REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL FIRST DIVISION

****

NEXT MOBILE INC., (formerly NEXTEL COMMUNICATION PHILS., INC.)
Petitioner,

- *versus* -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 7965

Members:
UY, *Chairperson, and*
FABON-VICTORINO, *JJ.*

Promulgated:

OCT 13 2017 ; 9:48am

x - x

AMENDED DECISION

UY, *J*.:

Before this Court is **CTA Case No. 7965** remanded to the Special First Division of this Court by the Court of Tax Appeals (CTA) *En Banc* in **CTA EB Case No. 1001**, pursuant to the Supreme Court's Decision[1] dated December 7, 2015 in **G.R. No. 212825** entitled ***"Commissioner of Internal Revenue, Petitioner, versus Next Mobile, Inc. (formerly Nextel Communications Phils., Inc.), Respondent"***, the dispositive portion of which reads as follows:

> "**WHEREFORE,** premises considered, the Court resolves to **GRANT** the petition. The Decision of the Court of Tax Appeals *En Banc* dated May 28, 2014 in CTA EB Case No. 1001 is hereby **REVERSED** and **SET ASIDE.** Accordingly, let this case be remanded to the

[1] EB Docket, pp. 185 to 211; Penned by Associate Justice Presbitero J. Velasco, Jr., concurred in by Associate Justice Diosdado M. Peralta, Associate Justice Martin S. Villarama, Jr., and Associate Justice Bienvenido L. Reyes.

> Court of Tax Appeals for further proceedings in order to determine and rule on the merits of respondent's petition seeking the nullification of the BIR Formal Letter of Demand and Assessment Notices/Demand No. 43-734, both dated October 17, 2005.
>
> **SO ORDERED**."

CTA EB Case No. 1001

CTA EB Case No. 1001 entitled "***Commissioner of Internal Revenue, Petitioner, versus Next Mobile, Inc. (Formerly Nextel Communications Phil., Inc.), Respondent",*** is a Petition for Review filed before the CTA *En Banc* on May 2, 2013 seeking the reversal of the Decision rendered in the instant case, **CTA Case No. 7965** dated December 11, 2012 and the Resolution dated March 14, 2013 affirming the said Decision, both rendered by the former First Division of this Court in the case entitled "***Next Mobile, Inc. (formerly Nextel Communications Phils., Inc.), Petitioner, versus Commissioner of Internal Revenue, Respondent.***

The CTA *En Banc* denied the Petition for Review filed in said case on the Decision[2] rendered on May 28, 2014, the dispositive portion of which reads as follows:

> "**WHEREFORE,** premises considered, the instant *Petition for Review* is **DENIED.** The December 11, 2012 Decision and March 14, 2013 Resolution of the former First Division in CTA Case No. 7965, are hereby **AFFIRMED.**
>
> **SO ORDERED.**"

As mentioned earlier, the Decision in CTA EB Case No. 1001, was reversed and set aside and the same was remanded to this Court for further proceedings by the Supreme Court in **G.R. No. 212825** promulgated on December 7, 2015.

Correspondingly, the CTA *En Banc* in the Resolution dated August 11, 2016 remanded CTA Case No. 7965, the instant case, to

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[2] EB Docket, pp. 151 to 167, penned by Associate Justice Amelia R. Cotangco – Manalastas, concurred in by Associate Juanito C. Castañeda, Jr.., Associate Justice Lovell R. Bautista, Associate Justice Caesar A. Casanova, Associate Justice Esperanza R. Fabon – Victorino, Associate Justice Cielito N. Mindaro-Grulla and Associate Justice Ma. Belen Ringpis-Liban.

the court of origin for further proceedings in order to determine and rule on the merits of respondent's petition seeking the nullification of the BIR Formal Letter of Demand and Assessment Notices/Demand No. 43-734, both dated October 17, 2005.

Hence, this Amended Decision.

THE FACTS

It appearing that no supervening events transpired from the time that the Decision in CTA Case No. 7965 was rendered on December 11, 2012 until the rendition of the Supreme Court Decision in G.R. No. 212825 on December 7, 2015, the facts of the instant case as stated in Our Decision dated December 11, 2012[3], are hereby adopted and deemed incorporated herein.

THE ISSUE

As directed by the Supreme Court in its Decision in G.R. No. 212825, this Court is tasked to determine and rule on the merits of the instant *Petition for Review*, specifically whether or not the BIR's Formal Letter of Demand and Assessment Notices/Demand No. 43-734, all dated October 17, 2005,[4] assessing petitioner for the following deficiency tax liabilities for taxable year 2001 in the aggregate sum of ₱313,339,610.41, should be nullified. The assailed assessments consist of the following:

Type of Tax	Basic Tax	Surcharge	Interest	Total
Income Tax	₱ 31,698,303.55		₱ 22,854,476.86	₱ 54,552,780.41
Expanded Withholding Tax (EWT)	529,972.21		403,838.82	933,811.03
Final Withholding Tax (FWT)	143,179,838.32		109,103,036.80	252,282,875.12
Increments for Late Remittance of EWT, FWT and Withholding Tax on Compensation (WTC)		₱5,300,646.37	75,497.48	5,376,143.85
Compromise Penalties for failure to file BIR Form Nos. 1604F and 1604E, inventory list and alphalist of income payments subjected to withholding tax, late				194,000.00

[3] Docket—Vol. III, pp. 1305 to 1339.

[4] Exhibits "G", "G-1", "G-2", "G-3", "G-4", and "XXX", Docket—Vol. II, pp. 372 to 379, and Vol. I, 24 to 33, respectively.

ND

filing/remittance of taxes withheld				
Total	**₱175,408,114.08**	**₱5,300,646.37**	**₱132,436,849.96**	**₱313,339,610.41**

THE COURT'S RULING

For an orderly discussion, the subject tax assessments shall be addressed in this sequence:

Deficiency Tax	Total Amount
I. EWT	₱ 933,811.03
II. FWT	252,282,875.12
III. Increments for Late Remittance of EWT, FWT and Withholding Tax on Compensation (WTC)	5,376,143.85
IV. Compromise Penalties	194,000.00
V. Income Tax	54,552,780.41
	₱313,339,610.41

I. DEFICIENCY EWT - ₱933,811.03

Finding that there were income payments made by petitioner in the year 2001 comprising of professional fees in the amount of ₱5,249,849.00 and contractor's fees in the amount of ₱498,731.14 which were not subjected to 10% and 1% EWT, respectively, in alleged violation of Section 57 of the National Internal Revenue Code (NIRC) of 1997, and implemented by Revenue Regulations (RR) No. 02-98, as amended, respondent assessed petitioner of deficiency EWT in the amount of ₱933,811.03, inclusive of interest, computed as follows:[5]

Income Payments	Amount	Rate	EWT Due
Professional fees	₱ 5,249,849.00	10%	₱ 524,984.90
Contractor's fees	498,731.14	1%	4,987.31
Deficiency EWT			**₱ 529,972.21**
Add: 20% interest p.a. from 01/26/02 to 11/17/05			403,838.82
Total Amount Due			**₱ 933,811.03**

Respondent arrived at the amounts of ₱5,249,849.00 professional fees and ₱498,731.14 contractor's fees not subjected to EWT in this manner, *viz*:[6]

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[5] Exhibit "G", Docket—Vol. II, pp. 372 and 375.
[6] Exhibit "G", Details of Discrepancies/Assessments (Schedule I), I.b, Docket—Vol. p. 374.

Outside services per ITR		₱ 83,540,126.00[7]
Add: Professional fees recorded as non-outside services		3,757,720.00
	Total	₱ 87,297,846.00
Less: Professional fees & mgmt consultancy subject to final tax	₱ 51,647,726.00	
Payments to contractors subjected to 1%/2%	15,765,129.00	
Payments to general professional partnership	14,635,142.00	82,047,997.00
Professional fees not subjected to EWT		**₱ 5,249,849.00**
Contractors fee subject to withholding tax		₱ 1,423,472.14
Contractors fee subjected to withholding tax		924,741.00
Contractors fee not subjected to withholding tax		**₱ 498,731.14**

It is to be noted that the assessed professional fees of ₱5,249,849.00 originated from two accounts, namely, "Outside Services" amounting to ₱83,540,126.00 and professional fees recorded under "Non-outside Services" amounting to ₱3,757,720.00.

The Court-commissioned Independent Certified Public Accountant (ICPA) compared the professional fees under "Outside services" reflected per petitioner's Annual Income Tax Return (ITR) with those reported in the Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) [BIR Forms No. 1601-E] for the year 2001 and noted a variance in the amount of ₱18,528,570.99, as shown below:[8]

Account Name	Exhibits	Per 1601E
1. Professional fee - legal	"III"[9]	₱ 1,013,128.65
2. Professional fee - audit and tax	"JJJ"[10]	200,000.00
3. Professional fee - consulting	"KKK"[11]	16,090,441.87
4. Professional fee - contract labor	"LLL"[12]	13,144,098.00
5. Professional fee - legal paid to GPP	"MMM"[13]	5,678,130.21
6. Professional fee - tax and audit paid to GPP	"NNN"[14]	9,245,167.14
7. Professional fee - subjected to compensation		19,640,589.00
Total		**₱65,011,554.87**
Per Annual ITR		83,540,125.86
Variance		**₱18,528,570.99**

[7] Refer to BIR Records, p. 185.
[8] Exhibit "RRR", Docket—Vol. II, pp. 995.
[9] Docket—Vol. II, pp. 776.
[10] Docket—Vol. II, pp. 777.
[11] Docket—Vol. II, pp. 778 to 779.
[12] Docket—Vol. II, pp. 780 to 786.
[13] Docket—Vol. II, pp. 787 to 789.
[14] Docket—Vol. II, pp. 789-A.

A scrutiny of the supporting schedules,[15] BIR Forms No. 1601-E,[16] BIR Certifications,[17] and Schedules of Withholding Taxes,[18] shows that the professional fees classified under numbers 1 to 4 were indeed subjected to appropriate EWT pursuant to Section 2.57.2(A), (B) and (E) of RR No. 02-98, as amended.

With regard to the professional fees paid to general professional partnerships (GPPs) in the amounts of ₱5,678,130.21 and ₱9,245,167.14 totaling ₱14,923,297.35, respondent admitted that petitioner made such income payments but in the amount of ₱14,635,142.00. This can be seen from the respondent's deduction of the latter figure in arriving at the assessed professional fees of ₱5,249,849.00.[19]

Section 22(B) of the NIRC of 1997, as amended, defines GPPs as *"partnerships formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business".* As a corollary thereto, Section 26 of the same law provides that a general professional partnership shall not be subject to income tax. Its partners are the ones liable for income tax only in their separate and individual capacities.[20]

Consequently, GPPs are exempt from EWT as provided for under Section 2.57.5 of RR No. 2-98, as amended by RR No. 14-02, to wit:

> "Sec. 2.57.5. *Exemption from Withholding.* — **The withholding of creditable withholding tax prescribed in these Regulations shall not apply to income payments made to the following**:
>
> xxx xxx xxx
>
> B) Persons enjoying exemption from payment of income taxes pursuant to the provisions of any law, general or special, such as but not limited to the following:
>
> xxx xxx xxx

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[15] Exhibits "III" to "NNN", Docket—Vol. II, pp. 776 to 789-A.
[16] Exhibits "W" to "AA", "DD" to "HH", "Docket—Vol. II, p. 450 to 459.
[17] Exhibits "UUU" and "VVV", Docket—Vol. II, pp. 1034 to 1035.
[18] BIR Records, pp. 79 to 87, 70 to 76 and 521 to 644.
[19] Refer to Exhibit "G", Docket—Vol. II, p. 374.
[20] Section 26, NIRC of 1997.

(4) **General professional partnerships.**"

(Emphases and underscoring supplied)

Clearly, the professional fees paid by petitioner to GPPs are not subject to EWT. However, since petitioner failed to support the ₱288,155.35 discrepancy between the professional fees paid to GPPs as found by the ICPA *vis-à-vis* the amount admitted by respondent, the same shall be assessed of the corresponding 10% EWT of ₱28,815.54.

With reference to the professional fees subjected to compensation in the amount of ₱19,640,589.00, this was also deducted by respondent (part of the amount of ₱51,647,726.00) in arriving at the assessed professional fees of ₱5,249,849.00. Thus, it can be deduced that respondent found the amount of ₱19,640,589.00 to have been properly subjected to withholding tax.

Regarding the variance in the amount of ₱18,528,570.99 noted by the ICPA between the professional fees under "Outside services" reflected per petitioner's Annual ITR with that as shown per petitioner's Alphalist, the same was accounted for by the ICPA as follows:[21]

		Amount
1	Professional fees paid to Mc Grow International Limited Inc.	₱ 12,258,350.00
2	Accrued Professional fees not subjected to EWT	5,556,881.00
3	Contractor's fees not subjected to EWT	498,731.00
4	Unaccounted Variance	214,608.99
	Total	**₱18,528,570.99**

The amounts of ₱12,258,350.00 and ₱5,556,881.00 representing professional fees paid to Mc Grow International Limited Inc. and accrued professional fees, respectively, formed part of the assessed professional fees/management consultancy of ₱32,007,137.00 not subjected to FWT which will be addressed subsequently.

As to the contractor's fees of ₱498,731.00 which were not subjected to EWT as required under RR 02-98, and unaccounted professional fees of ₱214,608.99, petitioner is liable to pay the

[21] Exhibit "RRR", Docket—Vol. II, p. 995.

corresponding 1% and 10% EWT in the amounts of ₱4,987.31 and ₱21,460.90, respectively.

Anent the amount of ₱3,757,720.00, representing professional fees recorded under "Non-outside services" which was added by respondent to the amount of ₱83,540,126.00 professional fees recorded under "Outside services", based on the Court's verification of the schedule[22] provided by petitioner detailing the breakdown of the ₱3,757,720.00 professional fees, BIR Forms No. 1601-E,[23] BIR Certifications,[24] and Schedules of Withholding Taxes,[25] it was established that the EWT corresponding to the professional fees of ₱3,757,720.00 was withheld and remitted to the BIR, as shown below:

Payee	Tax Base	Rate	Tax Withheld	Month Withheld
Oracle System (Phils) Inc.	₱ 650,832.00	5%	₱ 32,541.60	May 2001
Information Professionals, Inc.	115,552.00	5%	5,777.60	June 2001
Nocon, Carlos S.	105,000.00	5%	5,250.00	June 2001
Alejandro, Jose	5,555.50	10%	555.55	June 2001
Asperin, Bernard	5,555.50	10%	555.55	June 2001
Mackay, Stephen A.	168,314.98	10%	16,831.50	June 2001
Mackay, Stephen A.	15,895.83	10%	1,589.58	June 2001
Sanchez, Wilfrido	1,111,111.10	10%	111,111.11	June 2001
Tolton, John	20,147.10	10%	2,014.71	June 2001
Alejandro, Jose	5,555.50	10%	555.55	July 2001
Asperin, Bernard	5,555.50	10%	555.55	July 2001
Information Professionals, Inc.	96,166.60	5%	4,808.33	Aug. 2001
Information Professionals, Inc.	115,737.40	5%	5,786.87	Aug. 2001
Nocon, Carlos S.	225,000.00	10%	22,500.00	Aug. 2001
Ashley& Derby, Inc.	14,100.00	10%	1,410.00	Sept. 2001
Information Professionals, Inc.	128,278.70	10%	12,827.87	Sept. 2001
Marsh Phils., Inc.	45,500.00	10%	4,550.00	Sept. 2001
Oracle System (Phils) Inc.	266,448.00	10%	26,644.80	Sept. 2001
Information Professionals, Inc.	112,220.80	10%	11,222.08	Oct. 2001
Juanito Aquias	200,000.00	20%	40,000.00	Oct. 2001
Information Professionals, Inc.	145,193.00	10%	14,519.30	Nov. 2001
Aquias, Juanito	200,000.00	20%	40,000.00	Nov. 2001
	₱3,757,719.51		**₱ 361,607.55**	

[22] Exhibit "J", Annex 1, Docket—Vol. II, p. 385.
[23] Exhibits "W" to "AA", "DD" to "HH", "Docket—Vol. II, p. 450 to 459.
[24] Exhibits "UUU" and "VVV", Docket—Vol. II, pp. 1034 to 1035.
[25] BIR Records, pp. 79 to 87, 70 to 76 and 521 to 644.

To sum up, petitioner is liable to pay basic deficiency EWT for taxable year 2001 only in the amount of ₱55,263.74, computed as follows:

		Amount	EWT Rate	Basic Deficiency EWT
Professional fees:				
Discrepancy between the professional fees paid to GPPs as found by the ICPA *vis-a-vis* the amount admitted by respondent	₱288,155.35			
Unaccounted professional fees	214,608.99	₱ 502,764.34	10%	₱ 50,276.43
Contractor's fees		498,731.00	1%	4,987.31
Basic Deficiency EWT				**₱ 55,263.74**

II. DEFICIENCY FWT - ₱252,282,875.12

Respondent assessed petitioner of deficiency FWT in the amount of the amount of ₱252,282,875.12, inclusive of interest, on the following expenses citing Section 28(B)(1) of the NIRC of 1997, as legal basis therefor:[26]

Income Payments	Amount	Rate	EWT due
Professional fee/management consultancy	₱32,007,137.00	32%	₱ 10,242,283.84
Software/hardware maintenance	4,319,142.75	32%	1,382,125.68
Interest expense	877,036,192.00	15%	131,555,428.80
Deficiency FWT			₱ 143,179,838.32
Add: 20% Interest p.a. from 01.26.02 to 11.17.05			109,103,036.80
TOTAL AMOUNT DUE			**₱252,282,875.12**

For easy reference, Section 28(B)(1) of the NIRC of 1997 is quoted herein below:

> "SEC. 28. *Rates of Income Tax on Foreign Corporations.* -
>
> xxx xxx xxx
>
> (B) *Tax on Nonresident Foreign Corporation.* –
>
> (1) *In General.* - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-

[26] Exhibit "G", Docket—Vol. II, pp. 372 and 375.

five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs 5(c): *Provided*, That effective 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and, effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%)."

In relation thereto, Section 2.57-1(I)(1) of RR No. 2-98 provides as follows:

"*Sec. 2.57-1 Income Payments Subject to Final Withholding Tax* – The following forms of income shall be subject to final withholding tax at the rates herein specified;

xxx xxx xxx

(I) *Income Derived From all Sources Within the Philippines by Non-Resident Foreign Corporation* – The following shall be subject to final withholding tax based on the gross amount of income and at the rate of tax prescribed therefor:

(1) *In general* – On gross income derived from all sources within the Philippines such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments, or other fixed or determinable annual, periodic or casual gains, profits and income and capital gains (except capital gains realized from sale, exchange, disposition of shares of stock in any domestic corporation which is subject to capital gains tax under Sec. 28(B)(5)(c) – at the following rates:

34% - beginning January 1, 1998
33% - beginning January 1, 1999 and
32% - beginning January 1, 2000 and thereafter".

A. Professional fee/management consultancy - ₱32,007,137.00

Respondent computed the assessed professional fee/management consultancy of ₱32,007,137.00 as follows:[27]

Professional fees & management consultancy subject to FWT	₱ 51,647,726.00
Less: Professional fees & management consultancy subjected to withholding tax on compensation	19,640,589.00
Professional fees & management consultancy not subjected to FWT	**₱ 32,007,137.00**

Petitioner, in its protest letter[28], explained that:

"The amount of P32,007,137.00 is broken down as follows:

1. P14,191,905.00 – We have remitted the withholding tax due on these fees in accordance with RR2-98, Section 2.57.2 as per attached Annex 2.

2. P12,258,350.00 – Other expenses amounting to P12,258,350.44 per attached Annex 3 had not been subjected to EWT since these were services rendered outside the Philippines

3. P 5,556,882.00 – These are accruals that were not subjected to EWT since these were estimates only."

As We have discussed and determined earlier under the deficiency EWT assessment, out of the ₱83,540,126.00 professional fees reflected under "Outside services" per petitioner's 2001 Annual ITR, only the following amounts were not subjected to withholding tax:

	Amount
Professional fees paid to Mc Grow International Limited Inc.	₱ 12,258,350.00
Accrued Professional fees	5,556,881.00
Discrepancy between the professional fees paid to GPPs as found by the ICPA*vis-a-vis* the amount admitted by respondent	288,155.35
Unaccounted Professional fees	214,608.99
Contractor's fees	498,731.00

[27] Exhibit "G", Details of Discrepancies (Schedule I), I.d, Docket—Vol. II, p. 374.
[28] Exhibit "J", Docket—Vol. II, p. 381.

Total	**₱18,816,726.34**

Thus, the amount of ₱14,191,905.00, as stated in petitioner's protest letter, must be stricken down from the assessment because it is not included in the ₱18,816,726.34 professional fees found to have been not subjected to withholding tax.

With reference to the professional fees paid to Mc Grow International Limited Inc. in the amount of ₱12,258,350.00, since no documentary evidence was presented to prove petitioner's claim that the related services were performed outside the Philippines, the Court is constrained to uphold the deficiency FWT assessment thereon.

Regarding the accrued professional fees of ₱5,556,881.00, the ICPA found that these should be subjected to EWT instead of FWT[29]. However, other than a breakdown of the amount of ₱5,556,881.00 which was attached as Annex 13 of the ICPA report,[30] no supporting documents, such as invoices, billing statements and official receipts, were submitted in order for this Court to ascertain the actual nature and proper tax implication of the said expenses. Hence, the deficiency FWT assessment on this item shall remain.

B. Software and hardware maintenance expenses – ₱4,319,142.75

Respondent's verification disclosed that software and hardware maintenance expenses of ₱4,319,142.75 were not subjected to FWT as required under Section 28(B)(1) of the NIRC of 1997, as amended.[31]

Petitioner argued that the amount of ₱4,319,142.75 pertains to fees paid to a non-resident foreign corporation for services performed outside the Philippines, hence, not subjected to FWT.[32]

However, the records do not contain any evidence to support petitioner's assertion. Hence, the Court has no means to verify the truthfulness thereof. For petitioner's failure to prove that the subject

[29] Exhibit "RRR", Docket—Vol. II, p. 1000.
[30] Exhibit "RRR", Docket—Vol. II, p. 1014.
[31] Exhibit "G", Details of Discrepancies (Schedule I), Docket—Vol. II, p. 375.
[32] Petition for Review, par. 52, Docket—Vol. I, p. 15.

services were performed outside the Philippines, the same shall be subject to the 32% FWT imposed under the aforequoted Section 28(B)(1) of the NIRC of 1997 and Section 2.57-1(I)(1) of RR No. 2-98.

C. Interest expense - ₱877,036,192.00

The assessed interest expense of ₱877,036,192.00 resulted from respondent's comparison of the interest expense reflected per petitioner's financial statements (FS) *vis-à-vis* that reported per FWT returns, as shown below:[33]

Interest expense per F/S	₱ 919,128,745.00[34]
Less: Interest expense per returns	42,092,553.00
Amount not subjected to final tax	**₱ 877,036,192.00**

As aptly found by the ICPA, during the year 2001, petitioner had no obligation yet to withhold FWT on the interest expense of ₱919,128,745.00.

The subject interest expense pertains to the Convertible Promissory Note[35] executed between petitioner and NII Holdings, Inc., wherein it was provided that:

> "1. **Maturity**. Unless converted as provided in Section 2, this Note will automatically mature and be due and payable on December 31, 2005 (the 'Maturity Date'). Subject to Section 2 below, **interest shall accrue on this Note but shall be due and payable until the Maturity Date**. xxx."

Section 2.57.4 of RR No. 2-98, provides when the obligation to withhold arises, to wit:

> "SECTION 2.57.4. *Time of Withholding.* — The obligation of the payor to deduct and withhold the tax under Section 2.57 of these regulations arises at the time an income is paid or payable, whichever comes first, the term 'payable' refers to the date the obligation become due, demandable or legally enforceable."

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[33] Exhibit "G", Docket—Vol. II, p. 375.
[34] Exhibit "UU", Statement of Cash Flows for the year ended December 31, 2001, Docket—Vol. II, p. 487.
[35] Exhibit "WW", Docket—Vol. II, pp. 501 to 504.

The above provision was subsequently amended by RR No. 12-01, which states:

> "Sec. 2.57.4. *Time of withholding.* — The obligation of the payor to deduct and withhold the tax under Section 2.57 of these Regulations arises at the time an income payment is paid or payable, or the income payment is accrued or recorded as an expense or asset, whichever is applicable, in the payor's books, whichever comes first. The term 'payable' refers to the date the obligation becomes due, demandable or legally enforceable.
>
> Provided, however, that where income is not yet paid or payable but the same has been recorded as an expense or asset, whichever is applicable, in the payor's books, the obligation to withhold shall arise in the last month of the return period in which the same is claimed as an expense or amortized for tax purposes."

Based on the afore-quoted provision of petitioner's loan agreement with NII Holdings, Inc., petitioner's liability for interest payment became due and demandable on maturity date, and therefore "payable" on December 31, 2005 only. Thus, petitioner is not required to withhold the FWT thereon during the year 2001. While petitioner recorded in its books of accounts the accrued interest for the year 2001 before the same became due and demandable, petitioner was not obligated to withhold and remit the FWT at the time of the accruals since petitioner did not claim the interest expense as deduction for income tax purposes, as can be seen in petitioner's Reconciliation of Net Income per books against taxable income in the ITR.[36] However, it was observed that the amount of interest expense that was added to petitioner's net loss per books was ₱919,097,628.00 which is lesser by ₱31,117.00 when compared with the ₱919,128,745.00 interest expense subject of the assessment. For failure to explain the discrepancy of ₱31,117.00, petitioner shall be liable for the corresponding 15% FWT in the amount of ₱4,667.55.

To recapitulate, petitioner is liable for basic deficiency FWT for taxable year 2001 in the amount of ₱7,087,667.15, computed as follows:

	Amount	FWT Rate	FWT Due
Professional fees/Management consultancy			

[36] Exhibit "XX", Docket—Vol. II, pp. 505 to 509.

Professional fees paid to Mc Grow International Limited Inc.	₱12,258,350.00			
Accrued Professional fees	5,556,881.00	17,815,231.00	32%	₱5,700,873.92
Software/hardware maintenance expenses		4,319,142.75	32%	1,382,125.68
Interest expense		31,117.00	15%	4,667.55
Basic Deficiency FWT				**₱7,087,667.15**

III. INCREMENTS FOR LATE REMITTANCE OF EWT, FWT AND WTC- ₱5,376,143.85

Pursuant to Sections 248(A), 249(B) and 255 of the NIRC and Revenue Memorandum Order (RMO) No. 1-90, respondent imposed twenty-five percent (25%) surcharge and twenty percent (20%) interest on petitioner's WTC and EWT due for the months of January and March 2001 as well as FWT due for the months of January to April 2011 in the total amount of ₱5,376,143.85, computed as follows:[37]

Period	**Due Date**	**Date of Payment**	**Basic**	**25% Surcharge**	**Interest**	**Total Surcharge and Interest**
Withholding Tax on Compensation						
January 2001	02/12/01	02/13/01	₱ 6,141,757.43	₱1,535,439.36	₱ 3,412.09	₱1,538,851.45
March 2001	04/10/01	04/11/01	10,148,489.29	2,537,122.32	5,638.05	2,542,760.37
Sub-Total			₱16,290,246.72	₱4,072,561.68	₱ 9,050.14	₱4,081,611.82
Expanded Withholding Tax						
January 2001	02/12/01	02/13/01	₱ 1,082,707.56	₱ 270,676.89	₱ 601.50	₱ 271,278.39
March 2001	04/10/01	04/11/01	1,905,444.71	476,361.18	1,058.58	477,419.76
Sub-Total			₱ 2,988,152.27	₱ 747,038.07	₱ 1,660.08	₱ 748,698.15
Final Withholding Tax						
January 2001	02/12/01	06/11/01	₱ 165,356.50	₱ 41,339.13	₱10,931.90	₱ 52,271.03
February 2001	03/12/01	06/11/01	80,134.93	20,033.73	4,051.27	24,085.00
March 2001	04/10/01	06/11/01	1,197,637.36	299,409.34	41,251.95	340,661.29
April 2001	05/10/01	06/11/01	481,057.69	120,264.42	8,552.14	128,816.56
		Sub-Total	₱ 1,924,186.48	₱ 481,046.62	₱64,787.26	₱ 545,833.88

[37] Exhibits "G" and "G-4", Docket—Vol. II, pp. 373, 375 and 379; Par. 4, Petition for Review (referring to Annex "B") vis-à-vis Par. 1, Answer, Docket—Vol. I, pp. 2, 34 to 35, and 92.

Total	**₱21,202,585.47**	**₱5,300,646.37**[38]	**₱75,497.48**[39]	**₱5,376,143.85**[40]

Section 2.58(A)(2)(a), (b) of RR No. 2-98 provides for the time of filing and remittance of creditable and final income taxes withheld as follows:

> "Sec. 2.58. RETURN 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) The withholding tax return, whether creditable or final, shall be filed and payments should be made **within ten (10) days after the end of each month** except for taxes withheld **for December** which shall be filed **on or before January 25 of the following year;**
>
> (b) For large taxpayers, the filing of the return and the payment of tax shall be made within twenty five (25) days after the end of each month." *(Emphases supplied)*

Similarly, Section 2.81 of RR No. 2-98 prescribes the filing and remittance of withholding tax on compensation as follows:

> "Sec. 2.81. FILING OF RETURN AND PAYMENT OF INCOME TAX WITHHELD ON COMPENSATION (FORM NO. 1601). — Every person required to deduct and withhold the tax on compensation shall make a return and pay such tax **on or before the 10th day of the month following the month in which withholding was made** to any authorized agent bank within the Revenue District Office (RDO) or in places where there are no agent banks, to the Revenue District Officer of the City or Municipality where the withholding agent/employers legal residence or place of business or office is located; provided, however, that taxes withheld from the **last**

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[38] This is a rectified figure. The amount per schedule is ₱5,180,381.95.
[39] This is a rectified figure. The amount per schedule is ₱66,945.34.
[40] This is a rectified figure. The amount per schedule is ₱5,247,327.29.

compensation (December) for the calendar year shall be paid **not later than January 25 of the succeeding year**; Provided, further, that large taxpayers as determined by the Commissioner shall remit taxes withheld on or before the 25th day of the following month.

xxx xxx xxx." *(Emphases supplied)*

Since the records do not show that petitioner is a large taxpayer, the prescribed period for the filing of petitioner's WTC, EWT and FWT returns and payment of the tax is within ten (10) days after the end of the month in which withholding was made, except for taxes withheld for the month of December which shall be on or before January 25 of the following year.

A scrutiny of petitioner's WTC[41], EWT[42] and FWT[43] returns covering the subject periods shows that petitioner timely filed its WTC and EWT returns and paid the corresponding tax for the month of March 2001 on April 10, 2001. Thus, respondent's assessment for deficiency increments thereon in the amounts of ₱2,542,760.37 and ₱477,419.76 for WTC and EWT, respectively, totaling ₱3,020,180.13 must be cancelled. However, petitioner belatedly filed the returns and paid its WTC and EWT covering the month of January 2001 on February 13, 2001. Thus, the assessed deficiency increments thereon in the amounts of ₱1,538,851.45 and ₱271,278.39, respectively, totaling ₱1,810,129.84, must be sustained, pursuant to Sections 248(A)(1) and 249(A) of the NIRC of 1997, which provide as follows:

"SEC. 248. *Civil Penalties.* —

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

(1) Failure to file any return and pay the tax due thereon as required under the provisions of this Code or rules and regulations on the date prescribed; or"

"SEC. 249. *Interest.* —

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[41] Exhibits "L" and "N", Docket—Vol. II, pp. 422, 424 and 425.

[42] Exhibits "W" and "J", Annex 5-A, Docket—Vol. II, pp. 450 and 413, respectively; BIR Records, p. 94.

[43] Exhibit "MM" and "J", Annex 6, Docket—Vol. II, pp. 463 and 414 to 415, respectively.

> (A) *In General.* — There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid. xxx."

With regard to the petitioner's FWT due for the months of January to April 2001, the same were paid and corresponding return filed only on June 11, 2001, which is beyond the prescribed period. Thus, petitioner is liable for the 25% surcharge and 20% interest thereon. However, as correctly pointed out by petitioner, the 25% surcharge of ₱481,046.62 formed part of the total ₱2,498,020.62 FWT paid by petitioner on June 11, 2001.[44] Hence, respondent's assessed 25% surcharge in the amount of ₱481,046.62 must be cancelled, but the assessed deficiency interest in the amount of ₱64,787.26 shall remain pursuant to Section 249(A) of the NIRC of 1997, as amended.

To sum up, the assessed increments for late remittance of WTC and EWT for the month of January 2001 and FWT for the months of January to April 2001 are upheld in the total amount of ₱1,874,917.10, broken down as follows:

Period	Due Date	Date of Payment	Basic	25% Surcharge	Interest	Total Surcharge and Interest
Withholding Tax on Compensation						
January 2001	02/12/01[45]	02/13/01	₱6,141,757.43	₱1,535,439.36	₱ 3,412.09	₱1,538,851.45
Expanded Withholding Tax						
January 2001	02/12/01	02/13/01	₱1,082,707.56	₱ 270,676.89	₱ 601.50	₱ 271,278.39
Final Withholding Tax						
January 2001	02/12/01	06/11/01	₱ 165,356.50		₱10,931.90	₱ 10,931.90
February 2001	03/12/01[46]	06/11/01	80,134.93		4,051.27	4,051.27
March 2001	04/10/01	06/11/01	1,197,637.36		41,251.95	41,251.95
April 2001	05/10/01	06/11/01	481,057.69		8,552.14	8,552.14
		Sub-Total	₱1,924,186.48		₱64,787.26	₱ 64,787.26
		Total	**₱9,148,651.47**	**₱1,806,116.25**	**₱68,800.85**	**₱1,874,917.10**

[44] Refer to Exhibit "MM", Docket—Vol. II, p. 463.
[45] February 10, 2001 fell on a Saturday.
[46] March 10, 2001 fell on a Saturday.

IV. COMPROMISE PENALTIES - ₱194,000.00

Pursuant to RMO No. 01-90, compromise penalties are only amounts suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. It is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[47] Absent a showing that herein petitioner consented to the compromise penalty, its imposition should be deleted. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[48]

Thus, there being no clear consent on the part of petitioner in paying the subject compromise penalties imposed by respondent for its alleged failure to file BIR Form Nos. 1604F, 1604E, inventory list and alphalist subjected to withholding tax and late filing/remittance of taxes withheld in the total amount of ₱194,000.00[49], the same must be cancelled.

V. DEFICIENCY INCOME TAX - ₱54,552,780.41

Respondent found petitioner liable for deficiency income tax for taxable year 2001 in the amount of ₱54,552,780.41, computed as follows:

Taxable income (loss) per return			₱ (3,572,090,039.00)
Add:	Adjustments/Disallowances per investigation		
	Salaries & wages not subjected to WT	₱ 48,251,080.00	
	Professional fees not subjected to EWT	5,249,849.00	
	Contractors' fees not subjected to EWT	498,731.14	
	Professional fees/Management consultancy not subjected to FWT	32,007,137.00	
	Software & hardware not subjected to FWT	4,319,142.75	
	Prior year's expense	8,007,934.02	98,333,873.91
Adjusted net loss per investigation			**₱ (3,473,756,165.09)**

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47 *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et. al.*, G.R. Nos. L-12928 and L-12932, March 31, 1962.
48 *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et. al.*, G.R. No. L-35266, January 21, 1991.
49 Exhibit "XXX", Docket—Vol. I, p. 24.

Add:	Net operating loss carry-over (NOLCO)	3,572,090,039.00
Taxable income per investigation		**₱ 98,333,873.91**
Income tax due thereon (32%)		₱ 31,466,839.65
Add:	Unsupported tax credit carried forward to next year	231,463.90
Deficiency income tax		**₱ 31,698,303.55**
Add:	20% interest p.a. from 4.16.02 to 11.17.05	22,854,476.86
TOTAL AMOUNT DUE		**₱ 54,552,780.41**

In order to determine whether or not the assessment is correct, We shall look into the propriety of each of the following items:

A.	Salaries & wages not subjected to WT	₱ 48,251,080.00
B.	Professional fees not subjected to EWT	5,249,849.00
C.	Contractors fees not subjected to EWT	498,731.14
D.	Professional fees/Management consultancy not subjected to FWT	32,007,137.00
E.	Software & hardware not subjected to FWT	4,319,142.75
F.	Prior year's expense	8,007,934.02
G.	Net operating loss carry-over (NOLCO)	3,572,090,039.0
H.	Unsupported tax credit carried forward to next year	231,463.90

A. Salaries and Wages not subjected to WT - ₱48,251,080.00

Invoking Section 34(K) of the NIRC of 1997, and Section 2.78.1 of RR No. 02-98, respondent disallowed as deduction from petitioner's gross income, the amount of ₱48,251,080.00, representing the difference between the salaries and wages as reflected per petitioner's Annual ITR in the amount of ₱344,411,113.0 and that shown in petitioner's Alphalist in the amount of ₱296,160,033.00, to wit:[50]

Salaries and wages per ITR	₱ 344,411,113.00
Less: Salaries and wages per Alphalist	296,160,033.00
Amount not subjected to withholding tax	**₱ 48,251,080.00**

The Court partially finds the disallowance proper.

Section 34(K) of the NIRC of 1997 sets forth additional requirements for the deductibility from gross income of any amount paid or payable by an income taxpayer, to wit:

[50] Exhibit "G", Details of Discrepancies (Schedule I), 1.a, Docket—Vol. II, p. 374.

"(K) *Additional Requirements for Deductibility of Certain Payments.* — Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section, Sections 58 and 81 of this Code."

Per petitioner's reconciliation, the salaries and wages that were not subjected to withholding tax amounted to ₱50,573,368.76, broken down as follows:[51]

SSS and ECC Contribution	₱ 2,616,364.90
Philhealth contribution	426,168.75
Pag-Ibig contribution	452,556.50
Insurance benefit expense	8,644,615.42
Expenses subjected to Fringe Benefits Tax (FBT)	8,125,200.94
Retrenchment pay	30,308,462.25
Total	**₱50,573,368.76**

Indeed, the mandatory employer's contributions to the Social Security System (SSS), Philippine Health Insurance Corporation (Philhealth) and Home Development Mutual Fund (HDMF/Pag-ibig) are excluded from the computation of the employees' taxable compensation income, and thus, not subject to withholding tax pursuant to Section 32(B)(7)(f) of the NIRC of 1997, to wit:

"SEC. 32. *Gross Income.* —

xxx xxx xxx.

(B) *Exclusion from Gross Income.* — **The following items shall <u>not</u> be included in gross income and shall be exempt from taxation under this Title**:

xxx xxx xxx

(7) *Miscellaneous Items.* —

xxx xxx xxx

(f) *GSIS, SSS, Medicare and Other Contributions.*

[51] Exhibit "AAAA", pp. 2 to 3, Docket—Vol. II, pp. 1046 to 1047.

— GSIS, **SSS, Medicare and Pag-Ibig contributions**, and union dues of individuals." *(Emphases and underscoring supplied)*

However, only the amounts of ₱2,616,364.90 and ₱426,168.75 pertaining to petitioner's SSS and ECC[52] and Philhealth[53] contributions for its employees are duly supported by contributions payment returns and bank validation/receipts. Petitioner failed to provide supporting documents for the claimed Pag-ibig contributions,[54] hence, the assessment on the amount of ₱452,556.50 shall not be disturbed.

Moreover, to prove that the insurance benefit expense of ₱8,644,615.42 pertains to the premiums paid for the health insurance of its employees, petitioner presented the returned checks issued to Aetna Healthcare, Inc. (Aetna) and Standard Chartered Bank's Cashier's Order Counter Delivery Control Sheet.[55] However, based solely on these documents, the Court cannot ascertain the actual nature of the total amount of ₱8,644,615.42 paid by petitioner to Aetna and its appropriate tax implication. As such, the disallowance of the expense by respondent is proper.

With reference to the ₱8,125,200.94 expenses allegedly subjected to FBT, the ICPA noted in his report dated July 27, 2010,[56] that the same pertain to amortization of company cars under finance lease from various leasing companies.

Petitioner submitted the related FBT returns (BIR Forms No. 1603) and payment transaction records[57] which reflected FBT payments totaling ₱2,600,064.29, broken down as follows:

Exhibit	Period Covered	FBT Paid
GGG-1 to GGG-2[58]	1st Quarter 2001	₱ 756,846.62
GGG-3 to GGG-4[59]	2nd Quarter 2001	577,031.84
GGG-5 to GGG-6[60]	3rd Quarter 2001	686,634.62

[52] Exhibit "DDD-1 to DDD-12" as summarized Annex 2 of Exhibit "AAAA", Docket—Vol. II, pp. 558 to 569, and 1089.
[53] Exhibit "EEE-1 to EEE-12" as summarized in Annex 3 of Exhibit "AAAA", Docket—Vol. II, pp. 570 to 581, and 1090.
[54] Exhibit "AAAA", Annex 4, Docket—Vol. II, p. 1091.
[55] Exhibits "FFF-1" to "FFF-16", Docket—Vol. II, pp. 582 to 597.
[56] Exhibit "RRR", p. 3, Docket—Vol. II, p. 989.
[57] Exhibits "GGG-1 to GGG-7", Docket—Vol. II, pp. 598 to 604.
[58] Docket—Vol. II, pp. 598 to 599.
[59] Docket—Vol. II, pp. 600 to 601.
[60] Docket—Vol. II, pp. 602 to 603.

GGG-7[61]	4th Quarter 2001	579,551.21
	Total	**₱ 2,600,064.29**

The grossed-up monetary value of the employees' fringe benefits corresponding to the aforesaid FBT payment is ₱8,125,200.94[62]. Since said employees' fringe benefits of ₱8,125,200.94 were subjected to FBT pursuant to Section 33[63] of the NIRC of 1997, the same may be validly deducted against petitioner's gross income for taxable year 2001.

Regarding the claimed retrenchment pay of ₱30,308,462.25, petitioner presented various checks and acknowledgement receipts proving payment of the said amount to various employees listed in Annex 13[64] of the ICPA's supplemental report dated October 19, 2010.

Petitioner likewise submitted Establishment Termination Reports (ETRs)[65] with attached Lists[66] of Terminated Workers duly received by the Department of Labor and Employment (DOLE). As indicated in the ETRs, the employees listed therein were retrenched due to redundancy, company reorganization/downsizing and lack of capital. In short, the separation from the service of the subject employees was due to causes beyond their control. Thus, the retrenchment pay received by the employees as a result of such separation are exempt from income tax and consequently from withholding tax pursuant to Section 32(B)(6)(b) of the NIRC of 1997, as amended, which states as follows:

> "SEC. 32. *Gross Income.* —
>
> xxx xxx xxx.
>
> (B) *Exclusion from Gross Income.* — **The following items shall <u>not</u> be included in gross income and shall be exempt from taxation under this Title**:

---

[61] Docket—Vol. II, p. 604.

[62] ₱2,600,064.29 divided by FBT rate of 32%.

[63] SEC. 33. *Special Treatment of Fringe Benefit.* —

(A) *Imposition of Tax.* — A final tax of thirty-four percent (34%) effective January 1, 1998; thirty-three percent (33%) effective January 1, 1999; and thirty-two percent (32%) effective January 1, 2000 and thereafter, is hereby imposed on the grossed-up monetary value of fringe benefit furnished or granted to the employee (except rank and file employees as defined herein) by the employer, whether an individual or a corporation xxx

[64] Exhibit "AAAA", Docket—Vol. II, pp. 1082, 1118 to 1121.

[65] Exhibits "VV" and "ZZ", Docket—Vol. II, p. 499 to 500, and 510 to 514.

[66] Exhibits "VV-1" and "ZZ-1", Docket—Vol. II, pp. 510, and 511 to 514.

xxx xxx xxx

(6) *Retirement Benefits, Pensions, Gratuities, etc.* —

xxx xxx xxx

(b) Any amount received by an official or employee or by his heirs from the employer as a consequence of separation of such official or employee from the service of the employer because of death, sickness or other physical disability or for any cause beyond the control of the said official or employee."

However, upon comparison of the list of retrenched employees in Annex "17"[67] of the ICPA's Supplemental Report dated October 19, 2010[68] against the list of terminated workers attached to the ETRs[69] submitted to the DOLE shows that there were employees included in the former (*i.e.*, the said Annex "17") but was excluded in the latter (*i.e.*, the said ETRs), namely:

EMPLOYEE'S NAME	AMOUNT
ALARCON, ROLANDO	₱ 2,443,472.25
AQUINO, MICHAEL ERIC	86,942.54
AYSON, MARIE KAREEN	220,564.00
BAUTISTA, ALEX	237,517.48
BAUTISTA, VANESSA ANTONNETTE H.	59,856.81
CORPUZ, BENJAMIN	199,364.12
CRUZ, NICOLAS	434,650.69
CUENCA, CHERYL LEE ANN	220,495.91
CUSTODIO, FRANCISCO	65,783.39
EVALLE, ROY AGUSTIN K.	1,846,594.82
JAMON ROWENA	106,411.10
TOLOSA, LAZARUS	243,782.59
TUPAZ, ARMANDO	39,479.40
Total	**₱ 6,204,915.10**

Hence, the disallowance of the amount of ₱6,204,915.10 as deduction from petitioner's gross income shall remain.

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[67] Docket—Vol. II, pp. 1053 to 1056.
[68] Exhibit "AAAA", Docket—Vol. II, pp. 1045 to 1052.
[69] Exhibits "VV" and "ZZ", Docket—Vol. II, p. 499 to 500, and 510 to 514.

In fine, for petitioner's failure to prove that the following claimed salaries, wages and benefits totaling ₱15,302,087.02 are not subject to withholding tax, the same cannot be deducted from its taxable gross income for taxable year 2001, pursuant to the above-quoted Section 34(K) of the NIRC of 1997:

Pag-Ibig contribution	₱ 452,556.50
Insurance benefit expense	8,644,615.42
Retrenchment pay	6,204,915.10
Total	**₱ 15,302,087.02**

B. Professional fees not subjected to EWT - ₱5,249,849.00
C. Contractor's fees not subjected to EWT - ₱498,731.14
D. Professional fees/Management consultancy not subjected to FWT - ₱32,007,137.00
E. Software and hardware maintenance expenses not subjected to FWT - ₱4,319,142.75

Relying on the same Section 34(K) of the NIRC of 1997, as aforequoted, respondent disallowed petitioner's claimed deductions for professional fees in the amount of ₱5,249,849.00; contractor's fees in the amount of ₱498,731.14; professional fees/management consultancy in the amount of ₱32,007,137.00; and software and hardware maintenance expenses in the amount of ₱4,319,142.75.

Notably, petitioner was also assessed of the corresponding deficiency EWT and FWT for the above income payments. Thus, based on the Court's findings under the deficiency EWT and FWT assessments, petitioner failed to withhold and remit the proper taxes on the subject income payments but in the reduced amount of ₱23,135,869.09, detailed as follows:

Professional fees not subjected to EWT	₱ 502,764.34
Contractor's fees not subjected to EWT	498,731.00
Professional fees/Management consultancy not subjected to FWT	17,815,231.00
Software/hardware maintenance expenses not subjected to FWT	4,319,142.75
Total	**₱23,135,869.09**

Consequently, the amount of ₱23,135,869.09 shall be disallowed from petitioner's claimed deductible expenses, pursuant to Section 34 (K) of the NIRC of 1997.

F. Prior year's expense – ₱8,007,934.02

Respondent disallowed the prior year's expense amounting to ₱8,007,934.02 as deduction from petitioner's current year's gross income pursuant to Section 34(A)(1)(a) of the NIRC of 1997,[70] which states that, "(t)*here shall be allowed as deduction from gross income all the ordinary & necessary expenses* ***paid or incurred during the taxable year*** *in carrying on or which are directly attributable to the development, management, operation and/or conduct of the trade, business or exercise of a profession.*"

For petitioner's failure to refute respondent's finding that the amount of ₱8,007,934.02 pertains to a prior year's expense, the assessment on this item shall stand.

G. Net Operating Loss Carry Over – ₱3,572,090,039.00

Respondent excluded, in the computation of the petitioner's income tax deficiency, the net loss reflected in the latter's 2001 Annual ITR amounting to ₱3,572,090,039.00, and labeled it as *"Net operating loss carry over (NOLCO)"*, allegedly on the basis of Section 34(D)(3) of the NIRC of 1997.[71]

We disagree.

The governing law regarding net operating loss carry-over (NOLCO) is Section 34(D)(3) of the NIRC of 1997, which provides as follows:

> "SEC. 34. *Deductions from Gross Income.* — Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), **there shall be allowed the following deductions from gross income**:

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[70] Refer to Exhibit "G", Details of Discrepancies (Schedule I), I.f, Docket—Vol. II, p. 374.

[71] Exhibit "G", Docket—Vol. II, pp. 372 and 375.

> xxx xxx xxx.
> (D) *Losses.* —
>
> xxx xxx xxx
>
> (3) *Net Operating Loss Carry-over.* — **The net operating loss of the business or enterprise for any taxable year immediately preceding the current taxable year, which had not been previously offset as deduction from gross income <u>shall be carried over as a deduction from gross income for the next three (3) consecutive taxable years immediately following the year of such loss</u>**: xxx
>
> xxx xxx xxx
>
> For purposes of this Subsection, **the term <u>'net operating loss'</u> shall mean the excess of allowable deduction over gross income of the business in a taxable year**:
>
> xxx xxx xxx." *(Emphases and underscoring supplied)*

Based on the foregoing, it is clear that a net operating loss, which is defined as *"the excess of allowable deduction over gross income of the business in a taxable year"*, may be allowed to be carried over to the next three (3) consecutive years, and may be made as a deduction from gross income for such periods.

In this case, it is undisputed that the said amount of ₱3,572,090,039.00 pertain to the loss per petitioner's Income Tax Return for taxable year 2001.[72] However, upon a cursory examination of the said amount would reveal that a significant portion thereof pertains to the NOLCO of the previous years totaling ₱2,749,949,144.00,[73] determined as follows:

NOLCO - 2000	₱ 714,744,556.00
NOLCO- 1998 & 1999	2,035,204,588.00
Total	**₱ 2,749,949,144.00**

Correspondingly, the remaining part in the amount of

[72] Refer to Exhibits "I" and "59", BIR Records, pp. 24 to 26.
[73] Refer to Exhibits "I" and "59", BIR Records, at p. 26.

₱822,140,895.00 (of the said amount of ₱3,572,090,039.00) would be representing the deductions claimed by petitioner for the same taxable year. Thus, it was error on the part of respondent to treat the said amount of ₱822,140,895.00 as NOLCO.

In any event, the above-stated amount of ₱2,749,949,144.00 should be allowed as a deduction from gross income for taxable year 2001, since Section 34(D)(3) of the NIRC of 1997 allows such deduction. In this connection, respondent has not provided any clear legal basis why the total amount of ₱3,572,090,039.00 should be added to the *"Adjusted net loss per investigation"* to arrive at the *"Taxable income per investigation"* amounting to ₱98,333,873.91, to which the corporate income tax rate of 32% was applied.

In fine, the amount of ₱3,572,090,039.00 should **not** be considered as part of the *"Taxable income per investigation"* as determined by respondent.

H. Unsupported tax credit carried forward to next year - ₱231,463.90

Respondent disallowed petitioner's claimed tax credits for the year 2001 amounting to ₱231,463.90 for being unsupported.

As correctly found by the Court-commissioned ICPA[74], out of the total claimed tax credits of ₱231,463.90, petitioner was able to substantiate with Certificates of Creditable Tax Withheld at Source (BIR Forms No. 2307)[75] only in the amount of ₱91,882.22. In other words, petitioner was not able to present the pertinent BIR Forms No. 2307 for the remaining balance of ₱139,581.68. Thus, only the amount of ₱91,882.22 shall be recognized as valid tax credits for taxable year 2001.

Notwithstanding the foregoing conclusions, no deficiency income tax is due from petitioner in view of the significant net loss it suffered in 2001, as shown by the following computation:

Taxable income (loss) per return		₱ (3,572,090,039.00)
Add: Adjustments/Disallowances per investigation		
Salaries & wages not subjected to WT	₱ 15,302,087.02	
Professional fees not subjected to		

[74] Exhibit "RRR", p. 6, Docket—Vol. II, p. 992.
[75] Exhibits "PPP-1" to "PPP-229" as summarized in Annex 14 of Exhibit "RRR", Docket—Vol. II, pp. 713 to 739, 842 to 980 and 1016 to 1020.

EWT	502,764.34	
Contractors fees not subjected to EWT	498,731.00	
Professional fees/Management consultancy not subjected to FWT	17,815,231.00	
Software & hardware not subjected to FWT	4,319,142.75	
Prior year's expense	8,007,934.02	46,445,890.13
Adjusted net loss per investigation		**₱ (3,525,644,148.87)**
Income tax due thereon (32%)		-
Less: Tax Credits:		
Creditable Taxes Withheld for the fourth quarter per return	₱ 231,463.90	
Less: Unsupported by BIR Forms No. 2307	139,581.68	91,882.22
Income Tax Overpayment		**₱ (91,882.22)**

WHEREFORE, in light of the foregoing considerations, the instant *Petition for Review* is hereby **PARTIALLY GRANTED**. The assessments issued by respondent against petitioner for taxable year 2001 covering compromise penalties in the amount of ₱194,000.00 and deficiency income tax in the amount of ₱54,552,780.41 are **CANCELLED AND WITHDRAWN**.

However, the assessments issued by respondent against petitioner for taxable year 2001 covering deficiency EWT, FWT, and increments for late remittance of EWT, FWT and WTC are hereby **PARTIALLY AFFIRMED**.

Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **₱8,928,663.62 (EIGHT MILLION NINE HUNDRED TWENTY-EIGHT THOUSAND SIX HUNDRED SIXTY-THREE PESOS AND 62/100),** representing basic EWT and FWT, inclusive of the 25% surcharges imposed under Section 248(A)(3) of the NIRC of 1997; and the amount of **₱1,874,917.10 (ONE MILLION EIGHT HUNDRED SEVENTY-FOUR THOUSAND NINE HUNDRED SEVENTEEN PESOS AND 10/100),** representing 25% surcharge and 20% interest for late remittance of EWT, FWT and WTC; or in the aggregate sum of **₱10,803,580.72 (TEN MILLION EIGHT HUNDRED THREE THOUSAND FIVE HUNDRED EIGHTY PESOS AND 72/100),** computed as follows:

Tax Type	Basic Tax	Surcharge	Interest	Total
EWT	₱ 55,263.74	₱ 13,815.94	-	₱ 69,079.68
FWT	7,087,667.15	1,771,916.79		8,859,583.94

Subtotal	**₱7,142,930.89**	**₱1,785,732.73**	**-**	**₱ 8,928,663.62**
Increments for late remittance of EWT, FWT and WTC		₱1,806,116.25	₱68,800.85	₱ 1,874,917.10
Subtotal		**₱1,806,116.25**	**₱68,800.85**	**₱ 1,874,917.10**
Total	**₱7,142,930.89**	**₱3,591,848.98**	**₱68,800.85**	**₱10,803,580.72**

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

a) Delinquency interest at the rate of twenty percent (20%) *per annum* on the total amount of ₱8,928,663.62, computed from November 17, 2005 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997; and

b) Delinquency interest at the rate of twenty percent (20%) *per annum* on the amount of ₱1,874,917.10, computed from November 17, 2005 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997.

SO ORDERED.

ERLINDA P. UY
Associate Justice

I CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

ATTESTATION

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

ERLINDA P. UY
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Acting Presiding Justice