REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

EL PASO PHILIPPINES ENERGY COMPANY, INC.,
Respondent.

CTA EB NO. 1319
(CTA Case No. 8013)

Present:

DEL ROSARIO, *PJ*
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA,
FABON-VICTORINO,
MINDARO-GRULLA,
RINGPIS-LIBAN, and
MANAHAN, *JJ.*

Promulgated:

MAR 06 2017 1:36 p.m.

x- x

DECISION

Fabon-Victorino, J.:

On February 23, 2015, the Court in Division rendered a Decision[1] in CTA Case No. 8013, entitled *El Paso Philippines Energy Company, Inc. (EPPECI) vs. Commissioner of Internal Revenue (CIR),* the dispositive portion of which reads as follows:

Assailed Decision of February 23, 2015:

> **WHEREFORE**, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessments issued by respondent against petitioner for taxable year 2004 covering

[1] En Banc docket, pp. 11-48.

deficiency income tax in the amount of ₱28,134,150.84, deficiency expanded withholding tax in the amount of ₱186,395.72, deficiency improperly accumulated earnings tax in the amount of ₱35,153,053.99 and compromise penalty in the amount of ₱25,000.00 are hereby **CANCELLED** and **WITHDRAWN**. However, respondent's assessments covering deficiency value-added tax and final withholding tax for taxable year 2004 are hereby **AFFIRMED**, and petitioner is held liable to pay the modified amount of ₱12,120,947.06, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248 (A) (3) of the NIRC of 1997, computed as follows:

	BASIC TAX	SURCHARGE	TOTAL
Value-added Tax	₱ 3,258,957.25	₱ 814,739.31	₱ 4,073,696.56
Final Withholding Tax	6,437,800.40	1,609,450.10	8,047,250.50
Total	₱ 9,696,757.65	₱ 2,424,189.41	₱ 12,120,947.06

In addition, petitioner is held liable to pay:

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT in the amount of ₱3,258,957.25 and basic FWT in the amount of ₱6,437,800.40 computed from January 25, 2005 and January 15, 2005, respectively, until full payment thereof, pursuant to Section 249 (B) of the NIRC of 1997, as amended; and

(b) Delinquency interest at the rate of 20% per annum on the total amount of ₱12,120,947.06 and on the deficiency interest which have accrued as afore-stated in (a) computed from December 2, 2009 until full payment thereof, pursuant to Section 249 (C) of the NIRC of 1997, as amended.

SO ORDERED.

The foregoing ruling was effectively affirmed when the Court in Division issued the similarly assailed Resolution[2] dated May 18, 2015, in the following fashion:

> **WHEREFORE**, in view thereof, both respondent's and petitioner's Motions for Partial Reconsideration are **DENIED** for lack of merit.
>
> **SO ORDERED.**

Both unconvinced, the CIR and EPPECI elevated the foregoing Decision and Resolution via their respective Petitions for Review filed before the Court *En Banc* on June 5, 2015[3] and July 9, 2015, respectively.

On December 22, 2015, EPPECI moved to withdraw its Petition for Review as it already paid the Bureau of Internal Revenue (BIR) the assessed Value Added Tax (VAT) and Final Withholding Tax (FWT) assessments, including the surcharge and interest in accordance with the ruling in the Decision dated February 23, 2015.

Thus, only the Petition for Review filed by petitioner CIR remains for the determination and resolution of the Court *En Banc*.

In his Petition, petitioner CIR prays to set aside the Decision dated February 23, 2015 and the Resolution dated May 18, 2015 and thereafter render judgment upholding the validity of the following assessments issued against EPPECI for taxable year 2004, to wit:

1. deficiency Income Tax (IT) in the amount of ₱28,134,150.84;

2. deficiency Expanded Withholding Tax (EWT) in the amount of ₱186,395.72;

3. deficiency Improperly Accumulated Earnings Tax (IAET) in the amount of ₱35,153,053.99; and

---

[2] *En Banc* docket, pp. 49-59.
[3] *En Banc* docket, pp. 1-10.

4. compromise penalty in the amount of ₱25,000.00.

THE FACTS AND THE PROCEEDINGS

The established facts are as follows:

Petitioner CIR is the Commissioner of the BIR vested with the power, among others, to collect national internal revenue taxes. He holds office at BIR National Office Building, Agham Road, Quezon City.

Respondent EPPECI, on the other hand, is a domestic corporation, with principal place of business at the Ground Floor PFDA Building, Navotas Fish Port Complex, Navotas City.

On August 23, 2005, respondent received from the BIR Revenue District Office (RDO) No. 43-Pasig City Letter of Authority (LOA) No. 00009462[4] dated August 18, 2005 for the examination of its books of accounts and other related accounting records for calendar year 2004. Attached to the said LOA is a formal request for the submission of respondent's books of accounts, financial statements, and other related accounting records and supporting documents.

On September 5, 2005, respondent, in compliance with the said request, furnished the CIR with copies of its books of account, financial statements, and other pertinent accounting records and supporting documents with covering letter[5] of even date. It was received by petitioner, through BIR RDO No. 43-Pasig City, on the same day. Additional documents were transmitted[6] to BIR RDO No. 43-Pasig City on November 22, 2006, as requested.

Sometime in January 2007, BIR RDO No. 43-Pasig City issued a Notice [7] dated January 23, 2007, informing

---

[4] Exhibit A-1, *Rollo*, pp. 903.
[5] Exhibits A and A-2, *Rollo*, p. 902.
[6] Exhibits B and B-1, *Rollo*, p. 904.
[7] Exhibit C, *Rollo*, p. 905.

respondent of its alleged tax liabilities and requiring it to appear before the said office for an informal conference set on February 1, 2007.

Thereafter, respondent received a Revised Post Reporting Notice[8] dated October 30, 2007 from the same BIR RDO with attached Summary of Computation of Deficiency Taxes and Details of Discrepancy.

On November 26, 2007, respondent filed a reply letter[9], contesting the alleged deficiency taxes contained in the Revised Post Reporting Notice.

On January 8, 2008, respondent received a Preliminary Assessment Notice[10] (PAN) dated December 28, 2007 for its alleged deficiency IT, VAT, EWT, FWT, and IAET in the aggregate amount of ₱76,900,903.32, inclusive of interests, for calendar year 2004.

On January 22, 2008, respondent received a Formal Letter of Demand[11] (FLD) No. 431130 dated January 15, 2008 with attached Assessment Notices, demanding payment of the deficiency tax assessments for calendar year 2004, computed as follows:

I. DEFICIENCY INCOME TAX			
Taxable Income per return			-
Add: Disallowances/Adjustments per investigation:			
Unaccounted income		₱48,641,323.00	
Unaccounted prime contractors		1,044,141.23	
Professional fees not subjected to EWT		1,154,982.00	
Interest expense not subjected to final tax		4,973,138.20	
Disallowed interest expense		288,715.93	₱56,102,300.36
Taxable income per investigation			56,102,300.36
Income tax due thereon			17,952,736.11
Less: Payments/tax credits			
Prior years excess tax credits claimed		10,715,585.00	
Creditable withholding tax claimed		15,517,047.00	
Total		26,232,632.00	
Less: Excess tax credits to be carried forward	₱22,203,593.00		
Deferred MCIT	4,029,039.00	26,232,632.00	-
Deficiency income tax			17,952,736.11
Add: 20% interest p.a. from 4.16.05 to 2.15.08			10,181,414.73
TOTAL AMOUNT DUE			₱28,134,150.84

[8] Exhibit D, *Rollo*, pp. 908-912.
[9] Exhibits E and E-1, *Rollo*, pp. 913-914.
[10] Exhibit F, *Rollo*, pp. 915-918.
[11] Exhibit G, *Rollo*, pp. 919-929.

II. DEFICIENCY VALUE-ADDED TAX			
Taxable receipts per return			72,705,617.83
Add: Adjustments/discrepancies per investigation:			
Unaccounted income	48,641,323.00		
Gross receipts not subjected to VAT	32,584,572.81		81,225,895.81
Taxable receipts per investigation			153,931,513.64
Value-added tax due thereon			15,393,151.36
Less: Allowable input tax/payments			
Payments	6,194,285.89		
Input tax during the year	1,076,276.07		7,270,561.95
Deficiency value-added tax			8,122,589.40
Add: 20% interest p.a. from 1.25.05 to 2.15.08			4,967,019.05
TOTAL AMOUNT DUE			₱13,089,608.45
III. DEFICIENCY EXPANDED WITHHOLDING TAX			
Expanded withholding tax due thereon			115,498.20
Add: 20% interest p.a. from 1.16.05 to 2.15.08			71,197.52
TOTAL AMOUNT DUE			₱186,695.72
IV. DEFICIENCY FINAL WITHHOLDING TAX ON INTEREST EXPENSE			
Interest expense not subjected to final withholding tax			4,973,138.20
Final withholding tax rate			20%
Final withholding tax on interest expense due thereon			994,627.64
Add: 20% interest p.a. from 1.16.05 to 2.15.08			613,126.63
TOTAL AMOUNT DUE			₱1,607,754.27
V. DEICIENCY IMPROPERLY ACCUMULATED EARNINGS TAX			
Taxable income			(435,096,750.00)
Add: Interest income subject to final tax		607,823.00	
Equity in net earnings of subsidiary		171,352,773.00	
Losses		485,906,173.00	657,866,769.00
Balance			222,770,019.00
Less: Income tax payable			4,029,039.00
Balance			218,740,980.00
Less: Capital stock			8,140,000.00
Improperly accumulated earnings			210,600,980.00
Improperly accumulated earnings rate			10%
Improperly accumulated earnings tax			21,060,098.00
Add: 25% Surcharge		5,265,024.50	
20% interest p.a. from 1.11.06 to 2.15.08		8,827,931.49	14,092,955.99
TOTAL AMOUNT DUE			₱35,153,053.99

Respondent protested[12] the said FLD on January 25, 2008.

In a Letter[13] dated February 15, 2008, petitioner informed respondent that its protest shall be forwarded to BIR RDO No. 43-Pasig City.

On April 30, 2008, respondent received a Tax Verification Notice[14] dated April 1, 2008 stating that

---

[12] Exhibits H and H-1, *Rollo*, pp. 930-934.
[13] Exhibit I, *Rollo*, p. 935.
[14] Exhibit J, *Rollo*, p. 936.

Revenue Officer Marjonie Ando had been authorized to verify supporting documents in relation to the "Re-investigation (AIRT)" covering the taxable year 2004. Attached thereto was a letter[15] dated April 18, 2008, requesting respondent to submit supporting documents of its protest within ten (10) days from notice.

On May 19, 2009, petitioner issued a Referral Note[16] to Revenue Officer (RO) Rodrigo Peralta, directing him to continue the audit of respondent's tax liabilities.

On September 11, 2009, RO Peralta made a Report of Investigation[17] to the Revenue District Officer of RDO No. 43A-East, Pasig City recommending the denial of respondent's request for reinvestigation for failure to substantiate its claim for cancellation of assessment.

On November 27, 2009, respondent received from BIR Revenue Region No. 7, Quezon City, Regional Task Force a Preliminary Collection Notice[18] dated October 23, 2009, demanding payment of the alleged deficiency tax assessments in the aggregate amount of ₱78,196,263.26.

This prompted respondent to file a Petition for Review with the Court in Division on December 28, 2009 for the cancellation of the questioned assessment issued by petitioner.

In his Answer[19], petitioner claimed that since the Petition for Review was filed beyond the 30-day prescriptive period provided under Section 228 of the Tax Code, as amended, the Court in Division no longer had the competence to hear and determine the case. Nevertheless, he argued that: (1) the assessments for deficiency IT, VAT, EWT, and IAET were valid and in accordance with law; (2) the said assessments were determined and computed based on respondent's records; and (3) assessments were *prima facie* presumed correct and made in good faith.

---

[15] Exhibit J-1, *Rollo*, p.937.
[16] Exhibit 11-a, BIR Records, p. 660.L.
[17] Exhibit 14, BIR Records, p. 667.L.
[18] Exhibit K, *Rollo*, p. 938.
[19] Rollo, pp. 236-239.

On May 21, 2010, petitioner moved for a preliminary hearing on the issue of prescription[20], but the same was denied in the Resolution dated November 2, 2010, ruling that the Petition for Review was seasonably filed. [21] Petitioner's bid for a reconsideration suffered the same fate in the Resolution[22] promulgated on February 9, 2011.

Trial ensued during which both parties presented evidence in support of their respective positions.

On February 23, 2015, the Court in Division rendered the assailed Decision which it affirmed in the similarly assailed Resolution of May 18, 2015.

As earlier stated, both petitioner and respondent elevated the matter to the Court *En Banc,* however, respondent subsequently withdrew its appeal on ground of payment in accordance with the assailed Decision.

On April 28, 2016, the instant Petition for Review was submitted for decision.[23]

THE ISSUE

Petitioner anchored its appeal on the sole ground to wit:

> THE 2nd DIVISION OF THE HONORABLE COURT OF TAX APPEALS ERRED IN CANCELLING THE ASSESSMENT ON DEFICIENCY INCOME TAX IN THE AMOUNT OF ₱28,134,150.84, DEFICIENCY EXPANDED WITHHOLDING TAX IN THE AMOUNT OF ₱186,395.72, DEFICIENCY IMPROPERLY ACCUMULATED EARNINGS TAX IN THE AMOUNT OF ₱35,153,053.99 AND COMPROMISE PENALTY IN THE AMOUNT OF ₱25,000.00 FOR TAXABLE

---

[20] TSN dated May 21, 2010, *Rollo*, p. 379.
[21] Resolution dated November 2, 2010, *Rollo*, pp. 421-435.
[22] *Rollo*, pp. 458-461.
[23] Resolution dated April 28, 2016, *En Banc* docket, pp. 183-185.

YEAR 2004 BECAUSE THE ASSESSMENTS ARE WITH FACTUAL AND LEGAL BASES AND THEREFORE, VALID.

Petitioner insists that the deficiency assessments for income tax (IT), expanded withholding tax (EWT), improperly accumulated earning tax (IAET) and Compromise Penalty are valid given their factual and legal bases. Allegedly, respondent has deficiency IT as it has unaccounted source of income revealed through some discrepancies on its income tax return and creditable withholding tax and alphalist/BIR Form No. 1601-E. Respondent's receipts as reflected in its financial statements/income tax return (FS/ITR) and as computed based on the creditable income taxes withheld from it, show a discrepancy of ₱48,641,323.00. This amount represents unaccounted income subject to income tax per Section 32 of the Tax Code. The same is true with the discrepancy on respondent's income payments to its prime contractors per FS/ITR and per alphalist amounting to ₱1,044,141.23.

On the other hand, the discrepancy on respondent's professional fee per FS/ITR and per alphalist amounting to ₱1,154,982.00, represents professional fees not subjected to EWT, hence, disallowed as deduction from its gross income pursuant to Section 34(K) of the Tax Code. Part of respondent's interest expense was also disallowed due to its failure to subject the same to FWT. Moreover, the disallowance of respondent's interest expense in the amount of ₱288,715.93 was due to its failure to apply the limitation of deductibility of interest expense as provided under the Tax Code.

Further, respondent failed to withhold and remit the EWT on professional fees paid amounting to ₱1,154,982.00, rendering liable to pay the deficiency EWT thereof amounting to ₱186,385.72, pursuant to Revenue Regulations (RR) No. 2-98, as amended.

Respondent as well has improperly accumulated earnings for taxable year 2004 amounting to ₱210,600,980.00, precisely it was assessed of deficiency IAET of ₱35,153,053.99, by virtue of RR No. 02-99, as amended. The failure of respondent to file/pay its IAET warrants the imposition of ₱25,000.00 compromise penalty mandated under Revenue Memorandum Order (RMO) No. 1-90.

In rejecting petitioner's claim, respondent echoes the Court in Division's findings and submits that the Court in Division correctly cancelled the deficiency IT of ₱28,134,150.84, the deficiency EWT of ₱186,395.72, the IAET of ₱35,153,053.99, and the compromise penalty of ₱25,000.00.[24]

RULING OF THE COURT EN BANC

Petitioner's position in the present appeal could not be any different from his previous stance before the Court in Division. In fact, the ground relied upon by petitioner in this Petition for Review was practically truncated, if not reproduced *verbatim,* from his Motion for Partial Reconsideration filed on March 5, 2015. On this account and at the risk of being repetitive, the Court *En Banc* quotes with approval the discussion of the Court in Division in the assailed Decision pertaining to each and every item in the assessment to press the point, thus:

> **I. DEFICIENCY INCOME TAX - ₱28,134,150.84**
>
> Respondent (herein petitioner) computed the deficiency income tax assessment for taxable year 2004 in the amount of ₱28,134,150.84 as follows:

Taxable income per return		₱ -
Add: Disallowances/Adjustments per investigation:		
Unaccounted income	₱48,641,323.00	
Unaccounted prime contractors	1,044,141.23	
Professional fees not subjected to EWT	1,154,982.00	
Interest expense not subjected to final tax	4,973,138.20	
Disallowed interest expense	288,715.93	56,102,300.36
Taxable income per investigation		₱ 56,102,300.36

[24] EPPECI's Comment, *En Banc* docket, pp. 81-108.

Income tax due thereon			₱ 17,952,736.11
Less: Payments/tax credits			
Prior years excess tax credits claimed		₱10,715,585.00	
Creditable withholding tax claimed		15,517,047.00	
Total		₱26,232,632.00	
Less: Excess tax credits to be carried forward	₱22,203,593.00		
Deferred MCIT	4,029,039.00	26,232,632.00	-
Deficiency Income Tax			₱ 17,952,736.11
Add: 20% Interest p.a. from 04.16.05 to 2.15.08			10,181,414.73
TOTAL AMOUNT DUE			**₱28,134,150.84**

Petitioner (herein respondent) contends that the assessed deficiency income tax in the amount of ₱28,134,150.84 is baseless since it is based on the application of the "net worth" method.

On the other hand, respondent insists that due to some discrepancies on petitioner's income tax return and creditable withholding tax and alphalist/1601-E, petitioner has unaccounted source of income.

The Court will now determine the validity of the said assessment by looking into the propriety of the income imputed, as well as the expense deductions and tax credits disallowed by respondent, namely:

Unaccounted income	₱ 48,641,323.00
Unaccounted prime contractors	1,044,141.23
Professional fees not subjected to EWT	1,154,982.00
Interest expense not subjected to final tax	4,973,138.20
Disallowed interest expense	288,715.93
Excess tax credits to be carried forward	22,203,593.00
Deferred MCIT	4,029,039.00

a. Unaccounted income — ₱48,641,323.00

Invoking Section 32 of the National Internal Revenue Code (NIRC) of 1997, as amended, respondent assessed petitioner of deficiency income tax on the alleged unaccounted income of ₱48,641,323.00, representing the discrepancy between petitioner's receipts as reflected in its financial statements/income tax return (FS/ITR) and as computed by respondent based on the creditable income taxes withheld from petitioner:

Receipts per investigation:		
Creditable withholding tax	₱15,517,047.00	
Divided by the rate	10%	₱ 155,170,470.00
Receipts per FS/ITR		106,529,147.00
Difference		**₱ 48,641,323.00**

Petitioner asserted that respondent erred in using ten percent (10%) as the withholding tax rate in computing its gross receipts since the withholding tax rates applicable to its management fees vary from 10% to fifteen percent (15%). In support of its claim, petitioner presented the Certificates of Creditable Tax Withheld at Source (BIR Form No. 2307) issued by its clients for taxable year 2004 that reflected the following income payments and creditable taxes withheld therefrom:

EXHIBIT	PAYOR	INCOME PAYMENT	TAX RATE	CWT
M	Duracom Mobile Power Corp.	₱ 9,184,999.70	10%	₱ 918,499.97
N	East Asia Utilities Corp.	50,735,294.10	10%	5,073,529.41
PPP	Cebu Private Power Corp.	35,294,117.67	15%	5,294,117.65
O	East Asia Power Resources Corp.	28,221,498.76	15%	4,233,224.81
TOTAL		**₱123,435,910.23**		**₱15,519,371.84**

For management fees from East Asia Utilities Corporation, the Court-commissioned Independent CPA found that the tax withheld was 15% (not 10%) per sales invoices examined and that income payments received amounted to ₱33,823,529.41 (not ₱50,735,294.10):

EXHIBIT	INVOICE NO.	INVOICE DATE	TAX RATE	AMOUNT	EWT
NNN-7	N530N531-001	8/18/2004	15%	₱ 16,176,470.59	₱ 2,426,470.59
NNN-8	N530N531-002	8/18/2004	15%	17,647,058.82	2,647,058.82
TOTAL				**₱33,823,529.41**	**₱ 5,073,529.41**

The Independent CPA likewise observed that the net amount of ₱28,750,000.00 (₱33,823,529.41 less ₱5,073,529.41) received by petitioner from East Asia Utilities Corporation is supported by a corporate check dated September 22, 2004.

As a result, petitioner's adjusted total gross receipts for taxable year 2004 amounted to ₱106,524,145.54, detailed as follows:

EXHIBIT	PAYOR	INCOME PAYMENT
M	Duracom Mobile Power Corp.	₱ 9,184,999.70
NNN-7 and NNN-8	East Asia Utilities Corp.	33,823,529.41
PPP	Cebu Private Power Corp.	35,294,117.67
O	East Asia Power Resources Corp.	28,221,498.76
TOTAL		**₱ 106,524,145.54**

However, when the adjusted total gross receipts per withholding tax certificates and invoices are compared with that reported in petitioner's financial statements and income tax return, there remains a discrepancy of ₱5,001.46, computed as follows:

Gross receipts per FS/ITR	₱ 106,529,147.00
Adjusted gross receipts per withholding tax certificates	106,524,145.54
Difference	**₱ 5,001.46**

In its Reconciliation of Unaccounted Income, petitioner noted of the foregoing difference, in this wise:

> "Note: The management fees billed to DMPC and EAPRC were in United States Dollars. As such, there are differences in foreign exchange rates used by the companies and upon payment/collection."

On the other hand, the Independent CPA did not verify further the source of the difference because of the minimal amount involved.

In sum, petitioner has sufficiently explained the alleged unaccounted income found by respondent, except for the amount of ₱5,001.46. Consequently, petitioner shall be liable to pay deficiency income tax on the unaccounted difference of ₱5,001.46 in line with the rule that tax assessments by tax examiners are presumed correct and made in good faith, with the taxpayer having the burden of proving otherwise. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.

b. Unaccounted payments to prime contractors — ₱1,044,141.23

Respondent's examiner compared petitioner's income payments to prime contractors as reported in its FS/ITR with those reflected in petitioner's alphalist/BIR Form No. 1601-E, and construed the difference as unaccounted source of income amounting to ₱1,044,141.23, broken down as follows:

Payments to prime contractors:	
Per FS/ITR	₱ 18,697.37
Per alphalist/BIR Forms No. 1601-E	1,062,838.60
Difference	**₱ 1,044,141.23**

Petitioner explained that the difference pertains to travel expenses by company officers and several payments made by petitioner on behalf of El Paso Bangladesh, its affiliated company. Those payments were purportedly made to a travel agency and were recorded as either Travel and Transportation Expenses or Accounts Receivable and were reported in petitioner's financial statements as such.

The Court finds for petitioner.

A scrutiny of petitioner's Alphalist of Payees Subject to Expanded Withholding Tax as of December 31, 2004 shows the following:

PAYEE	ATC	INCOME PAYMENT	RATE	EWT
Travel Counsellors Inc.	WC120	₱ 1,044,141.53	2%	₱ 20,882.83
DHL Worldwide Express	WC120	10,551.07	2%	211.02
Santiago, Jay Daniel R.	WI010	55,000.00	10%	5,500.00
Adfa Graph Enterprises	WC120	8,146.00	2%	162.92
TOTAL		**₱1,117,838.60**		**₱ 26,756.77**

Based on the listing of Alphanumeric Tax Codes (ATC) under Revenue Memorandum Order (RMO) No. 29-98, all of the foregoing with ATC WC120 represent payments to prime contractors/sub-contractors subject to 2%

creditable withholding tax; while the payment to Santiago, Jay Daniel R. with ATC WI010 represents professional fees paid to an individual, such as lawyer, CPA, engineer, etc., subject to 10% creditable withholding tax. The latter was not included in the computation; thus, respondent's examiner arrived at the amount of ₱1,062,838.60 income payments per alphalist, as shown below:

PAYEE	INCOME PAYMENT	EWT
Travel Counsellors Inc.	₱ 1,044,141.53	₱ 20,882.83
DHL Worldwide Express	10,551.07	211.02
Adfa Graph Enterprises	8,146.00	162.92
TOTAL	**₱1,062,838.60**	**₱ 21,256.77**

As regards petitioner's income payments to DHL Worldwide Express and Adfa Graph Enterprises in the respective amounts of ₱10,551.07 and ₱8,146.00, totalling ₱18,697.07, respondent's examiner correctly found that these were reported in petitioner's FS/ITR for taxable year 2004.

Petitioner's general ledger for taxable year 2004 disclosed that the amount of ₱10,551.07, representing courier charges paid to DHL Worldwide Express, and the amount of ₱8,146.00, representing cost of printing invoices and official receipts paid to Adfa Graph Enterprises, were recorded under the "Communications" and "Miscellaneous" expense accounts, respectively. However, in its FS and ITR for taxable year 2004, both amounts were reported under "Others" and "Miscellaneous" expense accounts, respectively.

With reference to the income payments to Travel Counsellors, Inc. totaling ₱1,044,141.23, the same were reported in petitioner's FS/ITR for taxable year 2004 contrary to respondent's allegation.

As aptly found by the Independent CPA, the income payments of ₱1,044,141.23 were recorded as either "Transportation and Travel" expense or "Accounts Receivable-EPEIC" in petitioner's general ledger for taxable year 2004.

Petitioner's Notes to its Audited Financial Statements as of December 31, 2004 and 2003, indicate that EPEIC stands for El Paso Energy International Company — foreign affiliate of petitioner. Below is the breakdown of the amount of ₱1,044,141.23:

NAME OF PAYEE	OR No.	OR DATE	AMOUNT	EWT	REFERENCE	DEBITED TO ACCOUNT TILE AS FOLLOWS	EXH.	BIR RECORDS (EXHIBIT 1)
Travel Counsellors, Inc.	38675	25-Aug-04	₱ 147,440.00	₱ 2,948.80	JV#080407	Transportation and Travel	"P", "P-1" to "P-4"	Page 229
Travel Counsellors, Inc.	38858	17-Sep-04	187,841.82	3,756.84	JV#090405	Transportation and Travel	"Q", "Q-1" to "Q-6"	Page 229
Travel Counsellors, Inc.	39057	13-Oct-04	394,462.73	7,889.25	JV#100411	Accounts Receivable-EPEIC	"R", "R-1" to "R-6"	Page 239
Travel Counsellors, Inc.	39409	26-Nov-04	210,739.09	4,214.78	JV#110410	Accounts Receivable-EPEIC	"S", "S-1" to "S-5"	Page 239
Travel Counsellors, Inc.	39579	22-Dec-04	103,658.18	2,073.16	JV#120410	Accounts Receivable-EPEIC	"T", "T-2" to "T-6"	Page 239
			₱1,044,141.82	**₱20,882.84**				

The above income payments of ₱147,440.00 and ₱187,841.82 formed part of petitioner's claimed deduction for "Transportation and Travel" in the amount of ₱845,528.00 in its ITR for the year 2004.

In its Statement of Income for the year ended December 31, 2004, petitioner reflected as part of its Expenses the amount of ₱969,722.00 representing "Others", which composed of the ₱8,403.00 Representation and Entertainment, ₱845,528.00 Transportation and Travel, and ₱115,790.00 Miscellaneous expenses.

On the other hand, the income payments in the amounts of ₱394,462.73, ₱210,739.09, and ₱103,658.18 formed part of the Accounts Receivable-EPEIC ending balance as of December 31, 2004 in the amount of ₱1,261,700.02. The latter amount was included in the Receivable of ₱30,273,203.00, reflected in petitioner's Balance Sheet as of December 31, 2004.

As indicated in Note 3 of petitioner's Notes to Financial Statements, the Receivables in the amount of ₱30,273,203.00 is composed of the following:

Related Parties	₱ 8,038,169.00
Creditable withholding tax and others	22,235,034.00
	₱30,273,203.00

The Receivables from Related Parties of ₱8,038,169.00 consisted of the balances of the following Accounts Receivables as of December 31, 2004:

Accounts Receivable – EPEAC	₱ 6,776,468.99
Accounts Receivable - EPEIC	1,261,700.02
	₱ 8,038,169.01

Based on the foregoing, petitioner duly reported the income payments of ₱1,044,141.82 in its FS/ITR for taxable year 2004.

Respondent's allegation that petitioner had undeclared income arising from the alleged unreported income payments of ₱1,044,141.82 is without factual basis. By comparing petitioner's income payments to prime contractors/subcontractors per alphalist with those allegedly shown in petitioner's FS/ITR, respondent concluded that the difference pertains to petitioner's undeclared income. By doing so, respondent merely relied on assumptions without obtaining any evidence corroborating such findings. This is contrary to the doctrine laid down by the Supreme Court in *Collector of Internal Revenue v. Benipayo*, wherein it was held that:

xxx xxx xxx

Even if these alleged unaccounted income payments are to be treated as income, the same shall be offset by reporting the equivalent payments as expenses. Hence, no taxable income will result from the said transactions.

For lack of factual basis, the deficiency income tax assessment pertaining to the alleged

w/

undeclared income from unaccounted income payments of ₱1,044,141.23 should be cancelled.

c. Professional fees not subjected to EWT — ₱1,154,982.00

Pursuant to Section 34 (K) of the NIRC of 1997, as amended, respondent disallowed petitioner's claimed deduction for professional fees in the amount of ₱1,154,982.00, as computed below, for its alleged failure to subject the same to EWT:

Professional fees:	
Per FS/ITR	₱ 1,209,982.00
Per alphalist	55,000.00
Difference	**₱ 1,154,982.00**

Petitioner argued that the difference represents payments made to general professional partnerships, which are exempt from withholding tax pursuant to Section 2.57.5 (B) (4) of Revenue Regulations (RR) No. 2-98, as amended by RR No. 14-02. Petitioner submitted various documents to support its position, to wit:

EXHIBIT	PAYEE	AMOUNT
X-2 and Y	SGV & Co.	₱ 74,122.00
Z and Z-2	SGV & Co.	72,770.00
AA and AA-3	SGV & Co.	62,000.00
BB, BB-2 to BB-11	Puno & Puno Law Offices	221,938.17
DD and DD-3	Puno & Puno Law Offices	438,549.26
EE to EE-4	Puno & Puno Law Offices	40.36
FF-3 and FF-4	Siguion Reyna Montecillo & Ongsiako Law Offices	400.00
GG and GG-4	Puno & Puno Law Offices	732.93
HH-4	SGV & Co.	65,000.00
II, II-9 and II-10	Atty. Editha P. Talaboc	80.00
JJ-3	SyCip Salazar Law Offices	206,420.00
KK-3	SyCip Salaazar Law Offices	12,929.62
TOTAL		**₱1,154,982.34**

The Court agrees with petitioner. Payments amounting to ₱1,154,982.34 were made to general professional partnerships, such as law offices and accounting/auditing firms. Section 22 (B) of the NIRC of 1997, as amended, defines general professional partnerships as partnerships formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business. Corollary thereto, Section 26 of the same Code provides that a general professional partnership shall not be subject to income tax. Its partners are the ones liable in their individual capacity for the payment of income tax.

