REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

UNITED DISTRIBUTION MANAGEMENT, INC.,
Petitioner,

- versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. Case No. 7885

Members:

Bautista, *Chairperson*
Palanca-Enriquez,
Cotangco-Manalastas, *JJ.*

Promulgated:
SEP 24 2012
[signature] 10:55 a.m.

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DECISION

COTANGCO-MANALASTAS, J.:

Before Us is a Petition for Review filed on March 20, 2009, seeking the cancellation and withdrawal of the assessment issued against petitioner for alleged deficiency final tax including interest, surcharges and compromise penalty, in the amount of P1,675,034.65 for taxable year 2004.

FACTS

Petitioner United Distribution Management, Inc. is a domestic corporation duly organized and existing under Philippine law, with principal office at 497 President Quirino Avenue corner Zulueta Street, Malate, Manila.[1]

On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) vested under the appropriate laws with the authority to carry out the functions, duties and responsibilities of said office, including, *inter alia,* the power to decide disputed assessments, cancel and abate tax

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[1] Exhibit "A"; Par. 1, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), docket, p. 76.

liabilities pursuant to the provisions of the National Internal Revenue Code (NIRC) of 1997 and other tax laws, rules and regulations.

On January 26, 2008, petitioner received Assessment Notice No. 34-2004, with an attached letter bearing Demand No. 34-2004, both dated January 23, 2004[2], signed by Mr. Alfredo Misajon, Regional Director of Revenue Region No. 6, Manila, assessing petitioner deficiency income tax, value-added tax (VAT), documentary stamp tax (DST) and final tax in the total amount of P33,779,639.11, inclusive of interest, surcharges and penalties.[3]

The deficiency taxes and penalties were computed as follows:[4]

	BASIC TAX	INTEREST	SURCHARGE	COMPROMISE PENALTY	TOTAL
Income	P15,617,006.85	P 8,676,012.54		P 50,000.00	P24,343,019.39
VAT	4,745,435.17	2,847,261.10		25,000.00	7,617,696.27
DST	50,000.00	48,888.80	20,000.00	25,000.00	143,888.80
Final Tax	891,934.87	540,116.06	222,983.72	20,000.00	1,675,034.65
Total	P21,304,376.89	P12,112,278.50	242,983.72	P120,000.00	P33,779,639.11

Petitioner filed a Protest and Reply to the Assessment Notice on February 22, 2008, stating, among others, that petitioner availed of the tax amnesty on October 26, 2007, pursuant to the provisions of Republic Act (RA) No. 9480.[5]

On February 27, 2009, petitioner received from the BIR a letter dated February 10, 2009, informing petitioner that its 2004 deficiency assessment for final tax amounting to P1,675,034.65 will be forwarded to the Collection Division of Revenue Region No. 6 for enforcement of collection.[6]

Petitioner, through counsel, also received on March 19, 2009 an undated letter acknowledging petitioner's availment of the tax amnesty and confirming the

[2] Per allegations in the JSFI, but is actually dated January 23, 2008.
[3] Par. 3, Admitted Facts, JSFI, docket, p. 77.
[4] Par. 4, Admitted Facts, JSFI, docket, p. 77
[5] Exhibit "E"; Par. 5, Admitted Facts, JSFI, docket, p. 77.
[6] Par. 6, Admitted Facts, JSFI, docket, p. 78.

cancellation of the deficiency income tax, VAT and DST assessments for 2004, but stressing that the deficiency final tax assessment is not covered by the tax amnesty.[7]

Inasmuch as respondent reiterated only the assessment for final tax and cancelled the other assessments for deficiency income tax, VAT and DST, petitioner deemed it a partial denial of its protest.[8]

Accordingly, petitioner appealed the partial denial of its protest of the assessment for deficiency final tax by filing the instant Petition for Review on March 20, 2009.

Respondent filed her Answer[9] on April 27, 2009, interposing the following defenses:

> "9. The assessment is valid and correct and the petitioner has the burden of proof to impugn its validity (*Behn Meyer and Co. vs. Collector of Internal Revenue*, 27 Phil. 647). Thus, similarly held, tax assessments by examiners are presumed correct and made in good faith and the taxpayer has the duty to prove otherwise. (*Commissioner of Internal Revenue vs. Construction Resources of Asia, Inc.*, 145 SCRA 671); and assessments duly made by a BIR examiner and approved by her superior officers will not be disturbed (*Gutierrez vs. Villegas*, 8 SCRA 547).
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> 10. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but also that the taxpayer is right (*Tan Guan vs. Court of Tax Appeals, et. al.*, 19 SCRA 903 [1967]; *Collector of Internal Revenue vs. Bohol Land Transportation Co.*, 107 Phil. 967 [1960]).
>
> 11. Pursuant to Section 222 of the Tax Code of 1997, in the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed at anytime within ten (10) years after the discovery of the falsity, fraud or omission."

[7] Exhibit "G"; Par. 7, Admitted Facts, JSFI, docket, p. 78.
[8] Par. 8, Admitted Facts, JSFI, docket, p. 78.
[9] Docket, pp. 42-45.

The case was then set for Pre-Trial Conference on May 15, 2009.[10] Petitioner filed its Pre-Trial Brief[11] on May 12, 2009; while Respondent's Pre-trial Brief[12] was filed on May 14, 2009.

On June 15, 2009, the parties filed with this Court their Joint Stipulation of Facts and Issues[13]; which was later approved in a Resolution[14] dated June 18, 2009. In the same Resolution, the Pre-Trial Conference was terminated.

Trial proceeded, giving both parties the opportunity to present their respective documentary and testimonial evidence.

Petitioner presented and formally offered Exhibits "A" to "EE-1", which were admitted pursuant to this Court's Resolution[15] dated November 9, 2010. Petitioner also formally offered as part of its documentary evidence Exhibits "FF" to "QQ-1", which were admitted as per this Court's Resolution[16] dated February 14, 2012.

On the other hand, respondent presented and formally offered Exhibits "1" to "27", which were admitted pursuant to this Court's Resolution[17] dated June 22, 2011.

Subsequently, respondent's Memorandum[18] was submitted on March 19, 2012; while petitioner's Memorandum was filed through registered mail on April 20, 2012.[19] Accordingly, the case was submitted for decision on April 30, 2012.[20]

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[10] Docket, p. 50.
[11] Docket, pp. 58-66.
[12] Docket, pp. 67-70.
[13] Docket, pp. 76-80.
[14] Docket, p. 81.
[15] Docket, pp. 401-402.
[16] Docket, pp. 527-528.
[17] Docket, pp. 469-470.
[18] Docket, pp. 529-540.
[19] Docket, pp. 577-609.
[20] Docket, p. 611.

ISSUES

The parties submitted the following issues[21] for this Court's disposition:

1. Whether respondent's right to assess petitioner for alleged deficiency withholding tax for taxable year 2004 has prescribed;

2. Whether or not petitioner declared dividends to its stockholders for taxable year 2004;

3. Whether or not Assessment No. 34-2004 dated January 23, 2008 for deficiency final tax in the amount of P1,675,034.65 was validly issued; and

4. Whether or not petitioner is liable for withholding tax of P1,675,034.65 on dividends.

DISCUSSION/RULING

Since the foregoing issues are interrelated, the Court shall resolve them simultaneously.

Petitioner alleged that the subject assessment was not validly issued considering that respondent only has three (3) years, reckoned from the date of actual filing of the return or from the last date prescribed by law for the filing of such return, whichever comes later, within which to assess national internal revenue taxes. Here, the withholding tax return for petitioner's purported payment of dividends should have been filed on January 15, 2005 pursuant to Section 2.58 of Revenue Regulations No. 2-98. Counting from said date, respondent had until January 15, 2008 to assess petitioner for any deficiency final withholding taxes. Since the disputed Assessment Notice No. 34-2004, with an attached letter bearing Demand No. 34-2004, was received by petitioner on January 26, 2008, petitioner concluded that the assessment was issued beyond the three-year prescriptive period.[22]

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[21] Docket, pp. 79-80.
[22] Docket, pp. 556-557.

On the other hand, respondent averred that its right to assess petitioner for its 2004 deficiency final withholding tax has not yet prescribed inasmuch as it has ten (10) years from the discovery of the falsity, fraud or omission in the filing of petitioner's final withholding tax return within which to assess as prescribed under Section 222(a) of the NIRC of 1997.

It must be noted that there is nothing in the records which would show that petitioner filed a return for the final withholding tax on payments to stockholders treated as dividends subject to final tax. In fact, petitioner argued that it did not file a return corresponding to the final withholding tax on the alleged declared dividends because it did not declare or pay cash dividends during taxable year 2004. Consequently, the applicable prescriptive period here is the ten-year period to assess from discovery of the falsity, fraud or omission provided in Section 222(a) of the NIRC of 1997, which states:

> "SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* -
>
> (a) In the case of a false or fraudulent return with intent to evade tax or of **failure to file return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission**: *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof." (*Emphasis supplied*)

It must be pointed out that the actual date of discovery of such omission was not established. However, since the taxable year subject of the assessment is year 2004, and the notice of assessment was issued on January 23, 2008, or after only approximately four (4) years, it is clear that the assessment for deficiency final withholding tax was issued within 10 years after the discovery of the falsity, fraud or omission. Thus, said assessment has not prescribed.

Petitioner asserted that the assessment lacks factual and legal basis considering that petitioner did not declare or pay cash dividends to its stockholders during taxable year 2004.

Respondent countered that the payments made in 2004 to Mr. Enrique Fernandez, who practically owned the corporation, are deemed distribution of dividends to a stockholder. Likewise, the interest payments to Mr. Fernandez were not subjected to final withholding tax.

Perusal of Assessment Notice No. 34-2004[23], Letter of Demand with Demand No. 34-2004[24] and its Details of Discrepancy[25] would show that petitioner was assessed by respondent for deficiency final tax under Section 24 of the National Internal Revenue Code of 1997, as amended, subjecting both petitioner's payments to stockholders and interest payments made to them to final tax of ten percent (10%).

Notably, in the Memorandum Report[26] submitted by Revenue Officer Betty B. Esplana, it was mentioned that the payments made and interest paid to Mr. Fernandez were treated as dividends subject to 10% final tax. Respondent applied the 10% final tax on dividends found under Section 24(B)(2) of the National Internal Revenue Code of 1997, as amended, the pertinent portion of which reads:

> "SEC. 24. *Income Tax Rates.* –
>
> xxx xxx xxx
>
> (B) *Rate of Tax on Certain Passive Income.* –

[23] Exhibit "19".
[24] Exhibit "18".
[25] Exhibit "17".
[26] Exhibit "15".

> xxx xxx xxx
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> (2) *Cash and/or Property Dividends.* - **A final tax at the following rates shall be imposed upon the cash and/or property dividends actually or constructively received by an individual from a domestic corporation** or from a joint stock company, insurance or mutual fund companies and regional operating headquarters of multinational companies, or on the share of an individual in the distributable net income after tax of a partnership (except a general professional partnership) of which he is a partner, or on the share of an individual in the net income after tax of an association, a joint account, or a joint venture or consortium taxable as a corporation of which he is a member or co-venturer:
>
> xxx xxx xxx
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> **Ten percent (10%) beginning January 1, 2000.**" *(Emphasis supplied)*

Under the circumstances, the Court further cites Section 57(A) of the NIRC of 1997, as amended, which requires the withholding by the payor of the income provided under Section 24(B)(2) of the same Code. Section 57(A) of the NIRC of 1997 states as follows:

> "SEC. 57. *Withholding of Tax at Source.* —
>
> (A) ***Withholding of Final Tax on Certain Incomes.*** - Subject to rules and regulations the Secretary may promulgate, upon the recommendation of the Comissioner, requiring the filing of income tax return by certain income payees, the tax imposed or prescribed by Sections 24(B)(1), **24(B)(2)**, 24(C), 24(D)(1); 25(A)(2), 25(A)(3), 25(B), 25(C), 25(D), 25(E); 27(D)(1), 27(D)(2), 27(D)(3), 27(D)(5); 28(A)(4), 28(A)(5), 28(A)(7)(a), 28(A)(7)(b), 28(A)(7)(c), 28(B)(1), 28(B)(2), 28(B)(3), 28(B)(4), 28(B)(5)(a), 28(B)(5)(b), 28(B)(5)(c); 33; and 282 of this Code on **specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 58 of this Code.**" (*Emphasis supplied*)

Applying the foregoing provisions to the facts of this case, the Court finds that the assessment lacks factual basis.

In assessing petitioner for deficiency final tax with interest, surcharge and compromise penalty in the total amount of P1,675,034.65[27], respondent treated the

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[27] Exhibits "18", "19", and "26".

payments made to stockholders and interest payments in the total amount of P8,919,348.66 as dividends.

However, records would show that some of the payments made to stockholders correspond to the outstanding balance of petitioner's advances from a stockholder as of December 31, 2004 amounting to P8,071,781.00, which was paid in full with interest in 2005.[28]

Likewise, petitioner pointed out that it did not declare and pay any dividends to its stockholders in 2004 as testified to by Mr. Richard S. Querido, the external auditor of petitioner for the years 2002, 2003, 2004, and the three-month period ended March 31, 2005. According to Mr. Querido, they also examined petitioner's minutes of board meetings as part of the audit and they did not come across any document authorizing the declaration of dividends.[29]

This is further bolstered by the fact that petitioner's retained earnings amounted only to P1,895,568.00 as per its audited financial statements for the year 2004[30]; while a deficit of P89,360.00 was reflected as its retained earnings in its audited financial statements for 2003[31].

On this matter, let it be pointed out that dividends, regardless of the form these are declared, that is, cash, property or stocks, are valued at the amount of the declared dividend taken from the unrestricted retained earnings of a corporation.[32]

[28] Exhibits "D" and "I".
[29] Exhibit "X".
[30] Exhibits "D" and "I'.
[31] Exhibit "I".
[32] *Philippine Long Distance Telephone Company vs. National Telecommunications Commission, et al.*, G.R. No. 152685, December 4, 2007.

Thus, petitioner could not have declared dividends in the amount of P8,919,348.66 since it did not have sufficient retained earnings to support any declaration of dividends in the year 2004 and prior year.

The said payments to its stockholder and the interest paid in the total amount of P8,919,348.66, if they were indeed dividends, were out of proportion to petitioner's issued shares of stock which is only 693,976 shares and its authorized capital stock which is only 1,000,000.00 with P1.00 par value as per its audited financial statements for taxable year 2004[33].

It is true that as a general rule, tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment. It is to be presumed, however, that such assessment was based on sufficient evidence. Upon the introduction of the assessment in evidence, a *prima facie* case of liability on the part of the taxpayer is made. If a taxpayer files a Petition for Review before the CTA and assails the assessment, the *prima facie* presumption is that the assessment made by the BIR is correct, and that in preparing the same, the BIR personnel regularly performed their duties.[34]

However, the *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious. Where the BIR has come out with a "naked assessment," *i.e.*, without any foundation character, the determination of the tax due is without rational basis. In such a situation, the U.S. Court of Appeals ruled that the determination of the Commissioner contained in a deficiency notice disappears. Hence, the determination

[33] Exhibits "D" and "I".
[34] *Commissioner of Internal Revenue vs. Hantex Trading Co., Inc.*, G.R. No. 136975, March 31, 2005.

by the CTA must rest on all the evidence introduced and its ultimate determination must find support in credible evidence.[35]

In this case, respondent failed to prove in court that the payment to the stockholder and the interest paid were indeed dividends. Clearly, in issuing the assessment, respondent merely assumed that the said payments made to the stockholder and the interests paid are dividends, which has neither legal nor factual basis. Well-settled is the rule that "the presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption."

This was the ruling of the Supreme Court in the case of *Collector of Internal Revenue vs. Benipayo*[36], where the High Court ruled that:

> "(O)n this question the Court of Tax Appeals said the following in the appealed decision:
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> > To our mind, the appealed decision has no factual basis and must be reversed. **An assessment fixes and determines the tax liability of a taxpayer. As soon as it is served, an obligation arises on the part of the taxpayer concerned to pay the amount assessed and demanded. Hence, assessments should not be based on mere presumptions no matter how reasonable or logical said presumptions may be. xxx**
> >
> > **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 that the circumstances in 1952 and 1953 are presumed to be the same as those existing in 1949 to 1951 and July 1955. In the case under consideration there are no substantial facts to support the assessment in question. ...**
>
> **A review of the records has not disclosed anything sufficient to justify a reversal of the above finding made by the Court of Tax Appeals.** It should be borne in mind that to sustain the deficiency tax assessed against respondent would amount, in effect, to a finding that he had, for a considerable period of time, cheated and defrauded the government by selling to each adult patron two children's tax-free tickets

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[35] *Ibid.*
[36] G.R. No. L-13656, January 31, 1962.

> instead of one ticket subject to the amusement tax provided for in Section 260 of the National Internal Revenue Code. Fraud is a serious charge and, to be sustained, it must be supported by clear and convincing proof which, in the present case, is lacking." *(Emphasis Supplied)*

Considering that respondent has neither legal nor factual basis to presume that payments made to the stockholder and the interest paid are dividends, respondent's assessment of deficiency final tax for taxable year 2004 must necessarily fail.

WHEREFORE, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, the assessment issued against petitioner for deficiency final tax, including surcharges, interest and compromise penalty in the aggregate amount of P1,675,034.65 for taxable year 2004 is hereby **CANCELLED**.

SO ORDERED.

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

OLGA PALANCA-ENRIQUEZ
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.

LOVELL R. BAUTISTA
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII 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.

ERNESTO D. ACOSTA
Presiding Justice