REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

HOLLAND MILK PRODUCTS, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3756

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x ---------------------------- x

8/29/86

D E C I S I O N

Petitioner comes on an issue questioning the factual and legal basis of the respondent's denial of its protest against the deficiency assessments for witholding tax at source for 1974 and income taxes for the years 1975, 1976 and 1977 as originally demanded in a letter dated June 20, 1983 itemized and computed as follows:

1974 - Deficiency Withholding Tax At Source

Selling price of HCMI shares in HOMPI ...	₱ 6,000,000.00
Less: Cost of shares of stock	4,000,000.00
Capital gains subject to tax	₱ 2,000,000.00
35% Tax due thereon	700,000.00
Add: 50% Surcharge	350,000.00
42% Interest (maximum)	294,000.00
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 1,344,000.00

1975 - Deficiency Income Tax

Net income per return	₱17,822,747.00
Add: Additional income:	
Undeclared income arising from rebates, overpricing, price fall protection, interest adjustments, freight rebates, insurance claim, commission and short landings.	
A$670,000 @ ₱9.5033	6,367,211.00
Net income per investigation	₱24,189,958.00

Income tax due thereon	₱ 8,456,485.00
Less: Income tax due per return	6,227,961.00
Balance	₱ 2,228,524.00
Add: 50% Surcharge	1,114,262.00
42% Interest (maximum)	935,980.08
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 4,278,766.08

1976 - Deficiency Income Tax

Net income per return .... ₱29,897,863.00
Add: Additional income:
Undeclared income arising from rebates, overpricing, price fall protection, interest adjustments, freight rebates, insurance claim, commission and short landings.

January 5, 1976

A $127,176.61 x ₱9.4531 = ₱1,202,213.21

June 20, 1976

A $450,000.00 x ₱9.1946 = 4,137,570.00

July 9, 1976

A $418,268.81 x ₱9.2212 = 3,856,940.35   9,196,723.56

Net income per investigation	₱39,094,586.56
Income tax due thereon	₱13,673,105.00
Less: Income tax due per return	10,454,252.00
Balance	₱ 3,218,853.00
Add: 50% Surcharge	1,609,426.50
42% Interest (maximum)	1,351,918.26
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 6,180,197.76

1977 - DeficiencyIIncome Tax

Net income per return .... ₱ 39,858,099.00
Add: Additional income:
Undeclared income arising from rebates, overpricing, price fall protection, interest adjustments, freight rebates, insurance claim, commissions and short landings.

March 9, 1977

A $585,968.42 x ₱8.1967 =
₱4,803,007.35

March 27, 1977

A $826,894.10 x ₱8.2088=
₱6,787,808.29

	₱11,590,815.64
Net income per investigation	₱51,448,914.64
Income tax due thereon	₱19,491,253.00
Less: Income tax due per return	15,097,857.00
Balance	₱ 4,393,396.00
Add: 50% Surcharge	2,196,698.00
14% Int. fr. 4/16/78 to 7/31/80	1,409,137.83
20% Int. fr. 8/01/80 to 4/16/81	621,841.27
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 8,621,073.10

Petitioner, Holland Milk Products, Inc. (HOMPI for short) a domestic corporation organized and existing under and by virtue of Philippine laws is engaged in the manufacture/production of dairy/milk products. It secures raw materials (skim powder milk, etc.) from the Australian Dairy Corporation (formerly the Australian Dairy Produce Board), an agency of the Australian Government. Its capital shares are owned and distributed as follows:

GF Equity, Inc.	60%
*Holland Canned Milk International	26 2/3%
*Australian Dairy Produce Board	13 1/3%

(*Non-resident foreign corporation)

Sometime in 1974, HOMPI shares owned or held by Holland Canned Milk International, a non-resident foreign corporation were sold and transferred to the Australian Dairy Produce Board (now Australian Dairy Corporation), likewise a non-resident foreign corporation not engaged in trade or business in the Philippines.

In fealty to the statutory requisitions, petitioner filed corporate income tax returns for the years 1974, 1975, 1976 and 1977 and paid the corresponding tax due as follows:

Year	Amount Paid	O.R. and Dates
1974	₱1,769,520.00	2207298 - 4-14-75
1975	5,045,058.00	2977333 - 4-19-76
1976	6,674,842.00	09358425- 4-15-77
1977	7,433,210.00	30692056- 4-17-78

In a subsequent investigation/verification of the aforesaid tax returns conducted by the respondent's office, there was assessed against, and paid by the petitioner, the following deficiency income taxes, viz.:

Year	Deficiency Assessment	O.R. & Date
1974	₱ 9,397.41	2207458 - 5-19-75
1975	34,932.00	11959525 - 8- 4-77
1976	30,498.38	21230941 - 2-10-78
1977	73,353.27	2453446 - 7- 2-79

Accordingly, corresponding letters of confirmation were issued by the respondent's Office declaring petitioner's tax cases for the years 1974 through 1977 closed and terminated.

It appears however that by a report of the Revenue Attache in Australia sometime in September, 1981, evoking a sense of a <u>deja vu</u> as to petitioner's "possible tax evasion" in its business dealings with the Australian Dairy Corporation, respondent Commissioner of Internal Revenue ordered a second look into the books of accounts and other accounting records of the petitioner which culminated in another deficiency assessment now under consideration..

Petitioner protested and sought cancellation and withdrawal of the assessments in a letter dated July 25, 1983, but to no avail as the same was denied by the respondent Commissioner of Internal Revenue under letter dated February 22, 1984.

Hence this petition for review.

All told the disputed tax cases of the herein petitioner covering a four year (4) period - 1974 to 1977, were the subject of earlier investigation/verification, found deficient, corresponding taxes paid and the cases accordingly declared closed and terminated by the respondent's predecessors. Petitioner must have found a reassuring prospect of a warm cubby-hole within the import and scope of that legal constraint against multiple investigation such that taxpayers' books of accounts and records "shall be subject to examination only once in a taxable year during the five year period by internal revenue officers." (Sec. 324, Tax Code). Having fared consistent with the legal mandate, it must have come as an unwarranted expectation for petitioner to labor again through a gauntlet of a demanding wringer of an examination/verification giving rise to the assessments for deficiency withholding and income taxes encapsulated in respondent's letter of demand of June 20, 1983, supra.

The apparent patina of cogency impressed nonetheless, we have but to view with ease the petitioner's righteous indignation in prying loose from what it considers an arbitrarily imposed second assessment. Settled is the rule that the Government is not estopped by the errors and mistakes of its agents.

The first issue raised, re: deficiency withholding tax at source for the year 1974, hardly presents a gripping question. Petitioner is being held liable as withholding agent for the amount of ₱700,000.00 before the incremental surcharge and interest, representing the tax on the capital gains derived by Holland Canned Milk International in the sale of its HOMPI stocks to the Australian Dairy Corporation pursuant to Section 53(b)(2) of the Tax Code, providing, "In the case of foreign corporations subject to tax under this Title not engaged in trade or business within the Philippines, there shall be deducted and withheld at source in the same manner and upon the same items as is provided in subsection (b)(1) of this section, as well as on remunerations for technical services or otherwise, <u>a tax equal to thirty-five (35%) per cent thereof</u>." (Emphasis supplied). Moreover, Presidential Decree No. 1457 has grafted an amendatory proviso in Section 37(e) of the Tax Code, providing, "That gain from the sale of shares of stock in a domestic corporation shall be treated as derived entirely from sources within the Philippines regardless of where the said shares are sold."

The petitioner maintains that no tax is due on the sale and transfer of the petitioner's stocks by Holland Canned Milk International to the Australian Dairy Corporation, both non-resident corporations not engaged in trade or business in the Philippines, because the locus of the undertaking was outside the Philippines. "Admittedly, the sale of HOMPI (petitioner) shares between Holland Canned Milk International and Australian Dairy Produce Board (now Australian Dairy Corporation) which are both non-resident foreign corporations, was entered into and consummated outside the Philippines in 1974. This fact was confirmed by the BIR agents in Par. 8 of their Joint Affidavit. Clearly, the capital gains received by Holland Canned Milk International was derived solely from sources outside the Philippines. Therefore, it is not subject to tax by the Philippine Government, pursuant to Section 24(b) of the NIRC, as amended, which provides:

> '(b) Tax on foreign corporations. - (1) Non-resident corporations - a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five per cent of the gross income <u>received during each taxable year from all sources within the Philippines, as interest, dividends, rents, royalties, including remunerations for technical services, salaries, premiums, emoluments or other fixed or determinable annual, periodical or casual gains, profits and income and capital gains.</u>' (Underscoring supplied)

That whatever gains received by Holland Canned Milk International arising out of the sale of its stockholdings in HOMPI (petitioner), to the Australian Dairy Produce Board, is income outside the Philippines, is supported by the clear and unmistakable provision of Section 37(e), last sentence, before its amendment in 1978, Thus, it provides:

> 'x x Gains, profits, and income derived from the purchase of personal property within and its sale without the Philippines x x x <u>shall be treated as derived entirely from sources within the country in which sold.</u>' (underscoring supplied)

As thus shown, insofar as the provisions of Section 24(b) and Section 37(e) of the Tax Code are brought to bear upon the facts and circumstances obtaining in the case at bar, the capital gains realized by Holland Canned Milk International as a consequence of the sale of stocks were solely from sources outside the Philippines and therefore not subject to tax by the Philippine Government. Petitioner was under no obligation much less in a position to withhold the tax as it never was the payor nor the custodian of the income. The amendatory provision in PD 1457, <u>supra</u>, interposed by the respondent, finds no application as it took effect only on June 11, 1978 and the transaction in the case at bar dates back to 1974. Obviously, the deficiency assessment for withholding tax at source against the petitioner as withholding agent has fallen sharply at odds with the statutory proscription.

The deficiency income taxes for the years 1975, 1976 and 1977, assessed on the alleged "huge underdeclaration of income" by petitioner (HOMPI) "through its officers, derived by way of rebate arrangements, over-pricing, price fall protection, interest adjustments, insurance claims, commissions and shortlandings with the Australian Dairy Corporation in connection with the sale and supply of skim milk powder and other dairy products between the two corporations" appear to have been based on the copies of the report and related documents submitted by the Revenue Attache in Australia which respondent deemed as the best evidence obtainable, to wit:

> (a) Report prepared by the Australian Dairy Corporation (ADC) and Asia Dairy Industries (HK) Ltd., (ADI) dated October 2, 1982 on the "Sales of Skim Milk Powder to Holland Milk Products, Inc. (petitioner)";
>
> (b) Report dated April 27, 1982 of K.F. Brigden, Auditor General, Australia, on the "Rebate Arrangement which applied to Australian Dairy Produce Board/ Australian Dairy Corporation sales of skim milk powder to Holland Milk Products, Inc. during the period December, 1974 to 1977"; and,
>
> (c) "Official Hansard Report" of the proceedings in the Australian Senate Committee on Finance and Government Operations regarding the rebate arrangement by Australian Dairy Corporation with Holland Milk P Products. Inc.

Ensconced in the aforesaid reports is an information "pointing out in particular the payments made, to HOMPI's credit, by the Australian Dairy Corporation/Asia Dairy Industries on the shipments of skim milk powder to HOMPI pursuant to the supply agreement covering the period from 10 October 1975 to 27 March 1977, to wit:

> 'Once the system was established, Mr. Uytengsu telephoned at irregular intervals, inquired as to HOMPI's credit, and then nominated an amount to be remitted in the established fashion. Payments were made as follows:

Payment Date	Amount (A$)
30.10.75	670,000.00
5. 1.76	127,176.61
20. 6.76	450,000.00
9. 7.76	418,268.81
9. 5.77	585,968.42
27. 3.77	826,894.10
Total..	3,078,307.94

> 'These remittances formed part of the ADC Annual Financial Statements and were subject to audit by the Commonwealth Auditor-General.

> 'The way in which these amounts paid has arisen to the credit to HOMPI as follows:

Item	Amount (A$)
1. Rebate-$25 per tonne on 31.362 tonnes	784,042.00
2. Overpricing	1,323,219.00
3. Price Fall Protection	517,699.00
4. Interest Adjustments	292,079.00
5. 2 per cent commission	103,962.00
6. Freight rebate/insurance claims/shortlandings	57,148.00
Total ...	3,078,149.00

> 'The difference between the two amounts, (credits and amount paid), is due to bank charges, roundings, etc.'

(Exhibit 2-B, p. 43, BIR Rec.)"

Petitioner assails the legal sufficiency of the reports as the sole evidentiary basis for the assessments and holds on to the proposition that - "On the admissibility of the various reports, namely, the Report of ADC/ADI Management and the Report of the Auditor General of Australia, we strongly restate our position that the said evidence are double hearsay and should have been excluded from the records. There is no showing whatsoever that HOMPI was involved or a party to the investigation conducted. If at all, the investigation was conducted for the purpose of exposing certain irregularities in some Australian government agencies. There is no scintilla of evidence linking HOMPI to the transactions. Thus, in two investigations previously conducted by representatives of respondent, there had been no indication whatsoever of HOMPI's participation, directly or indirectly in the so-called rebate or commission arrangements. HOMPI's name was only utilized as a front but it did not receive any benefit from the alleged arrangements. Again, at the risk of being repetitious, it is stressed that the exhibits, Report of ADC/ADI Management and Report of the Auditor General of Australia, should be excluded for being inadmissible as they miserably failed to meet the requirement of Section 20, Rule 132 of the Rules of

Court, which provides that:

> 'Whenever a copy of a writing is attested for the purpose of evidence, the attestation must state in substance that the copy is a correct copy of the original or specific part thereof, as the case may be. The attestation must be under the official seal of the attesting officer, if there be any, or if he be the clerk of court having a seal, under the seal of such court.'

So be it. Rather than be flummoxed into taking a precipitate action we choose not to resort to the narrow labyrinthical technicalities and by reason thereof discombobulate altogether the opportunity of having the case adjudicated on the merit.

The subject tax deficiency is essentially addressed to the alleged "huge underdeclaration of income" consequenced by a kind of slickly practiced arrangements under the supply of skim milk powder agreement between the petitioner and Australian based corporations. If we go by the records, the circumstances obtaining are by no means clear as to any showing of direct and affirmative participation or involvement of the petitioner in the "irregularities" committed by certain officials of the Australian Dairy Corporation and the Asia Dairy Industries (HK) Ltd. It comes as an aggravated chutzpah considering that "petitioner did not have any opportunity to be heard for it was never a party thereto." Neither is it clear as to any showing of petitioner's effective control and ownership of any specific amount of funds drawn or derived from such affiliating business practices of rebates, commissions and the like, extended by the Australian Dairy Corporation.

Clearly discernible from the "ADC/ADI Report" which brooks the circumstantial clout for the controverted assessments, are such findings denegating petitioner's availment of any such bounty directly or serendiptiously, thus --

> "ULTIMATE DESTINATION OF THE FUNDS - The total amounts involved were remitted as directed by Mr. Uytengsu to the 'Chartered Bank Singapore for account of Chartered Bank, Hongkong per instruction of Mr. W. Uytengsu or Mr. G. Young.' It can be seen that the amount that left ADC was not paid to HOMPI (petitioner), the organization which had the credit entitlement, although the payment method was directed by the President of HOMPI." (Page 23 of Exh. 2-A; p. 41, BIR records) (Underlining supplied).

> "CURRENT STATUS OF THE ACCOUNT - As indicated earlier it is not known in whose name the account is conducted or at which bank the account is conducted. It is not known whether amounts have been withdrawn from the account and for what purpose they have been utilized. It is not known, for example, if the Dutch partners in HOMPI (Hollànd Canned Milk) have received their notional equity in the amounts remitted by ADC." (Page 27 of Exh 2-A; p. 37, BIR Records) (Underlining supplied)

> "8.16. The rebate was therefore not in fact paid to HOMPI; it was paid to a bank to be held for disbursement at the direction of either of the two principals of HOMPI's majority shareholders, GF Equity. If the rebate had been paid direct to HOMPI, it would presumably have been distributed to the shareholders as dividends or in some other way accounted for to the shareholders, x x x Furthermore, we have been able to obtain no additional

> information on the details of the disbursement of the remainder of the rebate funds." (BIR Records, pp. 73-74)
>
> "8.17. The matter is complicated even more by the fact that the ADC paid moneys to the foreign bank significantly over and above the rebate payments. x x x The eventual whereabouts of these funds is also unknown to the Committee. The Auditor-General did not comment on these large payments when auditing the ADC accounts. x x x"
> (BIR Records, p. 73) (Underlining supplied)

Viewed in the light of the foregoing, we cannot validly infuse cognizance to an assessment found short of specific support in terms of tractable data openly laid and fully disclosed, much less fashion a "possible tax evasion" case out of inconclusive ends with ambiguous means of validating the principal cause of action. It will be too much of a stretch to hold petitioner accountable for such amount of income more than what was called upon it by law to declare. It may be necessary to repeat what the Supreme Court held and what so plainly apply to the case at bar that - Assessments should not be based on mere presumptions no matter how reasonable or logical said presumptions may be. And, 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. (Collector of Internal Revenue v. Benipayo, 4 SCRA 185). The respondent has fumbled into a reversible error.

The reach of the issues upon which we rest our decision renders resolution of other subsidiary questions of prescription and fraud unnecessary.

UPON THE VIEW WE TAKE OF THE CASE, the assessments for deficiency withholding tax at source and income taxes for the taxable years 1974-1977 inclusive of interest and penalty against the petitioner are hereby set aside and cancelled. No costs.

SO ORDERED.

Quezon City, Metro Manila, August 29, 1986.

ALEX Z. REYES
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge