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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ANTONIO TUASON, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3865

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

10/14/88

D E C I S I O N

Under date of February 27, 1981, respondent Commissioner of Internal Revenue assessed petitioner Antonio Tuason, Inc.:

(a)	Deficiency income tax for the years 1975, 1976 and 1978	P 37,491.83
(b)	Deficiency corporate quarterly income tax for the first quarter of 1975.....	161.49
(c)	25% surtax on unreasonable accumulation of surplus for the years 1975-1978	1,151,146.98

Petitioner did not object to the first and second items and, therefore, paid the amounts demanded. However, petitioner protested the assessment for 25% surtax in regard to the third item on the ground that the accumulation of surplus profits during the years in question was solely for the purpose of expanding its business operations as real estate broker. The request for reinvestigation was granted on condition that a waiver of the statute of limitation should be filed by petitioner. In reply, petitioner advised respondent that there was no need of a waiver of the statute of limitation because the right of the Government to assess said tax does not prescribe.

It appears that no investigation was conducted nor a decision rendered on petitioner's protest. Meantime, respondent issued warrants of distraint and levy to enforce collection of the total amount originally assessed including the amounts already paid. Hence, the present petition for review with a request that pending determination of the case on the merits, an order be issued to restrain respondent and/or his representatives from enforcing the warrants of distraint and levy. Since the right asserted by respondent in behalf of the collection of the taxes involved herein by the summary methods of distraint and levy was not clear, and it was shown that portions of the tax liabilities involved in the assessment had already been paid, a writ of injunction was issued by this Court dated November 26, 1984 ordering respondent to refrain from enforcing said warrants of distraint and levy without requiring petitioner to file a bond.

Section 25(a) of the applicable National Internal Revenue Code imposes an additional tax upon a corporation formed or availed of for the purpose of preventing the imposition of the tax upon its shareholders or the shareholders of any other corporation through the medium of permitting its gains and profits to accumulate instead of being divided or distributed. Under Section 25(b) thereof, the fact that the corporation is a mere holding company or an investment company where at any time during the taxable year more than fifty (50%) per centum in value of its outstanding stock is owned, directly or indirectly, by one person shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. And Section 25(c) provides that the fact that 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 on shareholders unless the corporation shall prove to the contrary by a clear preponderance of the evidence.

Petitioner is a domestic corporation organized and existing under the laws of the Philippines with principal office at 401 (formerly 504) A & T Building, Escolta, Manila. It is engaged in business as real estate dealer and its income is derived mainly from sales of lots and rentals of real property. During the years under review (1975-1978), it paid the annual real estate dealer's fixed tax. (Exh. 1, p. 180, BIR records; See also pp. 54, 78, 98 and 126, BIR records.)

For calendar years 1975, 1976 and 1978, petitioner filed its corporate annual income returns and after investigations thereof, respondent assessed against petitioner deficiency income tax of P37,491.83; deficiency corporate quarterly income tax for the first quarter of 1975 of P161.49; and 25% surtax for alleged unreasonable accumulation of surplus of P1,151,148.96. As stated earlier, petitioner paid the P37,491.83 and P161.49 but protested the P1,151,146.98.

With the issuance by respondent of the warrants of distraint and levy to enforce collection of the assessment, petitioner Antonio Tuason, Inc., brought this appeal on the question of whether or not petitioner is liable for the 25% surtax on undue accumulation of surplus for the years 1975, 1976, 1977 and 1978 in the sum of P1,151,148.96.

Since the provisions of Section 25 of the National Internal Revenue Code which were in effect during the ears under review were bodily lifted from Section 102 of the U.S. Internal Revenue Code of 1939, including the regulations issued in connection therewith, it would be proper to refer to applicable cases decided by the American Federal Courts for guidance and enlightenment. (Manila Wine Merchants, Inc. vs. Commissioner of Internal Revenue, L-26145, Feb. 20, 1984, 127 SCRA 483.)

A prerequisite to the imposition of the tax has been that the corporation be formed or availed of for the <u>purpose</u> of avoiding the income tax (or surtax) on its shareholders, or on 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. If the failure to pay dividends is due to some other cause, such as the use of the undistributed earnings and profits for the reasonable needs of the business, such purpose does not fall within the interdiction of the statute. (Mertens, Law of Federal Income Taxation, Vol. 7, Chapter 39, p. 44; See also Sec. 21, Rev. Regs. No. 2; Manila Wine Merchants, Inc. vs. Commissioner of Internal Revenue, supra.)

Inasmuch as purpose involves a state of mind or intent, it is always necessary to look at the surrounding circumstances and the attendant facts in each individual case to determine whether the purpose of the failure to make distribution was to permit the shareholders to avoid the income tax or for some other purpose, such as the use of the earnings and profits for the reasonable needs of the business. In this regard, although the testimony of the taxpayer, officers and stockholders is entitled to some weight, generally the issue is to be resolved in the light of the surrounding circumstances, including the interests of those in control and their actual conduct. (Mertens, Law of Federal Income Taxation, Vol. 7, Chapter 39, p. 45.) The applicable principles of law are clear and in the end the decision in this case must rest upon its own peculiar facts and circumstances.

Section 25(b) of the Tax Code at the time the surtax involved herein was assessed provided that a corporation which was a mere holding or investment company was considered *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. This presumption, as expressly provided by the law, is only *prima facie*. Thus, while respondent's determination is presumptively correct and casts upon petitioner the burden of offering evidence in opposition thereto, the Court recognizes that once such evidence is presented the presumption of correctness disappears and the question then is whether under all the evidence petitioner has sustained the burden placed upon it by the applicable law. Obviously, our decision should therefore turn upon whether the finding of the Commissioner of Internal Revenue that petitioner accumulated earnings and profits beyond the reasonable needs of its business is supported by the evidence, and if so, whether petitioner has sustained the burden which the applicable law then places upon it to overcome the effect thereof.

The circumstances relied upon by respondent as indicating that petitioner has permitted its earnings to accumulate beyond the reasonable needs of the business are as follows: (pp. 129-131, CTA records.)

> Antonio Tuason, Inc. during the years in question is engaged in business as real estate dealer. However, its business operations was more of a holding or investment company, deriving income mostly from interest, dividends and rental realized from sale of realty. It is likewise found by respondent's revenue examiner that although petitioner sold subdiv ion lots, it did not in a strict sense, involved on development of subdivisions but merely subdivided the lot it owned and sold the same for bigger profits (Exhibit "1-c", Respondent; page 179, BIR records).
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> In a letter submitted to the Bureau by petitioner's Corporate Secretary dated June 17, 1980 (page 36, BIR records), Antonio Tuason, Inc., is virtually owned and controlled by its President, Antonio Tuason, who, out of the 25,306 shares of stock, owned 25,302 shares thereof, or 99.99% of the total shares outstanding.

Section 25(b) of the Tax Code of 1977 as amended, provides that the mere existence of a holding or investment company is a *prima facie* evidence of its purpose to avoid imposition of progressive income tax upon its shareholders on the undistributed surplus where at anytime during the taxable year more than fifty per centum in value of its outstanding stock is owned directly or indirectly by one person. In the instant case, Antonio Tuason, president of herein petitioner owned 99.99% of its shares of stocks.

Accordingly, it can be conclusively presumed that petitioner is liable for 25% surtax on its undue accumulation of surplus for the years 1975, 1976, 1977 and 1978 because the same was intended to avoid the imposition of the progressive income tax in the hands of its shareholders.

In the resolution of the Supreme Court in G.R. No. L-29485 entitled "Commissioner of Internal Revenue vs. Ayala Securities Corp., et al", promulgated on November 21, 1980, 101 SCRA 231-242, it was held that:

> "The underlying purpose of the additional tax in question on a corporation's improperly accumulated profits or surplus is as set forth in the text of Section 25 of the Tax Code itself to avoid the situation where a corporation unduly retains its surplus earnings instead of declaring and paying dividends to its shareholders or members who would then have to pay the income tax due on such dividends received by them. The record amply show that respondent corporation is a mere holding

> company of its shareholders through its mother company, a registered co-partnership then set up by the individual shareholders belonging to the same family and that the prima facie evidence and presumption set up by the Tax Code, therefore, applied without having been adequately rebutted by the respondent corporation."

The remaining question therefore is whether petitioner Antonio Tuason, Inc., has met the burden which the statute places upon it to overcome the presumption that it was availed of for the prohibited purpose. Such presumption arose by virtue of the finding of respondent that "the mere existence of a holding or investment company is a *prima facie* evidence of its purpose to avoid imposition of progressive income tax upon its shareholders on the undistributed surplus where at anytime during the taxable year more than fifty per centum in value of its outstanding stock is owned directly or indirectly by one person. In the instant case, Antonio Tuason, president of herein petitioner owned 99.99% of its shares of stocks.

In the instant case, we think that petitioner Antonio Tuason, Inc., has adequately sustained the burden placed upon it by the law that it was not availed of for the purpose of preventing the imposition of the surtax upon its stockholders. Petitioner has sufficiently rebutted the presumption by clear preponderance of evidence that its surplus profits during the years in question were invested by it for a legitimate business purpose as a real estate dealer.

As amply supported by the record and the evidence presented, sometime in 1975, the Board of Directors of petitioner decided to expand its business operation as its income from sales of lots was gradually receding so that its real estate business would no longer provide enough means to sustain its operation for the succeeding years. It was, therefore, decided to construct low-cost housing as evidenced by the minutes of the meeting of the Board of Directors on November 26, 1976, the pertinent portion of which reads as follows:

> A discussion ensued as to what investment could be made with said surplus. Suggestions were made to engage in the construction of low-cost housing and to construct apartments for lease. After taking note of the pros and cons of the suggestion, it was resolved, upon motion of Mr. Araneta, duly seconded.

> That the President and the Treasurer be commissioned to make a study of the best or most profitable investments to be made with the surplus and to get, if they deem it necessary, the advice of others.

(Exh. A-3, page 217, BIR records.)

In 1977, Mr. Antonio Tuason and Miss Lucy Gonzalez, President and Treasurer, respectively, of petitioner corporation were "authorized to determine the best site available for apartment houses, to engage the services of architects for the preparation of the necessary plans for said apartment houses, and to recommend to the Board the approval of such plans as they may deem acceptable and such amount as may be necessary to appropriate or set aside for the construction thereof." (See minutes of the meeting of the Board of Directors, November 28, 1977, Exh. A-2, page 217, BIR records.)

In 1978, it was decided to construct the apartment house on Lot No. 12, Block 2, covered by T.C.T. No. 44736 of the Register of Deeds of Quezon City. The plan for the construction of the apartment building as prepared by Architect Ramon Eguaras was submitted to and approved by the Board. At the same time, the plan for the construction of said building was submitted to and approved by the Ministry of Human Settlement and the Office of the City Engineer of Quezon City. (See minutes of the meeting of the Board of Directors, August 28, 1978 and November 20, 1978, Exhs. A and A-1, pp. 215-216, BIR records.)

In 1979, after accumulating a surplus of P3,263,305.88, sufficient to start its expansion program, the construction of an apartment building was started. The building was completed in 1981 at a cost of P1,525,672.74. (See Exh. C, p. 66-A, CTA records.) In addition to the apartment building, petitioner acquired a condominium apartment in 1980 at a cost of P1,752,332.87 which was intended for sale or lease. (See Exhs. D and D-1, pp. 64-B and 66-C, CTA records.) Since acquisition of these properties, petitioner has been deriving substantial income as evidenced by its annual income tax returns.

It is the accumulated surplus for the years 1975-1978 in the aggregate amount of P3,263,365.58 which has been treated by respondent as having been "accumulated beyond the reasonable needs" of the business of petitioner. Accordingly, respondent sought to impose upon petitioner the penalty tax of 25% of the alleged unreasonable accumulation of profits, pursuant to Section 25 of the 1977 Code. However, as can clearly and plainly be observed, the entire surplus accumulated during the years in question were utilized solely and exclusively for the expansion of petitioner's business operation as a real estate dealer. No part of said amount was invested in any activity or enterprise alien to the business of petitioner.

All these facts and circumstances, which are not questioned or disputed by respondent, amply support the conclusion that petitioner Antonio Tuason, Inc., was not availed of for the purpose of preventing the imposition of the surtax upon its shareholders. Petitioner having successfully negatived such a purpose by a clear preponderance of the evidence, the assessment against it in the amount of P1,151,148.96 as surtax for alleged unreasonable accumulation of surplus for the years 1975 to 1978 cannot be sustained.

WHEREFORE, the decision appealed from should be, as it is hereby, reversed. No costs.

SO ORDERED.

Quezon City, Metro Manila, October 14, 1988.

AMANTE FILLER
Presiding Judge

WE CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

ALEX Z. REYES
Associate Judge

C E R T I F I C A T I O N

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

AMANTE FILLER
Presiding Judge
Court of Tax Appeals