REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PAPER INDUSTRIES CORPORATION
OF THE PHILIPPINES,
Petitioner,

- versus - C.T.A. CASE NO. 3458

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
x - - - - - - - - - - - - - x

1/29/88

D E C I S I O N

By this appeal, petitioner seeks a reversal of the revised income tax assessment issued by respondent Commissioner of Internal Revenue against petitioner Paper Industries Corporation of the Philippines in the amount of ₱4,763,750.00 as deficiency income tax for the year 1975 and ₱246,532.97 as withholding tax at source on interest paid on foreign loans, itemized as follows: (Exh. "10", p. 150, BIR records)

1 9 7 5

Net income/loss per return		(₱39,856,525.00)
Add: Unallowable Deductions/Additional Income:		
Income derived from unmanifested logs cut in 1975 . . .	₱42,780,999.41	
Interest expense . . .	1,936,747.36	
Prior year's expenses .	1,826,232.89	
Other disallowed exp. claimed	430,031.60	46,974,011.26
Net income per investigation.		₱ 7,117,486.26

Income tax due thereon	₱ 2,481,120.00
Add: 50% surcharge	1,240,560.00
14% int. p.a. (42% maximum)	1,042,070.40
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 4,763,750.40

Total interest on foreign loans	₱15,368,303.00
15% withholding tax due thereon	2,305,245.42
Less: Withholding tax already paid	2,131,630.66
Deficiency withholding tax at source . . .	₱ 173,614.76
Add: 14% int. p.a. (42% maximum)	72,918.21
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 246,532.97

The pertinent facts as related in respondent's memorandum read: (pp. 107-108, CTA records.)

> PAPER INDUSTRIES CORPORATION OF THE PHILIPPINES, hereinafter referred to as "PICOP" is a corporation organized on April 1, 1952 and existing under and by virtue of the laws of the Republic of the Philippines. It is registered with the B.I.R., Securities & Exchange Commission and other government agencies as engaged in the logging business and as producer of kraft and newsprint products. It is also registered with the Board of Investments (BOI) on December 29, 1968 under Certificate of Registration No. 68-22 as a preferred pioneer enterprise under R.A. 5186, for the production and manufacture of /integrated pulp and paper products and under Certificate of Registration No. 78-562 dated February 15, 1978 as a preferred pioneer enterprise under same Act for the production and manufacture of/ newsprint and container board. No BOI incentive was availed during the year. (p. 105, BIR rec.).
>
> It has its factories at Bislig, Surigao del Sur. It has two (2) operating departments for the manufacture of

said products: The Timber Product Group (TPG) which produces logs for local and export sales and for the manufacture of lumber, veneer and plywood; and the Paper Products Group (PPG) which manufactures linerboard, corrugated medium and newsprint products. Its logging concessions are located in various municipalities in the province of Surigao del Sur having an area of 23,273 hectares under industrial tree planting plantations. (pp. 103-104, BIR rec.).

Under Letter of Authority 00944 NA dated September 3, 1976 Revenue Examiners Bienvenido Y. Boado and Francisco P. Magno conducted an investigation of petitioner's business and on the basis of their findings, PICOP was assessed in a Letter of Demand dated February 27, 1981, the amounts of ₱13,539,504.00 as deficiency income tax for the year 1975 and ₱246,532.37 as withholding tax-at-source on interest paid on foreign loans, plus the sum of ₱300.00 as compromise penalty for its failure to file the corporate quarterly income tax returns for the 1st, 2nd and 3rd quarters of the same year. (pp. 101-105, BIR rec.).

Petitioner, through counsel, in a letter dated April 27, 1981 protested the assessments and requested that the same be cancelled and withdrawn. (pp. 117-121, BIR rec., Exh. "E", Petitioner.).

On May 27, 1981, the case was referred to Revenue Examiners Bienvenido Y. Boado and Francisco P. Magno, inviting their attention to the protest filed by counsel for the petitioner. (p. 124, BIR rec.).

On September 18, 1981, based on the reinvestigation report of Revenue Examiner Bienvenido Y. Boado, a revised letter of demand dated April 15, 1982 was issued against petitioner requesting payment of the amounts of ₱4,763,750.40 as deficiency income tax for 1975, ₱246,532.07 as withholding tax at source for interest paid on foreign loans and the suggested compromise penalty of ₱300.00 for its failure to file the corporate quarterly income tax returns for the 1st, 2nd and 3rd quarters of 1975. (pp. 133-135, 149-151, BIR rec., Exhs. 6, 10 & 10-a, Respondent.).

Hence, this appeal.

The issues presented are:

1. Whether petitioner derived unreported income in the amount of ₱42,780,999.41 from allegedly unmanifested logs totalling 249,030.79 cubic meters (net).

2. Whether respondent correctly disallowed:

(a) interest expense of ₱1,936,747.36;

(b) prior year's expenses of ₱1,826,232.89; and

(c) other expenses claimed amounting to ₱430,031.60.

3. Whether respondent correctly imposed the fraud surcharge of 50%.

4. Whether petitioner is required to withhold 15% income tax from interest due on foreign loans on

amounts not actually paid or remitted to its foreign lenders.

Anent the first issue, respondent contends that based on his revenue examiners' revised computation of the logs handled and disposed of by petitioner, there was a net volume of 249,030.79 cubic meters of unmanifested logs cut by petitioner from which it derived unreported income in the amount of ₱42,780,999.41. (p. 130, BIR records.)

The record discloses that after the original investigation conducted by respondent's examiners on the business tax aspect of petitioner, they rendered a report showing that petitioner did not manifest a gross volume of 446,557.14 cubic meters of logs or a net volume of 325,048.94 cubic meters after deducting the 27.21% legal allowance for natural defects of timber. (p. 82, BIR records.) On the basis of these findings, respondent assessed petitioner for deficiency income tax on the income realized from the sale of said unmanifested logs in the amount of ₱55,840,151.40. (pp. 103-104, BIR records.)

In his protest against the assessment on this item, petitioner's counsel objected to the method by which the examiners computed the unmanifested logs cut, contending that (1) for uniformity, the log production of 755,239.81 cubic meters (net) should be taken up at gross, that is, including the 27.21% allowance for defects provided by the Bureau of Forest Development, since the log inventories were stated at gross; and (2) the 27.21% allowance for defects should be excluded from the gross volume of the alleged unmanifested logs in computing the income on said logs as these defects have no economic value. (p. 119, BIR records.)

The revenue examiner assigned to the income tax aspect of the case "subscribing to the views of petitioner's counsel and in fairness to the taxpayer" recomputed accordingly in his report of reinvestigation by (1) adjusting the net volume of 755,239.81 cubic meters of logs produced/manifested in the original computation to a gross volume of 1,422,411 cubic meters in the revised computation, and (2) deducting the 27.21% allowance for defects from the resultant gross volume of 342,122.25 cubic meters of unmanifested logs, thereby reducing the unmanifested logs to a net volume of 249,030.79 cubic meters. (See examiner's memorandum to the Commissioner, pp. 130-134, BIR records.)

No other change was made aside from the two corrections. As a result of the revision, the alleged income derived from unmanifested logs was reduced from ₱55,840,157.40 to ₱42,780,999.41, the amount presently in issue on this item. Correspondingly, respondent cancelled the original deficiency income tax assessment and issued a new one for ₱4,763,750.00, which is the subject of this appeal.

Despite the corrections made by respondent, petitioner insists that the revised computation still contained discrepancies and inaccuracies. Petitioner introduced the computation prepared in 1976 by its independent auditors in connection with the audit of its 1975 books of accounts, wherein the logs received and produced in 1975 were all accounted for. (Exh. "H".) This computation of its auditors was supported with the summary of log production and the summary of sales/issues of logs for that year, both of which had been submitted by petitioner to the Bureau of Forest Development and the Bureau of Internal Revenue as required by law. (Exhs. "I"& "J".)

It is petitioner's stand that since the figures in its computation had been reported to the abovementioned government agencies long before the assessments were made and were properly audited by a reputable firm, these figures should be entitled to credence and given due weight.

Respondent maintains that his computation is reliable and accurate since it is based on "figures gathered from the taxpayer's inventory summaries submitted to this Bureau which are also reflected in the auditor's notes to the Financial Statement attached to the income tax return filed, and from figures gathered from the monthly Forestry Statistics on Log Production, Export, Processed Volumes and other Related Data submitted by the taxpayer to the Bureau of Forest Development, Office of the District Forester, Mangagoy, Bislig, Surigao del Sur". All these documents were submitted as attached to a separate report, dated March 30, 1980, supporting the assessed forest charges and fees liabilities of the taxpayer for the year 1975 in a companion case docketed as CTA Case No. 3841. (p. 135, BIR records; See pp. 2-77 & p. 141, BIR records, CTA Case No. 3841.)

For ready reference, a comparison of the computations presented by both parties is shown as follows:

	Logs in cubic meters (gross)		PICOP Computation prepared by auditors Exhibit "H"	BIR Computation p. 130, BIR records	Difference
1.	Inventory, beg. 12/31/74		276,370.86	276,370.86	
2.	Add: Logs produced/received				
	a. From concessions (net volume 1,033,500.87)	1,300,370.87			
	b. From tree farms	186,940.71			
	c. From outside concessions	205.91			
	Total logs produced/received		1,487,517.49	1,422,411.00	65,106.49
	Total logs handled		1,763,888.35	1,698,781.86	
3.	Logs sold/disposed of:				
	a. Export sales		717,316.00	716,908.46	407.54
	b. Local sales		62,917.00	62,912.06	4.94
	c. Company use		2,444.00	-	2,444.00
	d. Transfer to (in process)				
	1. Veneer plant	57,534.00			
	2. Plywood plant	72,877.00			
	3. Lumber mill	74,169.00			
	4. Plywood plant No. 2	78,992.00	283,572.00	282,862.74	709.26
	5. Pulp and paper mill		403,663.00	-	403,663.00
	Total logs sold/disposed of		1,469,912.00	1,062,683.26	
	Ending balance 12/31/75		293,976.35	636,098.60	
4.	Inventory, end 12/31/75 (Exh. "B")		293,976.35	293,916.35	
	Logs "unaccounted for" - gross		-	342,122.25	
	Deduct: Allowance for natural defect of logs (27.21%)			93,091.46	
	Logs "unaccounted for" - Net (72.29%)			249,030.79	

The beginning and ending inventories of logs in 1975 in both computations are not disputed. The controversy centers mainly on the volume of logs produced/received and the 403,663 cubic meters of logs processed in the pulp and paper mill in petitioner's computation which was not taken up by respondent.

In the computation prepared by petitioner's auditors it will be noted that the logs produced/ received in 1975 from concessions (Exh. "I") was increased from a gross volume of 1,033,500.87 cubic meters of logs as reported to the Bureau of Forest Development, to 1,300,370.87 cubic meters. The reason for this as indicated in the footnote in their worksheet (Exh. "H"), was that the auditors considered the gross volume of 1,033,500.87 cubic meters as equivalent to 79.47% only of the total production of logs. The balance of 20.53% represented allowance for the defect in the logs. With the use of an illustration of a log, Exh. "L", (see Annex "A"), this manner of computation was justified by petitioner's lone witness, the Senior Assistant Vice President and Assistant Treasurer of the corporation in his testimony before the Court as follows: (t.s.n., pp. 2-10, July 22, 1983.)

Q. Mr. witness, in the last hearing you testified on and identified Exhibits "H" and "I". Exhibit "H" is the worksheet of your auditors showing how you computed the beginning and ending inventory; while Exhibit "I" is the report that PICOP filed with the Bureau of Forest Development showing its log production for 1975, January to December.

Will you see these documents if they are the ones you testified on?

A. Yes, these are the documents I testified before.

Q. You will note that in Exhibit "H" you showed wood deliveries of 1,300,370.87 cu. m. as gross, and yet in Exhibit "I" you showed a gross of only 1,033,500.87 which was the figure picked up by the BIR examiner. Will you please explain to the Honorable Court if you know of your own personal knowledge why this difference exist?

A. Yes. In the volume presented by the auditors, these includes all the volumes of logs subject to forest charges and those not subject to forest charges, like some firewoods which normally are not subject to forest charges, some of the waste which we bring in to be used as additional raw materials.

Q. At this juncture, could you use in their explanation an illustration or sketch? I ask you to prepare an enlarge portion of Exhibit "L" which is a sketch of the log.

A. Based on the sketch of this log, normally the log around 20 ft. in length is loaded in the truck and to measure it when it arrive at the scaling station, normally the BIR and the Bureau of Forest Development representatives look at the smaller end of the logs. And they measure the small end of the logs by drawing an imaginary straight line through to the opposite end; say, this is the diameter of this small end and then they compute the area. Normally this is the sound log that they arrive at, roughly 72% of the log which has been over the years of our experience and the industry's experience that the logs normally not usable cannot be sold and cannot be turned into lumber.

Q. Will you identify with the figures the sound log you just mentioned?

A. These are figures B, C, F and E.

Q. What are those?

A. These are the portions considered as sound log.

B, C, E and F, these form the area of the sound log.

Q. What do these numbers represent, 1, 2, 3 and 4?

A. 1, 2, 3 and 4 represents defects within the sound log.

Q. For purposes of determining the forest charges due from PICOP, how much of B, C, E and F is subject to forest charges?

A. It is subjected only to 72%.

Q. How about the 27.21%?

A. It is an allowance for defects.

Q. Now, in the experience of PICOP . . .

Let me withdraw that.

You testified before that after the log is measured by the BIR and BFD examiners in the scaling station, PICOP bring the logs to your production pond. What is done there in the pond?

A. The moment it enters the production pond, it is now cut into pieces and segregated into different uses. Some of the good logs end up as exportable logs, a portion of it ended as raw materials for the plywood and sawmill, and some of the logs end up as raw materials for the pulp and paper mill.

Q. In the experience of PICOP this economic recovery that you are mentioning are those taken only from the area B, C, E and F?

A. No. It is taken from A, B, F, E, C and D because these areas can be use for fuel wood. We can recover some woods here. For purposes of forest charges, these areas are normally not subjected.

Q. Suppose there are logs where the defects 1, 2, 3 and 4 do not exists or if they exist they are less than 27.21%. Do you use those also for economic recovery?

A. Yes, we recover it also. Because the normal defect of a log, this is what you call cannot be use for sound log but it can be use for chips, it can be use for firewood, can be use for some other purpose for manufacturing chipboards.

Q. Now, in 1977 what was the percentage of recovery or for economic use as determined in the production pond that you experience?

A. The economic recovery for determination is 79½%.

Q. In other words, although you paid only 72% of the log for forest charges actually you utilized in 1977 more than 79%?

A. Yes, we were able to recover through getting as much as possible out of the sound logs.

Q. What did your auditors used in determining the ending and beginning inventory as of 1977?

A. It's the gross volume of sound area in the log, A, D, E and F.

Q. The 79% or the 72%?

A. The 79%.

Q. So that is your explanation for the difference between Exhibits "H" and "I".

A. Yes sir .

Can I add some more?

Q. Yes, please do.

Because the soundness of the logs were actually industry wide practice so the application become very, very favorable for PICOP because we try to recover every sound logs. Unlike in other concessions wherein all they recover were the exportable and sometimes the local logs that could be sold. All other portions of the logs for that purpose are thrown away so the BFD and the BIR feels they should not be taxed for it. But in our case we are using it, we try to recover; that is the reason for the integrated approach of PICOP; so we recover every conceivable, usable raw materials. I think that is the reason also why the Japanese firm who import these logs can now compete with anybody because they use every conceivable portion of the logs rather than throw it away.

Q. For what use do you make out of these defective portions that you said?

A. We chip it into small items and cook it into pulp, use as raw material for pulp and paper mill. In some cases, if it is so sawn, what you call the "tatal", we burn it into fuel. In some cases what you call the "pinaglagarian"or something, we use it as blockboard.

So it's really a total approach concept so that we can utilize the whole material.

Q. Did you take into consideration the

consumption in the pulp mill in determining the inventory?

A. Yes, they used transfer to the pulp mill as the whole volume because they have to account for the whole volume that was transferred to them.

Q. In 1977, how much volume was used by the paper mill?

A. In 1977 the pulp and paper mill used 403,663 cu. m.

Q. Now, was that volume taken into account by the BIR examiner when they computed the deficiency assessment?

A. It was not taken into account.

Q. You mean 403,663 cu.m. were totally disregarded by the BIR?

A. Yes, it was totally disregarded by the BIR.

Through his foregoing testimony, witness explained that the difference between petitioner's and respondent's computation in the log production was due to the defective portions of the whole logs cut that were utilized for economic recovery. It was these defective portions, processed in the pulp and paper mill, with a volume of 403,663 cubic meters of timber, which were not considered by respondent in his computations. Thus, petitioner accounted for the figures in its computation.

As to the "logs produced/received" item in respondent's computation in the amount of 1,422,411 cubic meters, respondent was unable to show the basis of this figure. Nowhere in the records presented by respondent as the source of the data in his computation can the details of the 1,422,411 cubic meters be found. A careful scrutiny of these records will show that only the net volume of the 755,239.81 cubic meters of logs manifested and its breakdown is reflected therein as the logs produced by petitioner in 1975. (See pp. 2-74, BIR records, CTA Case No. 3841.) There is no evidence or record whatsoever as to how respondent arrived at the gross volume of 1,422,411 cubic meters in his revised computation. Respondent gave no other reason for adjusting said net volume to 1,422,411 cubic meters, aside from acceding to petitioner's view that it should be converted to gross. The evidence of record show, however, that respondent's conversion is erroneous.

The District Intelligence and Liaison Officer of the Regional Anti-Smuggling Action Center, Northern Mindanao, Region X, District of Surigao del Sur, Lianga, Surigao del Sur, in his letter to the District Forester dated February 17, 1976 recommending that petitioner PICOP be investigated for technical smuggling and economic subversion, noted that in 1975 the company manifested a total gross volume of 1,037,512.69 cubic meters of timber. (p. 69, BIR records.) (Underlining supplied.) This gross volume was taken into consideration by the revenue examiners in their original computation of petitioner's alleged unpaid taxes as relayed in their report to the Chief Investment Incentives Division dated March 31, 1980, the pertinent portion of which is reproduced hereunder: (Exh. "G", p. 83, BIR records.)

> "FINDINGS OF FACTS
>
> After a review of the pertinent documents presented by PICOP relative to its log operation for the year 1975, the amount ascertained as its total unpaid tax liability amounted to ₱9,254,896.71, which represents unpaid forestry charges, fees and penalties due the government. This amount was determined after taking into consideration the following:
>
> 1. xxx xxx xxx
>
> 2. PICOP's gross volume of logs manifested during the calendar year 1975 was 1,037,512.69 cubic meters, per attached letter dated February 17, 1976 of Mr.

> Eugenio L. Chavez, District Intelligence Officer, Regional Anti-Smuggling Action Center, Northern Mindanao, Region X, District of Surigao del Sur, with a net volume of 755,239.81 cubic meters after deducting 27.21% as allowance for natural defects of timber." (Underlining supplied.)

Based on the foregoing findings of the examiners, it is clear that in their revised computation the gross volume of 755,239.81 cubic meters (net) of logs produced/manifested by petitioner in 1975 should be 1,037,512.69 cubic meters instead of 1,422,411 cubic meters. As will be noted the gross volume of 1,033,500.87 cubic meters of logs reported by petitioner to the Bureau of Forest Development as its production for 1975 (Exh. "I") is close to said amount.

Moreover, the mathematical verification of the 1,037,512.69 cubic meters as the gross volume by deducting therefrom the 27.21% allowance for defects will result in a net volume of 755,205.49 cubic meters which approximates the net volume of the 755,239.81 cubic meters of logs in respondent's original computation.

Conformably, respondent's revised computation is recomputed as follows:

1975

Log inventory 12-31-74 gross		276,370.86 cu.m.
Logs production "		1,037,512.69 " "
Logs handled "		1,313,883.55 " "
Log inventory 12-31-75 "		293,976.35 " "
Logs disposed		1,019,907.20 " "
Logs actually disposed:		
Export sales of logs, gross	716,908.46	
Domestic sale of logs "	62,912.06	
Processed logs "	282,862.74	
Total logs actually disposed		1,062,683.26 " "
Unaccounted logs, gross		(42,776.06 " ")

It is evident from the above computation that no logs were unmanifested by petitioner for income tax purposes since the total logs actually disposed appear to be even more than the input or those which had to be accounted for. Finding respondent's computation for alleged unmanifested logs in error, we cannot therefore sustain his determination that petitioner derived undeclared income in the amount of ₱42,780,999.41 therefrom.

The second issue deals with the disallowance by respondent of the deductions for the following expenses:

a. interest expense of ₱1,936,747.36;

b. prior years expenses of ₱1,826,232.89; and

c. other expenses claimed amounting to ₱430,031.60.

Respondent avers that the amount of ₱1,936,747.36 represented interest on foreign loans secured for the construction of petitioner's Plywood Plant No. 2 at Bislig, Surigao del Sur applicable to the months of January and February, 1975, prior to the completion of said plant in March, 1975, hence, it should have been capitalized or charged to "Construction in Progress" account and not taken up as an expense. (Exh. "4-a", p. 103, BIR records; see working papers, p. 95, BIR records.)

On the other hand, petitioner claims that the interest in question corresponds to loans for use in its operations and other purposes and not for plant construction which did not start until 1978. (Petitioner's memorandum, p. 70, CTA records.) Aside from this bare contention, petitioner did not offer any evidence, whatsoever, to show that the construction on the abovementioned plant was begun only in 1978 or that the interest expense was incurred on loans borrowed for purposes other than for plant construction.

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 that he (taxpayer) is right. (Lino Gutierrez v. Collector of Internal Revenue, CTA Case No. 504, January 28, 1962; See also Tan Guan vs. Court of Tax Appeals, L-23676, April 27, 1967, 19 SCRA 903.) And if the taxpayer fails to present evidence or proof in support of his allegations in his petition for review, as in this case, conformably to the doctrine of the presumption in favor of the correctness of tax assessment (Inter-provincial Auto-bus Co., Inc. vs. Collector of Internal Revenue, L-6741, January 31, 1956, 98 Phil. 290; Collector of Internal Revenue vs. Bohol Land Transportation Co., L-13099 and L-13462, April 29, 1960, 107 Phil. 965), the Court of Tax Appeals will merely sustain the assessment against the taxpayer. (Caresosa vs. Bureau of Internal Revenue, CTA Case No. 3713, January 25, 1985, certiorari denied in G.R. No. L-70758, August 30, 1985.)

Deductions for expenses in the total sum of ₱1,826,232.89 were disallowed by respondent for the reason that these expenses were incurred in years prior to 1975, so that they should not have been deducted in the year 1975. (See examiners' worksheets, pp. 91-93, BIR records.)

Under Section 30 of the National Internal Revenue Code which allows as deductions all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, three conditions are imposed for the deductibility of business expenses, namely: (1) the expense must be ordinary and necessary; (2) it must be paid or incurred within the taxable year; and (3) it must be paid or incurred in carrying on a trade or business. (Collector of Internal Revenue vs. Philippine Education Co., May 30, 1956, 99 Phil. 319.) "Paid" or "incurred" means that expenses are deductible in the year they are actually paid out by a taxpayer who keeps his books on the actual receipts basis and deductible in the year incurred, although not actually paid, by a taxpayer who keeps his books on the accrual basis.

Petitioner, whose records are kept on the accrual basis, does not dispute that the expenses in question were incurred in years prior to 1975. But it is argued that these expenses were billed to it only in 1975 and since it was only at the time they were billed that petitioner was made aware of these liabilities, it was only from the receipt of the bill or demand for payment that the obligation to make payment arose, as billing was the act on the part of the creditors which triggered accrual for it marked the time when they would have a legal unconditional right to collect from petitioner.

Petitioner's stand is not well taken. "Each year's return, so far as practicable, both as to gross income and deductions, therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year." (Section 76, Income Tax Regulations, Revenue Regulations No. 2.)

Pursuant to the above provision of the regulations, taxpayer is obligated to make every reasonable effort to ascertain the facts necessary to render a correct return. Here, petitioner failed to prove that in the case of subject expenses, he exerted such an effort. No evidence was introduced to establish that the bills were received only in 1975 and that there was no way they could have been ascertained prior to 1975. As stated earlier, if petitioner fails to substantiate its allegations with competent evidence, the Court will merely sustain the assessment against petitioner.

With respect to the other disallowed deductions for expenses in the total amount of ₱430,031.60, representing major repairs which should have been capitalized, personal expenses of foreign executives and deferred charges, petitioner did not attempt to justify these expenses. As a matter of fact these disallowances were not contested in petitioner's memorandum. Consequently, they are deemed to have been abandoned.

On the third issue, as to whether the fraud penalty was correctly imposed by respondent, the imposition of the 50% surcharge was based by respondent on his determination that petitioner misdeclared its income by the substantial amount of ₱42,780,999.41 which it derived from the sale of unmanifested logs. (Respondent's memorandum, p. 114, CTA records.) In view of our finding that there was no such undeclared income, the assessment of the 50% fraud penalty should be reversed.

Notwithstanding the foregoing conclusions, no deficiency income tax is due from petitioner in view of the heavy net loss it suffered in 1975, as shown by the following computation:

	1975	
Net loss per return		(₱39,856,525.00)
Add: Unallowable deductions:		
Interest expense	₱1,936,747.36	
Prior year's expenses	1,826,232.89	
Other disallowed expenses claimed	430,031.60	4,193,011.85
Net loss per investigation		(₱35,663,513.15)

Finally, the remaining issue to be decided is whether petitioner is required to withhold 15% income tax from interest due on foreign loans on amounts not actually paid or remitted to its foreign lenders.

The facts are not disputed. The records of petitioner show that in 1975, the total interest due on its foreign loans amounted to ₱15,368,303.00 of which ₱14,210,871.07 was actually remitted to the foreign lender in 1975. Petitioner paid the 15% withholding tax of ₱2,131,630.64 to respondent on the amount remitted but did not pay the withholding tax on the balance of ₱1,157,432.00 which was not remitted in that year. (Exh. "M-1", p. 134, BIR records.) Respondent assessed petitioner for deficiency withholding tax at source in the amount of ₱246,532.97 representing 15% withholding tax, inclusive of interest on the unpaid balance of ₱1,157,432.00 on the ground that "the liability to withhold and pay income tax withheld at source from interest payments to foreign corporations is at the time of accrual of payments of said interest income and not at the time of actual remittance thereof". (BIR Ruling No. 71-003, Respondent's memorandum, p. 115, CTA records.)

Petitioner, disagrees, asserting that the 15% withholding tax is due only upon payment of the income to the foreign lender and not upon its accrual in the books. To support its argument, petitioner cites and relies heavily on the case of Bayer Pharmaceuticals vs. Commissioner of Internal Revenue, CTA Case No. 2846, March 16, 1979, certiorari denied in Commissioner of

Internal Revenue vs. Court of Tax Appeals, et al., G.R. No. 72054, October 10, 1986.

The Bayer case is not in point. There, the income could not be remitted to the non-resident foreign corporation due to Central Bank restrictions, while in the present case there is no showing of any restriction on the remittance of the interest income to the foreign lender. In the dispositive portion of the Bayer case, this Court clearly stated:

> "We, accordingly, rule that since the royalties in question could not be paid or remitted in 1972 by petitioner Bayer Pharmaceuticals, Inc. to non-resident foreign corporation Bayer Aktiengesellschalft, Leverkusen Bayermerk due to Central Bank restrictions, petitioner was under no obligation to withhold and pay income tax-at-source on said royalties and, therefore, it is not liable for the deficiency withholding tax-at-source assessment of respondent Commissioner of Internal Revenue in the amount of ₱36,834.73 for the year 1972."

In a later case, that of Western Palawan Lumber Corporation vs. Commissioner of Internal Revenue, CTA Case No. 3544, June 5, 1987, this Court elucidating the rule laid down in the Bayer case said further:

> "This Court unequivocally ruled that since the royalties could not be remitted to the non-resident foreign

> corporation due to Central Bank restrictions, the time of payment of the royalties is the maturation point of the withholding duty. It bears emphasis, therefore, that if the income payable to a non-resident foreign corporation can be paid or remitted because there are no restrictions against its payment or remittance thereof, the liability to withhold and pay the tax thereon attaches at the time of accrual, not at the time of actual remittance."

In the instant case, there is nothing in the record that indicates that petitioner was restricted from remitting in 1975 the interest due on its loans from foreign creditors. In fact of the ₱15,368,303.00 interest payable in 1975, petitioner remitted ₱14,210,871.07 of said interest in 1975 but left unpaid in that year the balance of ₱1,157,431.97. Petitioner gave no explanation for the delay in the payment of this balance. Neither was there any evidence as to when this balance was remitted and the withholding tax at source paid, if any. In the absence of any restriction against the remittance of the above interest due on the foreign loan of petitioner in this case, the liability to withhold and pay the tax thereon attaches at the time of accrual, not at the time of actual remittance thereof.

As aptly cited by respondent, applicable to the case at bar is the ruling laid down in Construction Resources of Asia, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 3307, November 25, 1983, certiorari denied in G.R. No. 68413, December 10, 1984 which is quoted herein below:

> "Payment of the withholding tax-at-source due from a foreign lender attaches upon accrual of the interest to be remitted abroad. The interest accrues at the time it is earned. At such time, the tax on the interest attaches and the contractor is obligated to remit the tax to the government since it already and properly belongs to the government. Indeed, there is no reason why the overseas contractor, petitioner in this case, who is based in the Philippines, should wait until it remits the interest due the foreign lender before paying the withholding tax-at-source. Otherwise, the government will be at the mercy of the taxpayer who may take time in remitting the interest to the foreign lender."

Accordingly, petitioner is liable for the amount of ₱246,532.97 as 15% withholding tax at source, inclusive of interest, on the balance of the interest income in the amount of ₱1,157,431.97 due to its foreign lender in 1975.

As regards the sum of ₱300.00 sought to be imposed upon petitioner as compromise penalty, the rule is well established that the same cannot be imposed or collected without the agreement and conformity of the taxpayer. (Wonder Mechanical Engineering Corporation vs. Court of Tax Appeals, L-22803 & 27858, June 30, 1975, 64 SCRA 555.)

WHEREFORE, the decision appealed from is modified. Petitioner Paper Industries Corporation of the Philippines is hereby ordered to pay to respondent Commissioner of Internal Revenue the amount of ₱246,532.97 as withholding tax at source, plus surcharge and interest on delinquency as provided for by law. Without pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, January 29, 1988.

Amante Filler

AMANTE FILLER
Presiding Judge

WE CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

ALEX Z. REYES
Associate Judge

CERTIFICATION

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

AMANTE FILLER
Presiding Judge

Exh L
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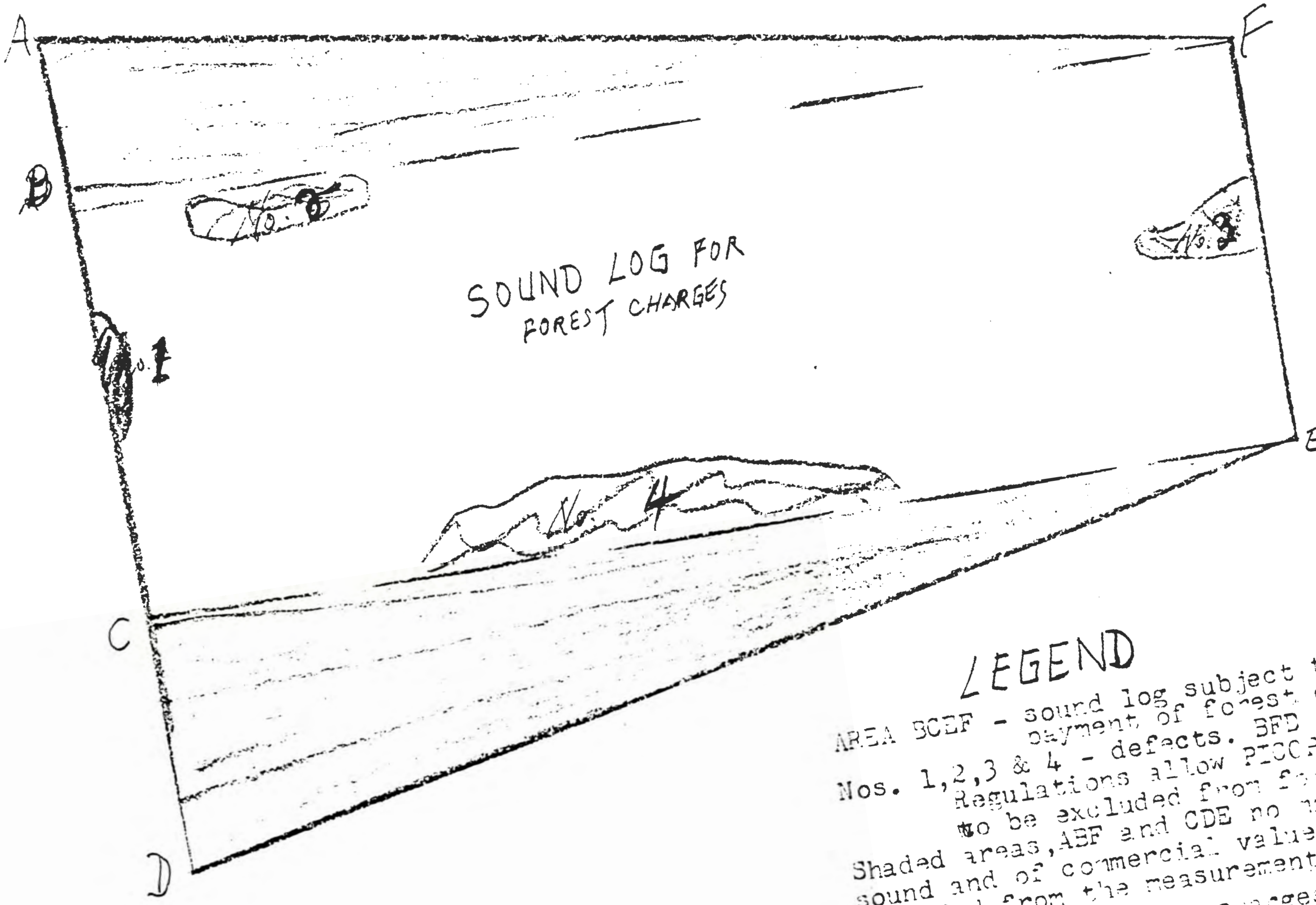
Dmd



LEGEND

AREA BCEF - sound log subject to payment of forest charges.

Nos. 1,2,3 & 4 - defects. BFD and BIR Regulations allow PICOP 27.31% to be excluded from forest charge.

Shaded areas, ABF and CDE no matter how sound and of commercial value are excluded from the measurement of volume subject to pay forest charges.