REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FILINVEST DEVELOPMENT CORPORATION and FILINVEST ALABANG, INC.,
Petitioners,

- versus -

C.T.A. CASE NO. 6182

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
SEP 10 2002

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DECISION

Elevated before this Court is a Petition for Review seeking for the annulment and cancellation of the following alleged deficiency tax assessments, issued by respondent against herein petitioners, thus:

I. Against Filinvest Development Corporation (FDC) –

a. Deficiency income tax – P 150,074,066.27 (for 1996)
b. Deficiency income tax – P 5,716,972.03 (for 1997)
c. Deficiency documentary stamp tax – P 10,425,487.06 (for 1996)
d. Deficiency documentary stamp tax – P 5,796,699.40 (for 1997)

II. Against Filinvest Alabang, Inc.(FAI) –

a. Deficiency income tax – P 1,477,494,638.23(for 1997)

The facts of the case, as adduced from the parties' "Stipulation of Facts, Documents and Issues" dated February 14, 2001 and approved by this Court in a resolution promulgated on February 16, 2001, are as follows:

RE: The Parties

1.00 Petitioners Filinvest Development Corporation and Filinvest Alabang Inc. are both domestic corporations duly registered and existing under Philippine laws, with office addresses at 173 P. Gomez Street, San Juan, Metro Manila, and FAI Administration Office, Alabang-Zapote Road, Filinvest Corporate City, Alabang, Muntinlupa City, respectively (Par. 2.00, Petition; par. 1, Answer);

1.01 Respondent Commissioner of Internal Revenue is the head of the Bureau of Internal Revenue, with office address at the Office of the Commissioner of Internal Revenue, BIR Building, Quezon City, Metro Manila (par 2.01, Petition; par.1, Answer).

RE: The Deed of Exchange

1.02 On November 29,1996, petitioner Filinvest Development Corporation (FDC), petitioner Filinvest Alabang, Inc., (FAI) and Filinvest Land Incorporated (FLI) entered into a Deed of Exchange whereby FDC and FAI agreed to transfer to FLI certain parcel of land, with a total appraised value of P 4,306,777.00, in exchange for 463,094,301 shares of stock of FLI (pars.1.01 and 3.00, Petition; pars. 1 & 2, Answer).

1.03 The properties transferred by FDC and FAI to FLI pursuant to the Deed of Exchange are suitable and intended for medium rise residential and commercial building development. FDC is an investment holding company with substantial investments in real estate companies, principally FLI and FAI, and is not directly engaged in the business of holding title to, developing and selling commercial, industrial or residential properties. On the other hand, among the companies of the Filinvest Group, FLI, being directly engaged in real property development, has the experience, resources and expertise required to successfully undertake such intended development of the properties subject of the exchange. The execution of the Deed of Exchange was premised on legitimate business reasons (par. 3.01, Petition; par. 2, Answer).

1.04 The comparative stock ownership structure of FLI prior to and after the exchange is, as follows:

Prior to the exchange, the ownership structure of FLI was, as follows:

Stockholder	No. of shares held	Ownership %
FDC	2,537,358,000	67.42%
FAI	NONE	0%
Others	1,226,177,000	32.58%
Total Outstanding FLI shares	3,763,535,000	100%

After the exchange, new shares of stock of FLI were issued to FDC and FAI in exchange for the properties conveyed by FDC and FAI to FLI. As a result, the ownership structure of FLI was changed, as follows:

Stockholder	Number of Shares owned	Additional Shares issued	Total Number of shares	% of Ownership
FDC	2,537,358,000	42,217,000	2,579,575,000	61.03%
FAI		NONE	420,877,000	9.96%
Others	1,226,177,000		1,226,177,000	29.01%
Total	3,763,535,000	443,094,000	4,226,629,000	100.00%

(par. 5.11, Petition; par. 7, Answer)

1.05 The reduction of FDC's proportionate equity interest in FLI resulted from an increase in the total number of outstanding shares of FLI brought about by the issuance of additional shares necessitated by the exchange. As of the date of the Deed of Exchange and up to the present, FDC directly owned 80% of the outstanding shares of FAI, the remaining 20% being held by FLI. Through its 80% ownership of FAI, FDC's ownership interest in FLI increased through FAI's acquisition of 9.96% of the outstanding shares of FLI after the exchange, as shown below:

% of FLI shares directly owned by FDC	% of FLI Shares held indirectly through FAI (80% of FAI's % ownership)	FCD's Total % Ownership after the Exchange
61.03%	7.968%	68.998%

1.06 On January 13, 1997, FLI wrote to the BIR requesting for a ruling that no gain or loss would be recognized in the transfer of the real properties subject of the Deed of Exchange by FDC and FAI to FLI, in accordance with BIR Revenue Memorandum Order No. 26-92 and Section 34, paragraphs (c)(2) and (6)(c), of the old NIRC.

1.07 The Bureau of Internal Revenue (BIR) ruled on February 3, 1997 (Ruling No. S-34-046-97) that the exchange fell squarely among the transactions contemplated under Section 34(c)(2) of the National Internal Revenue Code (NIRC), which provides that "[n]o gain or loss shall be recognized if property is transferred to a corporation by a person in exchange for stock in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four persons, gains control of said corporation" (pars. 3.03 and 5.05, Petition; pars. 4 and 9, Answer).

1.08 Upon request for clarification by FLI on February 10, 1997, the BIR reiterated its above ruling, stressing that the transferors FDC and FAI clearly gained control of FLI (pars. 3.04 and 5.06, Petition; pars. 4 and 9, Answer).

1.09 The implementing requirements imposed by BIR Ruling No. S-34-046-97, declaring that the exchange in question fell among the transactions contemplated under Section 34(c)(2) of the old NIRC where no gain shall be recognized, which requirements had to be observed in order that the taxpayers may avail of the non-recognition of gain as provided for in said section, were all complied with by FDC, FAI, and FLI.

<u>RE: The Inter-company Advances</u>

1.10 On various dates during the years ended December 31, 1996 and December 31, 1997, FDC extended to its affiliates various advances.

<u>RE: The Joint Venture Company</u>

1.11 On November 15, 1996, FDC entered into a Shareholders' Agreement ("SA") with Reco Herrera Pte Ltd ("RHPL") for the formation of a joint venture company named Filinvest Asia Corporation ("FAC"), which is based in Singapore (pars. 1.01 and 6.11, Petition; pars. 1 and 7, Answer).

1.12 FAC, the joint venture company formed by FDC and RHPL, is tasked to develop and manage the 50% ownership interest of FDC in its PBCom Office Tower Project ("Project") with the Philippine Bank of Communications (par. 6.12, Petition; par. 7, Answer).

1.13 Pursuant to the SA between FDC and RHPL, the equity participation of FDC and RHPL in FAC was 60% and 40%, respectively.

1.14 In accordance with the terms of the SA, FDC subscribed to P500.7 million worth of shares of stock representing a 60% equity participation in FAC. In turn, RHPL subscribed to P433.8 million worth of shares of stock of FAC representing a 40% equity participation in FAC.

1.15 In payment of its subscription in FAC, FDC executed a Deed of Assignment transferring to FAC a portion of FDC's rights and interests in the Project to the extent of P500.7 million.

1.16 FDC reported a net loss of P190,695,061.00 in its Annual Income Tax Return for the taxable year 1996.

RE: The Deficiency Assessments

1.17 On January 3, 2000, petitioner FDC received from the BIR a Formal Notice of Demand with accompanying four (4) Assessment Notices, all dated January 3, 2000, informing petitioner that after investigation, there was found due from FDC a deficiency income tax of P150,074,066.27 for 1996, a deficiency documentary stamp tax of P10,425,487.06 for the same year, a deficiency income tax of P5,716,972.03 for 1997, and a deficiency documentary stamp tax of P5,796,699.40, also for 1997 (par. 3.12, Petition; par. 2, Answer).

1.18 On the same date, January 3, 2000, petitioner FAI received from the BIR a Formal Notice of Demand with its accompanying Assessment Notice, all dated January 3, 2000, informing petitioner that after investigation, there was found due from FAI a deficiency income tax of P 1,477,494,638.23 for 1997 (par. 3.15, Petition; par. 2, Answer).

RE: The Requests for Reconsideration/ Protests filed by petitioners

1.19 On January 26, 2000, or within the reglementary period of thirty (30) days, FDC filed with the BIR a Request for Reconsideration/Protest of the assessments against it (par. 3.17, Petition; par. 2, Answer).

1.20 On the same date, January 26, 2000, or likewise within the reglementary period of thirty (30) days, FAI also filed with the BIR a Request for Reconsideration/Protest (par. 3.18, Petition; par. 2, Answer).

1.21 On March 24, 2000, in compliance with the letter dated January 31, 2000 of the Appellate Division of the BIR, to which the aforesaid Requests for Reconsideration/Protests were referred, and within the reglementary period of sixty (60) days from filing of the protests, petitioners submitted to the Appellate Division all relevant supporting documents (par. 3.19, Petition; par. 2, Answer).

1.22 On September 11, 2000, petitioners filed with the BIR Appellate Division a letter dated September 11, 2000, informing the latter that the one hundred eighty-day period within which the BIR had to act on their Requests for Reconsideration/Protests under the last paragraph of Section 228 of the NIRC of 1997 was to expire on September 20, 2000, and requesting for an early resolution of said Requests for Reconsideration/Protests (par. 3.20, Petition; par. 2, Answer).

1.23 On September 19, 2000, petitioners filed with the Commissioner of Internal Revenue a letter dated September 18, 2000 reiterating their request of September 11, 2000 (par. 3.21, Petition; par. 2, Answer).

1.24 As of the date of the Petition for Review in this case, no action had been taken by respondent on petitioners' Requests for Reconsideration/Protests (par. 3.22, Petition; par. 2, Answer).

1.25 The Petition is an appeal from the deficiency income tax and documentary stamp tax assessments made against petitioners by the BIR, arising from the inaction of respondent Commissioner of Internal Revenue with regard to the Requests for Reconsideration/Protests which petitioners filed under Section 228 of the NIRC of 1997 on said assessments (par. 1.00, Petition; par. 1, Answer).

1.26 The Petition was filed pursuant to the last paragraph of Section 228 of the 1997 NIRC, which provides that if the protest is not acted upon within one hundred eighty (180) days from submission of the relevant supporting documents, the taxpayer adversely affected by the inaction may appeal to this Honorable Court within thirty (30) days from the lapse of the 180-day period, or until October 20, 2000 (pars. 1.03 and 3.23, Petition; pars. 1 and 2, Answer).

1.27 The Petition was filed within the 30-day period from the lapse of the 180-day period (par. 3.24, Petition; par. 2, Answer) ***(Stipulated Facts, par. 1.00-1.27, CTA docket. pp. 202-211)***

To have a clearer picture of the items of assessment issued by respondent against herein petitioners, we deem it best to provide hereunder the breakdown of the deficiency income and DST for calendar years 1996 and 1997 *(Exhibits D and E, CTA docket pp. 269 and 280)*, thus:

A. **Filinvest Development Corporation**

Deficiency Income Tax	1996	1997
Net Income (Loss) Per Return	(P 190,695,061.00)	(P 83,308,762.00)
Add: Additional taxable Income		
Interest Income (total)	140,948,001.38	95,208,065.64
Gain on Property Swap	263,386,921.00	-
Gain on Dilution	60,000,000.00	-
Taxable Income per Investigation	273,639,861.38	11,899,303.64
Income Tax Due thereon @ 35%	95,773,962.00	4,164,756.00
Less: Tax Due & Paid per return		
Deficiency Income Tax	95,773,962.00	4,164,756.00
Add: 20% Interest per annum	54,275,104.27	1,527,216.03
Compromise Penalty	25,000.00	25,000.00
TOTAL AMOUNT DUE	P 150,074,066.27	P 5,716,972.03

Documentary Stamp Tax

DST (Intercompany Advances)	P 6,400,693,62	P 4,050,599.62
Add: 20% Interest per annum	3,999,793.44	1,721,099.78
Compromise Penalty	25,000.00	25,000.00
TOTAL AMOUNT DUE	P 10,425,487.06	P 5,796,699.40

B. Filinvest Alabang Incorporated

Deficiency Income Tax	1997
Net Income (Loss) Per Return	(P 112,768,633.00)
Add: Gain on Property Swap	3,201,480,000.00
Taxable Income per Investigation	3,088,711,367.00
Income Tax Due thereon @ 35%	1,081,048,978.00
Less: Tax Due & Paid per return	-
Deficiency Income Tax	1,081,048,978.00
Add: 20%Interest per annum	396,420,660.23
Compromise Penalty	25,000.00
TOTAL AMOUNT DUE	P 1,477,494,638.23

On November 28, 2000, respondent, for his part, filed an Answer to the instant Petition for Review and raised the following Special and Affirmative Defenses, to wit:

1. The transfer of the properties of Filinvest Development Corporation (FDC) and Filinvest Alabang, Inc., (FAI) in exchange for shares of stock of Filinvest Land, Inc., (FLI) should not be considered as a tax-free exchange under Section 34 (c)(2) of the Tax Code. FDC's interest in FLI was, in fact, eroded after the exchange. The transfer leading to the corporate reorganization did not result in further control for FDC. Neither did FAI gain control. Hence, said transaction gave rise to a taxable gain on the part of the petitioners.

2. FDC realized gain on dilution arising from its Shareholders' Agreement with Reco Herrera PTE Ltd. for the formation of a joint venture company, Filinvest Asia Corporation. Such gain is taxable.

3. The various loans obtained by FDC from banks were interest-bearing but when the same were re-lent to its affiliates, these were non-interest bearing. Section 43, now Section 50 of the 1997 Tax Code, gives the Commissioner of Internal Revenue the power to allocate, distribute or apportion income or deductions between or among such organizations, trades or business in order to prevent evasion of taxes.

   This was implemented under Revenue Regulations No. 2, Section 179, (b) and (c), which clarified that indeed, the Commissioner can intervene by making distribution, allocation or apportionment as he may deem necessary on any item affecting net income between or among controlled taxpayers in order to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer.

4. The imposition of documentary stamp tax on inter-company loans and advances covered by an inter-office memo, check vouchers, and written instruction for fund transfers is anchored on the provisions of Section 180 of the Tax Code and Revenue Regulations No. 9-94, which provide that loan transactions, such as those entered into by FDC with its affiliates, whether or not evidenced by a formal agreement or by mere office memo, shall be subject to DST.

5. The assessments were issued in accordance with law and regulations.

6. All presumptions are in favor of the correctness of tax assessments *(CIR vs. Construction Resources Asia, Inc., 145 SCRA 67)*, and the burden to prove otherwise is upon the petitioner. *(Respondent's Answer, Items No. 14-19, CTA docket p. 172-174).*

The issues to be resolved in the case at bar which were jointly stipulated upon by the parties are as follows:

1. Has the exchange of shares of stock for property among FDC, FAI, and FLI met all the requirements for the non-recognition of a taxable gain [under] Section 34 (c)(2) of the old NIRC?

2. May interest income be imputed by respondent on the advances made by FDC to its affiliates?

3. May income tax be imposed on the prospective gain from appreciation in the value of FDC's shareholdings in FAC but not yet realized through sale or conversion of said shareholdings?

4. May documentary stamp tax be imposed on instructional letters or cash vouchers evidencing advances extended by FDC to its affiliates? *(Stipulated Issues, par. 4.01-4.04, CTA docket p. 223)*

The first issue which deals mainly with the deficiency income tax assessment against FDC and FAI is based upon the BIR examiners' finding that FDC and FAI failed to reflect in their income tax returns the alleged taxable income resulting from the property swap involving the parcels of land belonging to FDC and FAI and the shares of stock of FLI, and to pay the corresponding income tax due thereon.

However, petitioners aver that the transaction subject of the Deed of Exchange which took place among FDC, FAI and FLI qualified as a tax-free exchange under the then Section 34(c)(2) of the old Tax Code (now Section 40(c)(2) of the 1997 NIRC) for the reason being that the exchange of the parcels of land for the shares of stocks met all the requirements for the non-recognition of taxable gain, and as a result of the exchange, FAI and FDC collectively gained further control of FLI. Herein respondent, on the other hand, posits a contrary view saying that the transfer of property for shares should not be considered as tax-free since FDC's interest in FLI was, in fact eroded after the exchange and the transfer leading to the corporate re-organization did not result in further control for FDC.

We do not agree with the respondent.

The controversy at bar is one that shall be resolved in the light of the provision of Section 34 (c)(2) of the old Tax code, then applicable when the subject transaction took place, thus:

> "***Section 34. Determination of amount of and recognition of gain or loss.-***
>
> x x x x x x x x x
>
> (c) Exchange of property.
>
> x x x x x x x x x
>
> (2) Exception.- x x x
>
> No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for shares of stock in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four persons, gains control of said corporation: Provided, That stocks issued for services shall not be considered as issued in return of property."

As can be inferred from the aforequoted provision, no taxable gain from an exchange of property for shares of stock of a corporation shall be recognized if as a result of the exchange the transferor, alone or together with others, not exceeding four persons, gains control of the corporation. The term "control" as used in the above section shall mean ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stock entitled to vote (Section 34(c)(6)(c) of the 1993 Tax Code).

In order to determine whether FDC and FAI gained control of FLI as a result of the exchange, we deem it appropriate to examine the comparative stock ownership structure of FLI prior to and after the exchange, thus:

Prior to the exchange, the ownership structure of FLI was, as follows:

Stockholder	No. of shares held	Ownership %
FDC	2,537,358,000	67.42%
FAI	NONE	0%
Others	1,226,177,000	32.58%
Total Outstanding FLI shares	3,763,535,000	100%

After the exchange, new shares of stock of FLI were issued to FDC and FAI in exchange for the properties conveyed by FDC and FAI to FLI. As a result, the ownership structure of FLI was changed, as follows:

Stockholder	Number of Shares owned	Additional Shares issued	Total Number of shares	% of Ownership
FDC	2,537,358,000	42,217,000	2,579,575,000	61.03%
FAI	NONE	420,877,000		9.96%
Others	1,226,177,000		1,226,177,000	29.01%
Total	3,763,535,000	443,094,000	4,226,629,000	100.00%

It is significant to note that prior to the exchange FDC held 67.42% of the total voting stocks of FLI while FAI, initially, did not hold any stock at all. After the exchange, new shares of stock were issued and as a result, FDC owned 61.03% and FAI had 9.96% of stockholdings. Evidently, the exchange of properties between FDC and FAI with FLI resulted in the further control of FDC and FAI as far as stock ownership in FLI is concerned.

The seeming reduction of the number of shares owned by FDC after the exchange does not affect the so-called control requirement. As correctly pointed out by the petitioners, it is incorrect to isolate the effect of the exchange on FDC's equity in FLI from that of FAI. The transaction of FDC and FAI with FLI should not be treated separate and distinct from each other, but instead they must be viewed together. Section 34(c)(2), as above-quoted, speaks of control being acquired "alone or together with others, not exceeding four persons." Clearly the control requirement is sufficiently met when after the transfer, the transferors, not more than four, collectively become the owners of at least 51% of the equity of the transferee, or if already owning 51%, increase their equity further in the transferee corporation. It is not required that each of the several transferors individually gains control or individually increases their interest. What is important is that each of the transferor, numbering not more than four, collectively increases his equity in the transferee corporation by 51% or more.

Numerous BIR rulings were even issued which categorically confirmed the non-recognition of any taxable gain or loss if the exchange resulted in the further control of the transferors in the transferee's stockholdings (*BIR Ruling No. 132-95*, August 29, 1995; *BIR Ruling No. 109-94*, May 31, 1994; *BIR Ruling No. 244-82*, September 7, 1983; *BIR Ruling No. 506-93*, December 22, 1993; *BIR Ruling No. 06-93*, January 14, 1993; and *BIR Ruling No. 149-94*, September 29, 1994). All these rulings involved situations where the transferors were more than one but not more than four and gained control of the transferee by collectively owning at least 51% of the latter's capital stock. While it is true that rulings, which merely embody administrative opinions on queries, do not have the force and effect of laws (Alexander Howden, & Co., Ltd. vs. Collector of Internal Revenue, 13 SCRA 601, April 14, 1965), courts may uphold the same especially where there is no showing that they are contrary to law *(Commissioner of Internal Revenue vs. Ledesma, L-17509, January 30, 1970).*

It must likewise be noted that FLI requested for a ruling from the BIR with regards to the non-recognition of taxable gain on exchanges of this nature. In response thereto, the BIR issued BIR Ruling 046-97 dated February 3, 1997, which provides, thus:

> "...no gain or loss shall be recognized both to the transferors and the transferee corporation on the transfer by Filinvest Development Corporation and Filinvest Alabang, Inc. of their properties in exchange for shares of stock of the transferee corporation, Filinvest Land, Inc., considering that as a consequence of the exchange, the transferors gained control of the transferee corporation by owning 99.89% of its total voting stocks."

The aforesaid ruling relied upon by petitioners cannot be modified, reversed or even nullified by the BIR as it would run counter to Section 246 of the NIRC on the non-retroactivity of rulings, to the prejudice of the petitioners, thus:

> ***"Section 246. Non-Retroactivity of Rulings.-*** Any revocation, modification or reversal of any of the rules and regulations promulgated in accordance with the preceding section or any of the rulings or circulars promulgated by the Commissioner shall not be given retroactive

> application if the revocation, modification, or reversal will be prejudicial to the taxpayers except in the following cases: (a) where the taxpayer deliberately misstates or omits material facts from his return or in any document required by him by the BIR; (b) where the facts subsequently gathered by the BIR are materially different from the facts on which the ruling is based; or (c) where the taxpayer acted in bad faith."

There being no showing that the ruling is contrary to law, then this Court upholds the said BIR ruling on the matter.

As it is, the total number of shares of FDC and FAI, if sum up together is 70.99%, which is more than the 51% contemplated by law to have the so-called control in the corporation. With all the elements having been complied with, we conclude that Section 34 (c)(2) is on all fours applicable to the subject exchange. Hence, any gain or loss derived thereat is not recognized it being a tax-free exchange.

On the second issue, petitioner FDC is disputing the income tax assessment issued by the BIR with regards to the alleged interest income on the advances it made to its affiliates. In support of its assessment, the BIR cited Section 43 (now Section 50) of the Tax Code, in relation to Revenue Regulations No. 2, Section 179 (b), which gave the Commissioner of Internal Revenue the power to allocate, distribute or apportion income or deductions between or among such organizations, trades or businesses as he may deem necessary in order to prevent evasion of taxes or clearly reflect the true income of any such organizations, trades or businesses. However, petitioner sets forth the view that the application of Section 43 is misplaced as the power of the Commissioner is merely limited to distributing, apportioning and allocating gross income or deduction and does not include the power to impute theoretical interest on interest-free advances.

We do not agree with the petitioner. Section 43 of the old Tax Code *(then applicable when the subject transaction took place)*, provides:

> ***"Section 43. Allocation of Income and Deductions.*** **-** In any case of two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or indirectly by the same interests, the Commissioner of Internal Revenue is authorized to distribute, apportion or allocate gross income or deductions between or among such organizations, trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or businesses."

The purpose of the aforequoted section is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer to so conduct its affairs that its transactions and accounting records truly reflect the net income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable net income is thereby understated, the statute contemplates that the Commissioner of Internal Revenue shall intervene, and by making such distributions, apportionments, or allocations as he may deem necessary of gross income or deductions, or of any item or element affecting net income, between or among the controlled taxpayers constituting the group, shall determine the true net income of each controlled taxpayer dealing at arms-length with another controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer. Section 44 (now 50) grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the Commissioner of Internal Revenue to apply such provisions (*Section 179 (b), Revenue Regulations No. 2*).

It is important to note that this provision gave the Commissioner of Internal Revenue the leeway to deal with the various forms of fraudulent schemes orchestrated by taxpayers. This court believes that this provision was designed with the end in view of forestalling tax evasion that would deprive the government of its much-needed revenue.

Apparently, Section 43 (now 50) of the Tax Code is similar to Section 482 of the Internal Revenue Code of the United States. The two laws, if juxtaposed, contain similar words to the effect of giving the Commissioner (Secretary, in the US) the power to distribute, apportion or allocate gross income and deductions between two related or unrelated companies. It bears stressing that in the United States, said law was further implemented by Sections 1.482-1 and 1.482-2 of the 1965-69 Regulations giving more detailed guidance on how to carry out the said provision. Thus, Section 1.482-2 of the 1965-1969 Regulations of the Law of Federal Income Taxation, which deals mainly with transactions involving loans and advances, provides:

> ***S 1.482-2. Determination of Taxable Income in Specific Situations. (a) Loans or Advances-*** (1) In general. Where one member of a group of controlled entities makes a loan or advance directly or indirectly to, or otherwise becomes a creditor of, another member of such group, and charges no interest, or charges interest at a rate which is not equal to an arms length rate as defined in subparagraph (2) of this paragraph, the district director may make appropriate allocations to reflect an arms-length interest rate for the use of such loan or advance."

We cannot see any reason why said regulations cannot be regarded with persuasive effect on our jurisdiction considering that said regulations implement a basic law similar to ours and there being no jurisprudence yet which particularly deals with

Section 43 of our Tax Code. We can thus infer from the aforecited US regulations that the authority of the Commissioner to allocate, distribute and apportion gross income and deductions under Section 43 of the old Tax Code (now Section 50) actually covers the power to make appropriate allocations to reflect an arms-length interest rates on loans and advances. This being so, Section 43 actually validates herein respondent's assessment of deficiency income tax on the basis of the appropriate allocations made to reflect an arm's length interest rate to petitioner's gross income.

In the case at bar, there is no denying that for the years 1996 and 1997, FDC made several cash advances to its affiliates, particularly Filinvest Land, Inc. (FLI), Filinvest Capital, Inc. (FCI), Davao Sugar Central Co. (DSCC) and Filinvest Alabang, Inc.(FAI), with no stipulation on interest. This court, however, finds it quite dubious for any person or entity to advance money without any interest. That is why Section 43 gave the Commissioner the power to make necessary adjustments by rectifying any distortions on income brought about by common control, through the adoption of standards considered fair, reasonable or at arm's length and determine for that matter the true net income of each of the parties. As such, the advances made by petitioner FDC to its affiliates merit some necessary adjustments. However, it must be pointed out that the allocation of an arms-length interest rate in the taxable income of petitioner should carry with it a correlative adjustment to the net income of the affiliates involved in the transaction, such that an increase in the income of the petitioner necessarily results to a decrease in the taxable income of the affiliates.

Thus, we affirm respondent's findings on petitioner's deficiency income tax and uphold its computation based on the BSP's schedule of interests rate prevailing when the subject transaction took place. Hence, petitioner is liable to pay a deficiency income tax for taxable year 1997 in the amount of P5,691,972.03, excluding the compromise penalty. Petitioner has no tax liability for 1996 as it was in a net loss position. Thus:

	1996	1997
Deficiency Income Tax		
Net Income (Loss) Per Return	(P 190,695,061.00)	(P 83,308,762.00)
Add: Additional taxable Income		
Interest Income (total)	140,948,001.38	95,208,065.64
Taxable Income (loss)	(49,747,059.62)	11,899,303.64
Income Tax Due thereon @ 35%	-	4,164,756.00
Less: Tax Due & Paid per return	-	-
Deficiency Income Tax	-	4,164,756.00
Add: 20% Interest per annum	-	1,527,216.03
TOTAL AMOUNT DUE	P nil	P 5,691,972.03

We now proceed to resolve the third issue of whether or not the gain on dilution as a result of the increase in the value of FDC's shareholdings in FAC is subject to income tax under the Tax Code.

As can be gleaned from the records of the case, respondent assessed FDC of deficiency income tax on the alleged gain of P 60 million, which arose when FDC entered into a Shareholders' Agreement (SA) with Reco Herrera Pte Ltd (RHPL) for the formation of a joint venture company named Filinvest Asia Corporation (FAC) which will manage the 50% ownership interest of FDC in the PBCom Tower project. Under the SA, FDC will assign to FAC a portion of FDC's rights in the said project together with its interest in its financial contribution in the project in payment of FDC's subscription amounting to P 500.7M worth of shares of stock of FAC. The equity participation of FDC and RHPL in FAC is 60-40 respectively.

As records would show, FDC subscribed to the shares of FAC worth P560.7M but only paid the amount of P500.7M, realizing a gain of P60M. Thus, the alleged taxable gain was computed by the BIR as follows:

Initial Project Cost	P	1,800 M
Add: Interest Earned		69 M
Total Fund Balance		1,869 M
50% share of FDC		934.5 M
FDC shareholdings in FAC		60%
Total		560.7 M
Payment for its subscription		500.7 M
Gain on Dilution	P	60 M

Petitioner FDC, on the other hand, is firm on its assertion that said assessment is premature as said gain has yet to be realized. According to petitioner, the prospective gain did not result from any alienation of property but represents merely an increase in the value of the shareholdings of FDC in FAC resulting from the assignment of a percentage of its interest in FAC. Petitioner contends that such gain may become taxable only if and when FDC actually realizes the incremental value of its investment should it finally dispose of its shares in FAC.

We are in accord with petitioner's view.

The supposed gain on dilution that resulted from the exchange of FDC's interest on the project for the subscription of the equivalent shares in FAC cannot be considered gain or income within the purview of our Tax Code. It must be pointed out that the increase in the value of shares in FAC owned by the petitioner did not result to any economic advantage on the part of the petitioner. The P 60M gain merely represents the corresponding increase in the value of the shares purchased, and such increase is not taxable under our tax laws. In an old case entitled ***Nelly Lopez Magallanes vs. The Commissioner of Internal Revenue, CTA Case No. 2607, April 21, 1982,*** this Court had the occasion to pass upon a similar issue:

> "In other words, the mere increase in value from their original net book value xxx to their asserted fair market value xxx is not income but merely unrealized increased in value through the conversion of property which is not fundamentally taxable." (Mertens, Law of Federal Income taxation, Vol. I, par 5.05 x x x)"

True enough, only upon sale or disposition of the subject shares could the gain be realized as income by FDC. A mere increase in the value of property is not income but merely an unrealized increase in capital. In the case of ***Fisher vs Trinidad, G.R. No. 17518, October 30, 1922,*** the Supreme Court, citing the case of Gray vs Darlington (82 US. 63) held that mere advance in value in no sense constitutes the "income" specified in the revenue law as "income" of the owner for the year in which the sale of the property was made. Such advance constitutes and can be treated merely as an increase of capital.

Section 38 of Revenue Regulations No. 2 provides that the appreciation in the value of property does not result to an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. In other words, taxable gain does not accrue to the purchaser of property until he sells or otherwise disposes of it. Thus, the assessment on the alleged deficiency income tax issued by the BIR has no leg to stand on as no income has yet been realized by the petitioner on the increase and appreciation of the value of its shareholdings with FAC.

Anent the fourth issue, respondent assessed petitioner (FDC) of the documentary stamp tax (DST) on the advances made to its affiliates based on Section 180 of the Tax Code, in relation to Section 3(b) and Section 6 of Revenue Regulations No. 9-94. However, petitioner avers that said advances were merely temporary in nature and supported only by either instructional letters with their corresponding journal vouchers or by cash vouchers. As such they should not be subjected to DST.

Thus, what we are tasked to resolve here is whether or not said letters of instructions can be considered as loan agreements which are subject to documentary stamp tax pursuant to Section 180 of the Tax Code.

Section 3 (b) of Revenue Regulations No. 9-94 defines a loan agreement as follows:

> "It is a contract in writing where one of the parties delivers to another money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid. The term shall include credit facilities, which may be evidenced by credit memo, advice or drawings."

It can be discerned from the foregoing definition that nothing in the nature of the so called "instructional letters or vouchers" could we find any direct semblance with the concept of a loan agreement. As clearly worded, a loan agreement is a contract in writing whereby one party delivers to the other party money or other consumable thing subject to repayment. The instructional letters and vouchers that respondent subjected to DST do not contain the necessary elements of a loan agreement. It does not embody an express stipulation between the parties, where one is obligated to deliver and the other to repay. Neither is it a contract in writing. It is merely an internal document, unilaterally prepared by petitioner for the purpose of recording the advances it made to its affiliates to avoid the co-mingling of funds of the corporate affiliates ***(BIR Ruling 116-98, July 30, 1998).***

As we have held in the case of ***APC Group, Inc. vs. CIR, CTA Case no. 6155, March 11, 2002***:

> "There is nothing in Section 180 that provides that board resolutions, inter-office memoranda, letters of instructions, journal or cash vouchers evidencing lending/borrowings are subject to Documentary Stamp Tax. Clearly, what Section 180 taxes are loan agreements, promissory notes, bill of exchange, drafts, instruments and securities issued by the government or any of its instrumentalities or certificates of deposits drawing interest and others not payable on sight or demand." ***(underscoring ours)***

It should likewise be stressed that in Section 173 of the Tax Code, documentary stamp tax is essentially a tax upon documents, instruments, loan agreements and papers. The instructional letter and cash/journal vouchers containing petitioner's advances to its affiliates, are not loan agreements within the contemplation of Section 173 in relation to Section 3 (b) and Section 6 of Revenue Regulations No. 9-94. At this point, it is worthy to note that even the BIR issued a ruling (BIR Ruling No. DA-666-A-99, dated December 3, 1999), which clearly states that inter-company advances covered only by board resolutions and cash vouchers are not subject to DST under Section 180 of the Tax Code. Such being the case, the imposition of DST on instructional letters or vouchers should necessarily fail.

WHEREFORE, in view of all the foregoing, the court finds the instant petition partly meritorious. Accordingly, Assessment Notice No. SP-INC-96-00018-2000 imposing deficiency income tax on FDC for taxable year 1996, Assessment Notice No. SP-DST-96-00020-2000 and SP-DST-97-00021-2000 imposing deficiency documentary stamp tax on FDC for taxable years 1996 and 1997, respectively and Assessment Notice No. SP-INC-97-0027-2000 imposing deficiency income tax on FAI for the taxable year 1997 are hereby **CANCELLED and SET ASIDE.** However, petitioner is hereby **ORDERED to PAY** the amount of P 5,691,972.03 as deficiency income tax for taxable year 1997. In addition, petitioner is also **ORDERED to PAY** 20% delinquency interest computed from February 16, 2000 until full payment thereof pursuant to Section 249 (c)(3) of the Tax Code.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

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

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge