Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

MODERN IMAGING SOLUTIONS, INC., Petitioner,	**CTA Case No. 8987**
	Members: **CASTAÑEDA, JR.**, *Chairperson,* **CASANOVA,** *and* **MANAHAN,** *JJ.*
-versus-	
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: MAR 2 1 2017 11:30 a.m.

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DECISION

CASANOVA, J.:

This is a Petition for Review filed by Modern Imaging Solutions, Inc., seeking the reversal of the Formal Assessment Notice dated June 24, 2014 issued by respondent, assessing petitioner for deficiency Income Tax, Expanded Withholding Tax (EWT), and Documentary Stamp Tax (DST) for taxable year 2009 in the total amount of ₱3,104,954.00, inclusive of surcharge, interests and compromise penalty.

Petitioner is a Philippine Branch Office of Modern Imaging Solutions, Inc., a corporation organized and existing under the laws of the United States of America and is duly licensed by the Securities and Exchange Commission "to engage in the operation of a call center for the sale and distribution of business supplies"[1]. Petitioner's office is located at Unit B, 5/F One World Square Building, Upper Mckinley Road, Mckinley Tower Center, Fort Bonifacio, Taguig City.[2]

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[1] Exhibits "P-1" and "P-2".
[2] Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Simplification of Issues (JSFSI), Docket, (Vol. I), p. 247.

On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) vested under appropriate laws with the authority to carry out the functions, duties and responsibilities of said office, including, but not limited to, the power to decide disputed assessments and cancel and abate tax liabilities. He is represented by the Legal Division of Revenue Region No. 8, with office located at the 2nd Floor BIR Building, 313 Gil Puyat Avenue, Makati City.[3]

On January 19, 2011, respondent issued a Letter of Authority No. 050-2011-00000028[4], authorizing the examination of the books of accounts and other accounting records of petitioner covering taxable year 2009[5], which petitioner received on January 25, 2011.[6]

Thereafter, respondent sent a Preliminary Assessment Notice[7] (PAN) dated May 5, 2014, which was received by petitioner on May 20, 2014.[8] It was stated in the said PAN that the period of prescription was extended up to June 30, 2014 due to several waivers of defense of prescription executed by petitioner on September 28, 2012, April 30, 2013 and September 13, 2013, respectively.

On June 24, 2014, respondent issued a Formal Assessment Notice[9] (FAN), which was received by petitioner on June 25, 2014[10], finding petitioner liable for deficiency Income Tax, EWT, and DST for taxable year 2009 in the total amount of ₱3,104,954.00, inclusive of surcharge, interests and compromise penalty, broken down as follows:

Tax Type	Basic	Surcharge	Interest	Total Amount Due
Income Tax	₱ 1,481,083.73		₱ 1,270,891.57	₱ 2,751,975.30
EWT	163,236.90		148,120.72	311,357.62
DST	17,394.00	₱ 4,348.50	15,878.58	37,621.08
Compromise Penalty				4,000.00
Total	**₱1,661,714.63**	**₱4,348.50**	**₱1,434,890.87**	**₱3,104,954.00**

[3] Par. 2(b), respondent's Answer, Docket (Vol. I), p. 45.
[4] Exhibit "R-1".
[5] Par. 2, Stipulation of Facts, JSFSI, Docket (Vol. I), p. 248.
[6] Exhibit "R-1-B".
[7] Exhibit "P-4".
[8] Par. 4, Stipulation of Facts, JSFSI, Docket (Vol. I), p. 248 and Exhibit "R-10".
[9] Exhibit "P-5" and Exhibit "R-11".
[10] Par. 5, Stipulation of Facts, JSFSI, Docket (Vol. I), p. 248.

Petitioner filed its Protest Letter[11] to the FAN on July 23, 2014 with a Request for Reinvestigation.[12]

There being no action on the part of the respondent on its protest, petitioner filed the instant Petition for Review[13] on February 18, 2015.

On April 10, 2015, respondent filed his Answer[14] and interposed the following special and affirmative defenses:

> "5. Section 228 of the 1997 Tax Code partly reads as follows:
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> xxx xxx xxx
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> 5.1 Implementing the aforesaid provision, Section 3, 3.1.5 of Revenue Regulations No. 12-99 dated September 6, 1999, provides that that [*sic*] taxpayer shall submit the required documents in support of its protest within sixty (60) days from the date of filing of the protest, otherwise, The phrase "submit the required documents" includes submission or presentation of the pertinent documents for scrutiny and evaluation by the Revenue Officer conducting the audit and the said Revenue Officer shall state this fact in his report of investigation. In the instant case, despite the length of time given to herein petitioner, it failed to submit the required documents in support of its protest against the Formal Assessment Notice. Consequently, the assessment became final, executory and demandable. As such, this Honorable Court has no jurisdiction to act on the instant petition.
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> 6. Further yet, Section *(sic)* 7 and 11 of Republic Act (RA) No. 1125, as amended by RA No. 9282 and RA No. 9503, which enumerates *(sic)* the cases over which the Court of Tax Appeals has appellate jurisdiction, relevantly states:
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[11] Exhibit "P-6".
[12] Par. 6, Stipulation of Facts, JSFSI, Docket (Vol. I), p. 248.
[13] Docket (Vol. I), pp. 6-18.
[14] Docket (Vol. I), pp. 45-50.

7. Indubitably, the Court of Tax Appeals, being a court of special jurisdiction, can take cognizance only of matters that are clearly within its jurisdiction (Allied Banking Corporation vs. Commissioner of Internal Revenue, G.R. No. 175097, February 5, 2010 citing Rizal Commercial Banking Corporation vs. Commissioner of Internal Revenue, G.R. No. 168498, 522 SCRA 144, 150). Its jurisdiction may only invoked in the particular instances enumerated in Section 7 of Republic Act (RA) No. 1125, as amended by Section 7 of RA No. 9282 (Moog Controls Corporation Philippine Branch vs. Commissioner of Internal Revenue, CTA EB. No. 44, May 10, 2005). Verily, Section 3, Rule 4 of the Revised Rules of the Court of Tax Appeals provides that only decisions of the Commissioner of Internal Revenue (CIR) in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code (NIRC) or other laws administered by the Bureau of Internal Revenue can be subject of appeal before this Court. And considering that the petitioner failed to file the necessary supporting documents, the assessment in the instant case already became final and executory, and demandable.

8. At the outset, the Formal Assessment Notice (FAN) and its Details of Discrepancies both dated June 24, 2014, reflect the internal revenue liabilities of the petitioner for the 2009 taxable year, *viz*:

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I. <u>INCOME TAX</u>

Undeclared Income from Unaccounted Rent, ₱11,116.75 - Verifications disclosed that some of petitioner's rent payments per Alphalist were not accounted/reflected in the Financial Statements. The differences were treated as unaccounted source of cash which was considered as undeclared income. In the case of Perez vs CTA and CIR (May 29, 1957), the Supreme Court held that unreflected sources of funds not accounted for in the taxpayer's tax returns led to the inference that part of its income had not been reported; hence, assessed pursuant to Section 32 of the 1997 Tax Code, as amended.

Disallowed Expense due to non-withholding, ₱4,925,829.01- Verification disclosed that petitioner has not withheld the appropriate withholding tax due on its income payments. Section 34 (k) of the NIRC, as amended, expressly provides that "..... any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the BIR.

II. EXPANDED WITHHOLDING TAX

Basic Expanded Withholding tax due, ₱163,236.90– Considering the failure of the petitioner to withhold/remit the correct withholding tax due (refer to Schedule 2), petitioner is therefore liable to pay the deficiency withholding tax thereon pursuant to Section 2.57.1 of Revenue Regulations (RR) No. 2-98, as amended.

III. DOCUMENTARY STAMP TAX

Basic Tax Due, ₱17,394.00– Verification disclosed that petitioner failed to file and pay documentary stamp tax due on the increase in the fund received from Home Office in violation of Section 179 of the Tax Code, as amended.

9. Further yet, A *(sic)* revenue regulation, the issuance of which is authorized by statute, has the force and effect of law (*Vitug & Acosta, Tax Law and Jurisprudence, 3rd Edition, p. 55*).

10. Assessment are *prima facie* presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. (*Aban, Law of Basic Taxation in the Philippines, 1st Edition, p. 109*);

11. Over and above all, petitioner should be reminded that taxes are important because it is the lifeblood of the government and so should be calculated without unnecessary hindrance (Commissioner vs. Algue, Inc. L-28896, 17 February 1988). Taxes are enforced proportional contribution from persons and property levied by the state, thus, no one is considered entitled to recover that which he must give up to another – xxx."

Thereafter, a Notice of Pre-Trial Conference[15] was issued by the Court on April 29, 2015, setting the case for pre-trial conference on May 28, 2015, but was later reset to June 25, 2015[16]. Accordingly, the Pre-Trial Brief (for the Respondent)[17] was filed on May 27, 2015, while petitioner's Pre-Trial Brief[18] was filed by registered mail, on May 25, 2015 by registered mail and received by the Court on May 28, 2015.

On July 15, 2015, the parties filed, thru registered mail, their Joint Stipulation of Facts and Simplification of Issues[19] ("JSFI"). Thereafter, a Pre-Trial Order[20] was issued on August 4, 2015, approving the parties' JSFI and terminating the pre-trial.

During trial, petitioner presented Ms. Bambam L. Caraan, petitioner's Finance Manager, as its lone witness. [21] Petitioner filed, thru registered mail, its Formal Offer of Evidence[22] on October 13, 2015. In the Resolution[23] dated November 25, 2015, the Court admitted all of petitioner's evidence.

[15] Docket (Vol. I), pp. 52-53.
[16] Docket (Vol. I), p. 148.
[17] Docket (Vol. I), pp. 55-57.
[18] Docket (Vol. I), pp. 67-73.
[19] Docket (Vol. I), pp. 247-253.
[20] Docket (Vol. I), pp. 256-260.
[21] Minutes of the Hearing dated September 2, 2015, Docket (Vol. I), p. 261.
[22] Docket (Vol. I), pp. 284-298.
[23] Docket (Vol. I), pp. 392-393.

On the other hand, respondent presented Revenue Officer Raquel G. Hombrebueno as his lone witness[24], and, thereafter, filed, thru registered mail, his Formal Offer of Evidence[25] on December 14, 2015. In a Resolution[26] dated February 5, 2016, the Court admitted all of respondent's evidence.

This case was submitted for decision on April 27, 2016, taking into consideration petitioner's Memorandum[27] filed, thru registered mail, on April 11, 2016, and the Records Verification[28] dated April 22, 2016 stating that respondent failed to file his memorandum.[29]

The sole issue to be resolved is whether there is factual and lawful ground for the assessment of petitioner's alleged deficiency Income Tax, EWT, and DST in the total amount of ₱3,104,954.00, inclusive of interests and compromise penalty, for taxable year 2009.[30]

The Court shall first address the issue on jurisdiction over the instant case in relation to respondent's allegation that the subject assessment has already attained finality.

In his Answer, respondent argues that petitioner failed to submit the required documents within sixty (60) days in support of its protest against the FAN. Consequently, the assessment became final, executory and demandable. As such, the Court has no jurisdiction to act on the instant petition.

The Court is not convinced.

Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, provides:

> "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

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[24] Minutes of the Hearing dated December 7, 2015, Docket (Vol. I), p. 394.
[25] Docket (Vol. I), pp. 404-407.
[26] Docket (Vol. II), pp. 433-434.
[27] Docket (Vol. II), pp. 451-473.
[28] Docket (Vol. II), p. 476.
[29] Docket (Vol. II), p. 477.
[30] Issue, JSFSI, Docket (Vol. I), p. 248.

> preassessment notice shall not be required in the following cases:
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> xxx xxx xxx
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> 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.
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> 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.
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> 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.**
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> 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." *(Emphasis supplied)*

In this case, petitioner received the FAN on June 25, 2014[31], thus, counting thirty (30) days therefrom, petitioner had until July 25, 2014 within which to file its protest pursuant to Section 228 of the NIRC of 1997, as amended. Petitioner filed its Protest Letter[32] to the FAN on July 23, 2014 with no attached supporting documents.

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[31] As stipulated by the parties, see par. 5, Stipulation of Facts, JSFSI, Docket (Vol. I), p. 248. However, Exhibit "R-11", BIR Records, pp. 221-229, shows that the FAN was received by a certain Alan Elamparo on June 26, 2014.

[32] Exhibit "P-6", Docket (Vol. I), pp. 317-323.

However, as explained by the Supreme Court in the case of *Commissioner of Internal Revenue vs. First Express Pawnshop Company, Inc.*[33], it is the taxpayer who determines what documents are relevant and necessary to support its protest, *to wit*:

> "**The term 'relevant supporting documents' should be understood as those documents necessary to support the legal basis in disputing a tax assessment as determined by the taxpayer.** The BIR can only inform the taxpayer to submit additional documents. The BIR cannot demand what type of supporting documents should be submitted. Otherwise, a taxpayer will be at the mercy of the BIR, which may require the production of documents that a taxpayer cannot submit." *(Emphasis supplied)*

From the foregoing, should petitioner decide not to submit any supporting documents within sixty (60) days from the date of filing of the protest, the same does not render the assessment final and executory. Further, there is no showing that respondent required petitioner to submit additional documents in order for him to decide on the protest.

Pursuant to Section 228 of the NIRC of 1997, as amended, if the protest is not acted upon within 180 days from submission of supporting documents, the taxpayer may appeal the inaction to this Court within thirty (30) days from the lapse of the 180-day period. Considering that petitioner did not submit any supporting documents within the 60-day period provided by law, the 180-day period shall be counted from the date of filing of the protest. Counting 180 days from July 23, 2014, respondent had until January 19, 2015 to decide on the protest. Due to the inaction of respondent within such period, petitioner had thirty (30) days from January 19, 2015 or until February 18, 2015 within which to file an appeal before this Court. Hence, petitioner timely filed the instant Petition for Review with this Court on February 18, 2015.

The Court shall now determine the merits of the deficiency tax assessments issued by respondent against petitioner. *a*

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[33] G.R. Nos. 172045-46, June 16, 2009.

I. Deficiency Income Tax (₱2,751,975.30) vis-à-vis Deficiency Expanded Withholding Tax (₱311,357.62)

Respondent assessed petitioner for deficiency income tax for taxable year 2009 in the amount of ₱2,751,975.30, inclusive of interest, computed as follows:

Taxable Income(Loss) per Return		-
Add: Adjustments		
Undeclared Income from unaccounted source of cash	₱ 11,116.75	
Disallowed expenses due to non-withholding	4,925,829.01	₱ 4,936,945.76
Adjusted taxable income		4,936,945.76
Income Tax Due (30%)		₱ 1,481,083.73
Less: Tax Credits/Payments		-
Deficiency Income Tax		₱ 1,481,083.73
Add: Interest (4/16/10 to 7/30/14)		1,270,891.57
Total Amount Due		**₱ 2,751,975.30**

As shown above and, based on the details of discrepancies, the deficiency income tax assessment arose from two findings: (1) undeclared income from unaccounted source of cash (unaccounted rent) in the amount of ₱11,116.75; and (2) disallowed expenses due to non-withholding in the amount of ₱4,925,829.01.

(1) ***Undeclared Income from Unaccounted Rent - ₱11,116.75***

Respondent's verification disclosed that some of petitioner's rent payments per Alphalist were not accounted/reflected in the Financial Statements (FS)/Income Tax Return (ITR). The difference of ₱11,116.75, as computed below, was then treated as unaccounted source of cash which was considered as undeclared income, following the pronouncement in the case of *Perez vs. CTA and CIR (L-9193 dated May 29, 1957)*, where it was held that unreflected sources of funds not accounted for in the taxpayer's tax returns led to the inference that part of the income has not been reported, hence, assessed pursuant to Section 32 of the NIRC of 1997, as amended.

Rent per Alphalist	₱ 1,422,959.75
Less: Rent per FS/ITR	1,411,843.00
Undeclared Income from Unaccounted Rent	**₱ 11,116.75**

The Court finds the above item of assessment bereft of merit.

It is worthy to note that the imputation of alleged undeclared income is based on a mere presumption that since there were alleged undeclared rent payments, there was a corresponding undeclared income. Moreover, even if these alleged undeclared rent payments are to be considered as unaccounted source of cash translating into income, the same will be offset by recording the alleged undeclared rent payments as expenses. Hence, no taxable income will result from the said transaction.

Furthermore, it must be emphasized that, for income tax purposes, a taxpayer is free to deduct from its gross income a lesser amount or not claim any deduction at all. What is prohibited by the income tax law is to claim a deduction beyond the amount authorized therein.[34] Hence, even granting that there is an undeclared expense, the same is not prohibited by law.

Bearing in mind that an undeclared expense is not prohibited by law, it goes without saying that petitioner can exercise its discretion on whether it will declare a lesser amount of deduction or none at all.

While it is axiomatic that all presumptions are in favor of the correctness of tax assessments, the assessment itself should not be based on mere presumptions no matter how logical the presumption might be. In order to stand the test of judicial scrutiny, the assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption.[35]

Also, the Court noted that the case cited by respondent, *i.e., Perez vs. CTA and CIR (L-9193 dated May 29, 1957),* as basis for treating the difference between petitioner's rent payments per Alphalist and per FS/ITR as unaccounted source of cash which was then considered as undeclared income, did not even remotely discuss "unaccounted source of cash" or "unreflected sources of funds". The issue raised in that case was in the order of presentation of evidence, as there was no showing of any specific rules governing the

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[34] *Commissioner of Internal Revenue vs. Phoenix Assurance Co. Ltd.*, G.R. No. L-19727, May 20, 1965.

[35] *Collector of Internal Revenue vs. Benipayo*, G.R. No. L-13656, January 31, 1962.

presentation of evidence in the Court of Tax Appeals at that time. Hence, reliance on *Perez vs. CTA and CIR* is misplaced.

Such being the case, the deficiency income tax assessment arising from petitioner's *"Undeclared income from unaccounted source of cash/rent"* in the amount of ₱11,116.75 must be cancelled.

(2) *Disallowed expenses due to non-withholding - ₱4,925,829.01 vis-à-vis basic deficiency EWT - ₱163,236.90*

In the Details of Discrepancies[36] attached to the FAN, respondent disallowed the expenses of ₱4,925,829.01 for failure to subject the same to expanded withholding taxes, pursuant to Section 34(K) of the NIRC of 1997, as amended, in relation to Section 2.57.1 of Revenue Regulations (RR) No. 2-98, as amended, computed as follows:

Income Payments	**Per FS/ITR**	**Per Alphalist**	**Disallowed Expenses**	**Tax Rate**	**Tax Due**
Purchase of Services/Contractors					
Light and Water	₱ 1,170,947.00				
Communication	1,057,570.00				
Representation	800,354.00				
Taxes and licenses	148,876.00				
Repairs and maintenance	128,778.00				
Advertising and promotion	105,810.00				
Miscellaneous	1,858,752.00				
Sub-total	₱ 5,271,087.00	₱ 1,154,262.00	₱ 4,116,825.00	2%	₱ 82,336.50
Professional Fee					
at 10% not more than ₱720,000.00	1,015,484.00	206,479.99	809,004.01	10%	80,900.40
Total Disallowed Expenses	**₱6,286,571.00**	**₱1,360,741.99**	**₱4,925,829.01**		**₱163,236.90**

Petitioner argues that the assessment for deficiency EWT lacks legal basis. The items listed under purchases of services/contractors and professional fees are not among the listed items subject to withholding tax under the said provision of Section 2.57.1 of RR No. 2-98. Further, Section 2.57.1 of RR No. 2-98 does not impose EWT, but instead imposes final withholding tax on specific transactions, which do not include purchases of services/contractors and professional fees.

[36] Exhibit "P-5", Docket (Vol. I), pp. 307-309.

Indeed, the transactions covered by Section 2.57.1 (Income Payments subject to Final Withholding Tax) of RR No. 2-98 subject to withholding tax do not include the foregoing expenses incurred by petitioner. Clearly, respondent's deficiency EWT assessment is without legal basis considering that the cited provision is inapplicable to the above-enumerated expenses.

Section 228 of the NIRC of 1997, as amended, provides that the taxpayer shall be informed in writing of the law and the facts on which the assessment is made. It is clear from Section 228 that a taxpayer must be informed in writing of the legal and factual bases of the tax assessment made against him. The use of the word "shall" in these legal provisions indicates the mandatory nature of the requirements laid down therein.[37]

Moreover, the Court cannot simply assume that based on the above tabulation and rates used, respondent might have inadvertently or unintentionally cited Section 2.57.1 instead of Section 2.57.2 of RR No. 2-98, where withholding of taxes may be required on the foregoing expenses as its basis for the deficiency EWT assessment.

The law requires that the legal and factual bases of the assessment be stated in the formal letter of demand and assessment notice. Thus, such cannot be presumed.[38]

From the foregoing, the basic deficiency EWT assessment in the amount of ₱163,236.90, including the related interest imposed, shall be cancelled. Accordingly, the disallowances of the related expenses made by respondent shall, likewise, be cancelled.

Besides, respondent cannot hold petitioner liable for deficiency income tax merely because of the disallowance of the foregoing expenses, for the same does not at all constitute taxable revenue on the part of petitioner. Simply put, the disallowance of certain expenses does not by itself result in the imposition of income tax.

The three (3) elements in the imposition of income tax are: (1) there must be gain or profit, (2) that the gain or profit is realized or received, actually or constructively, and (3) it is not exempted by law

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[37] *Commissioner of Internal Revenue vs. Enron Subic Power Corporation*, G.R. No. 166387, January 19, 2009.
[38] *Ibid.*

or treaty from income tax. Income tax is assessed on income received from any property, activity or service that produces the income.[39] Such being the case, income tax should not be imposed or assessed simply because there was a disallowance of certain expenses, but should be imposed when there was an income, and such income was received or realized by the taxpayer.

In this case, the above elements are not present. Respondent merely imposed income tax on petitioner simply because there were disallowed expenses, and nothing more.

Moreover, respondent disregarded the fact that petitioner incurred a net loss of ₱8,232,978.00[40] in the year 2009. Even with the disallowance of the foregoing expenses, petitioner would still be in a net loss position and would not result to any deficiency income tax, to wit:

Taxable Income(Loss) per Return	₱ (8,232,978.00)
Add: Disallowed expenses due to non-withholding	4,925,829.01
Adjusted Taxable Income (Loss)	**₱ (3,307,148.99)**

Therefore, respondent's deficiency income tax assessment against petitioner for taxable year 2009 should be cancelled.

II. Documentary Stamp Tax (₱37,621.08)

Respondent's verification disclosed that petitioner also failed to file and pay DST due on the increase in its fund received from home office, which is in violation of Section 179 of the NIRC of 1997, as amended. The basic deficiency DST due amounting to ₱17,394.00 was computed as follows:

Increase in Fund Received from Home Office	₱ 3,478,768.00
Multiply by: Tax Rate	₱1.00/₱200
Basic DST due	**₱ 17,394.00**

On the other hand, petitioner insists that "increase in fund received from home office" is not an issue price of a debt instrument,

[39] *Commissioner of Internal Revenue vs. Court of Appeals, et al.*, G.R. No. 108576, January 20, 1999.
[40] BIR Records, p. 136.

thus, not subject to DST under Section 179 of the NIRC of 1997, as amended.

Petitioner avers that it is the Philippine Branch office of its foreign corporation as can be seen from its License to Transact Business in the Philippines[41] dated January 23, 2006. Petitioner further claims that, as a Philippine branch office of a foreign corporation, petitioner has no separate personality from said foreign corporation, following the ruling in the case of *Philippine Deposit Insurance Corporation vs. Citibank, N.A., et al.*,[42] the Supreme Court held that as.

Petitioner further argues that a debt instrument covers "borrowing and lending transactions." In this case, however, petitioner, a Philippine branch office, receives funds from its "Home Office." The branch office and "Home Office" do not have separate juridical personalities. They are one and the same foreign corporation – Modern Imaging Solutions, Inc. Thus, Citibank and Bank of America's position in the above-captioned case is descriptive of the circumstances in this case.

In the case of *Philippine Deposit Insurance Corporation (PDIC) vs. Citibank, N.A. and Bank of America, S.T. & N.A.*,[43] respondent Citibank, N.A. (Citibank) is a banking corporation while respondent Bank of America, S.T. & N.A. (BA) is a national banking association, both of which are duly organized and existing under the laws of the United States of America and duly licensed to do business in the Philippines. Both branches received from its respective head office and other foreign branches, a sum of money in dollars, covered by Certificates of Dollar Time Deposit that were interest-bearing with corresponding maturity dates. These funds, which were lodged in Citibank's books under the account "Their Account-Head Office/Branches-Foreign Currency" while lodged in BA's books under the account "Due to Head Office/Branches", were excluded as deposit liabilities subject to assessment for insurance. In view thereof, deficiency assessments were imposed on both branches. The Supreme Court opined that the key to the resolution of the controversy is the relationship of the Philippine branches of Citibank and BA to their respective head offices and their other foreign branches and held that:

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[41] Exhibit "P-1", Docket (Vol. I), pp. 294.
[42] G.R. No. 170290, April 11, 2012.
[43] *Ibid.*

"The Court begins by examining the manner by which a foreign corporation can establish its presence in the Philippines. It may choose to incorporate its own subsidiary as a domestic corporation, in which case such subsidiary would have its own separate and independent legal personality to conduct business in the country. In the alternative, it may create a branch in the Philippines, which would not be a legally independent unit, and simply obtain a license to do business in the Philippines.

In the case of Citibank and BA, it is apparent that they *both did not incorporate* a separate domestic corporation to represent its business interests in the Philippines. Their Philippine branches are, as the name implies, merely branches, without a separate legal personality from their parent company, Citibank and BA. Thus, being one and the same entity, the funds placed by the respondents in their respective branches in the Philippines should not be treated as deposits made by third parties subject to deposit insurance under the PDIC Charter.

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There is no need to complicate the matter when it can be solved by simple logic bolstered by law and jurisprudence. Based on the foregoing, it is clear that the head office of a bank and its branches are considered as one under the eyes of the law. While branches are treated as separate business units for commercial and financial reporting purposes, in the end, the head office remains responsible and answerable for the liabilities of its branches which are under its supervision and control. As such, it is unreasonable for PDIC to require the respondents, Citibank and BA, to insure the money placements made by their home office and other branches. Deposit insurance is superfluous and entirely unnecessary when, as in this case, the institution holding the funds and the one which made the placements are one and the same legal entity."

Applying the foregoing by analogy, petitioner-Philippine Branch Office and its Home Office are one and the same entity. Hence, the same entity cannot be a creditor or debtor of itself. Funds received by petitioner from its Home/Head Office should not be treated as loans. Notably, the "Due to Home Office", appears in the "Equity" section of the Balance Sheet, which is a separate item from the Liabilities section of the Balance Sheet.

Moreover, the "Funds received from Home Office", used as basis in the deficiency DST assessment, was lifted from the "Statements of Assets, Liabilities and Due to Home Office"[44], a component of petitioner's FS. It should be noted that the components of the FS of a Philippine Branch Office is different with that of a subsidiary or affiliate in the Philippines. A Philippine Branch Office does not have a "Statement of Changes in Equity" in its FS as subsidiaries and affiliates do, understandably because it has no capital stock, but in lieu thereof, it has the Statement pertaining to the "Home Office" account, where transactions between the home office and branch are recorded, which is an intracompany account.

The Court is aware of the CTA *En Banc* case of *E.E. Black Ltd.-Philippine Branch vs. Commissioner of Internal Revenue*[45], where the Court *En Banc* affirmed the ruling of the Court in Division that cash and journal vouchers evidencing intercompany loans or advances are subject to DST (citing *Commissioner of Internal Revenue vs. Filinvest Development Corp.*[46]); that the general rule that a foreign corporation is the same juridical entity as its branch office in the Philippines cannot apply for purposes of imposing the DST (citing *Marubeni Corporation vs. Commissioner of Internal Revenue and Court of Tax Appeals*[47]); and the cash advances and intercompany trade payables and receivables which were booked under "due to/from accounts" are well within the purview of 'debt instruments' under Section 179 of the 1997 NIRC, as amended.

However, the Court finds the said case inapplicable considering that no cash and journal vouchers evidencing intercompany advances and no intercompany trade payables and receivables that can be considered as debt instruments under Section 179 of the NIRC of 1997, as amended, were mentioned in this case. Moreover, the accounts that were assessed with DST in the said case were "Due from Head

[44] BIR Records, p. 130.
[45] CTA EB Case No. 1196, November 11, 2015.
[46] G.R. Nos. 163653 and 167689, July 19, 2011.
[47] G.R. No. 76573, September 14, 1989.

Office and Parent Company" and "Due to Parent Company and Affiliates" which means that not only was the head office involved but also the parent company and affiliates which have separate legal personalities.

The case of *Marubeni Corporation (formerly Marubeni — Iida, Co., Ltd.) vs. Commissioner of Internal Revenue and Court of Tax Appeals (Marubeni case)*[48], where the head office and branch were treated as separate entities, is likewise inapplicable. The factual milieu of the said case is not the same as the instant case. In the *Marubeni* case, Marubeni Japan (Head Office) has equity investments in AG&P of Manila, which declared and paid dividends. The determination of whether Marubeni Japan is a resident or a non-resident foreign corporation under Philippine laws was central to the issue of Marubeni Japan's tax liability on its dividend income from Philippine sources. The Supreme Court held that the head office in Japan is a separate and distinct income taxpayer from the branch in the Philippines, agreeing with the Solicitor General's argument that:

> "The general rule that a foreign corporation is the same juridical entity as its branch office in the Philippines cannot apply here. This rule is based on the premise that the business of the foreign corporation is conducted through its branch office, following the principal agent relationship theory. It is understood that the branch becomes its agent here. So that when the foreign corporation transacts business in the Philippines independently of its branch, the principal-agent relationship is set aside. The transaction becomes one of the foreign corporation, not of the branch. Consequently, the taxpayer is the foreign corporation, not the branch or the resident foreign corporation.
>
> Corollarily, if the business transaction is conducted through the branch office, the latter becomes the taxpayer, and not the foreign corporation."

From the foregoing, the *Marubeni* case is not applicable to the instant case considering that petitioner's Home Office did not transact business in the Philippines independently from its branch that would set aside the principal-agent relationship, thus treating them as

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[48] *Ibid.*

separate entities. In fact, neither the Home Office nor Philippine Branch Office transacted business with another entity. Hence, the "Funds received from Home Office" is simply internal dealings within the same legal entity.

III. Compromise Penalty (₱4,000.00)

In lieu of instituting criminal action, respondent imposed a compromised penalty amounting to ₱4,000.00 against petitioner for its alleged failure to file and pay the DST on advances pursuant to Section 179 of the NIRC of 1997, as amended, in relation to Section 255 of the same code.

However, such imposition cannot be sustained. Under Revenue Memorandum Order (RMO) No. 01-90, as amended by RMO No. 19-2007, compromise penalties are only amounts suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Thus, compromise penalty implies a mutual agreement between the taxpayer and the CIR. Absent any showing that petitioner consented to the compromise penalty, the same should not be imposed. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[49]

WHEREFORE, the instant Petition for Review is **GRANTED**. Accordingly, the Final Assessment Notice dated June 24, 2014 assessing petitioner for deficiency Income Tax, EWT, and DST for taxable year 2009 in the total amount of ₱3,104,954.00, inclusive of surcharge, interests and compromise penalty, is **CANCELLED** for lack of legal and factual bases.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

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[49] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.*, G.R. No. L-35266, January 21, 1991.

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.

ROMAN G. DEL ROSARIO
Presiding Justice