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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PARAMOUNT INSURANCE CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 4844

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 07 1996

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DECISION

This case involves assessments for alleged deficiency income and expanded withholding taxes for the calendar year 1986.

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines. It is engaged in the business of non-life insurance.

On April 15, 1987, petitioner filed its Corporate Annual Income Tax Return for the calendar year 1986.

On August 21, 1989, petitioner received respondent's 1986 deficiency assessments for income tax amounting to P1,369,925.50, expanded withholding taxes in the amounts of P51,060.12 and P61,902.75, all inclusive of interest and charges for taxable year 1986.

On September 4, 1989, petitioner protested the amount of P1,369,925.50 income tax assessment and the

₱61,902.75 expanded withholding tax assessment without mentioning the other deficiency expanded withholding tax assessment in the amount of ₱51,060.12.

In a letter dated May 13, 1991, petitioner offered to settle its deficiency tax liabilities by offering 50% of the total basic taxes assessed pursuant to Revenue Memorandum Order No. 3-91.

The offer was not accepted by the respondent.

On July 30, 1992, petitioner received a letter from the respondent, dated July 15, 1992, requesting it to sign a waiver of the statute of limitations. The waiver extended the period within which respondent can collect from petitioner up to December 31, 1993. Petitioner signed the waiver on August 6, 1992 and respondent accepted the same on August 12, 1992.

On August 7, 1992, petitioner received respondent's warrant of distraint and/or levy dated August 3, 1992. Warrants of Garnishments were also served on petitioner's depository banks.

Construing the service of the warrants as a denial of its protest, petitioner on September 4, 1992 filed the instant petition for review. Hence, this appeal.

During the trial of the case, petitioner presented and submitted documentary and testimonial evidence. Respondent likewise presented testimonial evidence as well as the BIR records as part of her evidence pursuant to Section 2, Rule 7 of the Rules of Court of Tax Appeals.

Is petitioner liable to pay for the alleged deficiency income and expanded withholding taxes for the calendar year 1986?

The deficiency tax assessments shall be discussed as follows:

1.	Deficiency income tax	P1,369,925.50
2.	Deficiency expanded withholding tax	51,060.12
3.	Expanded withholding tax	61,902.75
	Total	P1,482,888.37

1. **Deficiency income tax - P1,369,925.50**

The deficiency income tax arose from the revenue examiners' disallowance of certain deductions from the petitioner's gross income, to wit:

a.	Miscellaneous expenses	P 46,345.64
b.	Representation expenses	103,600.00
c.	Rental, maintenance and commission expenses	510,004.26
d.	Portion of deduction allocable to non-taxable revenue	1,534,297.51
	Total	P2,194,247.41

The miscellaneous expenses were disallowed by revenue examiners on the ground that they were incurred in prior year and unsupported.

Petitioner explained, in its protest, that the miscellaneous expenses were actually representation, transportation and professional fees incurred by its officers in 1985 (Exh. "C"). These were reported only in 1986 after an officer asked for reimbursement. To prove its stand, petitioner presented various vouchers together with their corresponding receipts (Exhs. "G" to "Y", inclusive of sub-markings).

Petitioner further argued that since they are business-related, they should be allowed as a deduction from its gross income pursuant to Section 29(a)(1)(A) of the National Internal Revenue Code, as amended.

When expenses can be deducted?

Under the cash method of accounting, business expenses are deducted in the tax year they are actually paid, even if they were incurred in an earlier year. Under the accrual method of accounting, business expenses are deductible when the taxpayer becomes liable for them, whether or not they are paid in the same year. All the events that set the amount of the liability must have happened (including, when appropriate, economic performance), and the taxpayer must be able to figure the amount of expenses with reasonable accuracy. **(Mertens, Law of Federal Income Taxation, Vol. 6, * 25.20).** The propriety of an accrual must be judged by the facts that a taxpayer knew, or could reasonably expected to have known, at the closing of its books for the taxable year

(Baltimore Transfer Co. of Baltimore City v. Comm., 8 TC 1 [1947]).

Petitioner adopts the accrual method.

Thus, the miscellaneous expenses incurred by its officers are deductible when petitioner becomes liable for them.

When does the liability of petitioner arise? Only when a particular officer asked for reimbursement. It is only then that such an expense can be accrued and eventually can be taken on petitioner's account. It is impossible for a taxpayer to recognize an expense without knowing its occurrence. Hence, although the receipts pertain to 1985, the same only accrue in 1986, the time when petitioner acquire knowledge of its liability to pay for expenses not reimbursed by its officers towards the end of 1985.

The revenue examiners also disallowed the amount of P103,600.00 representing representation expenses. These were disallowed on the ground that they were paid in cash and unsupported.

Petitioner, in its protest, reasoned that the representation expenses are additional benefit given to its officers which were subjected to 10% withholding tax (Exh. "C"). A scrutiny of the evidence offered by petitioner, revealed otherwise. The representation expenses are advances to its officers subject to liquidation by receipts (Exhs. "Z", "AA", "BB" and "CC", inclusive of sub-markings).

Representation expenses fall under the category of business expenses which are allowable deductions, if they are ordinary and necessary; paid or incurred in carrying on a trade or business; and they are reasonable. **(Mariano Zamora vs. CIR; Esperanza Zamora v. Col. of Int. Rev. & CTA, 8 SCRA 163).**

We agree with the revenue examiners in not allowing the representation expenses which are not properly supported by official receipts. For a mere receipts when signed by the company officers themselves are not sufficient, for while they may show that they received the amount from the company, they do not proved payment of the alleged representation expenses to the entity in which the same is incurred or that they were incurred **(Col. of Int. Rev. vs. Goodrich Int. Rubber Co., 21 SCRA 1336).** Further, the absence of invoices, receipts or vouchers, particularly lack of proof of the items constituting the expense is fatal to the allowance of the deduction **(Gancayco v. Co. of Int. Rev., 1 SCRA 980).**

Among the exhibits presented by petitioner only the sum of P20,367.12 represents valid representation expenses supported by official receipts (Exhs. "Z-1" to

"Z-15", "AA-1" to "AA-18", "BB-1" to "BB-23", and "CC-1" to "CC-21"). The remaining amount of P83,232.88 is not deductible.

Another disallowance made by the revenue examiners is the amount of P510,004.20. This represents income payments made by petitioner as follows:

a.	Rental expense	P 20,826.00
b.	Maintenance service	3,531.00
c.	Commission expense	485,647.20
	Total	P510,004.20

These were disallowed on the ground that petitioner failed to withhold the tax required under Revenue Regulations No. 6-85.

Petitioner contends that it did comply with the requirement under the law except for the commission paid to its reinsurance agents.

Petitioner alleged that it cannot withhold the corresponding tax thereon because it has no control over it. The collections received by petitioner from its reinsurance agents were already net of the latter's commission.

Petitioner presented various documents to prove that it did withhold from the aforesaid income payments (Exhs. "DD" to "GG", inclusive of sub-markings).

However, the evidence presented by petitioner is wanting. Nothing in the exhibits will show that the withholding taxes pertain to the subject income payments disallowed by the revenue officers. The evidence only proved that certain taxes were withheld on management bonus, direct businesses, and various businesses but nothing pertains to rental, maintenance and commission expenses.

Petitioner also failed to support its allegation that the collections received from its reinsurance agents were already net of the latter's commission. There was no evidence presented for that purpose.

The revenue examiners, further, disallowed the amount of ₱1,534,297.51 representing the portion of expenses allocable to petitioner's non-taxable revenue. This finding was based on the theory that in every investment there is a corresponding cost that entails thereon.

Petitioner averred that the disallowance made by the revenue examiners is arbitrary and devoid of merit. The passive income referred to by the revenue examiners, among others, were interest income from money market placement, treasury bills and government bonds which were already been subjected to 20% final withholding tax.

The Court finds favor for the petitioner.

In the similar case of **Sime Darby Philippines, Inc., (Formerly Sime Darby International Tire Co., Inc.)** vs.

The Commissioner of Internal Revenue, C.T.A. Case No. 4448, August 8, 1994, the Court ruled:

> xxx (T)he respondent claims that since the petitioner also earned income from interests and money market placements, it should allocate a certain part of its operating cost to the generation of such passive income, thus in effect, disallowing a proportionate amount of deductible expenses from the petitioner's income in the manufacture and recapping of tires.
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> However, the undisputed claim of the petitioner is that no expenses were incurred in the production its passive income such as income earned from the interests in bank deposits. Moreover, these income had already been subjected to a final withholding tax of 20%. By the very nature of a final tax, the income is taxed based on its gross amount, without consideration of any deductions or costs that may have actually been incurred in their production.
>
> We therefore cannot find any valid reason for the respondent's allocation of deductible expenses to the petitioner income that has been subject to a final tax. Neither can we find any legal basis for adopting the abovementioned formula in view of the unrefuted testimony of the petitioner's witness that during the examination on its accounting records, all the pertinent journals, ledgers and documents covering both taxable and non-taxable revenues were duly presented to the respondent. **(Citytrust Investment Philippines, Inc. (formerly Citicorp Investment Philippines, Inc.) vs. The Commissioner of Internal Revenue, C.T.A. Case No. 4443, January 18, 1994)**

Therefore, to allocate the expenses between taxable income and non-taxable income is erroneous.

In sum, the deficiency income tax assessed by the respondent should be modified. Interest should be computed from the date prescribed for payment until fully paid pursuant to Sec. 283 of the Tax Code. However, the compromise penalty imposed on said assessment should be deleted since there was no agreement reached between the parties. A compromise by its very nature implies mutual agreement by the parties in regard to the thing or subject matter which is to be compromised. An offer of compromise does not, therefore, assume the category of a compromise until it is voluntarily accepted by the other party, and no obligation arises or is created by a simple offer or suggestion coming from one of the parties without acceptance by the other (**Ben L. Chuy, et al. vs. Collector of Internal Revenue, CTA case, prom. July 16, 1958**).

2. Deficiency expanded withholding tax - P51,060.12

As regards the P51,060.12 deficiency expanded withholding tax assessment, it will be observed that petitioner did not contest the same in its administrative protest filed with the Bureau of Internal Revenue (Exh. "C"). Only the 1986 Deficiency Income Tax in the amount of P1,369,925.50 and the 1986 Expanded Withholding Tax in the amount of P61,902.75 have been contested. The validity of this particular assessment was only brought up when the instant petition was filed.

A question not previously brought up in the administrative forum can not be raised for the first time in court (**Aguinaldo Industries Corporation v. CIR, No. L-29790, February 25, 1982, 112 SCRA 136)**. Furthermore, well settled is the rule that all presumptions are in favor of the correctness of tax assessments (**Kischindchand Chellaram (Manila) Inc. v. Court of Tax Appeals, G.R. 60787, March 27, 1990)**. Hence, the expanded withholding tax assessment in the amount of P51,600.00 becomes final.

However, interest should be deleted considering that the interest has to be recomputed from the date the tax plus surcharage are prescribed for payment until fully paid pursuant to Sec. 283 of the Tax Code. While the compromise penalty is deleted because there was no mutual agreement reached by the parties (**Ben L. Chuy, et al. vs Collector of Internal Revenue, supra)**.

3. Expanded Withholding Tax - P61,902.75

Respondent also finds petitioner liable to pay for the amount of P61,902.75 representing expanded withholding tax on accrued management fees for 1986.

Petitioner objects this finding of respondent on the ground that said fees could not possibly be accrued in 1986 because the management fees were based on the audited financial statements which became available in 1987. As testified by petitioner's witness Ms. Rosanna Go:

Q. Normally when are these bonuses given?

A. The bonuses are usually given on the following calendar year.

Q. Why they are given only on the following calendar year?

A. Because the basis on which the bonuses are calculated becomes only fixed and determinable after the audited financial statements as prepared by our external auditors become final and that usually on April 15 when we file our income tax return.

Q. For the taxable year 1986, the taxable year in questioned for this particular case, when were the management bonuses given?

A. They were paid I believe in March and May of 1987.

Q. Why do you think this have been given on these particular months?

A. Because the payment for March by that time the auditors was able to prepare a preliminary audited financial statements. So part of the bonus are probably released by that time and it was only after the final audited statements were fixed and that was April 15, that we were be able to give the final amount and that was paid out in May of 1987. **(TSN, August 31, 1993, pp. 13-14)**.

However, the testimony of petitioner's witness run counter with what was reflected in its 1986 income tax return (BIR records, pp. 1-12). The management fees were already been deducted on petitioner's gross income.

Section 9 of Revenue Regulations No. 6-85, otherwise known as the Expanded Withholding Tax Regulations, provides:

> Sec. 9. Requirement for deductibility. - Any income payment, which is otherwise deductible under Section 30 and 57 of the Tax Code, as amended, shall be allowed as a deduction from the payor's gross income only if it is shown that the tax required to be withheld has been paid to the Bureau of Internal Revenue in accordance with Sections 53, 54, 91 and 93 also of the Tax Code.

Clearly, petitioner violates the above provision. It deducted the management fees from its gross income prior to withholding and payment of the tax required therefrom.

Therefore, the assessment for expanded withholding tax of respondent is proper.

However, since petitioner paid the withholding taxes on subsequent dates, which is on April 10, 1987 and on June 10, 1987, as evidenced by Exhibits "DD" and "EE", inclusive of their sub-markings, petitioner is only liable to pay for the penalties for late payment of the tax.

In summary, computed below are petitioner's income and expanded withholding tax liabilities based on the 1986 Tax Code:

Deficiency Income Tax

Net income per return		P1,008,526.00
Add unallowable deductions:		
a. Representation expense	P 83,232.88	
b. Rental, maintenance and commission expenses	510,004.20	593,237.08
Net taxable income		P1,601,763.08
Income tax due thereon (Sec. 24)		P 550,617.08
Less income tax already assessed		352,984.00
Basic deficiency income tax		P 197,633.08
Add surcharge (Sec. 282)		49,408.27
Deficiency income tax		P 247,041.35

Deficiency Expanded Withholding Tax

Income Payments	Amount	Rate	E.W.T. Due
Rental expense	P 20,826.00	5%	P 1,041.30
Maintenance service	3,531.00	1%	35.31
Commission expense	485,647.20	5%	24,282.36
Basic deficiency E.W.T.			P25,358.97
Add surcharge (Sec. 282)			6,339.74
Deficiency expanded withholding tax			P31,698.71

Expanded Withholding Tax

Management fees	P1,588,586.40
Tax due thereon - 10%	P 158,858.64
Surcharge	P 39,714.66
Interest	
i. 52,952.85 x 20% x 88/365 (1.12.87 to 4.10.87)	2,553.34
ii. 101,977.00 x 20% x 149/365 (1.12.87 to 6.10.87)	8,325.79
Total amount due and collectible	P 50,593.79

WHEREFORE, in view of all the foregoing, petitioner is hereby ordered to pay the respondent Commissioner of Internal Revenue the deficiency income and expanded withholding taxes in the amounts of P247,041.35 and P31,698.71, respectively, both inclusive of the 25% surcharge plus 20% interest per annum from the date prescribed for their payment until fully paid pursuant to Sec. 283 of the 1986 Tax Code. Furthermore, petitioner is hereby ordered to pay the amount of P50,593.79 representing penalties for late payment of expanded withholding tax on accrued management fees.

Costs against petitioner.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

(on leave)
MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this 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
Court of Tax Appeals