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[G.R. No. 163653, July 19, 2011]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. FILINVEST DEVELOPMENT CORPORATION, RESPONDENT.

[G.R. NO. 167689]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. FILINVEST DEVELOPMENT CORPORATION, RESPONDENT.

D E C I S I O N

PEREZ, J.:

Assailed in these twin petitions for review on *certiorari* filed pursuant to Rule 45 of the *1997 Rules of Civil Procedure* are the decisions rendered by the Court of Appeals (CA) in the following cases: (a) Decision dated 16 December 2003 of the then Special Fifth Division in CA-G.R. SP No. 72992; [1] and, (b) Decision dated 26 January 2005 of the then Fourteenth Division in CA-G.R. SP No. 74510. [2]

The Facts

The owner of 80% of the outstanding shares of respondent Filinvest Alabang, Inc. (FAI), respondent Filinvest Development Corporation (FDC) is a holding company which also owned 67.42% of the outstanding shares of Filinvest Land, Inc. (FLI). On 29 November 1996, FDC and FAI entered into a Deed of Exchange with FLI whereby the former both transferred in favor of the latter parcels of land appraised at P4,306,777,000.00. In exchange for said parcels which were intended to facilitate development of medium-rise residential and commercial buildings, 463,094,301 shares of stock of FLI were issued to FDC and FAI. [3] As a result of the exchange, FLI's ownership structure was changed to the extent reflected in the following tabular *précis*, *viz.*:

Stockholder	*Number and Percentage of Shares Held Prior to the Exchange*		*Number of Additional Shares Issued*	*Number and Percentage of Shares Held After the Exchange*	
FDC	2,537,358,000	67.42%	42,217,000	2,579,575,000	61.03%

FAI	0	0	420,877,000	420,877,000	9.96%
OTHERS	1,226,177,000	32.58%	0	1,226,177,000	29.01%
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	3,763,535,000	100%	463,094,301	4,226,629,000	(100%)

On 13 January 1997, FLI requested a ruling from the Bureau of Internal Revenue (BIR) to the effect that no gain or loss should be recognized in the aforesaid transfer of real properties. Acting on the request, the BIR issued Ruling No. S-34-046-97 dated 3 February 1997, finding that the exchange is among those contemplated under Section 34 (c) (2) of the old National Internal Revenue Code (NIRC) [4] which provides that "(n)o gain or loss shall be recognized if property is transferred to a corporation by a person in exchange for a stock in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation." [5] With the BIR's reiteration of the foregoing ruling upon the 10 February 1997 request for clarification filed by FLI, [6] the latter, together with FDC and FAI, complied with all the requirements imposed in the ruling. [7]

On various dates during the years 1996 and 1997, in the meantime, FDC also extended advances in favor of its affiliates, namely, FAI, FLI, Davao Sugar Central Corporation (DSCC) and Filinvest Capital, Inc. (FCI). [8] Duly evidenced by instructional letters as well as cash and journal vouchers, said cash advances amounted to P2,557,213,942.60 in 1996 [9] and P3,360,889,677.48 in 1997. [10] On 15 November 1996, FDC also entered into a Shareholders' Agreement with Reco Herrera PTE Ltd. (RHPL) for the formation of a Singapore-based joint venture company called Filinvest Asia Corporation (FAC), tasked to develop and manage FDC's 50% ownership of its PBCom Office Tower Project (the Project). With their equity participation in FAC respectively pegged at 60% and 40% in the Shareholders' Agreement, FDC subscribed to P500.7 million worth of shares in said joint venture company to RHPL's subscription worth P433.8 million. Having paid its subscription by executing a Deed of Assignment transferring to FAC a portion of its rights and interest in the Project worth P500.7 million, FDC eventually reported a net loss of P190,695,061.00 in its Annual Income Tax Return for the taxable year 1996. [11]

On 3 January 2000, FDC received from the BIR a Formal Notice of Demand to pay deficiency income and documentary stamp taxes, plus interests and compromise penalties, [12] covered by the following Assessment Notices, *viz.*: (a) Assessment Notice No. SP-INC-96-00018-2000 for deficiency income taxes in the sum of P150,074,066.27 for 1996; (b) Assessment Notice No. SP-DST-96-00020-2000 for deficiency documentary stamp taxes in the sum of P10,425,487.06 for 1996; (c) Assessment Notice No. SP-INC-97-00019-2000 for deficiency income taxes in the sum of P5,716,927.03 for 1997; and (d) Assessment Notice No. SP-DST-97-00021-2000 for deficiency documentary stamp taxes in the sum of P5,796,699.40 for 1997. [13] The foregoing deficiency taxes were assessed on the taxable gain supposedly realized by FDC from the Deed of Exchange it executed with

FAI and FLI, on the dilution resulting from the Shareholders' Agreement FDC executed with RHPL as well as the "arm's-length" interest rate and documentary stamp taxes imposable on the advances FDC extended to its affiliates. [14]

On 3 January 2000, FAI similarly received from the BIR a Formal Letter of Demand for deficiency income taxes in the sum of P1,477,494,638.23 for the year 1997. [15] Covered by Assessment Notice No. SP-INC-97-0027-2000, [16] said deficiency tax was also assessed on the taxable gain purportedly realized by FAI from the Deed of Exchange it executed with FDC and FLI. [17] On 26 January 2000 or within the reglementary period of thirty (30) days from notice of the assessment, both FDC and FAI filed their respective requests for reconsideration/protest, on the ground that the deficiency income and documentary stamp taxes assessed by the BIR were bereft of factual and legal basis. [18] Having submitted the relevant supporting documents pursuant to the 31 January 2000 directive from the BIR Appellate Division, FDC and FAI filed on 11 September 2000 a letter requesting an early resolution of their request for reconsideration/protest on the ground that the 180 days prescribed for the resolution thereof under Section 228 of the NIRC was going to expire on 20 September 2000. [19]

In view of the failure of petitioner Commissioner of Internal Revenue (CIR) to resolve their request for reconsideration/protest within the aforesaid period, FDC and FAI filed on 17 October 2000 a petition for review with the Court of Tax Appeals (CTA) pursuant to Section 228 of the 1997 NIRC. Docketed before said court as CTA Case No. 6182, the petition alleged, among other matters, that as previously opined in BIR Ruling No. S-34-046-97, no taxable gain should have been assessed from the subject Deed of Exchange since FDC and FAI collectively gained further control of FLI as a consequence of the exchange; that correlative to the CIR's lack of authority to impute theoretical interests on the cash advances FDC extended in favor of its affiliates, the rule is settled that interests cannot be demanded in the absence of a stipulation to the effect; that not being promissory notes or certificates of obligations, the instructional letters as well as the cash and journal vouchers evidencing said cash advances were not subject to documentary stamp taxes; and, that no income tax may be imposed on the prospective gain from the supposed appreciation of FDC's shareholdings in FAC. As a consequence, FDC and FAC both prayed that the subject assessments for deficiency income and documentary stamp taxes for the years 1996 and 1997 be cancelled and annulled. [20]

On 4 December 2000, the CIR filed its answer, claiming that the transfer of property in question should not be considered tax free since, with the resultant diminution of its shares in FLI, FDC did not gain further control of said corporation. Likewise calling attention to the fact that the cash advances FDC extended to its affiliates were interest free despite the interest bearing loans it obtained from banking institutions, the CIR invoked Section 43 of the old NIRC which, as implemented by Revenue Regulations No. 2, Section 179 (b) and (c), gave him "the power to allocate, distribute or apportion income or deductions between or among such organizations, trades or business in order to prevent evasion of taxes." The

CIR justified the imposition of documentary stamp taxes on the instructional letters as well as cash and journal vouchers for said cash advances on the strength of Section 180 of the NIRC and Revenue Regulations No. 9-94 which provide that loan transactions are subject to said tax irrespective of whether or not they are evidenced by a formal agreement or by mere office memo. The CIR also argued that FDC realized taxable gain arising from the dilution of its shares in FAC as a result of its Shareholders' Agreement with RHPL. [21]

At the pre-trial conference, the parties filed a Stipulation of Facts, Documents and Issues [22] which was admitted in the 16 February 2001 resolution issued by the CTA. With the further admission of the Formal Offer of Documentary Evidence subsequently filed by FDC and FAI [23] and the conclusion of the testimony of Susana Macabelda anent the cash advances FDC extended in favor of its affiliates, [24] the CTA went on to render the Decision dated 10 September 2002 which, with the exception of the deficiency income tax on the interest income FDC supposedly realized from the advances it extended in favor of its affiliates, cancelled the rest of deficiency income and documentary stamp taxes assessed against FDC and FAI for the years 1996 and 1997, [25] thus:

> **WHEREFORE**, in view of all the foregoing, the court finds the instant petition partly meritorious. Accordingly, Assessment Notice No. SP-INC-96-00018-2000 imposing deficiency income tax on FDC for taxable year 1996, Assessment Notice No. SP-DST-96-00020-2000 and SP-DST-97-00021-2000 imposing deficiency documentary stamp tax on FDC for taxable years 1996 and 1997, respectively and Assessment Notice No. SP-INC-97-0027-2000 imposing deficiency income tax on FAI for the taxable year 1997 are hereby **CANCELLED** and **SET ASIDE**. However, [FDC] is hereby **ORDERED to PAY** the amount of P5,691,972.03 as deficiency income tax for taxable year 1997. In addition, petitioner is also **ORDERED to PAY** 20% delinquency interest computed from February 16, 2000 until full payment thereof pursuant to Section 249 (c) (3) of the Tax Code. [26]

Finding that the collective increase of the equity participation of FDC and FAI in FLI rendered the gain derived from the exchange tax-free, the CTA also ruled that the increase in the value of FDC's shares in FAC did not result in economic advantage in the absence of actual sale or conversion thereof. While likewise finding that the documents evidencing the cash advances FDC extended to its affiliates cannot be considered as loan agreements that are subject to documentary stamp tax, the CTA enunciated, however, that the CIR was justified in assessing undeclared interests on the same cash advances pursuant to his authority under Section 43 of the NIRC in order to forestall tax evasion. For persuasive effect, the CTA referred to the equivalent provision in the Internal Revenue Code of the United States (IRC-US), *i.e.*, Sec. 482, as implemented by Section 1.482-2 of 1965-1969 Regulations of the Law of Federal Income Taxation. [27]

Dissatisfied with the foregoing decision, FDC filed on 5 November 2002 the petition for review docketed before the CA as CA-G.R. No. 72992, pursuant to Rule 43 of the *1997 Rules of Civil Procedure*. Calling attention to the fact that the cash advances it extended to its affiliates were interest-free in the absence of the express stipulation on interest required under Article 1956 of the *Civil Code*, FDC questioned the imposition of an arm's-length interest rate thereon on the ground, among others, that the CIR's authority under Section 43 of the NIRC: (a) does not include the power to impute imaginary interest on said transactions; (b) is directed only against controlled taxpayers and not against mother or holding corporations; and, (c) can only be invoked in cases of understatement of taxable net income or evident tax evasion. [28] Upholding FDC's position, the CA's then Special Fifth Division rendered the herein assailed decision dated 16 December 2003, [29] the decretal portion of which states:

> **WHEREFORE**, premises considered, the instant petition is hereby **GRANTED**. The assailed Decision dated September 10, 2002 rendered by the Court of Tax Appeals in CTA Case No. 6182 directing petitioner Filinvest Development Corporation to pay the amount of P5,691,972.03 representing deficiency income tax on allegedly undeclared interest income for the taxable year 1997, plus 20% delinquency interest computed from February 16, 2000 until full payment thereof is **REVERSED and SET ASIDE** and, a new one entered annulling Assessment Notice No. SP-INC-97-00019-2000 imposing deficiency income tax on petitioner for taxable year 1997. No pronouncement as to costs. [30]

With the denial of its partial motion for reconsideration of the same 11 December 2002 resolution issued by the CTA, [31] the CIR also filed the petition for review docketed before the CA as CA-G.R. No. 74510. In essence, the CIR argued that the CTA reversibly erred in cancelling the assessment notices: (a) for deficiency income taxes on the exchange of property between FDC, FAI and FLI; (b) for deficiency documentary stamp taxes on the documents evidencing FDC's cash advances to its affiliates; and (c) for deficiency income tax on the gain FDC purportedly realized from the increase of the value of its shareholdings in FAC. [32] The foregoing petition was, however, denied due course and dismissed for lack of merit in the herein assailed decision dated 26 January 2005 [33] rendered by the CA's then Fourteenth Division, upon the following findings and conclusions, to wit:

> 1. As affirmed in the 3 February 1997 BIR Ruling No. S-34-046-97, the 29 November 1996 Deed of Exchange resulted in the combined control by FDC and FAI of more than 51% of the outstanding shares of FLI, hence, no taxable gain can be recognized from the transaction under Section 34

(c) (2) of the old NIRC;

2. The instructional letters as well as the cash and journal vouchers evidencing the advances FDC extended to its affiliates are not subject to documentary stamp taxes pursuant to BIR Ruling No. 116-98, dated 30 July 1998, since they do not partake the nature of loan agreements;

3. Although BIR Ruling No. 116-98 had been subsequently modified by BIR Ruling No. 108-99, dated 15 July 1999, to the effect that documentary stamp taxes are imposable on inter-office memos evidencing cash advances similar to those extended by FDC, said latter ruling cannot be given retroactive application if to do so would be prejudicial to the taxpayer;

4. FDC's alleged gain from the increase of its shareholdings in FAC as a consequence of the Shareholders' Agreement it executed with RHPL cannot be considered taxable income since, until actually converted thru sale or disposition of said shares, they merely represent unrealized increase in capital. [34]

Respectively docketed before this Court as G.R. Nos. 163653 and 167689, the CIR's petitions for review on *certiorari* assailing the 16 December 2003 decision in CA-G.R. No. 72992 and the 26 January 2005 decision in CA-G.R. SP No. 74510 were consolidated pursuant to the 1 March 2006 resolution issued by this Court's Third Division.

The Issues

In G.R. No. 163653, the CIR urges the grant of its petition on the following ground:

> **THE COURT OF APPEALS ERRED IN REVERSING THE DECISION OF THE COURT OF TAX APPEALS AND IN HOLDING THAT THE ADVANCES EXTENDED BY RESPONDENT TO ITS AFFILIATES ARE NOT SUBJECT TO INCOME TAX.** [35]

In G.R. No. 167689, on the other hand, petitioner proffers the following issues for resolution:

I

THE HONORABLE COURT OF APPEALS COMMITTED GRAVE

ABUSE OF DISCRETION IN HOLDING THAT THE EXCHANGE OF SHARES OF STOCK FOR PROPERTY AMONG FILINVEST DEVELOPMENT CORPORATION (FDC), FILINVEST ALABANG, INCORPORATED (FAI) AND FILINVEST LAND INCORPORATED (FLI) MET ALL THE REQUIREMENTS FOR THE NON-RECOGNITION OF TAXABLE GAIN UNDER SECTION 34 (c) (2) OF THE OLD NATIONAL INTERNAL REVENUE CODE (NIRC) (NOW SECTION 40 (C) (2) (c) OF THE NIRC.

II

THE HONORABLE COURT OF APPEALS COMMITTED REVERSIBLE ERROR IN HOLDING THAT THE LETTERS OF INSTRUCTION OR CASH VOUCHERS EXTENDED BY FDC TO ITS AFFILIATES ARE NOT DEEMED LOAN AGREEMENTS SUBJECT TO DOCUMENTARY STAMP TAXES UNDER SECTION 180 OF THE NIRC.

III

THE HONORABLE COURT OF APPEALS GRAVELY ERRED IN HOLDING THAT GAIN ON DILUTION AS A RESULT OF THE INCREASE IN THE VALUE OF FDC'S SHAREHOLDINGS IN FAC IS NOT TAXABLE.[36]

The Court's Ruling

While the petition in G.R. No. 163653 is bereft of merit, we find the CIR's petition in G.R. No. 167689 impressed with partial merit.

In G.R. No. 163653, the CIR argues that the CA erred in reversing the CTA's finding that theoretical interests can be imputed on the advances FDC extended to its affiliates in 1996 and 1997 considering that, for said purpose, FDC resorted to interest-bearing fund borrowings from commercial banks. Since considerable interest expenses were deducted by FDC when said funds were borrowed, the CIR theorizes that interest income should likewise be declared when the same funds were sourced for the advances FDC extended to its affiliates. Invoking Section 43 of the 1993 NIRC in relation to Section 179(b) of Revenue Regulation No. 2, the CIR maintains that it is vested with the power to allocate, distribute or apportion income or deductions between or among controlled organizations, trades or businesses even in the absence of fraud, since said power is intended "to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or businesses." In addition, the CIR asseverates that the CA should have accorded weight and respect to the findings of the CTA which, as the specialized court dedicated to the study and consideration of tax matters, can take judicial notice of US income tax laws and

regulations. [37]

Admittedly, Section 43 of the 1993 NIRC [38] provides that, "(i)n any case of two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or indirectly by the same interests, the Commissioner of Internal Revenue is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization, trade or business." In amplification of the equivalent provision [39] under Commonwealth Act No. 466, [40] Sec. 179(b) of Revenue Regulation No. 2 states as follows:

> *Determination of the taxable net income of controlled taxpayer.* - (A) *DEFINITIONS.* - When used in this section -
>
> (1) The term "organization" includes any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, or a corporation or association, irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt or taxable, or whether affiliated or not.
>
> (2) The terms "trade" or "business" include any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on.
>
> (3) The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or mode of exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.
>
> (4) The term "controlled taxpayer" means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.
>
> (5) The term "group" and "group of controlled taxpayers" means the organizations, trades or businesses owned or controlled by the same interests.
>
> (6) The term "true net income" means, in the case of a controlled taxpayer, the net income (or as the case may be, any item or element affecting net income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, any item or element affecting net income) which

would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrangement or other act) dealt with the other members or members of the group at arm's length. It does not mean the income, the deductions, or the item or element of either, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interest controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

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

(C) *APPLICATION* - Transactions between controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid or escape taxes. In determining the true net income of a controlled taxpayer, the Commissioner of Internal Revenue is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income or deductions. The authority to determine true net income extends to any case in which either by inadvertence or design the taxable net income in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. [41]

As may be gleaned from the definitions of the terms "controlled" and "controlled taxpayer" under paragraphs (a) (3) and (4) of the foregoing provision, it would appear that FDC and its affiliates come within the purview of Section 43 of the 1993 NIRC. Aside from owning significant portions of the shares of stock of FLI, FAI, DSCC and FCI, the fact that FDC

extended substantial sums of money as cash advances to its said affiliates for the purpose of providing them financial assistance for their operational and capital expenditures seemingly indicate that the situation sought to be addressed by the subject provision exists. From the tenor of paragraph (c) of Section 179 of Revenue Regulation No. 2, it may also be seen that the CIR's power to distribute, apportion or allocate gross income or deductions between or among controlled taxpayers may be likewise exercised whether or not fraud inheres in the transaction/s under scrutiny. For as long as the controlled taxpayer's taxable income is not reflective of that which it would have realized had it been dealing at arm's length with an uncontrolled taxpayer, the CIR can make the necessary rectifications in order to prevent evasion of taxes.

Despite the broad parameters provided, however, we find that the CIR's powers of distribution, apportionment or allocation of gross income and deductions under Section 43 of the 1993 NIRC and Section 179 of Revenue Regulation No. 2 does not include the power to impute "theoretical interests" to the controlled taxpayer's transactions. Pursuant to Section 28 of the 1993 NIRC, [42] after all, the term "gross income" is understood to mean all income from whatever source *derived*, including, but not limited to the following items: compensation for services, including fees, commissions, and similar items; gross income derived from business; gains derived from dealings in property;" interest; rents; royalties; dividends; annuities; prizes and winnings; pensions; and partner's distributive share of the gross income of general professional partnership. [43] While it has been held that the phrase "*from whatever source derived*" indicates a legislative policy to include all income not expressly exempted within the class of taxable income under our laws, the term "income" has been variously interpreted to mean "cash *received* or its equivalent", "the amount of money *coming* to a person within a specific time" or "something distinct from principal or capital." [44] Otherwise stated, there must be proof of the actual or, at the very least, probable receipt or realization by the controlled taxpayer of the item of gross income sought to be distributed, apportioned or allocated by the CIR.

Our circumspect perusal of the record yielded no evidence of actual or possible showing that the advances FDC extended to its affiliates had resulted to the interests subsequently assessed by the CIR. For all its harping upon the supposed fact that FDC had resorted to borrowings from commercial banks, the CIR had adduced no concrete proof that said funds were, indeed, the source of the advances the former provided its affiliates. While admitting that FDC obtained interest-bearing loans from commercial banks, [45] Susan Macabelda - FDC's Funds Management Department Manager who was the sole witness presented before the CTA - clarified that the subject advances were sourced from the corporation's rights offering in 1995 as well as the sale of its investment in Bonifacio Land in 1997. [46] More significantly, said witness testified that said advances: (a) were extended to give FLI, FAI, DSCC and FCI financial assistance for their operational and capital expenditures; and, (b) were all temporarily in nature since they were repaid within the duration of one week to three months and were evidenced by mere journal entries, cash vouchers and instructional letters." [47]

Even if we were, therefore, to accord precipitate credulity to the CIR's bare assertion that FDC had deducted substantial interest expense from its gross income, there would still be no factual basis for the imputation of theoretical interests on the subject advances and assess deficiency income taxes thereon. More so, when it is borne in mind that, pursuant to Article 1956 of the *Civil Code of the Philippines*, no interest shall be due unless it has been expressly stipulated in writing. Considering that taxes, being burdens, are not to be presumed beyond what the applicable statute expressly and clearly declares, [48] the rule is likewise settled that tax statutes must be construed strictly against the government and liberally in favor of the taxpayer. [49] Accordingly, the general rule of requiring adherence to the letter in construing statutes applies with peculiar strictness to tax laws and the provisions of a taxing act are not to be extended by implication. [50] While it is true that taxes are the lifeblood of the government, it has been held that their assessment and collection should be in accordance with law as any arbitrariness will negate the very reason for government itself. [51]

In G.R. No. 167689, we also find a dearth of merit in the CIR's insistence on the imposition of deficiency income taxes on the transfer FDC and FAI effected in exchange for the shares of stock of FLI. With respect to the Deed of Exchange executed between FDC, FAI and FLI, Section 34 (c) (2) of the 1993 NIRC pertinently provides as follows:

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

As even admitted in the 14 February 2001 Stipulation of Facts submitted by the parties, [52] the requisites for the non-recognition of gain or loss under the foregoing provision are as follows: (a) the transferee is a corporation; (b) the transferee exchanges its shares of stock for property/ies of the transferor; (c) the transfer is made by a person, acting alone or together with others, not exceeding four persons; and, (d) as a result of the exchange the transferor, alone or together with others, not exceeding four, gains control of the transferee. [53] Acting on the 13 January 1997 request filed by FLI, the BIR had, in fact, acknowledged the concurrence of the foregoing requisites in the Deed of Exchange the former executed with FDC and FAI by issuing BIR Ruling No. S-34-046-97. [54] With the

BIR's reiteration of said ruling upon the request for clarification filed by FLI, [55] there is also no dispute that said transferee and transferors subsequently complied with the requirements provided for the non-recognition of gain or loss from the exchange of property for tax, as provided under Section 34 (c) (2) of the 1993 NIRC. [56]

Then as now, the CIR argues that taxable gain should be recognized for the exchange considering that FDC's controlling interest in FLI was actually decreased as a result thereof. For said purpose, the CIR calls attention to the fact that, prior to the exchange, FDC owned 2,537,358,000 or 67.42% of FLI's 3,763,535,000 outstanding capital stock. Upon the issuance of 443,094,000 additional FLI shares as a consequence of the exchange and with only 42,217,000 thereof accruing in favor of FDC for a total of 2,579,575,000 shares, said corporation's controlling interest was supposedly reduced to 61%.03 when reckoned from the transferee's aggregate 4,226,629,000 outstanding shares. Without owning a share from FLI's initial 3,763,535,000 outstanding shares, on the other hand, FAI's acquisition of 420,877,000 FLI shares as a result of the exchange purportedly resulted in its control of only 9.96% of said transferee corporation's 4,226,629,000 outstanding shares. On the principle that the transaction did not qualify as a tax-free exchange under Section 34 (c) (2) of the 1993 NIRC, the CIR asseverates that taxable gain in the sum of P263,386,921.00 should be recognized on the part of FDC and in the sum of P3,088,711,367.00 on the part of FAI. [57]

The paucity of merit in the CIR's position is, however, evident from the categorical language of Section 34 (c) (2) of the 1993 NIRC which provides that gain or loss will not be recognized in case the exchange of property for stocks results in the control of the transferee by the transferor, alone or with other transferors not exceeding four persons. Rather than isolating the same as proposed by the CIR, FDC's 2,579,575,000 shares or 61.03% control of FLI's 4,226,629,000 outstanding shares should, therefore, be appreciated in combination with the 420,877,000 new shares issued to FAI which represents 9.96% control of said transferee corporation. Together FDC's 2,579,575,000 shares (61.03%) and FAI's 420,877,000 shares (9.96%) clearly add up to 3,000,452,000 shares or 70.99% of FLI's 4,226,629,000 shares. Since the term "control" is clearly defined as "ownership of stocks in a corporation possessing at least fifty-one percent of the total voting power of classes of stocks entitled to one vote" under Section 34 (c) (6) [c] of the 1993 NIRC, the exchange of property for stocks between FDC FAI and FLI clearly qualify as a tax-free transaction under paragraph 34 (c) (2) of the same provision.

Against the clear tenor of Section 34(c) (2) of the 1993 NIRC, the CIR cites then Supreme Court Justice Jose Vitug and CTA Justice Ernesto D. Acosta who, in their book *Tax Law and Jurisprudence*, opined that said provision could be inapplicable if control is already vested in the exchangor prior to exchange. [58] Aside from the fact that that the 10 September 2002 Decision in CTA Case No. 6182 upholding the tax-exempt status of the exchange between FDC, FAI and FLI was penned by no less than Justice Acosta himself, [59] FDC and FAI significantly point out that said authors have acknowledged that the position taken by the BIR is to the effect that "the law would apply even when the

exchangor already has control of the corporation at the time of the exchange." [60] This was confirmed when, apprised in FLI's request for clarification about the change of percentage of ownership of its outstanding capital stock, the BIR opined as follows:

> Please be informed that regardless of the foregoing, the transferors, Filinvest Development Corp. and Filinvest Alabang, Inc. still gained control of Filinvest Land, Inc. The term 'control' shall mean ownership of stocks in a corporation by possessing at least 51% of the total voting power of all classes of stocks entitled to vote. Control is determined by the amount of stocks received, i.e., total subscribed, whether for property or for services by the transferor or transferors. In determining the 51% stock ownership, only those persons who transferred property for stocks in the same transaction may be counted up to the maximum of five (BIR Ruling No. 547-93 dated December 29, 1993. [61]

At any rate, it also appears that the supposed reduction of FDC's shares in FLI posited by the CIR is more apparent than real. As the uncontested owner of 80% of the outstanding shares of FAI, it cannot be gainsaid that FDC ideally controls the same percentage of the 420,877,000 shares issued to its said co-transferor which, by itself, represents 7.968% of the outstanding shares of FLI. Considered alongside FDC's 61.03% control of FLI as a consequence of the 29 November 1996 Deed of Transfer, said 7.968% add up to an aggregate of 68.998% of said transferee corporation's outstanding shares of stock which is evidently still greater than the 67.42% FDC initially held prior to the exchange. This much was admitted by the parties in the 14 February 2001 Stipulation of Facts, Documents and Issues they submitted to the CTA. [62] Inasmuch as the combined ownership of FDC and FAI of FLI's outstanding capital stock adds up to a total of 70.99%, it stands to reason that neither of said transferors can be held liable for deficiency income taxes the CIR assessed on the supposed gain which resulted from the subject transfer.

On the other hand, insofar as documentary stamp taxes on loan agreements and promissory notes are concerned, Section 180 of the NIRC provides follows:

> Sec. 180. **Stamp tax on all loan agreements, promissory notes, bills of exchange, drafts, instruments and securities issued by the government or any of its instrumentalities, certificates of deposit bearing interest and others not payable on sight or demand.** - *On all loan agreements signed abroad wherein the object of the contract is located or used in the Philippines; bill of exchange (between points within the Philippines), drafts, instruments and securities issued by the Government or any of its instrumentalities or certificates of deposits drawing interest, or orders for the payment of any sum of money otherwise than at sight or on demand, or on all promissory notes, whether negotiable or non-negotiable, except bank notes issued for circulation, and on each renewal of any such note, there shall be collected a documentary*

stamp tax of Thirty centavos (P0.30) on each two hundred pesos, or fractional part thereof, of the face value of any such agreement, bill of exchange, draft, certificate of deposit or note: **Provided**, *That only one documentary stamp tax shall be imposed on either loan agreement, or promissory notes issued to secure such loan, whichever will yield a higher tax:* **Provided however**, *That loan agreements or promissory notes the aggregate of which does not exceed Two hundred fifty thousand pesos (P250,000.00) executed by an individual for his purchase on installment for his personal use or that of his family and not for business, resale, barter or hire of a house, lot, motor vehicle, appliance or furniture shall be exempt from the payment of documentary stamp tax provided under this Section.*

When read in conjunction with Section 173 of the 1993 NIRC, [63] the foregoing provision concededly applies to "(a)ll loan agreements, whether made or signed in the Philippines, or abroad when the obligation or right arises from Philippine sources or the property or object of the contract is located or used in the Philippines." Correlatively, Section 3 (b) and Section 6 of Revenue Regulations No. 9-94 provide as follows:

> Section 3. Definition of Terms. - For purposes of these Regulations, the following term shall mean:
>
> (b) 'Loan agreement' - refers to a contract in writing where one of the parties delivers to another money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid. The term shall include credit facilities, which may be evidenced by credit memo, advice or drawings.
>
> The terms 'Loan Agreement" under Section 180 and "Mortgage' under Section 195, both of the Tax Code, as amended, generally refer to distinct and separate instruments. A loan agreement shall be taxed under Section 180, while a deed of mortgage shall be taxed under Section 195."
>
> "Section 6. Stamp on all Loan Agreements. - All loan agreements whether made or signed in the Philippines, or abroad when the obligation or right arises from Philippine sources or the property or object of the contract is located in the Philippines shall be subject to the documentary stamp tax of thirty centavos (P0.30) on each two hundred pesos, or fractional part thereof, of the face value of any such agreements, pursuant to Section 180 in relation to Section 173 of the Tax Code.
>
> In cases where no formal agreements or promissory notes have been executed to cover credit facilities, the documentary stamp tax shall be based on the amount of drawings or availment of the facilities, which may be evidenced by

> credit/debit memo, advice or drawings by any form of check or withdrawal slip, under Section 180 of the Tax Code.

Applying the aforesaid provisions to the case at bench, we find that the instructional letters as well as the journal and cash vouchers evidencing the advances FDC extended to its affiliates in 1996 and 1997 qualified as loan agreements upon which documentary stamp taxes may be imposed. In keeping with the caveat attendant to every BIR Ruling to the effect that it is valid only if the facts claimed by the taxpayer are correct, we find that the CA reversibly erred in utilizing BIR Ruling No. 116-98, dated 30 July 1998 which, strictly speaking, could be invoked only by ASB Development Corporation, the taxpayer who sought the same. In said ruling, the CIR opined that documents like those evidencing the advances FDC extended to its affiliates are not subject to documentary stamp tax, to wit:

> On the matter of whether or not the inter-office memo covering the advances granted by an affiliate company is subject to documentary stamp tax, it is informed that nothing in Regulations No. 26 (Documentary Stamp Tax Regulations) and Revenue Regulations No. 9-94 states that the same is subject to documentary stamp tax. Such being the case, said inter-office memo evidencing the lendings or borrowings which is neither a form of promissory note nor a certificate of indebtedness issued by the corporation-affiliate or a certificate of obligation, which are, more or less, categorized as 'securities', is not subject to documentary stamp tax imposed under Section 180, 174 and 175 of the Tax Code of 1997, respectively. Rather, the inter-office memo is being prepared for accounting purposes only in order to avoid the co-mingling of funds of the corporate affiliates.

In its appeal before the CA, the CIR argued that the foregoing ruling was later modified in BIR Ruling No. 108-99 dated 15 July 1999, which opined that inter-office memos evidencing lendings or borrowings extended by a corporation to its affiliates are akin to promissory notes, hence, subject to documentary stamp taxes. [64] In brushing aside the foregoing argument, however, the CA applied Section 246 of the 1993 NIRC [65] from which proceeds the settled principle that rulings, circulars, rules and regulations promulgated by the BIR have no retroactive application if to so apply them would be prejudicial to the taxpayers. [66] Admittedly, this rule does not apply: (a) where the taxpayer deliberately misstates or omits material facts from his return or in any document required of him by the Bureau of Internal Revenue; (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or (c) where the taxpayer acted in bad faith. [67] Not being the taxpayer who, in the first instance, sought a ruling from the CIR, however, FDC cannot invoke the foregoing principle on non-retroactivity of BIR rulings.

Viewed in the light of the foregoing considerations, we find that both the CTA and the CA

erred in invalidating the assessments issued by the CIR for the deficiency documentary stamp taxes due on the instructional letters as well as the journal and cash vouchers evidencing the advances FDC extended to its affiliates in 1996 and 1997. In Assessment Notice No. SP-DST-96-00020-2000, the CIR correctly assessed the sum of P6,400,693.62 for documentary stamp tax, P3,999,793.44 in interests and P25,000.00 as compromise penalty, for a total of P10,425,487.06. Alongside the sum of P4,050,599.62 for documentary stamp tax, the CIR similarly assessed P1,721,099.78 in interests and P25,000.00 as compromise penalty in Assessment Notice No. SP-DST-97-00021-2000 or a total of P5,796,699.40. The imposition of deficiency interest is justified under Sec. 249 (a) and (b) of the NIRC which authorizes the assessment of the same "at the rate of twenty percent (20%), or such higher rate as may be prescribed by regulations", from the date prescribed for the payment of the unpaid amount of tax until full payment. [68] The imposition of the compromise penalty is, in turn, warranted under Sec. 250 [69] of the NIRC which prescribes the imposition thereof "in case of each failure to file an information or return, statement or list, or keep any record or supply any information required" on the date prescribed therefor.

To our mind, no reversible error can, finally, be imputed against both the CTA and the CA for invalidating the Assessment Notice issued by the CIR for the deficiency income taxes FDC is supposed to have incurred as a consequence of the dilution of its shares in FAC. Anent FDC's Shareholders' Agreement with RHPL, the record shows that the parties were in agreement about the following factual antecedents narrated in the 14 February 2001 Stipulation of Facts, Documents and Issues they submitted before the CTA, [70] *viz.*:

> "1.11. On November 15, 1996, FDC entered into a Shareholders' Agreement (`SA') with Reco Herrera Pte. Ltd. (`RHPL') for the formation of a joint venture company named Filinvest Asia Corporation (`FAC') which is based in Singapore (pars. 1.01 and 6.11, Petition, pars. 1 and 7, Answer).
>
> 1.12. FAC, the joint venture company formed by FDC and RHPL, is tasked to develop and manage the 50% ownership interest of FDC in its PBCom Office Tower Project (`Project') with the Philippine Bank of Communications (par. 6.12, Petition; par. 7, Answer).
>
> 1.13. Pursuant to the SA between FDC and RHPL, the equity participation of FDC and RHPL in FAC was 60% and 40% respectively.
>
> 1.14. In accordance with the terms of the SA, FDC subscribed to P500.7 million worth of shares of stock representing a 60% equity participation in FAC. In turn, RHPL subscribed to P433.8 million worth of shares of stock of FAC representing a 40% equity participation in FAC.
>
> 1.15. In payment of its subscription in FAC, FDC executed a Deed of Assignment transferring to FAC a portion of FDC's right and interests in the

Project to the extent of P500.7 million.

1.16. FDC reported a net loss of P190,695,061.00 in its Annual Income Tax Return for the taxable year 1996." [71]

Alongside the principle that tax revenues are not intended to be liberally construed, [72] the rule is settled that the findings and conclusions of the CTA are accorded great respect and are generally upheld by this Court, unless there is a clear showing of a reversible error or an improvident exercise of authority. [73] Absent showing of such error here, we find no strong and cogent reasons to depart from said rule with respect to the CTA's finding that no deficiency income tax can be assessed on the gain on the supposed dilution and/or increase in the value of FDC's shareholdings in FAC which the CIR, at any rate, failed to establish. Bearing in mind the meaning of "gross income" as above discussed, it cannot be gainsaid, even then, that a mere increase or appreciation in the value of said shares cannot be considered income for taxation purposes. Since "a mere advance in the value of the property of a person or corporation in no sense constitute the `income' specified in the revenue law," it has been held in the early case of *Fisher vs. Trinidad*, [74] that it "constitutes and can be treated merely as an increase of capital." Hence, the CIR has no factual and legal basis in assessing income tax on the increase in the value of FDC's shareholdings in FAC until the same is actually sold at a profit.

WHEREFORE, premises considered, the CIR's petition for review on *certiorari* in G.R. No. 163653 is **DENIED** for lack of merit and the CA's 16 December 2003 Decision in G.R. No. 72992 is **AFFIRMED *in toto.*** The CIR's petition in G.R. No. 167689 is **PARTIALLY GRANTED** and the CA's 26 January 2005 Decision in CA-G.R. SP No. 74510 is **MODIFIED.**

Accordingly, Assessment Notices Nos. SP-DST-96-00020-2000 and SP-DST-97-00021-2000 issued for deficiency documentary stamp taxes due on the instructional letters as well as journal and cash vouchers evidencing the advances FDC extended to its affiliates are declared valid.

The cancellation of Assessment Notices Nos. SP-INC-96-00018-2000, SP-INC-97-00019-2000 and SP-INC-97-0027-2000 issued for deficiency income assessed on (a) the "arms-length" interest from said advances; (b) the gain from FDC's Deed of Exchange with FAI and FLI; and (c) income from the dilution resulting from FDC's Shareholders' Agreement with RHPL is, however, upheld.

SO ORDERED.

Corona, C.J., Carpio, Velasco, Jr., Brion, Peralta, Bersamin, Del Castillo, Abad, Villarama, Jr., and *Mendoza, JJ.,* concur.
Leonardo-De Castro, J., with separate concurring opinion.

Sereno, [*], *J.*, on leave.

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[*] Associate Justice Maria Lourdes P. A. Sereno is on Special Leave from 16-30 July 2011 under the Court's Wellness Program.

[1] *Rollo* (G.R. No. 163653), pp. 40-57.

[2] *Rollo* (G.R. No. 167689), pp. 68-88.

[3] Id. at 219-222; 241-245.

[4] Now Section 40 of the NIRC.

[5] *Rollo* (G.R. No. 167689), pp. 246-251.

[6] Id. at 252-253.

[7] Id. at 222.

[8] *Rollo*, (G.R. No. 163653), pp. 211-309.

[9] FLI (P863,619,234.42), FAI (P1,216,477,700.00); and DSCC (P477,117,008.18).

[10] FLI (P1,717,096,764.22); FAI (P1,258,792,913.26); and, FCI (P385,000,000.00).

[11] *Rollo*, (G.R. No. 167689), pp. 223-224.

[12] Id. at 284-285.

[13] Id. at 291-294.

[14] Id. at 286-290.

[15] Id. at 295-296.

[16] Id. at 299.

[17] Id. at 297-298.

[18] Id. at 300-315; 316-326.

[19] Id. at 327.

[20] Id. at 179-211.

[21] Id. at 212-217.

[22] Id. at 218-240.

[23] *Rollo* (G.R. No. 163653), p. 45.

[24] *Rollo* (G.R. No. 167689), pp. 412-454.

[25] Id. at 455-477.

[26] Id. at 477.

[27] Id. at 463-476.

[28] *Rollo* (G.R. No. 163653), pp. 81-121.

[29] Id. at 40-57.

[30] Id. at 56.

[31] *Rollo* (G.R. No. 167689), pp. 479-480.

[32] Id. at 30 and 76.

[33] Id. at 68-88.

[34] Id. at 76-88.

[35] *Rollo* (G.R. No. 163653), p. 19.

[36] *Rollo*, (G.R. No. 167689), pp. 31-32.

[37] *Rollo* (G.R. No. 163653), pp. 20-32.

[38] Now Section 50 of the 1997 NIRC.

[39] Section 44.

[40] *An Act to Revise, Amend and Codify the Internal Revenue Laws of the Philippines.*

[41] As quoted in Montejo, *National Internal Revenue Code Annotated*, 1963 ed., pp. 164-165.

[42] Now Section 32 of the 1997 NIRC.

[43] *CIR v. Philippine Airlines, Inc.,* G.R. No. 160528, 9 October 2006, 504 SCRA 90, 99.

[44] *CIR v. AIR India,* 241 Phil. 689, 694-695 (1988) citing *CIR v. British Overseas Airways Corporation,* G.R. No. L-65773-74, 30 April 1987, 149 SCRA 395.

[45] *Rollo* (G.R. No. 167689), pp. 446-447. TSN, 25 July 2001, pp. 9-10.

[46] Id. at 15-16.

[47] Id. at 426. TSN, 26 June 2001, p. 15.

[48] *Republic of the Philippines v. Intermediate Appellate Court*, G.R. No. 69344, 26 April 1991, 196 SCRA 335, 340.

[49] *Mactan Cebu International Airport Authority v. Hon. Ferdinand J. Marcos*, 330 Phil. 392, 405 (1996).

[50] *CIR v. Court of Appeals*, 338 Phil. 322, 330 (1997).

[51] *Commissioner of Internal Revenue v. Reyes*, G.R. No. 159694, 27 January 2006; *Azucena T. Reyes v. Commissioner of Internal Revenue*, G.R. No. 163581, 27 January 2006, 480 SCRA 382, 397.

[52] *Rollo* (G.R. No. 167689), pp. 218-240.

[53] Id. at 229.

[54] Id. at 246-251.

[55] Id. at 252-253.

[56] Id. at 222.

[57] Id. at 33-40.

[58] Tax Law and Jurisprudence, 2000 Edition, p. 161.

[59] *Rollo* (G.R. No. 167689), pp. 455-477.

[60] Tax Law and Jurisprudence, 2000 Edition, pp. 161-162.

[61] *Rollo* (G.R. No. 167689), p. 253.

[62] Id. at 221.

[63] Sec. 173. Stamp taxes upon documents, instruments, loan agreements and papers. - Upon documents, instruments, loan agreements, and papers, and upon acceptances, assignments, sales, and transfers of the obligation, right or property incident thereto, there shall be levied, collected and paid for, and in respect of the transaction so had or accomplished, the corresponding documentary stamp taxes prescribed in the following Sections of this Title, by the person making, signing, issuing, accepting , or transferring the same wherever the document is made, signed, issued, accepted or transferred when the obligation or right arises from Philippine sources or the property is situated in the Philippines, and at the same time such act is done or transaction had: **Provided**, That whenever one party to the taxable document enjoys exemption from the tax herein imposed, the other party thereto who is not exempt shall be the one directly liable for the tax.

[64] After a careful restudy of the aforementioned ruling, this office is of the opinion as it hereby hold that inter-office memo covering the advances granted by a corporation affiliate company, i.e., or inter-office memo evidencing lendings/borrowings is in the nature of a promissory note subject to the documentary stamp tax imposed under Section 180 of the Tax Code of 1997.

This modifies BIR Ruling No. 116-98 dated 30 July 1998 insofar as inter-office memo covering the advances granted by a corporation affiliate company, i.e., inter-office memo evidencing lendings/borrowings, is concerned which shall be subject to documentary stamp tax imposed under Section 180 of the Tax Code of 1997.

[65] Section 246. Non-retroactivity of Rulings. - Any revocation, modification, or reversal of any of the rules and regulations promulgated in accordance with the preceding section or any of the rulings or circulars promulgated by the Commissioner shall not be given retroactive application if the revocation, modification, or reversal will be prejudicial to the taxpayers except in the following cases: (a) where the taxpayer deliberately misstates or omits material facts from his return or in any document required of him by the Bureau of Internal Revenue; (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or (c) where the taxpayer acted in bad faith.

[66] *CIR v. Benguet Corporation*, G.R. No. 145559, 14 July 2006, 495 SCRA 59, 65-66.

[67] Section 246, 1993 NIRC.

[68] Sec. 248. Interest. (a) In general. - There shall be assessed and collected on any unpaid tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.

(b) Deficiency Interest. - Any deficiency in the tax due as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

[69] Sec. 250. Failure to File Certain Information Returns. - In the case of each failure to file an information return, statement or list, or keep any record, or supply any information required by this Code or by the Commissioner on the date prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall, upon notice and demand by the Commissioner, be paid by the person failing to file, keep or supply the same, One thousand pesos (P1,000) for each such failure: ***Provided, however***, That the aggregate amount to be imposed for all such failures during a calendar year shall not exceed Twenty-five thousand pesos (P25,000).

[70] *Rollo*, (G.R. No. 167689), pp. 218-240.

[71] Id. at 223-224.

[72] *Commissioner of Internal Revenue v. Acosta*, G.R. No. 154068, 3 August 2007, 529 SCRA 177, 186.

[73] *Chevron Philippines*, *Inc. v. Commissioner of the Bureau of Customs*, G.R. No. 178759, 11 August 2008, 561 SCRA 710, 742.

[74] 43 Phil. 973, 981 (1922).

CONCURRING OPINION

LEONARDO-DE CASTRO, *J.:*

I concur that the property-for-shares exchange between Filinvest Development Corporation (FDC) and Filinvest Alabang, Inc. (FAI), on one hand, and Filinvest Land, Inc. (FLI), on the other, was tax-free under Section 34(C)(2) of the National Internal Revenue Code (NIRC) of 1993.

Section 34(C)(2) of the NIRC of 1993 provided:

> Sec. 34. *Determination of amount of and recognition of gain or loss*. -
>
> x x x x
>
> (c) *Exchange of property*. -
>
> x x x x
>
> (2) *Exception*. - No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation (a) a corporation which is a party to a merger or consolidation exchanges property solely for stock in a corporation which is a party to the merger or consolidation, (b) a shareholder exchanges stock in a corporation which is a party to the merger or consolidation solely for the stock of another corporation also a party to the merger or consolidation, or (c) a security holder of a corporation which is a party to the merger or consolidation exchanges his securities in such corporation solely for stock or securities in another corporation, a party to the merger or consolidation. **No gain or loss shall be also be recognized if property is transferred to a corporation by a person in exchange for stock in such a corporation of which as a result of such exchange said person, alone or with others, not exceeding four persons, gains control of said corporation.** *Provided*, That stocks issued for services shall not be considered as issued in return for property. (Emphasis ours.)

Control was defined as "ownership of stocks in a corporation possessing at least fifty-one

per cent of the total voting power of all classes of stock entitled to vote." [1]

When FDC and FAI transferred real property to FLI, they respectively acquired, in return, 61.03% and 9.96% of the outstanding capital stock of FLI. Together, FDC and FAI held 70.99% of the outstanding capital stock of FLI after the exchange, thus, gaining control of FLI.

There is no basis for the argument of the Commissioner of Internal Revenue (CIR) that the foregoing property-for-shares exchange was not tax-free because as a result of the same, the shareholding of FDC in FLI actually decreased from 67.42% to 61.03%. Even with such decrease, the shareholding of FDC in FLI after the exchange was still beyond 51%, hence, FDC still had control of FLI within the meaning of Section 34(C)(2) of the NIRC of 1993. Control by FDC over FLI after the exchange is even more evident when the shareholdings of FDC in FLI are combined with that of FAI. It is also significant to note that FDC owns 80% of FAI.

Section 34(C)(2) of the NIRC of 1993 is clear. Therefore, no statutory construction or interpretation is needed. Neither can conditions or limitations be introduced where none is provided for. Rewriting the law is a forbidden ground that only Congress may tread upon. The Court may not construe a statute that is free from doubt. Where the law speaks in clear and categorical language, there is no room for interpretation. There is only room for application. The Court has no choice but to see to it that its mandate is obeyed. [2]

I likewise agree that any increase in the value of the shareholdings of FDC in Filinvest Asia Corporation (FAC) is not yet taxable income for it remains unrealized until said shareholdings are sold or disposed of. Income in tax law is "an amount of money coming to a person within a specified time, whether as payment for services, interest, or profit from investment." [3] It means cash or its equivalent. It is gain derived and severed from capital, from labor, or from both combined. [4] Income should be reported at the time of the actual gain. For income tax purposes, income is an actual gain or an actual increase of wealth. [5] In this case, FDC will only enjoy actual gain if it is able to sell its shareholdings in FAC at a price higher than the cost of acquiring the same. In fact, as along as FDC holds on to its shareholdings in FAC, FDC is at risk of suffering loss should the value of its shareholdings in FAC decrease in the future.

Although I am also in accord with the majority opinion that the CIR may not impute interest income on the cash advances FDC extended to its affiliates, I have a different basis for my vote.

Section 43 of the NIRC of 1993 grants the CIR specific authority over controlled taxpayers, *viz*:

Sec. 43. *Allocation of income and deductions*. - In any case of two or more

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

The majority opinion acknowledged that the situation sought to be addressed by Section 43 of the NIRC of 1993 seemingly exists considering FDC and its affiliates are controlled taxpayers; and FDC extended substantial sums of money as cash advances to its affiliates as financial assistance for the operational and capital expenditures of the latter. The majority opinion further conceded that the power of the CIR to distribute, apportion, or allocate gross income or deductions between or among controlled taxpayers may be exercised whether or not fraud inheres in the transaction/s under scrutiny; and for as long as the controlled taxpayer's taxable income is not reflective of that which it would have realized had it been dealing at arm's length with an uncontrolled taxpayer, the CIR can make the necessary rectifications in order to prevent evasion of taxes.

Nonetheless, the majority opinion held that the CIR cannot impute interest income on the cash advances extended by FDC to its affiliates because: (1) there was no evidence that the cash advances extended by FDC to its affiliates were sourced from the loans obtained by FDC from commercial banks and for which FDC claimed deductions of interest expense from its gross income; (2) there was no proof of actual or probable receipt or realization by FDC of interest income from the cash advances; and (3) there was no express stipulation in writing that interest would be due on the cash advances as required under Article 1956 of the Civil Code.

I believe, however, that the CIR need not establish that the cash advances extended by FDC to its affiliates were sourced from the loans obtained by FDC from commercial banks. The source of the cash advances is irrelevant. What the CIR is seeking to tax herein is the interest income FDC should have earned from the cash advances it extended to its affiliates; the theory being that FDC would have imposed and collected said interest had it been dealing at arm's length with an uncontrolled company.

It is just as unnecessary for the CIR to present proof of actual or probable receipt by FDC of interest income from the cash advances it extended to its affiliates. Section 43 of the NIRC of 1993 should be appreciated as an exception to the general rules on income taxation as it addresses a very specific situation: controlled taxpayers dealing with each other not at arm's length. To exercise his authority under said provision, it is already sufficient for the CIR to establish that the income reported by the controlled taxpayer from the transaction amongst themselves fall below the arm's length standard; in which case, the CIR may already impute such arm's length income on the transaction, and accordingly distribute, apportion, or allocate the same among the controlled taxpayers who participated

in said transaction. To require the CIR to still submit proof of the actual or probable income received by the controlled taxpayers from the transaction, and limit the income which the CIR may distribute, apportion, or allocate to that which was thus proved, would not only severely limit the authority of the CIR under Section 43 of the NIRC of 1993, but would also render the arm's length standard useless and superfluous.

Even more alarming is the statement in the majority opinion that for the CIR to exercise its authority to attribute interest income on the cash advances FDC extended to its affiliates under Section 43 of the NIRC of 1993, there must be an express stipulation in writing that such interest was due on the transaction in accordance with Article 1956 of the Civil Code. Section 43 of the NIRC of 1993 prevails over Article 1956 of the Civil Code. *Lex specialis derogat generali*. General legislation must give way to special legislation on the same subject, and generally is so interpreted as to embrace only cases in which the special provisions are not applicable. In other words, where two statutes are of equal theoretical application to a particular case, the one specially designed therefore should prevail. [6]

As for loans and advances among controlled taxpayers, tax evasion may be committed by (1) charging interest thereon but not at arm's length rate; or (2) not charging any interest at all. Expectedly, in the latter case, there would be no express stipulation in writing that interest is due on the loans or advances. Are we saying that the CIR may impute arm's length interest in the former case, but is totally powerless to impute any interest in the latter case? This will render the latter a completely effective means of tax evasion. Controlled taxpayers can just do away with any written stipulation of interest on the loans or advances altogether, and even when such absence of interest is contrary to the arm's length standard, the CIR will be unable to exercise its authority under Section 43 of the NIRC of 1993.

I submit that the CIR cannot impute any interest income on the cash advances FDC extended to its affiliates for the simple reason that Revenue Memorandum Order (RMO) No. 63-99, which sets down the guidelines for the determination of taxable income on inter-company loans or advances, applying what is now Section 50 of the NIRC of 1997, was issued only on July 19, 1999. Pertinent provisions of RMO No. 63-99 reads:

> 2. *Coverage:*
>
> This paper applies to all forms of bona fide indebtedness and includes:
>
> 2.1 Loans or advances of money or other consideration (whether or not evidence by a written instrument);
> 2.2 Indebtedness arising in the ordinary course of business out of sales, leases, or the rendition of services by or between members of the group, or any other similar extension;
> 2.3 But does not apply to alleged indebtedness which was in fact a contribution of capital or a distribution by a corporation with respect to its shares.

x x x x

4. *Determination of Taxable Income on Inter-company Loans or Advances:*

4.1 *In general.* Where one member of a group of controlled entities makes a loan or advances directly or indirectly, or otherwise becomes a creditor of another member of such group, and charges no interest, or charges interest at a rate which is not equal to an arm's-length rate as defined in subparagraph (2) of this paragraph, the Commissioner may make appropriate allocations to reflect an arm's length interest rate for the use of such loan or advance.

4.1.1 If payments are made to parties under common control according to a legally enforceable contract, the contract may still be recognized as valid. However, for purposes of determining the true taxable income of the parties involved, the interest rate charged may be subjected to reallocation.

4.1.2 Section 50 does not apply only to taxable entities. Reallocation may also apply to tax-exempt organizations.

4.2 *Arm's Length interest rate.*

4.2.1 *In general*. For purposes of this Order, the arm's length interest rate shall be the rate of interest which was charged or would have been charged at the time the indebtedness arose in independent transaction with or between unrelated parties under similar circumstances. All relevant factors will be considered, including the amount and duration of the loan, the security involved, the credit standing of the borrower, and the interest rate prevailing at the situs of the lender or creditor for comparable loans.

4.2.2 For purposes of determining the arm's length rate in domestic transactions, the interest rate to be used is the Bank Reference Rate (BRR) prescribed by the Bangko Sentral ng Pilipinas (BSP).

4.2.3.The fact that the interest rate actually charged on a loan or advance is expressly indicated on a written instrument does not preclude the application of Section 50 to such loan or advance.

5. *Interest Period*

5.1 The interest period shall commence at the date the indebtedness arises, except that with respect to indebtedness arising in the ordinary course of business out of sales, leases, or supply of goods and services which are generally considered as trade accounts receivables or payables, the interest period shall not commence if the taxpayer is able to establish that the normal trade practice in a given industry is to allow balances,

in the case of similar transactions with unrelated parties, to remain outstanding for a longer period without charging interest.

5.2 For purposes of determining the period of time for which a balance is outstanding, payments of credits shall be applied against the earliest balance outstanding. The taxpayer may, in accordance with an agreement, apply such payments or credits in some other order in its books only after establishing that the arrangement is customary for parties in that particular business.

FDC extended the cash advances to its affiliates in 1996 and 1997, when there was yet no clear regulation as to the tax treatment of loans and advances among controlled taxpayers that would have accordingly guided the concerned taxpayers and the Bureau of Internal Revenue (BIR) officials. RMO No. 63-99 cannot be applied retroactively to FDC and its affiliates as Section 246 of the NIRC of 1997 expressly proscribes the same, 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, except in the following cases:
>
> (a) where the taxpayer deliberately misstates or omits material facts from his return or any document required of him by the Bureau of Internal Revenue;
>
> (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or
>
> (c) where the taxpayer acted in bad faith.

Finally, I join the majority opinion in classifying the instructional letters, journals, and cash vouchers evidencing the advances FDC extended to its affiliates as loan agreements, upon which documentary stamp taxes (DST) may be imposed. Regardless of whether or not the CIR may impute interest on the cash advances, there is no dispute that said advances were in the nature of loans, which were extended by FDC to its affiliates as financial assistance for the latter's operational and capital expenditures, and which were repaid by the affiliates to FDC within the duration of one week to three months.

For the foregoing reasons, I join the majority in (1) dismissing for lack of merit the Petition of the CIR in G.R. No. 163653 and affirming the Decision dated December 16, 2003 of the Court of Appeals in CA-G.R. SP No. 72992; and (2) partially granting the Petition of the CIR in G.R. No. 167869 and affirming the Decision dated January 26, 2005 of the Court of Appeals in CA-G.R. SP No. 74510 with the modification that Assessment Notice Nos. SP-

DST-96-00020-2000 and SP-DST-97-00021-2000 for deficiency DST on the instructional letters, journals, and cash vouchers, evidencing the cash advances FDC extended to its affiliates, are declared valid.

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[1] Section 34, Definitions (c) of the NIRC of 1993.

[2] *Commissioner of Internal Revenue v. American Express International, Inc. (Philippine Branch)*, 500 Phil. 586, 608 (2005).

[3] *Commissioner of Internal Revenue v. Court of Appeals*, 361 Phil. 103, 120 (1999).

[4] Id.

[5] *Bañas, Jr. v. Court of Appeals*, 382 Phil. 144, 159 (2000).

[6] *Roque, Jr. v. Commission on Elections*, G.R. No. 188456, September 10, 2009, 599 SCRA 69, 196.

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