**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

**ABBOTT LABORATORIES, INC.,**
Petitioner,

- versus -

C.T.A. CASE NO. 5718

**COMMISSIONER OF INTERNAL REVENUE,**
Respondent.

Promulgated:

FEB 16 2001

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# DECISION

Before Us for consideration is a Petition for Review filed by the Petitioner on January 18, 1999, seeking the annulment of Income Tax Assessment Notice issued by the Respondent demanding from the Petitioner the payment of deficiency income tax in the amount of P19,901,770.75 for taxable year 1994.

The facts of the case giving rise to the controversy at bar are as follows:

Petitioner is a domestic corporation organized and existing under and by virtue of the laws of the Philippines.

Records reveal that Petitioner filed its Corporate Annual Income Tax Return on March 15, 1995 for the fiscal year 1994 reflecting an income tax due in the amount of P139,113,783.00 computed as follows:

| | |
|---|---|
| Gross Income | P721,394,618.00 |
| Less: Deductions | 323,936,666.00 |
| Net Income | P397,467,952.00 |
| Less: Deduction under Special Laws | - 0 - |
| Taxable Income | P397,467,952.00 |
| Multiply by Income Tax Rate | 35% |
| Income Tax Due | P139,113,783.00 |

On March 23, 1998, Petitioner received from Respondent an Assessment Notice demanding payment for alleged deficiency income tax liabilities for 1994 in the amount of P19,901,770.75.

On April 22, 1998, Petitioner filed its protest with the Bureau of Internal Revenue contesting the said assessment on the following grounds:

a) The Income Tax Assessment Notice does not comply with the requirements of Section 228 of the Tax Code that "the taxpayer shall be informed in writing of the law and the facts on which the assessment is made;

b) Petitioner is a domestic corporation and not a permanent establishment of Abbott USA. Hence royalty payments made by Petitioner to Abbott USA are deductible for Philippine income tax purposes; and

c) The Tax Code and the various BIR Regulations do not require taxes to be withheld and remitted at the time salaries, wages or other compensation are accrued. Hence, Respondent erred in disallowing the compensation expense for Petitioner's "supposed failure" to withhold and remit the taxes at such time.

After several attempts to clarify the matter with the Respondent Bureau, the protest allegedly remained unresolved, thus prompting the Petitioner to elevate its grievance to this Court via Petition for Review to forestall the finality of the disputed assessment.

In his Answer filed on February 23, 1999, Respondent prayed for this Court's affirmation of the assessment and the dismissal of the instant Petition for Review. Moreover, Respondent advanced the following Special and Affirmative Defenses, to wit:

"8. That the details stated in the assessment notice, Annex "C" substantially complied with the provisions of Section 228 of the Tax Code of 1997 relative to the taxpayer being informed in writing of the law and the facts in which the assessment is based;

9. That the disallowances of the amount of P12,177,617.70 as royalty payments is in accordance with the RP-US Tax Treaty and the further amount of P23,749,992.00 as accrued salaries, wages and

commission is in accordance with Revenue Regulations No. 6-85 and Section 29 (V) now Section 34(A) of the Tax Code the law and regulations applicable to the said amount disallowed;

10. That in view of paragraph 6 of this answer the right of the Petitioner to institute the instant petition for review either had lapsed or filed prematurely, hence this Honorable Court has no jurisdiction over this petition for review.

In its Memorandum filed on May 5, 2000, Petitioner reiterates its stance a quo, arguing that the assessment notice is null and void for not stating the facts and the law on which the assessment is based. And assuming arguendo that the assessment notice is not fatally defective in its form, Petitioner asserts that there is no merit in the subject assessment since the royalty payments disallowed by the Respondent are allowable deductions as business expense pursuant to Article 8 of the RP-US Tax Treaty. Likewise, Petitioner asserts that Respondent erred in disallowing Petitioner's accrued salaries, wages and commissions for purposes of computing its taxable income since the disallowance was based on Revenue Regulations No. 6-85. Petitioner argues that since the accruals are for compensation income payments, the same are not covered by Revenue Regulations No. 6-85.

In a resolution promulgated July 7, 2000, this case was considered submitted for decision sans the memorandum of the Respondent.

The issues to be resolved in this case based on the Joint Stipulation of Facts and Issues filed by the contending parties are as follows:

a) Whether or not, in issuing the Assessment Notice against Petitioner, Respondent violated the requirements of Section 228 of the National Internal Revenue Code (Tax Code) that the taxpayer must be informed in writing of the facts and the law upon which the assessment is made, otherwise, the assessment is void;

b) Whether or not Respondent erred in disallowing Petitioner's royalty payments to Abbott USA in the amount of P12,177,617.70 for purposes of computing Petitioner's taxable income; and

c) Whether or not Respondent erred in disallowing Petitioner's accrued salaries, wages and commissions in the amount P23,749,992.00 for purposes of computing Petitioner's taxable income.

We rule in favor of the Petitioner.

At the outset, it must be stressed that the resolution of the first issue concerns the Respondent's duty to inform the taxpayer of the basis of the assessment. It must be borne in mind that taxes are burdens, hence, if the State expects its taxpayers to observe fairness and honesty in paying their taxes, so must it apply the same standard against itself.

Section 228 of the 1997 Tax Code in part provides thus:

> "The taxpayers shall be informed in writing of the laws and the facts on which the assessment is made; otherwise, the assessment shall be void."

Clearly, Section 228 of the National Internal Revenue Code requires the Respondent to inform the taxpayer in writing of the law and the facts on which the assessment is made; otherwise the assessment shall be void. As thus worded, the Respondent has the bounden duty to inform the taxpayer not only of the law but more importantly, the surrounding circumstances supporting the assessment, for it is only through a detailed apprisal of its basis that the taxpayer may be able to dispute the imposition or agree with it. While we concede that taxation is inevitable and indispensable, taxes being the lifeblood of the government, it is a requirement that it be exercised reasonably and in accordance with the prescribed procedure. Otherwise, for all the awesome power of the Bureau, it may still be corrected if the law has not been observed.

In his Answer, Respondent insists that the details in the assessment notice substantially complied with the provisions of Section 228 of the 1997 Tax Code in so far as informing the taxpayer of the law and the facts upon which the assessment is made.

While the sufficiency of the assessment notice insofar as compliance with Section 228 may be the subject of a debate, one thing stands out, and that is the fact that Respondent's counsel miserably failed to support the conclusion of the Commissioner and that of her revenue examiner embodied in the assessment notice, in this Court. If Respondent had only exerted diligent efforts to apprise this Court as to how the deficiency assessment came about by means of testimonial or documentary evidence, then we could have liberally applied the provisions of Section 228 in favor of Respondent. However, Respondent was not only remiss in defending his case, his lack of interest and concern was evident in his failure to submit a Formal Offer of Evidence and Memorandum. During the hearings held in this Court, the witnesses for Respondent all failed to attend. They did not even bother to respond to the Subpoena *Ad Testificandum* and Subpoena *Duces Tecum* issued by this Court. Lastly and most importantly, the Respondent did not even submit the BIR records to support the assessment issued to Petitioner. Even the revenue examiner who prepared the assessment failed to attend the scheduled hearing where he was to be presented as a hostile witness of Petitioner. Furthermore in the hearing held on February 24, 2000, Respondent's counsel even informed the Court of the recommendation by the Chief Appellate Division and by the Legal Service of the BIR for the cancellation of this assessment.

This Court is well-aware of the presumption of the correctness and validity of an assessment but this presumption holds true only if such assessment is based on actual facts. The presumption of the correctness of an assessment being a mere presumption cannot be made to rest on another presumption (*Commissioner of Internal Revenue vs. Island Garment Manufacturing Corporation 153 SCRA 665*). In studying this case, the Court had no facts to rely upon, hence we had no basis upon which to refer to in studying this case same that of vague reference to royalties not allowable under Articles of the RP-US Tax Treaty. In the case of *Benipayo vs. Collector, 4 SCRA 182*, the Supreme Court ruled that for an assessment to stand the test of judicial scrutiny, it must be based on actual facts and not on mere presumptions. Unfortunately, the records of the instant case clearly show that the assessment did not pass this test as the Respondent apparently expected this Court to conduct its own investigation in his behalf.

Anent the issue of royalty payments disallowed by the Respondent, it is necessary to prove that Petitioner is a permanent establishment of Abbott USA to which the royalty payments were made. For the proper disposition of this issue, the pertinent provisions of the RP-US Tax Treaty are hereby reproduced, thus:

> "In the determination of the business profits of a permanent establishment, there shall be allowed as deductions ordinary and necessary expenses which are reasonable allocable to such profits, including executive and general administrative expenses whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere. However, no such deductions shall be allowed in respect of amounts paid or payable (other than reimbursement of actual expenses) by the permanent establishment to the head office of the resident of which it is a permanent establishment or any of its other offices, by way of –
>
> a) royalties, fees or other similar payments in return for the use of patents or other rights; x x x." (Emphasis supplied)

As correctly pointed out by the Petitioner, permanent establishment is defined under the RP-US Tax Treaty as a "fixed place of business through which a resident of one of the Contracting State engages in a trade or business". Under Article 5, paragraph 2 of the same treaty, the term "fixed place of business" includes, but is not limited to:

a. A set of management;
b. A branch;
c. An office;
d. A store or other sales outlet;
e. A factory;
f. A workshop;
g. A warehouse;
h. A mine, quarry, or other places of extraction of natural resources;
i. A building site or construction or assembly project or supervisory activities in connection therewith, provided such site, project or activity continues for a period of more than 183 days; and
j. The furnishing of services, including consultancy services, by a resident of one of the Contracting States through employees or other personnel, provided activities of that nature continue (for the same or connected project) with the other Contracting State for a period or periods aggregating more than 183 days.

Paragraph 8 of Article 5 of the RP-US Tax Treaty provides:

"The fact that a corporation of one of the Contracting States controls or is controlled by or is under common control with:

a) A corporation of the other Contracting State; or

b) A corporation which carries on business in the other Contracting State (whether through a permanent establishment or otherwise),

shall not be taken into account in determining whether the activities of a fixed place of business of either corporation constitutes a permanent establishment of the other corporation.

A thorough scrutiny of the records of this case readily reveals that the Petitioner is not a permanent establishment of Abbott USA, the same having been clarified by the

Respondent in his own BIR Ruling No. 023-95 where the Respondent declared that a mere subsidiary corporation in the Philippines controlled by a foreign corporation does not constitute a permanent establishment of the foreign corporation within the Philippines.

Thus, the Petitioner having been incorporated under and by virtue of the laws of the Philippines, it is indeed a subsidiary which has a personality separate and distinct from Abbott USA. Prescinding from this, the Respondent erred in disallowing the royalty payments in the computation of Petitioner's taxable income.

Proceeding now to the issue of disallowance made by the Respondent as regards Petitioner's accrued salaries, wages and commissions for purposes of computing Petitioner's taxable income, it may be assumed that the disallowance was by virtue of Revenue Regulations No. 6-85. In this respect, this Court likewise, agree with the Petitioner that the Respondent must justify the disallowance by presenting evidence to the effect that certain provisions of the said revenue regulations have been violated. Unfortunately, Respondent failed to do the same not to mention its manifest error in relying on Revenue Regulations 6-85 which governs the withholding of creditable income taxes from certain payments enumerated therein. Apparently, the Respondent disallowed the aforementioned deductions because the Petitioner did not withhold and remit any tax upon the accrual of the salaries, wages and commissions. However, these salaries, wages and commissions are all compensation and therefore governed by Revenue Regulations No. 6-82 as amended by Revenue Regulations No. 12-86 which pertains to the Withholding Tax on Compensation Income of Employed Resident Citizens and Aliens, Non-resident Citizens and Non-resident Aliens engaged in trade or business in the Philippines, the pertinent portion of which reads:

> "x x x these Regulations are hereby promulgated prescribing the **collection at source of income tax on compensation income paid** x x x." (Emphasis supplied).
>
> Section 7 of Rev. Reg. 6-82 (as amended by Rev. Reg. 12-86) provides that:
>
> "1. Withholding of tax on compensation paid to resident employees. (a) In general, an employer **making payment** of compensation shall deduct and withhold from such compensation a tax determined in accordance with the prescribed x x x
>
> B. Computation of Withholding Tax
>
> 1. In general. – The employer shall determine the tax to be deducted and withheld in accordance with the following:
>
> x x x
>
> (b) Determine the total monetary and non-monetary (cash value) compensation **paid** to an employee. x x x " (Emphasis supplied).

To the dismay of this Court, the Respondent failed, in this respect, to substantiate its allegations involving the disallowance of accrued salaries, wages and commissions. As earlier adverted to, the Respondent never bothered, during the entire proceedings of this case, to present evidence, documentary or otherwise, that would support the assessment thereby constraining Us to conclude without any cloud of doubt that the assessment notice has no leg to stand on. Accordingly, the assessment must fail.

Parallel to this, the counsel for Respondent, in the hearing dated February 4, 2000 has manifested in open court that there was already a recommendation for cancellation of the subject Assessment Notice in the administrative level.

**WHEREFORE**, in view of all the foregoing, the questioned Assessment issued against Petitioner for alleged deficiency income tax is deemed **CANCELLED** and **WITHDRAWN**. Respondent is hereby **ORDERED** to **DESIST** from collecting the assessed income tax deficiency of Petitioner for taxable year 1994.

**SO ORDERED.**

**ERNESTO D. ACOSTA**
Presiding Judge

**WE CONCUR:**

**RAMON O. DE VEYRA**
Associate Judge

**AMANCIO Q. SAGA**
Associate Judge

## CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

**ERNESTO D. ACOSTA**
Presiding Judge