

SECOND DIVISION

[G.R. No. 108067, January 20, 2000]

CYANAMID PHILIPPINES, INC., PETITIONER, VS. THE COURT OF APPEALS, THE COURT OF TAX APPEALS AND COMMISSIONER OF INTERNAL REVENUE, RESPONDENTS.

D E C I S I O N

QUISUMBING, J.:

Petitioner disputes the decision^[1] of the Court of Appeals which affirmed the decision^[2] of the Court of Tax Appeals, ordering petitioner to pay respondent Commissioner of Internal Revenue the amount of three million, seven hundred seventy-four thousand, eight hundred sixty seven pesos and fifty centavos (P3,774,867.50) as 25% surtax on improper accumulation of profits for 1981, plus 10% surcharge and 20% annual interest from January 30, 1985 to January 30, 1987, under Sec. 25 of the National Internal Revenue Code.

The Court of Tax Appeals made the following factual findings:

Petitioner, Cyanamid Philippines, Inc., a corporation organized under Philippine laws, is a wholly owned subsidiary of American Cyanamid Co. based in Maine, USA. It is engaged in the manufacture of pharmaceutical products and chemicals, a wholesaler of imported finished goods, and an importer/indentor.

On February 7, 1985, the CIR sent an assessment letter to petitioner and demanded the payment of deficiency income tax of one hundred nineteen thousand eight hundred seventeen (P119,817.00) pesos for taxable year 1981, as follows:

| | |
|--|---------------|
| "Net income disclosed by the return as audited | 14,575,210.00 |
| Add: Discrepancies: | |
| Professional fees/yr | 262,877.00 |
| Per investigation | 110,399.37 |
| Total Adjustment | 152,477.00 |
| | |
| Net income per Investigation | 14,727,687.00 |
| | |
| Less: Personal and additional exemptions | |
| | |
| Amount subject to tax | 14,727,687.00 |
| | |
| Income tax due thereon ... 25% | 3,237,495.00 |
| Surtax | 2,385,231.50 |
| Less: Amount already assessed | 5,161,788.00 |

| | |
|----------------------|----------------------------|
| | |
| BALANCE | 75,709.00 |
| | |
| ___ monthly interest | 44,108.00 |
| from..... | 1,389,636.00 |
| _____ | _____ |
| | |
| Compromise penalties | _____ |
| | |
| TOTAL AMOUNT DUE | 119,817.00" ^[3] |
| | |
| | 3,774,867.50 |

On March 4, 1985, petitioner protested the assessments particularly, (1) the 25% Surtax Assessment of P3,774,867.50; (2) 1981 Deficiency Income Assessment of P119,817.00; and 1981 Deficiency Percentage Assessment of P8,846.72.^[4] Petitioner, through its external accountant, Sycip, Gorres, Velayo & Co., claimed, among others, that the surtax for the undue accumulation of earnings was not proper because the said profits were retained to increase petitioner's working capital and it would be used for reasonable business needs of the company. Petitioner contended that it availed of the tax amnesty under Executive Order No. 41, hence enjoyed amnesty from civil and criminal prosecution granted by the law.

On October 20, 1987, the CIR in a letter addressed to SGV & Co., refused to allow the cancellation of the assessment notices and rendered its resolution, as follows:

"It appears that your client availed of Executive Order No. 41 under File No. 32A-F-000455-41B as certified and confirmed by our Tax Amnesty Implementation Office on October 6, 1987.

In reply thereto, I have the honor to inform you that the availment of the tax amnesty under Executive Order No. 41, as amended is sufficient basis, in appropriate cases, for the cancellation of the assessment issued after August 21, 1986. (Revenue Memorandum Order No. 4-87) Said availment does not, therefore, result in cancellation of assessments issued before August 21, 1986, as in the instant case. In other words, the assessments in this case issued on January 30, 1985 despite your client's availment of the tax amnesty under Executive Order No. 41, as amended still subsist.

Such being the case, you are therefore, requested to urge your client to pay this Office the aforementioned deficiency income tax and surtax on undue accumulation of surplus in the respective amounts of P119,817.00 and P3,774,867.50 inclusive of interest thereon for the year 1981, within thirty (30) days from receipt hereof, otherwise this office will be constrained to enforce collection thereof thru summary remedies prescribed by law.

This constitutes the final decision of this Office on this matter."^[5]

Petitioner appealed to the Court of Tax Appeals. During the pendency of the case, however, both parties agreed to compromise the 1981 deficiency income tax assessment of P119,817.00. Petitioner paid a reduced amount --twenty-six thousand, five hundred seventy-seven pesos (P26,577.00) -- as compromise

settlement. However, the surtax on improperly accumulated profits remained unresolved.

Petitioner claimed that CIR's assessment representing the 25% surtax on its accumulated earnings for the year 1981 had no legal basis for the following reasons: (a) petitioner accumulated its earnings and profits for reasonable business requirements to meet working capital needs and retirement of indebtedness; (b) petitioner is a wholly owned subsidiary of American Cyanamid Company, a corporation organized under the laws of the State of Maine, in the United States of America, whose shares of stock are listed and traded in New York Stock Exchange. This being the case, no individual shareholder of petitioner could have evaded or prevented the imposition of individual income taxes by petitioner's accumulation of earnings and profits, instead of distribution of the same.

In denying the petition, the Court of Tax Appeals made the following pronouncements:

"Petitioner contends that it did not declare dividends for the year 1981 in order to use the accumulated earnings as working capital reserve to meet its "reasonable business needs". The law permits a stock corporation to set aside a portion of its retained earnings for specified purposes (citing Section 43, paragraph 2 of the Corporation Code of the Philippines). In the case at bar, however, petitioner's purpose for accumulating its earnings does not fall within the ambit of any of these specified purposes.

More compelling is the finding that there was no need for petitioner to set aside a portion of its retained earnings as working capital reserve as it claims since it had considerable liquid funds. A thorough review of petitioner's financial statement (particularly the Balance Sheet, p. 127, BIR Records) reveals that the corporation had considerable liquid funds consisting of cash accounts receivable, inventory and even its sales for the period is adequate to meet the normal needs of the business. This can be determined by computing the current asset to liability ratio of the company:

$$\begin{aligned} \text{current} &= \text{current assets} / \text{current liabilities} \\ \text{ratio} &= \text{P } 47,052,535.00 / \text{P } 21,275,544.00 \\ &= \underline{2.21: 1} \end{aligned}$$

The significance of this ratio is to serve as a primary test of a company's solvency to meet current obligations from current assets as a going concern or a measure of adequacy of working capital.

x x x

We further reject petitioner's argument that "the accumulated earnings tax does not apply to a publicly-held corporation" citing American jurisprudence to support its position. The reference finds no application in the case at bar because under Section 25 of the NIRC as amended by Section 5 of P.D. No. 1379 [1739] (dated September 17, 1980), the exceptions to the accumulated earnings tax are expressly enumerated, to wit: Bank, non-bank financial intermediaries, corporations organized

primarily, and authorized by the Central Bank of the Philippines to hold shares of stock of banks, insurance companies, or personal holding companies, whether domestic or foreign. The law on the matter is clear and specific. Hence, there is no need to resort to applicable cases decided by the American Federal Courts for guidance and enlightenment as to whether the provision of Section 25 of the NIRC should apply to petitioner.

Equally clear and specific are the provisions of E.O. 41 particularly with respect to its effectivity and coverage...

... Said availment does not result in cancellation of assessments issued before August 21, 1986 as petitioner seeks to do in the case at bar. Therefore, the assessments in this case, issued on January 30, 1985 despite petitioner's availment of the tax amnesty under E.O. 41 as amended, still subsist."

X X X

WHEREFORE, petitioner Cyanamid Philippines, Inc., is ordered to pay respondent Commissioner of Internal Revenue the sum of P3,774,867.50 representing 25% surtax on improper accumulation of profits for 1981, plus 10% surcharge and 20% annual interest from January 30, 1985 to January 30, 1987."^[6]

Petitioner appealed the Court of Tax Appeal's decision to the Court of Appeals. Affirming the CTA decision, the appellate court said:

"In reviewing the instant petition and the arguments raised herein, We find no compelling reason to reverse the findings of the respondent Court. The respondent Court's decision is supported by evidence, such as petitioner corporation's financial statement and balance sheets (p. 127, BIR Records). On the other hand the petitioner corporation could only come up with an alternative formula lifted from a decision rendered by a foreign court (Bardahl Mfg. Corp. vs. Commissioner, 24 T.C.M. [CCH] 1030). Applying said formula to its particular financial position, the petitioner corporation attempts to justify its accumulated surplus earnings. To Our mind, the petitioner corporation's alternative formula cannot overturn the persuasive findings and conclusion of the respondent Court based, as it is, on the applicable laws and jurisprudence, as well as standards in the computation of taxes and penalties practiced in this jurisdiction.

WHEREFORE, in view of the foregoing, the instant petition is hereby DISMISSED and the decision of the Court of Tax Appeals dated August 6, 1992 in C.T.A. Case No. 4250 is AFFIRMED in toto."^[7]

Hence, petitioner now comes before us and assigns as sole issue:

WHETHER THE RESPONDENT COURT ERRED IN HOLDING THAT THE PETITIONER IS LIABLE FOR THE ACCUMULATED EARNINGS TAX FOR THE YEAR 1981.^[8]

Section 25^[9] of the old National Internal Revenue Code of 1977 states:

"Sec. 25. *Additional tax on corporation improperly accumulating profits or surplus*

"(a) *Imposition of tax.* -- If any corporation is formed or availed of for the purpose of preventing the imposition of the tax upon its shareholders or members or the shareholders or members of another corporation, through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there is levied and assessed against such corporation, for each taxable year, a tax equal to twenty-five *per-centum* of the undistributed portion of its accumulated profits or surplus which shall be in addition to the tax imposed by section twenty-four, and shall be computed, collected and paid in the same manner and subject to the same provisions of law, including penalties, as that tax.

"(b) *Prima facie evidence.* -- The fact that any corporation is mere holding company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. Similar presumption will lie in the case of an investment company where at any time during the taxable year more than fifty *per centum* in value of its outstanding stock is owned, directly or indirectly, by one person.

"(c) *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 clear preponderance of evidence, shall prove the contrary.

"(d) *Exception* -- The provisions of this sections shall not apply to banks, non-bank financial intermediaries, corporation organized primarily, and authorized by the Central Bank of the Philippines to hold shares of stock of banks, insurance companies, whether domestic or foreign.

The provision 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.

Relying on decisions of the American Federal Courts, petitioner stresses that the accumulated earnings tax does not apply to Cyanamid, a wholly owned subsidiary of a publicly owned company.^[10] Specifically, petitioner cites *Golconda Mining Corp. vs. Commissioner*, 507 F.2d 594, whereby the U.S. Ninth Circuit Court of Appeals had taken the position that the accumulated earnings tax could only apply to a closely held corporation.

A review of American taxation history on accumulated earnings tax will show that the application of the accumulated earnings tax to publicly held corporations has been problematic. Initially, the Tax Court and the Court of Claims held that the