**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

***SECOND DIVISION***

**NIKKEN PHILIPPINES, INC.,**
*Petitioner,*

**CTA Case No. 8714**

**Members:**

- versus-

**Castañeda, Jr.,** *Chairperson*
**Casanova,** and
**Cotangco-Manalastas,** *JJ.*

**COMMISSIONER OF INTERNAL REVENUE,**
*Respondent.*

**Promulgated:**

JUN 2 3 2016

2:30 p.m.

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# DECISION

**COTANGCO-MANALASTAS, *J.:***

This case involves a Petition for Review filed by Nikken Philippines, Inc. to seek the cancellation and withdrawal of the Formal Assessment Notice issued by the Commissioner of Internal Revenue (CIR) that found it liable for alleged deficiency income tax and deficiency expanded withholding tax (EWT) for taxable year 2006 in the aggregate amount of ₱18,804,081.54.[1]

## FACTS

Petitioner Nikken Philippines, Inc. is a domestic corporation organized and existing under Philippine laws, with principal office at JMT Corporate Condominium, Suite 10B, ADB Avenue, Ortigas Center, 1603 Pasig City. It is engaged in the business of buying, selling, distribution and marketing at wholesale, various kinds of health support products and accessories, including entering into contracts for the

[1] Brief Statement of the Case, Joint Stipulation of Facts and Issues (JSFI), docket, vol. II, p. 900; Pre-Trial Order, docket, vol. II, p. 908.

acquisition and sale, which includes importation and exportation of these products.[2]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR), who is responsible for the assessment and collection of all national internal revenue taxes, fees and charges and the enforcement of all forfeitures, penalties and fines connected with such taxes. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Petitioner filed its Annual Income Tax Return[3] (ITR) for taxable year 2006 on March 27, 2007.

Subsequently, petitioner received a Notice of Informal Conference on June 10, 2009, informing petitioner that a report of the investigation of its internal revenue tax liabilities for taxable year 2006 was submitted for consideration.[4]

Petitioner then executed a Waiver of the Defense of Prescription under the Statute of Limitations of the National Internal Revenue Code[5] in connection with the re-investigation of its tax liabilities (extending the period of assessment until September 30, 2010), which became effective on June 29, 2009.[6]

Respondent issued the Preliminary Assessment Notice (PAN)[7] on August 2, 2010, which petitioner received on August 11, 2010[8].

Consequently, petitioner filed its position paper[9] in response to the PAN on August 26, 2010.

Thereafter, respondent issued the Formal Letter of Demand (FLD) with the Final Assessment Notice (FAN)[10] on September 6, 2010, which was received by petitioner on

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[2] Par. 1, Summary of Facts Admitted, JSFI, docket, vol. II, p. 900.
[3] Exhibit "P-19", docket, vol. IV, pp. 1610 to 1613.
[4] Exhibit "R-2", BIR records, p. 1073.
[5] Exhibit "P-2", docket, vol. IV, pp. 1366 to 1367; Exhibit "R-4", BIR records, p. 1080.
[6] Par. 3, Summary of Facts Admitted, JSFI, docket, vol. II, p. 901.
[7] Exhibit "P-1", docket, vol. IV, pp. 1364 to 1365.
[8] Par. 7, Petition for Review, docket, vol. I, p. 8.
[9] Exhibit "P-3", docket, vol. IV, pp. 1370 to 1383.
[10] Exhibit "P-4", docket, vol. IV, pp. 1445 to 1449; Exhibit "R-6", BIR records, pp. 1236 to 1241.

September 16, 2010[11]. Petitioner was assessed for alleged deficiency income tax, value-added tax (VAT), and EWT, computed as follows:

| DEFICIENCY INCOME TAX | | |
|---|---|---|
| Taxable Income per ITR | | ₱ 12,904,392.00 |
| Add: Adjustments per investigation | | |
| Undeclared sales | ₱ 833,959.33 | |
| Income payments not subjected to EWT | 42,482,391.16 | |
| Unaccounted income payments | 20,207,318.52 | |
| Salaries and wages not subject to CWE | 543,638.49 | 64,067,307.50 |
| Total income per investigation | | ₱ 76,971,699.50 |
| | | |
| Income tax due thereon | | ₱ 26,940,094.83 |
| Less: Tax credits/payments | | |
| Payments | ₱ 2,001,529.00 | |
| Creditable Withholding Tax | 2,617,218.00 | |
| Total | 4,618,747.00 | |
| Less: Excess credits to be carried over | 102,209.00 | 4,516,538.00 |
| Deficiency income tax | | 22,423,556.83 |
| Add: 20% interest p.a. (04.17.07 to 10.06.10) | | 15,579,764.41 |
| **TOTAL AMOUNT DUE** | | **₱ 38,003,321.24** |

| DEFICIENCY VALUE-ADDED TAX | | |
|---|---|---|
| Taxable sales/receipts per returns | | ₱ 105,430,643.18 |
| Add: Adjustments | | |
| Unaccounted income payments | | 20,207,318.52 |
| Taxable sales/receipts per investigation | | ₱ 125,637,961.70 |
| | | |
| Output tax due thereon (12%) | | ₱ 15,076,555.40 |
| Less: Tax credits/payments | | |
| Payments | ₱ 8,151,970.76 | |
| Input tax claimed for the year | 4,500,096.46 | 12,652,067.22 |
| Deficiency value-added tax | | ₱ 2,424,488.19[12] |
| Add: 20% interest p.a. (01.26.07 to 10.06.10) | | 1,792,128.53 |
| **TOTAL AMOUNT DUE** | | **₱4,216,616.72**[13] |

| DEFICIENCY EXPANDED WITHHOLDING TAX | | | |
|---|---|---|---|
| | **Amount** | **Tax Rate** | **EWT due** |
| Purchase of goods | ₱35,413,014.48 | 1% | ₱354,130.14 |
| Purchase of services | 7,057,027.68 | 2% | 141,140.55 |
| Rent | 12,349.00 | 5% | 617.45 |
| Deficiency expanded withholding tax | 42,482,391.16 | | ₱495,888.15[14] |
| Add: 20% interest p.a. (01.16.07 to 10.06.10) | | | 369,266.85 |
| **TOTAL AMOUNT DUE** | | | **₱ 865,155.00**[15] |

[11] Par. 11, Petition for Review, docket, vol. I, p. 9.
[12] The amount should be ₱2,424,488.18.
[13] The amount should be ₱4,216,616.71.
[14] The amount should be ₱495,888.14.
[15] The amount should be ₱865,154.99 (due to rounding off).

Petitioner protested the FLD on October 18, 2010.[16]

Subsequently, respondent informed petitioner, through a letter[17] dated March 1, 2012, that a report of the re-investigation had been submitted and the Computations of Deficiency Taxes per Re-investigation[18] were attached to the said letter, which petitioner received on March 7, 2012.

In the Final Decision on Disputed Assessment (FDDA)[19] dated September 21, 2012, which petitioner received on September 3, 2013[20], respondent still found petitioner liable for deficiency income tax and EWT, computed as follows:

| | | | |
|---|---|---|---|
| **DEFICIENCY INCOME TAX** | | | |
| Taxable income per investigation | | | ₱ 76,971,699.50 |
| Add (deduct) adjustment per re-investigation: | | | |
| Undeclared sales-accounted under various accounted per FS | | ₱ (833,959.33) | |
| Income payments not subjected to WE | | | |
| Per re-investigation | ₱18,401,942.35 | | |
| Per investigation | 42,482,391.98 | (24,080,449.63) | |
| Unaccounted income payments-accounted under various accounts | | (20,207,318.52) | |
| Salaries and wages not subject to WC-various Employee benefits | | (543,638.49) | (45,665,365.97) |
| Total income per re-investigation | | | ₱ 31,306,333.53 |
| Income tax rate | | | 35% |
| Income tax due | | | ₱ 10,957,216.74 |
| Less: Payments/Tax credits | | | |
| MCIT applied | | ₱ 2,181,371.00 | |
| BIR Form No. 2307 | | 435,846.88 | |
| Quarterly payments | | 2,001,529.03 | |
| Less: Carried over to 2007 | | (102,209.00) | 4,516,537.91 |
| Basic deficiency income tax | | | ₱ 6,440,678.83 |
| Add: 25% surcharge | | - | |
| 20% interest p.a. (04.17.07 to 09.30.13) | | ₱ 8,321,709.96 | 8,321,709.96 |
| **TOTAL AMOUNT DUE** | | | **₱ 14,762,388.79** |
| | | | |
| **DEFICIENCY EXPANDED WITHHOLDING TAX** | | | |
| Taxable income payments per investigation | | | ₱ 42,482,391.16 |
| Add (deduct) adjustment per re-investigation: | | | |
| Income not subjected to WE (Schedule III) | | | 11,811,502.35 |
| Taxable income payments per re-investigation | | | ₱ 54,293,893.51 |
| | | | |
| WE due | | | ₱ 4,826,309.00 |
| Less: Payments/tax credits | | | 3,096,456.92 |
| Basic deficiency WE | | | ₱ 1,729,852.08 |

[16] Exhibit "P-5", docket, vol. IV, pp. 1450 to 1474.
[17] Exhibits "R-7", BIR records, p. 1445.
[18] Exhibits "R-7-A", "R-7-B", and "R-7-C", BIR records, p. 1443.
[19] Exhibit "P-6", docket, vol. IV, pp. 1570 to 1571; Exhibit "R-10", BIR records, pp. 1503 to 1504.
[20] Par. 14, Petition for Review, docket, vol. I, p. 10.

| | | | | |
|---|---|---|---|---|
| Add: | 25% surcharge | | - | |
| | 20% interest p.a. (01.16.07 to 09.30.13) | | ₱ 2,311,840.67 | 2,311,840.67 |
| **TOTAL AMOUNT DUE** | | | | **₱ 4,041,692.75** |
| | | | | |
| **TOTAL DEFICIENCY TAX DUE** | | | | **₱18,804,081.54** |

As a result, petitioner filed the present Petition for Review[21] before this Court on October 2, 2013.

In the Answer[22] filed on December 20, 2013, respondent raised the following special and affirmative defenses:

> "4. The Final Decision on Disputed Assessment (FDDA) and Formal Letter of Demand and Assessment Notice (FAN) dated 21 September 2012 and 30 August 2013 respectively were issued in compliance with the provisions of Section 228 of the National Internal Revenue Code (NIRC) and in accordance to Revenue Regulations No. 12-99 in relation to the right of the taxpayer and in the instant case, the petitioner to be informed of the factual and legal bases upon which the assessments were made;
>
> 5. The herein Petitioner was fully appraised of the facts and the law on which the Final Assessment was issued. The Formal Letter of Demand and Assessment Notice (FAN) and the Final Decision on Disputed Assessment (FDDA) which were all sent to the Petitioner include the details of discrepancy which provides the legal and factual bases of the assessment;
>
> 6. The assessment is the annualized amount of expense as reflected in the Audited Financial Statement, thus prescription could not be made as a defense. The assessment was made for the month of December as shown in the PAN/FAN, which effectively showing an assessment date effective 26 January 2007.
>
> 7. Moreover, Rent expense in the amount Php12,349.00 was not subjected to EWT, as shown in Annex 'U'. Furthermore, since the payment is for rental, as shown in Petitioner's vouchers and other related documents, the payment is clearly should be subjected to 5% EWT;
>
> 8. The assessment of Professional Fees at 10% is correct. The Professional Fees Schedule provides that all payments from January to May in the amount of Php

[21] Docket, vol. I, pp. 6 to 36.
[22] Docket, vol. I, pp. 309 to 313.

2.6 million should be subjected to EWT. However, from the Petitioner's schedule itself, only Php 879,000 was subjected to EWT;

9. The assessment of the Commission is correct. Per Alphalist, only Php 19 million was subjected to EWT as shown in the Alpha-Numeric Tax Code (ATC Code). Per Audited Financial Statement (AFS), Php 34.8 million was the amount of commission payment recognized in the (AFS).

10. Petitioner also alleged that the training of the local distributors was actually performed outside of the country and the recipient of the purported commission payment is actually an alien, and therefore, the international commission amounting to Php10,051,592.31 cannot be subjected to income tax. Again, these are without merit. The payment to the international sponsor are truly commission in its proper sense being dependent on sales consummated. Without the consummation of sales, no commission is due notwithstanding the training provided. It is only when there is sales that the commission accrues. The commission being based on sales made within the Philippines is considered source within the Philippines and therefore subject of the Philippine taxation system;

11. The assessment of the Regular Services is also correct. The comparison in the Audited Financial Statement and the Alphalist resulted to a difference of Php2,212,950.05. Paragraphs (73) to (102) are all allegations without proof nor documents to substantiate such allegations;

12. It has been held that in the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is prima facie valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously. The burden of proof is upon the complaining party to show clearly that the assessment is erroneous. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment."

Petitioner filed its Reply (To Respondent's Answer dated 19 December 2013)[23] on February 5, 2014.

[23] Docket, vol. I, pp. 325 to 344.

Thereafter, petitioner's Pre-Trial Brief[24] and respondent's Pre-Trial Brief[25] were filed on March 7, 2014 and on May 20, 2014, respectively.

The parties submitted their Joint Stipulation of Facts and Issues[26] on June 5, 2014. Afterwards, the Court issued a Pre-Trial Order[27] dated June 11, 2014.

To prove its claim, petitioner presented Ms. Concepcion Turingan and Ms. Nenita Maayo as witnesses.

On the other hand, respondent presented Atty. Bryan Francis G. Lim and Dolores F. Gillego to disprove petitioner's allegations.

The parties likewise offered their respective documentary evidence.

Petitioner formally offered Exhibits "P-1", "P-2", "P-3", "P-4", "P-5", "P-6", "P-7", "P-7-A", "P-7-B", "P-8", "P-8-A", "P-8-B", "P-9", "P-9-A", "P-9-B", "P-10", "P-10-A", "P-10-B", "P-11", "P-11-A", "P-11-B", "P-12", "P-12-A", "P-12-B", "P-13", "P-13-A", "P-13-B", "P-14", "P-14-A", "P-14-B", "P-15", "P-15-A", "P-15-B", "P-16", "P-16-A", "P-16-B", "P-17", "P-17-A", "P-17-B", "P-18", "P-18-A", "P-18-B", "P-19", "P-20", "P-21", "P-22", "P-23", "P-24", "P-25", "P-26", "P-27", "P-27-A", "P-27-B", "P-28", "P-29", "P-30", "P-31", "P-32", "P-33", "P-34", "P-35", "P-36", "P-37", "P-37-A", "P-38", and "P-38-A"[28]; which were all admitted as petitioner's evidence via Resolutions dated October 8, 2014[29] and October 13, 2014[30].

On the other hand, respondent formally offered Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-7A", "R-7B", "R-7C", "R-8", "R-9", "R-10", "R-11", and "R-12".[31] The Court admitted the foregoing exhibits, as respondent's evidence, in the Resolution[32] dated April 8, 2015.

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[24] Docket, vol. I, pp. 350 to 366.
[25] Docket, vol. II, pp. 853 to 856.
[26] Docket, vol. II, pp. 900 to 906.
[27] Docket, vol. II, pp. 908 to 913.
[28] Docket, vol. IV, pp. 1349 to 1363.
[29] Docket, vol. IV, pp. 1753 to 1754.
[30] Docket, vol. IV, p. 1772.
[31] Docket, vol. IV, pp. 1795 to 1800.
[32] Docket, vol. IV, pp. 1869 to 1870.

The Court declared the case submitted for decision on June 30, 2015[33], after petitioner filed its Memorandum[34] on June 19, 2015 and after the issuance of the Records Verification Report[35] dated June 29, 2015 by the Court's Judicial Records Division stating that respondent failed to file her memorandum.

## ISSUES

The parties submitted the following issues[36] for this Court's resolution:

1. Whether the assessment for deficiency taxes issued by the respondent is void for lack of factual and legal basis;

2. Whether respondent's right to assess petitioner for deficiency expanded withholding tax for the period January to May 2006 has already prescribed, thus, effectively barring the respondent to enforce the deficiency tax assessment for the cited period; and

3. Whether respondent gravely erred in finding the discrepancies in petitioner's income payments which were purportedly not validly subjected to expanded withholding tax.

## DISCUSSION/RULING

Petitioner contends that the FDDA dated September 21, 2012 failed to inform petitioner of the legal and factual bases on which the assessments were based. Petitioner explains that even though the FDDA provided a breakdown or computation of its alleged tax deficiencies, respondent did not indicate the facts and the law it relied upon for the determination of the subject tax deficiencies. According to petitioner, the FDDA merely itemized the figures

[33] Resolution, docket, vol. IV, p. 1917.
[34] Docket, vol. IV, pp. 1884 to 1915.
[35] Docket, vol. IV, p. 1916.
[36] Statement of the Issues, JSFI, docket, vol. II, p. 901.

corresponding to the deductions disallowed, the applicable tax rate, and the interests to be applied on the deficiency taxes, but the factual and legal bases for such particulars were unreasonably left out by respondent. As such, petitioner was allegedly left guessing as to the significance and source of each of the figures stated in the FDDA.

Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, provides that the taxpayer shall be informed in writing of the law and the facts on which the assessment is made, *to wit*:

> "SEC. 228. *Protesting of Assessment.*– When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however*, That a preassessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> xxx xxx xxx"

Relative thereto, Section 3.1.4 of Revenue Regulations (RR) No. 12-99 states:

> "3.1.4. *Formal Letter of Demand and Assessment Notice.* – The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void. The same shall be sent to the taxpayer only by registered mail or by personal delivery. xxx"

Based on the foregoing, a taxpayer must be informed in writing of the legal and factual bases of the tax assessment made against him. The use of the word "shall" in these legal provisions indicates the mandatory nature of the requirements laid down therein.

The law requires that the legal and factual bases of the assessment must be stated in the formal letter of demand and assessment notice. Thus, such cannot be presumed. Otherwise, the express provisions of Section 228 of the NIRC of 1997 and RR No. 12-99 would be rendered nugatory.[37]

After a thorough evaluation of the FLD and the FDDA, which recomputed petitioner's tax liabilities, the Court finds the same compliant with the requirements laid down under Section 228 of the NIRC of 1997, as amended, and Section 3.1.4 of RR No. 12-99.

It is worthy to note that petitioner was also able to intelligently protest the FLD.

As regards the second issue, petitioner argues that respondent's right to assess the former of deficiency EWT for the months of January to May 2006 had already prescribed, pursuant to Section 203 of the NIRC of 1997, as amended.

Section 203 of the NIRC of 1997, as amended, specifically provides that respondent has three (3) years to assess and collect an internal revenue tax, *to wit*:

> "SEC. 203.*Period of Limitation Upon Assessment and Collection.* – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided,* That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

Corollary thereto is Section 2.58(A)(2)(a) and (b) of RR No. 2-98, as amended by RR No. 17-03, which requires that the withholding tax must be deducted and remitted on a monthly basis, *viz:*

[37] *CIR vs. United Salvage and Towage (Phils.), Inc.*, G.R. No. 197515, July 2, 2014 citing *CIR vs. Enron Subic Power Corporation*, G.R. No. 166387, January 19, 2009.

"Sec. 2.58. RETURNS AND PAYMENT OF TAXES WITHHELD AT SOURCE.

(A) *Monthly return and payment of taxes withheld at source.–*

xxx xxx xxx

(2) WHEN TO FILE –

(a) For both large and non-large taxpayers, the withholding tax return, whether creditable or final (including final withholding taxes on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements) shall be filed and payments should be made, **within ten (10) days after the end of each month, except for taxes withheld for the month of December of each year, which shall be filed on or before January 15 of the following year**; xxx

(b) With respect, however, to taxpayers, whether large or non-large, who availed of the electronic filing and payment system (EFPS), **the deadline for electronically filing the applicable withholding tax returns and paying the taxes due thereon via the EFPS shall be five (5) days later than the deadlines set above, unless the EFPS regulations provide for different deadline dates** xxx." (*Emphasis supplied*)

Under Section 203 of the NIRC of 1997, internal revenue taxes must be assessed within three years counted from the period fixed by law for the filing of the tax return or the actual date of filing, whichever is later. This mandate governs the question of prescription of the government's right to assess internal revenue taxes primarily to safeguard the interests of taxpayers from unreasonable investigation. Accordingly, the government must assess internal revenue taxes on time so as not to extend indefinitely the period of assessment and deprive the taxpayer of the assurance that it will no longer be subjected to further investigation for taxes after the expiration of reasonable period of time.[38]

[38] *CIR vs. FMF Development Corporation*, G.R. No. 167765, June 30, 2008.

Petitioner is enrolled in the EFPS and its business industry is classified under Group C.[39] Pursuant to RR No. 26-02[40] dated December 5, 2002, petitioner is required to file its monthly returns for expanded withholding tax on or before the thirteenth (13th) day following the end of the month. Thus, the reckoning dates of the 3-year period and the last day to assess are summarized hereunder:

| Month | Exhibit | Date Filed | Reckoning of the 3-year Period | Last Day to Assess |
|---|---|---|---|---|
| January | P-7-A | February 9, 2006 | February 13, 2006 | February 13, 2009 |
| February | P-8-A | March 7, 2006 | March 13, 2006 | March 13, 2009 |
| March | P-9-A | April 7, 2006 | April 13, 2006 | April 13, 2009 |
| April | P-10-A | May 8, 2006 | May 13, 2006 | May 13, 2009 |
| May | P-11-A | June 5, 2006 | June 13, 2006 | June 13, 2009 |
| June | P-12-A | July 6, 2006 | July 13, 2006 | July 13, 2009 |
| July | P-13-A | August 7, 2006 | August 13, 2006 | August 13, 2009 |
| August | P-14-A | September 7, 2006 | September 13, 2006 | September 13, 2009 |
| September | P-15-A | October 9, 2006 | October 13, 2006 | October 13, 2009 |
| October | P-16-A | November 8, 2006 | November 13, 2006 | November 13, 2009 |
| November | P-17-A | December 6, 2006 | December 13, 2006 | December 13, 2009 |
| December | P-18-A | January 13, 2007 | January 13, 2007 | January 13, 2010 |

In this case, the FLD with the FAN was issued on September 6, 2010 and received by petitioner on September 16, 2010. Clearly, the same was issued beyond the prescriptive period provided by law. However, since petitioner executed a Waiver of the Defense of Prescription under the Statute of Limitations of the National Internal Revenue Code (Waiver)[41], extending the period of assessment until September 30, 2010, only respondent's right to assess petitioner for deficiency EWT for the months of January to May 2006 had already prescribed when the said Waiver became effective on June 29, 2009. As such, respondent is already barred from assessing petitioner for deficiency EWT corresponding to the months of January to May 2006.

Nevertheless, it must be noted that while respondent's right to assess petitioner of deficiency EWT for the months of January to May 2006 already prescribed, petitioner was unable to establish that the subject deficiency EWT pertains to the months of January to May 2006. Thus, in the absence of proof, this Court shall consider the entire deficiency EWT as

[39] Petitioner's line of industry as "MLN/Wholesaler" as indicated in its Annual Income Tax Return (Exhibit "P-19") falls under Group C classification.

[40] Amending Further Revenue Regulations No. 9-2001, as Amended by Revenue Regulations No. 2-2002 and Revenue Regulations No. 9-2002, Providing for the Staggered Filing of Returns of Taxpayers Enrolled in the Electronic Filing and Payment System (EFPS) Based on Industry Classification.

[41] Exhibit "P-2", docket, vol. IV, pp. 1366 to 1369.

pertaining to the unprescribed months of June to December 2006.

The Court shall now proceed to determine the merits of the deficiency tax assessments issued by respondent against petitioner.

## I. DEFICIENCY INCOME TAX

Based on the FDDA, the deficiency income tax arose from the following items:

| | |
|---|---|
| A. Income payments not subjected to EWT | ₱18,401,942.35 |
| B. Excess tax credits carried over to the succeeding period | ₱ 102,209.00 |

## A. Income payments not subjected to withholding tax

Respondent's verification disclosed that petitioner failed to subject the following income payments to withholding tax as required under RR No. 2-98, as amended; thus, the same were disallowed as deductions from gross income pursuant to Section 34(K) of the NIRC of 1997, as amended:[42]

| Account Title | Per FS/Re-investigation | Per Alphalist | Difference |
|---|---|---|---|
| Rent | ₱3,069,049.00 | ₱ 3,056,700.00 | ₱12,349.00 |
| Professional fee at 10% | 2,382,843.00 | 879,000.00 | 1,503,843.00 |
| Professional fee at 15% | 5,369,111.09 | 5,369,111.82 | (0.73) |
| Commission | 34,798,507.83 | 19,377,803.70 | 15,420,704.13 |
| Regular supplier of goods | 2,413,284.82 | 3,161,188.32 | (747,903.50) |
| Regular [supplier] of services | 6,261,097.77 | 4,048,147.32 | 2,212,950.45 |
| **Total** | **₱54,293,893.51** | **₱35,891,951.16** | **₱18,401,942.35** |

### 1. ***Rent - ₱12,349.00***

Petitioner claims that the difference of ₱12,349.00 was already subjected to EWT. This amount allegedly corresponds to petitioner's payment to Philippine Fuji Xerox Corporation (Fuji) for the use of the latter's photocopying machine incurred in the month of June 2006 pursuant to the Full Service and

[42] FDDA, Details of Discrepancies, Exhibit "P-6", docket, vol. IV, p. 1571; Exhibit "R-10", BIR records, p. 1503.

Maintenance Agreement[43] executed between petitioner and Fuji. Petitioner likewise avers that based on the Schedule of Rent Expense[44], such payment was subjected to 2% EWT as it was actually in the nature of services and not rental of equipment.

The Court finds petitioner's contention untenable.

The Alphalist of Payees Subject to EWT (Alphalist)[45] attached to petitioner's BIR Form No. 1604-E[46] shows that the total income payments to Fuji for taxable year 2006 that were subjected to 2% EWT by petitioner amounted to ₱70,952.00[47]. However, the Court cannot ascertain whether the disputed difference of ₱12,349.00 is already included in the said total amount per Alphalist. Neither can it be traced to BIR Form No. 1601-E for the month of June 2006[48] since no Alphalist was attached for the said month.

While petitioner presented the corresponding check voucher and official receipt[49] to support the transaction in question, the same cannot be given credence by the Court since these documents merely prove the existence and occurrence of such transaction but not the actual remittance of the corresponding withholding tax.

For failure of petitioner to prove that the amount of ₱12,349.00, representing the difference between the FS/Reinvestigation and per Alphalist, was actually subjected to EWT, the Court is constrained to uphold respondent's disallowance of the amount of ₱12,349.00 as deduction from petitioner's gross income.

***2. <u>Professional fee at 10% - ₱1,503,843.00</u>***

The Schedule of Professional and Audit Fees[50] provided by petitioner during trial shows that the professional fees of

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[43] Exhibit "P-20", docket, vol. IV, pp. 1631 to 1635.
[44] Exhibit "P-21", docket, vol. IV, p. 1636.
[45] Docket, vol. IV, pp. 1648 to 1668.
[46] Exhibit "P-27", docket, vol. IV, pp. 1646 to 1647.
[47] Docket, vol. IV, p. 1649.
[48] Exhibit "P-12-A", docket, vol. IV, p. 1590.
[49] Exhibits "P22" and "P-23", docket, vol. IV, pp. 1637 to 1638.
[50] Exhibit "P-24", docket, vol. IV, pp. 1639 to 1641.

₱879,000.00 that were subjected to 10% withholding tax were lodged in the following expenses:

| | |
|---|---|
| Employee Benefits | ₱ 60,000.00 |
| Marketing Expense | 214,500.00 |
| Professional Fee | 264,500.00 |
| Training Expense | 340,000.00 |
| **Total** | **₱879,000.00** |

On the other hand, based on the schedules of various expense accounts provided by petitioner, respondent found that the professional fees that should have been subjected to 10% withholding tax amount to ₱2,382,843.00[51], broken down as follows:

| | |
|---|---|
| Employee Benefits | ₱ 60,000.00 |
| Marketing Expense[52] | 1,679,771.73 |
| Professional Fee[53] | 264,500.00 |
| Training Expense[54] | 378,571.27 |
| **Total** | **₱2,382,843.00** |

Based on the foregoing, respondent's findings of the discrepancy of ₱1,503,843.00 not subjected to 10% EWT can be traced from the following:

| | **Per Petitioner's Schedule** | **Per BIR's Findings** | **Difference** |
|---|---|---|---|
| Marketing Expense | ₱ 214,500.00 | ₱ 1,679,771.73 | ₱ 1,465,271.73 |
| Training Expense | 340,000.00 | 378,571.27 | 38,571.27 |
| **Total** | **₱554,500.00** | **₱2,058,343.00** | **₱1,503,843.00** |

Despite the findings of respondent, petitioner did not offer any explanation why the discrepancy of ₱1,503,843.00 should not be subjected to 10% EWT. Neither did petitioner submit any corroborating documentary evidence wherein this Court can ascertain the nature and veracity of such expenses.

For petitioner's failure to submit additional documentary evidence to further prove its contention, respondent's findings shall be upheld in line with the principle that "tax

[51] Exhibit "R-7-C", BIR records, p. 1443.
[52] BIR records, pp. 1364 to 1375.
[53] BIR records, pp. 1253, 1255 and 1336; Exhibit "P-24", docket, vol. IV, p. 1639.
[54] BIR records, p. 1343.

assessments by tax examiners are presumed correct and made in good faith, and all presumptions are in favor of the correctness of a tax assessment unless proven otherwise"[55]. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.[56] Consequently, the amount of ₱1,503,843.00 shall be disallowed as deduction from petitioner's gross income.

### 3. *Commission - ₱15,420,704.13*

As a result of the re-investigation, respondent found a discrepancy of ₱15,420,704.13 in petitioner's commission that was not subjected to withholding tax, computed as follows:

| | |
|---|---|
| Per FS/Re-investigation | ₱ 34,798,507.83 |
| Per Alphalist | 19,377,803.70 |
| **Discrepancy** | **₱15,420,704.13** |

Petitioner avers that this assessment is bereft of any legal and factual bases. The same has failed to show the basis and source for the amount equivalent to ₱34,798,507.83.

Petitioner merely assumed that the said figure was computed from the item on "Commissions/Incentives", which is part of the Cost of Sales[57] per Annual ITR of petitioner.

However, contrary to petitioner's allegation, respondent was able to provide a detailed computation[58] of how she arrived at such amount of discrepancy, *to wit*:

| **Commission/Incentives** | |
|---|---|
| Per ITR - credit cards[59] | ₱ 5,004,097.00 |
| Accounted under Purchases[60] | 35,163,521.92 |
| Less: Subjected to 15% WE (WC/WI051) | (5,369,111.09) |
| **Total** | **₱34,798,507.83** |

[55] *CIR vs. Gonzales, et al.*, G.R. No. 177279, October 13, 2010.
[56] *Marcos II vs. Court of Appeals, et al.*, G.R. No. 120880, June 5, 1997.
[57] Exhibit "P-25", docket, vol. IV, p. 1642.
[58] Exhibit "R-7-C", BIR records, p. 1443.
[59] Exhibit "P-19", Line 87, Section D, Annual ITR, docket, vol. IV, p. 1612; Merchant Fees, Statement of Income, AFS, docket, vol. IV, p. 1619.
[60] Exhibit "P-25", docket, vol. IV, p. 1642.

Petitioner insists that it had commission payments of ₱24,746,915.52 which were subjected to the appropriate EWT, detailed as follows:

| Type of Commission | Tax Rate | Amount | Tax |
|---|---|---|---|
| Commission of independent and/or consultant | 10% | ₱ 19,377,803.70 | ₱ 1,937,780.37 |
| Commission of independent and/or consultant whose income exceeds P720,000.00 | 15% | 5,369,111.82 | 805,366.77 |
| **Total** | | **₱24,746,915.52** | **₱2,743,147.14** |

Accordingly, the difference would amount only to ₱10,051,592.31 (₱34,798,507.83 – ₱24,746,915.52).

It may be observed in its computation that petitioner improperly included the amount of ₱5,369,111.82, which represents income payments to independent and/or consultant whose income exceeds ₱720,000.00, in accounting for the difference noted by respondent. The same amount was already excluded by respondent in her computation of discrepancy (based on the above detailed computation). Hence, the difference which must be accounted for by petitioner was correctly computed at ₱15,420,704.13.

Petitioner claims that the difference found was not actually in the nature of an income payment for commissions as contemplated under our withholding tax laws.[61]

Petitioner explains that its business in the Philippines is essentially carried out by its local distributors. Said distributors are trained and educated by petitioner's international sponsors who are actually based outside of the country.[62] The local distributors are sent out of the country for the necessary training and education regarding petitioner's corporate history, products, and structure by its international sponsor. Upon receipt of the necessary training and expertise abroad, the local distributors are recommended for appointment by the international sponsor who trained them. Thereafter, the local distributors are authorized to act as such within the Philippine territory.[63]

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[61] Par. 75, Memorandum, docket, vol. IV, p. 1903.
[62] Par. 75.1, Memorandum, docket, vol. IV, p. 1903.
[63] Par. 75.2, Memorandum, docket, vol. IV, pp. 1903 to 1904.

Any local sale secured by petitioner's local distributor entitles the said distributor to commission. It is such commission payment that is subjected to income and withholding taxes by petitioner. And as shown above, these commission payments were indeed subjected to withholding tax.[64]

Meanwhile, as an incentive to the international sponsor who trained and recommended the local distributor, the international sponsor will be entitled to an agreed amount termed as international commission by petitioner.[65]

Hence, the commission is actually in the nature of payment for the training and education provided by the international sponsor to the local distributor.[66]

On the other hand, respondent avers in her Answer[67] that the payment to international sponsor is truly a commission in its proper sense being dependent on the sales consummated. Without the consummation of such sales, no commission is due notwithstanding the training provided. It is only when there are sales that the commission accrues. The commission being based on sales made within the Philippines is considered sourced within the Philippines and therefore subject to the Philippine taxation system.

However, no other documentary evidence was presented by petitioner to prove that indeed the subject commission should not be subjected to withholding tax. It is an elementary rule that in the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. All presumptions are in favor of tax assessments. Failure to present proof of error in the assessment will justify judicial affirmance of said assessment.[68]

***4. <u>Regular supplier of services - ₱2,212,950.45</u>***

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[64] Par. 75.3, Memorandum, docket, vol. IV, p. 1904.
[65] Par. 75.4, Memorandum, docket, vol. IV, p. 1904.
[66] Par. 75.5, Memorandum, docket, vol. IV, p. 1904.
[67] Par. 10, Special and Affirmative Defenses, docket, vol. I, p. 311.
[68] *CIR vs. Court of Appeals, et al.*, G.R. Nos. 104151 and 105563, March 10, 1995.

Based on respondent's detailed computation[69], the following income payments should be subjected to EWT:

| | | | |
|---|---|---|---|
| **Item No.** | Regular supplier of services - WC/WI160 | | |
| 4.1 | Travel and transportation | | |
| 4.1.a | Freight charges | | ₱ 1,495,049.97 |
| 4.1.b | Transportation and travel | | |
| | Per investigation | ₱1,743,328.24 | |
| | Not qualified | 903,988.56 | 839,339.68 |
| 4.2 | Marketing | | 251,974.34 |
| 4.3 | Utilities | | 1,463,878.00 |
| 4.4 | Communications | | |
| | Per investigation | 1,440,486.76 | |
| | Not qualified | 10,311.02 | 1,430,175.74 |
| 4.5 | Repairs and maintenance | | 303,188.09 |
| 4.6 | Security | | 322,230.41 |
| 4.7 | Health care benefits accounted under Salaries and wages | | 155,261.54 |
| | | | **₱6,261,097.77** |

However, based on petitioner's Alphalist, respondent found that only the income payments of ₱4,048,147.32 were subjected to withholding tax. Hence, the difference amounting to ₱2,212,950.45 was disallowed as deduction from petitioner's gross income.

Petitioner asserts that by simply lumping the expense accounts relating to petitioner's regular services, respondent failed to consider the nature of each and every expense account comprising petitioner's regular services. Petitioner further points out that some of the expense accounts relating to the said regular services are actually in the nature of mere reimbursements. As such, the same cannot be validly subjected to expanded withholding tax.

However, petitioner did not offer any documentary evidence to justify its claim. It bears stressing that respondent's assessments were based on the schedules petitioner itself prepared and then submitted to respondent. From the said schedules, respondent found that a portion of certain expenses should be subjected to withholding tax. Thus, the burden of proof to prove that the assessments were not correct is now shifted to petitioner. Accordingly, it is incumbent upon petitioner to prove that the expenses subject of assessment, are indeed not subject to withholding tax. In the absence of any other documentary evidence that could

[69] Exhibit "R-7-B", BIR records, p. 1443.

prove petitioner's claim, the disallowance of the expenses not subjected to EWT as deduction from its gross income shall be sustained.

**B. Disallowed Tax Credits Carried Over (₱102,209.00)**

Respondent disallowed petitioner's excess tax credits for taxable year 2006 amounting to ₱102,209.00[70] but gave no explanation in the FLD or FDDA in doing so. The Court can only surmise that the tax credits carried over to the succeeding year was disallowed in order to recapture the tax benefit realized by petitioner in carrying the said amount to the succeeding year.

However, the Court finds it improper for respondent to disallow the said excess tax credits because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2007. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year.

In sum, the Court finds petitioner liable for basic deficiency income tax in the amount of ₱6,338,470.11, computed as follows:

| | | |
|---|---|---|
| Taxable income per return | | ₱12,904,392.00 |
| Add: Adjustments per investigation | | |
| Income payments not subjected to EWT | | 18,401,942.35 |
| Total income per this Court's verification | | ₱31,306,334.35 |
| Income tax rate | | 35% |
| Income tax due thereon | | ₱10,957,217.02 |
| Less: Tax credits/payments | | |
| MCIT applied | ₱2,181,371.00 | |
| BIR Form No. 2307 | 435,846.88 | |
| Quarterly payments | 2,001,529.03 | 4,618,746.91 |
| **Basic deficiency income tax** | | **₱6,338,470.11** |

## II. DEFICIENCY EXPANDED WITHHOLDING TAX

As earlier discussed, the Court finds it proper to disallow various income payments of petitioner as deduction from its gross income for its failure to withhold taxes on the said

[70] Exhibit "P-19", Line 29, docket, vol. IV, p. 1610.

income payments. Consequently, the deficiency EWT assessment of respondent against petitioner shall be sustained. Thus, petitioner shall be held liable for basic deficiency EWT in the amount of ₱1,729,852.08, detailed as follows:

| Particulars | Per FS/Re-investigation | Tax Rate | EWT Due |
|---|---|---|---|
| Rent | ₱3,069,049.00 | 5% | ₱ 153,452.45 |
| Professional fee at 10% | 2,382,843.00 | 10% | 238,284.30 |
| Professional fee at 15% | 5,369,111.09 | 15% | 805,366.66 |
| Commission | 34,798,507.83 | 10% | 3,479,850.78 |
| Regular supplier of goods | 2,413,284.82 | 1% | 24,132.85 |
| Regular supplier of services | 6,261,097.77 | 2% | 125,221.96 |
| **Total** | **₱54,293,893.51** | | **₱4,826,309.00** |
| Less: Payment | | | 3,096,456.92 |
| **Basic Deficiency EWT** | | | **₱1,729,852.08** |

**WHEREFORE**, premises considered, the assessments issued by respondent against petitioner for taxable year 2006 involving deficiency income tax and expanded withholding tax are **AFFIRMED** but **WITH MODIFICATIONS**. Accordingly, petitioner is **ORDERED TO PAY** the amount of **₱10,085,402.74**, representing deficiency income tax and EWT, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

| Tax Type | Basic | 25% Surcharge | Total |
|---|---|---|---|
| Income Tax | ₱ 6,338,470.11 | ₱ 1,584,617.53 | ₱ 7,923,087.64 |
| Expanded Withholding Tax | 1,729,852.08 | 432,463.02 | 2,162,315.10 |
| **Total** | **₱8,068,322.19** | **₱2,017,080.55** | **₱10,085,402.74** |

In addition, petitioner is hereby **ORDERED TO PAY**:

a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax and EWT computed from the dates indicated below until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended:

| Tax Type | Interest to run from |
|---|---|
| Income Tax | April 15, 2007 |
| Expanded withholding tax | January 13, 2007 |

b) Delinquency interest at the rate of 20% per annum on the total amount of ₱10,085,402.74 and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from September 30, 2013 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

**SO ORDERED.**

**AMELIA R. COTANGCO-MANALASTAS**
Associate Justice

**WE CONCUR:**

**JUANITO C. CASTAÑEDA, JR.**
Associate Justice

**CAESAR A. CASANOVA**
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.**
Associate Justice
Chairperson

**CERTIFICATION**

Pursuant to Section 13, Article VIII 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.

**ROMAN G. DEL ROSARIO**
Presiding Justice