REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ATR KIM ENG FINANCIAL CORPORATION
(formerly Philtread Holdings Corporation),
Petitioner,

- versus -

C.T.A. CASE NO. 5722

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 31 2004

x - x

DECISION

This case involves an assessment for deficiency income and documentary stamp taxes in the amount of **TWO HUNDRED SIX MILLION ONE HUNDRED TWENTY TWO THOUSAND ONE HUNDRED FORTY NINE AND 86/100 PESOS (P206,122,149.86)** and **TWO HUNDRED EIGHT THOUSAND TWO HUNDRED FORTY SEVEN AND 27/100 PESOS (P208,247.27)**, respectively, for the calendar year ended December 31, 1994.

Petitioner ATR Kim Eng Financial Corporation (formerly Philtread Holdings Corporation) is a domestic corporation organized and existing under the laws of the Republic of the Philippines with office address located at Suite 5-A Vernida I Building, 120 Amorsolo Street, Legaspi Village, Makati City (*par 1, Joint Stipulation of Facts & Issues).* At present, petitioner maintains its principal office at the 17th Floor, Tower One & Exchange Plaza, Ayala Triangle, Ayala Avenue, Makati City *(par 3, Memorandum for Petitioner*).

On April 17, 1995, petitioner filed its Tentative Corporate Annual Income Tax Return and Audited Financial Statements for the calendar year ended December 31,

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1994 *(Exhibit C)*. The Amended Corporate Annual Income Tax Return and Audited Financial Statements thereof were filed on November 9, 1995 *(Exhibit D)*. Below is the detailed diagram of petitioner's Resume of Income and Deductions and Schedule 5 Sales or Exchanges of Property Other Than Capital Assets as reported in its Tentative and Amended Corporate Annual Income Tax Returns and Audited Financial Statements for calendar year ended December 31, 1994:

Tentative Corporate Annual Income Tax Return and Audited Financial Statement December 31, 1994

SECTION A RESUME OF INCOME AND DEDUCTIONS			
Schedule No.	Gross Income (Section C)	Deductions (Section (D)	Net Income
1 (Section C)	(P116,414,966.00)	P279,858,713.00	(P396,273,679.00)
2 (Section C)	28,920,738.00		28,920,738.00
3 (Section C)	182,937,946.00		182,937,946.00
TOTAL	**P 95,443,716.00**	**P279,858,713.00**	**(P184,414,995.00)**

Schedule 5 Sales or Exchanges of Property Other Than Capital Assets

Gross Selling Price	Cost or Other Basis	Expense of Sale and Cost of Improvement	Depreciation Allowed or Allowable	Unrealized Gain on Sale of Land	Gains or (Loss)
662,818.00	2,185,450.00		2,213,806.00		601,174.00
460,000,000.00	4,158,069.00			273,505,159.00	182,336,772.00
					182,937,946.00

Amended/Final Corporate Annual Income Tax Return and Audited Financial Statement December 31, 1994

SECTION A RESUME OF INCOME AND DEDUCTIONS			
Schedule No.	Gross Income (Section C)	Deductions (Section (D)	Net Income
1 (Section C)	(P104,920,430.00)	P400,703,510.00	(P505,623,940.00)
2 (Section C)	28,920,738.00		28,920,738.00
3 (Section C)	456,443,105.00		456,443,105.00
TOTAL	**P380,443,413.00**	**P400,703,510.00**	**(P20,260,097.00)**

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Schedule 5 Sales or Exchanges of Property Other Than Capital Assets

Gross Selling Price	Cost or Other Basis	Expense of Sale and Cost of Improvement	Depreciation Allowed or Allowable	Unrealized Gain on Sale of Land	Gains or (Loss)
662,818.00	2,185,450.00		2,213,806.00		601,174.00
460,000,000.00	4,158,069.00				455,841,931.00
					456,443,105.00

(pars 31-34, Joint Stipulation of Facts & Issues)

Additionally, "Section F: Reconciliation of Net Income for Corporations and Taxable Partnerships" found on page 20 of petitioner's Tentative Corporate Annual Income Taxes and Audited Financial Statements, reported the following:

