REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

CTA EB No. 1971
(CTA Case No. 9105)

Present:

Del Rosario, *PJ*,
Castañeda, Jr.,
Uy,
Ringpis-Liban,
Manahan,
Bacorro-Villena, and
Modesto-San Pedro, *JJ.*

-versus-

FORTUNE TOBACCO CORPORATION,
Respondent.

Promulgated:

SEP 22 2020
4:25 p.m.

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DECISION

CASTAÑEDA, JR., *J.*:

Before this Court is a Petition for Review filed by the Commissioner of Internal Revenue (CIR) on December 20, 2020 assailing the Decision[1] and Resolution[2] promulgated on August 15, 2018 and on November 14, 2018, respectively, by the then CTA First Division/ Special First Division ("CTA Division", for brevity) in the case *Fortune Tobacco Corporation v. Commissioner of Internal Revenue,* docketed as CTA Case No. 9105. The CTA Division granted the Petition for Review filed by Fortune Tobacco Corporation (FTC), thus, the assessment for the calendar year 2009 as to Improperly Accumulated Earnings Tax (IAET) was cancelled.

[1] *Rollo,* pp. 28-51; Penned by Associate Justice Cielito N. Mindaro- Grulla (now Retired) and concurred in by Presiding Justice Roman G. Del Rosario and by Associate Justice Erlinda P. Uy; CTA First Division.
[2] *Id.*, pp. 52-55; CTA Special First Division.

CIR prays that FTC be ordered to pay the total amount of P2,602,478,844.21 for deficiency IAET for taxable year 2009 as well as 25% Surcharge, 20% Deficiency and Delinquency interest pursuant to Sections 248 and 249 of Tax Reform for Acceleration and Inclusion (TRAIN) law effective January 1, 2018.

The dispositive portion of the Decision ("Assailed Decision") reads:

> **WHEREFORE,** premises considered, the Petition for Review is **GRANTED**. The assessment issued by respondent Commissioner of Internal Revenue against petitioner Fortune Tobacco Corporation for the calendar year 2009 as to Improperly Accumulated Earning Tax is hereby **CANCELLED and SET ASIDE**.
>
> **SO ORDERED.**

The dispositive portion of the November 14, 2018 Resolution ("Assailed Resolution") reads:

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

THE FACTS

The facts of this case as stated by the then CTA First Division in the assailed Decision,[3] are as follows:

> On August 27, 2014, FTC received a Preliminary Assessment Notice (PAN) 9 dated May 19, 2014, together with the Details of Discrepancies and other attachments from the CIR, stating that after investigation, there had been found due from FTC deficiency Income Tax (IT), Value-Added Tax (VAT), Expanded Withholding Tax (EWT), Final Withholding Tax-VAT (FWT-VAT), Documentary Stamp Tax (DST), and Improperly Accumulated Earnings Tax (IAET) for the calendar year 2009, all amounting to P3,560,809,047.91.

[3] Assailed Decision, pp. 2-9, *Rollo*, pp. 29-36.

On September 11, 2014, or within the reglementary period of fifteen (15) days, FTC submitted its Reply to the Preliminary Assessment Notice.

On November 3, 2014, FTC received from the respondent CIR a Formal Letter of Demand (FLD) dated October 28, 2014, together with Assessment Notice No. ELTAD-II-IE-09-00004 for IAET and other Assessment Notices for IT, VAT, EWT, FWT-VAT, and DST, all dated October 28, 2014, and the Details of Discrepancies and other attachments, issued to FTC by the CIR.

The assessments for taxable year 2009 had an aggregate amount of P3,730,024,871.21 inclusive of surcharges and interests. The CIR requested FTC to pay the same on or before December 3, 2014. The computation of the alleged deficiency IAET of P2,442,651,058.87 is detailed in the FLD.

Within the reglementary period of thirty (30) days, or on December 3, 2014, FTC filed on the aforesaid FLD an Administrative Protest/Request for Reconsideration.

