REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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AB COMMUNICATIONS, INC. Petitioner,	**C.T.A. CASE NO. 6820**
	Members:
- versus -	**ACOSTA,** *Chairperson* **BAUTISTA,** and **CASANOVA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** MAR 25 2009 ; 2:30 p.m.

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DECISION

CASANOVA, ***J.*:**

This case is an appeal for the cancellation and withdrawal of the assessments issued by respondent holding petitioner liable for alleged deficiency income tax, value-added tax and expanded withholding tax in the amount of P59,348,484.78 (inclusive of increments and penalties) for the taxable year 1999.

THE FACTS

As stipulated by both parties, the facts of the case are as follows:

Petitioner is a domestic corporation, duly organized and existing under Philippine laws with principal place of business at the 20/F, Pacific Star Building, Makati City. Petitioner is registered with the Bureau of Internal Revenue with Tax Identification Number (TIN) 500-002-458-812.[1]

Respondent is the Commissioner of the Bureau of Internal Revenue, who was duly appointed and empowered to perform the duties of his office, including, among others, the power to decide, cancel, and abate tax liabilities pursuant to Section 204 (B) of the Tax Code, as amended by Republic Act ("R.A.") 8424, otherwise known as the "Tax Reform Act" ("Tax Code") of 1997.[2]

On January 30, 2003, petitioner received from respondent Formal Assessment Notices (FANs) with nos. IT-15771-99-03-177, VT-15771-99-03-177, WE-15771-99-03-177, and MC-15771-99-03-177, with corresponding demand letters, all dated January 24, 2003.[3]

The FANs covered the alleged deficiency income, value-added tax (VAT) and expanded withholding taxes (EWT) for taxable year 1999, in the amount of P59,348,484.78, inclusive of increments, broken down as follows:[4]

Nature of Deficiency Tax	Amount
Income Tax	P 4,537,197.15
Value-Added Tax	54,504,540.02
Expanded Withholding Tax	281,747.61
Compromise Penalty	25,000.00
Total	**P 59,348,484.78**

Based on the Details of Discrepancies, the detailed computation of the deficiency assessments are as follows:[5]

[1] Paragraph 1 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; docket, p. 138.
[2] Paragraph 2 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*, pp. 138-139.
[3] Paragraph 3 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*, p. 139.
[4] Paragraph 4 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[5] Paragraph 5 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*, pp. 139-140.

I. Deficiency Income Tax:

Net Income per Return		P 9,911,585.00
Add: Discrepancies per Audit		
Over claimed Salaries & Wages per F/S	P 2,983,589.06	
Rental	1,572,780.00	
Management & Consultancy	176,649.50	
Research & Monitoring	1,561,132.00	
Foreign Exchange Loss	833,665.00	
Bad Debts	675,518.00	
Miscellaneous	781,470.00	8,584,803.56
Net Taxable Income		P18,496,388.56
Tax Due		P 6,103,808.23
Less: Payments Made		3,216,812.68
Basic Income Tax Due		P 2,886,995.55
Add: Interest 04-16-00 to 02-24-03		1,650,201.60
Total Amount Due		**P 4,537,197.15**

II. Deficiency Value-Added Tax:

Taxable Sales/Receipts per audit	P 370,699,977.78
VAT due (P370,699,977.78/11)	P 33,699,997.78
Less: Creditable Input tax/payments	7,950,226.95
Deficiency VAT	P 25,749,770.83
Add: Surcharge (50%)	12,874,885.52
Interest 01-26-00 to 02-24-03	15,879,883.67
TOTAL AMOUNT DUE	**P 54,504,540.02**

III. Deficiency Expanded Withholding Tax:

	Figure Per F/S	Figure Per Alpha list	Subjected To EWT	Rate	EWT Due
Rental	P6,349,806.00	P4,777,025.94	P1,572,780.66	5%	P 78,639.03
Professional and Consultancy	-	333,530.00	-		-
Management Fees	3,440,590.86	3,263,941.36	176,649.50	10%	17,664.95
Contractor's Fees	221,618,644.00	221,618,644.00	-	-	-
	1,642,918.20	1,642,918.20	-	-	-
	69,000.00	69,000.00	-	-	-
Talent Fees	1,185,253.20	1,185,253.20	-	-	-
Research & Monitoring	1,561,132.00	-	1,561,132.00	5%	78,056.60
Dividend	3,000,000.00	3,000,000.00	-	-	-
					P174,360.58
Add :Interest 01-26-00 to 02-24-03					107,387.03
Total Amount Due					**P281,747.61**