SECTION F RECONCILIATION OF NET INCOME FOR CORPORATIONS AND TAXABLE PARTNERSHIPS		
Net Loss per Return (Total of Section B of the Return)		P 184,414,995.00
2. ADD : a. Non-taxable Income		
Write-off deferred income tax	P 49,510,882.00	
b. Income subjected to final income tax		
Interest income	2,039,659.00	
Gain on Sale Investments in Shares of Stock	2,114,040.00	
c. Charges against reserve (Specify)		
		53,664,581.00
3. DEDUCT: UNALLOWABLE DEDUCTIONS (SPECIFY)		
Provision for retirement pay	P 154,385,948.00	
Provision for probable loss on sale of land	104,000,000.00	
Provision for doubtful accounts	36,000,000.00	
Provision for inventory obsolescence	25,200,000.00	
Provision for taxes	20,458,849.00	
Deficiency Tax	353,561.00	340,398,358.00
NET PROFIT PER BOOK		(P471,148,772.00)

(par 35, Joint Stipulations of Facts & Issues)

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Likewise, on page 19 thereof, "Section F-1: Reconciliation of Net Loss and Analysis of Changes in Retained Earnings (Deficit) Computation of Tax Due" showed the following entries:

SECTION F RECONCILIATION OF NET INCOME FOR CORPORATIONS AND TAXABLE PARTNERSHIPS			
Taxable Loss per Return (total of Section B of the Return)			20,260,097.00
2. ADD : a. Non-taxable Income			
Write-off deferred income tax	49,510,882.00		
Interest Income Subjected to Final Income Tax	2,039,659.00		
Gain on Sale Investments in Shares of Stock	2,114,040.00		
Amortization of past service cost	1,249,615.00		
		54,914,196.00	
3. DEDUCT: UNALLOWABLE DEDUCTIONS (SPECIFY)			
Deferred income on sale of land taxable for income tax purposes	273,505,159.00		
Write down of property, plant and equipment	104,000,000.00		
Provision for other benefits	54,000,000.00		
Provision for doubtful accounts	36,000,000.00		
Provision for inventory obsolescence	25,200,000.00		
Depreciation of capitalized interest and duties	12,744,151.00		
Others	353,561.00		
		505,802,871.00	
4. Net Adjustments (item 2 minus item 3)			450,888,675.00

(par 36, Joint Stipulations of Facts & Issues)

On January 23, 1998, petitioner received from the Bureau of Internal Revenue Region No. 8 Assessment Division Chief Virginia P. Thomas, a Preliminary Assessment Notice for its alleged deficiency income taxes for the calendar year ended December 31, 1994 with details as follows (*pars 27 & 28, Joint Stipulation of Facts and Issues):*

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PRELIMINARY ASSESSMENT NOTICE FOR DEFICIENCY INCOME TAXES	
Net Income (loss) per return	**P(184,414,995.00)**
Add: Adjustments to net income	
Deferred income tax on sale of land	273,505,150.00
Reversal of deferred income tax	141,459,663.00
Reversal of entry re:1994 sales booked	
In 1993	14,674,924.00
Write-off of intercompany accounts	50,791,317.00
Discounts granted in 1993 claimed	
In 1994	502,594.00
Total Adjustments	**P480,933,657.00**
Net Income per investigation	296,518,622.00
Tax Rate	35%
Income Tax due Thereon	P103,781,532.00
Less: Payments	0
Tax Due	P103,781,532.00
Surcharge	25,945,383.00
Interest	72,504,373.00
Compromise	25,000.00
Total	**P202,256,288.00**

On March 27, 1998, respondent, through its Region 8 Assessment Division Chief Brenda Baltazar, issued Formal Assessment Notice Nos. 000056-94-408 and 02-172-94B-98-B2-408 for alleged deficiency income and documentary stamp taxes for the calendar year ended December 31, 1994 *(Exhibit R)*. These Assessment Notices were received by petitioner on April 2, 1998, with the following details:

Assessment Notice No. 000056-94-408 (Deficiency Income Tax)		
Tax Due	:	**P103,781,532.00**
Add: Surcharge 25%	:	25,945,383.00
Interest	:	76,370,234.86
Compromise	:	25,000.00
Total Amount Due	:	**P206,122,149.86**

Assessment Notice No. 02-172-94B-98-B2-408 (Deficiency Documentary Stamp Tax)		
Tax Due	:	P166,597.82
Add: Surcharge 25%	:	41,649.45
Total Amount Due	:	**P208,247.27**

On April 30, 1998, petitioner filed an administrative protest with the Bureau of Internal Revenue Region No. 8 Assessment Division challenging the findings of said bureau on the subject deficiency taxes *(Exhibit H)*. In support of its protest, petitioner submitted the following documents:

2. 1994 Tentative Income Tax Return and Audited Financial Statements filed on April 17, 1995;

2. 1994 Final Income Tax Return and Audited Financial Statements filed on November 9, 1995.

(par 16, Memorandum for Petitioner)

On July 29, 1998, petitioner filed a Waiver of the Statute of Limitations with the Bureau of Internal Revenue Region No. 8 Assessment Division, therein proposing that the period of investigation be extended to December 31, 1998 *(Exhibit I; par 8, Joint Stipulations of Facts & Issues)*.

On August 4, 1998, petitioner filed a Supplemental Administrative Protest. Attached to it were the same documents which petitioner had already submitted on April 30, 1998 together with its original letter-protest *(Exhibit J; pars 9 & 10, Joint Stipulation of Facts & Issues)*. The said Supplemental Administrative Protest merely reiterated the same factual and legal arguments as already contained in its original letter-protest.

Without any action on the part of the respondent, and the one-hundred eighty

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(180)-day period under Section 228 of the 1997 Tax Code in order for respondent to act on the protest of the petitioner having expired on December 26, 1998, petitioner filed the instant Petition for Review on January 22, 1999.

During the pre-trial date of the case, respondent questioned the jurisdiction of this court on the ground that the assessment had already become final, executory and demandable for the alleged failure of petitioner to submit all the supporting documents on time, using as his basis, the date petitioner filed its Supplemental Administrative Protest which was on August 4, 1998. A portion of the resolution promulgated by this court on June 30, 1999 denying respondent's motion is quoted below:

> *"Section 228 of the Tax Code clearly provides that within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted. Such is the situation in the case at bar. The document attached to the August 4, 1998 letter has already been submitted as early as April 30, 1998 and this court finds it grossly unfair to rule that the assessment became final due to petitioner's re-submission of the same document after the 60-day period. Petitioner filed its protest on time. It has also submitted all its relevant supporting documents within the 60-day period provided by law. xxx* "

A Motion for Reconsideration was then filed by respondent on July 21, 1999. Petitioner filed an Opposition to the Motion for Reconsideration on August 23, 1999.

On September 7, 1999, this court resolved to deny respondent's Motion for Reconsideration.

On November 4, 1999, respondent filed a Petition for Certiorari under Rule 65 of the Rules of Court before the Court of Appeals seeking for the annulment of this court's resolutions promulgated on June 30, 1999 and September 7, 1999.

On February 24, 2000, the Court of Appeals issued a resolution directing herein respondent to show cause within ten (10) days from notice thereof why the petition

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should not be dismissed for failure of respondent to allege the material date as to when they received a copy of the assailed order dated June 30, 1999. On July 17, 2000, the Fourteenth Division of the Court of Appeals dismissed the petition and was consequently recorded in their Book of Entries of Judgment August 9, 2000. Quoted below is the resolution of the Court of Appeals, thus:

> *"Since fifteen (15) days of the 60-day period to file Petition has elapsed when petitioner filed a motion for reconsideration, it had 45 days from September 9, 1999 when it received copy of the Order denying its motion for reconsideration or up to October 24, 1999 within which to file the instant Petition. As reflected above, however, it was filed on November 4, 1999, eleven (11) days late.*
>
> *WHEREFORE, the instant petition is hereby DENIED DUE COURSE and accordingly DISMISSED."*

On March 16, 2001, petitioner filed a Motion to Set Case for Continuation of Pre-Trial, which was granted by this court in an Order dated March 21, 2001.

Both parties having filed their respective Memorandum, this case was then submitted for decision on January 12, 2004.

On May 31, 2001, petitioner and respondent mutually agreed to the following stipulated issues:

1. Whether or not petitioner should be allowed to claim as legitimate business expenses and/or be subject to additional income on the following financial items for income tax purposes during calendar year ended December 31, 1994:

Deferred income tax on sale of land	273,505,159.00
Reversal of deferred income tax	141,459,663.00
Reversal of entry re:1994 sales booked in 1993	14,674,924.00
Write-off of intercompany accounts	50,791,317.00
Discounts granted in 1993 claimed in 1994	502,594.00
Total Adjustments	**480,933,657.00**

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> 2. Whether or not petitioner paid the proper amount of documentary stamp tax on the promissory notes it executed in favor of All Asia Capital & Trust Co..

However, on June 7, 2001, petitioner and respondent submitted a Supplemental Joint Stipulation of Issue to include a third issue to this case which was approved by this court in an Order dated June 18, 2001, to wit:

> 3. Whether or not the Formal Assessment Notices Nos. 000056-408 and 02-172-948-98-B2-408 **(should be 000056-94-408 and 02-172-94B-98-B2-408)** for alleged deficiency income tax and documentary stamp tax in the amounts of P206,122,149.86 and P208,247.27, respectively, for calendar year ended December 31, 1998 **(should be 1994)** are void because they did not inform the petitioner of the facts and the law on which the assessments are based in compliance with Section 228 of the Tax Code of 1997.

Petitioner and respondent filed a Joint Manifestation and Motion on March 10, 2003 which was properly noted by this court in an Order dated March 13, 2003, *viz*:

> *"Petitioner and Respondent, through undersigned counsel, respectfully state:*
>
> *1. The above-captioned case refers to the assessment issued by the Bureau of Internal Revenue ("BIR") against Petitioner for alleged deficiency income tax amounting to P206,122,149.86 and documentary stamp tax ("DST") amounting to P208,247.27, inclusive of increments for the taxable year 1994;*
>
> *2. On January 31, 2003, with the prior concurrence of counsel for Respondent, Petitioner settled the deficiency DST through the payment thereof to the BIR. A copy of the bank-validated deposit slip and Payment Form (BIR Form 0605) are attached herewith as Annex "A";*
>
> *3. On the basis of the settlement of the deficiency DST, only the assessment for deficiency income tax remains for the resolution of this Honorable Court."*

In view thereof, this court is left with the responsibility to resolve only the remaining two issues stipulated by the parties.

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With regard to the third issue, it is claimed by petitioner that the Formal Assessment Notices are void for they fail to inform petitioner of the facts and the law on which the assessments are based in compliance with Section 228 of the 1997 Tax Code. Section 228 of the Tax Code is partly quoted below for easy reference:

> **"Section 228. Protesting an Assessment** . – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: Provided, however, That a pre-assessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> **That the taxpayer shall be informed in writing of the law and the facts on which the assessment is made, otherwise, the assessment shall be void."**
> (Emphasis supplied)

An assessment contains a computation of the tax liabilities and a demand for payment of such liability within a prescribed period. It is noteworthy to emphasize that assessment notices need not be a full narration of the facts and laws on which the assessment is based. It is enough that petitioner be substantially informed of the law and the facts on which the assessment for a tax liability is made.

Going over the records of the case, it is evident that petitioner was already informed about its deficiency income and documentary stamp taxes for the calendar year ended December 31, 1994, even as early as when the Preliminary Assessment Notice was issued to petitioner and which was received by it on January 23, 1998 (*par 27, Joint Stipulation of Facts & Issues*). In fact, prior to the issuance and receipt of the Preliminary Assessment Notice, petitioner was already aware of an investigation on all its internal revenue taxes for the year 1994 when it received a Letter of Authority for

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the calendar year 1994 on July 17, 1995 *(Exhibit N; page 25, TSN, September 6, 2001*). It is noted that when petitioner received the Demand Letter and Assessment Notices from the BIR on April 2, 1998, it was able to write a letter-protest questioning the facts and entries as declared on these said documents. Clearly then, it is obvious that petitioner was informed of the facts and law on which the assessments were made, else, it would not have been able to comprehensively contest the said assessment notices based on factual and legal grounds. In petitioner's letter-protest against the final assessment notices issued by respondent, we hold that the explanations and arguments were based on the adjustments as those, which appeared on the preliminary assessment notices and final assessment notices. Thus, having knowledge of the nature and bases of the disallowed expenses, we find no merit in petitioner's claim that it was not properly informed of the facts and law on which the assessment notices were made.

Settled is the rule that tax assessments by tax examiners are presumed correct and made in good faith with the taxpayer having the burden of proving otherwise *(Cagayan Robina Sugar Milling Co. vs. Court of Appeals, et al., G.R. No. 122451, October 12, 2000)*. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed *(Ferdinand R. Marcos II vs. Court of Appeals, et al., G.R. No. 120880, June 5, 1997)*. Verily, failure of petitioner to present proof of any irregularity in the assessment notices will justify the judicial affirmance of said assessment notices.

