REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

PHILKO PEROXIDE CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8500

Members:

BAUTISTA, *Chairperson*
FABON-VICTORINO, *and*
RINGPIS-LIBAN, *JJ.*

Promulgated:

AUG 20 2015
1:28 p.m.

x- -x

DECISION

***Fabon-Victorino, J.*:**

This Petition for Review filed by Philko Peroxide Corporation seeks the cancellation and setting aside of Assessment Nos. IT-LA12660-08-0482 and WF-LA12660-08-11-0979 finding it liable for deficiency income tax (IT) and final withholding tax (FWT) for the year 2008 in the amounts of ₱500,236.30 and ₱1,682,718.69, respectively, with prayer for attorney's fees of ₱200,000.00 and cost of suit.

Petitioner Philko Peroxide Corporation is a registered taxpayer of the Bureau of Internal Revenue (BIR) Revenue District Office No. 50-South Makati, with Tax Identification No. (TIN) 002-835-718-000.[1]

Respondent Commissioner of Internal Revenue (CIR) is the head of the BIR, while Regional Director Nestor S. Valeroso represents Revenue Region No. 8 of Makati City,

[1] Par. A, Joint Stipulation of Facts/Admissions, Joint Stipulations of Facts and Issues (JSFI), docket, p. 256.

with address at 2/F Legal Division, BIR Bldg., 313 Sen. Gil Puyat Ave., Makati City.[2]

On April 2, 2009, petitioner filed its Annual Income Tax Return[3] (ITR) for taxable year 2008. Petitioner also filed its Monthly Remittance Return for Final Income Taxes Withheld[4] (FWT) and paid the tax due thereon on July 2, 2008.

On June 5, 2009, respondent issued a Letter of Authority[5] authorizing Revenue Officers Abelardo Camba and Almira Navarro to examine the books of account and other accounting records of petitioner for all internal revenue taxes for the period covering January 1, 2008 to December 31, 2008.

On November 8, 2011, respondent issued a Notice for Informal Conference[6] followed by a Preliminary Assessment Notice (PAN) on November 25, 2011.[7]

On December 19, 2011, petitioner filed its Letter Protest[8] to the PAN. On even date,[9] respondent issued a Formal Assessment Notice (FAN) with attached Details of Discrepancies,[10] to which petitioner filed a protest on January 27, 2012[11].

On May 9, 2012, respondent issued a Final Decision on Disputed Assessment[12] (FDDA), which petitioner received on May 11, 2012.[13] Hence, this Petition for Review filed on June 11, 2012.[14]

In her Answer,[15] respondent contends that petitioner failed to furnish proof assailing/overturning her finding that it overstated its gross income. Insofar as the deficiency FWT assessment is concerned, petitioner failed to secure prior approval for a tax treaty relief with the BIR International Tax

---

[2] Par. 2, Parties, Petition for Review, docket, p. 12; Par. 2, Answer, docket, p. 175.
[3] Exhibit "B", docket, p. 370.
[4] Exhibit "C", docket, p. 376.
[5] Exhibit "D", docket, p. 381.
[6] Exhibit "R-8", BIR Records, p. 698.
[7] Exhibit "E", docket, pp. 382-383.
[8] Exhibit "F", docket, pp. 386-390.
[9] Exhibits "G" and "G-1", docket, pp. 391-392.
[10] Exhibit "R-15", BIR Records, pp. 722-723.
[11] Exhibit "H", docket, pp. 396-401.
[12] BIR Records, pp. 862-863.
[13] Timeliness of the Appeal, Petition for Review, docket, p. 11.
[14] Petition for Review, docket, pp. 10-42.
[15] Docket, pp. 175-183.

Affairs Division (ITAD) at least fifteen (15) days before the transaction in violation of Revenue Memorandum Order (RMO) No. 1-2000. Moreover, petitioner failed to show that RMO No. 1-2000 is invalid and that the tax-sparing rule is applicable to its case. Finally, the defense of prescription should be raised at the earliest possible time and not for the first time on appeal.

During the trial, petitioner presented its Finance Manager Marietta Jardiolin[16] and its president Jose E. Reyes[17].

Marietta Jardiolin testified that as petitioner's Finance Manager since November 1994, she prepares its Financial Statements and directs the day to day activities of her department, including payment of taxes and duties on time.

Petitioner is into selling of diluted hydrogen peroxide and other industrial chemicals. It is a registered corporate taxpayer who pays its taxes to RDO No. 58, Revenue Region No. 8. For taxable year 2008, petitioner filed its ITR on April 2, 2009, and FWTR, on July 2, 2008.

Tax investigation was conducted against petitioner for the year 2008 by virtue of a Letter of Authority. On November 25, 2011, respondent issued a PAN followed by a FAN which petitioner received on December 19, 2011.

Respondent found petitioner liable for deficiency income tax arising from disallowed deductions of legal fees paid to a law firm. The said deductions for the year 2008 are valid since they were incurred - billed and paid also in the year 2008.

Respondent also found petitioner liable for deficiency FWT since it withheld only 10% from the dividends paid to a non-resident corporation pursuant to Article 10 of the tax treaty between the Republics of Korea and the Philippines. The BIR itself issued rulings in favor of petitioner upholding its entitlement to the 10% withholding tax rate under the treaty between the Republics of Korea and the Philippines.

---

[16] Minutes of the Hearing dated November 26, 2012, docket, p. 325; Minutes of the Hearing dated February 18, 2013, docket, p. 336.
[17] Minutes of the Hearing dated March 11, 2013, docket, p. 359.

Lastly, the assessment issued against petitioner is already barred by prescription since the assessment for deficiency taxes for the year 2008 was issued only in December of 2011, or beyond the 3-year prescriptive period mandated by law.

The witness however admitted that the subject cash dividend was declared by petitioner in 2008 while the ITAD Rulings pertaining to petitioner's entitlement to a 10% withholding rate pertain to petitioner's cash dividend declaration in 2010 and 2011.

Petitioner's President Jose E. Reyes partly corroborated the foregoing testimony adding that petitioner's defense of prescription was raised as early as the filing of petitioner's protest to the FAN which was issued beyond the 3-year prescriptive period. The same protest also questioned the validity of Revenue Memorandum Order (RMO) No. 1-2000 on the basis of which the respondent disallowed petitioner's preferential 10% rate of withholding for its declaration of dividends under the Philippine-Korea Tax Treaty. Under the said RMO, petitioner must first secure an ITAD ruling from respondent before it may avail of any tax treaty privileges which petitioner failed to do resulting in the disallowances.

Further, OCI Co. Ltd., formerly DC Chemical Co. Ltd is the non-resident foreign corporation who benefited in petitioner's declaration of dividends which was subjected to the disputed FWT.

Finally, petitioner was compelled to litigate and engage the services of counsel to protect its interest against the subject assessments and even had to post cash bond for the suspension of collection of the assessed taxes for which it is entitled to damages.

After Formal Offer of Evidence[18] on April 10, 2013, petitioner rested per Resolutions[19] dated May 28, 2013 and October 1, 2013[20].

[18] Docket, pp. 360-364.
[19] Docket, pp. 560-561.
[20] Docket, pp. 694-695.

For her part, respondent presented Revenue Officer **Josephine L. Paralejas** as her lone witness.[21]

She testified that she's been with the BIR since 1989 and has been assigned at BIR RDO 50-South Makati since January 2010 up to the present. She conducts tax verification and examination of the books of accounts of taxpayers to determine if they incur any tax liabilities. If so, she prepares a report of her findings and recommendations.

She audited petitioner's books of accounts for the year 2008. She found petitioner liable for deficiency income tax due to the disallowance of expense for failure to withhold, and the disallowance of professional fess as deduction paid in 2008 but incurred in 2007.

Petitioner was also found liable for deficiency Expanded Withholding Tax (EWT) based on its failure to withhold on its income payment expense. Deficiency FWT was likewise assessed due to petitioner's failure to withhold the correct 35% rate of WT on its dividend payments to DC Chemical Company Ltd., a non-resident foreign corporation. Petitioner used the incorrect lower rate of 10% for FWT under the Philippines-Korea Tax Treaty since it failed to apply for tax treaty relief with the International Tax Affairs Division of the BIR as required under RMO No. 1-2000.

With the foregoing observation, a Notice for Informal Conference was issued to petitioner. The latter however failed to submit any written explanation or supporting documents to counter the findings. Thereafter, she issued a Memorandum Report on petitioner's tax liabilities.

Respondent closed presentation of evidence per Resolution[22] dated June 16, 2014.

The case was submitted for decision on August 22, 2014.[23]

---

[21] Minutes of the February 10, 2014 Hearing, docket, p. 707; Exhibit "R-17", docket, pp. 715-720.
[22] Docket, pp. 731-732.
[23] Docket, p. 759.

STATEMENT OF ISSUES

The issues are summarized as follows:

1. Whether respondent's right to asses petitioner FWT has prescribed;

2. Whether petitioner is legally entitled to the preferential withholding tax rate of 10% under the RP-Korea Tax Treaty for dividends paid to a non-resident corporation; and

3. Whether the disputed assessment for deficiency income tax is valid.

DISCUSSION/RULING

First, let us determine the timeliness of the issuance of the assessment for FWT by respondent. Under Section 203 of the National Internal Revenue Code of 1997 (NIRC), as amended, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return or the actual date of filing of such return, whichever comes later. The same provision states that a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. Hence, an assessment notice issued after the three-year prescriptive period is no longer valid and effective. Exceptions however are provided under Section 222 of the NIRC.[24] Corollary to the foregoing is Revenue Regulations (RR) No. 06-01, which states that a taxpayer has fifteen (15) days after the end of the month, within which to file its FWT Return.

Record shows that petitioner filed its Monthly Remittance Return of Final Income Taxes Withheld[25] for the month of June through the BIR's Electronic Filing and Payment System (EFPS) on July 2, 2008. Applying Section 203 of the NIRC of 1997, as amended, in relation to RR No. 06-01, the reckoning date for the three-year period of

---

[24] Commissioner of Internal Revenue vs. Kudos Metal Corporation, G.R. No. 178087, May 05, 2010
[25] Exhibit "C", docket, pp. 376-377.

limitation is on July 15, 2008. Thus, respondent had until July 15, 2011, within which to issue assessment against petitioner for FWT.

Evidently, respondent's issuance of FAN on December 19, 2011,[26] was way beyond the 3-year prescriptive period. Clearly, respondent's right to assess petitioner for FWT had already prescribed. While there are exceptions to the 3-year prescriptive period, none of the exceptions under Section 222 of the Tax Code are attendant in the case at bar.

With the foregoing ruling, the second issue on whether petitioner is legally entitled to the preferential withholding tax rate of 10% under the RP-Korea Tax Treaty for petitioner's declaration of dividends paid to a non-resident corporation is unwarranted.

As to the validity of the assessments for deficiency income tax, respondent, in the Details of Discrepancies[27], found that:

> "**Expense Incurred in Prior Year, P875,000.00** - Verification disclosed that portion of your Professional Fees claimed as deduction from gross income pertained to prior year expenses which must not be charged to current operating expense, hence, disallowed pursuant to Section 34(A)(a) of the tax code, as amended."

Petitioner contends that the subject expense was paid and incurred for taxable year 2008, hence a valid deduction for the same year. The official receipt[28] issued by Castillo Laman Tan Pantaleon & San Jose Law Office (Law Office) shows that it was only on June 17, 2008 that petitioner determined with "reasonable accuracy" whether or not it incurred liability or expense.

Section 34(A)(1)(a) of the NIRC of 1997, as amended, provides:

> "SEC. 34. *Deductions from Gross Income.* - Except for taxpayers earning compensation

---

[26] Exhibit "G", docket, pp. 391-392.
[27] Exhibit "R-15", BIR Records, pp. 722-723.
[28] Exhibit "J", docket, p. 404.

> income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), there shall be allowed the following deductions from gross income:
>
> (A) *Expenses.* -
>
> (1) *Ordinary and Necessary Trade, Business or Professional Expenses.* -
>
> (a) *In General.* - There shall be allowed as deduction from gross income all the ordinary and necessary expenses **paid or incurred during the taxable year** in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession, including:"*(Emphasis supplied)*

Based on the afore-quoted provision, the requisites for the deductibility of ordinary and necessary trade or business expense are as follows:

1. that the expenses are ordinary and necessary;
2. that they must be paid or incurred within the taxable year;
3. that they must be paid or incurred in carrying on a trade or business; and
4. that they are supported by pertinent records or documents.[29]

Undeniably, petitioner incurred an expense in relation to its trade or business, i.e. the engagement of legal services for its claim for tax refund, duly supported by an official receipt. However, to claim the said expense as deduction for the year 2008, it must likewise be incurred or accrued during the same year.

[29] Esso Standard Eastern, Inc. (formerly Standard-Vacuum Oil Company) vs. The Commissioner of Internal Revenue, G.R. Nos. L-28508-9, July 7, 1989.

In this regard, the Supreme Court explained how and when to report income and deductions, in this wise:

> "The requisite that it must have been paid or incurred during the taxable year is further qualified by Section 45 of the National Internal Revenue Code (NIRC) which states that: '[t]he deduction provided for in this Title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed xxx'.
>
> Accounting methods for tax purposes comprise a set of rules for determining when and how to report income and deductions. In the instant case, the accounting method used by ICC is the accrual method.
>
> Revenue Audit Memorandum Order No. 1-2000, provides that under the accrual method of accounting, expenses not being claimed as deductions by a taxpayer in the current year when they are incurred cannot be claimed as deduction from income for the succeeding year. Thus, a taxpayer who is authorized to deduct certain expenses and other allowable deductions for the current year but failed to do so cannot deduct the same for the next year.
>
> The accrual method relies upon the taxpayer's right to receive amounts or its obligation to pay them, in opposition to actual receipt or payment, which characterizes the cash method of accounting. **Amounts of income accrue where the right to receive them become fixed, where there is created an enforceable liability. Similarly, liabilities are accrued when fixed and determinable in amount, without regard to indeterminacy merely of time of payment**.
>
> For a taxpayer using the accrual method, the determinative question is, when do the facts present themselves in such a manner that the

taxpayer must recognize income or expense? The accrual of income and expense is permitted when the all-events test has been met. This test requires: (1) fixing of a right to income or liability to pay; and (2) the availability of the reasonable accurate determination of such income or liability.

The all-events test requires the right to income or liability be fixed, and the amount of such income or liability be determined with reasonable accuracy. However, the test does not demand that the amount of income or liability be known absolutely, only that a taxpayer has at his disposal the information necessary to compute the amount with reasonable accuracy. The all-events test is satisfied where computation remains uncertain, if its basis is unchangeable; the test is satisfied where a computation may be unknown, but is not as much as unknowable, within the taxable year. The amount of liability does not have to be determined exactly; it must be determined with 'reasonable accuracy.' Accordingly, the term 'reasonable accuracy' implies something less than an exact or completely accurate amount.

The propriety of an accrual must be judged by the facts that a taxpayer knew, or could reasonably be expected to have known, at the closing of its books for the taxable year. Accrual method of accounting presents largely a question of fact; such that the taxpayer bears the burden of proof of establishing the accrual of an item of income or deduction."[30] (emphasis ours)

In the cited case, the Supreme Court likewise explained that the *all events test* requires that the right to income or liability should be fixed, and the amount thereof should be determinable with reasonable accuracy. On this score, a reading of petitioner's engagement letter[31] with the Law Office shows that the payment of the latter's legal fees is on a contingent basis. It states:

---

[30] Commissioner of Internal Revenue vs. Isabela Cultural Corporation, G.R. No. 172231, February 12, 2007.
[31] Exhibit "I", docket, pp. 402-403.

> "2. our legal fees shall be 25% of the amount of TCCs secured which shall be contingent on your actual receipt of the TCCs, payable upon our presentation of photocopies of the signed TCCs."

The email correspondence[32] of petitioner and the Law Office shows that on June 16, 2008 and June 17, 2008, they agreed that petitioner shall pay ₱875,000.00 as advance payment or as part of the agreed professional fees.

In this regard, petitioner paid the deposit for legal fees despite the pendency[33] of its tax refund case. Thus, while the payment of the legal fees is on a contingency basis, *i.e.*, its payment depends upon the outcome of the case, petitioner nevertheless already paid the same.

As such, considering that the payment of the legal fees is on a contingency basis as per agreement of petitioner and the Law Office, petitioner's liability or expense cannot be deemed to have been fixed as the amount of liability cannot be determined with reasonable accuracy.

In fact, the legal fees may vary depending on the outcome of the case. The possibility that petitioner may not even be obliged to pay the legal fees in the event of adverse ruling is also not remote.

On the basis of the cited jurisprudence wherein liabilities are accrued when fixed and determinable in amount, without regard to indeterminacy merely of time of payment, and considering that the amount of liability cannot be determined with reasonable accuracy for the year 2008, respondent was correct in disallowing said item as expense deduction for said year. Hence, the deficiency income tax assessment arising from the disallowance is deemed accurate and valid.

Finally, with respect to petitioner's prayer for attorney's fees, it has been held that an award of attorney's fees is an exception and there must be some compelling legal reason to bring the case within the exception and justify the

---

[32] Exhibit "L", docket, p. 428.
[33] Exhibits "K" to "K-10", docket, pp. 405-416.

award.[34] Even when a claimant is compelled to litigate with third persons or to incur expenses to protect his rights, still attorney's fees may not be awarded where no sufficient showing of bad faith could be reflected in a party's persistence in a case other than an erroneous conviction of the righteousness of his cause.[35]

In the present case, petitioner did not present any compelling legal reason to justify the award of attorney's fees. In issuing the subject assessment, the respondent is merely exercising the authority accorded her under the Tax Code to collect taxes, and in so doing, fulfilling her mandated duty as required under the law. For after all, the primary duty of the BIR is to collect taxes, since taxes are the lifeblood of the Government and their prompt and certain availability are imperious needs.[36] In fine, the prayer for attorney's fees is without any legal mooring.

In sum, the Court finds that petitioner is not liable to pay deficiency FWT considering that the right of respondent to assess had already prescribed. However, petitioner is liable to pay deficiency income tax for deducting its deposit for legal fees as an expense, when the same should not have been deducted for taxable year 2008.

WHEREFORE, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Respondent's assessment as to deficiency final withholding tax for taxable year 2008 in the amount of ₱1,682,718.69 under Assessment No. WF-LA12660-08-11-0979 is hereby **CANCELLED** and **SET ASIDE**.

On the other hand, respondent's deficiency income tax assessment for taxable year 2008 under Assessment No. IT-LA12660-08-12-0482 is hereby **AFFIRMED**. Accordingly, petitioner is **ORDERED TO PAY** the amount of ₱382,812.50, representing basic deficiency income tax and twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Taxable Income per ITR		₱43,690,079.00
Add: Adjustment/Disallowance		

[34] G.R. No. 183811, May 30, 2011.
[35] Philippine National Construction Corporation vs. Apac Marketing Corporation, Represented By Cesar M. Ong, Jr., G. R. No. 190957, June 05, 2013
[36] PNOC vs. CA, G.R. NO. 109976, April 26, 2005

Professional Fee		875,000.00
Adjusted Taxable Income		₱44,565,079.00
Income Tax Due		₱15,597,777.65
Less: Tax Paid/Credit		
Tax Paid	₱10,961,398.65	
Creditable Withholding Tax	4,330,129.00	15,291,527.65
Basic Deficiency Income Tax		₱ 306,250.00
Add: 25% Surcharge		76,562.50
Total		**₱ 382,812.50**

Petitioner is likewise **ORDERED TO PAY** (a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of ₱306,250.00 computed from April 15, 2009 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and (b) delinquency interest at the rate of 20% per annum on the total amount of ₱382,812.50 and on the 20% deficiency interest which have accrued as afore-stated in (a) computed from June 11, 2012 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

LOVELL R. BAUTISTA
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
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.

LOVELL R. BAUTISTA
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13 of Article VIII of the Constitution, and the Division's 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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice