REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

KASAMAHAN REALTY DEVELOPMENT CORPORATION (now known as STAG TRADING CORPORATION),
Petitioner,

-versus-

C.T.A. CASE NO. 6204

Members:

CASTAÑEDA, JR., *Chairman*
UY, and
PALANCA-ENRIQUEZ, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
FEB 16 2005 CMApolinario

x - x

DECISION

CASTAÑEDA, JR., *J.*:

Before Us is the Petition for Review filed by petitioner on November 24, 2000 involving deficiency income tax assessment in the aggregate amount of ₱44,578,524.36 for the taxable year 1994.

Borne from the records and Joint Stipulation of Facts by the parties,[1] the following are the uncontested facts:

---

[1] CTA Records, pp. 111-113.

On April 17, 1995, petitioner filed its 1994 Corporate Annual Income Tax Return and paid the amount of ₱1,403,574.00 as its tax due. The amount paid was computed as follows:

Gross Income:			
	Phelps Dodge Phils., Inc.		₱ 37,513.01
	Atlas Consolidated Mining Corp.		738,000.00
			₱38,251,014.00
Deductions			
	Administrative	₱1,980,000.00	
	Taxes and licenses	1,590,235.00	
	Salaries and wages	1,313,743.00	
	Maintenance	1,200,591.00	
	Depreciation	1,061,266.00	
	Interest	983,138.00	
	Transportation/traveling	450,000.00	
	Professional fees	368,807.00	
	Amortization of organization costs	287,087.00	
	Others	363,623.00	
		₱9,598,490.00	₱ 9,598,490.00
			₱28,652,524.00
Gain on Sales or Exchanges of Capital Assets			
	Land		8,969,148.00
Others			25,255.00
			₱37,646,927.00
Tax Due			**₱13,176,424.00**
Less:			
	Quarterly payments: 1st quarter	4,511,105.00	
	2nd quarter	2,409,956.00	
	3rd quarter	2,826,347.00	
		₱9,747,408.00	
	Creditable Tax Withheld:		
	1st quarter	919,012.00	
	2nd quarter	468,913.00	
	3rd quarter	637,571.00	
		₱2,025,442.00	(11,772,850.00)
Tax paid			**₱ 1,403,574.00**

On February 22, 1996, however, petitioner received a post-reporting notice[2] wherein it was informed of the audit conducted by Revenue Officers Jesus Q. Mendoza and Eleanor M. Santiago[3] who recommended for the assessment of deficiency taxes in the sum of ₱15,096,873.97, inclusive of penalties and interest, for the taxable year 1994.[4] The assessment of deficiency taxes resulted from the following findings:

> Note 1. xxx
>
> It may be recalled that on 25 February 1992 and 18 March 1992, two Deeds of Exchange duly signed by Mr. Ramon B. Santos, President-PDPI and Mr. Jose Ibazeta, President-KRDC, were executed by Phelps Dodge Philippines, Inc. for the transfer of its parcels of land, exclusive of improvements in favor of Kasamahan Realty Development Corporation in exchange for the latter's shares of stocks worth ₱100,000,000.00. It was noted that the Deed of Exchange dated 25 February 1992 was filed with and received by the Records Division, Securities and Exchange Commission on 28 February 1992. Whereas, the Deed of Exchange dated 18 March 1992 was filed with the BIR on 18 March 1992. The two instruments both covered land exclusive of improvements owned in PDPI under TCT Nos. 9227, 9228, 283519, 61547 and 277702 and ₱100,000,000 worth of shares of stocks owned by KRDC.
>
> xxx xxx xxx
>
> It was further noted from the Audited Financial Statements of PDPI from 1992, 1993 and 1994 that the supplemental informations on the non-cash investing activity in the exchange of land and buildings was for 99.7% common shares of stock of KRDC. Whereas, the Audited Financial Statement of KRDC from 1993 to 1994 showed that the issuance of 99.7% common stock for cash of ₱99,800.00 and for land and building of PDPI.
>
> xxx xxx xxx

---

2 BIR Records, p. 414.

3 Pursuant to the Letter of Authority No. 77399, dated July 31, 1995; *ibid.*, p. 455.

4 *Ibid.*, p. 410-412.

It was quite evident that Phelps Dodge Philippines, Inc. and Kasamahan Realty Development Corporation deliberately misstated material facts on the income tax returns filed, on the Deeds of Exchange filed on two different dates and on the description of properties in exchange. The requirements and conditions embodied under BIR Ruling No. 321-92 and Item I, B(2)(a) of Revenue Memorandum Order No. 26-92 were violated.