As regards the first and final issue, it has been stipulated that petitioner was assessed for the calendar year ended December 31, 1994 deficiency income tax in the

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amount of P206,122,149.86, inclusive of interests and surcharges. Said deficiency came about due to some of the disallowances/adjustments made by the respondent on petitioner's income tax as reported in its income tax return. Details are as follows:

Net Income disclosed by the return as audited	P(184,414,995.00)
Add: Discrepancies	
Deferred income on sale of land	273,505,159.00
Reversal of deferred income	141,459,663.00
Reversal of entry re 1994 sales booked in 1993 (JV#D-94)	14,674,924.00
Discounts granted in 1993 claimed in 1994	502,594.00
Write-off of intercompany accounts	50,791,317.00
Total Adjustments	P480,933,657.00
Net Income per investigation	P296,518,662.00
Income tax due thereon	103,781,532.00
Add:	
25% Surcharges	25,945,383.00
Interest	76,370,234.86
Compromise	25,000.00
TOTAL AMOUNT DUE	**P206,122,149.86**

To be able to explain properly and clearly the resolution of the remaining issue, this court deems it necessary to individually tackle the validity of the discrepancies as found by the respondent.

1. UNDECLARED INCOME ON SALE OF LAND IN THE AMOUNT OF P273,505,159.00

According to petitioner, the above-mentioned subject property was the land sold to Sucat Land Corporation in 1994. The said sale of land generated for the company in 1994 a net income in the amount of P456,443,105.00.

The respondent, on the other hand, is of the opinion that the total income on the sale of land was not reported by petitioner in its 1994 Annual Corporate Income Tax Return.

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After a careful verification of the evidence presented in this case, we agree with petitioner that there was indeed no under declaration of income resulting from the sale of the subject land to Sucat Land Corporation. A comparison of the 1994 Tentative and Amended Corporate Annual Income Tax Returns *(Exhibits C and D, respectively)* patently reveals that the discrepancy in the amount of P273,505,159.00 representing the unrealized gain on sale of land in the 1994 Tentative Income Tax Return had been reported by petitioner as taxable income in the 1994 Amended Income Tax Return. The documents submitted showed and convinced this court that petitioner had reported all the income it had derived from the sale of the land to Sucat Land Corporation and no deferment of the recognition and reporting of any portion thereof for the calendar year ended December 31, 1994 was ever made. Below is a detailed comparison for easy reference:

	TENTATIVE ITR Exh. "C-4"	**AMENDED ITR Exh. "D-3"**
Selling Price	P460,000,000.00	P460,000.000.00
Less: Cost of Sales	4,158,069.00	4,158,069.00
Net Income	P455,841,931.00	P455,841,931.00
Less: Unrealized gain on sale of land	273,505,159.00	-
Gain on sale of land reported	**P182,336,772.00**	**P455,841,931.00**

The disputed amount of P273,505,159.00 appears as a reconciling item in the 1994 Annual Income Tax Return, appearing as "deferred income on sale of land taxable for income tax purposes" *(Exhibit D-7-1)*. This was considered to be an allowable deduction recognized as income for income tax purposes *(Exhibit D-7)*.

Hence, this court is persuaded that the finding of the respondent with respect to the undeclared income in the amount of P273,505,159.00 is not substantiated and should be withdrawn and cancelled.

2. REVERSAL OF DEFERRED INCOME TAX IN THE AMOUNT OF P141,459,663.00

It is alleged by respondent that the amount of P141,459,663.00 corresponding to the "Reversal of Deferred Income" per its demand letter dated March 27, 1998 *(Exhibit 4, page 693, BIR Records)* would have implications on the computation of petitioner's net income for 1994, thus, should be properly considered as additional income for the calendar year ended December 31, 1994. Respondent further opines that the deferred income tax is a set up of income tax due from the deferred income from the sale of the property to Sucat Land Corporation. Consequently, in view of the fact that the deferred income from the sale of land is already taxable, such reversal as reported by petitioner is not permissible (*page 17, TSN, April 21, 2003).* As a result of this, respondent assessed petitioner an additional P141,459,663.00 as income. In this regard, a quick perusal of the Preliminary Assessment Notice dated January 21, 1998 (page 689, BIR Records) and the Memorandum Report dated January 6, 1998 of Revenue Officer Rona B. Marcellano *(Exhibit 2, pages 682-683, BIR Records)* reveals that the said amount pertains to alleged "Reversal of deferred income tax."

On the other hand, petitioner argues that the respondent misconstrued the facts by relating the above-mentioned amount to petitioner's sale of the land to Sucat Land Corporation. Petitioner explains that the write-off pertained to the tax effect of temporary difference between the financial reporting and tax reporting (*pages 7-18, TSN, May 15, 2002).* Furthermore, petitioner avers that the amount is not P141,459,663.00 as declared by the respondent, but rather P49,510,882.00 *(Exhibit D-7-2).*

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We are convinced.

There is nothing to indicate that there was reversal of deferred income tax in the amount of P141,459,663.00 by petitioner in 1994. There is instead reflected the amount of "Write-off of P49,510,882.00 deferred income tax" *(Exhibit D-7-2)* as a reconciling item in the petitioner's 1994 Final Annual Income Tax Return *(Exhibit D)*. As correctly pointed out by petitioner, the reversal of deferred income tax has no connection with its sale of land to Sucat Land Corporation, a 60% owned subsidiary, on December 27, 1994. As exhaustively explained by petitioner in its protest-letter *(Exhibit H)*:

> "The account "deferred income tax" usually arises in case a taxpayer has an income which it already recognized for the taxable year but has not yet been considered as realized for tax accounting purposes. This situation arises when the Company uses a different method of income or revenue recognition in its financial accounting system which maybe different from the acceptable method of income or revenue recognition in tax accounting system. Necessarily, an adjustment must have to be made to align the figures derived in the Company's operations through the financial accounting system with that of the acceptable figures as provided under the tax accounting system as implemented by the Bureau of Internal Revenue.
>
> In the event the Company recognizes a certain revenue under its financial accounting system (which is not considered as a realized income under the tax accounting system), there would be a corresponding income tax effect of said revenue. This income is classified as "deferred income tax" as its recognition is deferred, as the term itself implies, until the recognition thereof is acceptable or the revenue is realized under the tax accounting system. This account has no effect on the financials of the Company.
>
> xxx xxx xxx
>
> Please note that the "deferred income tax" account is a reconciling item under Section F of the Company's Annual Income Tax Return. This only proves that the results of the Company's operations (using the financial accounting system) are being adjusted to conform to the tax

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accounting system. And one of the items considered is the deferred income tax account which is a non-taxable income of the Company."

Thus, respondent erred in his finding.

3. REVERSAL OF ENTRY RE: 1994 SALES BOOKED IN 1993 IN THE AMOUNT OF P14,674,924.00

Respondent further assessed petitioner an additional income in the amount of P14,674,924.00 based on the reversal of entries pertaining to the sales booked in 1993 but was issued official receipts in 1994. It is the opinion of the respondent that these income should be recognized in 1994 considering that the official receipts were clearly issued in 1994. Accordingly, the reversal of the 1994 sales entries would patently diminish petitioner's sales.

Petitioner, on the other hand, emphasizes that the sales entries having been recorded twice, both in 1993 and 1994, a reversal was necessary to prevent a "double" recognition of revenue or sales for one particular transaction.

After a careful scrutiny of the documents presented, petitioner miserably failed to establish by convincing evidence that it had indeed reported its revenues or sales entry twice. The pieces of evidence on record do not in any way confirm that the reported sales in 1994 have already been declared in petitioner's return for 1993.

Therefore, this court gives weight to respondent's finding.

4. WRITE-OFF OF INTERCOMPANY ACCOUNTS IN THE AMOUNT OF P50,791,317.00

Respondent argues that petitioner writes-off an intercompany account but at the same time, sets up a corresponding accounts receivable in the same amount, resulting

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in a discrepancy in the "net income disclosed by the return" *(Exhibit R-1)*. Respondent maintains that before a write-off can be made; there must be established convincing circumstances to prove that such debt is worthless and uncollectible, therefore, available to be written-off. Respondent is also of the opinion that by the setting up of an accounts receivable-trade entry, an increase in sales resulted, and consequently concluded that there was an under declaration of petitioner's income. Reproduced below is the disputed entry:

	DR	CR
Accounts Receivable – trade		
(Makrubber Corp)	P 50,791,317.28	
Due to/from affiliate – MRC		P 50,791,317.28
To close interco account and set up A/R-Makrubber Corp.		

(Exhibit CC, page 668, BIR Records)

However, petitioner clarifies that there was no writing-off of an intercompany account, but rather a reclassification of an asset account to another account. Petitioner submits that since what was done was a mere reclassification to transfer the balance of one asset account to another asset account, it would be impossible that a corresponding credit to sale/income would result.

We agree with petitioner.

Records would show that petitioner has two types of buyers, the affiliate and regular. Petitioner's entries in its sales books would differ, depending on the type of buyer, to wit:

If petitioner sells to an affiliate, the entry would be:

	DR	CR
Due to/from affiliates	xxx	
Sales		xxx
To record sales to an affiliate		

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If petitioner sells to a regular client, the entry would be:

	DR	CR
Accounts Receivable-Trade	xxx	
Sales		xxx
To record sales to a trade client		

One of its affiliate accounts was that of Makilala Rubber Corporation or Makrubber Corporation. Makrubber Corporation used to be a wholly-owned subsidiary of petitioner before it sold its investment shares in Makrubber Corporation in 1993. As a result of this sale, the entry "Due to/from affiliate" in petitioner's books would subsequently have to be reclassified as "accounts receivable" account entry in its books *(Exhibit AA-4; page 24, TSN, June 19, 2002).* This would have to be done to be able to treat the previous sale of an affiliate to a regular client.

To better elaborate, this court deems it proper to illustrate the transaction as follows:

In 1993, the sale to Makrubber Corporation as an affiliate was recorded in the books as:

Date	Particulars	DR	CR
1993	Due to/from affiliate	P50,791,317.28	
	Sales		P50,791,317.28
	To record sales to an affiliate.		

In 1994, when Makrubber Corporation ceased to be an affiliate, there was a need to reclassify the said previous account to a trade account, thus:

Date	Particulars	DR	CR
1994	Accounts Receivable-Trade	P50,791,317.28	
	Due to/from affiliate		P50,791,317.28
	To close interco account to set up A/R account due to the sale of investment in shares of stock in Makilala Rubber Corporation.		

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As a result of the above entries, the entry "Due to/from affiliate" account is now closed, the sale to a previous affiliate buyer is now reclassified as an ordinary sale to a regular client and properly would have the following effect:

Date	Particulars	DR	CR
1994	Accounts Receivable-Trade	P 50,791,317.28	
	Sales		P 50,791,317.28

Clearly then, there is no unrecorded income to which the petitioner should be made liable.

5. DISALLOWED DISCOUNTS IN THE AMOUNT OF P502,554.00

It is respondent's position that the discounts should be disallowed as deductions from petitioner's gross income for 1994 for such were allegedly granted in 1993. Accordingly, these discounts should have been claimed as deductions in 1993 *(Exhibit 2)*.

Petitioner, however, maintains that it did not commit any infraction of the law with regard to claiming the subject disallowed discounts. Petitioner, although it did not categorically admit respondent's arguments, nevertheless, claims that it would still not be liable for deficiency income taxes considering that the subject disallowed expense is so negligible as to affect the results of its operating at a loss during the calendar year ended December 31, 1994.

We agree with petitioner that the disallowed discounts in the amount of P502,594.00 would not affect petitioner's net loss of P20,260,097.00 for the calendar year ended December 31, 1994. These unsupported discounts, even if disallowed and added back to petitioner's net loss, would not considerably result in an increase in the

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net income of the petitioner. In other words, there would be still no deficiency income tax despite such disallowance.

Below is a summary of the net loss position of petitioner, after taking into account respondent's validated discrepancies:

Net Loss	**P(20,260,097.00)**
Add: Discrepancies	
Reversal of entry re: 1994 sales booked in 1993	14,674,924.00
Discounts granted in 1993 claimed in 1994	502,594.00
Total	15,177,518.00
ADJUSTED NET LOSS	**P(5,082,579.00)**

Inasmuch as the net loss position of petitioner would not be affected, even with the validated discrepancies of the respondent added back to petitioner's "net loss" entry, petitioner is clearly not liable to any deficiency income tax.

IN VIEW OF ALL THE FOREGOING, the Petition for Review is hereby **GRANTED.** Accordingly, the subject disputed Assessment Notice Nos. 000056-94-408 and 02-172-94B-98-B2-408 are **CANCELLED** and **SET ASIDE**.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

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CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice