Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

BENJOY, INC., represented by its President, LOYALTY MENESES,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 7597

Members :
Castañeda, Jr., *Chairperson*
Uy, and
Palanca-Enriquez, *JJ.*

Promulgated:
NOV 2 5 2009
10:15 a.m.

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DECISION

UY, *J.*:

Before the Court is a Petition for Review that seeks the cancellation of the assessments issued by respondent, Commissioner of Internal Revenue, against petitioner, Benjoy Incorporated, for alleged deficiency income tax in the amount of Two Million Two Hundred Six Thousand One Hundred Eighty One Pesos (₱ 2,206,181.00), and for deficiency final withholding value-added tax (VAT) in the amount of Five Hundred Thirty One Thousand Three Hundred Seventy Nine Pesos and Fifty Two Centavos (₱ 531,379.52), covering the calendar year 2002, or in the aggregate amount of Two Million Seven Hundred Thirty Seven Five Hundred Sixty Thousand Pesos and Fifty Centavos (₱ 2,737,560.52), inclusive of increments.

THE FACTS

Petitioner, Benjoy Incorporated, is a corporation, organized and existing under Philippines laws, with principal office address at No. 6 Manga Road, New Manila, Quezon City.[1] It is engaged in the manufacturing of stuffed toys and other similar products being exported to different parts of the globe, including countries in Europe, Japan, Australia and New Zealand.[2] The majority and controlling stockholders of petitioner are the spouses Reuben and Dorothy Joy Alderson, Australian citizens, who were elected as Chairman and Vice Chairman of the company, respectively.[3]

On the other hand, respondent, Commissioner of Internal Revenue, is the head of the Bureau of Internal Revenue, the government agency in charge of the collection of revenues for the government, with office at Agham Road, Quezon City.[4]

Petitioner received a Preliminary Assessment Notice (PAN) dated May 26, 2006[5] from respondent, through its Regional Director, Nestor Valeroso, informing it, among others, that there have been findings of deficiency income tax and final

[1] *Joint Stipulation of Facts and Issues (JSFI)*, par. 1, Docket, p. 76.
[2] *JSFI*, par. 2, Docket, p. 76.
[3] *JSFI*, par. 3, Docket, p. 76.
[4] *Petition for Review*, par. 2, Docket, p. 1; *Answer*, par. 1, Docket, p. 57.
[5] Exhibit "B", Docket, pp. 216 to 219.

withholding on value-added tax (VAT) due the latter[6] for taxable year 2002. In the said PAN, respondent came up with the finding that the compensation of the Chairman and Vice Chairman being claimed as deductible expenses were excessive. Respondent used the salary of the President as the basis in determining the reasonable compensation which is due the Chairman and Vice Chairman, and arrived at the amount of Eight Hundred Forty Two Thousand Two Hundred Two Pesos and Sixty Six Centavos (₱ 842,202.66) for each officer, or a total of One Million Six Hundred Eighty Four Thousand Four Hundred Five Pesos and Thirty Two Centavos (₱ 1,684,405.32) in a year. Hence, the deductible expense in the amount of Three Million Three Hundred Fifty Two Thousand Eight Hundred Fifty Four Pesos and Sixty Eight Centavos (₱ 3,352,854.68) was disallowed stating that it is more of a return of investment, rather than salaries. Likewise, respondent assessed petitioner for deficiency final withholding on VAT in the total amount of Five Hundred Forty Thousand Nine Hundred Seventy Pesos and Fifty Centavos (₱ 540,970.50)[7], which the said salaries were allegedly not subjected to.

Petitioner requested for reconsideration of the said findings of the respondent[8] in its Letter dated June 20, 2006. On June 30, 2006, petitioner received a Formal Letter of Demand with Demand Number 40-591 issued on June 23, 2006, together with the corresponding Assessment Notices requesting

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[6] *JSFI*, par. 4, Docket, p. 76.
[7] *JSFI*, par. 5, Docket, pp. 76 to 77.
[8] *JSFI*, par. 6, Docket, p. 77. Exhibit "C", Docket, pp. 220 to 223.

petitioner to pay, among others, the amount of Two Million Two Hundred Six Thousand One Hundred Eighty One Pesos (₱ 2,206,181.00), representing deficiency income tax for the calendar year 2002, and the amount of Five Hundred Thirty One Thousand Three Hundred Seventy Nine Pesos and Fifty Two Centavos (₱ 531,379.52), representing deficiency final withholding VAT.[9]