Note 2.

Understatement of gain on sale of land to the Department of Public Works and Highways computed, as follows:

Selling Price, per Deed of Sale		₱9,002,000.00
Less:	Cost of land based on book value, per Audited Financial Statement of PDPI - (Land area of lot sold/Total land area x historical cost) or 643 sqm/42,223 sqm x P3,474,476.00	52,911.64
Net gain on sale of land		₱8,949,088.36
Less:	Gain on sale of land per books	7,721,556.00
UNDERSTATEMENT OF GAIN SALE OF LAND		₱8,949,088.36

Note 3. – Salaries and wages P1,590,235.00

In the course of the audit, it was traced that the above account have no actual proof of payments to employees/maintenance men, no taxes withheld and what was presented was debit memo of PDPI (DM 94-12-308) charging KRDC 50% total cost of SMS.

Note 4. – Interest Expense P983,140.19

Following the principle of matching cost against revenue, interest expense paid for the acquisition of 12 hectares of land in Tarlac should have been capitalized or charged to a deferred charge cost to be amortized in the event the land shall generate revenue for the company.

Note 5. – Transportation and Travelling P450,000.00

There were no actual proof of payments but mere reimbursement charged by PDPI.

Note 6. – Professional Fees P317,967.00

There were no actual proof of payments but mere reimbursement charged by PDPI.

The computation of petitioner's deficiency tax was subsequently revised and computed as follows:[5]

Net Income,per corporate return filed			₱37,646,927.00
Add:	Disallowances/Additions to Net Income:		
	1. Gain on exchange of shares of stocks for real properties	₱49,515,688.67	
	2. Salaries and wages	1,590,235.00	
	3. Interest expense	983,140.19	
	4. Transportation and travelling expenses	450,000.00	
	5. Professional fee	317,967.00	₱52,857,030.00
Total Net Income subject to corporate income tax			₱90,503,957.86
Corporate Income Tax Due			₱31,676,385.25
Less:	Income Taxes paid		
	Per BIR Form 1743-750	₱ 1,879,750.74	
	Cash Payments	11,150,981.93	₱13,030,732.67
Deficiency Income Tax			₱18,645,652.58
Add:	25% Surcharge		4,661,413.15
	20% Interest		4,661,413.15
	Compromise Penalty		25,000.00
Total Amount Still Due and Collectible			**₱27,993,478.88**

After several requests for postponements, petitioner filed on July 19, 1996 its protest on the revised computation of deficiency tax on the ground that the assessment was without factual or legal basis. Further, it requested that it be given an opportunity to examine the BIR docket and a period of thirty (30) days therefrom within which to file a detailed supplemental memorandum containing explanations and defenses against the proposed assessment.[6] Subsequently, petitioner filed another protest on the deficiency income tax assessment on February 23, 1998.[7]

---

5 *Ibid.*, p. 418.
6 *Ibid.*, pp. 423-428.
7 *Ibid*,. pp. 456-476.

In the Memorandum of Revenue Officers II Elanor M. Santiago and Jesus Q. Mendoza, the revised assessment of ₱30,166,930.53. (inclusive of increments) was based on the following facts:[8]

1. Gain on exchange of shares of stocks for property under Section 34(O)(2) - xxx

    a) The shares of stocks worth ₱100,000,000.00 issued by KRDC to PDPI were exchanged for land only, excluding building per two (2) Deeds of Exchange executed and filed on two (2) different dates, 25 February 1992 to the Securities and Exchange Commission and 18 March 1992 to the BIR. xxx
    b) KRDC recognized in its books of accounts both land and building despite the above Deeds of Exchange and Tax Declaration Nos. 00005-00672, 009 and 00669 which confirmed the building erected on the land subject of the exchange was still registered under PDPI and was not transferred to KRDC. xxx
    c) CAR No. 295079 showed that the Documentary Stamp Tax paid on 18 March 1992 (but 25 February 1992) by PDPI was specifically for land only; xxx
    d) The conditions for a tax-free exchange as mandated under BIR Ruling No. 321-92 and RMO 26-92 were not met;
    e) The Reformation of Instrument was executed only on 25 April 1995 after the issuance of Letter of Authority No. 65472 dated 27 October 1994 authorizing the 1993 investigation. Said instrument, however, was not filed with this Bureau. xxx

2. Salaries and Wages - Adjustment was made to conform with the correct figures of ₱1,313,743.17 instead of ₱1,590,235.00. xxx

3,4, and 5. Interest expense, transportation and travelling and professional fees -

1. Gain on exchange of shares of stocks for real properties (₱49,515,688.67) - Verification disclosed a misrepresentation of fact per Deed of Exchange which

---

8 *Ibid.*, pp. 446-448.

> nullify the exemption provided under Sec. 34(c)2(c) of NIRC. This resulted to the recognition of taxable gain.
>
> x x x x x x x x x
>
> 2. Salaries and Wages (₱1,313,743.17) - Verification disclosed that this account has no actual proof of payment to employees/maintenance men and no withholding tax remitted.
> 3. Transportation and Travelling Expenses (₱450,000.00) - Verification disclosed that there were no actual proof of payment to substantiate this account, hence, disallowed in audit.
> 4. Professional Fees (₱317,967.00) - Verification disclosed that there were no actual proof of payments but mere reimbursement charged by PDPI.
> 5. Interest Expense (₱983,140.19) - Verification disclosed that this item should have been capitalized or charged to a deferred cost to be amortized in the event the land shall generate revenues for the company.[9]

On August 21, 1996, Revenue District Officer Francis R. Guzman indorsed to the Regional Director of BIR Revenue Region No. 7, Quezon City, the above report for approval and recommended that the corresponding Assessment Notice be issued against petitioner. He noted that petitioner and PDPI had intentionally evaded the payment of correct income tax and documentary stamp tax by misrepresenting the material facts and for their failure to conform to the prescribed conditions laid in RMO 26-92.

On review, Chief, Legal Division, Orlando R. Resurreccion, concurred with the above findings and recommendation. He declared:[10]

> "Upon evaluation of the relevant facts and consideration of all the attendant circumstances this Office concurs with the position taken made by the Revenue Officers who conducted the investigation in recommending that the assessment notice be issued. In this particular case it is well-established that there was indeed a material misrepresentation of facts being represented considering the taxpayer

---

9 *Ibid.*, pp. 618-619.

10 *Ibid.*, pp. 596-597.

admitted in its protest letter dated February 19, 1998 that buildings and improvements (sic) was omitted in the Deed of Exchange. Apparently, upon learning of the omission an amended Deed was executed on April 25, 1995, in order to reflect the true intent of the parties, however, this reformation of instrument for the inclusion of buildings and improvements in the Deed of Exchange will not alter neither cure the defects of the facts being misrepresented. More so, for obvious reason submitted by the taxpayer that the same is omitted in the Deed of Exchange is most likely not acceptable. Thus, the misrepresentation of facts of not including building and improvements in the Deed of Exchange constitute fraud intended to evade the payment of taxes. Under Section 222(a), provides that in cases of fraud, a proceeding in court for the collection of such tax may be filed without assessment at any time within (10) years after the discovery of falsity, fraud or omission. Such being the case, the ruling adopted by the taxpayer in confirming the said tax free transaction shall be considered null and void as cited in **BIR Rulings No. 391-92 as amplified in BIR Rulings No. 321-93 and 547-93.** Hence, an assessment notice should therefore, be immediately issued based on the findings in the investigation conducted."

Thus, a Pre-Assessment Notice was issued informing petitioner of the result of the investigation with a finding of fraud and its deficiency income tax liability in the amount of ₱32,460,540.77.[11]

Petitioner, through SGV & Co., filed its protest on March 18, 1999 before the Assessment Division of the Bureau of Internal Revenue[12].

Further, in response to the query of whether petitioner should be assessed deficiency income tax due to fraud or misrepresentation of facts on the Deed of Exchange, Chief Orlando L. Resurreccion of the Legal Division of RDO 41 issued a Memorandum on May 5, 1999 that petitioner should be assessed deficiency income tax due to fraud.[13]

---

[11] *Ibid.*, pp. 599-600.
[12] Ibid, pp. 603-613.
[13] *Ibid.*, p. 617.

Petitioner, through SGV & Co., received Formal Assessment Notice and Formal Letter of Demand, both dated October 22, 1999, for deficiency income tax, with surcharge and interest, in the total amount of ₱44,578,524.36 for the taxable year 1994 computed as follows:[14]

Taxable income per return			₱37,646,927.00
Add:	Discrepancies per Investigation		
	1. Undeclared gain on exchange of stocks for real properties	₱49,515,688.67	
	2. No proof of payment of the following:		
	2.1 Salaries and Wages	1,313,743.17	
	2.2 Transportation & Travelling Expenses	450,000.00	
	2.3 Professional Fees	317,967.00	
	3. Non-deductible interest expense	983,140.19	52,580,539.03
Taxable income per Investigation			₱90,227,466.03
Income tax due thereon (35%)			₱31,579,613.11
Less:	Income Tax Paid		
	Per BIR Form 1743-750	₱ 1,879,750.74	
	Cash Payment	11,150,981.93	13,030,732.67
Balance			₱18,548,880.44
Add:	50% Surcharge for fraud	₱9,274,440.22	
	20% Interest per Annum from 4-16-95 to 10-22-99	16,755,203.70	26,029,643.92
Total amount due			**₱44,578,524.36**

The details of discrepancies show the following:[15]

"1. Gain on exchange of shares of stocks for real properties (₱49,515,688.67) - Verification disclosed a misrepresentation of fact per Deed of Exchange which nullify the exemption provided under Section 34(c)2(c) of NIRC. This resulted to the recognition of taxable gain.

xxx xxx xxx

2. Salaries and Wages (₱1,313,743.17) - Verification disclosed that this account has no actual proof of payment to employees/maintenance men and no withholding tax remitted.

---

14 Exhibits "A" and "B".

15 *Op. cit.*, pp. 618-619.

3. Transportation and Travelling Expenses (₱450,000.00) - Verification disclosed that there were no actual proof of payment to substantiate this account, hence, disallowed in audit.

4. Professional Fees (₱317,967.00) - Verification disclosed that there were no actual proof of payments but mere reimbursement charged by PDPI.

5. Interest Expense (₱983,140.19) - Verification disclosed that this item should have been capitalized or charged to a deferred cost to be amortized in the event the land shall generate revenues for the company."

On February 29, 2000, petitioner filed a protest letter with the Assessment Division of the Bureau of Internal Revenue ["BIR"] contesting the alleged deficiency income tax for the taxable year 1994.[16] It submits that the tax assessment had already prescribed and that the same was without legal and factual bases. A tax verification notice (TVN No. 00053637) was subsequently issued on March 27, 2000 relative to the petitioner's request for reinvestigation.[17]

Further, petitioner filed on April 28, 2000, a supplemental protest and attached therewith relevant documents in support of its opposition to the assessment.[18]

Directed to continue the reinvestigation and to submit a report,[19] Revenue Officer II Benedicto O. Santiago submitted his Memorandum to respondent and recommended assessment of deficiency taxes against petitioner and Phelps Dodge.[20] He explained:

---

16 Exhibit "C".
17 *Op. cit.*, p. 625.
18 Exhibit "D".
19 June 19, 2000 Memorandum of Revenue District Officer Isidro T. Casals, Jr.,; *op. cit.*, p. 627.
20 *Ibid.*, pp. 629-632.

"xxx Well established is the fact that there was misrepresentation in obtaining BIR Ruling No. 321-92 dated October 29, 1992. Principal point to consider is the Kasamahan's own admission in the Protest Letter dated February 19, 1998, confirming the fact that buildings and improvements were indeed omitted in the Deed of Exchange.

"Another point of consideration is the Reformation of the Deed of Exchange which was executed by Kasamahan and Phelps Dodge on April 24, 1995 in trying to cure the glaring misrepresentation committed by both parties. However, the effort of the parties in the reformation of the Deed of Exchange proved, futile, inasmuch as the ruling relied upon by the parties in connection with the exchange of property for shares, shall be considered null and void from the very beginning, as if it has not been issued.

"The organization of Kasamahan is prompted more on the purpose of tax shelter rather than for a legitimate business purpose. Kasamahan was organized by Phelps Dodge primarily to engage in property management and development. Phelps Dodge has the controlling shares of Kasamahan before, during and after the exchange of property for shares.

On February 25, 1992, pursuant to the Deed of Exchange between the parties concerned, Phelps Dodge transferred five (5) parcels of real property in Pioneer Street, Mandaluyong City in favor of Kasamahan for shares of stock of the latter corporation.

Corollarily, on October 22, 1993, Kasamahan executed a Service Contract in favor of Phelps Dodge, whereby the latter will manage the same five (5) parcels of real property which it owned previously, now owned by the former, for valuable consideration.

Kasamahan was organized and controlled by Phelps Dodge. Its primary purpose is to engage in property management and development. But, why is the management of the five (5) parcels of real property was returned to Phelps Dodge for valuable consideration, inasmuch as property management and development is its primary business. The reason is clear, we cannot conclude otherwise.

Considering the aforestated facts and circumstances, it is submitted that there was no armslength transaction between the two parties, they are one and of the [same] interest, with regard to both Deed of Exchange and Service Contract.

The allegation of both parties regarding the omission of buildings and improvements from the Deed of Exchange is unacceptable. According to them, due to inadvertence, buildings and improvements worth ₱47,892,538.67 was omitted in the preparation of the Deed of Exchange. But, how come, when the document was drafted, reviewed, revised, finalized and signed by all

> the parties concerned with the assistance of CPA and lawyer consultant and still failed to get notice of the apparent defects of the document. That allegation is really unacceptable.
>
> Considering the value of the property involved amounting to ₱47,892,538.67, the defense of inadvertent omission is not acceptable. What is stated in the document is not accidental, it is the real intention of the parties. They intentionally underdeclare the value of the property in order to avoid taxes which is misrepresentation pure and simple. xxx

Considering that respondent has not rendered a decision since petitioner filed its supplemental protest on April 28, 2000, the latter initiated the present action before the Court.[21]

Both parties stipulated on the following issues:[22]

1. Whether Petitioner has an undeclared gain on exchange of stocks for real properties in the amount of ₱49,515,688.67?

2. Whether Petitioner has incurred salaries and wages expenses in the amount of ₱1,313,743.17, and whether said expenses are allowable deductions from gross income?

3. Whether Petitioner has incurred transportation and travelling expenses in the amount of ₱450,000.00, and whether said expenses are allowable deductions from gross income?

4. Whether Petitioner has incurred professional fees expenses in the amount of ₱317,967.00, and whether said expenses are allowable deductions from gross income?

5. Whether Petitioner committed a fraudulent act relative to its filing of its income tax return for calendar year 1994, which consequently allowed respondent to issue an assessment beyond the prescriptive period?

---

[21] The case was submitted for decision after the court received petitioner's Memorandum on September 27, 2004 and respondent failed to file his Memorandum within the period given by the court.

[22] Joint Stipulation of Facts and Issues, Dockets, pp. 112-113.

6. Whether the alleged deficiency income tax assessment has already prescribed?

We first discuss the issue on prescription. Petitioner maintains that the Assessment Notice and Demand Letter were issued beyond the prescriptive period and, hence, void and ineffective. Respondent erred in invoking the 10-year prescription period provided in Sections 222 and 248(B) of the NIRC as petitioner did not commit any fraudulent act that would justify the application thereof.

We disagree.

Section 203 of the Tax Code provides:

> 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 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. **(Emphasis ours.)**

However, the period of limitation of assessment and collection of taxes differ in case of false or fraudulent return with intent to evade tax. Section 222 (a) of the same Code states that:

> SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes* –
>
> **(a) In the case of a false return with intent to evade tax or of failure to file a return, the tax may be assessed**, or a proceeding in court for the collection of such tax may be filed without assessment, **at any time within ten (10) years after the**

> **discovery of the falsity, fraud or omission**: *Provided*, that in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.**(Emphasis ours.)**
>
> x x x

In the present case, petitioner and PDPI executed two (2) Deeds of Exchange for the transfer of the latter's two parcels of land "exclusive of improvements" in favor of the former. On the basis of such Deeds of Exchange, respondent assessed and PDPI paid the documentary stamp tax of P1,000,000.00 for the deed transferring five (5) parcels of lot to petitioner. Furthermore, respondent issued BIR Ruling 321-92 confirming the tax-free transaction between the two corporations based on petitioner's representation that the transfer of property involves parcels of land "exclusive of the improvements thereon". Expectedly, petitioner declared "not applicable" the gain on the exchange or transfer of property in its Annual Income Tax Return for taxable year 1994 and thereby, incurring no taxable obligation or substantially lowers its obligation once gain is recognized in case it transfers the subject lot subsequently.

To recall, petitioner secured BIR Ruling No. 321-92 on October 29, 1992 to confirm the transaction as tax-exempt. While declaring the transaction tax-exempt, respondent also declared therein that "xxx Section 34(c)(2)(c) of the Tax Code merely defers recognition of the gain or loss from such transaction, for in determining the gain or loss from a subsequent transaction of the properties or stock acquired by it in the exchange, the original or historical cost of the properties or stocks is taken into consideration. Thus, if the transferor later sells or exchanges the shares of stock acquired by it in the exchange, it shall be subject to income tax on gains derived from such sale or exchange, taking into account that the cost basis of the shares shall be the same as the original acquisition cost of adjusted cost basis to the transferor of the properties exchanged therefor; and that the cost basis to the transferor of the properties exchanged therefor; and the cost basis to the transferee of the properties exchanged for stocks shall be the same as it would be in the hands of the transferor." Thereafter, petitioner and PDPI executed a Reformation of Instrument on April 25, 1995 allegedly to reflect the true intent of the parties to include not only transfer of lots but also the improvements thereon. **Petitioner did not furnish the BIR a copy of the said instrument, and also, did not offer to pay the corresponding deficiency documentary stamp tax or amend its return to reflect the true and correct value of the properties transferred in its name.** Thus, it is clear that such material omission constitutes sufficient ground to apply the ten-year prescriptive period counted from the discovery of the falsity, fraud or omission under the aforecited Section 222 of the Tax Code.

In ***Aznar vs. Court of Tax Appeals, G.R. No. L-20569, August 23, 1974, 58 SCRA 519***, the Supreme Court interpreted then Sections 331 (providing for a five (5) year ordinary prescriptive period) and 332(a), now Sections 203 and 222(a) of the Tax Code, to wit:

> xxx We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade

tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within ten years after the discovery of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely – "falsity", "fraud" and "omission". That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.

The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the NIRC should be applicable to normal circumstances, **but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities** due to false returns, fraudulent return intended to evade payment of tax or failure to file returns, the period of ten years provided for in Sec. 332(a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced. **(Emphasis ours.)**

The applicability of the ten-year period was retold in the recent case of ***Commissioner of Internal Revenue vs. The Estate of Benigno P. Toda, Jr. Etc., G.R. No. 147188, September 14,2004***, where the High Court ruled:

It is true that in a query dated 24 August 1989, Altonaga, through his counsel, asked the Opinion of the BIR on the tax consequence of the two sale transactions. Thus, the BIR was amply informed of the transactions even prior to the execution of the necessary documents to effect the transfer. Subsequently, the two sales were openly made with the execution of public documents and the declaration of taxes for 1989. However, these circumstances do not negate the existence of fraud. **And even assuming arguendo that there was no fraud, we find that the income tax return filed by CIC for the year 1989 was false**. It did not reflect the true or actual amount gained from the sale of the Cibeles property. Obviously, such was done with intent to evade or reduce tax liability. **(Emphasis ours.)**

In addition, petitioner failed to comply with the BIR Ruling No. 321-92 and RMO No. 26-92. As stated in respondent's ruling and consistent with RMO No. 26-92, petitioner must file together with its income tax return the following:

(a) A complete description of all properties received from PDPI;

(b) A statement of the original acquisition cost or other basis of the properties in the hands of PDPI and the adjusted cost basis thereof at the time of the transfer; and

(c) Information with respect to the capital stock of the corporation.

Aside from the annual income tax return, the Deed of Exchange filed before the BIR is false, incomplete or erroneous. Our tax law provides:

> Sec. 6. (B) *Failure to Submit Required Returns, Statements, Reports and other Documents.* – When a report required by law as a basis for the assessment of any national revenue tax shall not be forthcoming within the time fixed by law or rules and regulation or when there is reason to believe that any such report is false, incomplete or erroneous, the Commissioner shall assess the proper tax on the best evidence obtainable.
>
> In case a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise, files a false or fraudulent return or other document, the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise, which shall be prima facie correct and sufficient for all legal purposes.

Petitioner's failure to comply with the above requirements makes its annual income tax fraudulent or to say the least, false.

It is a well-established jurisprudence that "limitations upon the right of the government to assess and collect taxes will not be presumed in the absence of clear legislation to the contrary and that where the government has not by express statutory provision, provided a limitation upon its right to assess unpaid taxes, such right is imprescriptible." ***Commissioner of Internal Revenue vs. Ayala Securities Corp. and Court of Tax Appeals, G.R. No. L-29485, November 21, 1980.***

Hence, We hold that the prescriptive period for issuance of the deficiency tax assessment is ten (10) years from the discovery of fraud and/or false return.

Notwithstanding petitioner's false return, We, however, agree with petitioner and finds that the revenue examiners erred in finding an unreported gain on the exchange of petitioner's shares of stocks with real properties received from Phelps Dodge Philippines, Inc. Section 34(c)(2) of the 1993 NIRC provides that:

> No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four persons, gains control of said corporation: *Provided*, That stocks issued for services shall not be considered as issued in return of property.

It is clear that the above provision of the Tax Code applies in cases where: (1) a person transfers property in exchange for stocks in a corporation; and, (2) such person, alone or together with others, gains control of said corporation. The law has not laid any other condition for the application of the above-quoted section. Consequently, the Court has no other course but apply the same in the subject transaction. The recognition of gain or loss in the exchange of properties for stocks shall be deferred without prejudice to respondent's adjustment of historical cost or basis for the purpose of collecting the proper taxes, if any, on any subsequent disposition of the properties or stocks involved in the exchange transaction.

As to the issue on allowable deductions, it is beyond dispute that a taxpayer may claim deductions provided that he must clearly point to a specific provision of the statute in which deductions are authorized and he must prove that he is entitled to the deductions provided therein. Under the present Tax Code, Section 34 enumerates allowable deductions which include "ordinary and necessary trade or business expenses". Thus, in order to be deductible, an item of expenditure must fall squarely within its language.[23] Section 29 of the NIRC of 1993 states that:

> In computing taxable income subject to tax xxx, there shall be allowed as deductions the items specified in paragraphs (a) to (i) of this section: xxx
>
> (a) *Expenses.* - (1) *Business expenses.* - (A) *In general.* - All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; travelling expenses while away from home in the pursuit of a trade, profession or business, rentals or other payments required to be made as a condition to the continued use or possession, for the purpose of the trade, profession xxx
>
> xxx xxx xxx
>
> (b) *Interest.* - (1) *In general.* - The amount of interest paid or accrued within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business, except on indebtedness incurred or continued to purchase or carry obligation the interest upon which is exempt from taxation as income under this Title.
>
> xxx xxx xxx

---

[23] *Commissioner of Internal Revenue vs. Atlas Consolidated Mining & Development Corporation*, G.R. No. L-26924, January 27, 1981.

Petitioner argues that it is entitled to deduct as expenses the following:

(1) The expense account of "Personnel Services" represents the expenses incurred pursuant to the service contract between Petitioner and PDPI. Pursuant to an agreement dated October 22, 1993, PDPI shall administer the properties of petitioner and the latter shall reimburse PDPI for expenses incurred which includes the maintenance services provided by Superior Maintenance Service, Inc. (SMS). Thus, the payment of expenses for the administration of the properties represents a legitimate business expense which is ordinary and necessary in the conduct of its business and should be treated as an allowable deduction from its gross income;

(2) The interest expense paid for the acquisition of the land is a valid deduction from gross income based on previous rulings rendered by petitioner, this Court and the Supreme Court;

(3) Contrary to the findings of the revenue examiners, transportation and travelling expenses and professional fees were actually incurred which were ordinary and necessary in the conduct of petitioner's business, represents legitimate expenses and should be treated as allowable deduction from its gross income.

It is axiomatic that an expense to be deductible must be: (1) ordinary and necessary; (2) paid or incurred within the taxable year; and, (3) paid or incurred in carrying on a trade or business. Such expense must be proven by evidence or records. Mere allegation by a taxpayer that an item of expense is ordinary and necessary does not justify its deduction.[24] Thus:

> "xxx Ordinarily, an expense will be considered 'necessary' where the expenditure is appropriate and helpful in the development of the taxpayer's business. It is 'ordinary' when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term 'ordinary' does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique or non-recurring to the particular taxpayer affected.

---

24 *Ibid.*

"There is thus no hard and fast rule on the matter. The right to a deduction depends in each case on the particular facts and the relation of the payment to the type of business in which the taxpayer is engaged. The intention of the taxpayer often may be the controlling fact in making the determination. Assuming that the expenditure is ordinary and necessary in the operation of the taxpayer's business, the answer to the question as to whether the expenditure is an allowable deduction as a business expense must be determined from the nature of the expenditure itself, which in turn depends on the extent and permanency of the work accomplished by the expenditure.

"xxx xxx xxx

"xxx The burden of proof that the expenses incurred are ordinary and necessary is on the taxpayer and does not rest upon the Government. To avail of the claimed deduction under Section 30(a)(1) of the National Internal Revenue Code [now Section 34 under the 1997 NIRC], it is incumbent upon the taxpayer to adduce substantial evidence to establish a reasonably proximate relation between the expenses to the ordinary conduct of the business of the taxpayer. A logical link or nexus between the expense and the taxpayer's business must be established by the taxpayer."[25]

Respondent disallowed petitioner's salaries and wages, transportation and traveling expenses and professional fees allegedly for lack of actual proof of payment in the respective amounts of ₱1,313,743.17, ₱450,000.00 and ₱317,967.00. The Court disagrees and finds that petitioner was able to sufficiently explain and substantiate its expenses which, under our tax law, may be lawfully claimed as deductions.

Petitioner incurred salaries and wages expenses by virtue of its Service Contract[26] with PDPI.[27] Paragraph 4 thereof reads:

"NOW, THEREFORE, for and in consideration of the above premises, KRDC and PDP agree as follows:

---

25 *Ibid.*

26 Exhibit "I".

27 PDPI is referred to therein as "PDP".

1. xxx
2. xxx
3. xxx
4. In addition to the service fee, KRDC will reimburse all business expenses related to the administration of the properties."

Records show that PDPI engaged the services of Superior Maintenance Services, Inc. (SMS) for janitorial services of its company and of petitioner. PDPI paid a total amount of ₱2,627,575.23 for the janitorial services rendered by the latter.[28] Petitioner, on the other hand, reimbursed PDPI the amount of ₱1,313,743.17 (or 50% thereof) as evidenced by a debit memo.[29] PDPI issued the said debit memo as it deducted the amount of ₱1,313,743.17 from its obligation to pay petitioner the amount of ₱2,841,895.00 as monthly rental of the latter's land and buildings.[30] Simply, there was an offsetting of accounts (legal compensation) between petitioner and PDPI.

As petitioner reimbursed PDPI the expense incurred for the janitorial services rendered by SMS, it has no obligation to withhold income tax on the compensation of maintenance men. There is no employer-employee relationship between petitioner and SMS. In fact, SMS is the principal employer of the maintenance men and is liable to withhold income tax therefrom pursuant to paragraph (a) of Section 73 of the Tax Code which reads:

> "The employer shall be liable for the withholding and remittance of the correct amount of tax required to be deducted and withheld under this Chapter. xxx"[31]

---

28 Exhibit "M".
29 Exhibit "J".
30 See No. 2 of Notes to Financial Statements; BIR Records, p. 12.
31 Now paragraph (A) Section 57 of the 1997 Tax Code.

In the same manner, petitioner was able to prove transportation and traveling expenses and professional fees. It presented as evidence debit memo[32] and Journal Voucher[33] which explain that petitioner was charged for the costs of travel and entertainment (foreign), audit fees and retainer fees for the year 1994. Such expenses were further corroborated by the schedule of vouchers and invoices for transportation and traveling expenses, professional fees and others.[34]

Thus, all the above-mentioned expenses are valid business expenses. However, as presented above, petitioner paid only the amount of P300,000.00 for professional fees instead of the amount of P317,967.00 it declared. Hence, a discrepancy of P17,967.00 remains unsupported.

This Court agrees with respondent though in disallowing interest expense as deduction from petitioner's gross income. Petitioner has failed to present any evidence to support its claim of interest expense. The Court is emphatic that the best evidence to prove that petitioner actually incurred such expense are the official receipts. The latter has failed to adequately show or present supporting papers such as invoices or vouchers to establish its claim. Thus, this Court must affirm respondent's disallowance of petitioner's claimed deduction for its interest expense.[35]

---

32 Exhibit "P".

33 Exhibit "P-1".

34 See Exhibits "N", "N-1" to "N-5", "O" and "O-1" to "O-12".

35 *Paper Industries Corp. of the Philippines vs. Court of Appeals, et al.*, G.R. No. 106949-50, December 1, 1995.

From the foregoing, petitioner's salaries and wages, transportation and traveling expenses and professional fees are valid business expenses and the same may be deducted from its gross income, while petitioner's interest expense is being disallowed for insufficiency of evidence.

In sum, the disallowances on gain on exchange of shares of stocks for real properties in the amount of P49,515,688.67, salaries and wages in the amount of P1,590,235.00, transportation and traveling expenses in the amount of P450,000.00 and professional fees in the amount of P300,000.00 are cancelled, while petitioner's interest expense in the amount of P983,140.19 and portion of the professional fees in the amount of P17,967.00 are still disallowed.

In fine, petitioner is liable for deficiency income tax in the reduced amount of P1,192,628.99, computed as follows:

Taxable Income Per Return			P	37,646,927.00
Add: Unsupported Professional Fees	P	17,967.00		
Unsupported Interest Expense		983,140.19		1,001,107.19
Taxable Income Per Court's Verification			P	38,648,034.19
Income Tax Due Thereon			P	13,526,811.97
Less: Income Tax Paid				
Per BIR Form 1743-750	P	1,879,750.74		
Cash Payment		11,150,981.93		13,030,732.67
Basic Deficiency Income Tax			P	496,079.30
Add: 50% Surcharge for fraud				248,039.65
20% Interest from 4-16-95 to 10-22-99				448,510.05
TOTAL AMOUNT DUE & COLLECTIBLE			**P**	**1,192,628.99**

IN VIEW OF ALL THE FOREGOING, petitioner is **ORDERED to PAY** the respondent the amount of P1,192,628.99 representing deficiency income tax for the taxable year 1994, plus 20% delinquency interest from November 20, 1999 until the amount is fully paid pursuant to Section 249 of the 1997 Tax Code.

SO ORDERED.

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

We Concur:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

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

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Chairman