REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

TAKENAKA CORPORATION PHILIPPINE BRANCH, Petitioner,	**CTA CASE NO. 7542**
	Members:
- versus -	**CASTAÑEDA, JR.,** *Chairperson* **CASANOVA,** *and* **MINDARO-GRULLA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** AUG 2 5 2011 11:00 a.m.

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DECISION

CASANOVA, *J*.:

This is a Petition for Review filed by petitioner on November 8, 2006, seeking for the cancellation and setting aside of the assessment notices issued by the respondent in relation to petitioner's deficiency compensation withholding tax in the amount of P2,278,563.92 and deficiency expanded withholding tax in the amount of P10,815,409.63.

The facts of the case, as culled from the records, are as follows:

Petitioner is a foreign corporation organized and existing under the laws of Japan, duly licensed to transact business in the Philippines with principal business address at 18th Floor, Tower 2, The Enterprise Center, 6766 Ayala Avenue corner Paseo de Roxas, Makati City, Philippines[1]

Respondent-Commissioner of Internal Revenue (the "Commissioner") is the public officer authorized under the National Internal Revenue Code of 1997 (the "Tax Code") with the power to decide disputed assessments arising under said law and other laws or portions thereof administered by the Bureau of Internal Revenue. She holds office at the 5th Floor, Bureau of Internal Revenue, National Office Building, Agham Road, Diliman, Quezon City, where she may be served with summons, notices and other court processes.

On December 29, 2005, petitioner received from the respondent Preliminary Assessment Notice[2] with attached Details of Discrepancies[3] covering taxable year ending December 31, 2002 stating that petitioner has deficiency income tax of P164,354,535.58; deficiency value-added tax of P2,755,688.07; deficiency withholding tax on compensation of P2,252,756.71 and deficiency expanded withholding tax of P10,692,913.38

On January 9, 2006, petitioner filed a protest letter to the above-mentioned Pre-Assessment Notice.[4]

On January 14, 2006, a Formal Assessment Notice[5] was issued against the petitioner alleging that it is liable for deficiency income tax in the amount of P166,224,626.69, value-added tax in the amount of P2,786,970.56, withholding tax on compensation in the amount of

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[1] Petition for Review, Par. 1, Docket, p. 1
[2] Exhibit "C"
[3] Exhibit "C-1"
[4] Facts Admitted, Joint Stipulation of Facts and Issues (JSFI), par. 4, Docket, p. 75
[5] Exhibit "I"

P2,278,563.92 and expanded withholding tax in the amount of P10,815,409.63 for the taxable year 2002.

Petitioner, through counsel, filed a protest letter[6] questioning the abovementioned Final Assessment Notice on February 9, 2006 and submitted documents in support thereof on April 12, 2006.[7]

Respondent did not act with finality on the protest,[8] hence, petitioner filed its Petition for Review on November 8, 2006.[9]

Respondent filed her Answer[10] on December 20, 2006 and alleged the following Special and Affirmative Defenses:

> "4. The assessments in question were made and issued in accordance with law, rules and regulations.
>
> 5. Verification disclosed that there was an understatement of purchases in the amount of P82,700,340.72 as reflected in the partial tally of the computerized matching conducted by the Bureau on the sales by its suppliers against the purchases declared in petitioner's tax returns. The said amount resulted to an undeclared purchases and treated as an undeclared income pursuant to Section 32 of the NIRC, as amended.
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> 6. It was discovered that rentals subjected to withholding tax per 1601-E was higher than the amounts reflected per Financial Statements and Income Tax Returns, hence, was also considered as unaccounted source of cash which is treated as undeclared income pursuant to Section 32 of the NIRC, as amended.
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> 7. Reconciliation of Salaries and Wages per Financial Statements vs. per Alpha Lists disclosed that there were compensation not subjected to Withholding Tax amounting to P5,573,055.25. Hence, this was disallowed as deduction from gross income for income tax purposes pursuant to Section 34 of the NIRC, as amended.

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[6] Exhibit "J"
[7] Facts Admitted, JSFI, par. 7, *Ibid*, p. 76
[8] Facts Admitted, JSFI, par. 10, *Ibid*, p.76
[9] Petition for Review, Ibid, pp. 1-11
[10] *Ibid*, pp. 38-39

8. Verification revealed petitioner failed to subject to expanded withholding tax certain income payments (i.e., professional fees; payment to subcontractors, security expenses; and rental of equipments). Hence, these expenses were disallowed as deductions from gross income pursuant to Section 34 of the NIRC, as amended.

9. As previously discussed on undeclared income from undeclared purchases, the same amount was subjected to VAT under Sections 105 and 108 of the NIRC, as amended.

10. Since the petitioner has failed to remit the corresponding withholding tax on the Salaries and Wages previously disallowed from gross income, petitioner is found liable to pay the withholding tax on compensation pursuant to Section 79(A) of the NIRC, as amended and implemented under Section 2.78 of the Revenue Regulations No. 2-98. Moreover, since petitioner failed to remit the correct withholding tax due on compensation, petitioner was assessed of deficiency withholding tax in the amount of P5,568.36.

11. Petitioner was assessed of deficiency expanded withholding tax in the amount of P10,815,409.63 for its failure to withhold on its certain income payments claimed as deductions in its income tax return.

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

During trial, petitioner presented its testimonial and documentary evidence in support of its position. On February 14, 2008, petitioner filed a "Motion to Withdraw Petition"[11] stating that it has availed of the remedy under Republic Act No. 9480 ("RA 9480"), otherwise known as the "Tax Amnesty Law of 2007". The said motion was partially granted by this Court in a Resolution[12] dated March 19, 2008. The dispositive portion of the said Resolution is as follows:

"**WHEREFORE**, the petition for review is hereby **PARTIALLY WITHDRAWN** insofar as the Formal Assessment

[11] *Ibid*, pp. 169-172
[12] *Ibid*, p. 205

> Notice (FAN) Nos. IT-33755-02-06-0027 and VT-33755-02-06-0027 are concerned. The only issue remaining in this case covers FAN Nos. WC-33755-02-06-0027 and WE-33755-02-06-007.
>
> **SO ORDERED.**"

In a Resolution[13] dated September 22, 2010, this case is submitted for decision after considering petitioner's Memorandum,[14] filed on September 8, 2010, *sans* respondent's Memorandum.

By reason of petitioner's availment of tax amnesty pursuant to the provisions of RA 9480, and as confirmed by the Court in its March 19, 2008 Resolution, the only remaining issues submitted for decision are the following:

(a) Whether or not petitioner is liable for alleged deficiency expanded withholding tax in the amount of P10,932,370.09

(b) Whether or not petitioner is liable for alleged deficiency withholding tax on compensation in the amount of P2,278,563.92 both for the taxable year 2002.

The issues raised in this case will be discussed in seriatim.

A. Deficiency Expanded Withholding Tax

Respondent assessed petitioner for deficiency expanded withholding tax, inclusive of increments, in the amount of P10,815,409.63 *(sic)*, computed as follows:

Basic Tax Due	P	6,689,944.09
Add: 20% Interest (01.16.03 to 02.16.06)		4,125,465.54
Total Amount Due	**P**	**10,815,409.63**

[13] *Ibid*, p. 424
[14] *Ibid*, p. 402-423

Respondent alleged that petitioner failed to subject to expanded withholding tax certain income payments, pursuant to Section 2.57.2 of Revenue Regulations No. 2-98. The disallowed income payments are presented below[15]:

Income Payments	Per F/S / ITR	Per 1601-E	Discrepancy	Rate	EWT Due
Professional Fees	P 7,906,618.00	P 286,568.60	P 7,620,049.40	10%	P 762,004.94
Payment to Subcontractors (Subcontracted Labor)	1,701,263,050.00	1,422,121,948.50	279,141,101.50	2%	5,582,822.03
Security Expenses	15,939,041.00		15,939,041.00	2%	318,780.82
Rental of Equipment	4,126,726.00		4,126,726.00	5%	206,336.30
TOTAL	**P 1,729,235,435.00**	**P 1,422,408,517.10**	**P306,826,917.90**		**P6,869,944.09**[16]

1. Professional Fees

Petitioner argues that respondent's finding is incorrect. For this item of the FAN, respondent compared some expense accounts on the Financial Statements (FS) as against the expenses subject to expanded withholding tax per BIR Form 1601-E. As a result of such comparison, it was alleged that petitioner has deficiency taxes.

Petitioner explains that the discrepancy of P7,620,049.40 represents payments made to general professional partnerships which are not subject to withholding tax.

Records reveal that the professional fees in the amount of P7,906,618.00 were derived from the total amount of P15,701,124.74 per general ledger (GL)[17]. For financial statement purposes, this account was reclassified as follows:

[15] Schedule 4 of Annex "A" of Exhibit "HH"
[16] Erroneously indicated as P6,689,944.09 in the Formal Letter of Demand and Assessment Notice
[17] Exhibit SS-23

Charged to Operating Expense	P	7,907,232.82
Charged to Cost of contracts - Subcontracted labor		7,793,891.92
Total	**P**	**15,701,124.74**

Petitioner asserts that out of the total amount of P15,701,124.74, P2,482,908.93[18] represents payments to general professional partnerships (GPPs) which are exempt from withholding tax; while for the remaining amount of P13,218,215.81, petitioner either withheld 10% in the case of payments to consultants, or 2% in the case of payments to maintenance services.

Verification disclosed that of the alleged payment to GPPs, only the amount of P1,475,764.00 can be considered as professional fees exempt from expanded withholding taxes. The remaining amount of P1,007,144.93, as presented in detail below, should be subjected to ten percent (10%) expanded withholding tax for petitioner's failure to substantiate the same with proper supporting documents.

Supplier/Payee	Exhibit	Amount	Remarks
Abello Concepcion Regala & Cruz Law Office		P 245,284.93	No supporting document
Joaquin Cunanan & Co.	QQQ-1-a-9	180,000.00	No proof that the payment made was indeed for professional fee
Emil Lamprea	RRR-3-a-41	140.00	No proof that the payment made was indeed for professional fee
SGV & Co.	QQQ-1-a-40	290,000.00	No proof that the payment made was indeed for professional fee
SGV & Co.		291,720.00	No supporting document
Total		**P 1,007,144.93**	

Moreover, the remaining amount of P13,218,215.81 allegedly subjected to 10% and 2% withholding taxes, this court finds that petitioner was not able to fully remit the withholding taxes due thereon. Presented

[18] Exhibit QQQ-1

herein below is the additional deficiency withholding tax on professional fee of P67,458.02 due from petitioner.

Payee	Exhibit No.	Amount	Rate	EWT Due	EWT Withheld	Additional Deficiency Withholding Tax on Professional Fee
ACL Asia, Inc.	QQQ-1-a-3	P 125,000.00	2%	P 2,500.00	P 2,500.00	-
Control Risk Phils., Inc.	QQQ-1-a-5	104,560.00	2%	2,091.20		2,091.20
KDDI Corp.	QQQ-1-a-15	57,102.27	2%	1,142.05	1,142.04	0.01
KDDI Corp.	QQQ-1-a-16	81,477.27	2%	1,629.55	1,629.55	(0.00)
KDDI Corp.	RRR-1-a-35	113,340.90	2%	2,266.82		2,266.82
KDDI Corp.	RRR-1-a-36	113,340.90	2%	2,266.82		2,266.82
KDDI Corp.	QQQ-1-a-17	303,227.26	2%	6,064.55	6,064.56	(0.01)
KDDI Corp.	QQQ-1-a-18	62,409.09	2%	1,248.18	1,248.18	0.00
KDDI Corp.	QQQ-1-a-19	163,704.54	2%	3,274.09	3,274.09	0.00
KDDI Corp.	QQQ-1-a-20	703,022.73	2%	14,060.45	14,060.45	0.00
KDDI Corp.	QQQ-1-a-21	1,681.83	2%	33.64	33.63	0.01
Maunsell Phils., Inc.	QQQ-1-a-27	2,052,650.00	2%	41,053.00	41,053.00	-
Maunsell Phils., Inc.	QQQ-1-a-28	2,164,960.00	2%	43,299.20	43,299.20	-
Maunsell Phils., Inc.	QQQ-1-a-29	1,239,250.00	2%	24,785.00	24,785.00	-
MJ Ineternational Co., Ltd.	QQQ-1-a-30	15,454.55	2%	309.09	309.09	0.00
MJ Ineternational Co., Ltd.	QQQ-1-a-31	40,909.09	2%	818.18	818.18	0.00
MJ Ineternational Co., Ltd.	QQQ-1-a-32	27,272.73	2%	545.45	545.45	0.00
MJ Ineternational Co., Ltd.	QQQ-1-a-33	40,909.09	2%	818.18	4,090.91	(3,272.73)
Tengson Ces Associates Phils., Inc.	QQQ-1-a-45	1,406,594.81	2%	28,131.90	24,615.63	3,516.27
Tengson Ces Associates Phils., Inc.		(1,406,594.81)		-		-
Tengson Ces Associates Phils., Inc.	QQQ-1-a-46	1,395,424.87	2%	27,908.50	24,420.16	3,488.34
Tengson Ces Associates Phils., Inc.	QQQ-1-a-47	1,391,065.87	2%	27,821.32	24,343.87	3,477.45
Tengson Ces Associates Phils., Inc.	QQQ-1-a-48	1,393,245.37	2%	27,864.91	24,382.02	3,482.89
Tengson Ces Associates Phils., Inc.	QQQ-1-a-49	1,242,166.87	2%	24,843.34	21,737.88	3,105.46
Tengson Ces Associates Phils., Inc.	QQQ-1-a-50	1,250,348.81	2%	25,006.98	21,881.07	3,125.91
Tengson Ces Associates Phils., Inc.	QQQ-1-a-51	1,242,628.18	2%	24,852.56	21,746.10	3,106.46
Tengson Ces Associates Phils., Inc.	QQQ-1-a-52	1,013,485.52	2%	20,269.71	17,735.92	2,533.79
Tengson Ces Associates Phils., Inc.	QQQ-1-a-53	1,264,172.30	2%	25,283.45	22,122.71	3,160.74
Tengson Ces Associates Phils., Inc.	QQQ-1-a-54	1,153,250.00	2%	23,065.00	20,181.74	2,883.26
Tengson Ces Associates Phils., Inc.	QQQ-1-a-55	1,089,338.22	2%	21,786.76	21,528.75	258.01
Tengson Ces Associates Phils.,	QQQ-1-a-56		2%			

Inc.		1,025,878.89		20,517.58	20,517.84	(0.26)
Tengson Ces Associates Phils., Inc.	RRR-1-a-35	1,051,583.17	2%	21,031.66		21,031.66
Tengson Ces Associates Phils., Inc.	QQQ-1-a-57	(10,250,000.00)		-		-
TIS Manila Consultants, Inc.	RRR-1-a-35	18,181.82	2%	363.64		363.64
TIS Manila Consultants, Inc.	QQQ-1-a-58	27,272.73	2%	545.45	545.45	0.00
TIS Manila Consultants, Inc.	QQQ-1-a-59	27,272.73	2%	545.45	545.45	0.00
TIS Manila Consultants, Inc.	QQQ-1-a-60	68,181.82	2%	1,363.64	1,363.64	(0.00)
TIS Manila Consultants, Inc.	QQQ-1-a-61	97,552.46	2%	1,951.05	1,951.05	(0.00)
TIS Manila Consultants, Inc.	QQQ-1-a-62	40,909.09	2%	818.18	818.18	0.00
TIS Manila Consultants, Inc.	QQQ-1-a-63	26,748.26	2%	534.97	534.97	(0.00)
TIS Manila Consultants, Inc.	QQQ-1-a-64	45,454.55	2%	909.09	909.09	0.00
TIS Manila Consultants, Inc.	QQQ-1-a-65	75,000.00	2%	1,500.00	1,500.00	-
TIS Manila Consultants, Inc.	QQQ-1-a-66	136,363.64	2%	2,727.27	2,727.27	0.00
TIS Manila Consultants, Inc.	QQQ-1-a-67	136,363.64	2%	2,727.27	2,727.27	0.00
I-Merge Phils., Inc.	QQQ-1-a-6	31,818.18	10%	3,181.82	3,181.82	(0.00)
Legal Information Network Corp.	QQQ-1-a-22	209,120.00	10%	20,912.00	20,912.00	-
Legal Information Network Corp.	QQQ-1-a-23	133,225.00	10%	13,322.50	13,322.50	-
Legal Information Network Corp.	QQQ-1-a-24	26,715.00	10%	2,671.50	2,671.50	-
Legal Information Network Corp.	QQQ-1-a-25	26,875.00	10%	2,687.50	2,687.50	-
Legal Information Network Corp.	QQQ-1-a-26	130,050.00	10%	13,005.00	2,601.00	10,404.00
Wilma Urmaza	QQQ-1-a-34	1,683.00	10%	168.30		168.30
Myra Ratuiste	QQQ-1-a-35	4,172.76	10%	417.28	417.28	(0.00)
Myra Ratuiste	QQQ-1-a-36	6,666.92	10%	666.69	666.69	0.00
Myra Ratuiste	RRR-3-a-41	6,385.31	10%	638.53	638.53	0.00
Myra Ratuiste	QQQ-1-a-37	6,189.02	10%	618.90	618.90	0.00
Myra Ratuiste	QQQ-1-a-38	5,574.75	10%	557.48	557.48	(0.00)
Myra Ratuiste	QQQ-1-a-39	5,579.81	10%	557.98	557.98	0.00
Wilfredo Montes	QQQ-1-a-68	24,000.00	10%	2,400.00	2,400.00	-
Wilfredo Montes	QQQ-1-a-69	24,000.00	10%	2,400.00	2,400.00	-
Wilfredo Montes	QQQ-1-a-70	39,000.00	10%	3,900.00	3,900.00	-
Wilfredo Montes	QQQ-1-a-71	39,000.00	10%	3,900.00	3,900.00	-
Wilfredo Montes	QQQ-1-a-72	39,000.00	10%	3,900.00	3,900.00	-
Wilfredo Montes	QQQ-1-a-73	30,000.00	10%	3,000.00	3,000.00	-
Wilfredo Montes	QQQ-1-a-74	24,000.00	10%	2,400.00	2,400.00	-
Wilfredo Montes	QQQ-1-a-75	33,000.00	10%	3,300.00	3,300.00	-
Total		**P13,218,215.81**		**P565,180.59**	**P 497,722.57**	**P 67,458.02**

In sum, the deficiency withholding tax on professional fees amounts to P168,172.51, broken down as follows:

Withholding tax due on the unsubstantiated payments to GPPs (P1,007,144.93 x 10%)	P 100,714.49
Additional withholding tax subject to 2% and 10% rates	67,458.02
Total deficiency withholding tax on professional fees	**P168,172.51**

2. *Security Expenses*

Based on records, the "Security Guard Cost" per GL amounting to P15,939,040.80[19] was reflected in the ITR/FS of the petitioner as follows:

Charged to Operating Expense	P 8,932,139.00
Charged to Cost of contracts - Subcontracted labor	7,006,902.00
Total	**P 15,939,041.00**

The "Security Guard Cost" amount of P15,939,041.00 represents payments made to the following security agencies for the security services rendered:

Supplier	Amount
Core Watchmen Security & Detective Agency	P 12,508,339.07
Discovery Tours, Inc.	99,334.07
Philippine Aviation Security Services Corp.	2,754,875.13
St. Anthony Security & Protective Agency	576,492.52
Total	**P 15,939,040.79**

According to respondent, petitioner failed to withhold and remit in full the amount of P318,780.82 representing withholding tax due on the said security expenses of P15,939,041.00, pursuant to Section 2.57.2 of RR No. 2-98.

In its protest letter, petitioner argued that the company properly withheld tax/es on its income payments to security agencies, and that respondent failed to take into consideration that in the BIR Form 1601-E, these expenses were included in the payment to prime contractors/subcontractors.

A scrutiny of the schedule of expanded withholding taxes[20] supporting petitioner's BIR Form 1601-E or the Monthly Remittance Return of Creditable

[19] Exhibit PPP-2

Income Taxes Withheld (Expanded)[21], for the period January to December 2002, reveals that petitioner made certain remittances pertaining to "Security Guard Cost" which were, indeed, included in the payment to prime contractors/subcontractors leaving the amount of P3,327,977.43, with the corresponding expanded withholding tax of P66,559.55, unremitted, computed as follows:

Payee	Exhibit No.	Amount	Rate	EWT Due
Core Watchmen Security & Detective Agency	PPP-1-27	P 931,850.75	2%	P18,637.02
Core Watchmen Security & Detective Agency	PPP-1-28	931,850.75	2%	18,637.02
Core Watchmen Security & Detective Agency	PPP-1-29	179,690.88	2%	3,593.82
Discovery Tours Inc.	PPP-1-30	99,334.07	2%	1,986.68
Philippine Aviation Security Services Corp.	PPP-1-41	179,690.88	2%	3,593.82
Philippine Aviation Security Services Corp.	PPP-1-44	173,894.40	2%	3,477.89
Philippine Aviation Security Services Corp.	PPP-1-45	173,894.40	2%	3,477.89
Philippine Aviation Security Services Corp.	PPP-1-46	639,800.57	2%	12,796.01
St. Anthony Security & Protective Agency	PPP-1-69	17,970.73	2%	359.41
Total		**P3,327,977.43**		**P66,559.55**

Hence, petitioner's deficiency withholding tax on security expenses amounts only to P66,559.55.

3. *Rental of Equipment*

An examination of petitioner's ITR/FS shows that the total rent amounts to P8,268,452.00, broken down as follows:

Rent - COS	P	4,126,726.00
Rent - OE		4,141,726.00
Total Rent	**P**	**8,268,452.00**

On the other hand, the balance of the rent account per General Ledger[22] amounts to P8,253,452.64 which, for financial statement purposes, was reclassified as follows:

[20] Exhibits NN-1-a to NN-12-a
[21] Exhibits NN-1 to NN-12
[22] Exhibit OO-1

Charged to Operating Expenses	P 4,126,726.00
Charged to Rental of Equipment used in Construction	4,126,726.00
Total Rent	**P 8,253,452.00**

Transactions charged to this account are mainly amortization of rentals which were allegedly paid and subjected to withholding tax upon prepayment.

The discrepancy of P15,000.00 between the ITR/FS and the GL amounts is attributed to the rental classified in the GL as Land and Housing Cost[23] of P30,000.00 (P15,000.00[24] of which is under the Other contract costs, while the other P15,000.00[25] was charged to Rental of equipment used in construction, both under Cost of Contracts per ITR/FS).

The amount of P8,268,452.00 may be further broken down as follows[26]:

Prior Years Rent Amortized in Year 2002		
Adrian Ocampo	P 590,526.30	
Angelita Lhuiller	634,800.00	
Elizabeth Kassiri	92,630.00	
Emmanuel Ledesma	720,000.00	
Jerry Chang	57,900.00	
JTL Development Corp.	630,000.00	
Manuel Quiogue	748,000.00	
Margarita Properties	886,930.00	
Roberto Ramiscal	852,210.51	
Ma. Cassandra Tankiang	175,000.00	P 5,387,996.81
2002 Rent		
Angelita Lhuiller	634,800.00	
Elizabeth Kassiri	441,000.00	
Emmanuel Ledesma	396,000.00	
Irene Siopongco	631,578.95	
Margarita Properties	177,386.00	
Roberto Ramiscal/Anna Belinda Ramiscal	447,530.88	
KSA Realty Corporation	137,160.00	

[23] Exhibit OO-2
[24] Included in the Other Contract Cost of P586,109.00, Note 11 – Cost of Contracts, page 11 of Exhibit "K"
[25] Included in the Rental of Equipment Used in Construction of P4,126,726.00, Note 11 – Cost of Contracts, page 11 of Exhibit "K"
[26] Annex A of this Decision, Summarized as per Exhibit OO-1-1 to OO-1-21

Metro Parking Management (Phils) Inc.	15,000.00	2,880,455.83
Total		**P 8,268,452.64**

Aside from the amortizations of rentals under the "Rent Account", the following pertains to rentals classified under various accounts:

Renting Cost for Temporary Work Use		
Integrated Waste Management	RRR-28-a-3 to 14; RRR-1-a-35	P1,520,403.01
Land and House Renting Cost		
Metro Parking Management Corp.		15,000.00
Other Temporary works		
Siemens Fujihaya Consortium	RRR-2-a-25	450,000.00
Total		**P1,985,403.01**

The foregoing rentals are subject to five percent (5%) expanded withholding tax pursuant to Section 2.57.2 (C) of Revenue Regulations No. 2-98. Likewise, the prepayments on the rentals (unexpired portion of rentals paid in year 2002) amounting to P2,077,033.85, as detailed below, are subject to 5% expanded withholding tax:

Suspense Payment (Prepaid Rent)	
KSA Realty Corp.	P 583,011.00
KSA Realty Corp.	274,320.00
Irene Siopongco	100,000.00
Angelita Lhuiller	317,400.00
Margaritta Propertiesn Inc.	354,772.00
Anna Belinda Ramiscal	447,530.85
Total	**P 2,077,033.85**

Thus, the expanded withholding tax pertaining to rentals amounts to P616,544.48, computed as follows:

	Tax Base	Rate	Tax Due
Prior Years Rent Amortized in Year 2002	P 5,387,996.81	5%	P 269,399.84
2002 Rent	2,880,455.83	5%	144,022.79
Suspense Payment (Prepaid Rent)	2,077,033.85	5%	103,851.69
Renting Cost for Temporary Work Use	1,520,403.01	5%	76,020.15
Land and House Renting Cost	15,000.00	5%	750.00
Other Temporary works	450,000.00	5%	22,500.00
Total	**P 12,330,889.50**		**P 616,544.48**

On the other hand, petitioner was able to show that it withheld the corresponding 5% withholding tax of P300,337.28 on its rental payment of P6,006,754.60.

Period	Exhibit	Payee	Withholding Tax	Rent
January	NN-1	IWM	9,170.45	183,409.00
February	NN-2	IWM	9,170.45	183,409.00
February	NN-2	Kassiri	22,050.00	441,000.00
March	NN-3	IWM	9,170.45	183,409.00
April	NN-4	IWM	9,170.45	183,409.00
May	NN-5	IWM	9,170.45	183,409.00
June	NN-6	IWM	7,570.45	151,409.00
July	NN-7	IWM	6,170.45	123,409.00
July	NN-7	Lhuiller	47,610.00	952,200.00
July	NN-7	Ramiscal	44,753.09	895,061.80
July	NN-7	Siopongco	31,578.95	631,579.00
August	NN-8	IWM	2,374.50	47,490.00
September	NN-9	IWM	5,170.45	103,409.00
October	NN-10	IWM	5,170.00	103,409.00
October	NN-10	Margarita Properties	26,607.90	532,158.00
November	NN-11	IWM	5,170.45	103,409.00
November	NN-11	Ledesma	19,800.00	396,000.00
December	NN-12	IWM	2,958.79	59,175.80
December	NN-12	Siemens Fujihaya	22,500.00	450,000.00
December	NN-12	Siopongco	5,000.00	100,000.00
Total			**300,337.73**	**6,006,754.60**

In addition, the tax of P73,820.50 was also properly withheld on the tax rate of 5% but reflected in the Monthly Remittance Return as withholding on payments made to prime contractors/subcontractors, accounted as follows:

	Exhibit No.	Tax Withheld
KSA Realty Corporation	NN-9-a	P 20,574.00
Metro Parking Mgt. (Phils.) Inc.	NN-11-a / NN-12-a	1,500.00
KSA Realty Corp.	NN-12-a	29,150.55
Emmanuel Ledesma	NN-8-a	19,800.00
Integrated Waste Management	NN-8-a	2,795.95
Total		**P 73,820.50**

The Court-Commissioned Independent CPA, Ms. Myra Celeste Dabalos, in her supplemental Report[27] stamped received by this Court on April 15, 2008, states that:

> *"We verified whether the amount of rental amortized were already subjected to withholding tax upon prepayment by examining the vouchers evidencing payment of rent and tracing the amount of tax withheld to the schedules attached to the withholding tax return to ascertain that the tax withheld has been remitted."*

Indeed, for the prepayments of rentals made in year 2002, the corresponding taxes were withheld and remitted to the BIR. However, for the prepayments of rentals made in prior years which were amortized during the year 2002 in the amount of P5,387,996.81, no proof of withholding and remittance thereof was presented before this Court. Petitioner presented only the payment vouchers[28] pertaining to the amortizations, but such are not conclusive proof that the corresponding taxes thereon were actually withheld and remitted to the BIR.

In sum, this court finds that petitioner fell short in remitting the expanded withholding tax due on rentals in the amount of P242,386.25, computed as follows:

Expanded Withholding Tax Due			P 616,544.48
Less:	Tax Withheld		
	Tax Withheld classified under rentals	P 300,337.73	
	Tax Withheld classified under prime contractors/subcontractors	73,820.50	374,158.23
Deficiency Expanded Withholding Tax on Rentals			**P 242,386.25**

[27] Exhibit "LLL", page 7
[28] Exhibits OO-3-1 to OO-3-14

4. Payment to Subcontractors (Subcontracted Labor)

The P279,141,101.50 discrepancy on payment to subcontractors was arrived at by comparing the subcontracted labor cost per ITR/FS as against the payments made to prime contractors/sub-contractors as per BIR Form 1601-E.[29] However, the amount of P1,422,121,948.50 used by respondent in comparison with the subcontracted labor cost per ITR/FS is in fact not limited to such account, *i.e.,* it also includes other income payments such as, but not limited to, payments for professional fees, rentals and security services to certain contractors, which were subjected to withholding tax but were classified as payments to prime contractors/sub-contractors as per BIR Form 1601-E.

On the other hand, records show that subcontracting cost per financial statements amounts to P1,701,263,050.00, the breakdown of which is presented under Exhibit "UU". Although generally most of the transactions recorded in this account is subject to 2% EWT, some of the components of this account are subject to 5% EWT such as in the case of renting cost for temporary work use or 10% EWT such as in the case of professional fees (already accounted for under the titles Rental of Equipment and Professional Fees). The same account also includes payments to joint ventures such as Siemens Fuji Haya, and to non-residents such as Lufthansa Systems Infratec GMBH which were subjected to final tax.

Moreover, the tax base per BIR Form 1601-E of P1,422,121,948.50 appears to be incorrect. Although the correct amount of tax withheld was remitted, the tax base was erroneously computed. For instance, for the month

[29] Exhibits NN-1 to NN-12, as summarized in Exhibit NN

of September 2002[30], Legal Information Network Corp. rendered services for the petitioner. Instead of reflecting a tax base of P209,120.00[31] (P20,912.00/.10) under professional fee, the BIR Form 1601-E reflected a tax base of P1,045,600.00 (P20,912.00/.02) under subcontractors. This resulted in an overstatement in the tax base for the payment to subcontractors account while understating the tax base for the professional fees.

Thus, by verifying the transactions based on the supporting schedules[32] and available supporting documents,[33] this court finds that the deficiency expanded withholding tax on subcontracted labor amounts only to P1,445,668.76, details of which are presented in Annex B of this Decision.

In sum, petitioner is liable to pay the deficiency expanded withholding taxes in the amount of P1,922,787.07, computed as follows:

Income Payments	EWT Due
Professional Fees	P 168,172.51
Security Expenses	66,559.55
Rental of Equipment	242,386.25
Payment to Subcontractors (Subcontracted Labor)	1,445,668.76
TOTAL	**P 1,922,787.07**

B. Deficiency Withholding Tax on Compensation

Pursuant to Section 79(A) of the NIRC of 1997 and Section 2.78 of Revenue Regulations No. 2-98, respondent assessed petitioner of deficiency withholding tax on compensation amounting to **P2,278,563.92**, inclusive of interest, computed as follows:

[30] Exhibit NN-9-a, item no.27
[31] Exhibit QQQ-1-a-22
[32] Exhibits QQQ-1-a and RRR-1-a to RRR-28-a
[33] Exhibits QQQ-1-a-1 to QQQ-1-a-75 and RRR-1-a-1 to RRR-28-a-16

Salaries and Wages Claimed per FS / ITR:		
Salaries and Other Employees Benefits- OE	P 15,334,664.00	
Salaries and Other Employees Benefits- COS	91,662,543.00	P 106,997,207.00
Salaries and Wages Per Alphalist:		
Employees Terminated Before Dec. 31	15,768,526.26	
Foreign Employees Terminated	20,689,463.50	
Employees with No Previous Employer	20,983,354.59	
Foreign Employees with No Previous Employer	43,982,807.40	101,424,151.75
Discrepancy on Salaries and Wages		**P 5,573,055.25**
Multiply by Percentage of Tax Compliance		
Tax Due/Total Taxable Compensation		
(P24,166,890.99/P95,924,759.03)		25.19%
Withholding Tax Due Thereon		**1,403,852.62**
Add: Underemitted Withholding Tax:		
Tax Withheld per Alphalist	24,172,459.35	
Tax Remitted per Returns	24,166,890.99	5,568.36
Basic Deficiency Withholding Tax		**1,409,420.98**
Add: 20% Interest (01.16.03 to 02.16.06)		869,142.94
Total Amount Due		**P 2,278,563.92**

Petitioner asserts that it properly withheld taxes on all its salaries and wages subject to withholding tax on compensation. Petitioner argues that the BIR examiner did not take into consideration the fact that there are some employee benefits that are not subjected to withholding taxes but nonetheless included in the account title Salaries and Wages in the FS.

Based on the petitioner's FS, the 'Salaries and other employee benefits' account consisted of the following:

Salaries & other employee benefits COS		
Salaries and wages	P88,392,476.00	
Termination pay	2,338,342.00	
Bonuses & 13th month pay	931,725.00	P91,662,543.00
Salaries & other employee benefits OE		
Salaries and wages	8,840,006.00	
Termination pay	247,740.00	
Bonuses & 13th month pay	977,354.00	
SSS, Medicare, ECC and HDMF	1,250,555.00	
Reversal of Provision for termination benefit	(752,545.00)	
Other employee benefits (FB)	4,771,554.00	15,334,664.00
Total		**P106,997,207.00**

Of the above amount, petitioner claims that payments for SSS, Medicare, ECC and HDMF; reversal of provision for termination benefit; other employee benefits and a portion of bonuses & 13th month pay are non-taxable compensation, which amount to P5,573,055.25-- the same amount subjected by respondent to deficiency withholding tax on compensation, to wit:

SSS, Medicare, ECC and HDMF	P 1,250,555.00
Reversal of Provision for termination benefit	(752,545.00)
Other employee benefits (FB)	4,771,554.00
Bonuses & 13th month pay	303,491.25
Non-taxable compensation	**P 5,573,055.25**

Verification of records shows that petitioner failed to sufficiently substantiate its stand.

Contributions remitted to SSS, Medicare (Philhealth) and Pag-ibig are excluded from the computation of taxable income, thus, not subject to withholding tax. Section 32(B)(7)(f) of the NIRC of 1997 provides:

> **SEC. 32.** ***Gross Income.***
>
> xxx xxx xxx
>
> **(B)** ***Exclusions from Gross Income***. - The following items shall not be included in gross income and shall be exempt from taxation under this title:
>
> xxx xxx xxx
>
> (7) *Miscellaneous Items.* –
>
> xxx xxx xxx
>
> (f) *GSIS, SSS, Medicare and Other Contributions.* - GSIS, SSS, Medicare and Pag-ibig contributions, and union dues of individuals.

However, petitioner failed to present any supporting source document that will prove actual remittance of the P1,250,555.00 contributions to SSS, Philhealth and Pag-ibig.

As for the Other Employee/ Fringe Benefits in the amount of P4,771,554.00[34], under Section 33 (A)[35] of the NIRC of 1997, the gross-up monetary value of fringe benefit furnished or granted to the employee (except rank and file employees) by the employer, whether an individual or a corporation, is subject to final tax. On the other hand, the same provision of the Code also provides that fringe benefits which are "required by the nature of, or necessary to the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer" are not subject to the fringe benefit tax. In some instances, there are fringe benefits that are not taxable as provided for in Section 33(C)[36] of the NIRC of 1997.

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[34] Exhibit RR-3

[35] SEC. 33. *Special Treatment of Fringe Benefit.-*

> (A) *Imposition of Tax.-* A final tax of thirty-four percent (34%) effective January 1, 1998; thirty-three percent (33%) effective January 1, 1999; and thirty-two percent (32%) effective January 1, 2000 and thereafter, is hereby imposed on the grossed-up monetary value of fringe benefit furnished or granted to the employee (except rank and file employees as defined herein) by the employer, whether an individual or a corporation (unless the fringe benefit is required by the nature of, or necessary to the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer). The tax herein imposed is payable by the employer which tax shall be paid in the same manner as provided for under Section 57 (A) of this Code. The grossed-up monetary value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by sixty-six percent (66%) effective January 1, 1998; sixty-seven percent (67%) effective January 1, 1999; and sixty-eight percent (68%) effective January 1, 2000 and thereafter: *Provided, however,* That fringe benefit furnished to employees and taxable under Subsections (B), (C), (D) and (E) of Section 25 shall be taxed at the applicable rates imposed thereat: *Provided, further*, That the grossed -up value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by the difference between one hundred percent (100%) and the applicable rates of income tax under Subsections (B), (C), (D), and (E) of Section 25.
>
> xxx xxx xxx

[36] (C) Fringe Benefits Not Taxable.- The following fringe benefits are not taxable under this Section:
(1) Fringe benefits which are authorized and exempted from tax under special laws;
(2) Contributions of the employer for the benefit of the employee to retirement, insurance and hospitalization benefit plans;
(3) Benefits given to the rank and file employees, whether granted under a collective bargaining agreement or not; and
(4) De minimis benefits as defined in the rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

Based on the records, it can be surmised that the Other Employee/ Fringe Benefits of P4,771,554.00 claimed by petitioner as non-taxable are those benefits falling under Section 33(C) of the NIRC of 1997. However, petitioner failed to establish that the fringe benefits granted are indeed not subject to tax, as it did not present any document to support such claim. Thus, we are constrained to include the same to salaries and wages subject to tax on compensation.

With reference to the amount of P303,491.25, it cannot be ascertained if the same, indeed, pertains to non-taxable bonuses & 13th month pay granted to employees, in the absence of any supporting document.

In sum, for petitioner's failure to present documentary proof to substantiate the alleged non-taxable compensation of P5,573,055.25, the respondent's assessment for deficiency withholding tax on compensation in the amount of P1,409,420.98 shall be upheld.

WHEREFORE, premises considered, the assessment against petitioner covering deficiency expanded withholding tax and withholding tax on compensation is hereby **AFFIRMED** with some modifications.

Accordingly, petitioner is **ORDERED** to pay respondent the amount of P4,165,260.07 representing deficiency withholding taxes for taxable year 2002, inclusive of 25% surcharges imposed pursuant to Section 248(3) of the NIRC of 1997, computed as follows:

The Secretary of Finance is hereby authorized to promulgate, upon recommendation of the Commissioner, such rules and regulations as are necessary to carry out efficiently and fairly the provisions of this Section, taking into account the peculiar nature and special need of the trade, business or profession of the employer.

	Basic	Surcharge	Total
WTC	P 1,409,420.98	P 352,355.25	P 1,761,776.23
EWT	1,922,787.07	480,696.77	2,403,483.84
Total	**P 3,332,208.05**	**P 833,052.02**	**P 4,165,260.07**

Likewise, petitioner is **ORDERED** to pay (a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency WTC in the amount of P1,409,420.98 and EWT in the amount of P1,922,787.07 computed from January 15, 2003 and January 25, 2003, respectively, until full payment thereof pursuant to Section 249(B) of the NIRC of 1997; and (b) delinquency interest at the rate of twenty percent (20%) per annum on the 20% deficiency interest which have accrued from the dates aforestated in (a) until February 16, 2006 and on the total deficiency taxes of P4,165,260.07, computed from February 16, 2006 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

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

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Acting Presiding Justice
Chairperson, 2nd Division