REPUBLIC OF THE PHILIPPINES
Court Of Tax Appeals
QUEZON CITY

SECOND DIVISION

NIDEC COPAL PHILIPPINES CORPORATION, ***Petitioner,***	**C.T.A. CASE NO. 6577**
	Members:
-versus-	CASTAÑEDA, JR., Chairman UY, and PALANCA-ENRIQUEZ, JJ.
COMMISSIONER OF INTERNAL REVENUE, ***Respondent.***	**Promulgated:** SEP 2 5 2006

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DECISION

PALANCA-ENRIQUEZ, J.:

May petitioner Nidec Copal Philippines Corporation be held liable for deficiency income, fringe benefits, final withholding and documentary stamp taxes and increments for late payment of final withholding tax for the fiscal year ended March 31, 1999 in the aggregate amount of P10,713,749.74?

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THE CASE

This is the issue raised in this Petition For Review filed by Nidec Copal Philippines Corporation (hereafter "petitioner corporation") praying for the cancellation of the assessments issued by the Commissioner of Internal Revenue (hereafter "respondent") against petitioner involving deficiency income, fringe benefits, final withholding and documentary stamp taxes and increments for late payment of final withholding tax for the fiscal year ended March 31, 1999 in the aggregate amount of P10,713,749.74.

THE FACTS

In their Joint Stipulation of Facts and Issues, the parties stipulated as follows:

> "1. Petitioner is a domestic corporation duly licensed by the Securities and Exchange Commission ('SEC') and registered with the Philippine Economic Zone Authority ('PEZA') with PEZA Registration Certificate No. 91-019 dated July 5, 1991. It has office address at main Avenue corner Binary Street, Light Industry & Science Park of the Philippines I, Special Economic Zone, Bo. Diezmo, Cabuyao, Laguna.
>
> Petitioner may be served with papers, orders, and other processes of this Honorable Court through undersigned counsel.
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> 2. Respondent is the Commissioner of Internal Revenue ('CIR'), duly appointed to perform the duties of his office,

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including, *inter alia*, the power to decide disputed assessments, subject to the exclusive appellate jurisdiction of this Honorable Court, pursuant to *Section 4* of the *Tax Code*.

3. Respondent holds office and, hence, may be served with all papers, orders, and other legal processes of this Honorable Court at the 5th Floor, Bureau of Internal Revenue ('BIR') National Office Building, BIR Road, Diliman, Quezon City.

4. On April 29, 2002, Petitioner received copies of the formal letter of Demand and the Final Assessment Notice (Assessment Notice No. 57-99) both dated April 19, 2002 issued by Respondent. In the said letter of demand and assessment notice, Respondent assessed petitioner for deficiency income, fringe benefits, expanded withholding, and documentary stamp taxes and compromise penalty in the aggregate amount of ₱10,713,749.74, inclusive of increments, for fiscal year ended March 31, 1999, computed as follows:

	Tax Type	Total Tax Due
I.	Income Tax - Unregistered Activity	P 2,168,639.65
II.	Income Tax – Special Tax Rate	657,278.39
III.	Income Tax – Disallowance	613,165.16
IV.	Documentary Stamp Tax - Loan Agreements,	
	Instruments and Paper	1,095,622.77
V.	Final Withholding Tax - Royalty Expense	5,592,789.05
VI.	Increments - Late Payment of EWT on Interest	220,411.00
VII.	Documentary Stamp Tax - Loan and Lease	
	Agreements	61,399.01
VIII.	Fringe Benefits Tax - Rental (Housing)	304,444.71
	Total	**P 10,713,749.74**

5. Pursuant to *Section 228* of the *Tax Code,* Petitioner made a timely protest thereof in a letter dated May 29, 2002 filed with the Revenue Region No. 9 of the Bureau of Internal Revenue ('BIR') on May 29, 2002. Said protest letter specified and discussed the factual and legal bases of the protest against the assessment and requested that the same be cancelled and, consequently, the case against

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> Petitioner be considered closed and terminated. *Section 228* of the *Tax Code* is applicable since the assessments were issued when the 1997 Tax Code is already in effect.
>
> 6. The 180-day period within which Respondent is mandated by law to render a decision on the protest filed by a taxpayer lapsed on November 25, 2002, but Respondent failed to act on Petitioner's protest. Hence, petitioner has thirty (30) days from said date, or until December 26, 2002 (December 25, 2002 being a holiday), within which to appeal to this Honorable Court.
>
> 7. This Honorable Court has exclusive appellate jurisdiction to take cognizance of the instant Petition pursuant to *Section 228* of the *Tax Code* in conjunction with *Section 4* of the same *Code*, as well as *Section 7 of Republic Act No. 1125*, otherwise known as *'An Act Creating the Court of Tax Appeals'*."

In his amended answer, respondent alleged by way of special and affirmative defenses that there were income/adjustments from unregistered activities which were excluded in the computation of taxable income and these consist of rework charges (P276,329.90), Vishay losses (P7,803,456.74) and selling price adjustment (P232,302.00); that a deficiency income tax in the amount of P387,342.00 resulted from the disallowance of the inventory written- off and communication expense; *Revenue Regulations No. 16-99* allowing Subic Special Economic and Freeport Zone (SSEFZ) entities to deduct communication expenses, does not state that the same is applicable to PEZA registered entities; SSEFZ and PEZA registered entities are similar only insofar as the 5% preferential tax is concerned; petitioner's Loan Agreements with Copal Co. Ltd. ($7,400,000.00 and JPY250,000,000.00) and Temic Telefunken ($480,000.00) were not subjected to DST of P1,095,622.77 pursuant to *Section 180 of the Tax Code*; petitioner did not pay DST of P61,196.95, inclusive of increments and surcharge, on its Lease Contract (P2,390,160.00) and Loan Agreement (P14,442,278.00) with its affiliate, El Nuevo Diezmo Realty, Inc., pursuant to *Sections 194 and 180 of the Tax Code*; petitioner's royalty expense charge on operations amounted to P17,550,137.00 with an additional adjustment of P76,069.31; however, the total remittance of final withholding tax on royalty payments amounted only to P1,370,500.85 resulting to a discrepancy of P3,017,033.00 and P19,767.32, excluding increments and surcharges; petitioner failed to remit to the BIR within the prescribed period a final withholding tax on interest in the amount of P316,018.00, resulting to the imposition of increments in the amount of P220,411.00, pursuant to *Revenue Regulations 2-98*; and the fringe benefit tax assessment was issued within the prescribed period.

Petitioner presented Wilfredo Onag, as witness, and submitted its "Formal Offer of Evidence", which were admitted by the Court, except

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for *Exhibits "W", "W-1", "W-2", "X", and X-1"* for failure of the petitioner to present the originals for comparison.

Upon petitioner's "Motion For Partial Reconsideration", the Court admitted *Exhibits "W" and "X",* inclusive of their submarkings.

On the other hand, respondent Commissioner of Internal Revenue presented Wilma Enrique, as witness, and submitted his Formal Offer of Evidence, which were all admitted by the Court.

Both parties were ordered to file their simultaneous memoranda, within thirty (30) days from notice. Upon their respective motions, petitioner was granted thirty (30) days from July 25, 2005 or until August 24, 2005, and respondent was granted a total extension of forty five (45) days from July 27, 2005 or until September 10, 2005, within which to file their respective memoranda.

On August 31, 2005, petitioner filed a "Motion To Admit", which the Court granted and the "Memorandum For the Petitioner" was admitted.

On the other hand, respondent filed his "Memorandum For the Respondent" on September 12, 2005.

Thereafter, the case was deemed submitted for decision.

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ISSUES

Stipulated Issues

As stipulated upon by the parties, the following are the issues for this Court's consideration:

I

INCOME TAX – UNREGISTERED ACTIVITY

a. Whether the income from the sale of scrap and other activities in the amount of P4,089,526.19 is subject to 34% income tax;

b. Assuming arguendo that the income from the sale of scrap and other activities is subject to 34% income tax, whether petitioner can claim deductions from said income pursuant to Section 34 of the 1997 Tax Code.

II

INCOME TAX – SPECIAL RATE

Whether the amount of P8,312,088.64 consisting of rework charges, Vishay losses and selling price adjustments should be included in computing income subject to 5% preferential tax.

III

INCOME TAX – DISALLOWANCE OF COST OF SALES

Whether the disallowance of the amount of P7,746,834.41 representing inventory written-off and communication expenses as part of cost of sales is proper.

IV

DOCUMENTARY STAMP TAX (DST) ON LOAN AGREEMENTS, INSTRUMENTS AND PAPERS

Whether petitioner is liable for deficiency DST on its loan agreements with non-resident foreign corporations.

V

FINAL WITHHOLDING TAX ("FWT") ON ROYALTY EXPENSE

a. Whether respondent's right to assess deficiency FWT on royalty payments has already prescribed when it issued the Formal Letter of Demand and Assessment Notices.

b. Whether the imposition of 25% surcharge in addition to the basic tax due is proper.

VI

INCREMENTS FOR LATE PAYMENT OF FWT

Whether petitioner remitted the final tax on interest payments on foreign loans to the Bureau of Internal Revenue (BIR) within the prescribed period.

VII

DST ON LOAN AND LEASE AGREEMENTS

Whether petitioner is liable for deficiency DST on its loan and lease agreements with El Nuevo Diezmo Realty Inc.

VIII

FRINGE BENEFITS TAX ("FBT") ON RENTAL-HOUSING

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a. Whether respondent's right to assess deficiency FBT has already prescribed when it issued the Formal Letter of Demand and Assessment Notices;

b. Whether petitioner's rental payments on the real properties located at 69 A San Gregorio St., Magallanes Village are fringe benefits subject to FBT.

Principal Issue

The foregoing issues raised by both parties boil down to the principal issue of whether or not the petitioner is liable to pay the following deficiency tax assessments in the aggregate sum of P10,713,749.74 covering the fiscal year ended March 30, 1999:

	TYPE OF TAX	TOTAL TAX DUE (W/ INCREMENTS)
I.	INCOME TAX – UNREGISTERED ACTIVITY	P 2,168,639.65
II.	INCOME TAX - SPECIAL TAX RATE	657,278.39
III.	INCOME TAX – DISALLOWANCE	613,165.16
IV.	DOCUMENTARY STAMP TAX – LOAN AGREEMENTS, INSTRUMENT & PAPER	1,095,622.77
V.	FINAL WITHHOLDING TAX – ROYALTY EXPENSE	5,592,789.05
VI.	INCREMENTS - LATE PAYMENT OF EWT ON INTEREST	220,411.00
VII.	DOCUMENTARY STAMP TAX – LOAN & LEASE AGREEMENTS	61,399.01
VIII.	FRINGE BENEFITS TAX – RENTAL (HOUSING)	304,444.71
	TOTAL AMOUNT DUE	**P10,713,749.74**

THE COURT'S RULING

The Petition is partly meritorious.

There is no dispute that petitioner is duly registered with the PEZA as an Ecozone Export Enterprise entitled to the 5% preferential tax rate under *Section 24 of Republic Act No. 7916* (hereafter "*RA No. 7916*"),

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otherwise known as "The Special Economic Zone Act of 1995" [PEZA Law], which provides:

> "SEC. 24. *Exemption from Taxes Under the National Internal Revenue Code.* — Any provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu of paying taxes, five percent (5%) of the gross income earned by all businesses and enterprises within the ECOZONE shall be remitted to the national government. This five percent (5%) shall be shared and distributed as follows:
>
> (a) Three percent (3%) to the national government;
>
> (b) One percent (1%) to the local government units affected by the declaration of the ECOZONE in proportion to their population, land area, and equal sharing factors; and
>
> (c) One percent (1%) for the establishment of a development fund to be utilized for the development of municipalities outside and contiguous to each ECOZONE: Provided, however, That the respective share of the affected local government units shall be determined on the basis of the following formula:
>
> (1) Population — fifty percent (50%);
> (2) Land area — twenty-five percent (25%); and
> (3) Equal sharing — twenty-five percent (25%)."

On the other hand, Gross Income is defined in *Section 2(nn), Rule I* of the *Rules and Regulations to Implement RA No. 7916*, as follows:

> "'**Gross Income**' for purposes of computing the special tax due under Section 24 of the Act refers to gross sales or gross revenues derived from business activity within the ECOZONE, net of sales discounts, sales returns and allowances and minus costs of sales or direct costs but before any deduction is made for administrative expenses or incidental losses during a given taxable period. The allowable deductions from 'gross income' are specifically enumerated under Section 2, Rule XX of these Rules."

In this regard, *Section 2, Rule XX of the PEZA Rules* enumerates the specific deductions for ECOZONE Export Enterprises, as follows:

"**SEC. 2. Gross Income Earned; Allowable Deductions.** — For purposes of these Rules, Gross Income earned shall be as defined in Section 2(nn), Rule I of these Rules subject to the following allowable deductions for specific types of enterprises:

1. **ECOZONE Export Enterprises**, Free Trade Enterprises and Domestic Market Enterprises

- Direct salaries, wages or labor expenses
- Production supervision salaries
- Raw materials used in the manufacture of products
- Goods in process (intermediate goods)
- Finished goods
- Supplies and fuels used in production
- Depreciation of machinery and equipment used in production, and buildings owned or constructed by an ECOZONE Enterprise
- Rent and utility charges associated with building, equipment and warehouses, or handling of goods
- Financing charges associated with fixed assets."

In its income tax return for the fiscal year ended March 31, 1999 filed with the BIR on July 15, 1999 (*Exhibit "B"*), petitioner reported a gross income amount of P153,434,651.00 (*Exhibit "B-2"*) with the corresponding 5% tax in the amount of P7,671,733.00 (*Exhibit "B-3"*). However, the revenue examiners who conducted an investigation of petitioner's books of accounts and other accounting records had different perspective as to petitioner's income tax liability for the fiscal year 1999, thus, the assessments for the following deficiency income taxes:

I.	**INCOME TAX – UNREGISTERED ACTIVITY**	**P2,168,639.65**
II.	**INCOME TAX – SPECIAL TAX RATE**	**657,278.39**
III.	**INCOME TAX – DISALLOWANCE**	**613,165.16**

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Validity of the Subject Assessments

I. INCOME TAX – UNREGISTERED ACTIVITY

Respondent assessed petitioner of deficiency income tax on unregistered activity in the amount of P2,168,639.65, computed as follows:

Sale of Scrap		P4,069,919.36
Add:	Others	24,657.63
Total		P4,094,576.99
Less:	Others (expanded)	5,050.80
Taxable Income		P 4,089,526.19
Tax due rate		34%
Tax due		P 1,390,438.90
Add:	Interest (54.17%)(7/1*6106/99-3/31/02)	753,200.75
	Compromise	25,000.00
Total Amount Due		**P 2,168,639.65**

In imputing the amount of P2,168,639.65 against petitioner, respondent posits that the proceeds from petitioner's sale of scrap materials in the amount of P4,069,919.36 and income from other activities in the amount of P24,657.63 fall outside of petitioner's registered activity as a PEZA enterprise and should be subjected to the regular income tax rate of 34%, instead of the 5% preferential tax rate.

Petitioner, however, counters that the scrap materials sold came from the manufacture of its registered products, hence, the income therefrom is incidental to and necessarily connected with its registered activity and subject to the preferential tax rate of 5%. Likewise,

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petitioner contends that PEZA normally allows registered export enterprises to have local sales not in excess of 30% of their local sales. In this case, the proceeds from the sale of scrap materials represent less than 1% of petitioner's total sales of P1,209,831,364.00 for fiscal year ended March 31, 1999. Petitioner further claims that the cost of the raw materials, including the cost of the scrap materials sold, formed part of the cost of sales, which petitioner deducted from gross sales for purposes of computing the 5% preferential tax. Thus, it was proper to subject the proceeds from the sale of the scrap materials to the 5% preferential tax, to make it at par with the tax benefit derived by petitioner in claiming the said amount as part of the cost of sales. This practice is consistent with the "tax benefit rule" sanctioned under *RR No. 5-99.*

We find respondent's contention tenable.

"*Scrap*" is a term used to describe manufactured articles or parts rejected or discarded and useful only as material for reprocessing: especially waste and discarded metal (*Webster's New Collegiate Dictionary, 1977 edition*). In other words, these scrap materials are recoverable wastes, where the proceeds derived from the sale thereof shall be taxed in accordance with the applicable provisions of the *NIRC of 1997 referred to under Section 8, Rule VIII, Part V of the PEZA Rules*, to wit:

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"PART V

Tax Treatment of Merchandise in the ECOZONES

RULE VIII

Tax Treatment of Merchandise in the Restricted Areas of the ECOZONES

SEC. 8. *Rejects, Seconds and Recoverable Wastes.* — Subject to the provisions of Section 3 of this Rule, rejects, seconds and recoverable wastes shall, when taken from the restricted areas of the ECOZONES to the customs territory, or to the non-restricted areas of the ECOZONE, be taxed in accordance with the applicable provisions of the customs and internal revenue laws and regulations of the Philippines."

While it is true that the income accruing from petitioner's sale of scrap materials is incidental to petitioner's registered activity, it is specifically provided under the afore-quoted PEZA Rules that the same shall be taxed under the normal circumstances.

Clearly, the scrap sales amounting to P4,069,919.36 qualify as gross income subject to normal corporate income tax rate (34% effective January 1, 1998 and 33% effective January 1, 1999) under *Section 27,* in relation to *Sections 31 and 32 of the NIRC of 1997, as amended,* which provide, as follows:

"SEC. 27. *Rates of Income Tax on Domestic Corporations.* —

(A) *In General.* — Except as otherwise provided in this Code, an income tax of thirty-five

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> percent (35%) is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: Provided, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).

In the case of corporations adopting the fiscal-year accounting period, the taxable income shall be computed without regard to the specific date when specific sales, purchases and other transactions occur. Their income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the period.

The reduced corporate income tax rates shall be applied on the amount computed by multiplying the number of months covered by the new rates within the fiscal year by the taxable income of the corporation for the period, divided by twelve."

"SEC. 31. *Taxable Income Defined.* – The term "taxable income' means the pertinent items of gross income specified in this Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by this Code or other special laws."

"SEC. 32. *Gross Income.* —

(A) *General Definition.* — Except when otherwise provided in this Title, gross income means all income derived from whatever source, including (but not limited to) the following items:

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(2) Gross income derived from the conduct of trade or business or the exercise of a profession;

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As regards petitioner's other income in the amount of P24,657.63, the same shall also be taxed at the normal rate pursuant to the provisions of the NIRC of 1997 considering that it does not fall under petitioner's registered activity. As correctly pointed out by the respondent, the preferential tax rate of 5% applies only to petitioner's registered activity, as provided for under *Part VII, Rule XIII of the PEZA Rules*, thus:

"Part VII

Incentives to ECOZONE Enterprises

Application and Entitlement

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SEC. 5. *Limitation of Entitlement to Incentives.* – Incentives granted by the PEZA shall apply only to registered operations of the ECOZONE Enterprises and only during the period of its registration with PEZA."

Having resolved that petitioner's scrap sales and income from other activities are subject to normal corporate income tax, We now proceed to the issue of whether or not petitioner can claim deductions from said income, pursuant to *Section 34 of the NIRC of 1997*.

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Although under *Section 34 of the NIRC of 1997*, petitioner may validly claim as deductions any ordinary and necessary business expenses it paid or incurred in relation to its income from scrap sales and other activities, petitioner, however, failed to present documentary proof of the alleged deductible costs/expenses. Moreover, the costs related to the scrap materials sold already formed part of the cost of sales deducted by petitioner in computing its 5% income tax payment of P7,671,733.00.

In sum, this Court finds petitioner liable for deficiency income tax on unregistered activity in the amount of P1,812,636.48 , computed as follows:

Sale of Scrap			P 4,069,919.36
Add: Others			24,657.63
Total Gross Income			P 4,094,576.99
Less: Others (expanded)			5,050.80
Taxable Income			P 4,089,526.19
Income Tax Due			
April 1, 1998 - Dec. 31, 1998	P3,067,144.64	34%	P 1,042,829.18
Jan. 1, 1999 - Mar. 31, 1999	1,022,381.55	33%	337,385.91
	P4,089,526.19		
Total Income Tax Due			P 1,380,215.09
Less: 5% tax already paid			204,476.31
Deficiency basic tax due			P 1,175,738.78
Add: Interest (54.17%)(7/16/99-3/31/02)			636,897.70
TOTAL AMOUNT DUE			**P 1,812,636.48**

It bears stressing that the 5% tax already paid by petitioner on the subject income was deducted from the basic tax due.

Furthermore, the compromise penalty of P25,000.00 originally imposed by respondent was excluded, there being no compromise agreement between the parties.

II. INCOME TAX – SPECIAL RATE

In arriving at the deficiency income tax assessment (special rate) of P657,278.39, respondent treated the amount of P8,312,088.64 representing rework charges, Vishay Losses, and selling price adjustment as petitioner's income/adjustments from registered activities subject to the 5% preferential tax rate, thus:

Rework Charges		P 276,329.90
Vishay Losses		7,803,456.74
Selling Price Adjustment		232,302.00
Total		P8,312,088.4
Tax Rate		5%
Tax Due		P 415,604.00
Add:	Interest (54.17%) (7/10/99-3/31/02)	225,674.39
	Compromise	16,000.00
Total Amount Due		**P 657,278.39**

Petitioner, on the other hand, maintains that the aforementioned items were already included in the computation of petitioner's gross income earned for the fiscal year ending March 31, 1999, specifically as part of its other income. Consequently, the same had already been subjected to the 5% preferential tax rate.

Petitioner's contention is meritorious.

As shown in petitioner's income tax return for the fiscal year ended March 31, 1999 (*Exhibit "B"*) and schedule of income tax computation (*Exhibit "U"*), the Vishay losses account amounting to P7,803,456.74 (*Exhibit "U-4"*), rework charges amounting to P276,329.90 (*Exhibit "U-5"*), and selling price adjustment in the amount of P232,302.00 (*Exhibit "U-6"*) formed part of the total gross income of P153,434,650.79, upon which petitioner paid the corresponding 5% tax of P7,671,733.00 (*Exhibit "B-1"*). Considering that the deficiency income tax assessment of P657,278.39 is without factual and legal basis, this Court finds petitioner not liable thereto.

III. INCOME TAX - DISALLOWANCE

The deficiency income tax assessment in the amount of P613,165.16 resulted from respondent's disallowance of the inventory write-off in the amount of P5,530,136.33 and communication expenses in the amount of P2,216,698.08 which formed part of petitioner's claimed deduction for cost of sales, thus:

Inventory written-off	P5,530,136.33
Communication	2,216,698.08
Total	P7,746,834.41
Tax Rate	5%
Tax Due	P 387,342.00
Add: Interest (54.17%)(7/16/99-03/31/02)	209,823.16
Compromise	16,000.00
Total Amount Due	**P 613,165.16**

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The disallowance of the inventory write-off was based on the examiner's finding that the same was without prior BIR approval nor presence of a representative from the BIR.

Petitioner, on its part, contends that the subject inventories had actually been destroyed and written-off. The requirements of prior BIR approval and/or presence of a representative from the BIR are mere administrative requirements, which should not abrogate the substantive right of the taxpayer to claim the inventory write-off as a deduction. Otherwise, formalities will defeat the taxpayer's substantive rights.

The Court finds the disallowance proper.

Inventory write-offs refer to losses resulting from the destruction of inventory which cannot be sold even at reduced prices due to obsolescence or deterioration of the inventory (*BIR Ruling DA-476-03, December 10, 2003*). The fact that inventory write-offs are deductible from gross sales for purposes of computing the 5% tax on gross income earned is not disputed. The respondent's examiner disallowed petitioner's claimed inventories written-off in the amount of P5,530,136.33 for being unsubstantiated, there being no prior BIR approval nor the presence of a representative from the BIR. While a certification from the BIR of the actual destruction of the claimed obsolete inventories is not necessary in order that the cost thereof maybe written-off and claimed as deduction, petitioner should have presented competent documentary evidence to establish that the amount of P5,530,136.33 actually pertained to destroyed obsolete inventories. For failure of the petitioner to substantiate the inventory written-off amounting to P5,530,136.33, this Court sustains the disallowance of the same.

As to petitioner's claimed communication expenses in the amount of P2,216,698.08, respondent disallowed the same on the ground that it is not an allowed deduction under *RA No. 7916*.

Petitioner, however, contends that the said communication expenses were included in the cost of sales because they were incurred by petitioner as one of the necessary incidents of its manufacturing process. Petitioner further claims that PEZA registered enterprises are akin to enterprises registered with the Subic Special Economic and Freeport Zone ("SSEFZ") created under *RA No. 7227* which are also subject to the 5% preferential tax rate. SSEFZ enterprises are allowed to deduct communication expenses under *RR No. 16-99*. Petitioner further points out that under *Section 51 of the PEZA Law*, it is provided that:

> "SEC. 51. *Ipso Facto Clause*. – All privileges, benefits, advantages or exemptions granted to special economic zones under Republic Act No. 7227 shall *ipso facto* be accorded to special

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> economic zones already created or to be created under this Act. The free port status shall not be vested upon the new special economic zones."

According to petitioner, pursuant to the above provision, the privileges, benefits and advantages granted to and enjoyed by SSEFZ-registered enterprises are *ipso facto* accorded to their PEZA-registered counterparts. Since SSEFZ enterprises are allowed to claim communication expenses as a deduction under *RR No. 16-99*, PEZA registered enterprises, like herein petitioner, shall *ipso facto* enjoy the same privilege or benefit and may properly claim their communication expenses as a deduction.

Again, We find the disallowance to be valid.

Indeed, by virtue of the *ipso facto* clause under *Section 51 of RA 7916*, the privileges, benefits, advantages or exemptions granted to SSEFZ enterprises equally apply to PEZA entities. However, under *Section 57(a) of the Implementing Rules and Regulations of RA No. 7227, otherwise known as the "Bases Conversion and Development Act of 1992"*, communication expense is not listed as one of the allowable deductions for purposes of computing the 5% tax on gross income earned by SSEFZ enterprises.

While *RR No. 16-99* cited by petitioner included communication expense as one of the allowable deductions, the said regulations cannot be made applicable to the instant case because it was issued by the BIR on September 27, 1999 only. Moreover, *RR No. 02-05*, which later on repealed the provisions of *RR No. 16-99,* excluded communication expense as one of the allowable deductions.

This Court, therefore, finds the inventories written-off in the amount of P5,530,136.33 and communication expense in the amount of P2,216,698.08 totalling P7,746,834.41 as proper disallowances from petitioner's claimed deduction for cost of sales for the fiscal year 1999. Consequently, petitioner is liable to pay the deficiency tax corresponding to the said disallowances in the amount of P597,165.16, computed as follows:

Inventories written-off	P 5,530,136.33
Communication Expense	2,216,698.08
Total Disallowances	P 7,746,834.41
Tax Rate	5%
Tax Due	P 387,342.00
Add: Interest (54.17%)(7/16/99-03/31/02)	209,823.16
Total Amount Due	**P 597,165.16**

IV. DEFICIENCY DOCUMENTARY STAMP TAX – LOAN AGREEMENTS, INSTRUMENTS & PAPERS

Invoking *Section 180 of the NIRC of 1997*, respondent assessed petitioner of deficiency DST in the amount of P1,095,622.77 on two (2) loan agreements entered into by petitioner with its foreign licensor, Copal Company, Ltd. of Japan, in the amounts of US$7,400,000.00 and Y250,000,000.00 and on its loan agreement with Temic Telefunken, a non-resident German corporation, in the amount of US$480,000.00, as shown below:

Loan Agreements		
	Copal Co. Ltd.	US$ 7,400,000.00
	Conversion rate	38.819
	Total Php	Php287,260,600.00
Tax rate		0.0015
Tax due		Php 430,891.00
Add:	25% Surcharge	107,723.00
	Interest (62.51%)(2/16/99-3/31/02)	269,350.00
	Compromise – late payment	15,000.00
Total		Php 822,964.00
	Copal Co. Ltd.	JPY250,000,000.00
	Conversion rate	0.30
	Total Php	Php 75,000,000.00
Tax rate		0.0015
Tax due		Php 112,500.00
Add:	25% Surcharge	28,125.00
	Interest (47.52%)(11/9/99-3/31/02)	53,460.00
	Compromise – late payment	5,000.00
Total		Php 199,085.00
	Temic Telefunken	US$ 480,000.00
	Conversion rate	38.819
	Total Php	18,633,120.00
Tax rate		0.0015
Tax due		Php 27,949.00
Add:	25% Surcharge	6,987.00
	Interest (127.51%)(11/16/95-3/31/02)	35,637.77
	Compromise – late payment	3,000.00
Total		Php 73,573.77
Total Amount Due		**Php 1,095,622.77**

Petitioner submits that pursuant to *Section 24 of RA No. 7916*, as amended by *RA No. 8748*, it is only liable to the preferential tax rate of

5% on its gross income which shall be in lieu of local and national taxes. Since the 5% preferential tax rate is a commutation of all local and national taxes otherwise due from businesses and enterprises operating within the ecozone, petitioner is exempt from the payment of DST.

We agree with petitioner.

Section 24 of RA No. 7916 or the PEZA Law provides:

> "**SEC. 24. Exemption from Taxes Under the National Internal Revenue Code.** — Any provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu of paying taxes, five percent (5%) of the gross income earned by all businesses and enterprises within the ECOZONE shall be remitted to the national government. xxx."

Corollary thereto, *Section 1, Rule XX of the PEZA Rules* provides:

> "RULE XX
> Gross Income Taxation
>
> SECTION 1. Special Tax Rate. — Pursuant to Section 24 of the Act, ECOZONE Enterprises, except ECOZONE Service Enterprises, shall, in lieu of payment of national and local taxes, be liable to the payment of a five per cent (5%) final tax on gross income earned xxx."

Pursuant to the above provisions, PEZA registered enterprises, like herein petitioner, are only liable to pay 5% tax on gross income earned (GIE) on their registered activities, which is in lieu of payment of national and local taxes. The phrase "in lieu of payment of national and

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local taxes" means that petitioner, after paying a 5% final tax on GIE, is exempt from payment of local and national taxes which includes the DST imposed under *Section 180 of the NIRC of 1997*.

The "in lieu of all other taxes" proviso in the franchises of numerous grantees has been consistently upheld by no less than the Supreme Court. In the case of Philippine National Railways vs. Nolting *(34 Phil. 401)*, it was held that the "in lieu of" clause in PNR's franchise exempted it from the documentary stamp tax imposed on bills of lading issued by railway companies. PNR's franchise provided that the annual payment for which PNR is liable, when promptly and fully made, shall be in lieu of all taxes of every name and nature, municipal, provincial or central, upon its capital stock, franchise, right of way, earnings and all other property owned or operated by the grantee, under this concession or franchise. In upholding PNR's exemption from DST on bill of lading it had issued, the Supreme Court said:

> "The phrase 'all taxes of every name and nature' is a very inclusive statement, especially when it names, in connection therewith, the only government entities who have a right to collect taxes, it not only includes all payments which might be regarded as taxes, but it excludes everything which might by any possibility, be denominated taxes x x x"

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Likewise, in the case of Province of *Misamis Oriental vs. Cagayan Electric Power and Light Company, Inc. (181 SCRA 38)*, the Supreme Court upheld the validity and effectivity of the "in lieu of all taxes" provision found in therein petitioner's legislative franchise and held that the franchise was not amended by *P.D. 231* (*Local Tax Code*) which authorized provinces to impose franchise tax on businesses operating in the provinces.

V. DEFICIENCY FINAL WITHHOLDING TAX ON ROYALTY EXPENSE

Based on the examiner's findings that petitioner under-remitted final withholding taxes in the amounts of P3,017,033.00 and P19,767.32 (excluding surcharge and interest) on its royalty expenses of P17,550,137.00 and P79,069.31, respectively, respondent assessed petitioner of deficiency final withholding tax in the amount of P5,592,789.06, computed as follows:

Royalty Expense		P17,550,137.00
Tax rate		25%
Tax due		P 4,387,534.25
Less:	Payments	1,370,501.00
Deficiency Tax		P 3,017,033.00
Add:	25% Surcharge	754,258.00
	Interest (58.89%)(4/26/99-3/31/02)	1,776,730.73
	Compromise-late payment	25,000.00
Total		P 5,573,021.73
Adjustment		P 79,069.31

Rate	25%
Total	P 19,767.33
Total Amount Due	P 5,592,789.06

Petitioner, however, avers that except for the month of March 1999, respondent's right to assess deficiency FWT on royalty payments for the fiscal year 1999 had already prescribed, pursuant to *Section 203 of the NIRC of 1997.*

We agree with petitioner.

Section 203 of the NIRC of 1997, as amended, provides as follows:

> "**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-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."

In conjunction thereto, *Section 2.58(A)(2) of RR No. 2-98, implementing Section 57(A) of the NIRC of 1997*, provides:

> *"Sec. 2.58 RETURNS AND PAYMENT OF TAXES WITHHELD AT SOURCE.*
>
> (A) *Monthly return and payment of taxes withheld at source –*

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> xxx xxx
>
> *(2) WHEN TO FILE –*
>
> (a) The withholding tax return, whether creditable or final, shall be filed and payments should be made within ten (10) days after the end of each month except for taxes withheld for December which shall be filed on or before January 25 of the following year."

Pursuant to the aforecited *Section 203 of the NIRC of 1997*, the three-year period to assess commences from the date of actual filing of the return or from the last date prescribed by law for the filing of such return, whichever comes later. In the case of final withholding taxes, the return is required to be filed within ten (10) days after the end of each month for final taxes withheld during the months of January until November, while the return for final taxes withheld for the month of December shall be filed on or before January 25 of the following year. 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 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. Therefore, respondent had until the following dates

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within which to assess petitioner for the subject deficiency final withholding tax for fiscal year ending March 31, 1999, to wit:

Exh	Period Covered	Amount of Royalty Payment	Final Tax Paid	Date of Filing of Return	Last day to file return	Last day to assess
E	April , 1998	P 1,047,750.00	P 104,775.00	8-May-98	11-May-98 *	10-May-01 **
F	May , 1998	986,043.00	98,640.30	10-Jun-98	10-Jun-98	11-Jun-01
G	June , 1998	871,311.00	87,131.10	10-Jul-98	10-July-98	9-Jul-01
H	July , 1998	1,104,750.00	110,475.00	10-Aug-98	10-Aug-98	9-Aug-01
I	Aug , 1998	1,235,549.00	123,554.90	10-Sep-98	10-Sep-98	10-Sep-01
J	Sept, 1998	1,159,655.40	115,965.54	9-Oct-98	12-Oct-98 *	11-Oct-01
K	Oct, 1998	1,349,135.50	134,913.55	10-Nov-98	10-Nov-98	9-Nov-01
L	Nov, 1998	1,808,989.00	180,898.90	10-Dec-98	10-Dec-98	10-Dec-01
M	Dec, 1998	1,131,338.00	113,133.80	25-Feb-99	10-Jan-99	25-Feb-02
M	Jan, 1999	1,085,708.00	108,570.80	25-Feb-99	10-Feb-99	25-Feb-02
N	Feb, 1999	946,159.00	94,615.90	25-Mar-99	10-Mar-99	25-Mar-02
O	Mar , 1999	981,134.00	98,113.40	26-Apr-99	12-Apr-99 *	25-Apr-02
	Total	P13,707,521.90	P1,370,788.19			

* May 10, 1998 fell on a Sunday, while October 10, 1998 & April 10, 1999 fell on a Saturday
** Year 2000 was a leap year

Clearly, the formal letter of demand and assessment notice issued on April 19, 2002 is beyond the three-year prescriptive period within which respondent could make an assessment for deficiency final withholding tax for the months of April 1998 to February 1999.

Nonetheless, respondent's right to assess petitioner for deficiency final withholding tax for the month of March, 1999 has not yet prescribed,considering that the issuance of the assessment notice on April 19, 2002 was made before the three-year period expired on April 25, 2002.

Having resolved that only the assessment for deficiency final withholding tax on royalty expense for the month of March 1999 was

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issued within the period allowed by law, We now proceed to the issue of whether or not petitioner is liable for any deficiency final withholding tax for said month.

A comparison of the royalty payments of P13,707,521.90 upon which the final withholding tax remittances in the amount of P1,370,788.19 was based and the royalty expenses claimed by petitioner for the fiscal year 1997 in the amounts of P17,550,137.00 and P79,069.31 totalling P17,629,206.31 reveals a discrepancy of P3,921,684.41. Since petitioner did not present any document to prove that the difference of P3,921,684.41 represents royalty payments for any of the months of April 1998 to February 1999, the same shall be considered as payment for the month of March 1999. Petitioner is therefore liable for the corresponding deficiency final withholding tax in the amount of P5,577,995.30, computed as follows:

Total Royalty Expense for the year		P17,629,206.31
Multiplied by FWT Rate		25%
Final Withholding Tax Due for the year		P 4,407,301.58
Less:	Payments made	1,370,501.00
Deficiency Basic Final Withholding Tax		P 3,036,800.58
Add:	Surcharge (25%)	759,200.14
	Interest (58.68%) (4/26/99-3/31/02)	1,781,994.58
Total Amount Due		**P 5,577,995.30**

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Considering that there was no compromise agreement between the parties, the compromise penalty of P25,000.00 imposed by respondent is hereby cancelled.

However, with regard to the imposition of the 25% surcharge in addition to the basic tax due, the Court finds the same to be in accordance with *Section 248(A) of the NIRC of 1997*, which provides:

> "SEC. 248. *Civil Penalties.* –
>
> (A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:
>
> (1) Failure to file any return and pay the tax due thereon as required under the provisions of this Code or rules and regulations on the date prescribed; or
>
> (2) Unless otherwise authorized by the Commissioner, filing a return with an internal revenue officer other than those with whom the return is required to be filed; or
>
> (3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or
>
> (4) Failure to pay the full or part of the amount of tax shown on any return required to be filed under the provisions of this Code or rules and regulations, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment."

The law is very clear. The imposition of surcharge is mandatory. This is justified because the intention of the law is precisely to discourage

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delay in the payment of taxes due to the State. The delay in the payment of the deficiency tax within the time prescribed for its payment in the notice of assessment justifies the imposition of a 25% surcharge, pursuant to *Section 248(A)(3) of the Tax Code* (*Felisa L. Vda. de San Agustin vs. CIR, 364 SCRA 810*). Even the alleged good faith of the taxpayer in failing to pay the tax upon advice of counsel is not sufficient justification for seeking exemption from the payment of surcharges (*Commissioner of Internal Revenue vs. Royal Interocean Lines, 34 SCRA 21*).

It is basic that "surcharge" is an overcharge or exaction imposed by law as an addition to the main tax required to be paid. It is not really a penalty as used in criminal law but a civil administrative sanction provided primarily as a safeguard for the protection of the State revenue and to reimburse the government for the expenses in investigating and the loss resulting from the taxpayer's fraud. In other words, the imposition of a surcharge is not penal but compensatory in nature — they are compensation to the State for the delay in the payment, or for the concomitant use of the funds by the taxpayer beyond the date he is supposed to have paid them to the State (*Republic of the Phils. vs. Phil. Bank of Commerce, 34 SCRA 369*).

VI. INCREMENTS FOR LATE PAYMENT OF FINAL WITHHOLDING TAX

Respondent assessed petitioner of deficiency increments, i.e., surcharge, interest and compromise penalty in the amount of P220,411.00 for late payment of final withholding tax related to the accrued interest on petitioner's foreign loan from Copal-Japan, computed as follows:

Accrued Interest – COPAL	P 2,106,789.20
Tax rate	0.15
Tax due	P 316,018.38
25% Surcharge	P 79,004.00
Interest (32%)	126,407.00
Compromise – late payment	15,000.00
Total Amount Due	**P 220,411.00**

On the other hand, petitioner maintains that the assessment is erroneous because it remitted the final withholding tax due on its interest payments within the prescribed period. It contends that based on its loan agreement with COPAL, the interest payments are payable on a quarterly basis and that the first interest payment accrued and became payable only at the end of June 1999. Hence, petitioner filed the return and paid the corresponding final withholding tax due on the first accrued interest payments on time when it filed said return and paid the tax on June 29, 1999.

We rule for the petitioner.

Sections 2.57.4 and 2.58(B)(3)(a) of RR No. 2-98 provide as follows:

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

"*Sec. 2.58 RETURNS AND PAYMENT OF TAXES WITHHELD AT SOURCE.*

(B) *Monthly return and payment of taxes withheld at source –*

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(2) WHEN TO FILE –

(a) The withholding tax return, whether creditable or final, shall be filed and payments should be made within ten (10) days after the end of each month except for taxes withheld for December which shall be filed on or before January 25 of the following year."

From the aforequoted regulations, it is clear that the withholding tax return shall be filed and the final tax remitted within ten (10) days following the month an income is paid or becomes payable. The term "payable" refers to the date the obligation becomes due, demandable or legally enforceable.

In the case at bench, the interest payments subject of the assessment, were payable on a quarterly basis and the first interest payment covering the period February 16, 1999 to May 31, 1999 became

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payable only at the end of June 1999, as provided in petitioner's loan agreement with COPAL, to wit:

> "6. **INTEREST PAYMENT DATE AND METHOD OF PAYMENT:**
>
> The first interest payment shall be made at the end of June 1999 excluding OFF-SHORE TAX, covering from February 16, 1999 to May 31, 1999. The succeeding interest period covering the next three months shall be made at the end of the month after the past three months. Payment of interest shall be made together with the quarterly principal amortization."

Petitioner timely remitted the final withholding tax due covering the first interest payment and filed the corresponding Monthly Remittance Return of Income Taxes Withheld on June 29, 1999 (*Exhibit "V"*). While petitioner may have recorded in its books of accounts the accrued interest for the period February 16, 1999 to March 31, 1999 before the same became due and demandable, petitioner was not obligated to withhold and remit the final withholding tax at the time of the accruals since petitioner did not claim the interest expense as deduction for income tax purposes.

Accordingly, the Court finds and so holds that the assessment for deficiency increments for late payment of final withholding tax in the amount of P220,411.00 is without factual and legal basis, and should therefore be cancelled and withdrawn.

VII. DEFICIENCY DOCUMENTARY STAMP TAX – LOAN AND LEASE AGREEMENTS

Based on the examiner's findings, petitioner has a Lease Contract in the amount of P2,390,160.00 and a Loan Agreement in the amount of P14,442,278.40 with its affiliate El Nuevo Diezmo Realty, Inc., both of which are subject to DST under *Sections 194 and 180 of the NIRC of 1997*, respectively. These agreements, therefore, have given rise to a deficiency DST liability in the amount of P61,399.01, computed as follows:

Lease – El Nuevo Diezmo Realty (1998)		P 2,390,160.00
Basic Tax Due		P 2,392.00
Add:	Surcharge	598.00
	Interest (291.67%) (7/01/89-3/31/02)	6,996.84
	Compromise – late payment	1,000.00
Total		P 10,986.84
Loan Agreement – El Nuevo Diezmo Realty		P 14,442,278.40
Basic Tax Due		P 21,663.42
Add:	Surcharge	5,415.85
	Interest (80.01%) (4/01/98-3/31/02)	17,332.90
	Compromise – late payment	6,000.00
Total		P 50,412.17
Total Amount Due		**P 61,399.01**

Petitioner, however, submits that it is not subject to DST by virtue of its payment of the 5% final tax on Gross Income Earned (GIE), which is in lieu of all national and local taxes. Petitioner further argues that while under *Section 173 of the NIRC of 1997*, the "other party" to the

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transaction (in this case, El Nuevo Diezmo Realty, Inc.), who is not exempt from DST, shall be held directly liable for the DST, petitioner being the party exempt from DST, was not under obligation to collect the DST and remit the same to the BIR. Even under *RR No. 9-2000*, dated August 31, 2000, which governs the mode of payment and/or remittance of documentary stamp tax, petitioner does not fall under the category of the various enterprises or entities constituted as DST collecting agents. Petitioner maintains that granting for the sake of argument that it would fall under the category of "collecting agents", the said regulations do not apply to the particular borrowing transaction which occurred at the time that the regulations have not yet been issued.

There is merit in petitioner's contention.

As We have earlier ruled, petitioner, being a PEZA registered entity, is only liable to pay 5% tax on Gross Income Earned (GIE) on its registered activities which is in lieu of payment of national and local taxes. The phrase " in lieu of payment of national and local taxes" means that petitioner, after paying a 5% final tax on GIE, is exempt from payment of local and national taxes which includes the documentary stamp tax imposed under *Sections 194 and 180 of the NIRC of 1997*.

VIII. FRINGE BENEFITS TAX – RENTAL (HOUSING)

Petitioner claims that except for the fourth quarter, respondent's right to assess deficiency fringe benefits tax (FBT) for the fiscal year ending March 31, 1999 is already barred by prescription.

Petitioner's contention is meritorious.

Pursuant to *Section 2.33(A) of RR No. 3-98* implementing *Section 33*, in relation to *Sections 57(A) and 58(A) of the NIRC of 1997*, the return for final withholding tax on fringe benefits shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter. Pursuant to said regulations and *Section 203 of the NIRC of 1997*, respondent had until the following dates within which to assess petitioner for deficiency FBT for the four quarters of fiscal year ending March 31, 1999, to wit:

Exh	Taxable Quarter	Date of filing of return	Last day to File return	Last day to Assess
P	April 1 to June 30, 1998	27-Jul-98	27-Jul-98	27-Jul-01
Q	July 1 to Sept 30, 1998	9-Oct-98	26-Oct-98	25-Oct-01
R	Oct 1 to Dec 31, 1998	25-Jan-99	25-Jan-99	24-Jan-02
S	Jan 1, 1999 to March31,1999	26-Apr-99	26-Apr-99	25-Apr-02

Considering that the assessment notice was issued on April 19, 2002, respondent's right to assess petitioner of deficiency FBT for the fiscal year ending March 31, 1999 had already prescribed, except for the fourth quarter.

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Proceeding to the issue of whether or not petitioner is liable to pay for deficiency FBT for the fourth quarter of fiscal year ending March 31, 1999, a perusal of the Details of Discrepancies attached to the Formal Letter of Demand shows that the 1999 assessment for deficiency FBT in the amount of P304,444.71 resulted from the following findings of the revenue examiner:

> "8. FRINGE BENEFITS TAX (Rental-Housing)
>
> Verification disclosed that there are several Real properties rented for employees not belonging to the rank and file (see attached audit sheet) Section 33(A) of the CTRP states that a final tax of thirty-three (33%) percent effective January 1, 1999 is imposed on the grossed-up monetary value of fringe benefit furnished or granted to the employee by the employer. Furthermore, Section 2.33(B)1a of Revenue Regulation #3-98 states that if the employer leases a residential property for the use of his employee, as is in the instant case, as the usual residence of the employee, the value of the benefit shall be the amount of rental paid thereon by the employer. The monetary value of the fringe benefit shall be (50%) of the value of the benefit."

Based on the above findings, the examiner computed the alleged deficiency FBT for fiscal year 1999 in the amount of P304,444.71, as follows:

28 B.Garcia Village St.	P 798,741.65
240 Calatagan St., Ayala-Alabang Village	730,075.45
69A San Gregorio St., Magallanes Village	713,097.00
Total Rental Expense	P 2,241,914.10
Less: 50% Privilege	1,120,957.05
Rental Expense subject to FBT	P 1,120,957.05
Divided by FBT divisor	67%

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Gross-up Monetary Value		P 1,673,070.20
FBT Rate		33%
FBT Due		P 552,113.15
Less:	FBT Payments	395,255.99
FBT Balance		P 156,857.20
Add:	25% Surcharge	39,214.30
	Interest (58.89%) (4/26/99-3/31/02)	92,373.21
	Compromise Penalty	16,000.00
Total Amount Due		**P 304,444.71**

As shown in the examiner's computations, petitioner rented the following residential properties for the fiscal year 1999 for a total amount of P2,241,914.10:

28 B.Garcia Village St.	P 798,741.65
240 Calatagan St., Ayala-Alabang Village	730,075.45
69A San Gregorio St., Magallanes Village	713,097.00
Total Rental Expense	P 2,241,914.10

The fact that the rental payments for the residential properties located at 28 B. Garcia Village St. and 240 Calatagan St., Ayala-Alabang Village qualify as fringe benefits subject to FBT under *Section 33 of the NIRC of 1997* is uncontroverted. What is being objected to by petitioner is that the rental payments for the residential property located at 69A San Gregorio St., Magallanes Village, cannot be considered as fringe benefits subject to FBT under *Section 2.33(B) of RR No. 3-98* because the transient employees who stayed therein were subsequently charged the corresponding dormitory fees, as shown by the sample journal voucher

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and statement of account for the month of June 1998, marked as *Exhibits "W", "W-1", "X" and "X-1"*.

Petitioner's contention cannot be sustained.

The sample journal voucher and statement of account referred to by petitioner do not at all prove that the rental payments were subsequently charged to and paid by petitioner's employees. Petitioner should have presented competent documentary evidence to prove actual receipt of rental payments from the employees. For failure to refute the examiner's findings, petitioner is liable to pay deficiency FBT for the fourth quarter of fiscal year ending March 31, 1999 in the amount of P73,078.00, computed as follows:

28 B. Garcia Village St.		P 204,750.00
240 Calatagan St., Ayala Alabang Village		189,000.00
69A San Gregorio St., Magallanes Village		178,274.25
Total Rental - fourth quarter of FY 1999		P 572,024.25
Less:	50% Privilege	286,012.13
Rental Expense subject FBT		P 286,012.13
Divided by FBT divisor		67%
Gross-up Monetary Value		P 426,883.77
FBT Rate		33%
FBT Due		P 140,871.64
Less:	Payment	101,131.58
FBT Balance		P 39,740.06
Add:	25% Surcharge	9,935.02
	Interest (58.89%) (4/26/99-3/31/02)	23,402.92
Total Amount Due		**P 73,078.00**

WHEREFORE, in view of all the foregoing, the Petition for Review is hereby **PARTIALLY GRANTED**. The following deficiency

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tax assessments in the total amount of P2,034,711.17 are hereby **CANCELLED** and **WITHDRAWN** for lack of merit:

INCOME TAX - SPECIAL TAX RATE	P 657,278.39
DOCUMENTARY STAMP TAX – LOAN AGREEMENTS, INSTRUMENT & PAPER	1,095,622.77
INCREMENTS - LATE PAYMENT OF EWT ON INTEREST	220,411.00
DOCUMENTARY STAMP TAX – LOAN & LEASE AGREEMENTS	61,399.01
TOTAL	**P2,034,711.17**

However, petitioner is hereby **ORDERED TO PAY** to respondent the following deficiency tax assessments for fiscal year 1999 in the total amount of **P8,060,874.94**, broken down as follows :

TYPE OF TAX	**TOTAL TAX DUE (W/ INCREMENTS)**
INCOME TAX - UNREGISTERED ACTIVITY	P 1,812,636.48
INCOME TAX – DISALLOWANCE	597,165.16
FINAL WITHHOLDING TAX - ROYALTY EXPENSE	5,577,995.30
FRINGE BENEFITS TAX – HOUSING	73,078.00
TOTAL AMOUNT OF DUE	**P 8,060,874.94**

In addition, petitioner is **ORDERED TO PAY** to respondent 20% delinquency interest on P8,060,874.94 computed from May 20, 2002 until fully paid, pursuant to *Section 249(C)(3) of the NIRC of 1997, as amended.*

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

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WE CONCUR:

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

ERLINDA P. UY
Associate Justice

ATTESTATION

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

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairman, Second Division

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice

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