**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

## SPECIAL SECOND DIVISION

**1MAPLE SALES, INC.,**
Petitioner,

- versus -

**COMMISSIONER OF INTERNAL REVENUE,**
Respondent.

**CTA CASE NO. 8925**

Members:

**CASTAÑEDA, JR.,** *Chairperson, and*
**CASANOVA,** *JJ.*

Promulgated:

MAY 15 2017 10:30 pm

x - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - x

# RESOLUTION

**CASTAÑEDA, JR., *J.*:**

For the Court's resolution is petitioner's **Motion for Reconsideration (of the Decision promulgated on December 16, 2016)**, filed on January 5, 2017, without respondent's comment as per Records Verification dated February 7, 2017.

Petitioner moves for the reconsideration of the Decision[1] promulgated on December 16, 2016, the dispositive portion of which is quoted as follows:

> "**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

[1] Docket, Vol. II, pp. 686-711.

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, 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 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

**SO ORDERED.**"

Petitioner raised the following issues for reconsideration:

1. Whether or not petitioner failed to pass the so-called "Immediacy Test";

2. Whether petitioner, for the year 2009, 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; *gr*

3. Whether the Net Retained Earnings ₱70,071,318.00 as of December 31, 2009 is a proper subject in the examination of petitioner's books of accounts and other accounting records of petitioner for all internal revenue taxes for the taxable year 2010; and

4. Assuming *arguendo* that the petitioner may be held liable for Improperly Accumulated Earnings Tax (IAET) in the year under audit, whether the computation of IAET was correct.

Petitioner claims that the appropriation was set as a standby capital for reasonable needs of the business to pursue its planned business expansion. Petitioner asserts that by virtue of its Exclusive Marketing Agreement 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. According to petitioner, when it expanded by investing in additional goods and inventories, it meant expansion of business operations, eyeing the reserved funds to support the payments for purchases, loans and trade payables. Petitioner alleges that it is also a reasonable need of the business to remain liquid while implementing an expansion plan.

Petitioner's claim has no merit.

It bears stressing that petitioner's reason for accumulating its earnings of ₱110 Million in 2009 was to maintain its liquidity in order to purchase inventories to prepare for its alleged business expansion plan in the Visayas Region in connection with the Exclusive Marketing Agreement with FTC in 2006. However, petitioner's alleged business expansion plan failed to pass the so-called "Immediacy Test". It failed to justify its claim that the accumulated profits are for the immediate and reasonable needs of the business.

The Court observed that instead of being immediately utilized through the alleged implementation of the planned business expansion for taxable years 2007, 2008, 2009 and 2010, the appropriated retained earnings even increased from ₱15 million to ₱165 million in the span of four (4) years. The Court reiterates its findings in the assailed Decision, as follows:

"In the instant case, petitioner asserts that by virtue of its Exclusive Marketing Agreement 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. Allegedly, it is also a reasonable need of the business to remain liquid while implementing an expansion plan.

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:

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, 2009 and 2010, 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 |

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.

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

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 immediate and reasonable needs of the business.

In the case of *Cyanamid Philippines, Inc. vs. The Court of Appeals, et. al.*, 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 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.'

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." (*Citations omitted*)

The upward trend clearly runs counter to the so-called "Immediacy Test" in the *Cyanamid* case which stated that that "accumulated profits must be used within a reasonable time after the close of the taxable year." In other words, if the funds sourced from appropriated retained earnings were truly needed to address the immediate needs of the business, why did it consistently end up accumulating more and more profits for the four (4) consecutive year-ends? Unfortunately, petitioner failed to offer sufficient evidence to explain the increase of its profits for 4 years.

Moreover, the self-serving testimonies on the alleged business expansion plan were contradicted by the fact that the same never took place because of the business combination that transpired between FTC and Philip Morris Corporation, which created the Philip Morris Fortune Tobacco Corporation (PMFTC). Thus, in November 2013, petitioner reverted ₱230 million appropriated earnings to unrestricted retained earnings and declared the same as cash dividends. In April 2014, cash dividends in the amount of ₱58 million was also declared. Considering these events, petitioner, however, did not bother to explain how the combination could have affected the alleged business expansion plan to the extent that the funds previously held up were no longer needed and had to be eventually distributed to its stockholders.

Considering the foregoing, petitioner's allegation on the matter is found to be bereft of merit.

Likewise, petitioner contends that the Consolidated Financial Statement for the years 2009 and 2010 shows as Note No. 10 to the Statements of Financial Position the disclosure about the appropriations. However, the Court cannot consider the same as sufficient disclosure in accordance 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;
>
> (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 that is deemed relevant to an understanding of any of them.** (*Emphasis supplied*)

Petitioner failed to comply with such disclosure requirement. A significant transaction such as an appropriation for future business expansion is one of the information needed to be disclosed in the financial statements to apprise (1) the stockholders, on the reduction of the retained earnings available for distribution to them; and (2), more importantly, the government and public, as to the entity's accountability as a taxpayer and a service provider.[2] Thus, petitioner is subject to IAET for its failure to provide the details of its planned business expansion as required under Paragraph 103 of PAS 1.

It is also worthy to note that the Secretary's Certificate dated February 17, 2010 issued by petitioner's 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" did not also provide the details of the alleged planned expansion, as held in the assailed Decision, as follows:

> "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'.
>
> 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."

Accordingly, the Court shall not sustain petitioner's claim that by the Notes to Financial Statements No. 10, the readers of its

---

[2] *Greenhills Properties, Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 8295, May 15, 2015.

Financial Statements as of year-end 2010 and 2009 were apprised of the appropriations of the retained earnings.

Petitioner also argues that the Net Retained Earnings ₱70,071,318.00 as of December 31, 2009 is a proper subject in the examination of petitioner's books of accounts and other accounting records of petitioner for all internal revenue taxes for the taxable year 2010. According to petitioner, retained earnings as of the end of 2009 which was appropriated in 2010 should not be included in the 2009 IAET assessment as the tax is not yet due until January 15, 2011. In this regard, Section 29 of the National Internal Revenue Code (NIRC) of 1997, as amended provides:

> "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.
>
> xxx xxx xxx
>
> (C) *Evidence of Purpose to Avoid Income Tax.* –
>
> xxx xxx xxx
>
> (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." (*Emphasis supplied*)

Section 7 of Revenue Regulations (RR) No. 02-01 also provides:

"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.

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 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)*

Pursuant to the above provisions, an improperly accumulated earnings tax equivalent to 10% of the improperly accumulated earnings shall be imposed on corporations that permit its earnings and profits to accumulate, instead of being distributed as dividends. Specifically, there is *prima facie* instance of accumulation of profits as provided above when a corporation allows its earnings to accumulate in excess of 100% of the paid-up capital, not otherwise intended for the reasonable needs of its business, which is also indicative of the purpose to avoid income tax upon shareholders.

In this case, it must be noted that respondent found that petitioner had earnings in excess of one hundred percent (100%) of its capital stock in taxable year 2009. Moreover, petitioner failed to prove that these accumulated earnings in 2009 are for the immediate and reasonable needs of its business. In fact, petitioner's alleged business expansion plan for which it allocated ₱110 Million did not take place. Hence, petitioner made a declaration of cash dividends in November 2013 and April 2014. Therefore, the imposition of IAET against petitioner's accumulated income in taxable year 2009 is proper.

Finally, petitioner contends that the computation must not include retained earnings from prior years. It must be stressed, however, that the undistributed earnings or profits of prior years are taken into consideration in order to determine unreasonable accumulation of profits, as held in the case of *Basilan Estates, Inc. vs. The Commissioner of Internal Revenue, et al.*[3], as follows:

> "Petitioner questions why the examiner covered the period from 1948-1953 when the taxable year on review was 1953. The surplus of ₱347,507.01 was taken by the examiner from the balance sheet of petitioner for 1953.

[3] G.R. No. L-22492, September 5, 1967.

> To check the figure arrived at, the examiner traced the accumulation process from 1947 until 1953, and petitioner's figure stood out to be correct. There was no error in the process applied, for previous accumulations should be considered in determining unreasonable accumulations for the year concerned. 'In determining whether accumulations of earnings or profits in a particular year are within the reasonable needs of a corporation, it is necessary to take into account prior accumulations, since accumulations prior to the year involved may have been sufficient to cover the business needs and additional accumulations during the year involved would not reasonably be necessary.'"

In view of all the foregoing, the Court finds no compelling reasons that will justify the reversal of the assailed Decision.

**WHEREFORE**, premises considered, petitioner's **Motion for Reconsideration (of the Decision promulgated on December 16, 2016)** is **DENIED** for lack of merit.

**SO ORDERED.**

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

I CONCUR:

**CAESAR A. CASANOVA**
Associate Justice