Supreme Court E-Library

REPORTS OF CASES

DETERMINED IN THE

SUPREME COURT OF THE PHILIPPINES

EN BANC

[G.R. Nos. 106949-50. December 1, 1995]

PAPER INDUSTRIES CORPORATION OF THE PHILIPPINES (PICOP), *petitioner, vs.* COURT OF APPEALS, COMMISSIONER OF INTERNAL REVENUE and COURT OF TAX APPEALS, *respondents.*

[G.R. Nos. 106984-85. December 1, 1995]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* PAPER INDUSTRIES CORPORATION OF THE PHILIPPINES, THE COURT OF APPEALS and THE COURT OF TAX APPEALS, *respondents.*

SYLLABUS

1. **TAXATION; RA 5186 (INVESTMENT INCENTIVES ACT); EXEMPTION OF PIONEER ENTERPRISES FROM ALL TAXES UNDER THE NIRC EXCEPT INCOME TAX; NOT EXEMPT FROM PAYMENT OF TRANSACTION TAX WHICH IS INCOME TAX.—** We agree with the CTA and the Court of Appeals that Picop's tax exemption under R.A. No. 5186, as amended, does *not* include exemption from the thirty-five percent (35%) transaction tax. In the first place, the thirty-five percent (35%) transaction tax is an income tax, that is, it is a tax on the interest income of the lenders or creditors. *The 35% transaction tax is imposed on interest income from commercial papers issued in the primary money market.*

Supreme Court E-Library

Being a tax on interest, it is a tax on income. The 35% transaction tax is an income tax on interest earnings to the lenders or placers. The latter are actually the taxpayers. Therefore, the tax cannot be a tax imposed upon the petitioner. In other words, *the petitioner who borrowed funds from several financial institutions by issuing commercial papers merely withheld the 35% transaction tax before paying to the financial institutions the interests earned by them and later remitted the same to the respondent Commissioner of Internal Revenue.* The tax could have been collected by a different procedure but the statute chose this method. Whatever collecting procedure is adopted does not change the nature of the tax. It is thus clear that the transaction tax is an *income* tax and as such, in any event, falls outside the scope of the tax exemption granted to registered pioneer enterprises by Section 8 of R.A. No. 5186, as amended. Picop was the withholding agent, obliged to withhold thirty-five percent (35%) of the interest payable to its lenders and to remit the amounts so withheld to the Bureau of Internal Revenue ("BIR"). As a withholding agent, Picop is made *personally liable* for the thirty-five percent (35%) transaction tax and *if* it did not actually withhold thirty-five percent (35%) of the interest monies it had paid to its lenders, Picop had only itself to blame. We conclude that Picop was properly held liable for the thirty-five percent (35%) transaction tax due in respect of interest payments on its money market borrowings.

2. **ID.; PRESIDENTIAL DECREE NO. 1154; 35% TRANSACTION TAX ON COMMERCIAL PAPER; WITH NO RETROACTIVE APPLICATION.**— The transaction tax may be levied only in respect of the interest earnings of Picop's money market lenders accruing after P.D. No. 1154 went into effect, and not in respect of all the 1977 interest earnings of such lenders. P.D. No. 1154 is not, in other words, to be given retroactive effect by imposing the thirty-five percent (35%) transaction tax in respect of interest earnings which accrued before the effectivity date of P.D. No. 1154, there being nothing in the statute to suggest that

Supreme Court E-Library

the legislative authority intended to bring about such retroactive imposition of the tax.

3. **ID.; NATIONAL INTERNAL REVENUE CODE; AUTHORITY OF THE SECRETARY OF FINANCE TO PROMULGATE RULES AND REGULATIONS; AUTHORITY TO IMPOSE CIVIL PENALTIES MUST BE EXPRESSLY GIVEN BY THE ENABLING STATUTE; IMPOSITION OF 25% SURCHARGE AND 14% INTEREST PER ANNUM FOR NON-PAYMENT OF TRANSACTION, WITHOUT LEGAL BASIS.**— With respect to the transaction tax due, the CIR prays that Picop be held liable for a twenty-five percent (25%) surcharge and for interest at the rate of fourteen percent (14%) per annum from the date prescribed for its payment. In so praying, the CIR relies upon Section 10 of Revenue Regulation 7-77 dated 3 June 1977, issued by the Secretary of Finance. The 1977 Tax Code itself,in Section 326 in relation to Section 4 of the same Code, invoked by the Secretary of Finance in issuing Revenue Regulation 7-77, set out, in comprehensive terms, the rule-making authority of the Secretary of Finance. Section 4 of the same Code contains a list of subjects or areas to be dealt with by the Secretary of Finance through the medium of an exercise of his quasi-legislative or rule-making authority. This list, however, while it purports to be open-ended, does *not* include the imposition of administrative or civil penalties such as the payment of amounts additional to the tax due. Thus, in order that it may be held to be legally effective in respect of Picop in the present case, Section 10 of Revenue Regulation 7-77 must embody or rest upon some provision in the Tax Code itself which imposes surcharge and penalty interest for failure to make a transaction tax payment when due. P.D. No. 1154 did not itself impose, nor did it expressly authorize the imposition of, a surcharge and penalty interest in case of failure to pay the thirty-five percent (35%) transaction tax when due. Neither did Section 210 (b) of the 1977 Tax Code which re-enacted Section 195-C inserted into the Tax Code by P.D. No. 1154. It will be seen that Section 51 (c) (1) and (e) (1) and (3), of the 1977

Supreme Court E-Library

Tax Code, authorize the imposition of surcharge and interest only in respect of a "*tax imposed by this Title*," that is to say, *Title II on "Income Tax."* It will also be seen that Section 72 of the 1977 Tax Code imposes a surcharge only in case of failure to file a return or list "*required by this Title*," that is, *Title II on "Income Tax.*" The thirty-five percent (35%) transaction tax is, however, imposed in the 1977 Tax Code by *Section 210 (b) thereof which Section is embraced in Title V on "Taxes on Business"* of that Code. Thus, while the thirty-five percent (35%) transaction tax is in truth a *tax imposed on* interest *income* earned by lenders or creditors purchasing commercial paper on the money market, the relevant provisions, i.e., Section 210 (b), were *not* inserted in Title II of the 1977 Tax Code. The end result is that the thirty-five percent (35%) transaction tax is *not* one of the taxes in respect of which Section 51 (e) authorized the imposition of surcharge and interest and Section 72 the imposition of a fraud surcharge. It is not without reluctance that we reach the above conclusion on the basis of what may well have been an inadvertent error in legislative draftsmanship, a type of error common enough during the period of Martial Law in our country. Nevertheless, we are compelled to adopt this conclusion. We consider that the authority to impose what the present Tax Code calls (in Section 248) *civil penalties* consisting of additions to the tax due, must be expressly given in the enabling statute, in language too clear to be mistaken. The grant of that authority is not lightly to be assumed to have been made to administrative officials, even to one as highly placed as the Secretary of Finance.

4. ID.; ID.; SECTION 247 (A) IMPOSING CIVIL PENALTIES AS SURCHARGE AND INTEREST WITHOUT RETROACTIVE APPLICATION.— The state of the present law tends to reinforce our conclusion that Section 51 (c) and (e) of the 1977 Tax Code did not authorize the imposition of a surcharge and penalty interest for failure to pay the thirty-five percent (35%) transaction tax imposed under Section 210 (b) of the same Code. The corresponding provision in the *current* Tax Code very clearly embraces

Supreme Court E-Library

failure *to pay all taxes imposed in the Tax Code,* without any regard to the Title of the Code where provisions imposing particular taxes are textually located. In other words, Section 247 (a) of the current NIRC supplies what did not exist back in 1977 when Picop's liability for the thirty-five percent (35%) transaction tax became fixed. We do not believe we can fill that legislative *lacuna* by judicial fiat. There is nothing to suggest that Section 247 (a) of the present Tax Code, which was inserted in 1985, was intended to be given retroactive application by the legislative authority.

ID.; RA 5186 (INVESTMENT INCENTIVES ACT); EXEMPTION OF PIONEER ENTERPRISES FROM ALL TAXES UNDER THE NIRC EXCEPT INCOME TAX; EXEMPTION INCLUDES PAYMENT FROM DOCUMENTARY STAMP TAXES.— The issuance of debenture bonds is certainly conceptually distinct from pulping and paper manufacturing operations. But no one contends that issuance of bonds was a principal or regular business activity of Picop; only banks or other financial institutions are in the regular business of raising money by issuing bonds or other instruments to the general public. We consider that the actual dedication of the proceeds of the bonds to the carrying out of Picop's registered operations constituted a sufficient nexus with such registered operations so as to exempt Picop from stamp taxes ordinarily imposed upon or in connection with issuance of such bonds. We agree, therefore, with the Court of Appeals on this matter that the CTA and the CIR had erred in rejecting Picop's claim for exemption from stamp taxes. It remains only to note that after commencement of the present litigation before the CTA, the BIR took the position that the tax exemption granted by R.A. No. 5186, as amended, *does* include exemption from documentary stamp taxes on transactions entered into by BOI-registered enterprises. BIR Ruling No. 088, dated 28 April 1989, for instance, held that a registered preferred pioneer enterprise engaged in the manufacture of integrated circuits, magnetic heads, printed circuit boards, etc., is exempt from the payment of documentary stamp taxes. Similarly, in

Supreme Court E-Library

BIR Ruling No. 013, dated 6 February 1989, the Commissioner held that a registered pioneer enterprise producing polyester filament yarn was entitled to exemption "from the documentary stamp tax on [its] sale of real property in Makati up to December 31, 1989." It appears clear to the Court that the CIR, administratively at least, no longer insists on the position it originally took in the instant case before the CTA.

6. **ID.; TAX EXEMPTIONS; STRICTLY CONSTRUED.**— Tax exemptions are, to be sure, to be "strictly construed," that is, they are not to be extended beyond the ordinary and reasonable intendment of the language actually used by the legislative authority in granting the exemption.

7. **ID.; NATIONAL INTERNAL REVENUE CODE; GROSS INCOME; INTEREST PAYMENTS ON LOANS, DEDUCTIBLE.**— Interest payments on loans incurred by a taxpayer (whether BOI-registered or not) are allowed by the NIRC as deductions against the taxpayer's gross income. (Section 30 of the 1977 Tax Code) Thus, the general rule is that interest expenses are deductible against gross income and this certainly includes interest paid under loans incurred in connection with the carrying on of the business of the taxpayer. Our 1977 NIRC does *not* prohibit the deduction of interest on a loan incurred for acquiring machinery and equipment. Neither does our 1977 NIRC compel the capitalization of interest payments on such a loan. The 1977 Tax Code is simply silent on a taxpayer's right to elect one or the other tax treatment of such interest payments. Accordingly, the general rule that interest payments on a legally demandable loan are deductible from gross income must be applied.

8. **ID.; ID.; ID.; LOSSES ACTUALLY SUSTAINED CAN BE CHARGED OFF ONLY AGAINST INCOME EARNED DURING THE SAME YEAR.**— The rule applicable in respect of corporations *not* registered with the BOI as a preferred pioneer enterprise — is that *net operating losses cannot be carried over.* Under our Tax Code, both in 1977 and at present, losses may be deducted from gross

Supreme Court E-Library

income only if such losses were actually sustained in the same year that they are deducted or charged off. (Section 30 of the 1977 Tax Code; Section 76 of the Philippine Income Tax Regulations [Revenue Regulation No. 2, as amended]) It is thus clear that under our law, and outside the special realm of BOI-registered enterprises, there is no such thing as a carry-over of net operating loss. To the contrary, *losses must be deducted* against current income *in the taxable year when such losses were incurred.* Moreover, such losses may be charged off *only against income earned in the same taxable year when the losses were incurred.*

9. **ID.; RA 5186 (INVESTMENT INCENTIVES ACT); CARRY-OVER OF NET OPERATING LOSSES WITH RESPECT TO THEIR REGISTERED OPERATION; PURPOSE.**— Thus it is that R.A. No. 5185 introduced the carry-over of net operating losses as a *very special incentive* to be granted only to registered pioneer enterprises and only with respect to their registered operations. The statutory purpose here may be seen to be the encouragement of the establishment and continued operation of pioneer industries by allowing the registered enterprise to accumulate its operating losses which may be expected during the early years of the enterprise and to permit the enterprise to offset such losses against income earned by it in later years after successful establishment and regular operations. To promote its economic development goals, the Republic foregoes or defers taxing the income of the pioneer enterprise until after that enterprise has recovered or offset its earlier losses. We consider that the statutory purpose can be served only if the accumulated operating losses are carried over and charged off against income subsequently earned and accumulated *by the same enterprise engaged in the same registered operations.*

10. **ID.; ID.; ID.; NET OPERATING LOSS OF ONE ENTERPRISE NOT DEDUCTIBLE FROM GROSS INCOME OF ANOTHER DESPITE MERGE.**— The CTA and the Court of Appeals allowed the offsetting of RPPM's accumulated operating losses against Picop's 1977 gross income, basically because towards the end of the

Supreme Court E-Library

taxable year 1977, upon the arrival of the effective date of merger, only one (1) corporation, Picop, remained. The losses suffered by RPPM's registered operations and the gross income generated by Picop's own registered operations now came under one and the same corporate roof. We consider that this circumstance relates much more to form than to substance. We do not believe that that single purely technical factor is enough to authorize and justify the deduction claimed by Picop. Picop's claim for deduction is not only bereft of statutory basis; it does violence to the legislative intent which animates the tax incentive granted by Section 7 (c) of R.A. No. 5186. In granting the extraordinary privilege and incentive of a net operating loss carry-over to BOI-registered pioneer enterprises, the legislature could not have intended to require the Republic to forego tax revenues in order to benefit a corporation which had run no risks and suffered no losses, but had merely purchased another's losses. We conclude that the deduction claimed by Picop in the amount of P44,196,106.00 in its 1977 Income Tax Return must be disallowed.

11. **REMEDIAL LAW; EVIDENCE; BURDEN OF PROOF; TAXPAYER HAS THE BURDEN OF PROVING ENTITLEMENT TO CLAIMED DEDUCTION.**— A taxpayer has the burden of proving entitlement to a claimed deduction. In the instant case, even Picop's own vouchers were not submitted in evidence and the BIR Examiners denied that such vouchers and other documents had been exhibited to them. Moreover, cash vouchers can only confirm the fact of disbursement but not necessarily the purpose thereof. The best evidence that Picop should have presented to support its claimed deduction were the invoices and official receipts issued by the Register of Deeds. Picop not only failed to present such documents; it also failed to explain the loss thereof, assuming they had existed before. Under the best evidence rule, therefore, the testimony of Picop's employee was inadmissible and was in any case entitled to very little, if any, credence. We consider that entitlement to Picop's

Supreme Court E-Library

claimed deduction of P1,237,421.00 was not adequately shown and that such deduction must be disallowed.

12. **ID.; ID.; ADMISSION; HIGHER SALES REFLECTED IN PICOP'S BOOK OF ACCOUNTS, AN ADMISSION AGAINST ITS OWN INTEREST.**— In its assessment for deficiency income tax for 1977, the CIR claimed that Picop had understated its sales by P2,391.644.00 and, upon the other hand, overstated its cost of sales by P604,018.00. Thereupon, the CIR added back both sums to Picop's net income figure per its own return. The 1977 Income Tax Return of Picop set forth its total sales as P800,814,851.00. Upon the other hand, Picop's Books of Accounts reflected higher sales figures of P803,206,495.00. The above figures thus show a discrepancy between the sales figures reflected in Picop's Books of Accounts and the sales figures reported in its 1977 Income Tax Return, amounting to: P2,391,644.00. The CIR has made out at least a *prima facie* case that Picop had understated its sales and overstated its cost of sales as set out in its Income Tax Return. For the CIR has a right to assume that Picop's Books of Accounts speak the truth in this case since, as already noted, they embody what must appear to be admissions against Picop's own interest. Accordingly, we must affirm the findings of the Court of Appeals and the CTA.

13. **TAXATION; R.A. 5186 (INVESTMENT INCENTIVES ACT); NON-EXEMPTION FROM PAYMENT OF INCOME TAX; CORPORATE DEVELOPMENT TAX, AN INCOME TAX; REQUISITE FOR PAYMENT.**— The five percent (5%) corporate development tax is an additional corporate income tax imposed in Section 24 (e) of the 1977 Tax Code. This additional tax shall be imposed only if the net income exceeds 10 per cent of the net worth, in case of a domestic corporation, or net assets in the Philippines in case of a resident foreign corporation. Since this five percent (5%) corporate development tax is an *income* tax, Picop is not exempted from it under the provisions of Section 8 (a) of R.A. No. 5186. The adjusted net income of Picop for 1977, as will be seen below, is P48,687,355.00. Its net worth

Supreme Court E-Library

figure or total stockholders' equity as reflected in its Audited Financial Statements for 1977 is P464,749,528.00. Since its adjusted net income for 1977 thus exceeded ten percent (10%) of its net worth, Picop must be held liable for the five percent (5%) corporate development tax in the amount of P2,434,367.75.

VITUG, *J.*, *concurring and dissenting opinion*:

1. **TAXATION; REPUBLIC ACT NO. 5186 (INVESTMENT INCENTIVES ACT); EXEMPTION FROM PAYMENT OF INCOME TAX DOES NOT INCLUDE EXEMPTION FROM TRANSACTION TAX.**— R.A. No. 5186, also known as the Investment Incentives Act, has provided for incentives by, among other things, granting to registered pioneer enterprises an exemption from all taxes, except income tax, under the National Internal Revenue Code. The income tax, referred to, in my view, is that imposed in Title II, entitled "Income Tax," of the Revenue Code. Nowhere under that title is there a 35% transaction tax.

2. **ID.; NATIONAL INTERNAL REVENUE CODE; 35% TRANSACTION TAX; LEVIED ON BORROWER-ISSUER OF COMMERCIAL PAPERS NOT ON INVESTOR-LENDER.**— There was, to be sure, a 35% transaction tax still in effect in 1977 but it was a tax, *not on the investor-lender* in whose favor the interest income on the commercial paper accrues. The tax was, instead, *levied on the borrower-issuer* of commercial papers transacted in the primary market. Being the principal taxpayer, the borrower-issuer could not have been likewise contemplated to be a mere tax withholding agent. The tax was conceived as a tax on business transaction, and so it was rightly incorporated in Title V, entitled "Privilege Taxes on Business and Occupation" of the Tax Code.

3. **ID.; TAXES; FACT THAT TAXPAYER CAN SHIFT PAYMENT OF INDIRECT TAXES TO ANOTHER DOES NOT MAKE THE LATTER THE TAXPAYER AND THE FORMER THE WITHHOLDING AGENT.**—

Supreme Court E-Library

> The fact that a taxpayer on whom the tax is imposed can shift, characteristic of indirect taxes, the burden thereof to another does not make the latter the taxpayer and the former the withholding agent. Indeed, the facility of shifting the burden of the tax is opposed to the idea of a *direct* tax to which class the income tax actually belongs.

APPEARANCES OF COUNSEL

Ma. Lourdes A. Gadioma for Paper Industries Corporation of the Phil.

The Solicitor General for the Commissioner of Internal Revenue.

D E C I S I O N

FELICIANO, *J*:

The Paper Industries Corporation of the Philippines ("Picop"), which is petitioner in G.R. Nos. 106949-50 and private respondent in G.R. Nos. 106984-85, is a Philippine corporation registered with the Board of Investments ("BOI") as a preferred *pioneer* enterprise with respect to its integrated pulp and paper mill, and as a preferred *non-pioneer* enterprise with respect to its integrated plywood and veneer mills.

On 21 April 1983, Picop received from the Commissioner of Internal Revenue ("CIR") two (2) letters of assessment and demand both dated 31 March 1983: (a) one for deficiency transaction tax and for documentary and science stamp tax; and (b) the other for deficiency income tax for 1977, for an aggregate amount of *P88,763,255.00*. These assessments were computed as follows:

"Transaction Tax

Interest payments on money market borrowings	P45,771,849.00

Supreme Court E-Library

35% Transaction tax due thereon		16,020,147.00	
Add: 25% surcharge		4,005,036.75	
Total		P 20,025,183.75	
Add:			
14% int. fr. 1-20-78 to 7-31-80	P 7,093,302.57		
20% int. fr. 8-1-80 to 3-31-83	10,675,532.58		
		17,768,826.15	
			P37,794,009.90

Documentary and Science Stamps Tax

Total face value of debentures		P100,000,000.00	
Documentary Stamps Tax Due (P0.30 x P100,000.00) (P200)		P 150,000.00	
Science Stamps Tax Due (P0.30 x P100,000.00) (P200)		150,000.00	
Total		P 300,000.00	
Add: Compromise for non-affixture		300.00	
			300,300.00
TOTAL AMOUNT DUE AND COLLECTIBLE			P38,094,309.90

Deficiency Income Tax for 1977

Net income per return	P	258,166.00

Supreme Court E-Library

Add: Unallowable deductions

1) Disallowed deductions availed of under R.A. No. 5186	P44,332,980.00	
2) Capitalized interest expenses on funds used for acquisition of machinery & other equipment	42,840,131.00	
3) Unexplained financial guarantee expense	1,237,421.00	
4) Understatement of sales	2,391,644.00	
5) Overstatement of cost of sales	604,018.00	
		P91,406,194.00
Net income per investigation		P91,644,360.00
Income tax due thereon		34,734,559.00
Less: Tax already assessed per return		80,358.00
Deficiency		P34,654,201.00
Add:		
14% int. fr. 4-15-78 to 7-31-81	P11,128,503.56	
20% int. fr. 8-1-80 to 4-15-81	4,886,242.34	
		P 16,014,745.90
TOTAL AMOUNT DUE AND COLLECTIBLE		P50,668,946.90"[1]

[1] As quoted in the decision of CTA, CTA Case No. 3843, *Rollo* of G.R. Nos. 106949-50, pp. 55-56. Hereafter, unless otherwise indicated, the *Rollo* of G.R. Nos. 106949-50 is cited simply as "*Rollo*."

Supreme Court E-Library

On 26 April 1983, Picop protested the assessment of deficiency transaction tax and documentary and science stamp taxes. Picop also protested on 21 May 1983 the deficiency income tax assessment for 1977. These protests were not formally acted upon by respondent CIR. On 26 September 1984, the CIR issued a warrant of distraint on personal property and a warrant of levy on real property against Picop, to enforce collection of the contested assessments; in effect, the CIR denied Picop's protests.

Thereupon, Picop went before the Court of Tax Appeals ("CTA") appealing the assessments. After trial, the CTA rendered a decision dated 15 August 1989, modifying the findings of the CIR and holding Picop liable for the reduced aggregate amount of P20,133,762.33, which was itemized in the dispositive portion of the decision as follows:

"35% Transaction Tax	P16,020,113.20
Documentary & Science Stamp Tax	300,300.00
Deficiency Income Tax Due	3,813,349.33
TOTAL AMOUNT DUE AND PAYABLE	P20,133,762.53"[2]

Picop and the CIR both went to the Supreme Court on separate Petitions for Review of the above decision of the CTA. In two (2) Resolutions dated 7 February 1990 and 19 February 1990, respectively, the Court referred the two (2) Petitions to the Court of Appeals. The Court of Appeals consolidated the two (2) cases and rendered a decision, dated 31 August 1992, which further reduced the liability of Picop to P6,338,354.70. The dispositive portion of the Court of Appeals decision reads as follows:

---

[2] *Id.*, p. 80.

Supreme Court E-Library

"WHEREFORE, the appeal of the Commissioner of Internal Revenue is denied for lack of merit. The judgment against PICOP is modified, as follows:

1. PICOP is declared liable for the 35% transaction tax in the amount of P3,578,543.51;

2. PICOP is absolved from the payment of documentary and science stamp tax of P300,000.00 and the compromise penalty of P300.00;

3. PICOP shall pay 20% interest per annum on the deficiency income tax of P1,481,579.15, for a period of three (3) years from 21 May 1983, or in the total amount of P888,947.49, and a surcharge of 10% on the latter amount, or P88,984.75.

No pronouncement as to costs.

SO ORDERED."

Picop and the CIR once more filed separate Petitions for Review before the Supreme Court. These cases were consolidated and, on 23 August 1993, the Court resolved to give due course to both Petitions in G.R. Nos. 106949-50 and 106984-85 and required the parties to file their Memoranda.

Picop now maintains that it is not liable at all to pay any of the assessments or any part thereof. It assails the propriety of the thirty-five percent (35%) deficiency transaction tax which the Court of Appeals held due from it in the amount of P3,578,543.51. Picop also questions the imposition by the Court of Appeals of the deficiency income tax of P1,481,579.15, resulting from disallowance of certain claimed financial guarantee expenses and claimed year-end adjustments of sales and cost of sales figures by Picop's external auditors.[3]

The CIR, upon the other hand, insists that the Court of Appeals erred in finding Picop not liable for surcharge and

---

[3] Picop's Memorandum, *Rollo*, p. 167.

Supreme Court E-Library

interest on unpaid transaction tax and for documentary and science stamp taxes and in allowing Picop to claim as deductible expenses:

(a) the net operating losses of another corporation (i.e., Rustan Pulp and Paper Mills, Inc.); and

(b) interest payments on loans for the purchase of machinery and equipment.

The CIR also claims that Picop should be held liable for interest at fourteen percent (14%) per annum from 15 April 1978 for three (3) years, and interest at twenty percent (20%) per annum for a maximum of three (3) years; and for a surcharge of ten percent (10%), on Picop's deficiency income tax. Finally, the CIR contends that Picop is liable for the corporate development tax equivalent to five percent (5%) of its correct 1977 net income.

The issues which we must here address may be sorted out and grouped in the following manner:

I. Whether Picop is liable for:

(1) the thirty-five percent (35%) transaction tax;
(2) interest and surcharge on unpaid transaction tax; and
(3) documentary and science stamp taxes:

II. Whether Picop is entitled to deductions against income of:

(1) interest payments on loans for the purchase of machinery and equipment;
(2) net operating losses incurred by the Rustan Pulp and Paper Mills, Inc.; and
(3) certain claimed financial guarantee expenses; and

III. (1) Whether Picop had understated its sales and overstated its cost of sales for 1977; and
(2) Whether Picop is liable for the corporate development tax of five percent (5%) of its net income for 1977.

We will consider these issues in the foregoing sequence.

Supreme Court E-Library

I.

(1) Whether Picop is liable for the thirty-five percent (35%) transaction tax.

With the authorization of the Securities and Exchange Commission, Picop issued commercial paper consisting of serially numbered promissory notes with the total face value of P229,864,000.00 and a maturity period of one (1) year, i.e., from 24 December 1977 to 23 December 1978. These promissory notes were purchased by various commercial banks and financial institutions. On these promissory notes, Picop paid interest in the aggregate amount of P45,771,849.00. In respect of these interest payments, the CIR required Picop to pay the thirty-five percent (35%) transaction tax.

The CIR based this assessment on Presidential Decree No. 1154 dated 3 June 1977, which reads in part as follows:

"Section 1. The National Internal Revenue Code, as amended, is hereby further amended by adding a new section thereto to read as follows:

'Sec. 195-*C. Tax on certain inter*est.— There shall *be le*vied, assessed, collected and pa*id on every commercial paper issued in the primary market as principal instrument, a transaction tax equivalent to thirty-five percent (35%) based on the gross amount of interest there*to as defined hereun*der, which shall be paid by the borrower/iss*uer: *Prov*ided, *how*ever, that in the case of a long-term commercial paper whose maturity exceeds more than one year, the borrower shall pay the tax based on the amount of interest corresponding to one year, and thereafter shall pay the tax upon accrual or actual payment (whichever is earlier) of the untaxed portion of the interest which corresponds to a period not exceeding one year.

The transaction tax imposed in this section shall *be a final tax to be paid by the borro*wer and shall be allowed as a deductible item for purposes of computing the borrower's taxable income.

Supreme Court E-Library

For purposes of this tax —

(a) "Commercial paper" shall be defined as an instrument evidencing indebtedness of any person or entity, including banks and non-banks performing quasi-banking functions, which is issued, endorsed, sold, transferred or in any manner conveyed to another person or entity, either with or without recourse and irrespective of maturity. *Principally, commercial papers are promissory no*tes and/or similar instrumen*ts issued in the primary mar*ket and shall not include repurchase agreements, certificates of assignments, certificates of participations, and such other debt instruments issued in the secondary market.

(b) The term "interest" shall mean the difference between what the principal borrower received and the amount it paid upon maturity of the commercial paper which shall, in no case, be lower than the interest rate prevailing at the time of the issuance or renewal of the commercial paper. Interest shall be deemed synonymous with discount and shall include all fees, commissions, premiums and other payments which form integral parts of the charges imposed as a consequence of the use of money.

In all cases, where no interest rate is stated or if the rate stated is lower than the prevailing interest rate at the time of the issuance or renewal of commercial paper, the Commissioner of Internal Revenue, upon consultation with the Monetary Board of the Central Bank of the Philippines, shall adjust the interest rate in accordance herewith, and assess the tax on the basis thereof.

The tax herein impos*ed shall be remitted by the borrower to the Commissioner of Internal Revenue or his Collection Agent* in the municipality where such borrower has its principal place of business within five (5) working days from the issuance of the commercial paper. In the case of long term commercial paper, the tax upon the untaxed portion of the interest which corresponds to a period not exceeding one year shall be paid upon accrual payment, whichever is earlier.'" (Italics supplied)

Supreme Court E-Library

Both the CTA and the Court of Appeals sustained the assessment of transaction tax.

In the instant Petition, Picop reiterates its claim that it is exempt from the payment of the transaction tax by virtue of its tax exemption under R.A. No. 5186, as amended, known as the Investment Incentives Act, which in the form it existed in 1977-1978, read in relevant part as follows:

"Sec. *8. Incentives to a Pioneer Enterprise.*— In addition to the incentives provided in the preceding section, pioneer enterprises shall be granted the following incentive benefits:

(a) Tax Exemption. Exemption from all taxes under the National Internal Revenue Code, except income tax, from the date the area of investment is included in the Investment Priorities Plan to the following extent:

(1) One hundred per cent (100%) for the first five years;
(2) Seventy-five per cent (75%) for the sixth through the eighth years;
(3) Fifty per cent (50%) for the ninth and tenth years;
(4) Twenty per cent (20%) for the eleventh and twelfth years; and
(5) Ten per cent (10%) for the thirteenth through the fifteenth year.

x x x x x x x x x"[4]

We agree with the CTA and the Court of Appeals that Picop's tax exemption under R.A. No. 5186, as amended, does *not* include exemption from the thirty-five percent (35%) transaction tax. In the first place, the thirty-five percent (35%) transaction tax[5] is an income tax, that is, it is a tax on

---

[4] Section 8 (a), R.A. No. 5186, as amended by P.D. No. 92 dated 6 January 1973.

[5] This tax was first imposed by P.D. No. 1154 dated 3 June 1977 which inserted Section 195-C into the Tax Code. It was re-enacted, in identical terms, as Section 210 (b) of the 1977 Tax Code, by virtue of P.D. No. 1158 also dated 3 June 1977.

Supreme Court E-Library

the interest income of the lenders or creditors. In *Western Minolco Corporation v. Commissioner of Internal Revenue*,[6] the petitioner corporation borrowed funds from several financial institutions from June 1977 to October 1977 and paid the corresponding thirty-five (35%) transaction tax thereon in the amount of P1,317,801.03, pursuant to Section 210 (b) of the 1977 Tax Code. Western Minolco applied for refund of that amount alleging it was exempt from the thirty-five (35%) transaction tax by reason of Section 79-A of C.A. No. 137, as amended, which granted new mines and old mines resuming operation "five (5) years complete tax exemptions, except income tax, from the time of its actual *bonafide* orders for equipment for commercial production." In denying the claim for refund, this Court held:

"The petitioner's contentions deserve scant consideration. *The 35% transaction tax is imposed on interest income from commercial papers issued in the primary money market. Being a tax on interest, it is a tax on income.*

As correctly ruled by the respondent Court of Tax Appeals:

'Accordingly, we need not and do not think it necessary to discuss further the nature of the transaction tax more than to say that the incipient scheme in the issuance of Letter of Instructions No. 340 on November 24, 1975 (O.G. Dec. 15, 1975), *i.e.*, to achieve operational simplicity and effective administration in capturing the interest-income "windfall" from money market operations as a new source of revenue, has lost none of its animating principle in parturition of amendatory Presidential Decree No. 1154, now Section 210 (b) of the Tax Code. *The tax thus imposed is actually a tax on interest earnings of the lenders or placers who are actually the taxpayers in whose income is imposed.* Thus "the borrower withholds the tax of 35% from the interest he would have to pay the lender so that he (borrower) can pay the 35% of the interest to the Government." (Citation omitted).

---

[6] 124 SCRA 121 (1983).

Supreme Court E-Library

> x x x. Suffice it to state that the broad consensus of fiscal and monetary authorities is that "even if nominally, the borrower is made to pay the tax, actually, the tax is on the interest earning of the immediate and all prior lenders/placers of the money. x x x." (*Rollo*, pp. 36-37)

The 35% transaction tax is an income tax on interest earnings to the lenders or placers. The latter are actually the taxpayers. Therefore, the tax cannot be a tax imposed upon the petitioner. In other words, *the petitioner who borrowed funds from several financial institutions by issuing commercial papers merely withheld the 35% transaction tax before paying to the financial institutions the interests earned by them and later remitted the same to the respondent Commissioner of Internal Revenue.* The tax could have been collected by a different procedure but the statute chose this method. Whatever collecting procedure is adopted does not change the nature of the tax.

x x x x x x x x x."[7] (Italics supplied)

Much the same issue was passed upon in *Marinduque Mining and Industrial Corporation v. Commissioner of Internal Revenue*[8] and resoved in the same way:

"It is very obvious that the transaction tax, *which is tax on interest derived from commercial paper issued in the money market*, is not a tax contemplated in the above-quoted legal provisions. The petitioner admits that it is subject to income tax. Its tax exemption should be strictly construed.

We hold that petitioner's claim for refund was justifiably denied. *The transaction tax, although nominally categorized as a business tax, is in reality a withholding tax* as positively stated in LOI No. 340. The petitioner could have shifted the tax to the lenders or recipients of the interest. It did not choose to do so. It cannot be heard now to complain about the tax. LOI No. 340 is an extraneous or extrinsic aid to the construction of Section 210 (b).

---

[7] 124 SCRA at 130-131.

[8] 137 SCRA 88 (1985).

Supreme Court E-Library

x x x x x x x x x"[9] (Italics supplied)

It is thus clear that the transaction tax is an *income* tax and as such, in any event, falls outside the scope of the tax exemption granted to registered pioneer enterprises by Section 8 of R.A. No. 5186, as amended. Picop was the withholding agent, obliged to withhold thirty-five percent (35%) of the interest payable to its lenders and to remit the amounts so withheld to the Bureau of Internal Revenue ("BIR"). As a withholding agent, Picop is made *personally liable* for the thirty-five percent (35%) transaction tax[10] and *if* it did not actually withhold thirty-five percent (35%) of the interest monies it had paid to its lenders, Picop had only itself to blame.

Picop claims that it had relied on a ruling, dated 6 October 1977, issued by the CIR, which held that Picop was not liable for the thirty-five (35%) transaction tax in respect of debenture bonds issued by Picop. Prior to the issuance of the promissory notes involved in the instant case, Picop had also issued debenture bonds P100,000,000.00 in aggregate face value. The managing underwriter of this debenture bond issue, Bancom Development Corporation, requested a formal ruling from the Bureau of Internal Revenue on the liability of Picop for the thirty-five percent (35%) transaction tax in respect of such bonds. The ruling rendered by the then Acting Commissioner of Internal Revenue, Efren I. Plana, stated in relevant part:

"It is represented that PICOP will be offering to the public primary bonds in the aggregate principal sum of one hundred million pesos (P100,000,000.00); that the bonds will be issued as debentures in denominations of one thousand pesos (P1,000.00)

---

[9] 137 SCRA at 93.

[10] Sections 53 and 54, 1977 Tax Code; Sections 51 and 251, current NIRC; and see Commissioner of Internal Revenue *v.* Procter and Gamble Philippines Manufacturing Corporation, 204 SCRA 377, 384-385 (1991).

Supreme Court E-Library

or multiples, *to mature in ten (10) years* at 14% interest per annum payable semi-annually; that *the bonds are convertible into common stock of the issuer* at the option of the bond holder at an agreed conversion price; that *the issue will be covered by a 'Trust Indenture'* with a duly authorized trust corporation as required by the Securities and Exchange Commission, which trustee will act for and in behalf of the debenture bond holders as beneficiaries; that once issued, *the bonds cannot be preterminated by the holder and cannot be redeemed by the issuer until after eight (8) years from date of issue*; that the debenture bonds will be *subordinated to present and future debts of PICOP*; and that said bonds are intended to be listed in the stock exchanges, which will place them alongside listed equity issues.

In reply, I have the honor to inform you that although the bonds hereinabove described are commercial papers which will be issued in the primary market, however, *it is clear from the abovestated facts that said bonds will not be issued as money market instruments*. Such being the case, and considering that the purposes of Presidential Decree No. 1154, as can be gleaned from Letter of Instruction No. 340, dated November 21, 1975, are (a) to regulate money market transactions and (b) to ensure the collection of the tax on interest derived from money market transactions by imposing a withholding tax thereon, *said bonds do not come within the purview of the 'commercial papers' intended to be subjected to the 35% transaction tax prescribed in Presidential Decree No. 1154*, as implemented by Revenue Regulations No. 7-77. (See Section 2 of said Regulation) Accordingly, *PICOP is not subject to 35% transaction tax on its issues of the aforesaid bonds*. However, those investing in said bonds should be made aware of the fact that the transaction tax is not being imposed on the issuer of said bonds by printing or stamping thereon, in bold letters, the following statement: 'ISSUER NOT SUBJECT TO TRANSACTION TAX UNDER P.D. 1154. BONDHOLDER SHOULD DECLARE INTEREST EARNING FOR INCOME TAX.'"[11] (Italics supplied)

---

[11] Annex "A" of Picop's Petition for Review before the CTA, CTA Case No. 3843, Records, pp. 7-8.

Supreme Court E-Library

In the above quoted ruling, the CIR basically held that Picop's debenture bonds did not constitute "commercial papers" within the meaning of P.D. No. 1154, and that, as such, those bonds were not subject to the thirty-five percent (35%) transaction tax imposed by P.D. No. 1154.

The above ruling, however, is not applicable in respect of the promissory notes which are the subject matter of the instant case. It must be noted that the debenture bonds which were the subject matter of Commissioner Plana's ruling were long-term bonds maturing in ten (10) years and which could not be pre-terminated and could not be redeemed by Picop until after eight (8) years from date of issue; the bonds were moreover subordinated to present and future debts of Picop and convertible into common stock of Picop at the option of the bondholder. In contrast, the promissory notes involved in the instant case are short-term instruments bearing a one-year maturity period. These promissory notes constitute the very archtype of money market instruments. For money market instruments are precisely, by custom and usage of the financial markets, ***short-term*** instruments with a tenor of one (1) year or less.[12] Assuming, therefore, (without passing

---

[12] In Perez *v.* Court of Appeals, 127 SCRA 636 (1984), the Court said:

> "There is another aspect to this case. What is involved here is a money market transaction. As defined by Lawrence Smith 'the *money market is a market dealing* in standardized *short-term credit instruments* (involving large amounts) *where lenders and borrowers do not deal directly with each other but through a middle man or dealer in the open market.*' It involves 'commercial papers' which are instruments 'evidencing indebtedness of any person or entity . . ., which are issued, endorsed, sold or transferred or in any manner conveyed to another person or entity, with or without recourse.' The fundamental function of the money market devices in its operation is to match and bring together in a most impersonal manner both the 'fund users' and the 'fund suppliers.' The money market is an impersonal market, free from personal

Supreme Court E-Library

upon) the correctness of the 6 October 1977 BIR ruling, Picop's short-term promissory notes must be distinguished, and treated differently, from Picop's long-term debenture bonds.

We conclude that Picop was properly held liable for the thirty-five percent (35%) transaction tax due in respect of interest payments on its money market borrowings.

At the same time, we agree with the Court of Appeals that the transaction tax may be levied only in respect of the interest earnings of Picop's money market lenders accruing after P.D. No. 1154 went into effect, and not in respect of all the 1977 interest earnings of such lenders. The Court of Appeals pointed out that:

"PICOP, however, contends that even if the tax has to be paid, it should be imposed only for the interests earned after 20 September 1977 when PD 1154 creating the tax became effective. We find merit in this contention. *It appears that the tax was levied on interest earnings from January to October, 1977.* However, as found by the lower court, PD 1154 was published in the Official Gazette only on 5 September 1977, and *became effective only fifteen (15) days after the publication, or on 20 September 1977*, no other effectivity date having been provided by the PD. Based on the Worksheet prepared by the Commissioner's office, *the interests earned from 20 September to October 1977 was P10,224,410.03. Thirty-five (35%) per cent of this is P3,578,543.51 which is all PICOP should pay as transaction tax.*"[13] (Italics supplied)

---

considerations.' The market mechanism is intended to provide quick mobility of money and securities." (127 SCRA at 645; italics supplied)

In Sesbreño *v.* Court of Appeals (222 SCRA 466 [1993]), the Court reiterated the above excerpt from *Perez*.

[13] *Rollo*, pp. 47-48.

Supreme Court E-Library

P.D. No. 1154 is not, in other words, to be given retroactive effect by imposing the thirty-five percent (35%) transaction tax in respect of interest earnings which accrued before the effectivity date of P.D. No. 1154, there being nothing in the statute to suggest that the legislative authority intended to bring about such retroactive imposition of the tax.

(2) Whether Picop is liable for interest and surcharge on unpaid transaction tax.

With respect to the transaction tax due, the CIR prays that Picop be held liable for a twenty-five percent (25%) surcharge and for interest at the rate of fourteen percent (14%) per annum from the date prescribed for its payment. In so praying, the CIR relies upon Section 10 of Revenue Regulation 7-77 dated 3 June 1977,[14] issued by the Secretary of Finance. This Section reads:

"Sec. 10. *Penalties.*— Where the amount shown by the taxpayer to be due on its return or part of such payment is not paid on or before the date prescribed for its payment, *the amount of the tax shall be increased by twenty-five (25%) per centum,* the increment *to be a part of the tax* and the *entire amount shall be subject to interest at the rate of fourteen (14%) per centum* per annum from the date prescribed for its payment.

In the case of *willful neglect to file the return* within the period prescribed herein or in case a *false or fraudulent return* is willfully made, there shall be added to the tax or to the deficiency tax in case any payment has been made on the basis of such return before the discovery of the falsity or fraud, a *surcharge of fifty (50%) per centum of its amount.* The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the falsity or fraud, in which case the amount so added shall be collected in the same manner as the tax.

---

[14] Text in 73 Official Gazette 6176 (4 July 1977).

Supreme Court E-Library

In addition to the above *administrative penalties*, the *criminal and civil penalties* as provided for under Section 337 of the Tax Code of 1977 shall be imposed for violation of any provision of Presidential Decree No. 1154."[15] (Italics supplied)

The 1977 Tax Code itself, in Section 326 in relation to Section 4 of the same Code, invoked by the Secretary of Finance in issuing Revenue Regulation 7-77, set out, in comprehensive terms, the rule-making authority of the Secretary of Finance:

"Sec. 326. *Authority of Secretary of Finance to Promulgate Rules and Regulations.* The Secretary of Finance, upon recommendation of the Commissioner of Internal Revenue, shall promulgate *all needful rules and regulations for the effective enforcement* of the provisions of this Code." (Italics supplied)

Section 4 of the same Code contains a list of subjects or areas to be dealt with by the Secretary of Finance through the medium of an exercise of his quasi-legislative or rule-making authority. This list, however, while it purports to be open-ended, does *not* include the imposition of administrative or civil penalties such as the payment of amounts additional to the tax due. Thus, in order that it may be held to be legally effective in respect of Picop in the present case, Section 10 of Revenue Regulation 7-77 must embody or rest upon some provision in the Tax Code itself which imposes surcharge and penalty interest for failure to make a transaction tax payment when due.

P.D. No. 1154 did not itself impose, nor did it expressly authorize the imposition of, a surcharge and penalty interest in case of failure to pay the thirty-five percent (35%) transaction tax when due. Neither did Section 210 (b) of the 1977 Tax Code which re-enacted Section 195-C inserted into the Tax Code by P.D. No. 1154.

---

[15] These Regulations are entitled "Imposition of Tax on Interest Derived from Commercial Papers Issued in the Primary Market."

Supreme Court E-Library

The CIR, both in its petition before the Court of Appeals and its Petition in the instant case, points to Section 51 (e) of the 1977 Tax Code as its source of authority for assessing a surcharge and penalty interest in respect of the thirty-five percent (35%) transaction tax due from Picop. This Section needs to be quoted *in extenso*:

"Sec. 51. *Payment and Assessment of Income Tax.*

(c) *Definition of deficiency.* As used in this Chapter in respect of *a tax imposed by this Title*, the term 'deficiency' means:

(1) The amount by which *the tax imposed by this Title* exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amount previously abated, credited, returned, or otherwise in respect of such tax; x x x

x x x x x x x x x

(e) *Additions to the tax in case of non-payment.*

(1) *Tax shown on the return.* Where the amount determined by the taxpayer as *the tax imposed by this Title* or any installment thereof, or any part of such amount or installment is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of fourteen *per centum per annum* from the date prescribed for its payment until it is paid: Provided, That the maximum amount that may be collected as interest on deficiency shall in no case exceed the amount corresponding to a period of three years, the present provisions regarding prescription to the contrary notwithstanding.

(2) *Deficiency. Where a deficiency*, or any interest assessed in connection therewith under paragraph (d) of this section, *or any addition to the taxes provided for in Section seventy-two of this Code* is not paid in full within thirty days from the date of notice and demand from the Commissioner of Internal Revenue, there shall be collected upon the unpaid amount as part of the tax, interest at the rate of fourteen *per centum per annum* from the date

Supreme Court E-Library

of such notice and demand until it is paid: Provided, That the maximum amount that may be collected as interest on deficiency shall in no case exceed the amount corresponding to a period of three years, the present provisions regarding prescription to the contrary notwithstanding.

(3) *Surcharge*. If any amount of tax included in the notice and demand from the Commissioner of Internal Revenue is not paid in full within thirty days after such notice and demand, there shall be collected in addition to the interest prescribed herein and in paragraph (d) above and as part of the tax a surcharge of five *per centum* of the amount of tax unpaid." (Italics supplied)

Section 72 of the 1977 Tax Code referred to in Section 51(e)(2) above, provides:

"Sec. 72. *Surcharges for failure to render returns and for rendering false and fraudulent returns*. In case of wilful neglect to file *the return or list required by this Title* within the time prescribed by law, or in case a false or fraudulent return or list is wilfully made, the Commissioner of Internal Revenue shall add to the tax or to the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud, as *surcharge of fifty per centum of the amount of such tax or deficiency tax*. In case of any failure to make and file a return or list within the time prescribed by law or by the Commissioner or other Internal Revenue Officer, *not due to willful neglect*, the Commissioner of Internal Revenue shall add to the tax *twenty-five per centum of its amount*, except that, when a return is voluntarily and without notice from the Commissioner or other officer filed after such time, and it is shown that the failure to file it was due to a reasonable cause, no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time, in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax." (Italics supplied)

It will be seen that Section 51 (c)(1) and (e)(1) and (3), of the 1977 Tax Code, authorize the imposition of surcharge

Supreme Court E-Library

and interest only in respect of a "*tax imposed by this Title*," that is to say, *Title II on "Income Tax.*" It will also be seen that Section 72 of the 1977 Tax Code imposes a surcharge only in case of failure to file a return or list "*required by this Title*," that is, *Title II on "Income Tax.*" The thirty-five percent (35%) transaction tax is, however, imposed in the 1977 Tax Code by *Section 210 (b) thereof which Section is embraced in Title V on "Taxes on Business*" of that Code. Thus, while the thirty-five percent (35%) transaction tax is in truth a *tax imposed on* interest *income* earned by lenders or creditors purchasing commercial paper on the money market, the relevant provisions, *i.e.*, Section 210 (b), were *not* inserted in Title II of the 1977 Tax Code. The end result is that the thirty-five percent (35%) transaction tax is *not* one of the taxes in respect of which Section 51 (e) authorized the imposition of surcharge and interest and Section 72 the imposition of a fraud surcharge.

It is not without reluctance that we reach the above conclusion on the basis of what may well have been an inadvertent error in legislative draftsmanship, a type of error common enough during the period of Martial Law in our country. Nevertheless, we are compelled to adopt this conclusion. We consider that the authority to impose what the present Tax Code calls (in Section 248) *civil penalties* consisting of additions to the tax due, must be expressly given in the enabling statute, in language too clear to be mistaken. The grant of that authority is not lightly to be assumed to have been made to administrative officials, even to one as highly placed as the Secretary of Finance.

The state of the present law tends to reinforce our conclusion that Section 51 (c) and (e) of the 1977 Tax Code did not authorize the imposition of a surcharge and penalty interest for failure to pay the thirty-five percent (35%) transaction tax imposed under Section 210 (b) of the same Code. The corresponding provision in the *current* Tax Code very clearly

Supreme Court E-Library

embraces failure *to pay all taxes imposed in the Tax Code*, without any regard to the Title of the Code where provisions imposing particular taxes are textually located. Section 247 (a) of the NIRC, as amended, reads:

"Title X

Statutory Offenses and Penalties

Chapter I

Additions to the Tax

Section 247. *General Provisions.* (a) The additions to the tax or deficiency tax prescribed in this Chapter shall *apply to all taxes, fees and charges imposed in this Code*. The amount so added to the tax shall be collected at the same time, in the same manner and as part of the tax. x x x

Section 248. *Civil Penalties.* (a) There shall be imposed, *in addition to the tax required to be paid, penalty equivalent to twenty-five percent (25%) of the amount due*, in the following cases:

x x x x x x x x x

(3) failure to pay the tax within the time prescribed for its payment; or

x x x x x x x x x

(c) the penalties imposed hereunder shall form part of the tax and the entire amount shall be subject to the interest prescribed in Section 249.

Section 249. *Interest.* (a) *In General.* There shall be assessed and collected *on any unpaid amount of tax, interest* at the rate of *twenty percent (20%) per annum* or *such higher rate as may be prescribed by regulations*, from the date prescribed for payment until the amount is fully paid. x x x." (Italics supplied)

In other words, Section 247 (a) of the current NIRC supplies what did not exist back in 1977 when Picop's liability for the thirty-five percent (35%) transaction tax became fixed. We

Supreme Court E-Library

do not believe we can fill that legislative *lacuna* by judicial fiat. There is nothing to suggest that Section 247 (a) of the present Tax Code, which was inserted in 1985, was intended to be given retroactive application by the legislative authority.[16]

(3) Whether Picop is Liable for Documentary and Science Stamp Taxes.

As noted earlier, Picop issued sometime in 1977 long-term subordinated convertible debenture bonds with an aggregate face value of P100,000,000.00. Picop stated, and this was not disputed by the CIR, that the proceeds of the debenture bonds were in fact utilized to finance the BOI-registered operations of Picop. The CIR assessed documentary and science stamp taxes, amounting to P300,000.00, on the issuance of Picop's debenture bonds. It is claimed by Picop that its tax exemption "exemption from all taxes under the National Internal Revenue Code, except income tax" on a declining basis over a certain period of time includes exemption from the documentary and science stamp taxes imposed under the NIRC.

The CIR, upon the other hand, stresses that the tax exemption under the Investment Incentives Act may be granted or recognized only to the extent that the claimant Picop was engaged in registered operations, *i.e.*, operations forming

---

[16] Section 247 (a) was inserted by P.D. No. 1994 dated 5 November 1985. (Originally appearing as Section 281 (a), it assumed its present position pursuant to E.O. No. 273 dated 25 July 1987 which rearranged the Tax Code.) The applicable general principle is that tax laws are to be given only prospective application, in the absence of an explicit statutory command, that a particular provision be applied retroactively. (See, *e.g.*, *Vitug, Compedium of Tax Law and Jurisprudence*, p. 35 [3rd rev. ed., 1993]).

Supreme Court E-Library

part of its integrated pulp and paper project.[17] The borrowing of funds from the public, in the submission of the CIR, was not an activity included in Picop's registered operations. The CTA adopted the view of the CIR and held that "the issuance of convertible debenture bonds [was] not synonymous [with] the manufactur[ing] operations of an integrated pulp and paper mill."[18]

The Court of Appeals took a less rigid view of the ambit of the tax exemption granted to registered pioneer enterprises. Said the Court of Appeals:

"x x x PICOP's explanation that the debenture bonds were issued to finance its registered operation is logical and is unrebutted. We are aware that tax exemptions must be applied strictly against the beneficiary in order to deter their abuse. *It would indeed be altogether a different matter if there is a showing that the issuance of the debenture bonds had no bearing whatsoever on the registered*

---

[17] The CIR here relied on Section 7, R.A. No. 5186 as amended which, in its opening clause, reads:

"Sec. 7. *Incentives to Pioneer Enterprise*. A registered enterprise, *to the extent engaged in a preferred area of investment*, shall be granted the following incentive benefits:

x x x x x x x x x."

(Italics supplied)

and on Section 1, Rule 13, of the "Revised Rules and Regulations to Implement the Intent and Provisions of R.A. No. 5186, as amended," which reads:

"Rule XIII

Additional Incentives to Pioneer Enterprises

Sec. 1. The additional incentives granted in Section 8 of the Act, as amended, shall be available to all registered pioneer enterprises, whether or not controlled by Philippine nationals, *but only to the extent in which they are engaged in registered operations*." (Italics supplied)

[18] Decision of the CTA, CTA Case No. 3843, *Rollo*, p. 65

Supreme Court E-Library

operations of PICOP and that they were *issued in connection with a totally different business undertaking of PICOP other than its registered operation.* There is, however, a dearth of evidence in this regard. It cannot be denied that PICOP needed funds for its operations. One of the means it used to raise said funds was to issue debenture bonds. *Since the money raised thereby was to be used in its registered operation, PICOP should enjoy the incentives granted to it* by R.A. 5186, one of which is the exemption from payment of all taxes under the National Internal Revenue Code, except income taxes, *otherwise the Purpose of the incentives would be defeated. Documentary and science stamp taxes on debenture bonds are certainly not income taxes.*"[19] (Italics supplied)

Tax exemptions are, to be sure, to be "strictly construed," that is, they are not to be extended beyond the ordinary and reasonable intendment of the language actually used by the legislative authority in granting the exemption. The issuance of debenture bonds is certainly conceptually distinct from pulping and paper manufacturing operations. But no one contends that issuance of bonds was a principal or regular business activity of Picop; only banks or other financial institutions are in the regular business of raising money by issuing bonds or other instruments to the general public. We consider that the actual dedication of the proceeds of the bonds to the carrying out of Picop's registered operations constituted a sufficient nexus with such registered operations so as to exempt Picop from stamp taxes ordinarily imposed upon or in connection with issuance of such bonds. We agree, therefore, with the Court of Appeals on this matter that the CTA and the CIR had erred in rejecting Picop's claim for exemption from stamp taxes.

It remains only to note that after commencement of the present litigation before the CTA, the BIR took the position that the tax exemption granted by R.A. No. 5186, as amended, *does* include exemption from documentary stamp taxes on

[19] *Rollo*, pp. 48-49.

Supreme Court E-Library

transactions entered into by BOI-registered enterprises. BIR Ruling No. 088, dated 28 April 1989, for instance, held that a registered preferred pioneer enterprise engaged in the manufacture of integrated circuits, magnetic heads, printed circuit boards, etc., is exempt from the payment of documentary stamp taxes. The Commissioner said:

"You now request a ruling that as a preferred pioneer enterprise, you are exempt from the payment of Documentary Stamp Tax (DST).

In reply, please be informed that your request is hereby granted. Pursuant to Section 46(a) of Presidential Decree No. 1789, pioneer enterprises registered with the BOI are exempt from all taxes under the National Internal Revenue Code, except from all taxes under the National Internal Revenue Code, except income tax, from the date the area of investment is included in the Investment Priorities Plan to the following extent:

x x x x x x x x x

Accordingly, *your company is exempt from the payment of documentary stamp tax to the extent of the percentage aforestated on transactions connected with the registered business activity.* (BIR Ruling No. 111-81) However, if said transactions conducted by you require the execution of a taxable document with other parties, said parties who are not exempt shall be the one directly liable for the tax. (Sec. 173, Tax Code, as amended; BIR Ruling No. 236-87)

In other words, said parties shall be liable to the same percentage corresponding to your tax exemption." (Italics supplied)

Similarly, in BIR Ruling No. 013, dated 6 February 1989, the Commissioner held that a registered pioneer enterprise producing polyester filament yarn was entitled to exemption "from the documentary stamp tax on [its] sale of real property in Makati up to December 31, 1989." It appears clear to the Court that the CIR, administratively at least, no longer insists on the position it originally took in the instant case before the CTA.

Supreme Court E-Library

II

(1) Whether Picop is entitled to deduct against current income interest payments on loans for the purchase of machinery and equipment.

In 1969, 1972 and 1977, Picop obtained loans from foreign creditors in order to finance the purchase of machinery and equipment needed for its operations. In its 1977 Income Tax Return, Picop claimed interest payments made in 1977, amounting to P42,840,131.00, on these loans as a deduction from its 1977 gross income.

The CIR disallowed this deduction upon the ground that, because the loans had been incurred for the purchase of machinery and equipment, the interest payments on those loans should have been capitalized instead and claimed as a depreciation deduction taking into account the adjusted basis of the machinery and equipment (original acquisition cost plus interest charges) over the useful life of such assets.

Both the CTA and the Court of Appeals sustained the position of Picop and held that the interest deduction claimed by Picop was proper and allowable. In the instant Petition, the CIR insists on its original position.

We begin by noting that interest payments on loans incurred by a taxpayer (whether BOI-registered or not) are allowed by the NIRC as deductions against the taxpayer's gross income. Section 30 of the 1977 Tax Code provided as follows:

"Section 30. *Deduction from Gross Income*. The following may be deducted from gross income:

(a) *Expenses*:

x x x x x x x x x

(b) *Interest*:

Supreme Court E-Library

(1) *In general.* The amount of *interest paid* within the taxable year on *indebtedness*, except on indebtedness incurred or continued to purchase or carry obligations the interest upon which is exempt from taxation as income under this Title: x x x" (Italics supplied)

Thus, the general rule is that interest expenses are deductible against gross income and this certainly includes interest paid under loans incurred in connection with the carrying on of the business of the taxpayer.[20] In the instant case, the CIR does not dispute that the interest payments were made by Picop on loans *incurred in connection with the carrying on of the registered operations of Picop*, i.e., the financing of the purchase of machinery and equipment actually used in the registered operations of Picop. Neither does the CIR deny that such interest payments were *legally due and demandable* under the terms of such loans, and in fact paid by Picop during the tax year 1977.

The CIR has been unable to point to any provision of the 1977 Tax Code or any other statute that requires the disallowance of the interest payments made by Picop. The CIR invokes Section 79 of Revenue Regulations No. 2 as amended which reads as follows:

"Section 79. *Interest on Capital. Interest* calculated for cost-keeping or other purposes on account of capital or surplus invested in the business, *which does not represent a charge arising under an interest-bearing obligation*, is *not* allowable deduction from gross income." (Italics supplied)

---

[20] Section 30 (b)(1) of the 1977 Tax Code is now Section 29 (b)(1) of the present Tax Code which provides:

"(b) *Interest.* (1) *In general.* The amount of *interest paid or accrued* within a taxable year *on indebtedness in connection with the taxpayer's* profession, trade or *business*, except on indebtedness incurred or continued to purchase or carry obligation the interest upon which is exempt from taxation as income under this Title." (Italics supplied)

Supreme Court E-Library

We read the above provision of Revenue Regulations No. 2 as referring to so called "theoretical interest," that is to say, interest "*calculated*" or computed (and not *incurred* or *paid*) for the purpose of determining the "opportunity cost" of investing funds in a given business. Such "theoretical" or imputed interest does *not* arise from a legally demandable interest-bearing obligation incurred by the taxpayer who however wishes to find out, e.g., whether he would have been better off by lending out his funds and earning interest rather than investing such funds in his business. One thing that Section 79 quoted above makes clear is that interest which does constitute a charge arising under an interest-bearing obligation *is* an allowable deduction from gross income.

It is claimed by the CIR that Section 79 of Revenue Regulations No. 2 was "patterned after" paragraph 1.266-1 (b), entitled "Taxes and Carrying Charges Chargeable to Capital Account and Treated as Capital Items" of the U.S. Income Tax Regulations, which paragraph reads as follows:

"(B) *Taxes and Carrying Charges*. The items thus chargeable to capital accounts are

(11) In the case of real property, whether improved or unimproved and whether productive or nonproductive.

(a) Interest on a loan (but not theoretical interest of a taxpayer using his own funds)."[21]

The truncated excerpt of the U.S. Income Tax Regulations quoted by the CIR needs to be related to the relevant provisions of the U.S. Internal Revenue Code, which provisions deal with the general topic of adjusted basis for determining allowable gain or loss on sales or exchanges of property and allowable depreciation and depletion of capital assets of the taxpayer:

---

[21] As quoted in Court of Appeals Decision, *Rollo*, pp. 42-43.

Supreme Court E-Library

"*Present Rule.* The Internal Revenue Code, and the Regulations promulgated thereunder provide that '*No deduction shall be allowed for amounts paid* or accrued *for* such taxes and *carrying charges* as, under regulations prescribed by the Secretary or his delegate, are chargeable to capital account with respect to property, *if the taxpayer elects*, in accordance with such regulations, *to treat such* taxes or *charges as so chargeable.*'

At the same time, under the adjustment of basis provisions which have just been discussed, it is provided that adjustment shall be made for all 'expenditures, receipts, losses, or other items' properly chargeable to a capital account, thus including taxes and carrying charges; however, *an exception exists, in which event such adjustment to the capital account is not made, with respect to* taxes and *carrying charges which the taxpayer has not elected to capitalize but for which a deduction instead has been taken.*"[22] (Italics supplied)

The "carrying charges" which may be capitalized under the above quoted provisions of the U.S. Internal Revenue Code include, as the CIR has pointed out, interest on a loan "(but not theoretical interest of a taxpayer using his own funds)." What the CIR failed to point out is that *such "carrying charges" may*, at the election of the taxpayer, *either be (a) capitalized* in which case the cost basis of the capital assets, *e.g.*, machinery and equipment, will be adjusted by adding the amount of such interest payments *or*, alternatively, be *(b) deducted from gross income* of the taxpayer. Should the taxpayer elect to deduct the interest payments against its gross income, the taxpayer cannot *at the same time* capitalize the interest payments. In other words, the taxpayer is *not* entitled to *both the deduction from gross income and the adjusted (increased) basis* for determining gain or loss and the allowable depreciation charge. The U.S. Internal Revenue Code *does not prohibit the deduction of interest on a loan*

---

[22] Mertens, Law of Federal Income Taxation, Vol. 3A, § 21.233, p. 563 (Rev. Zimet and Weiss, 1958); citations omitted.

Supreme Court E-Library

obtained for purchasing machinery and equipment against gross income, *unless* the taxpayer has *also or previously capitalized the same interest payments* and thereby adjusted the cost basis of such assets.

We have already noted that our 1977 NIRC does *not* prohibit the deduction of interest on a loan incurred for acquiring machinery and equipment. Neither does our 1977 NIRC compel the capitalization of interest payments on such a loan. The 1977 Tax Code is simply silent on a taxpayer's right to elect one or the other tax treatment of such interest payments. Accordingly, the general rule that interest payments on a legally demandable loan are deductible from gross income must be applied.

The CIR argues finally that to allow Picop to deduct its interest payments against its gross income would be to encourage fraudulent claims to double deductions from gross income:

"[t]o allow a deduction of incidental expense/cost incurred in the purchase of fixed asset in the year it was incurred would *invite tax evasion* through *fraudulent application of double deductions from a gross income*."[23] (Italics supplied)

The Court is not persuaded. So far as the records of the instant cases show, Picop has not claimed to be entitled to double deduction of its 1977 interest payments. The CIR has neither alleged nor proved that Picop had previously adjusted its cost basis for the machinery and equipment purchased with the loan proceeds by capitalizing the interest payments here involved. The Court will not assume that the CIR would be unable or unwilling to disallow "a double deduction" should Picop, having deducted its interest cost from its gross income, also attempt subsequently to adjust upward the cost

---

[23] CIR Memorandum, *Rollo*, p. 218.

Supreme Court E-Library

basis of the machinery and equipment purchased and claim, e.g., increased deductions for depreciation.

We conclude that the CTA and the Court of Appeals did not err in allowing the deductions of Picop's 1977 interest payments on its loans for capital equipment against its gross income for 1977.

(2) Whether Picop is entitled to deduct against current income net operating losses incurred by Rustan Pulp and Paper Mills, Inc.

On 18 January 1977, Picop entered into a merger agreement with the Rustan Pulp and Paper Mills, Inc. ("RPPM") and Rustan Manufacturing Corporation ("RMC"). Under this agreement, the rights, properties, privileges, powers and franchises of RPPM and RMC were to be transferred, assigned and conveyed to Picop as the surviving corporation. The entire subscribed and outstanding capital stock of RPPM and RMC would be exchanged for 2,891,476 fully paid up Class "A" common stock of Picop (with a par value of P10.00) and 149,848 shares of preferred stock of Picop (with a par value of P10.00), to be issued by Picop , the result being that Picop would wholly own both RPPM and RMC while the stockholders of RPPM and RMC would join the ranks of Picop's shareholders. In addition, Picop paid off the obligations of RPPM to the Development Bank of the Philippines ("DBP") in the amount of P68,240,340.00, by issuing 6,824,034 shares of preferred stock (with a par value of P10.00) to the DBP. The merger agreement was approved in 1977 by the creditors and stockholders of Picop, RPPM and RMC and by the Securities and Exchange Commission. Thereupon, on 30 November 1977, apparently the effective date of merger, RPPM and RMC were dissolved. The Board of Investments approved the merger agreement on 12 January 1978.

Supreme Court E-Library

It appears that RPPM and RMC were, like Picop, BOI-registered companies. Immediately before merger effective date, RPPM had over preceding years accumulated losses in the total amount of P81,159,904.00. In its 1977 Income Tax Return, Picop claimed P44,196,106.00 of RPPM's accumulated losses as a deduction against Picop's 1977 gross income.[24]

Upon the other hand, even before the effective date of merger, on 30 August 1977, Picop sold all the outstanding shares of RMC stock to San Miguel Corporation for the sum of P38,900,000.00, and reported a gain of P9,294,849.00 from this transaction.[25]

In claiming such deduction, Picop relies on Section 7 (c) of R.A. No. 5186 which provides as follows:

"Section 7. *Incentives to Registered Enterprise.*— A registered enterprise, *to the extent engaged in a preferred area of investment,*

---

[24] The Report of the BIR Examiners on Picop, dated 25 November 1982, to the CIR, concerning Picop's 1977 Income Tax, set down Picop's total claim for deduction of losses in the following terms:

"RPPMI Previous Losses at Merger Date	P81,159,904.00
Less: Deductions claimed in 1977	44,196,106.00
Balance	P36,966,798.00
Deductions claims in 1977	P44,196,106.00
Carry forward in 1975 los	136,874.00
Total Claimed in 1977 per Reconciliation in Income Tax Return	P44,332,984.00"

(Record of CTA Case No. 3843, p. 128.)

The item "Carry forward in 1975 loss" appears to refer to operating loss previously incurred by Picop and is not really in dispute in the instant case. In the subsequent pages, therefore, we deal only with the propriety of the deduction of P44,196,106.00 of accumulated losses incurred by RPPM prior to merger effective date.

[25] Note 12 of the Audited Financial Statements of Picop for the years ended 31 December 1978 and 1977; Records of CTA Case No. 3843, p. 84.

Supreme Court E-Library

shall be granted the following incentive benefits:

x x x x x x x x x

(c) *Net Operating Loss Carry-over. A net operating loss incurred in any of the first ten years of operations may be carried over as a deduction from taxable income for the six years immediately following the year of such* loss. The entire amount of the loss shall be carried over to the first of the six taxable years following the loss, and any portion of such loss which exceeds the taxable income of such first year shall be deducted in like manner from the taxable income of the next remaining five years. *The net operating loss shall be computed in accordance with the provisions of the National Internal Revenue Code, any provision of this Act to the contrary notwithstand*ing, except that income not taxable either in whole or in part under this or other laws shall be included in gross income." (Italics supplied)

Picop had secured a letter-opinion from the BOI dated 21 February 1977 that is, after the date of the agreement of merger but before the merger became effective relating to the deductibility of the previous losses of RPPM under Section 7 (c) of R.A. No. 5186 as amended. The pertinent portions of this BOI opinion, signed by BOI Governor Cesar Lanuza; read as follows:

"*2) PICOP will not be allowed to carry over the losses of Rustan prior to the legal dissolution of the latter because at that time the two (2) companies still had separate legal personalit*ies;

3) After BOI approval of the merger, PICOP can no longer apply for the registration of the registered capacity of Rustan because with the approved merger, such registered capacity of Rustan transferred to PICOP will have the same registration date as that of Rustan. In this case, *the previous losses of Rustan may be carried over by PICOP, because with the merger, PICOP assumes all the rights and obligations of Rustan subject, however, to the period prescribed for carrying over of such losse*s"[26] (Italics supplied)

[26] *Rollo*, p. 36.

Supreme Court E-Library

Curiously enough, Picop did not also seek a ruling on this matter, clearly a matter of tax law, from the Bureau of Internal Revenue. Picop chose to rely solely on the BOI letter-opinion.

The CIR disallowed all the deductions claimed on the basis of RPPM's losses, apparently on two (2) grounds. Firstly, the previous losses were incurred by *"another taxpay*er," RPPM, and not by Picop in connection with Picop's own registered operations. The CIR took the view that Picop , RPPM and RMC were merged into one (1) corporate personality only on 12 January 1978, upon approval of the merger agreement by the BOI. Thus, during the taxable year 1977, Picop on the one hand and RPPM and RMC on the other, still had their separate juridical personalities. Secondly, the CIR alleged that these losses had been incurred by RPPM "from the borrowing of funds" and not from carrying out of RPPM's registered operations. We focus on the first ground.[27]

The CTA upheld the deduction claimed by Picop; its reasoning, however, is less than crystal clear, especially in respect of its view of what the U.S. tax law was on this matter. In any event, the CTA apparently fell back on the BOI opinion of 21 February 1977 referred to above. The CTA said:

"Respondent further averred that the incentives granted under Section 7 of R.A. No. 5186 shall be available only to the extent in which they are engaged in registered operations, citing Section 1 of Rule IX of the Basic Rules and Regulations to Implement the

[27] The CIR failed to explain the second ground and, so far as we have been able to determine, the record furnishes no indication as to why or on what basis the CIR took this view. The CIR may have been trying to distinguish between losses arising from operations (*e.g.*, manufacturing, marketing, etc.) as distinguished from losses resulting from payment of amortizations on loans obtained from third parties: operating revenues being offset or wiped out by interest expense and payments on principals of loans. This, however. can only be speculated upon.

Supreme Court E-Library

Intent and Provisions of the Investment Incentives Act, R.A. No. 5186.

We disagree with respondent. The purpose of the merger was to rationalize the container board industry and not to take advantage of the net losses incurred by RPPMI prior to the stock swap. Thus, when stock of a corporation is purchased in order to take advantage of the corporation's net operating loss incurred in years prior to the purchase, the corporation thereafter entering into a trade or business different from that in which it was previously engaged, *the net operating loss carry-over may be entirely lost.* [IRC (1954), Sec. 382(a), Vol. 5, Mertens, Law of Federal Income Taxation, Chap. 29.11a, p. 103].[28] Furthermore, once the BOI approved the merger agreement, the registered capacity of Rustan shall be transferred to PICOP, and the previous losses of Rustan may be carried over by PICOP by operation of law. [BOI ruling dated February 21, 1977 (Exh. J-1)] It is clear therefrom, that the deduction availed of under Section 7(c) of R.A. No. 5186 was only proper." (pp. 38-43, *Rollo* of SP No. 20070)"[29] (Italics supplied)

In respect of the above underscored portion of the CTA decision, we must note that the CTA in fact overlooked the statement made by petitioner's counsel before the CTA that:

"Among the attractions of the merger to Picop was the accumulated net operating loss carry-over of RMC that it might possibly use to relieve it (Picop) from its income taxes, under Section 7 (c) of R.A. 5186. Said section provides:

x x x x x x x x x

With this benefit in mind, Picop addressed three (3) questions to the BOI in a letter dated November 25, 1976. The BOI replied on February 21, 1977 directly answering the three (3) queries."[30] (Italics supplied)

---

[28] Here the CTA appeared to be arguing against itself.

[29] *Rollo*, p. 38.

[30] Memorandum for petitioner Picop in CTA Case No. 3843, p. 12; Record of CTA Case No. 3843.

Supreme Court E-Library

The size of RPPM's accumulated losses as of the date of the merger more than P81,000,000.00 must have constituted a powerful attraction indeed for Picop.

The Court of Appeals followed the result reached by the CTA. The Court of Appeals, much like the CTA, concluded that since RPPM was dissolved on 30 November 1977, its accumulated losses were appropriately carried over by Picop in the latter's 1977 Income Tax Return "because by that time RPPMI and Picop were no longer separate and different taxpayers."[31]

After prolonged consideration and analysis of this matter, the Court is unable to agree with the CTA and Court of Appeals on the deductibility of RPPM's accumulated losses against Picop's 1977 gross income.

It is important to note at the outset that in our jurisdiction, the ordinary rule that is, the rule applicable in respect of corporations not registered with the BOI as a preferred pioneer enterprise is that *net operating losses cannot be carried over*. Under our Tax Code, both in 1977 and at present, losses may be deducted from gross income only if such losses were actually sustained in the same year that they are deducted or charged off. Section 30 of the 1977 Tax Code provides:

"Sec. 30. *Deductions from Gross Income*.— In computing net income, there shall be allowed as deduction

x x x x x x x x x

(*d*) *Losses*:

(*1*) *By Individuals*.— In the case of an individual, losses *actually sustained during the taxable year* and not compensated for by an insurance or otherwise

(A) If incurred in trade or business;

---

[31] Court of Appeals Decision, p. 12; *Rollo*, p. 39.

Supreme Court E-Library

x x x x x x x x x

(*2*) *By Corporations.*— In a case of a corporation, all losses *actually sustained and charged off within the taxable year* and not compensated for by insurance or otherwise.

(3) *By Non-resident Aliens or Foreign Corporations.* In the case of a non-resident alien individual or a foreign corporation, the losses deductible are those *actually sustained during the year* incurred in business or trade conducted *within the Philippines*, x x x."[32] (Italics supplied)

Section 76 of the Philippine Income Tax Regulations (Revenue Regulation No. 2, as amended) is even more explicit and detailed:

"Section. 76. *When charges are deductible.*— Each year's return, so far as practicable, both as to gross income and deductions therefrom should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. *The expenses*, liabilities, *or deficit of one year cannot be used to reduce the income of a subsequent year.* A taxpayer has the right to deduct all authorized allowances and it follows that *if he does not within any year deduct certain of his expenses, losses*, interests, taxes, or other charges, *he can not deduct them from the income of the next or any succeeding year.* x x x

x x x x x x x x x

x x x. If subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year *which has not been deducted from gross income*, he may render *an amended return for such preceding taxable year* including such amount of loss in the deduction from gross income and may

---

[32] Note that the 1977 Tax Code allows a net *capital loss* carry-over to the succeeding taxable year, for a taxpayer "*other than a corporation*"; Section 34 (d).

The corresponding provisions in the current Tax Code are Section 29 (d)(1) and (2) and Section 33 (d).

Supreme Court E-Library

in proper cases file a *claim for refund of the excess paid by reason of the failure to deduct such loss in the original return.* A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained." (Italics supplied)

It is thus clear that under our law, and outside the special realm of BOI-registered enterprises, there is no such thing as a carry-over of net operating loss. To the contrary, *losses must be deducted* against current income *in the taxable year when such losses were incurred.* Moreover, such losses may be charged off *only against income earned in the same taxable year when the losses were incurred.*

Thus it is that R.A. No. 5186 introduced the carry-over of net operating losses as a *very special incentive* to be granted only to registered pioneer enterprises and only with respect to their registered operations. The statutory purpose here may be seen to be the encouragement of the establishment and continued operation of pioneer industries by allowing the registered enterprise to accumulate its operating losses which may be expected during the early years of the enterprise and to permit the enterprise to offset such losses against income earned by it in later years after successful establishment and regular operations. To promote its economic development goals, the Republic foregoes or defers taxing the income of the pioneer enterprise until after that enterprise has recovered or offset its earlier losses. We consider that the statutory purpose can be served only if the accumulated operating losses are carried over and charged off against income subsequently earned and accumulated *by the same enterprise engaged in the same registered operations.*

In the instant case, to allow the deduction claimed by Picop would be to permit one corporation or enterprise, Picop, to benefit from the operating losses accumulated by another corporation or enterprise, RPPM. RPPM far from benefitting from the tax incentive granted by the BOI statute,

Supreme Court E-Library

in fact gave up the struggle and went out of existence and its former stockholders joined the much larger group of Picop's stockholders. To grant Picop's claimed deduction would be to permit Picop to shelter its otherwise taxable income (an objective which Picop had from the very beginning) which had not been earned by the registered enterprise which had suffered the accumulated losses. In effect, to grant Picop's claimed deduction would be to permit Picop to purchase a tax deduction and RPPM to peddle its accumulated operating losses. Under the CTA and Court of Appeals decisions, Picop would benefit by immunizing P44,196,106.00 of its income from taxation thereof although Picop had not run the risks and incurred the losses which had been encountered and suffered by RPPM. Conversely, the income that would be shielded from taxation is not income that was, after much effort, eventually generated by the same registered operations which earlier had sustained losses. We consider and so hold that there is nothing in Section 7 (c) of R. A. No. 5186 which either requires or permits such a result. Indeed, that result makes non-sense of the legislative purpose which may be seen clearly to be projected by Section 7 (c), R.A. No. 5186.

The CTA and the Court of Appeals allowed the offsetting of RPPM's accumulated operating losses against Picop's 1977 gross income, basically because towards the end of the taxable year 1977, upon the arrival of the effective date of merger, only one (1) corporation, Picop, remained. The losses suffered by RPPM's registered operations and the gross income generated by Picop's own registered operations now came under one and the same corporate roof. We consider that this circumstance relates much more to form than to substance. We do not believe that that single purely technical factor is enough to authorize and justify the deduction claimed by Picop. Picop's claim for deduction is not only bereft of statutory basis; it does violence to the legislative intent which animates the tax incentive granted by Section 7

Supreme Court E-Library

(c) of R.A. No. 5186. In granting the extraordinary privilege and incentive of a net operating loss carry-over to BOI-registered pioneer enterprises, the legislature could not have intended to require the Republic to forego tax revenues in order to benefit a corporation which had run no risks and suffered no losses, but had merely purchased another's losses.

Both the CTA and the Court of Appeals appeared much impressed not only with corporate technicalities but also with the U.S. tax law on this matter. It should suffice, however, simply to note that in U.S. tax law, the availability to companies generally of operating loss carry-overs and of operating loss carry-backs is *expressly provided and regulated in great detail by statute*.[33] In our jurisdiction, save for

[33] See USCA, Title 26, 172; U.S. Internal Revenue Code of 1986.

In the United States although the U.S. Internal Revenue Code expressly provides for loss carry-overs and loss carry-backs for business corporations generally, *federal courts have looked well beyond simple corporate formalities in determining the deductibility by one corporation of losses accumulated by another (merged) corporation*. In this connection, it is instructive to consider Libson Shops, Incorporated *v.* Koehler, 353 U.S 382, 1 L. Ed. 2nd 924 (1957), affirming 229 F. 2nd 220 (CA 8th, 1956). The summary in Mertens, Law of Federal Taxation, Vol. 5, Section 29.11c, pp. 124-125, is helpful:

> "The District Court and the Court of Appeals denied such carry-over of the pre-merger losses against post-merger profits, on the ground that the corporation surviving the merger was not the same 'taxpayer' as the corporations which had sustained the losses. The Supreme Court affirmed the holding of the lower courts, and likewise said that the controversy centered on the meaning of 'the taxpayer,' and that 'The contentions of the parties require us to decide whether it can be said that petitioner, a combination of 16 sales businesses, is "the taxpayer" having the pre-merger losses of three of those businesses.' In deciding this question, however, the [U.S.] *Supreme Court relied on a theory of business continuity* which it considered dispositive of the case, referring to the following contention: '*The Government contends that the carry-over privilege is not available unless there is a continuity of business enterprise*. It argues that *the prior year's*

Supreme Court E-Library

Section 7 (c) of R.A. No. 5186, no statute recognizes or permits loss carry-overs and loss carry-backs. Indeed, as already noted, our tax law expressly rejects the very notion of loss carry-overs and carry-backs.

We conclude that the deduction claimed by Picop in the amount of P44,196,106.00 in its 1977 Income Tax Return must be disallowed.

(3) Whether Picop is entitled to deduct against current income certain claimed financial guarantee expenses.

In its Income Tax Return for 1977, Picop also claimed a deduction in the amount of P1,237,421.00 as financial guarantee expenses.

---

loss can be offset against the current year's income only to the extent that this income is derived from the operation of substantially the same business which produced the loss. Only to that extent is the same "taxpayer" involved.' *The Court concluded 'that petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced by substantially the same businesses which incurred the losses.'"*

See further, *id.*, pp. 127-128:

"x x x The decision of the Supreme Court in the Libson Shops case has made it clear that *where a net operating loss is sustained by a corporation prior to its merger with another corporation and the business of the loss corporation becomes a unit of the business conducted by the surviving corporation*, such pre-merger losses may *not* be used to offset the income of other units of the surviving corporation which prior to the merger were operated by the other corporation *because the income against which the offset is made was not produced by substantially the same business which incurred the losses.* And *such rule has been applied even though the corporation which sustained the losses is the corporation surviving the merger.* x x x" (Citations omitted; italics supplied)

Libson Shops has been followed in numerous other U.S. cases collected in *id.*, pp. 124 *et seq.*

Supreme Court E-Library

This deduction is said to relate to chattel and real estate mortgages required from Picop by the Philippine National Bank ("PNB") and DBP as guarantors of loans incurred by Picop from foreign creditors. According to Picop, the claimed deduction represents registration fees and other expenses incidental to registration of mortgages in favor of DBP and PNB.

In support of this claimed deduction, Picop allegedly showed its own vouchers to BIR Examiners to prove disbursements to the Register of Deeds of Tandag, Surigao del Sur, of particular amounts. In the proceedings before the CTA, however, Picop did not submit in evidence such vouchers and instead presented one of its employees to testify that the amount claimed had been disbursed for the registration of chattel and real estate mortgages.

The CIR disallowed this claimed deduction upon the ground of insufficiency of evidence. This disallowance was sustained by the CTA and the Court of Appeals. The CTA said:

"No records are available to support the above mentioned expenses. The vouchers merely showed that the amounts were paid to the Register of Deeds and simply cash account. *Without the supporting papers such as the invoices or official receipts of the Register of Deeds, these vouchers standing alone cannot prove that the payments made were for the accrued expenses in question. The best evidence of payment is the official receipts issued by the Register of Deeds*. The testimony of petitioner's witness that the official receipts and cash vouchers were shown to the Bureau of Internal Revenue will not suffice if no records could be presented in court for proper marking and identification."[34] (Italics supplied)

The Court of Appeals added:

---

[34] CTA Decision, CTA Case No. 3843, p. 22; *Rollo*, p. 75.

Supreme Court E-Library

"The mere testimony of a witness for PICOP and the cash vouchers do not suffice to establish its claim that registration fees were paid to the Register of Deeds for the registration of real estate and chattel mortgages in favor of Development Bank of the Philippines and the Philippine National Bank as guarantors of PICOP's loans. The witness could very well have been merely repeating what he was instructed to say regardless of the truth, while the cash vouchers, which we do not find on file, are not said to provide the necessary details regarding the nature and purpose of the expenses reflected therein. *PICOP should have presented, through the guarantors, its owner's copy of the registered titles with the lien inscribed thereon as well as an official receipt from the Register of Deeds evidencing payment of the registration fee.*"[35] (Italics supplied)

We must support the CTA and the Court of Appeals in their foregoing rulings. A taxpayer has the burden of proving entitlement to a claimed deduction.[36] In the instant case, even Picop's own vouchers were not submitted in evidence and the BIR Examiners denied that such vouchers and other documents had been exhibited to them. Moreover, cash vouchers can only confirm the fact of disbursement but not necessarily the purpose thereof.[37] The best evidence that Picop should have presented to support its claimed deduction were the invoices and official receipts issued by the Register of Deeds. Picop not only failed to present such documents; it also failed to explain the loss thereof, assuming they had

---

[35] Court of Appeals Decision, pp. 23-24; *Rollo*, pp. 50-51.

[36] Commissioner of Internal Revenue *v.* Construction Resources of Asia, Inc., 145 SCRA 671 (1986); Atlas Consolidated Mining and Development Corporation *v.* Commissioner of Internal Revenue, 102 SCRA 246 (1981); Consolidated Mines *v.* Court of Tax Appeals, 58 SCRA 618 (1974).

[37] Consolidated Mines *v.* Court of Tax Appeals, 58 SCRA 618 (1974).

Supreme Court E-Library

existed before.[38] Under the best evidence rule,[39] therefore, the testimony of Picop's employee was inadmissible and was in any case entitled to very little, if any, credence.

We consider that entitlement to Picop's claimed deduction of P1,237,421.00 was not adequately shown and that such deduction must be disallowed.

III

(1) Whether Picop had understated its sales and overstated its cost of sales for 1977.

In its assessment for deficiency income tax for 1977, the CIR claimed that Picop had understated its sales by P2,391,644.00 and, upon the other hand, overstated its cost of sales by P604,018.00. Thereupon, the CIR added back both sums to Picop's net income figure per its own return.

The 1977 Income Tax Return of Picop set forth the following figures:

Sales (per Picop's Income Tax Return):

Paper	P537,656,719.00
Timber	P263,158,132.00
Total Sales	P800,814,851.00

Upon the other hand, Picop's Books of Accounts reflected higher sales figures:

Sales (per Picop's Books of Accounts):

---

[38] See TSN (CTA Case No. 3843), 17 October 1985, pp. 17-20.

[39] Sections 3 and 5, Rule 130, Rules of Court. See, *e.g.*, People *v.* Dismuke, 234 SCRA 51 (1994); Ong Ching Po *v.* Court of Appeals, 239 SCRA (1994); De Vera *v.* Aguilar, 218 SCRA 602 (1993); Lazatin *v.* Campos, 92 SCRA 250 (1979).

Supreme Court E-Library

Paper	P537,656,719.00
Timber	P265,549,776.00
Total Sales	P803,206,495.00

The above figures thus show a discrepancy between the sales figures reflected in Picop's Books of Accounts and the sales figures reported in its 1977 Income Tax Return, amounting to: P2,391,644.00.

The CIR also contended that Picop's cost of sales set out in its 1977 Income Tax Return, when compared with the cost figures in its Books of Accounts, was overstated:

Cost of Sales (per Income Tax Return)	P607,246,084.00
Cost of Sales (per Books of Accounts)	P606,642,066.00
Discrepancy	P 604,018.00

Picop did not deny the existence of the above noted discrepancies. In the proceedings before the CTA, Picop presented one of its officials to explain the foregoing discrepancies. That explanation is perhaps best presented in Picop's own words as set forth in its Memorandum before this Court:

"x x x that the adjustment discussed in the testimony of the witness, represent the best and most objective method of determining in pesos the amount of the correct and actual export sales during the year. It was this correct and actual export sales and costs of sales that were reflected in the income tax return and in the audited financial statements. These corrections did not result in realization of income and should not give rise to any deficiency tax.

x x x x x x x x x

What are the facts of this case on this matter? Why were adjustments necessary at the year-end?

Supreme Court E-Library

Because of PICOP's procedure of recording its export sales (reckoned in U.S. dollars) on the basis of a fixed rate, day to day and month to month, regardless of the actual exchange rate and without waiting when the actual proceeds are received. In other words, PICOP recorded its export sales at a pre-determined fixed exchange rate. That pre-determined rate was decided upon at the beginning of the year and continued to be used throughout the year.

At the end of the year, the external auditors made an examination. In that examination, the auditors determined with accuracy the actual dollar proceeds of the export sales received. What exchange rate was used by the auditors to convert these actual dollar proceeds into Philippine pesos? They used the average of the differences between (a) the recorded fixed exchange rate and (b) the exchange rate at the time the proceeds were actually received. It was this rate at time of receipt of the proceeds that determined the amount of pesos credited by the Central Bank (through the agent banks) in favor of PICOP. These accumulated differences were averaged by the external auditors and this was what was used at the year-end for income tax and other government-report purposes. (T.s.n., Oct. 17/85, pp. 20-25)"[40]

The above explanation, unfortunately, at least to the mind of the Court, raises more questions than it resolves. Firstly, the explanation assumes that all of Picop's sales were export sales for which U.S. dollars (or other foreign exchange) were received. It also assumes that the expenses summed up as "cost of sales" were all dollar expenses and that no peso expenses had been incurred. Picop's explanation further assumes that a substantial part of Picop's dollar proceeds for its export sales were not actually surrendered to the domestic banking system and seasonably converted into pesos; had all such dollar proceeds been converted into pesos then the peso figures could have been simply added up to reflect the actual peso value of Picop's export sales. Picop offered no evidence in respect of these assumptions, no explanation why and how

[40] *Rollo*, pp. 175-176.

Supreme Court E-Library

a "pre-determined fixed exchange rate" was chosen at the beginning of the year and maintained throughout. Perhaps more importantly, Picop was unable to explain why its Books of Accounts did not pick up the same adjustments that Picop's External Auditors were alleged to have made for purposes of Picop's Income Tax Return. Picop attempted to explain away the failure of its Books of Accounts to reflect the same adjustments (no correcting entries, apparently) simply by quoting a passage from a case where this Court refused to ascribe much probative value to the Books of Accounts of a corporate taxpayer in a tax case.[41] What appears to have eluded Picop, however, is that its Books of Accounts, which are kept by its own employees and are prepared under its control and supervision, reflect what may be deemed to be admissions against interest in the instant case. For Picop's Books of Accounts precisely show *higher* sales figures and *lower* cost of sales figures than Picop's Income Tax Return.

It is insisted by Picop that its Auditors' adjustments simply present the "best and most objective" method of reflecting in pesos the "correct and *ACTUAL* export sales"[42] and that the adjustments or "corrections" "did not result in realization of [additional] income and should not give rise to any deficiency tax." The correctness of this contention is not self-evident. So far as the record of this case shows, Picop did not submit in evidence the aggregate amount of its U.S. dollar proceeds of its export sales; neither did it show the Philippine pesos it had actually received or been credited for such U.S. dollar proceeds. It is clear to this Court that the testimonial evidence submitted by Picop fell far short of demonstrating the correctness of its explanation.

---

[41] Consolidated Mines, Inc. *v.* Court of Tax Appeals, et al., 58 SCRA 618, 637 (1974).

[42] Picop's Memorandum, *Rollo*, p, 177.

Supreme Court E-Library

Upon the other hand, the CIR has made out at least a *prima facie* case that Picop had understated its sales and overstated its cost of sales as set out in its Income Tax Return. For the CIR has a right to assume that Picop's Books of Accounts speak the truth in this case since, as already noted, they embody what must appear to be admissions against Picop's own interest.

Accordingly, we must affirm the findings of the Court of Appeals and the CTA.

(2) Whether Picop is liable for the corporate development tax of five percent (5%) of its income for 1977.

The five percent (5%) corporate development tax is an additional corporate income tax imposed in Section 24 (e) of the 1977 Tax Code which reads in relevant part as follows:

"(e) *Corporate development tax.* In addition to the tax imposed in subsection (a) of this section, an additional tax in an amount equivalent to 5 per cent of the same taxable net income shall be paid by a domestic or a resident foreign corporation; Provided, That this additional tax shall be imposed only if the net income exceeds 10 per cent of the net worth, in case of a domestic corporation, or net assets in the Philippines in case of a resident foreign corporation: x x x.

The additional corporate income tax imposed in this subsection shall be collected and paid at the same time and in the same manner as the tax imposed in subsection (a) of this section."

Since this five percent (5%) corporate development tax is an *income* tax, Picop is not exempted from it under the provisions of Section 8 (a) of R.A. No. 5186.

For purposes of determining whether the net income of a corporation exceeds ten percent (10%) of its net worth, the term "net worth" means the stockholders' equity represented

Supreme Court E-Library

by the excess of the total assets over liabilities as reflected in the corporation's balance sheet provided such balance sheet has been prepared in accordance with generally accepted accounting principles employed in keeping the books of the corporation.[43]

The adjusted net income of Picop for 1977, as will be seen below, is P48,687,355.00. Its net worth figure or total stockholders' equity as reflected in its Audited Financial Statements for 1977 is P464,749,528.00. Since its adjusted net income for 1977 thus exceeded ten percent (10%) of its net worth, Picop must be held liable for the five percent (5%) corporate development tax in the amount of P2,434,367.75.

Recapitulating, we hold:

(1) Picop is liable for the thirty-five percent (35%) transaction tax in the amount of P3,578,543.51.

(2) Picop is not liable for interest and surcharge on unpaid transaction tax.

(3) Picop is exempt from payment of documentary and science stamp taxes in the amount of P300,000.00 and the compromise penalty of P300.00.

(4) Picop is entitled to its claimed deduction of P42,840,131.00 for interest payments on loans for, among other things, the purchase of machinery and equipment.

(5) Picop's claimed deduction in the amount of P44,196,106.00 for the operating losses previously incurred by RPPM, is disallowed for lack of merit.

(6) Picop's claimed deduction for certain financial guarantee expenses in the amount P1,237,421.00 is disallowed for failure adequately to prove such expenses.

---

[43] Section 2, Revenue Regulations No. 11-77.

Supreme Court E-Library

(7) Picop has understated its sales by P2,391,644.00 and overstated its cost of sales by P604,018.00, for 1977.

(8) Picop is liable for the corporate development tax of five percent (5%) of its adjusted net income for 1977 in the amount of P2,434,367.75.

Considering conclusions nos. 4, 5, 6, 7 and 8, the Court is compelled to hold Picop liable for deficiency income tax for the year 1977 computed as follows:

Deficiency Income Tax

Net Income Per Return		P 258,166.00
Add:		
Unallowable Deductions		
(1) Deduction of net operating losses incurred by RPPM	P 44,196,106.00	
(2) Unexplained financial guarantee expenses	P 1,237,421.00	
(3) Understatement of Sales	P 2,391,644.00	
(4) Overstatement of Cost of Sales	P 604,018.00	
Total		P48,429,189.00
Net Income as Adjusted		P48,687,355.00
Income Tax Due Thereon[44]		P17,030,574.00
Less:		
Tax Already Assessed per Return		80,358.00
Deficiency Income Tax		P16,560,216.00
Add:		
Five percent (5%) Corporate Development Tax		P 2,434,367.00

[44] Section 24 (a), 1977 Tax Code.

Supreme Court E-Library

Total Deficiency Income Tax	P18,994,583.00
Add:	
Five percent (5%) surcharge[45]	P 949,729.15
Total Deficiency Income Tax with surcharge	P19,944,312.15
Add:	
Fourteen percent (14%) interest from 15 April 1978 to 14 April 1981[46]	P 8,376,610.80
Fourteen percent (14%) interest from. 21 April 1983 to 20 April 1986[47]	P11,894,787.00

---

[45] Section 51 (e)(3), 1977 Income Tax Code imposed a five percent (5%) surcharge on "the amount of tax unpaid," excluding interest (Commissioner of Internal Revenue *v.* Air India, et al., 157 SCRA 648, 659 [1988]; see *Vitug, Compendium of Tax Law and Jurisprudence*, 139 [1st ed., 1984]).

[46] Section 51 (d), 1977 Income Tax Code.

[47] Section 51 (e)(2), 1977 Income Tax Code imposed fourteen percent (14%) interest "upon the unpaid amount," (deficiency tax plus surcharge plus interest under Section 51 [d]) computed from the "date of such notice and demand"; see, in this connection, the *Air India* case where the Court clearly distinguished between interest due under Section 51 (d) and that due under Section 51 (e)(2), 1977 Tax Code.

Here, the assessment for deficiency income tax was received by Picop on 21 April 1983 (Record of Exhibits, CTA Case No. 3843). The second interest period (*i.e.*, under Section 51 [e][2]) accordingly began on 21 April 1983.

The Court of Appeals had applied the twenty percent (20%) interest rate and ten percent (10%) surcharge imposed under Section 51 (e) as amended by P.D. No. 1705 dated 1 August 1980. We do not believe, however, that the increased rates of surcharge and interest should be given retroactive application to the taxable year 1977. The Court of Appeals also failed to impose the penalty interest due under Section 51 (d) and imposed only the penalty interest due under Section 51 (e)(2). This is corrected now in the computation above.

Supreme Court E-Library

Total Deficiency Income Tax
Due and Payable P40,215,709.00

WHEREFORE, for all the foregoing, the Decision of the Court of Appeals is hereby MODIFIED and Picop is hereby ORDERED to pay the CIR the aggregate amount of P43,794,252.51 itemized as follows:

(1) Thirty-five percent (35%) transaction tax ..... P 3,578,543.51

(2) Total Deficiency Income Tax Due P40,215,709.00

Aggregate Amount Due and Payable P43,794,252.51

No pronouncement as to costs.

SO ORDERED.

Narvasa, C.J., Regalado, Davide, Jr., Romero, Bellosillo, Melo, Puno, Kapunan, Mendoza, Francisco, Hermosisima, Jr., and *Panganiban, JJ.*, concur.

Vitug, J., see concurring & dissenting opinion.

Padilla, J., took no part in view of personal holdings in PICOP.

VITUG, *J., concurring and dissenting opinion:*

In usual erudite manner, Mr. Justice Florentino P. Feliciano has written for the Court the *ponencia* that presents in clear and logical sequence the issues, the facts and the law involved. While I share, in most part, the conclusions expressed in the opinion, I regrettably find it difficult, nevertheless, not to propose a re-examination of the Court's holding in Western Minolco Corporation *vs.* Commissioner of Internal Revenue (124 SCRA 121), reiterated in Marinduque Mining and Industrial Corporation *vs.* Commissioner of Internal Revenue (137 SCRA 88), that has taken the 35% transaction tax on commercial papers issued in the primary market under the

Supreme Court E-Library

1977 Revenue Code, in relation to Republic Act ("R.A.") 5186, to be an income tax.

R.A. No. 5186, also known as the Investment Incentives Act, has provided for incentives by, among other things, granting to registered pioneer enterprises an exemption from all taxes, except income tax, under the National Internal Revenue Code. The income tax, referred to, in my view, is that imposed in Title II, entitled "Income Tax," of the Revenue Code. Nowhere under that title is there a 35% transaction tax.

There was, to be sure, a 35% transaction tax still in effect in 1977 but it was a tax *not on the investor-lender* in whose favor the interest income on the commercial paper accrues. The tax was, instead, *levied on the borrower-issuer* of commercial papers transacted in the primary market. Being the principal taxpayer, the borrower-issuer could not have been likewise contemplated to be a mere tax withholding agent. The tax was conceived as a tax on business transaction, and so it was rightly incorporated in Title V, entitled "Privilege Taxes on Business and Occupation" of the Tax Code.

The fact that a taxpayer on whom the tax is imposed can shift, characteristic of indirect taxes, the burden thereof to another does not make the latter the taxpayer and the former the withholding agent. Indeed, the facility of shifting the burden of the tax is opposed to the idea of a *direct* tax to which class the income tax actually belongs.

Accordingly, I vote to so reduce the tax liability of petitioners as adjudged by the amount corresponding to the 35% transaction tax. In all other respects, I concur with the majority in the judgment.