REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MANUEL V. PANGILINAN
RICARDO S. PASCUA, and
VICENTE C. TINSAY III,
Petitioners,

- versus -

C.T.A. CASE NO. 4826

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated : AUG 23 1994

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DECISION

Sought to be refunded by petitioners in the case at bar is the total amount of P386,683.37 representing alleged excess capital gains tax paid under protest on the sale of shares of stock of a domestic corporation.

The facts of the case are not disputed.

The above-named petitioners are Filipino citizens, all of legal age and with office address at Metro House, #345 Sen. Gil J. Puyat Avenue, Makati, Metro Manila.

On May 11, 1990, the petitioners sold to Messrs. Carlo A. Carag, Manuelito O. Caballes and Elpidio C. Jamora their respective shares of stock in FPSP Holdings Corporation ("FPSP Holdings"), involving the aggregate amount of 191,998 shares at a price computed at the par value thereof of P10.00 per share as well as their respective shares in First Pacific Securities Philippines, Inc. (FPSPI), involving the aggregate amount of 926,232 shares at a price computed at book value thereof of P14.49 (Exhibits "A" to "A-5"). Shown below is a summary of said transactions:

Seller	Buyer	No. of Shares	Selling Price per share	TOTAL
A. FPSP Holdings Corp.				
M. V. Pangilinan	C.A. Carag	64,000	P 10.00	P 640,000.00
R.S. Pascua	M.O. Caballes	63,999	10.00	639,990.00
V.C.Tinsay	E.C. Jamora, Jr.	63,999	10.00	639,990.00
	TOTAL	191,998		P1,919,980.00
B. First Pacific Securities Philippines, Inc.				
M.V. Pangilinan	C.A. Carag	308,744	P 14.49	P 4,473,700.56
R.S. Pascua	M.O. Caballes	308,744	14.49	4,473,700.56
V.C. Tinsay	E.C. Jamora, Jr.	308,744	14.49	4,473,700.56
		926,232		P13,421,101.68

The cost to petitioners of the FPSP Holdings shares was at par value or P10.00 per share while the FPSPI shares cost approximately P8.26487 per share. Consequently, there was no capital gains on the sale of the FPSP Holdings shares but each petitioner has a capital gains of P1,921,970.56 on the sale of FPSPI shares. The capital gains tax due from each petitioner as a result of the foregoing sales amount to P374,394.11 computed as follows:

Seller	Selling Price	Cost	Capital Gains	Capital Gains Tax
A. FPSP Holdings Corp.				
M.V. Pangilinan	P 640,000.00	P 640,000.00	0	0
R.S. Pascua	639,990.00	639,990.00	0	0
V.C. Tinsay	639,990.00	639,990.00	0	0
TOTAL	P1,919,980.00	P1,919,980.00	0	0
B. First Pacific Securities Corp.				
M.V. Pangilinan	P 4,473,700.56	P2,551,730.00	P1,921,970.56	P 374,394.11
R.S. Pascua	4,473,700.56	2,551,730.00	1,921,970.56	374,394.11
V.C. Tinsay	4,473,700.56	2,551,730.00	1,921.970.56	374,394.11
TOTAL	P 13,421,101.68	P7,665,190.00	P5,765,911.68	P1,123,182.33

On May 14, 1990, the petitioners filed their individual capital gains tax return on stock transactions (Exhibits "B" to "B-2") with the BIR Revenue District Office No. 32, Makati East and paid the corresponding capital gains tax due thereon as per confirmation receipts submitted (Exhibits "C" to "C-2").

A tax clearance for the sale however, was not issued by the Bureau of Internal Revenue (BIR) since the revenue officer assigned to the case disagreed with the computation of the capital gains tax due on the sale by petitioners of the FPSP Holdings shares on the ground that the capital gains thereon should be computed based on the book value of P20.07 per share as against petitioners' computation based on the alleged true book value of P9.81 per share or P0.19 below its par value of P10.00 per share. Accordingly, petitioners were asked to pay the capital gains tax due on the sale of the FPSP Holdings shares in the total amount of P386,683.87.

On July 4, 1990, petitioners paid under protest the total amount of P386,683.87 (Exhibits "E" to "E-2") in order that the sale of the FPSP Holdings shares can already be recorded in the books of the company and registered in the name of the new owners.

On July 17, 1990, by way of protesting their payment of P386,683.87 as alleged unpaid capital gains tax and in order to formalize its claim for refund of the said amount, the petitioners, thru counsel, submitted a letter-claim for refund to the Chief, Appellate Division of the BIR (Exhibit "F").

On July 2, 1992, petitioners filed the instant petition for review because respondent did not act upon the petitioners' claim for refund since the time it was filed and to interrupt the running of the prescriptive period (CTA records, pages 1-14).

The issue in this case is whether or not petitioners are entitled to their claims for refund in the total amount of P386,683.37.

The petitioners submit that no capital gains tax was due on their sale of the FPSP Holdings shares since the selling price of P10.00 per share is equal to its acquisition cost of P10.00 per share while the "true" book value thereof was computed by petitioners to be only P9.81 per share or P0.19 below it par value of P10.00 per share. There being no capital gains on the sale of FPSP Holdings shares, petitioners claim that they are entitled to an immediate refund of the amount of P386,683.87 paid by them under protest as alleged unpaid capital gains tax due on aforesaid sale.

Whereas, respondent strongly insists that the payment by petitioners of the capital gains tax on the sale of FPSP Holdings shares in the amount of P386,683.87 is legal and proper. The capital gains thereon should allegedly be computed based on the book value of P20.07 per share determined as per the audited financial statements of FPSP Holdings Corporation as of December 31, 1989. Deducting therefrom the acquisition cost of P10.00 per share, the capital gains realized on the sale thereof is P10.07 per share. Accordingly, the capital gains of petitioners on the sale of the 191,998 FPSP Holdings shares amount to P1,933,419.86 on which, the capital gains tax allegedly due thereon is P386,683.87.

The difference in the computation of capital gains tax due on the sale of the FPSP Holdings shares can be traced to the difference in the manner by which the parties assigned the book value on said shares. Petitioners' followed the "cost method" of accounting as recommended by FPSP Holdings Corp. external auditor Sycip Gorres and Velayo while respondent simply applied the "equity method" of accounting as this was the method by which the financial statements of FPSP Holdings was presented. Shown hereunder is the mathematical illustration for purposes of comparison:

	Respondent's Equity Method	Petitioners' Cost Method
Capital Stock - P10 par value Issued and outstanding - 301,000 shares	P3,010,000.00	P3,010,000.00
Retained Earnings	3,030,678.00	3,030,678.00
	6,040,678.00	6,040,678.00
Less: Accumulated equity in net earnings of FPSI	-	(3,086,482.00)
STOCKHOLDERS' EQUITY	6,040,678.00	2,954,196.00
Divide by outstanding shares	301,000 shares	301,000 shares
Book Value Per Share	P 20.07	P 9.81

The threshold question that need to be addressed is whether or not the retained earnings reflected in the financial statements arising from accumulated equity in the net earnings of a subsidiary (FPSPI) shall be considered in the determination of the book value of the parent company (FPSP Holdings) shares for purposes of computing the capital gains tax on the sale by the petitioners of the said shares.

The petitioners contend that the reflection by FPSP Holdings in the Financial Statements of its "share in the net earnings of its subsidiary" even prior to the receipt thereof as dividends is mandated by equity method of accounting under Financial Accounting Standard No. 11. They are of the view that said financial statements prepared pursuant to the "equity method" of accounting while necessary to comply with generally accepted accounting principles, is not conclusive for taxation purposes, or specifically in this case, for determining the true book value of the FPSP Holdings shares and computing the corresponding capital gains tax due in the sale by the petitioners of said shares.

The alleged true book value of the FPSP Holdings share in the amount of P9.81 or P0.19 below its par value of P10.00 per share is arrived at by disregarding the amount of P3,030,678.00 reflected as FPSP Holdings retained earnings under the financial statements and taking into account its accumulated losses of P55,884.00 (P3,030,678.00 - P3,086,482.00). Where the parent company has not realized as income any "share in the net earnings" of the subsidiary and said accumulated equity in net earnings of the subsidiary remains part of its retained earnings, the "cost method" of accounting should allegedly be followed in determining the true book value of shares of the holding company.

Where the capital gains tax on the sale of the shares of the subsidiary (FPSPI), computed based on the book value thereof, has already been paid by petitioners, to include the equity in net earnings of a subsidiary which is reflected in the financial statements of the parent company (FPSP Holdings) as "retained earnings", in the computation of its book value results in inequity since the same amount has already been considered in determining the book value of the subsidiary's shares for purposes of computing the capital gains tax on the sale thereof by the petitioners. The effect is to tax the same retained earnings both on the level of the subsidiary (FPSPI) and of the parent company (FPSP Holdings).

Petitioners likewise cite BIR Ruling No. 117 dated June 15, 1989 which lays down the rule that accumulated and current equity in the subsidiary's net earnings, without dividend declaration of said earnings in favor of the parent corporation, is not considered as income and should not be included in the determination of the book value of the shares of the parent corporation for purposes of the capital gains tax on the sale of said shares.

On the other hand, respondent argues that since the "equity method" of accounting was used in the preparation of the financial statement of FPSP Holdings, the same method should be used in the computation of the book value of FPSP Holdings shares of stock. The shifting to the "cost method" in the determination of the book value of FPSP Holdings share of stock must not allegedly be countenanced.

In the equity method of accounting, the parent company includes in its accounting records its share of the subsidiary's net income or net loss, adjusted for amortization of differences between current fair value and carrying amount of a purchased subsidiary's net assets as of the date of the business combination as well as its share of dividends declared by the subsidiary [Larsen, John E.; Meigh, Walter B.; Masich, A.M.; "Modern Advanced Accounting", (1980), p. 292]. There being only one class of stock outstanding, the book value of P20.07 is arrived at by dividing the total stockholders' equity as reflected in the financial statement by the number of shares outstanding.

The determination of tax base for purposes of the capital gains tax is provided by Revenue Regulations No. 2-82, the pertinent portion of which is quoted hereunder:

> **SEC. 6.** *Determination of Tax Base.* - In determining the tax base, the following rules shall apply:
>
> (a) Determination of selling price. - x x x
>
> (1) x x x
>
> (2) x x x
>
> (3) In the case of sale, transfer or exchange of shares not listed in the stock exchange, the following rules shall be observed:
>
> > (i) In general, the unlisted shares shall be valued at their book value nearest the valuation date. The book value of these unlisted shares of stock shall be prima facie considered as their fair market value.
> >
> > (ii) x x x
> >
> > If such lower fair market valuation is not clearly established and documented, the book value of the unlisted shares of stock shall be adopted. If there have been previous bonafide sales/exchanges of the unlisted shares of stock, the price at which these shares exchanged hands should be taken/considered as its fair market value/s.

In the case at bar, the book value of P20.07 is arrived at following the valuation as provided in Revenue Regulations No. 2-82 and shall be considered as its fair market value. Respondent further claims that petitioners failed to disprove the same.

BIR Ruling No. 117 which was cited by petitioners in support of its case allegedly contemplates of different sets of facts and circumstances. Respondent alleges that petitioners never presented any evidence other than its mere allegations to prove that indeed the retained earnings were from its subsidiary (FPSPI). Since claims for refund are in the nature of exemption from taxation, they are construed strictly against the claimant (**MERALCO vs. CIR, 67 SCRA 357**). Thus, petitioners failed to show that they are entitled to the refund.

We find in favor of petitioners.

While it is true that Revenue Regulations No. 2-82, Section 6(a)(3)(i) provides that in the case of sale of shares not listed in the stock exchange, the unlisted shares shall be valued at their book value nearest the valuation date, the same shall be merely prima facie considered as their fair market value for purposes of determining the tax base for capital gains tax. It further provides that in case the shares are valued on a basis lower than their book values, a justification for the deviation from the book value, together with the evidences in support thereof, should be submitted.

The book value of the FPSP Holdings share of P20.07 as per the financial statements for the year ended December 31, 1989 under the "equity method" should thus be merely prima facie considered as the fair market value of the said share. The petitioners have indubitably shown that the book value of the FPSP Holdings share for capital gains tax is P9.81 per share using the "cost method" of accounting.

The equity method employed by FPSP Holdings in the preparation of financial statements is in accordance with the generally accepted accounting principles. However, it does not necessarily follow that in determining the book value and capital gains tax, the same should be applied. They do not accurately reflect the retained earnings of FPSP Holdings and the book value of its shares for purposes of computing the corresponding capital gains tax due thereon because it includes its share in the net earnings of its subsidiary (FPSPI), even though it has not received the same as no cash dividend was ever declared by the latter since its incorporation (Exhibit "F").

The equity in net earnings of the subsidiary (FPSI) was never realized as income by the parent company (FPSP Holdings) and remains a part of retained earnings of the subsidiary (FPSPI). In actuality, it was considered in computing the book value and capital gains tax on the sale of the FPSPI shares.

To include the same retained earnings in determining the book value and capital gains tax on the sale of FPSP Holdings share even without declaration of cash dividend is tantamount to taxing the same retained earnings both in the level of FPSPI (the subsidiary) and of FPSP Holdings (the parent company),

Pursuant to BIR Ruling No. 117-89 dated June 5, 1989, then Commissioner of Internal Revenue Jose U. Ong ruled in a case with substantially similar set of facts as the case at bar as follows:

> "In reply thereto, I have the honor to inform you that appreciation in value of property is not even an accrual of income to taxpayer prior to the realization of such appreciation through sale or conversion of the property (Sec. 38, Revenue Regulations No. 2). Such being the case, <u>the "accumulated and current equity in the investees net earnings" i.e., the imputation but without dividend declaration of the earnings of the subsidiary or sister corporation to the parent or stockholder corporation in the amount of P117,562,844.00</u> and the "share in revaluation increments" i.e., increase in value of property because of reappraisal thereof at current value without sale or exchange in the amount of P114,004,128.00 <u>are not considered as income and should not therefore be included in the determination of the book value of the PHINMA shares for purposes of the capital gains tax on the sale of said shares.</u>" (Underscoring supplied.)

The audited financial statements of FPSP Holdings for the year ended December 31, 1989 and the accompanying notes to the financial statements (Exhibit "D") clearly illustrate and serve as justification for the use of the "cost method" of accounting in determining the book value and capital gains tax on the sale of FPSP Holdings shares. It should be noted that FPSP Holdings only subsidiary is FPSPI, its only asset is its investment therein and its income is to a large extent its equity (share) in the net earnings of its subsidiary. The book value of P9.81 per share of FPSPI Holdings using the cost method is therefore correct hence, no capital gains is recognizable upon its sale at P10.00 per share.

In view of the foregoing, We find petitioners to have factually and legally established their entitlement to the refund sought.

WHEREFORE, respondent Commissioner of Internal Revenue is hereby ordered to refund to petitioners the amount of P386,683.87 representing excess capital gains tax paid on their sale of FPSP Holdings Corporation shares of stock.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals