REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

1MAPLE SALES, INC., Petitioner,	**CTA CASE NO. 8925**
	Members:
-versus-	Castañeda, Jr., *Chairperson, and* Casanova, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** DEC 1 6 2016 1:30 p.m.

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D E C I S I O N

CASTAÑEDA, JR., *J.*:

STATEMENT OF THE CASE

This is a Petition for Review[1] filed on November 10, 2014 by 1Maple Sales, Inc. to seek the reversal and setting aside of the Final Assessment Notice issued by the Commissioner of Internal Revenue against it in the aggregate amount of ₱13,301,158.15, representing alleged deficiency Improperly Accumulated Earnings Tax (IAET) inclusive of surcharges and interest for taxable year 2009.

STATEMENT OF FACTS

Petitioner 1Maple Sales, Inc. is a corporation duly organized and existing under the laws of the Philippines, with business address at

[1] Petition for Review, Docket, Vol. I, pp. 6-21.

Abelarde Compound, Brgy. Pusok, Cebu City.[2] It is engaged in the business of trading goods on wholesale or retail basis, dealing mainly in cigarette products produced by Fortune Tobacco Corporation.[3]

Petitioner is registered with the Securities and Exchange Commission (SEC) as evidenced by its SEC Certificate No. CS 20059949.[4] It is likewise registered with the Bureau of Internal Revenue (BIR) under Revenue District Office (RDO) No. 80 of Revenue Region No. 13, bearing Taxpayer Identification No. (TIN) 242-452-902-000.[5] It was classified by the BIR as a Large Taxpayer under the jurisdiction of Large Taxpayers Service.[6]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue, empowered to perform the duties of his office, including, among others, the approval of claims for refund or tax credit as provided by law. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On May 14, 2010, a Letter of Authority (LOA) was issued authorizing Revenue Officers Juan Luna, Jr., Gloria Morales, Alexander Atienza, Melchor Gaytos, and Teodore Maroket to conduct the examination of the books of accounts and other accounting records of petitioner for all internal revenue taxes for taxable year 2009.[7]

On January 15, 2013, petitioner received a Notice of Informal Conference.[8] Subsequently, petitioner received a copy of the Preliminary Assessment Notice (PAN) dated September 16, 2013 with attached Details of Discrepancies on November 22, 2013.[9]

On March 19, 2014, petitioner received a Formal Letter of Demand (FLD) dated March 17, 2014, together with Final Assessment Notice (FAN) No. ELTAD-II-IE-09-0002, assessing petitioner of deficiency IAET for taxable year 2009.[10] gc

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[2] Par. 2, Joint Stipulation of Facts and Issues (JSFI), Docket, Vol. I, p. 149.
[3] Par. 4, JSFI, Docket, Vol. I, p. 150.
[4] Par. 3, JSFI, Docket, Vol. I, p. 150.
[5] Par. 5, JSFI, Docket, Vol. I, p. 150.
[6] Par. 6, JSFI, Docket, Vol. I, p. 150.
[7] Par. 7, JSFI, Docket, Vol. I. p. 150.
[8] Par. 8, JSFI, Docket, Vol. I, p. 150.
[9] Par. 9, JSFI, Docket, Vol. I, p. 150.
[10] Par. 10, JSFI, Docket, Vol. I, p. 150.

On April 15, 2014, petitioner filed its administrative protest by way of a request for reconsideration[11] with the BIR. In view of respondent's failure to act on petitioner's protest, petitioner filed the present Petition for Review before this Court on November 10, 2014.

Respondent filed his Answer[12] through registered mail on February 20, 2015 and received by the Court on February 26, 2015, interposing the following Special and Affirmative Defenses:

> "4. The 2009 deficiency assessment for Improperly Accumulated Earnings Tax (IAET) was issued in accordance with law, jurisprudence and administrative issuances.
>
> **Assessment is well supported by facts and laws**
>
> 5. Assessments are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously.
>
> 6. In the present case, petitioner is being taxed for Improperly Accumulated Earnings Tax, under Section 29 of the NIRC, as amended. Relevant provisions thereto are quoted herein as follows:
>
> **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

[11] Exhibit "P-4", Docket, Vol. II, pp. 501-511.
[12] Docket, Vol. I, pp. 105-112.

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 earnings and profits to accumulate instead of being divided or distributed.

xxx

(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 preponderance of evidence, shall prove to the contrary.

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7. The imposition and collection of IAET is more particularly discussed under Revenue Regulations (RR) No.

2-2011 and Revenue Memorandum Circular (RMC) No. 35-2011.

RR No. 2-2011

SEC. 2. Concept of Improperly Accumulated Earnings Tax (IAET). – Pursuant to Section 29 of the Code, there is imposed for each taxable year, in addition to other taxes imposed under Title II of the Tax Code of 1997, a tax equal to 10% of the improperly accumulated taxable income of corporations formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or 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. The rationale is that if the earnings and profits were distributed, the shareholders would then be liable to 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. Thus, a tax is being imposed in the nature of a penalty to the corporation for the improper accumulation of its earnings and as a form of deterrent to the avoidance of tax on shareholders who are supposed to pay dividends tax on the earnings distributed to them by the corporation.

The touchstone of the liability is the purpose behind the accumulation of the income and not the consequences of the accumulation. Thus, if the failure to pay dividends is due to some other causes, such as the use of undistributed earnings and profits for the **reasonable needs of the business**, such purpose would not generally make the accumulated or undistributed earnings subject to the tax. However, if there is a determination that a corporation has accumulated income beyond the reasonable needs of the business, the 10% improperly accumulated earnings tax shall be imposed.

8. Petitioner contends that the Final Assessment Notice (FAN) failed to state the facts and laws upon which

the assessment was based in violation of Sec. 228 of the NIRC, as amended.

9. However, a cursory reading of the Final Assessment Notice (FAN), Formal Letter of Demand (FLD) and the Details of Discrepancy shows that it has complied with the minimum requirements specified under Sec. 228 of the NIRC.

10. The FAN, FLD and the attached Details of Discrepancy specifically discloses the facts and laws rules [sic] and regulations on which they are based. As indicated therein, the petitioner is liable for Improperly Accumulated Earnings Tax as imposed under Sec. 29 of the NIRC and as implemented by RR No. 2-2001 and RMC No. 35-2011.

11. The amount of the deficiency tax is also indicated therein as follows:

Improperly Accumulated Earnings Tax	
Taxable Income for 2009	P 71,738,452.00
Add: Income excluded from Gross Income	1,943,010.00
	73,681,462.00
Less: Income Tax Paid	21,521,536.00
Total	52,159,926.00
Add: Retained Earnings from Prior Years	21,411,392.00
Less: Amount that may be retained	(3,500,000.00)
Net Retained Earnings	P 70,071,318.00
Improperly Accumulated Earnings Tax	P 7,007,131.80
Add: Surcharge	1,751,782.95
Interest	4,492,243.40
Compromise Penalty	50,000.00
TOTAL DEFICIENCY TAX PER INVESTIGATION	**P13,301,158.15**

12. Based on the foregoing, the FAN clearly stated the facts and the laws on which it is based.

Petitioner is liable for Improperly Accumulated Earnings Tax

13. The taxpayer is a closely-held corporation under the Lucio Tan Group of Companies and is therefore covered

by the provisions of the IAET under Sec. 29 of the Tax Code, as amended, and implemented by RR No. 2-2001 and RMC No. 35-2011.

14. In the course of the informal conference, the subject taxpayer submitted a notarized Corporate Secretary's Certificate stating that 100% of the retained earnings as of December 31, 2009 have been appropriated. This appropriation is also reflected in its audited financial statements for the taxable year under audit.

15. However, petitioner's justification regarding its actual use of the funds appropriated was rejected by respondent.

16. Moreover, petitioner submitted that the purpose of the retention of the earnings was for corporate expansion. However, this planned expansion never took place.

17. An analysis of the cash flow statement disclosed that the subject amount, along with other various sources of funds, were used to pay the corporation's current liabilities as shown by the decrease in the amount of petitioner's Trade and Other payables account in the succeeding year of 2010.

18. This runs contrary to the Board Resolution passed and approved by the Board of Directors on February 12, 2010 authorizing the corporation to retain One Hundred Ten Million Pesos (P110,000,000.00) of its earnings for 'planned expansion.'

19. Under Sec. 29 of the NIRC, petitioner must prove by clear preponderance of evidence that the accumulation of the earnings or profits are not for the purpose of avoiding the tax upon its members or association. Respondent maintains that petitioner failed to establish that the accumulation was done without the intention to avoid the payment of taxes.

20. As the said amount was utilized to pay for petitioner's Trade and Other Payables account, it was improper to accumulate these profits. Payment of Trades and other Payables account does not fall under the purview of reasonable needs of the business relating to the accumulation of retained earnings.

Final discussions

21. Assessments are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously.

22. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise the presumption of correctness of tax assessment stands. The presumption in favor of the correctness of tax assessment stands where evidence to the contrary is wanting. Hence, the assessment issued against petitioner is imbued with factual and legal bases.

23. All presumptions are in favor of the correctness of tax assessments. Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice."

The Pre-Trial Conference[13] was set on April 16, 2015. Petitioner filed its Pre-Trial Brief[14] on April 13, 2015; while respondent filed through registered mail an Urgent Motion to Defer Pre-Trial Conference[15] on April 8, 2015 and received by the Court on April 16, 2015.

[13] Notice of Pre-Trial Conference, Docket, Vol. I, p. 115.
[14] Docket, Vol. I, pp. 119-125.
[15] Docket, Vol. I, pp. 128-130.

The parties filed their Joint Stipulation of Facts and Issues[16] on May 8, 2015, which was approved by the Court upon issuance of the Pre-Trial Order[17] on May 18, 2015.

On July 15, 2015, petitioner filed its Formal Offer of Evidence[18], offering Exhibits "P1", "P2", "P3", "P4", "P5", "P6", "P7", "P8", "P9", "P10", "P11", "P11-a", "P12", "P13", "P14", "P15", "P15-a", "P16", "P17", "P18", "P19", "P21", and "P22" as its documentary exhibits. Respondent filed his Comment To Petitioner's Formal Offer of Evidence (Dated 15 July 2015)[19] on July 20, 2015.

In the Resolution[20] dated August 25, 2015, the Court admitted Exhibits "P1", "P2", "P3", "P4", "P5", "P6", "P7", "P8", "P9", "P10", "P11", "P11-a", "P12", "P13", "P14", "P15", "P15-a", "P16", "P17", "P21", and "P22", but denied Exhibits "P18" and "P19" for failure to submit the originals for comparison.

On September 14, 2015, respondent filed his Formal Offer of Evidence[21], offering Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-7-A", and "R-8" as his documentary exhibits. Petitioner filed its Comments (to the Respondent's Offer of Documentary Evidence)[22] on September 21, 2015.

Meanwhile, on September 17, 2015, petitioner filed a Motion to Admit (the attached Motion for Reconsideration with Formal Offer of Additional Evidence for the Petitioner Arising from Cross-Examination of Respondent's Witness)[23]. In its Motion for Reconsideration with Formal Offer of Additional Evidence, petitioner sought the admission of Exhibits "P18" and "P19" and at the same time offered Exhibits "P-23" to "P-23-9", "P-23-8-A", and "P-23-9-A" as its additional documentary exhibits. However, respondent failed to file his comment to petitioner's Motion for Reconsideration.[24]

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[16] Docket, Vol. I, pp. 149-154.
[17] Docket, Vol. I, pp. 156-161.
[18] Docket, Vol. II, pp. 487-496.
[19] Docket, Vol. II, pp. 590-592.
[20] Docket, Vol. II, pp. 595-596.
[21] Docket, Vol. II, pp. 602-607.
[22] Docket, Vol. II, pp. 621-623.
[23] Docket, Vol. II, pp. 611-619.
[24] Records Verification dated October 1, 2015, docket, vol. II, p. 624.

In the Resolution[25] dated October 28, 2015, the Court granted petitioner's Motion to Admit (the attached Motion for Reconsideration with Formal Offer of Additional Evidence for the Petitioner Arising from Cross-Examination of Respondent's Witness) and, therefore admitted the attached Motion for Reconsideration with Formal Offer of Additional Evidence.

In the same Resolution, the Court also granted petitioner's Motion for Reconsideration with Formal Offer of Additional Evidence, admitting petitioner's Exhibits "P18", "P19", "P-23" to "P-23-9", "P-23-8-A", and "P-23-9-A". The Court likewise admitted respondent's Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-7-A", and "R-8".

Petitioner filed its Memorandum[26] on January 5, 2016; while respondent filed his Memorandum[27] on January 8, 2016. Hence, the case was declared submitted for decision on January 18, 2016.[28]

STATEMENT OF THE ISSUES

The parties raised the following issues[29] for this Court's resolution:

1. Whether or not there was a valid appropriation of retained earnings; and

2. Whether or not petitioner is liable to pay respondent ₱13,301,158.15 representing alleged deficiency Improperly Accumulated Earnings Tax, inclusive of surcharges and interest for taxable year 2009.

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[25] Docket, Vol. II, pp. 626-628.
[26] Docket, Vol. II, pp. 638-665.
[27] Docket, Vol. II, pp. 666-674.
[28] Resolution dated January 18, 2016, Docket, Vol. II, p. 676.
[29] JSFI, Docket, Vol. I, pp. 150-151.

DISCUSSION/RULING

The Court shall address first the matter of timeliness of the filing of the present Petition for Review.

Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, provides:

> "SEC. 228. *Protesting of Assessment.* – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however*, That a preassessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> **Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment** in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> **If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180)**

> **days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.**" *(Emphasis supplied)*

Petitioner received on March 19, 2014 the FLD dated March 17, 2014, together with the FAN No. ELTAD-II-IE-09-0002, assessing petitioner for deficiency IAET for taxable year 2009. Petitioner filed its administrative protest by way of a request for reconsideration with the BIR on April 15, 2014. Since respondent failed to act on its protest, petitioner had thirty (30) days from October 12, 2014, the lapse of 180 days, or until November 11, 2014 to file a Petition for Review before this Court. Hence, the present Petition for Review filed on November 10, 2014 was filed within the prescriptive period.

The Court will now proceed to determine whether petitioner is liable for Improperly Accumulated Earnings Tax.

Respondent's examiners found that in taxable year 2009, petitioner had earnings in excess of one hundred percent (100%) of its capital stock, computed as follows:

Taxable Income for 2009	₱71,738,452.00
Add: Income excluded from Gross Income	1,943,010.00
	73,681,462.00
Less: Income Tax Paid	21,521,536.00
Total	52,159,926.00
Add: Retained Earnings from Prior Years	21,411,392.00
Less: Amount that may be retained	(3,500,000.00)
Net Retained Earnings	₱70,071,318.00

Pertinent to the resolution of this issue is Section 29 of the NIRC of 1997, as amended, quoted hereunder for ready reference:

> "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 earnings and profits to accumulate 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** gr

members unless the corporation, by the clear 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:

(1) Income exempt from tax;
(2) Income excluded from gross income;
(3) Income subject to final tax; and
(4) The amount of net operating loss carry-over deducted;

And reduced by the sum of:

(1) Dividends actually or constructively paid; and
(2) 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." *(Emphasis supplied)*

The foregoing provision is implemented by Sections 5, 6 and 7 of Revenue Regulations (RR) No. 02-01, which provide:

"SECTION 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;
(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).

xxx xxx xxx

SECTION. 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.

SEC. 7. *Determination of Purpose to Avoid Income Tax.* – The fact that a 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. Likewise, **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.** In both instances, the corporation may, by clear preponderance of evidence in its favor, prove the contrary.

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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 order to determine whether profits are accumulated for the reasonable needs of the business as to avoid the imposition of the improperly accumulated earnings tax, the controlling intention of the taxpayer is that which is manifested at the time of accumulation, not subsequently declared intentions which are merely the product of afterthought. A speculative and indefinite purpose will not suffice. The mere recognition of a future problem or the discussion of possible and alternative solutions is not sufficient. Definiteness of plan/s coupled with action/s taken towards its consummation are essential." *(Emphasis supplied)*

Petitioner argued that there was no improper accumulation of profits and that the accumulation of earnings was inspired by a reasonable need of the business. Ms. Connie Tan Bautista, petitioner's accountant averred:[30]

> A There was no improper accumulation of earnings as of December 31, 2009 as our company earmarked our retained earnings for our expansion plan and for reasonable needs of the business.
>
> Q34 By the way, how is earmarking of retained earnings done?
>
> A In the case of our company, it is done by the passage and approval of a Board Resolution restricting the spending of retained earnings or accumulated income for some identified purpose.
>
> xxx xxx xxx
>
> Q37 ... [Y]ou said that your company earmarked its retained earnings for planned expansion or reasonable needs of the business, what was that reasonable needs of the business?
>
> A Our company has expansion plans vis-à-vis its being the marketing arm of Fortune Tobacco Corporation, a manufacturer of cigarettes.
>
> xxx xxx xxx
>
> Q41 How did your company intend to implement the marketing agreement?
>
> A The plan calls for investment in additional goods and inventories for the purpose of generating sales and maintaining its presence in the whole Visayas Region; thereby contributing to its growth in the industry.

[30] Judicial Affidavit of Connie Tan Bautista, Docket, Vol. I, pp. 352-354.

Likewise, petitioner presented Mr. Prudencio F. Tatunay, an Independent Certified Public Accountant, as an expert witness, who said:[31]

A The claim of the BIR that there were improperly accumulated earnings as of December 31, 2009, and therefore its assessment **(Exhibit "P3")** for Improperly Accumulated Earnings Tax (IAET) in the amount of PhP13,301,158.15, has no basis, sir.

Q25 Why do you say so?

A My independent analysis tells me that there was no improper accumulation of earnings as of December 31, 2009 as 1Maple Sales, Inc. earmarked its retained earnings for its expansion plan and for reasonable needs of the business.

Q26 How is earmarking of retained earnings done?

A As this is a policy matter for a corporate unit, it is usually done by the passage and approval of a Board Resolution restricting the spending of retained earnings or accumulated income for some specific purpose.

xxx xxx xxx

Q29 You said that 1Maple earmarked its retained earnings for planned expansion or reasonable needs of the business, what was this expansion plan all about?

A The expansion plan calls for investments in additional goods and inventories for the purpose of generating sales and thereby increases its growth in the industry.

[31] Judicial Affidavit of Prudencio F. Tatunay, Docket, Vol. I, pp. 178-179.

> It is also a reasonable need of the business to remain liquid while implementing an expansion plan.

Petitioner submitted the Secretary's Certificate dated February 17, 2010 issued by its Corporate Secretary, Ms. Bernadette M. Yu, attesting that petitioner's Board of Directors passed a resolution appropriating ₱110,000,000.00 "for and as standby capital to enable the Corporation to pursue with its planned expansion".[32]

However, the Court finds the said Secretary's Certificate wanting as the details of the alleged planned expansion were not included in the Secretary's Certificate. Further, it should be noted that Section 7 of RR No. 02-01 as previously quoted provides explicitly that a speculative and indefinite purpose will not suffice. Definiteness of plans coupled with actions taken towards its consummation are essential.

In the case of *Greenhills Properties, Inc. vs. Commissioner of Internal Revenue*[33], the Court found that therein petitioner's retained earnings were for the reasonable needs of the business, to wit:

> "To prove such claim, petitioner presented a copy of its Minutes of Special Meeting of the Board of Directors (BOD) held on April 19, 2006 which contains a proposal by the GPI's President that there is a need 'to redevelop the El Pueblo Project, Pasig City, Metro Manila to improve and maximize return on investment. The existing improvements are not attractive to prospective business establishments such that some of the buildings for quite sometime have been vacant and are not producing rental income.' Acknowledging this need, the BOD approved the earmarking of ₱1,000,000,000.00 from the accumulated unrestricted earnings of GPI as of December 31, 2006, which amounted to ₱1,782,509,264.00.

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[32] Exhibit "P-7", Docket, Vol. II, p. 514.
[33] CTA Case No. 8295, May 15, 2015.

In fine, petitioner's reason in setting aside portion of its accumulated retained earnings is within the reasonable needs of the business as contemplated in Section 29 of the Tax Code, implemented by Section 3 of RR 2-2001 to wit:

xxx xxx xxx

To further strengthen its claim, petitioner presented the proposal from Palafox Associates dated November 20, 2007, the contracted architectural firm, which was agreed upon and signed by Mr. Gerardo Lanuza, Jr., President of GPI, to prove that the development of the El Pueblo Project is an immediate need and is in fact already in progress.

It may infer from the foregoing pieces of evidence that petitioner's business has reasonable needs of accumulating its earnings, profits, thus, the imposition of the IAET is improper."

Based on the foregoing, Greenhills Properties, Inc. proved the reasonableness of the appropriation of retained earnings through a definite plan it made with respect to the El Pueblo Project and the actions it took to implement that plan by contracting an architectural firm.

In the instant case, petitioner asserts that by virtue of its Exclusive Marketing Agreement[34] with Fortune Tobacco Corporation (FTC) dated January 27, 2006, in which it became the exclusive distributor of cigarettes manufactured by FTC in the whole Visayas Region, it had to expand business by investing in additional goods and inventories for the purpose of generating sales and maintaining its presence in the whole region. Thereafter, bank loans and trade payables were incurred, eyeing the reserved funds to support the payments for the purchases.[35] Allegedly, it is also a reasonable need of the business to remain liquid while implementing an expansion plan.[36]

[34] Exhibit "P-22", Docket, Vol. II, pp. 583-589.
[35] Judicial Affidavit of Connie Tan Bautista, Q&A 41, 43, and 44, Docket, Vol. I, pp. 353-354.
[36] Judicial Affidavit of Prudencio F. Tatunay, Q&A 29, Docket, Vol. I, p. 179.

In their Judicial Affidavits, Mr. Tatunay and Ms. Bautista declared their observations on the following changes in petitioner's Audited Comparative Financial Statements for the years 2010 and 2009:[37]

1. Investments were made by purchasing additional goods and increasing year-end inventories in the amount of ₱866,999,682 from ₱687,307,126 inventory balance of taxable year 2008;

2. Trade and other payables were paid in the total amount of ₱1,295,803,832.00; and

3. Payment of existing bank loan in the amount of ₱715,600,000.

Petitioner claims that the increase in inventory, decrease in trade and other payables, and payment of bank loan came from its appropriated retained earnings.

However, the Court is not convinced considering that petitioner failed to provide sufficient evidence to prove its claim. In fact, it may be observed from its Audited Financial Statements (AFS) that for taxable years 2007, 2008,[38] 2009 and 2010,[39] instead of being decreased by the alleged implementation of the planned business expansion, the appropriated retained earnings have increased from ₱15 million to ₱165 million in the span of four (4) years, as shown below:

Taxable Year	**Appropriated Accumulated Profit**
2007	₱ 15,000,000.00
2008	₱ 20,000,000.00
2009	₱110,000,000.00
2010	₱165,000,000.00

[37] *Ibid.*, Q&A 40, Docket, Vol. I, p. 182 and Judicial Affidavit of Connie Tan Bautista, Q&A 45, Docket, Vol. I, pp. 354-355.
[38] Exhibit "P-21", Note 7, Docket, Vol. II, p. 579.
[39] Exhibit "P-16", Note 10, Docket, Vol. II, p. 551.

If it is true that it already used its appropriated accumulated retained earnings, how come its appropriations escalated in each of the said years?

Petitioner further avers that the appropriated retained earnings were immediately reverted to unappropriated status as soon as the reasonable demands of the business ceased. Petitioner also pointed out that it did not finish the implementation of the alleged expansion plan due to the business combination that transpired between Fortune Tobacco Corporation and Philip Morris Corporation, which created the Philip Morris Fortune Tobacco Corporation (PMFTC). Petitioner was not able to forge a new marketing/distribution agreement with PMFTC.[40]

Thus, in November 2013, petitioner reverted ₱230 million appropriated earnings to unrestricted retained earnings and declared the same as cash dividends.[41] Subsequently, cash dividends in the amount of ₱58 million were declared in April 2014.[42]

The foregoing events even prove that petitioner's accumulated appropriations were not used in years prior to 2013 and thus, negate petitioner's claim that its earmarking is for the immediate and reasonable needs of the business.

In the case of *Cyanamid Philippines, Inc. vs. The Court of Appeals, et. al.*[43], the Supreme Court explained how to determine whether the profits are accumulated for the reasonable needs of the business:

> "In order to determine whether profits are accumulated for the reasonable needs of the business to avoid the surtax upon shareholders, it must be shown that the controlling intention of the taxpayer is manifested at the time of accumulation, not intentions declared subsequently, which are mere afterthoughts. Furthermore, **the accumulated profits must be used within a reasonable time after the close of the taxable year.** In the instant case, petitioner did not establish, by clear

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[40] Judicial Affidavit of Connie Tan Bautista, Q&A 46 and 47, Docket, Vol. I, p. 355.
[41] Exhibit "P-10", Docket, Vol. II, pp. 517-518.
[42] Exhibit "P-14", Docket, Vol. II, p. 528.
[43] G.R. No. 108067, January 20, 2000.

and convincing evidence, that such accumulation of profit was for the immediate needs of the business.

In *Manila Wine Merchants, Inc. vs. Commissioner of Internal Revenue,* we ruled:

> 'To determine the 'reasonable needs' of the business in order to justify an accumulation of earnings, the Courts of the United States have invented the so-called **'Immediacy Test' which construed the words 'reasonable needs of the business' to mean the immediate needs of the business**, and it was generally held that if the corporation did not prove an immediate need for the accumulation of the earnings and profits, the accumulation was not for the reasonable needs of the business, and the penalty tax would apply. (Mertens, *Law of Federal Income Taxation,* Vol. 7, Chapter 39, p. 103).'" *(Emphasis supplied)*

Here, petitioner failed to pass the so-called "Immediacy Test" considering that it failed to prove that it has an immediate need for the accumulation of its earnings and that the appropriation made in 2009 was used in its alleged planned expansion.

Further, for the year 2009,[44] petitioner failed to disclose in its Notes to Financial Statements the appropriations made, which are significant transactions and/or information that the stockholders, the government, and the public should be apprised about. Such disclosure is in consonance with Paragraph 103 of the Philippine Accounting Standards (PAS) 1: *Presentation of Financial Statements,* which states that the notes shall:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with paragraphs 108-115; ℊ

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[44] Note 8, Audited Comparative Financial Statements for Years 2008 and 2009, BIR Records, p. 245.

(b) disclose any information required by IFRS that is not presented on the face of the balance sheet, income statement, statement of changes in equity, or cash flow statement; and

(c) **provide additional information that is not presented on the face of the balance sheet, income statement, statement of changes in equity or cash flow statement, but is relevant to an understanding of any of them.** *(Emphasis supplied)*

In fine, as to whether or not there was a valid appropriation of retained earnings, the Court is not persuaded by petitioner's arguments. Consequently, petitioner should be held liable to pay deficiency Improperly Accumulated Earnings Tax.

The Court notes, however, that the compromise penalty of ₱50,000.00 should be cancelled. Pursuant to Revenue Memorandum Order (RMO) No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Compromise penalties imply mutual agreement between the taxpayer, on one hand, and the respondent, on the other. Absent any showing that petitioner consented to the compromise penalties, the same should not be imposed.

WHEREFORE, premises considered, the instant Petition for Review is hereby **DENIED**. Accordingly, the assessment issued by respondent against petitioner for Improperly Accumulated Earnings Tax for taxable year 2009 is **SUSTAINED**. Petitioner is hereby **ORDERED TO PAY** the amount of ₱8,758,914.75, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Taxable Income for 2009	₱ 71,738,452.00
Add: Income excluded from Gross Income	1,943,010.00
	73,681,462.00
Less: Income Tax Paid	21,521,536.00
Total	52,159,926.00
Add: Retained Earnings from Prior Years	21,411,392.00
Less: Amount that may be retained	(3,500,000.00)
Net Retained Earnings	70,071,318.00
Improperly Accumulated Earnings Tax	7,007,131.80
Add: Surcharge (25%)	1,751,782.95
TOTAL	**₱8,758,914.75**

In addition, petitioner is **ORDERED TO PAY**:

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic Improperly Accumulated Earnings Tax in the amount of ₱7,007,131.80 computed from January 15, 2011,[45] pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) Delinquency interest at the rate of 20% per annum on the total amount of ₱8,758,914.75 and on the deficiency interest which have accrued as afore-stated in (a) computed from March 31, 2014[46] until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

I CONCUR:

CAESAR A. CASANOVA
Associate Justice

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[45] Section 6 of Revenue Regulations No. 2-2001.
[46] Exhibit "P-3", Docket, Vol. II, p. 500.

ATTESTATION

I attest 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's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and Division Chairperson's Attestation, 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