

**EN BANC****[ 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; <sup>[1]</sup> and, (b) Decision dated 26 January 2005 of the then Fourteenth Division in CA-G.R. SP No. 74510. <sup>[2]</sup>

***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. <sup>[3]</sup> As a result of the exchange, FLI's ownership structure was changed to the extent reflected in the following tabular *précis*, viz.:

<i>Stockholder</i>	<i>Number and Percentage of Shares Held Prior to the Exchange</i>	<i>Number of Additional Shares Issued</i>	<i>Number and Percentage of Shares Held After the Exchange</i>
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%		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]