in the resulting rights and liabilities. Unless, therefore, such is the evident intention, a mere purchase or acquisiton of another corporation's assets or property does *not* constitute a merger, or a consolidation *particularly where there is no state law authorizing a consolidation, even though it is advertised as such by the parties, or is referred to as a consolidation in certain resolutions and letters of the respective corporations,* or there is an assumption of liability on the part of the purchasing corporation, especially where the selling corporation still retains its franchise and certain stock of the purchasing company. *A fortiori,* a transfer of part of its assets by one corporation to another *does not constitute a merger.*" [26]

Moreover, the aforecited Section 28½ of our Corporation Law, has never been held as a source of authority for a corporation to continue its corporate life and activities through the instrumentality of another corporation. Thus, where the purpose of the sale and transfer of all its property to another corporation is *not to wind up its business* and *distribute its properties among the stockholders,*

[24] McAlester v. Florence Cotton & Iron Co., 128 Ala. 240, 30 So. 633.
[25] Sec. 6(4) Corporation Law.
[26] 15 FLETCHER, *op. cit., supra* note 20, at 15-19.

but to continue its existence as a corporation thru the instrumentality of another corporation, the transaction is open to question. As aptly stated in one case:

> "There was to be a corporation within a corporation. Individual activity was to cease, but corporate energy was to be exercised through a living corporation, whose life and functions were to be controlled through the shares held by its corporate creator and master. Forbidden to exercise the very functions for which the breath of corporate life had been breathed into it by the state, there would remain standing only the shell of a corporation, retaining corporate existence only for the purpose of controlling and directing the new corporation in which was vested its corporate capital, and to receive and distribute its aliquot proportion of those earnings as dividends among its own stockholders. The effect of this action of the corporation was to divest itself of the power to exercise the essential and vital elements of its franchise, by a renunciation of the right to engage directly and individually in the very business which it was organized to carry on, and is a disregard of the conditions upon which corporate existence was conferred. The state is presumed to grant corporate franchise in the public interests, and to intend that they shall be exercised through the proper officers and agencies of the corporation, and does not contemplate that corporate powers will be delegated to others. Any conduct which destroys their functions or maims and cripples their separate activity, by taking away the right freely and independently to exercise the functions of their franchise, is contrary to a sound public policy."[27]

It is contended, however, that the third form of reorganization—acquisition by one corporation of all or substantially all the properties of another corporation solely for stock[28]—may be undertaken within the purview of Section 28½ of our Corporation Law, since the sale or exchange, or disposition of all or substantially all of the corporation's property and assets authorized thereunder may be for such consideration as *stock* or other security of the corporation.

This contention overlooks the following potent considerations:

First. The third form of reorganization requires that it must be *pursuant to a plan of merger or consolidation.* As a matter of fact, it is included in the definition of the term "merger" or "consolidation." In view of the *lack of authority* of our corporations to merge or consolidate, no such acquisition or disposition of corporate properties can likewise be made *in pursuance of a plan of merger or consolidation.*

Second. The disposition of all of the corporate assets under Section 28½ may be effected as a preliminary step to *dissolve* the cor-

[27] McCutcheun v. Merz Capsule Co., 71 Fed. 787, pp. 220-221.
[28] Sub-section 5, (b) Republic Act No. 1921.

poration and *distribute the properties* and assets among the stockholders.[29] On the other hand, the acquisition of all or substantially all of the property of another corporation pursuant to a plan of merger or consolidation under Republic Act No. 1921 (now subsection 5[b] of Section 35 of the Internal Revenue Code) *does not contemplate a winding* up of the business of the old corporation and a *distribution of its property.* In fact, the very object of the transaction and of the statutes which permit it *is to continue* the business of the old corporation. This is made more evident by the fact that the transaction requires a "continuity of interest" either on the part of the transferor corporation or "on the part of the old stockholders in the new business so that the old stockholder *does not actually liquidate his holdings,* but *continues* to be a participant in the enterprise."[30]

Third. An authority to sell, lease, exchange and dispose of property does not include the power to reincorporate or reorganize so as to change the terms by, and the purpose for, which the property was held by the old company, or to confer enlarged powers on its agents, or to dispose of all the corporate property *in return for a part thereof.* A reorganization law enacted after the corporation is created cannot be given effect where to do so would constitute a *modification* of the corporate charter with resultant confiscation of vested property rights. If the statute under the authority of which the reorganization is accomplished be for some reason void but the business is carried on by the new company, the continued business will be regarded as really that of, and belonging to, the old company.[31]

A careful perusal of all these sections will reveal, therefore, that the American concepts of merger and consolidation of corporations, and acquisition by one *corporation* of the property of another *corporation* solely from stock pursuant to a plan of merger or consolidation are not provided therein, nor implied therefrom.

On the contrary, the sections assume that no merger or consolidation of corporations occurs in the transaction contemplated therein. This can be inferred from the fact that in said sections 18 and 28½, there is an injunction against the payment of the value of the shares of dissenting stockholders, *if the value of the corporate assets which would remain after such payment would not be at least equal to the aggregate amount of the corporation's debts and liabilities,* exclusive of capital stock, thus, assuming that the

[29] PINEDA and CARLOS, THE LAW ON PRIVATE CORPORATIONS AND CORPORATE PRACTICE, 220 (1960 ed.)

[30] 16 FLETCHER, *op cit supra* note 20, at 89; Cortland Specialty Co. v. Commissioner, 60 F.2d. 937; Mead Coal Co. v. Commissioner, 72 F.2d.

[31] 16 FLETCHER, *op. cit. supra* note 20, at 342.

corporation *would still continue to exist* despite the transactions entered into by virtue of any of the said sections. Moreover, the transactions authorized by sections 17½, 18, and 28½ are *not* among the recognized modes for *dissolving* corporations.[32]

Such *continuation* of the corporate existence *negatives* the idea of a merger or consolidation of *corporations*, because, in such cases, the corporation that is merged or consolidated with another corporation necessarily becomes extinct and is *swallowed* up, either by the other corporation in case of merger or by a new corporation in case of consolidation.

It is true that the power to merge or consolidate is *not expressly prohibited* to the corporations by our Corporation Law, but neither is it expresssly nor impliedly granted to them. In such case, it must be considered as impliedly prohibited and the corporation cannot exercise it. The charter of a corporation is the measure of its powers, and the enumeration of these powers implies the exclusion of all others.[33] Finally, "to say that the right of merger must be plainly afforded is to say in substance that we must be fully convinced that it is afforded. In such a situation, *to doubt, is to deny*."[34]

(b) *Section 6 of Securities Act does not authorize merger or consolidation.*

Section 6 of Commonwealth Act No. 83, otherwise known as the "Securities Act," may not also be regarded as a legislative grant to corporations of authority to merge or consolidate. Said section merely provides that:

> "The provisions of this Act shall not apply to the sale of any security in any of the following transactions: x x x (e) The transfer or exchange by one corporation to another corporation of their own securities in connection with a consolidation or merger of such corporations. x x x"

It is clear from the terms of the provision that it merely exempts such transaction from the requirements of the Securities Act, but does not in itself constitute the grant of authority to corporations to merge or consolidate. At the most, it implies or assumes that

[32] The recognized modes for dissolving corporations are: (1) Expiration of the period provided in the articles of incorporation (Sec. 77); (2) legislative enactment (Sec. 76); (3) judicial decree of forfeiture, by *quo warranto* proceedings against the corporation in any of the following instances: (a) when it has offended against a provision of an Act for its creation or renewal; (b) when it has forfeited its privileges and franchises by non-user; (c) when it has committed or omitted an act which amount to a surrender of its corporate rights, privilege, or franchises: (5) when it has misused a right, privilege, or franchise conferred upon it by law, or when it has exercised a right, privilege, or franchise in contravention of law (Section 2, Rule 68, Rules of Court); (e) when it has been found guilty of a violation of any of the provisions of the Corporation Law, not otherwise penalized therein. (Section 190-197, Corporation Law); and (4) failure by the corporation to organize and commence the transaction of its business or the construction of its work within 2 years from the date of its incorporation—results in *ipso facto* dissolution of the corporation. (Section 19.)

[33] Thomas v. West Jersey Railway Co., 101 U.S. 71, 25 L.Ed. 950.

[34] 15 FLETCHER, *op. cit. supra* note 20, at 35-37.

the exemption provided therein would operate only in cases where another law has granted the power to merge or consolidate.

Moreover, it is significant to note that the provisions of our Securities Act are patterned after the Federal Securities Exchange Act of 1934, the Federal Securities Act of 1933, as amended by a rider in the Federal Securities Exchange Act of 1934, and the provisions of the Uniform Sales of Securities Act drafted by the Commissioners of Uniform State Laws of the United States.[35] Thus, the provisions which we have copied were originally intended for a jurisdiction in which the power of corporations to merge or consolidate *has been specifically granted by the legislature to corporations in general*.[36] Such a situation does not obtain in this country, and therefore, the interpretation given in the United States to these provisions should not be indiscriminately adopted here, as these provisions, like other provisions of law, should be understood and applied in the context of the particular legal system which has adopted them.

(c) *Only two statutes expressly authorize merger or consolidation of corporations.*

So far, only two Philippine statutes authorize the merger or consolidation of corporations. They are Act No. 2772 [37] and Act No. 146.[38]

(1) Section 1 of Act No. 2772 expressly provides:

> "SEC. 1. Any corporation organized, or to be organized, under any law, or laws, of the Philippine Islands may merge or consolidate into a single corporation with any other corporation organized, or to be organized, under any law, or laws, of the United States or of any State or Territory of the United States, or of the Philippine Islands, *and owning and operating any railway lines* within the Philippine Islands, which said consolidated corporation shall, upon the payment of a proper charter fee, thereby become a domestic corporation of the Philippine Islands, and may be either one of said merging or consolidating corporations, or a new corporation to be formed by means of such merger or consolidation, so that by virtue of this Act, and the proceedings had pursuant thereto, such corporations shall be merged or consolidated, so that all property, rights, franchises, and privileges by law vested in such corporations so merged or consolidated shall be transferred to and vested in the corporation into which such merger or consolidation shall be made."

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[35] 2 TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE COMMERCIAL LAWS OF THE PHILIPPINES, 800 (7th ed.,

[36] 13 Am. Jur., 1087-1089.

[37] An Act authorizing the merger or consolidation of certain corporations.

[38] An Act to reorganize the Public Service Commission, prescribe its powers and duties, define and regulate public services, provide and fix the rates and quota of expenses to be paid by the same and for other purposes.

Section 2 of said Act prescribes the conditions, restrictions and detailed procedure to be followed in the consummation of the merger or consolidation of the railroad corporations.

(2) Section 20(g) of Commonwealth Act No. 146, otherwise known as the Public Service Act, provides:

> "SEC. 20 (g)—To sell, alienate, mortgage, encumber or lease its property, franchises, certificates, privileges, or rights, or any part thereof, or merge or consolidate its property, franchises, privileges or rights, or any part thereof, with those of any other public service. The approval herein required shall be given, after notice to the public and after hearing the persons interested at a public hearing, if it be shown that there are just and reasonable grounds for making the mortgage or encumbrance, for liabilities of more than one year maturity, or the sale, alienation, lease, merger, or consolidation to be approved, and that the same are not detrimental to the public interest, and in case of a sale, the date on which the same is to be consummated shall be fixed in the order of approval: *Provided, however,* That nothing herein contained shall be construed to prevent the transaction from being negotiated or completed before its approval or to prevent the sale, alienation, or lease by any public service of any of its property in the ordinary course of its business."

Our Supreme Court held the aforequoted provision of the Public Service Act sufficient to carry out not only the merger or consolidation of the *assets and properties* of two public service corporations, but also of the *two such corporations themselves.*[39] The Court said:

> "Granting arguendo, that the disputed resolution has really the intention and the purpose of carrying out the merger or consolidation both of the assets and properties of the two *as well as of the two corporations themselves in the true sense of the word,* or in the light of the American authorities, still we believe that this can be carried out in this jurisdiction *in the light of our Public Service Law.* Thus *section 20 (g) of Commonwealth Act No. 146,* as amended, prohibits any public service operator, unless with the approval of the Public Service Commission, "to sell, alienate, mortgage, incumber or lease its property, franchises, certificates, privileges, or rights, or any part thereof, *or merge or consolidate* its property, franchises, privileges, or right or any part thereof, with those of any other public service." This law speaks of merger or consolidation of public services engaged in land transportation. It does not impose any qualification except that it shall be done with the approval of the Public Service Commission. There is no doubt that *the intended merger or consolidation comes within the purview of this legal provision*".

It is to be noted that the express authorization in these two laws are not available to other corporations. A statute authorizing con-

[39] Reyes, *et als.* v. Blouse, *et als.*, G.R. No. L-4420, May 19, 1952.

solidation of *particular corporations* only, or of corporations of a *particular* class only, does *not* apply to other corporations or corporations of a different class. Thus:

> "In investigating the statutes relating to consolidation and merger, it should be kept in mind that in most of the states there are separate, and often times considerably different, statutes relating to consolidation or merger or both, governing particular classes of corporations, such as railroads, banks, etc. In some states there is merely a general statute relating to consolidation, applicable generally to all corporations within its terms; in other states, there is a general statute providing for the consolidation of particular corporations, such as railroad companies, street railway companies, etc.; and in still other states there is no statute authorizing consolidation of corporations generally, but merely one or more statutes authorizing the consolidation of particular corporations, such as railroads, street railroads, banks, or the like.
>
> "A statute *authorizing consolidation of particular* corporations only, or of corporations *of a particular class only, does not apply to other corporations, or corporations of a different class.* So where the statute in direct terms or by necessary construction applies only to corporations organized to carry on business, an incorporated social club *does not* come within the purview thereof. If the statute merely permits "manufacturing" companies to consolidate, it is held that this permits a consolidation of electric light companies *but not* of ice companies merely collecting and selling natural ice.
>
> "There are special statutes in some states authorizing and governing the merger or consolidation of railroad companies, and they apply to, and include, street railroads, unless there is something to show an intention to exclude them. Of course, there are statutes which in express terms include street railway companies and authorize them to merge or consolidate, and under them a city line may lawfully consolidate with an interurban line.
>
> "Specific provisions are also to be found in the statutes conferring the power to consolidate or merge on various other classes or kinds of corporations in addition to those just mentioned, such as gas companies, building and loan associations, insurance companies, trust, and banking companies. Under the National Bank Act, national banks are given the rights to consolidate with other national banks, and provision is also made for the consolidation with national banks or banks incorporated under the laws of any state or in the District of Columbia."[40]

3. THE AMERICAN CONCEPTS OF MERGER AND CONSOLIDATION NOT APPLICABLE TO OUR JURISDICTION.

As shown in the preceding pages, Republic Act No. 1921 has incorporated into our Tax Code the concepts of merger or consolidation *as intended and understood in American jurisprudence.* To repeat, the distinguishing feature of these two forms of American corporate reorganization is that in a merger one corporation *absorbs* the other and remains in existence while the other is *dissolved;* and

[40] 15 FLETCHER, *op. cit. supra* note 20, at 38-42.

in a consolidation, a new corporation is created and the consolidating corporations are *extinguished.*

In *Reyes et als. vs. Blouse, et als.*,[41] the principal issue involved was whether the disputed resolution to take the necessary steps to consolidate the properties and franchises of the Laguna Tayabas Bus Co. with those of the Batangas Transportation Co. constituted a merger or consolidation of the properties and franchises of the two public service companies *within the meaning of our law;* and in the affirmative case, whether said merger or consolidation can be carried out under the law now existing and in force in the Philippines. In resolving the issue, the Supreme Court held:

> "Appellants contend that the disputed resolution calls for a *real* merger or consolidation in the sense and in the manner said terms are *intended and understood under the law and authorities of the United States,* citing in support of their contention a *long line of American authorities,* and that viewing the resolution in that light, the same cannot come within the purview of section 28½ of our Corporation Law, as claimed by appellees. But even if we view the resolution *in the light of the American authorities,* we are of the opinion that the transaction called for therein *cannot be considered, strictly speaking, as a merger or consolidation of the two corporations because, under said authorities,* a merger implies necessarily the *termination or cessation of the merged corporations and not merely a merger of their properties and assets.* This *situation does not here obtain.* The two corporations will *not lose their* corporate existence or personality, or at least the Laguna Tayabas Bus Co., but *will continue to exist* even after the consolidation. In other words, what is intended by the resolution is *merely a consolidation of properties and assets, to be managed and operated by a new corporation, and not a merger or the corporations themselves.*"

The aforequoted portion of the decision of our Supreme Court, therefore, makes at least two things: (1) the *American* concept of merger and consolidation which implies necessarily the *termination* or the cessation of the merged corporations is not applicable in our jurisdiction; and (2) the merger or consolidation authorized by our Corporation Law is merely that of *corporate properties and assets and not of corporations themselves;* and, therefore, the two corporations which are parties to the transaction do not lose their corporate existence or personality.

If it is correct that the American concept of merger and consolidation of corporations is not applicable in this jurisdiction, then the "continuity of interest" requirement of tax-free reorganizations, originated in *Pinellas Ice and Cold Storage Co. v. Commissioner* (281 U.S. 462), the "business purpose" requirement developed in *Gregory vs. Helvering* (293 U.S. 465), and the "step transaction doctrine"

[41] See note 39 *supra.*

posited in *Helvering v. Elkhorn Coal Co.* (95 F.2d. 732) and *Heller v. Commissioner* (2 T.C. 371), would not have any relevance at all to mergers or consolidations of corporate properties and assets authorized by our Corporation Law. At the most, they may be delved into only in the merger or consolidation of public services engaged in land transportation under the Public Service Act and railroad corporations under Act No. 2772.

(a) *Distinction between merger or consolidation of corporations and that of corporate properties and assets.*

The basic distinctions between merger or consolidation of *corporations* and merger or consolidation of *corporate properties* are:

(1) The term "merger of *corporations*" means the *absorption* of one corporation by another, which retains its name and corporate identity with the added capital, franchises and powers of the merged corporation, while the term "consolidation of *corporations*" means that all of the consolidating companies surrender their separate existence and become parts of a new corporation.[42]

On the other hand, the concept of a *merger of corporate properties* means that although the properties of the corporation are transferred to another corporation, in exchange for money, stock, or other securities, *both the transferor and the transferee corporations remain in existence,*[43] despite the possibility that the transferor corporation might be holding no properties of its own, ownership or holding of property *not being necessary* for a corporation to exist. Neither is the fact that the corporation owns or holds no properties a cause for its dissolution, *ipso facto* or otherwise.[44]

(2) *Corporations* merged under legislative authority, and the rights of stockholders of the combining corporations are defined and regulated by the governing statute and the merger agreement made in conformity with such statute. When they become stockholders in the absorbing company, their rights as such are largely determined by their relation to such company.

On the other hand, if a corporation sells all or substantially all of its *assets or properties,* the rights of the stockholders are generally *not changed* as they remain stockholders of the same corporation.

(3) A mere transfer by one corporation of its franchises and *property* to another, does not, as a general rule, affect a transfer of all of the powers and immunities of the transferor, although it may pass to the purchasing corporation the title and rights of the

[42] Commissioner of Internal Revenue v. Freund C.C.A. 3, 98 F.2nd 201, 204.
[43] Reyes *et al.* v. Blouse *et al.*, *supra.*
[44] Boston Glass v. Langdon, 24 Pick. 49, 35 Am. Dec. 292.

other company in the property involved, and invest it with the right to use the corporate name of the selling company. Thus, in the case of *Southern Car & Foundry Co. v. Calhoun County*,[45] it was held that a license issued to a selling company does not inure to the benefit of a purchasing company so as to enable it to do business thereunder. And, according to the case of *Rogers v. Toccoa Elec. Power Co.*[46] where a corporation is by judgment of court denied the power of eminent domain because its charter is void, a corporation which takes over all its property is not bound by such judgment. Another case, *United Zinc Companies v. Harwood*[47] a corporate action to sue its officers for secret profits does not pass to a new corporation created for the purpose of receiving the property of the old one but not merged with the old corporation by legislative authority.

On the other hand, the corporation resulting from a *real consolidation or merger* acquires all the property, rights, powers, franchises and privileges of the constituent companies.[48]

(b) *Administrative recognition of corporate merger, or consolidation or exchange not a source of authority.*

The claim has been unduly pressed that the test of non-taxability followed in American decisions was followed in this jurisdiction in a number of rulings issued by the Bureau of Internal Revenue governing similar corporate reorganizations undertaken by local corporations even before the enactment of Republic Act No. 1921.[49]

Such administrative determinations cannot furnish a corporate authority where such is not plainly and explicitly conferred by the legislature. Administrative determinations and practice cannot repeal existing laws.[50]

Moreover, the creation of a corporation is an exercise of sovereign power[51] and the neglect, omission or errors of administrative officials in the discharge of their official duties, even if followed for a long time, will not work an estoppel against the state.[52] Verily, even the consent of a Securities and Exchange Commission to a consolidation does not authorize a consolidation offending public policy; and a consolidation made without compliance with the conditions

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[45] 141 Ala. 250, 37 So. 425.

[46] 163 Ga. 919, 137 S.E. 272.

[47] 216 Mass. 474, 103 N.E. 1037.

[48] 16 FLETCHER, *op. cit. supra* note 20, at 85. MONTGOMERY'S FEDERAL TAXES, CORPORATION AND PARTNERSHIP, 1946-47, p. 243.

[49] Letter-opinion of Atty. Juan Ponce Enrile dated July 16, 1960 submitted to this Commission, pp. 10-15.

[50] Art. 6. Civil Code of the Philippines: "Laws are repealed only by subsequent ones, and their violation or non-observance shall not be excused by disuse, or custom or practice to the contrary . . Administrative or executive acts, orders and regulations shall be valid only when they are not contrary to the laws or the Constitution."

[51] Chicago etc. R. Co. v. Douglas County, 114 N.W. 511.

[52] Ang Giok Chip v. Springfield F. & M. Inc., 56 Phil. 375, 384.

upon which a Public Service Commission has given its consent is still illegal and void.[53]

Until and unless, therefore, our Corporation Law is amended [54] or an enabling act is enacted expressly conferring to the corporations the authority to merge, consolidate or exchange properties pursuant to a plan of merger or consolidation, the non-recognition rule of gain or loss meticulously set forth in Republic Act No. 1921 will apply only to two kinds of corporations—the railroad and public service corporations—but not to others.

(c) *Observations apply with greater force to expiring corporations.*

The foregoing observations apply with greater cogency to expiring corporations. The reasons are as follows:

(1) While tax advantages may or may not be a primary motivation to the merger of two existing corporations with many more years of corporate existence ahead of them, to an expiring corporation they certainly will play a highly significant, if not the sole, consideration in entering into this kind of corporate combination which offers virtually the ideal tax solution. The transaction will enable an expiring corporation not to liquidate and consequently avoid the income tax due on stockholders' liquidating dividends. Its stockholders "receive, without tax, liquid assets in the form of stock readily salable on the market at known values. This stock can be held if desired, or sold off in pieces or as a whole when the stockholder *desires*—then incurring a tax at only capital gain rates. In this way, cash funds can be realized inexpensively through partial sales, as desired by the holder . . ." [55]

(2) The reorganization provisions are "tax-*deferring*, rather than tax-*exempting* provisions," as these corporate transactions are deemed by Congress to be "transitional, continuing transactions which are not sufficiently 'closed' to justify economically (though there may be a different answer on a strict *legal* basis) the imposition of capital gains tax at the immediate moment of an 'ordinary business transaction.' The pious, put vain, hope is that there will be no ultimate escape from tax . . ." [56]

This "pious, but vain, hope" has less chances of being realized in the merger of an *expiring* corporation with a new corporation put up by it, or with a subsidiary corporation purchased before the merger transaction or with one of its departments. For such a trans-

[53] 15 FLETCHER, *op. cit. supra* note 20, at 34-35.
[54] Sec. 76, Corporation Law (Act No 1459).
[55] Hellerstein, *Mergers, Taxes and Realism*, 71 HARV. L. REV. 257 (1957).
[56] *Id.* at 272

action will not only lengthen the interval between increase in wealth and its taxation beyond the requirements of normal principles of income realization but within this lengthened period can furnish better opportunities for reducing taxes on increased values of securities through gifts, or the creation of trusts, or by reason of death, and for postponement of taxation to a more favorable point of time selected by the taxpayer or his transferee.[57]

> "But, and most important of all, it was clear that the statutes did not merely postpone collection of the tax but resulted, even in their legitimate use, *in actual loss of revenue.* Thus, the taxpayer may save surtax by electing to pay the tax in a year in which he has small income or large losses. Conversely, if the transaction shows a loss, the postponement may enable the taxpayer to deduct it when he cannot in the year of reorganization. The tax may be delayed to a year in which rates are lower, or when a larger percentage of the gain is exempt. In boot transactions, splitting the recognition of gain over two or more transactions results in *irrecoverable loss of surtax.* If recognition is delayed beyond the point of taxpayer's death, the *whole tax is lost* because the basis in the hands of the heirs is market value and not basis in the hands of the deceased." [58]

(3) The term of existence of a corporation has been fixed by our Corporation Law *not to exceed fifty years.*[59] *Although this term may,* by amendment to the articles of incorporation, *be shortened, it cannot legally be extended* thereafter by the shareholders *even if a term of less than fifty years is fixed therein.* And upon the expiration of this period, the corporation is considered dissolved and enters upon the period of liquidation precisely as it would had the original term expired.[60] It is obvious, therefore, that no agreements whatsoever between associates can result in giving rise to a *new and distinct personality,* possessing independent rights and obligations, unless the law itself shall decree such result.[61] At present, except for domestic life insurance companies,[62] there is *no* such law decreeing such result.

Authorities are agreed that in the absence of any statutory provision authorizing the extension or continuance of corporate exist-

[57] *Ibid*

[58] Sandberg, The Income Tax Subsidy to "Reorganizations", p. 122, cited in Hellerstein, *supra,* p. 272. (*underscoring* supplied).

[59] Sec. 6, par. 4.

[60] Sec. 18, par. 1; Tognazzine v. Jordan, 165 Cal. 19. It becomes incapable of making contracts or receiving a grant (Sec. 77, Corp. Law). Its existence, though, is continued for a term of three years for the purpose of prosecuting and defending suits by or against it and of enabling it gradually to settle and close its affairs, to dispose of and convey its property and to divide its capital stock.

[61] Benguet Cons. Mining Co. v. Pineda, G.R. No. L-7231, March 28, 1956; 52 O.G. 1961.

[62] By express provision of law, only a domestic life insurance corporation may extend its corporate existence for a period not exceeding 50 years in any one instance by amendment of its articles on or before the expiration of the term so fixed in said articles (Sec. 1, Rep. Act No. 1932).

ence, a corporation becomes *ipso facto* dissolved and no longer has any existence at all, either *de jure* or *de facto*, for there is no law under which it can longer exist. This dissolution in such case is declared by the act of the legislature itself; the limited term of existence has expired and no judicial determination of that fact is requisite.[63]

To follow the construction which expiring corporations would like to attach to Republic Act No. 1921, which, as noted before, *is not an amendment to our Corporation Law* nor an *enabling act* authorizing corporate reorganizations, would be to furnish the unintended refuge for these corporations to extend their legal lives behind a cleverly erected screen of corporate dummies which may either be their former subsidiaries or departments. And after having transferred to, or exchanged their assets with, the new corporations, these *expiring* corporations, although considered dissolved, in effect will still continue in existence, this time through the instrumentalities of *new* corporations, with literally a renewed lease of corporate existence for another fifty years, thereby nullifying the explicit prohibition in our present Corporation Law against extension of corporate existence beyond the maximum period of fifty years or the period fixed in their articles of incorporation.

(d) *Congressional attitude supports this view.*

That Republic Act No. 1921 cannot be the vehicle to arrive at this result is made manifest by two bills filed during this current session with the House of Representatives and the Senate of the Congress of the Philippines[64] seeking to amend paragraph 4 of Section 18 of our Corporation Law so as to allow a corporation *to extend* the term of its existence, for the reason that:

> "In our own case in the Philippines, a number of reputable and well established corporations organized during the turn of the century are about to terminate their corporate existence under the Corporation Law. Needless to say, if these corporations should cease to operate by virtue of the Corporation Law, we shall be confronted with more economic problems. If the stockholders of these corporations should vote to extend the life of the corporation, in a meeting called for the purpose, we have everything to gain to grant such an extension. It may be mentioned here that during the last Congress Republic Act No. 1932 was enacted extending the corporate existence of domestic life insurance corporations by a mere amendment of its articles of incorporation on or before the expiration of the term fixed in the said articles."[65]

[63] 18 C.J.S. 470; See note 22 *supra.*; 13 Am. Jur. 226.
[64] H.R. No. 1874; S No. 223.
[65] Explanatory Note to Senate Bill No. 223

It is also noteworthy that the Senate Committee on Banks, Corporations and Franchises in recommending the approval of House Bill No. 1874 proposed the following amendments:

> "And provided further that the corporation whose corporate life is *thus extended* and/or its stockholders shall, within two years from the date of expiration of the corporation's original life, *pay all taxes which the corporation and/or its stockholders should have paid at the time of expiration*, to the same extent as if the corporation has been actually dissolved and the extension had not been effected under this Act.
>
> "A corporation whose corporate life *has already expired* may avail itself of the provision of this Act, provided the extension is effected within sixty days from date of expiration of its corporate life and within thirty days from date of effectivity of this Act." [66]

No mention of Republic Act No. 1921 is ever made either in the purview of the bill or in the Explanatory Note. And the proposed amendments of the Senate Committee on Banks, Corporations and Franchises requiring payment of all taxes which the corporations and its stockholders should have paid at the time of expiration are clearly indicative that the merger, consolidation and exchange of corporate properties defined in Republic Act No. 1921 have never been intended, much less deliberately designed, to allow expiring corporations *to extend their terms of existence* through such corporate combinations or to enable them to surreptitiously escape the taxes legitimately due at the *expiration of their original charters.*

D. CONCLUSIONS.

In view of the foregoing, it is respectfully submitted:

1. That Republic Act No. 1921 is not a law which expressly authorizes merger, consolidation of corporations on acquisition of the properties of another corporation pursuant to a plan of merger or consolidation as intended in American jurisdiction. It merely assumes that these corporate reorganizations may be made under our Corporation Law or other enabling acts and for the purpose sets the rules for non-recognition of gains or losses involved in these transactions;

2. That our Corporation Law does not have any provisions expressly authorizing such corporate reorganizations;

3. That for the present, only Act No. 2772 (*re* railroad corporations) and Commonwealth Act No. 146 (*re* public service corporations) provide for merger and consolidation of *corporations;* and only

[66] *Underscoring* supplied.

merging or consolidating corporations under these laws can avail of the tax-exempting provisions of Republic Act No. 1921; and

4. That at the most, our Corporation Law authorizes only merger and consolidation of *corporate properties and assets.*

"The state and its officers have an obvious interest in the term of life of associations, since the conferment of juridical capacity upon them during such period is privilege that is derived from statute. It is obvious that no agreement between associates can result in giving rise to a new and distinct personality, possessing independent rights and obligations, unless the law itself shall decree said result. And the State is naturally interested that this privilege be enjoyed only under the conditions and not beyond the period that it sees fit to grant; and particularly that it be not abused in fraud and to the detriment of other parties. (Benguet Cons. Mining Co. vs. Pineda, 52 O.G. 1961 (1956). For this reason it has been ruled that the limitation of corporate existence to a definite period is an exercise of control in the interest of the public (Smith vs. Eastwood Wire Mfg. Co. 43 A. 568)." [67]

"The rule elsewhere noticed, that there can be no corporation *de facto* unless there is a law under which a *de jure* corporation might be created, is applicable to *de facto* consolidations. Corporations must have legal authority to consolidate, and where there is no law authorizing the particular consolidation, neither a *de jure* nor a *de facto* consolidation results, and the validity of the consolidation may be questioned even in a collateral proceeding. The company thus formed can neither acquire rights nor incur liabilities as a consolidated company. In such a case, however, they may acquire rights and incur liabilities in their *original corporate capacity*, by reason of their business and transactions as a consolidated company; but it has been held that the constituent companies are not liable thereon, nor bound by, contracts made by the consolidated company where the consolidation was unauthorized, unless there is something to show that they made or authorized the contract." [68]

Guided by the principles above enunciated, two remedies are open to the Government, namely:

1. Dissolution by means of any of the following:

(a) Judicial proceedings. By *quo warranto* proceedings under section 190-1/7 of our Corporation Law which provides:

"Sec. 190-1/7.—The violation of any of the provisions of this Act and its amendments not otherwise penalized therein, shall be punished by a fine of not more than one thousand pesos and by imprisonment for not more than five years in the discretion of the court. If the violation is committed by a corporation, the same shall, upon violation being proved, be dissolved by *quo warranto* proceedings instituted by the Solicitor General or by any provincial fiscal, by order of said Solicitor General: *Provided*, That nothing in this section provided shall be construed to

[67] Pineda & Carlos, *op. cit. supra* note 29 at 35.
[68] See note 22 *supra.*

repeal the other causes for the dissolution of corporations prescribed by existing law, and the remedy provided for in this section shall be considered as additional to the remedies already existing." (As amended by Acts Nos. 3518 and 3610.)

(b) Legislative enactment under Section 76 of our Corporation Law, which states:

> "Sec. 76.—This Act or any part thereof may be amended or repealed at any time by the legislative authority, and any or all corporations created by virtue of this Act may be dissolved by legislative enactment. No right or remedy in favor of or accrued against any corporation, its stockholders or officers, nor any liability incurred by any such corporation, its stockholders or officers, shall be removed or impaired either by the subsequent dissolution of said corporation or by any subsequent amendment or repeal of this Act or of any part or portion thereof."

2. Administrative action, through the collection of capital gains tax by the Bureau of Internal Revenue. In pursuing this remedy, which does not bar any of the two above-mentioned actions, the following recommendations of two government experts may be considered, namely:

> (a) That all the assets of the expired corporations would be appraised according to the market value thereof at the time of the expiration or transfer thereof to a new corporation;
>
> (b) That the transfer of all such assets of the expired corporations to new corporations should be considered as a sale or exchange thereof in accordance with the provisions of section 28½ of the corporation law and the gains should be recognized and taxed accordingly;[69]
>
> (c) Subject corporations after their 50-year term has expired be required to liquidate, at least on paper and pay the taxes that will result as a consequence; and
>
> (d) As alternative proposition, the old corporations may pay the 25 per cent additional tax on their undistributed profit or surplus existing at the time of their expiry date pursuant to section 25 of the Tax Code.[70]

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[69] Recommendations of Mr. Elias E. Vega, Revenue Operation Executive (Assessment) (BIR).
[70] Recommendations of Prof. Isidro Evangelista, Chief, Direct Taxes Branch, Tax Commission.