REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION
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ASIA COAL CORPORATION, *Petitioner,*	**C.T.A. Case No. 6803**
	Members:
-versus-	**ACOSTA**, *P.J.* **BAUTISTA**, and **CASANOVA**, *JJ.*
THE COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	**Promulgated:** FEB 13 2008, 10:05AM

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DECISION

Acosta, PJ:

This Petition for Review seeks to declare the assessment of deficiency income taxes for the year 1999 in the amount of P36,548,896.38 (inclusive interest) as of December 26, 2002, against petitioner Asia Coal Corporation, void for want of factual and legal basis. It is filed pursuant to Section 228 of the National Internal Revenue Code (NIRC) and Section 7(a)(2) of Republic Act 1125, as amended by Republic Act 9282 on inaction of respondent on the protest of petitioner.

Below are the facts as culled from the records:

Petitioner is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines, with principal office at Level 11, Phinma Plaza, 39 Plaza Drive, Rockwell Center, Makati City 1200. It is primarily engaged in the business of operating coal mines and coal terminals; prospecting for mining, washing, blending, beneficiating and otherwise preparing coal for market; and trading, buying, selling, exchanging, transporting, and otherwise producing and dealing in coal and all kinds of minerals, hydrocarbons, ores, metals, commodities, fertilizers and chemicals. On the other hand, respondent Commissioner of Internal Revenue is the chief of the Bureau of Internal Revenue (BIR), which is the government agency charged with the collection of national internal revenue taxes.[1]

On January 29, 2003, petitioner received from the Bureau of Internal Revenue, a Formal Letter of Demand dated December 26, 2002 and an unnumbered Audit Result/Assessment Notice of the same date, assessing petitioner for alleged deficiency income tax for taxable year 1999 in the amount of P36,548,896.38 (including interest) as of December 26, 2002,[2] computed as follows:

Net Income per Return		P 32,084,671.00
Add: Discrepancies per investigation		
A. Understatement of ending inventory	P 640,608.49	
B. Income not subjected to income tax	69,425,029.26	70,065,637.75
Total Income per investigation		P102,150,308.75
Tax Due: 34%, 33%		33,879,852.41
Less: Tax due per return		10,641,416.00
Tax still due		P 23,238,436.41
Add: 20% interest per annum up to 12-26-02 or 57.28%		13,310,459.97
Total tax due		P 36,548,896.38

Based on the Details of Discrepancies,[3] the deficiency income tax was purportedly due to the understatement of ending inventory in the amount of P640,425,029.26 This alleged understatement of ending inventory, was in turn due to

[1] *Paragraphs 1 and 2, Joint Stipulation of Facts and Issues*
[2] *Paragraph 3, ibid.; Exhibit "A"*
[3] *Exhibit "A-1"*

petitioner's use of the specific identification method in costing the ending inventory which was found not to be consistent with the average costing method used in the previous year. On the other hand, and income not subjected to income tax in the amount of P69,425,029.26[4] was due to supposed higher sales reflected in the certificate of Creditable Tax Withheld at Source as compared to petitioner's sales per books.[5]

Within the reglementary period of thirty (30) days from receipt of the Final Assessment Notice on February 27, 2003, petitioner filed before the Bureau of Internal Revenue, its protest of even date against the Final Letter of Demand and unnumbered Audit Result/Assessment Notice, both dated December 26, 2002.[6] In the said protest letter, petitioner questioned the legality of respondent's assessment for lack of factual and legal basis.[7]

As of October 21, 2003, the 180th day from April 24, 2003, date of the submission of all documents relevant to the protest, petitioner has not received from respondent any letter denying its protest in whole or in part, or giving due course thereto. Thus, petitioner had every reason to believe that respondent has not acted upon its protest within 180 days from submission of the said documents.[8]

This prompted the filing of the instant Petition with this Court on October 23, 2003, pursuant to Section 228 of the NIRC in order to protect petitioner's rights as tax protestant and to prevent the questioned assessment from attaining finality.[9]

On December 11, 2003, respondent filed an Answer raising the following Special and Affirmative Defenses:

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[4] *Paragraph 4, , Joint Stipulation of Facts and Issues*
[5] *Paragraph 5, ibid.*
[6] *Paragraph 6, ibid.*
[7] *Paragraph 7, ibid.*
[8] *Paragraph 8, ibid.*
[9] *Paragraph 9, ibid.*

"4. Petitioner's understatement of ending inventory in the amount of P640,608.49-Verification disclosed that costing used in ending inventory is specific identification method which is not consistent with the average costing method used in the previous year; thus the amount of P640,608.49 was disallowed as part of cost of sale pursuant to Section 41 of the Tax Reform Act of 1997.

5. Petitioner's income not subjected to income tax in the amount of P69,425,029.26-Verification disclosed that sales reflected in the Certificate of Creditable Tax Withheld at Source are higher than sales per books and were not subjected to income tax; thus, assessed pursuant to Section 32(a)(2) of the Tax Reform Act of 1997.

6. The assessment was issued in accordance with law and regulations.

7. All presumptions are in favor of the correctness of tax assessments."

The parties limited to the following the issues to be resolved by the Court:

a. whether or not the amount of P640,608.49 should be allowed as part of cost of sales.

b. whether or not the amount of P69,425,029.26 was subjected to income tax.

c. whether or not petitioner is liable for Deficiency Income Tax for the taxable year 1999.[10]

On July 20, 2007, with the filing of respondent's and petitioner's Memorandum on June 29, 2007 and July 13, 2007, respectively, this case was submitted for decision.

The Court finds no merit in this Petition.

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[10] *Joint Stipulation of Facts and Issues, Records, page 81*

In the Details of Discrepancies attached to the Formal Letter of Demand, respondent alleged that the costing method used on ending inventory is "specific identification method" which is not consistent with the "average costing method" used in the previous year. According to respondent, the statement of petitioner that the best accounting practice commonly used in the coal trading business is "specific identification method" to avoid costly build-up of inventories and that the "average costing method" is not acceptable because coal prices vary significantly considering the different specifications required by buyers does not justify the issue of inconsistency in the valuation of the ending inventory. Likewise, while it is stated in the Notes to Financial Statements that inventories are valued at lower of average cost or market, respondent applied the average cost in the valuation of ending inventory since there was no documentary evidence in support of the market price. This resulted in the conclusion of the supposed understatement in ending inventory in the amount of P640,608.49 and its disallowance as part of petitioner's cost of sales pursuant to Sec. 41 of the NIRC which states:

> "SEC. 41. **Inventories.**—Whenever in the judgment of the Commissioner, the use of inventories is necessary in order to determine clearly the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Secretary of Finance, upon recommendation of the Commissioner, may, by rules and regulations, prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.
>
> If a taxpayer, after having complied with the terms and conditions prescribed by the Commissioner, uses a particular method of valuing its inventory for any taxable year, then such method shall be used in all subsequent taxable years unless:
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> > (i) with the approval of the Commissioner, a change to a different method is authorized; or
> >
> > (ii) the Commissioner finds that the nature of the stock on hand (*e.g.*, its scarcity, liquidity, marketability and price movements) is such that inventory gains should be

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> considered realized for tax purposes and, therefore, it is necessary to modify the valuation method for purposes of ascertaining the income, profits, or loss in a more realistic manner; *Provided, however*, That the Commissioner shall not exercise his authority to require a change in inventory method more often than once every three (3) years: *Provided, further*, That any change in an inventory valuation must be subject to approval by the Secretary of Finance."

According to respondent, the "average costing method" is commonly used in the industry with prices that vary significantly because of its acceptability. This method does not permit profit manipulation unlike the "specific identification method" which open doors to possible profit manipulation through the choice of particular units for delivery. Respondent explains that during investigation, no stock cards were presented which prompted the checking of the valuation of petitioner's ending inventory by making an independent computation using the "average costing method". Further, while its is stated in the Notes to Financial Statements that inventories are valued at lower of average cost or market, respondent applied the average cost in the valuation of ending inventory since there was no documentary evidence to support the market price. This resulted in an understatement of ending inventory in the amount of P640,608.49.

