REPUBLIC OF THE PHILIPPINES

Court of Tax Appeals

QUEZON CITY

Third Division

NORTHERN TOBACCO REDRYING CO. INC., *Petitioner,*	**CTA CASE NO. 8866**
-versus-	Members: ***Bautista,*** *Chairperson* ***Fabon-Victorino,*** *and* ***Ringpis-Liban,*** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Promulgated: FEB 23 2017 2:35 p.m.

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DECISION

BAUTISTA, J:

The Case

This is a Petition for Review[1] filed on August 12, 2014, pursuant to *Section 7(a)(2)*[2] of *Republic Act ("RA") No. 1125*[3], as amended by *RA No. 9282*[4] and *RA No. 9503*[5], praying that judgment be rendered:[6]

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[1] *Records, CTA Case No. 8866, Vol. 1, Petition for Review ("PFR")*, pp. 14-187, with annexes.

[2] "Sec. 7. *Jurisdiction.* - The Court of Tax Appeals shall exercise:

(a) Exclusive appellate jurisdiction to review by appeal, as herein provided.

xxx xxx xxx

(2) Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relations thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period of action, in which case the inaction shall be deemed a denial; xxx"

[3] An Act Creating the Court of Tax Appeals, as amended.

[4] An Act Expanding the Jurisdiction of the Court of Tax Appeals (CTA), Elevating its Rank to the Level of a Collegiate Court with Special Jurisdiction and Enlarging its Membership, Amending for the Purpose Certain Sections of Republic Act No. 1125, as amended, Otherwise Known as the Law Creating the Court of Tax Appeals, and for Other Purposes.

[5] An Act Enlarging the Organizational Structure of the Court of Tax Appeals, Amending for the Purpose Certain Sections of the Law Creating the Court of Tax Appeals, and for Other Purposes.

[6] *Records, Vol. 1, PFR, Prayer*, p. 54.

1. Declaring null and void the assessment notices issued against petitioner assessing it for deficiency income tax ("IT"), value-added tax ("VAT"), expanded withholding tax ("EWT"), withholding tax on compensation ("WTC"), documentary stamp tax ("DST"), and improperly accumulated earnings tax ("IAET") for the year ending December 31, 2010, in the aggregate amount of Php89,823,645.18, inclusive of increments;

2. Declaring null and void the above-mentioned deficiency assessments for being based purely on mere assumptions; and

3. Other reliefs just and equitable under the premises.

The Parties[7]

Petitioner Northern Tobacco Redrying Co. Inc. is a corporation organized and existing under Philippine laws, with business address at No. 24 Fortune Avenue, Brgy. Fortune, Marikina City. Its primary purpose is to establish, operate, manage, acquire, buy, lease, and sell or otherwise dispose of tobacco re-drying and flue-curing plants, machineries and equipment.[8] It is registered with the Securities and Exchange Commission ("SEC"), with SEC Certificate No. 126605[9] issued on May 21, 1985; and with the Bureau of Internal Revenue ("BIR"), with BIR Certificate of Registration No. 8RC0000049826[10], as a Large Taxpayer.

Respondent Commissioner of Internal Revenue ("CIR") is the duly appointed Commissioner of the BIR vested, under appropriate laws, with the authority to carry out the functions, duties, and responsibilities of his office, including *inter alia*, the power to decide disputed assessments, and cancel and abate tax liabilities, pursuant to the provisions of the *1997 National Internal Revenue Code*, as amended *("1997 NIRC")* and other tax laws, rules and regulations.

The Facts

[7] *Records, Vol. 2, Joint Stipulation of Facts and Issues ("JSFI")*, pp. 610-611.
[8] *Id., Exhibit "P-2," Articles of Incorporation*, p. 304.
[9] *Id., Exhibit "P-1," SEC Certificate of Registration*, p. 302.
[10] *Id., Exhibit "P-3," BIR Certificate of Registration*, p. 323.

On February 25, 2010, petitioner (as transferor) and Fortune Landequities and Resources Inc. ("FLRI"), a domestic corporation, (as transferee) entered into a Deed of Transfer[11] whereby petitioner agreed to transfer ownership over certain parcels of land located in Vigan, Ilocos Norte to FLRI in exchange for a total of 5,722 (4,292 additional subscription and 1,430 unpaid original subscription) common shares in FLRI.

On June 7, 2010, FLRI filed its Request for Tax-Free Exchange Ruling of Transfer of Land in Exchange for Shares of Stock[12] with the BIR Law Division. On even date, an Application and Joint Certification[13] (BIR Form No. 1927) was likewise filed.

On July 19, 2011, petitioner received Letter of Authority ("LOA") No. 124-2011-00000048[14] dated July 19, 2011,[15] authorizing Revenue Officers ("RO") Nicanor San Juan, Ponciano Garma, Lamberto Vasquez, and Group Supervisor ("GS") Ronaldo Camba to examine petitioner's books of accounts and accounting records for all internal revenue taxes for the period running from January 1, 2010 to December 31, 2010.

On March 11, 2013, a Memorandum of Assignment[16] was issued by OIC-Chief, Excise LT Audit Div II Lindagrace B. Sagun ("OIC Chief Sagun") to ROs Romualdo I. Plocios, Melinda M. Rugayan, and Lolita G. Sabado, and GS Samuel C. Reyes, to continue the audit or investigation against petitioner, replacing the previously-assigned RO Roque Doloiras, Jr.

On March 14, 2013, petitioner, through Debbie Ting-Alcantara ("Ms. Alcantara"), received a letter[17], with attached List of Requirements[18], from OIC Chief Sagun dated March 13, 2013, informing petitioner of the change of ROs and GS authorized to conduct audit.

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[11] *Records, Vol. 2, Exhibit "P-8," Deed of Transfer,* pp. 376-378, with annex.
[12] *Id., Exhibit "9," Request for Tax-Free Exchange Ruling,* pp. 380-392, with annex.
[13] *Id., Exhibit "P-9-C," Application and Joint Certification,* pp. 716-725.
[14] *Id., Exhibit "P-4," Letter of Authority ("LOA"),* p. 325.
[15] *Id., JSFI,* p. 611.
[16] *BIR Records, Exhibit "R-1," Memorandum of Assignment,* p. 213.
[17] *Id., Exhibit "R-2,"* p. 216.
[18] *Id., Exhibit "R-3,"* pp. 214-215.

On July 22, 2013, a Final Report[19] was submitted by ROs Plocios, Rugayan, Sabado, Lilia G. Pascual and GS Reyes to OIC-Assistant Commissioner LTS Alfredo V. Misajon, recommending the issuance of a Notice for Informal Conference ("NIC") against petitioner.

On August 30, 2013, petitioner received an NIC[20] issued by OIC-Assistant Commissioner LTS Misajon.

On October 21, 2013, ROs Plocios, Rugayan, Sabado, Pascual and GS Reyes submitted a Memorandum[21] to OIC-Assistant Commissioner LTS Misajon, recommending the issuance of a Preliminary Assessment Notice ("PAN") against petitioner.

On November 22, 2013, petitioner, through Ms. Alcantara received a PAN[22], with an assessment for deficiency IT, VAT, WTC, EWT, DST and IAET in the total amount of Php86,613,710.78, inclusive of surcharges, interest, and compromise penalties.

On December 4, 2013, ROs Plocios, Rugayan, Sabado, Pascual and GS Reyes submitted a Memorandum[23] to OIC-Assistant Commissioner LTS Misajon, recommending the issuance of a Formal Assessment Notice ("FAN") against petitioner for failure to file a protest to the PAN.

On December 16, 2013, petitioner, likewise through Ms. Alcantara, received a Formal Letter of Demand ("FLD")[24] with an assessment for deficiency IT, VAT, WTC, EWT, DST and IAET in the total amount of Php89,823,645.18, inclusive of surcharges, interest, and compromise penalties, along with the Final Assessment Notices[25] ("FANs") issued on December 11, 2013, detailed as follows:

KIND OF TAX	BASIC TAX		SURCHARGE		INTEREST		COMPROMISE PENALTY		TOTAL
IT	Php	9,636,748.11	Php	-	Php	5,227,605.82	Php	50,000.00	Php 14,914,353.93
VAT		6,608,093.99		-		3,892,438.93		50,000.00	10,550,532.92

[19] *BIR Records, Exhibit "R-4," Final Report*, pp. 278-288, with annexes.
[20] *Id., Exhibit "R-5," Notice of Informal Conference ("NIC")*, p. 298.
[21] *Id., Exhibit "R-6,"* pp. 349-353.
[22] *Records, Vol. 2, Exhibit "P-5," Preliminary Assessment Notice ("PAN")*, pp. 327-333, with annexes; *BIR Records, Exhibit "R-7," PAN*, pp. 358-363, with annexes.
[23] *BIR Records, Exhibit "R-8,"* pp. 385-389.
[24] *Records, Vol. 3, Exhibit "P-6," Formal Letter of Demand ("FLD")*, pp. 902-907, with annexes; BIR *Records, Exhibit "R-9," FLD*, pp. 405-410.
[25] *Records, Vol. 3, Exhibit "P-6," Final Assessment Notices ("FAN")*, pp. 908-913; *BIR Records, Exhibits "R-9-a," "R-9-b," "R-9-c," "R-9-d," "R-9-e," "R-9-f," FANs*, pp. 394, 396, 398, 400, 402, and 404.

WTC		215,300.47		-		127,410.69		16,000.00		358,711.16
EWT		5,349.32		-		3,165.62		1,500.00		10,014.94
DST		1,280,140.00		320,035.00		764,576.77		25,000.00		2,389,751.77
IAET		37,489,949.72		9,372,487.43		14,687,843.31		50,000.00		61,600,280.46
TOTAL	PHP	55,235,581.61	PHP	9,692,522.43	PHP	24,703,041.14	PHP	192,500.00	PHP	89,823,645.18

On January 15, 2014, petitioner filed an administrative protest[26] with the Large Taxpayers Service, requesting for a reconsideration of the FLD and the FANs.

There being no action on its protest, petitioner filed the present Petition for Review[27] on August 12, 2014.

On October 13, 2014, respondent filed his Answer[28] by registered mail, interposing Special and Affirmative Defenses, in sum: *(1)* that the period to assess has not prescribed; and *(2)* that petitioner is liable to pay deficiency IT, VAT, WTC, EWT, DST and IAET.

Respondent and petitioner filed their respective Pre-trial Briefs on February 20, 2015[29] and March 12, 2015[30].

On April 6, 2015, the parties filed their Joint Stipulation of Facts and Issues[31] ("JSFI"); thus, a Pre-Trial Order[32] was issued on April 20, 2015.

Petitioner presented the following witnesses: *(1)* Ms. Melody Grace O. Ngo, its Accounting Officer;[33] and *(2)* Mr. Prudencio F. Tatunay, the Court-appointed[34] Independent Certified Public Accountant ("ICPA").[35]

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[26] *Records, Vol. 3, Exhibit "7," Administrative Protest,* pp. 914-940.
[27] *Id., Vol. 1, PFR,* pp. 14-187, with annexes.
[28] *Id., Answer,* pp. 218-237.
[29] *Id., Vol. 2, Respondent's Pre-Trial Brief,* pp. 258-263.
[30] *Id., Pre-Trial Brief,* pp. 283-288.
[31] *Id., JSFI,* pp. 610-617.
[32] *Records, Vol. 2, Pre-Trial Order ("PTO"),* pp. 625-637.
[33] *Records, Vol. 2, Judicial Affidavit ("JA") of Ms. Melody Grace O. Ngo,* pp. 292-300; *Supplemental JA of Ms. Ngo,* pp. 646-652; *Records, Vol. 3, June 26, 2015 Minutes of Hearing,* p. 760.
[34] *Records, Vol. 3, JA of Prudencio F. Tatunay,* pp. 764-777, with annexes; *Records, Vol. 3, July 6, 2015 Minutes of Hearing,* p. 778; *Records, Vol. 3, Compliance,* pp. 779-785, with annexes; *Records, Vol. 3,* pp. 795-796.
[35] *Records, Vol. 3, Exhibits "P-15," "P-15-a," "P-15-b," "P-15-c," "P-15-d," and "P-15-d-1," Independent Certified Public Accountant ("ICPA") Report, Executive Summary,* pp. 800-805; *Records, Vol. 3, Exhibit "P-16," ICPA Report,* pp. 806-861; *Records, Vol. 3, JA of Prudencio F. Tatunay,* pp. 869-890; *Records, Vol. 3, October 5, 2015 Minutes of Hearing,* p. 891.

On October 14, 2015, Formal Offer of Evidence for the Petitioner[36] was filed, offering *Exhibits* "P-1" to "P-9," "P-9-A" to "P-9-J," "P-10," "P-10-A," "P-11" to "P-13," "P-15," "P-15-A" to "P-15-D," "P-15-D-1," "P-16," "P-16-A," "P-17," and "P-18." This was resolved by the Court in its Resolution[37] dated November 16, 2015, admitting all of petitioner's evidence, save for *Exhibit* "P-18" for not being properly marked.

Respondent presented its sole witnesses, RO Plocios, one of the ROs assigned to petitioner's case.[38]

On February 26, 2016, Respondent's Formal Offer of Evidence[39] was filed, offering *Exhibits* "R-1" to "R-9," "R-9-a" to "R-9-f," "R-10," and "R-10-a."

In its April 11, 2016 Resolution[40], the Court admitted all of respondent's offered exhibits, and ordered the parties to file their respective memoranda within thirty (30) days from receipt thereof.

After both parties were granted extension/s,[41] petitioner and respondent then filed their Memoranda on June 1, 2016[42], and June 14, 2016[43], respectively.

On June 14, 2016, the Court promulgated a Resolution[44] submitting the case for decision; hence, this Decision.

The Issues[45]

WHETHER PETITIONER'S TRANSFER OF ITS PARCELS OF LAND TO FLRI, IN EXCHANGE OF 4,292 COMMON SHARES OF STOCK, CONSTITUTES A TAX-FREE EXCHANGE TRANSACTION, IN ACCORDANCE WITH THE *1997 NIRC*;

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[36] *Records, Vol. 3, Formal Offer of Evidence for the Petitioner,* pp. 892-901.
[37] *Id., Vol. 3,* pp. 949-950.
[38] *Id., Vol. 2, Exhibit "R-10," JA of Revenue Officer ("RO") Romualdo I. Plocos,* pp. 268-277; *Records, Vol. 3, February 16, 2016 Minutes of Hearing,* p. 953
[39] *Records, Vol. 3, Respondent's Formal Offer of Evidence,* pp. 954-964.
[40] *Id., Vol. 3,* pp. 979-980.
[41] *Id.* at 981-987, 1038-1041, in relation to 1043-1044.
[42] *Id., Memorandum for Petitioner,* pp. 988-1037.
[43] *Id., Memorandum (For Respondent),* pp. 1045-1062.
[44] *Id., Vol. 3,* p. 1064.
[45] *Records, Vol. 2, PTO, Issues,* p. 626.

WHETHER PETITIONER IS LIABLE TO PAY RESPONDENT PHP89,823,645.18 REPRESENTING ALLEGED DEFICIENCY IT, VAT, EWT, WTC, DST, AND IAET, INCLUSIVE OF SURCHARGES AND INTEREST FOR TAXABLE YEAR ("TY") 2010;

WHETHER RESPONDENT'S RIGHT TO ASSESS PETITIONER FOR ALLEGED DEFICIENCY INTERNAL REVENUE TAXES HAS ALREADY PRESCRIBED; AND

WHETHER A TAX RULING IS A CONDITION PRECEDENT FOR THE APPLICATION OF *SECTION 40(C)(2) OF THE 1997 NIRC.*

***Petitioner's Arguments*[46]**

Petitioner avers that it is not liable to pay respondent Php89,823,645.18 representing alleged deficiency IT, VAT, EWT, WTC, DST, and IAET, inclusive of surcharges and interest for TY 2010; that its transfer of parcels of land to FLRI in exchange of shares constitutes a tax-fee exchange transaction; that a tax ruling is not a condition precedent for the application of *Section 40(C)(2) of the 1997 NIRC;* and that respondent's right to assess has prescribed under *Section 203 of the 1997 NIRC.*

***Respondent's Counter-Arguments*[47]**

Respondent counters that petitioner filed a false return, giving respondent ten (10) years from discovery of such falsity to assess petitioner, pursuant to *Section 222 of the 1997 NIRC;* and that petitioner is liable to pay deficiency IT, VAT, WTC, EWT, DST, and IAET.

The Ruling of the Court

Petitioner's transfer of land to FLRI is a tax-free exchange transaction under *Section 40(c)(2) of the 1997 NIRC,* and a tax ruling

[46] *Records, Vol 3, Memorandum for Petitioner,* pp. 1000-1036.
[47] *Id., Memorandum (For Respondent),* pp. 1047-1059.

is not a condition precedent for the application thereof.

Respondent assessed petitioner for deficiency IT, VAT, DST and IAET arising from alleged gains from exchange of parcels of land for shares of stock entered into between petitioner (along with other corporations) and FLRI. He anchored these on the failure of petitioner to secure a BIR Ruling declaring the said transaction as tax free.

Petitioner argues that a BIR Ruling is not a condition precedent for the application of *Section 40(C)(2) of the 1997 NIRC* since the law itself does not require said Ruling.

The relevant provision is *Section 40(C) of the 1997 NIRC*, to wit:

> SEC. 40. *Determination of Amount and Recognition of Gain or Loss.* -
>
> xxx xxx xxx
>
> (C) *Exchange of Property.* -
>
> (1) *General Rule.* — Except as herein provided, upon the sale or exchange of property, the entire amount of the gain or loss, as the case may be, shall be recognized.
>
> (2) *Exception.* — No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation—
>
> (a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or
>
> (b) A shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock of another corporation also a party to the merger or consolidation; or
>
> (c) A security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such corporation, solely for stock or securities in another corporation, a party to the merger or consolidation.

> No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation: Provided, That stocks issued for services shall not be considered as issued in return for property.[48]

From the above provision, the requisites for the non-recognition of gain under or loss under *Section 40(C)(2) of the 1997 NIRC* are as follows: *(1)* the transferee is a corporation; *(2)* the transferee exchanges its shares of stock for property/ies of the transferor; *(3)* the transfer is made by a person, acting alone or together with others, not exceeding four (4) persons; and, *(4)* as a result of the exchange the transferor, alone or together with others not exceeding four (4), gains control of the transferee.[49] The term "control" is defined as "ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote."[50]

In relation to the above-stated requirements, the Court finds that all the foregoing requirements were met, to wit:

1. It is undisputed that FLRI is a domestic corporation;

2. It is likewise undisputed that on February 25, 2010, petitioner and FLRI entered into a Deed of Transfer[51] whereby petitioner agreed to transfer ownership over certain parcels of land in exchange for a total of 5,722 (4,292 additional subscription and 1,430 unpaid original subscription) common shares in FLRI;

3. Petitioner and (4) four other companies, namely: Fortune Tobacco Corporation ("FTC"), Dominium Realty and Construction Co. ("DRCC"), Parity Packaging Corporation ("PPC") and Orecla Realty, Inc. ("ORI") entered into an exchange of properties with FLRI;[52]

4. Records reveal that after the transfer, the combined ownership of petitioner (along with FTC, DRCC, PPC and ORI) went

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[48] Underscoring ours.
[49] *Commissioner of Internal Revenue v. Filinvest Development Corporation,* G.R. Nos. 163653 and 167689, July 19, 2011.
[50] *Section 40(C)(6)(c) of the 1997 NIRC.*
[51] *Records, Vol. 2, Exhibit "P-8," Deed of Transfer,* pp. 376-378, with annex.
[52] *Id., Exhibit "P-9-C," Application and Joint Certification,* pp. 716-725, with annex.

up to 99.99%, which shows that it gained control over FLRI, for reference:[53]

SUBSCRIBER	AFTER TRANSFER		
	NO. OF SHARES	PERCENTAGE	
FTC	334,295	34.82240%	
PPC	29,522	3.07521%	
DRCC	14,459	1.50615%	
NTRCI	5,722	0.59604%	
ORI	575,997	59.99969%	99.99948%
Harry C. Tan	1	0.00010%	0.00010%
Lucio K. Tan	1	0.00010%	0.00010%
Christopher Nelson	1	0.00010%	0.00010%
Varinia Elero	1	0.00010%	0.00010%
Raymond Miranda	1	0.00010%	0.00010%
TOTAL	**960,000**	**100.00000%**	**100.00000%**

As to respondent's claim that a BIR Ruling is a *condicio sine qua non* before petitioner can avail the benefits under *Section 40(C) of the 1997 NIRC,* the Court finds no basis therefor.

The Revenue Regulations that respondent relied upon merely provide the guidelines in monitoring tax-free exchanges of property, and in order that, in cases of subsequent sales of said property, they shall be taxed accordingly. Therefore, the BIR Ruling or Certification required under *RR No. 18-01* is for determining gain or loss on a subsequent sale or disposition of property subject of the tax-free exchange, and not a precondition for a taxpayer to be entitled to an exemption. There is nothing therein explicitly requiring a party, in exchanging property for shares of stocks, to first secure a BIR confirmatory certification or tax ruling before it can avail itself of tax exemption.

In view of the foregoing discussion, the subject transaction should be considered tax-free under *Section 40(C) of the 1997 NIRC.*

The assessments relating to VAT (first to third quarters), EWT (January to November), and WTC (January to November) already prescribed.

[53] *Records, Vol. 2, Exhibit "P-9-C," Application and Joint Certification,* pp. 716-725, with annex.

Petitioner argues that since the deficiency assessments were issued on December 16, 2013, the assessments for VAT, EWT, WTC and DST, were issued outside the prescriptive period provided in *Section 203 of the 1997 NIRC*. It further posits that respondent's belated claim in his Answer that there was a false or fraudulent return does not justify the application of *Section 222 of the 1997 NIRC* since the same should have been explicitly stated at the earliest opportunity and in the assessment notices, for it is a fundamental requirement of due process that the taxpayer be informed of the factual and legal bases of the assessment. It is the contention of petitioner that if respondent truthfully claims entitlement to ten (10) years, he would not have indicated the due date of December 31, 2013 in its assessment notices.

As to fraud, petitioner avers that it should be proved to exist by clear and convincing evidence, with the sole object of avoiding taxation, and not just by conjectures and speculations; that failure to file a return is not, in itself, evidence of fraud; and that the testimony of respondent's sole witness is absent of any sort of justification as to why his team issued the assessment beyond the three (3) year period.

Lastly, petitioner emphasized that it is a settled rule that an assessment should not be based on mere presumptions, no matter how reasonable or logical; and that due to respondent's failure to prove the basis for extending the period beyond the reglementary three (3) years, assessment beyond it is void.

Respondent, on the other hand insists that petitioner filed a false return, hence, respondent has ten (10) years from discovery thereof to assess petitioner, in view of *Section 222 of the 1997 NIRC*. He further stated that *Section 8 of Revenue Regulations ("RR") No. 18-01* mandates the inclusion of certain information in the Final Adjustment Return and the Audited Financial Statements ("AFS") in cases of tax-free exchanges of property for shares under *Section 40(C)(2) of the 1997 NIRC*; that this strict mandate stems from a long established rule that tax-free exchange transactions partake the nature of tax exemptions, which are strictly construed against the taxpayer and liberally in favor of the state; and that petitioner is charged with the heavy burden of proving that it has complied with and satisfied all statutory and administrative requirements to be entitled thereto.

It is claimed by respondent that petitioner cannot unilaterally assert that the transaction entered into is tax-free, and compliance with

RR No. 18-01 is an indispensable requirement to such claim; that petitioner did not attach to its ITR and AFS its request for ruling and the corresponding certification/ruling from the BIR; that despite the fact that the request for ruling filed on June 7, 2010 has not yet been acted upon, petitioner still filed its ITR on April 15, 2011 excluding the transaction claimed to be tax-free; and that petitioner's failure to comply with the mandatory provisions of *RR No. 18-01* constitutes an intentional wrong-doing, with the sole intent to evade taxes due on the exchange transaction.

Sections 203 and 222(a) of the 1997 NIRC mandates that respondent should issue an assessment for deficiency taxes within three (3) years from the last day prescribed by law to file the tax return or the actual date of filing of such return, whichever comes later; and any assessment notice issued beyond this three (3)-year prescriptive period shall not be valid, save in cases wherein no return was filed, in which assessment may be made within ten (10) years from discovery of the omission, to wit:

> SECTION 203. *Period of Limitation Upon Assessment and Collection.* — Except as provided in Section 222, <u>internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return</u>, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That <u>in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed</u>. For purposes of this Section, <u>a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.</u>
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> xxx xxx xxx
>
> SECTION 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* —
>
> (a) <u>In the case of a false</u> or fraudulent <u>return</u> with intent to evade tax or of failure to file a return, <u>the tax may be assessed</u>, or a proceeding in court for the collection of such tax may be filed without assessment, <u>at any time within ten (10) years after the discovery of the falsity</u>, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken

> cognizance of in the civil or criminal action for the collection thereof.[54]

As to the claim of falsity, in order to warrant a ten (10)-year period to assess, respondent must not only clearly state his basis, he must also present substantial evidence in support thereto.[55] Mere allegations in the pleadings that the case falls under the exception will not suffice.[56]

Respondent's Formal Offer of Evidence[57] failed to provide any proof relating to his claim if falsity. Likewise, his sole witness, RO Plocos, never mentioned that petitioner filed a false return in his Judicial Affidavit[58] as well as during his cross, re-direct and re-cross examinations[59]. Therefore, the general rule [of three (3) years] applies.

Nonetheless, the Court shall determine the issue of prescription for all the assessed taxes. Since the instant case involves deficiency IT, VAT, EWT, WTC, DST, and IAET, the prescribed due dates for the filing of the returns, to be used as bases for the three (3)-year [or ten (10) years for non-filing of a return] prescriptive period, vary accordingly.

Income Tax

Section 77(B) of the 1997 NIRC provides that the filing of the Annual Income Tax Return shall be on or before the fifteenth (15th) day of April, or the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be, to wit:

> SECTION 77. *Place and Time of Filing and Payment of Quarterly Corporate Income Tax.* -
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> xxx xxx xxx

[54] Underscoring ours.
[55] *Commissioner of Internal Revenue v. Next Mobile, Inc.*, G.R. No. 212825, December 5, 2015, affirming the CTA's findings in *Next Mobile, Inc. v. Commissioner of Internal Revenue*, CTA Case No. 7965, December 11, 2012.
[56] *Id.*
[57] *Records, Vol. 3, Respondent's Formal Offer of Evidence*, pp. 954-964.
[58] *Id., Vol. 2, Exhibit "R-10," JA of RO Romualdo I. Plocos*, pp. 268-277
[59] *Transcript of Stenographic Notes ("TSN"), February 16, 2016 Hearing*, pp. 5-28.

> (B) *Time of Filing the Income Tax Return.* - The corporate quarterly declaration shall be filed within sixty (60) days following the close of each of the first three (3) quarters of the taxable year. The final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be.[60]

Using the above as basis, the assessment relative to IT was timely received by petitioner on December 16, 2013 and has not yet prescribed, for reference:

DUE DATE FOR FILING OF RETURN	ACTUAL DATE OF FILING OF RETURN	BASIS	LAST DAY TO ASSESS
15-Apr-11	13-Apr-11[61]	15-Apr-11	15-Apr-14

Value-Added Tax

The filing of the Quarterly VAT Returns must be made within twenty-five (25) days after the close of each taxable quarter. *Section 114(A) of the 1997 NIRC* provides, as follows:

> SECTION 114. *Return and Payment of Value-added Tax.-*
>
> (A) In General. - Every person liable to pay the value-added tax imposed under this Title shall file a quarterly return of the amount of [his/her/its] gross sales or receipts within twenty-five (25) days following the close of each taxable quarter prescribed for each taxpayer: Provided, however, That VAT-registered persons shall pay the value-added tax on a monthly basis.[62]

Therefore, in view of the assessment for VAT on December 16, 2013, respondent's right to assess the first to third quarters of 2010 has prescribed and only the fourth quarter remains, to wit:

2010	DUE DATE FOR FILING OF RETURN	ACTUAL DATE OF FILING OF RETURN	BASIS	LAST DAY TO ASSESS
First Quarter	25-Apr-10	19-Apr-10[63]	25-Apr-10	25-Apr-13
Second Quarter	25-Jul-10	19-Jul-10[64]	25-Jul-10	25-Jul-13

/

[60] Underscoring ours.
[61] *BIR Records*, pp. 195-210.
[62] Underscoring ours.
[63] *BIR Records*, pp. 120-121.
[64] *Id.* at 110-111.

Third Quarter	25-Oct-10	19-Oct-10[65]	25-Oct-10	25-Oct-13
Fourth Quarter	25-Jan-11	25-Jan-11[66]	25-Jan-11	**25-Jan-14**

Creditable and Expanded Withholding Taxes
Withholding Tax on Compensation

Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) must be filed within ten (10) days after the end of each month. However, for the month of December, it shall be filed on or before January 15 of the following year. *Section 58 of the 1997 NIRC* provides that:

> SECTION 58. *Returns and Payment of Taxes Withheld at Source.* –
>
> (A) *Quarterly Returns and Payments of Taxes Withheld.* - xxx
>
> xxx xxx xxx
>
> The return for final withholding tax shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter, while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which withholding was made: Provided, That the Commissioner, with the approval of the Secretary of Finance, may require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the government.[67]

However, the above provision was amended by *Section 2.58(A)(2) of RR No. 2-98*[68], as amended by *RR No. 17-03*[69], *viz.*:

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[65] *BIR Records*, pp. 101-102.
[66] *Id.* at 88-90.
[67] Underscoring ours.
[68] Implementing *Republic Act No. 8424*, "An Act Amending The National Internal Revenue Code, as Amended, "Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Tax," April 17, 1998.
[69] Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as Amended, Providing for Additional Transactions Subject to Creditable Withholding Tax; Re-Establishing the Policy that the Capital Gains Tax on the Sale, Exchange or Other Disposition of Real Property Classified as Capital Assets Shall be Collected as a Final Withholding Tax, Thereby Further Amending Revenue Regulations Nos. 8-98 and 13-99, as Amended by Revenue Regulations No. 14-2000; and for Other Purposes, March 31, 2003.

SECTION 2.58. *Returns and Payment of Taxes Withheld at Source.*

(A) *Monthly return and payment of taxes withheld at source* –

xxx xxx xxx

(2) *WHEN TO FILE* –

(a) For both large and non-large taxpayers, the withholding tax return, whether creditable or final (including final withholding taxes on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements) shall be filed and payments should be made, within ten (10) days after the end of each month, except for taxes withheld for the month of December of each year, which shall be filed on or before January 15 of the following year; and except for the final capital gains tax on the sale or other onerous disposition of real property considered as capital asset which must be taken/withheld from the seller by the buyer and remitted within thirty (30) days from the date of notarization of the transfer document to the collecting agent of the RDO having jurisdiction over the place where the property is located. xxx[70]

Further, *Section 6.3.2(a) of RR No. 17-10* states the following relating to large taxpayers, such as petitioner:

6.3.2 *Withholding Tax Remittance and Information Returns*

a. All withholding taxes for remittance by the Head Office and/or all branches/units of a Large Taxpayer shall be e-filed in a consolidated return within ten (10) days following the end of each month for January to November, and on or before January 15 of the following year for the month of December, using BIR Form Nos. 1601-C, 1601-E, 1601-F and 1602, respectively, on a staggered basis according to the classification of industry pursuant to existing issuances. For the

[70] Underscoring ours.

e-payment, the taxpayer shall give instruction to the AAB to debit its account for the amount of tax payable on or before the due date for payment thereof as prescribed under the prevailing / applicable laws / regulations.

xxx xxx xxx[71]

In view of petitioner's enrollment with the Electronic Filing and Payment System ("EFPS") of the BIR, filing of returns (except for December) shall be in accordance with the schedule set forth in *RR No. 26-2002*, to wit:

Group A	Fifteen (15) days following the end of the month
Group B	Fourteen (14) days following the end of the month
Group C	Thirteen (13) days following the end of the month
Group D	Twelve (12) days following the end of the month
Group E	Eleven (11) days following the end of the month

Considering that petitioner is in the business on "curing and re[-]drying tobacco leaves" and "other business activities, N.E.C.," it belongs to Group B and fourteen (14) days apply.

Therefore, as to EWT and WTC, respondent's right to assess from January to November 2010 has prescribed, leaving December 2010 for which he has the right to assess, *viz.*:

EWT				
2010	**DUE DATE FOR FILING OF RETURN**	**ACTUAL DATE OF FILING OF RETURN**	**BASIS**	**LAST DAY TO ASSESS**
January	14-Feb-10	8-Feb-10[72]	14-Feb-10	8-Feb-13
February	14-Mar-10	9-Mar-10[73]	14-Mar-10	14-Mar-13
March	14-Apr-10	10-Apr-10[74]	14-Apr-10	14-Apr-13
April	14-May-10	6-May-10[75]	14-May-10	14-May-13
May	14-Jun-10	8-Jun-10[76]	14-Jun-10	14-Jun-13
June	14-Jul-10	9-Jul-10[77]	14-Jul-10	14-Jul-13
July	14-Aug-10	7-Aug-10[78]	14-Aug-10	14-Aug-13
August	14-Sep-10	7-Sep-10[79]	14-Sep-10	14-Sep-13
September	14-Oct-10	7-Oct-10[80]	14-Oct-10	14-Oct-13
October	14-Nov-10	8-Nov-10[81]	14-Nov-10	14-Nov-13

[71] Underscoring ours.
[72] *BIR Records*, p. 81D.
[73] *Id.* at 81.
[74] *Id.* at 79.
[75] *Id.* at 77.
[76] *Id.* at 75.
[77] *Id.* at 71.
[78] *BIR Records*, p. 69.
[79] *Id.* at 67.
[80] *Id.* at 65.
[81] *Id.* at 64.

November	14-Dec-10	8-Dec-10[82]	14-Dec-10	14-Dec-13
December	15-Jan-11	10-Jan-11[83]	15-Jan-11	**15-Jan-14**
		WTC		
2010	**DUE DATE FOR FILING OF RETURN**	**ACTUAL DATE OF FILING OF RETURN**	**BASIS**	**LAST DAY TO ASSESS**
January	14-Feb-10	8-Feb-10[84]	14-Feb-10	14-Feb-13
February	14-Mar-10	8-Mar-10[85]	14-Mar-10	14-Mar-13
March	14-Apr-10	10-Apr-10[86]	14-Apr-10	14-Apr-13
April	14-May-10	6-May-10[87]	14-May-10	14-May-13
May	14-Jun-10	7-Jun-10[88]	14-Jun-10	14-Jun-13
June	14-Jul-10	7-Jul-10[89]	14-Jul-10	14-Jul-13
July	14-Aug-10	7-Aug-10[90]	14-Aug-10	14-Aug-13
August	14-Sep-10	7-Sep-10[91]	14-Sep-10	14-Sep-13
September	14-Oct-10	7-Oct-10[92]	14-Oct-10	14-Oct-13
October	14-Nov-10	8-Nov-10[93]	14-Nov-10	14-Nov-13
November	14-Dec-10	8-Dec-10[94]	14-Dec-10	14-Dec-13
December	15-Jan-11	10-Jan-11[95]	15-Jan-11	**15-Jan-14**

Documentary Stamp Tax

Section 200(B) of the 1997 NIRC provides, as follows:

> SECTION 200. *Payment of Documentary Stamp Tax.* –
>
> xxx xxx xxx
>
> (B) *Time for Filing and Payment of the Tax.* – Except as provided by rules and regulations promulgated by the Secretary of Finance, upon recommendation of the Commissioner, the tax return prescribed in this Section shall be filed within ten (10) days after the close of the month when the taxable document was made, signed, issued, accepted, or transferred, and the tax thereon shall be paid at the same time the aforesaid return is filed.

Corollary thereto, *Section 5 of RR No. 06-01* mandates the filing of DST Returns and payment of the DST due thereon within five (5) days

[82] *BIR Records,* p. 62.
[83] *Id.* at 58.
[84] *Id.* at 55.
[85] *Id.* at 51-52.
[86] *Id.* at 48-49.
[87] *Id.* at 44-45.
[88] *BIR Records,* pp. 41-42.
[89] *Id.* at 37-38.
[90] *Id.* at 33-34.
[91] *Id.* at 30-31.
[92] *Id.* at 25-26.
[93] *Id.* at 21-22.
[94] *BIR Records,* pp. 17-18.
[95] *Id.* at 13-14.

after the close of the month when the subject document was made, signed, issued, accepted, or transferred, to wit:

> SECTION 5. *Time for Filing of Documentary Stamp Tax Returns and the Payment of Taxes Due Thereon.* — The time for filing of the documentary stamp tax returns and the payment of the taxes due thereon shall be revised in accordance with the appropriate amendments to existing regulations, as presented below.
>
> (1) Paragraph 19 of Revenue Memorandum Circular No. 1-98 is hereby amended to read as follows:
>
> > "(19) <u>The documentary stamp tax return shall be filed within five (5) days after the close of the month when the taxable document was made, signed, accepted, or transferred, and the tax thereon shall be paid at the same time the aforesaid return is filed.</u>"
>
> (2) For large taxpayers, Section 4(3.6) of Revenue Regulations No. 1-98 is hereby amended to read as follows:
>
> > "Section 4. <u>*Filing of Returns and Payment of Taxes*</u>. —
> >
> > xxx xxx xxx
> >
> > 3. *When to File and Pay*
> >
> > *3.6 Documentary Stamp Taxes*
> >
> > <u>Large taxpayers shall pay their documentary stamp taxes within five (5) days after the close of the month when the taxable document was made, signed, issued, accepted or transferred by the filing of the documentary stamp tax returns, through purchase or actual affixture or by imprinting the documentary stamps through a documentary stamp tax metering machine.</u>"[96]

DST is paid on a *per* transaction basis. Hence, it is important to look into whether petitioner filed the required returns relative to the transactions assessed. Based on the FLD[97], DST assessment relates to the following transactions:

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[96] Underscoring ours.

[97] *Records, Vol. 3, Exhibit "P-6," FLD, Details of Discrepancies, DST,* p. 339.

1. Advances from stockholders on the taxable amount of Php71,000,000.00 pursuant to *Section 179 of the 1997 NIRC*; and

2. Exchange of Assets on the taxable amount of Php61,675,544.00 pursuant to *Section 196 of the 1997 NIRC.*

1. Advances from stockholders

Based on the AFS, advances from stockholders relate to in the amount of Php132,500,000.00 as of December 31, 2010, which are non-interest bearing, uncollaterized and payable on demand.[98] A study of petitioner's 2010 General Ledger[99] shows the components of the advances from stockholders for TY 2010, to wit:

Beginning Balance	Php	61,500,000.00
January 2010		31,000,000.00
April 2010		20,000,000.00
July 2010		30,000,000.00
TOTAL	**PHP**	**132,500,000.00**

Pursuant to *Section 200(B) of the 1997 NIRC,* as amended by *Section 5 of RR No. 06-01,* the DST Return shall be filed within five (5) days after the close of the month when the taxable document was made, signed, issued, accepted, or transferred. Also, *Sections 203 and 222(a) of the 1997 NIRC* mandates that respondent should issue an assessment for deficiency taxes within three (3) years from the last day prescribed by law to file the tax return or the actual date of filing of such return, whichever comes later.

Records reveal that petitioner submitted its Documentary Stamp Tax Declaration/Return (BIR Form No. 2000)[100] on January 4, 2012 covering accumulated DST from the year 2009 to 2011, including the above transactions in January, April, and July 2010 in the amounts of Php31,000,000.00, Php20,000,000.00, and Php30,000,000.00, respectively. Considering that assessment was made on December 16,

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[98] *Records, Vol. 2, Exhibit "P-10-A," AFS, Note 13,* p. 416; in relation to *Records, Vol. 2, Exhibit "P-10," AFS,* p. 396.
[99] *ICPA Report Annexes, Exhibit "P-17," Annex IC-74 (III.e),* p. 605.
[100] *Id., Exhibit "P-17," Annex IC-75 (III.e),* pp. 606-607.

2013, the DST assessment relating to advances from stockholders on the taxable amount of Php71,000,000.00 has not yet prescribed.

2. *Exchange of Assets*

The item on exchange of assets relates to a transaction entered into on February 25, 2010 *per* Deed of Transfer[101]. Considering that petitioner never filed a DST Return relating thereto for taxable year 2010, the assessment may be made within ten (10) years from discovery of the omission.

Records reveal that as early as July 22, 2013, respondent, through its ROs and GS, already found petitioner liable for deficiency DST[102] for the "Exchange of Assets/Disposal of Land (@1.5%, Section 196, NIRC) [Php]61,675,544.00." Hence, it was recommended that an NIC be issued.

Using July 22, 2013 as the date of discovery of petitioner's omission to file a DST Return, the right of respondent to assess will prescribe on July 22, 2023. Records reveal that the assessment was received by petitioner on December 16, 2013, hence, respondent's right to assess has not yet prescribed.

Improperly Accumulated Earnings Tax

The Improperly Accumulated Earnings Tax Return shall be filed within fifteen (15) days after the close of the year immediately succeeding the taxpayer's covered TY, as stated in *Section 6.3.1(b) of RR No. 17-10, viz.*:

> Section 6. FILING OF RETURNS AND PAYMENT OF TAXES BY LARGE TAXPAYERS
>
> xxx xxx xxx
>
> 6.3 When to File and Pay for Large Taxpayers
>
> 6.3.1 Income Tax

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[101] *Records, Vol. 2, Exhibit "P-8," Deed of Transfer,* pp. 376-378, with annex.
[102] *BIR Records, Exhibit "R-4," July 22, 2013 Memorandum,* p. 284.

xxx xxx xxx

> b. Corporate taxpayers with Improperly Accumulated Earnings Tax (BIR Form No. 1704), shall e-file and e-pay within fifteen (15) days after the close of the year immediately succeeding taxpayer's covered taxable year.

Considering that petitioner never filed an IAET for TY 2010, the assessment may be made within ten (10) years from discovery of the omission.

Records reveal that as early as July 22, 2013, respondent, through its ROs and GS, already found petitioner liable for deficiency IAET[103] in the total amount of Php58,457,287.42, inclusive of surcharge, interest and compromise penalty; and by virtue of the above findings, the ROs and GS recommended the issuance of an NIC.

Using July 22, 2013 as the date of discovery of petitioner's omission to file its IAET Return, the right of respondent to assess will prescribe on July 22, 2023. Considering that assessment was received by petitioner on December 16, 2013, respondent's right to assess has not yet prescribed.

Petitioner is liable to pay deficiency IT, EWT, and WTC, in reduced amounts.

Having settled the issue of prescription, the Court shall now determine the tax liabilities of petitioner.

Income Tax - Php14,914,353.93

Respondent computed the deficiency IT assessment in the amount of Php14,914,353.93, inclusive of increments, as follows:

DETAILS			AMOUNTS	
1. Disallowed salaries and wages not subjected to WTC			Php	304,487.77
2. Disallowed expenses/income payment - No EWT				
A. Expenses/income payments subject to 1% EWT	Php	252,410.00		
B. Expenses/income payments subject to 2% EWT		141,260.93		393,670.93

[103] *BIR Records, Exhibit "R-4," July 22, 2013 Memorandum*, p. 284.

3. Gain on sale of assets				31,424,335.00
Taxable Income *Per* Audit			Php	32,122,493.70
Tax Rate				30%
Deficiency Tax Due			Php	9,636,748.11
Add: Interest (4-16-11 to 12-31-13)	Php	5,227,605.82		
Compromise Penalty		50,000.00	Php	5,277,605.82
TOTAL DEFICIENCY INCOME TAX DUE			**PHP**	**14,914,353.93**

Three (3) items are vital in the determination of whether or not petitioner is liable for any deficiency IT for TY 2010, namely:

ITEMS		AMOUNTS	
1.	Disallowed salaries and wages not subjected to WTC	Php	304,487.77
2.	Disallowed expenses/income payments not subjected to EWT		393,670.93
3.	Gain on sale of assets		31,424,335.00

1. *Disallowed Salaries and Wages not Subjected to WTC – Php304,487.77*

Respondent computed the disallowed salaries and wages not subjected to WTC as follows:

DETAILS	AMOUNTS	
Total compensation payments *per* audited FS/ITR		
Cost of services - salaries and wages	Php	49,440,135.00
Operating expenses and charges - salaries and wages		9,688,385.20
Total	Php	59,128,520.20
Less: Cost and expenses/compensation subject to WTC *per* alphalist		58,824,032.03
TOTAL COMPENSATION NOT SUBJECTED TO WTC *PER* AUDIT	**PHP**	**304,488.17**

Petitioner argued that the assessment lacks factual and legal basis; and that the disallowed amount represents monetized unused vacation leave credits which is part of the *de minimis* benefits given to managerial, and rank and file employees not subject to WTC, as provided in *RR No. 2-98*, in relation to *Section 32(B)(7)(e)(iv) of the 1997 NIRC.*

While petitioner submitted supporting documents, such as Alphabetical List of Employees/Payees from whom Taxes were Withheld for the Year 2010[104], Summary of Payroll for the year 2010[105] and General Ledger 2010-Vacation Leave[106], the disallowed amount cannot be considered as *de minimis* benefits because petitioner failed to

[104] *Records, Vol. 2, Exhibit "P-13,"* pp. 439-596.
[105] *ICPA Report Annexes, Exhibit "P-17," Annexes IC-32.1 (III.a) to IC-32.84 (III.a),* pp. 165-419.
[106] *Id., Exhibit "P-17," Annex IC-32 (III.a),* p. 164.

provide payroll lists, with relevant details or schedule detailing the names of its employees; as well as the number of monetized leave credits and its corresponding amount received by each employees; in order for this Court to ascertain whether the same did not exceeded the acceptable ceiling for *de minimis* set by *Section 2.78.1 of RR No. 02-98*, that is the monetized value of unused vacation leave credits of ten (10) days or less, which were paid to the employee during the year. Hence, respondent's assessment on this item is upheld.

2. *Disallowed Expenses/Income Payments not Subjected to EWT – Php393,670.93*

2.1 *Expenses/Income Payments Subject to 1% EWT - Php252,410.00.*

In the FLD's Details of Discrepancies[107], respondent stated that the disallowed expenses/income not subjected to one percent (1%) EWT can be broken down as follows:

ITEMS	AMOUNTS	
Machinery and Equipment	Php	79,464.00
Car and Delivery Equipment		62,500.000
Office Equipment		109,446.00
Medical Supply		1,000.00
TOTAL	**PHP**	**252,410.00**

The Court-appointed ICPA stated in his ICPA Report[108] that the amount of Php251,410.00 (Php79,464.00 plus Php62,500.00 and Php109,446.00) was reflected as an increase in Property, Plant and Equipment ("PPE") in the 2009 AFS. The same amount was subjected to EWT, as verified and validated against the 2009 Alphalist of Payees Subject to [EWT].[109]

The Court agrees with these findings, an examination of the 2010 AFS[110] also reveals that these PPEs were already disposed as of December 31, 2009, thus, non-existent throughout the assessment period. On this account, the assessment on disallowed expenses/income not subject to one percent (1%) EWT amounting to Php251,410.00 is cancelled. However, the assessment on medical

[107] *Records, Vol. 3, Exhibit "P-6,"* p. 903.
[108] *Id., Exhibit "P-16,"* p. 819.
[109] *ICPA Report Annexes, Exhibit "P-17," Annex IC-34 (III.a),* pp. 451-461.
[110] *Records, Vol. 2, Exhibit "P-10-A,"* p. 414.

supply of Php1,000.00 remains for petitioner's failure to provide documents in support thereto.

2.2 *Expenses/Income Payments Subject to 2% EWT - Php141,260.93.*

On the other hand, respondent computed the disallowed expenses/income payments not subjected to two percent (2%) EWT in the following manner:

Insurance	Php	249,446.50
Transportation and Travel		48,605.62
Communication, Light and Water		8,625.21
Miscellaneous		590,936.08
Total	Php	897,613.41
Less: Expenses/income payments subjected to 2% EWT		756,352.48
EXPENSES/INCOME PAYMENTS NOT SUBJECTED TO 2% EWT	**PHP**	**141,260.93**

2.2.a) Insurance - Php249,446.50

Petitioner paid insurance to Value Care Health Systems, Inc. amounting to Php748,339.48 (without VAT) with Official Receipt ("OR") No. 057078.[111] An examination of the said OR reveals that petitioner paid EWT of Php14,966.79 or two percent (2%) of Php748,339.48. Hence, this Court agrees with the ICPA that the amount of Php249,446.50, being referred to by respondent, represents the amortized portion of the Prepaid Insurance account, thus, subjecting it to two percent (2%) EWT is improper.

2.2.b) Transportation and Travel - Php48,605.62

This amount of Php48,605,.62 represents reimbursements for local transportation, *e.g.* jeepney, bus, padyak and kalesa, where obtaining a receipt and subjecting it to withholding tax is impossible. However, petitioner did not present documents such as ORs, invoices, schedules, and reimbursements vouchers to corroborate such expenses, thus, this assessment remains.

2.2.c) Communication, Light and Water - Php8,625.21

[111] *ICPA Report Annexes, Exhibit "P-17," Annex IC-36 (III.a),* p. 477.

This was paid to Digitel Telecommunications Philippines, Inc. amounting to Php8,014.00 with OR Nos. 000146842[112], 000146843[113], 000146844[114], 000146845[115] and 000146846[116]. Upon scrutiny of the said ORs, the Court finds that petitioner did not withhold EWT for these transactions. Although the ICPA stated that this amount was subjected to EWT, which was remitted and reported *per* BIR Form No. 1604E, such BIR Form was not presented, hence, the assessment is upheld.

2.2.d) Miscellaneous - Php590,936.08

This represents penalties for late payments of land acquisition amounting to Php428,110.75 and various petty cash expenses amounting to Php162,825.33.

Petitioner presented Withholding Tax Remittance Return (BIR Form No. 1606)[117] and PNB BTR-BIR Payment Slip[118] reflecting the payment of surcharge, interest and compromise for land acquisition amounting to Php428,110.75. For this reason, the Court cancels this assessment.

However, the assessment on various petty cash expenses amounting to Php162,825.33 is proper since petitioner provided only its Cash Disbursements Book ("CDB") to dispute this assessment. It must be noted that ORs, invoices, schedules, and other documents are necessary to support the entries in the CDB.

3. *Gain on Sale of Assets – Php31,424,335.00*

As previously discussed, petitioner's exchange of assets is considered tax-free, as provided under *Section 40(C) of the 1997 NIRC;* thus, any gain resulting therefrom is not subject to tax. Consequently, respondent's assessment on this transaction is inappropriate.

Based from the foregoing, petitioner is liable for basic deficiency IT for TY 2010 in the amount of Php157,663.18, computed as follows:

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[112] *ICPA Report Annexes, Exhibit "P-17," Annex IC-37 (III.a),* p. 479.
[113] *Id.*
[114] *Id.*
[115] *Id.* at 480.
[116] *Id.*
[117] *Id., Annex IC-38.1 (III.a),* p. 505.
[118] *ICPA Report Annexes, Exhibit "P-17," Annex IC-38.1 (III.a),* p. 506.

DETAILS		AMOUNTS		
1. Disallowed salaries and wages not subjected to WTC			Php	304,487.77
2. Disallowed expenses/income payment - No EWT				
A. Expenses/income payments subject to 1% EWT				
Medical Supply	Php	1,000.00		
B. Expenses/income payments subject to 2% EWT				
Transportation and Travel		48,605.62		
Communication, Light and Water		8,625.21		
Miscellaneous		162,825.33	Php	221,056.16
Taxable Income *Per* Audit			Php	525,543.93
Tax Rate				30%
BASIC DEFICIENCY INCOME TAX DUE			**PHP**	**157,663.18**

Value-Added Tax - Php10,550,532.92

Respondent assessed petitioner for deficiency VAT for TY 2010 amounting to Php10,550,532.92, inclusive of increments, for failure to account for the proceeds on exchange/disposal of land, computed as follows:

DETAILS		AMOUNTS		
Total Sales *per* Return			Php	72,103,957.20
Adjustments *per* investigation				
Proceeds on Exchange of Assets (Gross up by /1.12)	Php	61,675,544.00		
Less: VAT Portion		6,608,094.00		55,067,450.00
Total Taxable Sales *per* Audit			Php	127,171,407.20
Output Tax Due				
Output Tax Due (12%)			Php	15,260,568.86
Less: Input Tax *Per* Return				6,446,060.15
Output Tax Payable			Php	8,814,508.71
Less: Payment *Per* Return				2,206,414.72
VAT Still Due			Php	6,608,093.99
Add: Interest (1/26/2011 to 12/31/2013)	Php	3,892,438.93		
Compromise Penalty		50,000.00		3,942,438.93
TOTAL VAT PAYABLE			**PHP**	**10,550,532.92**

The above VAT assessment arose purely from petitioner's transfer of property, which was already settled by this Court as a tax-free transaction. For this reason, respondent's deficiency VAT assessment bears no merit.

Withholding Tax on Compensation - Php358,711.16

Respondent's assessment on deficiency WTC arises from a discrepancy between the salaries and wages *per* alphalist and *per* AFS/ITR, which petitioner failed to substantiate with proper documents. Such deficiency was computed as follows:

DETAILS	TAX BASE		TAX DUE	
Total compensation payments *per* audited FS/ITR				
Cost of Services - Salaries and Wages	Php	49,440,135.00		
Operating Expense and Charges - Salaries and Wages		9,688,385.20		
Total	Php	59,128,520.20	Php	2,848,494.82
Cost and Expenses subject to WTC *per* Alphalist		58,824,032.03		2,633,194.35
Cost and Expenses not subjected to WTC	Php	304,488.17		
Basic Deficiency WTC (using ave. rate of 0.04817)			Php	215,300.47
Add: Interest (20% from 1-16-11 to 12-31-13)				127,410.69
Compromise Penalty				16,000.00
TOTAL WTC DUE			PHP	358,711.16

This Court will use the amount of Php304,488.17 as the basis for cost/expenses not subjected to WTC since it cannot determine how respondent computed the assessment pertaining to the "Tax Due" portion. The Court noticed that there were mathematical errors committed like Php59,128,520.20 multiplied by 0.04817 is Php2,848,220.82, and not Php2,848,494.82; as well as Php58,824,032.03 multiplied by 0.04817 is Php2,833,553.62, and not Php2,633,194.35.

As previously discussed, Php304,488.17 represents employee benefits in the form of monetization of unused vacation leaves. As previously discussed, this was upheld by the Court since petitioner failed to provide relevant documents or schedules to determine compliance with the ten (10)-day ceiling of monetization of unused vacation leaves.

In line with the issue on prescription, the Court already ruled that respondent's right to assess from January to November 2010 has already prescribed, leaving December 2010 for which he has the right to assess. Accordingly, petitioner is only liable for basic deficiency WTC in the amount of Php782.39 for December 2010, computed as follows:

DETAILS	AMOUNTS	
Monetized Vacation Leaves for 2010[119]	Php	304,488.17[120]
Monetized Vacation Leaves		
January to November 2010		288,245.96
December 2010		16,242.21
Average Rate		0.04817
BASIC DEFICIENCY WTC	**PHP**	**782.39**

PAYROLL PERIOD	PAYEES	AMOUNT

[119] *Records Vol. 3, Exhibit "P-16,"* pp. 816-818.
[120] Difference of Php363.63.

12/3/2010	Officers and Staff	Php	5,207.67 [121]
12/4/2010	Daily-Regular		5,887.00 [122]
12/11/2010	Daily-Regular		3,157.50 [123]
12/13/2010	Officers and Staff		815.38[124]
12/15/2010	Officers and Staff		1,174.66 [125]
TOTAL		**PHP**	**16,242.21**

Expanded Withholding Tax - Php10,014.94

Respondent computed the deficiency EWT amounting to Php10,014.94, inclusive of increments, in the following manner:

Expanded Withholding Tax *Per* Return			Php	18,802.05
Income Payments not Subjected to EWT				
@ 1% EWT (Php252,410.00)	Php	2,524.10		
@ 2% EWT (Php141,260.93)		2,825.22	Php	5,349.32
Total			Php	24,151.37
EWT remitted *per* Return				18,802.05
Basic EWT Deficiency			Php	5,349.32
Interest (1-16-11 to 12-31-13)				3,165.62
Compromise Penalty				1,500.00
TOTAL EWT DUE			**PHP**	**10,014.94**

As earlier discussed, petitioner failed to provide substantial documents to refute respondent's assessment on EWT, hence, petitioner has expenses not subjected to EWT in the amount of Php221,056.16, broken down as follows:

Disallowed expenses/income payment - No EWT				
A. Expenses/income payments subject to 1% EWT				
Medical Supply			Php	1,000.00
B. Expenses/income payments subject to 2% EWT				
Transportation and Travel	Php	48,605.62		
Communication, Light and Water		8,625.21		
Miscellaneous		162,825.33		220,056.16
DISALLOWED EXPENSES/INCOME PAYMENTS NOT SUBJECTED TO EWT			**PHP**	**221,056.16**

As already settled by this Court, respondent's right to assess from January to November 2010 already prescribed. Therefore, only unsupported/disallowed transactions for December 2010 will be assessed for non-withholding of EWT.

[121] *Records Vol. 3, Exhibit "P-16,"* p. 817.
[122] *Id.*
[123] *Id.*
[124] *Id.* at 818.
[125] *Id.*

ORs[126] supporting communication, light and water expenses amounting to Php8,625.21 were all dated January 23, 2010, thus prescribed.

Miscellaneous expenses amounting to Php162,825.33 represents various petty cash purchases. However, an examination of the CDB reveals that only Php5,248.00 (Php2,800.00[127] plus Php2,448.00[128]) were incurred in December 2010, therefore only the said miscellaneous expenses will be subjected to two percent (2%) EWT.

For not being supported by any document, the full amounts of expenses relating to Medical Supply, and Transportation and Travel, amounting to Php1,000.00 and Php48,605.62, respectively, are subject to EWT since it is impossible for this Court to determine the expenses in relation thereto incurred solely in December 2010.

In fine, petitioner is liable for basic deficiency EWT amounting to Php1,087.07, computed as follows:

ITEMS	EXPENSES		RATES	EWT	
Medical Supply	Php	1,000.00	1%	Php	10.00
Transportation and Travel		48,605.62	2%		972.11
Miscellaneous		5,248.00	2%		104.96
BASIC EWT DUE				**PHP**	**1,087.07**

Documentary Stamp Tax - Php2,389,751.77

Respondent assessed petitioner for deficiency DST resulting from transactions involving advances from stockholders and exchange of assets, computed as follows:

DETAILS	AMOUNTS		RATES	DST DUE	
Advances from Stockholders	Php	132,500,000.00			
Less: Beg. Balance - included in 2009 PAN		61,500,000.00			
Loans during the Year	Php	71,000,000.00	1.00 *per* 200.00	Php	355,000.00
Exchange of Assets - Land	Php	61,675,544.00	1.5%	Php	925,140.00
Basic Deficiency DST Due				Php	1,280,140.00
Add: Surcharge	Php	320,035.00			
Interest (1-6-11 to 12-31-13)		764,576.77			
Compromise Penalty		25,000.00		Php	1,109,611.77

[126] *ICPA Report Annexes, Exhibit "P-17," Annex IC-37 (III.a),* pp. 479-480.
[127] *Id., Annex IC-38 (III.a),* p. 503.
[128] *Id.* at 504.

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TOTAL DST DUE	PHP	2,389,751.77

1. *Advances from Stockholders - Php355,000.00*

Petitioner submitted Documentary Stamp Tax Declaration/Return (BIR Form No. 2000)[129], filed on January 4, 2015 and paid[130] on January 5, 2012, pertaining to "bonds, loan agreements," with the computation below:

DETAILS	AMOUNTS	
Tax Base	Php	212,500,000.00
Tax Rate		1.00 *per* 200.00
DST PAID	**PHP**	**1,062,500.00**

The Court agrees with the analysis of the ICPA that the above DST payment represents accumulated DST from TYs 2009 to 2011. Considering that the corresponding DST due for TY 2010 was already paid, the assessment relating to DST on advances from stockholders is hereby cancelled.

2. *Exchange of Assets - Php925,140.00*

Records disclose that no DST was paid on this particular transaction, thus, petitioner was assessed for non-payment of DST. However, as discussed earlier, this involves a tax-free transaction, hence, imposing DST is erroneous. Moreover, *Section 199(m) of the 1997 NIRC* provides that the same is not subject to DST, to wit:

> SECTION 199. *Documents and Papers Not Subject to Stamp Tax.* — The provisions of Section 173 to the contrary notwithstanding, the following instruments, documents and papers shall be exempt from the documentary stamp tax:
>
> xxx xxx xxx
>
> (m) Transfer of property pursuant to Section 40(c)(2) of the National Internal Revenue Code of 1997, as amended.[131]

[129] *ICPA Report Annexes, Exhibit "P-17," Annex IC-75 (III.e)*, pp. 606-607.
[130] *Id.* at 608.
[131] Underscoring ours.

Improperly Accumulated Earnings Tax - Php61,600,280.46

Section 29 of the 1997 NIRC is the basis for the imposition of IAET, for reference:

> *SECTION 29. Imposition Improperly Accumulated Earnings Tax-*
>
> (A) *In General* - In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.
>
> (B) *Tax on Corporations subject to Improperly accumulated Earnings Tax. -*
>
> (1) *In General* - The improperly accumulated earnings tax imposed in the preceding Section shall apply to every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.
>
> xxx xxx xxx[132]

The Court agrees with the ICPA in his reliance on *Section 5*[133] *of SEC Memorandum Circular No. 11,* which states that actual earnings or profits, net of unrealized items, shall be considered for a corporation to declare dividends, to wit:

> SECTION 5. *Retained earnings available for dividends.* Dividends, whether cash, property or stock, shall be declared out of unrestricted retained earnings of the Corporation. Accordingly, a corporation cannot declare dividends when it has zero or negative retained earnings otherwise known as Retained Earnings deficit. For such purpose, the surplus profits or income must be a *bona fide* income founded upon actual earnings or profits. The existence, therefore, of surplus

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[132] *Id.*
[133] *ICPA Report Annexes, Exhibit "P-17," Annex IC-78 (III.f)*, p. 617.

profits arising from the operation of corporate business is a condition precedent to the declaration of dividend.

Respondent assessed petitioner for deficiency IAET, amounting to Php61,600,280.45, inclusive of increments, computed as follows:

Taxable Income from Operations			Php	(143,057.90)
Add: Income Subject to Final Tax	Php	31,424,335.00		
Effects of Change in Accounting For Employee Benefits		4,395,628.00		35,819,963.00
Total			Php	35,676,905.10
Income Tax for the Year				525,992.95
Improperly Accumulated Earnings			Php	35,150,912.15
Add:				
Retained Earnings from prior period				349,748,585.00
Accumulated Earnings as of the Taxable Year			Php	384,899,497.15
Less: Amount that maybe retained (100% of paid-up as of 2010)				10,000,000.00
Taxable IAET			Php	374,899,497.15
Rate				10%
Basic IAET Due			Php	37,489,949.72
Add: Surcharge	Php	9,372,487.43		
Interest (1-16-12 to 12-31-13)		14,687,843.31		
Compromise Penalty		50,000.00		24,110,330.74
TOTAL DEFICIENCY IAET			**PHP**	**61,600,280.46**

The above assessment arose from transactions involving petitioner's gain on exchange land amounting to Php31,424,335.00 and unrealized gain on exchange of assets amounting to Php349,748,585.00, which the Court already ruled to be tax-free, hence, not subject to IAET.

The effects of change in accounting for employee benefits of Php4,395,628.00 represents the actuarial revaluation of retirement benefits. This accrued benefit cost is an unfunded obligation[134], therefore not a realized revenue but only a theoretical income. Therefore, this Court agrees with the findings of the ICPA that in accordance with *SEC Memo Circular No. 11*[135], there is no Distributable Income[136], therefore, there is no improperly accumulated earnings that could be subjected to IAET.

Consequently, the assessment on basic deficiency IAET, as well as its increments, amounting to Php61,600,280.46 is hereby canceled.

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[134] *Records, Vol. 2, Exhibit "P-10," Notes to AFS, Note 14,* pp. 416-417.
[135] Series of 2008.
[136] *ICPA Report Annexes, Exhibit "P-17," Annex IC-79 (III.f),* p. 621.

Petitioner is not liable to pay Php192,500.00 as total compromise penalty.

Respondent's imposition of compromise penalties amounting to Php192,500.00 cannot be sustained. Under *Revenue Memorandum Order ("RMO") No. 01-90,* as amended by *RMO No. 19-07,* compromise penalties are only amounts suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that the taxpayer refuses to pay the same.

It is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because, by its very nature, it implies a mutual agreement between the parties with respect to the thing or subject matter that is so compromised, and the choice of paying or not paying the penalty distinctly belongs to the taxpayer.[137] The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[138]

Absent any clear showing that petitioner consented to the compromise penalties, its imposition should be deleted.

In view of the foregoing, the present Petition for Review is hereby **PARTIALLY GRANTED**. Petitioner is hereby **ORDERED TO PAY** deficiency IT, WTC and EWT in the reduced amount of Php199,415.80, inclusive of the twenty five percent (25%) surcharge imposed under *Section 248(A)(3) of the 1997 NIRC,* computed as follows:

TAX TYPE		BASIC	25% SURCHARGE			TOTAL
IT	Php	157,663.18	Php	39,415.80	Php	197,078.98
WTC		782.39		195.60		977.99
EWT		1,087.07		271.77		1,358.84
TOTAL	**Php**	**159,532.64**	**Php**	**39,883.16**	**Php**	**199,415.80**

In addition, petitioner is also **ORDERED TO PAY**:

[137] *The Philippines International Fair, Inc. v. Collector of Internal Revenue, et. al.,* G.R. Nos. L-12928 and L-12932, March 31, 1962, 4 SCRA 774.

[138] *Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc., et. al.,* G.R. No. L-35266, January 21, 1991, 193 SCRA 86.

1. Deficiency interest at the rate of twenty percent (20%) *per annum* on the basic deficiency IT, WTC and EWT computed from the dates indicated below until full payment thereof, pursuant to *Section 249(B) of the 1997 NIRC;* and

TAX TYPE	BASIC	DEFICIENCY INTEREST COMPUTED FROM
IT	Php 157,663.18	April 15, 2011
WTC	782.39	January 15, 2011
EWT	1,087.07	January 15, 2011

2. Delinquency interest at the rate of twenty percent (20%) *per annum* on the amount of Php199,415.80, representing the basic deficiency IT, WTC and EWT and the corresponding twenty five percent (25%) surcharge, and on the twenty percent (20%) deficiency interest which have accrued as aforestated in item (1), computed from December 16, 2013[139] until full payment thereof, pursuant to *Section 249(C) of the 1997 NIRC.*

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

Ma. Belen M. Ringpis-Liban

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

[139] *Records, Vol. 2, Exhibit "P-6,"* p. 335.

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 *Article VIII, Section 13 of the Constitution* and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice