REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL THIRD DIVISION

THE MERRY COOKS, INC., *Petitioner,*	**CTA Case No. 10994**
	Present:
-versus-	**REYES-FAJARDO,** *Chairperson and* **ANGELES,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE *Respondent.*	Promulgated: JUL 08 2026 4:20 p.m.

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DECISION

REYES-FAJARDO, *J.*:

Before the Court is a Petition for Review[1] filed on September 29, 2022, by The Merry Cooks, Inc., seeking the cancellation of the assessments for deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT), and improperly accumulated earnings tax (IAET) issued against it for the period from January 1, 2017 to December 31, 2017 (TY 2017), in the respective amounts of ₱6,267,959.40, ₱6,793,418.26, ₱363,968.25, and ₱1,659,886.48, inclusive of interest, and praying that the same be declared null and void.[2]

PARTIES

Petitioner The Merry Cooks, Inc. is a domestic corporation organized and existing under the laws of the Republic of the Philippines, with business address at No. 704 Aurora Boulevard,

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1 Petition for Review, Docket, pp. 7 - 13.

2 Statement of the Case, Pre-Trial Order dated February 19, 2024, Docket, p. 228.

Barangay Valencia, Quezon City.[3] Petitioner is engaged in the food and beverage industry, including the sale, development, production, and customization of food products, the management of food and beverage concessions and brands, catering services, and consultancy services related to food retail, toll packing, and hotel and restaurant management.

Respondent is the duly-appointed Commissioner of the Bureau of Internal Revenue (BIR), vested with the authority and powers under his office, including *inter alia*, the power to conduct investigation of the internal revenue taxes paid by the taxpayers, issue deficiency tax assessments, and decide on any disputed internal revenue tax assessments. He holds office at the 5th floor, BIR National Office Building, Agham Road, Diliman, Quezon City.[4]

FACTS

On July 6, 2018, Regional Director (RD) Marina C. De Guzman of Revenue Region No. 007 - Quezon City, Revenue District No. 039 - South Quezon City, issued the Letter of Authority (LOA) No. 039-2018-00000530,[5] authorizing Revenue Officer (RO) Elizabeth Aligato and Group Supervisor (GS) Evelyn Garcia of Revenue District No. 039-South Quezon City to examine petitioner's books of accounts and other accounting records for TY 2017.

On July 8, 2020, the Notice of Informal Conference was issued by Revenue District Officer Arnulfo A. Galapia of Revenue District No. 39.[6]

On December 14, 2020, RD Albino M. Galanza of Revenue Region No. 7A - Quezon City then issued the Preliminary Assessment Notice (PAN),[7] containing the proposed deficiency income tax, VAT, EWT, and IAET assessments found against petitioner for TY 2017.

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[3] Par. 1, Petition for Review, vis-à-vis par. 1, Answer, Docket, pp. 7 and 87, respectively.

[4] Par. 2, Petition for Review, vis-à-vis par. 2, Answer, Docket, pp. 7 and 87, respectively.

[5] Par. 3, Petition for Review, vis-à-vis par. 3, Answer, Docket, pp. 7 and 87, respectively; Exhibit "P-1," Docket, p. 310; Exhibit "R-2," Docket, p. 362.

[6] Exhibit "R-3," Docket, p. 364.

[7] Par. 4, Petition for Review, vis-à-vis par. 3, Answer, Docket, pp. 7 and 87, respectively; Exhibit "P-2," Docket, pp. 311 to 315; Exhibits "R-5" to "R-5-A," Docket, pp. 367 to 371.

On January 8, 2021, RD Galanza issued the Formal Letter of Demand with Assessment Notices (FLD/FAN),[8] assessing petitioner of deficiency income tax, VAT, EWT, and IAET, for TY 2017, in the amounts of ₱6,402,561.25, ₱5,952,965.81, ₱376,109.05, and ₱1,632,448.11, respectively, inclusive of interests.

On February 15, 2021,[9] petitioner filed its administrative protest *via* Letter dated February 11, 2021,[10] and submitted its supporting documents on April 26, 2021, *via* its letter dated April 19, 2021,[11] addressed to BIR Revenue District Office No. 39.

On March 11, 2022, RD Galanza served upon petitioner the LOA No. 039-2022-00000242 dated March 9, 2022,[12] authorizing RO Francis Marc Dela Cruz and GS Arnel de Jesus to examine its books of accounts and other accounting records for TY 2017.[13]

RO Dela Cruz then wrote an undated Memorandum Report addressed to the Regional Director regarding his re-investigation of petitioner's tax liabilities for TY 2017.[14]

On August 30, 2022, petitioner received the Final Decision on Disputed Assessment (FDDA) dated August 17, 2022, together with the Details of Discrepancies,[15] which still held petitioner liable to pay deficiency income tax, VAT, EWT, and IAET, for TY 2017, in the amounts of ₱6,267,959.40, ₱6,793,418.26, ₱363,968.25, and ₱1,659,886.48, respectively, inclusive of interests.

On September 29, 2022, petitioner filed the present Petition for Review.[16]

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8 Par. 5, Petition for Review, vis-à-vis par. 3, Answer, Docket, pp. 8 and 87, respectively; Exhibits "P-3" to "P-6," BIR Records (Exhibit "R-13"), pp. 126 to 129-A; Exhibits "R-6" to "R-6-E," Docket, pp. 372 to 380.

9 BIR Records (Exhibit "R-13"), pp. 142 to 148.

10 Exhibit "P-7," Docket, pp. 316 to 322.

11 Exhibit "P-8," Docket, pp. 323 to 324.

12 Exhibit "P-9," BIR Records (Exhibit "R-13"), p. 166; Exhibit "R-1," Docket, p. 361.

13 Par. 8, Petition for Review, *vis-à-vis* par. 2, Answer, Docket, pp. 8 and 87, respectively.

14 Exhibit "R-7," BIR Records (Exhibit "R-13"), pp. 162 to 164.

15 Pars. 9 and 10, Petition for Review, *vis-à-vis* par. 3, Answer, Docket, pp. 8 and 87, respectively; Exhibits "P-10" to "P-11," Docket, pp. 325 to 332; Exhibits "R-9" to "R-9-A," Docket, pp. 388 to 391.

16 Docket, pp. 7 to 17.

Meanwhile, on November 14, 2022, the Memorandum of Assignment[17] was issued to RO Maricel B. Marquez, directing her to prepare and serve the Warrant of Distraint and/or Levy (WDL) and to perform other duties, among others. Subsequently, on November 29, 2022, the BIR issued the WDL No. RR7A-11-21-2022-2529.[18]

On March 6, 2023, respondent filed his Answer,[19] interposing the following special and affirmative defenses, to wit: (1) the Court has no jurisdiction over the subject matter, for failure of petitioner to submit all relevant supporting documents, within 60 days from the filing of the protest, pursuant to Section 228 of the Tax Code and Subsection 3.1.4 of Revenue Regulations (RR) No. 12-99, as amended by RR No. 18-2013; (2) due to such failure, the assessment became final and, thus, RD Galanza's formal assessment must be upheld; and (3) that respondent was never remiss in according petitioner due process in the issuance of the deficiency tax assessments against it.

On October 26, 2023, the Pre-Trial Conference was held.[20] There, the parties formulated the issue/s to be addressed. Further, the parties were requested to submit their Joint Stipulation of Facts and Issues (JSFI) on or until November 28, 2023. The schedules for the parties' presentation of evidence, along with the marking of their exhibits were set.

The parties failed to submit their JSFI as of December 5, 2023.[21] By Minute Resolution dated January 5, 2024,[22] the parties were deemed to have waived the filing thereof and resolved to issue a Pre-Trial Order based on the matters agreed upon at the Pre-Trial Conference.

On February 19, 2024, the Pre-Trial Order was issued.[23]

Trial ensued.

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17 Exhibit "R-10," Docket, p. 392.

18 Exhibit "R-12," Docket, p. 394.

19 Docket, pp. 87 to 94.

20 Notice of Resetting dated August 3, 2023, Docket, p. 113; Minutes of the hearing held on, and Order dated, October 26, 2023, Docket, pp. 187, and 196 to 198, respectively.

21 Records Verification Report dated December 5, 2023 issued by this Court's Judicial Records Division, Docket, p. 210.

22 Docket, pp. 222 to 223.

23 Docket, pp. 228 to 235.

Petitioner presented: (1) Mr. Rodrigo V. Bacon, Jr.,[24] petitioner's Accounting Manager; (2) Ms. Irene M. Dela Cruz,[25] petitioner's Operations Manager; and (3) Mr. Glenn M. Abanador,[26] the Court-commissioned Independent Certified Public Accountant (ICPA),[27] as witnesses.

On June 18, 2024, petitioner filed its Formal Offer of Evidence,[28] to which respondent filed his Comment/Opposition (Re: Petitioner's Formal Offer of Evidence dated June 14, 2024) on July 4, 2024.[29]

In the Resolution dated September 25, 2024,[30] the Court admitted all of petitioner's offered exhibits. Petitioner rested its case.

Respondent then presented: (1) Francis Marc Dela Cruz,[31] and (2) Maricel B. Marquez,[32] as witnesses.

On October 28, 2024, respondent filed his Formal Offer of Evidence,[33] without petitioner's comment.[34]

In the Resolution dated February 28, 2025,[35] the Court admitted all of respondent's offered exhibits. Respondent rested its case.

On April 4, 2025, respondent filed his Memorandum.[36] Petitioner, however, failed to file its memorandum.[37]

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[24] Exhibits "P-12," Docket, pp. 245 to 251; Minutes of the hearing held on, and Order dated, March 14, 2024, Docket, pp. 255, and 257 to 258, respectively.

[25] Exhibits "P-13," Docket, pp. 264 to 267; Minutes of the hearing held on, and Order dated, April 4, 2024, Docket, pp. 268 to 270.

[26] Exhibit "P-16," Docket, pp. 289 to 299; Minutes of the hearing held on, and Order dated, May 30, 2024, Docket, pp. 300 to 302.

[27] Oath of Commission dated March 14, 2024, Docket, p. 256; Minutes of the hearing held on, and Order dated, March 14, 2024, Docket, pp. 255, and 257 to 258, respectively.

[28] Docket, pp. 303 to 309.

[29] Docket, pp. 335 to 342.

[30] Docket, pp. 345 to 346.

[31] Exhibit "R-14," Docket, pp. 132 to 142; Minutes of the hearing held on, and Order dated, September 26, 2024, Docket, pp. 347 to 349, respectively.

[32] Exhibit "R-15," Docket, pp. 146 to 151; Minutes of the hearing held on, and Order dated, September 26, 2024, Docket, pp. 347 to 349, respectively.

[33] Docket, pp. 351 to 360.

[34] Records Verification dated November 28, 2024 issued by the Judicial Records Division of this Court, Docket, p. 397.

[35] Docket, pp. 402 to 403.

[36] Docket, pp. 405 to 416.

[37] Records Verification dated April 22, 2025 issued by the Judicial Records Division of this Court, Docket, p. 418.

On May 9, 2025, the case was deemed submitted for decision.[38]

ISSUE

Is petitioner liable for the amounts of ₱6,267,959.40, ₱6,793,418.26, ₱363,968.25 and ₱1,659,886.48, representing deficiency income tax, VAT, EWT, IAET and compromise penalty assessments, inclusive of interest and surcharge, respectively, for the TY 2017?[39]

ARGUMENTS

Petitioner essentially argues that the deficiency income tax, VAT, EWT, and IAET assessments for TY 2017 are null and void for lack of factual and legal basis. As to income tax and EWT, petitioner claims that it properly withheld taxes, that the alleged discrepancies involved purchases not subject to withholding tax, and that respondent improperly imposed EWT on all "purchases of contractors" without verifying whether each transaction was actually subject to withholding tax.[40] Petitioner further argues that the Details of Discrepancies failed to provide sufficient information to allow it to verify the assessed transactions, in violation of its right to due process under Section 228 of the NIRC, as amended.[41] As to VAT, petitioner maintains that the assessment did not explain how the alleged unsupported exempt sales and undeclared amounts were determined, and that the BIR failed to consider its VAT output tax payments.[42] Finally, as to IAET, petitioner contends that the RO failed to consider its 2018 appropriation of retained earnings for legitimate business purposes, particularly its planned plant transfer, expansion, and renovation.[43]

For its part, respondent contends that the Court has no jurisdiction over the subject matter of the instant Petition for Review; that petitioner is liable for deficiency income tax, VAT, EWT and IAET; and that the Details of Discrepancies clearly outline the factual and legal bases on how the deficiency taxes were derived; hence, petitioner's sweeping and unfounded claims cannot be relied upon.

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38 Minute Resolution dated May 9, 2025, Docket, p. 421.

39 Issue, Statement of Facts and Issues, Pre-Trial Order dated February 19, 2024, Docket, p. 229.

40 Par. 14, Petition for Review, Docket, p. 11.

41 Par. 12, Petition for Review, Docket, p. 10.

42 Par. 13, Petition for Review, Docket, p. 11.

43 Par. 15, Petition for Review, Docket, p. 11.

RULING

The present Petition for Review is partly meritorious.

The Court has jurisdiction over the present Petition for Review

Respondent argues that the Court has no jurisdiction over the present Petition for Review because the subject assessments had allegedly become final, executory, and demandable due to petitioner's failure to submit supporting documents within the 60-day period from the filing of its request for reinvestigation.

The Court disagrees.

At the outset, respondent himself admitted in his Memorandum that he received petitioner's request for reinvestigation on February 15, 2021. Accordingly, petitioner had until April 16, 2021 within which to submit the relevant supporting documents.[44] Records show that petitioner submitted its supporting documents through a letter dated April 19, 2021, addressed to BIR Revenue District Office No. 39, which was filed on April 26, 2021.[45]

While the submission appears to have been made beyond the original deadline, the Court takes judicial notice of the restrictions on movement brought about by the COVID-19 pandemic, particularly the enhanced community quarantine (ECQ) imposed in NCR Plus. In view thereof, and pursuant to the Bayanihan to Heal as One Act,[46] the BIR issued Revenue Memorandum Circular (RMC) No. 45-2021 dated April 5, 2021,[47] which extended the deadlines for the filing and submission of certain letters and documents falling due during the ECQ period, to wit:

> This Circular is being issued in order to provide relief to taxpayers, in relation to the current surge in COVID-19 cases

44 Respondent's Memorandum, at Docket, at p. 408.

45 Exhibit "P-8," Docket, pp. 323 to 324.

46 Republic Act No. 11469, Section 4 (z).

47 Extension of the Deadline for the Filing of Position Papers, Replies, Protests, Documents and Other Similar Letters and Correspondences in Relation to Ongoing BIR Audit Investigations, and Filing of VAT Refund with VAT Credit Audit Division (VCAD)

prompting the government to impose Enhanced Community Quarantine (ECQ) in NCR Plus which includes Metro Manila, Laguna, Cavite, Bulacan, and Rizal thereby restricting movement within these areas. Thus, the deadline for filing of the following letters and documents falling due on April 5, 2021 and during the ECQ period, including extensions thereof, and for filing of VAT refund with VCAD, for taxpayers registered with RDOs in NCR Plus areas and other registered taxpayers outside NCR Plus who have transactions with any BIR office within NCR Plus, is hereby extended as follows:

Letter/Correspondence	**Extended Deadline**
Position Paper and Supporting Documents in Response to Notice of Discrepancy	30 days from lifting of the ECQ
Reply and Supporting Documents in Response to the Preliminary Assessment Notice (PAN)	15 days from lifting of the ECQ
Protest Letter in Response to the Final Assessment Notice/Formal Letter of Demand (FAN/FLD)	30 days from lifting of the ECQ
Transmittal Letter and Supporting Documents in relation to Request for Reinvestigation	**30 days from lifting of the ECQ**
Request for Reconsideration to the Commissioner of Internal Revenue (CIR) on Final Decision on Disputed Assessment (FDDA)	30 days from lifting of the ECQ
Submission of Documents in Response to *Subpoena Duces Tecum*	15 days from lifting of the ECQ
Submission of Documents in relation to First, Second and Final Notice	10 days from lifting of the ECQ
Other Similar Letters and Correspondences	30 days from lifting of the ECQ
xxx	xxx

Moreover, face to face meetings of BIR officials and employees with taxpayers and/or their authorized representatives in NCR Plus areas are deferred and rescheduled until lifting of ECQ."[48]

The National Capital Region (NCR), among other areas, was placed under Modified Enhanced Community Quarantine from April 12, 2021 to April 30, 2021, and again from May 1, 2021 to May 14, 2021, pursuant to the Inter-Agency Task Force for the Management of Emerging Infectious Diseases (IATF) Resolution Nos. 109-A dated April 10, 2021 and 113-A dated April 29, 2021, respectively. Thereafter, NCR was placed under General Community Quarantine from May 15,

[48] Emphasis supplied.

2021 to May 31, 2021, pursuant to IATF Resolution No. 115-A dated May 13, 2021.

Therefore, petitioner's submission of its supporting documents on April 26, 2021,[49] through its letter dated April 19, 2021, was made within the extended period provided under RMC No. 45-2021.

At any rate, even if petitioner failed to submit documents in support of its request for reinvestigation within the 60-day period, such failure would not result in the conclusiveness of the formal assessment. To be precise, the word 'final' in the paragraph "... Within sixty (60) days from filing of the protest, all relevant, supporting documents shall have been submitted; otherwise, the assessment shall become final." under Section 228 of the NIRC, as amended, is not meant as the assessment being final and unappealable. Rather, the word 'final' means that the taxpayer is barred from disputing the correctness of the issued assessment by introduction of newly discovered or additional evidence. This would result in the denial of the request for reinvestigation, and consequently, the issuance of the FDDA against the taxpayer.[50]

Finally, petitioner received RD Galanza's FDDA on August 30, 2022. Counting 30 days therefrom, petitioner had until September 29, 2022 to seek judicial recourse. Thus, the timely filing of its Petition on September 29, 2022,[51] vested the Court with jurisdiction over CTA Case No. 10994.

