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## HUMAN RIGHTS ACCORDING TO *PACEM IN TERRIS* AND THE CONSTITUTION OF THE PHILIPPINES: A LIFE OF DIGNITY FOR ALL \*

By ENRIQUE M. FERNANDO

Chief Justice

Supreme Court of the Philippines

It is a great honor for the Philippines to be the host country for the Tenth Congress of the International Movement of Catholic Jurists. May I on behalf of the judiciary and the lawyers of this nation add my words of welcome to the brethren in the profession from abroad and our other visitors. It is my fervent hope that your stay, however brief, will be both pleasant and fruitful. It is likewise appropriate considering this time of the year so meaningful to those of us of the Christian faith to extend to you the greetings of the season.

The Congress is to be congratulated on its choice of the principal theme: The Dignity of Man. It is not only of vital importance but of crucial significance. For Pope John Paul II, the Universal Declaration of Human Rights, a testament to the dignity to which every human being, irrespective of the color of his skin, race, creed, or economic status is entitled, "is the basic inspiration and cornerstone of the United Nations."<sup>1</sup>

It is my assumption that when we speak of man's dignity, we have in mind human beings everywhere. To be more specific, I trust that I am not mistaken in my further assumption that we lawyers, to be true to the highest ideals of our profession, will not forget the sad plight of our fellowmen living in developing countries and the worse condition of those in the depressed areas of the world. If it were otherwise, we would not be living up to our responsibility as men of the law. The welfare of the poor and the needy, I have been taught since my youth, is the Almighty's abiding concern.

During the course of the recent triumphal tour of Pope John Paul II in Ireland and the United States, he emphasized: "When power is used to dominate the weak, \* \* \* and to deny the basic necessities of the people, we will stand up and reaffirm the demands of justice and social love."<sup>2</sup> It is to the credit of the Catholic Church that such a fundamental principle has been expressed time and time again from the landmark *Rerum Novarum* of Pope Leo XIII issued in 1891 to

\*Edited version of extemporaneous keynote address delivered at the Tenth International Congress of Catholic Jurists held in Manila, December 23, 1979.

the latest encyclical of social significance, *Populorum Progressio*, of Pope Paul VI, of 1967 vintage. It was in 1931 that *Quadragesimo Anno* of Pope Pius XI came out. Pope John XXIII of blessed memory was responsible for two encyclicals *Mater Et Magistra* in 1961 and *Pacem in Terris* in 1963. The latter has been hailed as Pope John's great tribute to the dignity of men of all faiths, a message of monumental significance for all mankind.

It is of the latter that I propose to discuss briefly insofar as human rights are concerned with a brief comparison with the equivalent provisions found in the Constitution of the Philippines. According to the encyclical: "The doctrinal principles outlined in this document \* \* \* provide Catholics therefore with a vast field in which they can meet and come to an understanding both with Christians separated from this Apostolic See and also with human beings who are not enlightened by faith in Jesus Christ, but who are endowed with the light of reason and with a natural operative honesty."<sup>3</sup>

As to human rights, it is noteworthy that the *Pacem in Terris* stresses at the outset those of social and economic character. It starts thus: "Beginning our discussion of the rights of man, we see that every man has the right to life, to bodily integrity, and to the means which are necessary and suitable for the proper development of life. These are primarily food, clothing, shelter, rest, medical care, and finally the necessary social services. Therefore a human being also has the right to security in cases of sickness, inability to work, widowhood, old age, unemployment, or in any other case in which he is deprived of the means of subsistence through no fault of his own."<sup>4</sup>

The scope of economic rights is further clarified in these words: "Human beings have the natural right to free initiative in the economic field and the right to work. Indissolubly linked with those rights is the right to working conditions in which physical health is not endangered, morals are safeguarded and young people's normal development is not impaired. Women have the right to working conditions in accordance with their requirements and their duties as wives and mothers. \* \* \* Furthermore — and this must be especially emphasized — there is the right to a working wage, determined according to criteria of justice, and therefore sufficient in proportion to the available resources, to give the worker and his family a standard of living in keeping with the dignity of the human person.

Nor is the right to private property, including that over "productive goods" ignored, which, according to such encyclical, "also derive from the nature of man. This right, as We have elsewhere declared, 'is a suitable means for safeguarding the dignity of the human person and for the exercise of responsibility in all fields; it strengthens and gives serenity to family life, thereby increasing the peace and prosperity of the State.' However, it is opportune to point out that there is a social duty essentially inherent in the right of private property."<sup>5</sup>

The present Constitution of the Philippines, as did the 1935 Charter, saw no need to specify a man's right to life as well as to his bodily integrity. The Revised Penal Code, as could be expected, imposes severe penalty on an accused who would deprive another person of his life or inflict physical injuries on the latter.<sup>6</sup> Moreover, the Civil Code provision on quasi-delicts or torts as known to American law are likewise intended to assure that harm caused another individual whether due to fault or negligence could be the basis of a civil suit.<sup>7</sup>

Social and economic rights, on the other hand, are expressly set forth. Such was the case with the 1935 Constitution of the Philippines, antedating the Universal Declaration of Human Rights by thirteen years. Even then, the Filipinos were of the view that liberty to be meaningful should not be limited to the absence of governmental interference with man's intellectual and physical freedom but includes the obligation to assure a life of dignity for all. For them necessitous men are not free men. The expanded social justice and protection to labor provisions of the present Constitution emphasize even more the national aspiration for a "compassionate society" in the felicitous language of the First Lady, now Minister of Human Settlements, Imelda Romualdez Marcos.<sup>8</sup>

It is to be admitted that under the 1935 Constitution, the provisions on social justice<sup>9</sup> and protection to labor<sup>10</sup> were far from specific. The provisions on such fundamental principles in the present Constitution do not suffer from that ambiguity. The commitment of government to provide for the welfare of each and every Filipino in terms of a decent existence is clearly spelled out. With that, no doubt is left as to the positive aspect of freedom. The economically underprivileged, those living on the margins of adequacy, receive the proper attention and care. In his address before the 1977 annual meeting of the Board of Governors of the Asian Development Bank, President Marcos stressed anew such a policy: "In many of our countries, there is great urgency today for national development to affirm and give real substance to our avowals in favor of human rights. Without any concrete effort to provide for basic needs, and the minimum of human

welfare, our commitment to human rights would become a farce. But we cannot procure our development at the expense of the rights of those whom we are, in the first place, pledged to liberate."<sup>11</sup>

The social justice provision of the present Constitution reads: "The State shall promote social justice to ensure the dignity, welfare, and security of all the people. Towards this end, the State shall regulate the acquisition, ownership, use, enjoyment, and disposition of private property, and equitably diffuse property ownership and profits."<sup>12</sup> Immediately thereafter comes this section: "The State shall establish, maintain, and ensure adequate social services in the field of education, health, housing, employment, welfare, and social security to guarantee the enjoyment by the people of a decent standard of living."<sup>13</sup> There is likewise the mandate for the State "to formulate and implement an agrarian reform program aimed at emancipating the tenant from the bondage of the soil and achieving the goals enunciated in this Constitution."<sup>14</sup>

Nothing can be clearer, therefore, than that the principle of social justice, an aspect of the police power, has an even more basic role to play in aiding those whose lives are spent in toil, with destitution an ever-present threat. It is the attainment of their economic well-being that is the fundamental objective. Social justice calls for an active and militant role by the government. Only thus may there be reality and substance to the proclaimed aspiration of a better life for all. It was in that spirit that as far as 1969, in *Del Rosario v. De los Santos*, the Supreme Court of the Philippines defined such a concept. In the realistic language of the late President Magsaysay: "He who has less in life should have more in law."

The opinion in that case left no doubt that such an approach amounts to an insuperable barrier to the claim that tenancy measures could be tainted by infirmity and that as a consequence "from the enactment of the Constitution with its avowed concern for those who have less in life, the constitutionality of such legislation has been repeatedly upheld."<sup>15</sup> Social justice is thus a principle that calls for the continuing governmental "efforts to assist the economically underprivileged. For under existing conditions, without such succor and support, they might not, unaided, be able to secure justice for themselves."<sup>16</sup> Even under the 1935 Constitution then, the doctrine consistently adhered to was that social justice is rightly identified with governmental measures, whether exercised through police power, taxation, or eminent domain intended to redress the existing imbalance between

the dominant economic groups and the vast majority of the economically underprivileged, whether in industry or in agriculture.

If that were so under the 1935 Constitution, it is even more so now. It is quite obvious that at present the objections against governmental action of a similar nature would be even less persuasive. As noted, social and economic rights have been expanded to cope with the ever-increasing need for the amelioration of the deplorable condition of the less fortunate in life. The invocation, therefore, of traditional property rights for the purpose of demonstrating invalidity is even less likely to be attended with success. Otherwise, social justice would not suffice "to ensure the dignity, welfare and security of all the people."<sup>17</sup> To reach that goal, the State, to repeat, "shall regulate the acquisition, ownership, use, enjoyment, and disposition of private property, and equitably diffuse property ownership and profits."<sup>18</sup>

The vital role of social justice in the future of the Philippines was stressed by President Marcos on the occasion of the signing of the Philippine Development Plan for 1978 to 1982.<sup>19</sup> Thus: "In the past, development was considered as simply the movement towards economic progress and growth, measured in terms of sustained increase in per capita income and Gross National Product (GNP). In the New Society, however, development does not only imply economic advance. It also means the improvement in the well-being of the broad masses of our people.

\*\*\* Considering the visible disparities in our society, development also means the sharing, or more appropriately, the democratization of social and economic opportunities, the substantiation of the true meaning of social justice. \*\*\* Thus, Philippine development is aimed primarily at rectifying grave economic and social inequities that have accumulated in the course of our ascent to nationhood."<sup>20</sup> To erase any doubt, he reiterated: "At the heart of the Plans is the concern for social justice. The preparation of these social and economic development plans has been guided by one objective: 'No Filipino will be without sustenance.'"<sup>21</sup> The goal clearly is a life of dignity for all.

Another cluster of rights is classified into the basic freedom to worship God according to one's conscience, as well as the freedom to seek the truth and to express one's opinions, including the right to freedom of assembly, association, and participation in public affairs. In the more traditional terminology of the Anglo-American legal system, they would be denominated as civil and political rights.

For some scholars, they are referred to as man's liberty of intellect, whether secular or spiritual, and of his personality as a social being.

Its primacy in the scheme of human values is undeniable. A man should be free to think as he pleases, whether in the secular or religious sphere, to give expression to such beliefs by oral discourse or through the media and in person or through groups of which he forms a part, whether in a gathering or in a less transient relationship. We can thus speak of freedom of religion, freedom of speech and of the press, freedom of peaceable assembly and petition, and freedom of association. It is worth noting that unlike in the United States, freedom of association in the Philippines is not merely implied but explicitly provided for in the Philippine Constitution.<sup>22</sup>

It adds to one's dignity, as Laski correctly pointed out, if there is "freedom of the mind."<sup>23</sup> Otherwise, if he is coerced into silence, "he becomes a dumb and inarticulate creature whose personality is neglected in the making of policy. Without freedom of the mind and of association, a man has no means of self-protection in or social order."<sup>24</sup> Cox was even more categorical when he stated that freedom of inquiry and of thought "is of the essence of human dignity and its suppression an affront to the human personality."<sup>25</sup> When belief is given expression through speech or press or assembly, it is permissible under the Constitution of the Philippines to set limits in accordance with the clear and present danger principle.<sup>26</sup> There is freedom to discuss matters of public interest, without censorship or subsequent liability, unless "there be a clear and present danger of a substantive evil that [the State] has a right to prevent."<sup>27</sup> During times of emergency, the situation may present a risk to state authority sufficient to call for further restraints without infringing on freedom of expression. \* \* \* Their duration, however, should be limited to the period of extreme gravity. The drastic restrictions on the freedom of the mind and the spirit should not last a moment longer.

As to freedom of conscience, the *Pacem in Terris* is quite specific: "Every human being has the right to honor God according to the dictates of an upright conscience, and therefore the right to worship God privately and publicly. For, as Lactantius so clearly taught: 'We were created for the purpose of showing to the God Who bore us the submission we owe Him, of recognizing Him alone, and of serving him. We are obliged and bound by this duty to God; from this religion itself receives its name.'<sup>28</sup>

There is relevance to what has been concluded on religious freedom by Vatican II. The general principle reads in this wise: "The Vatican Council declares that the human person has a right to religious freedom. Freedom of this kind means that all men should be immune from coercion on the part of individuals, social groups and every human power so that, within due limits, nobody is forced to act against his convictions in religious matters in private or in public, alone or in association with others. The Council further declares that the right to religious freedom is based on the very dignity of the human person as known through the revealed word of God and by reason itself. This right of the human person to religious freedom must be given such recognition in the constitutional order of society as will make it a civil right."<sup>29</sup>

The rights to freedom of expression, assembly, association and participation in public life necessarily find mention. According to such encyclical: "By the Natural Law every human being has the right to respect for his person, to his good reputation; the right to freedom in searching for truth and in expressing and communicating his opinions, and in pursuit of art, within the limits laid down by the moral order and the common good; and he has the right to be informed truthfully about public events."<sup>30</sup> Also: "From the fact that human beings are by nature social, there arises the right of assembly and association. They have also the right to give the societies of which they are members the form they consider most suitable for the aim they have in view, and to act within such societies on their own initiative and on their own responsibility in order to achieve their desired objectives."<sup>31</sup> Lastly: "The dignity of the human person involves the right to take an active part in public affairs and to contribute one's part to the common good of the citizens. For, as Our Predecessor of happy memory, Pius XII, pointed out: "The human individual, far from being an object and, as it were, a merely passive element in the social order, is in fact, must be and must continue to be, its subject, its foundation and its end."<sup>32</sup>

Now as to martial law in the Philippines. The commitment during martial law to the freedom of conscience and religion has been quite evident. It cannot be otherwise as the Philippines, a predominantly Catholic country, has a tradition of according full respect to such constitutional guarantee. The Filipinos of such faith have not confined themselves to attending church services. Their interest in public affairs has been quite marked. They have not left the authorities in doubt as to their attitude towards and response to the conditions of the times. The clergy belonging to the Catholic faith has never been more militant. There were occasions when men of the cloth had clearly gone over the line separating church and state. When their opposition to the continuance of martial law manifested itself in anti-societal acts penalized by law, they could not justifiably lay claims to any immunity premised on liberty of conscience. At present, there are criminal charges

pending against some of them. The other Filipino Christians, members of Protestant denomination, are equally left unmolested, unless again proceeded against for the perpetration of acts defined as crimes.

It is even more understandable, considering the Muslim rebellion in Southern Philippines, why the government has been engaged in the most serious efforts at conciliation. The clash of arms had taken its toll in lives lost and property destroyed. The sooner it is peacefully resolved, the better for all concerned. In the past, there had been no deliberate policy to antagonize the Muslim Filipinos. At present, the approach is much more positive. There is shown a greater understanding of their ways and their culture. The authorities are bent on removing every trace of discrimination that at times and without forethought could in the past have characterized their dealings with them.

It is likewise the Philippine experience that martial law, while calling for some remedial measures to assure the return of normalcy has not unnecessarily encroached upon the sphere of press freedom. As of May of 1973, a Media Advisory Council was created.<sup>33</sup> Then in November of 1974, it was abolished, with the explicit recognition of the principle that mass media may operate "without government intervention of supervision in policy determination and news dissemination activities."<sup>34</sup> All indications point to the utmost respect being accorded the freedom of the mass media, compatible with the gravity of the situation in certain places in the Philippines. The press has not limited itself to the language of approbation. Where corrective measures are needed, it has not hesitated to urge that they be taken. Only the other week, one of the leading journalists, Mrs. Kerima Polotan could emphatically assert: "There is freedom of the press, as much of it as anyone has the courage for, but we still don't know how to use it."<sup>35</sup>

At any rate, the return to normalcy appears to be merely a question of time. Local elections will be held early next year. The transition to a modified parliamentary system is proceeding smoothly. There is thus hardly any sign that martial law, even in its most limited sense, is still operative. True, the Philippines is still under an emergency regime. The exercise of the broad discretionary authority of the Executive, however, is the exception rather than the rule.

There is realization on my part that I have taxed your patience unduly, that I have spoken long enough. This keynote address is taking too much of your time. I cannot let this opportunity pass, however, without recalling one of the memorable

events that happened to me during my last official trip that took me to the European countries of Spain, Italy, France, Romania and England and to the United States. It was my good fortune, through the medium of television, to witness the inspiring presence of Pope John Paul II during his triumphal tour of Ireland and the United States.

It has earned him — and justly so — the most lavish praise by some of the ablest pundits. To cite an example, may I refer to the words of the famed James Reston of the New York Times: "He has brought us back to elemental things, and shown that even a lonely voice, crying for the beliefs we have lost, can be important. 'This is the way of greatness,' Walter Lippmann wrote back in 1943. 'In the supreme moments of history, terms like duty, truth, justice and mercy — which for our torpid hours are tired words — become the measure of decision.'"<sup>36</sup>

Allow me to draw your attention to this excerpt from what has been referred to as his most eloquent address in Ireland. Thus: "On my knees I beg you to turn away from the paths of violence and to return to the ways of peace. You may claim to seek justice. I too believe in justice and seek justice. But violence only delays the day of justice."<sup>37</sup>

No truer words are spoken. As we look at the contemporary scene all over the world, we see the tragic confirmation of his utterance. Violence is king. What a travesty on the noble ideal of the Prince of Peace.

It behooves those of us in the profession then to heed those words, take them to heart. Failure to do so is a betrayal of the trust reposed on us. Law stands for order based on justice, for peaceful accommodation instead of settlement of disputes through the use of force, the arbitrament of arms.

To quote from a Philippine decision: "Such is the way of the law. So it has been in the past. So it should continue to be. If it were otherwise, the intellect no longer holds sway, the dictates of moderation are ignored, and passion takes over. The words of Dean Pound come to mind: 'Civilization involves subjection of force to reason, and the agency of this subjection is law.'<sup>38</sup> To borrow the language of Justice Frankfurter: "Law alone saves a society from being rent by internecine strife or ruled by mere brute power, however disguised."<sup>39</sup>

This is not to say that as men of the law, we should be complacent, accept things as they are, and close our eyes to the imperfections of whatever legal system is followed in our respective countries. Precisely because of the nature of our pro-

feffion, the public expects from us a just appraisal of conditions as they really are, an accurate perception of the frustrations that breed dissatisfaction and resentment.

That it has a right to expect. Not that the matter ends there. Ours is the profession men turn to for the leadership that hopefully may minimize the evils and inequities that plague our societies. Moreover, with the growing complexity of the times brought about by the rapid increase of population, dwindling natural resources, and rapid technological change, the need for innovation and reconstruction becomes urgent.

The attainment of such desirable objective should, however, be through means compatible with the rule of law. It has happened that in quite a number of places, extremist groups, regrettably with representation from our ranks, are of a different mind. Nor do they confine themselves to inflammatory language. They are not above using force. They are not appalled by violence.

We must ever be on our guard then lest our reaction be misconstrued as one of sympathy. We must repudiate such groups. We should be with the forces of moderation. We must make unmistakable our rejection of what they stand for, so odious to everything with which law is rightfully identified.

We should supply that happy confluence of principle and practicality. We must beware of that kind of rhetoric that may possibly lend plausibility to extravagant claims devoid of any mooring in reality. It is for us to make full use of our analytical powers to ascertain whether they can stand the test of rigid scrutiny.

That is to be true to that glorious tradition by which the history of the human spirit has been enriched by the contribution of distinguished Catholic jurists. We must hold fast to a vision of an ideal society, according to the tenets of our faith. Perhaps, more accurately put, it must be a vision of an ideal to which a just society can realistically aspire. That is to assure the dignity of man.

Thank you for your kind attention.

<sup>1</sup>Time Magazine, October 15, 1979, p. 33.

<sup>2</sup>Homily at the mass, October 8, 1979 reported in New York Daily News, October 9, 1979, p. 15.

<sup>3</sup>Pope John XXIII, *Pacem in Terris*, The Five Great Social Encyclicals, 213 (1969).

<sup>4</sup>Ibid, 179.

<sup>5</sup>Ibid, 181.

<sup>6</sup>Title Eight of Book Two of the Revised Penal Code Act No. 3815 (1932) speaks of Crimes Against Persons and includes parricide (Art. 246), murder (Art. 248), homicide (Art. 249), death or physical injuries caused in a tumultuous affray (Arts. 251-252), discharge of firearms (Art. 254), infanticide (Art. 255), abortion whether intentional or unintentional (art. 256-257), responsibility of participants in a ducl (Art. 260), mutilation (Art. 262), serious physical injuries (Art. 263), less serious physical injuries (Art. 265), and slight physical injuries and maltreatment (Art. 266).

<sup>7</sup>According to Article 2176 of the Civil Code of the Philippines (1950): "Whoever by act or omission causes damage to another, there being fault or negligence, is obliged to pay for the damage done. Such fault or negligence if there is no pre-existing contractual relation between the parties, is called a quasi-delict and is governed by the provisions of this Chapter."

<sup>8</sup>Romualdez Marcos, *The Compassionate Society*, 1-8 (1973). The term was quoted with approval in the following cases: *Philippine Air Lines, Inc. v. Philippine Airlines Employees Association*, L-24626, June 28, 1974, 57 SCRA 489; *Almira v. B.F. Goodrich Philippines*, L-34974, July 25, 1974, 58 SCRA 120; *Philippine Virginia Tobacco Administration v. Court of Industrial Relations*, L-32052, July 25, 1975, 65 SCRA 416; *Goodrich Employees Association v. Flores*, L-30211, October 5, 1976, 73 SCRA 297.

<sup>9</sup>As to social justice, according to Article II, Sec. 5: "The promotion of social justice to insure the well-being and economic security of all the people should be the concern of the State."

<sup>10</sup>As to protection to labor, according to Article XIV, Sec. 6: "The State shall afford protection to labor, especially to working women and minors, and shall regulate the relations between landowners and tenant, and between labor and capital industry and agriculture. The State may provide for compulsory arbitration."

<sup>11</sup>Marcos, *Human Rights and Economic Development*, 10 (1977).

<sup>12</sup>Article II, Sec. 6.

<sup>13</sup>Ibid, Sec. 7.

<sup>14</sup>Article XIV, Sec. 12.

<sup>15</sup>L-20586, March 21, 1969, 22 SCRA 1196. The author wrote the opinion.

<sup>16</sup>*Lopez Carrillo v. Allied Workers Assn.*, L-23689, July 31, 1968, 24 SCRA 566. The opinion was penned by the author.

<sup>17</sup>Article II, Sec. 6, first sentence.

<sup>18</sup>Ibid.

<sup>19</sup>Presidential Decree No. 1200 (1977).

<sup>20</sup>Philippine Development Plan, 2.

<sup>21</sup>Ibid, 3-4.

<sup>22</sup>Cf. Article IV, Sec. 7 of the Philippine Constitution. The 1935 Charter contained an identical provision, found in its Article III, Sec. I, par. (6).

<sup>23</sup>Laski, *Liberty in the Modern State* 73 (1949).

<sup>24</sup>*Ibid.*

<sup>25</sup>Cox, *The Role of the Supreme Court in American Government* 37 (1976).

<sup>26</sup>Cf. *Gonzales v. Commission on Elections*, 27 SCRA 835 (1969). Where political matters are concerned, Justice Barredo is for absolutely free speech and press. Former Chief Justice Castro followed the balancing interests test as a standard of limitation. Justice Teehankee is of the same persuasion.

<sup>27</sup>*Ibid.*, 856-857.

<sup>28</sup>Pope John XXIII, *Pacem in Terris*, The five Great Social Encyclicals, 180 (1969). The second paragraph reads thus: "And on this point Our Predecessor of immortal memory, Leo XIII, declared: 'This genuine, this honorable freedom of the sons of God, which most nobly protects the dignity of the human person, is greater than any violence or injustice; it has always been sought by the Church, and always most dear to her. This was the freedom which the Apostles claimed with intrepid constancy, which the apologists defended with their writings, and which the martyrs in such numbers consecrated with their blood.' "

<sup>29</sup>Flannery, *The Documents of Vatican II*, 800 (1975).

<sup>30</sup>Pope John XXIII, *Pacem in Terris*, The Five Great Social Encyclicals, 179 (1969).

<sup>31</sup>*Ibid.*, 182.

<sup>32</sup>*Ibid.*

<sup>33</sup>Cf. Presidential Decree No. 191. It is headed by the President of the National Press Club as chairman with a recognized civil leader appointed by the President as co-chairman, and a representative each from the Manila Overseas Press Club, print, radio, and television groups.

<sup>34</sup>Cf. Presidential Decree no. 576. It was therein provided that both the Print Media and Broadcast Media may organize its own regulatory council responsible for formulating systems of self-regulation and internal discipline within its own ranks.

<sup>35</sup>Response on the FIDA Katuparan Award, December 19, 1979.

<sup>36</sup>*Newsweek*, October 15, 1979, 40.

<sup>37</sup>*Newsweek*, October 8, 1979, 12.

<sup>38</sup>*Phil. Assn. of Free Labor Unions v. Salvador*, L-29471, 25 SCRA 393, 403.

<sup>39</sup>*United States v. United Mine Workers of America*, 330 US 258, 308, Con. (1947).

## SECTION 35(c)(2) OF THE TAX CODE: A TAX TRAP OR A TAX SHELTER?

by EXEQUIEL G. JAVIER, B.S., LL.B., L.I.M.

### I. Introduction

Property may be transferred to a corporation in exchange for its stock without immediate tax consequences. However, tax authorities, because of statutory gaps or dearth in judicial precedents, have taken liberties in the existing tax rules which may contain a tax trap for the unwary investor.<sup>1</sup> Investors, for the same reasons, have used stock transaction as a tax shelter either to insulate income from the steep individual tax rates or to avoid income tax on gains.

A basic knowledge of the tax rules is a great help to the investor in planning a desired tax result. He can avoid the traps carved out by administrative interpretation. For example, if he desires to transfer property with a low acquisition cost (adjusted basis) but subject to a mortgage in excess of the adjusted basis, he may transfer the property and enough cash to prevent recognition of gain on the excess of the mortgage over the adjusted basis of the property.

The investor may likewise consider which type of incorporation — taxable or tax-free — will be more advantageous. If substantial amount of gain will be realized on incorporation, the investor will usually want to defer recognition of gain for as long as possible. Or if he owns an appreciated capital asset, he may transfer the asset to the corporation in a taxable incorporation, pay the tax at capital gains rate, and give the corporation a stepped-up basis to reduce the ordinary income tax at the corporate level. This would apply generally in a case where a corporation would be engaged in business as a real estate developer. A taxable corporation is likewise advantageous in the case of a property with an unrealized loss. In a tax-free transaction, however, the loss will go unrecognized.

To a high income tax bracket investor, a tax-free incorporation of his investment portfolio in stock gets generous tax results even if the corporation runs the risk of incurring the personal holding company tax. For long term investments, however, a taxable transaction may likewise be preferable.

The tax benefits derived from a tax free or taxable incorporation ultimately depend on a case to case basis. No hard and fast rule may be formulated.