Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City
Office of the General Counsel

20 April 2012

SEC-OGC Opinion No. 12-06
Treasury shares

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Sir:

This refers to your letter dated 10 August 2011 requesting opinion on treasury shares of Trackworks Advertising, Promotion and Vending Corporation (Trackworks).

Your letter states that you are a stockholder of Trackworks and that sometime in 2007, the shares of two other stockholders, namely, AAMES Group Company Inc. (AAMES) and the late Leo Gueco, were bought by Trackworks using company funds and assets. It further states that Joselito P. De Joya, its incumbent President and CEO, listed said stockholders as such in Trackworks' General Information Sheet (GIS) and obtained their proxy votes to gain control of the Board. It also states that Mr. De Joya informed you that the treasury shares cannot be distributed since Trackworks has no retained earnings. Finally, it states that the shares of AAMES were purchased by Mr. De Joya, Mr. Gil G. Chua and Mr. Rosalino Marable in their personal capacity using company funds and assets entered as advances to officers in the accounting books of Trackworks.

Given the foregoing, you are now asking this Office the following:

1. When records show that some stockholders sold their shares to the corporation, is it legal to list said stockholders as such in the corporation's GIS? Is such an act punishable as perjury? Is the act of listing the former shareholders as such by the President and CEO of Trackworks punishable as perjury?

2. Can a stockholder who sold his shares in a corporation be held criminally liable for executing proxies, despite knowledge that he has been paid the value of such shares prior to the execution of the said proxies?

3. Is it correct that treasury shares cannot be distributed to the remaining stockholders because the company has no retained earnings? If it cannot be distributed, how do we compute the percentage of ownership? If treasury shares can be distributed despite the absence of retained earnings, how is it distributed?

After a careful evaluation of the disclosed facts, this Office deems that answering your first and second queries require the determination of factual issues and a review or interpretation of contract, both of which may be a proper subject of a court case. Thus, the Commission, as a matter of policy, shall refrain from rendering an opinion pursuant to SEC Memorandum Circular No. 15, series of 2003.

However, as to your last query, it is necessary for you to understand the nature of treasury shares. Treasury shares are shares of stock which have been issued and fully paid for, but subsequently reacquired by the issuing corporation by purchase, redemption, donation, or through some other lawful means.[1] In other words, **treasury shares are shares that have been earlier issued and are regarded as property acquired and currently owned by the corporation and not by any of its stockholders.**

Being the owner of treasury shares, the corporation may opt to retire, sell or distribute as property dividends said shares. In case of retirement of treasury shares, the corporation shall amend its Articles of Incorporation by decreasing the capital stock of the corporation in accordance with Section 38 of the Corporation Code of the Philippines for the purpose of eliminating the treasury shares.[2] On the other hand, the corporation may, like any of its other properties, sell/dispose said shares for a reasonable price fixed by the board of directors.[3] Once sold or reissued, the treasury shares again become outstanding stock and regain voting rights.

In case of declaration of treasury shares as property dividends, the corporation can only do so if the amount of the retained earnings previously used to support their acquisition has not been subsequently impaired by losses. Generally, a corporation can reacquire its own shares for legitimate corporate purpose/s provided it has sufficient amount of unrestricted retained earnings to support the cost of said shares.[4] **Consequently, the amount of such earnings equivalent to the cost of the treasury shares being held cannot be declared and distributed as dividends until said shares are reissued or retired.**[5] The reason for this is that such amount of earnings equivalent to the cost of treasury shares is not considered part of earned or surplus profits that is distributable as dividends.

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[1] Corporation Code of the Philippines, Section 9.
[2] SEC Rules CCP No. 1 (April 26, 1982), entitled "Rules governing Redeemable and Treasury Shares," Section 4 (2).
[3] See note 1.
[4] Id, Section 41.
[5] See note 2, Section 4 (1).

On the other hand, if there are retained earnings arising from the business of the corporation other than the amount equivalent to the cost of treasury shares, treasury shares, being property of the corporation, may be distributed among the stockholders as property dividends.[6] Any declaration and issuance of treasury shares as property dividend shall be disclosed and properly designated as property dividend in the books of the corporation and in its financial statements.[7]

The requirement of unrestricted retained earnings is based on the trust fund doctrine which means that capital stock, property and other assets of a corporation are regarded as equity in trust for the payment of corporate creditors.[8] Creditors of a corporation are preferred over the stockholders in the distribution of corporate assets.[9] **There can be no distribution of assets among the stockholders without first paying corporate creditors.**[10]

In sum, treasury shares are regarded as property owned by the corporation and cannot be distributed as property dividends among the stockholders in the absence of unrestricted retained earnings other than the amount equivalent to the cost of treasury shares, because to do so would violate the trust fund doctrine.

The foregoing opinion rendered is based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission whether of similar or dissimilar circumstances.[11] If, upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

CAMILO S. CORREA
General Counsel

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[6] See note 2, Section 5 (3).
[7] Id.
[8] Philip Turner et al v. Lorenzo Shipping Corporation, G.R. No. 157479, 24 November 2010.
[9] Id.
[10] Id.
[11] SEC Memorandum Circular No. 15, series of 2003.