REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

CDL HOTELS (PHILS.) CORPORATION,
Petitioner,

\- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6585

Members:

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

Promulgated:

JUL 12 2007

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DECISION

CASTAÑEDA, JR., *J*.:

Before Us is a Petition for Review seeking for the declaration of nullity of respondent's assessment issued against petitioner for alleged deficiency income, value-added and withholding taxes for the taxable year 1998 in the amount of FORTY ONE MILLION NINE HUNDRED EIGHT THOUSAND EIGHT HUNDRED FIFTY FOUR PESOS AND TEN CENTAVOS (₱41,908,854.10), inclusive of interest and charges.

Petitioner CDL Hotels (Phils) Inc. is a corporation duly organized and existing under the laws of the Republic of the Philippines with principal office

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address at 10th Floor, The Heritage Hotel, EDSA Extension, Pasay City.[1] Its primary purpose is to own, lease, operate, manage or act as consultant to hotels, inns, resorts, condominiums, condotels, restaurants and clubs, other businesses as may be necessary or desirable in connection therewith and to maintain any and all services and facilities incident thereto.[2]

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue, authorized to perform the duties of his office, including, among others, the power to decide, cancel and abate tax liabilities pursuant to Section 204(B) of the National Internal Revenue Code ("NIRC") of 1997. His office address is at the 4th Floor, BIR National Office Building Agham Road, Diliman, Quezon City, Philippines.[3]

On October 15, 1997, petitioner and Grand Plaza Hotel Corporation (GPHC) entered into a Management Contract[4] "for the management and operation of [The Heritage Hotel, Manila] by [petitioner] and for the provision by the [petitioner] of marketing sales and reservation support upon the terms and conditions" set forth in the said agreement.

On March 8, 1999, petitioner paid no income tax for the calendar 1998 but filed its Annual Income Tax Return[5] showing the following details:

Tax Due	P2,612,664.84
Tax credits/Withheld/Payments for the First Three Quarters	2,381,118.04
Tax Withheld Per BIR Form No. 2307 for the Fourth Quarter	559,075.31
Total Tax Credits/Payments	2,940,193.35
Payable	(327,528.51)
Amount Payable	(327,528.51)

[1] Paragraph 1 of the parties Joint Stipulation of Facts.
[2] Exhibit "Q".
[3] Joint Stipulation of Facts and Issues, paragraph 1.2. See also par. 2 of the Statement of the Case in respondent's Memorandum.
[4] Exhibit "S."
[5] Exhibit "W".

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The Income Statements found in petitioner's Account Information Form (BIR Form 1702AIF-1) gives the following details:[6]

Gross Revenues/Receipts/Fees	43,668,973.00
Cost of Sales/Services	43,668,973.00
Gross Profit From Operations	43,668,973.00
Deductible Items (Not Included in Cost of Sales/Services)	43,668,973.00
Share in Group Services Expenses	35,410,945.00
Professional Fees	388,012.00
Taxes and Licenses	125,513.00
Miscellaneous	60,194.00
Total Deductions	35,984,664.00
Net Income	7,684,309.00

By virtue of the Letter of Authority No. LOA 1998 00009881 dated October 20, 1999, received by petitioner on November 3, 1999,[7] respondent conducted an examination of petitioner's books of account and other accounting records for its all internal revenue taxes for the calendar year 1998.

As a result of the investigation and pursuant to the Memorandum-Report dated October 1, 2001 of Revenue Officer II Domingo V. Pedrozo to the Regional Director of Revenue Region No. 8, Makati City,[8] Preliminary Notice of Assessment (PAN) and Details of Discrepancies were issued on January 10, 2002 and received by petitioner on January 14, 2002.[9]

On January 28, 2002, petitioner wrote Regional Director Antonio I. Ortega of the BIR Revenue Region No. 8, Makati and "reiterated [the] proposed assessments for deficiency income tax, VAT and final tax be reconsidered and accordingly withdrawn and cancelled."[10]

[6] Exhibits "W-2" to "W-4."
[7] BIR Records, p. 20.
[8] Exhibit "1".
[9] BIR Records, pp. 115-116.
[10] *Ibid.*, pp. 128-130.

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On January 29, 2002, respondent issued Final Letter of Demand, Final Assessment Notice and Details of Discrepancies, against the petitioner for the amount of P18,413,279.73 as deficiency income tax); P4,031,358.23 as deficiency VAT); and P19,464,216.14 as deficiency final withholding tax, computed as follows:[11]

Deficiency Income Tax

Net Income per return	P7,684,309.00
Add: Share in group services expenses	35,410,945.00
Taxable income per investigation	P43,095254.00
Tax due thereon (34%)	P14,652,386.36
Less: Tax paid	2,940,193.35
Deficiency tax due	P11,712,193.01
Add: Interest from 04-16-99 to 02-25-02	6,701,086.72
TOTAL	**P18,413,279.73**

Deficiency Value Added Tax

Gross receipts subject to VAT	P27,429,860.00
VAT due	P2,493,623.64
Add: Interest from 01-26-99 to 02-25-02	1,537,734.59
TOTAL AMOUNT DUE	**P 4,031,358.23**

Deficiency Final Withholding Tax

Share in group services expense	P35,410,945.00
Withholding Tax due	P12,039,721.30
Add: Interest 01-26-99 to 02-25-02	7,424,494.84
TOTAL AMOUNT DUE	**P19,464,216.14**

In a letter dated February 18, 2002, received by respondent on the same date, petitioner protested the above assessment and requested for a re-investigation.[12] In response, the Revenue District Officer wrote to petitioner on February 20, 2002; and requested for the copies of the Management

[11] Exhibits "A to D".
[12] Exhibits "E" to "E-3."

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Agreement between petitioner and CDL Hotel-Singapore, Management Agreement between petitioner and Grand Plaza Hotel Corporation; statement of accounts/expense vouchers/invoices, auditor's working papers; books of accounts; and articles of incorporation.[13] Subsequently, for failure of petitioner to submit the documents as requested, Revenue Officer II Domingo V. Pedrozo recommended that the assessment notice to petitioner be made final and executory.[14]

After the reinvestigation, Revenue District Officer of the Revenue District No. 51, Pasay City informed petitioner in a letter dated August 19, 2002 that there has been found due deficiency income tax in the amount of P19,442,240.40, value-added tax in the amount of P2,268,745.47 and withholding tax in the amount of P19,464,216.14.[15]

Thus, on December 20, 2002, petitioner received respondent's "Final Decision on Disputed Assessment" and Amended Assessment Notices for deficiency VAT and compromise penalty, all dated December 10, 2002, affirming the FAN but with certain modifications on the amount of the deficiency VAT, to wit:[16]

Deficiency Value-Added Tax:

Due from related company, Jan. 1, 1998	P14,434,938.00
Less: Output tax component on Receivables	1,312,267.09
Net	P13,122,670.91
Add: Net income for the year	43,668,973.00
Total	P56,791,643.91
Less: Due from related company, Dec. 31, 1998 (Net of Tax)	27,885,501.91
Gross receipts subject to VAT	P28,906,143.91
Tax rate	10%
VAT due	P2,890,614.30

[13] Exhibits "2," "3" and "4."
[14] BIR Records, p. 151.
[15] Exhibits "F" and "G;" "7" and "8."
[16] Exhibits "I," "J," "K," and "L."

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Add: Surcharge (25%)	722,653.57
Interest (1.26.99 to 2.28.00)	798,712.86
Total	P4,411,921.44
Less: VAT paid on February 28, 2000	2,890,614.30
Deficiency VAT	1,521,307.14
Add: Interest (3.1.00 to 12.20.02)	854,432.77
Amount still due	**P2,375,739.91**

Aggrieved, petitioner filed the instant petition for review on January 13, 2003.

For his part, respondent filed his Answer on March 25, 2003 interposing the following special and affirmative defenses:

> "6. The assessments in question were made and issued in accordance with law, rules and regulations.
>
> 7. No deduction from gross income shall be allowed unless the taxpayer shall substantiate with sufficient evidence the amount of expense being deducted, and the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer. (Gancayco vs. CIR, 1 SCRA 980)
>
> 8. The petitioner's share in group services expenses in the amount of P35,410,945.00 which is actually a payment to CDL Hotel International-Singapore, a non-resident foreign corporation, was not subjected to final withholding tax.
>
> 9. Contrary to petitioner's claim that the amount of P35,410,945.00 represents reimbursable expenses by CDL-Singapore for the sales promotion services rendered to petitioner as one of its international subsidiary, nonetheless, the same would not be considered as a deductible business expense of the petitioner.
>
> Under the Management Agreement executed by and between the petitioner and Grand Plaza Hotel Corporation (GPHC), owner of Heritage Hotel (the 'Hotel'), it was stated that from the revenue of the Hotel, there shall be deducted the entire cost and expenses of maintaining, conducting and supervising the operation of the Hotel. Thus, any and all expenses incurred by the petitioner for the benefit of the Hotel shall be for the account of the Hotel and do not constitute as a deductible expenses in so far as the taxable income of the petitioner is concerned.
>
> 10. The aforesaid share in the group services expense as recorded in the books of the petitioner do not actually represent reimbursable expenses incurred by and payable to CDL-Singapore but rather more of profit allocation or payments made by the petitioner to the latter in consideration for its part in marketing, advertising, sales and reservation support services rendered for the promotion and development of Heritage Hotel.

