NOTE

PARTNERSHIP IN INCOME TAXATION

Partnership

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I. INTRODUCTION

Since the introduction of income tax in the Philippines,[1] partnerships have always received a consistent but distinct treatment. Under the present National Internal Revenue Code,[2] duly registered general copartnerships are not taxable entities; the individuals carrying on business in partnership are liable for tax only in their individual capacity.[3] This means that partners are obliged to report as an item of their income from "all sources" (partnership and non-partnership) their distributive share of the "net income of the partnership" of which they are members. Whether or not there is actual distribution is immaterial.[4]

On the other hand, unregistered partnerships are deemed included in the term "corporation" and therefore taxable as such.[5]

Sections 26 and 48(b) of the National Internal Revenue Code have always been in the income tax laws since the enactment of Act No. 2833[6] without any substantial change. Taxpayers, internal revenue officers, lawyers and accountants, all alike knew of these provisions on the taxability of partnerships, and in all probability assumed an attitude of indifference towards them until the Supreme Court rendered its decision in the case of **Eufemia Evangelista v. Collector of Internal Revenue**,[7] followed this up with another decision in **Collector of Internal Revenue v. Batangas Transportation Company**[8] both of which dealt with the taxability of unregistered partnerships. Such was the importance of the first case cited above that the Collector of Internal Revenue has implemented it by instructing all internal

* Ll.B., Ateneo de Manila, 1960.
1 Act No. 2833, as amended, Acts No. 2926 and 3605.
2 C. A. No. 466.
3 Nat'l. Int. Rev. Code § 26.
4 6 MERTENS, FEDERAL INCOME TAXATION 105.
5 Nat'l. Int. Rev. Code §§ 84 (b) and 24.
6 Approved March 7, 1919 §§ 8 (e) and 10 (a).
7 G.R. No. L-9996, Oct. 15, 1957.
8 G.R. No. L-9692, Jan. 6, 1958.

revenue officers that "properties held by co-heirs and co-owners which are income-producing or profit-earning properties, except those belonging to duly organized copartnerships, trusts or estates in the course of administration proceedings, should be considered as owned by unregistered partnerships and the income derived therefrom should be held subject to income, residence, or real estate dealer's taxes."[9]

Considering the prevalence of income-producing properties held by co-heirs and co-owners in the Philippines, it will not take too much imagination to foresee the numerous problems that may arise from the application of the two decisions mentioned above. It is, therefore, in anticipation of some of such problems that this work has been written in order to analyze, clarify, explain and suggest possible solutions to these problems.

II. THE PROBLEMS INVOLVED

A full and proper comprehension of the problem that may stem from the application of the Evangelista decision necessarily calls for a brief resumé of the facts of the case, which, in the concise words of Justice Montemayor,[10] are as follows:

> "The three Evangelista sisters borrowed from their father about ₱59,000 and adding thereto their own personal funds, bought real properties, such as a lot with improvements thereon for the sum of ₱100,000 in 1943, parcels of land with a total area of almost 4,000 square meters with improvements thereon for ₱18,000 in 1944, another lot for ₱237,000 in the same year. The relatively large amounts may be explained by the fact that purchases were made during the Japanese occupation, apparently in Japanese military notes. In 1945, the sisters appointed their brother to manage these properties, with full power to lease, to collect and receive rents, in default of such payment, to bring suits against the defaulting tenants, to sign all letters and contracts, etc. The properties therein involved were rented to various tenants, and the sisters, through their brother as manager, realized a net rental income of ₱5,948 in 1945, ₱7,498 in 1947 and ₱12,615 in 1948."

On these facts, the Supreme Court held that the three sisters had the intention to form a partnership and thus constituted an unregistered partnership within the meaning of the income tax law. To their contention that they were co-owners, not co-partners, on account of lack of an independent personality, distinct and separate from each of them, the Court answered that when the law includes partnerships within the term "corporation" it refers to associations

9 INT. REV. FIELD CIRCULAR No. V-109 (1957).
10 Collector v. Batangas Trans. Co., G.R. No. L-9692, Jan. 6, 1958.

which are not necessarily partnerships in the technical sense of the term.

From this case alone, many questions at once become apparent. For instance, when does a co-ownership become a partnership for income tax purposes? May a single joint venture transaction give rise to an unregistered partnership? Granting that an association is an unregistered partnership, is it to be treated as a "corporation" also with respect to the other provisions of the income tax law applicable to corporations?

The case of **Collector of Internal Revenue v. Batangas Transportation Company** supra, applies the Evangelista doctrine to an association of two bus companies operating under a joint management and dividing the net profits between themselves. In this connection, it may be asked whether the Supreme Court meant that the companies involved constituted an unregistered partnership or whether the association came within the meaning of the term "joint venture (cuentas en participacion)." Of particular interest in this case is the question of how to treat the share of each company in the net profits of the partnership or joint venture, as the case may be. Should such share be treated as dividends coming from a domestic corporation and consequently, only 25% thereof is taxable? And bearing in mind that, as a rule, dividends are taxable only when actually received, should the same treatment be extended to the share of each company?

All these questions remain unresolved, and it is to be hoped that the following discussions will in some small way contribute to their logical and judicious solution, to the end that, if at all necessary, proper amendments to the partnership provisions of the present income tax law may be suggested, for only if we face the reality of defects in our existing laws can we attain progressive legislation geared to the changing complexities of our social and economic life.

III. THE CONCEPT OF PARTNERSHIP

A. *Under the New Civil Code:*

Nowhere in the National Internal Revenue Code can a precise and adequate definition of partnership be found. On the contrary, the Tax Code seems to be content with merely classifying partnerships into duly registered general copartnerships and unregistered partnerships. Necessarily, therefore, resort must be made to the provisions of the New Civil Code on Partnerships,[11] just as the Supreme Court did in

[11] Title IX, Bk. IV, Civil Code of the Philippines.

the Evangelista case. The Civil Law concept of partnership emphasizes the contractual nature of partnership in that it considers a partnership as a contract by virtue of which "two or more persons bind themselves to contribute money, property or industry to a common fund, with the intention of dividing the profits among themselves."[12]

From the very definition itself, it is clear that the following are the requisites of a partnership:

(1) two or more persons who bind themselves to contribute money, property, or industry to a common fund; and

(2) intention on the part of the partners to divide the profits among themselves.[13]

An interesting observation with respect to the common fund is that it is necessary that each partner undertakes to surrender dominion over his contribution thereto, be such contribution corporeal or incorporeal property or services. Where the arrangement is one in which the control of each member over his contribution remains distinct and severable, there is no partnership.[14]

Although not mentioned in the second requisite but clearly implied therein, there must also exist the intention to realize profits and the intention to participate in the losses.[15]

As to the question of juridical personality, the law provides that a partnership has a juridical personality, separate and distinct from that of each of the partners.[16] A partnership, once formed and put into action, becomes in contemplation of law a moral being, distinct from the persons who compose it.[17] Consequently a partnership may sue and be sued in the company name and likewise be served with process through its chief officer or managing agent.[18] Furthermore, if suit is brought against a partnership as a legal entity, the death of one partner will not cause the dismissal of the action.[19]

[12] Art. 1767 New Civil Code.

[13] Yulo v. Yang Chiao Seng, G.R. No. L-12541, Aug. 28, 1949; Evangelista v. Collector, G.R. No. L-9996, Oct. 15, 1957; Fernandez v. De la Rosa, 1 Phil. 671 (1903).

[14] FRANCISCO, PARTNERSHIPS 31 (1958) citing GILMORE, PARTNERSHIPS 35, and Mayrant vs. Marston, 67 Ala. 453.

[15] Evangelista v. Collector, *op. cit. supra*, note 13; FRANCISCO, PARTNERSHIPS, 34 and 35.

[16] Art. 1768 New Civil Code.

[17] Pilcher, *Succession*, 39 La. Ann. 362.

[18] Vargas & Co. v. Chan, 29 Phil. 446 (1915).

[19] Ngo Tian Tek v. Phil. Education Co., 78 Phil. 271 (1947).

B. *Under the National Internal Revenue Code:*

Under the present income tax law, partnerships, except duly registered general copartnerships, are included in the term "corporation."[20] In other words, the law classifies partnerships into: (1) Duly registered general copartnerships and (2) Unregistered partnerships. It will not be amiss to state at this point, that in the United States, where the Revenue Code has its own concept of the term "partnership",[21] the courts have expressed a reluctance to lay down a comprehensive definition of the term. It is not easy to define the term nor to determine whether under a given state of facts a partnership exists. It is a question either of fact, or of law, or both. The rules of law determining whether a partnership does or does not exist are confusing and factually the existence of a partnership is often "problematical and difficult to determine."[22]

Duly registered copartnerships are those whose articles of copartnership are recorded in the Mercantile Registry[23] or with the Securities and Exchange Commission.[24] The requirement of such registration has been held to be for the purpose of encouraging the registration of partnerships so that the public may know the capital stock of the partnership, the names of the partners and the amount of stock owned by each.[25]

Conversely, unregistered partnerships are those whose articles of copartnership are not registered as above indicated, or according to the Supreme Court, in the absence of articles of copartnership, those which are not necessarily partnerships in the technical sense of the term.[26]

It is fairly easy to determine whether or not a partnership is registered so long as the fact of partnership is evidenced by articles of association. Great difficulty, however, is encountered when an association of persons does not admit with certainty the existence of a partnership, such as co-ownership or single joint venture transactions or a joint venture where one of the participants is a corporation. Such anomalous groups, therefore, require a more or less elaborate discussion, to which we now proceed.

[20] Nat'l. Int. Rev. Code § 84 (b).
[21] 6 MERTENS, *op. cit. supra,* note 4 at 106.
[22] *Ibid,* pp. 106-107.
[23] Art. 25 Code of Commerce.
[24] R.A. No. 1055; Art. 1772 New Civil Code.
[25] Tan Sengguan & Co. v. Collector, 55 Phil. 439 (1930).
[26] Evangelista v. Collector, *op. cit. supra,* note 13.

IV. CO-OWNERSHIP AS AN UNREGISTERED PARTNERSHIP

In determining whether or not a co-ownership may be held liable for income tax as an unregistered partnership, it would seem indispensable to ascertain the presence of the elements required by the New Civil Code for the constitution of a partnership. This procedure is justifiable on the ground that, as pointed out previously, the Tax Code does not do more than classify partnerships into duly registered general copartnerships and unregistered partnerships, which is plainly no help in establishing the existence or non-existence of a partnership.

For purposes of discussion, we shall analyze co-ownership as to its creation, namely: (1) By law; (2) By contract; (3) By succession; (4) By fortuitous event; and (5) By occupancy.[27]

Generally, co-ownership arising from law hardly merits any discussion in connection with the income tax law inasmuch as the law designates such a community of interest as simple co-ownership. It should be noted, in passing, that the conjugal partnership[28] is accorded a separate treatment for income tax purposes.[29]

However, the co-ownership between a man and a woman, who live together without being married, over the property acquired through the work or industry of either or both of them during cohabitation[30] apparently presents a problematical situation, for if the property was acquired through the work or industry or the wages or salaries of both of them, there would seem to be a contribution of industry and property to a common fund.[31]

But the problem vanishes when we consider that under the present Civil Code, the rule under the Spanish Civil Code that an informal civil partnership was created between a man and a woman who cohabited, without any legal impediment to their marriage, over property acquired through their joint efforts, has been changed by an express provision to the effect that such property shall be governed by the rules on co-ownership.[32] The indication is all too clear that the intent of the law is to impress upon such a community the fact of co-ownership.

[27] 1 CAGUIOA, CIVIL LAW 568 (1959).
[28] Art. 143 New Civil Code.
[29] Nat'l. Int. Rev. Code § 45 (d).
[30] Art. 144 New Civil Code.
[31] Camporedondo v. Aznar, G.R. No. L-11483, Feb. 14, 1958; Flores v. R.F.C., 50 O.G. 1029 (1954).
[32] I CAGUIOA, *op. cit. supra,* note 27 at 190.

Co-ownership created by fortuitous event, such as commixtion or confusion,[33] cannot give rise to a partnership, the relationship having been brought about by chance; hence, no intention to contribute to a common fund may be ascribed to the co-owners. Co-ownership originating from occupancy may properly be included in co-ownership arising from contract.

The line of distinction between co-ownerships by contract or by succession and partnership becomes increasingly vague, for in these classes of co-ownership there is the greatest possibility that the elements of a partnership may also exist. In connection with the income tax, with which we are here concerned, these co-ownerships deserve particular attention.

A. *Co-ownership arising from contract.*

This class of co-ownership most frequently arises from purchase. Purchase necessarily requires a contribution from the prospective co-owners to a common fund, and if the property acquired is income-producing, it is to be expected that the co-owners must come to some sort of agreement on the division of the profits therefrom. Here we find the essential requisites of a partnership to be present. But is the presence of such requisites alone sufficient to subject the community to taxation as an unregistered partnership?

Since the case of **Evangelista et al. v. Collector**, supra, is in point, it will help a great deal towards the solution of the question at issue to analyze the decision therein before proceeding with the present discussion. In that case, the Supreme Court found that there existed the two elements of a partnership substantiated by the facts, as follows:

(a) The agreement to contribute money, property, or industry to a common fund was supported by the contribution of the three sisters of their own personal funds towards the series of purchases of real estate in 1943 and 1944;

(b) The intent to divide the profits among themselves was deduced from the *collective effect of the following circumstances*:

(1) The common fund was not something they found already in existence. It was not a property inherited by them pro-indiviso. They created it purposely. What is more they jointly borrowed a substantial portion thereof in order to establish said common fund.

(2) They invested the same, not merely in one transaction, but in a series of transactions.

(3) The lots were not devoted to residential purposes, or to other personal uses of petitioners.

[33] Art. 472 New Civil Code; Santos v. Bernabe, 54 Phil. 19 (1929).

(4) Since August, 1945, the properties have been under the management of one person, the brother of petitioners.

(5) The foregoing conditions have existed for more than ten (10) years.

(6) Petitioners have not testified or introduced any evidence, either on the purpose in creating the set-up already adverted to, or on the causes for its continued existence. They did not even try to offer an explanation therefor.

From the foregoing decision, we can see plainly that in the determination of whether or not a co-ownership is an unregistered partnership, the collective effect of the facts and circumstances attendant in each particular case should be given due consideration in order to ascertain if the intent of the co-owners was to form a partnership. It would not do to say that because the co-owners of a specific income-producing property divide the income therefrom, an unregistered partnership exists, for the law allows the co-owners to share in the benefits and charges from the property owned in common in proportion to their respective interests.[34] Also, co-ownership or co-possession does not of itself establish a partnership, whether such co-owners or co-possessors do or do not share any profits made by the use of the property.[35] Much less may it be contended that the sharing of gross returns is an indicia of the existence of a partnership,[36] "for the reason that such an agreement is inconsistent with the joint ownership of the profits."[37]

The law provides, however, that the sharing of profits in a business is **prima facie** evidence of the existence of a partnership, except under certain circumstances.[38] This interest in profits must be real, not nominal; a proprietary interest in profits as such. x x x The fact that a right to share in profits, if any, is given to one who advances funds or allows the use of rights or property to another, to induce such accommodation, will not transform an essentially debtor-creditor relationship into a partnership or joint venture.[39]

But in ascertaining the intent of the supposed co-owners, it is important to note that it is not of the essence of a partnership that the parties to it should have known that their contract in law created a partnership. If the parties enter into such a contract as in the eyes of the law constitutes a partnership, they thereby become partners, whether they are designated as such or not in the contract. And when all the conditions exist which by law create a legal relation, the effects flowing legally from such relation follow whether the

[34] Art. 485 New Civil Code.
[35] Art. 1769 (2) New Civil Code.
[36] Art. 1769 (3) New Civil Code.
[38] Bine v. Kennedy, 164 N.C. 290.
[38] Art. 1769 (4) New Civil Code.
[39] 6 MERTENS, *op. cit supra*, note 4 at 112.

parties foresaw and intended them or not.[40] Thus, where three co-owners enter into a written agreement to improve their property, subdivide and sell the same, the contract is one of partnership intended principally to put an end to or dissolve the co-ownership, notwithstanding the incidental obligation to preserve the co-ownership, until all the lots have been sold.[41]

On the question of the juridical personality of an unregistered partnership, the Supreme Court, as already mentioned, has ruled that "when our Internal Revenue Code includes 'partnerships' among the entities subject to the tax on 'corporation', said Code must allude, therefore, to organizations which are not necessarily 'partnerships' in the technical sense of the term. Thus, for instance, section 24 of said Code exempts from the aforementioned tax 'duly registered general copartnerships' which constitute precisely one of the most typical forms of partnerships in this jurisdiction. Likewise, as defined in section 84(b) of said Code, 'the term corporation includes partnerships, **no matter how created or organized.**' This qualifying expression indicates that a joint venture need not be undertaken in any of the standard forms, or in conformity with the usual requirements of the law on partnerships, in order that one could be deemed constituted for purposes of the tax on corporations. Again, pursuant to said section 84 (b), the term 'corporation' includes, among others, 'joint accounts (cuentas en participacion), and 'associations', none of which has a legal personality of its own, independent of that of its members. Accordingly, the lawmaker could not have regarded that personality as a condition essential to the existence of the partnerships therein referred to. In fact, as above stated, 'duly registered general copartnerships'—which are possessed of the aforementioned personality—have been expressly excluded by law (sections 24 and 84/b/) from the connotation of the term 'corporation'. x x x"[42] This portion of the Court's decision is quoted at length because, as will be presently shown, something in it does not seem to ring true.

With due respect to the opinion of the Supreme Court, just what was meant by "not necessarily partnerships, in the technical sense of the term"? Did the Court mean those organizations which have not complied with the formal requisites of law for the constitution of a partnership? If it did, then there would have been no necessity to exclude from the purview thereof the "duly registered general copartnerships" since the latter certainly have complied with the formalities required by law. Or did the Court refer to those associations which do not possess the requisites essential to the existence of the partnership? Of course, the Court could not have had this in mind after going the length in establishing the existence of the essential requisites of a partnership from the facts of the case. From either viewpoint, then, the interpretation of the Court would necessarily obviate the exclusion of duly registered general copartnerships from unregistered partnerships in Section 84 (b) of the Tax Code.

[40] 47 Am. Jur. 157; Jo Chung Cang v. Pacific Commercial Co., 45 Phil. 142 (1923).

[41] Tuason v. Tuason, G.R. No. L-3404, April 2, 1951.

[42] Evangelista v. Collector, *op. cit supra*, note 13.

In the second place, the Court also construed the qualifying expression "no matter how created or organized" to mean "that a joint venture need not be undertaken in any of the standard forms, or in conformity with the usual requirements of the law on partnerships x x x." It should be remembered that when the National Internal Revenue Code was enacted—the same may be said of its predecessor, Act No. 2833—the provisions of the Code of Commerce on partnerships were still in force, so that both civil and commercial partnerships were then recognized. In view of this fact, would it not be more logical to say that the phrase "no matter how created or organized" was intended to signify "whether created or organized under the Civil Code (of Spain) or under the Code of Commerce?"

Finally, if, as reasoned out by the Court, the other entities mentioned in Sec. 84(b) do not possess an independent legal personality, in effect saying that "partnerships" also mentioned therein had no separate personality, the exclusion of "duly registered general copartnerships" from the purview of "corporation" would then be superfluous and unnecessary. Why exclude something from another in which it is not included at all? And it is a well-known principle of statutory construction that in construing a statute, effect is to be given to all its provisions such that between two interpretations, that is to be adopted which renders none of the provisions superfluous.

Therefore, we shall not be entirely without reason if we differ with the Supreme Court on this matter. It is submitted that "partnerships", as used in Section 84(b) of our Tax Code should be interpreted to mean those that are essentially partnerships but which have failed to comply with all the legal formalities. This contention finds added support when we recall that the purpose of subjecting unregistered partnerships to income tax is to encourage the registration of partnerships,[43] implying of necessity that for registration to be possible there must first be an existing partnership the articles of which are to be registered. Moreover, "partnership has been said to be a matter of contract. No particular form of contract is necessary to its crea-

[43] Tan Senguan & Co. c. Collector, *op. cit. supra*, note 25.

tion, and, in this respect, it differs from corporations. Indeed a partnership may exist without any formal agreement. The agreement to operate as a partnership may be casual and merely oral.[44]

By way of summary, "and having also in mind the precautionary thought that no one test of the existence of a partnership should be regarded as wholly controlling, taxpayers may analyze business organizations in the light of the following principles and tests:

(1) Mutual interest in profits (the so-called "profit sharing" test). x x x

(2) Mutual liability, joint and several, for debts and loss of capital. This test is associated with the mutual interest in profits, and is no more conclusive than other tests. Even sharing in losses may be consistent with the employee status, and both sharing in profits and losses may fall short of partnership or joint venturing.

(3) Mutual agency and responsibility in the conduct of the business, though it is well recognized that a partnership may exist notwithstanding a delegation to one member of the right to decide whether profits should be distributed, the right to a division of profits and the right to withdraw them being quite distinguishable. Concentration of management in the hands of a single partner likewise does not destroy firm status.

(4) Common contribution to and ownership of the partnership property; though this test is probably of slight value since there may be a partnership in which one partner is the sole owner of the property, and the firm capital may consist merely of the right to use property contributed by and belonging to one member.

(5) The rendition of services by all partners; but partners may be inactive partners. Like the contribution of capital the lack of contribution of services is a test frequently resorted to in order to deny the existence of a partnership, but sometimes rendition of services will aid in supporting partnership status.

(6) The nonalienability of an interest in the business, though it is established that a restriction on alienability of an interest does not necessarily negate existence of a partnership.

"Existence of a partnership is not precluded by an agreement postponing realization of profits until obligations are met, or because *the object of the arrangement is a single transaction.* On the other hand, partnership is to be distinguished from the ordinary principal-agent or master-servant relationship and *from ordinary co-ownership of property,* also from trust relationships. And though there is a sharing of profits between a land owner and a share cropper, the arrangement is regarded as not a true partnership and the landlord cannot be compelled to pay taxes on the tenant's share of the crops."[45]

B. *Co-ownership arising from succession.*

At the outset, we may say that there is co-ownership by operation of law before the whole estate of the decedent has been partitioned

[44] 6 MERTENS, *op. cit. supra,* note 4 at 109.
[45] 6 MERTENS, *op. cit. supra,* note 4 at 111-116.

and there are two or more heirs to the same.[46] Even the Collector takes cognizance of this co-ownership in Field Circular No. V-109 by excepting it from taxability as an unregistered partnership with the words "estates in the course of administration."

Proceeding now to the analysis of co-ownerships by succession, we find it convenient to divide them further into: (1) co-ownership by testate succession, and (2) co-ownership by intestate succession.

The testator is allowed by law to prohibit the division of his estate, provided the period of indivision does not exceed twenty years.[47] Such indivision will in effect force co-ownership upon the heirs of the testator, constraining them to adopt a "modus vivendi" whereby each one may enjoy the benefits from the inherited property to the fullest extent possible. If the property is productive, this enjoyment will consist in a share of the profits derived from the exploitation of the property. Again we find that the difference between co-ownership and partnership narrows down to the point of overlapping, in the sense that the element of division of profits is present. In the present case, however, the problem is not too hard to resolve because it is obvious that the intent to share the profits is not of the will of the co-heirs but of the testator. Hence, there cannot be any partnership to speak of where the division of the income results from the wishes of the testator and not by agreement among the co-owners. It may be well to remember, in this connection, that the relations between the partners should be one of trust and confidence.

The situation becomes more difficult when co-ownership of income-producing properties originate from intestate succession, either through judicial or extra-judicial settlement. For the sake of clarity, we shall first pursue the matter of judicial settlement of the decedent's estate.

The practice in the Philippines is that before a distribution is made, a project of partition is presented, either by the administrator, a duly authorized commissioner or the interested parties, to the court, which may approve and accept the same, after due notice and hearing. A project of partition must be reasonable. It is not necessary, however, to show what specific property is given to one heir in exchange of the share that is not given him in another property; it is sufficient if the result of the partition shows that all the heirs have received substantially equal shares.[48] From this procedure, it may be inferred that generally the order of distribution,

[46] Arts. 494 and 1083 New Civil Code.
[47] Art. 1078 New Civil Code.
[48] 2 MORAN, COMMENTS ON THE RULES OF COURT 477.

being based on the project of partition, which is approved only after due notice and hearing, partakes of the nature of an agreement among the heirs. It follows that if the said heirs should consent to the co-ownership by and among them of all or some of the income-producing properties of the estate, they thereby contribute money or property to a common fund with the consequent necessity of dividing the profits therefrom.

In extra-judicial settlement by agreement among the heirs, the estate may be divided among themselves as they see fit, provided the legal requisites therefor are present.[49] If the heirs should agree to the co-ownership pro-indiviso of income-producing properties, we cannot but reach the same conclusion as in the case of judicial settlement, more so in this case since the intervention of the court is not necessary.

It seems then that in both instances, an unregistered partnership may exist for income tax purposes. But we cannot discount the possibility that sound and valid reasons may have prompted the heirs to choose indivision, such as where part of the property faces an important avenue or street but the greater portion of the property is in the interior, thus making an equitable distribution of the whole impracticable. Or the project of partition may have been approved or altered by the court over the objection of the heirs in the belief that co-ownership would be the most equitable division, the consent of the said heirs having been given eventually in submission to the court's order.

V. CONSEQUENCES OF TAXING UNREGISTERED PARTNERSHIPS AS CORPORATIONS

When an unregistered partnership is taxed as a corporation, the distribution of its net profits to the members thereof are again taxed as income in the hands of the recipients. It should be noted, however, that in view of Section 84 (b) which includes unregistered partnerships within the term "corporation", the respective shares of the members are taxable only when actually distributed. And since the same section excludes from the idea of corporation duly registered general copartnerships, the provisions of Section 26, subjecting to income tax the shares of its members in their individual capacity, whether such shares are distributed or not, should not be applied to the shares of the members of unregistered partnerships.

Following the same line of thought, will the actual distributions of their respective shares be in the nature of dividends? For the

[49] Rule 74 § 1.

answer, we turn to the statutory definition of dividends, which defines it "as any distribution made by a corporation to its shareholders out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders whether in money, or in other property."[50] There can be no doubt then that, construed together with Section 84 (b), the scope of the term "dividends" is wide enough to embrace within its meaning the distributions of profits of unregistered partnerships. If the recipients are domestic or resident foreign corporations, only 25% of such distributions are subject to income tax.[51] This theory has been followed by the Collector in the assessment of the deficiency income taxes in the case of Batangas Transportation Company, supra, and although not passed upon directly, it seems to have been allowed by the Supreme Court, especially so since one of the points at issue therein was the propriety of the Collector's revision of the assessment after the Court of Tax Appeals had acquired jurisdiction over the case, such revision being due precisely to the taxability of 25% of the profit distribution.

VI. CORPORATIONS AS PARTNERS

Previously we had questioned the decision in the case of Batangas Transportation Company, supra, as to whether the Court considered the joint management of the two bus companies involved therein as a partnership or a joint venture. The reason is that after applying the Evangelista ruling, which, incidentally, dealt with a partnership among natural person, to the joint management, the Court held "that the Joint Emergency Operation or sole management or joint venture in this case falls under the provisions of Section 84 (b) of the Internal Revenue Code, and consequently, it is liable to income tax provided for in Section 24 of the same Code." In other parts of the opinion, the Court used the terms "partnership" and "joint venture" interchangeably and, it seems, synonymously.

True, the question is merely academic since the joint management comes within the meaning of "corporation" whether it be a partnership or a joint venture. But the Court should have stated categorically whether it was the one or the other, instead of interchanging the two terms as if they had the same legal significance. There is the danger that this case might be used as a precedent in a subsequent action involving a partnership between two corporations, the legality of which might be questioned, but which may not concern taxation at all.

[50] Nat'l Int. Rev. Code § 83 (a).
[51] Nat'l Int. Rev. Code § 24.

Moreover, the need for precision assumes greater importance when we consider that the weight of authority inclines to the view that corporations may not engage in partnership operations. The reason behind this prohibition is explained thus:

"Unless the authority is expressly conferred as a general rule, the management of a corporation cannot bind it to continue in a partnership relation with another, as this is considered to involve too great a delegation of the power of management exercised by the board of directors. The general manager or officers of a corporation would have to obey the orders of the Board of Directors but each partner is co-equal in the management of the firm unless otherwise granted. As the Tennessee Supreme Court said: 'the whole policy of the law creating and regulating corporations looks to the exclusive management of the affairs of each corporation by the officers provided for or authorized by its charter. This management must be separate and exclusive, and any arrangement by which the control of the affairs of the corporation should be taken from its stockholders and the authorized officers and agents of the corporation would be hostile to the policy of our incorporation acts."[52]

Even our own Supreme Court adhered to this theory when it ruled that "the contention that Gregorio Araneta, Inc. cannot act as managing partner for plaintiff on the theory that it is illegal for two corporations to enter into a partnership is without merit, for the true rule is that though a **corporation has no power to enter into a partnership,** it may nevertheless enter into a **joint venture** with another where the nature of the venture is in line with the business authorized by its charter."[53]

VII. CONCLUSION

A past President of the Philippine Institute of Accountants expressed the opinion that since the inequality in the treatment of partnerships has been brought about by the need of encouraging registration of all partnerships, this no longer holds true because of Article 1772 of the New Civil Code, and therefore "all partnerships must be given the same tax dose."[54]

But it appears to us that Article 1772, which requires every contract of partnership having a capital of ₱3,000 or more shall appear in a public instrument which must be recorded in the Securities and Exchange Commission, is merely a formal requisite failure to comply with which will not prevent the formation of a partnership. And similar to Article 25 of the Code of Commerce, Article 1772

[52] BALLANTINE, CORPORATIONS 234-235.
[53] Tuason & Co. v. Bolaños, G.R. No. L-4935, May 28, 1954.
[54] J.S. Zulueta, An Analysis of Our Tax Laws, THE ACCOUNTANTS' JOURNAL, Sept. 1956.

of the present Civil Code would not have a sanction to oblige the partners to register the articles of copartnership, if we should equalize the taxability of both registered and unregistered partnerships.

It is, therefore, our considered opinion, from all the foregoing discussions, that the best way to forestall the numerous controversies that may arise from the interpretation of the partnership provisions in our Tax Code in accordance with the precepts of the Civil Law is the appropriate amendment of the income tax law by incorporating therein an accurate definition of partnership, mentioning with precision the conditions for its taxability or non-taxability. Only in this manner may the courts determine the existence of a partnership for tax purposes without resort to the general law on partnerships, which, by way of a final reminder, have been strongly criticized by an eminent jurist on the ground that the Code Commission had incorporated therein the provisions of the Uniform Partnership Act "without pausing to harmonize the same with the retained provisions of the Code of 1889 and apparently without noticing the fundamental differences in the Civil and Common Law conceptions of this institution."[55]

[55] J.B.L. Reyes, Observations on the New Civil Code, XVI L. J. 95.