On June 29, 2015, FTC received the FDDA dated June 9, 2015 of the CIR on its Administrative Protest/Request for Reconsideration dated December 3, 2014, stating that its Administrative Protest/Request for Reconsideration "is hereby denied for lack of factual and legal basis."

On June 30, 2015, FTC paid the IT in the amount of P34,684,986.33, inclusive of interest; the VAT in the amount of P12,833,363.65, interest included; the EWT in the amount of P5,827,024.25, inclusive of increments; for DST in the amount of P168,352.43, interest included; and the Miscellaneous Tax in the amount of P140,000.00.

With respect to the alleged deficiency IAET, in support thereof, it is stated in the FDDA, among other things, that "The rationale is that if the earnings and profits were distributed, the shareholders would then be liable to income tax thereon"; that "a tax is being imposed in the nature of penalty to the corporation x x x as a form of deterrent to the avoidance of tax upon shareholders who are supposed to pay dividends tax on the earnings distributed to them by the corporation"; and that "if there is a determination that a corporation has accumulated income beyond the reasonable needs of the business, the 10% improperly accumulated earnings tax shall be imposed." It is further stated that the CIR questions the propriety of the appropriation amounting to P14.3 Billion as of year-end 2009 in the audited financial statements because two months after the close of the taxable year 2009, FTC entered into a "business combination" with Philip Morris Phils., Inc. (PMPI) where FTC would be earning passive income only; and that the case filed by the Republic of the Philippines against FTC in the Sandiganbayan (Civil Case No. 0005) should not be a reason for not declaring dividends for taxable year 2009 since FTC had paid dividends in 2013.

On July 27, 2015, the subject Petition for Review was filed by FTC.

On November 9, 2015, Answer was filed by the CIR. The CIR's Pre-Trial Brief was filed on February 11, 2016; while FTC's Pre-Trial Brief was filed on February 15, 2016.

The parties filed their Joint Stipulation of Facts and Issues (JSFI) on March 11, 2016, which was approved by the Court *via* Resolution dated March 23, 2016.

FTC presented witnesses Nestor C. Mendones on May 17, 2016, Lt. Gen. Salvador M. Miso and Mrs. Juanita Tan Lee on July 26, 2016, and Ms. Evita Panteleon on August 23, 2016.

On September 20, 2016, FTC filed its Formal Offer of Evidence offering Exhibits "P", "P-1", "P-2", "P-2-a", "P-2-b", "P-2-c", "P-2-d", "P-2-e", "P-2-f", "P-2-g", "P-2-h", "P-2-i", "P-2-j", "P-2-k", "P-2-l", "P-2-m", "P-2-n", "P-2-o", "P-2-p", "P-2-q", "P-2-r", "P-3", "P-2-s", "P-2-t", "P-2-u", "P-17", "P-17-a", "P-4", "P-5", "P-5-a", "P-5-b", "P-6", "P-16", "P-16-a", "P-15", "P-15-a", "P-8", "P-9", "P-9-a", "P-9-b", "P-10", "P-12", "P-14", "P-11", "P-13", "P-18", "P-18-a", "P-7", "P-1-a", as its documentary evidence. The CIR filed his Comment (Re: Petitioner's Formal Offer of Evidence) on September 29, 2016.

In the Resolution dated November 24, 2016, the Court admitted Exhibits "P", "P-1", "P-2", "P-2-a", "P-2-b", "P-2-c", "P-2-d", "P-2-e", "P-2-f", "P-2-g", "P-2-h", "P-2-i", "P-2-j", "P-2-k", "P-2-l", "P-2-m", "P-2-n", "P-2-o", "P-2-p", "P-2-q", "P-2-r", "P-3", "P-2-s", "P-2-t", "P-2-u", "P-17", "P-17-a", "P-4", "P-

5", "P-5-a", "P-5-b", "P-6", "P-16", "P-16-a", "P-15", "P-15-a", "P-8", "P-9", "P-9-a", "P-9-b", "P-10", "P-12", "P-14", "P-11", "P-13", "P-18", "P-18-a", "P-7" but denied the admission of Exhibit "P-1-a".

