REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

****

LITTLEGIANT STEEL PIPE CORPORATION,
Petitioner,

C.T.A. CASE NO. 6203

Members:

\- versus -

ACOSTA, *Chairman*
BAUTISTA, and
CASANOVA, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

JUL 19 2005

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DECISION

***ACOSTA, E., P.J.*:**

This case involves a judicial review of the final decision[1] of the respondent Commissioner of Internal Revenue regarding two (2) disputed assessments for deficiency income tax and value-added tax in the aggregate amount of P140,958,961.72 for the calendar year ended December 31, 1997.

The facts as established by the records and pleadings of the case are as follows:

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[1] Exhibits PPPPPP and PPPPPP-1.

Petitioner Littlegiant Steel Pipe Corporation is a corporation duly organized and existing under the laws of the Republic of the Philippines with office address at JTKC Compound, Cainta, Rizal.[2]

On July 20, 1998, petitioner received a Letter of Authority No. 000018424 dated July 17, 1998 authorizing Revenue Officers E. Sandoval, S. Pagdilao, C. Dongon, C. Lee, M. Arias, and C. Floreza to be supervised by Grp. Head S. Camara of Special Team created pursuant to RSO 673-98 to examine its books of accounts and other accounting records for all internal revenue taxes for the period 1997 and unverified prior years.[3]

Eventually, on January 20, 2000, petitioner received two (2) undated Assessment Notices issued by the Enforcement Service of the Bureau of Internal Revenue through Assistant Commissioner Percival T. Salazar covering the following 1997 deficiency tax assessments[4]:

	Basic	Interest	Compromise	Total
Deficiency Income Tax (ST-INC-97-0160-2000)	P 76,635,252.15	P18,476,376.12	P25,000.00	P 95,136,628.27
Deficiency Value-Added Tax (ST-VAT-97-0159-2000)	30,196,045.36	15,601,288.09	25,000.00	45,822,333.45
Totals	P106,831,297.51	P34,077,664.21	P50,000.00	P140,958,961.72

On January 21, 2000, petitioner received Final Notice[5] of demand requiring it to pay within thirty days upon receipt the deficiency tax assessments the total amount of P140,958,961.72.

On February 21, 2000, petitioner posted through registered mail its protest[6] requesting for the cancellation of the aforementioned deficiency tax assessments.

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[2] Per Letter of Authority No. 000018424, Exhibit LLLLLL.
[3] BIR Records, p. 438; Summary of Stipulated Facts, par. 3.
[4] BIR records, pages 830 and 831.
[5] Exhibit OOOOOO.

On April 24, 2000, petitioner submitted all the relevant supporting documents to refute the merit of the assessments in accordance with Section 228 of the National Internal Revenue Code of 1997.[7]

On November 20, 2000, within thirty (30) days from the lapse of one hundred eighty (180) days from the submission of supporting documents with the respondent, petitioner filed the instant Petition for Review with this Court pursuant to Section 228 of the National Internal Revenue Code of 1997.

The jointly stipulated issues to be resolved by the Court are the following:

> 1. Whether the assessment for deficiency income tax in the amount of P95,136,628.27, inclusive of increments, has basis in fact and in law. Such assessment is broken down, as follows:
>
> > 1.1. Whether there are alleged unrecorded sales of P193,032,000.00 to Milwaukee Industries Corporation.
> >
> > 1.2. Whether the foreign exchange losses totaling P12,444,701.84 sustained by Petitioner during the year are proper deductions from gross income during that year.
> >
> > 1.3. Whether the custom duties paid to the banks for incoming importations of the company should be allowed as deductions from gross income.
> >
> > 1.4. Whether there are undeclared importations which resulted in an alleged untaxed gross profit of P11,264,518.73.
> >
> > 1.5. Whether export sales amounting to P1,727,504.38 are not supported by documents.
>
> 2. Whether the assessment for deficiency value-added tax in the amount of P45,822,333.45, inclusive of increments,

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[6] Exhibit QQQQQQ.
[7] Exhibit RRRRRR; Summary of Stipulated Facts, par. 7.

has basis in fact and in law. Such assessment is broken down, as follows:

2.1. Whether there are alleged unrecorded sales of P193,032,000.00 to Milwaukee Industries Corporation.

2.2. Whether discounts after sales in the amount of P1,245,823.76 are not allowable for VAT purposes.

2.3. Whether there is a substantive discrepancy between total vatable sales per invoices, net of discounts, and total vatable sales declared per return which resulted in unaccounted vatable sales of P35,551,883.56.

1. DEFICIENCY INCOME TAX P95,136,628.27

The deficiency income tax of petitioner was computed by the examiners as follows[8]:

Taxable Net Income per Return		P 1,397,215.20
Add/(Less) Adjustments		
Unrecorded sales to Milwaukee Ind.	P193,032,000.00	
Disallowed exchange rate differential	12,444,701.84	
Disallowed import purchases	1,295,759.00	
Untaxed gross profit on unrecorded imported purchases	11,264,518.73	218,036,979.57
Taxable Net Income per Audit		P219,434,194.77
Income Tax Due		P 76,801,968.17
Less: Tax Withheld/Paid per Return		166,716.02
Deficiency Income Tax		P 76,635,252.15
Add:		
Interest	P 18,476,376.12	
Compromise	25,000.00	18,501,376.12
TOTAL AMOUNT PAYABLE		P 95,136,628.27

1.1. Unrecorded sales

In September 1997, petitioner delivered to Milwaukee Industries Corporation 21,448 metric tons of hot rolled steel coils valued at P193,032,000.00. The deliveries were paid through local Letters of Credit (LC) opened with Rizal Commercial Banking Corporation (RCBC) and were credited in petitioner's Current Account Number 109-04347-8.

[8] BIR Records, page 764.

However, after evaluation of petitioner's pro-forma sales invoices and delivery receipts, the examiners noted that the sales were not recorded by petitioner. They also found that the proceeds of the letters of credit were not recorded in petitioner's books of accounts. Hence, the latter was assessed of unrecorded sales in the amount of P193,032,000.00.

Petitioner does not dispute the deliveries of hot rolled steel coils to Milwaukee Industries Corporation and the drawing of letters of credit with RCBC for the payment of the goods. However, petitioner argues that there are no unrecorded sales. The delivery and drawing of the LC were erroneous being based on the misunderstanding of the parties. The sales were not recorded because they were eventually cancelled. Milwaukee returned the goods and petitioner paid the equivalent amount of the LCs drawn. And since the sales were not recorded, petitioner also did not record the goods returned by Milwaukee Industries Corporation. Hence, it alleges that the unrecorded sales were already offset against the unrecorded sales returns.

Petitioner presented the letter dated October 8, 1997 of Milwaukee Industries Corporation[9] to support its contention that the parties agreed to cancel the sales. For better appreciation, the said letter is hereby fully reproduced:

October 8, 1997

LITTLEGIANT STEEL PIPE CORPORATION
F.P. Felix Avenue, Cainta, Rizal

Attention: Mr. Nazarito Fua
Plant Manager
Re: Hot Rolled Steel Coils

[9] *Exhibits KKKKKK and KKKKKK-1.*

Gentlemen:

We write to confirm our agreement on the matter. To prevent litigation and by way of compromise, we agreed on the following:

(1) Milwaukee will be returning the hot rolled steel coils. Littlegiant delivered under Delivery Receipts Nos. 16872, 17915, 17918, 17952, 17857, 179556, 179652, and 179673 on September 8 to26, 1997. Milwaukee shall be able for returning the cost of returning the same. Milwaukee confirms receipt through Rizal Commercial Banking Corporation (RCBC) check nos. 651119, 651142, 651143 and 651179 totalling 193,032,000.00 (in pesos) of drawing erroneously made by Littlegiant on RCBC Letters of Credit BFX109LC9700D4233, BFX103LC9700D4236, FBX109LC9700D4238, and BFX109LC9700D4241;

(2) Milwaukee and Littlegiant shall release, remiss and forever discharge each other, their officers, employees, agents and successors-in-interest from any action, sum of money or other obligations arising from or in connection with the above-referenced matter.

If the foregoing reflects our agreement, kindly signify your signature by signing the space provided below.

Very truly yours,

(signed)
Philip Go
Milwaukee Industries Corporation

Conforme:

(signed)
Nazarito Fua
Littlegiant steel Pipe Corporation

Likewise, to prove that petitioner returned the proceeds of the LCs in the sum of P193,032,000.00, four checks in favor of Milwaukee Industries Corporation were offered as evidence to the Court, to wit:

PAYMENT				LETTER OF CREDIT			
Date	Check No.	Exh.	Amount	Date	LC No.	Exh.	Amount
09/26/97	651119	A, A-1	P 52,020,000.00	09/26/97	BFX109LC9700D4233	F	P 52,020,000.00
09/30/97	651142	B, B-1	54,000,000.00	09/30/97	BFX103LC9700D4236	G	54,000,000.00
10/02/97	651143	C, C-1	47,007,000.00	10/02/97	BFX109LC9700D4238	H	47,007,000.00
10/06/97	651179	D, D-1	40,005,000.00	10/06/97	BFX109LC9700D4241	I	40,005,000.00
			P193,032,000.00				P193,032,000.00

Moreover, the deliveries of the returned hot rolled steel coils to petitioner by Milwaukee were supported by the following documents:

Date	Exh.	Covered by DR No.	Weight in MT	Amount
10-13-97	Z	179652	2,222.50	P 20,002,500.00
10-16-97	AA	179673	2,222.50	20,002,500.00
10-20-97	BB	16872	2,890.00	26,010,000.00
10-23-97	CC	17857	2,890.00	26,010,000.00
10-27-97	DD	17952	2,611.50	23,503,500.00
10-29-97	EE	179556	2,611.50	23,503,500.00
11-02-97	FF	17918	3,100.00	27,900,000.00
11-05-97	GG	17915	2,900.00	26,100,000.00
Total			21,448.00	P193,032,000.00

We find the above documentary evidence of petitioner sufficient to support its explanation that indeed its sales to Milwaukee Industries Corporation of hot rolled steel coils were cancelled.

We are also convinced that the unrecorded sales were cured by the unrecorded sales returns emanating from the cancelled sales. In fact, the examiners additionally noted that the proceeds of sales were not recorded by petitioner. This means that while petitioner drew the LCs, it did not record the amount encashed, denoting petitioner's intention not to reflect the whole cancelled sale transaction.

Hence, there is no reason for the petitioner to be assessed for undeclared sales because the said sales were cancelled.

The above finding notwithstanding, this Court believes that petitioner should be liable for penalty in violation of Section 6 of Revenue Regulations

No. V-1, as amended, otherwise known as the "Bookkeeping Regulations" which provides:

> Section. 6. **Transactions to be recorded in the simplified set of bookkeeping records**. – The amount of sales of goods, wares, or merchandise or the value of services rendered for the day, whether cash or on credit, shall be entered in the record of daily sales and cash receipts not later than five o'clock in the afternoon of the day following the date of the transaction. Xxx.

Petitioner admitted that it did not record the sale of hot rolled steel coils to Milwaukee Industries Corporation in the amount of P193,032,000.00 and the subsequent cancellation thereof. Now, for such violation petitioner should be liable for a fine of three hundred pesos (P300.00) pursuant to "Chapter VI – General penal provisions" of the Bookkeeping Regulations, to wit:

> Chapter VI. – **General penal provisions**
>
> A person who violated any provision of this Code or any regulation of the Department (now Ministry) of Finance made inconformity with the same, for which delinquency no specific penalty is provided by laws shall be punished by a fine of not more than three hundred pesos or by imprisonment for not more than six months, or both. (Sec. 352, Commonwealth Act No. 466).

1.2. Foreign Exchange Losses

In the Final Decision on Disputed Assessment, the Assistant Commissioner for Enforcement Service, Percival T. Salazar, maintains that petitioner's foreign exchange losses in the amount of P12,444,701.84 for the year 1997 should be disallowed as a deduction from gross income. The reason being:

> The liabilities under Trust Receipt Payable were restated by debiting Miscellaneous Expense-Exchange Rate Differential

and crediting Trust Receipt Payable. This is a mere provision because loss is recognized only upon remittance or payment.

Petitioner expounds that the foreign exchange losses arose from nineteen (19) US dollar-denominated Letters of Credit under Trust Receipts (LC/TRs) which were actually sustained by the petitioner during the year 1997.[10] The foreign exchange losses are detailed in the table below:

Arising from the 16 dollar-denominated LC/TRs:		
Payment in 1997		P 5,166,802.76
Arising from the 3 dollar-denominated LC/TRs:		
Payment in 1997	P1,305,828.00	
Payment in 1998 after conversion of 2 dollar-denominated LC/TRs to peso-denominated LC/TRs in 1997	5,972,071.00	7,277,899.00
Unlocated difference		(0.08)
Total Foreign Exchange Losses		P12,444,701.84

Petitioner elaborates the above foreign exchange losses in two categories:

1.2.a. Losses from 16 dollar-denominated LC/TRs

During the years 1996 and 1997, petitioner on various occasions opened sixteen (16) US dollar-denominated LC/TRs with RCBC, to wit:

Entry Date	Exh.	For LC/TR No.	Amount in US$	Conversion Rate at Opening	Peso Value
1/24/96	LL	95-4196	1,016,052.55	26.200	26,620,576.81
5/13/96	MM	96-5321	124,349.13	26.190	3,256,703.71
8/29/96	NN	96-5917	114,270.06	26.220	2,996,160.98
12/10/96	OO	96-6516	112,395.38	26.305	2,956,560.47
11/6/96	PP	96-6517	122,516.82	26.270	3,218,516.86
2/3/97	QQ	97-0056	115,310.17	26.360	3,039,576.08
3/21/97	RR	97-0082	183,313.45	26.350	4,830,309.41
3/24/97	SS	97-0365	154,000.00	26.350	4,057,900.00
4/29/97	TT	97-0433	98,345.88	26.390	2,595,347.78
3/25/96	UU	96-4706	201,373.40	26.260	5,288,065.48
9/30/97	VV	97-1415	105,000.00	34.420	3,614,100.00
10/15/97	WW	97-1414	105,560.00	34.250	3,615,430.00
7/22/97	XX	97-0968	14,500.00	28.450	412,525.00
7/31/97	YY	97-1252	150,339.86	29.400	4,419,991.88
10/1/97	ZZ	97-1620	156,734.33	34.900	5,470,028.12
3/14/96	AAA	96-4924	120,457.35	26.250	3,162,005.43
	T o t a l		2,894,518.38		79,553,798.01

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[10] Pages 16 to 25, TSN, March 11, 2003.

In 1997, petitioner either partially or fully paid the above listed LC/TRs. Due to exchange rate differential of US dollar to Philippine peso from the opening of the LC/TRs to the actual payment thereof, petitioner allegedly incurred foreign exchange losses in the aggregate amount of P5,166,802.76.

There is no disagreement between the parties that foreign exchange losses are deductible from gross income. The main reason of respondent for the disallowance is because the account is a mere provision and that the expense was not yet paid or remitted. Hence, the Court is tasked to look upon the deductibility of the expense.

The laws applicable are Section 37 and Section 39 of the National Internal Revenue Code of 1993 which provide:

> **SEC. 37. General Rule.** – The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) **in accordance with the method of accounting regularly employed** in keeping the books of the taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computations shall be made in accordance with such method as in the opinion of the Commissioner of Internal Revenue does clearly reflect the income. xxx

> **SEC. 39. Period for which deductions and credits taken.** The deductions provided for in this Title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred" **dependent upon the method of accounting** upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions should be taken as of a different period. xxx *(Both underlining supplied)*

Based on the Court's evaluation of the records of the case, petitioner adopts the accrual method of accounting with the calendar year as its accounting period.

"Accrual Basis" is defined in Black's Law Dictionary as:

> [M]ethod of accounting that reflects expenses incurred and income earned for any one tax year. In contrast to the cash basis of accounting, <u>expenses do not have to be paid to be deductible</u> nor does income have to be received to be taxable. *(Underlining supplied).*

Under the accrual method of accounting, losses are recognized as they are incurred and not when they are paid. Hence, foreign exchange losses incurred during the year must be deducted from gross income in the same year in order to reflect proper income. Of course, when an expense is paid during the year, the expense is also deductible during the year.

Records show that in the year 1997, petitioner either partially or fully settled the above listed sixteen (16) LC/TRs as evidenced by either an RCBC Debit Advice or company voucher. Below, is a summary of documents purporting payments for the respective LC/TRs as admitted by the Court:

Date	RCBC Debit Advice	Littlegiant Voucher	For LC/ TR No.	Amount in US$	US$-Peso Rate	Peso Value
01-07-97	QQQ		95-4196	16,000.00	26.305	420,880.00
04-08-97	RRR		96-5321	124,349.13	26.375	3,279,708.30
04-08-97	SSS		96-5917	14,270.06	26.375	376,372.83
04-14-97	TTT		96-5917	100,000.00	26.375	2,637,500.00
11-03-97	UUU		96-6516	112,395.38	35.400	3,978,796.45
07-28-97	VVV		96-6517	70,000.00	28.900	2,023,000.00
07-22-97	WWW		96-6517	52,156.82	28.600	1,501,981.05
11-25-97		XXX	97-0056	60,000.00	34.300	2,064,688.50
10-30-97		YYY	97-0056	310.17	35.000	42,136.50
11-12-97		ZZZ	97-0056	55,000.00	34.250	1,895,566.25
10-22-97	AAAA		97-0082	313.45	34.800	10,908.06
12-15-97	BBBB		97-0082	50,000.00	39.800	1,990,000.00
12-09-97	CCCC		97-0082	50,000.00	35.100	1,755,000.00
12-08-97	DDDD		97-0082	20,000.00	35.250	705,000.00
12-01-97	EEEE		97-0082	30,000.00	35.200	1,056,000.00
11-26-97	FFFF		97-0082	33,000.00	34.670	1,144,110.00
05-02-97	GGGG		97-0365	154,000.00	26.380	4,062,520.00
11-03-97	HHHH		97-0433	28,345.88	35.400	1,003,444.15
11-10-97	IIII		97-0433	70,000.00	34.850	2,439,500.00
03-05-97		JJJJ	96-4706	201,373.40	26.350	5,306,189.09
10-06-97	KKKK		97-1415	18,000.00	35.275	634,950.00

10-20-97		LLLL	97-1414	100,000.00	34.050	1,940,850.00
10-22-97		MMMM	97-1414	43,000.00	34.800	1,496,400.00
09-01-97	NNNN		97-0968	14,500.00	30.500	442,250.00
08-07-97		OOOO	97-1252	60,339.86	28.650	1,728,736.99
07-31-97		PPPP	97-1252	90,000.00	29.400	2,646,000.00
10-20-97		QQQQ	97-1620	100,000.00	34.050	3,405,000.00
02-05-97	RRRR		96-4924	90,457.35	26.345	2,383,098.89
03-11-97	SSSS		96-4924	30,000.00	26.350	790,500.00

Verification of the above documents leads Us to conclude that foreign exchange loss was incurred by petitioner in the year 1997 in the amount of P4,841,888.58 due to foreign exchange rate differential of the sixteen LC/TRs from their opening up to the actual settlement thereof, computed as follows:

Payment Date	RCBC Debit Advice	Petitioner Voucher	LC/TR No.	Amount Settled	Original Exchange Rate	Payment Exchange Rate	Exchange Rate Differential	Foreign Exchange Loss/(Gain)
01/07/97	QQQ		95-4196	$ 16,000.00	26.200	26.305	0.105	P 1,680.00
03/05/97		JJJJ	96-4706	201,373.40	26.260	26.350	0.090	18,123.61
02/05/97	RRRR		96-4924	90,457.35	26.250	26.345	0.095	8,593.45
03/11/97	SSSS		96-4924	30,000.00	26.250	26.350	0.100	3,000.00
04/08/97	RRR		96-5321	124,349.13	26.190	26.375	0.185	23,004.59
04/08/97	SSS		96-5917	14,270.06	26.220	26.375	0.155	2,211.86
04/14/97	TTT		96-5917	100,000.00	26.220	26.375	0.155	15,500.00
11/03/97	UUU		96-6516	112,395.38	26.305	35.400	9.095	1,022,235.98
07/22/97	WWW		96-6517	52,516.82	26.270	28.600	2.330	122,364.19
07/28/97	VVV		96-6517	70,000.00	26.270	28.900	2.630	184,100.00
10/30/97		YYY	97-0056	310.17	26.360	35.000	8.640	2,679.87
11/12/97		ZZZ	97-0056	55,000.00	26.360	34.250	7.890	433,950.00
11/25/97		XXX	97-0056	60,000.00	26.360	34.300	7.940	476,400.00
10/22/97	AAAA		97-0082	313.45	26.350	34.800	8.450	2,648.65
12/01/97	EEEE		97-0082	30,000.00	26.350	35.200	8.850	265,500.00
12/08/97	DDDD		97-0082	20,000.00	26.350	35.250	8.900	178,000.00
12/09/97	CCCC		97-0082	50,000.00	26.350	35.100	8.750	437,500.00
12/15/97	BBBB		97-0082	50,000.00	26.350	39.800	13.450	672,500.00
11/26/97	FFFF		97-0082	33,000.00	26.350	34.670	8.320	274,560.00
05/02/97	GGGG		97-0365	154,000.00	26.350	26.380	0.030	4,620.00
11/03/97	HHHH		97-0433	28,345.88	26.390	35.400	9.010	255,396.38
11/10/97	IIII		97-0433	70,000.00	26.390	34.850	8.460	592,200.00

09/01/97	NNNN		97-0968	14,500.00	28.450	30.500	2.050	29,725.00
07/31/97		PPPP	97-1252	90,000.00	29.400	29.400	-	-
08/07/97		OOOO	97-1252	60,339.86	29.400	28.650	(0.750)	(45,254.90)
10/20/97		LLLL	97-1414	57,000.00	34.250	34.050	(0.200)	(11,400.00)
10/22/97		MMMM	97-1414	43,000.00	34.250	34.800	0.550	23,650.00
10/06/97	KKKK		97-1415	18,000.00	34.420	35.275	0.855	15,390.00
10/20/97		QQQQ	97-1620	100,000.00	34.900	34.050	(0.850)	(85,000.00)
						Adjustments:		
Foreign exchange gains unsupported[11] but were verified by independent CPA in his report								(81,990.10)
Total								P4,841,888.58

1.2.b. Losses from 3 dollar-denominated LC/TRs

Likewise, in 1996 and 1997 another three LC/TRs were opened by petitioner with RCBC on the following dates:

Entry Date	Exh.	For LC/TR No.	Amount in US$	Conversion Rate at Opening	Peso Value
09-19-96	II	96-7005	1,353,541.75	26.260	35,544,006.36
07-15-97	JJ	97-1080	146,953.35	32.000	4,702,507.20
05-22-97	KK	97-0563	121,565.82	26.385	3,207,514.16
T o t a l			1,622,060.92		43,454,027.72

Petitioner also paid the above listed LC/TRs partially in 1997 as follows:

Payment Date	RCBC Debit Advice	Littlegiant Voucher	For LC/ TR No.	Amount in US$	US$-Peso Rate	Peso Value
5/8/97	BBB		96-7005	53,541.75	26.385	1,412,699.07
5/19/97	CCC		96-7005	200,000.00	26.380	5,276,000.00
5/28/97	DDD		96-7005	100,000.00	26.380	2,638,000.00
6/5/97	EEE		96-7005	75,000.00	26.380	1,978,500.00
6/13/97	FFF		96-7005	75,000.00	26.385	1,978,875.00
6/16/97	GGG		96-7005	75,000.00	26.390	1,979,250.00
6/23/97	HHH		96-7005	40,000.00	26.390	1,055,600.00
6/25/97	III		96-7005	115,000.00	26.385	3,034,275.00
6/30/97	JJJ		96-7005	100,000.00	26.390	2,639,000.00
9/1/97	KKK		96-7005	7,000.00	30.500	213,500.00
10/20/97	LLL		96-7005	13,000.00	34.050	442,650.00
10/28/97	MMM		96-7005	70,000.00	35.450	2,481,500.00
10/22/97		OOO	97-1080	5,953.35	34.800	207,176.58
10/22/97		PPP	97-0563	1,565.82	34.800	54,490.54
				931,060.92		25,391,516.19

From the above payment, the foreign exchange loss of petitioner is computed to be at P907,488.47, to wit:

Payment Date	RCBC Debit Advice	Petitioner Voucher	LC/TR No.	Amount Settled	Original Exchange Rate	Payment Exchange Rate	Exchange Rate Differential	Foreign Exchange Loss/(Gain)
05/08/97	BBB		96.7005	53,541.75	26.260	26.385	0.125	6,692.72
05/19/97	CCC		96-7005	200,000.00	26.260	26.380	0.120	24,000.00
05/28/97	DDD		96-7005	100,000.00	26.260	26.380	0.120	12,000.00
06/05/97	EEE		96-7005	75,000.00	26.260	26.380	0.120	9,000.00
06/13/97	FFF		96-7005	75,000.00	26.260	26.385	0.125	9,375.00
06/16/97	GGG		96-7005	75,000.00	26.260	26.390	0.130	9,750.00
06/23/97	HHH		96-7005	40,000.00	26.260	26.390	0.130	5,200.00
06/25/97	III		96-7005	115,000.00	26.260	26.385	0.125	14,375.00
06/30/97	JJJ		96-7005	100,000.00	26.260	26.390	0.130	13,000.00
09/01/97	KKK		96-7005	7,000.00	26.260	30.500	4.240	29,680.00
10/20/97	LLL		96-7005	13,000.00	26.260	34.050	7.790	101,270.00
10/28/97	MMM		96-7005	70,000.00	26.260	35.450	9.190	643,300.00
10/22/97		OOO	97-1080	5,953.35	32.000	34.800	2.800	16,669.38
10/22/97		PPP	97-0563	1,565.82	26.385	34.800	8.415	13,176.38
Tota l				P931,060.92				P907,488.48

On December 29, 1997, the outstanding balance for the two dollar-denominated LC/TR Nos. 96-7005 and 97-0563 in the amounts of US$430,000.00 and US$120,000.00, respectively, was *converted* into peso-denominated obligation at the exchange rate of P37.90 to US$1.00.[12] The peso equivalent of the said two LC/TRs is P20,845,000.00 (US$550,000.00 x P37.900/US$). The foreign exchange loss in the amount of P6,387,000.00 is thereby computed as follows:

LC/TR No.	Outstanding Balance in US$	Original Exchange Rate	Exchange Rate	Exchange Rate Differential	Foreign Exchange Loss/(Gain)
96-7005	430,000.00	26.260	37.900	11.640	P 5,005,200.00
97-0563	120,000.00	26.385	37.900	11.515	1,381,800.00
Total	550,000.00				P 6,387,000.00

[11] Exhibits TTTT and UUUU were not among the documents admitted by the Court.
[12] Exhibit JJJJJJ.

On the same day, petitioner paid the converted peso-denominated obligation in the sum of P1,297,000.00 for LC/TR No. 96-7005 leaving a peso balance of P15,000,000.00 for the said LC/TR[13]. Thus, the total foreign exchange loss incurred by petitioner during the year 1997 for the above listed three (3) LC/TRs is P1,305,828.36 (P907,488.47 + P398,339.89 [(P34,221.64 x 26.260) less (P34,221.64 x 37.900)]).

Hence, pursuant to Section 29(d) of the National Internal Revenue Code of 1993, the amounts of P4,841,888.58 and P1,305,828.36 or a total of P6,147,716.94 which were paid in 1997 as foreign exchange losses from the nineteen (19) LC/TRs are deductible from petitioner's gross income.

The controversy now lies with the remaining balance of P6,296,984.90 (P12,444,701.84 less P6,147,716.94) which was allegedly sustained by petitioner during the year 1997 under accrual method.

After a careful scrutiny of the documents relative to the claimed deduction, the Court is not convinced that the amount of P6,296,984.90 was sustained during the year 1997. The testimony of petitioner's witness is wanting of corroborative documents. The Certification issued by RCBC as to conversion of US$ to Peso denominated obligation in December 1997 is lacking of details. In addition, as noted by the commissioned independent CPA, the above amount was not supported by Peso Trust Receipts Statements.[14]

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[13] Exhibit NNN.
[14] Exhibit IIIII-4.

1.3. Disallowed Import Purchases

Respondent disallowed the import purchases in the amount of P1,295,759.00 on the ground stated in the Final Decision on Disputed Assessment as follows:

> The taxpayer availed of the Voluntary Assessment Program (VAP) by paying value-added tax (VAT) of PhP61,900.00 for sales of PhP619,000.00 and income tax of PhP216,650.00 (35% of PhP619,000.00). In the same series of entries, imported purchases of PhP1,295,759.00 were debited with corresponding credit to cash for the same amount. Obviously, to allow this additional cost adjustment of PhP1,295,759.00 in 1997 against the cost of PhP619,000.00 which was subject of VAT and income tax paid through Voluntary Assessment Program (VAP) would negate the effect of VAP. In fact, the taxpayer would even gain in terms of reduction of the income tax liability in 1997 as a result of said cost adjustment.

Petitioner explicates that the amount of P1,295,759.00 represents payment for advance customs duties for importations in 1997 which are duly supported by RCBC's bank debit advices and validated Import Entry Declarations. It is a year-end adjustment to correct the amount of customs duties chargeable to imported goods for sale (which forms part of the cost of inventory and the cost of sales) and for imported machineries and supplies (which forms part of the operating expenses). The expense is allowable deduction from gross income pursuant to Section 29(1)(a) of the National Internal Revenue Code of 1993.

We find for the petitioner.

The settlement of the present issue lies on the determination of the effect of year-end adjustment to petitioner's availment of VAP.

We see no plausible reason why respondent should disallow a year-end adjustment just because petitioner availed of the VAP. While it is true that the customs duties will increase the amount of cost of goods sold and consequently decrease the sales of petitioner of the same amount, however, such adjustment is necessary to correct petitioner's financial record and to reflect proper income. As correctly premised by petitioner, the customs duties are ordinary and necessary business expense deductible from its gross income pursuant to Section 29(1)(a) of the National Internal Revenue Code of 1993. To quote:

> **Sec. 29. Deductions from gross income**. – In computing for taxable income subject to tax under Sections 21(a); 24(a), (b) and (c); and 25(a)(1), there shall be allowed as deductions the items specified in paragraphs (a) to (i) of this section xxx
>
> (a) **Expenses**. – (1) **Business expenses**. – (A) **In general**. All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses while away from home in pursuit of a trade, profession or business, rentals or other payments required to be made as a condition to the continued use or possession, for the purpose of trade, profession or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

In fact, respondent did not question the deductibility of the expense but merely concerned himself of the effect of VAP due to the recognition of the expense. We find no direct relation between petitioner's availment of VAP and the recording of customs duties as addition to cost of goods sold. We further observe that the VAP availed by petitioner was for the year 1996 while cost adjustment pertains to 1997[15]. Inasmuch as respondent failed to show what effect of 1996 VAP was negated in the year 1997, this Court holds that 1997 year-end adjustment for customs duties which were duly substantiated by receipts[16] is a proper deduction from gross income. However, the total customs duties that was duly supported by document based on the report of the commissioned independent CPA[17], amounted only to P1,283,106.00. Therefore, the difference of P12,653.00 (P1,295,759.00 less P1,283,106.00) cannot be allowed as a deduction from gross income for being unsubstantiated.

1.4. Untaxed Gross Profit on Unrecorded Imported Purchases

Respondent concludes that petitioner has untaxed gross profit due to undeclared importation in the amount of P11,264,518.73. This comes from the data gathered from the Third Party Information Unit of the Bureau of Internal Revenue which originated from Sociedad Generales de Surveillance (SGS). The documents from SGS disclosed that during the year 1997, petitioner had a total importation of US$3,833,016.57. However, the worth of goods per importation documents presented by petitioner to the respondent amounted only to US$1,902,271.44 leaving an understatement of imported purchases in the sum of US$1,930,745.13. Consequently, the alleged understatement resulted in untaxed gross profit in the amount of P11,264,518.73 derived at as follows:

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[15] (see page 747, BIR records)
[16] Exhibit IIIIII, inclusive of submarkings.
[17] Exhibit FFFFFF-7.

Importation per SGS records	US$ 3,833,016.57
Less: Importation per LGSPC records	1,902,271.44
Variance	US$ 1,930,745.13
Multiply by conversion rate	PhP/US$ 30.63
Peso Equivalent	PhP59,138,723.33
Divide by rate of Cost of Sales to Net sales	84%
Understatement of imported purchases	PhP70,403,242.05
Multiply by gross profit rate	16%
Untaxed Gross Profit on Understatement Of Imported Purchases	PhP11,264,518.73

Not surprised with the discrepancy noted by the respondent, petitioner clarifies that the amount of importation per SGS records and that of its books of accounts will indeed not reconcile. The data of SGS cover all importations made by petitioner during the year 1997 whether the goods imported are for sale to its customer or to be used for its business operations. The account "Purchases-Imported" appearing in petitioner's books which was (the only account) examined by respondent is limited to importation of goods for sale to customer. Respondent failed to consider other imported goods purchased by petitioner for its operations which were recorded under the account titles "Machineries", "Supplies", "Prepaid Charges" and other appropriate accounts.[18]

We find the explanation of petitioner well taken.

In the report of Our commissioned independent CPA[19] the difference between the figures appearing in the importation documents of SGS and that of petitioner's records were reconciled and accounted for. We find the audit procedures adopted by accounting firm, CGM Co., complete and sufficient to come-up with the conclusion that there was no unrecorded

[18] Exhibit FFFFFF-4.
[19] Exhibit FFFFFF.

imported purchases which should be taxed based on gross profit ratio. The examination, as evaluated by the Court, is carried out meticulously and the findings noted were all supported by documents.

We have verified the report against the documents on record and We find the same in order. Hence, there is no basis for imposition of additional income.

1.5. Unsupported Export Sales.

The unsupported export sales in the amount of P1,727,504.38 was not among the discrepancies noted for 1997 deficiency income tax but part of the assessment for 1997 deficiency value-added tax of petitioner. Hence, We will tackle the same when We discuss the validity of the assessment for 1997 deficiency value-added tax.

Prescinding from the above findings, petitioner is still liable for 1997 deficiency income tax in the amount of P3,140,804.83, computed as follows:

Taxable Net Income per Return		P1,397,215.20
Add/(Less) Adjustments		
Disallowed exchange rate differential	P6,296,984.90	
Disallowed import purchases	12,653.00	6,309,547.90
Taxable Net Income per Audit		P7,706,853.10
Income Tax Due		P2,697,398.59
Less: Tax Withheld/Paid per Return		166,716.02
Deficiency Income Tax		P2,530,682.57
Add: Interest		610,122.26
TOTAL AMOUNT PAYABLE		P3,140,804.83

The compromise penalty of P25,000.00 will not be imposed as compromise implies mutual agreement which is absent in the case under consideration ***(H. Tambunting Pawnshop, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6915, April 11, 2005).*** The imposition of the same without the conformity of the taxpayer is illegal and unauthorized ***(Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., G.R. No. 35266, January 21, 1991).***

2. DEFICIENCY VALUE-ADDED TAX P45,822,333.45

Respondent believes that petitioner is liable for 1997 deficiency value-added tax in the amount of P45,822,333.45. The deficiency was arrived at after respondent held petitioner liable for 10% value-added tax on five (5) items of discrepancies. The assessment[20] is reproduced hereunder for better appreciation, to wit:

Taxable Receipts per Return		P311,385,470.32
Add/(Less) Adjustments:		
Unrecorded sales to Milwaukee	P193,032,000.00	
Disallowed discounts granted after Sales	1,245,823.76	
Unsupported export sales	1,727,504.38	
Unaccounted vatable sales	35,551,883.56	
Undeclared sales traceable to Unrecorded import purchases	70,403,242.05	301,960,453.75
Taxable Receipts per Audit		P613,345,924.07
Output Tax Due		P 61,334,592.41
Less: Creditable Input VAT		13,535,958.31
VAT Due		P 47,798,634.10
Less: Tax Withheld/Paid Per Return		17,602,588.74
Deficiency Value-Added Tax		P 30,196,045.36
Add:		
Interest	P 15,601,288.09	
Compromise	25,000.00	15,626,288.09
TOTAL AMOUNT PAYABLE		P 45,822,333.45

2.1. Unrecorded Sales to Milwaukee

Earlier, We have discussed that the unrecorded sales of petitioner to Milwaukee Industries Corporation in the amount of P193,032,000.00 were cancelled. Accordingly, there is no taxable transaction. However, We find it appropriate to hold petitioner liable for deficiency interest for the unrecorded

[20] BIR records, page 761.

sales from the time petitioner should have paid the VAT on such sales up to the dates of their cancellation (the return of the goods).

We have noted that the unrecorded sales were made by petitioner from September 8 to 26, 1997[21] but the goods were returned by Milwaukee Industries Corporation on different dates in October and November 1997[22]. Hence, petitioner should pay deficiency interest computed from the time the output VAT on unrecorded sales in September 1997 should have been paid up to the return of goods in October and November 1997.

For the unrecorded sales of petitioner in September 1997, the output VAT is due on October 20, 1997 pursuant to Section 110(a) of the National Internal Revenue Code of 1993. Consequently, the deficiency interest is computed from October 21, 1997 to the respective dates of sales returns in October and November 1997, to wit:

Should be Payment Date	Date Returned	Unrecorded Sales	Output VAT Due	20% Deficiency Interest
10-20-97	10-13-97	P 20,002,500.00	P 2,000,250.00	-
10-20-97	10-16-97	20,002,500.00	2,000,250.00	-
10-20-97	10-20-97	26,010,000.00	2,601,000.00	-
10-20-97	10-23-97	26,010,000.00	2,601,000.00	P 4,275.62
10-20-97	10-27-97	23,503,500.00	2,350,350.00	9,015.04
10-20-97	10-29-97	23,503,500.00	2,350,350.00	11,590.77
10-20-97	11-02-97	27,900,000.00	2,790,000.00	19,873.97
10-20-97	11-05-97	26,100,000.00	2,610,000.00	22,882.19
Total		P193,032,000.00	P19,303,200.00	P 67,637.59

Therefore, petitioner is liable to pay deficiency interest in the amount P67,637.59 due to unrecorded sales.

[21] Exhibits J to Q.
[22] Exhibits Z, AA to GG.

2.2. Disallowed Discounts Granted After Sales

There is no dispute that discounts granted after sales is not allowed as deduction from gross sales for purposes of computing output VAT liability pursuant to Section 100(d)(2) of the National Internal Revenue Code of 1993 which provides:

> **Sec. 100. Value-added tax on sale of goods or properties. – (a)** ***Rate and base of tax.- xxx***
>
> **xxx xxx xxx**
>
> **(d) Determination of the tax. –** (1) The tax shall be computed by multiplying the total amount indication in the invoices by 1/11.
>
> (2) Sales returns, allowances and sales discounts. – The value of goods or properties sold and subsequently returned or for which allowances were granted by a VAT-registered person may be deducted from the gross sales or receipts for the quarter in which a refund is made or a credit memorandum or refund is issued. Sales discount granted and indicated in the invoice **at the time of sale** and the grant of which does not depend upon the happening of a future event may be excluded from the gross sales within the same quarter it was given. *(Underlining supplied).*

Petitioner, however, maintains that it has no discounts granted after sales. The amount disallowed by the respondent of P1,245,823.76[23] actually represents sales transactions wherein sales invoices were issued to customers but no deliveries were made due to non-availability of goods or the goods to be delivered were found defective.[24]

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[23] Should be P1,255,823.76 per 1997 Quarterly VAT returns.
[24] Pages 5 to 6, TSN, December 11, 2001.

After a painstaking verification of the documents supporting the petitioner's cancelled sales[25] the Court is convinced that the amount of P1,255,823.76 actually pertains to cancelled sales and not to discounts granted after sales. However, as reported by the commissioned independent CPA, the amount of P223,291.50[26] was not properly substantiated, broken down as follows:

Cancelled sales recorded twice in the Sales Book – Local Sales	P208,416.76
Cancelled sales – partial with no supporting Credit Memorandum	14,874.74
Total	P223,291.50

Thus, pursuant to the above-quoted Section 100(d)(2) of the National Internal Revenue Code of 1993 only the amount of P1,032,532.26 (P1,255,823.76 less P223,291.50) is deductible from gross sales. The amount of P223,291.50 is subject to 10% value-added tax.

2.3. Unsupported Export Sales

Petitioner declared in its quarterly VAT returns[27] export sales in the aggregate amount of P1,727,504.38. However, respondent subjects the said export sales to 10% VAT for alleged failure of petitioner to substantiate the same. Hence, We have to determine whether the sales of petitioner in the amount of P1,727,504.38 is subject to VAT at 0%.

We rule against petitioner.

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[25] Exhibits ZZZZZ-1 to ZZZZZ-140 & YYYYY-1 to YYYYY-4, DDDDDD-1 to DDDDDD-143a in relation to the report the commissioned CPA (Exhibit XXXXXX).

[26] Exhibits DDDDDD-76, DDDDDD-92, DDDDDD-99, DDDDDD-100, DDDDDD-101 and DDDDDD-122, inclusive of submarkings.

[27] Exhibits [illegible]

After a careful perusal of the documents presented by petitioner to prove that the amount of P1,727,504.38 represents export sales,[28] We have noted that the commercial invoices of petitioner failed to comply with invoicing requirements under Section 4.108-1 of Revenue Regulations No. 7-95 in relation to Sections 108 and 238 of the National Internal Revenue Code of 1993.

> Section 4.108-1. *Invoicing Requirements.* – All VAT-registered persons shall, for every sale or lease of goods or properties or service, issue duly registered receipts or sales or commercial invoices which must show:
>
> 1. the name, TIN, and address of seller;
> 2. date of transaction;
> 3. quantity, unit cost and description of merchandise or nature of service;
> 4. the name, TIN, business style, if any, and address of the VAT-registered purchaser, customer or client;
> 5. the word "zero-rated" imprinted on the invoice covering zero-rated sales; and
> 6. the invoice value or consideration.
>
> xxx xxx xxx
>
> SEC. 108. *Invoicing and accounting requirements for VAT-registered persons. – (a) Invoicing Requirements*. - A VAT-registered person, shall for every sale, issue an invoice or receipt. In addition to the information required under Section 238, the following information shall be indicated in the invoice or receipt:
>
> (1) A statement that the seller is a VAT-registered person, followed by his taxpayer's identification number (TIN); and
>
> (2) The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax.
>
> xxx xxx xxx

[28] Exhibits EEEEEE-1 to EEEEEE-5, inclusive of submarkings.

> SEC. 238. *Issuance of receipts or sales or commercial invoices.* – All persons subject to an internal revenue tax shall, for each sale or transfer of merchandise or for services rendered valued at P25.00 or more, issue receipts or sales or commercial invoices, prepared at least in duplicate, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service: *Provided,* That in the case of sales, receipts or transfers in the amount of P100.00 or more, or regardless of amount, where the sale or transfer is made by a person liable to value-added tax to another person also liable to value-added tax; or, where the receipt is issued to cover payment made as rentals, commissions, compensations or fees, receipts or invoices shall be issued which shall show the name, business style, if any, and address of the purchaser, customer or client. *xxx*"

The commercial invoices issued by petitioner to support its export sales failed to meet the above standard. Petitioner failed to indicate that it is a VAT-registered person, followed by his taxpayer's identification number. The word "zero-rated" is also not imprinted in the invoices. In addition, there was no indication that the commercial invoices were authorized to be printed by the Bureau of Internal Revenue as required in Section 239 of the National Internal Revenue Code of 1993 which provides:

> SEC. 239. *Printing of receipts or sales or commercial invoices.* – All persons who print receipts or sales or commercial invoices shall, for every job order, secure from the Bureau of Internal Revenue an authority to print said receipts or invoices before printing the same.
>
> No authority to print receipts or sales or commercial invoices shall be granted unless the receipts or invoices to be printed are serially numbered and shall show, among other things, the name, business style, taxpayer account number and business address of the person or entity to use the same.
>
> xxx xxx xxx

Corollarily, for failure of petitioner to comply with the requisites under the law, the export sales in the amount of P1,727,504.38 cannot be qualified as zero-rated for VAT purposes. Moreover, the commissioned independent CPA noted the said export sales have either no export declaration/permits or supported by photocopied export declaration/permits.[29] Hence, respondent's assessment for 10% value-added tax is sustained.

2.4. Unaccounted Vatable Sales

This discrepancy refers to the alleged unaccounted difference between the amount of sales recorded in sales book and the declared vatable sales in the quarterly VAT returns of petitioner, to wit:

Sales per Sales Book-Local	P 346,907,354.06
Less: Sales subject to VAT per Quarterly VAT Return	311,385,470.32
Discrepancy	P 35,521,883.74

The amount was disallowed by respondent for failure of petitioner to properly account (as the title suggests) for the vatable sales appearing in its local sales book.

Petitioner explains that it is its practice to record sales in the sales book inclusive of VAT.[30] However, in the Quarterly VAT returns, the declared sales are net of output VAT. Obviously, the total sales per book (which is inclusive of output VAT) and the total sales reported in the VAT returns (which is net of output VAT) will not tally.

After a thorough examination of the records supporting petitioner's stand, We are swayed that petitioner has no unaccounted vatable sales.

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[29] Exhibit XXXXXX-8.
[30] TSN, December 11, 2001, pages 8 to 10.

Worthy to note at this juncture is the report of the commissioned independent CPA with respect to the alleged disparity.[31] Pertinent portions of the said report state that:

> Based on the procedures we performed, we present below our findings and observation:
>
> 1. The amount of the Company's total local sales for the taxable year 1997, as recorded in the Sales Book-Local Sales provided to us by the Company, that we ascertained to be properly substantiated by supporting documents as outlined under the procedures performed is **P346,907,354.06.**
>
> 2. The Company's total sales net of cancelled sales and VAT for the taxable year 1997 amounting to **P313,123,093.28,** which consists of both local and export sales amounting to **P311,385,470.28** and **P1,737,623,** respectively, as derived from its Sales Book-Local and Export Sales, is equal to the amount presented in the Company's 1997 audited FS. The details are shown in the following table:

Table 1

Accounts	Annex	Per Sales Book-Local	Per Audited FS	Per VAT Returns	Difference
Local Sales:					
Gross Sales	A & B	**P346,907,354.06**		P312,641,294.08	P 34,266,059.98
Cancelled Sales	A & B	**4,383,336.75**		**1,255,823.76**	**3,127,512.99**
Net Sales-gross of VAT	A & B	342,524,017.31		**311,385,470.32**	**31,138,546.99**
Output VAT	A & B	31,138,547.03		-	(31,138,547.03)
Net Sales-net of VAT	A & B	**311,385,470.28**		**311,385,470.32**	(0.04)
Export Sales	A & B	**1,737,623.00**		1,727,504.38	10,118.62
Total Sales	A	**313,123,093.28**	313,123,093.31		(0.03)
	B			313,112,974.70	10,118.58

> We noted that it is the Company's practice to record local sales in the Sales Book-Local Sales at the invoice amount, which includes the 10% output VAT. Cancelled sales are recorded as a separate entry under cancelled sales rather than a mere cancellation of the original sales entry. At the end of each month, entries are made to record sales (net of output VAT) and the output VAT. It is in the General Ledger (GL) recording that the invoice amount is segregated into sales and output VAT. The amount of

[31] Exhibit XXXXXX.

sales that is recorded in the GL is the total sales (per Sales Book) during the month less cancelled sales and output VAT.

As illustrated in Table 1 above, the amount declared in the Quarterly VAT returns filed for the taxable year 1997 as gross taxable sales amounting to **P311,385,470.32** actually represents the Company's total local sales net of cancelled sales and VAT as derived from the Sales Book-Local Sales and that the difference of **P31,138,546.99** represents the total output VAT on local sales.

Moreover, the unaccounted variance per Sales Book-Local Sales and per VAT returns amounting to **P35,551,883.56** computed by the BIR and included in the assessment is accounted for as follows:

Table 2

Annex	Description			Amount
	Total Unaccounted Variance per Sales Book and per VAT Returns as Assessed by the BIR			35,551,883.56
	Accounted for as follows:			
A & B	Cancelled Sales per Sales-Book-Local Sales		4,383,336.75	
A	Output VAT per Sales Book-Local Sales		31,138,547.03	
	Difference on Gross Sales between:			
	Per BIR's Computation	346,937,354.06		
B	Per Sales Book-Local	346,907,354.06	30,000.00	35,551,883.78
	Remaining Unaccounted Variance			**0.22**

The summaries showing the total sales net cancelled sales, at both gross and net of VAT, for taxable year 1997 derived from Sales Book-Local Sales versus the total sales per Company's 1997 audited FS and amounts per Quarterly VAT returns and supporting attachments are presented in *Annexes A and B* of this Report, respectively. Photocopies of supporting Sis on gross sales are submitted to this Court as Exhibits CCCCCC-1 to CCCCCC-4374 and DDDDDD-1 to DDDDDD-143a and are faithful reproductions of the originals.

The above report is explicit and is hereby adopted. We have verified the supporting documents cited therein and We find the same in order. Therefore, the unaccounted vatable sales should be disregarded as explained in the report cited.

2.5. Undeclared Sales Traceable to Unrecorded import purchases

Lastly, respondent opines that petitioner has undeclared sales arising from undeclared importation.

This particular item stems from the unmatched importation per petitioner's books of accounts and from the data gathered by the Third Party Information Unit of the Bureau of Internal Revenue which originated from Sociedad Generales de Surveillance (SGS).

However, We have earlier ruled in issue 1.4 of the deficiency income tax that petitioner has no unmatched importation based on the audit report[32] submitted to Us by the commissioned independent CPA which were duly supported by documents. Hence, We find this particular issue moot and academic for discussion.

In sum, petitioner is still liable for 1997 deficiency value-added tax in the reduced amount of P363,508.92, computed as follows:

Taxable Receipts per Return		P311,385,470.32
Add/(Less) Adjustments		
Disallowed discounts granted after Sales – Unsupported	P 223,291.50	
Unsupported export sales	1,727,504.38	1,950,795.88
Taxable Receipts per Audit		P313,336,266.20
Output Tax Due		P 31,333,626.62
Less: Creditable Input VAT		13,535,958.31
VAT Due		P 17,797,668.31
Less: Tax Withheld/Paid Per Return		17,602,588.74
Deficiency Value-Added Tax		P 195,079.57
Add:		
Interest on Deficiency VAT		100,791.76
Interest on Unrecorded Sales		67,637.59
TOTAL AMOUNT PAYABLE		P 363,508.92

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[32] Exhibit FFFFFF, inclusive of submarkings.

The compromise penalty of P25,000.00 should not be imposed in the absence of mutual agreement between the parties ***(Collector of Internal Revenue vs. UST, 104 Phil. 1062; Dr. Felisa L. Vda. De San Agustin, in substitution of Jose Y. Feria, in his capacity as Executor of the Estate of Jose San Agustin vs. Commissioner of Internal Revenue, G.R. No. 138485, September 10, 2001).***

WHEREFORE, premises considered, the Petition for Review is hereby ***DENIED***. The deficiency assessments for income and value-added taxes are hereby ***UPHELD*** but in reduced amounts, computed as follows:

	Basic	Interest	Total
Deficiency Income Tax (ST-INC-97-0160-2000)	P2,530,682.57	P610,122.26	P3,140,804.83
Deficiency Value-Added Tax (ST-VAT-97-0159-2000)	195,079.57	168,429.35	363,508.92
Totals	P2,725,762.14	P778,551.61	P3,504,313.75

Accordingly, petitioner is **ORDERED** to **PAY** the respondent the aggregate amount of P3,504,313.75, plus 20% delinquency interest per annum from February 21, 2000 until fully paid, pursuant to Section 249 of the National Internal Revenue Code of 1993. In addition, a fine of three hundred pesos (P300.00) is imposed for violation of the Bookkeeping Regulations.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
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