On February 28, 2003, petitioner, through its tax counsels, filed with the respondent its Protest Letter dated February 27, 2003 against the abovementioned FANs pursuant to Section 228 of the Tax Code of 1997, as amended. The said Protest Letter specified the factual and legal bases for the protest against the alleged deficiency income, VAT and EWT for taxable year 1999.[6]

Petitioner, within the reglementary period prescribed by law, filed its supplemental protest attaching thereto complete supporting documents on April 28, 2003.[7]

In both the Protest Letter and the Supplemental Protest, petitioner requested for the cancellation and withdrawal of the deficiency tax assessments.[8]

To date, respondent has not yet finally acted on the aforesaid petitioner's protest and supplemental protest.[9]

In view of respondent's inaction on petitioner's Protest and Supplemental Protest, petitioner instituted the instant Petition pursuant to R.A. 1125, otherwise known as "An Act Creating the Court of Tax Appeals" and Section 228 of the Tax Code.[10]

This Court has the exclusive appellate jurisdiction to review the instant Petition for Review, based on Section 7 of R.A. 1125.[11]

In issuing the deficiency tax assessment, compliance with the substantive rules laid down in Section 228 of the Tax Code is mandatory.[12]

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[6] Paragraph 6 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*, pp. 140-141.
[7] Paragraph 7 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*. p. 141.
[8] Paragraph 8 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[9] Paragraph 9 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[10] Paragraph 10 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[11] Paragraph 11 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[12] Paragraph 12 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*, p. 142.

Under Section 228 of the Tax Code, two (2) conditions must be met in issuing a tax deficiency assessment: (1) the deficiency tax assessment must be made in writing; and (2) must state the law and the facts on which the assessment is made. Both conditions must concur, otherwise, the assessment is considered void.[13]

Respondent's findings for alleged deficiency income tax arose from the disallowance as deductions of several items of ordinary and business expense of the petitioner, for the alleged failure of petitioner to subject them to proper withholding tax.[14]

Respondent's finding of over-claimed salaries and wages apparently arose from the discrepancy, which resulted from the comparison of petitioner's Financial Statement (FS) and the Alpha List amounting to ₱2,983,589.06, that was allegedly not properly subjected to corresponding withholding taxes.[15]

PETITIONER'S ARGUMENTS

In its Petition for Review, petitioner raised the following arguments:

I. The Assessments are void for failure to comply with Section 228 of the Tax Code, as amended, and Revenue Regulations 12-99.

II. The deficiency tax assessments are erroneous, and devoid of any legal or factual bases.

RESPONDENT'S ARGUMENTS

In his Answer filed on January 29, 2004, respondent raised the following Special and Affirmative Defenses:

[13] Paragraph 13 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[14] Paragraph 14 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*
[15] Paragraph 15 of the Statement of Facts Admitted in the Joint Stipulation of Facts and Issues; *id.*

"5. It was disclosed that based on the reconciliation of the Financial Statement account with the Alpha List resulted to an over-claimed amount per financial statement and the same was not subjected to the proper withholding tax rates in violation of Section 34(K) of the 1997 Tax Code which provides that '... any amount paid or payable which is otherwise deductible from or taken into account in computing gross income... shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue'.

6. It was also discovered that certain income payments such as rent, management consultancy fees and research monitoring in the amounts of Php1,572,780.00, Php176,649.50 and Php1,561,132.00 respectively, were not properly subjected to expanded withholding tax, again in violation of Section 34(K), thus should be disallowed as a deduction from gross income.

7. Since petitioner failed to withhold expanded withholding tax on rental payments, management consultancy fees and research and monitoring fees, which is a clear violation of Section 2.57 of Revenue Regulations 2-98 in relation to Section 34(K) of the 1997 Tax Code, petitioner was assessed of deficiency expanded withholding tax as well as interest and penalties accrued thereon.

8. It was unveiled that expenses claimed as deductions from gross income such as bad debts, foreign exchange loss, and miscellaneous expense were not supported and substantiated during the audit and thus disallowed as deduction from gross income pursuant to Section 34(A)(1)(b) xxx.

9. The creditable tax withheld at source in the amount of Php54,010.32 was disallowed because it was discovered that this pertains to creditable taxes withheld for the taxable year 1998 while the tax year subject of the assessment is taxable year 1999. This is a clear violation of Section 57(B) of the 1997 Tax Code xxx.

10. It was also revealed that taxable gross receipts in the amount of Php370,699,977.78 were not subjected to VAT as required in Section 108(A) of the 1997 Tax Code xxx.

11. The investigation of the petitioner's internal revenue tax liabilities for the year 1999 revealed a tax obligation of Php59,348,484.78 representing deficiency income, value-added tax (VAT) and expanded withholding tax (EWT), inclusive of interests and surcharges.

12. That the deficiency tax assessments were issued in accordance with law and pertinent regulations and complied with the provisions of Section 228 of the National Internal Revenue Code relative to the taxpayer being informed in writing of the facts and law in which the assessment is based and the same is contained in the 'Details of Discrepancies' dated January 24, 2003. Notices received by the taxpayer detailing the assessments and various demand letters (such as preliminary assessments and various demand letters) can meet the purpose of appraising the taxpayer of the factual and legal bases of the assessments (*Philacor Credit Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5674, August 14, 2003).*

13. All presumptions are in favor of the correctness of tax assessments and the burden of proof to prove otherwise is upon the petitioner."[16]

ISSUES

The parties presented the following issues for this Court's resolution:

1. Whether Formal Assessment Notice Nos. IT-15771-99-03-177, VT-15771-99-03-177, WE-15771-99-03-177 and MC-15771-99-03-177 all dated January 14, 2003 and issued by respondent against petitioner for alleged deficiency Income, VAT and EWT are valid;

2. Whether petitioner is liable for the alleged deficiency Income, VAT and EWT for taxable year 1999, in the aggregate amount of P59,348,484.78, inclusive of interests and surcharges;

3. Whether or not petitioner is liable for the alleged deficiency income tax in the amount of P4,537,197.15;

   (a) Whether petitioner has over-claimed salaries and wages as deduction to gross income in the amount of P2,983,589.06;

   (b) Whether petitioner has non-deductible income payments in the amount of P1,572,780.00;

   (c) Whether bad debts written-off by petitioner is not supported by necessary documents;

[16] *Id.*, pp. 69-71.

(d) Whether petitioner has disallowed creditable tax withheld at source in the amount of P54,010.32;

4. Whether petitioner is liable for the alleged deficiency EWT for 1999 in the aggregate amount of P281,747.61;

5. Whether petitioner is liable for the alleged deficiency VAT in the amount of P54,504,540.02; and

(a) Whether petitioner has alleged gross receipts in the amount of P370,699,977.78, which was not subjected to VAT.

THIS COURT'S RULING

DEFICIENCY INCOME TAX

Respondent assessed petitioner of deficiency income tax for taxable year 1999 in the amount of P4,537,197.15, computed as follows:

Net Income per Return		P 9,911,585.00
Add: Discrepancies per Audit		
Over claimed Salaries & Wages per F/S	P 2,983,589.06	
Rental	1,572,780.00	
Management & Consultancy	176,649.50	
Research & Monitoring	1,561,132.00	
Foreign Exchange Loss	833,665.00	
Bad Debts	675,518.00	
Miscellaneous	781,470.00	8,584,803.56
Net Taxable Income		P18,496,388.56
Tax Due		P 6,103,808.23
Less: Payments Made		3,216,812.68
Basic Income Tax Due		P 2,886,995.55
Add: Interest 04-16-00 to 02-24-03		1,650,201.60
Total Amount Due		**P 4,537,197.15**

As stated in the Details of Discrepancies attached to the Formal Assessment Notice, the deficiency income tax assessment of P4,537,197.15 was based on the following findings by respondent's examiners:

1. **Over-claimed Salaries and Wages per Return (P2,983,589.06)** – Reconciliation of the Financial Statement account with the Alpha list resulted to an over-claimed amount per financial statement and which was not subjected to the proper withholding tax rates. Section 34(K) which provides for the *Additional Requirement for Deductibility of Certain Payments* states that "... any amount paid or payable which is otherwise deductible from or taken into account in computing gross income ... shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue.

2. **Non-deductible Income Payments (Rent – P1,572,780.00, Mgt/Consultancy Fees – P176,649.50, and Research and Monitoring – P1,561,132.00)** – Verification disclosed that certain income payments were not properly subjected to the Expanded Withholding Tax rates of 5%, 10% and 5% respectively. As provided for in Section 34(K) of the National Internal Revenue Code specifying the requirement for deductibility of any income payment, the amount is therefore disallowed as deduction from gross income.

3. **Unsupported deductions (P2,290,653.00) – Expenses claimed as deductions representing Foreign Exchange Loss of P833,665.00, Bad Debts Written-off amounting P675,518.00 and Miscellaneous Expenses totaling P781,470.00** were unsupported and unsubstantiated during the audit therefore disallowed as deduction from gross income. Section 34(A)(1)(b) provides for the *Substantiation Requirements of Deductions* and states that, "....no deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer..."

4. **Disallowed Creditable Tax Withheld at Source (P54,010.32)** – This amount represents the creditable taxes withheld for the taxable year 1998. Section 57(B) of the NIRC provides for the *Withholding of Creditable Tax at Source* – "... require the withholding of a tax on the items of income payable to natural or juridical persons ... at the rate of not less than one percent (1%) but not more than thirty-two (32%) thereof, which shall be credited against the income tax liability of the taxpayer for the taxable year..."

We shall now determine the validity of the foregoing deficiency income tax assessment items.

Over-claimed Salaries and Wages - P2,983,589.06

Respondent alleged that a reconciliation of petitioner's financial statements (FS) and alpha list showed an over-claimed "Salaries and Wages" in the amount of P2,983,589.06[17] which was not allegedly subjected to proper withholding tax on compensation.

Petitioner countered that the amounts pertaining to "Salaries and Wages" per FS and alpha list showed only a discrepancy in the amount of P567,597.48 and not in the amount of P2,983,589.06 as claimed by respondent representing amount allegedly not subjected to withholding tax. Petitioner alleged that the difference of P567,597.48 consisted of the following[18]:

Salaries and wages of contractual and casual employees	P526,557.98
Overtime allowances	41,039.50
Total	**P567,597.48**

Petitioner argues that:[19]

> "30. Under Section 2.79 (A) of RR No. 2-98, as amended, the withholding of tax on compensation is not required where the total compensation income of an individual does not exceed the statutory minimum wage of P5,000.00 monthly or P60,000.00 a year, whichever is higher[.]
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> 31. On the other hand, remuneration for casual labor not in the course of an employer's trade or business is likewise exempt from the withholding tax on compensation (Section 2.78, [B][4], RR No. 2-98, as amended).

[17] BIR Records, p. 258A.
[18] Petition for Review, Docket, p. 8.
[19] Docket, pp. 8-9.

32. Overtime allowances in the aggregate amount of P41,039.50 consist of meal and transportation allowances given to employees undertaking overtime work. Since the amount involved is of small value, these overtime allowances are considered as 'de minimis' benefits not subject to withholding tax on compensation."

Thus, petitioner maintained that although the amount of P567,597.48 was not included in its alpha list, the same still constitutes ordinary and necessary expenses deductible from its gross income for income tax purposes.

The Court agrees with petitioner that the discrepancy in the salaries reported per its income tax return and audited income statement *vis-à-vis* those reported per alpha list amounts to only P567,597.19, as computed below, and not P2,983,589.06 as alleged by respondent:

Salaries and Wages Per FS *(Exhibit "F", CTA Records, page 236)*				P30,278,883.00
Salaries and Wages Per Alphalist	*Exh. "G"*	*Exh. "G-1"*	*Exh. "G-2"*	
Non-Taxable				
13th month	P 1,456,448.42	P 84,034.99	P 79,564.58	
SSS/PHIC & Pag-Ibig/Union Dues	410,912.15	26,962.50	22,792.80	
Salaries & Other Forms of Compensation	-	195,000.00	-	
Taxable				
13th month	2,291,882.79	24,166.67	56,088.79	
Salaries & Other Forms of Compensation	20,600,557.14	1,168,025.28	519,849.70	
Exemption	2,096,000.00	370,000.00	309,000.00	
Total Sal and Wages per Alpha list	P26,855,800.50	P1,868,189.44	P987,295.87	29,711,285.81
Difference				**P 567,597.19**

However, contrary to petitioner's assertion, the discrepancy of P567,597.19[20] cannot be validly deducted from its taxable gross income. Other than a bare statement that the amount of P567,597.19 pertains to salaries and wages paid to each contractual/casual employee which did not exceed P5,000.00 monthly or P60,000.00 a year, petitioner was not able to show by documentary evidence to substantiate such allegation. Although the law and regulations exempt employees' salaries and wages not exceeding P5,000.00 monthly or P60,000.00 a year from the

[20] Upon confirmation by this Court, actual difference is P567, 597.19 and not P567,597.48 as alleged by petitioner.

withholding tax on compensation, petitioner failed to present proof that the amount of P567,597.19 falls within the said exemption.

Section 34(K) of the Tax Code of 1997 reads:

> **"SEC. 34.** ***Deductions from Gross Income.***- Except for taxpayers earning compensation 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;
>
> xxx
>
> **(K)** ***Additional Requirements for Deductibility of Certain Payments.***- Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section, Sections 58 and 81 of this Code."

Thus, pursuant to the above-quoted Section 34(K), petitioner's claimed deduction for salaries and wages in the amount of P567,597.19 should be disallowed as there was no tax withheld therefrom.

Rental - P1,572,780.00

Respondent disallowed petitioner's rental expense in the amount of P1,572,780.00, as computed below, for allegedly not being subjected to 5% expanded withholding tax:

Rental Per FS	P 6,349,806.00
Rental Per Alpha list	4,777,025.94
Disallowance	**P 1,572,780.06**

Petitioner argued that the rent expense of P6,349,806.00 reflected in its 1999 income statement consisted of the following:

Space Rentals	P 5,286,811.00
Equipment (computer) Rentals	1,062,995.00
Total	**P 6,349,806.00**

The space rentals amounting to P5,286,811.00 was allegedly subjected to the 5% withholding tax and was claimed by petitioner as rent expense deduction in its 1999 Annual Income Tax Return. On the other hand, equipment rentals of P1,062,995.00 which allegedly represent rentals for the lease of personal computers were not subjected to expanded withholding tax since the withholding tax regulations, or Revenue Regulations (RR) No. 2-98, as amended,[21] effective during such time did not impose expanded withholding tax thereon.

The Court finds the disallowance proper.

Absent of documentary proof that the rental expense of P1,062,995.00 actually pertains to lease of personal computers, the same shall be considered as rentals subject to 5% EWT. Thus, petitioner should have withheld and remitted 5% EWT on the entire rental expense of P6,349,806.00. Since only the rental payments of P4,777,025.94[22] were subjected to 5% EWT per petitioner's Schedule of Withholding Tax Payments For the Year Ended December 31, 1999,[23] and Annual Information Return of Creditable Income Taxes Withheld (Expanded)/Income Payments Exempt From Withholding Tax (BIR Form 1604-E),[24] petitioner cannot

[21] Dated April 17, 1998, RR 2-98 prescribes the regulations to implement Republic Act (RA) No. 8424 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.
[22] Exhibits "H-2" and "H-3".
[23] BIR Records, page 258.
[24] BIR Records, page 253.

claim as deduction from its taxable gross income the rental payment of P1,572,780.00 pursuant to Section 34(K) of the Tax Code of 1997.

Management and Consultancy Fees – P176,649.50

Respondent computed the disallowance of P176,649.50 allegedly representing management and consultancy fees which were not subjected to 10% EWT by comparing the amounts allegedly reflected in petitioner's financial statements and alpha list, as shown below:

	Management & Consultancy Fees
Figure per Financial Statements	P 3,440,590.86
Figure per Alpha list	3,263,941.36
Difference (Disallowance)	**P 176,649.50**

Petitioner, on the other hand, argued that it was at a loss at how the above computation was arrived at. An examination of petitioner's expenses reflected in its financial statements for 1999 would allegedly show that there is no item on management fees or consultancy fees. Petitioner stated that respondent's failure to indicate the particular management and consultancy fees referred to in the assessment is a clear violation of the requirement that the taxpayer should be informed in writing of the facts and the law on which the assessment is made.

The Court agrees with petitioner.

Section 228 of the Tax Code, 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 is in consonance with the due process requirement of the 1987 Philippine Constitution, which provides that "No person shall be deprived of his property without due process of law." The taxpayer needs to know the nature of the examiner's findings in order to be able to properly contest the same and submit supporting documents.

The Details of Discrepancies attached to the Formal Assessment Notice did not indicate on how the alleged "Management & Consultancy Fees", per financial statements and alphalist, in the respective amounts of P3,440,590.86 and P3,263,941.36 were arrived at. Without respondent's disclosure of the details on how the said amounts were computed, petitioner cannot be expected to be able to determine and thereafter refute the disallowance of P176,649.50. Hence, the disallowance of P176,649.50 is without bases and this Court cannot uphold the same for respondent's failure to inform petitioner in writing of the facts on which the said disallowance was based.

Research and Monitoring – P1,561,132.00

Respondent disallowed petitioner's claimed deduction for Research and Monitoring in the amount of P1,561,132.00 due to the alleged failure of petitioner to withhold 5% EWT thereon.

Petitioner, on the other hand, explained that the expenses for Research and Monitoring consisted of payments to entities engaged in monitoring television viewership and that in consideration of the fees paid to these entities; petitioner was provided with the results of ratings, surveys and studies conducted by these entities. Said expenses, being allegedly in the nature of subscription payments made to these entities on the result of the surveys and researches conducted by them on television viewership, are not one of those enumerated as subject to expanded withholding tax under RR No. 2-98, as amended.

Without documentary evidence to corroborate petitioner's allegations, this Court cannot determine the nature of the subject income payments, and is constrained to subject the Research and Monitoring expenses of P1,561,132.00 to withholding tax.

Foreign Exchange Loss – P833,665.00,
Bad Debts Written-off – P675,518.00 and
Miscellaneous expenses – P781,470.00

Invoking Section 34(A)(1)(b) of the Tax Code of 1997, respondent disallowed petitioner's claimed deductions for foreign exchange loss in the amount of P833,665.00, bad debts written-off in the amount of P675,518.00 and miscellaneous expenses in the amount of P781,470.00 for being unsupported. Since no evidence was offered by petitioner to refute this, the disallowances should be sustained. It is a well settled rule in taxation that the burden of proof lies on the taxpayer to prove with convincing evidence the legal as well as the factual infirmities attendant in an assessment; and failure to do so is fatal considering the prima facie presumption of correctness of the said assessment unless controverted.[25]

Disallowed Creditable Tax
Withheld at Source - P54,010.32

Respondent disallowed petitioner's claimed creditable taxes withheld at source in the amount of P54,010.32 on the ground that the same represents taxable year 1998.

A perusal of petitioner's 1999 income tax return shows that no amount of prior year's excess credits was indicated[26] and that petitioner's declared creditable

[25] *Collector of Internal Revenue vs. Bohol Land Transportation*, L-13099 & L-13462 (107 Phil. 965).
[26] Exhibit "E", Line 26A.

withholding taxes in the amount of P1,105,862.00 pertains to the first three quarters of taxable year 1999[27]. Thus, petitioner should have submitted withholding tax certificates pertaining to taxable year 1999 and not 1998. For petitioner's failure to support the amount of P54,010.32 with proper withholding tax certificates, respondent's disallowance of the same shall be sustained.

In sum, petitioner is liable to pay deficiency income tax for taxable year 1999 in the amount of P3,702,478.75, computed as follows:

Net Income per Return		P 9,911,585.00
Add: Discrepancies per Audit		
Over claimed Salaries & Wages per FS	P 567,597.19	
Rental	1,572,780.00	
Research & Monitoring	1,561,132.00	
Foreign Exchange Loss	833,665.00	
Bad Debts	675,518.00	
Miscellaneous	781,470.00	5,992,162.19
Net Taxable Income		P15,903,747.19
Tax Due (33%)		P 5,248,236.57
Less: Payments Made		3,216,812.68
Basic Income Tax Due		P 2,031,423.89
Add: 25% Surcharge		507,855.97
20% Interest (04-16-00 to 02-24-03)		1,163,198.89
Total Amount Due		**P 3,702,478.75**

It is to be noted that a 25% surcharge was imposed in addition to the basic tax due pursuant to Section 248(A)(3) of the Tax Code of 1997.

DEFICICENCY VALUE-ADDED TAX

Respondent computed the 1999 deficiency VAT assessment of P54,504,540.02 as follows:

Taxable Sales/Receipts per audit	P 370,699,977.78
VAT due (P370,699,977.78/11)	P 33,699,997.78
Less: Creditable Input tax/payments	7,950,226.95

[27] Exhibit "E", Line 26C.

Deficiency VAT	P 25,749,770.83
Add: Surcharge (50%)	12,874,885.52
Interest 01-26-00 to 02-24-03	15,879,883.67
TOTAL AMOUNT DUE	**P 54,504,540.02**

The deficiency VAT assessment of P54,504,540.02 emanated from respondent's computation of petitioner's gross receipts in the amount of P370,699,977.78, which was obtained from the following "Cash in Bank" accounts:

Taxable Receipts per Audit:	
Per Cash in Bank:	
FEBTC	P 275,922,417.02
Citibank – Pesos	24,236,836.43
Citibank – Dollars	70,540,724.33
Total Receipts	**P 370,699,977.78**

Petitioner, on the other hand, argues:

"47. Respondent's deficiency VAT assessment against Petitioner in the amount of P54,504,540.02 apparently arose from the mistaken presumption that the entire cash in bank of Petitioner represents its gross receipts.

48. Respondent obviously erred in assessing Petitioner deficiency VAT considering that the entire cash in bank of the Petitioner, without consideration of the particular circumstances of the transaction, is an erroneous basis in determining the gross receipts of the Petitioner.

49. Petitioner submits that by subjecting the entire amount of cash in bank to the 10% VAT, the Respondent erroneously included in the gross receipts of the Petitioner the amounts earmarked for payments to media which do not form part of Petitioner's gross receipts.

50. As previously stated, gross receipts for computing tax, specifically VAT should exclude any money which is specially earmarked by law, regulations or contract for some other than the taxpayer (*Commissioner of Internal Revenue vs. Tours Specialists, Inc., supra; citing The Collector of Internal Revenue vs. Manila Jocky Club, Inc., G.R. Nos. L-13887 & L-13890, June 30, 1960*).

'*Gross receipts*' <u>subject to tax under the Tax Code do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to the taxpayer's</u>

benefit; and it is not necessary that there must be a law or regulation which would exempt such monies and receipts within the meaning of gross receipts under the Tax Code. Parenthetically, the room charges entrusted by the foreign travel agencies to the private Respondent do not form part of its gross receipts within the definition of the Tax Code. The said receipts never belonged to the private respondent. The private respondent never benefited from their payment to local hotels. xxx'

xxx

52. The foregoing position is even bolstered by RR No. 6085 (Revised and Consolidated Expanded Withholding Tax Regulations) as amended by RR No. 2-98, where the gross payments to media are excluded from the tax base for purposes of determining the final withholding tax of advertising agencies:

xxx."

The Court agrees with petitioner.

Per verification of the Court-commissioned auditing firm, Ramon F. Garcia & Co., CPAs, petitioner's cash receipts for the year ended December 31, 1999 amounted to P371,996,163.13, which comprised of the following[28]:

Collection in Behalf of Suppliers	P 309,466,019.83
Commission Fees and Other Income	63,715,705.54
Value Added Tax on Income	6,366,743.28
Creditable Withholding Tax	(1,126,553.78)
Various charges (Deductions) – net	(6,425,751.74)
Total Amount Received	**P 371,996,163.13**

The amount of P309,466,019.83 ascertained by the commissioned CPA as "Collection in Behalf of Suppliers", or "Amount Due To Suppliers" as reflected in the petitioner's Billing Invoices,[29] does not pertain to payments for services performed or to be performed by petitioner but are merely held in trust for payment to the media networks. Considering so, the cash receipts of P309,466,019.83 do not fall within

[28] Exhibit "X".
[29] Exhibits "V1" to "V19", inclusive.

the definition of gross receipts subject to 10% VAT under Section 108(A) of the NIRC of 1997, to wit:

> "The term 'gross receipts' means the **total amount of money or its equivalent** representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advance payments **actually or constructively received during the taxable quarter for the services performed or to be performed for another person**, excluding value-added tax." (Emphasis supplied)

Moreover, in the case of ***Commissioner of Internal Revenue vs. Tours Specialists, Inc. and The Court of Tax Appeals***,[30] the Supreme Court held that:

> "As demonstrated in the above-mentioned case, gross receipts subject to tax under the Tax Code do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to the taxpayer's benefit; and it is not necessary that there must be a law or regulation which would exempt such monies and receipts within the meaning of gross receipts under the Tax Code."

Therefore, only the commission fees and other income in the amount of P63,715,705.54 represents petitioner's taxable gross receipts with the corresponding 10% output VAT due of P6,366,743.28[31]. After offsetting petitioner's creditable input VAT payments in the amount of P7,950,226.95 from the output VAT liability of P6,366,743.28, there still remains an unutilized input VAT of P1,583,483.67, computed as follows:

Commission Fees and Other Income	P 63,715,705.54
VAT Due thereon	P 6,366,743.28
Less: Input VAT	7,950,226.95
Excess Input VAT	**P 1,583,483.67**

[30] G.R. No. 66416, March 21, 1990 (183 SCRA 402).
[31] Schedule A of Exhibit "X".

From the foregoing, respondent's deficiency VAT assessment in the amount of P54,504,540.02 should be cancelled and withdrawn for lack of factual and legal bases.

DEFICIENCY EXPANDED WITHHOLDING TAX

Petitioner was assessed of alleged deficiency expanded withholding tax worth P281,747.61, computed as follows:

	Figure Per F/S	Figure Per Alpha list	Subjected To EWT	Rate	EWT Due
Rental	P6,349,806.00	P4,777,025.94	P1,572,780.66	5%	P 78,639.03
Management & Consultancy	3,440,590.86	3,263,941.36	176,649.50	10%	17,664.95
Research & Monitoring	1,561,132.00	-	1,561,132.00	5%	78,056.60
Total					P174,360.58
Interest (01-26-00 to 02-24-03)					107,387.03
Total Amount Due					**P281,747.61**

The income payments for which petitioner is allegedly liable for deficiency EWT are the same income payments disallowed under the deficiency income tax portion of the assessments.

As discussed earlier, respondent failed to disclose how it arrived at the income payment of P176,649.50 representing Management & Consultancy fees not subjected to 10% EWT in violation of Section 228 of the NIRC of 1997, thus, the EWT assessment on this item should be cancelled. However, petitioner shall be held liable to pay deficiency EWT in the amount of P292,891.98, as computed below, on Rental payments of P1,572,780.06 and Research & Monitoring expenses of P1,561,132.00 for petitioner's failure to show that the said income payments are not subject to EWT:

	Income Payments				
			Not Subjected to		
	Per FS	Per Alphalist	EWT	Rate	EWT Due
Rental	6,349,806.00	4,777,025.94	1,572,780.06	5%	P 78,639.00
Research & Monitoring	1,561,132.00	-	1,561,132.00	5%	78,056.60
Deficiency EWT					P 156,695.60
Add: 25% Surcharge					39,173.90
20% Interest (01-26-00 to 02-24-03)					97,022.48
Total Amount Due					**P 292,891.98**

It is to be noted that a 25% surcharge was imposed in addition to the basic tax due pursuant to Section 248(A)(3) of the NIRC of 1997.

COMPROMISE PENALTY:

The compromise penalty of P25,000.00 charged by respondent against petitioner was due to the alleged failure of petitioner to file schedule of sales/output tax/purchases/input tax and late filing of petitioner's December VAT return.[32]

The compromise penalties imposed by the respondent cannot be sustained as the same are suggested merely in lieu of criminal prosecution. This is clearly stated under Revenue Memorandum Order (RMO) No. 1-90,[33] thus:

> "III. Guidelines and Instructions
>
> (5) Since compromise penalties are only amounts suggested in settlement of criminal liability and may not therefore be imposed or exacted in the event that a taxpayer refuses to pay the suggested compromise penalty the violation shall be referred for criminal action as above-mentioned."

Since conviction for failure to present schedule of sales/output tax/purchases/input tax and the late filing of December VAT return is wanting in the instant case and that there is no showing that petitioner voluntarily entered into a

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[32] BIR Records, p. 390

[33] Amendments to the Provisions of a "Revised Schedule of Compromise Penalties" for Internal Revenue Violations as Prescribed in RMO 26-86.

compromise agreement with the respondent, the compromise penalties of P25,000.00 should be cancelled.

To sum up, assessment must be based on sufficient evidence. "xxx [T]he *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious. Where the BIR has come out with a 'naked assessment,' *i.e.*, without any foundation character, the determination of the tax due is without rational basis. In such a situation, the U.S. Court of Appeals ruled that the determination of the Commissioner contained in a deficiency notice disappears. *Hence, the determination by the CTA must rest on all the evidence introduced and its ultimate determination must find support in credible evidence.*"[34]

IN VIEW OF THE FOREGOING, the Petition for Review is hereby **PARTIALLY GRANTED**. The assessments issued by respondent against petitioner for taxable year 1999 covering deficiency VAT in the amount of P54,504,540.02 and compromise penalty in the amount of P25,000.00 are **CANCELLED** and **SET ASIDE** for lack of basis.

However, petitioner is **ORDERED** to pay deficiency income tax and expanded withholding tax in the reduced amounts of P3,702,478.75 and P292,891.98, respectively, or in the sum of P3,995,370.73, broken down as follows:

	Deficiency Tax		**Total Amount Due**
	Income Tax	**EWT**	
Basic Tax	P 2,031,423.89	P 156,695.60	
25% Surcharge	507,855.97	39,173.90	
20% Interest	1,163,198.89	97,022.48	
Total Amount Due	**P 3,702,478.75**	**P 292,891.98**	**P 3,995,370.73**

a

[34] *Commissioner of Internal Revenue v. Hantex Trading Co.*, G.R. No. 136975, March 31, 2005 (454 SCRA 301).

In addition, petitioner is liable to pay 20% delinquency interest on the total amount of P3,995,370.73 counted from February 25, 2003 until full payment thereof pursuant to Section 249(C)(3) of the Tax Code of 1997.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Chairman, First Division
Presiding Justice