REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

METRO, INC., Petitioner,	**C.T.A. CASE NO. 6356**
	Members:
- versus -	**CASTAÑEDA, JR.,** *Chairperson* **UY,** *and* **PALANCA-ENRIQUEZ,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** JUN 09 2009 4:30 p.m.

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DECISION

CASTAÑEDA, JR., *J.*:

Before this Court is a Petition for Review praying for the cancellation and withdrawal of the disputed deficiency tax assessment in the amount of FIFTY MILLION THIRTY-SIX THOUSAND EIGHT HUNDRED ONE PESOS AND SEVENTY ONE CENTAVOS (P50,036,801.71) for taxable year 1997.

Petitioner is a domestic corporation organized and existing under the laws of the Republic of the Philippines, with principal office address at La Fuerza Compound, Alabang-Zapote Road, Almanza, Las Pinas, Metro Manila.[1]

[1] Par. 1, Facts Admitted, Joint Stipulation of Facts and Issues (JSFI), Docket, p. 80.

Respondent is the duly appointed Commissioner of Internal Revenue empowered to perform the duties of said office including, among others, the power to issue deficiency tax assessments issued against taxpayers, and to decide assessment protests. He holds office at the 5th Floor, Bureau of Internal Revenue (BIR) National Office Building, Agham Road, Diliman, Quezon City.

Petitioner received from Regional Director Lucien E. Sayuno of BIR Region No. 8 the Final Assessment Notice No. 0000069-97-01-710 dated January 17, 2001, for alleged deficiency taxes in the total amount of P50,036,801.71 for taxable year 1997, broken down as follows:[2]

I. Deficiency income tax:

Taxable net income per return				P 1,554,126.00
Add:	Discrepancy per Audit:			
	Undeclared Sales			P 14,623,102.84
	Overclaimed Expense			558,783.00
	Disallowed Expenses:			
		Interest & bank charges	P 4,886,275.00	
		Foreign Exchange loss	4,849,619.00	
		Bad debts	1,016,428.00	
		Miscellaneous	1,078,915.00	
		Factory overhead	44,984,730.84	56,815,967.94
Taxable Income				P 71,997,853.78
Tax Due				P 25,743,192.89
Less:	Tax Withheld/paid per return			543,944.00
Basic Deficiency Income Tax				P 25,199,248.89
Add:	Surcharge			6,299,812.22
	Interest 04-16-98 to 02-12-01			17,790,501.20
	Suggested Compromise Penalty			25,000.00
Total Amount Due				**P 49,314,562.31**

II. Withholding tax on compensation:

Tax Due -	January	P 107,264.72
	February	81,082.46
	November (117,861 - 111,861)	6,000.00

[2] Par. 5, Facts Admitted, JSFI, Docket, pp. 81-82.

December (127,902.53 - 82,530.43)		45,372.10	P 239,719.28
25% Surcharge			59,929.82
Interest 1/11/98 to 2/12/01			184,783.61
Compromise Penalty			16,000.00
TOTAL ITW on compensation			**P 500,432.71**

III. Expanded Withholding Tax (EWT):

Rental	P5,997,282.00	5%	P 299,864.10
Manpower	1,903,423.00	1%	19,034.23
Professional Fees	70,000.00	10%	7,000.00
Commission	430,758.60	5%	21,537.93
Security Services	743,229.00	1%	7,432.29
Repairs & Maint	512,412.00	1%	5,124.12
Advertising & Promotions	403,267.00	1%	4,032.67
Basic Tax			P 364,025.34
Less: Payments			301,483.80
Balance of Tax Due			P 62,541.54
25% Surcharge			15,635.38
Interest 1/10/98 to 2/12/01			48,209.10
Compromise Penalty			12,000.00
Total EWT deficiency			**P 138,386.02**

IV. Documentary Stamp Tax (DST):

Basis	P 2,500,000.00
Tax Due at 1%	25,000.00
Surcharge	6,250.00
Interest 03-15-98 to 02-12-01	18,170.67
Compromise Penalty	6,000.00
TOTAL DST deficiency	**P 55,420.67**

V. Others:

Non filing of Quarterly Income Tax Return	
1st Quarter	P 1,000.00
2nd Quarter	1,000.00
3rd Quarter	1,000.00
No Books of Accounts	25,000.00
Total Amount Due	**P 28,000.00**

On February 21, 2001, the Assessment Division of BIR Revenue Region No. 8 (Makati City) received petitioner's letter dated February 19, 2001, formally protesting the aforementioned deficiency tax assessments pursuant to Section 228 of the National Internal Revenue Code (NIRC) of

1997, as amended; and requested that the same be reconsidered or reinvestigated for lack of factual and legal bases.[3]

On April 23, 2001, petitioner, through its external auditors, submitted to respondent additional supporting documents to further bolster its arguments against the subject assessments.[4]

On November 19, 2001, petitioner filed the present Petition in accordance with Section 228 of the NIRC of 1997.

The following are issues[5] stipulated by the parties for this Court's resolution:

"1. Whether or not Petitioner has undeclared sales in the amount of P14,632,102.84 for VAT purposes;

2. Whether or not the following expenses were correctly disallowed by the Respondent: interest and bank charges in the amount of P4,886,275.00; foreign exchange loss in the amount of P4,849,619.00; bad debts in the amount of P1,016,428.00; miscellaneous in the amount of P1,078,915.00; and factory overhead in the amount of P44,948,730.84;

3. Whether or not Petitioner had overstated its claim of expenses and deductions against its income for 1997 in the amount of P558,783.00;

4. Whether or not Petitioner is liable for non-withholding of taxes on compensation for the months of January and February of taxable year 1997 amounting to P107,264.72 and P81,082.46, respectively and under-remitted the amounts of P6,000.00 and P45,372.10 for the months of November and December of the same taxable year.

5. Whether or not Petitioner is liable for deficiency expanded withholding tax for non-withholding of rental, manpower, professional fees, commissions, security services, repair and maintenance, advertising and promotions in the aggregate amount of P138,386.02;

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[3] Par. 6, Facts Admitted, JSFI, Docket, p. 83.
[4] Par. 7, Facts Admitted, JSFI, *ibid.*
[5] Issues, JSFI, Docket, pp. 83-84.

6. Whether or not Petitioner is liable for Documentary Stamp Tax in the amount of P54,921.23 on the original issuance of shares of stocks in 1997;

7. Whether or not Petitioner failed to file its quarterly income tax returns and failed to maintain its Book of Accounts;

8. Whether or not there is factual and legal basis for the deficiency income tax, withholding tax on compensation, expanded withholding tax, documentary stamp tax and compromise penalty for taxable year 1997 covered by FAN No. 0000069-97-01-710 dated January 17, 2001."

I. DEFICIENCY INCOME TAX

1.1. *Undeclared Sales – P14,623,102.84*

Respondent alleges that petitioner had undeclared sales amounting to P14,623,102.84, which amount was lifted from an alleged discrepancy of purchases amounting to P3,000,000.00.[6] The latter amount represents the difference of purchases per VAT Returns (P28,183,820.50) and the figure derived during the investigation (P25,183,820.50). As such, the alleged understatement resulted in under-declaration of sales, shown as follows:

Purchases per VAT Returns	P 28,183,820.50
Divided by Ratio of Purchases against Sales	20.516%
Sales per Investigation	P 137,374,831.84
Sales per Income Statement	122,751,729.00
Under declared Sales	**P 14,623,102.84**

The computation of Ratio of Purchases against Sales is as follows:

$$\frac{\text{Claimed Purchases as per Investigation}}{\text{Claimed Sales per Investigation}} \quad \frac{\text{P 25,183,820.50}}{\text{P122,751,729.00}} = 20.516\%$$

[6] Exhibit "10-b", BIR Records, p. 357.

Petitioner argues that respondent's computation of undeclared sales was arbitrarily arrived at. The latter could not provide details as to what might comprise the discrepancy of sales. It is only anchored on the allegation that the purchases per VAT Returns for taxable year 1997 do not tally with the figures per investigation.

The Court agrees with petitioner.

Respondent did not refer to any source document that would show petitioner's claimed purchases under its cost of sales account amounted to P25,183,820.50. Likewise, it was erroneous on the part of respondent to compare the alleged purchases of P25,183,820.50 per cost of sales with the entire amount of P28,183,820.50 purchases per petitioner's VAT Returns, because the latter figure includes not only purchases relating to petitioner's cost of sales account but also purchases pertaining to its administrative and selling expenses. Evidently, the alleged understatement of P3,000,000.00 in petitioner's purchases that resulted in the alleged under-declaration of petitioner's sales in the amount of P14,623,102.84 is based on mere inferences and assumptions. In the case of *Collector of Internal Revenue vs. Alberto D. Benipayo* [7], the Supreme Court ruled that an assessment must be based on actual facts and should not be based on mere presumptions no matter how reasonable or logical said presumptions may be. For lack of factual basis, the deficiency income tax assessment corresponding to the undeclared sales of P14,623,102.84 should be cancelled. Jc

[7] G.R. No. L-13656, January 31, 1962, 4 SCRA 182.

1.2. *Overclaimed Expenses – P558,783.00*

Respondent alleges that petitioner overstated its claim of expenses and deductions against its income in the amount of P558,783.00, computed as follows:

Per Schedule of Deductions-attached to F/S			P 36,523,872.00
Less:	Deductions per investigation:		
	Per income statement	P 28,533,190.00	
	Foreign Exchange Loss	4,849,619.00	
	Interest	2,255,423.00	
	Others	326,857.00	35,965,089.00
Unaccounted Expenses/Deductions			**P 558,783.00**

Petitioner agrees that the amounts of P36,523,872.00 (total deductions) and P4,849,619.00 (foreign exchange losses) are traceable to the amounts declared in the attachments to its 1997 Income Tax Return. However, as to the other items, petitioner claims that it is at a loss where respondent picked up the said amounts. There is no indication what respondent was referring to by "Others" and "Per income statement." Respondent did not refer to any source document or include a breakdown of the items and an explanation of what income statement is involved. Petitioner posits that in the absence of any explanation, these figures are completely arbitrary.

The Court finds petitioner's arguments untenable.

It must be noted that respondent's basis of the amount of deductions per investigation totaling to P35,965,089.00 was the Audited Financial Statements presented by petitioner, specifically, from the Statements of Income and Unappropriated Retained Earnings.[8] Truly, a reconciliation of deductible items based on the data found in its Audited Income Statement

[8] Exhibit "ZZZZ-14-3".

and Annual Income Tax Return for taxable year 1997, reveals a discrepancy or an overclaimed expense amount of P558,783.00. For failure to explain such discrepancy of P558,783.00, petitioner shall be assessed for the corresponding deficiency income tax.

1.3. *Disallowed Expenses – P56,819,967.94*

A substantial portion of the alleged deficiency income tax is attributed to the disallowance of several deductions.

Anent the issue of allowable deductions, it is beyond dispute that a taxpayer may claim deductions provided that he clearly points to a specific provision of the statute in which deductions are authorized and proves that he is entitled to the deductions provided therein. Under the Tax Code of 1977, as amended,[9] Section 29(a)(1)(A) enumerates allowable deductions which include "ordinary and necessary trade or business expenses." Thus, in order to be deductible, an item of expenditure must fall squarely within its language.[10] It is axiomatic that an expense to be deductible must be: (1) ordinary and necessary; (2) paid or incurred within the taxable year; and (3) paid or incurred in carrying on a trade or business. Such expense must be proven by evidence or records. Mere allegation by a taxpayer that an item of expense is ordinary and necessary does not justify its deduction. The foregoing is corroborated by the explanation of the High Tribunal in the case

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[9] The 1977 Tax Code is applicable in the present case as the NIRC of 1997 took effect only on January 1, 1998.
[10] *Commissioner of Internal Revenue vs. Atlas Consolidated Mining and Development Corp.,* G.R. No. L-26924, January 27, 1981, 102 SCRA 246.

of *Commissioner of Internal Revenue vs. Atlas Consolidated Mining and Development Corp.*[11], in this wise:

> "xxx. Ordinarily, an expense will be considered 'necessary' where the expenditure is appropriate and helpful in the development of the taxpayer's business. It is 'ordinary' when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term 'ordinary' does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique or non-recurring to the particular taxpayer affected.
>
> There is thus no hard and fast rule on the matter. The right to a deduction depends in each case on the particular facts and the relation of the payment to the type of business in which the taxpayer is engaged. The intention of the taxpayer often may be the controlling fact in making the determination. Assuming that the expenditure is ordinary and necessary in the operation of the taxpayer's business, the answer to the question as to whether the expenditure is an allowable deduction as a business expense must be determined from the nature of the expenditure itself, which in turn depends on the extent and permanency of the work accomplished by the expenditure.
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> xxx xxx xxx
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> xxx. The burden of proof that the expenses incurred are ordinary and necessary is on the taxpayer and does not rest upon the Government. To avail of the claimed deduction under Section 30(a)(1) of the National Internal Revenue Code, it is incumbent upon the taxpayer to adduce substantial evidence to establish a reasonably proximate relation between the expenses to the ordinary conduct of the business of the taxpayer. A logical link or nexus between the expense and the taxpayer's business must be established by the taxpayer."

Respondent's verification disclosed that petitioner failed to substantiate several deductions amounting to P56,815,967.94. Hence, the same were correctly disallowed as deductions in conformity with the requisites for the deductibility of ordinary and necessary expenses and in violation of Section

[11] *Supra.*

29(a)(1)(A) of the Tax Code of 1977, as amended. Below is the breakdown of the disallowed expense deductions of P56,815,967.94:

Nature of Expenses / Deduction	Amount
Interest and Bank Charges	P 4,886,275.00
Foreign Exchange Loss	4,849,619.00
Bad Debts	1,016,428.00
Miscellaneous	1,078,915.00
Factory overhead	44,984,730.84
Total Disallowed Expense	**P 56,815,967.84**

1.3.1. Interest and Bank Charges – P4,886,275.00

The disallowed amount of P4,886,275.00 is composed of the following:

Bank Charges	P 2,018,141.03
Interest Expense	2,868,133.97
Total	**P 4,886,275.00**

The interest expense deducted by petitioner purportedly represents interests paid on various loans from PCI Bank, Metrobank and Citibank, to wit:[12]

Bank	Interest Paid on Loans	
PCI Bank	P 228,268.06	(US$8,668.89)
Citibank	828,227.50	(US$30,032.31)
Metrobank	1,728,917.56	
Metrobank (transit interest)	67,338.77	
	P 2,852,751.89	
Difference due to exchange rate valuation	15,382.11	
Total	**P 2,868,134.00**	

Respondent claims that the interest expense should be disallowed because petitioner failed to substantiate the said expense claimed against its gross income. Furthermore, the same was disallowed as deduction for failure to satisfy the requisites for the deductibility of ordinary and necessary expense.

[12] Exhibit "W".

Petitioner contends otherwise. It asserts that there are several supporting documents, marked by the Independent CPA as *Exhibits "ZZZZ-10b-1" to "ZZZZ-10b-32"*, showing the purposes of the loans for which the interest was incurred. According to petitioner, the loan was used to pay for foreign currency or working capital requirements and to pay for the import cost of goods or services necessary in the production of their goods.

There is no merit in petitioner's contention.

In *Delfin Ma. V. Cruz, Jr. vs. The Court of Tax Appeals and The Commissioner of Internal Revenue*[13], the Court of Appeals ruled that in order for interest expense to be considered as deduction from gross income, the foremost requirement is that the obligation must be in writing, to wit:

> "Petitioner in this appeal presents a single issue, that is, 'can an interest payment, where the obligation to pay the same is not evidenced in writing, be proven by collateral evidence and thus deductible for income tax purposes?' To which We have a negative answer.
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> Section 30(b) of the Tax Code, as amended, provides:
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> 'Section 30(b). Interest:
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> 1. *In general.* — That amount of interest paid or accrued within a taxable year on indebtedness incurred 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.
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> xxx xxx xxx'
>
> Pursuant to the above-cited provision of the Tax Code, the following requisites must concur to validly claim deductibility of interest payment, to wit: *ge*

[13] CA-G.R. SP No. 25308, April 7, 1992, which affirmed this Court's decision in *Delfin Ma. V. Cruz, Jr. vs. Commissioner of Internal Revenue,* (CTA Case No. 3806, June 29, 1990).

1. There must be an indebtedness;
2. The indebtedness must be that of the taxpayer;
3. The indebtedness must be connected with the business, trade or profession of the taxpayer;
4. The interest must have been paid or accrued during the taxable year; and
5. The interest must have been stipulated in writing (Teodoro and De Leon, The Law on Income Taxation, 1987 Edition, p. 82).

From the foregoing, it may be clearly inferred that for interest payment to be deductible, the same must be supported by a written agreement of the indebtedness the term of which stipulate for the payment of an interest. This is in consonance with Articles 1956 of the Civil Code, providing that:

> 'Article 1956. No interest shall be due unless it has been expressly stipulated in writing.'

In other words, the written agreement of the indebtedness is an indispensable requirement to support a claim of deductibility of interest payment. For how could a claimant prove concurrence of all the said requisites without showing the written agreement of the indebtedness. Mere certification of the alleged creditors as to the existence of the debt and/or to the payment of the interest thereon cannot dispense with the requisite of written agreement of the indebtedness. Otherwise, the law could be easily circumvented."

While petitioner presented bank certifications from Metrobank and Equitable PCI Bank,[14] and credit advices from Citibank[15] to prove its interest payments, petitioner failed to submit in evidence a vital document, which is the loan agreement. The mere certification of the alleged creditor as to the existence of the debt and/or as to the payment of the interest thereon cannot dispense with the requisite of presentation of the written agreement of indebtedness.

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[14] Exhibits "ZZZZ-10b-31" and "ZZZZ-10b-32".
[15] Exhibits "ZZZZ-10b-5", "ZZZZ-10b-26", and "ZZZZ-10b-27".

Although the promissory notes submitted by petitioner in support of its other interest payments to Citibank[16] may be considered as valid proofs of indebtedness, petitioner failed to prove that the corresponding loan proceeds were used in connection to its business. Petitioner alleged that the proceeds of the loan were used to pay for its foreign currency or working capital requirements and to pay for the import cost of goods or services necessary in the production of its goods; however, no documentary evidence was submitted to prove such allegation.

Considering that the claimed interest expense of P2,868,133.97 was not properly substantiated, the same cannot be allowed as deduction from petitioner's gross income for taxable year 1997.

As to the disallowed bank charges in the amount of P2,018,141.03, petitioner maintains that this represents service fees and commissions regularly charged by the banks in the course of its export business transactions. This amount supposedly included transit interest, service charges, handling charges, cable charges, DST, duties, chattel mortgage charges, trust receipt bookings, amendment charges, and Letters of Credit opening charges, which petitioner paid to Metrobank, Citibank, and PCI Bank on various dates in 1997. Petitioner further avers that it also paid bank charges for export proceeds, representing negotiation charges which were collected by the bank upon presentation of petitioner's export documents. Since the charges were incurred in remitting or receiving the foreign currency proceeds of its imports and exports, the same constitutes ordinary and necessary business expenses which can be deducted from its gross income. *gc*

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[16] Exhibits "ZZZZ-10b-1 to 4", "ZZZZ-10b-6 to 25", "ZZZZ10b-28 to 30".

In order to support its claim, petitioner submitted summaries of the bank charges for its Metrobank, Citibank, and PCI Bank accounts,[17] as well as the individual debit/credit memos, bank statements and journal vouchers[18], which were examined and marked by the Independent CPA.

However, upon verification of the Independent CPA Report and petitioner's supporting documents, out of the total claimed bank charges of P2,018,141.03, only the amount of P1,578,330.03 is properly documented and deductible against petitioner's gross income; while the remaining amount of P439,811.00 should be disallowed and subjected to deficiency income tax for the following reasons:

1. Bank charges per schedule were lesser than the bank charges claimed as deduction from gross income

	Ref. No.	Amount	
Claimed Deduction		P2,018,141.03	
Per Schedule	ZZZZ 2a-11	2,017,883.99	
Variance		P 257.04	P 257.04

2. Bank charges per schedule without supporting documents — 419,101.58

3. Bank charges with supporting debit/credit memos dated 1998

Document	Exhibit No.	Date	Amount	
Metrobank Credit Memo	ZZZZ-10a-544	9-Jan-98	P 6,224.21	
Metrobank Credit Memo	ZZZZ-10a-545	9-Jan-98	9,763.17	
Metrobank Credit Memo	ZZZZ-10a-546	9-Jan-98	4,465.00	20,452.38
			Total	**P439,811.00**

In sum, out of petitioner's claimed interest and bank charges in the total amount of P4,886,275.00, only the amount of P1,578,330.03 is a valid deduction against petitioner's 1997 gross income and the remaining amount of P3,307,944.97 shall be disallowed.

[17] Exhibits "CC", "DD", "EE", "FF", and "GG".
[18] Exhibits "ZZZZ-10a-1" to "ZZZZ-10a-550".

1.3.2. Foreign Exchange Loss – P4,849,619.00

Petitioner's deduction for foreign exchange loss was disallowed by respondent allegedly for being unsubstantiated and for not being in accordance with the requisites for the deductibility of ordinary and necessary expenses in the Tax Code.

On the other hand, petitioner argues that being engaged in the business of trade, importation and exportation of various goods and merchandise, it makes use of foreign currencies in its business transactions. Due to fluctuations in the exchange rate of the Philippine peso against the US dollar in 1997, petitioner supposedly suffered foreign exchange losses amounting to P4,849,619.00 on its export and manufacturing operations for the same year. The said foreign exchange losses were allegedly deducted from petitioner's 1997 gross income, pursuant to Section 29(d)(2) of the Tax Code of 1977, as amended, and Section 96 of Revenue Regulations No. 2, as amended.

The Court finds the disallowance proper.

Pursuant to Section 29(d)(2) of the Tax Code of 1977, as amended, the loss resulting from foreign exchange fluctuation ascertained and realized during the taxable period and not compensated by insurance or otherwise, except those provided in Section 30(b) of the same Code, is deductible from gross income of said taxable period, albeit it may relate to transactions of prior years.[19] Jr

[19] *The Coca-Cola Export Corporation vs. Commissioner of Internal Revenue*, C.T.A. Case No. 5238, December 19, 1997.

Foreign exchange loss is deductible only if the same had been realized. Without realization, there can be no loss. There is realization of loss in the year it is actually sustained.[20] It is sustained during the year in which the loss occurs as evidenced by the completed transaction and as fixed by identifiable events occurring in that year.[21] A closed transaction is a taxable event which has been consummated.[22] Mere fluctuation in the value of the foreign exchange vis-à-vis the Philippine peso, but short of a closed and completed transaction, does not result to recognition of deductible loss.[23]

In the present case, petitioner was not able to prove that foreign exchange losses were actually realized/sustained during taxable year 1997. Based on the Summary of Foreign Exchange Loss for taxable year 1997,[24] Detailed Schedule of Export Sales,[25] and testimony of petitioner's witness, Ms. Lucy Jimenez,[26] out of the total claimed foreign exchange (forex) loss of P4,849,619.00, the amount of P1,424,427.56 allegedly pertains to the difference in forex rates (Philippine peso against US dollar) used at the time of petitioner's recognition of its export sales and at the time of receipt of the foreign proceeds thereof. While petitioner's export sales transactions as indicated in the Detailed Schedule of Export Sales[27] can be traced to the export sales invoices presented by petitioner,[28] nonetheless, this Court cannot determine the accuracy of the total peso proceeds thereof. Petitioner should

[20] BIR Ruling No. 206-90 dated October 30, 1990.
[21] BIR Ruling No. DA-359-03 dated October 10, 2003.
[22] *Black's Law Dictionary,* fifth ed.
[23] VAT Ruling No. 239-89 dated September 20, 1989.
[24] Exhibit "II'.
[25] Exhibit "HH".
[26] TSN, March 4, 2004.
[27] Exhibit "HH".
[28] Exhibits "ZZZZ-9-1" to "ZZZZ-9-243".

have submitted the corresponding bank credit/debit memos or advice slips, bank statements or any other source document wherein the actual amount of dollar export proceeds it received and the actual foreign exchange rates used in converting the said proceeds in Philippine peso can be verified.

As to the remaining claimed foreign exchange loss of P3,425,191.44, this Court cannot also verify the accuracy thereof based solely on the journal vouchers submitted by petitioner.[29] Therefore, respondent's disallowance of foreign exchange losses amounting to P4,849,619.00 as deduction from petitioner's 1997 gross income is sustained.

1.3.3. Bad Debts – P 1,016,428.00

Respondent opines that the bad debt expense should be disallowed for the amount was not fully substantiated with documents in connection with the deductibility of deductions, pursuant to Section 29(e) of the Tax Code of 1977, as amended.

Meanwhile, petitioner submits that given the nature of its business operation as a manufacturing, importing and exporting concern, the uncollectibility of certain receivables is a common occurrence; particularly, with regard to customers who either evade their obligations or otherwise go into financial distress. Accordingly, petitioner's belief regarding its right to deduct the bad debts from its gross income is justified under Section 29(e) of the Tax Code of 1977, as amended, which provides:

[29] Exhibits "ZZZZ-11-1 to 42".

> "**SECTION 29.** ***Deductions from gross income.*** **–**
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> xxx xxx xxx
>
> **(e)** ***Bad Debts.*** **– (1)** ***In general.*** – Debts due to the taxpayer actually ascertained to be worthless and charged off within the taxable year except those not connected with profession, trade or business and those sustained in a transaction entered into between parties mentioned under Section 30 (b) of this Code."

In relation thereto, Section 102 of Revenue Regulations No. 2 provides:[30]

> "**SEC. 102.** ***Bad debts.*** – Where all the surrounding and attending circumstances indicate that a debt is worthless, and the debt is charged off on the books of the taxpayer within the year, the same may be allowed as a deduction in computing net income. There should accompany the return a statement showing the propriety of any deduction claimed for bad debts. Before a taxpayer may charge off and deduct a debt, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the uncollectibility of the debt. Any amount subsequently received on account of a bad debt previously charged off and allowed as a deduction for income tax purposes must be included in gross income for the taxable year in which it is received. In determining whether a debt is worthless, the Commissioner of Internal Revenue will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor.
>
> Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of those facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy is sometimes possible before and at the other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off on one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. If a taxpayer computes his

[30] Income Tax Regulations.

income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation."

Indeed, bad debt expense is an allowable business expense pursuant to Section 29(e) of the Tax Code of 1977, as amended, and amplified by Section 102 of Revenue Regulations No. 2. But before a receivable can be written-off and charged against current year's income, a taxpayer must comply with certain requisites which are determined by the following guidelines:

1. there is a valid and subsisting debt;
2. the debt must be actually ascertained to be worthless and uncollectible during taxable year;
3. the debt must be charged off during the taxable year; and
4. the debt must arise from the business or trade of the taxpayer.

Additionally, before a debt can be considered worthless, the taxpayer must also show that it is indeed uncollectible even in the future. Furthermore, there are steps outlined to be undertaken by the taxpayer to prove that he exerted diligent efforts to collect the debts, *viz*: (1) sending of statement of accounts; (2) sending of collection letters; (3) giving the account to a lawyer for collection; and (4) filing a collection case in court.[31]

Petitioner submits that it diligently complied with the above-mentioned requirements, and the same bad debts were fully documented.

This Court disagrees.

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[31]*Collector of Internal Revenue vs. Goodrich International Rubber Co.* (No. L-22265, December 26, 1967, 21 SCRA 1336; cited in *Philippine Refining Company (now known as "Unilever Philippines [PRC], Inc.") vs. Court of Appeals, Court of Tax Appeals and The Commissioner of Internal Revenue*, G.R. No. 118794, May 8, 1996, 256 SCRA 667.

In proving that there is a valid and subsisting debt, the sales invoices are the best evidence to prove that such transaction exists. Petitioner did not present such documentary evidence; thus, the Court cannot accept the correctness, validity and subsistence of the questioned bad debts expense. Moreover, based on the examination conducted by the Independent CPA, petitioner was not able to corroborate this expense with any other supporting documents. The Independent CPA was not able to trace the alleged expense to the 1996 Income Tax Return or 1996 audited financial statements for possible set-up of provision for bad debts and it was further revealed that petitioner does not have any bad debts expense recorded in its books of account for the year ended December 31, 1997, for the balance of Bad Debts Account as of December 31, 1997 is zero. Therefore, this Court believes that the disallowance of bad debts expense in the amount of P1,016,428.00 made by respondent is proper.

1.3.4. Miscellaneous – P1,078,915.00

Miscellaneous expenses were disallowed because of petitioner's failure to show the required documents at the time of examination.

Petitioner argues that said miscellaneous expenses are ordinary and necessary expenses which were incurred in the course of petitioner's trade or business, and are thus valid deductions.

This Court rules otherwise.

The mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction.[32] Petitioner should have

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[32] *Esso Standard Eastern, Inc. (formerly, Standard-Vacuum Oil Company) vs. The Commissioner of Internal Revenue*, G.R. No. L-28508-9, July 7, 1989, 175 SCRA 149.

submitted supporting documents. And based on the examination conducted by this Court, petitioner failed to present documents in support of said expenses. In some instances, the disallowed miscellaneous expenses amounting to P293,375.61, as per schedule[33] were supported by some vouchers with attached sales invoices or official receipts. But a closer examination of the invoices and official receipts would reveal that these were addressed not in the name of the company but to a particular person certainly not the petitioner in this case; therefore, non-deductible business expense. The variance of P785,539.39 is unsupported by sales invoices and/or official receipts. Accordingly, the amount of P1,078,915.00, which represents petitioner's miscellaneous expense, should be disallowed as deduction against gross income.

1.3.5. Factory Overhead – P44,984,730.84

Respondent disallowed petitioner's deduction for factory overhead amounting to P44,984,730.84 due to the latter's failure to substantiate the same. Petitioner counters that the disallowance is erroneous because its factory overhead expense is not P44,984,730.84 but only P33,974,357.60, and said expense is fully substantiated and eligible for deduction.

This Court partially agrees with petitioner.

Since it was not shown how respondent arrived at the factory overhead amount of P44,984,730.84, this Court is constrained to consider the factory overhead amount of P33,974,357.60 reflected per petitioner's Schedule of Cost of Goods Manufactured and Sold for the year 1997.[34] Thus, for

[33] Exhibit "ZZZZ-4-5".
[34] Exhibit "T-1".

purposes of determining the amount of factory overhead deductible from petitioner's 1997 gross income, the reference point shall be the amount of P33,974,357.60 instead of P44,984,730.84.

As verified by the Court-commissioned Independent CPA, petitioner's factory overhead account is broken down as follows:

Account Description		Reference No.	Amount Per Schedule
Manufacturing and Packing Supplies			
	Office Supplies	ZZZZ-5a(1)-3	216,465.47
	Manufacturing Supplies	ZZZZ-5a(2)-1	664,627.70
	Packing Supplies	ZZZZ-5a(3)-5	5,456,068.26
	Design and Production Dev.	ZZZZ-5a(4)-1	4,596.80
	Other Supplies	ZZZZ-5a(5)-2	470,577.27
	Small Tools	ZZZZ-5a(6)-1	172,512.10
	Subtotal		***6,984,847.60***
Depreciation and Amortization			
	Depreciation	ZZZZ-5b(1)-2	6,129,112.46
	Amortization of Leasehold Improvements	ZZZZ-5b(2)-1	142,818.00
	Subtotal		***6,271,930.46***
Salaries, Wages and Bonus			
	13th month pay	ZZZZ-5c(1)-2	1,094,818.70
	SSS & Medicare Contributions	ZZZZ-5c(2)-4	393,471.78
	Salaries & Wages	ZZZZ-5c(3)-3	4,828,115.21
	Workmens Compensation	ZZZZ-5c(4)-2	7,800.00
	Commission	ZZZZ-5c(5)-1	64,734.09
	Subtotal		***6,388,939.78***
Shipping and Documentation		ZZZZ-5d-3	***2,003,864.89***
Rental		ZZZZ-5e-1	***4,031,031.83***
Light, Water and Power		ZZZZ-5f-2	***1,974,386.14***
Employee Benefits		ZZZZ-5g(1)-2	9,485.00
	Dental & Medical	ZZZZ-5g(2)-2	95,707.98
	Representation	ZZZZ-5g(3)-1	210,333.70
	Training and Seminar	ZZZZ-5g(4)-1	96,192.72
	Staff Meeting	ZZZZ-5g(5)-1	11,226.81
	Subtotal		***422,946.21***
Repairs and Maintenance			
	RM-Machinery	ZZZZ-5h(1)-1	1,254,275.66
	RM-Vehicle	ZZZZ-5h(2)-1	139,185.99
	RM-others	ZZZZ-5h(3)-2	456,367.76
	Subtotal		***1,849,829.41***
Transportation and Trucking			
	Transportation	ZZZZ-5i(1)-5	630,050.96
	Gas and Oil	ZZZZ-5i(2)-1	220,041.45
	Subtotal		***850,092.41***
Insurance		ZZZZ-5j-1	***315,210.02***

Fumigation		ZZZZ-5k-1	***77,519.29***
Security and Other Services			
	Security and Services	ZZZZ-5l(1)-1	958,543.39
	Other Services	ZZZZ-5l(2)-1	1,831,398.74
	Subtotal		***2,789,942.13***
TOTAL			**33,960,540.17**

It must be noted that the factory overhead of P33,960,540.17 as indicated in the above schedule is lower by P13,817.43 when compared against the amount of P33,974,357.60 claimed by petitioner. Such discrepancy of P13,817.43 shall be disallowed outright.

Petitioner's factory overhead account of P33,960,540.17 included salaries, wages and bonus in the amount of P6,388,939.78 for which petitioner submitted check vouchers, journal vouchers and payroll summaries.[35] However, the preceding documents, being self-serving, do not prove actual payment of the amount of P6,388,939.78. Neither can the amount of P6,388,939.78 be traced in the 1997 alphalist of employees subjected to withholding tax on compensation.[36] Per petitioner's 1997 alphalist, gross salary payments amounted to only P14,456,048.56; while petitioner's claimed direct labor in the amount of P12,239,144.87,[37] salaries, wages and bonus per Schedular Deductions in the amount of P7,462,693.00[38] and salaries, wages and bonus under the factory overhead account of P6,388,939.78 totaled P26,090,777.65. Clearly, petitioner's claimed salaries, wages and bonus is a lot higher than the actual payments shown in the 1997 alphalist. For petitioner's failure to explain such discrepancy, the claimed

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[35] Exhibits "ZZZZ-13c(1)-1 to 27", "ZZZZ-13c(2)-1 to 73", "ZZZZ-13c(3)-1 to 95", "ZZZZ-13c(4)-1 to 39", and "ZZZZ-13c(5)-1 to 5".
[36] BIR Records, pp 50, 55-62.
[37] Exhibit "T".
[38] Exhibit "ZZZZ-15-8".

salaries, wages and bonus in the amount of P6,388,939.78 should be disallowed.

With reference to petitioner's claimed depreciation and amortization in the amount of P6,271,930.46, the same is a valid deduction against petitioner's 1997 gross income. As can be seen in the Schedule of Depreciation and Amortization attached to petitioner's 1997 Income Tax Return,[39] the depreciation/amortization of petitioner's equipment, furniture and fixtures, and leasehold improvements amounted to P10,198,161.00, from which the amount of P2,653,728.00 was claimed as part of petitioner's Schedular Deductions against gross income.[40] The remaining amount of P7,544,433.00 was charged against petitioner's Cost of Goods Manufactured and Sold.[41] Since respondent did not question petitioner's claimed depreciation expense in the amount of P2,653,728.00, there is no reason why the depreciation amount of P6,271,930.46 (included in the depreciation amount of P7,544,433.00) being claimed by petitioner as part of its factory overhead account cannot be allowed.

As to petitioner's claimed rental expense in the amount of P4,031,031.83, this Court finds the same deductible against petitioner's 1997 gross income. Per the 1997 Schedular Deductions, rental expense charged to petitioner's operations amounted to P1,766,634.00, which when added to the rental amount of P4,031,031.83 being claimed by petitioner as part of its factory overhead account, results in a total rental of P5,797,665.83. Since the total rental payment of P5,997,282.20 per petitioner's 1997 Alphalist of

[39] Exhibit "ZZZZ-15-9".
[40] Exhibit "ZZZZ-15-8" and Section A of "Exhibit ZZZZ-15-1".
[41] Exhibit "ZZZZ-15-9" and Section C of "Exhibit ZZZZ-15-2".

Payees Subjected to Expanded Withholding Tax[42] is greater than petitioner's claimed rental expense deduction for 1997 in the amount of P5,797,665.83, it is then safe to conclude that the rental amount of P4,031,031.83 which formed part of petitioner's factory overhead account was actually paid and subjected to withholding tax.

Regarding petitioner's claimed security services and other services in the respective amounts of P958,543.39 and P1,831,398.74 or in the sum of P2,789,942.13, a comparison of the said amounts with those reflected in the 1997 Alphalist of Payees Subjected to Expanded Withholding Tax reveals the following:[43]

	Per Alphalist	Per Factory Overhead	Per Schedular Deductions	Total Claimed Deductions	Discrepancy
Security Services	743,229.00	958,543.39	641,112.00	1,599,655.39	(856,426.39)
Other Services (Manpower)	1,903,423.00	1,831,398.74	-	1,831,398.74	72,024.26

Based on the above table, petitioner's total claimed deduction for security services in the amount of P1,599,655.39 (including the amount of P958,543.39, which formed part of petitioner's factory overhead account) is greater by P856,426.39, as compared against the amount of P743,229.00 reflected in the alphalist. Since the actual payment for security services as shown in the alphalist is lower than the total claimed deduction of P1,599,655.39, the security services of P958,543.39 included under the factory overhead account shall be disallowed.

As to petitioner's claimed deduction for other services in the amount of P1,831,398.74, the same is a valid deduction against petitioner's 1997 gross

[42] BIR Records, p. 51.
[43] BIR Records, p. 51.

income considering that the payments per petitioner's aphalist in the amount of P1,903,423.00 is more than the claimed deduction of P1,831,398.74.

As to the other expense items included in petitioner's factory overhead account in the amount of P14,478,695.97, computed as follows:

Total Factory Overhead	P33,960,540.17
Less: Salaries, Wages and Bonus	6,388,939.78
Depreciation and Amortization	6,271,930.46
Rental	4,031,031.83
Security and Other Services	2,789,942.13
Remaining Factory Overhead	**P14,478,695.97**

this Court finds that only the amount of P2,092,303.20 is supported by valid suppliers' invoices and/or official receipts;[44] thus, deductible against petitioner's 1997 gross income. The balance of P12,386,392.77 shall be disallowed for petitioner's failure to substantiate the same with proper documents.

To recapitulate, out of petitioner's claimed factory overhead amount of P33,974,357.60, only the amount of P14,226,664.23 is deductible from its 1997 gross income; while the balance of P19,747,693.37 shall be disallowed, as shown below:

Total Claimed Factory Overhead		P33,974,357.60
Less: Allowable Deductions		
Depreciation and Amortization	P6,271,930.46	
Rental	4,031,031.83	
Other Services	1,831,398.74	
Other Expense Items	2,092,303.20	14,226,664.23
Disallowed Factory Overhead		**P19,747,693.37**

Based on the above findings, petitioner is still liable for 1997 deficiency income tax in the amount of P20,952,015.76, computed as follows: Jr

[44] See details attached to this Decision.

DEFICIENCY INCOME TAX

Taxable Net Income Per Return			P 1,554,126.00
Add:	Overclaimed Expense		558,783.00
	Disallowed Expenses:		
	Interest & Bank Charges	P 3,307,944.97	
	Foreign Exchange Loss	4,849,619.00	
	Bad Debts	1,016,428.00	
	Miscellaneous	1,078,915.00	
	Factory Overhead	19,747,693.37	30,000,600.34
Taxable Income			P32,113,509.34
Income Tax Due			P11,239,728.27
Less:	Tax Withheld/Paid Per Return		543,944.00
Basic Deficiency Income Tax			P10,695,784.27
Add:	Surcharge		2,673,946.07
	Interest 04-15-98 to 02-12-01		7,582,285.42
Total Deficiency Income Tax			**P20,952,015.76**

The compromise penalty of P25,000.00 originally imposed by respondent is hereby cancelled, as compromise implies mutual agreement, which is absent in the case under consideration. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[45]

II. DEFICIENCY WITHHOLDING TAX ON COMPENSATION

The alleged deficiency withholding tax on compensation was computed as follows:

Tax Due -	January	P107,264.72	
	February	81,082.46	
	November (117,861 - 111,861)	6,000.00	
	December (127,902.53 - 82,530.43)	45,372.10	P 239,719.28
25% Surcharge			59,929.82
Interest	1/11/98 to 2/12/01		184,783.61
Compromise Penalty			16,000.00
TOTAL ITW on compensation			**P 500,432.71**

Respondent avers that the withholding taxes on compensation for the months of January and February amounting to P107,264.72 and P81,082.46,

[45] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc.*, G.R. No. L-35266, January 21, 1991, 193 SCRA 86.

respectively, were not actually paid. He further submits that petitioner under-remitted the amounts of P6,000.00 and P45,372.10 for the months of November and December 1997.

In contrast, petitioner maintains that it withheld and paid the correct amounts of withholding tax on compensation for taxable year 1997, including the months of January, February, November, and December 1997. With respect to the months of January and February, petitioner argues that the authority of the BIR to investigate and impute deficiency withholding taxes has already prescribed pursuant to Section 203 of the Tax Code of 1977, as amended.

This Court finds for petitioner.

Applying the provisions of Section 203 of the Tax Code of 1977, as amended, the right of respondent to issue deficiency assessment depends on the date the respective Returns for internal revenue taxes were filed. In the case of withholding tax on compensation, the Return is required to be filed within ten (10) days after the end of each month for taxes withheld during the months of January until November; while the Return for taxes withheld for the month of December shall be filed on or before January 25 of the following year, as provided in Section 2 of Revenue Regulations (R.R.) No. 5-85, as amended by RR Nos. 3-93 and 18-93, as follows:

> "**Sec. 2. *Monthly Return and Remittance of Taxes Withheld* –** Taxes deducted and withheld on:
>
> **(i)** compensation income;
> **(ii)** income payments subject to the creditable (expanded) withholding taxes; and
> **(iii)** income subject to final withholding taxes. 9c

> shall be remitted within ten (10) days after the end of each calendar month with the filing of appropriate return. (BIR Form 1743-W). However, taxes withheld from the last compensation/income payment for the calendar year (December) shall be remitted on or before the 25th of January of the succeeding year. xxx"

Records show that petitioner filed its January, February, November, and December 1997 Returns for withholding tax on compensation on the following dates:

Period Covered (1997)	Exhibit No.	Date Filed
January	ZZZZ-6-1	10-Feb-97
February	ZZZZ-6-2	10-Mar-97
November	ZZZZ-6-3	10-Dec-97
December	ZZZZ-6-4	12-Jan-98

Therefore, respondent had three years within which to issue his 1997 deficiency assessment for the aforementioned withholding tax on compensation computed either on the day required for filing of the Returns or on the date when the corresponding Returns were belatedly filed, to wit:

Period Covered (1997)	Exhibit No.	Date Filed	Last Day to File Return	Last Day to Issue Assessment
January	ZZZZ-6-1	10-Feb-97	10-Feb-97	10-Feb-00
February	ZZZZ-6-2	10-Mar-97	10-Mar-97	10-Mar-00
November	ZZZZ-6-3	10-Dec-97	10-Dec-97	11-Dec-00
December	ZZZZ-6-4	12-Jan-98	26-Jan-98[46]	26-Jan-01

Considering that the Formal Letter of Demand, Assessment Notice and Details of Discrepancies for 1997 Deficiency Withholding Tax on Compensation were issued on January 17, 2001, the same were clearly issued beyond the 3-year period allowed by law, insofar as the months of January, February, and November 1997 were concerned. After all, an assessment for deficiency taxes issued after the lapse of three years can no

[46] January 25, 1998 fell on a Sunday.

longer be valid and effective.[47] Only the assessment of deficiency withholding tax on compensation for the month of December 1997 was issued within the prescriptive period.

Even though the assessment was issued within the prescriptive period, the same should be cancelled for there was no under-remittance of P45,372.10 for the said month. Petitioner's Monthly Remittance Return for December 1997 shows that it correctly withheld and fully paid the amount of P127,902.53 and not respondent's alleged amount of P82,530.43, which actually pertains to withholding tax on compensation for the month of December 1996. Therefore, the assessment for deficiency withholding tax on compensation is without merit.

III. DEFICIENCY EXPANDED WITHHOLDING TAX

The alleged deficiency EWT for taxable year 1997 was computed as follows:

Rental	P5,997,282.00	5%	P 299,864.10
Manpower	1,903,423.00	1%	19,034.23
Professional Fees	70,000.00	10%	7,000.00
Commission	430,758.60	5%	21,537.93
Security Services	743,229.00	1%	7,432.29
Repairs & Maintenance	512,412.00	1%	5,124.12
Advertising & Promotions	403,267.00	1%	4,032.67
Basic Tax			P 364,025.34
Less: Payments			301,483.80
Balance of Tax Due			P 62,541.54
Add: 25% Surcharge			15,635.38
Interest 1/10/98 to 2/12/01			48,209.10
Compromise Penalty			12,000.00
Total EWT deficiency			**P 138,386.02**

[47] *Solid Cement Corp. vs. Liwayway Vinzons-Chato, in her Capacity as the Commissioner of Internal Revenue*, CTA Case No. 5420, May 27, 1999.

Based on the above computation, petitioner has a discrepancy on expanded withholding tax amounting to P62,541.54, which is further accounted for as follows:[48]

January Return	P 21,427.21
February Return	29,653.94
Not subject to withholding	9,001.34
Variance: 1743-IR vs 1743W	3,209.06
Unaccounted/Refund	(750.01)
Total	**P 62,541.54**

As earlier discussed under the assessment of deficiency withholding taxes on compensation, the alleged deficiency expanded withholding taxes for the months of January and February are likewise barred by prescription; hence, null and void.

The variance of P3,209.06 will account for December 1997. Petitioner remitted the amount of P25,633.41 as indicated in its Monthly Remittance Return of Income Taxes Withheld for the month of December 1997[49] and Annual Information Return of Income Tax Withheld on Compensation, Expanded and Final Withholding Taxes for the Year 1997.[50] Respondent erroneously picked up the amount of P22,424.35, which actually pertains to expanded withholding tax for the month of December 1996[51] and compared it to the amount indicated in the Annual Information Return for the Year 1997, which resulted in a discrepancy of P3,209.06. In view thereof, petitioner should not be assessed for the discrepancy amount of P3,209.06.

Respondent further considered the variance of P9,001.34, representing Repairs and Maintenance (P4,968.67) and Advertising and Promotions

[48] Docket, p. 38.
[49] Exhibit "ZZZZ-6-4".
[50] Exhibit "ZZZZ-6-5".
[51] Exhibit "ZZZZ-6-6".

(P4,032.67), as subject to the expanded withholding tax. Petitioner, on the other hand, alleges that it is not compelled by any law or regulation to withhold tax on the amount of P9,001.34 as it was actually paid to professional partnerships and not for repairs and maintenance, and advertising and promotions.

Income payments made to a general professional partnership as a juridical person is exempt from income tax and consequently, the expanded withholding tax. Its partners are the ones liable in their individual capacity for the payment of income tax pursuant to Section 23 of the Tax Code of 1977, as amended. This was elucidated by the Supreme Court in *Rufino R. Tan, et al. vs. Ramon R. del Rosario Jr., as Secretary of Finance and Jose U. Ong, as Commissioner of Internal Revenue*[52], to wit:

> "'Exempt partnerships,' upon the other hand, are not similarly identified as corporations nor even considered as independent taxable entities for income tax purposes. A general *professional* partnership is such an example. Here, the partners themselves, not the partnership (although it is still obligated to file an income tax return [mainly for administration and data]), are liable for the payment of income tax in their *individual* capacity computed on their respective and distributive shares of profits. In the determination of the tax liability, a partner does so as an *individual*, and there is no choice on the matter. In fine, under the Tax Code on income taxation, the general professional partnership is deemed to be no more than a mere mechanism or a flow-through entity in the generation of income by, and the ultimate distribution of such income to, respectively, each of the individual partners."

Petitioner however failed to present relevant documents to support the claimed payment of professional fees to a general professional partnership. Consequently, the deficiency expanded withholding tax assessment on the income payment of P9,001.34 shall be upheld. Petitioner is liable to pay

[52] G.R. Nos. 109289 and 109446 dated October 3, 1994.

deficiency expanded withholding tax in the amount of P18,218.47, computed as follows:

Repairs & Maintenance			P 4,968.67
Advertising & Promotions			4,032.67
Basic Deficiency Expanded Withholding Tax			P 9,001.34
Add:	Surcharge	P 2,250.34	
	Interest 1/10/98 to 2/12/01	6,966.79	9,217.13
Total Deficiency Expanded Withholding Tax			**P 18,218.47**

IV. DOCUMENTARY STAMP TAX

Respondent assessed petitioner for deficiency DST amounting to P55,420.67 for failure to file and pay the corresponding documentary stamp tax due arising from the original issuance of shares of stocks in violation of Section 175 of the Tax Code of 1977, as amended.

Petitioner, on the other hand, asserted that it had fully paid the DST due on all of its certificates of stock, including penalties and surcharges. Petitioner pointed out that respondent's DST assessment was based on the issuance of P2,500,000.00 worth of shares. This is supposedly the same amount by which petitioner increased its capital stock on April 1995 from P1,000,000.00 to P3,500,000.00 as evidenced by the Certificate of Filing of Certificate of Increase of Capital Stock issued by the Securities and Exchange Commission.[53] Petitioner argued that since there was no change in its capital stock requiring payment of DST for taxable year 1997, respondent's assessment is without legal and factual basis. Moreover, petitioner allegedly paid the DST on all of its authorized capital stock, as follows:

[53] Exhibit "D".

Date	No. of Shares	Par Value	Amount	DST Actually Paid (with surcharges/penalties)
12/16/1996	1,000	100.00	1,000,000.00	P27,500.00
6/30/1997	25,000	100.00	2,500,000.00	P34,375.00

Petitioner presented BIR Form 2000-A, entitled Corporate Stock Documentary Stamp Tax (DST) Declaration for Existing Corporation as of February 28, 1998, Authority to Accept Payment No. 4039929, and BIR Form 2000, entitled Documentary Stamp Tax Declaration[54], proving payment of the above DST amounts. Since petitioner paid the DST amount of P34,375.00 (inclusive of surcharges/penalties) for the P2,500,000.00 increase in capital stock, this Court finds no basis to uphold respondent's deficiency DST assessment of P55,420.67 and hereby cancels the same.

VI. OTHERS

Respondent alleges that petitioner failed to file its Quarterly Income Tax Returns and failed to maintain Books of Accounts. Such failure warrants the imposition of compromise penalties in accordance with RR 1-90, amounting to P28,000.00, broken down as follows:

Non filing of Quarterly Income Tax Return		
1st Quarter	P	1,000.00
2nd Quarter		1,000.00
3rd Quarter		1,000.00
No Books of Accounts		25,000.00
Total Amount Due	**P**	**28,000.00**

Based on the verification of the Court-commissioned Independent CPA on the said assessment, the following observations were noted:

> "**E. OTHER COMPROMISE PENALTIES**
>
> Compromise penalties arose from the alleged non filing of quarterly income tax for the first three quarters amounting to

[54] Exhibits "ZZZZ-8-1", "ZZZZ-8-2", and "ZZZZ-8-3".

> P3,000.00 and for having no books of accounts amounting to P25,000.00.
>
> In this regard, the Company provided us with the no payment income tax return, duly stamped and received by the BIR, for the first and second quarters only. Hence, the penalties may be reduced by P2,000.
>
> On the other hand, the Company was not able to provide return for the 1st quarter and the existence of its books of account or any approved permit from the BIR to authorize the Company to use loose-leaf form."

This Court agrees with the above findings. Petitioner admitted that it failed to file its Quarterly Income Tax Return for the first quarter of 1997.[55] Petitioner was able to present before this Court its Quarterly Income Tax Returns only for the second and third quarters of 1997.[56]

Likewise, records indicate that petitioner failed to present its books of accounts or any approved permit from the BIR authorizing the use of loose-leaf form. The voluminous documents presented and marked before this Court as *Exhibits "ZZZZ-1" to "ZZZZ-17"* cannot be considered as sufficient accounting records or equivalent to the required books of accounts, contrary to petitioner's assertion. Pursuant to Revenue Regulations V-1[57], all corporations, companies, partnerships or persons required by law to pay internal revenue taxes are required to keep books of accounts in accordance with the standard accounting system. The said books of accounts shall consist of a journal and a ledger, or their equivalent, and shall contain all information necessary for the accurate determination of the internal revenue taxes on their businesses. The journal may consist of only one book, the

[55] Petitioner's Memorandum, Docket, p. 392.
[56] Exhibit "ZZZZ-17-1" and "ZZZZ-17-5".
[57] The Bookkeeping Regulations.

general journal. Its equivalent may consist of several books such as sales book, purchase book, cash book and such other books as the taxpayer may find convenient for his business. Such books are also books of original entries where all the daily transactions, whether cash or otherwise, are recorded in their chronological order. A journal, in order to comply with the provisions of the regulations, must contain all the transactions affecting the business. Every entry in the general journal shall carry a brief but complete explanation of the nature of the business transaction and be supported by proper vouchers.

The ledger, like the journal, may consist of one book, the general ledger. Its equivalent may consists of several ledgers, such as customer's ledger, creditor's ledger, stock ledger, and such other books as the taxpayer may find convenient for his business. All entries in the journal must be posted to the ledger not later than seven days from the date of the transaction, and shall be classified in the ledger so as to show the assets, liabilities, capital, and the operating accounts from which a balance sheet, and a profit and loss statement covering the operation of the business can be prepared. No entry shall be made in the ledger or its equivalents unless said entry originates from the journal or its equivalent.

Notwithstanding petitioner's failure to file its Quarterly Income Tax Return for the first quarter of taxable year 1997 and failure to maintain books of accounts for taxable year 1997 in violation of Sections 68 and 232 of the Tax Code of 1977, as amended, the compromise penalties imposed by respondent in the amount of P28,000.00 cannot be sustained. The compromise penalties incident to the violations are suggested merely in lieu of criminal prosecution. This is clearly stated under Revenue Memorandum Order (RMO) No. 1-90[58], thus:

> "III. Guidelines and Instructions
>
> xxx xxx xxx
>
> (5) Since compromise penalties are only amounts suggested in settlement of criminal liability and may not therefore be imposed or exacted in the event that a taxpayer refuses to pay the suggested compromise penalty, the violation shall be referred for criminal action as heretofore mentioned."

Since there is no showing that petitioner voluntarily entered into a compromise agreement with respondent, the compromise penalties of P28,000.00 is likewise cancelled.

In sum, the 1997 assessments for deficiency withholding tax on compensation in the amount of P500,432.71, deficiency DST in the amount of P55,420.67, and compromise penalties in the amount of P28,000.00 are cancelled for reasons stated above. However, the assessments for deficiency income tax and EWT are sustained in the reduced amounts of P20,952,015.76 and P18,218.47, respectively, or in the sum of P20,970,234.23, detailed as follows:

	Basic	Surcharge	Interest	Total
Income Tax	P10,695,784.27	P2,673,946.07	P7,582,285.42	P20,952,015.76
EWT	9,001.34	2,250.34	6,966.79	18,218.47
TOTAL	**P10,704,785.61**	**P2,676,196.41**	**P7,589,252.21**	**P20,970,234.23**

In addition, petitioner is likewise liable for the twenty percent (20%) delinquency interest on the total amount of P20,970,234.23 computed from February 19, 2001 until full payment thereof pursuant to Section 249(c)(3) of the Tax Code of 1977, as amended. Jr

[58] Not RR 1-90 as erroneously cited by respondent.

However, this Court notes petitioner's Manifestation filed on March 6, 2008 alleging that it availed of the tax amnesty program granted under Republic Act (RA) No. 9480 and paid the corresponding amnesty tax. Also, this Court notes that petitioner submitted faithful reproductions of the following:

1. Exhibit "DDDDD" – Tax Amnesty Payment Form (Acceptance of Payment Form);
2. Exhibit "FFFFF" – Metrobank's Payment Slip for Companies with Collection Arrangements dated February 12, 2008 showing the amount of P100,000.00 as having been paid;
3. Exhibit "HHHHH" – Tax Amnesty Return (BIR Form No. 2116);
4. Exhibit "IIIII" – Annual Income Tax Return (BIR Form No. 1702) with attachments;
5. Exhibit "EEEEE" – Notice of Availment of Tax Amnesty dated February 7, 2008; and
6. Exhibit "GGGGG" – Statement of Assets, Liabilities and Networth as of December 31, 2005.

Inasmuch as petitioner has fully complied with the prescribed requisites of RA No. 9480 and is deemed a duly qualified tax amnesty applicant, petitioner shall be entitled to the privileges and immunities under the said law. Furthermore, the contestability period of one (1) year provided under Section 4 of RA No. 9480 had already lapsed, hence, the subject tax deficiencies in the case at bench are extinguished.

WHEREFORE, in light of the foregoing laws and jurisprudence and in view of the petitioner's availment of the Tax Amnesty under RA No. 9480 the subject Assessments for Deficiency Taxes are hereby **CANCELLED EXCEPT** the Assessment for Deficiency Expanded Withholding Tax inasmuch as withholding tax is not covered by RA No. 9480. Accordingly, petitioner is hereby **ORDERED TO PAY** P18,218.47 plus twenty percent (20%) ge delinquency interest from February 19, 2001 until full payment thereof pursuant to Section 249(c)(3) of the Tax Code of 1977, as amended.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice