# REPUBLIC OF THE PHILIPPINES
# Court of Tax Appeals
# QUEZON CITY

## *SECOND DIVISION*

| | |
|---|---|
| **STAR PERFORMANCE, INC.,**<br>Petitioner, | **C.T.A. CASE NO. 6237** |
| | Members: |
| - versus - | **CASTAÑEDA, JR.,** *Chairperson*<br>**UY,** *and*<br>**PALANCA-ENRIQUEZ,** *JJ.* |
| **COMMISSIONER OF INTERNAL REVENUE,**<br>Respondent. | **Promulgated:**<br>SEP 1 4 2006 |

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

# DECISION

***UY, J.:***

This Petition for Review seeks the cancellation of the assessment notices issued by respondent Commissioner of Internal Revenue, against petitioner, Star Performance, Inc., for deficiency income tax and value-added tax for taxable year 1996 in the respective amounts of P14,236,010.27 and P8,344,021.38, or in the sum of P22,580,031.65.

**THE FACTS**

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Philippines, with office address at J.Y. & Sons Industrial Compound, Phividec Industrial Complex, Taguig, Metro Manila. It is engaged in the manufacture and sale of ladies undergarments.[1] Respondent, on the other hand, is the duly appointed Commissioner of Internal Revenue who is vested with authority to administer and enforce national internal revenue laws, with office address at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On October 28, 1997, respondent issued Letter of Authority No. 101494,[2] authorizing Revenue Officer Lina U. Romero and Group Supervisor Edgardo M. Magpantay to examine the petitioner's books of accounts and other accounting records for the taxable year 1996. Correspondingly, petitioner's books of accounts and other accounting records relative to its income, business and withholding tax liabilities for taxable year 1996 were examined by the authorized officers of the respondent under Letter of Authority No. 171491 dated June 7, 1999[3] which revalidated the earlier Letter of Authority No. 101494 dated October 28, 1997.

As a result of the said investigation, petitioner received from respondent on April 25, 2000, two (2) Formal Assessment Notices, both numbered 000025-96-00-595 and dated April 11, 2000,[4] with accompanying Formal Letter of Demand and Details of Discrepancies[5] covering petitioner's alleged deficiency income tax and value-added tax (VAT) for taxable year 1996 in the respective amounts of P14,236,010.27 and P8,344,021.38 (inclusive of increments) totaling P22,580,031.65, computed as follows:

---

[1] TSN, December 4, 2001, p. 7.
[2] Letter of Authority No. 101494, BIR Records, p. 276.
[3] Letter of Authority No. 171491, BIR Records, p. 319.
[4] Exhibits "A" and "B", Rollo, pp. 159 and 160, respectively.
[5] Exhibits "C" and "C-1", Rollo, pp. 161-162.

***DEFICIENCY INCOME TAX***

| | | | |
|---|---|---|---|
| Taxable net income per return | | | P 2,347,527.00 |
| Add: | Discrepancies per investigation | | |
| | Undeclared sales | P20,738,574.70 | |
| | Salaries and wages | 406,623.87 | |
| | Professional fees | 595,420.00 | |
| | Advertising and promotions | 99,497.91 | |
| | Postage, telephone & telegram | 1,568.71 | |
| | Repairs & maintenance | 47,683.49 | |
| | Insurance | 58,136.51 | 21,947,505.19 |
| Taxable income per audit | | | P 24,295,032.19 |
| Tax due per audit | | | P 8,503,261.27 |
| Less: | Tax paid per return | | 821,634.00 |
| Balance | | | P 7,681,627.27 |
| Add: | 25% Surcharge | P 1,920,407.00 | |
| | 20% Interest per annum | 4,608,976.00 | |
| | Compromise penalty | 25,000.00 | 6,554,383.00 |
| Total Amount Due | | | **P 14,236,010.27** |

***DEFICIENCY VAT***

| | | | |
|---|---|---|---|
| Gross sales per investigation | | | P269,954,768.72 |
| 10% Output tax | | | P 26,995,476.87 |
| Less: | Input tax | | 15,695,424.70 |
| VAT due per investigation | | | P 11,300,052.17 |
| Less: | VAT paid per return | | 6,959,686.79 |
| Tax still due/payable | | | P 4,340,365.38 |
| Add: | 25% surcharge | P 1,085,091.00 | |
| | 20% interest per annum | 2,893,565.00 | |
| | Compromise | 25,000.00 | 4,003,656.00 |
| **TOTAL DEFICIENCY VAT DUE** | | | **P 8,344,021.38** |
| ***GRAND TOTAL*** | | | **P 2,580,031.65** |

On May 25, 2000, petitioner, through its external auditor, SGV & Co., filed with the Bureau of Internal Revenue (BIR), a protest letter against the Formal Assessment Notices contesting its alleged deficiency income and value added tax for taxable year 1996.[6] The BIR conducted a re-investigation of the subject deficiency tax assessments based on the protest letter of petitioner dated May 25, 2000. Within the sixty (60)-day reglementary period to submit supporting documents or on July 24, 2000,

[6] Exhibit "D", Rollo, pp. 163-171.

petitioner duly filed with the BIR a supplemental protest attaching thereto the relevant documents to support its position against the merit of the alleged deficiency tax assessments.

However, in view of respondent's failure to act with finality on petitioner's protest letters within the one hundred eighty (180)-day period allowed by law, petitioner filed the instant Petition for Review on February 16, 2001 in compliance with Section 228 of the National Internal Revenue Code (NIRC) of 1977, as amended.

## THE ISSUES

The parties mutually agreed on the following issues to be resolved by this Court as contained in their Joint Stipulation of Facts and Issues filed on August 9, 2001:[7]

1. "Whether or not petitioner has an undeclared sales in the amount of P8,424,360.00";

2. "Whether or not the advertising and promotion expenses are fully accounted for and substantiated with the corresponding documents to substantiate the expenses in the amount of P99,497.91";

3. "Whether or not petitioner is liable for the amounts of P5,867,394.14 and P492,686.86 as deficiency income and value-added taxes, respectively, for the taxable year 1996"; and

4. "Whether or not the right of the government to assess petitioner for alleged VAT deficiency has already prescribed under Section 114(A) in relation to Sections 203 and 222 of the Tax Code, as amended".

---

[7] Joint Stipulation of Facts and Issues, Rollo, pp. 76-80.

## THIS COURT'S RULING

The petition is meritorious.

The present deficiency income tax assessment arose from the adjustments made by the respondent's examiner on petitioner's 1996 net income representing alleged undeclared sales and unallowable deductions, enumerated as follows:

| | | |
|---|---|---|
| A. Undeclared sales | | P20,738,574.70 |
| B. Disallowed deductions | | |
| 1. Salaries and wages | P 406,623.87 | |
| 2. Professional fees | 595,420.00 | |
| 3. Advertising and promotions | 99,497.91 | |
| 4. Postage, telephone & telegram | 1,568.71 | |
| 5. Repairs & maintenance | 47,683.49 | |
| 6. Insurance | 58,136.51 | 1,208,930.49 |
| | | P21,947,505.19 |

The alleged undeclared sales in the amount of P20,738,574.70 was arrived at by the respondent's examiner by comparing the total sales per his investigation of petitioner's books of accounts and the total sales reflected in petitioner's audited financial statements (F/S), as follows:

| | |
|---|---|
| Total Sales per investigation of the recorded accounts | P 269,654,768.72 |
| Less: Total Sales per F/S | 249,216,193.00 |
| Undeclared Sales | P 20,438,575.72 |

In its protest letter dated May 25, 2000, petitioner explained that the discrepancy of P20,438,575.72 was a mere result of the examiner's misappreciation of petitioner's audited financial statements as well as the reclassification entries contained in its working papers as illustrated by the following reconciliation schedule:

| | | | | |
|---|---|---|---|---|
| Gross Sales per BIR Audit | | | | P269,954,769.00 |
| Add/(Less) Adjustments: | | | | |
| 1.) Sales Income - Raw & Auxiliary Materials classified by SGV under Miscellaneous Income | | | P 6,758,960.00 | |
| 2.) All Other Income classified by SGV under Miscellaneous Income | | | 1,201,718.00 | |
| 3.) Sales of Amo Stocks already part of Third Party Sales Per Trial Balance as follows: | | | 8,424,360.00 | |
| | Avon | 109,391,755.00 | | |
| | Amo | 8,424,360.00 | | |
| | | 117,816,115.00 | | |
| 4.) December 1996 Sales Invoices taken up twice by The Revenue Examiner since these already formed part of TIPI Sales per Trial Balance | | | | |
| Sales Invoice | 2078 | 798,993.00 | | |
| | 2079 | 662,051.00 | | |
| | 2080 | 585,931.00 | | |
| | 2081 | 598,991.00 | | |
| | 2088 | 607,330.00 | | |
| | 2089 | 637,960.00 | | |
| | 2117 | 462,280.00 | 4,353,536.00 | (20,738,574.00) |
| Total Sales Per Return | | | | P249,216,194.00 |

To further account for the discrepancy of P20,738,574.00, petitioner attached to its supplemental protest letter dated July 24, 2000, various documents such as the 1996 trial balance, general ledger, grouping of accounts per audited financial statements and sales invoices.[8]

The reinvestigation report submitted by the respondent's examiner did not find petitioner's case completely meritorious but recommended that petitioner be still held liable for an understatement of its 1996 sales in the amount of P8,424,360.00 representing AMO (a brand name which is much cheaper than the popular brands of Avon and Triumph) sales.[9]

Thus, to support its stand, petitioner presented before this Court the following documents:

---

[8] BIR Records, pp. 469-475 and 483-564.
[9] Exhibits "L" and "L-1", Rollo, pp. 229-230.

| | Description | Exhibit |
|---|---|---|
| 1.) | Schedule showing Sales Income - Third Party | J |
| 2.) | Sales Book AMO 1996 | J-1 to J-28 |
| 3.) | Trial Balance | K to K-5 |
| 4.) | Schedule of Sales Reconciliation | N to N-1 |
| 5.) | Annual Income Tax Return for 1996 | O to O-2 |
| 6.) | Audited Financial Statements for 1996 | P to P-10 |
| 7.) | Sales Invoices | Y to Y-1382 |
| 8.) | Summary of Debit/Credit Notes | Z |
| 9.) | Debit/Credit Notes | Z-1 to Z-23 |
| 10.) | CPA Report | AA to AA-3 |

After careful examination of the BIR records and evidence adduced by petitioner, We find the assessment pertaining to petitioner's alleged undeclared sales for taxable year 1996 in the amount of P20,738,574.00 erroneous and without factual basis.

Records reveal that the amount of P1,166,387.00 reported by petitioner as "Other Income" in its 1996 income tax return[10] consisted of petitioner's income from raw materials sold to its affiliated company, Triumph International Philippines, Inc. (TIPI), profit on sale of fixed assets, and all other income as shown below:[11]

| | |
|---|---|
| Cost of Raw Materials Sold | P 6,805,245.29 |
| Sales Income - TIPI (Raw & Aux. Materials) | **(6,758,959.89)** |
| All Other Income | **(1,201,717.73)** |
| Profit on Sale of Fixed Assets | (10,954.89) |
| | P(1,166,387.22) |

Clearly, the income amounts of P6,758,960.00 and P1,201,718.00 *(Adjustment Nos. 1 & 2 per reconciliation schedule)* included in the alleged discrepancy in sales of P20,738,574.00 have been duly declared by petitioner in its 1996 income tax return.

---

[10] Schedule 3, Section C, Exhibit "O-1", Rollo, p. 235.
[11] BIR Records, pp. 483-490.

With reference to the sales amount of P4,353,536.00 *(Adjustment No. 3 per reconciliation schedule)*, petitioner presented the corresponding sales invoices[12] which showed that the same pertained to its December 1996 sales to TIPI, which were entered and posted in its 1996 general ledger and eventually formed part of the reported sales in its 1996 income tax return.

With regard to the sales amount of P8,424,360.00 *(Adjustment No. 4 per reconciliation schedule)*, petitioner was also able to prove that it properly declared the same. Based on petitioner's 1996 trial balance,[13] the sales figure of P249,216,194.00 reflected in its 1996 income tax return comprised of the following:

| | |
|---|---|
| Sales Income - TIPI (FG Corsetry) | P 79,813,659.34 |
| Sales Income - TIPI (FG Briefs) | 36,000,446.69 |
| Sales Income - TIPI (FG Sloggi) | 13,153,020.67 |
| Sales Income - TIPI (Lingerie) | 638,289.66 |
| Sales Income - TI HK (FG Corsetry) | 1,794,662.59 |
| **Sales Income - THIRD PARTY (FG Corsetry)** | **109,625,301.25** |
| **Sales Income - THIRD PARTY (FG Briefts)** | **4,535,068.70** |
| **Sales Income - THIRD PARTY (FG Lingerie)** | **3,655,745.00** |
| | **P249,216,193.90** |

From the above, We can readily sum up petitioner's "Sales Income - THIRD PARTY" (FG Corsetry, Briefs, Lingerie) to P117,816,114.95. According to petitioner's Accounting Manager, Ms. Jennelyn Barrera, the account "Sales Income – THIRD PARTY" refers to sales made by petitioner to buyers other than TIPI, Triumph International Hongkong (TI HK) and other affiliates.[14] As illustrated by petitioner in its schedule of 1996 SALES – THIRD PARTY, the alleged undeclared sales amount of P8,424,360.00 formed

[12] BIR Records, pp. 469-475.
[13] BIR Records, pp. 559-560.
[14] TSN, February 21, 2002, p. 10.

part of the P117,816,114.95 Total Sales Income - THIRD PARTY.[15] Likewise, as correctly found by the commissioned auditing firm, CGM & Co, the amount of P8,424,360.00 was duly substantiated by sales invoices, debit/credit notes and reported in petitioner's 1996 sales book and general ledger.[16]

Having resolved that petitioner had no undeclared sales for taxable year 1996, We shall now discuss petitioner's claimed expenses totaling P1,208,930.49 which were disallowed by the respondent's examiner for being allegedly unsubstantiated pursuant to Section 29 of the NIRC of 1977, as amended, namely:

| | |
|---|---|
| 1. Salaries and wages | P 406,623.87 |
| 2. Professional fees | 595,420.00 |
| 3. Advertising and promotions | 99,497.91 |
| 4. Postage, telephone & telegram | 1,568.71 |
| 5. Repairs & maintenance | 47,683.49 |
| 6. Insurance | 58,136.51 |
| | P1,208,930.49 |

A perusal of the records in this case, more particularly, the Joint Stipulation of Facts and Issues of the parties, discloses that save for the amount of P99,497.91 representing petitioner's advertising and promotions expense, the deductibility of the aforementioned expenses in the total amount of P1,208,930.49 from petitioner's 1996 gross income was no longer disputed, to wit:

> 9. "Petitioner's declared expenses in the amount of P1,208,930.49 are allowable deductions from the gross income;
>
> 10. The items of salaries and wages are fully accounted for and supported with corresponding documents to fully substantiate the expenses in the amount of P406,623.87;

---

[15] Exhibits "J" and "J-1" to "J-28", Rollo, pp. 194-222.

[16] CPA Report, Exhibits "AA" to "AA-3"; Sales Invoices, Exhibits "Y" to "Y-1382"; Summary of Debit-Credit Notes, Exhibit "Z" and "Z-1" to "Z-23".

> 11. The professional fees are fully accounted for and supported with corresponding documents to fully substantiate the expenses in the amount of P595,420.00;
>
> 12. The expenses for postage, telephone and telegram are duly accounted for and supported with corresponding documents to substantiate the expenses in the amount of P1,568.71;
>
> 13. The repairs and maintenance are duly accounted for and supported with corresponding documents to substantiate the expenses in the amount of P47,683.49;
>
> 14. The expenses for insurance has been duly accounted for and supported with corresponding documents to substantiate the expenses in the amount of P58,136.51."[17]

Further, the various documents which were annexed to petitioner's supplemental protest letter dated July 24, 2000, such as the 1996 Allocation of Various Expenses, Reconciliation of Gross Compensation Income Against General Ledger and Annual Information Return of Income Tax Withheld on Compensation,[18] statement of accounts, invoices, official receipts, petty cash vouchers, journal vouchers, commercial vehicle policy, private car policy and postage receipts/registry notices,[19] collectively, proved that the aforesaid amounts represent ordinary and necessary business expenses incurred by petitioner in carrying on its business operations during the taxable year 1996 and are therefore valid deductions from its gross income for the same year pursuant to Section 29 of the NIRC of 1977, as amended.

What is now left for Us to determine is whether or not petitioner may validly claim as deduction from its 1996 gross income the amount of P99,497.91 representing advertising and promotion expense.

---

[17] Facts Admitted under paragraphs 9 to 14, Joint Stipulation of Facts and Issues, Rollo, pp. 77-78.
[18] BIR Records, pp. 478-482.
[19] BIR Records, pp. 402-468.

In its 1996 income tax return, petitioner's claimed deduction for advertising and promotions expense amounted to P757,971.00[20] representing shop and counter window décor.[21] Out of the total amount of P757,971.00, only the amount of P658,473.09 was found by the respondent's examiner to have been deducted the corresponding 1% expanded withholding tax. Thus, in his reinvestigation report, the respondent's examiner reiterated the disallowance of the remaining advertising and expense in the amount of P99,427.71 (P757,971.00 less P658,473.09) which was not allegedly subjected to expanded withholding tax.

We find the disallowance erroneous and improper.

The fact that the amount of P99,427.71 was incurred by petitioner in 1996 and supported by pertinent records and documents is not disputed. What is put into issue is whether or not petitioner withheld and remitted to the BIR the required 1% withholding tax thereon.

As indicated in the "Analysis of EWT Payment for Advertising and Promotion Expense" for the year 1996[22] prepared by petitioner, out of the total 1% withholding tax due of P7,579.71 on the total advertising and promotions expense of P757,971.00, the amount of P1,057.50 was withheld and remitted to the BIR in 1995 while the remaining amount of P6,522.21 was withheld and remitted to the BIR in 1996. The tax withheld in 1995 in the amount of P1,057.50 pertains to petitioner's 50% advance payment to Dialfa Creative Art amounting to P105,750.00.[23] The fact of withholding and

[20] Line 10, Schedule 1, Section D of Exhibit "O-1", Rollo, p. 235.
[21] BIR Records, p. 377 and Exhibit "K-4", Rollo, p. 227.
[22] Exhibits "Q" and "Q-1", Rollo, pp. 248-249.
[23] Exhibit "R", Rollo, p. 250.

remittance to the BIR of the amounts of P1,057.50 and P6,522.21 is evidenced by petitioner's vouchers,[24] official receipts issued by petitioner's supplier, Dialfa Creative Art,[25] certain pages of petitioner's 1995 Disbursements Book,[26] Annual Information Return of Income Tax Withheld on Compensation, Expanded and Final Withholding Taxes for 1995 and 1996,[27] and Alphabetical List of Payees from Whom Taxes Were Withheld for 1995 and 1996.[28]

In fine, this Court finds the 1996 deficiency income tax assessment in the amount of P14,236,010.27 without legal and factual bases and should therefore be cancelled and withdrawn. Accordingly, petitioner is not liable to pay any deficiency income tax for taxable year 1996.

We proceed to the issue of whether or not petitioner is liable to pay for deficiency VAT in the amount of P8,344,021.38 which resulted from the respondent's imposition of 10% output VAT on the alleged undeclared sales of petitioner in the amount of P20,738,574.00 and disallowance of petitioner's reported input VAT in the amount of P2,865,529.86 (P18,560,954.56 less P15,695,424.70).

Petitioner argues that the 1996 deficiency VAT assessment is already barred by prescription and that the same is baseless because petitioner had no undeclared sales in 1996.

We agree with the petitioner.

Section 203 of the NIRC of 1977, as amended, provides as follows:

---

[24] Exhibits "R", "S" and "V", Rollo, pp. 250, 251 and 255, respectively.
[25] Exhibits "T" and "T-1", Rollo, p. 252-253.
[26] Exhibits "W" and "W-1", Rollo, pp. 256-257.
[27] Exhibit "U", Rollo, p. 254; BIR Records, p. 202.
[28] Exhibits "X-3" and "X-4", Rollo, pp. 258-259; BIR Records, pp. 199-201.

> SEC. 203. *Period of limitation upon assessment and collection.* — Except as provided in the succeeding section, internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

Relative thereto, Section 110 of the same Code, states:

> SEC. 110. *Return and payment of value-added* tax - (a) *In general.* - Every person liable to pay the value-added tax imposed under this title shall file a quarterly return of the amount of his gross sales or receipts within twenty (20) days following the close of each taxable quarter prescribed for each taxpayer. xxx

Pursuant to Section 203 of the NIRC of 1977, as amended, the three-year period to assess commences 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. Based on Section 110 of the same Code, the quarterly VAT return is to be filed within twenty (20) days following the close of each taxable quarter. Hence, if the return was filed earlier than the last day allowed by law, the period to assess shall still be counted from the last day prescribed for filing of the return. However, if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. Accordingly, respondent had until the following dates within which to assess petitioner for subject deficiency VAT:

| Exhibit | 1996 | Date of Filing of Return | Last day to file return | Last day to assess |
|---|---|---|---|---|
| F | 1st quarter | April 22, 1996 | April 22, 1996* | April 22, 1999 |
| G | 2nd quarter | July 22, 1996 | July 22, 1996* | July 22, 1999 |
| H | 3rd quarter | Oct. 21, 1996 | Oct. 21, 1996* | Oct. 21, 1999 |
| I | 4th quarter | Jan. 20, 1997 | Jan. 20, 1997 | Jan. 20, 2000 |

* April 20 and July 20, 1996 fell on a Saturday while October 20, 1996 fell on a Sunday.

In the case at bench, it is undisputed that petitioner received the assessment notice only on April 25, 2000, which was beyond the three-year period within which the respondent could issue an assessment against petitioner for deficiency VAT for the four taxable quarters of 1996. And contrary to respondent's allegation,[29] Section 223 of the NIRC of 1977, as amended, which states that "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, or a proceeding in court for the collection of such tax may be filed without assessment, at anytime within ten years after the discovery of the falsity, fraud, or omission", is not applicable in the instant case considering that there was no fraud or falsity in petitioner's declaration in its 1996 quarterly VAT returns.

In view thereof, this Court rules that the 1996 deficiency VAT assessment in the amount of P8,344,021.38 is null and void for having been issued beyond the three (3)-year prescriptive period required under Section 203 of the NIRC of 1977, as amended, and should therefore be cancelled.

**WHEREFORE**, the instant Petition for Review is hereby **GRANTED.** Accordingly, the deficiency income tax and value-added tax assessments

---

[29] Answer, paragraph 9, Rollo, pp. 39-40, at p. 40.

issued by respondent against petitioner for taxable year 1996 are hereby **CANCELLED** and **SET ASIDE**.

**SO ORDERED.**

**ERLINDA P. UY**
Associate Justice

WE CONCUR:

**JUANITO C. CASTAÑEDA, JR.**
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.

**JUANITO C. CASTAÑEDA, JR.**
Associate Justice
Chairperson

## CERTIFICATION

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

**ERNESTO D. ACOSTA**
Presiding Justice