REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

****

OCEAN STAR REALTY, INC.,
Petitioner,

C.T.A. CASE NO. 7123

Members:

- versus -

ACOSTA, *Chairperson*
BAUTISTA, and
CASANOVA, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUL 18 2007, 3:25PM

x - x

DECISION

BAUTISTA, *J.*:

Before this Court is a Petition for Review with prayers for the cancellation of respondent's Assessment Notice No. 6779-00-04-730 dated April 14, 2004 against petitioner; and for this Court to grant petitioner's request for refund and order respondent to pay petitioner the amount of NINETY SIX THOUSAND EIGHT HUNDRED NINETY SIX PESOS AND SEVENTY CENTAVOS (₱96,896.70) allegedly representing excess creditable withholding taxes for the years 2000 and 2001.

Petitioner is a duly registered taxpayer with the Bureau of Internal Revenue ("BIR") and is engaged in realty business.[1] On the other hand, respondent is vested by law with the power to decide, approve and grant claims for refund or tax credit of internal revenue taxes; and holds office at the Bureau of Internal Revenue, National Office Building, Agham Road, Diliman, Quezon City.

On April 5, 2001, petitioner filed its Annual Income Tax Return for the taxable year 2000,[2] with the following details:

Sales/Revenue/Receipts/Fees		1,167,273.00
Less: Cost of Sales/Services		721,740.00
Gross Income from Operation		445,533.00
Add: Non-Operating & Other Income		5,882.00
Total Gross Income		451,415.00
Less: Deductions		941,011.00
Taxable Income		489,596.00
Tax Rate		32%
Income Tax		-
MCIT		9,718.40
Aggregate Income Tax Due	9,718.40	
Less: Tax Credits/Payments	162,859.00	
Creditable Tax Withheld for the First Three Quarters	38,909.12	
Creditable Tax Withheld Per BIR Form No. 2307 for the Fourth Quarter	19,454.56	
Tax Payable/Overpayment	(221,222.68)	
Total Amount Payable	(211,504.04)	

On April 9, 2002, petitioner filed its Annual Income Tax Return for the taxable year 2001 and reflected therein the following:[3]

Sales/Revenue/Receipts/Fees		1,167,272.76
Less: Cost of Sales/Services		667,913.80
Gross Income from Operation		499,358.96
Add: Non-Operating & Other Income		6,254.14
Total Gross Income		505,613.10
Less: Deductions		916,487.12
Taxable Income		(410,874.02)
Tax Rate		32%
Income Tax		N/A
MCIT		10,112.26
Tax on transactions under Regular Rate (Normal Income Tax or MCIT, whichever is higher)		10,112.26

[1] Paragraph 1 of the parties' *Joint Stipulation of Facts and Simplification of Issues*; rollo, p.80.
[2] Exhibit A; rollo, p. 116.
[3] Exhibit H; rollo, p. 136.

Balance		10,112.26
Aggregate Income Tax Due	10,112.26	
Less: Tax Credits/Payments		
Prior Year's Excess Credits	211,504.04	
Creditable Tax Withheld for the First Three Quarters	43,772.76	
Creditable Tax Withheld Per BIR Form No. 2307 for the Fourth Quarter	14,590.92	
Total Tax Credits/Payments	269,867.96	
Tax Payable/Overpayment	(259,755.70)	
Total Amount Payable	(259,755.70)	

On November 14, 2002, petitioner filed with respondent, through Revenue District Office ("RDO") No. 48, a request for refund of income taxes paid in the amount of ₱96,896.70 allegedly representing excess creditable withholding tax for taxable years 2000 and 2001.[4]

On May 6, 2003, petitioner amended its Income Tax Return for the year 2000 to reflect the following:[5]

Sales/Revenue/Receipts/Fees		1,167,273.00
Less: Cost of Sales/Services		721,740.00
Gross Income from Operation		445,533.00
Add: Non-Operating & Other Income		5,882.00
Total Gross Income		451,415.00
Less: Deductions		941,011.00
Taxable Income		489,596.00
Tax Rate		32%
Income Tax		-
MCIT		9,718.40
Aggregate Income Tax Due	9,718.40	
Less: Tax Credits/Payments	-	
Creditable Tax Withheld for the First Three Quarters	38,909.12	
Creditable Tax Withheld Per BIR Form No. 2307 for the Fourth Quarter	19,454.56	
Total Tax Credits/Payments	(58,363.68)	
Tax Payable/Overpayment	(48,645.28)	
Total Gross Income	(48,645.28)	

Petitioner also marked "X" the option "To be refunded" in its amended ITR for the year 2000.

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[4] Exhibit C; rollo. p.125.
[5] Paragraph 3 of the parties' Joint Stipulation of Facts, rollo. p.81; Exhibit B, rollo. p.120.

On January 30, 2004, respondent issued a Post Reporting Notice and found petitioner liable for deficiency Expanded Withholding Tax in the amount of P129,366.01, inclusive of surcharge, interest and compromise penalty.[6]

On February 19, 2004, petitioner sent respondent a letter explaining that "the amount of P57,486.57 represents over remittances by [petitioner] of its expanded withholding taxes for the year 1999, which [petitioner] has applied against its withholding taxes for the year 2000."[7]

On March 12, 2004, respondent issued a Preliminary Assessment Notice ("PAN") finding petitioner liable for deficiency Income Tax in the amount of P165,221.15 and deficiency Final Withholding Tax in the amount of P122,606.52.[8]

On March 29, 2004, petitioner filed a protest to the PAN raising as ground that the assessment lacks legal and factual basis. Petitioner also requested a reconsideration of the findings and the PAN to be recalled.[9]

On April 14, 2004, respondent issued Formal Assessment Notice ("FAN"), with Details of Discrepancies, finding petitioner liable for Deficiency Income Tax in the amount of P262,619.79 and Deficiency Final Withholding Tax in the amount of P124,270.74.[10]

On April 27, 2004, petitioner filed an administrative protest to the said FAN raising as ground that the assessment lacks legal and factual basis.[11]

On December 6, 2004, respondent issued his Final Decision on Disputed Assessment ("FDDA") and found petitioner liable for deficiency Income Tax in the amount of ₱280,497.54 and deficiency Final Withholding Tax in the amount of ₱131,557.62, the details of which are as follows:[12]

[6] BIR Records, p. 154.
[7] Exhibit D; rollo, pp. 125-126.
[8] BIR Records, pp. 186-187.
[9] BIR Records, pp. 201-203.
[10] Exhibits 18, 19, 20 and 20-b; BIR Records, pp. 222-227.
[11] Exhibit E; rollo. pp. 127-129.
[12] Exhibit F; rollo. pp. 130-131.

DEFICIENCY INCOME TAX

Taxable Income(Loss) per Return			P (489,596.00)
add: adjustments			
Outside Services not subjected to EWT		P 37,650.00	
Interest Expense not subjected to Final Tax		287,432.85	325,082.85
Adjusted Taxable Income			(164,513.15)
add: Net Operating Loss Carry Over			489,596.00
Taxable Income per Audit			P 325,082.85
Tax Due			P 104,026.51
less: Tax Payments/Credits			
Prior year's excess credit		P 162,859.00	
Creditable tax withheld	P 58,363.68		
less: Disallowed-opted to refund	58,363.68	-	
Total		162,859.00	
add: Tax paid (MCIT)		-	
Total		162,859.00	
less: Excess tax credit carried forward		221,222.68	(58,363.68)
Deficiency Income Tax			162,390.19
add: 20% Interest (4.16.01-1.05-05)			118,107.35
Total Amount Due			P 280,497.54

DEFICIENCY FINAL WITHHOLDING TAX:

Interest payments		P 640,445.35
x Rate		20%
Tax Due		128,089.07
less: Tax Credits/Payments		
Per Return	P 128,089.07	
less: Disallowed-1999 excess creditable tax withheld	57,486.57	70,602.50
Deficiency Tax		57,486.57
add: 50% Surcharge	P 28,743.29	
20% Interest (1.26.01 to 1.05.05)	45,327.77	74,071.06
Amount still due		P 131,557.63

The Details of Discrepancies, attached to the Final Decision on Disputed Assessment, averred that the tax liabilities arose from the following:[13]

"**Deficiency Income Tax:**

1) Outside Services not subjected to EWT (P37,650.00) – Verification disclosed that outside services of P37,650.00 claimed was not subjected to expanded withholding tax pursuant to Section 58 of the 1997 Tax Code as implemented by Revenue Regulation 2-98, hence the same was disallowed as imposed under Section 34(K) of the same Code.

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[13] Exhibit F-1; rollo. pp.132-133.

2) Interest expense not subjected to FT (P287,432.85) – Verification disclosed that 20% was withheld on interest payment of P640,445.35 or the equivalent of P128,089.07 tax due as implemented by RR 2-98, Section 2.57-1(G)(1). However from the total tax due, only P70,602.50 was remitted to the government, hence in view of your failure to remit in full the tax withheld pursuant to Section 58 of the 1997 Tax Code as implemented by Revenue Regulation 2-98, the said amount was disallowed as deduction from gross income as imposed under Section 34(K) of the same Code.

$$\text{Computation:}\frac{P128{,}089.07-P70{,}602.50}{20\%} = \frac{P57{,}486.57}{20\%} = P287{,}432.85$$

3) Net Operating Loss Carry Over (P489,596.00) – Verification disclosed that you had carried over the net operating loss incurred during the year in the subsequent year, in conformity with the provision of Section 34 (D)(3) of the National Internal Revenue Code. It is appropriate that such loss should be taken into consideration in computing the correct income tax liability for the current year in order to recapture the income tax benefit realized in the following year because of such carry over.

4) Creditable Tax Withheld (P58,36.68) – Verification disclosed that you opted to refund excess of the creditable tax withheld for the year 2000 per letter request dated November 14, 2002, hence excess credits claimed were disallowed as tax credit against computed deficiency income tax pursuant to Section 204 of the 1997 NIRC as implemented by RR-2-98, Section 2.58.3(C).

5) Minimum Corporate Income Tax (P9,718.40) – Payment was not applied against the computation of deficiency income tax because this shall be carried forward and credited against your normal corporate income tax for the three (3) immediately succeeding taxable years pursuant to Section 27(E)(2) of the 1997 Tax Code.

6) Excess Tax Credit Carried Forward (P221,222.68) – Verification disclosed that your final income tax return filed resulted to excess tax credit of P221,222.68. This excess amount cannot be considered in the computation of income tax deficiency because it had been automatically carried over to the next taxable year period.

Deficiency Final Withholding Tax:

Unremitted Tax Withheld (P57,486.57) – Verification disclosed that the amount of P57,486.57 excess income tax credit of your company for 1999 and prior years was credited/used as payment against Final Withholding tax remittance. The Legal Division, this Region, opined that no automatic offsetting of the amount claimed by the taxpayer as tax credit or refund against any tax liability can be allowed citing the case of Republic vs. Mambulao Lumber Co., and Domingo vs. Garliton, correspondent to existing BIR Rulings."

On January 7, 2005, petitioner filed this Petition for Review before this Court assailing respondent's assessment for deficiency Income Tax in the amount of Two Hundred Eighty Thousand Four Hundred Ninety Seven Pesos and Fifty Four Centavos (₱280,497.54) and deficiency Final Withholding Tax in the amount of One Hundred Thirty One Thousand Five Hundred Fifty Seven Pesos and Sixty Two Centavos (₱131,557.62).

In his Answer to the Petition, filed on April 22, 2005, respondent alleged the following special and affirmative defenses:

"A) *Deficiency Income Tax:*
I. Disallowed Outside Services:

9) The Tax Code provides that any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid (Section 34[K] NIRC);

10) Verification of the BIR records of this case showed that Petitioner's outide services in the amount of P37,650.00 was not subjected to withholding tax pursuant to Section 58 of the 1997 Tax Code, hence, the same was disallowed as deduction in accordance with the above-cited rule;

11) Petitioner's claim that the outside services is not subject to withholding tax as the same were paid to general professional partnership is bereft or merit as they were not able to substantiate the same;

II. Disallowed Interest Expense:

12) Further, Petitioner's interest expense in the amount of P640,445.35 is subject to 20% final withholding tax pursuant to Section 2.57-1(G)(1) of Revenue Regulations (RR) 2-98;

13) However, verification disclosed that only the amount of P70,602 or less than 12% was remitted to the government;

14) Hence, the interest expense of P287,432.85 representing the amount not subjected to 20% final withholding tax was disallowed as deduction pursuant to Section 34(K) of the 1997 Tax Code;

III. Disallowed Tax Credit:

15) Under RR 2-98, a corporate taxpayer's excess expanded withholding tax credits for the taxable quarter/year shall automatically be allowed as credit against his income tax due for the taxable quarter/years immediately succeeding the taxable quarterly/years in which the excess credit arose provided he has not opted for a cash refund [Section 2.58.3(C)];

16) Verification disclosed that Petitioner has opted to refund the excess of the creditable tax withheld for the year 2000, hence, the same was

disallowed as tax credit against its computed deficiency income tax pursuant to the preceding paragraph;

IV. Deficiency Final Withholding Tax:

17) As mentioned in paragraph 12 of this Answer, Petitioner's interest expense is subject to 20% final withholding tax under Section 2.57-1(G)(1) of RR 2-98;

18) However, verification disclosed that Petitioner only remitted P70,602.50 from its interest expense of P640,445.35, thus, it is still liable for P57,486.57;

19) Further, Petitioner cannot set off its excess creditable tax payments for 1999 that it remitted to the BIR as payments for its final withholding tax liability for 2000 inasmuch as taxes are not debts, consequently, it is not susceptible of set off (*Republic v. Mambulao Lumber, 4 SCRA 672*);

20) Moreover, Section 248(B) of the 1997 Tax Code imposes a penalty equivalent to 50% of the deficiency tax in case of a false or fraudulent return;

21) In this case, verification disclosed that Petitioner willfully made an under-remittance in its withholding tax returns for taxable year 2000, thus, making the same false or fraudulent and subject to a penalty of 50% of the deficiency tax;

22) Petitioner's Protest Letters dated 29 March 2004 and 27 April 2004 to the Preliminary Assessment Notice and Formal Assessment Notice, respectively, did not raised the issue of alleged prescription, hence, the same cannot be raised for the first time on appeal (*MD Transit and Taxi Co., Inc. v. Estrella, 30 March 1982*);

23) At any rate, considering that this case involves a false or fraudulent return, the period of prescription for assessment that would apply is 10 years from the discovery of the fraud or falsity (*Section 222, 1997 NIRC*);

24) All presumptions are in favor of tax assessments (*Interprovincial Autobus Co., Inc. v. Collector, 98 Phil. 290; Cecilia Teodoro Dayrit v. Mon. Fernando Cruz and Commissioner, L-39910, 26 September 1988; Bonifactio Sy Po v. CTA & Commissioner, G.R. No. 81446, 18 August 1988*)."

After both parties presented their respective documentary and testimonial evidence; and after petitioner filed its Memorandum on November 23, 2005, this Court issued a Resolution dated January 15, 2007 considering the present case as deemed submitted for decision.[14]

The parties stipulated on the following issues for the Court's resolution:

"1. Whether or not petitioner is entitled for refund as a matter of right in the amount of P96,896.70.

2. Whether or not petitioner is liable for the alleged deficiency income tax and final withholding tax in the amount of P280,497.54 and P131,557.62 respectively for the taxable year 2000.

3. Whether petitioner's Outside Services in the amount of P37,650.00 was subjected to withholding tax;

4. Whether petitioner's Interest Expense in the amount of P287,432.85 was subjected to 20% final withholding tax;

5. Whether petitioner can set off its excess creditable tax payments for 1999 as payments for its final withholding tax liability for 2000;

6. Whether petitioner can utilize as tax credit its excess creditable withholding tax in the amount of P58,363.68 for taxable year 2000, which it opted to refund;

7. Whether petitioner can alleged for the first time on appeal that the excess creditable withholding tax in the amount of P58,363.68 was never totally applied against its income tax due;

8. Whether petitioner made false or fraudulent return by willful under-declaration of its withholding tax return for taxable year 2000;

9. Whether the issue of prescription can be raised on the first time on appeal;

10. Whether petitioner's income tax assessments have become final and executory for its failure to submit all relevant supporting documents;

11. Whether for taxable year 2000, petitioner incurred the following tax liabilities: xxx a) Deficiency Income Tax covered by Assessment Notice No. IT-6779-00-04-730 dated 14 April 2004 in the amount of P262,619.79, and b) Deficiency Final withholding Tax covered by Assessment Notice No. WF-6779-00-04-730 dated 14 April 2004 in the amount of P124,270.74."[15]

As regards the first issue, this Court rules in the negative. Section 76 of the 1997 National Internal Revenue Code ("NIRC") reads:

"SEC. 76. Final Adjustment Return – Every corporation liable to tax under Section 27 shall file a final adjustment return covering the total taxable income for the preceding calendar or fiscal year. If the sum of the quarterly

[14] Rollo, p. 241.
[15] Joint Stipulation of Issues; rollo,. pp. 81-82.

tax payments made during the said taxable year is not equal to the total tax due on the entire taxable income of that year, the corporation shall either:

(A) Pay the balance of tax still due; or
(B) Carry-over the excess credit; or
(C) Be credited or refunded with the excess amount paid, as the case may be.

In case the corporation is entitled to a tax credit or refund of the excess estimated quarterly income taxes paid, the excess amount shown on its final adjustment return may be carried over and credited against the estimated quarterly income tax liabilities for the taxable quarters of the succeeding taxable years. **Once the option to carry-over** and apply the excess quarterly income tax against income tax due for the taxable quarters of the succeeding taxable years **has been made, such option shall be considered irrevocable for that taxable period and no application for cash refund or issuance of a tax credit certificate shall be allowed therefore**." (Emphasis and underscoring supplied.)

In several cases,[16] this Court has ruled that once the option to carry-over has been made and the excess quarterly income tax was already applied against the income tax due for the taxable quarters of the succeeding taxable years, such option shall be considered irrevocable and no application for cash refund or issuance of a tax credit certificate shall be allowed therefore.

A scrutiny of the evidence presented to this Court revealed that the composition of the subject claim for refund amounting to ₱96,896.70 were as follows: Excess Tax Credits for the year 2000 – ₱48,645.28 and Excess Tax Credits for the year 2001 – ₱48,251.42.

As to the excess tax credits for the year 2000 amounting to ₱48,645.28, a perusal of the evidence revealed that it was carried-over by the petitioner in the year 2001. Petitioner's original 2000 ITR showed the following information:

MCIT		9,718.40
Aggregate Income Tax Due	9,718.40	
Less: Tax Credits/Payments	162,859.00	
Creditable Tax Withheld for the First Three Quarters	38,909.12	
Creditable Tax Withheld Per BIR Form No. 2307 for the Fourth Quarter	19,454.56	
Tax Payable/Overpayment	(221,222.68)	
Total Amount Payable	(211,504.04)	

[16] *Subic Bay Distribution, Inc. vs. The Commissioner of Internal Revenue*, CTA EB No. 72, May 23, 2006; *Bank of the Philippine Islands vs. Commissioner of Internal Revenue*, CTA Case No. 6276, March 12, 2003; *Philam Asset Management, Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 6210, dated May 2, 2002.

The total amount of overpayment amounting to ₱211,504.04, as shown above, was carried-over by the petitioner to its 2001 ITR as Prior Year's Excess Credits.[17] Said amount included the subject claim for refund in the amount of P48,645.28 computed as follows:

Creditable Tax Withheld for the First Three Quarters	P	38,909.12
Creditable Tax Withheld per BIR Form No. 2307 for the Fourth Quarter	P	19,454.56
Total Tax Credits/Payments	**P**	**58,363.68**
Less: MCIT for the year 2001	P	(9,718.40)
Total Amount Payable (Overpayment)	**P**	**48,645.28**

As to the remaining subject claim for refund in the amount of ₱48,251.42, which pertains to the year 2001, a scrutiny of the evidence revealed that it was also carried-over by the petitioner in the year 2002. Petitioner's original 2001 ITR showed the following information:

Prior Year's Excess Credits	211,504.04
Creditable Tax Withheld for the First Three Quarters	43,772.76
Creditable Tax Withheld Per BIR Form No. 2307 for the Fourth Quarter	14,590.92
Total Tax Credits/Payments	269,867.96
Tax Payable/Overpayment	(259,755.70)
Total Amount Payable	(259,755.70)

The total amount of overpayment amounting to ₱259,755.70, as shown above, was carried-over by the petitioner to its 2002 ITR as Prior Year's Excess Credits.[18] Said amount included the subject claim for refund in the amount of ₱48,251.42, computed as follows:

Creditable Tax Withheld for the First Three Quarters	P	43,772.76
Creditable Tax Withheld per BIR Form No. 2307 for the Fourth Quarter	P	14,590.92
Total Tax Credits/Payments	**P**	**58,363.68**
Less: MCIT for the year 2001	P	(10,112.26)
Total Amount Payable (Overpayment)	**P**	**48,251.42**

Clearly, the amount being claimed for refund, which is ₱96,896.70, the sum of ₱48,645.28 and ₱48,251.42 for the year 2000, were already covered by the **irrevocability**

[17] Line 26A of Exhibit H; rollo. p. 136.

rule set forth in Section 76 of the NIRC. Again, once the option to carry-over has been made, the same becomes irrevocable and no application for cash refund or issuance of a tax credit shall be allowed for that taxable period.[19] The subsequent amendments done by petitioner on its 2000 and 2001 ITRs did not result to the exclusion of the same on the abovementioned rule.

Hence, petitioner's claim for refund is without merit.

DEFICIENCY FINAL WITHHOLDING TAX

The deficiency final withholding tax was brought about by the disallowance of the amount of ₱57,486.57.

Based on petitioner's Annual Information Return of Creditable Income Taxes Withheld (Expanded) [BIR Form 1604-E][20] for the year 1999, it has P57,486.57 excess tax remitted, computed by deducting "Taxes Withheld" in the amount of ₱125,746.47 from "Total Amount Remitted" of ₱183,233.04.[21] The following year, petitioner offset the amount of ₱57,486.57 against the taxes required to be remitted; and the nature of income payment was described by petitioner as "Interest Expense" in its BIR Forms 1601-E starting July 2000, illustrated as follows:

	Month Covered	Tax Required to be Withheld	"Overpayment 1999"	Tax Still Due (Overremittance)
Exhibit 9	July	10,340.99	(57,486.57)	(47,145.58)
Exhibit 10	August	10,031.12	(47,145.58)	(37,114.46)
Exhibit 11	September	10,117.36	(37,114.46)	(26,997.10)
Exhibit 12	October	10,765.81	(26,997.10)	(16,231.29)
Exhibit 13	November	10,536.48	(16,231.29)	(5,694.81)
Exhibit 15	December	11,576.82	(5,694.81)	5,882.01

[18] Line 26 of Exhibit I, Rollo. p. 140.
[19] *Paseo Realty and Development Corporation vs. Court of Appeals, Court of Tax Appeals and Commissioner of Internal Revenue*, 440 SCRA 235 (2004); *Comsys Philippines, Inc. vs. The Commissioner of Internal Revenue*, CTA Case No. 6651, April 28, 2005; *Permanent Homes, Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 6441, September 7, 2004; *Family Medicare Services, Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 6453, June 7, 2004.
[20] Exhibit G; rollo. pp. 134-135.

Based on the above, it is clear that petitioner did not pay the amount of ₱57,486.57 for the year 2000 because of the offsetting. Nonetheless, petitioner, filed monthly returns from July to December of that year showing the offsetting. The last payment/remittance of withholding taxes for the year 2000 made by the petitioner was on January 23, 2001, as evidenced by Philippine Veterans Bank's Official Receipt No. 399758A for the amount of P5,882.01.[22]

Section 2.58 (A) (2) of Revenue Regulations 2-98, which specifies the period for the filing of monthly returns and remittance of taxes withheld, provides:[23]

> "Sec. 2.58. *Returns and Payment of Taxes Withheld at Source.*
>
> (A) 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.
>
> (b) For large taxpayers, the filing of the return and the payment of tax shall be made within twenty five (25) days after the end of each month.
>
> (c) The return for final withholding taxes on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements shall be filed and the payment made within twenty five (25) days from the close of each calendar quarter."

Apparently, the three (3) year period within which respondent has to assess petitioner of creditable expanded withholding tax or final withholding tax shall be counted from the last day required by law for filing a monthly remittance return, which is on or before January 25 of the following year or within twenty five days from the close of each calendar quarter.

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[21] Part II, Schedule 1 of Exhibit G.
[22] BIR Records, p. 19.
[23] "Implementing Republic Act No. 8424, 'An Act Amending The National Internal Revenue Code, As Amended, Relative To The Withholding On Income Subject To The Expanded Withholding Tax And Final Withholding Tax, Withholding Of Income Tax On Compensation, Withholding Of Creditable Value-Added Tax And Other Percentage Taxes."

Respondent posits that the applicable prescriptive period for the subject assessment is ten (10) years because he claims that this case involves false or fraudulent returns under Section 222 of the Tax Code.

This Court does not agree.

False or fraudulent return, as exceptions to the period of limitation of assessment and collection of taxes provided in Section 222 of the NIRC of 1997, as amended, must be actual not constructive. It must be intentional, consisting of deception willfully and deliberately done or resorted to. Fraud must be proven by clear and convincing evidence amounting to more than mere preponderance. It cannot be justified by mere speculation. This is because fraud is never lightly to be presumed.[24] In order to render a return made by a taxpayer a "false return" within the meaning of Section 222 of the NIRC, there must appear a design to mislead or deceive on the part of the taxpayer, or at least culpable negligence. A mistake that is not culpable in respect of its value would not constitute a false return.[25]

This Court finds that petitioner's acts do not constitute bad faith and the returns filed cannot be considered as false or fraudulent. Petitioner's act of offsetting its excess tax credits for the year 1999 to its taxes to be remitted for the year 2000 is not allowed because it is tantamount to the non-remittance of the respective withholding taxes for the months affected. However, on the face of the returns,[26] it is clear that it was done in good faith, considering that the amounts from the year 1999 being charged against the amount to be remitted for the year 2000 were *clearly typewritten* on the faces of petitioner's BIR Forms 1601-E as "Balance of Overpayment for 1999." Hence, the three (3)-year prescriptive period[27] should apply.

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[24] *Yutivo Sons Hardware Company vs. Court of Tax Appeals and Collector of Internal Revenue,* 1 SCRA 160.
[25] *Commissioner of Internal Revenue vs. Ayala Hotels, Inc.,* CA-G.R. SP No. 70025, April 19, 2004.
[26] Exhibits 9, 10, 11, 12, 13 and 15.
[27] Section 203 of 1997 NIRC.

The last day prescribed by law for filing of the return (BIR Form 1601-E) in the instant case was January 25, 2001. Consequently, respondent has until January 26, 2004 within which to issue his assessment notice.[28] In the case at bar, the right to assess had prescribed as respondent issued his Assessment Notice No. 6779-00-04-730 on April 14, 2004.[29] Therefore, respondent's Assessment Notice No. 6779-00-04-730 issued for petitioner's Final Withholding Tax for the year 2000 is void.

As for the deficiency Income Tax, petitioner filed its 2000 ITR on April 14, 2001 and the last day of filing for petitioner's 2000 ITR was on April 17, 2001.[30] As the last day for respondent to assess the same was on April 17, 2004, the assessment issued by respondent on April 14, 2004 was within the prescribed period.

DEFICIENCY INCOME TAX

Petitioner is held liable for deficiency income tax due to the disallowance of the following items:

1. Outside Services not subjected to Expanded Withholding Tax – P37,650.00
2. Interest Expense not subjected to Final Tax – P287,432.85
3. Creditable Tax Withheld (for refund) – P58,363.68

Outside Services

The amount of ₱37,650.00 was disallowed by respondent as petitioner's deduction because of non-withholding of taxes therein. Petitioner counters that the amount was paid to a General Professional Partnership. Hence, it is not required to withheld tax.

Section 26 of the 1997 NIRC, states that:

> "Sec. 26. Tax Liability of Members of General Professional Partnerships.- A general professional partnership as such shall not be subject to the income tax imposed under this Chapter. Persons engaging in business

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[28] January 25, 2004 was a Sunday.
[29] Exhibit 19, Rollo. p.226.
[30] April 15, 2001 was a Saturday.

as partners in a general professional partnership shall be liable for income tax only in their separate and individual capacities.

xxx xxx xxx."

Also, Section 2.57.5 of Revenue Regulation 2-98 states:

"Sec. 2.57.5 *Exemption from withholding.* – The withholding of creditable withholding tax prescribed in these Regulations shall not apply to income payments made to the following:

(A) xxx;

(B) Persons enjoying exemption from payment of income taxes pursuant to the provisions of any law, general or special, such as but not limited to the following: xxx."

Thus, payment made to a general professional partnership is not subject to the withholding of taxes.

The composition of the disallowed amount of ₱37,650.00 is as follows:

	Reference	Payee	Amount	Tax Withheld and Remitted
Exhibit U and U-1	OR. No. 2159 Bill No. 7223	R.S. Bernaldo & Associates	15,000.00	none
Exhibit V and V-1	OR. No. 1757 Bill No. 6668	R.S. Bernaldo & Associates	10,000.00	none
Exhibit W	Receipt date 27-Dec-00	Velicaria, Vibar, Santiago, Palaña & Egenias Law Office	650.00	none
Exhibit X	Check Voucher with Check No. 148439	Narcissus L. Duran	12,000.00	1,200.00
			37,650.00	1,200.00

Based on the above, the amount of ₱25,650.00 pertains to the payments made by petitioner to a general professional partnership not subject to withholding tax.[31] As the dates in the documentary evidence are not disputed by the parties, this Court shall consider the same as pertaining to the subject taxable year.

[31] Total of Exhibits U, U-1, V, V-1 and W.

The remaining amount of ₱12,000.00 is not a payment to general professional partnership. Thus, said amount is not exempt from the withholding of tax due. However, evidence shows that petitioner complied with the withholding requirement; and withheld the amount of ₱1,200.00 and remitted the same to respondent as evidenced by its BIR Form 1601-E return for December 2000.[32] Therefore, the amount of ₱37,650.00 must be allowed as a deduction.

Interest Expense not subjected to Final Tax

Based on the evidence presented, respondent was correct when he disallowed the deduction of the amount of ₱287,432.85. Petitioner is not allowed to use it as a deduction because by off-setting the excess taxes amounting to ₱57,486.57 in 1999 against the Final Taxes due for the months of July to December 2000, it resulted to the non-payment of Final Withholding Taxes due on the aforementioned months. It also violated Section 2.57-1 (G)(1) of Revenue Regulation No. 2-98.

Creditable Tax Withheld

Respondent argues that since petitioner applied for the refund of the amount of ₱58,363.68, it is not allowed to use the same as tax credit for the year 2000.

This Court does not agree.

Petitioner's claim for refund in the amount of ₱96,896.70 was disallowed because petitioner carried over and applied the excess quarterly income tax against the income tax due for the taxable quarters of the succeeding taxable year. The amount carried over includes the Creditable Tax Withheld disallowed by respondent in the amount of ₱58,363.68 for the year 2000. However, only ₱48,645.28 out of ₱58,363.68 will be allowed as tax credit

[32] Exhibit Y; rollo. p. 170.

after deducting the MCIT for the year 2000 amounting to ₱9,718.40. Petitioner has prior year's excess credits in the amount of ₱162,859.00 for the year 2000 and an additional amount of ₱48,645.28. Hence, petitioner has a a total tax credit or overpayment of ₱211,504.28 for the year 2000.

According to the Final Decision on the Disputed Assessment, the amount of "Taxable Income (Loss) per Return" in the amount of ₱(489,596.00) was added back to the "Adjusted Taxable Income" by the respondent "in order to recapture the income tax benefit realized in the following year." However, respondent did not specify what year and what amount did petitioner carry over the same. Furthermore, verification disclosed that no carry over of that amount was apparent on petitioner's 2001 ITRs, both original and amended. Even if the amount was carried forward to the subsequent year, it was supposed to be on the subsequent year (2001) that the amount of ₱(489,596.00) should be added back and not on the year the Net Operating Loss Carry Over ("NOLCO") was incurred (in 2000) as it was in the year 2001 that petitioner will obtain tax benefit from such deduction from its gross income.

The respondent's assessment for deficiency Income Tax should be recomputed as follows:

DEFICIENCY INCOME TAX

Taxable Income(Loss) per Return			P	(489,596.00)
add: adjustments				
Interest Expense not subjected to Final Tax		287,432.85		325,082.85
Taxable Income				(164,513.15)
Tax Due 32%			P	-
MCIT				9,718.40
less: Tax Payments/Credits				
Prior year's excess credit	P	162,859.00		
Creditable tax withheld		58,363.68		221,222.68
Total				-
Total Amount Payable (Overpayment)				(211,504.28)

Although respondent was correct in disallowing petitioner's Interest Expense not subjected to Final Tax in the amount of P287,432.85; nonetheless, petitioner has no tax liability for the year 2000. Petitioner incurred a loss in the amount of ₱164,513.15. Also, after applying the amount of ₱9,718.40 MCIT against the total tax credit of ₱221,222.68, it appears that there was an overpayment of taxes in the amount of ₱211,504.28 for the year 2000. Hence, petitioner is not liable for deficiency Income Tax.

As to the issue on the non-submission of all relevant documents within the sixty (60)-day period, it must be emphasized that respondent is not the proper party to decide whether or not the documents submitted are essential and complete to support the protest of the taxpayer. It is up to the taxpayer to decide. This is to prevent respondent from abusing the exercise of his otherwise unlimited power to tax the petitioner.[33]

WHEREFORE, the Petition for Review is **PARTIALLY GRANTED**. Respondent's assessments for deficiency Income Tax and Final Withholding Tax for the taxable year 2000, in the amount of **Two Hundred Eighty Thousand Four Hundred Ninety Seven and 54/100 Pesos** (₱280,497.54) and **One Hundred Thirty One Thousand Five Hundred Fifty Seven and 62/100 Pesos** (₱131,557.62), respectively, are hereby **CANCELLED** and **SET ASIDE**. However, petitioner's request for refund in the amount of **Ninety Six Thousand Eight Hundred Ninety Six and 70/100 Pesos** (P96,896.70) is hereby **DENIED** for lack of merit.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

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[33] *The Commissioner of Internal Revenue vs. Maruka Enterprises, Inc.*, CTA EB No. 105, June 1, 2006.

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

(On Leave)
CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division