FTC filed a Motion for Reconsideration on December 14, 2016 *sans* comment from the CIR. The Court granted FTC's Motion for Reconsideration and admitted Exhibit "P-1-a" in the Resolution dated February 23, 2017.

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The CIR presented his lone witness, Revenue Officer Dominic M. Morales, on June 13, 2017.

On June 30, 2017, the CIR filed his Formal Offer of Evidence offering Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-8", "R-9", "R-10", "R-11", "R-12", "R-12-a", "R-12-b", "R-12-c", "R-12-d", "R-12-e", "R-13" and "R-14" as his documentary exhibits. FTC filed its Comment on July 28, 2017.

In the Resolution dated September 14, 2017, the Court admitted Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-8", "R-9", "R-10", "R-11", "R-12", "R-12-a", "R-12-b", "R-12-c", "R-12-d", "R-12-e", "R-13" and "R-14" as CIR's evidence.

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The Memorandum for the CIR was filed on October 19, 2017; while the Memorandum for the FTC was filed on October 26, 2017. Hence, the case was declared submitted for decision.

On August 15, 2018, the CTA Division granted FTC's petition and cancelled the assessment issued by the CIR against FTC for the calendar year 2009 as to IAET.

On November 14, 2018, the CTA Division denied CIR's Motion for Reconsideration.

On December 20, 2018, CIR filed the Petition for Review within the period of extension granted by the Court.

On January 21, 2019, the Court ordered FTC to file Comment.

On March 11, 2019, the Court noted FTC's Comment on the Petition for Review, and referred this case for mediation.[4] However, the parties decided not to have their case mediated by the Philippine Mediation Center Unit- CTA.[5]

Thereafter, the case was submitted for decision. Hence, this decision.

ISSUE

The following are the grounds raised by CIR:

> THE HONORABLE COURT FIRST DIVISION ERRED IN CONSIDERING AN ALLEGATION THAT WAS ONLY RAISED BY RESPONDENT FOR THE FIRST TIME IN THE ORIGINAL PETITION.
>
> THE HONORABLE COURT FIRST DIVISION ERRED IN RULING THAT RESPONDENT IS NOT LIABLE FOR IMPROPERLY ACCUMULATED EARNINGS TAX FOR CALENDAR YEAR 2009.

THIS COURT'S RULING

The petition is denied.

After a careful review of CIR's grounds/arguments in this petition as well as FTC's counter-arguments as stated in the Comment on the petition, this Court finds that these grounds/arguments were already raised and considered before the CTA Division in the resolution of the assailed resolution.

CTA conducts *trial de novo*

CIR alleges that the existence and any matters pertaining to the alleged syndicated loan agreement should not have been considered by the

[4] *Rollo*, pp. 113-114.
[5] *Rollo*, p. 115.

CTA Division in ruling on the liability of FTC for IAET for calendar year 2009. CIR states that the allegation of FTC that it has outstanding loans in the total amount of P19.5 billion was never mentioned nor discussed by FTC in its Reply to the Preliminary Assessment Notice (PAN) nor in its request for reconsideration on the Formal Letter of Demand (FLD). CIR submits that despite the ample remedies provided by the National Internal Revenue Code of 1997, as amended, (NIRC of 1997) as well as the pertinent rules and regulations, the matter pertaining to the alleged existence of a syndicated loan are being raised for the first time in the instant [original] petition. CIR alleges that this defense is deemed to have been abandoned. CIR states that this allegation of FTC is a mere afterthought, thus, it is estopped from raising the same in the original petition. CIR alleges that being in the nature of appeal, the Honorable Court's power is to determine, by review, the propriety of the decision rendered by CIR based on the arguments and records presented during the administrative level.

In its Comment, FTC argues that there is nothing in Republic Act (RA) No. 1125, as amended, the law creating the Court of Tax Appeals (CTA), which provides that matters not raised by a party in the Bureau of Internal Revenue (BIR) may not be raised in the CTA and the party is estopped or precluded to raise them. FTC states that considering that there is a *trial de novo* in the CTA and petitioner in the trial *de novo* is allowed to raise matters and issues that were not introduced in the BIR, the theory of "estoppel by silence" invoked by the CIR holds no water.

FTC argues that in the instant case, the matters raised by FTC in the petition for review below are all matters of record in the BIR and contained in the various documents which FTC submitted to the BIR in connection with this case, such as its 2009 Annual Income Tax Return and Audited Financial Statements (AFS) for the year ending December 31, 2009. FTC alleges that P500 Million portion of the syndicated loan that was due in February 2009 is indicated in the 2009 AFS of FTC (Exhibit "P-7), more particularly under "LIABILITIES" in the "Statements of Financial Position". Likewise, FTC points out that the P20 Billion syndicated loan itself is referred to in Notes Nos. 17 and 20 of the aforesaid AFS.

FTC states that it should be noted that the CIR's witness, Mr. Dominic B. Morales, in his Judicial Affidavit dated February 11, 2016, admitted that FTC submitted documents pursuant to the Final Notice sent to FTC requesting the submission of accounting and documentary records (at p. 3).

FTC also argues that the syndicated loan referred to by FTC in its petition for review below is not a mere afterthought. FTC states that the syndicated loan was contracted as early as February 5, 2008 (Exhibits "P-5", "P-5-a", and "P-5-b"), during the prior taxable year.

We find that CIR's arguments deserve scant consideration.

CTA is a court of record and conducts *trial de novo*, as correctly ruled by the CTA Division in the assailed Resolution[6], as follows:

> As to the issue of raising an argument for the first time before this Court, it must be emphasized that Section 8 of Republic Act No. 1125 (An Act Creating the Court of Tax Appeals) provides categorically that the Court of Tax Appeals shall be a court of record and as such it is required to conduct a formal trial *(trial de novo)* where the parties must present their evidence accordingly if they desire the Court to take such evidence into consideration.
>
> Moreover, even on the assumption that the syndicated loan agreement was not presented before the administrative level, in the case of *Commissioner of Internal Revenue vs. Philippine Bank of Communications,* citing the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.,* the Court *En Banc* ruled that the failure to submit documents in support of the taxpayer's administrative claim is not fatal to the judicial claim, as judicial claims are litigated *de novo* and decided based on what has been presented and formally offered by the parties during the trial.

In this case, the syndicated loan agreement was presented and formally offered by FTC, and was admitted by the Court.

CTA Division did not err
in ruling that FTC is not liable for
IAET for calendar year 2009

CIR maintains his position that FTC is not among those enumerated entities exempted from IAET. CIR states that being not among those exempted entities, FTC has the burden of proving that the accumulation of earnings is for the reasonable needs of the company. CIR alleges that FTC, however, failed to discharge this burden.

CIR alleges that FTC's own actions contradict its own allegation that it needed to observe certain financial ratios allegedly imposed by a syndicated loan to justify the accumulation of earnings, *i.e.,* first, there were dividends paid for the year 2013; second, on January 18, 2010, FTC through

[6] *Rollo*, pp. 53-54.

its Board of Directors appropriated P14.3 Billion of the its earnings as of December 31, 2009 as standby capital to pursue its anticipated investments; and finally, the audited financial statement for the year ended December 31, 2009 proved that there was really no intention to comply with the financial ratios provided in the loan agreement. CIR alleges that for the year ended December 31, 2009, total equities of FTC amounted to P18,070,106,551.00 which is way below the alleged P101 Billion equity it needed to maintain, and currents assets of FTC only amounted to P35,659,706,877.00 which is way below the alleged P65 Billion current assets it needed to maintain.

FTC argues that when it paid dividends in 2013, FTC and Philip Morris Phils. Inc. (PMPI) had already joined operations and the cash that was utilized for the declaration of dividends was received from the new company formed by FTC and PMPI, the "PMFTC Inc.", as testified by its witness Ms. Evita M. Pantaleon (*Judicial Affidavit dated February 21, 2016*, Exh. "P-18", at pp. 8-9).

FTC notes that the appropriation of P14.3 Billion was merely for "standby capital" and "to enable the Corporation to pursue its anticipated investments", and that as of the date of adoption of the Board Resolution, FTC had current assents amounting to P35,659,706,877.00. FTC stressed that as testified by Mr. Mendones, FTC did not have to raise additional funds to pay off the syndicated loan, which would have matured in 2013, because FTC's outstanding loan of P19 Billion was assumed by "PMFTC Inc.", the new company when FTC and PMPI joined their operations under the new company on February 25, 2010 *(Judicial Affidavit, at pp. 7-8)*. Mr. Mendones further testified that while providing for the aforementioned appropriation of P14.3 Billion, FTC was at the same time considering joining operations with PMPI, which in its judgment also offered a solution to its concerns.

FTC argues that in the Judicial Affidavit dated February 21, 2016 (Exhibit "P-15"; at p.6), Mr. Mendones clearly stated that in his Memorandum to the FTC Board, he recommended that FTC must maintain the financial ratios while the P20 Billion loan remained outstanding by not allowing its total equity to fall below P10.1 Billion, not P101 Billion as claimed by the CIR, and its current assets to go below P6.5 Billion, not P65 Billion as claimed by the CIR. FTC also argues that in the AFS of FTC for taxable year 2009 (Exhibit "P-7"), it is clearly stated, in its "STATEMENTS OF FINANCIAL POSITION", that FTC's "TOTAL EQUITY" is P18,070,106,551, which is way above the P10.1 Billion financial ratio that it must maintain, and that its "Total Current Assets" stood at P35,659,706,877.00, which is likewise way above the P6.5 *[Billion]* financial ratio that it should maintain.

CIR's arguments are bereft of merit.

It is already settled that "FTC does not fall among those exempt classes."[7] FTC did not contest this matter.

In the case *Cyanamid Philippines, Inc. v. The Court of Appeals, The Court of Tax Appeals and Commissioner of Internal Revenue,*[8] the Supreme Court categorically stated that, "the burden of proof to establish that the profits accumulated were not beyond the reasonable needs of the company, remained on the taxpayer."

Pertinent to this case is Section 29 of the 1997 National Internal Revenue Code, as amended, which states that:

> "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.
>>
>> (2) *Exceptions.* — The improperly accumulated earnings tax as provided for under this Section shall not apply to:
>>
>>> (a) Publicly-held corporations;

[7] Assailed Decision, *Rollo*, p. 44.
[8] G.R. No. 108067, January 20, 2000.

(b) Banks and other nonbank financial intermediaries; and
(c) Insurance companies.

(C) *Evidence of Purpose to Avoid Income Tax.* —

(1) *Prima Facie Evidence.* — The fact that any 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.

(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.

(D) *Improperly Accumulated Taxable Income.* — For purposes of this Section, the term 'improperly accumulated taxable income' means taxable income adjusted by:

(1) Income exempt from tax;
(2) Income excluded from gross income;
(3) Income subject to final tax; and
(4) The amount of net operating loss carryover deducted;

And reduced by the sum of:

(1) Dividends actually or constructively paid; and

(2) Income tax paid for the taxable year.

Provided, however, That for corporations using the calendar year basis, the accumulated earnings tax shall not apply on improperly accumulated income as of December 31, 1997. In the case of corporations adopting the fiscal year accounting period, the improperly accumulated income not subject to this tax, shall be reckoned, as of the end of the month comprising the twelve (12)-month period of fiscal year 1997-1998.

(E) *Reasonable Needs of the Business.* — For purposes of this Section, the term *'reasonable needs of the business'* includes the reasonably anticipated needs of the business.

In the determination of the reasonable needs of the business, Section 3 of Revenue Regulations (RR) No. 02-01,[9] states that:

SECTION 3. *Determination of Reasonable Needs of the Business.* — An accumulation of earnings or profits (including undistributed earnings or profits of prior years) is unreasonable if it is not necessary for the purpose of the business, considering all the circumstances of the case. To determine the "reasonable needs" of the business in order to justify an accumulation of earnings, these Regulations hereby adhere to the so-called "Immediacy Test" under American jurisprudence as adopted in this jurisdiction. Accordingly, the term *"reasonable needs of the business"* are hereby construed to mean the **immediate needs of the business, including reasonably anticipated needs.** In either case, **the corporation should be able to prove** an immediate need for the accumulation of the earnings and profits, or the direct correlation of anticipated needs to such accumulation of profits. Otherwise, such accumulation would be deemed to be not for the reasonable needs of the business, and the penalty tax would apply.

For purposes of these Regulations, the following constitute accumulation of earnings for the reasonable needs of the business:

a) Allowance for the increase in the accumulation of earnings up to 100% of the paid-up capital of the corporation as of Balance Sheet date, inclusive of accumulations taken from other years;

b) Earnings reserved for definite corporate expansion projects or programs requiring considerable capital expenditure as approved by the Board of Directors or equivalent body;

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[9] SUBJECT : *Implementing the Provision on Improperly Accumulated Earnings Tax Under Section 29 of the Tax Code of 1997.*

c) Earnings reserved for building, plants or equipment acquisition as approved by the Board of Directors or equivalent body;

d) Earnings reserved for compliance with any loan covenant or pre-existing obligation established under a legitimate business agreement;

e) Earnings required by law or applicable regulations to be retained by the corporation or in respect of which there is legal prohibition against its distribution;

f) In the case of subsidiaries of foreign corporations in the Philippines, all undistributed earnings intended or reserved for investments within the Philippines as can be proven by corporate records and/or relevant documentary evidence. *(Emphases Supplied).*

A plain reading of Section 3(d) of RR No. 02-01 shows that "Earnings reserved for compliance with any loan covenant or pre-existing obligation established under a legitimate business agreement" constitutes an accumulation of earnings for the reasonable needs of the business.

We agree with the CTA Division, as stated in the Assailed Resolution,[10] that, "Although *[FTC]* is not among the exempted corporations to pay IAET, ***[FTC]*** **was able to substantiate fully its exemption based on other reasons,** *i.e.,* no other than R.R. 02-01 is explicit that compliance with covenants of loan agreements is considered as reasonable needs to accumulate earnings." *(Emphasis Supplied).*

In this case, as found by the CTA Division, We reiterate with approval the discussion in the assailed Decision,[11] as follows:

"xxx upon review of the Syndicated Loan Agreement, the Company is required to comply with certain covenants, as follows:

'Section 7. COVENANTS OF THE BORROWER.

7.01 Affirmative Covenants

[10] *Rollo*, p. 54
[11] *Rollo*, pp. 46-49.

xxx xxx xxx

(p) *Financial Ratios.* The Borrower shall maintain the following financial ratios:

(i) The borrower's net debt to stockholder's equity ratio, computed as total liabilities less cash, cash equivalents and marketable securities divided by its total stockholder's equity, computed in accordance with PFRS and based on the most recent audited financial statements of the Borrower, shall have a maximum ratio of 2.0x; and

(ii) The Borrower's current assets to current liabilities ratio, computed in accordance with PFRS and based on the most recent audited financial statements of the Borrower, shall have a minimum ratio of 1.25x.'

Moreover, the said Syndicated Loan Agreement is explicit as to the consequence in case of non-observance of covenants by the borrower, to wit:

'SECTION 8. EVENTS OF DEFAULT

8.01 Events of Default

Each of the following events and circumstances shall be an Event of Default:

xxx xxx xxx

(b) *Non-Observance of Representations, Warranties, Covenants or Other Material Provisions.* Any representation or warranty made by the Borrower in this Agreement or in any certificate delivered or made pursuant hereto shall prove to be incorrect, untrue or misleading in any material respect as and when made or <u>any violation of any other material provision, term, condition,</u>

> representation, warranty, covenant or obligation contained in this Agreement or the Notes and such failure, if remediable, shall remain unremedied during the applicable grace period or, in the absence of such grace period, for a period of thirty (30) days in respect of the maintenance of the financial ratios provided for in this Agreement, and for a period of fifteen (15) days with respect to any other material provision, term, representation, warranty, condition, covenant or obligation under this Agreement, after written notice thereof shall have been received by the Borrower from the Facility Agent. For avoidance of doubt, it is understood that no curing period shall be allowed for a default by the Borrower in any of its payment obligations under this Agreement and the Notes.' (Underlining Supplied.)

Not to mention the existence of the syndicated loan agreement itself, the Memorandum to the FTC Board of Directors dated January 15, 2010 that was presented in Court, stated therein the advice to the Board of Directors of FTC on the propriety of non-declaration of dividends for the year 2009 and the findings and recommendations, as attested to by Mr. Nestor C. Mendones and Mr. Salvador M. Mison. In the said Memorandum, it was found among others that in view of the five-year syndicated loan which FTC obtained in February 2008 from seven local banks amounting to P20 billion, which was payable in annual installments of P500 million per year starting February 2009 and a lump sum payment of P18 billion in February 2013, there was an immediate need for FTC to set aside funds for the full repayment of the debt in 2013.

More importantly, the Memorandum made reference to certain financial ratios which had to be maintained by FTC while the P20 Billion loan remained outstanding. It was also stated that non-compliance with any of the financial ratios is considered an event of default if not cured or remedied within thirty (30) days from the breach thereof. Thus, FTC must maintain the financial ratios while the P20 Billion loan remained outstanding by not allowing its total equity to fall

> below P101 billion[12] and its current assets to go below P65 billion[13].
>
> **On that basis, FTC could not possibly distribute all its earnings as it will need all funds as required by the loan agreement's covenants.** To stress, the touchstone of the liability is the purpose behind the accumulation of the income and not the consequences of the accumulation. Thus, if the failure to pay dividends is due to some other causes, such as the use of undistributed earnings and profits for the reasonable needs of the business, particularly compliance with the covenants of the syndicated loan agreement in this case, **such purpose would not generally make the accumulated or undistributed earnings subject to the tax.**" *(Emphases Supplied).*

We reiterate that FTC could not possibly distribute all its earnings as it will need all funds as required by the loan agreement's covenants. In *Republic of the Philippines, represented by the Commissioner of Internal Revenue v. Team (Phils.) Energy Corporation (formerly Mirant (Phils.) Energy Corporation),*[14] the Supreme Court ruled that "it is fundamental that the findings of fact by the CTA in Division are not to be disturbed without any showing of grave abuse of discretion considering that the members of the Division are in the best position to analyze the documents presented by the parties."

Based on the foregoing discussions, We find no reversible error to disturb the assailed Decision and Resolution of the then CTA First Division.

WHEREFORE, premises considered, the present Petition for Review filed by the Commissioner of Internal Revenue is **DENIED.** Accordingly, the August 15, 2018 Decision and the November 14, 2018 Resolution of the then CTA First Division/ Special First Division in CTA Case No. 9105 are **AFFIRMED.**

SO ORDERED.

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

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[12] Should be P10.1 Billion.
[13] Should be P6.5 Billion.
[14] G.R. No. 188016, January 14, 2015 citing *Sea-Land Service Inc. v. Court of Appeals*, G.R. No. 122605, April 30, 2001, 357 SCRA 441, 445-446.

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

ERLINDA P. UY
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 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.

ROMAN G. DEL ROSARIO
Presiding Justice