Petitioner is liable for the deficiency tax assessments, inclusive of surcharge and interest, albeit in part.

In RD Galanza's FDDA, petitioner was assessed for deficiency income tax, VAT, EWT, and IAET for TY 2017, in the aggregate amount of ₱15,085,232.39, inclusive of surcharge and interest, broken down as follows:[52]

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49 Exhibit "P-8," Docket, pp. 323 to 324.

50 See *Commissioner of Internal Revenue v. Max's Sta. Mesa, Inc.*, CTA EB No. 2036, November 18, 2020, citing Section 3.1.4 of RR No. 18-2013.

51 Docket, pp. 7 to 17.

52 Exhibit "P-10," Docket – pp. 325 to 326.

Tax Type	Basic	25% Surcharge	12% Interest	Total
Income tax	₱ 4,094,139.55	₱ -	₱ 2,173,819.85	**₱ 6,267,959.40**
VAT	4,362,416.72	-	2,431,001.54	**6,793,418.26**
EWT	233,231.06	-	130,737.19	**363,968.25**
IAET	981,863.00	245,465.75	432,557.73	**1,659,886.48**
Total	**₱ 9,671,650.33**	**₱ 245,465.75**	**₱ 5,168,116.31**	**₱15,085,232.39**

The Court's findings on each item of deficiency internal revenue tax, and the corresponding justifications therefor, shall proceed *in seriatim.*

I. Deficiency Income Tax

Petitioner was assessed basic deficiency income tax in the amount of ₱4,094,139.55, computed as follows:[53]

Taxable Income per ITR		₱ 4,154,420.00
Add: Adjustments per investigation		
Disallowed expenses due to non-withholding	₱7,064,053.00	
Undeclared salaries and wages	2,345,275.28	
Revenues/receipts not subjected to income tax	83,383.55	9,492,711.83
Adjusted Taxable Income		₱13,647,131.83
Income Tax Due (30%)		₱ 4,094,139.55
Less: Allowed Tax Credits/Payments	₱1,246,326.00	
Disallowed Tax Credits/Payments	(1,246,326.00)	-
Basic Deficiency Income Tax		**₱ 4,094,139.55**

As shown above, the BIR increased petitioner's taxable income by adding the alleged: (a) disallowed expenses due to non-withholding amounting to ₱7,064,053.00, (b) undeclared salaries and wages of ₱2,345,275.28, and (c) revenues/receipts not subjected to income tax in the amount of ₱83,383.55. The BIR likewise disallowed petitioner's claimed tax credits/payments in the amount of ₱1,246,326.00, resulting in the full income tax due being assessed as deficiency income tax.

Accordingly, the Court shall determine the propriety of the income tax assessment by addressing each of the foregoing items *in seriatim.*

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53 Exhibit "P-10," Docket, p. 325.

I.1. Disallowed expenses due to non-withholding (₱7,064,053.00)

Upon verification of petitioner's 2017 Audited Financial Statements (AFS) and Annual Income Tax Return (ITR), the BIR disallowed as deductions expenses in the amount of ₱7,064,053.00 from petitioner's gross income, pursuant to Section 34(K) of the NIRC of 1997, in relation to Section 2.57.2 of RR No. 2-98,[54] for failure to withhold and remit EWT on its income payments for rent, services, and professional fees. Consider the following presentation:

Particulars	**Per AFS/ITR**	**Disallowed expenses**
Payment for Rent	*₱1,145,000.00*	*₱1,145,000.00*
Payment for Services		
Utilities	₱1,071,201.00	
Research and Development	277,023.00	
Delivery Expense	1,831,175.00	
Development	827,815.00	
Repairs and Maintenance	925,513.00	
Security Services	235,200.00	
Insurance	31,126.00	
Subtotal	*₱5,199,053.00*	*₱5,199,053.00*
Payment for Professional Fees		
Direct Cost	₱ 660,000.00	
Administrative Expense	60,000.00	
Subtotal	*₱ 720,000.00*	*₱ 720,000.00*
Grand Total		**₱7,064,053.00**

Petitioner, however, argues that a higher standard must be set for what constitutes the "details of discrepancies" or "facts on which the assessment is made." According to petitioner, the general statement that "verification disclosed that you have not withheld the appropriate withholding tax due on your income payments enumerated hereunder" does not sufficiently inform it of the factual and legal bases of the assessment.[55]

The Court agrees with petitioner.

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54 Implementing Republic Act No. 8424, "An Act Amending the National Internal Revenue Code, 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.

55 Par. 12, Petition for Review, Docket, at p. 10.

Section 228 of the NIRC, as amended, provides, among others, that "the taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void." This requirement is consistent with the constitutional guarantee of due process under the 1987 Philippine Constitution, which states that "[n]o person shall be deprived of life, liberty, or property without due process of law."

In *Commissioner of Internal Revenue v. Fitness by Design, Inc.*,[56] the Supreme Court explained that to respect the taxpayer's right to due process, it must be adequately informed of the factual and legal bases of the assessment to properly contest the same and submit supporting evidence:

> The rationale behind the requirement that taxpayers should be informed of the facts and the law on which the assessments are based conforms with the constitutional mandate that no person shall be deprived of his or her property without due process of law. **Between the power of the State to tax and an individual's right to due process, the scale favors the right of the taxpayer to due process.**[57]

Thus, in *Commissioner of Internal Revenue v. United Salvage and Towage (Phils.), Inc. (USTI)*,[58] the Supreme Court struck down the 1994 deficiency EWT found by the BIR against therein respondent because "... other than a tabulation of the alleged deficiency taxes due, no further detail regarding the assessment was provided by petitioner." *USTI* added that "[p]etitioner should have at least attached a detailed notice of discrepancy or stated an explanation why the amount of ₱48,461.76 is collectible against respondent and how the same was arrived at." Doubtless, the details of discrepancy constitute the document containing the factual and legal basis of an assessment.

In turn, the *sufficiency* of legal basis stated in the details of discrepancy in a formal assessment was tackled in the most recent case of *Ortiz Memorial Chapel, Inc., represented by Ronald Ortiz v. Commissioner of Internal Revenue (OMCI)*.[59] There, the Details of Discrepancies of the formal assessment issued by the BIR against therein petitioner, stated that it was assessed for income tax arising from undeclared income pursuant to Revenue Audit Memorandum

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56 G.R. No. 215957, November 9, 2016.
57 Emphasis supplied.
58 G.R. No. 197515, July 2, 2014.
59 G.R. No. 278483, December 3, 2025.

Order (RAMO) No. 1-2000 and Section 32 of the NIRC. *OMCI* found the legal basis provided by the BIR *insufficient,* attended by the following elucidation:

> Indeed, RAMO No. 1-2000 is not a substantive basis for assessment but merely an internal manual that prescribes audit procedures and documentation standards for revenue officers. Spanning more than one hundred pages, it outlines the step-by-step process for the proper examination of tax liabilities, specifies the reports to be prepared after audit, and identifies the minimum procedural requirements to be observed. It is essentially a guide for revenue officers - not a source of tax liability. Thus, a mere citation of RAMO No. 1-2000, without indicating which audit method was used, how it was applied, or why it was resorted to, does not satisfy the requirement that the taxpayer be informed of the factual and legal basis of the assessment.
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> Likewise, the BIR's reliance on Section 32 of the NIRC is equally unavailing. Section 32 is a comprehensive provision defining 'gross income' and listing a broad range of taxable and exempt items. Under paragraph (A), gross income 'means all income derived from whatever source,' and includes eleven categories such as compensation, business income, gains from property dealings, interests, rents, royalties, dividends, annuities, and others. Paragraph (B), on the other hand, enumerates exclusions from gross income, such as life insurance proceeds, gifts, compensation for injuries, retirement benefits, and treaty-exempt income, among others. The sheer breadth of this provision underscores that it provides general definitions and classifications; it does not, by itself, specify what constitutes undeclared income in a particular case.
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> **Without any indication of which specific subsection of Section 32 was invoked or how it was applied to OMCI's transactions, the citation of this provision is too general to inform the taxpayer of the legal bases of the assessment. A taxpayer confronted with such a vague reference cannot reasonably discern the nature of the supposed violation or determine how to effectively respond. The right to protest presupposes knowledge of what is being contested. Without such clarity, the taxpayer is deprived of a meaningful opportunity to be heard - an outcome the Constitution itself forbids.**[60]

The thrust of *OMCI* in relation to *USTI* is that a *general* legal basis does not inform the taxpayer. For a taxpayer to be sufficiently informed of the legal basis of the formal assessment, the latter must be

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60 Emphasis supplied.

able to point out the *specific* legal basis from which an item of assessment was based.

The BIR failed to meet the standard provided by *OMCI* in relation to *USTI*.

To justify the disallowance of expenses due to non-withholding of tax, the BIR invoked Section 2.57.2 of RR No. 2-98 as legal basis thereof. Section 2.57.2 contains several subsections governing different categories of income payments, payees, conditions, and withholding tax rates. Thus, a *general* reference thereto, without identifying the particular subsection relied upon, does not sufficiently inform the taxpayer of the specific legal basis of the assessment.

For one, with respect to rental payments amounting to ₱1,145,000.00, Section 2.57.2(C) of RR No. 2-98, as amended by RR Nos. 14-2002[61] and 17-2003,[62] classifies the 5% EWT on rentals into distinct categories, namely: (1) real properties; (2) personal properties; (3) poles, satellites, and transmission facilities; and (4) billboards, thus:

> **Sec. 2.57.2.** ***Income payments subject to creditable withholding tax and rates prescribed thereon.*** – Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines:
>
> ...
>
> **(C) Rentals**
>
> (1) **Real properties.** – On gross rental for the continued use or possession of real property used in business which the payor or obligor has not taken or is not taking title, or in which he has no equity – Five percent (5%);

61 Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as amended.

62 Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as Amended, Providing for Additional Transactions Subject to Creditable Withholding Tax; Re-Establishing the Policy that the Capital Gains Tax on the Sale, Exchange or Other Disposition of Real Property Classified as Capital Assets Shall be Collected as a Final Withholding Tax, Thereby Further Amending Revenue Regulations Nos. 8-98 and 13-99, as Amended by Revenue Regulations No. 14-2000; and for Other Purposes.

> (2) **Personal properties.** — On gross rental or lease in excess of Ten Thousand Pesos (P10,000.00) annually for the continued use or possession of personal property used in business which the payor or obligor has not taken or is not taking title, or in which he has no equity, except those under financial lease arrangements with leasing and finance companies authorized to operate under Republic Act No. 8556 (Financing Company Act of 1998). — Five percent (5%)
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> (3) **Poles, satellites and transmission facilities.** - On gross rentals or lease for the use of poles, satellites and/or transponder and transmission facilities which include but not limited to the following: switchboards, land lines/aerial cables, underground cables and submarine cables - Five percent (5%);
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> (4) **Billboards** - On gross rentals or lease of spaces used in posting advertisements in the form of billboards and/or structures similar thereto, posted in public places such as, but not limited to, buildings, vehicles, amusement places, malls, street posts, etc. - Five percent (5%).

Despite the foregoing distinctions, the BIR merely treated petitioner's "Payment for Rent" as subject to 5% EWT. The BIR did not identify the specific subsection of Section 2.57.2(C) allegedly applicable.

For another, the same deficiency permeated the assessment on "Payments for Services," totaling ₱5,199,053.00. The BIR imposed 2% EWT on certain expense accounts generically categorized as payments for services. However, income payments for services may fall under different provisions of Section 2.57.2 of RR No. 2-98, as amended. Particularly, Section 2.57.2(M) of RR No. 2-98, as amended by RR No. 06-2009,[63] imposes 2% EWT on income payments made by top 20,000 private corporations to their local or resident suppliers of services. On the other hand, Section 2.57.2(E) of RR No. 2-98, as amended by RR

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[63] Amending Further Pertinent Provisions of Revenue Regulations (RR) No. 2-98, as Amended, Providing for an Additional Criteria in the Determination of Top 20,000 Private Corporations, Including the Threshold on Their Purchases of Agricultural Products, and Additional Transactions Subject to Creditable Withholding Tax on Income Payments Made by the Top Five Thousand (5,000) Individual Taxpayers Engaged in Trade/Business or Practice of Profession.

Nos. 6-2001,[64] 14-2002,[65] 17-2003,[66] and 30-2003,[67] imposes 2% EWT on payments to certain contractors, including engineering contractors, general building contractors, specialty contractors, transportation contractors, janitorial and security agencies, advertising agencies, computer service providers, and other similar entities:

> **Sec. 2.57.2. Income payments subject to creditable withholding tax and rates prescribed thereon.** — Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items on income payments to persons residing in the Philippines:
>
> ...
>
> (E) Income payments to certain contractors — On gross payments to the following contractors, whether individual or corporate — Two percent (2%)
>
> (1) General engineering contractors — Those whose principal contracting business in connection with fixed works requiring specialized engineering knowledge and skill, including the following divisions or subjects:
>
> (a) Reclamation works;
>
> (b) Railroads;
>
> (c) Highways, streets and roads;

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64 Amending Pertinent Provisions of Revenue Regulations Nos. 1-98, 2-98, as Amended, and 7-95, as Amended, and Revenue Memorandum Circular No. 1-98 Relative to the Inclusion of Additional Taxpayers to be Subject to Final Withholding Tax, Revision of the Withholding Tax Rates on Certain Income Payments Subject to Creditable Withholding Tax, Time for the Filing of Various Tax Returns and Payment of the Taxes Due Thereon and Others.

65 Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as amended.

66 Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as Amended, Providing for Additional Transactions Subject to Creditable Withholding Tax; Re-Establishing the Policy that the Capital Gains Tax on the Sale, Exchange or Other Disposition of Real Property Classified as Capital Assets Shall be Collected as a Final Withholding Tax, Thereby Further Amending Revenue Regulations Nos. 8-98 and 13-99, as Amended by Revenue Regulations No. 14-2000; and for Other Purposes.

67 Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as Last Amended by Revenue Regulations No. 17-2003, and Revenue Regulations No. 8-98, as Amended, Providing for the Imposition of Final Withholding Tax on the Sale, Exchange or Other Disposition of Real Property Classified as Capital Assets by Nonresident Aliens, Increasing the Withholding Tax Rates on Certain Income Payments, Inclusion of Certain Income Payments, Sanctions to be Imposed on Payees Who Refuse the Withholding of Tax on Their Income/Receipts, and for Other Purposes.

(d) Tunnels;

(e) Airports and airways;

(f) Waste reduction plants;

(g) Bridges, overpasses, underpasses and other similar works;

(h) Pipelines and other systems for the transmission of petroleum and other liquid or gaseous substances;

(i) Land leveling;

(j) Excavating;

(k) Trenching;

(l) Paving; and

(m) Surfacing work.

(2) General building contractors — Those whose principal contracting business is in connection with any structure built, for the support, shelter and enclosure of persons, animals, chattels, or movable property of any kind, requiring in its construction the use of more than two unrelated building trades or crafts, or to do or superintend the whole or any part thereto. Such structure includes sewers and sewerage disposal plants and systems, parks, playgrounds, and other recreational works, refineries, chemical plants and similar industrial plants requiring specialized engineering knowledge and skills, powerhouse, power plants and other utility plants and installation, mines and metallurgical plants, cement and concrete works in connection with the above-mentioned fixed works.

(3) Specialty Contractors — Those whose operations pertain to the performance of construction work requiring special skill and whose principal contracting business involves the use of specialized building trades or crafts.

(4) Other contractors —

(a) Filling, demolition and salvage work contractors and operators of mine drilling apparatus;

(b) Operators of dockyards;

(c) Persons engaged in the installation of water system, and gas or electric light, heat or power;

(d) Operators of stevedoring, warehousing or forwarding establishments;

(e) Transportation contractors which include common carriers for the carriage of goods and merchandise of whatever kind by land, air or water, where the gross payments by the payor to the same payee amounts to at least two thousand pesos (P2,000) per month, regardless of the number of shipments during the month;

(f) Printers, bookbinders, lithographers and publishers except those principally engaged in the publication or printing of any newspaper, magazine, review or bulletin which appears at regular intervals, with fixed prices for subscription and sale;

(g) Messengerial, janitorial, private detective and/or security agencies, credit and/or collection agencies and other business agencies;

(h) Advertising agencies, exclusive of gross payments to media;

(i) Independent producers of television, radio and stage performances or shows;

(j) Independent producers of 'jingles';

(k) Labor recruiting agencies and/or 'labor-only' contractors. For this purpose, any person who undertakes to supply workers to an employer shall be deemed to be engaged in 'labor-only' contracting where such person does not have substantial capital or investment in the form of tools, equipment, machineries, work premises and other materials and the workers recruited and placed by such person are performing activities which are directly related to the principal business or operations of the employer which the workers are habitually employed;

(l) Persons engaged in the installation of elevators, central air conditioning units, computer machines and other equipment and machineries and the maintenance services thereon;

(m) Persons engaged in the sale of computer services, computer programmers, software/program developer/designer, internet service providers, web page designing, computer data processing, conversion or base services and other computer related activities;

(n) Persons engaged in landscaping services;

(o) Persons engaged in the collection and disposal of garbage;

(p) TV and radio station operators on sale of TV and radio airtime; and

(q) TV and radio blocktimers on sale of TV and radio commercial spots.

...

(M) Income payments made by the top twenty thousand (20,000) private corporations to their local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax. — Income payments made by any of the top 20,000 private corporations, as determined by the Commissioner, to their local/resident supplier of goods and local/resident supplier of services, including non-resident aliens engaged in trade or business in the Philippines. xxx

Supplier of goods	—	One percent (1%)
Supplier of services	**—**	**Two percent (2%)**[68]

Thus, several classes of income payments may be subject to 2% EWT under different legal bases. Nevertheless, the BIR failed to identify the particular services rendered, the payees involved, the factual basis for treating such payments as subject to EWT, and the

68 Emphasis supplied.

precise provision of Section 2.57.2 allegedly applicable to each transaction. The BIR merely selected certain expense accounts reflected in petitioner's 2017 Annual ITR and Audited Financial Statements and applied a 2% EWT rate thereon.

The same holds true for the assessed professional fees amounting to ₱720,000.00. Under Section 2.57.2(A) and (B) of RR No. 2-98, as amended by RR Nos. 30-2003 and 10-2013,[69] professional fees, talent fees, and other similar payments may be subject to either 10% or 15% EWT, depending on the nature of the payee and the amount of gross income earned during the taxable year. The regulation also distinguishes between payments made to individuals and those made to taxable juridical persons. Further, Section 2.57.2(I) thereof separately addresses professional fees paid to medical practitioners:

> *Sec. 2.57.2. Income payments subject to creditable withholding tax and rates prescribed thereon.* — xxx
>
> **(A) Professional fees, talent fees, etc., for services rendered by individuals.** — On the gross professional, promotional and talent fees or any other form of remuneration for the services of the following individuals — Fifteen percent (15%), if the gross income for the current year exceeds P720,000; and Ten percent (10%), if otherwise;
>
> (1) Those individually engaged in the practice of professions or callings; lawyers; certified public accountants; doctors of medicine; architects; civil, electrical, chemical, mechanical, structural, industrial, mining, sanitary, metallurgical and geodetic engineers; marine surveyors; doctors of veterinary science; dentists; professional appraisers; connoisseurs of tobacco; actuaries; interior decorators, designers, real estate service practitioners (RESPs), (i.e., real estate consultants, real estate appraisers and real estate brokers) requiring government insurance licensure examination given by the Real Estate Service pursuant to Republic Act No. 9646 and all other profession requiring government licensure examination regulated by the Professional Regulations Commission, Supreme Court, etc.; x x x

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69 Amending Further Pertinent Provisions of Revenue Regulations (RR) No. 2-98, as Last Amended by Revenue Regulations No. 30-2003, Providing for the Inclusion of Real Estate Service Practitioners (i. e. Real Estate consultant, Appraiser and Broker) Who Passed the Licensure Examination given by the Real Estate Service under the Professional Regulations Commission as defined in Republic Act No. 9646, "The Real Estate Service Act of the Philippines" as Among Those Professionals Falling Under Section 2.57.2(A)(1) of RR 2-98, as Amended, and RR 14-2002 as Regards Income Payments to Certain Brokers and Agents.

(2) Professional entertainers, such as, but not limited to, actors and actresses, singers, lyricist, composers and emcees;

(3) Professional athletes, including basketball players, pelotaris and jockeys;

(4) All directors and producers involved in movies, stage, radio, television and musical productions;

(5) Insurance agents and insurance adjusters;

(6) Management and technical consultants;

(7) Bookkeeping agents and agencies;

(8) Other recipient of talent fees;

(9) Fees of directors who are not employees of the company paying such fees, whose duties are confined to attendance at and participation in the meetings of the board of directors.

...

(B) **Professional fees, talent fees, etc., for services of taxable juridical persons.** — On the gross professional, promotional and talent fees, or any other form of remuneration enumerated in the preceding subparagraph for the services of taxable juridical persons — Fifteen percent (15%), if the gross income for the current year exceeds P720,000; and Ten percent (10%), if otherwise;

...

(I) **Professional fees paid to medical practitioners.** — Any amount collected for and paid to medical practitioners (includes doctors of medicine, doctors of veterinary science and dentists) by hospitals and clinics, or paid directly to the medical practitioners by patients who were 'admitted and confined' to such Hospitals or Clinics, or paid directly to such medical practitioners by health maintenance organizations (HMOs) and/or similar establishments which is likewise covered by Section 2.57.2(A)(1) — Fifteen percent (15%), if the income payments to the medical practitioner for the current year exceeds P720,000; and Ten percent (10%), if otherwise.

Despite the multiple types of WT on professional fees, the BIR merely treated certain payments as professional fees subject to 10% EWT, without identifying the nature of the services rendered, the identities and classifications of the payees, the relevant income threshold, and the particular provision of Section 2.57.2 allegedly applicable. The BIR's assessment therefore failed to disclose the factual and legal bases necessary to enable petitioner to understand and intelligently contest the assessment.

In sum, the BIR's assessment merely identified broad expense categories and imposed corresponding EWT rates without specifying the particular transactions involved, the applicable legal provisions, and the factual reasons why the payments were considered subject to withholding tax. Such generalized legal basis deprived petitioner of a meaningful opportunity to verify the transactions, ascertain the applicable withholding tax rules, and prepare an informed protest. Simply put, the BIR failed to satisfy the due process requirement under Section 228 of the NIRC, as amended, as interpreted by *USTI* and *OMCI*. *Ergo,* the deficiency income tax due to non-withholding of tax found by the BIR against petitioner should be cancelled.

I.2. Undeclared salaries and wages (₱2,345,275.28)

The BIR reconciled the salaries and wages reflected in petitioner's 2017 Audited Financial Statements (AFS) and Annual Income Tax Return (ITR) with the amounts subjected to withholding tax on compensation per petitioner's Monthly Remittance Returns of Income Tax Withheld on Compensation (BIR Forms No. 1601-C) for the same period. Based thereon, the BIR allegedly found unaccounted salaries and wages amounting to ₱2,345,275.28, which the BIR treated as an unaccounted source of cash or undeclared income pursuant to Section 32 of the NIRC, as amended, computed as follows:[70]

Particulars	**Amount**
Salaries and Wages per BIR Forms No. 1601-C	₱ 17,256,700.28
Salaries and Wages per AFS/Annual ITR	14,911,425.00
Undeclared Salaries and Wages	**₱ 2,345,275.28**

The BIR is in error.

70 Exhibit "P-11," Docket, p. 327.

The imposition of income tax requires the concurrence of the following elements: first, there must be gain or profit; second, such gain or profit must have been realized or received, actually or constructively; and third, the gain or profit must not be exempt from income tax by law or treaty. Income tax is imposed on income derived from any property, activity or service that produces the income.[71]

In this case, the income earners of those supposed unreported salaries and wages imputed by the BIR against petitioner, are the latter's employees. If the BIR seeks to exact *income taxes* on those salaries and wages, it should run after the employees of petitioner because they are the income earners thereof. To stress, the taxes thereon are imposed upon petitioner as the taxpayer, and *not* in its capacity as withholding agent of the compensation income of its employees, given that the legal basis used is Section 32 of the NIRC, as amended.

Besides, these unreported salaries and wages treated by the BIR as unaccounted cash, were sums disbursed, rather than amounts received or realized by petitioner, on which no income tax should be imposed. These remarks justify the cancellation of income tax assessment on undeclared income emanating from unreported salaries and wages of ₱2,345,275.28.

I.3. Revenues/Receipts not subjected to Income Tax (₱83,383.55)

The BIR compared petitioner's revenues/receipts declared in its Annual ITR with those reflected in its VAT Returns for TY 2017. Based thereon, the BIR found a discrepancy in the amount of ₱83,383.55,[72] representing revenues/receipts allegedly not subjected to income tax. Invoking Section 32 of the NIRC, as amended, the BIR assessed petitioner for deficiency income tax thereon, computed as follows:

Particulars	**Amount**
Revenues/Receipts per VAT Returns	₱ 86,467,119.55
Revenues/Receipts per Annual ITR	86,383,736.00
Revenues/Receipts not subjected to Income Tax	**₱ 83,383.55**

The BIR is correct.

[71] *Commissioner of Internal Revenue v. The Court of Appeals, et al.*, G.R. No. 108576, January 20, 1999.

[72] Exhibit "P-10," Docket, p. 328.

Section 32(A) of the NIRC, as amended, defines gross income broadly as "all income derived from whatever source," including, among others, "gross income derived from the conduct of trade or business or the exercise of a profession,"[73] along with "gains derived from dealings in property."[74] Thus, revenues or receipts derived from petitioner's business operations form part of gross income subject to income tax, unless shown to be excluded or exempt under the law.

Meanwhile, the amounts reported by petitioner in its VAT Returns may properly be considered in determining whether all revenues or receipts were declared for income tax purposes. Under Section 106(A) of the NIRC, as amended, VAT on the sale of goods or properties is based on the gross selling price or gross value in money of the goods or properties sold, bartered, or exchanged. Similarly, under Section 108(A) of the same Code, VAT on the sale of services or use or lease of properties is based on gross receipts derived from the sale or exchange of services, including the use or lease of properties.

Hence, the revenues or receipts declared in VAT Returns may be compared with those declared in the Annual ITR to determine whether there are revenues or receipts reported for VAT purposes but not correspondingly declared for income tax purposes.

Here, the discrepancy was established from petitioner's own tax returns for the same taxable year. Petitioner's VAT Returns reflected revenues/receipts of ₱86,467,119.55, while its Annual ITR reflected revenues/receipts of only ₱86,383,736.00, resulting in a difference of ₱83,383.55. This difference constitutes a sufficient factual basis for the BIR to treat the same as revenues or receipts not subjected to income tax. There being no sufficient evidence to show otherwise, the deficiency income tax assessment on the unreported revenues/receipts amounting to ₱83,383.55 is upheld.

I.4. Disallowed Tax Credits/Payments (₱1,246,326.00)

Per FDDA, the BIR disallowed petitioner's claimed tax credits/payments for TY 2017 in the amount of ₱1,246,326.00. However, the BIR failed to state in the Details of Discrepancies the

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73 Section 32(A)(2) of the NIRC, as amended.

74 Section 32(A)(3) of the NIRC, as amended.

factual and legal bases for such disallowance.[75] It means that petitioner was *not* informed of the legal basis of said action, violative of the latter's right to due process under Section 228 of the NIRC, as amended, as interpreted in *Fitness by Design, USTI,* and *OMCI.* For this reason, said disallowance should be voided.

CONCLUSION – Income Tax Assessment

Petitioner is liable for basic deficiency income tax in the amount of ₱25,015.07, computed as follows:

Taxable Income per ITR	₱4,154,420.00
Add: Adjustments per investigation	
Revenues/receipts not subjected to income tax	83,383.55
Adjusted Taxable Income	₱4,237,803.55
Income Tax Due (30%)	₱1,271,341.07
Less: Allowed Tax Credits/Payments	1,246,326.00
Basic Deficiency Income Tax	**₱ 25,015.07**

II. Deficiency VAT

The BIR computed the deficiency VAT assessment for TY 2017 in the amount of ₱6,793,418,26 as follows:[76]

Vatable Revenue/Receipts per VAT Returns		₱ 85,725,441.77
Add: Adjustments per investigation		
Unsupported Exempt Sales	₱ 741,677.78	
Undeclared Salaries and Wages	2,345,275.28	3,086,953.06
Adjusted Vatable Sales		₱ 88,812,394.83
Output Tax Due (12%)		₱ 10,657,487.38
Less: Allowed Tax Credits/Payments		
Input Tax in Current Purchases	₱ 4,949,154.51	
Payments	1,345,916.15	6,295,070.66
Deficiency VAT		₱ 4,362,416.72
Add: 12% Interest (01/26/2018 to 09/16/2022)		2,431,001.54
Basic Deficiency VAT		**₱ 6,793,418,26**

In so assessing, the BIR found that petitioner had unsupported exempt sales and undeclared salaries and wages which were allegedly

75 Exhibits "P-10" and "P-11," Docket, pp. 325, and 327 to 328.
76 Exhibit "P-10," Docket, p. 325.

subject to 12% VAT. The BIR likewise allowed VAT credits/payments of only ₱6,295,070.66. The Court shall discuss each item *in seriatim.*

II.1. Unsupported Exempt Sales (₱741,677.78)

The BIR said that the exempt sales declared in petitioner's VAT Returns in the total amount of ₱741,677.78[77] were unsupported by proper documents. Thus, these transactions are subject to 12% VAT pursuant to Sections 105, 106, and 108 of the NIRC, as amended.[78]

The BIR is partly correct.

The ICPA traced the BIR's finding of unsupported VAT exempt sales from two (2) transactions. These are: *first,* petitioner's sale of agricultural products, such as rice, eggs, beef, and similar items, to Swizzlestick, Inc. amounting to ₱481,135.04; *and second,* sales of processed products to Puregold Subic and Clark, which are zero-rated (0%), in the amount of ₱260,542.74, as summarized below:[79]

	Per BIR	Per Petitioner
Sales to Swizzlestick, Inc.		₱ 481,135.04
Sales to Puregold		260,542.74
Total	**₱741,677.78**	**₱741,677.78**

First. Petitioner's sale of agricultural products, such as rice, eggs, beef, and similar items, to Swizzlestick, Inc. in the alleged amount of ₱481,135.04, is indeed a VAT-exempt transaction. Section 109 (A) of the NIRC, as amended, confirmed:

> SEC. 109. *Exempt Transactions* – (1) Subject to the provisions of Subsection (2) hereof, the following transactions shall be exempt from the value-added tax:
>
> (A) Sale or importation of agricultural and marine food products in their original state, livestock and poultry of or kind generally used as, or yielding or producing foods for human consumption; and breeding stock and genetic materials therefor.

77 The sum of ₱61,553.33 (1st Quarter), ₱32,386.19 (2nd Quarter), ₱449,181.98 (3rd Quarter) and ₱198,556.28 (4th Quarter), Exhibits "P15-G3," "P15-G6," and "P15-G12," USB (Exhibit "P-15-a-1").

78 Exhibit "P-11," Docket, p. 328.

79 Exhibit "P-15," Docket, p. 284.

Products classified under this paragraph shall be considered in their original state even if they have undergone the simple processes of preparation or preservation for the market, such as freezing, drying, salting, broiling, roasting, smoking or stripping. Polished and/or husked rice, corn grits, raw cane sugar and molasses, ordinary salt and copra shall be considered in their original state;

...

Yet, of the claimed VAT-exempt sale to Swizzlestick, Inc. amounting to ₱481,135.04, only ₱374,194.45 was substantiated by petitioner. Consider the following presentation:

Exempt sales to Swizzlestick Inc.						
Per Sales Invoice			Per Delivery Receipt (Substantiated VAT-exempt Transactions)			
Number	Date	Amount	Description	Amount	Number	Date
Exhibit "P-15-D1"[80]						
24421	11/30/17	₱24,662.00				
			maharlika rice	₱ 7,150.00	2409	11/25/17
			maharlika rice	7,150.00	2368	11/18/17
			maharlika rice, chicken tocino, pork tocino	10,362.00	2347	11/16/17
Exhibit "P15-D2"[86]						
24480	12/31/17	85,573.02	maharlika rice	7,150.00	2713	12/27/17
			fresh eggs, pork tocino	12,936.00	2732	12/29/17
			rock salt, maharlika rice	7,600.00	2644	12/19/17
			whole salmon, pork tocino	10,274.44	2618	12/16/17
			beef short plates, cream dory fillet	20,994.60	2605	12/15/17
			pork tocino, chicken tocino	11,715.00	2455	12/01/17
Exhibit "P15-D3"[86]						
24337	10/31/17	12,233.10				
			whole chicken, pork kasim, cream dory fillet, banana blossom, eggplant, string beans, fresh okra, squash, ampalaya, bagoong alamang	2,333.10	2189	10/27/17
			fresh eggs	9,900.00	2048	10/03/17
Exhibit "P15-D4"[86]						
24242	09/30/17	209,109.74				
			Chef Selection beef angus burger, pork kasim, pork chop, whole chicken	24,216.18	1844	09/08/17
			whole chicken, chicken wings, chicken fillet, pork spareribs, beef sirloin, boneless angus	17,975.65	1947	09/09/17
			beef sirloin, pork chop, whole chicken	7,078.50	1948	09/11/17
			pork pata, pork kasim, whole chicken, chicken fillet, beef sirloin, bangus boneless	23,002.18	1946	09/12/17
			ground pork, pork kasim, whole chicken	17,386.60	2035	09/13/17
			bangus boneless, pork kasim, ground pork	9,515.00	1945	09/14/17
			whole chicken, chicken fillet, chicken wings	7,227.00	2034	09/15/17
			ground beef, ox tongue, beef brisket, pork liempo, chicken fillet, whole chicken, bangus boneless, maharlika rice	26,675.00	2033	09/18/17
			ground pork, ground beef, pork kasim, whole chicken, smoked fish	18,942.00	2032	09/20/17

80 USB, (Exhibit "P-15-a-1").

Exempt sales to Swizzlestick Inc.						
Per Sales Invoice			Per Delivery Receipt (Substantiated VAT-exempt Transactions)			
Number	Date	Amount	Description	Amount	Number	Date
			pork kasim, chicken fillet, whole chicken, ground beef	16,775.00	2031	09/21/17
			pork kasim, pork chop, beef tenderloin, whole chicken, bangus boneless,	28,669.30	2029	09/22/17
			pork kai, chicken liver, whole chicken, chicken fillet	19,294.00	2030	09/22/17
Exhibit "P15-D5"[86]						
24157	08/31/17	149,557.18				
			chicken tocino	3,960.00	1579	08/01/17
			tomato small, wansoy, fresh spinach, potato, carrots, red bell pepper, green bell pepper, celery, romaine lettuce	3,969.90	1307	06/06/17
			Fresh spinach, fresh mushroom, ripe mangoes, fresh basil	8,767.00	1308	06/06/17
			Whole chicken, beef sirloin, pork baby back ribs, pork spareribs	13,513.50	1806	08/30/17
			Pork kasim, pork liempo, pork chop, baga (bopis), whole chicken	19,662.50	1779	08/23/17
Total		**₱481,135.04**		**₱374,194.45**		

Therefore, the deficiency VAT assessment on the *unsubstantiated* sales to Swizzlestick, Inc. in the amount of ₱106,940.59 is sustained.

Second. Indeed, VAT on the sale of goods to persons or entities whose exemption under special laws or international agreements, effectively subjects such sales to zero percent (0%) VAT is a zero-rated sale transaction under Section 106(A)(2)(b) of the NIRC as amended. Among the transactions covered thereof are sale of goods to entities located within the Subic Freeport Zone and Clark Freeport Zone. Yet, petitioner failed to substantiate the alleged zero-rated sales to Puregold Subic and Clark in the amount of ₱260,542.74. *Ergo,* this item of VAT assessment is wholly sustained.

In fine, out of the ₱741,677.78 VAT-exempt sales declared by petitioner in its 2017 VAT Returns, only ₱374,194.45 was properly substantiated. For this reason, the BIR's imposition of 12% VAT on the remaining and unsubstantiated amounting to ₱367,483.33 is sustained.

II.2. Undeclared Salaries and Wages (₱2,345,275.28)

The BIR slapped deficiency VAT on petitioner's undeclared and unaccounted salaries and wages amounting to ₱2,345,275.28. For the BIR, said amount is subject to 12 % VAT under Sections 105 and 106 of the NIRC, as amended, subjected the alleged undeclared salaries and wages of ₱2,345,275.28 to 12% VAT.[81]

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81 Exhibit "P-11," Docket, p. 327.

The BIR is incorrect.

Under Section 106 (A) of the NIRC, as amended, the tax base for 12% VAT is "gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor." Significantly, the law defines "gross selling price" as follows:

> xxx 'gross selling price' means the total amount of money or its equivalent which the purchaser pays or is obligated to pay the seller **in consideration of the sale, barter or exchange of the goods or properties**, excluding the value-added tax.[82]

Indeed, before a transaction may be subjected to 12% VAT under Section 105, in relation to Section 106 of the NIRC, as amended, a sale, barter or exchange of goods or properties is required.[83] However, by no stretch of imagination could unreported salaries and wages be categorized as one arising from the sale, barter, or exchange of goods or properties. Besides, the sums pertaining to these salaries and wages were disbursed, rather than received by petitioner; hence, this could signify a purchase, rather than a sale. On these accounts, the VAT assessment on the alleged undeclared salaries and wages of ₱2,345,275.28 is cancelled.

II.3. Disallowed VAT Payments (₱3,991,982.36)

Petitioner points out that the BIR failed to consider its total VAT payments for TY 2017,[84] in the amount of ₱5,337,898.51. Specifically, the BIR only recognized ₱1,345,916.15 as its 2017 VAT payments, thereby ignoring ₱3,991,982.36 worth of 2017 VAT payments. The ICPA condensed such point in the following table:[85]

	Per BIR	Per Petitioner	Difference
Input VAT on current purchases	₱ 4,949,151.51	₱ 4,949,154.51	-
VAT payments	1,345,916.15	5,337,898.51	₱3,991,982.36
Total VAT credits/payments	**₱ 6,295,070.66**	**₱10,287,053.02**	

82 Boldfacing supplied.

83 *Association of Non-Profit Clubs, Inc. v. Bureau of Internal Revenue (BIR)*, G.R. No. 228539, June 26, 2019, citing *Commissioner of Internal Revenue v. Sony Philippines, Inc.*, 649 Phil. 519, 533 (2010).

84 Par. 13, Petition for Review, p. 5, Docket, at p. 11.

85 Exhibit "P-15," Docket, at p. 285.

Petitioner is correct.

Petitioner submitted copies of BTR-BIR Deposit Slips,[86] together with the monthly and quarterly VAT returns filed with the BIR for TY 2017. These documents collective show that the amount of ₱5,337,898.51 corresponds to the VAT payments by petitioner for TY 2017:

TY 2017	Output VAT	Input VAT	VAT Payments			
			1st Month	2nd Month	3rd Month	Total
1st Quarter	₱2,063,609.46	₱973,868.54	₱389,786.70[87]	₱359,833.42[88]	₱340,120.80[89]	₱1,089,740.92
2nd Quarter	2,529,912.70	1,082,413.07	426,225.81[90]	468,411.51[91]	552,862.31[92]	1,447,499.63
3rd Quarter	2,494,738.39	1,332,106.60	285,127.15[93]	355,119.00[94]	522,385.64[95]	1,162,631.79
4th Quarter	3,198,792.47	1,560,766.30	386,114.97[96]	557,020.48[97]	694,890.72[98]	1,638,026.17
	₱10,287,053.02	**₱4,949,154.51**	**₱1,487,254.63**	**₱1,740,384.41**	**₱2,110,259.47**	**₱5,337,898.51**

It means that the BIR erred in capping petitioner's 2017 VAT payments at ₱1,345,916.15. Thus, petitioner is entitled to have the full amount of ₱5,337,898.51 credited against its output VAT due.

CONCLUSION - VAT Assessment

Petitioner is liable for basic deficiency VAT for TY 2017, in the amount of ₱44,097.99, computed as follows:

Vatable Revenue/Receipts per VAT Returns	₱ 85,725,441.77
Add: Adjustments per investigation	
Unsupported Exempt Sales	367,483.33
Adjusted Vatable Sales	₱ 86,092,925.10

86 BIR Records, Exhibit "R-13," pp. 32 to 43.
87 BIR Records, Exhibit "R-13," p. 43.
88 BIR Records, Exhibit "R-13," p. 42.
89 BIR Records, Exhibit "R-13," p. 41.
90 BIR Records, Exhibit "R-13," p. 40.
91 BIR Records, Exhibit "R-13," p. 39.
92 BIR Records, Exhibit "R-13," p. 38.
93 BIR Records, Exhibit "R-13," p. 37.
94 BIR Records, Exhibit "R-13," p. 36.
95 BIR Records, Exhibit "R-13," p. 35.
96 BIR Records, Exhibit "R-13," p. 34.
97 BIR Records, Exhibit "R-13," p. 33.
98 BIR Records, Exhibit "R-13," p. 32.

Output Tax Due (12%)		₱ 10,331,151.01
Less: Allowed Tax Credits/Payments		
Input Tax in Current Purchases	₱ 4,949,154.51	
Payments	5,337,898.51	10,287,053.02
Basic Deficiency VAT		**₱ 44,097.99**

III. Deficiency EWT

The BIR assessed petitioner for deficiency EWT covering TY 2017, in the amount of ₱233,231.06, due to its failure to withhold and remit taxes on its expense payments for rent, services and professional fees amounting to ₱7,064,053.00, as demonstrated by the following table:

Payments for:	Disallowed expenses	EWT Rate	EWT Due
Rent	₱1,145,000.00	5%	₱ 57,250.00
Services	5,199,053.00	2%	103,981.06
Professional Fees	720,000.00	10%	72,000.00
	₱7,064,053.00		**₱233,231.06**

This deserves cancellation.

Adverting to our earlier discussion, the BIR failed to satisfactorily inform petitioner of the *particular* legal and factual basis of its disallowances on petitioner's payments for rental, service, and professional fees. The BIR identified broad expense categories and applied the corresponding EWT rates without specifying the particular transactions involved, the applicable provisions of Section 2.57.2 of RR No. 2-98, as amended, and the factual reasons why such payments were considered subject to WT, violative of petitioner's right to due process, guaranteed by Section 228 of the NIRC, as amended, as interpreted by *Fitness by Design, USTI,* and *OMCI*. Being so, the disallowances on petitioner's foregoing payments made by the BIR are void. Being null, the 2017 deficiency EWT assessment in the basic amount of ₱233,231.06, should likewise be invalidated.

IV. Deficiency IAET

The BIR's examination disclosed that petitioner's financial statements reflected retained earnings in excess of its paid-up capital stock at the close of TY 2017. Consequently, the BIR treated the excess as improperly accumulated earnings subject to the ten percent (10%)

IAET pursuant to Section 29 of the NIRC, as amended, RR No. 2-2001, and RMC No. 35-2011, with the following computation:[99]

Accumulated Earnings as of year-end		₱ 14,818,630.00
Less: Paid-up Capital		5,000,000.00
Improperly Accumulated Taxable Income		9,818,630.00
Multiply by tax rate		10%
Improperly Accumulated Earnings Tax		981,863.00
Add: 25% Surcharge	₱ 245,465.75	
12% Interest	432,557.73	678,023.48
Total Amount Due		**₱ 1,659,886.48**

In disagreement, petitioner's retention of earnings found by the BIR is justified by reason of the needs of its business. Specifically, the BIR failed to consider that petitioner subsequently made an appropriation for business purposes in 2018. According to petitioner, the appropriation was intended to fund its planned plant transfer, expansion, and renovation, which were allegedly necessary to increase production capacity and maintain the quality of its products, considering that its existing plant had already reached maximum capacity. Petitioner further claims that the appropriation was made only after the figures in its 2017 financial statements had been finalized. [100]

The Court sustains the BIR.

Section 29 of the NIRC, as amended, reads:

> SEC. 29. *Imposition of Improperly Accumulated Earnings Tax.* —
>
> (A) *In General.* — In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof, an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.
>
> (B) *Tax on Corporations Subject to Improperly Accumulated Earnings Tax.* —

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99 Exhibits "P-10" and "P-11," Docket, pp. 326, and 328 to 332.

100 Par. 15, Petition for Review, Docket, p. 11.

> (1) *In General.* — The improperly accumulated earnings tax imposed in the preceding Section shall apply to every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings, and profits to accumulate instead of being divided or distributed.
>
> ...
>
> (C) *Evidence of Purpose to Avoid Income Tax.* —
>
> ...
>
> (2) *Evidence Determinative of Purpose.* — The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by the clear preponderance of evidence, shall prove to the contrary.
>
> ...
>
> (E) *Reasonable Needs of the Business.* — For purposes of this Section, the term 'reasonable needs of the business' includes the reasonably anticipated needs of the business.

In *Cyanamid Philippines, Inc. v. Court of Appeals,*[101] the Supreme Court explained that the rationale behind the imposition of IAET is to discourage corporations from accumulating earnings beyond the reasonable needs of the business in order to avoid the imposition of tax on dividends that would otherwise be received by the shareholders. Thus, the IAET operates as a penalty tax designed to compel the distribution of earnings when their accumulation is not justified by the reasonable needs of the corporation.

Accordingly, the IAET equivalent to 10% of the improperly accumulated earnings is imposed on a corporation that permits its earnings and profits to accumulate beyond the reasonable needs of the business, instead of distributing the same as dividends to its shareholders or members. Where earnings or profits are permitted to accumulate beyond such reasonable needs, the law treats the accumulation as determinative of the purpose to avoid tax upon the

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[101] G.R. No. 108067, January 20, 2000.

shareholders or members, unless the corporation proves the contrary by clear preponderance of evidence.

The incidents constituting reasonable needs of the business are conceptualized under Section 3 of RR No. 2-2001. Thus:

> *SEC. 3. Determination of Reasonable Needs of the Business. — ...*
>
> ...
>
> For purpose of these Regulations, the following constitute accumulation of earnings for the reasonable needs of the business:
>
> a. Allowance for the increase in the accumulation of earnings up to 100% of the paid-up capital of the corporation as of Balance Sheet date, inclusive of accumulations taken from other years;
>
> b. Earnings reserved for definite corporate expansion projects or programs requiring considerable capital expenditure as approved by the Board of Directors or equivalent body;
>
> c. **Earnings reserved for building, plants or equipment acquisition as approved by the Board of Directors or equivalent body**;
>
> d. Earnings reserved for compliance with any loan covenant or pre-existing obligation established under a legitimate business agreement;
>
> e. Earnings required by law or applicable regulations to be retained by the corporation or in respect of which there is legal prohibition against its distribution;
>
> f. In the case of subsidiaries of foreign corporations in the Philippines, all undistributed earnings intended or reserved for investments within the Philippines as can be proven by corporate records and/or relevant documentary evidence.[102]

102 Emphasis supplied.

To substantiate its claim that the retention of earnings is for the needs of the business, petitioner presented a Board Resolution approved on April 26, 2018,[103] allocating ₱10,000,000.00 from its unrestricted retained earnings as of December 31, 2017. The allocation was purportedly made for petitioner's planned transfer and expansion of its office and manufacturing plant to meet the projected increase in production capacity and address industry demand for its products.

Too, petitioner relied on the following testimony of its Assistant Corporate Secretary, Ms. Irene M. Dela Cruz:[104]

> 9a) Q. What was the purpose of the said resolution, if you know?
>
> A. The resolution approved the allocation of the Company of the amount of P10,000,000.00 from its unrestricted Retained Earnings for the office and manufacturing plant transfer and expansion.
>
> 9b) Q. What happened to this plan for the transfer and expansion of the office and manufacturing plant of The Merry Cooks, Inc.?
>
> A. It was implemented in 2019. We have transferred to our current office and manufacturing plant at No. 704 Aurora Boulevard, Barangay Valencia, Quezon City.

These pieces of evidence leave much to be desired.

In *The Manila Wine Merchants, Inc. v. The Commissioner of Internal Revenue (MWMI),*[105] the Supreme Court made by the following pronouncement:

> In order to determine whether profits are accumulated for the reasonable needs of the business as to avoid the surtax upon shareholders, the **controlling intention of the taxpayer is that which is manifested at the time of accumulation not subsequently declared intentions which are merely the product of afterthought**. A speculative and indefinite purpose will not suffice. The mere recognition of a future problem and the discussion of possible and

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103 Exhibit "P15-H," USB (Exhibit "P-15-a-1").

104 Exhibit "P-13," Docket, pp. 265 to 266.

105 G.R. No. L-26145, February 20, 1984.

> alternative solutions is not sufficient. **Definiteness of plan coupled with action taken towards its consummation are essential....**[106]

Following *MWSI*, there must be proof of petitioner's controlling intention ***at time of accumulation*** of profits, which is by the end of TY 2017. Here, however, petitioner's evidence reveals its controlling intent to transfer and expand its office and manufacturing plant only when the Board Resolution[107] was issued on April 26, 2018, which was ***after*** the accumulation of its profits; hence, this is simply a product of afterthought.

Not only that. Even if petitioner's supposed transfer and expansion of its office and manufacturing plant to meet the projected increase in production capacity and address industry demand for its products were to be weighed, *MWSI* enjoins that there must be proof of the action taken towards consummation thereof. No such proof was adduced by petitioner. Witness Dela Cruz seconded:

> Q: Ms. Witness, I will repeat the question. In your answer to question 9B[,] you said that the plan for the transfer and expansion of the office and manufacturing plant was implemented in 2019?
>
> A: Yes.
>
> Q: Correct?
>
> A: Correct.
>
> Q: But, Ms. Witness, you did not attac[h] any proof to corroborate the alleged fact of implementation, correct, in your judicial affidavit?
>
> A: **Yes.**[108]

These notations gravitate toward a sole conclusion—petitioner failed to satisfactorily prove by clear preponderance of evidence that the accumulation of earnings beyond its paid-up capital was for the reasonable needs of the business, as required by Section 29 of the NIRC, as amended, *Cyanamid*, and *MWMI*. *Ergo*, the BIR's IAET

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106 Boldfacing ours.
107 Exhibit "P15-H," USB (Exhibit "P-15-a-1").
108 Transcript of Stenographic Notes (Hearing held on April 4, 2024), pp. 10-11. Boldfacing ours.

assessment found against petitioner in the amount of ₱981,863.00 is upheld.

WHEREFORE, the present Petition for Review is **PARTIALLY GRANTED**. The assessments for deficiency income tax, VAT, and IAET issued against petitioner for taxable year 2017 are **UPHELD IN PART.** However, the deficiency EWT assessment issued against petitioner for the same taxable year, in the total amount of ₱363,968.25, inclusive of interest and surcharge, is **CANCELLED.**

Petitioner is hereby **ORDERED TO PAY** respondent the aggregate amount of **₱1,784,133.84**, inclusive of the 25% surcharge, deficiency interests imposed under Sections 248(A)(3), and 249(B) of the NIRC of 1997, as amended by RA No. 10963, also known as Tax Reform for Acceleration and Inclusion (TRAIN), as implemented by RR No. 21-2018, computed as follows:

	Income Tax	VAT	IAET	Total
Basic Tax	₱ 25,015.07	₱ 44,097.99	₱ 981,863.00	₱ 1,050,976.06
25% Surcharge	6,253.77	11,024.50	245,465.75	262,744.02
12% Deficiency Interest				
from Apr. 16, 2018 to Sept. 16, 2022 *(₱25,015.07 x 12% x 1,615/365 days)*	13,281.97			13,281.97
from Jan. 26, 2018 to Sept. 16, 2022 *(₱44,097.99 x 12% x 1,695/365 days)*		24,574.06		24,574.06
from Jan. 16, 2019 to Sept. 16, 2022 *(₱981,863.00 x 12% x 1,340/365 days)*			432,557.73	432,557.73
Total	**₱ 44,550.81**	**₱ 79,696.55**	**₱ 1,659,886.48**	**₱ 1,784,133.84**

In addition, petitioner is **ORDERED TO PAY** respondent delinquency interest at the rate of 12% per annum on the **₱1,784,133.84** total amount due as of September 16, 2022, or an amount equivalent to ₱586.56 per day,[109] from September 16, 2022 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended by RA No. 10963 and implemented by RR No. 21-2018.

Lastly, pursuant to Section 13 of RA No. 9282, considering that this decision is partly favorable to the national government, the BIR, through respondent, is hereby authorized to seize and distraint any

[109] ₱1,784,133.84 x 12%/365 days.

goods, chattels, or effects, and the personal property, including stocks and other securities, debts, credits, bank accounts, and interests in and rights to personal property and/or levy the real property of petitioner in sufficient quantity to satisfy the tax or charge with any increment thereto incident to delinquency, as found in this Decision.

SO ORDERED.

MARIAN IVY F. REYES-FAJARDO
Associate Justice

I CONCUR:

HENRY S. ANGELES
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.

MARIAN IVY F. REYES-FAJARDO
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.

MARIA ROWENA MODESTO-SAN PEDRO
Acting Presiding Justice