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11. Petitioner constructively received from Grand Plaza Hotel Corporation (GPHC) an amount equal to P27,429,860.00 in payment of management and incentive fees. Petitioner receives income only and exclusively from GPHC for its performance of various roles enumerated in the Management Agreement as Manager of said the Hotel.

Since the petitioner and CDL-Singapore as part of the CDL Hotel International Group, the former is being billed by the latter for its part in marketing, advertising, sales and reservation support services rendered for the promotion and development of Heritage Hotel. These inter-related company transaction were presented in the balance sheet under the 'Due to – Due from – related company account'. Petitioner bills GPHC and a debit to 'Due from related company' account to recognize its income therefrom. On the other hand, the liability to CDL-Singapore was taken up in the books of accounts by crediting the account 'Due to related company'.

Thus analysis of the above-mentioned accounts revealed that GPHC directly remitted to CDL-Singapore in December 1998 the amount of P27,093,023.67. This remittance was correspondingly taken up in the books of the petitioner as a reduction to both its receivables from GPHC and its liability to CDL-Singapore, thereby, constituting constructive receipts subject to value-added tax (VAT) pursuant to Section 108 of the 1997 Tax Code.

"12. All presumptions are in favor of the correctness of the tax assessment. (Interprovincial Autobus vs. Collector of Internal Revenue, 98 Phil. 290)"

On January 4, 2007, petitioner filed its Memorandum.

On January 11, 2007, the Court issued a resolution considering this case submitted for decision upon consideration of petitioner's Memorandum and without respondent's Memorandum.

Both parties stipulated on the following issues for the Court's determination:

1. Whether or not the amount of P35,410,945.00 represents reimbursable expenses;
2. Whether or not the amount of P35,410,945.00 allegedly representing reimbursable expenses should be disallowed as deductions from petitioner's gross income for 1998;
3. Whether or not the amount of P35,410,945.00 should be subject to final withholding tax;
4. Whether or not the amount of P27,429,860.00 constitutes constructive receipts subject to 10% VAT;
5. Whether or not petitioner is liable for deficiency income tax, value-added tax and final withholding tax assessments in the amount of PhP18,413,279.73,

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PhP2,375,739.91, and PhP19,464,216.14, respectively, inclusive of surcharges and interests for the taxable year 1998, covered under Final Assessment Notice No. LOA-00009881-98-02-933 dated January 29, 2002.

Deficiency Income tax and Deficiency Withholding Tax

Petitioner submits that the amount of ₱35,410,945.00 is an expense incurred by CDL Hotel International-Singapore ("CDL-Singapore") in the sales promotion services, among others, for the benefit of its worldwide subsidiaries that includes petitioner; and that petitioner merely reimbursed said amount. As it is not an income payment, the same is not subject to withholding tax. Petitioner also submits that, as the advertising and promotion of the hotel is reasonable and necessary to the business of petitioner as the Manager, the subject amount reimbursed by petitioner to CDL-Singapore may be deducted from petitioner's gross revenues for the year 1998. Thus, there is no basis for the assessment of deficiency income tax. Even assuming that the said amount is income payment, petitioner argues that Article 7 of the RP-Singapore Tax Treaty provides that such income is not taxable.[17]

In support of its allegations, petitioner, among others, submitted to the Court the following:

1. Debit/Credit Notes dated August 31, 1998 and February 27, 1999 issued by CDL Hotels International –Singapore to prove that "there is factual and legal basis for petitioner's remittance of the amount of ₱35,410,945.00 since the same is in the nature of reimbursement for advertising expenses incurred by CDL Hotel

[17] "Convention Between the Republic of the Philippines and the Republic of Singapore For the Avoidance Of Double Taxation And the Prevention Of Fiscal Evasion With Respect To Taxes On Income."

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International-Singapore in promoting the Heritage Hotel which is managed and operated by petitionerxxx[;]"[18]

2. Management Agreement dated October 15, 1997, specifically Sections 3.10 and 3.10.1 thereof, to prove the agreement entered into between petitioner and Grand Plaza Hotel Corporation regarding the operation, running and management of The Heritage Hotel (Hotel) and that petitioner is authorized to advance all expenses to be incurred by its affiliates in promoting the hotel whether individually or as part of the chain of hotels and therefore there is legal and factual basis for its remittance of the amount of PP35,410,945.00;[19]
3. Testimonies of Atty. Eliseo A. Fernandez (Senior Managing Partner of Fernandez, Santos & Lopez, CPA's); Mr. Edgar Sorriente (Accounting Manager of Grand Plaza Hotel Corporation); and Mr. Yam Kit Sung (Treasurer of petitioner) – to prove that part of petitioner's duty is to include the Hotel in its worldwide promotion conducted by CDL-Singapore. In turn, petitioner is billed by the latter of its share in the worldwide promotion expenses incurred by CDL-Singapore;
4. Brochure/Worldwide Directory of member hotels of CDL Hotels International Group, Maritime Hotels, Millennium Hotels and Copthorne Hotels – to prove that petitioner is part of the worldwide chain of hotels owned, managed and/or operated by CDL Hotels International-Singapore and/or its affiliates;[20]
5. Annual Income Tax Return of CDL Hotels (Phils.) Corporation for the taxable period ending December 1998 to prove there is no basis for the assessment of deficiency income, valued-added, and withholding taxes;[21] and
6. Audit Report/Audited Financial Statements of CDL Hotels (Phils) Corporation for the taxable period ending December 1998 to prove there is no basis for the assessment of deficiency income, valued-added, and withholding taxes.[22]

Despite the petitioner's documentary evidence, this Court finds no convincing evidence that establishes the fact that the amount of

[18] Exhibit "O" and "P."
[19] Exhibit "S."
[20] Exhibit "T."
[21] Exhibits "W," and "W-1" to "W-12."
[22] Exhibit "X," and "X-1" to" X-5."

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₱35,410,945.00 represents a deductible expense, and not a profit or income remittance or allocation to CDL-Singapore.

The Debit/Credit Memos, supposed to be proofs to establish that the amount is a reimbursable expense, are insufficient to grant petitioner's claim for they only show the amounts of HK$3,524,119.06 and HK$3,388,156.26 as reimbursement of head office expenses for the year 1998. However, they do not contain a breakdown or details of the head office expenses that will show the expenses include the amount of ₱35,410,945.00 and that such amount is to be treated as a deductible expense.

There are no other pieces of evidence, like schedules detailing expenses incurred by CDL-Singapore; related receipts proving payments thereof by CDL-Singapore; CDL-Singapore's official receipts issued to petitioner; and petitioner's payment vouchers with sufficient description, that will establish the fact that the amount of ₱35,410,945.00 was incurred and that the same is a deductible expense under Our Tax Code.

In *Atlas Consolidated Mining & Development Corporation vs. Commissioner of Internal Revenue*,[23] the Supreme Court ruled:

> "The principle is recognized that when a taxpayer claims a deduction, he must point to some specific provision of the statute in which that deduction is authorized and must be able to prove that he is entitled to the deduction which the law allows. As previously adverted to, the law allowing expenses as deduction from gross income for purposes of the income tax is Section 30 (a) (1) [now Section 34(A)(1)] of the National Internal Revenue which allows a deduction of 'all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.' An item of expenditure, in order to be deductible under this section of the statute must fall squarely within its language.

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[23] Nos. L-26911 and L-26924, January 27, 1981.

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We come, then, to the statutory test of deductibility where it is axiomatic that to be deductible as a business expense, three conditions are imposed, namely: (1) the expense must be ordinary and necessary, (2) it must be paid or incurred within the taxable year, and (3) it must be paid or incurred in carrying in a trade or business. In addition, not only must the taxpayer meet the business test, he must substantially prove by evidence or records the deductions claimed under the law, otherwise, the same will be disallowed. The mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction.

xxx Similarly, this Court has never attempted to define with precision the terms 'ordinary and necessary.' There are however, certain guiding principles worthy of serious consideration in the proper adjudication of conflicting claims. Ordinarily, an expense will be considered 'necessary' where the expenditure is appropriate and helpful in the development of the taxpayer's business. It is 'ordinary' when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term 'ordinary' does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique or non-recurring to the particular taxpayer affected.

xxx The burden of proof that the expenses incurred are ordinary and necessary is on the taxpayer and does not rest upon the Government. To avail of the claimed deduction under Section 30(a)(1) [now Section 34(A)(1)] of the National Internal Revenue Code, it is incumbent upon the taxpayer to adduce substantial evidence to establish a reasonably proximate relation between the expenses to the ordinary conduct of the business of the taxpayer. A logical link or nexus between the expense and the taxpayer's business must be established by the taxpayer."[24]

On the other hand, this Court agrees with respondent that the subject amount is more of a profit allocation as stated in the assailed Final Decision and supported by the evidence on records. We quote:

"In Article V (52)(B3 to B6) of the Management Agreement executed by and between CDL-Phil. and Grand Plaza Hotel Corporation (GPHC), owner of Heritage Hotel, it

[24] *Ibid.*

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was stated that from the revenue of the Hotel, there shall be deducted the entire cost and expenses of maintaining, conducting and supervising the operation of the Hotel. From the above mentioned Management Agreement, CDL-Phils acts as a manager of Ground Plaza Hotel Corp., any and all expenses incurred by affiliates for the benefits of the hotel, if there is any, shall be for the account of the hotel and does not constitute as a deductible expense in so far as the taxable income of CDL-Phils. is concerned. Pursuant to Section 34(A)(1)(a) of the Tax Code of 1997, as amended, an expense to be deductible must be ordinary and necessary paid or incurred during the taxable year in carrying on or which are directly attributable to the development, management, operation, and/or conduct of trade, business, or exercise of profession. Expenses which are 'ordinary and necessary generally contemplates expenses which are directly connected with and proximately resulting from carrying on the business and must be shown to be appropriately helpful in the development of the taxpayer's business for the acquisition or pursuit of income or profit' (*Gancayco vs. CIR, 1 SCRA 980)*[.]

"The share in group services expenses amounting to ₱35,410,945.00 was taken up and recorded in the books of CDL-Phils as a deductible expense. Scrutiny of the records and additional documents submitted showed that this expense account seem to actually cover, although it is not, reimbursement of business expense for its sales promotion services rendered for the benefit and development of the Hotel being managed (Heritage Hotel) and not directly incurred in carrying on or which were attributable to the conduct of trade or business or to the operation of CDL Phils in particular, hence, disallowed. Granting for the sake of argument, that this expense actually represent 'reimbursable expenses', still it should not be taken up as a deductible business expense of CDL Phils. but rather an expense directly chargeable to the operation of the Heritage Hotel."[25]

The next point to resolve is whether the RP-Singapore Tax Treaty applies. This Court rules in the negative. Section 4 of Revenue Regulations No 7-82,[26] which implements the RP-Singapore Treaty, reads:

"SECTION 4. *Availment of treaty benefits.* - Any person availing of any benefits provided by the Convention shall file the appropriate BIR Form for Income Tax Convention, hereinbelow

[25] Exhibit "1," p. 1.
[26] "Revenue Regulations Implementing the RP-Singapore Tax Treaty."

> indicated with the *International Operations Division*,[27] Bureau of Internal Revenue, National Office Bldg., Quezon City. xxx xxx xxx. It shall be the duty of the Regional Director to forward the said form to the International Operations Division for proper action."

This Court *En Banc* ruled in *Mirant vs. CIR* that:[28]

> "However, it must be remembered that <u>a foreign corporation wishing to avail of the benefits of the tax treaty should invoke the provisions of the tax treaty and prove that indeed the provisions of the tax treaty applies to it, before the benefits may be extended to such corporation. In other words, a resident or non-resident foreign corporation shall be taxed according to the provisions of the National Internal Revenue Code</u>, unless it is shown that the treaty provisions apply to the said corporation, and that, in cases the same are applicable, the option to avail of the tax benefits under the tax treaty has been successfully invoked.
>
> Under Revenue Memorandum Order 01-2000 of the Bureau of Internal Revenue, it is provided that the availment of a tax treaty provision must be preceded by an application for a tax treaty relief with its International Tax Affairs Division (ITAD). This is to prevent any erroneous interpretation and/or application of the treaty provisions with which the Philippines is a signatory to. The implementation of the said Revenue Memorandum Order is in harmony with the objectives of the contracting state to ensure that the granting of the benefits under the tax treaties are enjoyed by the persons or corporations duly entitled to the same." (Emphasis supplied.)

Applying the above ruling in the case at bar, petitioner failed to prove that the treaty should apply to CDL-Singapore. There is no proof that CDL-Singapore, or through petitioner, applied with the ITAD of the BIR pursuant to Revenue Regulations No. 7-82. Petitioner immediately raised the defense that the amount of ₱35,410,945.00 is not subject to final withholding tax by virtue of the treaty, but without presenting any evidence to support its contention.

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[27] Now International Tax Affairs Division.
[28] C.T.A. EB 40 (CTA Case no. 6382), June 7, 2005.

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As previously stated that the amount of ₱35,410,945.00 is a profit allocation for CDL-Singapore, the same is therefore subject to final withholding tax as provided under Our Tax Code. In *Mirant case*,[29] the Court further ruled that non-resident foreign corporations are subject to final withholding tax. We quote:

> **"'SEC. 28. Rates of Income Tax on Foreign Corporations. –**
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> xxx xxx xxx
>
> **(B) Tax on Nonresident Foreign Corporation.-**
>
> (1) In General.- Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs 5(c) and (d): *Provided,* That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three (33%); and, effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).
>
> **REVENUE REGULATIONS NO. 2-98**
>
> **SEC. 2.57 – WITHHOLDING OF TAX AT SOURCE**
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> xxx xxx xxx

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[29] *Ibid.*

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> (I) Income Derived From all Sources Within the Philippines by Non-Resident Foreign Corporation. – The following shall be subject to final withholding tax based on the gross amount of income and at the rate of tax prescribed therefore:
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> (1) In general – On gross income derived from all sources within the Philippines such as interests, dividends, rents, royalties, salaries premiums (except reinsurance premiums), annuities, emoluments, or other fixed or determinable annual, periodic or casual gains, profits and income from capital gains (except capital gains realized from sale, exchange, disposition of shares of stock in any domestic corporation which is subject to capital gains tax under Sec. 28(B)(5)(c) – at the following rates:
>
> 34% - beginning January 1998
> 33% - beginning January 1999 and
> 32% - beginning January 2000 and thereafter.'
>
> Revenue Regulations No. 2-98 was issued to implement the provisions of R.A. No. 8424, An Act Amending the NIRC, as amended, relative to the Withholding on Income subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes. Additionally, Section 57 of the NIRC speaks of "Withholding of Tax at Source" and it enumerates under Subsection (A) thereof, the specific sections in the NIRC when "Withholding of Final Taxes on Certain Incomes" shall be imposed. The enumeration therein includes Section 28(B) of the NIRC, or the provision on the taxability of the income of non-resident foreign corporations, as subject to the final tax at 32%."

Now, this Court resolves the issue of prescription, which petitioner raised for the first time in its Memorandum.

The assessment involved in this case is for the taxable year 1998. Petitioner alleged that it filed its income tax return on March 9, 1999; and, in accordance with Section 203 of the 1997 NIRC, as amended, the prescriptive period for assessing petitioner would end on April 15, 2002. However,

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respondent issued the Final Assessment on December 10, 2002, which petitioner received the same on December 20, 2002. Hence, the subject assessment is void for having been issued beyond the prescriptive period. Petitioner also alleged that the waiver it executed failed to extend the prescriptive period inasmuch as the said waiver fell short of the requirements for valid and binding waiver.

This Court does not agree with petitioner.

As regards income tax, Section 203 of the 1997 NIRC, as amended, provides:

> "SEC. 203. *Period of Limitation Upon Assessment and Collection.* – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) 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 (3) 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."

Pursuant to Section 52 (A), in relation to Section 77(B), of the 1997 NIRC, a final adjustment return shall be filed on or before the 15th day of April, or on or before the 15th day of the fourth month following the close of the fiscal year, as the case may be. Even if petitioner filed its Income Tax Return on March 9, 1999 for the calendar year 1998, the prescriptive period commenced to run on April 16, 2002.

A close scrutiny of the records of this case shows that respondent issued its PAN and FAN on January 10, 2002 and January 29, 2002, respectively. Petitioner received both the PAN and the FAN January 14, 2002

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and February 4, 2002, respectively. From this point alone, it is clear that the respondent's right to assess petitioner for deficiency income tax has not prescribed.

The Final Assessment, which petitioner claims to have received on December 20, 2002, is not the assessment contemplated under Section 203 of the 1997 NIRC. As the records disclosed, petitioner received the Final Decision on the Disputed Assessment on December 20, 2002. An assessment is a written notice and demand by the Bureau on the taxpayer for the settlement of a due tax liability that is there definitely set and fixed.[30] Clearly, the assessment being referred to under the 1997 NIRC, as amended, is the PAN and FAN.

Even without delving into the issue of the validity of the waiver, still the assessment issued by respondent is not barred by prescription. Section 223 of the 1997 NIRC, as amended, states:

> "SEC. 223. *Suspension of Running of Statute of Limitations.* - The running of the Statute of Limitations provided in Section 203 and 222 on the making of assessment and the beginning of distraint or levy or a proceeding in court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or levy or a proceeding in court and for sixty (60) days thereafter; **when the taxpayer requests for a reinvestigation which is granted by the Commissioner**; when the taxpayer cannot be located in the address given by him in the return filed upon which a tax is being assessed or collected: *Provided*, That, if the taxpayer informs the Commissioner of any change in address, the running of the Statute of Limitations will not be suspended; when the warrant of distraint or levy is duly served upon the taxpayer, his authorized representative, or a member of his household with sufficient discretion, and no property could be located; and when the taxpayer is out of the Philippines." (Emphasis supplied.)

[30] Vitug and Acosta, *Tax Law and Jurisprudence*, 2nd ed., p. 282.

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From the above-quoted law, when a taxpayer requests for a reinvestigation and such request is granted by the Commissioner, the running of the statute of limitations provided for by section 203 is suspended. The grant of a request for reinvestigation interrupts the running of the prescriptive period since it, in effect, binds the hands of the BIR from filing suit for collection. The interruption terminates from the day there is a clear and unequivocal act on the part of the BIR such as issuing a warrant of distraint and levy showing that, as far as BIR is concerned, the assessment of the deficiency taxes is final; that the door which had been previously opened towards its possible reconsideration is definitely closed, and hence, collection of the amount assessed would proceed.[31]

Petitioner, in its protest letter to respondent's FAN dated February 18, 2002,[32] requested for a reinvestigation. The pertinent paragraph of the letter is hereby quoted below:

> "Our client would welcome and therefore, would consider this letter a request for a reinvestigation if your office would be inclined to take a closer second look at our client's books as would give yourselves and our client a clearer picture on the matter."

Petitioner's request was granted by respondent in a letter dated March 21, 2002, [33] which was received by petitioner on March 22, 2002. It follows that the running of the three year prescriptive period was interrupted on March 22, 2002. Obviously, there is no truth to the claim of petitioner that the assessment was already barred by prescription.

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[31] *Republic vs. Aquias*, No. L-21874, June 30, 1970.
[32] Exhibit "E-2"
[33] Exhibit "4"

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As regards the issue on the prescription of the assessment for deficiency final withholding tax, a review of the records would show that petitioner filed its various "Monthly Remittance Return of Income Taxes Withheld" for the year 1998 but without declaring any amount of income and other details thereto.

While the prescriptive period for assessment is three years as prescribed under section 203 of the 1997 NIRC, as amended; however, Section 222 of the 1997 NIRC provided for exceptions to the period of limitation of assessment and collection of taxes. We quote:

> "SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes. -*
>
> (a) In 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 any time within (10) years after the discovery of the falsity, fraud or omission: xxx;
>
> (b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by a subsequent written agreement made before the expiration of the period previously agreed upon.
>
> xxx xxx xxx"

A reasonable understanding of the foregoing law is that false return is different from fraudulent return with intent to evade tax or from failure to file a return. The above provision should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return. The difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due. The ordinary period of prescription of 3 years within which to assess tax liabilities under Sec. 203 of the 1997 NIRC, as amended, should be applicable to normal circumstances; but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent returns intended to evade payment of tax or failure to file returns, the period of ten years as provided for in Section 222 of the 1997 NIRC, as amended, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced. [34]

In the case at bar, although petitioner filed its monthly return as mandated by law, it failed to declare thereto the income subject to the tax under the belief that the income supposedly subject to the withholding tax is not an income but a deductible expense. The returns filed by petitioner can be considered as false return because it deviated from the truth when no income was declared, when in truth there was an income subject to tax. Being considered as false return, it is immaterial if petitioner intentionally omitted to declare its income subject to final withholding tax or not.

Considering that petitioner's return is false, the applicable prescriptive period would be ten years from the discovery of falsity. In the case at bar, the latest return filed was on January 11, 1999, while the FAN was issued on January 29, 2002, such period being within the ten year period it follows that the assessment had not yet prescribed.

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[34] *Aznar vs. Court of Tax Appeals*, No. L-20569, August 23, 1974.

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Moreover, the Supreme Court had ruled that the filing of deficient returns which prevent the Commissioner of Internal Revenue from computing the proper taxes is tantamount to non-filing. The Commissioner had to determine and assess the taxes on data obtained, not from the return, but from other sources.[35] Hence, the assessment for deficiency final withholding tax, therefore, has not prescribed.

Deficiency Value–Added Tax

Respondent's basis of assessing petitioner a deficiency VAT is the fact that petitioner constructively received from GPHC the amount of ₱27,429,860.00 in payment of management and incentive fees. We quote the pertinent potions of respondent's "Final Decision on Disputed Assessment," to wit:

> "The subject taxpayer (your client) constructively received from Grand Plaza Hotel Corporation (GPHC) an amount equal to ₱27,429,860.00 in payment of management and incentive fees. CDL Phils. receives income only and exclusively from GPHC for its performance of various roles enumerated in the Management Agreement as Manager of the said Hotel.
>
> Since CDL Phils. And CDL-Singapore are part of the CDL Hotel International Group, the former is being billed by the latter for its part in marketing, advertising and sales and reservation support services rendered for the promotion and development of Heritage Hotel. These inter-related company transactions were presented in the balance sheet under the 'Due to – Due from – related company account'. CDL Phils. Bills Grand Plaza Hotel Corporation and a debit to 'Due from related company' account to recognize its income therefrom. On the other hand, the liability to CDL-Singapore was taken up in the books of accounts by crediting the account 'Due to related company'. Due from related company was stated at the balance sheet inclusive of the output tax component such was properly adjusted in the modified assessment as shown below (next page).

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[35] *Commissioner of Internal Revenue vs. Gonzales*, No. L-19495, November 24, 1966.

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> Analysis of the above mentioned accounts revealed that GPHC directly remitted to CDL-Singapore in December 1998 the amount of ₱27,093,023.67. This remittance was correspondingly taken up in the books of the subject taxpayer as a reduction to both receivables from GPHC and its liability to CDL-Singapore, thereby constituting constructive receipts subject to VAT in accordance with the provision of Section 108 of the NIRC, as amended.
>
> The alleged payment of your client (CDL Phils.) amounting to ₱9,346,908.93 made on February 28, 2000 were taken into consideration but up to the extent of the obligation arising from 1998 VAT Due only, since you have substantially justified that said payment were only made in year 2000 which includes collection of 1998 accounts from CDL Phils."

On the other hand, petitioner posits that the assessment for deficiency VAT is without basis since Grand Plaza paid the 1998 management fees only in 2000 and the corresponding VAT due was paid in 2000.

This Court does not agree with petitioner.

Review of the facts and the evidences of the case at bar reveals otherwise. In respondent's "Final Decision on Disputed Assessment" the following computations for the deficiency VAT are partly shown, to wit:

Due from related company, Jan. 01, 1998	P 14,434 938.00
Less:Output tax component on Receivables	1,312,267.09
Net	13,122,670.91
Add: Net income for the year	43,668,973.00
Total	P 56,791 643.91
Less:Due from related company, Dec. 31, 1998	P 27,885,501.91

It is important to note that petitioner admitted in its protest letter to the FAN that the account "Due from related company" reflects its management fees due from GPHC. If petitioner's allegation that there was no collection of management fees for 1998 is correct, then the balance of the account "Due from related company" should be ₱56,791,643.91 and not the ending balance of ₱27,885,501.91. Since the ending balance decreased from

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₱56,791,643.91 to ₱27,885,501.91, there is no other conclusion but petitioner received payment of management fees in 1998.

Petitioner presented the GPHC's Income Tax Return[36] and Audited Financial Statements[37] for 1998 to prove that there was no factual and legal basis for the assessment of deficiency value-added tax since the management and incentive fees for the year were not paid within the same year. The Court, however, cannot verify if GPHC did not really pay the management fees. Besides, while petitioner presented as evidence its monthly VAT returns and Metrobank receipts, the same do not prove that petitioner paid its VAT due in 1998.

As regards the prescription of the assessment for VAT, this Court notes that in petitioner's memorandum, it failed to fully explain to this Court why the assessment on the VAT had already prescribed.

A perusal of the records show that petitioner filed its Monthly VAT return for the year 2000 and paid the corresponding output tax on February 28, 2000.[38] Under Section 114(A), the VAT return shall be filed and the tax paid within 25 days following the end of each quarter specifically prescribed for a VAT-registered person. The reckoning period, therefore, in determining the prescriptive period under Section 203 is the filing of the taxpayers Quarterly VAT returns. However, no return was made part of the records of this case. The Quarterly VAT Returns duly received by the BIR, would have been the best evidence to prove the date of filing and payment of VAT. In the absence of Quarterly VAT Returns, the Court cannot make a proper ruling on

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[36] Exhibits "U", "U-1" to "U-13."
[37] Exhibits "V", "V-1" to "V-9."
[38] Exhibit "M" and "N."

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the matter of prescription. Prescription is a matter of defense and the burden of establishing the same is on the petitioner.

In closing, this Court is mindful of the well-entrenched principle that assessments are presumed to be correct unless the contrary is shown, and the burden of proof rest upon the taxpayer to overcome this presumption.[39] For failure of petitioner to present evidences that will overpower such presumption, the Court therefore stand by the truthfulness of respondent's assessment for deficiency income tax, final withholding tax and deficiency VAT.

WHEREFORE, the instant Petition for Review is **DISMISSED.** The final assessment issued by respondent for petitioner's "Deficiency Income Tax", "Deficiency VAT" and "Deficiency Final Withholding Tax" as appearing in respondents "Final Decision on Disputed Assessment" received by petitioner on December 10, 2002, is hereby **AFFIRMED with some modifications.**

Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of P46,191,214.36, computed as follows:

Type of Tax	Basic Tax	25% Surcharge	Interest	Total
Income Tax	P 11,712,193.01	P 2,928,048.25	P 6,701,086.72	P 21,341,327.98
VAT	P 1,521,307.14		P 854,432.77	P 2,375,739.91
Final Withholding Tax	P 12,039,721.30	P 3,009,930.33	P 7,424,494.84	P 22,474,146.47
Amount Due				**P 46,191,214.36**

Pursuant to Section 248 of the1997 NIRC, as amended, a 25% surcharge is hereby imposed on the Deficiency Income tax and Final Withholding Tax.

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[39] *Tan Guan vs. The Court of Tax Appeals and the Commissioner of the Bureau of Internal Revenue*, No. L-23676, April 27, 1967.

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In addition, petitioner is **ORDERED TO PAY** 20% delinquency interest on P46,191,214.36 computed from January 13, 2003 until full payment thereof pursuant to Section 249(C) of the Tax Code.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERLINDA P. UY
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

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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