REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

INTERGEN MANAGEMENT SERVICES (PHILIPPINES) LTD.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6893

Members:

CASTAÑEDA, JR., *Chairperson*
UY, *and*
PALANCA-ENRIQUEZ, *JJ.*

Promulgated:
NOV 19 2007
4:25 p.m.

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DECISION

CASTAÑEDA, JR., J.:

This petition seeks the cancellation and withdrawal of the assessments for alleged deficiency income and withholding taxes in the respective amounts of P1,019,529.32 and P1,052,131.31, issued by respondent for the taxable year 1999.

Intergen Management Services (Philippines) Ltd. (Petitioner) is a corporation duly organized and existing under and by virtue of the laws of the Cayman Islands, British West Indies, and authorized by the Philippine Securities and Exchange Commission (SEC) to establish a branch and engage in business in the Philippines. It is principally engaged in the business of performing management services for electric generation facilities in the Philippines. It is registered with the Bureau of Internal Revenue (BIR) with Tax Identification No. 047-005-295-344 and BIR Certificate of Registration bearing RDO Control No. 97-047-008861.[1]

Commissioner of Internal Revenue (Respondent) is the duly appointed officer of the BIR mandated by law to enforce and implement the provisions of the National Internal Revenue Code of 1997 (1997 Tax Code) as well as related tax statutes and their implementing rules and regulations, including the power to issue deficiency tax assessments and evaluate and decide upon the merits or the protest against deficiency tax assessments.[2]

On July 18, 2003, petitioner received from respondent a Formal Assessment Notice dated July 17, 2003,[3] together with two (2) Assessment Notices bearing Assessment Nos. IT-31618-99-03-345 and WC-31618-99-03-345, assessing petitioner for alleged deficiency income tax and withholding tax on compensation, respectively, for the taxable year 1999 in the amount of P2,071,660.45, inclusive of interest.[4] A detailed breakdown is provided hereunder, to wit:

Assessment No. IT-31618-99-03-345
Deficiency Income Tax

Taxable Net Income per Investigation		P 21,249,995.85
Less: Disallowed Salaries per Investigation	P 5,803,508.85	
Less: Salaries not subjected to withholding tax	1,853,508.85	
Salaries where withholding taxes has already been paid per VAAP		3,949,564.48
Taxable Net Income per reinvestigation		P 17,300,431.37
Tax Due thereon (33%)		P 5,709,142.35
Less: Tax due per return		5,097,341.00

[1] Paragraphs 1 and 3, Joint Stipulation of Facts and Issues (JSFI), Docket, page 101-102.
[2] Par. 2, JSFI, Docket, page 102.
[3] Exhibit "J", Docket, pages 301-302.
[4] Exhibits "I-1" and "I-2"; Docket, pages 299-300.

Deficiency Income Tax	P 611,801.35
Add: Interest (04/16/00 - 08/15/03)	407,727.97
Total Amount Payable	**P 1,019,529.32**

Assessment No. WC-31618-99-03-345	
Deficiency Withholding Tax - Compensation	
Salaries not subjected to withholding per investigation	P 5,803,508.85
Multiply by: Tax Rate	33%
Withholding Tax - Compensation due per investigation	P 1,915,157.92
Less: VAAP Payment (dated June 12, 2003)	1,303,356.28
Deficiency Withholding Tax - Compensation	P 611,801.64
Add: Interest (01/11/00 - 08/15/03)	440,329.67
Total Amount Payable	**P 1,052,131.31**

Petitioner filed with respondent a protest letter dated August 18, 2003, presenting its legal arguments, explanations and supporting documents against the subject assessment.[5]

Since respondent did not act on petitioner's protest within the one hundred eighty (180)-day period provided under Section 228 of the 1997 Tax Code, petitioner was constrained to bring this appeal before this Court on March 15, 2004.

In his Answer[6], respondent alleged the following Special and Affirmative Defenses:

> "5. He reiterates and repleads the preceding paragraphs of this answer as part of his Special and Affirmative Defenses;
>
> 6. Verification of the documents submitted by petitioner revealed that per books of accounts, it claimed the total amount of P51,534,471.27 as salaries and wages, while the salaries and wages per annual alpha lists submitted showed that only a total amount of P45,730,962.42 were subjected to tax, thus after subtracting the said amount and the salaries subjected to withholding per VAAP, it was revealed that petitioner failed to withhold taxes on salaries and wages amounting to P5,803,508.85, in violation of Section 34(K) of the NIRC, which provides as follows:

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[5] Par. 6, JSFI, Docket, page 103; Exhibit "K", Docket, page 304-307.
[6] Docket, pages 55-57.

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'(K) Additional requirements for Deductibility of Certain payments. – Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income, or for which depreciation or amortization may be allowed under this Section shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section, Sections 58 and 81 of this Code.'

7. Further, the failure of petitioner to withhold and to remit the corresponding withholding taxes due on salaries and wages, it violates the provisions of Revenue Regulations No. 2-98 and Section 80 of the 1997 Tax Code, which states that the employer shall be liable for the withholding and remittance of the correct amount of tax required to be deducted and withheld under this chapter. If the employer fails to withhold and remit the correct amount of tax as required to be withheld under the provision of this Chapter, such tax shall be collected from the employer together with the penalties or additions to the tax applicable in respect to such failure to withhold and remit. Hence, the same should be disallowed as deduction from its gross income for calendar year 1999.

8. Pursuant to Revenue Regulations No. 2-98 and Section 80 of the 1997 Tax Code, petitioner is under obligation to withhold and remit the corresponding withholding taxes due on salaries and wages of its employees (*i.e. expats and locals*).

9. The assessments issued against petitioner for deficiency income tax and withholding tax on compensation, for calendar year 1999, covered under Formal Assessment Notice No. IT-31618-99-03-345 and WC-31618-99-03-345, respectively, both dated July 17, 2003 were made in accordance with law and regulations.

10. All presumptions are in favor of the correctness of tax assessments."

On August 7, 2007, the case was submitted for decision upon petitioner's submission of its Memorandum on July 30, 2007 *sans* respondent's Memorandum. gr

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The parties interposed the following issue [7] for the Court's consideration:

"1. Whether or not Intergen failed to withhold and remit the corresponding withholding taxes due on salaries and wages, in violation of the provisions of Revenue Regulations No. 2-98 and Section 80 of the 1997 Tax Code.

2. Whether or not Intergen failed to withhold the taxes on salaries and wages amounting to P5,803,508.85 in violation of Section 34 (K) of the 1997 Tax Code.

3. Whether or not Intergen is liable for deficiency income and withholding tax on compensation in the amounts of P1,019,529.32 and P1,052,131.31, for taxable year 1997, covered under Assessment Notice Nos. IT-31618-99-03-345 and WC-31618-99-03-345, both dated July 17, 2003."

In resolving the issues submitted for resolution, the Court shall discuss the same jointly and simultaneously. The center of the controversy hinges on whether the amount of P1,853,508.85 is subject to income tax and to withholding tax on salaries.

Respondent explained the assessment for deficiency income tax as follows:[8]

> "a) Salaries and Wages (P1,853,944.37) = Verification of the documents submitted revealed that you failed to withhold taxes on salaries and wages amounting to P5,803,508.85 which is in violation of Section 34(K) of the NIRC. Per books of accounts, you claimed a total amount of P51,534,471.27 as salaries and wages, while the salaries and wages per annual alpha lists submitted showed that only a total amount of P45,730,962.42 were subjected to tax. However since you availed of the Voluntary Assessment and Abatement Program (VAAP) on disallowed salaries and wages of P3,949,564.48 the same has been deducted to taxable income per investigation.

[7] JSFI, Docket, page 104.
[8] Exhibit "J", Docket, page 303.

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Total Salaries & Wages per books	P 51,534,471.27
Less: Total Salaries & Wages per alpha lists	45,730,962.42
Salaries & Wages not subjected to withholding tax per investigation	P 5,803,508.85
Less: Salaries subjected to withholding per VAAP	3,949,564.48
Salaries & Wages not subjected to withholding tax per reinvestigation	P 1,853,944.37

Petitioner, on the other hand, argues that it was not obliged to withhold taxes on the amount of P1,853,944.37 because the amount does not represent salaries and wages but ordinary and necessary expense it paid in 1999. Petitioner clarified that the amount actually comprised of two (2) expenses it made in 1999 and the addition of an amount that should have been included in the expenses for salaries of local personnel:

Payment of 1998 expat salary true up adjustment	P 1,856,220.00
Local Salary inadvertently classified as a miscellaneous expense	(2,463.99)
Bank charges inadvertently classified as local salary	188.00
Total	P 1,853,944.37

According to petitioner, it properly withheld the appropriate income taxes on the amount of P2,463.99 while bank charges are properly deductible as expenses. Meanwhile, petitioner contends that its expat salary adjustment should not be included in its gross income for 1999 as this would amount to a tax upon a tax. Petitioner explains that P1,856,220.00 represents its payment in 1999 of the under-withheld taxes on the salaries of its expatriate employees for 1998 by virtue of an internal arrangement between them.

This Court disagrees with petitioner. By its own admission, petitioner failed to withhold the amount of P1,856,220.00 from the salaries of its expatriate employees. Instead of withholding the same, petitioner shouldered the payment thereof and claimed it as an ordinary and necessary expense for 1999. Petitioner cannot claim the payment of under-withheld taxes as ordinary and necessary expense under Section 34(A) of the 1997 Tax Code, which pertinently provides: gr

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> "**SEC. 34.** *Deductions from Gross Income*. - Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under subsection (M) hereof, in computing taxable income subject to income tax under Sections 24 (A); 25 (A); 26; 27 (A), (B) and (C); and 28 (A) (1), there shall be allowed the following deductions from gross income;
>
> (A) *Expenses.* –
>
> (1) *Ordinary and Necessary Trade, Business or Professional Expenses.*-
>
> (a) *In General.* - There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession, including:
>
> (i) A reasonable allowance for salaries, wages, and other forms of compensation for personal services actually rendered, including the grossed-up monetary value of fringe benefit furnished or granted by the employer to the employee: *Provided*, That the final tax imposed under Section 33 hereof has been paid;
>
> x x x"

Here, petitioner failed to show, much less prove, to this Court that the payment of under-withheld taxes on salaries is an ordinary and necessary expense. Besides, the payment of income tax is a personal liability of the employees which cannot be passed on to the employer; thus negating the ordinary and necessary nature of an expense which can be considered as an allowable deduction. Nevertheless, the employer, as withholding agent, becomes liable in case he fails to withhold and remit the correct amount of tax required to be deducted and withheld under Section 80(A) of the NIRC which provides:

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"**SEC. 80.** *Liability for Tax.* –

(A) *Employer.* - The employer shall be liable for the withholding and remittance of the correct amount of tax required to be deducted and withheld under this Chapter. If the employer fails to withhold and remit the correct amount of tax as required to be withheld under the provision of this Chapter, such tax shall be collected from the employer together with the penalties or additions to the tax otherwise applicable in respect to such failure to withhold and remit.

x x x"

More importantly, income taxes cannot be claimed as allowable deductions under Section 34(C)(1)(a) of the NIRC which pertinently states:

"**SEC. 34.** *Deductions from Gross Income.* – xxx

(C) *Taxes.-*

(1) *In General.* - Taxes paid or incurred within the taxable year in connection with the taxpayer's profession, trade or business, shall be allowed as deduction, *except*:

(a) The income tax provided for under this Title;

x x x

Provided, That taxes allowed under this Subsection, when refunded or credited, shall be included as part of gross income in the year of receipt to the extent of the income tax benefit of said deduction.

x x x" (*Emphasis supplied*)

Though the P1,856,220.00 was disallowed as an ordinary and necessary expense, respondent's assessment of deficiency withholding tax on compensation was erroneous because that amount represents under-withheld taxes on salaries which were collected from petitioner. As correctly pointed out by petitioner, the imposition of deficiency withholding tax on the under-withheld tax on compensation of its employees is a "tax upon tax." A tax should not be imposed upon another tax. This is tax pyramiding, which has no basis either in fact or in law.[9]

WHEREFORE, the Petition for Review is hereby **PARTIALLY GRANTED.** The assessment of deficiency expanded withholding tax on compensation against petitioner in the amount of P1,052,131.31 is hereby **CANCELLED** and **SET ASIDE**. However, petitioner is hereby **ORDERED TO PAY** respondent the amount of **P1,019,529.32** representing deficiency income tax for the taxable year 1999, plus 20% delinquency interest per annum, pursuant to Section 249(C)(3) of the National Internal Revenue Code, from August 18, 2003 until the amount is fully paid.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

[9] *People vs. Sandiganbayan, G.R. No. 152532. August 16, 2005.*

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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

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice

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