

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

SECOND DIVISION

CEBU AIR, INC.,

Petitioner,

CTA CASE NO. 9106

Members:

- versus -

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

**COMMISSIONER OF INTERNAL
REVENUE,**

Respondent.

Promulgated:

JAN 11 2018

X- - - - - X

DECISION

CASTAÑEDA, JR., J.:

THE CASE

The Petition for Review filed by Cebu Air, Inc. prays that the assessment for alleged deficiency improperly accumulated earnings tax (IAET) issued against it in the amount of ₱1,876,885,725.76 for taxable year (TY) 2010 be declared null and void.¹

THE FACTS

Petitioner Cebu Air, Inc. is a corporation duly organized and existing under and by virtue of the laws of the Republic of the *fe*

¹ Par. I, Summary of the Case, Pre-Trial Order dated March 31, 2016, docket, vol. II, p. 595.

Philippines, with principal office address at 2/F Doña Juanita M. Lim Building, Cebu City.² It is also registered with the Bureau of Internal Revenue (BIR) with Taxpayer Identification Number (TIN) 000-948-229-000.³ Petitioner is primarily incorporated to carry on, by means of aircraft of every kind and description, the general business of a private carrier, or charterer, engaged in the transportation of passengers, mail, merchandise, and freight, and in this connection to acquire, purchase, lease, construct, own, maintain, operate and dispose of airplanes and other aircraft of every kind and description, and also to own, purchase, construct, lease, operate and dispose of hangars, transportation depots, aircraft service stations and agencies, and other objects and service of a similar nature which may be necessary, convenient or useful as an auxiliary to aircraft transportation.⁴

On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Petitioner filed its Annual Income Tax Return⁵ for TY 2010 on April 13, 2011.

On September 28, 2011, respondent issued a Letter of Authority (LOA) No. LOA-123-2011-00000044⁶, authorizing Revenue Officers Lover Loveres, Vivian Pollisco, Angelita De Guzman and Group Supervisor (GS) Alicia Socorro Abutazil to examine petitioner's books of accounts and other accounting records for TY 2010.⁷ On even date, an electronic letter of authority⁸ (eLA) was issued and received by a certain C. Codoy on September 30, 2011. *gc*

² Par. II (1), Stipulation of Facts, Joint Stipulation of Facts and Issues (JSFI), docket, vol. II, p. 588; Exhibit "P-1", docket, vol. II, p. 373.

³ Exhibit "P-2", docket, vol. II, p. 397.

⁴ Exhibit "P-1", docket, vol. II, pp. 375 to 376.

⁵ Exhibit "P-14", docket, vol. III, pp. 867 to 869.

⁶ Exhibit "P-3", docket, vol. II, p. 398.

⁷ Par. II (2), JSFI, docket, vol. II, p. 589.

⁸ Exhibit "R-1", BIR records, p. 1.

On June 17, 2013, a Notice of Informal Conference was released.⁹ Then, a recommendation for the approval of the Preliminary Assessment Notice was issued on November 5, 2013.¹⁰

Respondent issued a Preliminary Assessment Notice¹¹ (PAN) on November 22, 2013, assessing petitioner for deficiency income tax, improperly accumulated earnings tax (IAET), valued-added tax (VAT), expanded withholding tax (EWT), and withholding tax on compensation (WTC) in the aggregate amount of ₱11,816,203,003.60, inclusive of increments, for TY ended December 31, 2010, which was received on November 28, 2013.¹² Petitioner protested the said assessment on December 12, 2013.¹³

Upon recommendation,¹⁴ a Formal Letter of Demand¹⁵ (FLD) and a Final Assessment Notice¹⁶ (FAN) were subsequently issued by respondent on September 1, 2014, which petitioner received on September 12, 2014; reducing the deficiency taxes in the total amount of ₱6,915,683,288.99, inclusive of increments, for TY ended December 31, 2010. Petitioner still disputed such assessment through letters¹⁷ it submitted on October 10, 2014 and December 8, 2014.

On March 20, 2015, respondent issued the Final Decision on Disputed Assessment (FDDA)¹⁸ signed by Mr. Nestor S. Valeroso (OIC-Assistant Commissioner of the BIR Large Taxpayers Service) after a recommendation¹⁹ for the issuance of the same was made, which partially granted petitioner's protest and reduced the assessed deficiency taxes from ₱6,915,683,288.99 to ₱3,335,018,786.27, which petitioner received on April 16, 2015.²⁰ Consequently, petitioner requested its reconsideration on May 15, 2015.²¹ *gc*

⁹ Exhibit "R-4", BIR records, p. 273.

¹⁰ Exhibit "R-5", BIR records, pp. 381 to 393.

¹¹ Exhibit "P-4", docket, vol. II, pp. 399 to 400; Exhibit "R-6", docket, vol. II, pp. 404 to 405.

¹² Par. II (3), JSFI, docket, vol. II, p. 589.

¹³ Exhibit "P-5", docket, vol. II, pp. 408 to 417.

¹⁴ Exhibit "R-7", BIR records, pp. 471 to 483.

¹⁵ Exhibit "P-6", docket, vol. II, pp. 423 to 424; Exhibit "R-8", BIR records, pp. 499 to 500.

¹⁶ Exhibit "R-9", BIR records, pp. 489 to 493.

¹⁷ Exhibits "P-7" and "P-8", docket, vol. II, pp. 435 to 443 and pp. 450 to 452, respectively.

¹⁸ Exhibit "P-9", docket, vol. II, pp. 453 to 454; Exhibit "R-11", BIR records, pp. 839 to 840.

¹⁹ Exhibit "R-10", BIR records, pp. 824 to 833.

²⁰ Par. II(5), JSFI, docket, vol. II, p. 589.

²¹ Exhibit "P-10", docket, vol. II, pp. 459 to 468.

On June 29, 2015, petitioner received a Letter²² dated June 26, 2015, granting its request for reconsideration and further reduced the deficiency taxes from ₱3,335,018,786.27 to ₱2,362,828,437.03, inclusive of increments, computed as follows:²³

Kind of Tax	Basic Tax	Surcharge	Interest	Compromise Penalty	Total
Income Tax	₱ 245,936,205.14	₱	₱ 204,969,297.55	₱ 50,000.00	₱ 450,955,502.69
Improperly Accumulated Earnings Tax	880,011,612.70	220,002,903.18	776,821,209.00	50,000.00	1,876,885,725.76
Value Added Tax	1,195,809.00		1,049,035.73	75,000.00	2,319,844.73
Expanded Withholding Tax	16,215,123.62		14,977,576.55	50,000.00	31,242,700.18
Withholding Tax on Compensation	730,140.00		644,523.66	50,000.00	1,424,663.75
Total	₱ 1,144,088,890.46	₱ 220,002,903.18	₱ 998,461,643.29	₱ 275,000.00	₱ 2,362,828,437.03

As such, petitioner filed this Petition for Review²⁴ on July 29, 2015. However, the subject of the petition was only the deficiency IAET assessment in the amount of ₱1,876,885,725.76.

Respondent filed an Answer²⁵ on October 14, 2015.

On October 19, 2015, petitioner moved to amend the Petition for Review,²⁶ which the Court granted and consequently, admitted the Amended Petition for Review²⁷ on January 4, 2016.²⁸ Thus, respondent filed an Amended Answer²⁹ on January 18, 2016, which interposed the following special and affirmative defenses:

“5. Respondent repleads and adopts the preceding paragraphs of this Answer as part of her Special and Affirmative Defenses.

The Letter of Authority is valid, hence, respondent’s assessment issued against petitioner is legal. *jr*

²² Exhibit “P-11”, docket, vol. II, pp. 474 to 475; Exhibit “R-12”, BIR records, pp. 895 to 896.
²³ Par. II(6), JSFI, docket, vol. II, p. 589; Exhibits “P-12”, “P-12-A”, “P-12-B”, “P-12-C”, and “P-12-D”, docket, vol. II, pp. 480, 481, 482, 483, and 484, respectively.
²⁴ Docket, vol. I, pp. 10 to 28.
²⁵ Docket, vol. I, pp. 120 to 138.
²⁶ Motion for Leave to Amend Petition for Review dated 27 July 2015, docket, vol. I, pp. 142 to 166.
²⁷ Docket, vol. I, pp. 145 to 166.
²⁸ Resolution, docket, vol. I, pp. 259 to 262.
²⁹ Docket, vol. I, pp. 273 to 294.

6. As alleged by petitioner, respondent issued Letter of Authority No. LOA-123-2011-00000044 on 28 September 2011 for taxable year 2010.

7. However, contrary to the allegation of petitioner that the assessment is void due to absence of electronic Letter of Authority (eLA), such allegation is clearly misplaced because respondent complied with the requirements of letter of authority.

8. Respondent maintains that there exists a valid eLA, thus respondent's assessment is manifestly lawful.

9. Perusal of the BIR records, respondent issued an electronic letter of authority dated September 28, 2011 which was received by petitioner on September 30, 2011. This eLA shows that it is a BIR Form No. 1966, with SN: eLA201000033121 LOA-123-2011-00000044.

A copy of the electronic letter of authority is hereto attached as Annex '1'.

10. Also, respondent substantially complied with RMO 69-2010 on its issuance of Memorandum of Assignment (MOA) NO. 123-12-09-00104 dated 3 September 2012.

RMO 69-2010 provides that:

III. Policies and Guidelines

xxx xxx

6. Manual serially-numbered MOA shall be issued for the following cases:

6.1 Reassignment for the continuation of the audit/investigation of a case to another RO due to *gc*

resignation/retirement/transfer of the original RO;

xxx xxx' (Emphasis supplied)

11. Further, the acts of petitioner in the course of the audit and investigation constitute as admission of the validity of the assessments issued by respondent.

12. Petitioner's allegation that the assessment is void due to absence of an eLA is contrary to its own actions during the course of audit investigation.

Section 26, Rule 130 of the Rules of Court states that:

'Section 26. Admission of a party. – The act declaration or omission of a party as to relevant fact may be given in evidence against the offeror.'

13. In the present case, petitioner keenly participated in the audit and investigation. It filed protest letters to NIC, PAN, FLD, and FDDA, respectively, and submitted documents to rebut the findings in the audit/investigation.

14. If petitioner truly believed that assessment proceedings were void for lack of eLA, it should not have entertained the Revenue Officers and immediately assert its right. But, none was made.

15. Petitioner's active participation in the audit proceedings shows its assent to the validity of the Letter of Authority.

16. Thus, with respondent's compliance with the requirement of LOA, and positive acts of petitioner in the conduct of audit/investigation, the subject eLA is validly 

issued and respondent validly and legally assessed petitioner of the deficiency tax involved.

Petitioner is liable to pay Improperly Accumulated Earnings Tax (IAET) for its improperly accumulated earnings in 2010.

A. The legal bases for the assessment of Improperly Accumulated Earnings Tax (IAET) issued against petitioner.

17. Section 29 of the Tax Code provides 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.

xxx xxx

(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. *jr*

(2) Evidence Determinative of Purposes. – 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.

xxx xxx

(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.' (Emphases supplied)

18. Revenue Regulations No. 2-2001 (RR 2-2001) which implements the provision on IAET under Section 29 of the Tax Code provides:

'SEC. 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; xxx xxx' (Emphases supplied)

19. Meanwhile, RMC 35-2011 gives clarification as to the amount that may be retained by a corporation, to wit:

'For purposes of this RMC, and in accordance with RR No. 2-2001, the **amount that may be retained**, taking into consideration the accumulated earnings within the "reasonable needs of the business" as determined under Section 3 of the said RR, shall be 100% of the paid-up capital or the amount contributed to the corporation representing the par value of the shares of stock, hence, **any excess capital over and above the par shall be excluded.**' (Emphases supplied)

20. Petitioner was informed of the factual and legal bases of the assessment. The Preliminary Assessment Notice with attached Details of Discrepancies. Formal Letter of Demand with attached Details of Discrepancies as well as Audit Result/Assessment Notice, Final Decision on Disputed Assessment, and Letter dated 26 June 2015 indicated not only the deficiency tax involved, surcharge, interest and compromise due thereon, but also sufficiently stated the facts, the law, rules and regulations on which the assessment is based.

B. To consider the retained earnings reasonable for the needs of business, the amount retained should only be up to 100% of the paid-up capital or the amount contributed to 

the corporation representing the par value of the shares of stocks.

21. 'Paid-up capital' is distinguished from the terms 'capital stock', 'authorized capital stock', 'subscribed capital stock' and 'outstanding capital stock' in the following manner:

'The *capital stock* is the money value assigned to a corporation's issued shares, consisting generally the legal capital of the corporation. It represents the equity of the stockholders in the corporate assets. It limits the maximum amount or number of each class of shares that may be issued by the corporation without formal amendment of the articles of incorporation. It remains the same even though the actual value of the shares as determined by the assets of the corporation is diminished or increased, unaffected by profits or losses.

(a) *Authorized capital stock* refers to the amount of capital stock as specified in the articles of incorporation. It is synonymous with capital stock where the shares of the corporation have par value. xxx xxx

Additional shares may not be issued unless the articles of incorporation are amended by vote of the stockholders. But unissued authorized shares may be issued at a later date without amendment of the articles of incorporation or approval of the stockholders.

(b) *Subscribed capital stock* is the amount of capital stock subscribed, whether fully paid or not. xxx xxx *ju*

(c) *Outstanding capital stock* is the portion of the capital stock which is issued and held by persons other than the corporation itself. The Code defines the term as the total shares of stock issued to the subscribers or stockholders, whether or not fully or partially paid, except treasury shares.

(d) *Paid-up capital stock* is that portion of the subscribed or outstanding capital stock that is actually paid. (Emphasis supplied)

22. In light of the foregoing, 100% paid-up capital is the amount actually paid by the shareholders to petitioner which is equivalent to, but not more than the par value of the subscribed or outstanding capital stocks.

23. The retained earnings of petitioner exceeded the 100% of paid-up capital or the amount contributed to the corporation representing the par value of the shares of stock, thus it is considered unreasonable for the needs of business and therefore penalty tax of IAET shall apply.

As stated in the Details of Discrepancies of the FDDA and Letter dated 26 June 2015:

IMPROPERLY ACCUMULATED EARNINGS TAX

Basic deficiency tax, P880,011,612.70 – Verification disclosed that there was an indication that you permitted the accumulation of your earnings and profits instead of being distributed through dividend declaration. Hence, you are hereby assessed improperly accumulated earnings tax, as computed hereunder, pursuant to Revenue Memorandum Circular No. 35-2011. Further, as ruled by CIR Kim S. Jacinto-Henares under BIR Ruling No. 094-2013 dated March 18, 2013, you are 

subject to the IAET imposed under Section 29 of the NIRC, as amended.

XXX

XXX

C. Additional paid-in capital is considered as excess capital over and above the par and is excluded from paid-up capital of petitioner.

24. Petitioner's paid-up capital cannot include the additional paid-in capital. Based on petitioner's Parent Company Statements of Financial Position as of 31 December 2010, common stocks of petitioner is 613,236,550. In view thereof, 100% of the paid-up capital cannot exceed ₱613,236,550 which represents the par value of its issued and outstanding shares. Therefore, its capital paid in excess of par value amounting to ₱8,405,568,120 is considered as premium or surplus which cannot be considered as part of the paid-up capital, thus such excess capital over the par shall be excluded.

25. Contrary to the allegation of petitioner that RMC 35-2011 contradicts the legal meaning of 'paid-up capital' as provided in Revenue Regulations No. 14-2001 (RR 14-2001), it is respectfully submitted that RR 14-2001 implements only the provision on Net Operating Loss Carry-Over (NOLCO) of the Tax Code and has no relation to provision on IAET, which is implemented by separate, distinct and independent Revenue Regulation, RR 2-2001, and further clarified by RMC 35-2011.

26. In fact, RR 14-2001 is particular to the provisions on NOLCO as it states that:

'Subject: Implementing Section 34(D) (3) of the National Internal Revenue Code of 1997, Relative to the Allowance of Net Operating Loss Carry-Over (NOLCO) as a Deduction from Gross Income.' *jr*

Section 1. *Scope.* – Pursuant to the provision of Section 244 of the National Internal Revenue Code of 1997 (hereinafter referred to as the Code), these Regulations are hereby promulgated to govern the deduction from gross income of the Net Operating Loss Carry-Over (NOLCO) pursuant to Section 34(D) (3) of the Code, xxx xxx

Section 3. *Definition of Terms.* – For purposes of these Regulations, the words and phrases herein provided shall mean as follows:

xxx xxx

3.5 Paid Up Capital of the Corporation – The term 'Paid Up Capital of the Corporation' shall refer to the total amount paid by stockholders for their subscriptions in the shares of stock of the corporation, including any amount paid over and above the par value or stated value of the share of stock (e.g., premium on capital). For this purpose, the taxpayers shall maintain complete and accurate records of the paid-up capital of the shareholders.' (Emphases supplied)

27. Moreover, if the definitions of 'paid-up capital' provided in RR 14-2001 were to be applied on imposition of IAET, the purpose for which IAET is imposed would have been defeated, that is, IAET 'is being imposed in the nature of a penalty to the corporation for the improper accumulation of its earnings, and 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.' In such case, taxpayers would evade tax by maintaining premiums or surplus in the form of additional paid-in capital in excess of par, considering that the Securities and Exchange Commission (SEC) pursuant to SEC Memorandum Circular specifically prohibits the declaration of additional paid-in capital as dividend. *gr*

28. As held in the case of THE PHILIPPINE AMERICAN LIFE AND GENERAL INSURANCE COMPANY vs. THE SECRETARY OF FINANCE AND THE COMMISSIONER OF INTERNAL REVENUE:

'It is axiomatic that laws should be given a reasonable interpretation which does not defeat the very purpose for which they were passed. Courts should not follow the letter of a statute when to do so would depart from the true intent of the legislature or would otherwise yield conclusions inconsistent with the purpose of the act. This Court has, in many cases involving the construction of statutes, cautioned against narrowly interpreting a statute as to defeat the purpose of the legislator, and rejected the literal interpretation of statutes if to do so would lead to unjust or absurd results.'

29. The purpose for which IAET is imposed is also seen the case of CYANAMID PHILIPPINES, INC., vs. THE COURT OF APPEAL where the Supreme Court stated that 'the provision (on IAET) discouraged tax avoidance through corporate surplus accumulation. When corporations do not declare dividends, income taxes are not paid on the undeclared dividends received by the shareholders. The tax on improper accumulation of surplus is essentially a penalty tax designed to compel corporations to distribute earnings so that the said earnings by shareholders could, in turn, be taxed.'

RMC 35-2011 merely called for strict application of Section 29 of the Tax Code and RR 2-2001, which were already in force the moment the Tax Code and RR 2-2001 were enacted.

30. The non-retroactivity of rulings under Section 246 of the Tax Code is not applicable in the present case considering that RMC 35-2011 is a mere clarification of RR 

2-2001. Respondent simply interpreted the law on IAET of the Tax Code and RR 2-2001.

31. RMC 35-2011 merely clarifies the term 'amount that may be retained' in relation to the provision on IAET of the Tax Code and RR 2-2001. It did not expand the coverage of IAET.

32. In a fairly recent case, it was held by the Supreme Court that:

'Moreover, Sec. 7(c.2.2) of RR 06-08 does not alter Sec. 100 of the NIRC but merely sets the parameters for determining the "fair market value" of a sale of stocks. Such issuance was made pursuant to the Commissioner's power to interpret tax laws and to promulgate rules and regulations for their implementation.'

Lastly, petitioner is mistaken in stating that RMC 25-11, having been issued after the sale, was being applied retroactively in contravention to Sec. 246 of the NIRC. Instead, **it merely called for the strict application of Sec. 100, which was already in force the moment the NIRC was enacted.** (Emphases supplied)

33. RMC 35-2011 as an interpretative ruling gives no consequence than what the law has already prescribed. As explained by the Supreme Court in the case of COMMISSIONER OF CUSTOMS AND THE DISTRICT COLLECTOR OF THE PORT OF SUBIC v. HYPERMIX FEEDS CORPORATION:

'When an administrative rule is merely interpretative in nature, its applicability needs nothing further than its bare issuance, for it gives no real consequence more than what the 

law itself has already prescribed. When, on the other hand, the administrative rule goes beyond merely providing for the means that can facilitate or render least cumbersome the implementation of the law but substantially increases the burden of those governed, it behooves the agency to accord at least to those directly affected a chance to be heard, and thereafter to be duly informed, before that new issuance is given the force and effect of law.' (Emphasis supplied)

34. It must be observed that RMC 35-2011 is an internal issuance that interprets and clarifies a previous regulation and does not go beyond mere internal administration. It effectively limits the definition of the 'amount that may be retained' in accordance with the provision on IAET of the Tax Code and RR 2-2001 together with the legislative intent in imposing IAET.

35. In fact, RMC 35-2011 has for its subject 'Clarification of Issues Concerning the Imposition of Improperly Accumulated Earnings Tax Pursuant to Section 29 of the Tax Code of 1997, in relation to Revenue Regulations No. 2-2001', and also provides that:

'For purposes of this RMC, and in accordance with RR No. 2-2001, the amount that may be retained, taking into consideration the accumulated earnings within the reasonable needs of business as determined under Section 3 of said RR, shall be 100% of the paid-up capital or the amount contributed to the corporation representing the par value of the shares of stocks, hence, any excess capital over and above the par shall be excluded.' (Emphases supplied)

Earnings in 2010 should not be excluded from the computation of improperly accumulated earnings. 92

36. Contrary to the contention of petitioner that earnings earned in 2010 should be excluded from computation of improperly accumulated earnings based on Section 6 of RR 2-2001, it is respectfully submitted that Section 6 of RR 2-2001 has no relation to the subject matter of the present case considering that improperly accumulated earnings were already existent and determined as of 2010.

37. Section 6 of RR 2-2001 provides:

'SEC. 6. Period for Payment of Dividend/Payment of IAET. – The dividends must be declared and paid or issued not later than one year following the close of the taxable year, otherwise, the IAET, if any, should be paid within fifteen (15) days thereafter.'

38. There was no need for the declaration and payment of dividends before IAET can be imposed upon petitioner, and it is not anymore necessary to wait for one year from the close of taxable year within which dividend must be declared and paid. **The fact that the amount retained by petitioner exceeded 100% of the paid-up capital, it permitted its earnings to accumulate beyond the reasonable needs of business which is determinative purpose of avoidance of tax upon its shareholders, thus IAET must be imposed.**

39. Section 29 (C) (2) of the Tax Code provides:

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 *je*

corporation, by the clear preponderance of evidence, shall prove to the contrary.

Also, again in CYANAMID PHILIPPINES, INC., vs. THE COURT OF APPEALS, it is provided that:

'If the CIR determined that the corporation avoided the tax on shareholders by permitting earnings or profits to accumulate, and the taxpayer contested such a determination, the burden of proving the determination wrong, together with the corresponding burden of first going forward with evidence, is on the taxpayer. This applies even if the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits.

In order to determine whether profits are accumulated for the reasonable needs to avoid the surtax upon shareholders, it must be shown that the controlling intention of the taxpayer is manifested at the time of accumulation, not intentions declared subsequently, which are mere afterthoughts. Furthermore, the accumulated profits must be used within a reasonable time after the close of the taxable year. In the instant case, petitioner did not establish, by clear and convincing evidence, that such accumulation of profit was for the immediate needs of the business.

In Manila Wine Merchants, Inc. vs. Commissioner of Internal Revenue, we ruled:

To determine the "reasonable needs" of the business in order to justify an accumulation of earnings, the Courts of the United States have invented the so-called "Immediacy Test" which *fe*

construed the words "reasonable needs of the business" to mean the immediate needs of the business, and it was generally held that if the corporation did not prove an immediate need for the accumulation of the earnings and profits, the accumulation was not for the reasonable needs of the business, and the penalty tax would apply.'

Petitioner is a closely-held corporation, and not a publicly-held corporation, thus it is subject to IAET.

40. Section 4 of RR 2-2001 provides that:

'SEC. 4. Coverage. The 10% Improperly Accumulated Earnings Tax (IAET) is imposed on improperly accumulated taxable income earned starting January 1, 1998 by domestic corporations as defined under the Tax Code and which are classified as closely-held corporations. Provided, however, that Improperly Accumulated Earnings Tax shall not apply to the following corporations:

- a. Banks and other non-bank financial intermediaries;
- b. Insurance companies;
- c. Publicly-held corporations;
- d. Taxable partnerships;
- e. General professional partnerships;
- f. Non-taxable joint ventures; and
- g. Enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under R.A. 7916, and enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under R.A. 7227, as well as other enterprises duly registered under special economic zones declared by law which enjoy payment of special tax rate on their *gr*

registered operations or activities in lieu of other taxes, national or local.

For purposes of these Regulations, **closely-held corporations** are those corporations at least fifty percent (50%) in value of the outstanding capital stock or at least fifty percent (50%) of the total combined voting power of all classes of stock entitled to vote is owned directly or indirectly by or for not more than twenty (20) individuals. Domestic corporations not falling under the aforesaid definition are, therefore, **publicly held corporation.**

For purposes of determining whether the corporation is closely held corporation, insofar as such determination is based on stock ownership, the following rules shall be applied:

1. **Stock Not Owned by Individuals.** – Stock owned directly or indirectly by or for a corporation, partnership, estate or trust shall be considered as being owned proportionately by its shareholders, partners or beneficiaries.

2. **Family and Partnership Ownership.** – An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family, or by or for his partner. For purposes of this paragraph, the "family of an individual" includes his brothers or sisters (whether by whole or half-blood), spouse, ancestors and lineal descendants.

3. **Option to Acquire Stocks.** – If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option and each one of a series *9c*

of option shall be considered as an option to acquire such stock.

4. Constructive Ownership as Actual Ownership. – Stock constructively owned by reason of the application of paragraph (1) or (3) hereof shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by the individual by reason of the application of paragraph (2) hereof shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

xxx xxx' (Emphases supplied)

41. Petitioner was considered to be a closely-held corporation as per BIR Ruling, to wit:

'A perusal of the General Information Sheets (GIS) attached to the above-stated Memorandum will show that CEBU AIR, INC a domestic corporation, is 66.15% owned by *CPAir Holdings, Inc.* On the other hand, *CPAir Holdings Inc.* is wholly-owned by *JG Summit* which, in turn, is owned by the following individual stockholders, to wit:

1.	Gokongwei Brothers Foundation	29.38%
	a. John Gokongwei, Jr.	
	b. Elizabeth Gokongwei	
	c. Lance Gokongwei	
	d. Robina Gokongwei	
	e. Patrick Henry L. Go	
	f. Johnson Robert Go, Jr.	
	g. James L. Go	
2.	John Gokongwei, Jr.	12.75%
3.	Lance Y. Gokongwei	
	&/or Elizabeth Gokongwei	3.46%
4.	James L. Go	2.19%
5.	John Gokongwei	
	&/or Lance Gokongwei	2.07%
6.	Robina Gokongwei Pe	
	&/or Elizabeth Gokongwei	<u>1.06%</u>

50.91%

xxx xxx

Based on the foregoing, this Office is of the opinion that CEBU AIR, INC. is not publicly held corporation since 66.15% of its shareholdings is owned by CPAir Holdings, Inc. which is wholly-owned by JG Summit. Although CEBU AIR, INC. is ultimately owned by JG Summit, a corporation owned by more than 20 stockholders, CEBU AIR, INC. is still not a publicly held corporation exempt from IAET as contemplated under Section 29 (B) of the Tax Code of 1997, as amended, in relation to RR No. 2-2001. The ownership of a domestic corporation for purposes of determining whether it is a closely-held corporation or a publicly-held corporation is ultimately traced to the individual shareholder of the parent company. Thus, where at least 50% in value of the outstanding capital stock or of the total combined voting power of all classes of stock entitled to vote in a corporation is owned directly or indirectly by not more than 20 individuals, the corporation is considered a closely-held corporation.

By applying the above-cited test under Section 4 of RR 2-2001, the ultimate parent company of CEBU AIR, INC., *JG Summit*, is not a publicly-held corporation for purposes of exemption from IAET. It is noted from the GSIS of JG Summit, as above listed, that at least fifty percent (50%) in value of the outstanding capital stock or at least fifty percent (50%) of the total combined voting power of all classes of stock entitled to vote is not owned directly or indirectly by or for not more than twenty (20) individuals. *je*

It must be observed that although the number of majority stockholders of *JG Summit* is more than 10, the actual number of persons who control the company is limited to 5-6 persons. It is noteworthy that stockholders of Gokongwei Brothers Foundation who owns 29.38% of *JG Summit* are likewise the majority stockholders of *JG Summit*. Thus, if we consider CEBU AIR, INC. a publicly-held corporation, the purpose of the IEAT provision will be defeated.' (Emphases supplied)

42. The determination whether Gokongwei Brothers Foundations (GBF) is a stock or non-stock corporation is immaterial. The fact is GBF and the persons composing it, to wit, the family members of Gokongwei, own shares in JG Summit, and ultimately, in Cebu Air Inc., and these are the determinative factors in computing the percentage ownership of stocks of petitioner.

43. The ownership of a domestic corporation for purposes of determining whether it is a closely-held corporation or a publicly-held corporation is ultimately traced to the individual shareholder of the parent company.

As held in the case of NARRA NICKEL MINING AND DEVELOPMENT CORP., TESORO MINING AND DEVELOPMENT, INC., and McARTHUR MINING, INC., vs. REDMONT CONSOLIDATED MINES CORP.:

'As further defined by Dean Cesar Villanueva, the Grandfather Rule is "the method by which the percentage of Filipino equity in a corporation engaged in nationalized and/or partly nationalized areas of activities, provided for under the Constitution and other nationalization laws, is computed, in cases where corporate shareholders are present, by attributing the nationality of the second or even subsequent their of ownership to determine the nationality of the corporate shareholder.'" *Jr*

Thus, to arrive at the actual Filipino ownership and control in a corporation, both the direct and indirect shareholdings in the corporation are determined.

This concept of stock attribution inherent in the Grandfather Rule to determine the ultimate ownership in a corporation is observed by the Bureau of Internal Revenue (BIR) in applying Section 127 (B) of the National Internal Revenue Code on taxes imposed on closely held corporations, in relation to Section 96 of the Corporation Code on close corporations.'

The assessment issued against petitioner is valid and lawful.

44. Assessments are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously. (*Marcos II vs. Court of Appeals G.R. No. 120880 June 5, 1997*)

45. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise the presumption of correctness of tax assessment stands. (*Commissioner of Internal Revenue vs. Hantex Trading Co., Inc., G.R. No. 136975, March 31, 2005*)

46. All presumptions are in favor of the correctness of tax assessment (Sy Po vs. Court of Tax Appeals, 164 SCRA 524). Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice. 

47. Following the premises above, petitioner has the burden of proving that the assessment of IAET has no factual and legal basis, failure to do so entitles respondent's assessment with presumption of regularity, thus legal and valid.

48. Petitioner is liable to pay its **assessed improperly accumulated earnings tax** in the total amount of One Billion Eight Hundred Seventy Six Million Eight Hundred Eighty Five Thousand Seven Hundred Twenty Five Pesos and 78/100 (₱1,876,885,725.78) as the said assessment was issued in accordance with law and jurisprudence."

Respondent's Pre-Trial Brief³⁰ was filed on February 11, 2016; while petitioner's Pre-Trial Brief³¹ was filed through registered mail on February 15, 2016 and received by the Court on February 19, 2016.

On March 9, 2016, the parties submitted their Joint Stipulation of Facts and Issues³². Consequently, the Court issued a Pre-Trial Order on March 31, 2016 and terminated the pre-trial.³³

To support its claim, petitioner presented its witnesses Mr. Robin C. Dui, Ms. Rosalinda F. Rivera, and Mr. Nicasio L. Lim. Thereafter, petitioner's documentary evidence as well as testimonial evidence were formally offered and admitted by the Court.³⁴

On the other hand, respondent presented Revenue Officers Lover L. Loveres and Ms. Gisela R. Amodia as his witnesses to rebut petitioner's claim. Then, respondent formally offered his documentary evidence and testimonial evidence, which the Court subsequently admitted.³⁵ *gr*

³⁰ Docket, vol. I, pp. 316 to 323.

³¹ Docket, vol. II, pp. 575 to 584.

³² Docket, vol. II, pp. 588 to 593.

³³ Pre-Trial Order, docket, vol. II, pp. 595 to 599.

³⁴ Resolution dated August 4, 2016, docket, vol. III, pp. 997 to 998.

³⁵ Resolution dated November 25, 2016, docket, vol. III, pp. 1025 to 1026.

After considering the Memorandum for the Petitioner³⁶ filed on January 16, 2017 and respondent's Memorandum³⁷ filed on January 3, 2017, the instant case was declared submitted for decision on January 23, 2017.³⁸

THE ISSUES

The parties stipulated the following issues³⁹ for the Court's consideration:

1. Whether petitioner is liable for deficiency IAET for TY 2010, inclusive of increments, in the amount of ₱1,876,885,725.76;
2. Whether petitioner has improperly accumulated earnings which are subject to IAET; and
3. Whether petitioner is a publicly-held corporation which is exempt from IAET.

Likewise, petitioner raised the issue of whether the assessments are null and void due to the absence of an electronic letter of authority covering the audit investigation against petitioner for TY ended December 31, 2009.⁴⁰

DISCUSSION/RULING

The Court shall determine first whether it has jurisdiction over the instant case.

Section 228 of the National Internal Revenue Code of 1997, as amended, provides: *jk*

³⁶ Docket, vol. III, pp. 1061 to 1101.

³⁷ Docket, vol. III, pp. 1027 to 1049.

³⁸ Resolution, docket, vol. III, p. 1104.

³⁹ Par. III, Stipulation of Issues, JSFI, docket, vol. II, pp. 589 to 590.

⁴⁰ Par. IV, Issue Raised by Petitioner, JSFI, docket, vol. II, p. 590.

"SEC. 228. *Protesting of Assessment.* – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however,* That a preassessment notice shall not be required in the following cases:

XXX

XXX

XXX

The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable."

Based on the foregoing, a taxpayer has 30 days from receipt of the decision to appeal the same. *gr*

Considering that petitioner received a copy of the Letter partially denying petitioner's request for reconsideration on June 29, 2015, it had 30 days therefrom or until July 29, 2015 within which to appeal the said denial before this Court.

Accordingly, since petitioner filed this Petition for Review on July 29, 2015, the same was timely filed.

Petitioner contends that the assessment is void due to the absence of an eLA as required under Revenue Memorandum Order (RMO) Nos. 69-10 and 62-10. Petitioner has denied receiving any eLA as a replacement of the manually prepared and issued LOA No. LOA-123-2011-00000044 dated September 28, 2011. It is alleged by petitioner that since it categorically denied the receipt of the eLA, the burden of proving the existence of the said eLA and its service to petitioner would rest upon respondent.

According to petitioner, Ms. Codoy is not an employee or an officer of petitioner, and she has no written authority to act on behalf of petitioner. Petitioner further claims that the mere fact that it opted to voluntarily pay, without admission of liability, the other tax types covered by the FDDA which are not the subject of the petition, it is not estopped from questioning the validity of the assessment. Petitioner maintains that it cannot be faulted for participating in the audit and investigation, prejudiced by its partial voluntary payment, and estopped from challenging the validity of the assessment because it was respondent who failed to comply with the duty to retrieve the manual letter of authority and replace it with an eLA.

On the other hand, respondent posits that the LOA is valid; thus, the assessment issued against petitioner is legal.

Respondent insists that an eLA was issued on September 28, 2011 and was received by petitioner on September 30, 2011. According to respondent, if there is indeed no eLA served to petitioner, the latter should have not entertained the revenue officers and should immediately assert its right. Respondent points out that instead of petitioner asserting its right, the latter actively participated in the audit proceedings showing its assent to the validity of the LOA. *jr*

It is maintained by respondent that if petitioner truly believed that the LOA is invalid for lack of eLA, it should not have paid the deficiency taxes assessed. Allegedly, it is conclusive that upon payment by petitioner of the assessed deficiency income tax, VAT, EWT, and withholding tax for compensation for TY 2010, petitioner abandoned or waived its right to contest the validity of the LOA.

A careful perusal of the records shows that the electronically prepared and issued eLA201000033121 dated September 28, 2011 was issued by respondent and served to petitioner through a certain C. Codoy on September 30, 2011.

Petitioner argues that Ms. Cecile Codoy is not an employee or an officer of the former, and she has no written authority to act on its behalf. On the other hand, respondent insists that petitioner received the eLA, and as such, the latter was able to comply partially with the investigation/examination.

Accordingly, it is imperative for this Court to scrutinize carefully the evidence presented by both parties to settle the factual issue of receipt of the eLA.

Petitioner's witness, Mr. Robin C. Dui testified that petitioner did not receive any eLA, to wit:⁴¹

"Q10. In your experience as Vice President-Comptroller, how does the BIR commence its tax audit investigations against Petitioner?

A10. The BIR would serve Petitioner with manual letters of authority or electronic letters of authority to commence its tax audit investigations.

Q11. How did the BIR commence its tax audit investigation against Petitioner for the year 2010?

A11. The BIR commenced its tax audit investigation against Petitioner for the year 2010 by serving Petitioner with a manual letter of authority. *ju*

⁴¹ Exhibit "P-37", docket, vol. II, pp. 362 to 363.

Q12. I am showing to you a Letter of Authority No. LOA-123-2011-00000044, which has been previously marked as *Exhibit 'P-3'*. What relation does this document have to the manual letter of authority served by the BIR to Petitioner?

A12. Exhibit 'P-3' is the manual letter of authority served by the BIR to Petitioner to commence the tax audit investigation against the latter for the year 2010.

Q13. When did the BIR serve Petitioner with the electronic letter of authority covering the tax audit investigation for the year 2010?

A13. I do not know. We did not receive any electronic letter of authority covering the tax audit investigation for the year 2010 from the BIR.

Q14. You mentioned that you did not receive any electronic letter of authority covering the tax audit investigation for the year 2010. I am now showing to you a document attached as Annex 'I' of the Respondent's Amended Answer, which Respondent claims is the electronic letter of authority for the tax audit investigation against Petitioner for the year 2010. At the lower portion of the said document, there is a handwritten name 'C. Codoy' beside the date '9/30/11'. What is the position of C. Codoy in Cebu Air, Inc., the Petitioner in this case?

A14. C. Codoy does not have any position in Cebu Air, Inc. and is neither an employee nor an officer of Petitioner.

Q15. What is Codoy's written authority to receive communications from the BIR on behalf of Petitioner for the year 2010?

A15. To my knowledge, Petitioner has never issued any written authority authorizing C. Codoy to receive communications from the BIR on its behalf. I also verified this fact with our Corporate Secretary and other members of my team who all confirmed that C. Codoy has no written official authority to receive communications from the BIR." 

On the other hand, Mr. Dui stated during the cross-examination that he knew Ms. Codoy and met her, but denied that the latter was an employee of petitioner, to wit:⁴²

"Q In your answer to question number 14, you mentioned that C. Codoy does not have any position in Cebu Air and neither an employee or an officer of the petitioner?

WITNESS:

A Yes, Ma'am.

ATTY. MENDOZA:

Q Do you know the person of C. Codoy?

A Yes, ma'am.

Q And in your answer to question number 15, you mentioned that petitioner has never issued any official written authority to receive communications from the BIR. What is your proof that you verified that fact, sir?

A Normally we wrote a written Authority authorizing somebody course through the Corporate Secretary of Cebu Pacific or the petitioner. So what I did was to ask the Secretary whether in fact C. Codoy was authorized and then the answer was not.

Q Do you have any communication to the Corporate Secretary regarding this matter?

A I do not recall any.

xxx xxx xxx

JUSTICE CASTAÑEDA, JR.:

Q Do you know the person concerned?

WITNESS:

A I know her but I am sure that she is not an employee of Cebu Pacific, she is not in the payroll.

ATTY. MENDOZA: *Je*

⁴² Transcript of Stenographic Notes (TSN) dated May 18, 2016, pp. 5 to 7.

Q But you mentioned a while ago that you know the person of Ms. C Codoy?

WITNESS:

A Yes I met her ten (10) to fifteen (15) years ago."

Petitioner presented the manually issued LOA to prove that it did not receive the eLA.

To refute petitioner's allegation of non-receipt of eLA, respondent presented Revenue Officer Lover L. Loveres who testified as follows:

"10Q You mentioned that you were a Revenue Officer at the Large Taxpayers Division-Cebu and assigned to examine the accounting records of petitioner, when did you start your examination in relation thereto?

10A In 2011, after I was authorized to examine the accounting records of Cebu Air, Inc.

11Q What is the authority to conduct the examination of petitioner's accounting records?

11A I was authorized under Letter of Authority No. LOA-123-2011-00000044 dated 28 September 2011.

12Q If this Letter of Authority will be shown to you, will you be able to identify the same?

12A Yes.

13Q I have with me a document entitled Letter of Authority No. LOA-123-2011-00000044 dated 28 September 2011 BIR FORM NO. 1966 bearing SN: eLA201000033121 found in page 1 of the BIR Records and marked as Exhibit R-1 for the respondent, what relation does this document has to the Letter of Authority that you mentioned earlier?

13A This is the Letter of Authority (LOA) that I mentioned earlier.

14Q After the issuance of such LOA, what happened next if any?

14A 1) I personally served the LOA; 2) I received partial compliance; 3) I conducted initial audit. I was re-assigned to LTRAD III at the BIR National Office, and thereafter the investigation was assigned to another Revenue Officers, one of them is Ms. Gisela R. Amodia." 

During cross-examination, Mr. Loveres testified that he served the eLA to Ms. Codoy who allegedly was a representative of petitioner, and thereafter, petitioner made a partial compliance in Manila. Mr. Loveres also stated during his re-direct examination that the eLA was served to petitioner's registered address, to wit:

ATTY. DRILON:

Q. Mr. Loveres, you mentioned that you personally served the Letter of Authority to petitioner?

MR. LOVERES:

A. Yes, sir.

ATTY. DRILON:

Q. To whom specifically did you serve the Letter of Authority?

MR. LOVERES:

A. Ms. Cecile Codoy.

ATTY. DRILON:

Ms. Cecile Codoy as it appears in Exhibit R-1 of the BIR.

MR. LOVERES:

A. Yes.

ATTY. DRILON:

Q. Before handing over the Letter of Authority to Ms. Cecile Codoy, what steps did you take to verify what her position is with petitioner, Cebu Air, Inc.?

MR. LOVERES:

A. She is the person receiving the correspondences in Cebu because in reality, Cebu Air, operates in Pasay City. But since the address is registered in the BIR, as well as their franchises is in Cebu, I have to go to the building designated as their business address. So Cecile Codoy was the one receiving for them.

ATTY. DRILON:

Q. But Ms. Codoy did not present any identification that she is an employee of petitioner, is that correct? *gr*

MR. LOVERES:

A. Yes. She just manifested that she is the one representing Cebu Air.

ATTY. DRILON:

Q. She manifested that she represents Cebu Air?

MR. LOVERES:

A. Yes, she is the one who receive for Cebu Air. And what made me believe that she is indeed the one representing them is that, after she received the correspondence, Cebu Air made partial compliance here in Manila.

ATTY. DRILON:

No further questions, Your Honors.

xxx

xxx

xxx

ATTY. MENDOZA:

Q. Sir Loveres, you were asked to whom you served the Letter of Authority?

MR. LOVERES:

A. Yes.

ATTY. MENDOZA:

Q. And you answered, you served to C. Codoy, Cecile Codoy?

MR. LOVERES:

A. In Cebu.

ATTY. MENDOZA:

Q. Am I right, sir?

MR. LOVERES:

A. Yes.

ATTY. MENDOZA:

Q. In Cebu?

MR. LOVERES:

A. Yes. 

ATTY. MENDOZA:

Q. What particularly is the address of to whom you served the Letter of Authority? The address was you served the Letter of Authority?

MR. LOVERES:

A. Actually, I think, it's Juanita Lim Building but it's also the Cebu Midtown.

ATTY. MENDOZA:

Q. Is that the registered address of Cebu Air?

MR. LOVERES:

A. Yes."

Apparently, Revenue Officer Loveres personally served a copy of the eLA to petitioner through Ms. Codoy who was then at the registered address of petitioner. Ms. Codoy likewise manifested that she was the representative of petitioner and even signed the eLA on behalf of petitioner.

On the other hand, Mr. Dui admitted that he had met Ms. Codoy 10 or 15 years ago but did not elaborate the extent of their familiarity with each other or the circumstances of such meeting.

Section 3(m) of Rule 131 of the Rules of Court provides:

"SEC. 3. *Disputable presumptions.* – The following presumptions are satisfactory if uncontradicted, but may be contradicted and overcome by other evidence:

xxx

xxx

xxx

(m) That official duty has been regularly performed;"

Considering the foregoing, it is apparent that Revenue Officer Loveres personally served the eLA to petitioner through Ms. Codoy who was then at petitioner's registered business office; thus, he performed his duty to serve the eLA. 92

It is noteworthy that despite the testimony of Mr. Dui, petitioner did not present any document to prove that Ms. Codoy was not among its employees in year 2010.

Further, the denial of receipt of the eLA by petitioner does not shift the burden of proof of receipt to respondent, because the service of the said eLA was not made through registered mail but by personal service.

In sum, petitioner has failed to overcome the disputable presumption of regularity in the performance of respondent's official duty.

As regards the issue of whether petitioner is a publicly-held corporation that is not subject to IAET, it contends that IAET shall not apply to publicly-held corporations in accordance with Section 29(b)(2)(a) of the NIRC of 1997, as amended.

Petitioner explains that respondent considered the former as closely-held corporation based on BIR Ruling No. 094-2013 dated March 18, 2013. Allegedly, respondent has erroneously considered the incorporators of Gokongwei Brothers Foundation (GBF) as individual stockholders when he concluded that petitioner is a closely-held corporation for purposes of imposing the IAET. Petitioner asserts that the shares of stock held by GBF in JG Summit cannot be considered as being owned proportionately by GBF's shareholders because the latter does not have shareholders. According to petitioner, GBF is a non-stock, non-profit foundation/corporation established under the laws of the Republic of the Philippines, which does not have capital stock that is divided into shares. It is maintained by petitioner that even assuming for the sake of argument that the shares held by GBF are to be counted as part of the shares held by Mr. John Gokongwei's family, petitioner is still considered a publicly-held corporation because at least 67.21% of its outstanding shares are owned directly or indirectly by hundreds of shareholders belonging to the investing public.

However, respondent argues that petitioner is a closely-held corporation subject to IAET. According to respondent, petitioner is considered to be a closely-held corporation as per BIR Ruling No. 094-13 dated March 18, 2013 which was explained and incorporated in the *gr*

assessments issued against petitioner. Respondent posits that the determination whether GBF is a stock or non-stock corporation is immaterial. Allegedly, the fact is GBF and the persons composing it own shares in JG Summit, and ultimately, in Cebu Air, Inc., and these are the determinative factors in computing the percentage ownership of stocks of petitioner. Respondent avers that the ownership of a domestic corporation for purposes of determining whether it is a closely-held corporation or a publicly-held corporation is ultimately traced to the individual shareholder of the parent company.

Section 29(B)(2)(a) of the NIRC of 1997, as amended, states:

"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;" Jr

Section 4 of Revenue Regulations (RR) No. 2-2001 provides:

"SECTION 4. *Coverage.* The 10% Improperly Accumulated Earnings Tax (IAET) is imposed on improperly accumulated taxable income earned starting January 1, 1998 by domestic corporations as defined under the Tax Code and which are classified as closely-held corporations. Provided, however, that Improperly Accumulated Earnings Tax shall not apply to the following corporations:

- a. Banks and other non-bank financial intermediaries;
- b. Insurance companies;
- c. Publicly-held corporations;
- d. Taxable partnerships;
- e. General professional partnerships;
- f. Non-taxable joint ventures; and
- g. Enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under R.A. 7916, and enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under R.A. 7227, as well as other enterprises duly registered under special economic zones declared by law which enjoy payment of special tax rate on their registered operations or activities in lieu of other taxes, national or local.

For purposes of these Regulations, closely-held corporations are those corporations at least fifty percent (50%) in value of the outstanding capital stock or at least fifty percent (50%) of the total combined voting power of all classes of stock entitled to vote is owned directly or indirectly by or for not more than twenty (20) individuals. Domestic corporations not falling under the aforesaid definition are, therefore, *publicly-held corporations*.

For purposes of determining whether the corporation is closely held corporation, insofar as such determination is



based on stock ownership, the following rules shall be applied:

1. *Stock Not Owned by Individuals.* – Stock owned directly or indirectly by or for a corporation, partnership, estate or trust shall be considered as being owned proportionately by its shareholders, partners or beneficiaries.”

To prove its allegations, petitioner presented Certifications issued by the Philippine Stock Exchange, Inc. (PSE) regarding the listing date of Cebu Air, Inc. and JG Summit Holdings, Inc.,⁴³ Letters dated January 14, 2010 and January 13, 2011 issued by JG Summit Holdings, Inc. with attached List of Top 100 Stockholders as of December 31, 2009 and 2010,⁴⁴ Letter dated January 14, 2011 issued by Cebu Air, Inc. with attached List of Top 100 Stockholders as of December 31, 2010,⁴⁵ CP Air Holdings, Inc.’s General Information Sheets for the years ended 31 December 2009 and 2010,⁴⁶ and Amended Articles of Incorporation and General Information Sheets for the years ended 31 December 2009 and 2010 of Gokongwei Brothers Foundation, Inc.⁴⁷

These pieces of evidence are not sufficient to prove that petitioner is a publicly-held corporation.

CP Air Holdings, Inc. held 63.361% of petitioner’s outstanding shares of stocks in 2010.⁴⁸ Also, the stockholders of CP Air Holdings (CP Air), Inc. in 2010 were JG Summit Holdings, Inc. (JG Summit) - 99.99%, John L. Gokongwei, Jr. - .0008%, James L. Go - .0008%, Lance Y. Gokongwei - .0008%, Johnson Robert G. Go, Jr. - .0008%, and Robina Y. Gokongwei-Pe - .0008%.⁴⁹

In 2010, JG Summit had the following stockholders holding bigger portion of its outstanding capital stocks:⁵⁰ *jc*

⁴³ Exhibits “P-15” and “P-16”, docket, vol. III, pp. 872 and 873, respectively.

⁴⁴ Exhibits “P-18” and “P-19”, docket, vol. III, pp. 881 to 885 and pp. 891 to 895, respectively.

⁴⁵ Exhibit “P-17”, docket, vol. III, pp. 874 to 875.

⁴⁶ Exhibits “P-20” and “P-21”, docket, vol. III, pp. 932 to 938 and pp. 940 to 946, respectively.

⁴⁷ Exhibits “P-22”, “P-23”, and “P-24”, docket, vol. III, pp. 948 to 960, pp. 961 to 965, and pp. 966 to 970, respectively.

⁴⁸ Exhibit “P-17”, docket, vol. III, p. 875.

⁴⁹ Exhibit “P-21”, docket, vol. III, p. 944.

⁵⁰ Exhibit “P-19”, docket, vol. III, p. 892.

1.	Gokongwei Brothers Foundation	29.381%
2.	PCD Nominee Corporation	16.051%
3.	RSB-TIG No. 030-46-000001-9	15.202%
4.	John Gokongwei	12.748%
		73.382%

However, petitioner has failed to present any evidence to show the numbers of stockholders of PCD Nominee Corporation and RSB-TIG No. 030-46-000001-9 in order for this Court to determine whether the fifty percent (50) of the total combined voting power of all classes of stock entitled to vote is owned directly or indirectly by or for not more than twenty individuals.

It is highly emphasized that for purposes of determining whether a corporation is a closely-held corporation, stock owned directly or indirectly by or for a corporation shall be considered as being owned proportionately by its shareholders, and at least the 50% in value of the outstanding capital stock or at least fifty percent (50) of the total combined voting power of all classes of stock entitled to vote is owned directly or indirectly by or for not more than twenty individuals.

In the case of *Cyanamid Philippines, Inc. vs. The Court of Appeals, et al.*⁵¹, the Supreme Court held that laws granting exemption from tax are construed *strictissimi juris* against the taxpayer and the burden of proof rests upon the party claiming exemption to prove that it is covered by the exemption claimed, to wit:

“The amendatory provision of Section 25 of the 1977 NIRC, which was PD 1739, enumerated the corporations exempt from the imposition of improperly accumulated tax: (a) banks; (b) non-bank financial intermediaries; (c) insurance companies; and (d) corporations organized primarily and authorized by the Central Bank of the Philippines to hold shares of stocks of banks. Petitioner does not fall among those exempt classes. Besides, the rule on enumeration is that the express mention of one person, thing, act, or consequence is construed to exclude all others. Laws granting exemption from tax are *je*

⁵¹ G.R. No. 108067, January 20, 2000.

construed *strictissimi juris* against the taxpayer and liberally in favor of the taxing power. Taxation is the rule and exemption is the exception. The burden of proof rests upon the party claiming exemption to prove that it is, in fact, covered by the exemption so claimed a burden which petitioner here has failed to discharge.”

Respondent found that petitioner permitted the accumulation of its earnings and profits, instead of having it distributed through dividend declaration. Hence, petitioner is assessed of IAET in the amount of ₱1,876,885,725.76, as computed hereunder, pursuant to Section 29 of the NIRC of 1997, as amended, Revenue Memorandum Circular (RMC) No. 35-2011, and BIR Ruling No. 094-2013 dated March 18, 2013:⁵²

Taxable income for TY 2010		₱ (533,255,953.00)
Add:		
Income exempt from tax	₱ 6,663,510,001.00	
Income excluded from gross income	-	
Income subject to final tax	1,289,210,989.00	7,952,720,990.00
Total		₱ 7,419,465,037.00
Less:		
Income tax paid/payable		-
Total		₱ 7,419,465,037.00
Add: Retained earnings from prior years		
Accumulated earnings as of December 31, 2009	₱ 1,993,887,640.00	
Less: Amount that may be retained (100% of paid-up capital)	613,236,550.00	
Dividend declared	-	1,380,651,090.00
Improperly accumulated earnings		₱ 8,800,116,127.00
Multiply by tax rate		10%
IAET Due		880,011,612.70
Add: Surcharge	₱ 220,002,903.18	
Interest 01/16/2011 – 03/31/2015	776,821,209.90	
Compromise – late payment	50,000.00	996,874,113.06
TOTAL AMOUNT DUE		₱ 1,876,885,725.76

In determining improperly accumulated earnings, petitioner argues that respondent failed to make the following necessary adjustments: (i) consider additional paid-in capital as part of its paid-up capital; and (ii) exclude its retained earnings in 2010.

i. *Additional paid-in capital is part of paid-up capital* *per*

⁵² Exhibits “P-9”, Details of Discrepancies and “P-11”, docket, vol. II, pp. 457 and 474, respectively.

Under Section 29 of the NIRC of 1997, as amended, a corporation that permits the accumulation of earnings and profits beyond the reasonable needs of the business, instead of dividing or distributing said profits, is subject to 10% IAET on the improperly accumulated taxable income, to wit:

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

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

(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 carry-over 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. *Je*

(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." (*Emphasis supplied*)

In relation thereto, Section 3 of RR No. 2-2001⁵³ prescribes the rules and regulations in the implementation of the provision on IAET, which states in part the following:

"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;" (*Emphasis supplied*)

Allegedly, respondent excluded the additional paid-in capital (APIC) for purposes of computing whether IAET is due, pursuant to RMC No. 35-2011⁵⁴, which reads as follows:

"For purposes of this RMC, and in accordance with RR No. 2-2001, the amount that may be retained, taking into consideration the accumulated earnings within the '*reasonable needs of the business*' as determined under Section 3 of the said RR, shall be 100% of the paid-up capital or the amount contributed to the corporation representing the par value of the shares of stock, hence, **any excess capital over and above the par shall be excluded.**" (*Emphasis supplied*)

Petitioner asserts that respondent has expanded the coverage of the IAET by excluding APIC from the definition of "paid-up capital" to the prejudice of all taxpayers, including petitioner. *Jr*

⁵³ Implementing the Provision on Improperly Accumulated Earnings Tax Under Section 29 of the Tax Code of 1997.

⁵⁴ Clarification of Issues Concerning the Imposition of Improperly Accumulated Earnings Tax Pursuant to Section 29 of the Tax Code of 1997, in Relation to Revenue Regulations No. 2-2001.

The APIC, which **forms part of the company's equity**, represents the amount of money that its shareholders pay in excess of the par value of the shares. In other words, it is the amount over the par value that investors are willing to pay for the stocks.

In *National Telecommunications Commission vs. Honorable Court of Appeals and Philippine Long Distance Telephone Company*⁵⁵, the Supreme Court defined "capital" as the amount that the corporation receives, inclusive of the premiums if any, in consideration of the issuance of shares, to wit:

"The term 'capital' and other terms used to describe the capital structure of a corporation are of universal acceptance, and their usages have long been established in jurisprudence. Briefly, capital refers to the value of the property or assets of a corporation. **The capital subscribed is the total amount of the capital that persons (subscribers or shareholders) have agreed to take and pay for, which need not necessarily be, and can be more than, the par value of the shares. In fine, it is the amount that the corporation receives, inclusive of the premiums if any, in consideration of the original issuance of the shares.** xxx" (*Emphasis supplied*)

Moreover, the Securities and Exchange Commission (SEC), in its *Guidelines on the Determination of Retained Earnings Available for Dividend Declaration*⁵⁶, has defined "paid-in capital" to include APIC or premium, to wit:

"*Paid-in Capital* – the amount of outstanding capital stock and additional paid-in capital or premium paid over the par value of shares."

Simply put, the APIC is the amount of capital in excess of the par value of the company's shares. If the APIC is to be excluded from the amount that may be retained, it would necessarily form part of the 

⁵⁵ G.R. No. 127937, July 28, 1999.

⁵⁶ Section 2, SEC Memorandum Circular No. 11, Series of 2008.

improperly accumulated earnings, which would then be subjected to IAET.

Note that the IAET is being imposed in the nature of a penalty to the corporation for the **improper accumulation of its earnings**, and 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.⁵⁷

Definitely, the APIC are not earnings/profits of a corporation generated from the normal and continuous operations of the business. Hence, petitioner may retain the total amount of ₱9,018,804,670.00, as shown below:⁵⁸

Common stock	₱ 613,236,550.00
Capital paid in excess of par value	8,405,568,120.00
Total Amount that may be Retained	₱9,018,804,670.00

At the outset, respondent cannot apply the afore-cited RMC, which was issued only on March 14, 2011, in the subject assessment pertaining to taxable year 2010, pursuant to Section 246 of the NIRC of 1997, to wit:

"SEC. 246. Non-Retroactivity of Rulings. – Any revocation, modification or reversal of any of the rules and regulations promulgated in accordance with the preceding Sections 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, xxx."

Accordingly, the RMC, as correctly pointed out by petitioner, cannot be given retroactive application.

The rule is that BIR rulings have no retroactive effect where a grossly unfair deal would result to the prejudice of the taxpayer.⁵⁹ *je*

⁵⁷ Section 2, RR No. 2-2001.

⁵⁸ Exhibits "P-13-A" and "P-13-B", docket, vol. III, p. 793.

⁵⁹ *Commissioner of Internal Revenue vs. Philippine Healthcare Providers, Inc.*, G.R. No. 168129, April 24, 2007.

ii. *Exclusion of earnings in 2010*

In 2010, petitioner earned income in the aggregate amount of ₱7,419,465,037.00, computed below, based on the figures reported in petitioner's Annual Income Tax Return:⁶⁰

Net taxable income (item 126)		₱ (533,255,953.00)
Income exempt from tax		
Gross income exempt from tax (item 21A)	₱ 7,551,120,417.00	
Less: Deductions to income exempt from tax (item 22A)	(887,610,416.00)	6,663,510,001.00
Income subject to final tax and income ex		1,289,210,989.00
Total Income Earned in 2010		₱ 7,419,465,037.00

Petitioner contends that respondent should have excluded its income earned in 2010 in computing for the alleged improperly accumulated earnings because a corporation is given one (1) year following the close of the taxable year in which such income was earned to declare dividends. Section 6 of RR No. 2-2001 reads:

"SEC. 6. *Period for Payment of Dividend/Payment of IAET.* – The dividends must be declared and paid or issued not later than one year following the close of the taxable year, otherwise, the IAET, if any, should be paid within fifteen (15) days thereafter."

To reiterate, Section 29 of the NIRC of 1997 provides that an IAET equivalent to 10% of the improperly accumulated earnings shall be imposed on corporations that permit its earnings and profits to accumulate, instead of being distributed as dividends. Specifically, there is *prima facie* instance of accumulation of profits when a corporation allows its earnings to accumulate in excess of 100% of the paid-up capital, not otherwise intended for the reasonable needs of its business, which is also indicative of the purpose to avoid income tax upon shareholders.

In this case, it must be noted that respondent found that petitioner had earnings in excess of 100% of its paid-up capital in taxable year 2010. Moreover, there is no showing that the accumulated *pe*

⁶⁰ Exhibit "P-14", docket, vol. III, pp. 868 to 871.

earnings in 2010 are for the immediate and reasonable needs of its business.

Truly, a corporation is given one (1) year following the close of the taxable year in which such income was earned to declare dividends. Nonetheless, petitioner failed to prove that it declared and paid or issued dividends before the taxable year 2011 ended. Therefore, the imposition of IAET on petitioner’s accumulated income in taxable year 2010 is proper.

The Court notes, however, that the compromise penalty of ₱50,000.00 should be cancelled. Pursuant to Revenue Memorandum Order (RMO) No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Compromise penalties imply mutual agreement between the taxpayer, on one hand, and the respondent, on the other. Absent any showing that petitioner consented to the compromise penalties, the same should not be imposed.

WHEREFORE, premises considered, the instant Petition for Review is **DENIED**. Accordingly, the assessment issued by respondent against petitioner for Improperly Accumulated Earnings Tax for taxable year 2010 is **SUSTAINED**. Thus, petitioner is **ORDERED TO PAY FORTY-NINE MILLION THREE HUNDRED EIGHTEEN THOUSAND FIVE HUNDRED PESOS AND 88/100 (₱49,318,500.88)**, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Taxable Income for 2010	₱(533,255,953.00)
Add: Non-taxable Income and Income subjected to Final Tax	1,289,210,989.00
Income exempt from tax	6,663,510,001.00
Total	₱7,419,465,037.00
Add: Retained earnings from prior years	1,993,887,640.00
Less: Amount that may be retained	9,018,804,670.00
Improperly Accumulated Taxable Income	₱ 394,548,007.00
Multiply by tax rate	10%
Improperly Accumulated Earnings Tax	₱ 39,454,800.70
Add: Surcharge (25%)	9,863,700.18
Total Amount Due	₱ 49,318,500.88

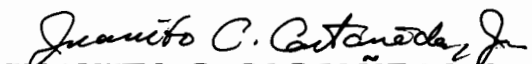
je

In addition, petitioner is **ORDERED TO PAY:**

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic Improperly Accumulated Earnings Tax in the amount of ₱39,454,800.70 computed from January 15, 2012 until full payment thereof, pursuant to Section 249(B) of the NIRC of 1997, as amended; and

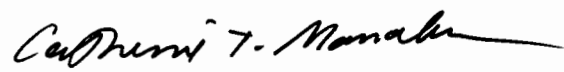
(b) Delinquency interest at the rate of 20% per annum on the total amount of ₱49,318,500.88, and on the 20% deficiency interest which have accrued as afore-stated in (a) computed from June 29, 2015⁶¹ until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.


JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:


CAESAR A. CASANOVA
Associate Justice


CATHERINE T. MANAHAN
Associate Justice

⁶¹ Exhibit "P-11", docket, vol. II, pp. 474-475.

ATTESTATION

I attest 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's Division.


JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, 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