REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

TRANS-ASIA (PHILIPPINES), INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3729

THE ACTING COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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1/30/87

D E C I S I O N

This case presents the question whether the petitioner, a domestic corporation incorporated on July 20, 1965, wholly-owned subsidiary of Trans-Asia Engineering Associates, Inc. (USA), engaged in architectural, engineering and designing consultancy, could be taxed under Section 25 of the Tax Code, infra, on improperly accumulated surplus for the taxable year 1974, as demanded in the respondent's letter dated March 15, 1979, detailed as follows:

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Improperly accumulated surplus	₱519,184.00
25% surtax	129,896.00
Add: 14% int. fr. 4-16-75 to 4-16-78 ...	54,566.32
TOTAL AMOUNT DUE AND COLLECTIBLE	₱184,452.32

In a letter dated April 16, 1979 petitioner protested and sought cancellation of the aforesaid assessment, alleging among other things, that the accumulation is proper; that the surplus found in the financial statement are for the reasonable needs of the business considering the low liquidity as the ratio of its current assets in relation to current liabilities is only 1.99 to 1; that part of the retained earnings is allocated to finance its expansion program; and that the intercompany advances are required by the demands of the business for convenience as certain expenses of its parent company and itself must have to be met.

Respondent Commissioner of Internal Revenue contends that the petitioner permitted profits and earnings to accumulate beyond the reasonable needs of the business and failed to declare dividends for the year 1974, denied the protest by reiterating the assessment in a letter dated December 13, 1983. Hence this appeal.

The pertinent provision of Section 25 of the Tax Code insofar as applicable states:

> Sec. 25. Additional tax on corporations improperly accumulating profits or surplus. - (a) Imposition of tax. If any corporation, except banks, insurance companies, or personal holding companies whether domestic or foreign, is formed or availed of for the purpose of preventing the imposition

> of the tax upon its shareholders or members or the shareholders or members of another corporation, through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there is levied and assessed against such corporation, for each taxable year, a tax equal to twenty-five per centum of the undistributed portion of its accumulated profits or surplus which shall be in addition to the tax imposed by Section twenty-four, and shall be computed, collected and paid in the same manner and subject to the same provisions of law, including penalties, as that tax.
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> xxx xxx xxx
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> (c) Evidence determinative of purpose. - The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by clear preponderance of evidence, shall prove the contrary.

The case before Us is essentially addressed to a surplus allegedly accumulated beyond the reasonable needs of the business. And, what argues strongly for the additional imposition of the 25% surtax under Section 25, supra, is the amount of advances rather than on the entire retained earnings deemed proof that the taxpayer had no immediate need for such amount as working capital. As so ascertained during the year under review, the petitioner's "financial position is strong and has sufficient funds to meet the needs of its business operation", in fact, "was in a position to advance as it did advance funds to finance its parent company's local activities. This indicated that it had sufficient funds available for dividend distribution, allegations of low liquidity notwithstanding. The records show that out of its total advances of ₱1,450,606.00, a balance of ₱519,584.00 remained unspent and unpaid by the parent company at the end of the year which unspent and unrefunded balances constitute indirect loans to stockholders and are indicative of unreasonable accumulation of surplus." The records further show that petitioner has not presented any evidence, documentary or otherwise, to prove repayment of such advances or loans in spite of the lapse of a considerable time. As thus, "If the taxpayer really wanted to declare dividends in 1974 it could have done so without impairing its cash position. This is by converting or declaring the unspent balance of the home office (₱519,584.00) into dividends the taxpayer being a wholly-owned subsidiary of the home office, practically owns 100% of the taxpayer's stocks."

By the foregoing finding We perceive no tenable justification for the loan preference vis a vis dividend distribution of the surplus. If a corporation can spare funds for loans to shareholders certainly it has the capacity to pay dividends. Petitioner's dividend paying track record which appears nil for the period from 1965 through 1974 comes as an aggravated chutzpah. This clearly focuses petitioner's particular vulnerability to the Section 25 tax. To hold otherwise would be to exalt an expedient contingency over the import of a permissible surplus and deprive the statutory provision in question of all serious purpose. If We recall, the avowed goal of Section 25 supra is to force certain corporation to distribute dividends for the reason that "If the earnings and profits were distributed, the shareholders would be required to pay an income tax thereon whereas, if the distribution were not made to them, they would incur no tax in respect to the undistributed earnings and profits of the corporation. Mertens, Law of Federal Income Taxation, Vol. 7, Chapter 39, p. 44. The touchstone of liability is the purpose behind the accumulation of the income and not the consequences of the accumulation. Thus, if the failure to pay is due to some other cause, such as the use of undistributed earnings and profits for the reasonable needs of the business, such purpose does not fall within the interdiction of the statute." (Manila Wine Merchants, Inc. v. Commissioner of Internal Revenue, 127 SCRA 493). We hesitate to further fashion an issue into a satisfactorily settled legal situation.

The aspect of an expansion program proffered by the petitioner as a reason for the undistributed earnings appears to have fallen short of measuring up to the proscription of "reasonably anticipated needs". As correctly observed by the respondent Commissioner of Internal Revenue, "We have likewise ruled out your defense of expansion program since it was found out that no reserve was set up in your client's (petitioner) books for such purpose. Neither was there a board resolution adopted to that effect. Accordingly, it is believed that the expansion program, if ever there was, lacked the requisite factual justification." In these circumstances the facts speak for themselves and are susceptible of but one interpretation. Such needs must be specific, definite and feasible. It may be necessary to repeat what the Supreme Court said and what so plainly apply to the case at bar, inter alia, "In order to determine whether profits are accumulated for the reasonable needs of the business as to avoid the surtax upon shareholders, 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. Basilan Estates, Inc. v. Comm. of Internal Revenue, 21 SCRA 17 citing Jacobs Mertens, Jr., The Law of Federal Income Taxation, Vol. 7 Cum Supp. p. 213; Smoot Sand & Gravel Corp. v. Comm. 241 F 2d 197. A speculative and indefinite purpose will not suffice. The mere recognition of a future problem and the discussion of possible and alternative solutions is not sufficient. Definiteness of plan coupled with action taken towards its consummation are essential. Fuel Carriers, Inc. v. US 202 F Supp. 497; Smoot Sand & Gravel Corp. v. Comm. supra." (Ibid. 127 SCRA 496). Petitioner has overplayed its understanding of "reasonably anticipated needs" which seemed more than a clumsy attempt to defuse an improper accumulation. Aptly enough We uphold the respondent Commissioner of Internal Revenue.

It may therefore suffice to state that We would do violence to the plain meaning of the statute and restrict a clear legislative intent to bring the taxing power to bear upon an improper accumulation were We to say that the surplus in the case at bar has been properly accumulated.

WHEREFORE, petition is dismissed and the petitioner ordered to pay the amount of ₱184,452.32 representing the 25% surtax and such other increment that had legally accrued, with costs.

SO ORDERED.

Quezon City, Metro Manila, January 30, 1987.

ALEX Z. REYES
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge