REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PICOP TRADING CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 4405

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
AUG 23 1994

x - x

DECISION

In this suit petitioner seeks to review the decision of respondent dated January 8, 1988, denying the protest against the assessments of deficiency income and withholding taxes for 1985.

It appears that petitioner's PICOP Trading Corporation, (PTC) a wholly owned subsidiary of Paper Industries Corporation of the Philippines (PICOP), is primarily engaged in the business of trading, at retail and wholesale, paper products. On May 1, 1982, petitioner entered into a Distributorship Agreement with PICOP to distribute on exclusive basis, the paper products manufactured by PICOP which was however terminated on November 1, 1985.

On the basis of the report of investigation of the revenue examiner, and having determined that there has been due from petitioner, deficiency tax liabilities, respondent, issued a demand letter and assessment notice both dated January 8, 1988, requesting petitioner to pay deficiency income and expanded withholding taxes for 1985 in the amounts of P6,623,930.30 and P114,534.84, respectively, inclusive of increments thereon (Annexes "A" and "AJ", pp. 8-9, CTA rec.; pp. 147-149, BIR rec.)

In a letter dated February 26, 1988, petitioner protested the assessments on the ground that the said assessments lack legal and factual basis (Annex "B", pp. 10-15, CTA rec.; pp. 150-155, BIR rec.)

In a letter dated August 21, 1989, respondent rendered his final decision on the disputed assessments denying the protest and reiterating the demand for the amounts of P6,623,930.30 and P114,534.84 representing deficiency income and withholding taxes (Annex "C", p. 17, CTA rec.; p. 165, BIR rec.)

Hence this appeal.

The issues for resolution in this controversy are as follows:

1. Whether or not petitioner's sales for 1985 was understated as a result of deducting the domex price difference from its gross sales;

2. Whether or not petitioner's interest income for 1985 was understated;

3. Whether or not the slitting and rewinding expenses are deductible as an expense item in 1985;

4. Whether or not petitioner should be assessed deficiency expanded withholding taxes.

Set forth are the discussion of the above issues ad seriatim.

1. *Domex Price Difference* -

It is the position of the petitioner that its sales for 1985 was not understated by the deduction of the domex price difference from gross sales. Justifying the stand, petitioner asserts that the domex price difference serves as an incentive to exporters to procure their packaging materials from local sources. To avail of such incentive scheme, the customers are required to submit proof that the products were actually exported abroad. It claimed that this price differential is a legitimate expense of PTC. Describing its procedure, it claims that in a sale of kraft paper products to customers, the transaction is taken in the book of the petitioner as follows:

Entries made upon sale with sample figures:

1.	Dr. Accounts Receivable	P15,500.00	
	Cr. Sales (To record export sales account at local price)		P15,000.00
2.	Dr. Sales	P 2,325.00	
	Cr. Domex Price Difference		

(To set-up provision for
domestic price difference) P 2,325.00

Limiting the examination to the above entries, the examiner naturally conclude that petitioner understated its sales in 1985. However, it asserts that had the examiner examined the entries covering payments of customers exports for the above transaction, he would have arrived to a different conclusion, thus:

3. Dr. Cash in Bank P13,175.00
Cr. Accounts Receivable
(To record partial collection
of account) P13,175.00

In effect according to petitioner, what was left in the transaction after the three entries is a debit balance accounts receivable at P2,325.00 and a credit balance for domex price difference in the same amount. This balance remained open in the books of PTC until the customer exporter liquidated the domex price difference thru the submission of export documents to PTC. Upon receipt of said documents, PTC issues a credit note to customer-exporter and makes the following entry:

4. Dr. Domex price difference P2,325.00
Cr. Accounts receivable
(To record credit note -
for liquidation of price
difference) P2,325.00

The above entries accordingly completed the transaction and closed the customer's account. From the foregoing, petitioner claims that it never intended and in fact, did not deprive the government of revenues.

Petitioner further contends that a domestic transaction involves different stages, the selling of kraft paper, to a converter (referred to as customer-exporter), the manufacture, then the delivery of boxes, by the converter to his customer, the act of exporting and the submission of export documents to the converter which in turn, submits the same to PTC. The process requires a lead time of at least 6 months. In other words, a single transaction may start in a particular year and end in another, which could not have been yet subject of deficiency assessment for understated sales and submits that the deficiency assessment in the amount of P9,863,047.30 should be set aside.

On the other hand, respondent contends otherwise. As stated in the examiners report, the amount of P9,863,049.30 (net credit balance for 1985) "represents mere provision for price adjustments to customer-exporter. The original entry to take up said provision was a debit to '<u>Sales-Kraft paper</u>' and a credit to '<u>Domex Price Difference</u>'. Subsequent entry was made when <u>Credit Note</u> was issued to customer-exporter for rebates based on approved liquidation of export documents required by the

Board of Investment (BOI) by debiting '<u>Domex Price Difference</u>' and crediting 'Accounts Receivable-Trade'. Hence, Sales-Kraft Paper was reduced by the provision made not yet liquidated during the year in the amount of P9,863,049.30."

We agree with respondent.

It is to be noted that from the entries made by petitioner, the accounts receivable was not reduced by the provision for domex price. In financial accounting, revenue means "gross increase in assets or gross decrease in liabilities recognized and measured in conformity with generally accepted accounting principles that result from those types of profit-directed activities of an enterprise that can change equity." (Pls. see Statement of Financial Accounting Standards No. 1, p. 40). Based on this definition, petitioner has obviously understated its sales since it recognized a gross increase in assets while the sale was lessened by the domex price difference. Petitioner could have done better had it explained to the Court the treatment of domex price difference at the end of 1985. However, what was explained during the hearing was the event thereafter. (Please see T.S.N., September 25, 1990, pp. 23-26).

2. *Deferred interest income* -

Petitioner contends that the deferred interest income in the amount of P4,597,716.00 should not be included as part of petitioner's gross income for it is more of imaginary income than a taxable one. Thus for 1985, only those interest and penalties actually collected were reported as interest income. In the same year, interest and penalties condoned were not taken up as expense by petitioner, justifying this treatment, on the ground that it is not a lending company which earns interest income in the ordinary course of business. In fine, it is argued that said amount of P4,597,716.00 is not a taxable income because there was no actual flow of wealth into the taxpayer at the end of the taxable year. In any event, interest income sought to be taxed was subsequently reported as income when collected and the remaining balance was not reported as expense when condoned. It added that the procedure was consistently applied in prior and subsequent years, thus, there was no loss of revenue on the part of the government.

We disagree with petitioner.

Income arising from late payment of accounts should be recognized because the earning process had already been completed. Since petitioner has adopted the accrual method of accounting, the interest income is supposed to be reported in the period earned rather than when the cash was received or paid. Hence, we find for respondent.

3. *Slitting and rewinding expenses in the amount of P120,919.34.*

The amount represents expense incurred between November 12 to December 4, 1985, after termination of the Distributionship Agreement. However, the same was disallowed by respondent.

Since the expenses were actually incurred and billed to petitioner for having paper rolls slit and rewinded in the year involved, (see BIR recs., pp. 92-107). These expenses are deemed deductible business expenses. The termination of the contract between PICOP and PTC is immaterial since these expenses were incurred to fulfill unterminated transactions arising therefrom.

4. *Deficiency expanded withholding tax.* - P114,534.84

After a careful consideration of the records of the case, we find that the petitioner indeed failed to withhold the required withholding taxes on payments to operators of stevedoring, warehousing, and transportation contractors for carriage of goods. Thus, pursuant to Sec. 54(e) of the Tax Code, petitioner is liable to pay the tax required to be deducted and withheld, a 25%

surcharge and an interest of 20% per annum from the time the tax is required to be withheld until the date of assessment. A recomputation of the 1985 income tax as well as the deficiency expanded withholding taxes are in order to wit:

* Recomputation of 1985 deficiency income tax:			
Net income/(loss) per return		(P 521,885.00)	
Add: Unallowable deductions and additional income			
a. domex price difference	P9,863,049.30		
b. deferred interest	4,597,716.81		
c. representation and entertainment	30,000.00	14,490,766.11	
Net income per Court computation		P13,968,881.11	
Income tax due thereon [Sec. 24]			P4,879,108.39
Add: Interest on deficiency [Sec. 51(d)] from 4-16-86 to 1-8-88 [4,879,108.39 x 20% x 633/365]			1,692,315.40
TOTAL AMOUNT DUE AND COLLECTIBLE			P6,571,423.79
1985 Deficiency Expanded Withholding Tax			
Delivery expenses		P2,142,457.87	
Freight expenses		6,384,252.91	
Arrastre & stevedoring		894,643.16	
Warehousing and storage		136,915.20	
Total		P9,558,269.14*	
1% Expanded withholding tax due		P 95,582.69	
Less: Amount already paid		13,037.55	
Deficiency expanded withholding tax			P 82,545.14
Add: Surcharge and interest [Sec. 54(e)]			
Surcharge [82,545.14 x 25%]			20,636.28
20% Interest from 10-31-85 to 1-8-88 [(82,545.14 x 20% X 799/365]			36,138.94
			P 139,320.36*
TOTAL DEFICIENCY TAXES DUE AND COLLECTIBLE			P6,710,744.15

*Corrected by the Court due to error in footing.

Wherefore the decision appealed from is hereby modified. Petitioner PICOP Trading Corporation is held liable for deficiency income and expanded withholding taxes in the amount of P6,571,425.79 and P139,320.36, respectively, or in the aggregate amount of P6,710,744.15 for the year 1985 inclusive of surcharge and interest. With costs.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13 Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals