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TAX LAW FOR BUSINESS

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Tax treatment of liquidating dividends

AS early as 1947, our Supreme Court had already characterized the gain or loss sustained by a stockholder of a corporation as a taxable income or a deductible loss. The same was reiterated in 2008 where the SC emphasized that any gain on the part of the stockholder is subject to income tax. On the part of a liquidating corporation, no tax shall be imposed, as the transfer in liquidation is not treated as a sale.

This pronouncement from the SC is actually anchored on the provision of our tax code. It is clearly provided in Section 73(A) of the code that the gain realized or loss sustained by a stockholder is a taxable income or a deductible loss. An expanded version of the same can also be found in Section 8 of Revenue Regulations 6-2008 whereby it is clarified that the capital gain or loss derived by stockholders in receiving liquidating dividends are subject to regular income-tax rates.

Viewed from the other perspective, however, the framing of the various statutory provisions in our tax code relating to taxation of sale of assets may provoke controversy as to the proper theory upon which to proceed in taxing stockholders on the receipt of liquidating distribution. For instance, in the recent Court of Tax Appeals (CTA) En Banc Case (1702), the Bureau of Internal Revenue (BIR) argued that the capital gains tax is a final tax on the presumed gain from the disposition of a property in exchange for shares of stock pursuant to Section 27 (D)(5) of our tax

code. In invoking this provision, one can assume that the BIR is looking from the viewpoint of the stockholder whereby it has all the characteristic of an outright sale.

At the CTA division level, however, the Court clarified that mere distribution of liquidating dividend on account of the dissolution of a corporation is not to be treated as sale for purposes of the imposition of capital gains tax. One of the reasons is that the conveyance of real property as a result of a valid dissolution is without any consideration. In sum, the CTA decision followed the justification of the 2008 SC decision.

In view of the various justifications to exempt the liquidating dividends from tax on the part of the liquidating corporation, the CTA En Banc made a clear stand that the basis for liquidating dividends as not subject to tax is not because of the absence of income from or the absence of sale, disposition or conveyance of real property.

The main basis is that such transaction is subject to ordinary income tax on the part of the individual stockholders, or corporate-income tax for corporate stockholders. As the Court says, “the law is clear. There is, therefore, no room for interpretation.”

Moving forward, while there may be various interpretations of the law if viewed from an interdisciplinary perspective, for taxation purposes, the term-liquidating dividend may only be viewed as not subject to tax on the point of view of the distributing corporation. But this is subject to tax on the part of the receiving stockholder.

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