REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL FIRST DIVISION

EL PASO PHILIPPINES ENERGY COMPANY, INC., Petitioner,	CTA CASE NO. 7997
	Members:
- versus -	UY, *Chairperson* and FABON-VICTORINO, JJ
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: OCT 29 2013 ; 10:30 a.m.

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DECISION

***Fabon-Victorino, J.*:**

Before the Court is a Petition for Review[1] for the cancellation of the assessments issued against petitioner El Paso Philippines Energy Company Inc. for alleged deficiency income tax (IT) of P14,385,900.88, final withholding tax (FWT) of P6,850,981.93, and value-added tax (VAT) of P2,843,835.63, inclusive of interests, for calendar year 2005.

Petitioner is a domestic corporation, with principal office at the Ground Floor PFDA Building, Navotas Fish Port Complex, Navotas City.[2]

Respondent, on the other hand, is the Commissioner of the Bureau of Internal Revenue (BIR), the government agency tasked, among others, to collect national internal revenue taxes. She holds office at the BIR National Office Building, Diliman, Quezon City.

[1] Docket, pp. 1-26.
[2] Par. 11, The Parties, Petition for Review, docket, p. 5.

Petitioner avers that on July 18, 2006 it received Letter of Authority (LOA) No. 00032295 dated July 7, 2006 from the BIR Revenue Region No. 7, Revenue District Office (RDO) No. 43, authorizing the examination of its books for calendar year 2005.[3] With the LOA is a letter dated July 18, 2006 requesting for petitioner's books of accounts, financial statements and other related accounting records and supporting documents.

On January 18, 2008, petitioner, through its Group Controller, executed a Waiver of the defense of prescription under the Statute of Limitations of the National Internal Revenue Code (NIRC).[4]

On January 21, 2008, the BIR issued a revalidation notice informing petitioner that LOA No. 00032295 had been revalidated as the "investigation is still on-going".[5]

On February 15, 2008, petitioner received from the BIR a final request for presentation of records and documents. Thereafter, it submitted to RDO No. 43 the Waiver of Statute of Limitations it earlier executed.

On March 26, 2008, petitioner received a copy of the Waiver of Statute of Limitations with the signature of the RDO in the "Accepted By" portion, *sans* the date of acceptance.[6]

On July 25, 2008, petitioner received a Notice of Informal Conference with attached computation of deficiency taxes, for it to controvert the BIR findings.

On January 30, 2009, petitioner received from respondent through the Regional Director of Revenue Region No. 7 a Formal Letter of Demand (FLD) No. 43-180 dated January 14, 2009[7] with attached Assessment Notices,[8] finding it liable for deficiency IT of P14,385,900.88,

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[3]Par. 1, Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI), docket, p. 204.
[4]Par. 2, Stipulated Facts, JSFI, docket, p. 205.
[5]Par. 3, Stipulated Facts, JSFI, docket, p. 205.
[6]Par. 6, Stipulated Facts, JSFI, docket, p. 206.
[7]Exhibit "A"; Par. 8, Stipulated Facts, JSFI, docket, p. 206.
[8] Exhibits "B" to "B-3"

deficiency FWT of P6,850,981.93, and deficiency VAT of P2,843,835.63, inclusive of interests, in the aggregate amount of P24,080,718.44 for calendar year 2005.[9] The Schedule 1 of the FLD reads:

DETAILS OF DISCREPANCIES

I. DEFICIENCY INCOME TAX

Income Payments not subjected to withholding tax (P28,255,462.21) – Verification disclosed that you failed to subject fully the interest expense to withholding tax as required under Revenue Regulations No. 2-98, as amended, thus disallowed as deductions from your gross income pursuant to Section 34(K) of the NIRC of 1997.

Interest Expenses per FS		P 156,206,061
Less: Interest subject to Final Tax per 1601F	P148,267,753.83	
Less: Interest Expense pertaining to 2004	20,317,155.04	127,950,598.79
Interest Expense not subjected to withholding tax		**P28,255,462.21**

II. DEFICIENCY VALUE ADDED TAX

Verification disclosed that exempt sales amounting to P17,647,058.82 were not supported with sufficient evidence/documents, therefore, subject to 10% VAT pursuant to Sections 106, 108 and 109 of the NIRC of 1997.

III. DEFICIENCY FINAL WITHHOLDING TAX

Verification disclosed that the following income payments were not fully subjected to Final withholding tax, hence, you are assessed pursuant to Revenue Regulations No. 2-98.

Interest Expenses per FS		P156,206,061.00
Less: Interest subject to Final tax per 1601F	P148,267,753.83	
Less: Interest Expense pertaining to 2004	20,317,155.04	127,950,598.79
Interest Expense not subjected to withholding tax		**P28,255,462.21**

[9]Par. 8, Stipulated Facts, JSFI, docket, p. 206.

IV. COMPROMISE PENALTY was imposed for non-submission of schedules pursuant to Sections 250 and 255 of the NIRC of 1997, with reference to Revenue Memorandum Order (RMO) No. 1-90.

On February 27, 2009, petitioner protested[10] the assessments.

In a letter dated March 11, 2009, the BIR Assessment Division informed petitioner that its protest letter would be forwarded to RDO No. 43-A Pasig City.

In a letter dated May 20, 209,[11] RDO No. 43-A requested petitioner to submit documents in support of its protest. On July 6, 2009, petitioner submitted its letter reply,[12]with the attached schedule of computations and documents.

On October 20, 2009, petitioner received a Preliminary Collection Notice[13] from the Regional Task Force of Revenue Region No. 7-Quezon City dated August 10, 2009, stating the assessed deficiency taxes in the aggregate amount of P24,080,718.44.

On November 12, 2009, BIR Officer George Larin served upon petitioner a Final Notice Before Seizure dated August 17, 2009[14] issued by the Collection Task Force of Revenue Region No. 7-Quezon City which states as follows:

> In this connection, we would like to inform you that we are giving you the last opportunity to settle said account within **FIVE (5)** days from receipt of this reminder letter.

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[10] Exhibit "C".
[11] Exhibit "E".
[12] Exhibit "F".
[13] Exhibit "G".
[14]Exhibit "H"; Par. 16, Stipulated Facts, JSFI, docket, pp. 209-210.

> Should this office fail to hear from you within the time prescribed, we will be constrained, much to our regret, to enforce collection thereof thru summary and/or judicial remedies by issuing the corresponding Warrants of Distraint/Levy and filing the necessary action in the courts of law to protect the interest of the government.

On November 19, 2009, petitioner filed the instant Petition for Review raising the following grounds[15]:

> I. THE ALLEGED DEFICIENCY INCOME TAX AND FINAL WITHHOLDING TAX ASSESSMENTS ARE DEVOID OF FACTUAL AND LEGAL BASIS (sic), CONSIDERING THAT IT WAS BASED ON THE 'NET WORTH METHOD' ADOPTED BY RESPONDENT COMMISSIONER WITHOUT CAREFUL CONSIDERATION OF THE RECORDS AND DOCUMENTS PRESENTED DURING THE COURSE OF EXAMINATION OF PETITIONER'S BOOK OF ACCOUNTS.
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> II. THE ALLEGED DEFICIENCY VALUE ADDED TAX (VAT) ASSESSMENTS ARE DEVOID OF FACTUAL AND LEGAL BASIS (sic), CONSIDERING THAT PETITIONER EPPECI IS EXEMPT FROM PAYING VAT WITH RESPECT TO THE SUBJECT TRANSACTION.

In her Answer filed on January 25, 2010,[16] respondent argues that the assessments for deficiency IT, FWT and VAT for calendar year 2005 in the amounts of P14,385,900.88, P6,850,981.93, and P2,843,835.63, respectively, were in accordance with law and regulations and are presumed correct and made in good faith.

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[15] Grounds for the Petition, Petition for Review, docket, p. 12.
[16] Docket, pp. 121-124.

On March 30, 2010, the parties filed their Joint Stipulation of Facts and Issues,[17] which was approved on April 7, 2010.[18]

In support of its case, petitioner presented its Officer-in-Charge, **Honorio S. Cruz,** who by way of a Judicial Affidavit,[19] testified that on January 30, 2009, he received FLD No. 43-180 dated January 14, 2009 with attached Assessment Notices assessing petitioner of deficiency internal revenue taxes for the calendar year 2005. In a separate FLD dated January 14, 2009, petitioner was also assessed Compromise Penalty of P8,000.00 for alleged non-submission of Quarterly Summary List of Sales and Purchases. On February 27, 2009, petitioner formally protested the assessments. In a letter dated March 11, 2009, the Assessment Division of Revenue Region No. 7 informed petitioner that its protest would be forwarded to the Revenue District Office No. 43-A, East Pasig City which office subsequently issued a Tax Verification Notice for the reinvestigation of petitioner for taxable period from January 1, 2005 to December 31, 2005. This was followed by another letter dated May 20, 2009, requesting for computations and documents in support of the protest.

On October 20, 2009, or after petitioner complied with the directive, it received a preliminary collection letter from Revenue Region No. 7, Regional Task Force, reiterating the assessed deficiency taxes contained in the FLD in the aggregate amount of P24,080,718.44.

On November 12, 2009, a Final Notice Before Seizure was served upon petitioner, hence, the instant petition.

Jaime B. Robles, also testified for petitioner. He declared in his Judicial Affidavit[20] that while he was the Controller of petitioner, he supervised and monitored the recording and documentation of petitioner's business transactions. He also prepared and filed petitioner's internal

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[17] Docket, pp. 204-213.
[18] Docket, p. 215.
[19] Docket, pp. 243-253.
[20] Docket, pp.307-323.

revenue tax returns and supervised and reviewed all correspondences pertaining to any deficiency assessments.

He opined that the alleged deficiency IT assessment of P14,385,900.88 is erroneous because the item "interest expense" of P28,255,462.21 should not be disallowed or be subject to any tax. He explained that the amount of P28,255,462.21 was arrived at by the BIR based on erroneous comparison of petitioner's interest expense per Financial Statements (FS) amounting to P156,206,061.39 with the one reported in its BIR Form No. 1601F (Final Withholding Tax Return) amounting to P127,950,598.00, net of P20,317,155.44 interest expense pertaining to year 2004. Had the BIR closely examined the components and supporting documents of the P156,206,061.39 interest expense per FS of 2005, to wit:

Description	Expense Amt.	Tax Base net of 10% VAT	EWT amount	EWT rate
Accrued interest pertaining to 2004	22,348,870.50	20,317,155.00	2,031,715.50	10%
Interest payments in 2005	131,089,479.74	119,172,254.31	16,253,157.21	15%
Non-deductible interest expense per ITR of 2005	2,725,121.39			
Realized forex loss	42,589.76			
Interest expense per FS	156,206,061.39		18,284,872.71	

it would have realized that there was really no difference between the said amount and the interest expense declared in petitioner's BIR Form No. 1601F for the year 2005. In view thereof, petitioner should not be assessed for the deficiency IT of P14,385,900.88 and deficiency FWT of P6,850,981.93.

The alleged deficiency VAT assessment of P2,843,835.63, inclusive of interest, is likewise erroneous. The supporting documents for sales receipts for services rendered to East Asia Utilities Corporation (EAUC) in the amount of P17,647,058.82 show that it is exempt from 10% VAT required under Sections 106, 108 and 109 of the NIRC of 1997 or is subject to VAT at zero-percent rate since EAUC is registered with the Philippine Economic Zone Authority (PEZA). As such, petitioner cannot be subject to VAT for its receipts from EAUC.

On November 5, 2010, the Court granted petitioner's Motion to Allow the Referral of Voluminous Documents to an Independent Certified Public Accountant[21] and gave the ICPA thirty (30) days within which to submit her report.[22]

The Court commissioned ICPA[23] **Atty. Rosario S. Bernaldo** filed a Partial Report[24] and a Final Report[25]on February 14, 2011. On March 7, 2011, she filed a Revised Final ICPA Report only to correct some material errors.[26]

She testified that the BIR's findings in its FLD No. 43-180 dated January 14, 2009 was derived by comparing the amount of interest expense reported in petitioner's FS and its interest expense subjected to FWT appearing in its BIR Form No. 1601F. Consequently, respondent disallowed as deductions from petitioner's gross income the amount of P28,255,462.21 under Section 34(K) of the NIRC of 1997 and correspondingly assessed petitioner IT and FWT.

Verification shows that petitioner paid and remitted to the BIR the corresponding FWT amounting to P21,678,205.38 on P152,923,806.16 interest expense. Thus, her recommendation to reduce the 15% FWT imposed on the alleged P28,255,462.21 interest expense not subject to withholding tax. The reduction and/or total elimination can be done after the P3,384,323.73 representing the remittance of withholding taxes on the accrual of interest expense for the period December 26-31, 2005 has been verified, as well as all the realized forex gains/losses arising from interest and FWT remittances of petitioner, which to date, only P982,500.82 has been validated.

With respect to the deficiency IT assessment, since it is premised on the non-deductibility of interest expenses for alleged non-withholding on the P28,255,462.21 interest expense, she recommends that P152,923,806.16 be allowed as "interest expense" deduction for IT purposes.

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[21] Docket, pp. 387-392.
[22] Minutes of the hearing, docket, p. 416.
[23] Docket, pp. 387-392.
[24] Docket, p. 424.
[25] Docket, p. 462.
[26] Docket, p. 581.

Finally, her audit shows that the deficiency VAT assessment pertains to petitioner's sales in the form of management fees paid by EAUC by virtue of the Management Agreement entered into between petitioner and EAUC. As a PEZA registered entity, EAUC is subject to 5% special income tax in lieu of all other internal revenue taxes, including VAT. That being the case, the assessment of P2,843,835.63 on VAT, inclusive of interest up to February 14, 2009, should be cancelled.

After formal offer of exhibits, petitioner rested its case as indicated in the Resolution[27] dated March 23, 2012, which admitted previously denied exhibits.[28]

For her part, respondent presented Revenue Officer III **Ricardo C. Navarro** who testified,[29] that pursuant to Referral Memorandum No. 043-2128-2007 dated October 5, 2007 issued by Revenue District Officer Florante R. Aninag, he continued the audit and investigation of all internal revenue taxes of petitioner for the year 2005. On February 28, 2008, petitioner executed a Waiver of the Defense of Prescription under the Statute of Limitations of the NIRC, extending respondent's right to assess petitioner of its internal revenue taxes for taxable year 2005 until June 30, 2009. Thereafter, a Notice of Informal Conference with attached Computation of Deficiency Taxes was issued to allow petitioner to present its side on the result of the investigation. In his Memorandum Report, he recommended the issuance of assessment notices to petitioner.

Upon submission of the said Memorandum Report, the case was forwarded to the Assessment Division and a Preliminary Assessment Notice (PAN) with Details of Discrepancies dated December 22, 2008 was issued against petitioner. This was followed by a FLD with Details of Discrepancies and Final Assessment Notices (FAN), all dated January 14, 2009.

When petitioner failed to reply on the Notice of Informal Conference, he forwarded the docket to the Assessment Division of the BIR.

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[27] Docket, pp. 1626-1629.
[28] Docket, pp. 1592-1604.
[29] Docket, pp. 1642-1647.

On September 7, 2012, respondent formally rested its case.[30]

In a Resolution[31] dated December 20, 2012, the Court deemed the case submitted for decision.

THE ISSUES

Upon stipulation, the following issues were submitted by the parties for the resolution of the Court:[32]

> 1. Whether or not petitioner has interest expense not subjected to withholding tax in the claimed amount of P28,255,462.21 subject of the Formal Letter of Demand No. 43-180 dated January 14, 2009.
>
> 2. Whether or not petitioner has unsupported VAT exempt sales in the claimed amount P17,647,058.82 subject of the Formal Letter of Demand No. 43-180 dated January 14, 2009.
>
> 3. Whether or not petitioner EAPRC (sic)is liable to pay respondent the subject assessments (inclusive of interests) in the alleged sums of:
>
> (a) deficiency income tax – Php14,385,900.88;
> (b) deficiency final withholding tax – Php6,850,981.93;
>
> (c) deficiency VAT – Php2,843,835.63.
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> 4. Whether or not petitioner is liable to pay Compromise Penalty in the sum of Php8,000.00;

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[30] Docket, pp. 1698-1701.
[31] Docket, p. 1785.
[32] Stipulated Issues, JSFI, docket, pp. 210-211.

5. Whether or not the Subject Assessments have become final and executory;

The foregoing issues may be summarized as follows:

Whether the subject assessments issued by respondent against petitioner for alleged deficiency income tax, deficiency FWT, and deficiency VAT in the total amount of P24,088,718.44, inclusive of interests, for calendar year 2005 have no factual and legal bases, hence, should be cancelled and set aside.

RULING OF THE COURT

The instant petition is partly meritorious.

The Formal Letter of Demand[33] issued by respondent on January 14, 2009 assessed petitioner for deficiency IT, VAT, and FWT in the total amount of P24,088,718.44, inclusive of twenty percent (20%) interest, and compromise penalty, broken down as follows:

TAX TYPE	BASIC DEFICIENCY TAX	INTEREST	COMPROMISE PENALTY	TOTAL AMOUNT DUE
Deficiency Income Tax	P9,183,025.22	P5,202,875.66		P14,385,900.88
Deficiency VAT	1,764,705.89	1,079,129.74		2,843,835.63
Deficiency FWT	4,238,319.33	2,612,662.60		6,850,981.93
Compromise Penalty			P 8,000.00	8,000.00
Total	**P15,186,050.44**	**P8,894,668.00**	**P8,000.00**	**P24,088,718.44**

Section 203 of the NIRC of 1997, as amended, requires that respondent should issue an assessment for deficiency taxes within three (3) years from the last day prescribed by law to file the tax return or the actual date of filing of such return, whichever comes later. Any assessment notice issued beyond the three-year prescriptive period shall not be

[33]Exhibits "A" to "B-3"

valid save certain cases in Section 222 of the NIRC of 1997, as amended, to wit:

> SEC. 203. *Period of Limitation Upon Assessment and Collection.* – Except as provided in Section 222, **internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period**: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. *(Emphasis supplied)*
>
> SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* –
>
> (a) In the case of a false or fraudulent 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.
>
> (b) **If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed**

> **upon.** The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon.
>
> (c) Any internal revenue tax which has been assessed within the period of limitation as prescribed in paragraph (a) hereof may be collected by distraintor levy or by a proceeding in court within five (5) years following the assessment of the tax.
>
> (d) Any internal revenue tax, which has been assessed within the period agreed upon as provided in paragraph (b) hereinabove, may be collected by distraint or levy or by a proceeding in court within the period agreed upon in writing before the expiration of the five (5)-year period.The period so agreed upon may be extended by subsequent written agreements made before the expiration of the period previously agreed upon.
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> (e) *Provided, however*, That nothing in the immediately preceding Section and paragraph (a) hereof shall be construed to authorize the examination and investigation or inquiry into any tax return filed in accordance with the provisions of any tax amnesty law or decree. *(Emphasis supplied)*

Based on the foregoing provision, the three-year prescriptive period may be extended through a written agreement between respondent or her duly authorized representative and the taxpayer wherein the latter waives the defense of prescription and the former duly accepts the same.

In the case of *Commissioner of Internal Revenue vs. Kudos Metal Corporation*[34], the Supreme Court enumerated

[34] G.R. No. 178087, May 5, 2010.

the procedure for the proper execution of the waiver in accordance with Revenue Memorandum Order (RMO) No. 20-90 issued on April 4, 1990 and Revenue Delegation Authority Order (RDAO) No. 05-01 issued on August 2, 2001, to wit:

> 1. The waiver must be in the proper form prescribed by RMO 20-90. The phrase 'but not after ______ 19 ___', which indicates the expiry date of the period agreed upon to assess/collect the tax after the regular three-year period of prescription, should be filled up.
>
> 2. The waiver must be signed by the taxpayer himself or his duly authorized representative. In the case of a corporation, the waiver must be signed by any of its responsible officials. In case the authority is delegated by the taxpayer to a representative, such delegation should be in writing and duly notarized.
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> 3. The waiver should be duly notarized.
>
> 4. **The CIR or the revenue official authorized by him must sign the waiver indicating that the BIR has accepted and agreed to the waiver. The date of such acceptance by the BIR should be indicated.** However, before signing the waiver, the CIR or the revenue official authorized by him must make sure that the waiver is in the prescribed form, duly notarized, and executed by the taxpayer or his duly authorized representative.
>
> 5. Both the date of execution by the taxpayer and date of acceptance by the Bureau should be before the expiration of the period of prescription or before the lapse of the period agreed upon in case a subsequent agreement is executed.

> 6. The waiver must be executed in three copies, the original copy to be attached to the docket of the case, the second copy for the taxpayer and the third copy for the Office accepting the waiver. The fact of receipt by the taxpayer of his/her file copy must be indicated in the original copy to show that the taxpayer was notified of the acceptance of the BIR and the perfection of the agreement. *(Emphasis supplied)*

In the instant case, the waiver[35] executed by petitioner is invalid for failure of respondent or her authorized representative to indicate therein the date of acceptance of such waiver. Without any pretension, respondent admitted this lapse in paragraph 6 of the parties' Joint Stipulation of Facts and Issues, *viz.*:

> 6. On March 26, 2008 petitioner received a copy of the said Waiver of Statute of Limitations signed by BIR's Revenue District Officer, Florante R. Aninag, in the 'Accepted By' portion thereof but without indicating the date of acceptance;[36]

On account of this defect in the waiver, the period to assess the tax was not extended.

However, such defect is of no moment under the obtaining circumstances. Section 203 of the NIRC of 1997, as amended, provides that in case the return is filed beyond the period prescribed by law, the three-year period to assess shall be counted from the day the return was filed. Record reveals that petitioner filed its VAT return on May 29, 2006, its FWT return on January 9, 2006, and Annual ITR on April 11, 2006; thus, the reckoning date of the three-year period

[35]Exhibit "2".
[36]Par. 6, Stipulated Facts, JSFI, docket, p. 206.

to assess shall be counted on said filing dates as indicated below:

	Last Day to File Return	Actual Date of Filing	Last Day to Assess	Date of Formal Letter of Demand
Value-added Tax	January 25, 2006[37]	May 29, 2006[38]	May 29, 2009	January 14, 2009[39]
Final Withholding Tax	January 15, 2006[40]	January 9, 2006[41]	January 15, 2009	January 14, 2009
Income Tax	April 15, 2006[42]	April 11, 2006[43]	April 15, 2009	January 14, 2009

In the instant case, respondent issued and sent the FLD with Assessment Notices on January 14, 2009.[44] Since an assessment is deemed made when notice to this effect is released, mailed or sent to the taxpayer,[45] the assessments for deficiency IT, VAT and FWT for calendar year 2005 were timely issued by respondent.

The Court shall now proceed with the merit of the impugned assessment issued against petitioner.

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[37]SEC. 114.*Return and Payment of Value-added Tax.* -
(A) In General. - Every person liable to pay the value-added tax imposed under this Title shall file a quarterly return of the amount of his gross sales or receipts within twenty-five (25) days following the close of each taxable quarter prescribed for each taxpayer: *Provided, however,* That VAT-registered persons shall pay the value-added tax on a monthly basis.
Any person, whose registration has been cancelled in accordance with Section 236, shall file a return and pay the tax due thereon within twenty-five (25) days from the date of cancellation of registration: *Provided,* That only one consolidated return shall be filed by the taxpayer for his principal place of business or head office and all branches
[38] BIR Form No. 2550-Q, BIR Records, p. 172.
[39]Exhibits "A-2" and "A-2-a"
[40]SEC. 58.*Returns and Payment of Taxes Withheld at Source.* -
(A) *Quarterly Returns and Payments of Taxes Withheld.* - Taxes deducted and withheld under Section 57 by withholding agents shall be covered by a return and paid to, except in cases where the Commissioner otherwise permits, an authorized Treasurer of the city or municipality where the withholding agent has his legal residence or principal place of business, or where the withholding agent is a corporation, where the principal office is located.
The taxes deducted and withheld by the withholding agent shall be held as a special fund in trust for the government until paid to the collecting officers.
The return for final withholding tax shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter, while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which withholding was made: *Provided,* That the Commissioner, with the approval of the Secretary of Finance, may require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the government. (As implemented by Section 2.58 of RR No. 2-98, as amended)
[41]BIR Form No. 1601-E, BIR records, p. 153.
[42]SEC. 77.*Place and Time of Filing and Payment of Quarterly Corporate Income Tax.* –
(B) *Time of Filing the Income Tax Return.* - The corporate quarterly declaration shall be filed within sixty (60) days following the close of each of the first three (3) quarters of the taxable year. The final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be.
[43] BIR Form No. 1702, BIR Records, p. 58.
[44] Exhibits "A-2" and "A-2-a"
[45] *Basilan Estates, Inc. vs. The Commissioner of Internal Revenue and the Court of Tax Appeals*, G.R. No. L-22492, September 5, 1967.

A. Deficiency Final Withholding Tax

Respondent assessed petitioner of deficiency FWT for calendar year 2005 in the amount of P6,850,981.93, computed as follows:

	Amount	Tax Rate	Deficiency
Interest Expense	P28,255,462.21	15%	P 4,238,319.33
Deficiency Final Withholding Tax			P 4,238,319.33
Add: 20% Interest p.a. (01.17.06 to 02.14.09)			2,612,662.60
Total Amount Due			**P6,850,981.93**

Respondent alleged that petitioner failed to subject fully its claimed interest expense to FWT as required under Revenue Regulation No. 2-98, as amended. Respondent computed the interest expense not subjected to FWT in the following manner:

Interest Expense per FS		P156,206,061.00
Less: Interest subject to Final Tax per 1601F	P148,267,753.83	
Less: Interest Expense pertaining to 2004	20,317,155.04	127,950,598.79
Interest Expense not subjected to withholding tax		**P28,255,462.21**

In its protest letter,[46] petitioner argued that the alleged expense not subjected to FWT was not taxable given that such amount was arrived at based on erroneous comparison of petitioner's interest expense per return and per Financial Statements. Petitioner claimed that the reported interest expense per Financial Statements in the amount of P156,206,061.00 were fully accounted and subjected to the corresponding FWT and the same was duly reconciled with its interest expense per BIR Form No. 1601-F. Petitioner accounted its interest expense as follows:

	Interest Expense	Tax Base net of 10% VAT	EWT	EWT Rate
Accrued Interest pertaining to 2004	P 22,348,870.50	P20,317,155.00	P 2,031,715.50	10%
Interest payments in 2005	131,089,479.74	119,172,254.31	16,253,157.21	15%
Non-deductible interest expense per ITR of 2005	2,725,121.39			
Realized for-ex loss	42,589.76			
Interest expense per FS	**P156,206,061.39**		**P18,284,872.71**	

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[46]Exhibit "C".

The amount of P156,206,061.39 represents interest payments on loan from petitioner's parent company, EPEC Nederland Holding B.V., with office address at 1075AD, Amsterdam, Koningslaan 34, the Netherlands.[47] As indicated in petitioner's notes to parent company financial statements, the amount payable to EPEC Nederland Holding was originally from loans payable to a foreign bank. On June 23, 2004, petitioner gave the foreign bank a notice of its intent to prepay the outstanding loan of US$52.4 million (US$2 million was paid on June 10, 2004) in full together with accrued and unpaid interest of US$511,591.00 and breakage cost of US$3,348.00 (collectively, the "Prepayment Amount") permitted under the facility agreement. However, on June 30, 2004, EPEC Nederland Holding B.V. paid the "Prepayment Amount" to the foreign bank. In effect, EPEC Nederland Holding B.V. was subrogated to the rights of the foreign bank under the facility agreement.[48]

Section 28(B)(5)(a) of the NIRC of 1997 imposes twenty percent (20%) FWT on interest on foreign loans, to wit:

> SEC. 28. *Rates of Income Tax on Foreign Corporations.* -
>
> xxx xxx xxx
>
> (B) *Tax on Nonresident Foreign Corporation.*–
>
> xxx xxx xxx
>
> (5)*Tax on Certain Incomes Received by a Nonresident Foreign Corporation.*-
>
> (a) *Interest on Foreign Loans.*- A final withholding tax at the rate of twenty percent (20%) is hereby imposed on the amount of interest on foreign loans xxx.

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[47] Note 1, Corporate Information and Status of Operations of the Company and its Subsidiaries, Parent Company Financial Statements, BIR Records, p. 44.
[48] Note 7, Payable to EPEC, Parent Company Financial Statements, BIR Records, p. 25.

However, Article 11 of the Philippines-Netherlands tax treaty provides lower tax rates of ten percent (10%) and fifteen percent (15%) on the following instances:

ARTICLE 11

Interest

1. Interest arising in one of the States and paid to a resident of the other State may be taxed in that other State.

2. However, such interest may also be taxed in the State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed:

   a) 10 percent of the gross amount if such interest is paid:

      (i) in connection with the sale on credit of any industrial, commercial or scientific equipment, or

      (ii) on any loan of whatever kind granted by a bank, or any other financial institution,

      (iii) in respect of public issues of bonds, debentures or similar obligations.

   b) <u>15 per cent of the gross amount of the interest in all other cases</u>.

xxx xxx xxx

5. The term 'interest' as used in this Article means income from Government securities, bonds or debentures, whether or not secured by mortgage

> but not carrying a right to participate in profits, and debt-claims of every kind as well as other income assimilated to income from money lent by the taxation law of the State in which the income arises. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article. (*Underscoring supplied*)

From the foregoing, petitioner subjected to withholding its interest payments to EPEC Nederland Holding using the preferential tax rate of 15%, which was not disputed by respondent.[49]

The ICPA examined and verified the foregoing interest expense and was able to account for the same as follows:[50]

Exhibit No.	JV No.	Date	US $ Equivalent	Amount	Remarks
Y-Y.2	10514	01/31/05	$ 178,423.08	P 9,939,414.52	January Accrual
Z-Z.2	20512	02/28/05	165,215.05	9,052,330.85	February Accrual
AA-AA.2	30514	03/31/05	187,817.44	10,222,884.64	March Accrual
AB-AB.2	60507	06/07/05	59,458.22	3,297,966.45	Expense adjustment
Total			**590,913.79**	**32,512,596.46**	
AC-AC.3	40513	04/30/05	220,093.72	12,094,676.69	April Accrual
AD-AD.2	50518	05/30/05	229,440.05	12,469,745.69	May Accrual
AE-AE.2	60533	06/30/05	229,305.11	12,671,262.93	June Accrual
Total			**678,838.88**	**37,235,685.31**	
AF-AF.2	70522	07/31/05	244,044.12	13,704,211.47	July Accrual
AG-AG.1	80516	08/31/05	252,196.35	14,245,294.84	August Accrual
AH-AH.2	90527	09/30/05	260,229.75	14,420,853.32	September Accrual
Total			**756,470.22**	**42,370,359.63**	
AI-AI.4	12515	12/31/05	**833,317.78**	**44,087,419.99**	4th Quarter Accrual
Total Interest Expense during 2005 per Books			**$2,859,540.67**	**P156,206,061.39**	

The interest relative to petitioner's loan from EPEC Nederland Holding B.V. was payable every quarter, not later than twenty (20) days after the end of each quarter.[51] Remittance covers interest from the 26th day of the last month of the previous quarter up to the 25th day of the last month of the current quarter. As such, the accrual for the

[49] See computation of Deficiency FWT Assessment, Exhibit "A".
[50] Schedule "A", Exhibit "DM", docket, pp. 1562 and 1551-1552.
[51] Note 8(a), Related Party Transactions, Parent Company Financial Statements, BIR Records, p. 25.

26th to month end of the last month of such quarter was remitted in the subsequent quarter. Simply stated, interest remittance for the first quarter of 2005 covers December 26, 2004 to March 25, 2005, while interest remittance for the second quarter covers accruals from March 26 to June 25, 2005.

For better appreciation of the facts, the accruals and remittances made by petitioner on the cited interest expense during 2005 shall be discussed below.

During the first quarter of 2005, petitioner's accrual of interest expense amounted to US$531,455.57 (inclusive of 10% FWT) with peso equivalent of P29,214,630.01, covering the period from January 1 to March 31, 2005, broken down as follows:

Exhibit No.	**JV No.**	**Date**	**In US Dollar**		**In Peso**	**Remarks**
			Exclusive of FWT	**Inclusive of FWT**		
Y-Y.2	10514	01/31/05	$ 162,202.80	$ 178,423.08	P 9,939,414.52	January Accrual
Z-Z.2	20512	02/28/05	150,195.50	165,215.05	9,052,330.85	February Accrual
AA-AA.2	30514	03/31/05	131,922.60	145,114.86	7,898,587.32	March 1-25 Accrual
			38,820.53	42,702.58	2,324,297.32	March 26-31 Accrual
Total			**$ 483,141.43**	**$ 531,455.57**	**P29,214,630.01**	

As evidenced by Journal Voucher No. 040507[52] with attached supporting documents, petitioner made interest payment on EPEC Nederland Holding loan on April 19, 2005 amounting to $471,845.17 (net of 10% FWT of $47,184.52) covering the period of December 26, 2004 to March 25, 2005, detailed as follows:

	In Dollar	**In Peso**
Interest Payments		
December 26-31, 2004	27,524.27	1,512,183.39
January 2005	162,202.80	8,911,421.83
February 2005	150,195.50	8,251,740.77
March 1-25, 2005	131,922.60	7,247,827.64
Total Interest Payments	**471,845.17**	**25,923,173.63**
FWT Payable (10%)	**47,184.52**	**2,592,317.36**

[52]Exhibits "AJ" to "AJ.5".

The corresponding FWT payable of US$47,184.52 was remitted to the BIR on May 10, 2005 based on the exchange rate at the time of the remittance as evidenced by the Filing Reference No.,[53] the BIR EFPS payment confirmation,[54] the Monthly Remittance Return of Final Income Taxes Withheld (BIR Form No. 1601F),[55] and the Schedule of Income Payments,[56] thereby realizing a foreign exchange gain of P11,418.59, to wit:

FWT Payable	$47,184.52 at P 54.94	P 2,592,317.36
FWT Remitted	$47,184.52 at P 54.70	2,580,898.77
Realized forex gain		**P 11,418.59**

Thus, as of the end of the first quarter of 2005, the interest expense representing accruals for the period March 26-31, 2005 in the amount of US$42,702.58 with peso equivalent of P2,324,297.32 remained outstanding as the payment was due for remittance to EPEC Nederland Holding not later than July 20, 2005.

As for the second quarter of 2005, petitioner's accrual of interest expense amounted to US$680,779.91 (inclusive of 15% FWT) with peso equivalent of P37,235,685.31 covering the period of April 1, 2005 to June 30, 2005 and adjustment of FWT for March 26-31, 2005, broken down as follows:

Exhibit No.	**JV No.**	**Date**	**In US Dollar**		**In Peso**	**Remarks**
			Exclusive of FWT	**Inclusive of FWT**		
AC-AC.3	40513	04/30/05	$ 1,941.03	$ 1,941.03	P105,731.79	FWT adj. for Mar. 26-31
			191,385.84	220,093.72	11,988,944.90	April Accrual
AD-AD.2	50518	05/31/05	199,513.09	229,440.05	12,469,745.69	May Accrual
AE-AE.2	60533	06/30/05	159,162.34	183,036.69	10,114,497.72	June 1-25 Accrual
			40,233.41	46,268.42	2,556,765.21	June 26-30 Accrual
Total			**$592,235.71**	**$680,779.91**	**P37,235,685.31**	

As shown in the Journal Voucher No. 070513[57] with attached supporting documents, petitioner made interest

[53]Exhibit "DF".
[54]Exhibit "DF.1".
[55]Exhibits "DF.2" to "DF.4".
[56]Exhibit "DF.5".
[57]Exhibits "AL" to "AL.8".

payment on EPEC Nederland Holding loan on July 18, 2005 amounting to US$588,881.80 (net of 15% FWT of US$88,332.27) covering the period of March 26, 2005 to June 25, 2005, detailed as follows:

	In Dollar	**In Peso**
Interest Payments		
March 26-31, 2005	$ 38,820.53	P 2,173,949.68
April 2005	191,385.84	10,717,607.04
May 2005	199,513.09	11,172,733.04
June 1-25, 2005	159,162.34	8,913,091.04
Total Interest Payments	**$588,881.80**	**P32,977,380.80**
FWT Payable (15%)	**$ 88,332.27**	**P 4,946,607.12**

The corresponding FWT payable of US$88,332.27 was remitted to the BIR on August 9, 2005 based on the exchange rate at the time of the remittance as indicated in the Filing Reference No.,[58] the BIR EFPS payment confirmation,[59] the Monthly Remittance Return of Final Income Taxes Withheld (BIR Form No. 1601F),[60] and the Schedule of Income Payments,[61] thereby realizing a foreign exchange gain of P28,354.66, to wit:

FWT Payable	$ 88,332.27 at P 56.00	P4,946,607.12
FWT Remitted	$ 88,332.27 at ₱55.679	4,918,252.46
Realized forex gain		**P28,354.66**

Likewise, on June 7, 2005, petitioner remitted to the BIR the amount of P3,297,966.45 (US$59,458.22[62]), representing the FWT for the interest payments made in October 2004, January 2005 and April 2005 as a consequence of the increase in tax rates of 10% to 15%, which was included in the 2005 interest expense of P156,206,061.00. The said remittance was supported by the Filing Reference No.,[63] the BIR EFPS payment confirmation,[64] the Monthly Remittance Return of Final

[58]Exhibit "DH".
[59]Exhibit "DH.1".
[60]Exhibits "DH.2" to "DH.4".
[61]Exhibit "DH.5".
[62] Exhibit "DM", docket, p. 1554.
[63]Exhibit "DG".
[64]Exhibit "DG.1".

Income Taxes Withheld (BIR Form No. 1601F),[65] and the Schedule of Income Payments.[66]

As of the end of the second quarter of 2005, the accrual for June 26-30, 2005 of US$46,268.42 remained outstanding, the payment of which to EPEC Nederland Holding was due for remittance not later than October 20, 2005.

Petitioner's accrual of interest expense during the third quarter of 2005 amounted to US$756,470.22 (inclusive of 15% FWT) with peso equivalent of P42,370,359.63 covering the period of July 1, 2005 to September 30, 2005, broken down as follows:

Exhibit No.	JV No.	Date	In US Dollar		In Peso	Remarks
			Exclusive of FWT	**Inclusive of FWT**		
AF-AF.2	70522	07/31/05	$ 40,233.41	$ 46,268.42	P 2,597,046.50	June 26-30 Accrual
			164,293.38	188,937.39	10,605,055.53	July 1-25 Accrual
			47,918.90	55,106.74	3,093,141.04	July 26-30 Accrual
			(40,233.41)	(46,268.42)	(2,591,031.60)	Reversal of June 26-30 Accrual
AG-AG.1	80516	08/31/05	219,301.17	252,196.35	14,245,294.84	August Accrual
AH-AH.2	90527	09/30/05	40,233.41	46,268.42	2,591,494.29	June 26-30 Accrual
			164,293.38	188,937.39	10,582,383.05	July 1-25 Accrual
			47,918.90	55,106.74	3,086,528.23	July 26-30 Accrual
			219,301.17	252,196.35	14,125,517.31	August Accrual
			180,589.03	207,677.38	11,632,010.31	September 1-25Accrual
			45,697.71	52,552.37	2,943,458.05	September 26-30 Accrual
			(471,746.86)	(542,508.89)	(30,540,537.91)	Reversal of Accruals made inJuly& August
Total			**$ 657,800.19**	**$ 756,470.22**	**P42,370,359.62**	

As evidenced by Journal Voucher No. 100513[67] with attached supporting documents, petitioner made interest payment on EPEC Nederland Holding loan on October 19, 2005 amounting to US$652,335.89 (net of 15% FWT of US$97,850.38) covering the period of June 26, 2005 to September 25, 2005, to wit:

[65]Exhibits "DG.2" to "DG.4".
[66]Exhibit "DG.5".
[67]Exhibits "AN" to "AN.9".

	In Dollar	In Peso
Interest Payments		
June 26-30, 2005	$ 40,233.41	P 2,253,473.29
July 2005	212,212.28	11,886,009.80
August 2005	219,301.17	12,283,058.53
September 1-25, 2005	180,589.03	10,114,791.57
Total Interest Payments	**$652,335.89**	**P36,537,333.19**
FWT Payable (15%)	**$ 97,850.38**	**P 5,480,599.98**

The corresponding FWT payable of US$97,850.38 was remitted to the BIR on November 8, 2005 based on the exchange rate at the time of the remittance as shown in the Filing Reference No.[68], the BIR EFPS payment confirmation[69], the Monthly Remittance Return of Final Income Taxes Withheld (BIR Form No. 1601F)[70], and the Schedule of Income Payments[71], thereby realizing a foreign exchange gain of P24,560.45, to wit:

FWT Payable	$ 97,850.38 at P56.01	P5,480,599.98
FWT Remitted	$97,850.38 at P55.759	5,456,039.53
Realized forex gain		**P 24,560.45**

As of the end of the third quarter of 2005, the accrual for September 26 to 30, 2005 of US $52,552.37 remained outstanding, the payment of which to EPEC Nederland Holding was due for remittance not later than January 20, 2006.

Petitioner's accrual of interest expense during the fourth quarter of 2005 amounted to US$833,318.38 (inclusive of 15% FWT) with peso equivalent of P44,087,420.00, covering the period of September 26 to December 25, 2005, broken down as follows:

Exhibit No.	JV No.	Date	In US Dollar		In Peso	Remarks
			Exclusive of FWT	Inclusive of FWT		
AI-AI.4	120515	12/31/05	$ 45,697.71	$ 52,552.37	P 2,790,005.14	September 26-30 Accrual
			239,913.26	275,900.25	14,647,544.22	October Accrual
			240,853.94	276,982.03	14,704,976.03	November Accrual
			188,231.96	216,466.75	11,492,219.97	December 1-25, 2005

[68]Exhibit "DI".
[69]Exhibit "DI.1".
[70]Exhibits "DI.2" to "DI.3".
[71]Exhibit "DI.4".

			55,625.52	63,969.35	3,396,132.69	December 26-31, 2005
			(45,697.71)	(52,552.37)	(2,943,458.05)	Reversal of Sept. 26-30 Accruals made in Sept. 2005
Total			**$724,624.68**	**$833,318.38**	**P44,087,420.00**	

As evidenced by Journal Voucher No. 020608[72] with attached supporting documents, petitioner made interest payment on EPEC Nederland Holding loan on February 24, 2006 amounting to US$714,696.87 (net of 15% FWT of US$107,204.53) covering the period of September 26, 2005 to December 25, 2005, with the following details:

	In Dollar	**In Peso**
Interest Payments		
September 26-30, 2005	$ 45,697.71	P 2,426,091.42
October 2005	239,913.26	12,736,994.97
November 2005	240,853.94	12,786,935.67
December 1-25, 2005	188,231.96	9,993,234.76
Total Interest Payments	**$714,696.87**	**P37,943,256.82**
FWT Payable (15%)	**$107,204.53**	**P 5,691,488.52**

The FWT payable of US$107,204.53 was remitted to the BIR only on March 9, 2006 based on the exchange rate at the time of the remittance as established by the Filing Reference No.[73], the BIR EFPS payment confirmation[74], the Monthly Remittance Return of Final Income Taxes Withheld (BIR Form No. 1601F)[75], and the Schedule of Income Payments[76], thereby realizing a foreign exchange gain of P115,888.09, to wit:

FWT Payable	$ 107,204.53 at P53.09	P5,691,488.52
FWT Remitted	$107,204.53 at P52.009	5,575,600.43
Realized forex gain		**P115,888.09**

As of the end of the fourth quarter of 2005, the accrual for December 26-31, 2005 of US$63,969.35 remained outstanding.

[72]Exhibits "AP" to "AP.9".
[73]Exhibit "DJ".
[74]Exhibit "DJ.4".
[75]Exhibits "DJ.1" and "DJ.5"
[76]Exhibit "DJ.3"

From the foregoing, petitioner's total interest expense per books for the year 2005 amounted to US$2,861,482.30 with peso equivalent of P156,206,061.39, as summarized below:

Accrual of the Period	US $ Equivalent	Peso Equivalent
1st Quarter	531,455.57	29,214,630.01
2nd Quarter	680,779.91	37,235,685.31
FWT adjustment	59,458.22	3,297,966.45
3rd Quarter	756,470.22	42,370,359.62
4th Quarter	833,318.38	44,087,420.00
TOTAL	**2,861,482.30**	**156,206,061.39**

On the other hand, the total interest payment on petitioner's EPEC Nederland Holding loan (inclusive of FWT) amounted to US$2,797,512.95 with peso equivalent of P153,547,166.43, computed as follows:

2005	Interest Payments		FWT Remittances		Total	
	In Dollar	In Peso	In Dollar	In Peso	In Dollar	In Peso
1st Quarter	$ 444,320.90	P 24,410,990.24	$ 44,432.09	P 2,430,346.51	$ 488,752.99	P 26,841,336.75
Adjustments	-	-	59,458.22	3,297,966.45	59,458.22	3,297,966.45
2nd Quarter	588,881.80	32,977,380.80	88,332.27	4,918,252.46	677,214.07	37,895,633.26
3rd Quarter	652,335.89	36,537,333.19	97,850.38	5,456,039.53	750,186.27	41,993,372.72
4th Quarter	714,696.87	37,943,256.82	107,204.53	5,575,600.43	821,901.40	43,518,857.25
Total	**$2,400,235.46**	**P131,868,961.05**	**$397,277.49**	**P21,678,205.38**	**$2,797,512.95**	**P153,547,166.43**

Due to dissimilarity of dollar exchange rate at the time of accruals and actual remittances, petitioner incurred foreign exchange loss from its interest payments on EPEC Nederland Holding loan amounting to P795,771.33 and foreign exchange gain from remittance of final withholding taxes in the amount of P58,533.59, which both formed part of the total interest payment of P156,206,061.39, as shown below:

	Exhibit	Accrual of Interest on Loan		Exhibit	Payment of Interest on Loan	Forex Gain/(Loss)
January 2005	Y-Y.2	$ 162,202.80	P 9,035,831.38		P 8,911,421.83	P 124,409.55
February 2005	Z-Z.2	150,195.50	8,229,391.68		8,251,740.77	(22,349.09)
March 1-25, 2005	AA-AA.2	131,922.60	7,180,533.93		7,247,827.64	(67,293.71)
		444,320.90	**24,445,756.99**	AJ-AJ.5	**24,410,990.24**[77]	**34,766.75**
March 26-31, 2005	AA-AA.2	38,820.53	2,112,997.57		2,173,949.68	(60,952.11)
April 2005	AC-AC.3	191,385.84	10,425,169.48		10,717,607.04	(292,437.56)
May 2005	AD-AD.2	199,513.09	10,843,257.12		11,172,733.04	(329,475.92)

[77] Total payment of P25,923,173.64 less interest payment of P1,512,183.40 pertaining to December 26-31, 2004 accruals.

June 1-25, 2005	AE-AE.2	159,162.34	8,795,215.41		8,913,091.04	(117,875.63)
		588,881.80	**32,176,639.58**	AL-AL.8	**32,977,380.80**	**(800,741.22)**
June 26-30, 2005	AE-AH.2	40,233.41	2,223,676.43		2,253,473.29	(29,796.86)
July 1-25, 2005	AH-AH.2	164,293.38	9,202,072.21		9,202,072.21	-
July 26-31, 2005		47,918.90	2,683,937.59		2,683,937.59	-
August 2005		219,301.17	12,283,058.53		12,283,058.53	-
September 1-25, 2005		180,589.03	10,114,791.57		10,114,791.57	-
		652,335.89	**36,507,536.33**	AN-AN.9	**36,537,333.19**	**(29,796.86)**
September 26-30, 2005	AI-AI.4	45,697.71	2,426,091.42		2,426,091.42	-
October 2005		239,913.26	12,736,994.97		12,736,994.97	-
November 2005		240,853.94	12,786,935.67		12,786,935.67	-
December 1-25, 2005		188,231.96	9,993,234.76		9,993,234.76	-
		714,696.87	**37,943,256.82**	AP-AP.9	**37,943,256.82**	-
TOTAL		**$2,400,235.46**	**P131,073,189.72**		**P131,868,961.05**	**P(795,771.33)**

	Exhibit	**Accrual of FWT**		**Exhibit**	**FWT Remittances**	**Forex Gain/(Loss)**
January 2005	Y-Y.2	$ 16,220.28	P 903,583.14			
February 2005	Z-Z.2	15,019.55	822,939.17			
March 1-25, 2005	AA-AA.2	13,192.26	718,053.39			
		44,432.09	**2,444,575.70**	AK-AK.3	**P2,430,346.51**[78]	**P14,229.19**
March 26-31, 2005	AC-AC.3	5,823.08	317,031.55			
April 2005		28,707.88	1,563,775.42			
May 2005	AD-AD.2	29,926.96	1,626,488.57			
June 1-25, 2005	AE-AE.2	23,874.35	1,319,282.31			
		88,332.27	**4,826,577.85**	AM-AM.3	**4,918,252.46**	**(91,674.61)**
	AB-AB.2	**59,458.22**	**3,297,966.45**	AB-AB.2	**3,297,966.45**	**-**
June 26-30, 2005	AE-AH.2	6,035.01	333,551.46			
July 1-25, 2005	AH-AH.2	24,644.01	1,380,310.83			
July 26-31, 2005		7,187.84	402,590.64			
August 2005		32,895.18	1,842,458.78			
September 1-25, 2005		27,088.35	1,517,218.74			
		97,850.39	**5,476,130.45**	AO-AO.3	**5,456,039.53**	**20,090.92**
September 26-30, 2005	AI-AI.4	6,854.66	363,913.71			
October 2005		35,986.99	1,910,549.25			
November 2005		36,128.09	1,918,040.35			
December 1-25, 2005		28,234.79	1,498,985.21			
		107,204.53	**5,691,488.52**	AQ-AQ.9	**5,575,600.43**	**115,888.09**
TOTAL		**$ 397,277.50**	**P21,736,738.98**		**P21,678,205.38**	**P58,533.59**

Note that there is a difference between petitioner's total interest expense per books and the total interest remittance amounting to US$63,969.35, computed as follows:

	In Dollar	**In Peso**
Interest Remittances	$2,797,512.95	P153,547,166.43
(-) Forex Loss on Interest Payment		(795,771.33)
(+)Forex Gain on FWT Remittance		58,533.59

[78] Total remittances of P2,580,898.77 less FWT of P150,552.26 pertaining to December 26-31, 2004 accruals.

Total	2,797,512.95	152,809,928.69
Less: Interest Expense per books	2,861,482.30	156,206,061.39
Difference	**$ 63,969.35**	**P3,396,132.70**

The difference actually pertains to the accrual for the period December 26-31, 2005 which remained outstanding as of the end of the fourth quarter of 2005. It was due for remittance to EPEC Nederland Holding not later than April 20, 2006.

As verified, the amount of P3,396,132.70 was included in the total interest expense per books of P156,206,061.39. On the other hand, the deductible interest expense per petitioner's 2005 ITR amounted to P153,480,940.00.[79] The difference of P2,725,121.39 represents forty-two percent (42%) of the interest income subjected to final tax and claimed by petitioner as non-deductible interest expense[80] in its 2005 ITR, in accordance with Section 34(B)(1) of the NIRC of 1997, as amended, which reads as follows:

> SEC. 34. *Deductions from Gross Income.*- xxx
>
> xxx xxx xxx
>
> (B) *Interest.*-
>
> (1) *In General.*- The amount of interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business shall be allowed as deduction from gross income: *Provided, however,* That **the taxpayer's otherwise allowable deduction for interest expense shall be reduced by forty-two percent (42%) of the interest income**

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[79] Section D, Item 93, 2005 Annual ITR, BIR Records, p. 64.
[80] Section E, Item 115, 2005 Annual ITR, BIR Records, p. 63.

> **subjected to final tax**: xxx *(Emphasis supplied)*

Since petitioner already recorded and accrued as expense in its book the income payment of US$55,625.52 and the corresponding FWT of US$8,343.83 or in the total amount of US$63,969.35 with peso equivalent of P3,396,132.70, further claiming it as a deduction from its gross income under its 2005 Annual Income Tax Return[81]; it is incumbent upon petitioner to withhold and remit to the collecting agent of the BIR the corresponding taxes thereon, pursuant to Section 2.57.4 of RR No. 2-98, as amended by Section 4 of RR No. 12-01, which provides:

> 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. *(Emphasis supplied)*

As clearly stated above, the duty of petitioner to withhold arises when the interest expense is paid, becomes payable, or is accrued/recorded as expense in petitioner's

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[81]BIR Records, pp. 53-68.

books, *whichever comes first.* In this case the accrual made on December 31, 2005 covering the interest expense for December 26 to 31, 2005 in the amount of P3,396,132.70 came first before the same became due and payable on April 20, 2006. As such, petitioner was obligated to withhold the FWT corresponding to the interest expense of P3,396,132.70 in 2005 and remit it to the BIR on or before January 15, 2006, pursuant to Section 2.58(A)(2) of Revenue Regulations No. 2-98, as amended by Revenue Regulations No. 17-03.

For petitioner's failure to show that it withheld and remitted the FWT of P442,973.93 (US$8,343.83 at P53.09), the assessment for the same must be sustained and petitioner should be held liable to pay basic deficiency FWT of P442,973.93 for calendar year 2005.

B. Deficiency Income Tax

Based on the finding that petitioner failed to withhold the FWT on the interest expense of P28,255,462.21, respondent disallowed the amount of P28,255,462.21 from petitioner's claimed deductions from gross income and assessed petitioner of deficiency income tax in the amount of P14,385,900.88, computed as follows:

I. DEFICIENCY INCOME TAX			
Taxable Income (Loss) per ITR			
Add: Adjustments per Investigation			
Income Payments not Subjected to FWT			P 28,255,462.21
Taxable Income per Investigation			P 28,255,462.21
Income Tax Due			P 9,183,025.22
Less: Allowable Tax Credits/Payments:			
Prior Year's Excess Credits Other Than MCIT		P22,203,593.00	
Creditable Tax Withheld		9,223,427.00	
Total		P31,427,020.00	
Less: Excess of MCIT Over Normal Income Tax (NIT) Carried Over to Succeeding Period	P 2,907,744.00		
Excess Tax Credits Carried Over to Succeeding Period	28,519,276.00	31,427,020.00	-
Deficiency Income Tax			P 9,183,025.22
Add: 20% Interest p.a. (04.18.06 to 02.14.09)			5,202,875.66
Total Amount Due			**P14,385,900.88**

As stated, petitioner failed to withhold and remit the FWT on the interest expense of only P3,396,132.70 and not P28,255,462.21 for calendar year 2005 as found by respondent. For failure to withhold and remit the corresponding FWT, petitioner cannot claim the interest expense of P3,396,132.70 as deduction from its taxable gross income for the year 2005 pursuant to Section 34(K) of the NIRC of 1997, which states:

> SEC. 34. *Deductions from Gross Income.* -
>
> xxx xxx xxx
>
> (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.

But despite the disallowance of the interest expense of P3,396,132.70, petitioner would still be in a net loss position in the amount of P45,259,013.30 with a Minimum Corporate Income Tax (MCIT) due of P2,907,744.00, which when applied against petitioner's tax credits of P31,427,020.00 would still not result in any deficiency income tax, as shown below:

Sales/Revenues/Receipts/Fees		P 52,941,176.00
Less: Cost of Sales/Services		
Gross Income from Operation		52,941,176.00
Add: Non-Operating and Taxable Other Income		92,446,020.00
Total Gross Income		P 145,387,196.00
Less: Deductions	P194,042,342.00	
Less: Disallowed Interest Expense	3,396,132.70	190,646,209.30

Net Loss		P(45,259,013.30)
Tax Due (MCIT)		P 2,907,744.00
Less: Tax Credits/Payments:		
Prior Year's Excess Credits Other Than MCIT	22,203,593.00	
Creditable Tax Withheld for the First Three Quarters	9,173,927.00	
Creditable Tax Withheld for the Fourth Quarter	49,500.00	31,427,020.00
Tax Overpayment		**P(28,519,276.00)**

C. Deficiency Value-added Tax

As to the deficiency VAT, respondent assessed petitioner as follows:

Taxable Sales per VAT Returns		P35,294,117.65
Add: Adjustments per Investigation		
Unsupported Exempt Sales		17,647,058.82
Sales/Receipts Subject to 10% VAT per Investigation		P52,941,176.47
Tax Rate		10%
Output Tax Due		P 5,294,117.65
Less: Allowable Tax Credits/Payments:		
Input Tax Carried Over From Previous Period	P 31,439.73	
Input Tax per Returns	307,031.21	
Payments	3,191,171.23	
Total	3,529,642.17	
Less: Excess Tax Credits Carried Over to Succeeding Period	230.41	3,529,411.76
Deficiency VAT		P 1,764,705.89
Add: 20% Interest p.a. (01.26.06 to 02.14.09)		1,079,129.74
Total Amount Due		**P2,843,835.63**

Respondent alleged that verification disclosed that exempt sales amounting to P17,647,058.82 were not supported with sufficient evidence/documents, which will subject petitioner to ten percent (10%) VAT pursuant to Sections 106, 108, and 109 of the NIRC of 1997.

In its protest letter, petitioner emphasized that the alleged unsupported VAT-exempt sale is not taxable as it pertains to sales/receipts from East Asia Utilities Corporation (EAUC), which is a PEZA-registered company and, as such, exempt from paying VAT.

In the BIR letter dated May 20, 2009,[82] respondent requested petitioner to submit proof of sales in the amount of P17,647,058.82 in favor of EAUC, and to further submit a certification from the appropriate government office that EAUC is in good standing as of December 2005 as per Republic Act No. 7916 and paragraph 3 of Certificate of Board Resolution No. 00-033.

In compliance with the said requirements, petitioner submitted the following documents:

a. Management Service Agreement[83] between petitioner and EAUC dated February 10, 2003;
b. PEZA Certificate of Board Resolution[84];
c. PEZA Certification[85] dated July 18, 2005;
d. PEZA Certification[86] dated October 8, 2007;
e. Petitioner's Journal Voucher No. 090501[87] dated September 2, 2005 to recognize the Management and Advisory Fee Income of P52,941,176.47;
f. Petitioner's Invoice No. 0001[88] dated August 3, 2005 issued to Cebu Private Power Corporation (CPPC) for Management Services Fee of P35,294,117.65 subject to 10% VAT of P3,529,411.75;
g. Petitioner's Invoice No. N530N531-004[89] dated August 3, 2005 issued to EAUC for Management Services Fee of P17,647,058.82;
h. Petitioner's Official Receipt[90] dated September 2, 2005 issued to CPPC;
i. Petitioner's Acknowledgment Receipt[91] dated September 2, 2005 for payment received from EAUC; and
j. Petitioner's Security Bank Peso Savings Account Passbook[92] and Check Deposit Slip[93] dated September 2, 2005.

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[82]Exhibit "E".
[83]Exhibit "I".
[84]Exhibit "K".
[85]Exhibit "L".
[86]Exhibit "M".
[87] Exhibit "DL".
[88] Exhibit "DL.3".
[89]Exhibit "DL.5"
[90] Exhibit "DL.4"
[91]Exhibit "DK"
[92] Exhibit "DL.1"

Scrutiny of the foregoing documents shows that the amount of P17,647,058.82 subject of the present deficiency VAT assessment pertains to sale of services to a PEZA entity subject to zero percent VAT pursuant to Section 108(B)(3) of the NIRC of 1997, as amended, and as clarified in Revenue Memorandum Circular (RMC) No. 74-99. Consequently, the present assessment for deficiency VAT should be cancelled.

D. Compromise Penalty

The compromise penalty imposed by respondent against petitioner for non-submission of Quarterly Summary List of Sales and Purchases in the amount of P8,000.00[94] must be cancelled as well, there being no compromise agreement entered into by the parties.

WHEREFORE, the instant Petition for Review is hereby **PARTIALLY GRANTED**. The assessments issued by respondent Commissioner of Internal Revenue against petitioner El Paso Philippines Energy Company, Inc. for calendar year 2005 covering deficiency Income Tax in the amount of P14,385,900.88 and deficiency Value-Added Tax in the amount of P2,843,835.63 are **CANCELLED** and **SET ASIDE**. However, the deficiency Final Withholding Tax assessment for calendar year 2005 is **UPHELD IN PART**. Accordingly, petitioner is hereby **DIRECTED TO PAY** respondent basic deficiency Final Withholding Tax in the amount of P442,973.93 and the corresponding twenty-five percent (25%) surcharge in the amount of P110,743.48 as imposed under Section 248(A)(3) of the NIRC of 1997, as amended, or in the sum of P553,717.41, computed as follows:

Basic Deficiency FWT	P 442,973.93
Add: 25% Surcharge	110,743.48
Total	**P553,717.41**

[93] Exhibit "DL.2"
[94] Exhibit "A-1"

In addition, petitioner is **ORDERED TO PAY**:(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency FWT of P442,973.93 computed from January 15, 2006, until full payment thereof pursuant to Section 249(B) of the NIRC of 1997; and (b) delinquency interest at the rate of 20% per annum on the total amount of P553,717.41 and on the deficiency interest which have accrued as afore-stated in (a) computed from February 14, 2009 until full payment thereof pursuant to Section 249(C)(3) of the NIRC of 1997, as amended.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

I Concur:

ERLINDA P. UY
Associate Justice

ATTESTATION

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

ERLINDA P. UY
Chairperson

CERTIFICATION

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

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