The Supreme Court, in the case of *Rufino R. Tan v. Ramon R. Del Rosario, Jr., et al.*, had the occasion to rule that the income tax is imposed not on the professional partnership, which is tax-exempt, but on the partners themselves in their individual capacity computed on their distributive shares of partnership profits. Considering that general professional partnerships are exempt from income tax, payments made to these partnerships are not subject to withholding tax pursuant to Section 2.57.5 of RR No. 2-98, as amended by RR No. 14-02, which states:

xxx xxx xxx

This means that respondent's disallowance of petitioner's claimed deduction for professional fees in the amount of ₱1,154,982.00 has no legal or factual basis. Consequently, the deficiency income tax assessment arising from the disallowed professional fees should be cancelled.

d. Interest expense not subjected to final withholding tax (FWT) — ₱4,973,138.20

Finding that part of petitioner's interest expense in the amount of ₱4,973,138.20 was not subjected to final withholding tax, respondent disallowed the same as deduction from petitioner's gross income, pursuant to Section 34 (K) of the NIRC of 1997, as amended. Below is the computation of the disallowed interest expense of ₱4,973,138.20:

Interest expense:	
Per FS	₱ 133,047,207.00

Per alphalist	128,074,068.80
Difference	**₱ 4,973,138.20**

Petitioner disagreed stating that all of its income payments amounting to ₱133,047,207.00 were subjected to the corresponding final tax and were remitted to the BIR as evidenced by its BIR Form Nos. 1601-F and 1604-CF. Further, respondent's computation is erroneous because it failed to consider petitioner's payments of interest expense in the succeeding taxable year 2005 for interest incurred in 2004; thus, explaining why the interest expense was reported in 2004 but not subjected to FWT in the same year.

To account for the difference of ₱4,973,138.20 found by respondent, petitioner submitted a Reconciliation of Interest Expense Per books and Per BIR Form No. 1701-F 67 and the related documents.

Examination of the foregoing shows that out of the ₱14,188,231.91 FWT remitted by petitioner to the BIR for the year 2004, only the FWT of ₱9,880,327.69 pertains to its interest expense for the said year, as computed below:

FWT per Annual Information Return of income Taxes Withheld on Compensation and Final Withholding Taxes (BIR Form No. 1604-CF)		₱14,188,231.91
Less: 1) FWT on Interest Expense for taxable year 2003		
Paid in January 2004	₱2,881,783.85	
Paid in March 2004	33,483.84	
2) Forex loss pertaining to FWT on Interest Expense for taxable year 2003 (see computation below)	11,811.55	
3) FWT on Management Fee Expense for 2004	1,380,824.98	4,307,904.22
FWT per BIR Form No. 1604-CF pertaining to Interest Expense for taxable year 2004		**₱ 9,880,327.69**

Forex gain(loss) per schedule [Exhs. "ZZ" and "ZZ-1"]				
January			₱(17,131.47)	
March			75.10	
April			23,234.34	
June			(2,857.43)	
October			2,983.54	₱ 6,304.08
Less: Forex loss pertaining to 2003 interest expense				

Included in the month of Jan. 2004 per schedule [Exhibit "ZZ"]	US$ Amount	FX Rate	Php Amount	
Accrued Interest thru Dec. 31, 2003 (US$52.4M Loan) [Exhibit "KKK-1.b"]	519,240.33	55.50	28,817,838.32	
Interest for Jan. 1 - 23, 2004	173,080.11	55.43	9,593,172.79	
Interest paid on Jan. 23, 2004	692,320.44		38,411,011.11	
FWT rate used	10%		10%	
FWT due	69,232.04		3,841,101.11	
FWT remittance [Exhibit "ZZ"]	69,232.04	55.72900	3,858,232.58	
Forex gain (loss)			(17,131.47)	
Forex gain (loss) pertaining to Accrued Interest thru Dec. 31, 2003	51,924.03	(0.229)	(11,890.60)	(11,890.60)
Included in the month of March 2004 per schedule [Exhibit "ZZ"]				
Accrued Interest, Dec. 10, 2003 - Feb. 29, 2004 (US$2M Loan) [Exhibit "KKK-5.a"]	23,270.63	56.3350	1,310,950.66	
Accrued Interest March 1-10, 2004	2,872.92	55.3861	159,119.56	
Interest Paid on March 10, 2004	26,143.55		1,470,070.22	
FWT rate used	10%		10%	
FWT due	2,614.36		147,007.02	
FWT remittance [Exhibit "ZZ"]	2,614.36	56.2020	146,931.92	
Forex gain (loss) [Exhibit "ZZ"]			75.10	
Accounted for as follows:				
Jan. 1-31, 2004 [Exhibit "KKK-2.a]	890.13	0.1330	118.39	
Feb. 1-29 [Exhibit "KKK-3.a]	842.56	0.1330	112.06	
March 1-10, 2004 [Exhibit "KKK-5.a]	287.29	(0.8159)	(234.40)	
Dec. 10-31, 2003 [Exhibit "KKK-2.a]	594.37	0.1330	79.05	79.05
	2,614.35		75.10	
Forex loss pertaining to FWT on interest expense for 2003				**(11,811.55)**
Forex gain pertaining to FWT on interest expense for 2004				**₱ 18,115.63**

Documents submitted by petitioner further show that petitioner's interest expense for taxable year 2004 amounting to ₱133,047,207.00 pertains to the remaining balance of drawdowns made on a loan facility from a foreign bank, Hollandsche Bank-Unie N.V. of Netherlands, totaling US$54.4 million as of December 31, 2003. The first drawdown was made on January 28, 1999 and petitioner made partial payments to the foreign bank upon availability of funds. The US$2 million loan was paid on June 20, 2004, while the US$52.4 million loan was prepaid in full on June 30, 2004 by petitioner's parent company, EPEC Netherland Holdings B.V. of Netherlands. In effect, the latter was subrogated to the rights of the foreign bank under the loan facility agreement. By virtue of subrogation, the US$52.4 million loan originally owed by petitioner to Hollandsche Bank-Unie N.V. of

Netherland became payable to EPEC Netherland Holdings B.V. of Netherlands.

Considering that the US$54.4 million loan was obtained by petitioner from a non-resident foreign bank (Hollandsche Bank-Unie N.V.), and that US$52.4 million thereof was subrogated to a non-resident foreign corporation (EPEC Netherland Holdings B.V.), the imposable tax on the interest derived from said loan is 20% pursuant to Section 28 (B) (5) (a) of the NIRC of 1997, as amended, which states:

xxx xxx xxx

However, paragraphs 2(a)(ii) and 2(b) of Article 11 of the Philippines-Netherlands Tax Treaty provide for the following preferential tax rates on interest:

xxx xxx xxx

It is clear from the foregoing, prior to the subrogation of the US$52.4 million loan to EPEC Netherland Holdings B.V., the applicable rate on the subject interest payments is the lower rate of ten percent (10%), pursuant to paragraph 2 (a) (ii) of Article 11 of the Philippines-Netherlands Tax Treaty.

On the other hand, upon subrogation of the US$52.4 million loan to EPEC Netherland Holdings B.V. on June 30, 2004, the applicable rate on the subject interest payments is fifteen percent (15%), pursuant to paragraph 2 (b) of Article 11 of the Philippines-Netherlands Tax Treaty.

Therefore, the FWT due on the ₱133,047,207.00 interest expense claimed by petitioner for taxable year 2004 amounted to ₱16,318,128.04, as computed below:

					FINAL WITHHOLDING TAX	
EXH.	**JV NO.**	**DATE**	**PARTICULARS**	**2004**	**RATE**	**AMOUNT DUE**
KKK-1	010411	1/23/2004	Jan1-23, $52.4M loan	₱ 10,552,489.87	10%	₱ 1,055,248.99
KKK-2	010413	1/31/2004	Jan1-31, $2M loan	551,601.72	10%	55,160.17
KKK-2	010413	1/31/2004	Jan24-31, $52.4M loan	3,671,252.99	10%	367,125.30

w/

KKK-3	020406	2/29/2004	Feb1-29, $2M loan	522,121.72	10%	52,212.17
KKK-3	020406	2/29/2004	Feb1-29, $52.4M loan	13,415,968.74	10%	1,341,596.87
KKK-4	030405	3/10/2004	Mar1-10, $2M loan	175,031.51	10%	17,503.15
KKK-5	030408	3/31/2004	Mar1-31, $52.4M loan	14,207,619.56	10%	1,420,761.96
KKK-5	030408	3/31/2004	Mar10-31, $2M loan	368,156.76	10%	36,815.68
KKK-6	040407	4/23/2004	Apr1-23, $52.4M loan	10,547,423.33	10%	1,054,742.33
KKK-7	040416	4/30/2004	Mar31-Apr30, $2M loan	524,823.40	10%	52,482.34
KKK-7	040416	4/30/2004	Apr24-30, $52.4M loan	3,248,146.39	10%	324,814.64
KKK-8	050404	5/31/2004	May1-31, $2M loan	534,725.73	10%	53,472.57
KKK-8	050404	5/31/2004	May1-31, $52.4M loan	14,285,587.66	10%	1,428,558.77
KKK-9	060402	6/10/2004	June1-10, $2M loan	174,111.86	10%	17,411.19
Subtotal				**₱ 72,779,061.24**		**₱ 7,277,906.13**
KKK-10	060405	6/30/2004	June1-30, $52.4M loan	₱ 14,254,490.72	15%	₱ 2,138,173.61
KKK-11	070409	7/31/2004	Jul1-31, $52.4M loan	7,197,333.59	15%	1,079,600.04
KKK-12	080411	8/31/2004	Aug1-31, $52.4M loan	6,856,461.75	15%	1,028,469.26
KKK-13	090418	9/30/2004	Sep1-25, $52.4M loan	5,661,894.69	15%	849,284.20
KKK-14	090418	9/30/2004	Sep26-30, $52.4M loan	1,424,892.94	15%	213,733.94
	100417	10/20/2004	Add'l Accrual of on interest for Jul1-Sep25	1,986,302.16	15%	297,945.32
	100421	10/31/2004	Oct1-31, $52.4M loan	7,852,003.81	15%	1,177,800.57
	110411	11/30/2004	Nov1-30, $52.4M loan	7,542,540.90	15%	1,131,381.14
	120414	12/31/2004	Dec1-25, $52.4M loan	5,790,893.15	15%	868,633.97
	120414	12/31/2004	Dec26-31, $52.4M loan	1,701,332.38	15%	255,199.86
Subtotal				**₱ 60,268,146.09**	15%	**₱ 9,040,221.91**
Total				**₱133,047,207.33**		**₱16,318,128.04**

After comparing the FWT due of ₱16,318,128.04 against the FWT remittances of ₱9,880,327.64, the Court finds petitioner liable for deficiency FWT of ₱6,437,800.40 on its interest expense of ₱45,003,324.53, computed as follows:

EXHIBIT	JV NO.	DATE	FWT DUE	FWT REMITTED	FWT STILL DUE	DISALLOWED INTEREST (FWT STILL DUE DIVIDED BY APPLICABLE RATE)
KKK-1	10411	1/23/2004	₱ 1,055,248.99	₱ 959,317.26	₱ 95,931.73	
KKK-2	10413	1/31/2004	55,160.17	50,145.61	5,014.56	
KKK-2	010413	1/31/2004	367,125.30	333,750.27	33,375.03	
KKK-3	020406	2/29/2004	52,212.17	47,465.61	4,746.56	
KKK-3	020406	2/29/2004	1,341,596.87	1,219,633.52	121,963.35	
KKK-4	030405	3/10/2004	17,503.15	15,911.96	1,591.19	
KKK-5	030408	3/31/2004	1,420,761.96	1,291,601.78	129,160.18	
KKK-5	030408	3/31/2004	36,815.68	33,468.80	3,346.88	
KKK-6	040407	4/23/2004	1,054,742.33	958,856.67	95,885.66	
KKK-7	040416	4/30/2004	52,482.34	47,711.22	4,771.12	
KKK-7	040416	4/30/2004	324,814.64	295,286.04	29,528.60	
KKK-8	050404	5/31/2004	53,472.57	48,611.43	4,861.14	

KKK-8	050404	5/31/2004	1,428,558.77	1,298,689.79	129,868.98	
KKK-9	060402	6/10/2004	17,411.19	15,828.35	1,582.84	
Subtotal			**₱ 7,277,906.13**	**₱ 6,616,278.31**	**₱ 661,627.82**	**₱ 6,616,278.20**
KKK-10	060405	6/30/2004	₱ 2,138,173.61	₱ 1,295,862.79	₱ 842,310.82	
KKK-11	70409	7/31/2004	1,079,600.04	719,733.36	359,866.68	
KKK-12	080411	8/31/2004	1,028,469.26	685,646.18	342,823.08	
KKK-13	090418	9/30/2004	849,284.20	566,189.47	283,094.73	
KKK-14	090418	9/30/2004	213,733.94		213,733.94	
	100417	10/20/2004	297,945.32	14,733.16	283,212.16	
	100421	10/31/2004	1,177,800.57		1,177,800.57	
	110411	11/30/2004	1,131,381.14		1,131,381.14	
	120414	12/31/2004	868,633.97		868,633.97	
	120414	12/31/2004	255,199.86		255,199.86	
Subtotal			**₱ 9,040,221.91**	**₱ 3,282,164.96**	**₱5,758,056.95**	**38,387,046.33**
Total			**₱16,318,128.04**	**₱ 9,898,443.27**	**₱6,419,684.77**	**₱45,003,324.53**
Forex gain pertaining to FWT on interest expense for 2004				**(18,115.63)**	**18,115.63**	
Net Amount			**₱16,318,128.04**	**₱9,880,327.64***	**₱6,437,800.40**	**₱45,003,324.53**

* The ₱.05 difference between the ₱9,880,327.69 FWT computed earlier and as computed above is due to rounding-off.

For failure to withhold and remit the corresponding FWT of ₱6,437,800.40, petitioner cannot claim the interest expense of ₱45,003,324.53 as deduction from its gross income for taxable year 2004, pursuant to Section 34 (K) of the NIRC of 1997, as amended, which states that:

xxx xxx xxx

e. Disallowed interest expense — ₱288,715.93

Petitioner's ITR for taxable year 2004 showed interest income subjected to final tax in the amount of ₱607,823.00. Pursuant to Section 34 (B) of the NIRC of 1997, as amended, respondent applied the limitation of deductibility of interest expense and disallowed the amount of ₱288,715.93, computed as follows:

Interest income subjected to final tax	₱ 607,823.00
Disallowed interest expense (₱607,823.00/80% x 38%)	**₱288,715.93**

It can be inferred from the foregoing that respondent assumed that the final tax rate on petitioner's interest income is 20%. Petitioner argued that the foregoing computation is erroneous because the applicable final tax rates on its interest income for the year 2004 are 7.5% (for US dollar accounts) and 20% (for Philippine peso accounts). Petitioner alleged that it had computed the interest expense limitation based on the amounts of interest income earned from its peso and US dollar accounts.

The Court agrees with petitioner.

Section 34 of the NIRC of 1997, as amended, prior to its amendment under Republic Act No. 9337, provides that the amount of interest that a taxpayer can deduct from his taxable gross income should be reduced by an amount equal to 38% of his interest income subjected to final tax, thus:

xxx xxx xxx

For taxable year 2004, petitioner earned interest income in the amount of ₱607,823.34 (net of withholding tax) on its US dollar and Philippine peso savings accounts as evidenced by the various journal vouchers, entries in petitioner's Security Bank US dollar and peso savings accounts passbooks, Security Bank's Confirmations of Purchase, as well as Confirmations of Sale Without Recourse of Fixed Rate Treasury Notes (FXTN), and petitioner's Temporary Investment Advice and letters to Security Bank Corporation.

Under Section 27 (D) (1) of the NIRC of 1997, as amended, the interest income derived by a domestic corporation from a depositary bank under the expanded foreign currency deposit system is subject to a final tax at the rate of either seven and a half percent (7.5%) for US dollar accounts and twenty percent (20%) for Philippine peso accounts. Consequently, petitioner's non-deductible interest expense for taxable year 2004 amounted to ₱274,557.00, as correctly computed by petitioner, detailed as follows:

EXHIBIT	DATE EARNED	AMOUNT OF INTEREST (NET OF FWT)	DIVISOR	LIMITATION RATE	NON-DEDUCTIBLE INTEREST EXPENSE
On US Dollar Accounts					
LLL-1 and LLL-1.b	3/31/2004	2,544.67	92.5%	38%	1,045.38
LLL-2 and LLL-2.b	6/30/2004	9,731.40	92.5%	38%	3,997.76
LLL-6 and LLL-6.a	9/20/2004	20,861.90	92.5%	38%	8,570.29
LLL-7 and LLL-7.c	9/30/2004	4,934.71	92.5%	38%	2,027.23
LLL-9 and LLL-9.a	10/19/2004	67,650.07	92.5%	38%	27,791.38
LLL-11 and LLL-11.a	11/18/2004	67,092.27	92.5%	38%	27,562.23
LLL-12 and LLL-12.a	12/20/2004	38,498.40	92.5%	38%	15,815.56
LLL-13 and LLL-13.c	12/29/2004	9,266.19	92.5%	38%	3,806.65
	Subtotal	**220,579.61**			**90,616.49**
On Peso Accounts					
LLL-1 and LLL-1.a	3/31/2004	10,391.83	80%	38%	4,936.12
LLL-2, LLL-2.a, LLL-3.a	6/30/2004	7,696.26	80%	38%	3,655.72
LLL-3 and LLL-3.a	7/9/2004	38,666.67	80%	38%	18,366.67
LLL-3.d and LLL-4	7/19/2004	16,237.93	80%	38%	7,713.02
LLL-5 to LLL-5.c	8/19/2004	58,518.42	80%	38%	27,796.25
LLL-7 to LLL-7.b	9/30/2004	7,557.81	80%	38%	3,589.96
LLL-8 and LLL-8.a	10/8/2004	79,632.35	80%	38%	37,825.37
LLL-10 to LLL-10.d, LLL-11.a	11/10/2004	159,442.23	80%	38%	75,735.06
LLL-13 to LLL-13.b	12/29/2004	9,100.23	80%	38%	4,322.61
	Subtotal	**387,243.73**			**183,940.77**
	Total	**607,823.34**			**274,557.26**

Examination of petitioner's ITR for taxable year 2004 shows that petitioner's claimed deduction for interest expense amounted to ₱132,772,650.00, an amount lower by ₱274,557.00 when compared with the interest expense of ₱133,047,207.00 reflected in its audited FS for the same year. Clearly, petitioner did not claim all of its reported interest expense by applying the limitation, as provided by the NIRC of 1997, as amended. As a result, the disallowance of petitioner's interest expense in the amount of ₱288,715.93 should be cancelled.

f. Excess Tax Carried Over to Succeeding Year — ₱22,203,593.00

Respondent disallowed petitioner's excess tax credits for taxable year 2004, but gave no explanation in the Details of Assessment/ Discrepancies. The Court could only surmise that the excess tax credits carried over to the succeeding year was disallowed in order to recapture the tax benefit realized by petitioner in carrying the said amount to the succeeding year.

However, it was improper for respondent to disallow the said excess tax credits because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2005. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year.

g. Minimum Corporate Income Tax (MCIT) — ₱4,029,039.00

Respondent likewise disallowed petitioner's MCIT payment in the amount of ₱4,029,039.00 without further explanation. Considering that the MCIT will be credited against the normal income tax for the three (3) immediately succeeding taxable years, pursuant to Section 27(E)(2) of the NIRC of 1997, as amended, its benefit will redound on the succeeding years. Thus, it is inappropriate to disallow the same for such is beyond the scope of the present assessment.

In fine, notwithstanding the ₱45,008,325.99 adjustments on petitioner's taxable income, representing the sum of petitioner's unaccounted income in the amount of ₱5,001.46 and disallowed interest expense in the amount of ₱45,003,324.53, petitioner still incurred a net loss in the amount of ₱390,088,424.04. Thus, petitioner's income tax liability was at the MCIT rate of two percent (2%) based on its gross income for taxable year 2004. However, petitioner's MCIT liability of ₱4,029,039.00 per its 2004 ITR shall be adjusted to ₱4,029,139.21 to reflect the unaccounted income of ₱5,001.46. Since petitioner's income tax credits were more than sufficient to cover its MCIT liability of ₱4,029,139.21, petitioner is not liable to pay any deficiency MCIT for taxable year 2004, as shown below:

Sales/Revenues/Receipts/Fees		₱ 106,529,147.00
Less: Cost of Sales/Services		9,205,500.00
Gross Income from Operation		₱ 97,323,647.00
Add: Non-operating and Other Income		104,128,312.00
Total Gross Income		₱ 201,451,959.00
Add: Unaccounted income		5,001.46
Adjusted Total Gross Income		₱ 201,456,960.46
Less: Deductions	₱636,548,709.00	
Less: Disallowed Interest Expense	45,003,324.53	591,545,384.47
Adjusted Net Loss		₱(390,088,424.01)
Minimum Corporate Income Tax Due		₱ 4,029,139.21
Less: Tax Credits		
Prior Year's Excess Credits	₱ 10,715,585.00	
Creditable Tax Withheld for the First Three Quarters	11,286,147.00	
Creditable Tax Withheld for the Fourth Quarter	4,230,900.00	26,232,632.00
Excess Tax Credits		**₱(22,203,492.79)**

xxx xxx xxx

III. DEFICIENCY EWT - ₱186,395.72

Upon investigation, it was found by respondent that petitioner failed to withhold and remit the EWT on professional fees paid. Thus, pursuant to Revenue Regulations No. 2-98, respondent assessed petitioner for deficiency EWT in the amount of ₱186,695.72, inclusive of interest, computed as follows:

Professional fees per FS/ITR	₱ 1,209,982.00
Professional fees per AL/1601-E	55,000.00
Professional fees not subjected to EWT	₱ 1,154,982.00
EWT rate	10%
EWT due thereon	₱ 115,498.20
Add: 20% interest p.a. from 01.16.05 to 2.15.08	71,197.52
TOTAL AMOUNT DUE	**₱ 186,695.72**

As discussed and determined earlier [see discussion under deficiency income tax assessment, item I(c)], the subject income payments amounting to ₱1,154,982.00 were made to general professional partnerships, which are exempt from income tax, pursuant to Section 26 in relation to Section 22(B) of the

