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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PAPER INDUSTRIES CORPORATION
OF THE PHILIPPINES,
Petitioner,

- versus -

C.T.A. CASE NO. 3843

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

5/15/89

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D E C I S I O N

Petitioner, Paper Industries Corporation of the Philippines (PICOP for short), is a domestic corporation duly registered with the Board of Investment as a preferred pioneer enterprise for the production/manufacture of integrated pulp and paper mill *(Exhs. A, A-1, & A-2)*. On April 21, 1983, PICOP received from the respondent, Commissioner of Internal Revenue, two demand letters both dated March 31, 1983, one for deficiency transaction tax and documentary/science stamp tax and the other for deficiency income tax for the year 1977, computed as follows: *(Exhs. F and G, pp. 23-24 and 171-172, BIR rec.)*

Transaction Tax

Interest payments on money market borrowings..		P45,771,849.00	
35% Transaction tax due thereon		16,020,147.00	
Add: 25% surcharge		4,005,036.75	
T o t a l		P20,025,183.75	
Add: 14% int. fr. 1-20-78 to 7-31-80 ..	P 7,093,302.57		
20% int. fr. 8-1-80 to 3-31-83 ..	10,675,523.58	17,768,826.15	P37,794,009.90

Documentary & Science Stamps Tax

Total face value of debentures	P100,000,000.00	
Documentary Stamps Tax Due (P0.30 x P100,000,000 / P200)..	P 150,000.00	
Science Stamps Tax Due (P0.30 x P100,000,000 / P200 ...	150,000.00	
Total	P 300,000.00	
Add: Compromise for non-affixture	300.00	300,300.00
TOTAL AMOUNT DUE AND COLLECTIBLE		P38,094,309.90

Deficiency Income Tax for 1977

Net income per return		P 258,166.00
Add: Unallowable deductions		
1) Disallowed deductions availed of under R.A. 5186	P44,332,980.00	
2) Capitalized interest expenses on funds used for acquisition of machinery & other equipment	42,840,131.00	
3) Unexplained financial guarantee expense ...	1,237,421.00	
4) Understatement of sales	2,391,644.00	

5) Overstatement of cost of sales	604,018.00	91,406,194.00
Net income per investigation		P91,664,360.00
Income tax due thereon		34,734,559.00
Less: Tax already assessed per return ...		80,358.00
Deficiency		P34,654,201.00
Add: 14% int. fr. 4-15-78 to 7-31-81	P11,128,503.56	
20% int. fr. 8-1-80 to 4-15-81	4,886,242.34	16,014,745.90
TOTAL AMOUNT DUE AND COLLECTIBLE		P50,668,946.90

Petitioner protested, on April 26, 1983, the 35% transaction tax and the documentary & science stamp tax assessments *(Exh. F-1)*, and on May 12, 1983, the deficiency income tax assessment *(Exh. G-1)*. However, these protests were not formally acted upon by the respondent. On September 26, 1984, respondent issued warrants of distraint of personal property and levy on real property, in effect, denying petitioner's protest *(Exhs. H and H-1, pp. 206 and 208, BIR rec.)*.

I S S U E S

1. Whether or not petitioner is liable to pay the 35% deficiency transaction tax pursuant to Presidential Decree No. 1154 including surcharge and interest;

2. Whether or not it is liable to pay the deficiency documentary/science stamp tax plus compromise, and;

3. Whether or not it is liable to pa the deficiency income tax plus interest for the year 1977. As a corollary question, Whether or not the disallowance of the following deductions were proper, to wit:

a. disallowed deductions availed of under R.A. No. 5186 amounting to P44,332,980.00;

b. capitalized interest expenses on funds used for the acquisition of machinery and other equipment amounting to P42,840,131.00;

c. unexplained financial guarantee expense of P1,237,421.00;

d. understatement of sales and overstatement of cost of sales amounting to P2,391,644.00 and P604,018.00, respectively.

4. Whether or not it is liable to pay the 5% development tax.

35% TRANSACTION TAX

The facts surrounding the imposition of the 35% transaction tax are as follows:

On June 3, 1977, the President of the Philippines signed Presidential Decree No. 1154 which imposes a final tax of 35% on interests derived from every commercial paper issued in the primary market to be paid by the borrower/issuer. This decree was published on June 16, 1977 in a newspaper of general circulation.

Sometime in 1977, PICOP offered to the public P100,000,000.00 worth of debenture bonds with Bancom Development Corporation as the managing underwriter of said bonds. The documentary and science stamp tax due thereon was not paid by petitioner.

On October 6, 1977, the BIR ruled that the issuance of P100,000,000.00 debenture bonds by petitioner do not come within the purview of "commercial papers" subject to the 35% transaction tax prescribed in P.D. No. 1154, as implemented by Revenue Regulation No. 7-77. Provided, the following statement appears, in bold letter, in the bond itself: "ISSUER NOT SUBJECT TO TRANSACTION TAX UNDER P.D. 1154. BONDHOLDER SHOULD DECLARE INTEREST EARNING FOR INCOME TAX". *(Exh. D-1-d, pp. 7-8, CTA rec.)*

Based on the foregoing, it appears that the P100,000,000.00 debenture bonds floated in the market are exempt from the 35% transaction tax.

On December 23, 1977, the Securities and Exchange Commission granted PICOP Certificate of Renewal No. R-112(75-2) authorizing petitioner to issue commercial papers worth P229,864,000.00 at any one time for a period of one year from December 24, 1977 to December 23, 1978. Thereafter, petitioner issued pre-serially numbered promissory notes to various banks and financial institutions.

Interest payments made by petitioner, on the issued promissory notes, where the alleged 35% transaction tax was not paid, totals as follows: *(See Schedule of Money Market Borrowings and Interest Payments, Worksheet of BIR examiners, p. 37, BIR rec.)*

1.	Bancom Development Corp.	P15,648,590.00
2.	Ayala Investment & Dev. Corp.	9,436,764.00
3.	State Investment House	4,103,389.00
4.	Bank of the Phil. Island	3,536,027.00
5.	Commercial Bank & Trust Co.	3,683,118.00
6.	Citicorp Investment of the Phils.	2,786,799.00
7.	Phil. Investment System Org.	1,752,782.00
8.	China Banking Corp.	1,753,217.00
9.	Phil. Pacific Capital Corp.	1,518,570.00
10.	A.E.A. Development Corp.	984,754.00
11.	City Trust	383,333.00
12.	State Financing Center	184,506.00
	Total Interest Payments	P45,771,849.00

The respondent contends that petitioner should have reported such interest payments in a return (BIR Form 25.26A), stating the total interest and taxes paid during the year, as required under

Sections 7 and 8 of Revenue Regulation No. 7-77 (June 3, 1977) implementing P.D. No. 1154.

Petitioner, on the other hand, questions the legality of P.D. No. 1154, which imposes the 35% transaction tax, on the ground that said decree was never published in the Official Gazette. Article 2 of the Civil Code provides for the publication of laws in the Official Gazette, and not elsewhere, as a requirement for their effectivity after fifteen days from such publication or after a different period provided by the legislature. Petitioner cited the case of ***Tanada vs. Tuvera, 146 SCRA 446*** *(December 29, 1986)*, where the Supreme Court held that all statutes, including those of local application and private laws, shall be published as a condition for their effectivity which shall begin fifteen days after publication unless a different effectivity date is fixed by the legislature. Covered by this rule are presidential decrees and executive orders promulgated by the President in the exercise of legislative powers. (Ibid)

Contrary to the allegations of petitioner that P.D. No. 1154 was published only in a newspaper of general circulation on June 16, 1977, and not in the Official Gazette, this Court finds the allegations to be mere conjectures, for in truth and in fact P.D. No. 1154 was actually published in the Supplement to the Official Gazette on September 5, 1977 in Vol. 73 No. 36, pages 8350-1 to 8350-3. The requirement of publication for the validity of the decree has, therefore, been met.

However, with respect to the validity of the penalty imposed in Revenue Regulation No. 7-77, implementing P.D. No. 1154, three conditions must concur in order that rules and regulations promulgated by administrative agencies shall have the force of penal law, to wit:

(1) The delegating statute itself must specifically authorize the promulgation of penal regulations, ***[U.S. vs. Grimmand, 220 U.S. 506 (1911)]***;

(2) The penalty must not be left to the administrative agency but must be provided by the statute itself, ***[U.S. vs. Barrias, 11 Phil. 327 (1908)]***; and,

(3) The regulation must be published in the Official Gazette ***[People vs. Que Po Lay, 94 Phil. 640]***.

In the case at bar, only the third requirement was present. Revenue Regulation No. 7-77 (June 3,

1977) was published in the Official Gazette on July 4, 1977 in Vol. 73 No. 27, pages 6176 to 6178 and on July 11, 1977 in Vol. 73 No. 28, pages 6458 to 6460. No penalty was prescribed in P.D. No. 1154 neither did the statute authorize the promulgation of penal regulation. Therefore, the provision of Sec. 10 of Revenue Regulation No. 7-77 imposing the 25% surcharge and 14% interest for late payment cannot have the force of a penal law.

In summary, only the basic 35% transaction tax shall be imposed on the following interest expenses paid and accrued for the year 1977, to wit:

1. Bancom Development Corp.	P15,648,590.00
2. Ayala Investment & Dev. Corp.	9,436,764.00
3. State Investment House	4,103,389.00
4. Bank of the Phil. Island	3,536,027.00
5. Commercial Bank & Trust Co.	3,683,118.00
6. Citicorp Investment of the Phils.	2,786,799.00
7. Phil. Investment System Org.	1,752,782.00
8. China Banking Corp.	1,753,217.00
9. Phil. Pacific Capital Corp.	1,518,570.00
10. A.E.A. Development Corp.	984,657.00*
11. City Trust	383,333.00
12. State Financing Center	184,506.00
Total Interest Payments	P45,771.752.00
35% Transaction Tax	x 35%
Transaction Tax Due	P16,020,113.20

*[Note: The correct amount of interest expense paid to A.E.A. Dev. Corp. is P984,657.00 *(See p. 98, BIR rec.)* and not P984,754.00 as appearing in the BIR examiner's worksheet.]

DOCUMENTARY/SCIENCE STAMP TAX

For failure to affix the necessary documentary and science stamp tax on the P100,000,000.00 worth of debenture bonds issued in 1977, the BIR assessed petitioner deficiency documentary and science stamp tax amounting to P300,000.00 plus compromise penalty of P300.00 or a total of P300,300.00.

Petitioner, being a registered pioneer enterprise, claims exemption from the payment of a stamp taxes on the issued P100,000,000.00 debenture bonds under Sec. 8(a) of Republic Act No. 5186 (as amended by P.D. No. 1789 otherwise known as the Omnibus Investment Code), and as far as pertinent, is hereby quoted as follows:

> "Sec. 8. Incentives to a Pioneer Enterprise. - In addition to the incentives provided in the preceding section, pioneer enterprises shall be granted the following incentives benefits:
>
> (a) Tax exemption. - Exemption from all taxes under the National Internal Revenue Code, except income tax, from the date the area of investment is included in the Investment Priorities Plan, to the following extent:
>
> "(1) One hundred per cent (100%) for the first five years;
> (2) Seventy-five per cent (75%) for the sixth through the eight years;
> (3) Fifty per cent (50%) for the ninth and tenth years;
> (4) Twenty per cent (20%) for the eleventh and twelfth years; and

(5) Ten per cent (10%) for the thirteenth through the fifteenth years.

xxx xxx xxx."

Respondent avers that the exemptions granted in Sec. 8(a) R.A. No. 5186 applies only to the extent in which it is engaged in registered operations, i.e. with regard to its integrated pulp and paper project only. *(Exh. A-3). [Section 1, Rule IX of the Basic Rules and Regulations to Implement the Intent and Opinions of the Investments Incentives Act (R.A. 5186)].* The borrowing of funds from the public is not one of those included in its registered operations.

We agree with respondent. For while it is true, pursuant to Sec. 8(a) of R.A. No. 5186, as incorporated in Art. 46(a) Chapter II of Title IV of P.D. No. 1789, otherwise known as the Omnibus Investment Code, a corporation registered with the BOI is exempt from all internal revenue taxes except income tax on a graduated basis. However, the above exemption privilege which includes exemption from documentary stamp tax, shall cover only the direct tax liabilities of the corporation as may be imposed in connection with the operation of the registered pioneer project and shall exclude such taxes as may be transferred or passed on to it either by business practice or mere contractual arrangement. *(Sec. 6, Rule IV, Rules and Regs. implementing P.D. 1789).* Surely, the issuance of convertible debenture bonds is not synonymous to the manufacture of an integrated pulp and paper mill.

/ An examination of the debenture bond certificate issued by petitioner shows that a space was provided at the bottom margin, where the amount of documentary and science stamps taxes are to be written, the same to be affixed on the stub of every debenture bond certificate issued. *(Exh. D).* The liability of an instrument to stamp tax, and the amount of the tax, are determined by the form and face thereof and cannot be affected by proof of facts outside of the instrument itself. ***(U.S. vs. Isham, 17 Wall, D96, 84 U.S. 496).*** The provision for documentary and science stamp tax in the certificate itself is equivalent to notice if not an admission that petitioner is liable to pay the documentary and science stamp tax for the issuance of the debenture bonds.

As regards the P300.00 penalty, Section 251 of the National Internal Revenue Code provides for a fine of not less than twenty pesos nor more than three hundred pesos against any person who fails to affix the correct amount of documentary stamps to any taxable document, instrument or paper. Thus, the imposition of P300.00 penalty is proper.

INCOME TAX ASSESSMENT:

a. Disallowed deductions availed of under R.A. No. 5186 amounting to P44,332,980.00

On January 18, 1977, a merger agreement was entered into between PICOP, as the surviving corporation, and Rustan Pulp and Paper Mills, Inc. (RPPMI) and Rustan Manufacturing Corporation (RMC), as the absorbed corporations. The merger agreement provided for the transfer, assignment and conveyance of all the rights, privileges, powers and franchises as well as all the properties, real, personal and mixed, of the absorbed corporations in favor of PICOP.

On June 7, 1977, PICOP transferred its 2,891,476 fully paid common shares and 148,848 preferred shares in exchange for the outstanding shares of RPPMI and RMC. PICOP also assumed the obligations of RPPMI in favor of the Development Bank of the Philippines (DBP) amounting to

P68,240,340.00 by issuing 6,824,034 preferred shares in its favor.

Later, in August of the same year, all the outstanding shares of stock in RMC were sold by PICOP to San Miguel Corporation for P38,900,000.00 with a gain of P9,249,849.00.

On November 30, 1977 RPPMI was dissolved but the final approval of the merger agreement by the BOI came only on January 12, 1978. *(Notes to Financial Statements, December 31, 1978 and 1977, p. 84, BIR rec.)*.

PICOP by virtue of the letter ruling of the BOI dated February 21, 1977 *(Exh. J-1)* deducted in 1977 the previous losses of RPPMI as well as the balance of its 1975 net operating loss carry-over amounting to P44,196,106.00 and P136,874.00 respectively, or a total of P44,332,980.00 pursuant to Sec. 7(c) of R.A. No. 5186. *(Exh. E, p,. 84, BIR rec.)*. The pertinent portion of said ruling reads as follows:

> "xxx xxx xxx
>
> 2) PICOP will not be allowed to carry over the losses of Rustan prior to the legal dissolution of the latter because at that time the two (2) companies still had separate legal personalities;
>
> 3) After BOI approval of the merger, PICOP can no longer apply for the registration of

> the registered capacity of Rustan because with the approved merger, such registered capacity of Rustan transferred to PICOP will have the same registration date as that of Rustan. In this case, the previous losses of Rustan may be carried over by PICOP, because with the merger, PICOP assumes all the rights and obligations of Rustan, subject, however, to the period prescribed for carrying over of such losses." (Underscoring supplied).

Respondent, on the other hand, maintains that the net operating loss sustained by a taxpayer can only be carried over and deducted in subsequent years by the same taxpayer, citing the cases of ***Standard Paving Co., vs. Commissioner of Internal Revenue [190 F(2) 330] and Stanton Brewery Inc. vs. Commissioner of Internal Revenue [176 F(2d) 573].*** In the case at bar, respondent alleged that the losses incurred by RFPMI cannot be carried over as a deduction to petitioner's gross income, for the simple reason that they are not the same taxpayer.

While it is true that under the 1939 amendment to the U.S. Internal Revenue Code, a successor corporation was not entitled to a deduction on account of the net operating losses of its predecessor, the 1954 Code, however, made some inroads into this doctrine. It has set out definite statutory rules covering the carry-over of net operating loss where the assets of the predecessor corporation were acquired in a tax free transaction such as in connection to a statutory merger or consolidation.

Nevertheless, the 1954 Code also provides special limitations on the net operating loss carry-overs in two situations:

1. Where the change in ownership of the "loss" corporation is due to a purchase of its stock or to a decrease in its outstanding stock, and there has been a change in its trade or business, the net-operating loss may be disallowed in full;

2. Where the change in ownership is due to a reorganization, the net operating loss carry-over may be disallowed in part.

By virtue of this change in the law, the succession to the net operating loss carry-overs has become mandatory and not elective where these statutory rules are met. *(Vol. 5, Mertens, Law of Federal Income Taxation, Chap. 29.11, p. 101).*

In the instant case, the limitations mentioned above does not exist. Although there was an increase in ownership, the successor corporation continues to carry on its prior business activities substantially undiminished with no change in its trade or business. Neither was there a change of ownership due to a reorganization.

Respondent further averred that the incentives granted under Section 7 of R.A. No. 5186 shall be available only to the extent in which they are engaged in registered operations, citing Section 1 of Rule IX of the Basic Rules and Regulations to Implement the Intent and Provisions of the Investment Incentives Act, R.A. No. 5186.

We disagree with respondent. The purpose of the merger was to rationalize the container board industry and not to take advantage of the net losses incurred by RPPMI prior to the stock swap. Thus, when stock of a corporation is purchased in order to take advantage of the corporation's net operating loss incurred in years prior to the purchase, the corporation thereafter entering into a trade or business different from that in which it was previously engaged, the net operating loss carry-over may be entirely lost. *CIRC (1954), Sec. 382(a), Vol. 5, Mertens, Law of Federal Income Taxation, Chap. 29.11a, p. 103.1.* Furthermore, once the BOI approved the merger agreement, the registered capacity of Rustan shall be transferred to PICOP, and the previous losses of Rustan may be carried over by PICOP by operation of law. [BOI ruling dated February 21, 1977 *(Exh. J-1)*]. It is clear therefrom, that the deduction availed of under Section 7(c) of R.A. No. 5186 was only proper.

b. Capitalized interest expense on funds used for acquisition of machinery and other equipment amounting to P42,840,131.00.

Petitioner borrowed loans from foreign creditors in 1969, 1972 and 1977 for the purpose of purchasing machinery and equipment needed in its operation. The interest payments made in 1977, covering these loans, were disallowed by respondent on the ground that the payment of interests should be capitalized, since it represented interest expense for loans incurred and obtained for the purpose of machinery and equipment for operations, thus, forming part of capital expenditure.

On the other hand, petitioner maintains that the deduction was pursuant to Section 30 of the National Internal Revenue Code because the machinery and equipment obtained from loans acquired in 1969 and 1972 were already operating as of 1973; and those acquired from loans incurred in 1977 were used only after December 31, 1977.

The general rule is that any amount of interest paid or accrued within the taxable year on indebtedness may be deducted from gross income. The requisites in order that interest may be deductible requires:

(1) that there should be an indebtedness;

(2) that the indebtedness must be a legal liability to pay the interest.

In the case of ***Central Real Estate Co. vs. Commissioner of Internal Revenue, 47 F2d 1037***, the Court said:

> "... The provision permitting proper adjustment to be made for any expenditure or item of loss properly chargeable to capital account clearly means such items as add to the value of the property. It would be impracticable for Congress to enumerate in detail what those items might be, but taxes and interest do not fall into that class and no difficulty presents itself in dealing with them specifically. All the revenue acts have specifically provided for the deduction of taxes and interest from gross income annually while dealing generally with other items of expense. If Congress had intended to give the taxpayer the privilege of adding taxes and interest to cost, it would have been very easy to have said so. As the Act does not so provide, the conclusion is inescapable that Congress did not so intend."

The courts and the Board followed this view and frequently held under revenue acts prior to the 1924 Act, as well as those which followed, that so-called carrying charges were not capital items. It was held that taxes during the period of building operations were not carrying charges (for purposes of computing invested capital). Interest during the construction of a dam was not a part of the cost as basis for the deduction of a loss under the 1918 Revenue Act. Interest paid during the construction of a plant was not a capital expenditure. *[Sec. 21. 225, Vol. 3A, Mertens, Law of Federal Income Taxation, Chap. 21, p. 621].*

Respondent failed to mention in his citation of U.S. Income Tax Regulation 1.266-1(b) that the taxpayer has the option to treat the taxes and carrying charges as chargeable to the capital account (either as a component of original cost or other basis, or as an adjustment to basis), notwithstanding that they are expressly deductible. The examiners' findings that the machinery and equipment purchased from these loans were used for organizational and pre-operating purposes cannot be given weight because during the year in question, 1977, the corporation was no longer in its organizational or pre-operational stage. Clearly, there is no valid reason to compel petitioner to capitalize interest expense from funds used for acquisition of machinery and equipment. Thus, the disallowance of P42,840,131.00 was improper.

c. Unexplained Financial, Guarantee and Interest Expense of P1,237,421.00

The respondent disallowed the deductions of unexplained financial, guarantee and interest expense for 1977, to wit: *(BIR Examiner's Worksheet, p. 37, BIR rec.)*

Date	Cash Voucher No.	Amount	Remarks
Oct. 5, 1977	12714	P330,421.00	Register of Deeds
Oct. 5, 1977	12716	7,000.00	Cash
Oct. 6, 1977	12771	500,000.00	Cash
Oct. 6, 1977	12772	400,000.00	Cash
		P1,237,421.00	

The basic principles governing deductions are:

1) The taxpayer seeking a deduction must point to some specific provisions of the statute in which that deduction is authorized;

2) He must be able to prove that he is entitled to the deduction which the law allows; and

3) Adequate records should be kept to support deductions. (1955, Ph. Fed. Tax Course, par. 1901).

It is required that the claimed deduction be supported by adequate evidence or records, otherwise the same will be disallowed. Accordingly, the mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction. *(Basilan Estate vs. Commissioner of Internal Revenue, L-22492, September 5, 1967).*

No records are available to support the abovementioned expenses. The vouchers merely showed that the amounts were paid to the Register of Deeds and simply Cash account. Without the supporting papers such as the invoices or official receipts of the Register of Deeds, these vouchers standing alone cannot prove that the payments made were for the accrued expenses in question. The best evidence of payment is the official receipts issued by the Register of Deeds. The testimony of petitioner's witness that the official receipts and cash vouchers were shown to the Bureau of Internal Revenue will not suffice if no records could be presented in court for proper marking and identification. As petitioner failed to substantiate the deduction of P1,237,421.00, respondent's disallowance of the said amount should be sustained.

d. Understatement of sales and overstatement of cost of sales amounting to P2,391,644.00 and P604,018.00, respectively.

The BIR examiners investigation showed that the amount of sales reported by petitioner in its income tax return for 1977 were understated and the cost of sales overstated, as per the following computations: *(BIR Examiner's Worksheet, p. 38, BIR rec.)*.

Sales per books of accounts:

Paper	P537,656,719.00	
Timber	265,549,776.00	P803,206,495.00

Sales per Income Tax:

Paper	P537,656,719.00	
Timber	263,158,132.00	800,814,851.00

Difference	P 2,391,644.00
Cost of Sales, Per Income Tax	P607,246,084.00
Cost of Sales, Per Books	606,642,066.00
Difference	P 604,018.00

According to petitioner the difference can be very well explained by the adjustments made at year-end in the financial report. From the testimony of petitioner's witness, it appears that it has been the practice of petitioner to record its export sales (in U.S. Dollars) on the basis of a pre-determined fixed dollar exchange rate at the beginning of each year. At the end of the year, its auditors determine the actual process of export sales this time converted into Philippine Pesos. The average of the recorded fixed exchange rate and the actual rate upon receipt of the process from export sales is computed in order to arrive at the adjusted sales at year-end. This adjusted bases of sales was the basis used for income tax purposes. *(t.s.n., October 17, 1985, pp. 20-25).*

Petitioner would want Us to believe that its auditors adjusted the amount of sales at year-end to its correct value as reported in its 1977 income tax return and audited financial statement, if so, why did it not carry the same adjustments in its books of accounts? Surely, there would have been no discrepancy if proper adjustments were truly made. The same adjustments would have been recorded in the books also, so as to properly show the true and correct amount of sales and cost of sales. As the BIR examiners have correctly observed, which We quote hereunder:

> "... they could have submitted the corrected figures as adjusted by them which intially uses a pre-determined rate at the beginning and continued throughout the year. Only at year end could the company's auditors determine with accuracy the actual dollar proceeds of the export sales - hence, these adjustments.
>
> Again, these facts could have been presented to the undersigned for proper evaluation at the pre-assessment level of this case. The records show that none was complied with."

On the basis of the foregoing, We see no reason why We ought to subscribe to petitioner's position.

5% Development Tax

The 5% corporate development tax is a tax imposed in addition to the corporate income tax. This tax is assessed on every corporation whose net income for the taxable year exceeds 10% of its net worth (in the case of a domestic corporation) or net assets in the Philippines (in case of a resident foreign corporation); or in the case of a closely-held corporation, the 5% corporate development tax shall always be due, regardless of the rate of return on its net worth. *(Sec. 24(e), NIRC; Sec. 1, Rev. Reg. No. 11-77)*.

For purposes of determining whether the net income of a corporation exceeds 10% of the net worth, the term "net worth" means the stockholders' equity represented by the excess of the total assets over liabilities as reflected in the corporation's balance sheet prepared in accordance with generally accepted accounting principles employed in keeping the books of the corporation. *(Sec. 2, Rev. Reg. 11-77)*.

Petitioner having failed to dispute and controvert the findings of respondent with respect to the unexplained financial guarantee expense, understatement of sales and overstatement of cost of sales, the Court has no other alternative than to hold petitioner liable for deficiency income tax for the year 1977, computed as follows:

Deficiency Income Tax for 1977

Net income per return		P 258,166.00
Add: Unallowable deductions		
1) Unexplained financial guarantee expense	P1,237,421.00	
2) Understatement of sales	2,391,644.00	
3) Overstatement of cost of sales	604,018.00	4,233,083.00
Net income as adjusted		P4,491,249.00
Income tax due thereon		P1,561,937.15
Less: Tax already assessed per return		80,358.00
Deficiency income tax		P1,481,579.15
Add: 14% int. fr. 4-15-78 to 7-31-80	P475,647.05	
20% int. fr. 8-01-80 to 4-15-81	P209,449.56	685,096.61
		P2,166,675.76
Add: 20% int. fr. 3-31-83 to 3-31-86		1,300,005.45
		P3,466,681.21
Add: 10% surcharge		346,668.12
TOTAL AMOUNT DUE AND COLLECTIBLE		P3,813,349.33

However, petitioner shall not be liable to the 5% corporate development tax because its net income, after adding the disallowed deductions, does not exceed 10% of its net worth or total stockholder's equity of P464,749,528.00, the net income for 1977 being only P4,491,249.00.

WHEREFORE, the findings of respondent, Commissioner of Internal Revenue, is hereby modified. Petitioner is ordered to pay respondent

the total amount of P20,133,762.33, itemized as follows:

35% Transaction Tax	P16,020,113.20
Documentary & Science Stamp Tax ..	300,300.00
Deficiency Income Tax Due	3,813,349.33
TOTAL AMOUNT DUE AND PAYABLE	P20,133,762.53

Cost against petitioner.

SO ORDERED.

Quezon City, Metro Manila, August 15, 1989.

ALEX Z. REYES
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge

C E R T I F I C A T I O N

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

AMANTE FILLER
Presiding Judge
Court of Tax Appeals