On July 31, 2006, petitioner filed a Letter of Protest dated July 30, 2006, informing respondent that they intend to settle some of the items that were the subject of the Assessment Notices (namely, expanded withholding tax, VAT and documentary stamp tax), but formally contested the matter of deficiency income tax and deficiency final withholding on VAT as well as the compromise penalty thereof with request for reinvestigation and re-evaluation of the said assessment.[10]

Thus, on the same date, petitioner paid (i) the deficiency expanded withholding tax in the amount of Thirty Eight Thousand Three Hundred Ninety Four Pesos and Twenty Nine Centavos (₱ 38,394.29),[11] (ii) the deficiency VAT in the amount of Four Thousand Two Hundred Twenty Two Pesos and Sixty Nine Centavos (₱ 4,222.69),[12] and (iii) the deficiency documentary stamp tax in the amount of Seven Thousand One Hundred Ninety Eight Pesos and Thirty Nine (₱ 7,198.39).[13]

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[9] *JSFI*, par. 7, Docket, p. 77. Exhibit "D", Docket, pp. 224 to 232.
[10] *JSFI*, par. 8, Docket, p. 77. Exhibit "G", Docket, pp. 238 to 241.
[11] Exhibits "E-1" and "E-2", Docket, pp. 233 to 234.
[12] Exhibits "F-1" and "F-2", Docket, pp. 236 to 237.
[13] Exhibit "I-1", Docket, p. 245.

On August 4, 2006, respondent's Regional Director for Revenue Region No. 7, Merlinda L. Ordoyo, advised petitioner to coordinate with Revenue District Office No. 40 in Cubao, Quezon City, for any and all communications relative to petitioner's protest.[14]

Pursuant to the procedural requirement of the law, petitioner submitted to the respondent relevant documents in support of its protest. Petitioner was supposed to submit the said documents on September 28, 2006, the sixtieth (60^{th}) day from the filing of petitioner's protest letter. However, typhoon *"Milenyo"* struck Metro Manila and offices were closed then. Petitioner was advised by respondent to just submit the documents on the next office day, hence, the same were submitted on October 2, 2006.[15]

Due to the inaction of respondent on the said protest, petitioner filed the instant *Petition for Review* on April 2, 2007.

On June 22, 2007, respondent filed his *Answer*[16] alleging the following special and affirmative defenses:

> "5. All presumptions are in favor of the correctness of the Assessment;
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> "6. The herein Petitioner was fully appraised of the facts and the law on which the Final Assessment was issued. The Final Assessment Notice, Demand Letter and Details of Discrepancies which were all together sent at the same time to the Petitioner, contained, in detail, the manner of computation, the facts on which the assessment is based and the provision of the law used in arriving at such deficiency assessment;

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[14] *JSFI*, par. 9, Docket, p. 77. Exhibit "H", Docket, p. 242.
[15] *JSFI*, par. 10, Docket, p. 77. Exhibit "I", Docket, pp. 243 to 244.
[16] Docket, pp. 57 to 59.

"7. Supporting documents were not submitted to completely substantiate Petitioner's allegations or to rebut the assessment issued. Verification by the Revenue District Office disclosed that receipts amounting to P17,493.90 was not recorded/supported;

"8. Salaries and wages of Reuben and Dorothy Alderson in the amount of P3,352,854.68 was disallowed for being unreasonable consonant to the provisions of Section 34(A)(1)(a)(i). Spouses Reuben and Dorothy Alderson are non-resident aliens who own 99.97% of the shares of stock of the corporation. Said excessive salaries are considered unreasonable and therefore should be construed as a return of capital and not as salaries;

"9. As per verification of the records of the Petitioner, it was ascertained that retainer's fees was recorded as purchases. Hence, the same was not subjected to withholding. The same should be disallowed as an item of deduction from gross income pursuant to Section 34(K) of the National Internal Revenue Code of 1997;

"10. Further, comparative analysis of the financial statements and alphalist submitted by the Petitioner on certain income payments, particularly that of the rentals, professional fees, repairs and maintenance, arrastre and B/L charges, and subcon salaries, revealed discrepancies in the amount of P761,778.49. Said income payments were not subjected to expanded withholding tax. Thus, the same should not be allowed as deductions from gross income pursuant to Section 34(K) of the National Internal Revenue Code of 1997;

"11. Salaries paid to Reuben and Dorothy Alderson were not subjected to final withholding on value-added tax, hence, the Petitioner was assessed pursuant to the provisions of Revenue Regulations 8-2002;

"12. Lease agreement as computed by the Bureau of Internal Revenue amounting to P3,410,526 was not subjected to documentary stamp tax. Hence, Petitioner was assessed deficiency documentary stamp tax in the amount P8,096.96;

"13. The salaries and related expense as reflected in the Financial Statements, when compared to that reflected in the Alphalist reflects the difference of P4,058,065.91. Said amount should be disallowed as a deduction from the gross income pursuant to Section 34(K) of the Tax Code, as amended.

"14. Further, compromise penalty of P12,000 was imposed on the Petitioner for Petitioner's issuance of unregistered (extended) commercial invoice, failure to provide schedule of depreciation and schedule of taxes;"

On September 27, 2007, the parties filed their *Joint Stipulation of Facts and Issues*, which was approved by this Court per its *Resolution* promulgated on October 9, 2007.[17] Thereafter, petitioner proceeded to present its oral and documentary evidence. On the other hand, respondent's counsel failed to appear during the scheduled initial presentation of respondent's evidence on September 10, 2008. Upon motion of petitioner's counsel, respondent was deemed to have waived the right to present evidence and counsel for petitioner was granted thirty (30) days from said date to file its Memorandum, while counsel for respondent was granted twenty (20) days from notice of the *Resolution* dated September 22, 2008 to file respondent's Memorandum.[18]

Only petitioner filed its Memorandum on October 15, 2008[19] and this case was considered submitted for decision in the *Resolution* dated November 27, 2008[20], without respondent's memorandum.

Hence, this Decision.

ISSUES

The issues as stipulated by the parties[21] are as follows:

[17] Docket, p. 80.
[18] Resolution dated September 22, 2008, Docket, p. 398.
[19] Docket, p. 399.
[20] *Id.*, p. 429.

"1. Whether or not the salaries given to the Chairman and the Vice Chairman of the petitioner Company being claimed as deductible expense are to be considered excessive and unreasonable;

"2. Whether or not the petitioner has unrecorded receipts in the amount of P17,493.90;

"3. Whether or not petitioner has income payments which were not subjected to expanded withholding tax;

"4. Whether or not the salaries or Reuben and Dorothy Alderson were subjected to final withholding on value-added tax."

THE COURT'S RULING

The Salaries Paid To The Spouses Alderson Are Excessive and Unreasonable

Section 34(A)(1)(a)(i) of the National Internal Revenue Code (NIRC) of 1997 provides as follows:

SEC. 34. *Deductions from Gross Income.*— Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26 ; 27(A), (B) and (C); and 28 (A)(1), there shall be allowed the following deductions from gross income:

(A) *Expenses.*—

(1) *Ordinary and Necessary Trade, Business or Professional Expenses.* —

(a) *In General.* — There shall be allowed as deduction from gross income all the **ordinary and necessary expenses** paid or incurred during the taxable year in carrying on or which are directly attributable to, the

[21] Docket, p. 78.

development, management, operation and/or conduct of the trade, business or exercise of a profession, including:

(i) A **reasonable** allowance for salaries, wages, and other forms of compensation for personal services actually rendered, including the grossed-up monetary value of fringe benefit furnished or granted by the employer to the employee: *Provided,* That the final tax imposed under Section 33 hereof has been paid; *(Emphases supplied)*

Based on the foregoing, a domestic corporation is allowed to deduct from its gross income certain *"ordinary and necessary expenses"*, including a *"reasonable allowance for salaries, wages, and other forms of compensation for personal services actually rendered"*, in arriving at its taxable income.

It must be emphasized, however, that the burden is on the taxpayer to prove the validity of the claimed deduction.[22] In the instant case, the question thus arises: Can the salaries received by the spouses Alderson, as Chairman and Vice Chairman of petitioner company for taxable year 2002 be deemed as reasonable and not excessive deductions from petitioner's gross income for the same year?

The answer is in the negative.

In determining the reasonableness of salaries, as deductible expense of a taxpayer, paid to a taxpayer's supposed employees, We can draw our guideline from Revenue Regulations No. 2, [23] specifically, Sections 70 and 71 thereof which provide as follows:

SEC. 70. *Compensation for personal services.*— Among the ordinary and necessary expense paid or incurred in

[22] *Commissioner of Internal Revenue vs. Algue, Inc., et al.*, G.R. No. L-28896, February 17, 1988.
[23] SUBJECT:INCOME TAX REGULATIONS (Promulgated February 11, 1931, 30 O.G. No. 18, 325)

carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are, in fact, payments purely for service. This test and its practical application may be further stated and illustrated as follows:

(1) **Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible**. (a) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having a few stockholders, practically all of whom draw salaries. **If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payment correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but the excessive payments are a distribution of earnings upon the stock**. xxx

xxx xxx xxx

(3) In any event the allowance for compensation paid may not exceed what is reasonable in all the circumstances. **It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises in like circumstances**. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned. *(Emphases supplied)*

SEC. 71. ***Treatment of excessive compensation.***— The income tax liability of the recipient in respect of an amount of ostensibly paid to him as compensation, but not allowed to be deducted as such by the payer, will depend upon the circumstances of each case. Thus, in the case of excessive payments by corporations, **if such payments correspond or bear a close relationship to stockholdings, and are found to be distribution of earnings or profits**, the excessive payments will be treated as dividend. xxx. *(Emphasis supplied)*

A cursory reading of the above provisions would reveal that the basic consideration in determining the reasonableness of the salaries of the subject

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employees who are also stockholders of the taxpayer-corporation, is whether or not the payment of the salaries were made under arm's length conditions? In other words, would such payment be "ordinarily paid for like services by like enterprises in like circumstances"?

If in the affirmative, then said salaries are regarded as reasonable, warranting the confirmation of the validity of their deduction from gross income. If not, then the salaries are not deemed as reasonable and thus, should be disallowed as deduction from gross income.

However, in this case, petitioner failed to present evidence, given the factual prevailing circumstances in the instant case, why the excessive payments made to the spouses Alderson should be considered as reasonable salary payments, instead of being considered as distribution from earnings or profit. As borne out by the records of this case, petitioner confined itself to comparing the services rendered by the spouses Alderson with that of its President and other employees in justifying its assertion that the salaries of said spouses are reasonable and just commensurate to the supposed services rendered to the corporation. Thus, Our determination will also be confined thereto vis-à-vis the findings of the respondent.

Petitioner presented in evidence the testimony of its President, Loyalty Meneses, by way of a Judicial Affidavit executed on February 5, 2008[24] to wit:

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[24] Exhibit "O", Docket, pp. 274 – 278.

Q: As Chairman of the Board, what does Mr. Reuben Alderson do in the corporation?

A: Mr. Reuben Alderson is the one responsible for the creation of Benjoy, Inc. Together with his wife, Dorothy Joy, they established the domestic corporation in the Philippines and was instrumental in procuring suppliers for the materials that is needed in manufacturing of stuffed toys and other nursery goods. Likewise, Mr. Alderson is the one responsible for the marketing of Benjoy products international. He is the one communicating and transacting with these suppliers and clients in any and all the matters relative to the purchase of materials to be used in manufacturing and supply of finished products as the case may be.

The Chairman, now based in Australia travels to the Philippines at least twice a year to personally attend and mind our company's booth at the annual FAME show. He does some product selling and handles any major problem with existing regular buyers that visit the show.

During his stay in the Philippines, he personally talks to our suppliers to renew & strengthen good business relationship with the company apart from ensuring that the company gets the best quality and best deal all the time.

While abroad, the Chairman maintains regular communication with us, the company in the Philippines, issues instructions and guidance while he continuously coordinate with suppliers and customers.

Mr and Mrs Alderson are the signatories to our agreement with our supplier.

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Q: As Vice-Chairman of the Corporation, what does Mrs. Dorothy Joy Alderson do?

A: Mrs. Alderson is the one who makes the company's product lines. She creates designs of the stuffed toys being manufactured by the petitioner Corporation. The Vice-Chairman has been training some of our qualified workers ahead by Ms. Teresita Tupaz to create patterns for the product designs. Mrs. Alderson supervise the training on-line and gives instructions in terms of the proper proportions, shapes, color combination, correct material to use and others. Mrs. Alderson forwards designs that she created herself and the same is used by our product development department as our example product which we normally show in the exhibit at the annual FAME SHOW twice a year.

Moreso, Mrs. Alderson has been training our Quality Control in-charge, Ms. Helen Fontarum for proper checking quality.

There are instances wherein our buyers submit their own designs that we need to develop for them which we submit to Mrs. Alderson for her inputs, comments and final approval prior to submission to buyers.

Q: You said you take care of the operations of the Corporation? Can you state the specific tasks you do?
A: I am the one responsible for making sure that the production is running properly, that is, doing the right order, right items at the right time to meet the delivery schedule committed with the buyer.
I am likewise responsible for overseeing the entire manufacturing side of the business including human resource management. I handle minor problems encountered but major problems and decisions are still being consulted to Mr. Alderson.

Q: Is there an instance where your functions overlaps with the functions of Mr. Alderson?
A: No ma'am.

Q: Can you specify the distinction between your function and the function of the Chairman of the Board?
A: The Chairman is basically in-charge of marketing and procurement side of the business, which is external dealings in nature, while I am basically in-charge of the manufacturing side, which is internal.

Q: Can Benjoy, Inc. operate without the participation of your Chairman of the Board?
A: The Corporation will have a hard time ma'am because Mr. Alderson is the one transacting with our suppliers as well as our buyers.

Q: So what will the effect if Mr. Alderson will not be around?

A: Mr. Alderson has established good relationship with our suppliers such that we were given good prices (though not necessarily low price) for the raw materials. Without him, we are not sure if we will be able to get the same deal as Mr. Alderson has been getting from them. Likewise, with regard to our buyers, we were able to command a good price for our products, Mr. Alderson has gained the trust of our buyers. Hence, even if we are constrained to increase our prices, our buyers remain loyal to our company.

Q: Can you cite an instance where Mr. Alderson was instrumental in dealins with the corporation's clients?
A: Actually, there are a lot of instances. But one instance is during the time that we have to increase our prices. Mr. Alderson was the one who talked to the customers and explained the need to increase prices and that the same are beyond our control. Fortunately, customers understood and they still opt to transaction business with us despite the increase in prices.

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Q: Is it possible that perform the function of the Chairman of the Board?
A: I don't think I can be as effective as Mr. Alderson.

Q: Why did you say so?
A: Firstly, the suppliers and buyers trust Benjoy, Inc. because they trust Mr. Alderson personally. Second, our suppliers and buyers are foreigners, some are Australian nationals. Mr. Alderson (being an Australian) is the best person to transact with these people.

Q: Based on your statements, can you categorically state if the salary of the President and the Chairman of the Board should be the same, given their respective functions in the company?
A: The salary of the President and Chairman of the Board should not be the same considering the fact as per our set up, our Chairman of the Board has vital functions than the President. While the two offices are important in the operations of the company, the function of the Chairman is essential given the fact that we operate with import-based materials and export-based products.

Q: With regard to the salary of the Vice-Chairman, would you say that it should be the same as the President?
A: No ma'am. Aside from the difference in functions, Mrs. Dorothy Alderson has been hired by the corporation to prepare designs for our customers and for our product line. Hence, she has to receive compensation for that.

While We are convinced that the spouses Alderson made significant contributions to the corporation's operations, and should be compensated for services rendered, We cannot agree that it should be in the amount claimed, which is ₱ 5,037,260.00.

The Court notes that the claimed expenses for the salaries of Mr. Alderson for taxable year 2002 are almost four times than that of its President, Ms. Meneses.[25] With such difference, said salaries of Mr. Alderson are inordinately large. In fact the combined salaries of the Spouses Alderson in the amount of ₱ 5,037,260.00 surpassed that of the Net Income per Income Tax Return of petitioner for taxable year 2002 which is only ₱ 4,280,875.78, thereby diminishing its corresponding corporate tax liability.

Hence, We are of the considered view that the salaries received by the spouses Alderson are unreasonable and thus, should be reduced accordingly to an amount equivalent to the salary of its president. Thus, in computing petitioner's taxable income for taxable year 2002, the claimed salaries of the spouses Alderson should be reduced from ₱ 5,037,260.00 to ₱ 1,684,405.32,

[25] See Exhibit "B" (Docket, p. 218). The claimed salaries of Mr. Alderson totaled ₱ 3,318,991.58, while that of Ms. Meneses totaled ₱ 842,202.66 (₱ 3,318,991.58 divided by ₱ 842,202.66 equals ***394.0846%***).

thereby resulting to a disallowance of ₱ 3,352,854.68 (₱ 5,037,260.00 less ₱ 1,684,405.32).

Deductions for income tax purposes partake of the nature of tax exemptions; hence, if tax exemptions are strictly construed, then deductions must also be strictly construed.[26]

PETITIONER FAILED TO ESTABLISH THAT THE RECEIPTS IN THE AGGREGATE AMOUNT OF ₱ 17,493.90 WERE RECORDED

The BIR found that petitioner has unrecorded receipts in the amount of ₱ 17,493.90, broken down as follows:[27]

Date	Name of Payor	OR#	Amount
March 22, 2003	(Various)	1364	₱ 320.00
June 19, 2002	Gil Umali	1396	6,515.90
October 18, 2002	Shan Washngton ($200 @ ₱ 53.29)	1424	10,658.00
	Total unrecorded receipts		₱ 17,493.90

During trial, petitioner attempted to establish that the foregoing receipts were indeed recorded. However, petitioner failed to convince this Court of such fact.

To prove it has recorded receipts in the amount of ₱ 17,493.90, petitioner presented in evidence its (1) *Official Receipt No. 1396* dated June 19, 2002 in the amount of ₱ 6,515.90;[28] (2) *Official Receipt No. 1424* dated October 18, 2002

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[26] *Commissioner of Internal Revenue vs. General Foods (Phils.), Inc.*, G.R. No. 143672, April 24, 2003.
[27] Exhibit "D", Docket, p. 227.
[28] Exhibit "J", Docket, p. 257.

in the amount of $200.00[29] (equivalent to ₱ 10,658.00)[30];and (3) some portions of petitioner's ledger.[31] It must be pointed out that the combined amounts of these receipts fall short of ₱ 17,493.90—the amount in question. Thus, with the foregoing evidence, We can hardly say that the amount of ₱ 17,493.90 was in fact recorded.

More importantly, to be considered as "recorded", it must be shown that the transactions are reflected on **all** the books of accounts required to be kept by a taxpayer in accordance with Section 232 of the NIRC of 1997, to wit:

> "**SEC. 232.** *Keeping of Books of Accounts.* —
>
> "(A) *Corporations, Companies, Partnerships or Persons Required to Keep Books of Accounts.* — All corporations, companies, partnerships or persons required by law to pay internal revenue taxes **shall keep a journal and a ledger or their equivalents**: xxx" *(Emphasis supplied)*

Such being the case, the taxpayer must present not only the official receipts and ledger, but also the journal. Considering that cases filed before this Court are litigated *de novo*, party-litigants shall prove *every minute aspect* of their cases.[32] Thus, the findings of respondent that the amount of ₱ 17,493.90 was unrecorded should be sustained, for petitioner's failure to convincingly refute the same.

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[29] Exhibit "K", Docket, p. 262.
[30] Docket, p. 227.
[31] Exhibits "J-1" and "K-1", Docket, pp. 261 and 264.
[32] *Dizon vs. Court of Tax Appeals, et al.*, G.R. No. 140944, April 30, 2008; *Atlas Consolidated Mining and Development Corporation vs. Commissioner of Internal Revenue,* G.R. No. 145526, March 16, 2007; and *Commissioner of Internal Revenue vs. Manila Mining Corporation,* G.R. No. 153204, August 31, 2005.

It is a well-settled rule that the determinations and assessments of the BIR are presumed correct and made in good faith.[33] The taxpayer has the duty of proving otherwise.[34] Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.[35]

CERTAIN INCOME PAYMENTS OF PETITIONER WERE NOT SUBJECTED TO EXPANDED WITHHOLDING TAX

The BIR also made the following findings,[36] to wit:

"c. *Retainer's fee which was recorded as purchases / not subjected to EWT (P35,520.00)* – Verification disclosed that retainer's fee amounting to P35,520.00 which was recorded as purchases, was not subjected to EWT, hence, disallowed as deduction from your gross income pursuant to the provisions of Section 34(K) of the Tax Code.

"d. *Income payments not subjected to EWT (P761,778.49)* – Verification disclosed that the following income payments were not subjected to EWT, hence, disallowed as deductions from (petitioner's) gross income pursuant to the provisions of Section 34(K) of the Tax Code.

Income Payments		Per F/S		Per Alphalist		Discrepancy
Rentals	P	1,281,789.42	P	1,165,263.11	P	116,526.31
Professional Fees		250230		247051.25		3,178.75
Repairs & Maintenance		228,849.51		-		228,849.51
Arrastre and B/L charges		412,983.06		-		412,983.06
Subcon Salaries		1,815,536.52		1,815,295.66		240.86
Total					P	761,778.49"

As can be gleaned from respondent's Formal Letter of Demand dated June 23, 2006,[37] the said disallowed deductions contributed to its assessment of deficiency income tax. In addition, deficiency expanded withholding tax were correspondingly assessed as follows:

Income payments	Amounts	Rate	EWT Due
Rentals	₱ 116,526.31	5%	₱ 5,826.32

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[33] *Marcos II vs. Court of Appeals, et al.*, G.R. No. 120880, June 5, 1997.
[34] *Id.*
[35] *Id.*
[36] Docket, p. 227.
[37] Exhibit "D", Docket, p. 225.

Retainer's fee	35,520.00	10%	3,552.00
Professional Fees	3,178.75	10%	317.88
Repairs and Maintenance	228,849.51	2%	4,576.99
Arrastre and B/L charges	412,983.06	2%	8,259.66
Subcon Salaries	240.86	2%	4.82
Deficiency EWT due			₱ 22,537.66
Add: 20% interest p.a. from 01.16.03 to 07.24.06			15,856.63
Total amount due			₱ 38,394.29

Petitioner failed to present or offer any evidence to controvert the above-stated findings. However, petitioner was able to prove that it has paid the BIR the said amount of ₱ 38,394.29, upon being assessed thereof.[38] Thus, this is a clear indication that the said income payments were indeed not subjected to the expanded withholding tax. Also, this practically resolves the issue on whether the said income payments were subjected to the expanded withholding tax.

However, We are confronted with a correlative issue on whether such payment has the effect of allowing now the deductions on petitioner's gross income previously disallowed by respondent, for purposes of computing the above-stated deficiency income tax.

After careful examination of the pertinent provisions of the NIRC of 1997, We are of the position that the disallowances made on the said deductions must be sustained. Said pertinent provisions are as follows:

"SEC. 34. *Deductions from Gross Income.*— xxx

xxx xxx xxx

[38] See Exhbits "E-1" and "E-2", Docket, pp. 233 to 234.

(K) *Additional Requirements for Deductibility.*— Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue **in accordance with this Section, Sections 58 and 81 of this Code**." *(Emphasis supplied)*

"SEC. 58. *Returns and Payment of Taxes Withheld at Source.*—

(A) *Quarterly Returns and Payments of Taxes Withheld.* — Taxes deducted and withheld under Section 57 by withholding agents shall be covered by a return and paid to, except in cases where the Commissioner otherwise permits, an authorized agent bank, Revenue District Officer, Collection Agent, or duly authorized Treasurer of the city or municipality where the withholding agent has his legal residence or principal place of business, or where the withholding agent is a corporation, where the principal office is located.

The taxes deducted and withheld by the withholding agent shall be held as a special fund in trust for the government until paid to the collecting officers.

The return for final withholding tax shall be filed and the payment made within twenty-five days from the close of each calendar quarter, **while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which withholding was made: *Provided,* That the Commissioner, with the approval of the Secretary of Finance, may require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the government.**
xxx xxx xxx." *(Emphasis supplied)*

In this connection, Section 2.58(A)(2) of Revenue Regulations No. (RR) 2-98,[39] as amended by RR 6-01, which were promulgated by the Secretary of Finance, upon the recommendation of the respondent, provides as follows:

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[39] SUBJECT: Implementing Republic Act No. 8424, *"An Act Amending The National Internal Revenue Code, as Amended"* Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding on Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes.

"SECTION 2.58. RETURNS AND PAYMENT OF TAXES WITHHELD AT SOURCE.

(A) Monthly return and payment of taxes

xxx xxx xxx

(2) WHEN TO FILE —

(a) For both large and non-large taxpayers, **the withholding tax return, whether creditable or final** (including final withholding taxes on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements) **shall be filed and payments should be made, within ten (10) days after the end of each month**, except for taxes withheld for the month of December of each year, which shall be filed on or before January 15 of the following year.

(b) With respect, however, to taxpayers, whether large or non-large, who availed of the electronic filing and payment (EFPS), **the deadline for electronically filing the applicable withholding tax returns and paying the taxes due thereon via the EFPS shall be five (5) days later than the deadlines set above.**" *(Emphases supplied)*

Based on the foregoing provisions, one of the requirements for the deductibility of an expense from the taxpayer's gross income, is that *"the tax required to be deducted and withheld therefrom has been paid"* to the BIR in accordance with, *inter alia*, Section 58 of the NIRC of 1997. This provision obliges the withholding agent to file the withholding tax return and pay to the BIR the withheld tax at a certain period, which as required under RR 2-98, as amended RR 6-01, should be within ten (10) days or five (5) days (in case of EFPS) after the end of each month. Simply put, the taxpayer must remit within the said period the tax withheld. Otherwise, the corresponding expense may not be allowed as a deduction from his or its gross income.

In this case, petitioner paid the supposed tax withheld only when respondent had made an assessment thereon or at a time already beyond the said ten-day or five-day period. Thus, even when petitioner paid the deficiency expanded withholding tax, upon being assessed thereof, it shall not be allowed to deduct the subject expenses or income payments to the pertinent withholding tax rates were applied.

Therefore, the deficiency income tax should, in its entirety, be sustained.

THE RESPECTIVE SALARIES OF THE SPOUSES ALDERSON ARE NOT SUBJECT TO FINAL WITHHOLDING VAT

Respondent anchors his stand in imposing VAT on the salaries of spouses Alderson on Section 4.110-3 of Revenue Regulations No. (RR) 7-95[40], as amended by RR 8-2002, which provides in part as follows:

> "SEC. 4.110-3. *Withholding of Creditable and Final Value-Added Tax.* —
>
> xxx xxx xxx
>
> "(b) *Withholding of Final VAT.* — The government or any of its political subdivisions, instrumentalities or agencies, including government-owned or controlled corporations (GOCCs), **as well as private corporations**, individuals, estates and trusts, whether large or non-large taxpayers, **shall withhold ten percent (10%) VAT with respect to the following payments**:
>
> "(1) Lease or use of properties or property rights owned by non-residents;

[40] SUBJECT: Consolidated Value-Added Tax Regulations.

"(2) Services rendered to local insurance companies, with respect to reinsurance premiums payable to non-residents; and

"(3) **Other services rendered in the Philippines by non-residents**." *(Emphases supplied)*

However, it appears that respondent failed to consider Section 109(o) of NIRC of 1997, to wit:

"SEC. 109. *Exempt Transactions.*— The following shall be **exempt from the value-added tax**:

xxx xxx xxx

"(o) **Services rendered by individuals pursuant to an employer-employee relationship**;" *(Emphases supplied)*

Thus, it was error for respondent to assess petitioner in the amount of ₱ 531,379.52 for its alleged failure to withhold VAT on the salaries received by Spouses Alderson as employees of petitioner. Such assessment must, therefore, be set aside.

WHEREFORE, all the foregoing considered, the instant *Petition for Review* is **PARTIALLY GRANTED**. The deficiency final withholding VAT assessment for taxable year 2002 issued against petitioner in the amount of ₱ 531,379.52 is hereby **CANCELLED** and **SET ASIDE**. The compromise penalties imposed by respondent are hereby likewise **CANCELLED** and **SET ASIDE**, there being no mutual agreement between the parties relative thereto.[41]

However, the deficiency income tax assessment for taxable year 2002 issued by respondent against petitioner is hereby **AFFIRMED**. Accordingly,

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[41] *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.

petitioner is **ORDERED TO PAY** respondent the amount of **ONE MILLION THREE HUNDRED THIRTY THREE THOUSAND SIX HUNDRED FORTY SEVEN PESOS AND SIX CENTAVOS (₱ 1,333,647.06)**, representing deficiency income tax for the said taxable year, computed as follows:

Net Income per ITR		₱ 4,280,875.78
Add: Discrepancies/adjustments:		
Disallowed salaries and wages	₱ 3,352,854.68	
Unrecorded receipts	17,493.90	
Retainers Fee recorded as purchases-not subjected to EWT	35,520.00	
Income payments not subjected to EWT	761,778.49	4,167,647.07
Adjusted Taxable Income		₱ 8,448,522.85
Income Tax due thereon (32%)		₱ 2,703,527.31
Less: Allowable tax credits/payments		1,369,880.25
Deficiency Income Tax		₱ 1,333,647.06

In addition to said amount, petitioner is hereby **ORDERED TO PAY** (i) a twenty five percent (25%) surcharge thereon, pursuant to Section 248(A)(3) of the NIRC of 1997; (ii) a deficiency interest, also on the same tax base, at the rate of twenty percent (20%) per annum from April 16, 2003 until fully paid in accordance with Section 249(B) of the NIRC of 1997; and (iii) a delinquency interest, likewise on the same tax base, at the rate of twenty percent (20%) per annum from July 24, 2006 until fully paid, pursuant to Section 249(C)(3) of the NIRC of 1997.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

I hereby certify that the 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
Presiding Justice