NIRC of 1997, as amended, and consequently, to withholding tax, as provided for under Section 2.57.5 of RR No. 2-98, as amended by RR No. 14-02. Therefore, respondent's deficiency EWT assessment on the said income payments shall be cancelled.

xxx xxx xxx

V. DEFICIENCY IMPROPERLY ACCUMULATED EARNINGS TAX - ₱35,153,053.99

xxx. Petitioner was assessed of improperly accumulated earnings tax in the total amount of ₱21,060,098.00, computed thus:

Taxable income		₱ (435,096,750.00)
Add: Interest income subject to final tax	₱ 607,823.00	
Equity in net earnings of subsidiary	171,352,773.00	
Losses	485,906,173.00	657,866,769.00
Balance		₱ 222,770,019.00
Less: Income tax payable		4,029,039.00
Balance		₱ 218,740,980.00
Less: Capital stock		8,140,000.00
Improperly accumulated earnings		₱ 210,600,980.00
Improperly accumulated earnings rate		10%
Improperly accumulated earnings tax		**₱ 21,060,098.00**

As correctly pointed out by petitioner, it cannot possibly have any improperly accumulated earnings, because it has a deficit of ₱3,707,998,535.00; thus, no earnings to speak of, much more accumulation thereof. Petitioner's Statements of Changes in Stockholders' Equity (Capital Deficiency) show that it has sustained a capital deficiency from the year 2002 until 2004. Therefore, respondent's assessment against petitioner for deficiency improperly accumulated earnings tax of ₱35,153,053.99 is devoid of factual basis and should be cancelled.

VI. COMPROMISE PENALTY - ₱25,000.00

For alleged non/late/filing/payment of improperly accumulated earnings tax, respondent imposed compromise penalty

> against petitioner for taxable year 2004 in the amount of ₱25,000.00.
>
> Pursuant to RMO No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Thus, compromise penalty implies mutual agreement between the taxpayer, on one hand, and the BIR, on the other. Absent any showing that petitioner consented to the compromise penalties, the same should not be imposed. Accordingly, respondent's imposition of compromise penalties, without the consent of petitioner, cannot be sustained. (*Citations omitted*)

WHEREFORE, the *Petition for Review* filed by the Commissioner of Internal Revenue on June 5, 2015, is hereby **DENIED,** for lack of merit. Accordingly, the assailed Decision and Resolution dated February 23, 2015 and May 18, 2015, respectively, are **AFFIRMED**.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

(with Concurring and Dissenting Opinion)
ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

Ma. Belen M. R.-L.
MA. BELEN M. RINGPIS-LIBAN
Associate Justice

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, 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

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

****

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**CTA EB No. 1319** (CTA Case No. 8013)
	Present:
- versus -	**DEL ROSARIO,** *P.J.*, **CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN,** and **MANAHAN,** *JJ.*
EL PASO PHILIPPINES ENERGY COMPANY, INC., Respondent.	**Promulgated:** MAR 06 2017 1:36 p.m.

x - x

CONCURRING AND DISSENTING OPINION

UY, *J.*:

With all due respect to the learned ponente and my other colleagues, while I concur on the affirmation of the ruling of the Second Division of this Court that El Paso Philippines Energy Company, Inc. is only liable for value-added tax (VAT) and final withholding tax (FWT), plus the corresponding 25% surcharges imposed thereon, for calendar year 2004, I dissent on the imposition of the deficiency interest thereon on the basis of Section 249(B) of the National Internal Revenue Code (NIRC) of 1997, and the inclusion of said deficiency interest in the computation of delinquency interest under Section 249(C) of the same Code.

Section 249 of the NIRC of 1997 reads:

"SEC. 249. *Interest.* –

> (A) *In General.* – There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) *per annum,* or such higher rate as may be prescribed by the rules and regulations, from the date prescribed for its payment until the amount is fully paid.
>
> (B) *Deficiency Interest.* – Any **deficiency** in the tax due, **as the term is defined in this Code**, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.
>
> (C) *Delinquency Interest.* – In case of failure to pay:
>
> xxx xxx xxx
>
> (3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax." *(Emphases supplied)*

Based on the foregoing Section 249(B), the *"Deficiency Interest"* shall be imposed on *"*[a]*ny deficiency in the tax due, as the term is defined in this Code"*, *i.e.*, as the term "deficiency" is defined in the NIRC of 1997. Relative thereto, an examination of the said Code discloses that there are only three (3) instances where it defines the term "deficiency", and this relates only and respectively to three (3) types of internal revenue taxes, namely, income tax, estate tax, and donor's tax, pursuant to Sections 56(B), 93 and 104 of the NIRC of 1997, viz:

> "SEC. 56. *Payment and Assessment of Income Tax for Individuals and Corporations.—*
>
> xxx xxx xxx
>
> (B) *Assessment and Payment of Deficiency Tax.—* After the return is filed, the Commissioner shall examine its and assess the correct amount of the tax. The tax or deficiency income tax so discovered shall be paid upon

/M

notice and demand from the Commissioner.

As used in this Chapter[1], in respect of a tax imposed by this Title[2], the term **'deficiency'** means:

(1) The amount by which the tax imposed by this Title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amount previously abated, credited, returned or otherwise repaid in respect of such tax; or

(2) If no amount is shown as the tax by the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency; but such amounts previously assessed or collected without assessment shall first be decreased by the amounts previously abated, credited, returned or otherwise repaid in respect of such tax." *(Emphasis supplied)*

"SEC. 93. *Definition of Deficiency.* — As used in this Chapter[3], the term **'deficiency'** means:

(a) The amount by which the tax imposed by this Chapter exceeds the amount shown as the tax by the executor, administrator or any of the heirs upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency and decreased by the amounts previously abated, refunded or otherwise repaid in respect of such tax; or

(b) If no amount is shown as the tax by the executor, administrator or any of the heirs upon his return, or if no return is made by the executor, administrator, or any heir, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency; but such amounts previously assessed or collected without assessment

---

[1] Chapter IX – RETURNS AND PAYMENT OF TAX.
[2] Title II – TAX ON INCOME.
[3] CHAPTER I – ESTATE TAX (under TITLE III – ESTATE AND DONOR'S TAXES).

> shall first be decreased by the amounts previously abated, credited, returned or otherwise repaid in respect of such tax." *(Emphasis supplied)*
>
> "SEC. 104. *Definitions.* — xxx
>
> The term **'deficiency'** means: (a) the amount by which the tax imposed by this Chapter[4] exceeds the amount shown as the tax by the donor upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, refunded or otherwise repaid in respect of such tax, or (b) if no amount is shown as the tax by the donor upon his return, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency, but such amounts previously assessed or collected without assessment shall first be decreased by the amounts previously abated, credited, returned or otherwise repaid in respect of such tax." *(Emphasis supplied)*

Such being the case, the deficiency interest under Section 249(B) should be applied only whenever there is a deficiency income tax, a deficiency estate tax, and a deficiency donor's tax. For this reason, in this case, no deficiency interest under Section 249(B) should be imposed on the deficiency VAT and deficiency FWT against El Paso Philippines Energy Company, Inc. Correspondingly, the computation of the delinquency interest imposed under Section 249(C) should not as well include the said deficiency interest.

Correspondingly, I vote for the DELETION of: (1) the imposition of deficiency interests on El Paso Philippines Energy Company, Inc.'s basic deficiency VAT in the amount of ₱2,958,405.41 and basic deficiency FWT in the amount of ₱6,437,800.40, both at the rate of 20% *per annum*; and (2) the inclusion of said deficiency interests in the computation of the delinquency interest to be imposed on the same basic deficiency VAT and basic deficiency FWT.

ERLINDA P. UY
Associate Justice

---

[4] CHAPTER II – DONOR'S TAX (under TITLE III – ESTATE AND DONOR'S TAXES).