REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

CEBU AIR, INC.,
Respondent.

CTA EB NO. 2013
(CTA Case No. 9106)

Present:
DEL ROSARIO, *P.J.*,
CASTAÑEDA, JR.,
UY,
FABON-VICTORINO,
MINDARO-GRULLA,
RINGPIS-LIBAN,
MANAHAN,
BACORRO-VILLENA, *and*
MODESTO-SAN PEDRO, *JJ.*

Promulgated:
JUN 30 2020
4:12 p.m.

x- -x

DECISION

RINGPIS-LIBAN, *J.*:

The Case

Before the Court is a Petition for Review seeking the nullification of the Amended Decision[1] dated September 27, 2018 ("Assailed Amended Decision") of the Court of Tax Appeals Second Division ("Second Division"), cancelling the assessment issued by Petitioner against Respondent for deficiency improperly accumulated earnings tax ("IAET") for taxable year 2010 in the amount of Php1,876,885,725.76.

The dispositive portion of the Assailed Amended Decision reads:

---

1 Penned by Associate Justice Juanito C. Castañeda, Jr., with Associate Justice Catherine T. Manahan concurring; Docket (CTA Case No. 9106), pp. 2147-2161.

> "**WHEREFORE**, premises considered, [Petitioner's] **Motion for Partial Reconsideration Re: Decision dated 11 January 2018** is **DENIED** for lack of merit. On the other hand, [Respondent's] **Motion for Reconsideration (of the Decision dated 11 January 2018)** is **GRANTED**. Accordingly, the dispositive portion of this Court's Decision dated January 11, 2018 is hereby amended to read as follows:
>
> > '**WHEREFORE**, premises considered, the assessment issued by [Petitioner] against [Respondent] for deficiency improperly accumulated earnings tax for taxable year 2010 in the amount of [Php]1,876,885,725.76 is **CANCELLED** and **WITHDRAWN**.
> >
> > **SO ORDERED**.'
>
> **SO ORDERED**."[2]

The Parties

Petitioner, is the duly appointed Commissioner of the Bureau of Internal Revenue ("BIR") who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code ("NIRC") of 1997, as amended, or other laws or portions thereof administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.[3]

Respondent Cebu Air, Inc., on the other hand, is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office address at 2/F Doña Juanita M. Lim Building, Cebu City. It is also registered with the BIR with Taxpayer Identification Number (TIN) 000-948-229-000. Petitioner is primarily incorporated to carry on, by means of aircraft of every kind and description, the general business of a private carrier, or charterer, engaged in the transportation of passengers, mail, merchandise, and freight, and in this connection to acquire, purchase, lease, construct, own, maintain, operate and dispose of airplanes and other aircraft of every kind and description, and also to own, purchase, construct, lease, operate and dispose of hangars, transportation depots, aircraft service stations and agencies, and other objects and service of a similar nature which may be necessary, convenient or useful as an auxiliary to aircraft transportation.[4]

---

[2] *Id.*, p. 2160.
[3] *Id.*, Decision, p. 1109.
[4] *Id*, Decision, pp. 1108-1109.

The Facts

The facts as found by the Second Division are as follows:

"[Respondent] filed its Annual Income Tax Return for TY 2010 on April 13, 2011.

On September 28, 2011, [Petitioner] issued a Letter of Authority (LOA) No. LOA-123-2011-00000044, authorizing Revenue Officers Lover Loveres, Vivian Pollisco, Angelita De Guzman and Group Supervisor (GS) Alicia Socorro Abutazil to examine petitioner's books of accounts and other accounting records for TY 2010. On even date, an electronic letter of authority (eLA) was issued and received by a certain C. Codoy on September 30, 2011.

On June 17, 2013, a Notice of Informal Conference was released. Then, a recommendation for the approval of the Preliminary Assessment Notice was issued on November 5, 2013.

[Petitioner] issued a Preliminary Assessment Notice (PAN) on November 22, 2013, assessing [Respondent] for deficiency income tax, improperly accumulated earnings tax (IAET), value-added tax (VAT), expanded withholding tax (EWT), and withholding tax on compensation (WTC) in the aggregate amount of [Php]11,816,203,003.60, inclusive of increments, for TY ended December 31, 2010, which was received on November 28, 2013. Petitioner protested the said assessment on December 12, 2013.

Upon recommendation, a Formal Letter of Demand (FLD) and a Final Assessment Notice 16 (FAN) were subsequently issued by [Petitioner] on September 1, 2014, which [Respondent] received on September 12, 2014; reducing the deficiency taxes in the total amount of [Php]6,915,683,288.99, inclusive of increments, for TY ended December 31, 2010. [Respondent] still disputed such assessment through letters it submitted on October 10, 2014 and December 8, 2014.

On March 20, 2015, [Petitioner] issued the Final Decision on Disputed Assessment (FDDA) signed by Mr. Nestor S. Valeroso (OIC-Assistant Commissioner of the BIR Large Taxpayers Service) after a recommendation for the issuance of the same was made, which partially granted [Respondent's] protest and reduced the assessed deficiency taxes from [Php]6,915,683,288.99 to [Php]3,335,018,786.27, which

M

[Respondent] received on April 16, 2015. Consequently, [Respondent] requested its reconsideration on May 15, 2015.

On June 29, 2015, [Respondent] received a Letter dated June 26, 2015, granting its request for reconsideration and further reduced the deficiency taxes from [Php]3,335,018,786.27 to [Ph]2,362,828,437.03, inclusive of increments, computed as follows:

Kind of Tax	Basic Tax	Surcharge	Interest	Compromise Penalty	Total
Income Tax	[Php]245,936,205.14		[Php]204,969,297.55	[Php]50,000.00	[Php]450,955,502.69
Improperly Accumulated Earnings Tax	880,011,612.70	[Php]220,002,903.18	776,821,209.00	50,000.00	1,876,885,725.76
Value Added Tax	1,195,809.00		1,049,035.73	75,000.00	2,319,844.73
Expanded Withholding Tax	16,215,123.62		14,977,576.55	50,000.00	31,242,700.18
Withholding Tax on Compensation	730,140.00		644,523.66	50,000.00	1,424,663.75
Total	**[Php]1,144,088,890.46**	**[Php]220,002,903.18**	**[Php]998,461,643.29**	**[Php]275,000.00**	**[Php]2,362,828,437.03**

As such, [Respondent] filed this Petition for Review on July 29, 2015. However, the subject of the petition was only the deficiency IAET assessment in the amount of [Php]1,876,885,725.76.

[Petitioner] filed an Answer on October 14, 2015.

On October 19, 2015, [Respondent] moved to amend the Petition for Review, which the Court granted and consequently, admitted the Amended Petition for Review on January 4, 2016. Thus, [Petitioner] filed an Amended Answer on January 18, 2016..."[5]

The Ruling of the Second Division

On January 11, 2018, the Second Division promulgated a Decision[6] denying the Petition for Review filed by herein Respondent. According to the Decision, Respondent has failed to: (1) overcome the disputable presumption of regularity in the performance of Petitioner's official duty in issuing and serving a Letter of Authority ("LOA") and (2) prove that it is exempt from the imposition of IAET. As a result, Respondent is liable for IAET for taxable year

---

[5] *Id.*, pp. 1109-1111.
[6] *Id.*, pp. 1108-1157.

2010 amounting to Php49,318,500.88, inclusive of the twenty-five percent (25%) surcharge, plus deficiency and delinquency interests.

Aggrieved, both Petitioner and Respondent filed their respective motions for reconsideration on January 29, 2018[7] and January 26, 2018[8]. On September 27, 2018, the Second Division issued the Assailed Amended Decision[9] denying Petitioner's "Motion for Partial Reconsideration Re: Decision dated 11 January 2018" for lack of merit, but at the same time granting Respondent's "Motion for Reconsideration (of the Decision dated 11 January 2018)".

The Second Division made the following findings in the Assailed Amended Decision: (1) Respondent duly received the electronic letter of authority (eLA) dated September 28, 2011, (2) Respondent failed to prove that it is a publicly-held corporation, (3) the assessment of IAET on earnings of Respondent in 2010 is within the scope of the LOA for the year 2010, and (4) additional paid-in capital ("APIC") is excess capital over and above the par but should be included in the paid-in capital/paid-up capital of Respondent for purposes of computing IAET. Most importantly, the court *a quo* ruled that Respondent sufficiently proved that it declared and paid cash dividends to its shareholders within one year from the close of the taxable year 2010. For this reason, Respondent is not liable for deficiency IAET for TY 2010. Consequently, the Second Division cancelled and withdrawn the assessment issued by Petitioner against Respondent for deficiency IAET for taxable year 2010 in the amount of Php1,876,885,725.76.

On October 16, 2018, Petitioner filed a "Motion for Reconsideration Re: Amended Decision dated 27 September 2018"[10], which the Second Division denied in a Resolution[11] dated January 23, 2019. In denying Petitioner's motion, the court *a quo* found no compelling reasons to modify or amend the Assailed Decision since Petitioner's arguments were mere reiterations.

The Proceedings in the Court of Tax Appeals En Banc

On February 14, 2019, Petitioner filed a "Motion for Extension of Time to File Petition for Review"[12], which the Court granted in a Minute Resolution dated February 18, 2019.[13]

On March 01, 2019, Petitioner filed the present "Petition for Review"[14].

---

[7] *Id.*, Motion for Partial Reconsideration Re: Decision dated 11 January 2018, pp. 1290-1305.
[8] *Id.*, Motion for Reconsideration (of the Decision dated 11 January 2018), pp. 1160-1182.
[9] *Id.*, pp. 2147-2161.
[10] *Id.*, pp. 2165-2181.
[11] *Id.*, pp. 2193-2196.
[12] Rollo, pp. 1-5. Record shows that Petitioner received the Assailed Resolution on January 31, 2019; Docket (CTA Case No. 9106), p. 2192.
[13] *Id.*, p. 6.

On March 21, 2019, the Court issued a Resolution[15] ordering Respondent to comment on the Petition for Review.

On April 12, 2019, Respondent filed its "Comment/Opposition (To the Petition for Review dated 1 March 2019)"[16] ("Comment/Opposition").

On May 03, 2019, the Court issued a Resolution[17] referring the instant case for mediation.

Since the parties decided not have their case mediated by the Philippine Mediation Center Unit – CTA, a Resolution[18] was issued on June 19, 2019 submitting the instant case for decision.

Assignment of Errors

Petitioner raises the following grounds in support of its petition:

1) Respondent failed to prove that it declared and paid cash dividends to its shareholders;

2) To consider the Retained Earnings reasonable for the needs of the business, the amount retained should only be up to one hundred percent (100%) of the paid-up capital or the amount contributed to the corporation representing the par value of the shares of stocks;

3) APIC is considered as excess capital over and above the par and is excluded from paid-up capital of Respondent;

4) Revenue Memorandum Circular ("RMC") No. 35-2011 merely called for strict application of Section 29 of the NIRC of 1997, as amended, and Revenue Regulations ("RR") No. 02-2001, which were already in force the moment the Tax Code and said RR were enacted; and

5) Compromise penalty should be properly imposed.[19]

---

14 *Id.*, pp. 7-25.
15 *Id.*, pp. 101-102.
16 *Id.*, pp. 103-116.
17 *Id.*, pp. 137-138.
18 *Id.*, pp. 146-147.
19 *Id.*, p. 10.

The Arguments of Parties

Petitioner mainly avers that the documents submitted by Respondent did not prove that the corporation actually paid cash dividends to its shareholders. The documents are mere self-serving evidence which should not have been considered by the Court in Division. Moreover, Petitioner claims that the presentation of additional evidence for the first time in Respondent's "Motion for Reconsideration (of the Decision dated 11 January 2018)" should not have been allowed, for the same constitutes forgotten evidence.

Petitioner also adds that under RMC No. 35-2011, the one hundred percent (100%) paid-up capital (which is used to compute the IAET of a corporation) is the amount actually paid by the shareholders, which is equivalent to but not more than the par value of the subscribed or outstanding capital stock. Hence, paid-up capital should not include Respondent's APIC, which is in excess of par value.

Furthermore, Petitioner submits that RMC No. 35-2011 is an internal issuance that interprets and clarifies the law. As such, the non-retroactivity of rulings under Section 246 of the NIRC of 1997, as amended, is not applicable in the present case.

Lastly, Petitioner contends that he correctly imposed compromise penalty against Respondent. For failure of Respondent to file return and pay the tax due, it is liable for compromise penalties provided for in Revenue Memorandum Order ("RMO") No. 7-2015.

On the other hand, Respondent in its Comment/Opposition counters that Petitioner failed to raise valid grounds to warrant the reversal of the court *a quo*'s rulings. *First*, the evidence on record sufficiently prove Respondent's declaration and payment of cash dividends to its shareholders, out of its earnings from taxable year 2010, thereby eliminating any improperly accumulated earnings that would be subject to IAET. *Second*, law and jurisprudence have settled that APIC should be included in counting the paid-up capital of the corporation. *Third*, RMC No. 35-2011 is void because it goes beyond, and does not merely clarify or interpret the existing law on IAET. *Lastly*, compromise penalty should not be imposed for it is only collected in case of a settlement of criminal liability, upon mutual agreement of the parties.

