REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE BULK CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 4301

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

8/10/93

x - x

D E C I S I O N

Is respondent required to condone the 25% surtax on accumulated surplus profits upon payment of the 30% compromise settlement of petitioner's deficiency income tax in 1979 pursuant to the provisions of Executive Order No. 44? If in the negative, is petitioner liable to pay the alleged deficiency surtax for 1979 in the amount of P1,573,561.23? These are the questions raised in this petition for review.

The undisputed facts are simple.

Petitioner is a duly organized domestic corporation with principal office located in Pulupandan, Negros Occidental. It is engaged in the business of bulk handling and warehousing in Pulupandan, Negros Occidental. It also operates and maintain wharves in said province.

On February 13, 1985, petitioner received a letter, dated January 24, 1985 (Exh. A), from BIR Deputy Commissioner Romulo Villa, informing petitioner that the following amounts are due from it: P52,528.69 as Deficiency Income Tax for 1979, inclusive of interest; and P1,573,561.23 as Deficiency Surtax (on accumulated earnings) for the year 1979, inclusive of interest, pursuant to Section 25(a) of the National Internal Revenue Code (NIRC).

In a letter, addressed to respondent, dated October 22, 1986 (Exh. K), petitioner expressed its desire to effect a compromise by paying 30% of the basic deficiency income tax involved (P33,197.56) pursuant to the provision of Section 1 of Executive Order No. 44 (E.O. 44 for short).

On October 23, 1986, petitioner paid the Bureau of Internal Revenue the amount of P9,959.27, representing 30% of P33,197.56. The payment is evidenced by BIR Confirmation Receipt No. B 7374346 (Exh. L) and Payment Order No. B 9128723 (Exh. L-1).

In a letter dated February 8, 1988 (Exh. M), Mr. Eduardo P. Pamittan, BIR Chief of the Receivable Accounts Division, acting for the Commissioner, informed petitioner that its offer to compromise its 1979 deficiency income tax and surtax liabilities involving the total amount of P1,626,089.92 has been denied by higher authorities. This constituted respondent's final request for petitioner to settle its account. Otherwise, warrants of distraint and levy shall be issued to enforce collection thereof.

On February 16, 1988 (Exh. N), petitioner protested respondent's denial of its offer to compromise. Petitioner contended that it was entitled as a matter of right to compromise its tax liability upon payment of 30% of the basic tax assessed after having availed of the privilege under E.O. 44. Respondent is, therefore, legally mandated to condone the corresponding interest and penalties on such basic tax pursuant to Sec. 1 of E.O. 44. Petitioner sought for the cancellation of the 1979 deficiency income and surtax assessments issued against in the sum of P1,626,089.92.

On September 2, 1988, petitioner received respondent's decision (Exh. O) stating that its request for the cancellation of the assessment had been granted insofar as the amount of P52,528.69, representing the deficiency income tax is concerned. However, with respect to the request for cancellation of the amount of P1,573,561.23, as alleged deficiency surtax, the same was denied on the ground that the "interest and penalties" condoned under Sec. 1 of E.O. 44 "refer only to the additions to the tax arising from failure to file a return and/or pay the tax on time," and "do not include the 25% surtax." Respondent stressed that the 25% surtax assessed on petitioner's accumulated profits, pursuant to Sec. 25(a) NIRC, is not an administrative penalty which can be condoned by the availment of the benefits of Sec. 1 of E.O. 44.

On September 23, 1988, petitioner filed the instant petition with this Court.

The issues raised are:

(1) whether or not respondent erred in not condoning petitioner's alleged 1979 Deficiency Surtax liability (in the amount of P1,573,561.23) upon payment of 30% of the basic income tax liability for the year 1979 pursuant to Sec. 1 of E.O. 44; and

(2) whether or not petitioner had improperly accumulated profits beyond the reasonable needs of its business making it liable to pay the alleged Deficiency Surtax for 1979.

The case was submitted to Us for decision by respondent on a purely legal question based on the pleadings and the CTA records of the case. Petitioner presented documentary and testimonial evidence to prove as a matter of fact that it did not improperly accumulate profits for it to be subjected to the surtax.

Executive Order No. 44 (effective Sept. 4, 1986) with its pertinent provisions read as follows: [82 O.G. Supp. No. 39, 4635 (Sept., 1986)]

EXECUTIVE ORDER NO. 44

AUTHORIZING THE BUREAU OF INTERNAL REVENUE TO ACCEPT COMPROMISE PAYMENTS ON DELINQUENT ACCOUNTS AND DISPUTED ASSESSMENTS PENDING AS OF DECEMBER 31, 1985

x x x x x x x x x.

SECTION 1. The Commissioner of Internal Revenue or his duly authorized representatives may compromise any disputed assessment or delinquent account pending as of December 31, 1985, upon the

> payment of an amount equal to thirty percent (30%) of the basic tax assessed. In such cases, the Commissioner of Internal Revenue or his duly authorized representatives shall **condone the corresponding interests and penalties.** (Emphasis supplied.)
>
> X X X X X X X X X.
>
> **SEC. 4.** Section 246 of the National Internal Revenue Code, as amended, is hereby suspended with respect to the disputed assessments and delinquent accounts referred to herein for the duration of the effectivity hereof.
>
> X X X X X X X X X."

The pertinent provision of the National Internal Revenue Code (1977) provides:

> "SEC. 25. **Additional tax on corporations improperly accumulating profits or surplus.** - (a) *Imposition of tax.* - If any corporation, except banks, insurance companies, or personal holding companies, whether domestic or foreign, is formed or availed of for the purpose of preventing the imposition of the tax upon its shareholders or members of the shareholders or members of another corporation, through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there is levied and assessed against such corporation, for each taxable year, a tax equal to twenty-five *per centum* of the undistributed portion of its accumulated profits or surplus which shall be **in addition to the tax imposed by Section 24, and shall be computed, collected and paid in the same manner and subject to the same provisions of law, including penalties, as that tax.**

[redacted]

> (b) *Prima facie evidence.* - The fact that any corporation is a mere holding company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. Similar presumption will lie in the case of an investment company where at any time during the taxable year more than fifty *per centum* in value of its outstanding stock is owned, directly or indirectly, by one person.
>
> (c) *Evidence determinative of purpose.* - The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or member unless the corporation, by clear preponderance of evidence, shall prove the contrary."

On the first issue, petitioner contends that the payment of at least 30% of the basic deficiency income tax for 1979 extinguishes its liability to pay the tax on accumulated profit (surtax) under Sec. 25(a) of the NIRC. According to petitioner, the surtax is in the nature of a penalty imposed upon the taxpayer for having unreasonably accumulated surplus. Being a penalty, it is deemed condoned upon payment of the 30% basic income tax liability as prescribed in Sec. 1 of E.O. 44.

Respondent stressed that the law states "the Commissioner of Internal Revenue or his duly authorized representatives shall condone the corresponding interest and penalties." This refers to the additions to the tax arising from failure to file a return and/or pay the tax on time or to the particular tax being assessed.

Please note that in this particlar the deficiency assessments for 1979 constitutes two counts: **One**, the deficiency income tax in the total amount (including surcharge and interest) of P52,528.69 and **Two** the surtax for unjust accumulation of surplus in the total amount of P1,573,561.23 (including surcharge and interest). The first assessment is under Section 24 while the latter is under Section 25 of the old Tax Code. Petitioner applied only for 30% compromise settlement to basic tax on the first assessment in the amount of P33,197.56. It does not in any case include the 25% surtax or tax on accumulated profits. Furthermore, the 25% surtax is imposed "<u>in addition to the tax imposed under Sec. 24 of the NIRC</u>". The surtax "<u>shall be computed, collected and paid in the same manner and subject to the same provisions of law, including penalties, as that tax.</u>"

Contrary to the opinion of petitioner, the 25% surtax, otherwise known as the accumulated earnings tax, is not the penalty envisioned in Sec. 1 of E.O. 44, rather "the accumulated earnings tax under Section 25 of the Tax Code is a <u>tax on obnoxious hoarding</u> as distinguished from harmless accumulation." **[The Manila Wine Merchants, Inc. v. The Commissioner of Internal Revenue, CTA Case No. 1415, February 28, 1966.]** "As a practical matter, liability for the tax under Section 25 of the Tax Code hinges on whether the corporation has accumulated the earnings in excess of the reasonable needs of the business." (supra.)

The Supreme Court in the case of **The Manila Wine Merchants, Inc. v. The Commissioner of Internal Revenue, G.R. No. L-26145, February 20, 1984, (127 SCRA 483)**, affirmed in toto this Court's decision in CTA Case No. 1415, involving the same parties, where it was held:

> "A prerequisite to the **imposition of the tax** has been that the corporation be formed or availed of for the purpose of avoiding the income tax (or surtax) on its shareholders, or on the shareholders of any other corporation by permitting the earnings and profits of the corporation to accumulate instead of dividing them among or distributing them to the shareholders. If the earnings and profits were distributed, the shareholders would be required to pay an income tax thereon **whereas, if the distribution were not made to them, they would incur no tax** in respect to the undistributed earnings and profits of the corporation. The touchstone of liability is the purpose behind the accumulation of the income and not the consequences of the accumulation. x x x." [Emphasis Ours.]

It is thus clear from the very wordings of Sec. 25 of the NIRC that the 25% surtax is an **additional tax** on corporations improperly accumulating profits or surplus. The legislative purpose of the surtax was to integrate properly the tax upon corporations improperly accumulating surplus. [7 Law of Federal Income Taxation Sec. 40.02, 334] This will compel corporations to distribute as dividends the corporate earnings not necessary in the business, so that the dividends may be properly taxed in the hands of the stockholders. [1 ARAÑAS, ANNOTATIONS AND

JURISPRUDENCE ON THE NATIONAL INTERNAL REVENUE CODE OF 1977, 92 (4th ed., 1978)].

In line with respondent's reasoning, the 25% surtax is a tax by itself imposed in addition to the corporate income tax (under Sec. 24). It shall be computed, collected and paid in the same manner and subject to the same provisions of law, including penalties, as that tax. [Sec. 25(a), NIRC.] Section 1 of E.O. 44 would not have included the 25% surtax in the term "corresponding interests and penalties". By itself the surtax is an additional tax other than the income tax. It is subject to the penalties similar to that of the income tax.

Petitioner further adds that the 25% surtax under Sec. 25 has been repealed by Sec. 6 of E.O. 37 (July 31, 1986). With the subsequent repeal of the accumulated profits tax all rights to levy said tax are put to an end even if already begun. Therefore, petitioner should no longer be held liable to pay the surtax.

We disagree with petitioner. It is an elementary rule in statutory construction that "in the absence of such words indicative of the extent of the statute's operation, the general rule is that a statute will be construed prospectively unless the legislative intent that it be given a retrospective operation clearly appears by necessary or unavoidable implication." [MARTIN, STATUTORY CONSTRUCTION 56 (rev. ed., 1972); citing, In re Davis Estate, 330 Mich., p. 647.] A statute should be prospectively enforced, whether it enacts, amends, or repeal a law, unless the language of that statute states in very clear language that it shall have retroactive effect. **[Lorenzo v.**

Posadas, 64 Phil. 366-367.] The repeal of Sec. 25 by Sec. 6 of E.O. 37 (1986) had no retroactive application there being no mention to that effect.

In fact, the prospective application of repealing statute was upheld in the case of **Co v. Coll. of Internal Revenue, 100 Phil. 464 (Nov. 29, 1956),** cited by petitioner, where it was there ruled:

> "Regarding the effects of repealing statutes, the argument has been advanced, that taxes assessed (but not collected) under the law before its repeal, may not be collected after such repeal - except, always, provisions to the contrary. But the courts permit such collection.
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> > "The rule favoring a prospective construction of statutes is applicable to statutes which repeal tax laws. Accordingly it is held that where such statute is not made retroactive a tax assessed before the repeal is collectible afterwards; and where taxes are levied under a law which is repealed by a subsequent act, unless it appears clearly that the legislature intended the repeal to work retrospectively, it will be assumed that it intended the taxes to be collected according to the law in force when they were levied." (Cooley, Taxation Section 538 Vol. 2.)
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> So, if taxes assessed may still be demanded after the repeal of the law, it follows that taxes already collected *may be* and *should be* retained after the repeal. Unless of course the repealing statute provides otherwise."

Respondent was correct in not condoning the 25% surtax since petitioner paid only 30% of the basic income tax liability for 1979. Petitioner's failure to compromise and pay 30% of the basic surtax liability for 1979 did not extinguish the assessment

[redacted]

for surtax. Thus, respondent cannot condone the surtax plus the interest and penalties corresponding thereto.

Anent the second issue, petitioner maintains that it is not liable for surtax for the year 1979 because it did not improperly accumulate any surplus beyond the reasonable needs of its business. To prove its point, petitioner offered as evidence the following documents:

a. Excerpts of the Minutes of Meetings of the Board of Directors from 1975 to 1985 [Exhs. B and C] showing that the surplus earnings of the corporation were retained for expansion purposes: such as, the construction of additional warehouses; purchase of additional handling equipment, payloader, dredging machine; to defray expenses for dredging the loading area (the wharf and berthing area) of the Terminal; and to replace the Fender Pile Clusters to ensure the safety of docking vessels and loading installation. Likewise, the corporation through its Board of Directors also declared stock dividends in 1977, 1978, 1981 and 1984.

b. The Analysis of Fixed Assets for the years 1975 to 1979 [Exh. D] and 1979 to 1989 [Exh. D-2], showing the purchases of equipment, furniture's and fixtures, fender clusters, cost of building improvements and installation of loader gears etc. all added to the Fixed Assets.

c. The Memorandum Register showing the purchase of a second hand payloader in 1980 costing P150,000.00 [Exh. D-5].

d. The Journal Voucher entries recording as capital expenditure the repairs and improvement of buildings and structures [Exhs. E, J-4, J-5 and J-6] and that of bulk handling installation [Exhs. F, J-2 and J-3].

e. The Certificates of Sale showing petitioner as the highest bidder and purchaser of railroad rails [Exh. G], payloader [Exh. H], second hand bulldozer-caterpillar [Exh. I], second hand mosler vault [Exh. J], and a second hand diebold vault [Exh. J-1].

Meanwhile, the circumstances relied upon by the examiner as indicating petitioner's intent to improperly accumulate surplus profits are manifested by the following acts, to wit: [Memorandum Report, dated June 29, 1984, pp. 76-77, BIR record.]

> "(1) In the 'Secretary's Certificate' (Signed by: Betty B. Pizana, Asst. Secretary) the Minutes of the Special Meeting of the Board of Directors held on April 20, 1976, which resolved that the surplus profits of the company as of December 31, 1975 be appropriated for plant expansion, however, in the same year the corporation made cash advances in the amount of P520,000.00 to its officers - employees taken up under the item of 'Advances to Employees - Cubao,' itemized in the 'Working Sheet, Schedule H.' As of December 31, 1979 the above-stated cash advances are still outstanding and have not earned interest income from 1975 to 1979.
>
> (2) Another important point that should be considered which was in contravention to its projected expansion were the advances to associated corporations/companies owned and/or controlled by Don J. Amado Araneta and family, under the item of 'OTHER ASSETS', the balances of which showed steady substantial increases from 1975 to 1979, as follows:

1975	1976	1977	1978	1979
P6,308,500	P7,633,572	P9,381,261	P16,312,884	P17,274,139

[redacted]

Included in the 'OTHER ASSETS' for 1979 is the item of 'Advances to Subscribers' in the amount of P930,000.00, which are deemed indirect loans to stockholders. According to Mr. Manuel A. Ferriols, Supervising Internal Auditor of the subject corporation, when asked about the substantial advances to associated corporations/companies owned or controlled by Don J. Amado Araneta and family, he revealed that majority of these associated corporations/companies are losing and therefore need new funding in their operations. Since, such was the case, the said cash advances must be retained by them for an unreasonably length of time and possibly might not even be repaid at all, therefore it cannot be reasoned out that the same is for the reasonable needs of the business.

(3) The said advances 'OTHER ASSETS' are not earning interest, while Philippine Bulk Corporation claimed an interest expense deduction for 1978 and 1979 in the amounts of P468,118.00 and P558,676.00, respectively. Without these cash advances to associated corporations/companies the taxpayer need not have to resort to borrowing because there will be sufficient funds for its operations and therefore would not be paying interest expenses from its loans, resulting in bigger profits.

(4) No reserve for plant expension were taken up in the financial statements and notes to financial statements for 1978 and 1979.

(5) Mr. Araneta failed to comment to Number (8) of my memorandum report dated January 25, 1984, neither did other representatives of the corporation, to the effect that no expansion has been undertaken up to December 31, 1979. He also failed to comment and/or object to the disallowance of 'Administration expenses' (unsupported) disallowed, therefore, the same is hereby reiterated.

> (6) If the corporation was really in need for additional funds for plant expansion, etc. the declaration of stock dividends of P612,900.00 and P7,966,206.00 out of the surplus profits in 1977 and 1978, respectively, and it seems that said dividends declaration are not necessary, but instead a 'Reserve for Plant Expansion' should have been made."

While it is true that respondent's assessment is presumptively correct, the Court also recognises that once the burden of proof has been overcome upon presentation of evidence to the contrary then the presumption of correctness disappears.

In this case, We think the petitioner was able to substantiate the burden placed upon it by law. As validly supported by the evidence, sometime in 1975-1976 the Board of Directors of petitioner decided to expand its business operation by the construction of additional warehouses (costing P4,000,000.00) and the purchase of additional handling equipments which projects have an estimated cost of P12,000,000.00. [Exh. B.] The corporation decided to appropriate P12,000,000.00 from its surplus earnings as of December 31, 1975 for this purpose. [p. 70, BIR record.]

The earned surplus of P9,758,418.00 as of December 31, 1977 was considered insufficient to meet the need for additional funds to improve its operations: to build additional storage facilities and to purchase additional handling equipments. Thus, from 1977 to 1978, petitioner declared stock dividends instead of cash dividends. [p. 71, BIR records.]

Then sometime in September, 1979, the Board of Directors appropriated the following amounts from surplus profits:

a. P30,000.00 to cover expenses for dredging [Exh. B];

b. P115,924.80 as cost for replacements of Fender Pile Clusters [Exh. B]; and

c. P150,000.00 as cost of a second hand payloader [Exhs. C and D-5].

For the period 1975 to 1979, petitioner also purchased fixed assets in the total amount of P728,677.00 [Exh. D-3]. Subsequently, other handling equipments were purchased by petitioner in line with its plan of expansion as reflected in the Certificates of Sales [Exhs. G to J-1, inclusive]. Thereafter, other equipments and improvements were capitalized as fixed assets from 1980 to 1989 in the sum of P3,178,741.00. [Exh. D-1.]

It was the accumulated surplus as found by the examiner for 1979 in the amount of P3,977,893.83, that have been treated as having been accumulated beyond the reasonable need of the business of petitioner. However, petitioner has proven that in its desire to improve its facilities an expansion program, worth almost P16,000,000.00, was necessary. The retained earnings as of December 31, 1979 amounting only to P3,934,752.00 [p. 31, BIR record] was not even enough to shoulder the P12,000,000.00 expansion program of the corporation in 1975. The plan was, however, partially implemented in 1979 and extended up to 1989.

In the direct examination of petitioner's witness, his testimony will show that the expansion project was extended from 1979 onwards, thus: [T.s.n., March 8, 1990, pp. 20-21]

"Q. Okay. Now Mr. dela Cruz, why were they spread in succeeding years and not in 1979 alone when you commenced the program of expansion by buying the payloader initially?

A. The operation of Pulupandan is dependent more on sugar productions and starting way back in 1977 there was an economic and financial difficulties on sugar industry and besides we have also not secured the necessary loans to finance the project considering the effects or considering the business situation on the area which is the sugar productions.

Q. Now, what are the other factors that you can attribute in spreading the implementation of the program originally set in 1974 to 1975 and 1979?

A. The main factor that contributed to this is the low production of sugar.

Q. And that is the reason why there was no asset acquisition for the years 1982, 1983, 1984 up to 1985, is that correct?

A. Yes, sir.

Q. Now, are there any other reasons why they were only implemented after 1979, the programs of expansion?

A. Well, for some other reasons was, for the implementation even though in the years 1982-83, 1983-84, and 1984-85 was

> minimal but in 1987-1988 we are hoping that sugar industry will improve that's why we have spent a little amount, more amount in 1987-1988 and 1988-1989."

Petitioner have successfully disputed the deficiency surtax assessment for 1979 by preponderance of evidence, showing the purpose for which the surplus accumulated during the year are to be used for expansion of its business. The only objections raised by respondent to petitioner's evidence was that the evidence marked as Exhs. B to J-6, inclusive, L and L-1 are self-serving. It must be observed that the Certificates of Sales are public documents issued by the Sheriff of the Department of Labor and Employment. Therefore, not hearsay evidence. The Minutes of Meetings of the Board of Directors of petitioner corporation as well as the Journal Vouchers and the Analysis of Fixed Assets Statements were prepared in the ordinary course of business.

When it was respondent's turn to present his evidence, he waived his right to present any evidence. He also failed to submit a memorandum for the guidance of the Court even when he was required to do so. He merely submitted the case for decision on a purely legal question based on the pleadings and the CTA records. Unfortunately, this case involves both legal and factual issues.

Settled is the rule that one who prays for judgment on the pleadings without offering proof as to the truth of his own allegations must be understood to admit the truth of all the material and relevant allegations of the opposing party, and to rest his motion for judgment on those allegations taken together with such as his own as are admitted in the pleadings. **[Bauermann v. Casas, et. al., 10 Phils. 386; Evangelista v. De la Rosa, 76 Phil. 115.]** Respondent may be considered to have not questioned seriously the evidence presented by petitioner proving that the purpose and reason for the accumulation of surplus profits for 1979 was within the reasonable needs of the business of petitioner. Moreso, the evidence of petitioner clearly establishes that there was no accumulation of profits beyond the needs of its business.

WHEREFORE, the decision of respondent ordering petitioner to pay the sum of P1,573,561.23, representing 25% surtax on improper accumulation of surplus profits for the year 1979, is hereby reversed. The deficiency surtax assessment for 1979 is **cancelled**. No costs.

SO ORDERED.

Quezon City, Metro Manila, August 10, 1993.

MANUEL K. GRUBA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that the above 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