REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

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COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

UNITED DISTRIBUTION MANAGEMENT, INC.,
Respondent.

CTA EB No. 974
(CTA Case No.7885)

Present:

DEL ROSARIO, *PJ*,
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA,
FABON-VICTORINO,
MINDARO-GRULLA,
COTANGCO-MANALASTAS, and
RINGPIS-LIBAN, *JJ.*

Promulgated:

OCT 30 2013 8:30 a.m.

x - x

DECISION

UY, *J.*:

This Petition for Review filed on January 2, 2013, seeks the reversal of the Decision dated September 24, 2012[1] and Resolution dated December 31, 2012[2], both promulgated by the Third Division of this Court"[3] (or Court in Division) in CTA Case No. 7885, entitled *United Distribution Management, Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent,* the dispositive portions of which respectively read:

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[1] Assailed Decision dated September 24, 2012, Docket, pp.13 to 25.
[2] Assailed Resolution dated December 13, 2012, Docket, pp. 26 to 27.
[3] The Third Division of this Court was then composed of the following: Associate Justice Lovell R. Bautista, as Chairperson, and Associate Justices Olga Palanca-Enriquez (Retired) as Senior member, and Amelia R. Cotangco-Manalastas (ponente), as Junior Member.

<u>Decision promulgated on September 24, 2012</u>:

> "**WHEREFORE**, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, the assessment issued against petitioner for deficiency final tax, including surcharges, interest and compromise penalty in the aggregate amount of P1,674,034,.65 for taxable year 2004 is hereby **CANCELLED**.
>
> **SO ORDERED**."

<u>Resolution promulgated on December 13, 2012</u>:

> "WHEREFORE, premises considered, the instant Motion for Reconsideration is hereby DENIED for lack of merit.
>
> **SO ORDERED**."

THE FACTS

Culled from the records of this case and as found by the Court in Division, these are the established facts of the case.

Petitioner is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) vested under the appropriate laws with the authority to carry out the functions, duties and responsibilities of said office, including, *inter alia*, the power to decide disputed assessments, cancel and abate tax liabilities pursuant to the provisions of the National Internal Revenue Code (NIRC) of 1997 and other tax laws, rules and regulations.

On the other hand, respondent United Distribution Management Inc. is a domestic corporation duly organized and existing under Philippine law, with principal office at 497 President Quirino Avenue corner Zulueta Street, Malate, Manila.

On January 26, 2008, respondent received Assessment Notice No. 34-2004, with an attached letter bearing Demand No. 34-2004, both dated January 23, 2004, signed by Mr. Alfredo Misajon, Regional Director of Revenue Region No. 6, Manila, assessing respondent of deficiency income tax, value-added tax (VAT), documentary stamp tax (DST), and final tax in the total amount of ₱ 33,779,639.11, inclusive of interest, surcharges, and penalties.

The deficiency taxes and penalties were computed as follows:

	BASIC TAX	INTEREST	SURCHARGE	COMPROMISE PENALTY	TOTAL
Income	₱ 15,617,006.85	₱ 8,676,012.54		₱ 50,000.00	₱ 24,343,019.39
VAT	4,745,435.17	2,847,261.10		25,000.00	7,617,696.27
DST	50,000.00	48,888.80	20,000.00	25,000.00	143,888.80
Final Tax	891,934.87	540,116.06	222,983.72	20,000.00	1,675,034.65
Total	₱ 21,304,376.89	₱ 12,112,278.50	₱ 242,983.72	₱ 120,000.00	₱ 33,779,639.11

Respondent filed a Protest and Reply to the Assessment Notice on February 22, 2008, stating, among others, that it availed of the tax amnesty on October 26, 2007, pursuant to the provisions of Republic Act No. 9480. On February 27, 2009, respondent received from the BIR the letter dated February 10, 2009, with the information that its 2004 deficiency assessment for final tax amounting to ₱ 1,675,034.65 will be forwarded to the Collection Division of Revenue Region No. 6 for enforcement of collection.

Respondent, through counsel, also received on March 19, 2009 an undated letter acknowledging its availment of the tax amnesty and confirming cancellation of the deficiency income tax, VAT and DST assessments for 2004, but stressing that the assessment for deficiency final tax is not covered by the tax amnesty.

Inasmuch as petitioner reiterated only the assessment for deficiency final tax and cancelled the assessments for deficiency income tax, VAT and DST, respondent deemed it a partial denial of its protest.

Accordingly, on March 20, 2009, respondent appealed the said partial denial of its protest of the assessment for deficiency final tax by filing a Petition for Review before the Court in Division docketed as CTA Case No. 7885.

Petitioner filed her Answer in CTA Case No. 7885 on April 27, 2009, interposing the following defenses:

> "9. The assessment is valid and correct and the [respondent] has the burden of proof to impugn its validity (*Behn Meyer and Co. vs. Collector of Internal revenue,* 27 Phil. 647). Thus, similarly held, tax assessments by examiners are presumed correct and made in good faith and the taxpayer has the duty to prove otherwise. (*Commissioner of Internal Revenue*

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vs. Construction Resources of Asia, Inc., 145 SCRA 671); and assessments duly made by a BIR examiner and approved by her superior officers will not be disturbed (*Gutierrez vs. Villegas,* 8 SCRA 547).

10. 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 if wrong but also that the taxpayer is right (*Tan Guan vs. Court of Tax Appeals, et al.* 19 SCRA 903 [1967]; *Collector of Internal Revenue vs. Bohol Land Transportation Co.,* 107 Phil. 967 [1960].

11. Pursuant to Section 222 of the Tax Code of 1997, in case of a false or fraudulent return with intent to evade tax or failure to file a return, the tax may be assessed at anytime within ten (10) years after the discovery of the falsity, fraud or omission."

During trial, both parties presented their respective documentary and testimonial evidence in CTA Case No. 7885. Upon termination thereof, both parties filed their respective Memorandum and CTA Case No. 7885 was submitted for decision on April 30, 2012.

On September 24, 2012, the Court in Division rendered the assailed Decision and ruled, in a nutshell, that inasmuch as the issuance of the assessment was based on a mere assumption that payments made to respondent's stockholder, Enrique Fernandez, are dividends, petitioner's assessment of deficiency final tax was cancelled. Thus, the Court in Division ordered the cancellation of the assessment issued against respondent for deficiency final tax, including surcharges, interest and compromise penalty in the aggregate amount of ₱ 1,675.034.65 for the taxable year 2004 for lack of factual or legal basis.

On October 12, 2012, petitioner filed a Motion for Reconsideration of said Decision. Respondent filed its Comment thereto on October 31, 2012. Finding no compelling reason to reverse the assailed Decision, the Court in Division denied petitioner's Motion for Reconsideration in the assailed Resolution dated December 13, 2012.

Undaunted, petitioner filed the instant Petition for Review, praying that the assailed Decision dated September 24, 2012 and Resolution dated December 13, 2012 be reversed, and the validity of the assessment against respondent for taxable year 2004 be upheld by ordering respondent to pay deficiency final withholding tax in the amount of ₱ 1,675.034.65, plus cost.[4]

In the Resolution dated January 23, 2013,[5] respondent was directed by the Court *En Banc* to file its Comment to the instant Petition for Review. Respondent filed its Comment on February 15, 2013.[6] After considering the issues raised by petitioner and the arguments submitted by respondent in its Comment, the Court *En Banc* resolved to give due course to the instant Petition for Review and directed both parties to file their respective memorandum in the Resolution dated April 3, 2013.[7] In compliance therewith, respondent filed its memorandum on May 20, 2013;[8] while petitioner's memorandum was filed on May 22, 2013.[9]

On May 27, 2013, the Court *En Banc* submitted the instant case for decision.[10] Hence, this Decision.

THE ISSUE

The issue for the resolution of the Court is whether or not respondent United Distribution Management, Inc. is liable for final withholding tax, including surcharges, interest and compromise penalty in the total amount of ₱ 1,675,034.65 for taxable year 2004.

THE ASSIGNED ERROR

An assignment of error is submitted by petitioner, to wit:

> **"THE HONORABLE COURT OF TAX APPEALS-THIRD DIVISION ERRED IN RENDERING THE DECISION PROMULGATED ON SEPTEMBER 24, 2012 GRANTING THE PETITION FOR REVIEW OF RESPONDENT UNITED DISTRIBUTION MANAGEMENT, INC. AND ORDERING**

[4] Docket, pp. 1 to 12
[5] Docket, pp. 29 to 30.
[6] Docket, pp. 31 to 35.
[7] Docket, pp. 37 to 38.
[8] Docket, pp. 39 to 56.
[9] Docket, pp. 57 to 65.
[10] Resolution dated May 27, 2013, Docket, pp. 67 to 68.

THE CANCELLATION OF THE ASSESSMENT ISSUED AGAINST THE RESPONDENT FOR DEFICIENCY FINAL TAX, INCLUDING SURCHARGES, INTEREST AND COMPROMISE PENALTY IN THE AGGREGATE AMOUNT OF P1,675.034.65 FOR TAXABLE YEAR 2004."[11]

Petitioner's Arguments:

Petitioner argues that the amount subject of the assessment should be treated as dividends because it was able to prove that the same was paid by respondent to its stockholder, Enrique Fernandez, who practically owned the corporation, and that respondent did not pay its corresponding final withholding tax. Petitioner further contends that because respondent failed to present any loan document, she treated the subject payments to Fernandez as distribution of dividends.

Furthermore, petitioner contends that interest payments made by respondent in favor of Fernandez should have been subjected to final tax under Section 24(B)(1) of the Tax Code. According to petitioner, Fernandez habitually extended loans to respondent and has allegedly, on several occasions in the year 2004, received from respondent interests in the total amount of ₱ 919,348.66.

In this regard, petitioner claims that Section 24(B)(1) of the NIRC imposes a final tax rate of twenty percent (20%) on the amount of interest derived from, among others, deposit substitutes; that BIR Ruling No. 106-90 dated May 29, 1990, it was ruled that the borrowings/lendings obtained by a lending investor is in the nature of deposit substitutes; and as to who is considered as a lending investor, BIR Ruling No. 452-88 dated September 15, 1988 defined the term *"as one who makes practice of lending money for themselves or others at interest."* Consequently, petitioner concludes that apart from the ₱ 8,000,000 payment to Fernandez, which petitioner treated as dividends, interest paid to Fernandez should have been subjected to the 20% (not 10%) final withholding tax.

Lastly, petitioner stresses that taxes are the life blood of the government and should be collected without unnecessary hindrance. Thus, for the interest of the government, the subject assessment must be paid by respondent without unnecessary delay.

[11] Docket, pp. 7 and 61.

Respondent's counter-arguments:

Respondent avers that the instant Petition for Review does not warrant this Court's consideration because the issues and arguments raised in the said Petition are mere restatements of petitioner's arguments set forth in its Memorandum dated March 16, 2012 and Motion for Reconsideration dated October 10, 2012 filed with the Court in Division which had already been carefully considered and passed upon by the latter. Respondent accentuates that the Court in Division already found that the assessment lacks factual or legal basis inasmuch as the same is based on a mere assumption and petitioner failed to prove in court that respondent's payments to its stockholder were indeed dividends. Well entrenched is the rule that findings and conclusions made by the CTA-Division will not be disturbed as long as these are supported by evidence and are consistent with prevailing laws and jurisprudence.

Moreover, respondent maintains that its total payments to its stockholder, Enrique Fernandez, in the amount of ₱ 8,919,348.66 represent payment of advances made by the stockholder and, thus, not subject to final withholding tax.

Finally, respondent asserts that it is not liable for deficiency final withholding tax on dividends for taxable year 2004 because respondent did not declare nor pay dividends to Fernandez in the same year as shown by the following:

1. Some of the payments made to the stockholder, Fernandez, correspond to the outstanding balance of respondent's advances from a stockholder as of December 31, 2004 amounting to ₱ 8,071,781.00;

2. There is no board resolution or any other document authorizing the declaration of dividends; and lastly,

3. Respondent had no sufficient unrestricted retained earnings to support any dividend declaration since respondent's retained earnings for the year 2004 amounted only to ₱ 1,895,568.00.

THE COURT *EN BANC*'S RULING

We find no merit in the instant Petition for Review.

Respondent was able to overturn the presumption of correctness of the assessment.

As a general rule, it is the duty of a taxpayer to present evidence to show inaccuracy in the method of assessment[12] adopted by petitioner. In this case, We find that respondent satisfactorily discharged such duty.

Respondent was able to prove, through preponderance of evidence, that petitioner's assessment lacks legal and factual bases. Specifically, respondent was able to show that the subject payments to its stockholder, Enrique Fernandez, are not dividends, but were merely advances made by the latter.

In the Sworn Statement of respondent's witness, Marlon B. Tornito,[13] the latter testified as follows:

> "Q32: Were any payments made by Petitioner (Respondent) to its stockholder?
>
> A32: Yes, there was a Php8,000,000.00 payment for the advances previously made by a stockholder, Mr. Enrique Fernandez, in favor of Petitioner (Respondent).
>
> Q33: What are the circumstances under which the advances were made by Mr. Fernandez to the Corporation?
>
> A33: In the normal course of business operations, Petitioner (Respondent) obtains advances from Mr. Fernandez to finance its operations. In November 2004, Mr. Fernandez lent Php8,000,000.00 to Petitioner [Respondent] to finance Petitioner's [Respondent's] payment of purchases of pharmaceutical products from United Laboratories. The advances were made in two tranches, at Php4,000,000.00 each."

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[12] *Mindanao Bus Co. vs. Collector of Internal Revenue*, G.R. No. L-14078, 24 February 1961.
[13] Exhibit "N", Docket (CTA Case No. 7885), pp. 324 to 331, at p. 329.

The fact that the amount of ₱ 8,000,000.00 is a loan obtained by respondent from Enrique Fernandez is supported by documentary evidence, to wit:

(a) the Certification from Planters Bank of the issuance of Check No. 73671 to United Distribution Management Inc., payee, in the amount of ₱ 4,000,000.00 on November 19, 2004 and Check No. 73719 to Enrique Cacho Fernandez, payee, also for the amount of ₱ 4,000,000.00 on November 26, 2004 from the proceeds of the placement of Enrique Fernandez with said bank (Exhibits "K"[14]) shows that the source of the amount of ₱ 8,000,000.00 is from Fernandez's bank account;

(b) Respondent's bank statements under Current Account No. 044-030-00033-9 with the International Exchange Bank-Intramuros Branch (Exhibit "AA"[15]) reflecting the entries made on November 19, 2004 and on November 26, 2004 crediting the amount of ₱ 4,000,000.00 on each date (Exhibits "AA-1" and "AA-2"[16]) demonstrates receipt of the same amount by respondent;

(c) Proofs of repayment of the loan granted by Enrique C. Fernandez in 2005 with interests, confirm the treatment of the said amount as "Advances from a Stockholder" in respondent's financial statements, namely: Duplicate Original of Respondent's Disbursement Voucher No. 1605 dated December 18, 2004 (Exhibit "O"); Certified True Copy of Respondent's International Exchange Bank Check No. 97257 dated December 21, 2004 issued to Mr. Enrique C. Fernandez (Exhibit "P"); Certified True Copy of Respondent's International Exchange Bank Check No. 97260 dated December 28, 2004 issued to Mr. Enrique C. Fernandez (Exhibit "Q"); Certified True Copy of Respondent's International Exchange Bank Check No. 97259 dated January 5, 2005 issued to Mr. Enrique C. Fernandez (Exhibit "R"); Certified True Copy of Respondent's International Exchange Bank Check No. 97261 dated January 12, 2005 issued to Mr. Enrique C. Fernandez (Exhibit "S"); Certified True Copy of Respondent's International Exchange Bank Check No. 97263 dated January 28, 2005 issued to Mr. Enrique C. Fernandez (Exhibit "T"); Duplicate Original of Respondent's Disbursement Voucher No. 1604 dated December 18, 2004 showing payment of loan to Mr. Enrique C. Fernandez, (Exhibit "U"); and Entries in Respondent's Bank Statement on various dates showing that petitioner's account were debited the total amount of Eight Million

[14] Docket (CTA Case No. 7885, P. 319
[15] Docket (CTA Case No. 7885, p. 361
[16] Docket (CTA Case No. 7885), pp. 365 and 367.

One Hundred Eighty Thousand Pesos [₱ 8,180,000.00] (Exhibit "AA-3" to "AA-7"[17]); Respondent's Audited Financial Statements for taxable years ended December 31, 2004 and 2003 (Exhibit "I"[18]); and Respondent's Comparative Audited Financial Statements for taxable years ended December 31, 2005 and 2004 (Exhibit "D"[19]).

Notably, Section 73(A) of the NIRC of 1997 provides the definition of "dividends", to wit:

> "SEC. 73. *Distribution of Dividends or Assets by Corporations.*—
>
> (A) *Definition of Dividends.* — The term **'dividends'** when used in this Title means <u>any distribution made by a corporation to its shareholders out of its earnings or profits and payable to its shareholders, whether in money or in other property</u>." *(Underscoring supplied)*

Jurisprudentially, a dividend is defined as *"a corporate profit set aside, declared, and ordered by the directors to be paid to the stockholders on demand or at a fixed time. Until the dividend is declared, these corporate profits belong to the corporation, not to the stockholders, and are liable for corporate indebtedness."*[20]

Thus, on the basis of the foregoing definitions, for a distribution or payment to be considered as "dividends", the following essential requisites must be present, to wit:

1) the concerned corporation must have earnings or profits;

2) such corporate earnings or profits must be set aside, declared, and ordered by the directors to be paid to the stockholders, on demand or at a fixed time; and

3) the distribution or payment of said corporate earnings or profits is in money or in other property.

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[17] Docket (CTA Case No. 7885), pp. 332 to 338, 374, 375, 379, and 381.
[18] Docket (CTA Case No. 7885), pp. 309 to 318, at pp. 310 and 317.
[19] Docket (CTA Case No. 7885), pp. 251 to 261, at p. 253.
[20] *Fisher vs. Trinidad*, G.R. No. 17518, October 30, 1922.

Correspondingly, any money received by Enrique Fernandez from respondent, even when he is the stockholder of the latter, does not automatically make the payment in the nature of dividends, if the said requisites are not present.

In the instant case, a perusal of the evidence presented by herein petitioner Commissioner of Internal Revenue, as the respondent in CTA Case 7885, fail to convince this Court that the subject payments to respondent are indeed dividends, as the term is defined by law and jurisprudence.

In the undated Memorandum Report of Betty B. Esplana,[21] Revenue Officer II—the BIR employee who examined respondent's records and recommended the subject tax assessment, the following are the self-serving statements relative thereto, to wit:

> "The advances of P8,000,000.00 made by Mr. Enrique Fernandez, company's president was treated as additional capital stock subject to documentary stamp pursuant to Sec. 174 of the Tax Code of 1997. The payment made and interest paid to him by UDMI[22] was treated as dividend subject to 10% final tax. Total deficiency documentary stamp tax and final tax are P80,000.00 and P891,934.87 respectively."

Furthermore, in Esplana's Judicial Affidavit,[23] she merely testified regarding the subject tax assessment as follows:

> "10. On the basis of my examination of [respondent]'s accounting records, I have noted some discrepancies, particularly in the account 'Advances from Stockholders'. I reflected this discrepancies in the schedule I prepared, which schedule (page 545 of the BIR records) was pre-marked as Exhibit '9' for the [petitioner]."

Said Exhibit "9",[24] in turn and insofar as the deficiency final tax assessment is concerned, simply stated the following:

[21] Exhibit "15", BIR Records, pp. 571 to 572.
[22] Respondent herein.
[23] Exhibit "25", Docket (CTA Case No. 7885), pp. 447 to 451, @ p. 449.
[24] BIR Records, p. 545.

"Schedule I:Advances from Stockholders

Beginning Balance per FS	432,703.00
Add: Additional per Cash debit/ledger books	8,000,000.00
TOTAL	8,432,703.00
Less: payment/cash disbursement book	8,180,000.00
Supposed Ending Balance per FS	252,703.00
Balance per FS, END	8,071,781.00
DISCREPANCY	-7,819,078.00"

Even the supposed Details of Discrepancy[25], attached to the subject tax assessment, only stated the following:

"4. DEFICIENCY FINAL TAX

> Payments to stockholders and interest payments made to them were subjected to final tax of 10%."

While petitioner provided documentary proof of the audit conducted and the resultant findings, nothing therein explains why petitioner treated respondent's payments as dividends or how petitioner came to conclude that respondent is liable for final withholding tax on dividends.

In other words, petitioner failed to establish the rationale behind treating respondent's advances to its stockholder and interest payments as dividends.[26] Thus, to the mind of this Court, petitioner merely presumed that the payments to Fernandez are dividends, without any factual basis.

At this juncture, it must be emphasized that, in order to stand judicial scrutiny, the assessment must be based on facts.[27] Furthermore, assessments should not be based on mere presumptions no matter how reasonable or logical said presumptions may be.[28]

Moreover, petitioner's arguments raised in the proceedings *a quo* are likewise self-serving considering that the conclusion that

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[25] Exhibit "17", BIR Records, p. 579.
[26] Exhibits "25" and "27", Division Docket (CTA Case No. 7885), pp. 447 to 457.
[27] *Commissioner of Internal Revenue vs. Hantex Trading Co., Inc.*, G.R. No. 136975, March 31, 2005.
[28] *Commissioner of Internal Revenue vs. Islands Garment Manufacturing Corporation, et al.*, G.R. No. L-46644, September 11, 1987, citing *Collector of Internal Revenue vs. Alberto D. Benipayo*, G.R. No. L-13656, January 31, 1962.

subject payments are dividends, are not supported by evidence in accordance with the legal definition thereof, to wit:

> **<u>Petitioner's Memorandum (for CTA Case No. 7885)</u>:**
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> "**4. Whether or not [Respondent] is liable for final withholding tax of Php1,675,034.65.**
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> The [respondent] is liable to pay deficiency final withholding tax in the amount of P1,675,034.65. The [petitioner] was able to prove that [respondent] made payments in 2004 to Mr. Enrique Fernandez, who practically owned the corporation, the [respondent] in the instant case, which were deemed distribution of dividends to a stockholder. Likewise, it was also proven that the interest payments to Mr. Fernandez were not subjected to the final withholding tax."[29]
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> **<u>Petitioner's Motion for Reconsideration (in CTA Case No. 7885)</u>:**
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> "[Respondent]'s payment to its stockholder, Mr. Enrique Fernandez, is and should have been subjected to final withholding tax. [Petitioner] was able to prove during trial that based on the accounting records of the [respondent], it made total payment to Mr. Fernandez in the amount of P8,180,100.00. Likewise, [respondent] also made interest payments in the total amount of P739,248.66 without subjecting the same to the final withholding tax.
>
> [Respondent] claimed that it did not declare and pay any dividends to its stockholders in 2004 and that the P8,000,000.00 it paid to Mr. Enrique Fernandez was in payment for the advances previously made by him. However, [respondent] failed to present any loan document during trial.
>
> Mr. Enrique Fernandez practically owned [respondent] corporation. He received payments from [respondent], including interest income, yet these payments were not subjected to the final withholding tax.

[29] Docket (CTA Case No. 7885), p. 534.

> Hence, [respondent] should be held liable for deficiency final withholding tax in the amount of P1,675,034.65, inclusive of interest and surcharges."[30]

Parenthetically, the foregoing arguments are practically reiterated in the instant case. However, the evidence on record is wanting of any proof that the directors of respondent ever set aside its corporate earnings or profits, and declared and ordered that the same be paid or distributed to its stockholder, Enrique Fernandez.

Respondent's failure to present any loan document is of no moment. As already observed, respondent clearly established by way of other evidence that the ₱ 8,000,000.00 is a loan obtained by respondent from Fernandez.

In *Commissioner of Internal Revenue vs. Hantex Trading Co., Inc.*,[31] the Supreme Court held:

> "We agree with the contention of the petitioner that, as a general rule, tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment. It is to be presumed, however, that such assessment was based on sufficient evidence. Upon the introduction of the assessment in evidence, a *prima facie* case of liability on the part of the taxpayer is made. If a taxpayer files a petition for review in the CTA and assails the assessment, the *prima facie* presumption is that the assessment made by the BIR is correct, and that in preparing the same, the BIR personnel regularly performed their duties. This rule for tax initiated suits is premised on several factors other than the normal evidentiary rule imposing proof obligation on the petitioner-taxpayer: the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the NIRC.
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> **However, the *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it**

[30] Docket (CTA Case No. 7885), p. 628.
[31] G.R. No. 136975, March 31, 2005.

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> **is arbitrary and capricious. Where the BIR has come out with a 'naked assessment,'** ***i.e.*****, without any foundation character, the determination of the tax due is without rational basis.** In such a situation, the U.S. Court of Appeals ruled that **the determination of the Commissioner contained in a deficiency notice disappears.** ***Hence, the determination by the CTA must rest on all the evidence introduced and its ultimate determination must find support in credible evidence.***" *(Emphases supplied)*

Based on the foregoing discussions, We find no cogent reason to reverse the Court in Division's finding that the subject assessment lacks factual or legal basis.

The Court of Tax Appeals cannot assess final tax on the subject interest payments without an assessment from respondent pursuant to Section 24(B)(1) of the NIRC of 1997.

As already noted, petitioner further contends that Fernandez habitually extended loans to respondent; and that apart from the ₱ 8,000,000.00 payment to him by respondent which was treated by petitioner as dividend payment, respondent also paid Fernandez on several occasions, in the year 2004, interests in the total amount of ₱ 919,348.66. Thus, according to petitioner, these payments should have been subjected to the 20% (not 10%) final withholding tax, pursuant to Section 24(B)(1) of the NIRC of 1997.

In the instant case, the deficiency final withholding tax on dividends in the aggregate amount of ₱ 1,675,034.65 was computed as follows:

Payments made to Stockholders	₱	8,180,100.00
Interest paid to Stockholders		739,248.66
Total	**₱**	**8,919,348.66**
Applicable Rate		10%
Final Tax Due	₱	891,934.87
Add: 25% Surcharge		222,983.72
20% Interest		540,116.06
Compromise Penalty		20,000.00
Total Amount Due	₱	1,675,034.65

Petitioner then is, in effect, saying that after treating the payments by respondent to Fernandez as dividends in the total amount of ₱ 8,919,348.66, and assessing the same with the 10% final withholding tax on dividends plus increments, portion thereof, which is the amount of ₱ 919,348.66, should likewise be considered as interests from loans, subject to the 20% final withholding tax.

The reasoning of petitioner is specious.

Interest has been defined as *"the compensation which is paid by the borrower of money to the lender for its use, and generally by a debtor to his creditor in recompense for his detention of the debt."*[32] From this definition, it can be easily discerned that the existence of interest presupposes that there is a loan. Apparently, this is completely untrue in the case of dividends. Thus, suffice it to state that a supposed income cannot be treated an interest and dividends (as defined earlier) at the same time. Neither should there be any instance where the same income is initially treated as dividends, and then subsequently treated as interest, respectively imposing income taxes thereon, as being suggested by petitioner in the instant case. This must be so because the two types of income completely differ in their respective nature.

Be that as it may, while undoubtedly the treatment of the amount of ₱ 8,000,000.00 as loan, and the amount of ₱ 919,348.66 as interest, is correct, no final withholding tax is due on such interest income under Section 24(B)(1) of the NIRC of 1997 (in relation to Section 2.57-1[33] of Revenue Regulations No. 2-98[34]) which provides as follows:

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[32] *Andreas vs. Bank of the Philippine Islands*, G.R. No. 23836, September 9, 1925, citing *Words and Phrases*, Volume 4, p. 3706

[33] "***Sec. 2.57-1 Income Payments Subject to Final Withholding Tax.***— The following forms of income shall be subject to final withholding tax at the rates herein specified;

(A) Income payments to a citizen or to a resident alien individual;

(1) Interest from any peso bank deposit, and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements; xxx — Twenty percent (20%)

xxx xxx xxx

(4) Interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas which was pre-terminated by the holder before the fifth (5th) year at the rates herein prescribed to be deducted and withheld from the proceeds thereof based on the length of time that the instrument was held by the taxpayer —

Holding Period	Rate
Four (4) years to less than five (5) years	5%
Three (3) years to less than four (4) years	12%
Less than three (3) years	20%"

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> "SEC. 24. *Income Tax Rates.*—
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> xxx xxx xxx
>
> (B) *Interests, Royalties, Prizes, and Other Winnings.* — A final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements; xxx *Provided, further*, That interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from the tax imposed under this Subsection: *Provided, finally*, That should the holder of the certificate pre-terminate the deposit or investment before the fifth (5^{th}) year, a final tax shall be imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposit or investment certificate based on the remaining maturity thereof:
>
> Four (4) years to less than five (5) years – 5%
> Three (3) years to less than four (4) years – 12%; and
> Less than three (3) years – 20%.

Based on the foregoing, there are only three (3) types of income where the 20% final tax is imposed, to wit: *first*, interest from any currency bank deposit; *second*, yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements; and *third*, interest income from long-term deposit or investment, which was pre-terminated by the holder before the third year.

In this case, the subject interest payments paid to Mr. Fernandez in the total amount of ₱ 919,348.66 do not come within the purview of the said types of income. Thus, there can be no merit in petitioner's contention that the same is subject to the 20% final withholding tax.

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[34] SUBJECT: Implementing Republic Act No. 8424, *"An Act Amending The National Internal Revenue Code, as Amended"* Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes.

But even granting that a final withholding tax on the subject interest payments at the rate of 20% is due, respondent cannot be obligated to pay the same in the instant case as there is no assessment made thereon by the BIR. Parenthetically, an obligation arises on the part of the taxpayer concerned to pay the amount assessed and demanded, only as soon as the assessment is served.[35]

It must be emphasized that the issuance of a valid formal assessment is a substantive prerequisite to tax collection, for it contains not only a computation of tax liabilities but also a demand for payment within a prescribed period, thereby signaling the time when penalties and interests begin to accrue against the taxpayer and enabling the latter to determine his remedies therefor. Due process requires that it must be served on and received by the taxpayer.[36]

WHEREFORE, all the foregoing considered, the Petition for Review is hereby **DENIED** for lack of merit. Accordingly, the Decision dated September 24, 2012 and Resolution dated October 10, 2012 of the Court in Division in CTA Case No. 7885, are hereby **AFFIRMED**.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

(On Leave)

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

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[35] See *Commissioner of Internal Revenue vs. Island Garment Manufacturing Corporation, et al.*, G.R. No. L-46644, September 11, 1987. Refer also to the second paragraph of Section 6(A) of the NIRC of 1997, to wit:

> "The tax or any deficiency tax so assessed shall be paid upon notice and demand from the Commissioner or from his duly authorized representative."

[36] *Commissioner of Internal Revenue vs. Menguito*, G.R. No. 167560, September 17, 2008.

Cielito N. Mindaro-Grulla

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

Ma. Belen M. Ringpis-Liban

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII 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 *En Banc*.

Juanito C. Castañeda, Jr.

JUANITO C. CASTAÑEDA, JR.
Acting Presiding Justice