In response, petitioner argues that the "average costing method" cannot be used to determine its ending inventory cost due since it has always used the specific identification method in determining ending inventory costing. And Section 41 of the NIRC prohibits both petitioner and respondent from using any other method of inventory valuation except the method that was used the previous year which in this case was the "specific identification method". According to petitioner since it has been using the "specific identification method" in the years prior to 1999, BIR cannot use any other method in computing for the cost of its ending inventory; as Section 41 clearly provides that once a particular method has been used, the same method shall be used in all subsequent taxable years, unless the taxpayer is authorized by the Commissioner to

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change the method. Moreover, the BIR cannot rely on Section 41(ii) because the provision clearly states that the Commissioner's power to modify the valuation method must be subject to approval by the Secretary of Finance, which was not obtained in this case.

Petitioner further avers that both the "specific identification method" and the "average costing method" are in accordance with generally accepted accounting principles. There is absolutely no evidence that the "average costing method" should be used because of its "acceptability" to petitioner's specific industry and that said method will reflect the actual price of petitioner's ending inventory. On the contrary, the "average costing method" will not reflect the actual cost of the ending inventory since the price per unit is determined using the average cost of all shipments for the taxable year and not the actual cost of the current shipment.

It likewise maintains that there were only three (3) shipments of coal received by petitioner in taxable year ending October 31, 1999. The supply of coal from the first two shipments has been fully delivered to petitioner's customers and that the ending inventory for year ending October 31, 1999 consisted only of deliveries of coal from Shell Coal Pty. Ltd. under Sales Invoice dated August 31, 1999 which was delivered by M/V Primax on September 10, 1999. Since its ending inventory consisted of only shipment for one source (Shell Coal Pty. Ltd.) the valuation of the shipment can easily be identified under the specific identification method, and cannot be subject of price manipulation, contrary to respondent's claim.

Petitioner concluded that since the "specific identification method" is the proper method that should be employed, the use of the "average costing method" by the respondent has no basis and therefore, the disallowance of the amount P640,608.49 on its cost of sales for the year ending October 31, 1999 has no basis.

After a judicious review of this case, the Court finds that petitioner failed to adduce sufficient evidence to prove its claim.

From the evidence presented, the method used by petitioner in the previous years, particular for the fiscal year ending October 31, 1998, cannot be determined. Its claim that it had employed and has been consistently using the "specific identification method" was not shown by evidence. Absent any evidence to prove that petitioner's ending inventory for the fiscal year 1998 was valued using the "specific identification method", the second paragraph of Section 41 of the NIRC cannot be applied. What applies is the first paragraph thereof which states that if the use of inventories is necessary in order to determine a taxpayer's income, then it shall be taken by the taxpayer based on rules and regulations issued by the Secretary of Finance, upon recommendation of the Commissioner; conforming as nearly as may be to the best accounting practice in the trade or business, and most reflecting income.

Simply put, the method of inventory taking should be that which reflects the taxpayer's income, for this is merely to ensure the assessment of correct taxes. As found by respondent, the "average costing method" commonly used in the industry should be applied since there was no documentary evidence in support of market price.

Given the well-entrenched principle in taxation that tax assessments by tax examiners are presumed correct and made in good faith; that the taxpayer has the duty to prove otherwise; that in the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed; and finally that all presumptions are in favor of the correctness of tax assessments,[11] the assessment should be upheld. Petitioner was not able to overturn these presumptions.

Anent the second issue of whether petitioner had income in the amount of P69,425,029.26 which was not subjected to income tax, the Court likewise finds for respondent.

According to respondent the sales reflected in the Certificate of Creditable Tax Withheld at Source is higher than the sales per books and was not subjected to income tax. And the sales reflected in the Certificate of Creditable Tax Withheld at Source which is higher than the sales per books was not fully explained and accounted for in the reconciliation of sales attached to the letter of protest dated December 3, 2002. This resulted in the denial of the reconciliation of sales presented by petitioner and the issuance of an assessment against petitioner, pursuant to Section 32(A)(2) of the National Internal Revenue Code on gross income.

In its Memorandum, petitioner argues that the Certificates of Creditable Tax Withheld at Source issued by its customers could not accurately and reliably serve as basis for computing sales subject to income tax. It claims that the computation of sales should be based on the sales invoices supported by delivery receipts issued for fiscal year ending October 31, 1999. It avers that it has no control over its customers' issuance of the Creditable Withholding Tax Certificates and that it could only claim the corresponding creditable withholding taxes during the year of receipt of the pertinent withholding tax certificates and not on the year of the delivery of the coal purchased by the customers or the year of the sale of the coal.

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[11] *In* ***Commissioner of Internal Revenue vs. Wyeth Suaco Laboratories and the Court of Tax Appeals***, *G.R. No. 76281, September 30, 1991*

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Petitioner maintains that it has presented sufficient evidence to establish that the discrepancy between its sales as reflected in the Creditable Withholding Tax Certificates and sales reported in its books was due to timing difference between the reporting of its sales and the claiming of the creditable withholding taxes pertaining to such sales. And that for fiscal year ending October 31, 1999, it duly reported all its sales, which were subject to income tax, contrary to the findings of the BIR.

Petitioner's argument that the computation of sales should be based on the sales invoices supported by delivery receipts issued for fiscal year ending October 31, 1999, has no basis in law. **Section 5 of the 1997 National Internal Revenue Code** finds application, it reads:

> SEC. 5 Power of the Commissioner to Obtain Information, and to Summon/Examine, and Take Testimony of Persons. - In ascertaining the correctness of any return, or in making a return when none has been made, or **in determining the liability of any person for any internal revenue tax**, or in collecting any such liability, or in evaluating tax compliance, **the Commissioner is authorized:**
>
> **(A) To examine any book, paper, record, or other data which may be relevant or material to such inquiry**.xxx

Respondent may utilize any kind of document, including the Certificates of Creditable Withholding Tax At Source to determine the correct sales of the petitioner for the questioned fiscal year.

Petitioner's claim that it has no control over its customers on their issuance of Creditable Withholding Tax Certificates and that it could only claim the corresponding Creditable Withholding Taxes during the year of receipt of the pertinent withholding tax certificates and not on the year of the delivery of the coal purchased by the customers or the year of the sale of the coal, is likewise untenable.

Section 2.58 (B) of Revenue Regulations No. 2-98 provides that every payor required to deduct and withhold taxes under these regulations **shall** furnish each payee, whether individual or corporate, with a withholding tax statement, using the prescribed form (BIR Form 2307) showing the income payments made and the amount of taxes withheld therefrom, for every month of the quarter **within twenty (20) days following the close of the taxable quarter** employed by the payee in filing his/its quarterly income tax return. **Upon request of the payee, however, the payor must furnish such statement to the payee simultaneously with the income payment**.

Moreover, petitioner failed to show that the related income on the questioned creditable withholding tax certificates were already declared in the income tax return of the previous fiscal year.

To recapitulate, respondent's disallowance of ending inventory amounting to P640,608.49 should be upheld. There is lack of material evidence to prove that the "specific identification method" was used by petitioner in previous years, particular for the fiscal year ending October 31, 1998, in order for the Court to conclude that it has been using said method consistently. Further, the additional income representing the difference between the amount of sales per Certificates of Creditable Withholding Tax At Source and sales per books which was assessed by respondent should also be upheld. Contrary to petitioner's assertion, sales invoices are not the only way to determine income earned. The National Internal Revenue Code allows the use of any book, paper, record, or other data which may be relevant to an inquiry pursuant to the above-quoted Section 5. And in this case, petitioner has failed to show that the related income on the questioned Creditable Withholding Tax Certificates was already declared in the income tax return of the previous fiscal year.

WHEREFORE, the Petition for Review is hereby **DENIED** for lack of merit. Accordingly, the assessment issued by respondent against petitioner on December 26, 2002 for deficiency income tax is hereby **UPHELD**. Petitioner is **ORDERED** to **PAY** the amount of P36,548,896.38 computed as follows:

Net Income per Return		P 32,084,671.00
Add: Discrepancies per investigation		
A. Understatement of ending inventory	P 640,608.49	
B. Income not subjected to income tax	69,425,029.26	70,065,637.75
Total Income per investigation		P102,150,308.75
Tax Due: 34%, 33%		33,879,852.41
Less: Tax due per return		10,641,416.00
Tax still due		P 23,238,436.41
Add: 20% interest per annum up to 12-26-02 or 57.28%		13,310,459.97
Total tax due		**P 36,548,896.38**

In addition, petitioner is **ORDERED** to **PAY** 20% delinquency interest per annum from January 26, 2003[12] until full payment thereof, pursuant to Section 249(C) of the National Internal Revenue Code.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

[12] *Exhibit "B"*

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 opinion writer of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division