The Ruling of the Court

Timeliness of Petition

The Court in Division issued the Assailed Resolution, denying Petitioner's "Motion for Reconsideration Re: Amended Decision dated 27

September 2018", on January 23, 2019. Petitioner received said Resolution on January 31, 2019. Pursuant to Rule 4, Section 2(a)(1)[20] in relation to Rule 8, Section 3(b)[21] of the Revised Rules of the Court of Tax Appeals[22] (RRCTA), Petitioner had fifteen (15) days from date of receipt of the resolution or until February 15, 2019 within which to file his petition for review.

On February 14, 2019, Petitioner timely filed a "Motion for Extension of Time to File Petition for Review", praying for an extension of fifteen (15) days or until March 02, 2019 within which to file the petition for review. The Court granted the same in a Minute Resolution dated February 18, 2019.

On March 01, 2019, Petitioner timely filed the present "Petition for Review". Hence, the Court *En Banc* validly acquired jurisdiction.

We now proceed to the merits of the case.

At the outset, Petitioner presents no new argument to persuade Us that it has a meritorious case. In fact, the instant Petition for Review is a reproduction of the "Motion for Reconsideration Re: Amended Decision dated 27 September 2018"[23] filed by Petitioner on October 16, 2018 before the Second Division, which the latter noted as mere rehash of the same facts and issues already passed upon and resolved in the Assailed Amended Decision.[24]. Nevertheless, we will discuss at length, once again, the demerits of Petitioner's arguments which may serve as a guidepost in deciding issues of similar nature in the future.

---

[20] **Sec. 2.** *Cases within the jurisdiction of the Court en banc.* — The Court *en banc* shall exercise exclusive appellate jurisdiction to review by appeal the following:

(a) Decisions or resolutions on motions for reconsideration or new trial of the Court in Divisions in the exercise of its exclusive appellate jurisdiction over:

xxx xxx xxx

(1) Cases arising from administrative agencies – Bureau of Internal Revenue, Bureau of Customs, Department of Finance, Department of Trade and Industry, Department of Agriculture; x x x

[21] **Sec. 3.** *Who may appeal; period to file petition.* — x x x

(b) A party adversely affected by a decision or resolution of a Division of the Court on a motion for reconsideration or new trial may appeal to the Court by filing before it a petition for review within fifteen days from receipt of a copy of the questioned decision or resolution. Upon proper motion and the payment of the full amount of the docket and other lawful fees and deposit for costs before the expiration of the reglementary period herein fixed, the Court may grant an additional period not exceeding fifteen days from the expiration of the original period within which to file the petition for review. (Rules of Court, Rule 42, sec. 1a)

[22] A.M. No. 05-11-07-CTA, November 22, 2005.

[23] Docket (CTA Case No. 9106), pp. 2165-2181.

[24] *Id.*, Resolution dated January 23, 2019, p. 2196.

The Second Division did not err in allowing Petitioner to submit supplemental evidence

In a Resolution[25] issued on May 29, 2018, the Second Division allowed Respondent to present additional documents, which were attached to its "Motion for Reconsideration (of the Decision dated 11 January 2018)", stating that there is valid justification to do so, to wit:

> "After a careful review of the arguments raised by the parties, the Court finds that **allowing the presentation of the documents attached to the instant motion for reconsideration will secure a just and complete disposition of the instant case.**"[26]

Admission of additional evidence is addressed to the sound discretion of the court.[27] Considerable latitude is allowed and such discretion will not be disturbed absent any showing of abuse or arbitrariness on the part of the court trying the case. Moreover, submission and presentation of supplemental evidence may be allowed if the evidence is clearly material to establish the party's cause. Consequently, it is not the first time where the Court in Division permitted a party to present and offer the documents attached to its motion for reconsideration to substantiate its arguments thereon.

Thus, We find that the court *a quo* properly exercised its discretion in ruling that there is sufficient basis for the presentation of additional evidence. In this case, the evidence received seeks to prove that there was payment by Respondent of cash dividend to its stockholders on May 12, 2011. Indeed, this is a significant factual circumstance necessary to answer whether or not the IAET assessment has basis in law.

The Second Division properly invalidated the IAET assessment

The Court will now proceed to determine whether Respondent is liable for deficiency IAET for taxable year 2010.

Pertinent to the resolution of this issue is Section 29 of the NIRC of 1997, as amended, which is reproduced below:

---

[25] *Id.*, pp. 1357-1359.
[26] *Emphasis and underscoring supplied.*
[27] *See BPI-Family Savings Bank, Inc. v. Court of Appeals, Court of Tax Appeals and The Commissioner of Internal Revenue*, G.R. No. 122480, April 12, 2000.

"SEC. 29. *Imposition of Improperly Accumulated Earnings Tax.* -

(A) *In General.* - In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof, an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.

(B) *Tax on Corporations Subject to Improperly Accumulated Earnings Tax.* -

(1) *In General.* - The improperly accumulated earnings tax imposed in the preceding Section shall apply to every corporation formed or availed **for the purpose of avoiding the income tax** with respect to its shareholders or the shareholders of any other corporation, **by permitting <u>earnings</u> <u>and</u> <u>profits</u> <u>to</u> <u>accumulate</u> instead of being divided or distributed**.

(2) *Exceptions.* - The improperly accumulated earnings tax as provided for under this Section shall not apply to:

(a) Publicly-held corporations;
(b) Banks and other nonbank financial intermediaries; and
(c) Insurance companies.

(C) *Evidence of Purpose to Avoid Income Tax.* -

(1) *Prima Facie Evidence.* - the fact that any corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members.

(2) *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 members unless the corporation, by the clear

N

preponderance of evidence, shall prove to the contrary.

(D) *Improperly Accumulated Taxable Income.* - For purposes of this Section, the term 'improperly accumulated taxable income' means taxable income adjusted by:

(a) Income exempt from tax;
(b) Income excluded from gross income;
(c) Income subject to final tax; and
(d) The amount of net operating loss carry-over deducted;

And reduced by the sum of:

(a) Dividends actually or constructively paid; and
(b) Income tax paid for the taxable year.

Provided, however, That for corporations using the calendar year basis, the accumulated earnings tax shall not apply on improperly accumulated income as of December 31, 1997. In the case of corporations adopting the fiscal year accounting period, the improperly accumulated income not subject to this tax, shall be reckoned, as of the end of the month comprising the twelve (12)-month period of fiscal year 1997-1998.

(E) *Reasonable Needs of the Business.* - For purposes of this Section, the term '*reasonable needs of the business*' includes the reasonably anticipated needs of the business."[28]

As expressed in the above provision, IAET is the income tax imposed at the rate of ten percent (10%) on the improperly accumulated taxable income of a corporation, if its earnings and profits are accumulated (*i.e.,* undistributed) instead of distributing them to the stockholders. It is essentially a penalty tax designed to compel corporations to distribute earnings so that the said earnings by shareholders could, in turn, be taxed.[29]

To be liable for IAET, the corporation must have an improperly accumulated taxable income for the current year. Section 5[30] of RR No.

---

[28] *Emphasis supplied.*
[29] *Cyanamid Philippines, Inc. v. The Court of Appeals, The Court of Tax Appeals and Commissioner of Internal Revenue,* G.R. No. 108067, January 20, 2000.
[30] **SEC. 5. Tax Base of Improperly Accumulated Earnings Tax.** - For corporations found subject to the tax, the "*Improperly Accumulated Taxable Income*" for a particular year is first determined by adding to that year's taxable income the following:
a. income exempt from tax;

02-2001[31], the regulation implementing Section 29 of the NIRC of 1997, as amended, provides the formula on how to determine if there is an improperly accumulated taxable income:

Taxable Income
Add:

- Income Exempt from Tax;
- Income Excluded from Gross Income;
- Income Subject to Final Tax; and
- Amount of Net Operating Loss Carry-Over ("NOLCO") Deducted.

Deduct:

- Income Tax Paid/Payable for the Taxable Year;
- Dividends Actually or Constructively Paid/Issued from the Applicable Year's Taxable Income; and
- Amount Reserved for the Reasonable Needs of the Business

Improperly Accumulated Taxable Income

Following Section 29 of the NIRC of 1997, as amended and RR No. 02-2001, the Second Division was able to calculate in the Assailed Amended Decision that Petitioner has no improperly accumulated taxable income, to wit:[32]

Taxable Income		Php (533,255,953.00)
Add:	Non-Taxable Income and Income Subject to Final Tax	1,289,210,989.00
	Income exempt from Tax;	6,663,510,001.00
Total		7,419,465,037.00
Add:	Retained Earnings from prior years	1,993,887,640.00
Less:	Amount that may be retained	9,018,804,670.00
	Cash dividends declared on April 14, 2011	1,833,709,650.00
Improperly Accumulated Taxable Income		**Php (1,439,161,643.00)**

b. income excluded from gross income;
c. income subject to final tax; and
d. the amount of net operating loss carry-over (NOLCO) deducted.

The taxable income as thus determined shall be reduced by the sum of:

a. income tax paid/payable for the taxable year;
b. dividends actually or constructively paid/issued from the applicable year's taxable income;
c. amount reserved for the reasonable needs of the business as defined in these Regulations emanating from the covered year's taxable income.

The resulting "*Improperly Accumulated Taxable Income*" is thereby multiplied by 10% to get the Improperly Accumulated Earnings Tax (IAET).

[31] February 12, 2001.

[32] Docket (CTA Case No. 9106), p. 2158.

Accordingly, Petitioner now comes to this Court in order to dispute two (2) line items found in the computation made by the Court in Division, namely the amount that may be retained and cash dividends declared on April 14, 2011.

1) Amount that may be retained

The first disputed line item pertains to the amount that may be retained or reserved "for the reasonable needs of the business" as expressed under Section 29(c)(2) of the NIRC of 1997, as amended.

RR No. 02-2001 considers accumulation of earnings up to one hundred percent (100%) of the paid-up capital of the corporation as within the "reasonable needs of the business". Likewise, earnings that are reserved for a justified purpose (*i.e.*, investment in business, stocks, bonds or other long-term securities) are also considered within the purview of "reasonable needs of the business."[33]

In the case at bar, the Second Division ruled in its Decision dated January 11, 2018 that "the amount that may be retained" pertains to the paid-up capital of Respondent, which included both the capital stock as well as the capital paid in excess of par value or APIC, in conformity with Respondent's view on the matter.

However, Petitioner contends that the paid-up capital of a corporation only refers to "one hundred percent (100%) of the paid-up capital or the amount contributed to the corporation representing the par value of the shares of stock" as provided for under RMC No. 35-2011. According to Petitioner, any excess capital over and above the par shall be excluded.

We are not persuaded of Petitioner's position. We agree with the court *a quo*'s ruling that for purposes of calculating the IAET, APIC should be included in the computation of "paid-up capital".

Fundamentally, APIC is not earnings or profit, but a part of capital.

---

[33] SEC. 7. Determination of Purpose to Avoid Income Tax. –

xxx xxx xxx

The following are prima facie instances of accumulation of profits beyond the reasonable needs of a business and indicative of purpose to avoid income tax upon shareholders:

a. Investment of substantial earnings and profits of the corporation in unrelated business or in stock or securities of unrelated business;
b. Investment in bonds and other long-term securities;
c. Accumulation of earnings in excess of 100% of paid-up capital, not otherwise intended for the reasonable needs of the business as defined in these Regulations.

In *National Telecommunications Commission v. Honorable Court of Appeals and Philippine Long Distance Telephone Company*[34], "capital" was defined to include both the par value and the premium over par value, *viz.*:

> "The **capital** subscribed **is** the total amount of the capital that persons (subscribers or shareholders) have agreed to take and pay for, which need not necessarily be, and **can be more than, the par value of the shares**. In fine, it is **the amount that the corporation receives, inclusive of the premiums if any, in consideration of the original issuance of the shares**."[35]

This premium over par value in accounting parlance is termed as APIC. It is the money an investor pays above and beyond the par value of a stock. It occurs when an investor buys a stock which is over the par value. The amount pertaining to the par value shall be recorded as capital stock, while the amount which is in excess of the par shall be recorded as APIC.

As previously stated, IAET is in the nature of a penalty on the corporation for the improper accumulation of its earnings. APIC is part and parcel of capital. It is not earnings or profit. Therefore, APIC should be a component of paid-up capital. It should not be excluded in the computation of reasonable needs of the business for IAET purposes. *Ratio legis est anima.* The spirit rather than the letter of the law. A statute must be read according to its spirit or intent, for what is within the spirit is within the statute although it is not within its letter.[36]

Moreover, in Section 2 of Securities and Exchange Commission ("SEC") Memorandum Circular ("MC") No. 11-2008[37], the SEC categorically defined paid-in capital as "the amount of outstanding capital stock and additional paid-in capital or premium paid over the par value of shares".

It is not the first time where technical rules or terms used in taxation find their meaning under corporate law. As an aid to taxation law, resort to corporate law may be made.

This is because a statute should be construed not only to be consistent with itself but also to harmonize with other laws on the same subject matter, as to form a complete, coherent and intelligible system.[38] *Interpretare et concordare leges legibus est optimus interpretandi modus.*

N

---

[34] G.R. No. 127937, July 28, 1999.
[35] *Emphasis and underscoring supplied.*
[36] *Rodolfo G. Navarro, Et. Al. v. Executive Secretary Eduardo Ermita, Et. Al.*, G.R. No. 180050, April 12, 2011.
[37] December 05, 2008.
[38] *Dreamwork Construction, Inc. v. Cleofe S. Janiola and Hon. Arthur A. Famini,* G.R. No. 184861, June 30, 2009 *citing* R.E. Agpalo, Statutory Construction 97 (4th ed., 1998).

MC No. 11-2008 was issued in relation to the second paragraph of Section 43 of the Corporation Code which prohibits corporations from retaining surplus profits in excess of one hundred percent (100%) of their paid-in capital stock, subject to certain exceptions. The pertinent portion of Section 43 of the Corporation Code provides:

> "**Sec. 43.** *Power to declare dividends.* –
>
> xxx xxx xxx
>
> Stock corporations are prohibited from retaining surplus profits in excess of one hundred (100%) percent of their paid-in capital stock, except: (1) when justified by definite corporate expansion projects or programs approved by the board of directors; or (2) when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its/his consent, and such consent has not yet been secured; or (3) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is need for special reserve for probable contingencies. (n)."

Notably, Section 29 of the NIRC of 1997, as amended, and the second paragraph of Section 43 of the Corporation Code cover the same specific subject matter, that is, accumulation of profits beyond the reasonable needs of business. They also have the same purpose which is to discourage tax avoidance through corporate earnings accumulation.

Statutes *in pari materia* should be read and construed together because enactments of the same legislature on the same subject are supposed to form part of one uniform system; later statutes are supplementary or complimentary to the earlier enactments and in the passage of its acts the legislature is supposed to have in mind the existing legislations on the subject and to have enacted its new act with reference thereto.[39]

Ultimately, although the definition of paid-up capital is not found in RR No. 02-01, the same is defined in at least two regulations of BIR, RR No. 14-01[40] and RR No. 10-07[41].

In RR No. 14-01 which implements the application of NOLCO under Section 34(D)(3) of the NIRC of 1997, as amended, "paid-up capital of a corporation" is defined in Section 3.5 as "total amount paid by stockholders for

---

[39] *Purificacion M. Vda. De Urbano, Et. Al. v. Government Service Insurance System (GSIS), Et. Al.*, G.R. No. 137904, October 19, 2001.
[40] August 27, 2001.
[41] July 18, 2007.

their subscriptions in shares of stock of the corporation, including any amount paid over and above the par value or stated value of the share of stock (e.g., premium on capital)".

Whereas in RR No. 10-07, which provides for guidelines on tax payments thru Electronic Filing and Payment System (EFPS), "paid-up capital stock" is defined in Section 2.13 as "the portion of authorized capital stock which has been both subscribed and paid. It also includes amount paid for the subscription of stock in a corporation, including amount paid in excess of par value, net of treasury stock".

The interpretation in RMC No. 35-2001 is inconsistent with the above BIR issuances on what constitutes "paid-up capital." In case of conflicting provisions found in BIR regulations, the provisions of revenue regulations, which are issued by the Secretary of Finance upon the recommendation of the Commissioner of Internal Revenue ("CIR"), prevail over that of revenue memorandum circulars, which are issued by the CIR.[42]

It must be stressed that Section 4 of the NIRC of 1997, as amended, provides that the CIR has the "power to interpret the provisions of the [Tax] Code...**subject to the review by the Secretary of Finance**". Ergo, the interpretation of the Secretary of Finance, as embodied in revenue regulations, prevails over regulations issued by the CIR.

2) Cash dividends declared and paid

To be a valid deduction in the computation of improperly accumulated taxable income, the dividends must be "declared and paid or issued not later than one year following the close of the taxable year" following Section 6[43] of RR No. 02-2001.

Since the period under review in the instant case pertains to taxable year 2010, Respondent must prove that it was able to pay dividends to its stockholders on or before December 31, 2011.

During the proceedings in the Second Division, Respondent presented evidence supporting its allegation that it paid on May 12, 2011 a regular cash dividend of Php2.00 per share and a special cash dividend of Php1.00 per share, or an aggregate amount of Php1,833,709,650.00 to all stockholders of

---

[42] *See Bank of Philippine Islands v. Commissioner of Internal Revenue*, G.R. No. 144653, August 28, 2001 *citing Victorias Milling Co., Inc. v. Social Security Commission*, G.R. No. L-16704, March 17, 1962 for the distinction between an interpretative rule and a legislative rule.

[43] **SEC. 6. Period for Payment of Dividend/Payment of IAET.** - The dividends must be declared and paid or issued not later than one year following the close of the taxable year, otherwise, the IAET, if any, should be paid within fifteen (15) days thereafter.

record as of April 14, 2011. To reiterate, it was well within the discretion of the court *a quo* to allow Respondent to submit such supplementary evidence.

A perusal of the supporting documents, taken all together, shows indeed that there was a declaration and payout of cash dividend to Respondent's stockholders well within the one-year period following the close of taxable year 2010.

Thus, We agree with the Second Division in disposing the issue in the following fashion:

> "To prove the alleged dividend declaration, [Respondent] submitted the original or certified true copy (CTC) of the following documents to support its motion for reconsideration:
>
> - Audited Financial Statements of Cebu Air, Inc. for the year ended December 31, 2011
> - Monthly Remittance Return of Final Income Taxes Withheld (BIR form No. 1601-F) for the month of May 2011 relating to [Respondent's] cash dividends paid in 2011
> - Secretary's Certificate executed by Atty. Rosalinda F. Rivera on March 21, 2011 and attested by Mr. Lance Y. Gokongwei on the declaration of dividends approved by the Board of Directors on March 17, 2011
> - SEC Form 17-C filed by [Respondent] on March 18, 2011.
>
> Upon examination of these pieces of evidence, the Court finds that the Parent Company Audited financial Statements for the year ended December 31, 2011 (specifically, the Statement of Changes in Equity, the Cash Flows from Financing Activities, and Note 18 Equity, Notes to the Financial Statements), the Secretary's Certificate, and the SEC Form 17-C show that [Respondent] declared cash dividends on March 17, 2011 for shareholders on record as of April 14, 2011 and was paid on May 12, 2011.
>
> On the other hand, the Monthly Remittance Return of Final Income Taxes Withheld (BIR Form No. 1601-F) provided by [Respondent] for the month of May 2011 does not reflect the amount of Php1,833,709,650.00 as the tax base, since cash dividends from domestic corporation paid to another domestic corporation are exempt from taxation.

N

> When these supporting documents are all taken together, it is sufficient to prove that [Respondent] declared and paid cash dividends to its shareholders."[44]

Having established that the APIC is part of paid-up capital and that Respondent was able to fully substantiate that it declared and paid cash dividends to its stockholders during 2011, We see no reversible error for the court *a quo*'s computation of improperly accumulated taxable income in its Amended Decision.

From all of the foregoing, We agree with the Second Division that Respondent has no improperly accumulated taxable income and that Petitioner's IAET assessment lacks factual and legal basis.

Compromise penalty applies only in the settlement of criminal liability

Petitioner insists that Respondent is liable for compromise penalty.

We do not agree.

A compromise penalty is a certain amount of money which the taxpayer pays to compromise a tax violation. This is usually paid in lieu of a criminal prosecution.[45]

The nature of a compromise penalty is explained in the case of *Commissioner of Internal Revenue v. Armando L. Abad*[46], to wit:

> "**a compromise implies agreement. One party cannot impose it upon the other.** If an offer of compromise is rejected by the taxpayer, as in this case, the Commissioner of Internal Revenue should file a criminal action if he believes that the taxpayer is criminally liable for violation of the tax law as the only way to enforce a penalty. As penalty can be imposed only on a finding of criminal liability."[47]

---

[44] Docket (CTA Case no. 9106), pp. 2156-2157.
[45] Aban, *Law of Basic Taxation in the Philippines* (2001), p. 237.
[46] G.R. No. L-19627, June 27, 1968.
[47] *Emphasis supplied.*

Based on the foregoing, the nature of a compromise penalty implies a mutual agreement between the parties and it cannot be imposed without the consent of the other.

In the instant case, there is no showing that Respondent consented to the compromise penalty. Hence, its imposition should be deleted.

More importantly in tax cases, compromise penalty is applicable only in the settlement of criminal liability. Considering that this case is merely civil in nature, no compromise penalty may be imposed against Respondent.

RMO No. 7-15 expressly provides that "compromise penalties are only amounts suggested in settlement of criminal liability."

Thus, the Court *En Banc* finds no basis for petitioner's imposition of compromise penalty.

WHEREFORE, premises considered, the Petition for Review filed with the Court *En Banc* on March 01, 2019 is **DENIED** for lack of merit. Accordingly, the September 27, 2018 Amended Decision and January 23, 2019 Resolution in CTA Case No. 9106 are **AFFIRMED**.

SO ORDERED.

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

ERLINDA P. UY
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice