REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

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TRIDHARMA MARKETING CORPORATION, INC., Petitioner,	**CTA CASE NO. 8833**
	Members:
- versus -	**CASTAÑEDA, JR.,** *Chairperson,* **CASANOVA,** *and* **MANAHAN,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** FEB 15 2018 3:40 p.m.

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DECISION

CASANOVA, *J.*:

Before this Court is a Petition for Review (with Motion to Suspend Collection of Taxes)[1], filed by petitioner Tridharma Marketing Corporation, Inc., praying that judgment be rendered reversing the decision of respondent Commissioner of Internal Revenue dated May 26, 2014.

Petitioner Tridharma Marketing Corporation, Inc. is a domestic corporation organized to engage in buying, selling, distributing and marketing of all kinds of goods. Its principal office is located at GPH Properties Corp., Plaridel Street, Bgy. Umapad, Mandaue City, Cebu.[2] It is duly registered with the Bureau of Internal Revenue (BIR) under Tax Identification Number (TIN) 241-650-638-000.[3]

On the other hand, respondent Commissioner of Internal Revenue (CIR), is the one vested by law with the authority to assess and collect

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[1] Docket (Vol. I), pp. 7-41.
[2] Paragraph 2, Joint Stipulation of Facts, Joint Stipulation of Facts and Issues (JSFI), Docket (Vol. III), p. 1466.
[3] Exhibit "P-62".

all national internal revenue taxes, fees, and charges. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

As early as 2005, petitioner is engaged in the distribution of imported goods, including, and primarily, the brand of *Kopiko* coffee products in the Philippines. During the height of demand for the said product, petitioner purchased *Kopiko* products, including *Fres* candies and *Energen* cereal drinks, from Etheria Trading - an importer and a single proprietorship owned by Mr. Ching C. Adraque.[4]

In 2010, petitioner's purchases from Etheria Trading totaled ₱4,942,937,053.81. To facilitate their transactions, petitioner sends purchase orders[5] (PO) to Etheria Trading who, in turn, sends transmittal documents[6] with indicated assignees to whom payments should be made. For its purchases during said year, petitioner issued check payments to either Globalhills Philippines, Inc. ("GPI") or Cadense Unlimited, Inc. ("CUI"), as per instruction by Mr. Adraque in its transmittal documents. Further, Etheria Trading executed separate special power of attorney in favor of GPI and CUI.

As proof of payments made to GPI and CUI, Etheria Trading issued sales invoices[7] and official receipts[8] to petitioner.

On August 16, 2013, petitioner received a Preliminary Assessment Notice[9] (PAN) dated July 31, 2013 from Officer-in-Charge (OIC) Assistance Commissioner of Internal Revenue (ACIR) Alfredo V. Misajon of the BIR Large Taxpayer Service. The PAN assessed petitioner with alleged deficiency income tax (IT), value-added tax (VAT), withholding tax on compensation (WTC), documentary stamp tax (DST) and expanded withholding tax (EWT), in the total amount of ₱4,640,934,039.97, inclusive of surcharge and interest.[10]

Petitioner replied to the PAN through a letter[11] dated August 30, 2013, which the BIR received on September 2, 2013.[12] a

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[4] *See* Transcript of Stenographic Notes (TSN), April 29, 2015.
[5] Exhibits "P-72-1" to "P-72-114".
[6] Exhibits "P-73-1" to "P-73-23".
[7] Exhibits "P-68-1" to "P-68-2153".
[8] Exhibits "P-67-1" to "P-67-2153".
[9] Exhibit "P-54".
[10] Par. 3, Joint Stipulation of Facts, JSFI, Docket (Vol. III), pp. 1466-1467.
[11] Exhibit "P-55".
[12] Par. 4, Joint Stipulation of Facts, JSFI, Docket (Vol. III), p. 1467.

On September 23, 2013, petitioner received a Formal Letter of Demand with attached Details of Discrepancies and Assessment Notices[13] (FLD-DDAN) dated September 16, 2013 assessing petitioner with alleged deficiency IT, VAT, WTC, DST and EWT for taxable year ended December 31, 2010, in the total amount of ₱4,697,696,275.25, inclusive of surcharge and interest.[14]

In response, petitioner filed on October 21, 2013 a protest letter[15] dated October 18, 2013 with the BIR.

On February 28, 2014, OIC-ACIR Alfredo V. Misajon issued a Final Decision on Disputed Assessment[16] (FDDA) against petitioner which it received on even date. The FDDA denied petitioner's protest letter by refusing to consider the purchases made from Etheria and, reiterated the assessment against petitioner of deficiency IT, VAT, WTC, DST and EWT for taxable year ended December 31, 2010, but in the slightly reduced amount of ₱4,473,228,667.87, inclusive of surcharge and interest, summarized as follows:

Tax Type	Basic Tax	Surcharge	Interest	Total
1. IT	1,527,100,903.98	763,550,451.99	878,605,999.55	₱3,169,257,355.52
2. VAT	612,723,525.25	306,361,752.63	379,049,238.36	1,298,134,526.24
3. WTC	1,679,413.14		1,048,137.84	2,727,550.98
4. DST	534,493.40		336,511.18	871,004.58
5. EWT	1,378,127.78		860,102.76	2,238,230.54
TOTAL	**2,143,416,463.55**	**1,069,912,204.62**	**1,259,899,989.69**	**₱4,473,228,657.86**

On March 28, 2014, petitioner appealed the FDDA to respondent *via* a letter request for reconsideration[17].

Meanwhile, on May 23, 2014, petitioner paid the assessments corresponding to the WTC, DST and EWT deficiency assessments inclusive of interest, in the total amount of ₱5,836,786.10.[18]

On June 2, 2014, petitioner received a letter-decision[19] dated May 26, 2014 from respondent, denying its request for reconsideration and

[13] Exhibit "P-56".
[14] Par. 6, Joint Stipulation of Facts, JSFI, Docket (Vol. III), p. 1467.
[15] Exhibit "P-57".
[16] Exhibit "P-58".
[17] Exhibit "P-59".
[18] Par. 10, Joint Stipulation of Facts, JSFI, Docket (Vol. III), p. 1467.

reiterating demand for payment in the aggregate amount of ₱4,473,228,667.87.

On June 13, 2014, petitioner elevated the matter to the Court of Tax Appeals (CTA) *via* the instant Petition for Review (with Motion to Suspend Collection of Taxes)[20]. Having earlier paid the WTC, DST and EWT assessments, petitioner only now questions the validity of the IT and VAT deficiency assessments in the total amount of ₱4,467,391,881.76.

In the Resolution[21] dated July 8, 2014, this Court found merit in petitioner's Motion to Suspend Collection of Taxes and granted the same on the condition of posting a surety bond in the amount of ₱6,701,087,822.64. Furthermore, this Court also granted respondent's Motion for Extension of Time Within Which to File Answer which was filed on July 3, 2014. Thus, respondent was given a period thirty (30) days within which to file his Answer.

On July 18, 2017, petitioner filed a Motion for Additional Time to Comply with this Honorable Court's Resolution dated 8 July 2014[22]. Petitioner seeks an extension of thirty (30) days within which to comply with this Court's Resolution dated July 8, 2014 due to the gargantuan amount imposed as surety bond. For that reason, this Court granted petitioner's Motion in its Resolution[23] dated July 23, 2014.

On July 24, 2014, petitioner filed, through registered mail, a Motion for Partial Reconsideration[24] praying for, among others, the reduction of the surety bond from ₱6,701,087,822.64 to ₱400,000,000.00. Conversely, respondent filed on August 15, 2014 a Comment/Opposition (Re: Petitioner's Motion for Partial Reconsideration)[25] asserting that petitioner's Motion was intended merely for delay. In response, petitioner filed a Reply (Re: Comment/Objection dated 15 August 2014)[26] on September 3, 2014 insisting its willingness to post bond but, however, a reasonable amount conditioned on its limited equity and operational requirements.

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[19] Exhibit "P-60".
[20] *Supra* No. 1.
[21] Docket (Vol. I), pp. 319-324.
[22] *Ibid.*, pp. 325-327.
[23] *Id.*, p. 329.
[24] *Id.*, pp. 358-370.
[25] *Id.*, pp. 381-386.
[26] *via* Motion to Admit, Docket (Vol. II), pp. 432-442.

Meanwhile, petitioner filed a Supplement (To the Motion for Partial Reconsideration)[27] on July 31, 2014.

Thereafter, on August 20, 2014, petitioner filed a Motion: (1) To Admit Second Supplement to the Motion for Partial Reconsideration dated 24 July 2014; and (2) To Set Case for Hearing to Receive Further Evidence for the Reduction of the Bond[28]. Petitioner mainly reiterates its inability to procure a bond in the amount required, given its equity of only ₱916,768,767.00,[29] which is just about twenty percent (20%) of the taxes assessed.

Subsequently, on August 27, 2014, petitioner filed a Manifestation and Motion[30] citing the case of *Spouses Emmanuel D. Pacquiao and Jinky J. Pacquiao vs. The Court of Tax Appeals – First Division and the Commissioner of Internal Revenue, G.R. No. 213394.* In the said case, the Supreme Court issued a Temporary Restraining Order (TRO) on August 18, 2014, enjoining the CTA from requiring spouses Pacquiao to deposit a cash or surety bond as a condition for the suspension of collection of deficiency income taxes and value-added tax. As such, petitioner insists the factual similarity of their predicaments, considering that in the said case, spouses Pacquiao were required to deposit a cash bond of ₱3.29 billion or post a surety bond of ₱4.95 billion when their net worth is only ₱1.18 billion; whereas, in the instant case, petitioner is required to post the amount of ₱6.70 billion as surety bond when its net worth is only ₱916 million.

In response thereto, respondent filed a Comment [Re: Petitioner's a) "Supplement (To the Motion for Partial Reconsideration)"; b) "Motion (1) to Admit Second Supplement to the Motion for Partial Reconsideration dated 24 July 2014; and (2) to Set the Case for Hearing to Receive Further Evidence for the Reduction of the Bond" and c) "Manifestation and Motion"][31]. Respondent prays that the foregoing Motions be denied chiefly because, first, the amount of surety bond must not be below the disputed amount in order to ensure that the interest of the government will be protected; and, second, the *Pacquiao case* cited by petitioner has not yet attained finality.

[27] Docket (Vol. I), pp. 348-353.
[28] *Ibid.*, pp. 387-395.
[29] Judicial Affidavit of Elvin John M. Santos; and Exhibit "P-3".
[30] Docket (Vol. I), pp. 410-413.
[31] Docket (Vol. II), pp. 501-508.

After several extensions of time, respondent finally filed, through registered mail, his Answer[32] on September 11, 2014, interposing special and affirmative defenses.

On September 22, 2014, a Notice of Pre-Trial Conference[33] was issued by this Court, setting the pre-trial conference on November 6, 2014 at 1:30 p.m.

Meanwhile, on September 30, 2014, respondent filed an Entry of Appearance[34] stating that Atty. Rowell B. Vicente be included in the service and furnishing of copies of all motions, orders, memoranda, manifestations, judgments and other papers and pleadings as new counsel in the instant case. Thus, in a Minute Resolution[35] dated October 1, 2014, this Court noted the appearance of respondent's new counsel.

On October 21, 2014, a Resolution[36] was promulgated by this Court granting petitioner's Motion (1) To Admit Second Supplement to the Motion for Partial Reconsideration dated 24 July 2014; and (2) To Set Case for Hearing to Receive Further Evidence for the Reduction of the Bond filed on August 20, 2014 while denying its Motion filed August 27, 2014. This Court also held in abeyance the resolution of petitioner's Motion for Partial Reconsideration filed on July 24, 2014 pending the presentation of its additional evidence.

On October 24, 2014, respondent filed a Motion to Defer Pre-Trial Conference (Set on November 6, 2014)[37] praying the deferment of the scheduled pre-trial conference in order to comply with the requirement of submitting the judicial affidavits of his witnesses. The same was granted by this Court *via* an Order dated October 30, 2014, thereby, moving the pre-trial conference to December 4, 2014 at 1:30 p.m.

After which, in the Resolution[38] dated October 23, 2014, this Court deemed the presentation of petitioner's additional evidence, in support of its Motion for the Reduction of Bond, complete and terminated. Furthermore, this Court gave the parties a period of twenty (20) days

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[32] *Ibid.*, pp. 471-489.
[33] *Id.*, p. 491.
[34] *Id.*, pp. 497-499.
[35] *Id.*, p. 500.
[36] *Id.*, pp. 518-523.
[37] *via* Manifestation and Motion filed on October 24, 2014, *id.*, pp. 604-610.
[38] Docket (Vol. II), pp. 631-632.

within which to file their respective Memoranda regarding the issue of the amount of petitioner's surety bond.

On October 30, 2014, petitioner filed an Omnibus Motion to Defer Pre-Trial Conference and To Commission an Independent Certified Public Accountant[39]. Petitioner prays that the initially scheduled pre-trial conference on November 6, 2014 be deferred due to voluminous documents in support of its claim. Petitioner further moves for the commissioning of Mr. Romeo A. De Jesus, Jr. of R.S. Bernardo & Associates as the Independent Certified Public Accountant (ICPA) of the instant case. In a similar Order[40] dated November 5, 2014, this Court granted petitioner's Omnibus Motion and set the pre-trial conference, as well as the commissioning of the ICPA, on December 4, 2014 at 1:30 p.m.

In compliance with this Court's directive, petitioner filed its Memorandum (Re: Reduction of Bond)[41] on November 12, 2014, while, respondent, on the other hand, stated in his Manifestation[42] filed on November 12, 2014, that he will instead be adopting the arguments in his Comment/Opposition filed on August 15, 2014 and Comment filed on October 3, 2014 in lieu of submitting a memorandum. Consequently, in an Order[43] dated November 13, 2014, this Court deemed the issue of petitioner's bond submitted for resolution.

On December 1, 2014, the parties simultaneously filed their respective pre-trial briefs[44].

On December 4, 2014, having no objection from respondent's counsel, this Court granted petitioner's Motion filed on October 30, 2014, thereby allowing Mr. Romeo A. De Jesus, Jr. to take his oath as the ICPA of the instant case.[45]

In the Resolution[46] dated December 22, 2014, this Court partially granted petitioner's Motion for Partial Reconsideration filed on July 24,

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[39] *Ibid.*, pp. 633-635.
[40] *Id.*, p. 646.
[41] *Id.*, pp. 647-669.
[42] Id., pp. 670-673.
[43] Docket (Vol. III), p. 1436.
[44] Pre-Trial Brief, Docket (Vol. III), pp. 1031-1049; and, Respondent's Pre-Trial Brief, Docket (Vol. III), pp. 1050-1058.
[45] Minutes of the Hearing dated December 4, 2014, Docket (Vol. III), p. 1438.
[46] Docket (Vol. III), pp. 1443-1447.

2014. This Court found merit in petitioner's plea but, however, took into account the government's interest thereby reducing the initial prescribed surety bond to equal of the amount assessed or in the amount of ₱4,467,391,881.76.

Thereafter, on January 20, 2015, the parties submitted their Joint Stipulation of Facts and Issues[47].

Meanwhile, on January 23, 2015, petitioner filed a Petition for Certiorari (With Urgent Application for the Issuance of a Status Quo Ante Order/Temporary Restraining Order and/or Writ of Preliminary Injunction)[48] with the Supreme Court and was docketed as G.R. No. 215950. Petitioner primarily prays that the Supreme Court gives due course to the Petition and, during its pendency, a restraining order be issued against the CTA Second Division from implementing the Resolutions dated July 8, 2014[49] and December 22, 2014[50], respectively, insofar as they require petitioner to post a bond as condition for the suspension of collection of tax.

On February 9, 2015, a Pre-Trial Order[51] was issued by this Court thence terminating the pre-trial.

On the same day, a Temporary Restraining Order (TRO) was issued by the Supreme Court which was received by this Court on February 13, 2015. The TRO enjoined the CTA Second Division, its agents, representatives, or persons acting in its place and stead from implementing its July 8, 2014 and December 22, 2014 Resolutions.

Then, on February 23, 2015, respondent filed, through registered mail, a Motion to Amend Pre-Trial Order[52]. Respondent seeks to correct the typographical error made in the description of his Exhibit "R-12". In the Resolution[53] dated April 22, 2015, this Court found merit and granted respondent's Motion.

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[47] *Ibid.*, pp. 1466-1483.
[48] Docket (Vol. IV), pp. 1583-1618.
[49] *Supra* No. 21.
[50] *Supra* No. 46.
[51] Docket (Vol. IV), pp. 1906-1916.
[52] *Ibid.*, pp. 1953-1956.
[53] Docket (Vol. V), pp. 1970-1971.

On June 2, 2015, petitioner filed its Formal Offer of Documentary Exhibits for Petitioner[54] offering Exhibits "P-1" to "P-75-a", inclusive of sub-markings, as its evidence. On June 22, 2015, respondent filed a Comment [Re: Petitioner's Formal Offer of Evidence dated 29 May 2015][55], to which petitioner countered with a Reply (To Comment dated 22 June 2015)[56] filed on July 3, 2015.

Accordingly, in the Resolution[57] dated July 23, 2015, this Court admitted most of petitioner's exhibits save for Exhibits "P-9", "P-10", "P-11" and "P-12" for its failure to present the originals for comparison; Exhibits "P-2", "P-12", "P-27-a", "P-65-2154", "P-65-2155", "P-66-2154", "P-66-2155", "P-67-2154", "P-67-2155", "P-68-2154", and "P-68-2155" for its failure to identify said exhibits; and "P-1" and "P-32" for failure of the exhibit formally offered to correspond with the document actually marked; and, Exhibits "P-65-26", "P-70-86", "P-70-181", "P-70-194", "P-70-279", "P-70-280", "P-70-769", "P-70-879", "P-70-884", "P-70-885", "P-70-887", "P-70-888", "P-70-890", "P-70-891", "P-70-892", "P-70-893", "P-70-894", and "P-70-895" for failure to submit the duly marked exhibits.

On August 11, 2015, petitioner filed an Omnibus Motion (a) For Partial Reconsideration of the Honorable Court's *Resolution* dated 23 July 2015; (b) To Correct the Judicial Affidavit of Independent Certified Public Accountant, Mr. Romeo A. De Jesus, insofar as Exhibits P-65-2154", "P-65-2155", "P-66-2154", "P-66-2155", "P-67-2154", "P-67-2155", "P-68-2154", and "P-68-2155" and Recall him for this purpose; (c) To correct TSN of 18 May 2015 hearing; and (d) To correct the description of Exhibit "P-1" in the Formal Offer of Exhibit dated 29 May 2015. On August 25, 2015, respondent filed his Comment/Opposition [Re: Petitioner's Omnibus Motion dated 11 August 2015][58].

Thus, in the Resolution[59] dated October 9, 2015, this Court granted petitioner's Omnibus Motion filed on August 11, 2015, except for its Motion for Partial Reconsideration, the resolution of which this Court had held in abeyance pending presentation of petitioner's recalled witness. Shortly, thereafter, this Court eventually granted petitioner's

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[54] *Ibid.*, pp. 2135-2168.
[55] *Id.*, pp. 2185-2190.
[56] *Id.*, pp. 2213-2215.
[57] *Id.*, pp. 2223-2225.
[58] *via* Motion for Leave to Admit Attached Comment/Opposition, *id.*, pp. 2245-2255.
[59] Docket (Vol. V), pp. 2283-2287.

Motion for Partial Reconsideration *via* Resolution[60] dated October 14, 2015.

On December 1, 2015, petitioner filed a Manifestation with Formal Offer[61]. Petitioner offered a copy of a Resolution by the Quezon City Prosecutor's Office dated March 25, 2015 entitled, *Bureau of Internal Revenue, Rep. by Marivic Bautista vs. Rene dela Calzada (I.S. No. XV-03-INV-13D-05915)*, as an additional exhibit marked as Exhibit "P-76". Then, on December 22, 2015, respondent filed his Comment [Re: Petitioner's Manifestation with Formal Offer dated 27 November 2015][62], opposing the admission of the foregoing additional exhibit on the premise that it violates the Best Evidence Rule. In response, petitioner filed a Reply[63] insisting that the document marked as Exhibit "P-76" was a certified true copy of the original Resolution, which is therefore admissible in lieu of the original.

Verily, in the Resolution[64] dated January 28, 2016, this Court granted and admitted petitioner's Exhibit "P-76".

On February 16, 2016, respondent filed his Formal Offer of Evidence[65], offering Exhibits "R-1" to "R-30-a" as his evidence. Petitioner filed its Opposition to Formal Offer of Evidence[66] on February 29, 2016. In response, respondent filed a Reply [Re: Petitioner's Opposition to Respondent's Formal Offer of Evidence][67]. Thus, in the Resolution[68] dated March 29, 2016, this Court granted respondent's exhibits save for Exhibit "R-5" for failure of the exhibit formally offered to correspond with the document actually marked. Moreover, this Court gave both parties a period of thirty (30) days within which to file their respective Memoranda.

On April 8, 2016, respondent filed an Omnibus Motion A. Motion for Reconsideration of the Honorable Court's Resolution dated 29 March 2016, B. Motion to Set Commissioner's Hearing, C. Motion to Defer Filing of Respondent's Memorandum[69]. On April 27, 2016, petitioner filed its

[60] *Ibid.*, p. 2291.
[61] *Id.*, pp. 2295-2297.
[62] *Id.*, pp. 2305-2310.
[63] *Id.*, pp. 2317-2319.
[64] *Id.*, pp. 2324-2327.
[65] *Id.*, pp. 2337-2354.
[66] Id., pp. 2360-2375.
[67] *via* Motion for Leave to Submit Attached Reply, *id.*, pp. 2376-2387.
[68] Docket (Vol. V), pp. 2389-2390.
[69] *Ibid.*, pp. 2392-2397.

Comment with Motion to Defer the Filing of the Memorandum for Petitioner[70].

In the Resolution[71] dated May 12, 2016, this Court granted both parties request for the deferment of the submission of their respective Memorandum. As to respondent's Motion for Reconsideration, the resolution of which was held in abeyance pending the result of a Commissioner's Hearing.

On May 31, 2016, respondent filed an Amended Formal Offer of Evidence[72], re-offering Exhibits "R-1" to "R-30-a" but now properly describes Exhibit "R-5". Petitioner filed its Comment/Opposition to Amend Formal Offer of Evidence[73] on June 8, 2016 stating that it is adopting the arguments in its previous Opposition to respondent's formal offer of evidence.

On July 21, 2016, a Resolution[74] was rendered by this Court granting respondent's pending Motion for Reconsideration filed on April 8, 2016. Consequently, the previously denied Exhibit "R-5" was then subsequently admitted. More so, the parties were given a new period of thirty (30) days within which to submit their respective Memoranda.

Thereafter, on August 5, 2016, a Notice of Judgment[75] was sent to this Court, *via* registered mail, stating that a Decision was rendered by the Supreme Court on June 20, 2016 in the special civil action for certiorari entitled, *Tridharma Marketing Corporation vs. Court of Tax Appeals, et al., G.R. No. 215950*, the dispositive portion of which reads as follows:

> "**WHEREFORE**, the Court **GRANTS** the petition for *certiorari*; **ANNULS** and **SETS ASIDE** the resolutions issued on July 8, 2014 and December 22, 2014 in CTA Case No. 8833 requiring the petitioner to post a surety bond of ₱4,467,391,881.76 as a condition to restrain the collection of the deficiency taxes assessed against it; **PERMANENTLY ENJOINS** the enforcement of the resolutions issued on July 8, 2014 and December 22, 2014 in CTA Case No. 8833; and

[70] *Id.*, pp. 2402-2405.
[71] *Id.*, pp. 2407-2408.
[72] *Id.*, pp. 2411-2428.
[73] *Id.*, pp. 2429-2431.
[74] Docket (Vol. VI), pp. 2433-2434.
[75] *Id.*, pp. 2504-2509.

> **REQUIRES** the Court of Tax Appeals, Second Division, to forthwith conduct a preliminary hearing in CTA Case No. 8833 to determine and rule on whether the bond required under Section 11 of Republic Act No. 1125 may be dispensed with or reduced to restrain the collection of the deficiency taxes assessed against the petitioner.
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> No pronouncement on costs of suit.
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> **SO ORDERED.**"

Meanwhile, petitioner filed on August 26, 2016 its Memorandum[76] in compliance with this Court's directive. While, respondent, on the other hand, after asking for an extension of time, filed his Memorandum[77] on September 26, 2016.

Acknowledging the Supreme Court's Notice of Judgment, this Court in the Resolution[78] dated September 16, 2016, set the case for a preliminary hearing on October 24, 2016 at 9:00 a.m. for the sole purpose of properly addressing the issue of posting a bond for the suspension of collection of taxes, as instructed by the Supreme Court in its Decision.

On October 14, 2016, petitioner filed a Manifestation with Motion[79], stating that in view of respondent's filing of a Motion for Reconsideration (Re: Decision dated June 20, 2016) with the Supreme Court, petitioner moves for the deferment of the preliminary hearing on October 24, 2016 until after the Decision of the Supreme Court attains its finality.

Thus, in the Resolution[80] dated October 20, 2016, this Court noted and granted petitioner's Manifestation with Motion filed on October 14, 2016. As a consequence, the initially scheduled preliminary hearing on October 24, 2016 was therefore cancelled. Moreover, considering the filing of the parties of their respective Memoranda, this court then deemed the instant case submitted for decision.

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[76] *Id.*, pp. 2435-2498.
[77] *Id.*, pp. 2511-2541.
[78] *Id.*, pp. 2542-2543.
[79] *Id.*, pp. 2549-2551.
[80] *Id.*, p. 2552.

On January 11, 2017, the Supreme Court sent by registered mail a Notice[81], informing this Court that they rendered a Resolution on October 3, 2016 which denied respondent's Motion for Reconsideration (Re: Decision dated June 20, 2016) with finality.

As such, in the Resolution[82] dated March 9, 2017, this Court recalled and set aside its Resolution dated October 20, 2016 which submitted the case for decision. Instead, a preliminary hearing on April 17, 2017 at 9:00 a.m. was scheduled for the propriety of posting petitioner's surety bond.

However, on April 11, 2017, a Notice of Resetting was sent to the parties informing them that in view of CTA Office Order No. 49-2017, the hearing previously set on April 17, 2017 is cancelled and reset to May 17, 2017 at 9:00 a.m.

In an Order dated May 17, 2017, this Court, in view of the manifestation made by respondent's counsel that he is adopting the arguments raised in the motion for suspension of collection of taxes, simultaneously deemed the issue on the propriety of the bond requirement, as well as the main issue in this case, submitted for decision.

On June 7, 2017, a Resolution was rendered by this Court dispensing with the requirement of posting of surety bond mainly so as to avoid any further delay and, in view of the fact that this case was already submitted for decision on the merits.

The following issues[83] were presented by the parties for this Court's resolution, *to wit*:

WHETHER THE DEFICIENCY ASSESSMENTS FOR IT AND VAT AND THE IMPOSITION OF A 50% SURCHARGE ARE VALID.

WHETHER THE ASSESSMENT FOR DEFICIENCY VAT AGAINST TRIDHARMA FOR THE FIRST AND SECOND QUARTERS OF 2010 HAS ALREADY PRESCRIBED.

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[81] *Id.*, p. 2555.
[82] *Id.*, pp. 2557-2559.
[83] Statement of the Issues, JSFI, Docket (Vol. III), p. 1468.

WHETHER PETITIONER IS LIABLE TO PAY THE ASSESSED AMOUNT OF ₱4,467,391,881.76 REPRESENTING DEFICIENCY INCOME TAX AND VALUE-ADDED TAX FOR TAXABLE YEAR 2010.

WHETHER THE HONORABLE COURT HAS JURISDICTION OVER THE INSTANT PETITION.[84]

In the instant case, petitioner mainly assails the disallowance made by the BIR of its purchases with Etheria Trading as part of its cost of goods. Petitioner submits that it dealt with Etheria Trading in good faith and relied on the regularity of its business transactions. Thus, any violation whatsoever made by Etheria Trading regarding the registration of its official receipts should be only between Etheria Trading and the BIR. Furthermore, petitioner asserts that it filed its VAT returns for the 1st and 2nd quarters of 2010 on April 20, 2010 and July 22, 2010, respectively. Considering that respondent assessed petitioner for deficiency VAT on September 16, 2013, the period within which to assess petitioner for its 1st and 2nd quarter VAT returns have already prescribed. Petitioner also claims that respondent's examiners violated Revenue Memorandum Order (RMO) No. 33-84 since their tax investigation went beyond 120 days without bothering to have the Letter of Authority (LOA) revalidated. Lastly, petitioner besets respondent's imposition of a 50% surcharge against it.

On the other hand, respondent believes that this Court has no jurisdiction to entertain the present case since the disputed assessment had already become final, executory and demandable. He continues that, petitioner's protest letter dated October 31, 2013 on the FLD-DDAN was denied on February 28, 2014. Under Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, petitioner has only thirty (30) days within which to elevate the denial to the CTA, or only until March 30, 2014. However, petitioner only filed the instant Petition for Review on June 13, 2014. Henceforth, the same was filed out of time. Respondent cites the case of Fishwealth Canning Corporation vs. Commissioner of Internal Revenue[85] *("Fishwealth case")* to bolster his claim. Moreover, assuming that petitioner timely appealed the deficiency assessments against it, the denial of purchases from Etheria Trading was the result of a thorough audit and third party cross verification of information. In fact, verification disclosed that a certain Carlos Adraque Ching, owner of Etheria Trading, does not anymore

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[84] Added as per Pre-Trial Order dated February 9, 2015, *Supra* No. 51.
[85] G.R. No. 179343, January 21, 2010.

exists considering that it had ceased operations since August 13, 2007. It has no income tax return filed for year 2010 nor any record of importation for the same year. Hence, taking into account the foregoing, respondent insists that petitioner engaged in fraudulent sale transactions. Finally, respondent argues that the 50% surcharge was based on fraud which also means that his deficiency assessments against petitioner were anchored on false or fraudulent return which has a prescription of ten (10) years.

After due consideration of the evidence, both documentary and testimonial, presented by the parties, this Court finds the instant Petition for Review partly meritorious.

To better understand the resolution of the issues raised in this case, this Court deems it best to first resolve the issue of jurisdiction since it is of primary importance. The other issues shall be discussed in the order that would best suit the continuity of the discussion.

THE CTA HAS JURISDICTION OVER THE INSTANT PETITION FOR REVIEW.

Settled is the rule that the perfection of an appeal in the manner and within the period laid down by law is not only mandatory but also jurisdictional. The CTA, being a court of special jurisdiction, can take cognizance only of matters that are clearly within its jurisdiction.[86] It is precisely for this reason that Section 228 of the NIRC of 1997, as amended, provides the manner upon which a taxpayer may question and appeal any deficiency tax assessment issued against it, *viz.*:

> "**SEC. 228.** *Protesting of Assessment.* — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: Provided, however, That a preassessment notice shall not be required in the following cases:
>
> *x x x*

[86] Allied Banking Corporation vs. CIR, G.R. No. 175097, February 5, 2010.

> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> **Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations.** Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> **If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.**" *(Emphases Supplied)*

In the instant case, it is respondent's position that following the above-quoted provision, petitioner received the denial of its administrative protest on February 28, 2014 *via* FDDA, it only has therefore until March 30, 2014 within which to file a Petition for Review with the CTA. However, instead of doing so, petitioner elevated the matter *via* Request for Reconsideration to the CIR through a letter dated March 28, 2014. Considering that the Supreme Court in the *Fishwealth case*, held that a motion for reconsideration of the denial of the administrative protest does not toll the 30-day period within which to appeal to the CTA, the instant Petition for Review was belatedly filed on June 13, 2014.

Unfortunately, respondent misapplied the pronouncements made in the *Fishwealth case* to the present case.

Tracing the origin of the *Fishwealth case* (CTA EB No. 223, July 5, 2007), it was clarified by the CTA *En Banc*, and was later on affirmed by the Supreme Court, that an FDDA issued by the CIR precludes the filing of a Motion for Reconsideration because the said Motion **does not toll** the 30-day period within which the taxpayer may appeal the case before the CTA.

However, in the instant case, the FDDA was issued not by respondent CIR himself, but only by his duly authorized representative, OIC-ACIR Alfredo V. Misajon. From this fact alone, the *Fishwealth case* is already rendered inapplicable.

More so, in the case of *MOOG CONTROLS CORPORATION PHILIPPINE BRANCH vs. COMMISSIONER OF INTERNAL REVENUE*[87], the CTA *En Banc* clarified the effect of appealing the decision rendered by the CIR's duly authorized representative:

> "In the case at bar, the petitioner appealed the decision of the Regional Director of the Bureau of Internal Revenue to the Commissioner of Internal Revenue. In doing so, **the decision of the Regional Director cannot be considered as the final decision on petitioner's protest since the power of the Commissioner of Internal Revenue to review the acts of his subordinates was invoked by the petitioner itself. It is as if the Regional Director did not render any decision on petitioner's protest at all.** There being no decision to speak of, the petitioner could not yet invoke the appellate jurisdiction of the Court pursuant to Section 7 of R.A. No. 1125 as amended by R.A. No. 9282." *(Emphasis supplied)*

From the foregoing, it is only when respondent himself issued a decision that the 30-day period within which to appeal to the CTA shall commence. Accordingly, by receiving respondent's letter-decision dated May 26, 2014, denying its request for reconsideration, only on June 2, 2014, petitioner is therefore given until July 2, 2014 within which to appeal to this Court. Thus, petitioner timely filed its Petition for Review on June 13, 2014.

RESPONDENT'S DEFICIENCY VAT ASSESSMENT FOR THE 1ST AND 2ND QUARTERS OF 2010 HAS ALREADY PRESCRIBED.

[87] CTA EB Case No. 44, May 10, 2005.

The general rule is that internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return or the actual date of filing of said return, whichever comes later. This mandate governs the question of prescription of the government's right to assess internal revenue taxes primarily to safeguard the interests of taxpayers from unreasonable investigation.[88] Section 203 of the NIRC of 1997, as amended 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 the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided,* That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed.
>
> For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

Corollary thereto, in case of VAT, the filing of Quarterly VAT Returns must be made within twenty-five (25) days after the close of each taxable quarter prescribed for each taxpayer. Hence, if the return was filed earlier than the last day allowed by law, the period to assess shall still be counted from the last day prescribed by law for filing of the return. However, if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. Section 114 (A) of the NIRC of 1997, as amended states that:

> "**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."

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[88] Commissioner of Internal Revenue vs. FMF Development Corporation, G.R. No. 167765, June 30, 2008.

In the instant case, petitioner filed its VAT returns for the 1st and 2nd quarters of taxable year 2010 on April 20, 2010[89] and July 22, 2010[90]. Following the period provided above, respondent has three years or until April 25, 2013 and July 25, 2013, respectively, to assess petitioner for its 1st and 2nd quarters deficiency VAT.

Records of the case reveal that petitioner received respondent's FLD-DDAN on September 23, 2013, which is more than the period allowed by law. A table is provided below for better clarity, *viz.*:

VAT Quarter	Last Day to File Return	Actual Date of Filing the Return	Last day to Assess Petitioner	Receipt of FLD-DDAN
1st	April 26, 2010[91]	April 20, 2010[92]	***April 25, 2013***	September 23, 2013
2nd	July 25, 2010	July 22, 2010[93]	***July 25, 2013***	
3rd	October 25, 2010	October 21, 2010[94]	October 25, 2013	
4th	January 25, 2011	January 25, 2011[95]	January 25, 2014	

Clearly, respondent's deficiency VAT assessment for the 1st and 2nd quarter has prescribed.

However, respondent imputes fraud in his deficiency assessments against petitioner. As such, respondent claims that his assessments fall under one of the exceptions mentioned in Section 203 of the NIRC of 1997, as amended. Section 222 (a) of the same Code provides that:

> "**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

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[89] Exhibit "P-32".
[90] Exhibit "P-35".
[91] April 25, 2010 falls on a Sunday.
[92] *Supra* No. 89.
[93] *Supra* No. 90.
[94] Exhibit "P-38".
[95] Exhibit "P-41".

fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof."

From the foregoing, respondent believes that he issued his deficiency assessments well within the 10-year prescriptive period. Respondent bears emphasis on the reckoning date of the period which commences from the date of discovery of the falsity, fraud or omission.

This Court is not convinced.

Parenthetically, fraud is a question of fact which cannot be presumed and must be proven by clear and convincing evidence by the party alleging the same.[96]

While respondent may have established that Mr. Carlos Adraque Ching, operating under the business name of Etheria Trading, did not file any income tax and VAT returns from taxable year 2010 to 2011 - since Etheria Trading had no record of transaction with the BIR[97] nor had it any record of any importation made from the BOC, these facts, however, are not sufficient to prove that it was, indeed, not engaged in any trade during those years or have already ceased to operate, nor was it sufficient to impute fraud on the part of petitioner.

Simple perusal of the documents submitted by petitioner in support of its purchases from Etheria Trading (*i.e.* sales invoices and delivery receipts[98]) reveal that they are regular and compliant on their face. There was no ostensible anomaly that would arouse attention to question and doubt the legality of the transaction. As a matter of fact, in the ordinary course of business, one cannot expect to outright scrutinize and verify the legality of each and every documents and receipts issued by its suppliers in their transactions. Also, considering the nature of petitioner's business - that the goods traded are fast-moving, it will be impractical and even more costly to conduct an in-depth verification of the legality for every purchase transaction.

It is also worth noting that, petitioner filed a criminal case against Mr. Carlos Adraque Ching after learning from the BIR examiners that the

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[96] *Petron Corporation vs. Commissioner of Internal Revenue*, G.R. No. 180385, July 28, 2010.
[97] Exhibits "R-13" to "R-14".
[98] Exhibits "P-67" series and "P-65" series.

documents supporting its purchases were spurious.[99] This even reinforced petitioner's good faith on the matter.

Moreover, as correctly pointed out by petitioner, the requirement of printing receipts or sales or commercial invoices under Section 238[100] of the NIRC of 1997, as amended, is directed against those who are engaged in business. The said Section is for the compliance of the taxpayer who issues a commercial document in a taxable transaction. It is not legislated for the purpose of burdening persons transacting with the said taxpayer so as to ensure at all times that the documents issued were in accordance with Section 238 of the NIRC of 1997, as amended. In fact, the sanction/penalty for violation of the said provision falls under the taxpayer issuing the document and not on the recipient of such document.

Furthermore, respondent questions the special power of attorneys executed by that Mr. Carlos Adraque Ching, on behalf of Etheria Trading, in favor of GPI and CUI, respectively. Respondent again imputes fraud in the said transactions by alleging that both special power of attorneys were executed in connivance with the dummy corporations of Etheria Trading to mislead the BIR.

This Court, again, is not convinced.

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[99] Exhibit "P-16".

[100] "**SEC. 238.** *Printing of Receipts or Sales or Commercial Invoices.* — All persons who are engaged in business shall secure from the Bureau of Internal Revenue an authority to print receipts or sales or commercial invoices before a printer can print the same.

No authority to print receipts or sales or commercial invoices shall be granted unless the receipts or invoices to be printed are serially numbered and shall show, among other things, the name, business style, Taxpayer Identification Number (TIN) and business address of the person or entity to use the same, and such other information that may be required by rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

All persons who print receipt or sales or commercial invoices shall maintain a logbook/register of taxpayers who availed of their printing services.

The logbook/register shall contain the following information:

(1) Names, Taxpayer Identification Numbers of the persons or entities for whom the receipts or sales or commercial invoices were printed; and

(2) Number of booklets, number of sets per booklet, number of copies per set and the serial numbers of the receipts or invoices in each booklet."

In the first place, the payment terms between petitioner and Etheria Trading, which eventually involved GPI and CUI as its assignees, are irrelevant in resolving the issue at hand. These matters are not uncommon in the business world and are within the sole prerogative of the contracting parties themselves.

The fact still remains that petitioner had an outflow of benefits in purchasing goods from Etheria Trading. Albeit, delivered to entities other than Etheria Trading, payments were still actually made in consideration of the said goods, and, more importantly, the official receipts for such payments were issued in the name of Etheria Trading itself[101] and not by GPI or CUI. Such fact indicates that Etheria Trading acknowledges the payments rendered by petitioner to its assignees, GPI and CUI, as settlement for the purchases of goods made by petitioner.

Moreover, respondent, through its authorized representatives, went beyond their mandate by swiftly determining that the special power of attorneys[102] executed by that Mr. Carlos Adraque Ching in favor of GPI or CUI were invalid. Due process dictates that, at the least, they should have given Mr. Carlos Adraque Ching the opportunity to prove the legitimacy of his signature thereon. Anent, respondent's reliance on the National Bureau of Investigation (NBI) report that the authenticity of Mr. Carlos Adraque Ching's signature on the questioned special power of attorneys is implausible does not give much evidentiary credence since the reference used in the NBI report was Mr. Carlos Adraque Ching's NBI Clearance Application from 1983.[103] Considering that an NBI Clearance expires every year after issuance, respondent should have been more circumspect in relying on an outdated 1983 document as basis in imputing fraud in the herein questioned transactions.

Accordingly, in view of the foregoing, by failing to satisfactorily prove any fraud committed by petitioner, the prescriptive period for respondent's deficiency assessments remains at 3 years.

Failure to revalidate the LOA after the 120-day prescribed investigation period.

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[101] Exhibit "P-69" series.
[102] Exhibits "P-14" to "P-15".
[103] Exhibit "R-23".

With regard to petitioner's sub-issue, that by conducting their tax investigation beyond the period of one hundred twenty (120) days without any revalidation, respondent's examiners violated RMO No. 33-84 by having an expired LOA which makes the deficiency assessments void.

This Court does not agree.

Incidentally, RMO No. 33-84[104] did not categorically state that any case report submitted after the 120-day prescribed period for investigation shall automatically lead to its invalidation. Instead, it only prescribed for a possible administrative sanction on the erring examiner. The relevant portion of the said RMO states that, *"x x x [a] final report of investigation of a tax case shall be accomplished and submitted by the examiner to his supervisor within 120 days from the date of issuance of the letter of authority. In case of failure to do so, the Division Chief or Revenue District Officer, respectively, shall require the examiner to show cause why sanctions should not be imposed against him for failure to render report of a tax case within the period required."*

Further, the issue on revalidation of LOA was already clarified in the more recent RMO No. 12-07[105] where it clearly instructed that LOAs for tax audits on taxable years 2006 onwards, the revalidation of LOA shall give rise to the extension of the period within which the concerned Revenue Officer (RO) shall submit the required report of investigation to higher authorities for review and approval without the imposition of applicable administrative sanctions. **Failure on the part of the RO to request for revalidation or the expiration of the "revalidation period" does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued.** However, this shall be considered as a ground for the imposition of disciplinary action and demerit in the performance rating of the concerned RO, including the reassignment of the case to another RO.

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[104] "AMENDMENT TO PARS. 2 AND 3 OF REVENUE MEMORANDUM ORDER NO. 19-84 DATED 20 JULY 1984", dated October 17, 1984.

A final report of investigation of a tax case shall be accomplished and submitted by the examiner to his supervisor within 120 days from the date of issuance of the letter of authority. In case of failure to do so, the Division Chief or Revenue District Officer, respectively, shall require the examiner to show cause why sanctions should not be imposed against him for failure to render report of a tax case within the period required.

[105] "2007 AUDIT PROGRAM FOR REVENUE DISTRICT OFFICES" dated July 3, 2007.

Accordingly, the worst consequence that an expired LOA may have is merely an administrative sanction on the part of the examiner failing to comply with the said RMOs. Nothing among these concerns the taxpayer nor the validity of the resulting assessment.

PETITIONER IS NOT LIABLE TO PAY THE ENTIRE ASSESSED AMOUNT OF ₱4,467,391,881.76 REPRESENTING DEFICIENCY INCOME TAX AND VALUE-ADDED TAX FOR TAXABLE YEAR 2010.

This Court shall now proceed to the cynosure of the present controversy. The table below shows the details of respondent's deficiency IT and VAT assessments against petitioner:[106]

I. INCOME TAX			
Taxable income per return			₱ 211,436,288.00
Add: Findings per investigation			
IT-1	Unregistered purchase invoices from Etheria Trading	₱4,942,937,053.82	
IT-2	Unrecorded sales for collections initially recorded as "Adv fr Customers"	-	
IT-3	Other incomes not reported in FS/ITR	22,699,669.52	
IT-4	Overclaimed interest expense, including tax arbitrage	1,439,034.86	
IT-5	Disallowed provision for SL/VL benefits and separation pay	-	
IT-6	Discrepancy on employee benefits expense	-	
IT-7	Discrepancy on ending inventory/Overstatement of COS	512,303.17	
IT-8	Unallowable expenses under Taxes & Licenses	10,852.00	
IT-9	Overstated depreciation expense on tools & equipment	1,877,848.82	
IT-10	Undeclared income due to overstatement of asset	-	
IT-11	Discrepancy in sales per SLS vs. ITR/FS/VAT return	91,938,060.19	
IT-12	Discrepancy in sales per matching of SLS, SAWT & AITIED Data	1,974,348.14	
IT-13	Undeclared importation on matching of SLI & BOC Data	5,643,209.71	
IT-14	Unsupported importation per vouching of IEDs	6,443,905.69	

[106] As per FDDA, Exhibit "R-22".

IT-15	Undeclared purchases on matching of SLP, MAP & AITIED Data	9,253,443.81	
	Total adjustments per audit		5,084,729,729.74
Taxable income per audit			₱ 5,296,166,017.74
Multiplied by: Income tax rate			30%
Income tax due per audit			**₱1,588,849,805.32**
Less: Allowable credits/payments			
	Cash payments	₱ 21,489,212.40	
	Creditable Wtax per return	42,966,006.00	
IT-16	Less: Unsupported creditable wtax	(2,706,317.06)	61,748,901.34
Basic income tax deficiency			**₱1,527,100,903.98**
Add: Increments			
	Surcharge (50%)	₱ 763,550,451.99	
	Interest - 2/28/2014	878,605,999.55	
	Compromise	-	1,642,156,451.54
Total amount due (IT)			**₱3,169,257,355.52**

II. VALUE-ADDED TAX			
VATable Sales			₱ 6,966,488,596.83
Add: Findings per investigation			
VT-1	Unrecorded sales for collections initially recorded as "Adv fr Customers"	₱ -	
VT-2	Other incomes not reported in FS/ITR	22,699,669.52	
VT-3	Undeclared income due to overstatement of asset	-	
VT-4	Discrepancy in sales per SLS vs. ITR/FS/VAT return	91,938,060.19	
VT-5	Discrepancy in sales on matching of SLS, SAWT & AITIED Data	1,974,348.14	
VT-6	Undeclared importation on matching of SLI & BOC Data	5,643,209.71	
VT-8	Undeclared purchases on matching of SLP, MAP & AITIED Data	9,253,443.81	
	Total adjustments per audit		131,508,731.37
Vatable sales per audit			₱ 7,097,997,328.20
Multiply by: VAT rate			12%
Output tax due			₱ 851,759,679.38
Less: Net allowable input tax			
	Input tax from current purchases	₱ 856,354,254.95	
	Less: Audit findings:		
VT-7	Unsupported importation per vouching of IEDs	(773,268.68)	
VT-9	Unsubstantiated input tax - Etheria Trading	(593,152,446.46)	
VT-10	Deferred input (CG) to be carried over	(3,011,827.51)	
	Excess input carry over for 2011	(30,670,292.00)	228,746,420.30
Net VAT due per audit			**₱ 623,013,259.09**
Less: VAT credits/payments			
	VAT remittances	₱ 2,676,044.44	
	VAT subsidy claimed per return	7,618,625.96	

VT-11	Less: Unsupported VAT withheld	(4,936.57)	10,289,733.83
Basic value added tax deficiency			**₱ 612,723,525.25**
Add: Increments			
	Surcharge (50%)	₱ 306,361,762.63	
	Interest - 2/28/2014	379,049,238.36	
	Compromise	-	685,411,000.99
Total amount due (VAT)			**₱1,298,134,526.24**

I. DEFICIENCY INCOME TAX and VALUE-ADDED TAX

As gleaned above, the following items were assessed with deficiency income tax with the consequential deficiency VAT, as such, this Court shall dispose of the same simultaneously:

IT-1 **VT-9**	Unregistered purchase invoices from Etheria Trading Unsubstantiated input tax - Etheria Trading	₱4,942,937,053.82 593,152,446.46
IT-3/VT-2	Other incomes not reported in FS/ITR	22,699,669.52
IT-11/VT-4	Discrepancy in sales per SLS vs. ITR/FS/VAT return	91,938,060.19
IT-12/VT-5	Discrepancy in sales per SLS, SAWT & AITIED Data	1,974,348.14
IT-13/VT-6	Undeclared importation on matching of SLI & BOC Data	5,643,209.71
IT-14 **VT-7**	Unsupported importation per vouching of IEDs	6,443,905.69 773,268.68
IT-15/VT-8	Undeclared purchases on matching of SLP, MAP & AITIED Data	9,253,443.81

- ***IT-1 – Unregistered purchase invoices from Etheria Trading***
- ***VT-9 – Unsubstantiated input tax – Etheria Trading***

In his assessment, respondent disallowed the deduction of petitioner's total purchases from Etheria Trading during taxable year 2010 in the total amount of ₱4,942,937,053.82. As a consequence, the corresponding input VAT from said disallowed purchases amounting to ₱593,152,446.46 was also disallowed as credit offset against petitioner's output VAT.

Respondent asserts that the denial of petitioner's purchases from Etheria Trading was the result of a thorough audit and third party cross verification of information, and is anchored on pieces of evidence gathered and legal provisions of the NIRC of 1997, as amended.

He continues that by examining Official Receipts and Sales Invoices purportedly coming from Etheria Trading reveals that the receipts and invoices were individually stamped and not "pre-numbered". Apropos, Etheria Trading's Authority to Print (ATP) with BIR Permit No. 1AU0000572356 dated January 15, 2009 is not among the agency's List of Permits Issued, as certified by the Head of the Revenue Data Center - Luzon 2 and Philcox Sysad (third party systems provider). Thus, the receipts and invoices cannot be considered valid evidence to prove purchases from Etheria Trading, for they violate the provisions of Section 34 (A)(1)(b)[107] and Section 113 (B)[108] of the NIRC of 1997, as amended.

Moreover, respondent insists that further audit of petitioner's books of accounts reveals inconsistencies and discrepancies in its recorded entries which are in violation of Section 257(B)(4)[109] of the

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[107] "**SEC. 34.** *Deductions from Gross Income. — x x x*
(A) Expenses. - *x x x*
(1) Ordinary and Necessary Trade, Business or Professional Expenses. - *x x x*
(b) Substantiation Requirements. - No deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer."
[108] "**SEC. 113.** *Invoicing and Accounting Requirements for VAT-Registered Persons. — x x x*
(B) Information Contained in the VAT Invoice or VAT Official Receipt. - The following information shall be indicated in the VAT invoice or VAT official receipt:
(1) A statement that the seller is a VAT-registered person, followed by his taxpayer's identification number (TIN);
(2) The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax: Provided, That:
(a) The amount of the tax shall be shown as a separate item in the invoice or receipt;
(b) If the sale is exempt from value-added tax, the term "VAT-exempt sale" shall be written or printed prominently on the invoice or receipt;
(c) If the sale is subject to zero percent (0%) value-added tax, the term "zero-rated sale" shall be written or printed prominently on the invoice or receipt;
(d) If the sale involves goods, properties or services some of which are subject to and some of which are VAT zero-rated or VAT-exempt, the invoice or receipt shall clearly indicate the breakdown of the sale price between its taxable, exempt and zero-rated components, and the calculation of the value-added tax on each portion of the sale shall be shown on the invoice or receipt: "Provided, That the seller may issue separate invoices or receipts for the taxable, exempt, and zero-rated components of the sale.
(3) The date of transaction, quantity, unit cost and description of the goods or properties or nature of the service; and
(4) In the case of sales in the amount of one thousand pesos (P1,000) or more where the sale or transfer is made to a VAT-registered person, the name, business style, if any, address and taxpayer identification number (TIN) of the purchaser, customer or client."
[109] **SEC. 257.** *Penal Liability for Making False Entries, Records or Reports, or Using Falsified or Fake Accountable Forms. —*
x x x

NIRC of 1997, as amended, in relation to RMO No. 19-07[110]. The said inconsistencies are as follows:

> *a)* Recordings in petitioner's Cash Disbursement Book showed that it advanced payments to Etheria Trading. On the other hand, JV entries on the General Ledger revealed that petitioner reversed the account Advances to Suppliers by debiting the Accounts Payable of GPI and CUI. However, it is rather questionable how the payments found its way to the hands of GPI and CUI.
>
> *b)* JV Entries on the General Ledger revealed that petitioner also have recordings of Interest Income from GPI and CUI. But in its protest letter dated October 18, 2013, petitioner acknowledged that the interest income was earned from the advanced payments made to its suppliers. However, recordings in the General Ledger specifically described the interest income as coming from GPI. Needless to say, petitioner had business transactions with GPI and CUI.

Lastly, respondent asserts that when he requested, *via* subpoena *duces tecum*, petitioner to submit proof of payments to Etheria Trading, the cancelled checks that were presented were issued for the account of GPI and CUI. A quick look on the two companies' financial standing reveals that their capitalization was only less than One (1) Million Pesos, thereby, leading the audit examiners to question how it was able to lend almost Five (5) Billion Pesos to Etheria Trading.

In defending its position, petitioner mainly claims that it acted in good faith in its dealings with Etheria Trading. Petitioner explains that the checks that were issued for the account of GPI and CUI were done under the instructions of Etheria Trading. Petitioner cites the case of *PILIPINAS SHELL PETROLEUM CORPORATION vs. COMMISSIONER OF INTERNAL REVENUE*[111] wherein the Supreme Court accorded protection to the rights of a party in good faith that acquired, and later utilized, tax credit certificates alleged to have been fraudulently issued. In concluding that the party who acquired the said certificates did not

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B) Any person who:
x x x
(4) Knowingly makes any false entry or enters any false or fictitious name in the books of accounts or record mentioned in the preceding paragraphs; or
x x x

[110] "THE CONSOLIDATION REVISED SCHEDULE OF COMPROMISE PENALTIES FOR VIOLATIONS OF THE NATIONAL INTERNAL REVENUE CODE", dated August 8, 2007.

[111] G.R. No. 172598, December 21, 2007.

participate in the fraud, the Supreme Court ruled that "[t]he transferee in good faith and for value may not be unjustly prejudiced by the fraud committed by the claimant or transferor in the procurement or issuance of the TCC from the Center. It is not only unjust but well-nigh violative of the constitutional right not to be deprived of one's property without due process of law. Thus, a re-assessment of tax liabilities previously paid through TCCs by a transferee in good faith and for value is utterly confiscatory, more so when surcharges and interests are likewise assessed."

This Court finds merit in petitioner's contention.

In the same case[112], the Supreme Court declared that the rights of an innocent purchaser for value must be protected and that the remedy of the government is to go after those who have perpetrated the fraud. Herein, petitioner dealt with Etheria Trading in good faith and relied on the regularity of its business transactions. It has no reason to doubt the genuineness of the receipts issued since it looked valid and regular on its face, not to mention the fact that, the goods for which the receipts were issued were promptly delivered by Etheria Trading to petitioner's warehouse.

As a matter of fact, petitioner's purchases for taxable year 2010 were all reported to the BIR and correspondingly subjected to withholding tax[113]. The summary list of purchases submitted by petitioner and the Analysis[114] prepared by the BIR confirms that the reported purchases of petitioner from Etheria Trading in the amount of ₱4,942,937,053.82 was subjected to expanded withholding tax for which petitioner paid the amount of ₱49,429,370.55.

In addition, since the questioned transactions involved goods, the fact of sale, as substantiated by sales invoices, is already sufficient to claim it as allowable deduction for cost of sales and as a claim for input tax under Sections 27 and 113 of the NIRC of 1997, as amended. Section 27 (A) as defines "gross income" for a trading or merchandising as follows:

"**Sec. 27.** *Rates of Income Tax on Domestic Corporations.* –

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[112] *Ibid.*
[113] Exhibits "P-42" to "P-53".
[114] Exhibits "R-5" and "R-6".

(A) *In General. — x x x*

For purposes of this Section, **the term 'gross income' derived from business shall be equivalent to gross sales less sales returns, discounts and allowances and cost of goods sold.** 'Cost of goods sold' shall include all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

For a trading or merchandising concern, 'cost of goods sold' shall include the <u>invoice cost of the goods sold</u>, plus import duties, freight in transporting the goods to the place where the goods are actually sold, including insurance while the goods are in transit.

For a manufacturing concern, 'cost of goods manufactured and sold' shall include all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and other costs incurred to bring the raw materials to the factory or warehouse.

x x x."

Notably, petitioner adopts the accrual method in accounting for its revenues and costs/expenses.[115] Under this method, purchases of inventory during a particular period do not automatically translate to sales in the same period. Some of these purchases remain on hand by the end of a taxable period and is presented as an entity's merchandise inventory. Hence, only those goods actually sold as at the end of the taxable period comprises the entity's costs which are deductible for tax purposes, and not the whole amount of purchases except when all these purchases were also sold in the same period, like herein petitioner's 2010 purchases from Etheria Trading. This can be verified from the fact that petitioner's Ending Inventory List submitted to the BIR no longer included any inventory purchased from Etheria Trading.[116] As such, the whole ₱4,942,937,054.81 worth of goods purchased from Etheria Trading in 2010 were translated into sales in the same year, and, therefore, are allowable deductions for income tax purposes.

As to respondent's claim that petitioner's books of accounts revealed inconsistencies and discrepancies in its recorded entries,

[115] Exhibit "P-64".
[116] BIR Records, pp. 157 to 158.

which violations, therefore, cannot be compromised because it involves fraud as decreed under RMO No. 19-07, such claim is inaccurate and respondent's reliance on the said RMO is misplaced.

Verily, a simple violation of a rule or regulation is not always tantamount to fraud. The policy still remains that fraud must be proven by clear and convincing evidence by the party alleging the same.

Finally, it is worth noting that, there is no law or regulation that requires petitioner to verify the validity of the receipts issued by Etheria Trading. As discussed earlier, the registration of the receipts is solely the burden of Etheria Trading as mandated by Section 238 of the NIRC of 1997, as amended. Any violation of the said Section is a matter between Etheria Trading and the BIR; it should not concern, more so burden, petitioner since it has nothing to do with the purported violation.

- ***IT-3/VT-2 – Other incomes not reported in FS/ITR***

Respondent also revealed that as per analysis of petitioner's books of accounts, particularly, the General Ledger (GL), shows that there are items of other income not reported in its Financial Statement (FS)/Income Tax Return (ITR) which are taxable as gross income under Section 32 of the NIRC of 1997, as amended. The said items are as follows:

Miscellaneous Other Income, per GL		₱ 1,891,982.40
Rental Income per GL		3,150,781.04
Total		₱ 5,042,763.44
Add: Additional Interest Income		
Interest Income per GL	₱21,681,419.73	
Less: Interest Income subjected to FT, per FS	691,013.00	20,990,406.73
Other Incomes not reported		₱26,033,170.17
Less: Adjustments per reinvestigation		
Variance on Interest Income		3,333,500.65
Net Other Income		₱22,699,669.52

Respondent subjected the same to deficiency output VAT.

In its defense, petitioner asserts that it is misleading and erroneous to simply sum up the amounts in the General Ledger without considering the reversals recorded therein. Petitioner continues that respondent should have considered the basis of the entries above and their corresponding explanations, *viz.*: the "Miscellaneous Other Income" consists of payments received from the discrepancies in its recorded sales and reimbursements for marketing support. As to the "Rental Income", it is the net amount of the rental income less rental expenses incurred by petitioner which arose from payments made by affiliate companies for their share in the rent of the shared spaces. While, the "Interest Income" are advances that petitioner made to its suppliers. Petitioner claims that it has already submitted to the BIR a Schedule for "Other Income", "Rental Expense", "Interest Income" and "Interest Expense" and other finance charges.

This Court finds respondent's revelation tenable.

By failing to present any documentary evidence or reconciliation of accounts and discrepancies to support its explanation and thereby refute respondent's assessment on this item, petitioner's assertions remain self-serving and uncorroborated. As such, this Court is constrained to uphold respondent's deficiency income tax assessment and the consequential deficiency VAT on the matter at hand.

- ***IT-11/VT-4 - Discrepancy in sales per SLS vs. ITR/FS/VAT return***

In this item, respondent requested petitioner to provide a copy of its Summary List of Sales (SLS) in compliance with RR Nos. 08-02[117] and 16-05[118], which requires taxpayers to submit Summary List of Sales, Purchases and Importations. After scrutiny of the documents requested, the amounts reflected in the SLS were summarized and compared to the amounts reflected in petitioner's ITR, FS, and VAT Return which revealed that petitioner's SLS has much higher value than the one

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[117] "AMENDING FURTHER PERTINENT PROVISIONS OF REVENUE REGULATIONS NO. 7-95, AS AMENDED, WITH RESPECT TO THE TIME OF FILING OF QUARTERLY VAT RETURNS; CONTENTS AND SUBMISSION OF QUARTERLY TOTAL OF MONTHLY SALES AND PURCHASES PER SUPPLIER OR CUSTOMER, AND PROVIDING FOR THE PENALTIES AND EFFECT OF NON-SUBMISSION THEREOF; AND CLARIFYING FURTHER THE MODE OF REMITTANCE OF VAT DUE FROM NON-RESIDENTS", dated June 13, 2002.
[118] "CONSOLIDATED VALUE-ADDED TAX REGULATIONS OF 2005", dated September 1, 2005.

reflected in its FS, ITR and VAT Returns. Respondent arrived at the discrepancy thereon as follows:

Sales per SLS		₱7,066,488,593.52
Sales per ITR/FS/VAT Return		6,966,488,597.00
Discrepancy		₱ 99,999,996.52
Less: Cancelled Inv./Credit Memo (May 2010):		
CM - ASB Mktg	₱ 366,613.39	
Cancelled Invoices	7,695,322.94	8,061,936.33
Unreconciled discrepancy		₱ 91,938,060.19

Respondent subjected the same to deficiency output VAT.

In its defense, petitioner explains that the discrepancy was attributed to cancelled invoices and credit memos. The difference between the aggregate sales reflected in its SLS and AFS/ITR was due to the fact that there were cancelled invoices by petitioner and that there were sales discounts deducted from its sales. Petitioner claims that these discrepancies were adequately explained in the Summary of Cancelled Invoices and the Credit Memo Summary, together with the supporting documents, which have been submitted to the BIR. Petitioner also presented its Accounting Manager, Ms. Joy Dela Paz, to testify and explain that the said discrepancy was caused by an error in petitioner's encoding of its Summary List of Sales.[119]

Unfortunately, this Court is not convinced.

Contrary to petitioner's claim, respondent had already considered the invoice cancellations and credit memos in arriving at the assessed amount. The only issue then left is the alleged typographical error committed in the encoding of petitioner's SLS.

As found by the ICPA, there seemed to have been typographical errors committed during the encoding of the sales amounts in the BIR Relief system. As the sales amounts in the FS, ITR and VAT returns were all in agreement and that there were no unrecorded sales during that month, the discrepancy noted between the Sales per SLS and the ITR/VAT returns appeared to have been a human error.[120]

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[119] Q&A No. 94, Judicial Affidavit of Joy Z. Dela Paz, Docket (Vol. II), p. 800.
[120] Exhibit "P-74", ICPA Report, p. 16

However, petitioner did not provide any supporting document to this Court for us to verify whether there really was a mere typographical error to warrant deletion of the assessment. By failing to do so, this Court is once again constrained to uphold the deficiency income tax and the corresponding VAT assessment for the same.

- ***IT-12/VT-5 - Discrepancy in sales per SLS, SAWT & AITIED Data***

Respondent noted another discrepancy on petitioner's sales after performing a line-by-line matching of its Summary List of Sales, Summary Alphalist of Withholding Tax (SAWT) and third-party information from BIR's Audit Information, Tax Exemption and Incentives Division (AITIED). The discrepancy in sales reflects the amount of income that petitioner failed to declare in its FS/ITR which was assessed as follows, *viz.*:

Excess of AITIED Data over SLS (corrected values)		₱ 73,137,751.37
Excess of SAWT over SLS (corrected values)		50,649,572.28
Undeclared Sales per line-by-line reconciliation		₱123,787,323.65
Less: Discrepancy in sales per SLS vs. FS/VAT Returns		
Sales schedule - Jan. to Dec.	₱7,066,488,593.52	
Sales per FS/VAT Returns	6,966,488,596.83	99,999,996.69
Net Undeclared Sales		₱23,787,326.96
Multiplied by GP Rate		8.30%
Gross profit on Undeclared Sales		₱ 1,974,348.14

Respondent subjected the same to deficiency output VAT.

In its defense, petitioner explains that the unmatched sales may be reconciled despite the fact that they appeared under different names. Petitioner then prepared a summary on its Analysis of Sales, following the examiners' schedule, which it submitted to the BIR for reference. Thus, petitioner claims that the foregoing deficiency income tax assessment due to alleged undeclared sales is baseless.

Again, this Court is not convinced.

Petitioner failed to present as evidence this reconciliation summary that it allegedly furnished respondent. As such, this Court has no point of reference in ascertaining/validating the veracity of petitioner's claims. Consequently, respondent's deficiency income tax and corresponding deficiency VAT must therefore remain.

More so, this Court notes that respondent only subjected the corresponding gross profit of ₱1,974,348.14 to deficiency output VAT instead of the gross sales of ₱23,787,326.96. Intrinsically, since the power to assess is exclusively lodged within the ambit of respondent's powers, this Court is constrained to limit its findings based on respondent's assessment.

- ***IT-13/VT-6 – Undeclared importation on matching of SLI & BOC Data***

Respondent found a discrepancy on petitioner's importation after performing line-by-line matching of petitioner's SLI and third-party information supplied by the BIR AITIED (BOC data). Respondent claims that this discrepancy was considered as undeclared revenue pursuant to the doctrine enunciated in the case of *Perez vs. CTA and CIR, L-10507 dated May 30, 1958* which states that, reflected sources of funds not accounted for in the taxpayer's returns lead to the inference that part of its income has not been reported. For that reason, respondent issued the corresponding income tax assessment against petitioner, *viz.:*

Excess BOC Data over SLI	₱62,347,268.73
Divided by: COS Ratio	91.70%
Undeclared Sales	₱67,990,478.44
Multiplied by: GP rate	8.30%
Gross Profit on Undeclared Importation	₱ 5,643,209.71

Furthermore, after considering additional copies of the Import Entry Declarations (IED) submitted, above line-by-line matching of SLI to that of the BOC data, respondent found that the same still resulted in undeclared importation. These undeclared importations were translated by respondent into sales when it only subjected the gross profit to deficiency income tax; and, since there was an imputed sale, the same was also subjected to deficiency output VAT.

In its defense, petitioner explains that the discrepancy in the amounts stated is due to timing differences in the recording of its importations. Petitioner cited the ruling of the CTA in the case *Commissioner of Internal Revenue vs. Philippine Daily Inquirer*[121], wherein it was stated that an under-declaration of purchases should not be translated into income, for in cases of imposition of income tax, it must be clear that there was an income, and the taxpayer received the said income.

This Court holds otherwise.

While this Court agrees with petitioner that underdeclaration of purchases should not be translated into income, it is, however, incumbent upon petitioner to prove which of these amounts did not translate to sales during the subject taxable period of the assessment.

On this aspect, petitioner failed.

It is a quandary why petitioner did not bother to provide reconciliations or supporting documents to corroborate its claims. By failing to do so, this Court is constrained to uphold the deficiency income tax assessment.

Once again, however, this Court notes that respondent subjected only the gross profit of ₱5,643,209.71 to deficiency output VAT instead of the gross sales of ₱67,990,478.44. As we have stated earlier, since the power to assess is exclusively lodged within the ambit of respondent's powers, this Court is constrained to limit its findings based on respondent's assessment and, thereby, upholds the lower amount of ₱5,643,209.71.

- ***IT-14/VT-7- Unsupported importation per vouching of IEDs***

Verily, audit procedures on "big ticket importation", as provided under RMO No. 22-07[122], involves the checking and verification of supporting source documents such as IEDs. There is a need to employ necessary procedures to ascertain the legitimacy and factual existence

[121] CTA EB Case No. 905 (CTA Case No. 7853), November 4, 2013.
[122] "PRESCRIBING ADDITIONAL PROCEDURES IN THE AUDIT OF INPUT TAXES CLAIMED ON IMPORTATIONS, AMENDING FOR THE PURPOSE "ANNEX B" OF REVENUE MEMORANDUM ORDER NO. 53-98", dated August 30, 2007.

of this transaction. As such, respondent summarized and comparted these documents to petitioner's declarations in its FS and VAT Returns. However, after reviewing the additional copies of IED's submitted by petitioner, respondent found that the same did not tally since there were unsupported amounts. The resulting discrepancy was disallowed and, thereafter, computed as follows:

Importation per FS/VAT Returns	₱1,792,366,016.83
Importation per IEDs (corrected values)	1,785,922,111.14
Unsupported	₱ 6,443,905.69

Being unsupported, respondent disallowed the amount of ₱773,268.68 which corresponds to petitioner's input tax.

In its defense, petitioner explains that the mere under-declaration of purchases cannot automatically translate to income. The deficiency IT assessment arising merely from allegedly unsupported importations per vouching of Import Entry Declarations is improper and without basis. Petitioner continues that its Accounting Manager, Ms. Joy Dela Paz, testified that the only reason why the said importations were deemed as unsupported was because respondent did not understand the figures indicated in the documents faxed by petitioner.

This Court finds petitioner's explanation untenable.

Parenthetically, the substantiation requirement for allowable deductions is primarily for verification that the entries claimed by the taxpayer as deductions in its income tax are legitimate business costs/expenses. The whole amount claimed as deduction must be substantiated by third party-issued commercial documents. For that reason, it is material that the commercial document purportedly substantiating a claimed deduction would clearly show the amount so that it may properly be accounted for. It is therefore imperative that the taxpayer claiming the deduction, provide a fully legible document to substantiate the same.

Unfortunately, on this aspect, petitioner failed. By not providing clear and comprehensible supporting import documents, respondent's deficiency income tax and VAT assessment on this item is upheld.

- ***IT-15/VT-8 – Undeclared purchases on matching of SLP, MAP & AITIED Data***

Respondent noted another discrepancy in petitioner's purchases after line-by- line matching of its SLP, Alphabetical List of Payees and third-party information from BIR AITIED (Relief Data). This discrepancy was considered as undeclared and the corresponding deficiency income tax due thereon was assessed as follows:

Excess of AITIED Data over SLP	₱ 19,854,344.62
Excess of EWT/MAP over SLP	82,379,486.44
Undeclared purchases per line-by-line reconciliation	₱102,233,831.06
Divided by: COS ratio	91.70%
Undeclared sales	₱111,487,274.87
Multiplied by: GP Rate	8.30%
Gross Profit on Undeclared Purchases	₱ 9,253,443.81

The above were undeclared purchases which were considered by respondent as sales only when it was subjected the gross profit to deficiency income tax. Thus, considering that there was an imputed sale, the same was subjected to deficiency output VAT.

In its defense, petitioner explains that the alleged discrepancy in its importation based on the line-by-line matching of its Summary List of Purchases, Alphalist of Payees and third-party information from BIR AITIED (Relief Data) does not support a finding of deficiency income tax. The rule is that in the deficiency assessment of income tax, it must clearly show that there was an income and that the taxpayer received said income.

While this Court agrees with petitioner that underdeclaration of purchases should not be automatically considered as income, petitioner still has the burden of proving which of these amounts did not translate to sales during the assessed taxable period. Unfortunately, by not again providing supporting documents to corroborate its arguments, petitioner failed to sway this Court. Hence, the deficiency income tax assessment for the same is upheld.

Nonetheless, this Court again notes that respondent subjected only the corresponding gross profit of ₱9,253,443.81 to deficiency output VAT, instead of the gross sales of ₱111,487,274.87. As such, this Court is constrained to limit its findings based on respondent's assessment.

II. DEFICIENCY INCOME TAX

The following findings were assessed solely as petitioner's deficiency income tax:

IT-4	Overclaimed interest expense, including tax arbitrage	₱1,439,034.86
IT-7	Discrepancy on ending inventory/Overstatement in COS	512,303.17
IT-8	Unallowable expenses under Taxes & Licenses	10,852.00
IT-9	Overstated depreciation expense on tools & equipment	1,877,848.82
IT-16	Less: Unsupported creditable wtax	2,706,317.06

- ***IT-4 – Overclaimed interest expense, including tax arbitrage***

Respondent asserts that as per the report of the reconciliation/grouping of accounts of the FS to ITR, specifically on interest expense, he found no proper expense account to justify the discrepancy in the amount of interest expense. Also, since the finance cost per FS were certified by an independent CPA, any discrepancies thereof should be presented in the notes to FS or as reconciling items in the ITR. Respondent insists that unsubstantiated expenses, such as overclaim of interest, when unjustified and unreconciled is disallowed pursuant to Section 34 of the NIRC of 1997, as amended. Furthermore, petitioner failed to observe the limit on the amount of allowable interest expense as provided under Section (4)(b) of RR No. 13-00[123].

Thus, applying the rule of deductibility of interest expense pursuant to RR No. 13-00, respondent computed the disallowed interest expense comprised of the overclaimed interest per ITR and the tax arbitrage should be as follows:

[123] "IMPLEMENTING SECTION 34(B) OF THE TAX CODE OF 1997 ON THE REQUIREMENTS FOR DEDUCTIBILITY OF INTEREST EXPENSE FROM THE GROSS INCOME OF A TAXPAYER", dated November 20, 2000.

Interest expense per ITR		₱68,232,667.00
Finance Costs per FS		67,078,675.00
Overclaimed interest expense per return		₱ 1,153,992.00
Add: Unallowable interest expense par Tax Arbitrage		
Interest subjected to final tax	₱691,013.00	
Divided by: Rate net of final tax	80%	
Grossed up interest income subjected to final tax	₱863,766.25	
Multiplied by: Rate of reduction	33%	
Amount to reduce interest expense		285,042.86
Total Unallowable Interest Expense		₱1,439,034.86

In its defense, petitioner assails respondent's computation. Petitioner claims that respondent assessed an amount for overclaimed expense and added an adjustment for tax arbitrage. This computation, however, is erroneous and will result in double taxation since petitioner's interest income was already subjected to final tax.

More so, petitioner continues that RR No. 13-00 in relation to Section 34(B) of the NIRC of 1997, as amended, which provides the rule on deductibility of interest expense, states that the amount of allowable interest expense is to be reduced by a portion of the interest income subject to final tax.

This Court upholds the assessment.

Again, despite its arguments, petitioner did not provide any reconciliation to explain the difference noted by respondent. Neither did it provide supporting documents to corroborate its assertions. In fact, only the amount of ₱45,872,027.00 were traced to the AFS note disclosures, computed as follows:

Nature	Amount of Finance Costs	AFS Reference Note[124]
Bank loans	₱43,575,156.00	10.1
Finance lease	480,909.00	10.2
Car loan	1,815,962.00	10.3
Total	**₱45,872,027.00**	

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[124] Exhibit "P-64".

Apparently, there still remains ₱21,206,648.00[125] as interest expense which cannot be traced to AFS disclosures. Petitioner failed to account said untraceable amount and the trial balance[126], likewise, did not show any detailed breakdown for interest expense.

Nonetheless, contrary to respondent's finding, petitioner observed the limit on deductible interest expense as instructed by Section (4)(b) of RR No. 13-00. This can be ascertained from the fact that petitioner's Reconciliation of Net Income Per Books Against Taxable Income (Section E) of the AITR showed a non-deductible interest expense amounting to ₱228,033.00 which was added to its taxable income for the year 2010.[127] However, as per respondent's re-computation in the FDDA, petitioner's non-deductible interest expense should be higher in the amount of ₱285,042.86. Thus, the difference thereof must be disallowed in the amount of ₱57,009.86.

Generally, a non-deductible interest expense supposedly lowers the amount which can be claimed as deduction from a taxpayer's taxable income. As such, it is expected that the amount of interest expense per AITR must be lower than that declared in the AFS, due to the non-deductible component.

Going back to the instant case, the amount of ₱68,232,667.00 claimed as interest expense per AITR is supposedly the net of the non-deductible interest expense. However, the amount claimed by petitioner as deduction for interest expense per AITR alone already amounted to ₱68,232,667.00, which is much higher than the amount declared in the AFS of ₱67,078,675.00. Clearly, there was an overclaim of interest expense for tax purposes.

Furthermore, this Court cannot assume that there were taxable interest income supposedly offset from the deductible interest expense, which could have explained a higher interest expense per AITR, since petitioner did not declare any taxable interest income in its AITR.

Thus, considering that respondent anchored its disallowance from Section 34 of the NIRC of 1997, as amended, which specifically requires adequate substantiation of ordinary and necessary business expenses and, the amount of understated non-deductible interest expense, a

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[125] ₱67,078,675.00 – ₱45,872,027.00.
[126] BIR Records, p. 534.
[127] Exhibit "P-29".

petitioner should have been disallowed the total amount of ₱22,417,649.86 as interest expense, computed as follows:

Interest expense claimed as deduction		₱68,232,667.00
Interest expense traced to AFS		45,872,027.00
Unsupported interest expense		22,360,640.00
Add: Understated non-deductible interest expense par Tax Arbitrage		
Interest subjected to final tax	₱691,013.00	
Divided by: Rate net of final tax	80%	
Grossed up interest income subjected to final tax	863,766.25	
Multiplied by: Rate of reduction	33%	
Amount to reduce interest expense	285,042.86	
Less: Limit already considered as non-deductible by petitioner	228,033.00	57,009.86
Should-be unallowable interest expense		₱22,417,649.86

Nonetheless, this Court shall, however, only consider the disallowance in the amount of ₱1,439,034.86 since this was only the extent assessed by respondent. Again, this Court is constrained to limit its findings based on respondent's assessment.

- ***IT-7 – Discrepancy on ending inventory/Overstatement in COS***

Respondent argues that the Cost of Sales requires that inventory accounts be properly checked. However, upon evaluation, he found that there were discrepancies in the amount of Ending Inventory reported under petitioner's FS/ITR as to that of the Inventory List that was filed with the BIR. Respondent continues that the provision for inventory losses should be presented as an allowance account in the FS and, then, as a reconciling item in the ITR. However, deducting a provision for losses in the inventory is not allowed unless a Certificate of Deductibility is first secured from the BIR. Respondent computed the discrepancy as follows:

Per inventory list	₱613,839,928.17
Per FS/ITR	613,327,625.00
Discrepancy	₱ 512,303.17

Furthermore, respondent asserts that an understatement of inventory would result to overstatement of cost of sales, which therefore leads to understatement of gross income, in direct violation of Section 41[128] of the NIRC of 1997, as amended. Conversely, the difference in the amount declared for inventory is an indication that there was a claim of loss and/or inventory write off. But before a reduction in inventory can be claimed, certain requisites must be complied with. Respondent continues that, due to petitioner's failure to comply with the substantiation requirement, petitioner's write-off/reduction was not duly supported by evidence, which is therefore, disallowed.

This Court does not agree.

Accordingly, petitioner's inventories are valued at the lower of cost and net realizable value (NRV).[129] Incidentally, the Philippine Accounting Standards (PAS) 2, Inventories (par. 7), provides that net realizable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business.

Indeed, petitioner properly presented its ending inventories at NRV as of December 31, 2010 amounting to ₱613,327,625.00, net of allowance for inventory losses amounting to ₱512,304.00, as disclosed in Note 6 of its AFS. The net amount was forwarded to the computation of Cost of Sales amounting to ₱6,388,595,972.00 for the year 2010, as

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[128] "**SEC. 41.** *Inventories.* - Whenever in the judgment of the Commissioner, the use of inventories is necessary in order to determine clearly the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Secretary of Finance, upon recommendation of the Commissioner, may, by rules and regulations, prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

If a taxpayer, after having complied with the terms and conditions prescribed by the Commissioner, uses a particular method of valuing its inventory for any taxable year, then such method shall be used in all subsequent taxable years unless: (i) with the approval of the Commissioner, a change to a different method is authorized; or (ii) the Commissioner finds that the nature of the stock on hand (e.g., its scarcity, liquidity, marketability and price movements) is such that inventory gains should be considered realized for tax purposes and, therefore, it is necessary to modify the valuation method for purposes of ascertaining the income, profit, or loss in a more realistic manner: Provided, however, That the Commissioner shall not exercise his authority to require a change in inventory method more often than once every three (3) years: Provided, further, That any change in an inventory valuation method must be subject to approval by the Secretary of Finance."

[129] Note 2.5, 2010 Audited Financial Statements, Exhibit "P-64".

disclosed in Note 11 of the AFS. The same was claimed as a deduction from Sales in petitioner's AITR for the year 2010.[130]

Apparently, the amount of ₱512,304.00 (with the slight difference due to rounding off) declared as allowance for inventory losses was the same amount being disallowed by respondent as deduction from petitioner's sales for the year 2010. While this Court agrees that the said allowance for inventory losses should have been considered as a reconciling item (as a non-deductible expense), as it was not yet actually realized by petitioner in 2010, respondent, however, failed to recognize the fact that the same allowance was already standing in the previous year.

As disclosed under Note 6 of the AFS, the ending inventories as of December 31, 2009 amounted to ₱85,012,390.00, while the net of allowance for inventory losses amounted to ₱512,304.00. This 2009 ending inventory at NRV was forwarded as beginning inventory in computing the Cost of Sales for the year 2010.

Since both beginning and ending inventories in 2010 were both understated by the same amount of allowance for inventory losses of ₱512,304.00, the same was then offset with each other leading to no misstatement at all on Cost of Sales for the year 2010. Neither did it result to any provision for inventory losses being claimed as deduction for income tax purposes.

The foregoing principles can be demonstrated in the comparative table of computation below, *to wit*:

	Amounts *Net* of Allowance for Inventory Losses of ₱512,304.00	**Amounts *Gross* of Allowance for Inventory Losses**
Merchandise Inventory at beginning of year	₱85,012,390.00	₱85,524,694.00
Net purchases	6,916,911,207.00	6,916,911,207.00
Merchandise Inventory at end of year	(613,327,625.00)	(613,839,929.00)
Cost of Sales	**₱6,388,595,972.00**	**₱6,388,595,972.00**

[130] Line 18C, AITR for the year 2010, Exhibit "P-29".

There being ultimately no overclaimed Cost of Sales for the year 2010, respondent's assessment to the extent of ₱512,303.17 is without basis and, thus, must be removed and cancelled.

Further, had there been an erroneous claim of provision for inventory losses as deduction from gross income, it must have occurred in previous periods. This is due to the fact that the same amount had already been carried over since 2009. As such, any disallowance for the same must be imposed in the year it was claimed as deduction, not in 2010.

- ***IT-8 – Unallowable expenses under Taxes & Licenses***

As per respondent's scrutiny of petitioner's Taxes and Licenses accounts reveals that there are items of deductions not allowed. Respondent argues that penalties and charges for late payment are not deductible pursuant to Section 34(A) of the NIRC of 1997, as amended, and therefore should be disallowed, thus:

Penalties and charges	₱10,852.00

In its defense, petitioner claims that no explanation was given by respondent as to how the amount was computed. The failure to explain the basis of the assessment deprives petitioner of the opportunity to adequately explain why the assessment is improper. Thus, making this item in the assessment void.

This Court finds petitioner's defense untenable.

Perusal of the records reveal that the Penalties and Charges account in the amount of ₱10,852.00 for the year 2010, can easily be viewed from petitioner's own Trial Balance that was submitted to respondent.[131] Thus, petitioner cannot feign innocence to the said amount since it was well-aware of how respondent arrived at the assessed amount. More so, by failing to present any evidence to sufficiently refute respondent's assessment, this Court shall uphold the disallowed amount as described in petitioner's Trial Balance.

- ***IT-9 – Overstated depreciation expense on tools & equipment***

[131] BIR Records, p. 533.

Respondent alleges that by tracing the amounts reflected in petitioner's FS to Trial Balance reveals a discrepancy in the amount of accumulated depreciation for Tools and Equipment. The said discrepancy will result to overstatement of depreciation expense which should, therefore, be disallowed. Thus:

Accum. Depreciation, per FS	₱2,648,524.00
Accum. Depreciation, per TB	770,675.18
Overclaimed depreciation expense	₱1,877,848.82

In its defense, petitioner insists that the amount of Accumulated Depreciation as indicated in the AFS had been subject to thorough review and certification by an external auditor. As such, any purported discrepancy between the amount per AFS and the amount per Trial Balance should not in itself give rise to a deficiency assessment for being mere conjecture.

This Court agrees with petitioner.

Ostensibly, respondent erroneously used the wrong account in determining alleged overclaimed depreciation expense.

The accumulated depreciation account represents the accumulated amount of yearly depreciation expense of a property or equipment from the time it was put into use and is still under the ownership of the entity as of period-end. This account excludes the corresponding accumulated depreciation of those property and equipment disposed of during the period.

Using only one period ending balance of the accumulated depreciation account does not correctly reflect the current period depreciation expense of a particular property or equipment.

In the instant case, examination of petitioner's 2010 Trial Balance, as audited by respondent, shows that the amount indicated in the Tools and Equipment (at cost) account is lower by ₱1,877,850.31 than that declared in the AFS.[132] This means that there was an addition made at zero carrying value since the amounts of cost and accumulated

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[132] BIR Records, p. 537.

depreciation were the same (with only a minimal difference of ₱1.49).[133] This in effect had zero impact in petitioner's total assets as of December 31, 2010.

Another explanation would have been that petitioner also might have immediately recognized for one period (or during 2010) a depreciation expense equivalent to the whole cost of the property. But then, it would be incorrect to assume that said whole cost amount of ₱1,877,848.82 was already recognized as a depreciation expense during 2010, since the total depreciation expense claimed for Tools and Equipment only amounted to ₱1,468,772.00.[134] This amount was traced to the total depreciation expense of ₱18,976,117.00 per AFS[135] and ITR[136] as of December 31, 2010.

Nevertheless, there is no overstatement of claimed depreciation expense under Tools and Equipment as alleged by respondent. Conversely, there is even, in fact, an understatement from the said account; that assuming that the whole amount of ₱1,877,530.31 was recognized as depreciation expense, rendering it favorable to the State.

- ***IT-16 - Unsupported creditable withholding tax (CWT)***

Respondent insists that audit of creditable withholding tax claimed per ITR requires that all must be properly supported with BIR Form 2307- Certificate of Taxes Withheld at Source. However, respondent found that the amount declared by petitioner in its ITR for its creditable withholding tax (CWT) is only supported by BIR Form 2307 up to the amount of around Php40.2 million. Thus, the remaining amount of unsupported creditable withholding tax was disallowed by respondent as a tax credit, pursuant to Section 2.58.3 (B) of RR No. 02-98[137], as amended, as follows:

133

Tools and equipment (cost)	₱1,877,850.31
Less: Tools and equipment - accum dep	1,877,848.82
Tools and equipment carrying value	₱ 1.49

134 Note 8 to AFS as at December 31, 2010, Exhibit "P-64".
135 Statement of Comprehensive Income, "Exhibit P-64".
136 Exhibit "P-29".
137 "IMPLEMENTING REPUBLIC ACT NO. 8424, 'AN ACT AMENDING THE NATIONAL INTERNAL REVENUE CODE, AS AMENDED' RELATIVE TO THE WITHHOLDING ON INCOME SUBJECT TO THE EXPANDED WITHHOLDING TAX AND FINAL WITHHOLDING TAX, WITHHOLDING OF INCOME TAX ON COMPENSATION, WITHHOLDING OF CREDITABLE VALUE-ADDED TAX AND OTHER PERCENTAGE TAXES", dated April 17, 1998.

Creditable Wtax Claimed per ITR	₱42,966,006.00
Creditable Wtax per vouching of Form 2307	40,259,688.94
Unsupported Creditable Wtax	₱ 2,706,317.06

Unfortunately, by failing to submit any documents that would refute respondent's findings, this Court is bound to uphold the said disallowance for being unsubstantiated.

Henceforth, in view of the foregoing discussion, this Court finds that petitioner's basic deficiency income tax liability for taxable year 2010 should be reduced to **₱43,772,489.22**, computed as follows:

Taxable income per return			₱ 211,436,288.00
Add: Findings per investigation			
IT-1	Unregistered purchase invoices from Etheria Trading	₱ 899,156.62*	
IT-3	Other incomes not reported in FS/ITR	22,699,669.52	
IT-4	Overclaimed interest expense, including tax arbitrage	1,439,034.86	
IT-7	Discrepancy on ending inventory/Overstatement in COS	-	
IT-8	Unallowable expenses under Taxes & Licenses	10,852.00	
IT-9	Overstated depreciation expense on tools & equipment	-	
IT-11	Discrepancy in sales per SLS vs. ITR/FS/VAT return	91,938,060.19	
IT-12	Discrepancy in sales per SLS, SAWT & AITIED Data	1,974,348.14	
IT-13	Undeclared importation on matching of SLI & BOC Data	5,643,209.71	
IT-14	Unsupported importation per vouching of IEDs	6,443,905.69	
IT-15	Undeclared purchases on matching of SLP, MAP & AITIED Data	9,253,443.81	
	Total adjustments per audit		140,301,680.54
Taxable income per audit			₱ 351,737,968.54
Multiplied by: Income tax rate			30%
Income tax due per audit			**₱105,521,390.56**
Less: Allowable credits/payments			
	Cash payments	₱21,489,212.40	
	Creditable Wtax per return	42,966,006.00	
IT-16	Less: Unsupported creditable wtax	(2,706,317.06)	61,748,901.34
Basic Deficiency Income Tax Due			**₱43,772,489.22**

* *reduced from ₱4,942,937,053.82 as found by the ICPA (Exhibit "P-74", p. 15)*

III. DEFICIENCY VALUE ADDED TAX

The following findings were assessed solely for petitioner's deficiency VAT:

VT-10	Deferred input (CG) to be carried over	₱3,011,827.51
	Excess input carry over for 2011	30,670,292.00

VT-11	Unsupported VAT wheld	4,936.57

- ***VT-10 – Deferred input (CG) to be carried over***
  – Excess input carry over for 2011

A. <u>Deferred input (CG) to be carried over</u>

Respondent claims that as part of the audit of petitioner's purchases and input tax, the amount of input tax claimed as tax credit in its VAT returns were accounted for and compared with the sources of input tax credit declared in the FS, pursuant to Revenue Audit Memorandum Order (RAMO) No. 01-99[138] and RR No. 16-05[139].

Respondent continues that input tax on petitioner's purchase of capital goods exceeding one (1) Million should have been amortized over a period of five (5) years or with the estimated useful life of the asset whichever is shorter. Failure to amortize capital goods indicates an overclaimed input tax. As such, respondent computed the overclaimed input tax as follows:

	Additions During the Year	Estimated Useful Life	Allowable Input on CG for the Year	Overclaimed Input on CG/Deferred Input to be Carried Over
Computer Equipment & Software	₱3,978,112.00	3	₱159,124.48	₱318,248.96
Transportation Equipment	19,127,367.00	5	459,056.81	1,836,227.23
Office Furniture & Equipment	1,790,947.00	5	42,982.73	171,930.91
Tools & Equipment	3,170,107.00	2	190,206.42	190,206.42
Leasehold Improvement	5,158,479.00	5	123,803.50	495,213.98
	₱33,225,012.00		**₱975,173.93**	**₱3,011,827.51**

Respondent also asserts that petitioner's expenditures on capital goods should be subjected to the limitations prescribed under Sections 4.110-3 and 4.110-7 of RR No. 16-05. Therefore, the amount indicated above pertaining to the Deferred Input Tax to be Carried Over cannot be allowed as a credit against the output tax for taxable year 2010.

Unfortunately, petitioner again did not present any substantial argument and relevant supporting documents to refute respondent's

[138] "VALUE-ADDED TAX AUDIT MANUAL", dated September 5, 1998
[139] *Supra* No. 118

findings in his assessment. By failing to do so, this Court upholds respondent's disallowances.

B. <u>Excess input carry over for 2011</u>

Following the computation presented in the FLD-DDAN[140] dated September 16, 2013, respondent disallowed petitioner's excess input tax carried over to the succeeding year 2011 in the amount of ₱30,670,292. However, further scrutiny of the assessment notice reveals that there are no legal and factual bases that were provided in the Details of Discrepancies[141] to justify the disallowance of such amount.

Despite petitioner's failure to refute the same, the Court finds it improper to uphold an assessment which is already void on its face. Section 228 of the NIRC of 1997, as amended, provides that the taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

- ***VT-11 – Unsupported VAT Withheld***

Respondent asserts that audit of tax credits being claimed requires that they must be properly supported with BIR Form 2302 - VAT Subsidy Certificates. However, respondent found that some of the certificates filed by petitioner pertain to the previous year, which therefore should be disallowed as tax credit, pursuant to RR No. 02-98, as amended. As such, respondent insists that the unsupported tax credit is taxable pursuant to the said Revenue Regulation in relation to Section 2.58.3 (B) of the NIRC of 1997, as amended. Thus:

VAT Withheld per return	₱7,618,625.96
VAT Subsidy Certificates per vouching Form 2302	7,613,689.39
Unsupported VAT subsidy	₱4,936.57

Unfortunately, petitioner again did not present any documents to refute respondent's assessment.

However, as discussed earlier, respondent's right to assess petitioner for any deficiency VAT for the 1st and 2nd quarter had already

[140] *Supra* No. 13
[141] Annex A, Exhibit "R-22".

prescribed. Considering, however, the amount claimed as Creditable VAT Withheld for this particular assessment item can be separated quarterly, we shall remove the amount attributable for the 1st and 2nd VAT Quarters:

Quarter	Claimed Creditable VAT Withheld (Line 26B)
1st[142]	₱1,724,590.27
2nd[143]	2,144,585.00
3rd[144]	1,708,206.69
4th[145]	2,041,244.00
Total	**₱7,618,625.96**

As shown above, a total of ₱3,869,175.27 arising from the 1st and 2nd quarters must be excluded from the assessment.

But then, by doing so, this Court cannot determine which specific quarter did the unsupported amount of ₱4,936.57 as such this Court is therefore constrained to uphold the said disallowance.

Henceforth, in view of the foregoing discussion, this Court finds that petitioner did not incur any deficiency VAT for the relevant taxable period and, as a matter of fact, even made a VAT overpayment in the amount of **₱10,991,314.40**, as computed as follows:

VATable sales per audit			₱6,966,488,596.83
Add: Findings per investigation			
VT-2	Other incomes not reported in FS/ITR	₱ 22,699,669.52	
VT-4	Discrepancy in sales per SLS vs. ITR/FS/VAT return	91,938,060.19	
VT-5	Discrepancy in sales per SLS, SAWT & AITIED Data	1,974,348.14	
VT-6	Undeclared importation on matching of SLI & BOC Data	5,643,209.71	
VT-8	Undeclared purchases on matching of SLP, MAP & AITIED Data	9,253,443.81	
	Total adjustments per audit		131,508,731.37
Vatable sales per audit			₱7,097,997,328.20
Multiply by: VAT rate			12%
Output tax due			₱ 851,759,679.38
Less: Net allowable input tax			
	Input tax from current purchases	₱856,354,254.95	
	Less: Audit findings:		

[142] *Supra* No. 89.
[143] *Supra* No. 90.
[144] *Supra* No. 94.
[145] *Supra* No. 95.

VT-7	Unsupported importation per vouching of IEDs	(773,268.68)	
VT-9	Unsubstantiated input tax - Etheria Trading	(107,898.79)	
VT-10	Deferred input (CG) to be carried over	(3,011,827.51)	
	Excess input carry over for 2011	-	852,461,259.97
VAT Overpayment per audit			**₱ (701,580.57)**
Less: VAT credits/payments			
	VAT remittances	₱ 2,676,044.44	
	VAT subsidy claimed per return	7,618,625.96	
VT-11	Less: Unsupported VAT withheld	(4,936.57)	10,289,733.83
Total VAT Overpayment per audit			**₱(10,991,314.40)**

THE IMPOSITION OF A 50% SURCHARGE ON THE DEFICIENCY IT AND VAT IS EXCESSIVE.

Respondent imposed a fifty percent (50%) surcharge on his deficiency assessment of petitioner's income tax and VAT, primarily by reason of substantial overstatement of deductions. Respondent anchors his 50% imposition under Section 248 (B) of the NIRC of 1997, as amended, which provides that:

> "**SEC. 248.** *Civil Penalties.* — x x x
>
> (B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case, any payment has been made on the basis of such return before the discovery of the falsity or fraud: Provided, That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein."

To enlighten us with the correct imposition of civil penalties relative to the resolution of the present issue, this Court finds the CTA

En Banc case of *Estate of Fidel F. Reyes and Estate of Teresita R. Reyes vs. Commissioner of Internal Revenue*[146] instructive on the matter, *viz.*:

> Section 248 (B) imposes the surcharge of fifty percent (50%) only in two instances. First, in case of willful neglect to file the return within the period prescribed, and second, in case a false or fraudulent return is willfully made. **Thus, it is not enough that the taxpayer failed to file the required tax return or that the return is false to justify the imposition of the 50% for fraud. The law is clear that "a false or fraudulent return is willfully made".** It must be emphasized that respondent did not present evidence to directly prove that there was a willful intention on the part of petitioners to evade the payment of taxes. What is evident in this case is the negligence and mistake of the petitioners in the interpretation of the law that caused the deficiencies found by the respondent in his assessments. However, We find no actual and intentional fraud through willful and deliberate misleading of the government agency concerned, the Bureau of Internal Revenue. The government was not induced to give up some legal right and place itself at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities because petitioners did not conceal anything. Error or mistake of law is not fraud. (*Emphasis supplied*)

Guided by the above pronouncement, this Court finds respondent's imposition of 50% surcharge by the mere fact of substantial overstatement of deductions as incorrect since there was no proof that there was "willful falsity" on the part of the petitioner.

Accordingly, this Court reduces the imposition of surcharge to the lower rate of twenty-five percent (25%) pursuant to Section 248 (A)(3)[147]. of the NIRC of 1997, as amended.

Application for Compromise of Income Tax and Value-Added Tax

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[146] CTA EB Case No. 189, March 21, 2007.
[147] **SEC. 248.** *Civil Penalties.* - (A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:
x x x
(3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment;
x x x

Lastly, petitioner offered and paid the amount of ₱50 million as compromise for the basic deficiency income tax assessment.[148] While the offer was not accepted by respondent, the amount paid by petitioner shall be deducted in the final settlement of its deficiency income tax including surcharge, deficiency interest, and delinquency interest.

Likewise, petitioner also offered and paid the amount of ₱20,000,000.00 as compromise for the basic deficiency VAT assessed by respondent.[149] While the offer was not accepted, the actual amount paid represents petitioner's VAT overpayment for taxable year 2010.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. Accordingly, respondent's deficiency VAT assessment for taxable year 2010 in the amount of ₱1,298,134,526.24 is hereby **CANCELLED AND WITHDRAWN**. On the other hand, respondent's deficiency income tax assessment for taxable year 2010 is hereby **UPHELD IN PART**. Consequently, petitioner is **ORDERED TO PAY** respondent the amount of **FIFTY-FOUR MILLION SEVEN HUNDRED FIFTEEN THOUSAND SIX HUNDRED ELEVEN PESOS AND FIFTY-THREE CENTAVOS (₱54,715,611.53)** representing basic deficiency income tax and the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Basic Deficiency Income Tax	₱ 43,772,489.22
Add: 25% Surcharge	10,943,122.31
Total	**₱54,715,611.53**

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

a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of ₱43,772,489.22 computed from April 15, 2011 until full payment thereof pursuant to Section 249(B) of the NIRC, as amended.

b) Delinquency interest at the rate of twenty percent (20%) per annum on the total amount of ₱54,715,611.53, and on the 20%

[148] Exhibits "P-17" and "P-19".
[149] Exhibits "P-18" and "P-20".

deficiency interest which have accrued as aforestated in (a) computed from June 2, 2014 until full payment thereof pursuant to Section 249(C) of the 1997 NIRC, as amended.

Provided, further, the amount of ₱50,000,000.00 paid by petitioner as offer of compromise shall be deducted in the final settlement of the above deficiency income tax including surcharge, deficiency interest, and delinquency interest.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

We Concur:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

ATTESTATION

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

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson, Second Division

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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice