REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

KERRY FOOD INGREDIENTS CEBU, INC., Petitioner,	CTA Case No. 8593
	Members:
- versus -	BAUTISTA, *Chairperson* FABON-VICTORINO, and RINGPIS-LIBAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: FEB 09 2016 2:56 p.m.

x- x

DECISION

***Fabon-Victorino, J.*:**

In this Petition for Review[1] filed on December 26, 2012, petitioner Kerry Food Ingredients Cebu, Inc. prays for the cancellation and withdrawal of assessment issued by respondent Commissioner of Internal Revenue (CIR) for deficiency Income Tax (IT), Value-Added Tax (VAT), Expanded Withholding Tax (EWT), Withholding Tax on Compensation (WTC), Final Withholding Tax (FWT), and Documentary Stamp Tax (DST) for taxable year 2007, in the total amount of ₱10,496,763.36.

Petitioner is a domestic corporation, with principal office located at P. Suico Street, Tabok, Mandaue City, Cebu.[2]

Respondent, on the other hand, is the Commissioner of the Bureau of Internal Revenue (BIR), with the authority to

[1] Docket, pp. 6-20.
[2] Par. 3, Joint Stipulation of Facts and Issues (JSFI), docket, p. 263

act on disputed assessments and cancel tax liabilities, pursuant to the provisions of the National Internal Revenue Code (NIRC) of 1997 and other tax laws, rules and regulations. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On June 28, 2010, petitioner received from respondent a Letter of Authority (LOA) No. 00007531[3], for the examination of its books of accounts and other accounting records relative to its internal revenue taxes for taxable year 2007.[4]

On November 4, 2011, petitioner received from respondent a Notice of Informal Conference[5] dated October 6, 2011, to be held within fifteen (15) days from notice, to discuss the result of the examination of its internal revenue taxes for taxable year 2007. Attached to the said Notice was a Computation of Deficiency Tax Due[6].

On February 3, 2012, petitioner received an undated Preliminary Assessment Notice (PAN)[7] with Details of Discrepancies[8] for deficiency IT, VAT, EWT, WTC, FWT, and DST for taxable year 2007, in the aggregate amount of ₱9,682,115.87.

Petitioner protested the PAN through a Letter dated February 17, 2012.[9]

On March 13, 2012, petitioner received a Formal Letter of Demand[10] (FLD) with Details of Discrepancies[11] and Final Assessment Notices[12] (FAN), for deficiencies in IT, VAT, EWT, WTC, FWT, and DST in the aggregate amount of ₱9,757,132.89 for taxable year 2007, computed as follows:[13]

---

[3] Exhibit "1", BIR records, p. 290
[4] Par. 4, JSFI, docket, p. 263
[5] Exhibit "2", BIR records, p. 572
[6] Exhibit "2-a", BIR records, pp. 566 to 571
[7] Exhibit "3", BIR records, pp. 688 to 690
[8] Exhibit "3-a", BIR records, p. 687
[9] Par. 6, JSFI, docket, p. 263
[10] Exhibit "4", BIR records, pp. 749 to 752
[11] Exhibit "4-a", BIR records, pp. 747 to 748
[12] Exhibits "4-b" to "4-g", BIR records, pp. 741 to 746
[13] Par. 7, JSFI, docket, p. 263

I. Income		Normal Rate
Taxable Income- per return		
Add: Disallowance		
(1) Interest expense– interest arbitrage limitation		434.19
(2) Unexplained source of cash- Sal. and wages over per alpha list		6,151,861.21
(3) Rental expense- overclaimed		776,094.49
Taxable Income- per investigation		6,928,389.89
Income Tax		2,424,936.46
Income Tax Due		2,424,936.46
Less Tax Credits/Payments		
Deficiency Income Tax		2,424,936.46
Add: Interest 04/15/2008 – 3/15/2012		1,898,725.25
Compromise Penalty		25,000.00
Total Amount Due		4,348,661.71
II. Value Added Tax		
Compromise penalty- failure to supply correct information		25,000.00
III. Withholding Tax		
	Income Payment	W/holding Tax
(4) Income payments not subjected to EWT		
5% Rental	55,079.40	2,753.97
10% Professionals	733,920.00	73,392.00
1% Purchases from Top 10T (Goods)	236,267,373.09	2,362,673.73
Deficiency Withholding Tax- Expanded	237,056,372.49	2,438,819.70
Interest 01/21/2008- 03/15/2012		2,048,608.55
Compromise penalty- no MAP Jan, Feb., March, July, Dec, 2007		10,000.00
Total Amount Due		4,497,428.25
IV. Withholding Tax- Compensation		
5) Taxable Basis- per audit		7,483,687.97
Tax due		928,783.52
Less: Tax paid		927,881.46
Def. Compensation W/Tax		902.06
Interest (1/21/2008- 3.15.2012)	0.84	757.73
Amount Payable		1,659.79
V. Withholding Tax- Final		
6) Interest paid on foreign denominated loans- per cash flow		4,411,327.00
Rate		10%
Deficiency tax- final		441,132.70
Interest 1/21/2008-03/15/2012	0.84	370,551.47
Total amount due		811,684.17

VI. Documentary Stamp Tax		
7) Advances to parent (Note 18 f/s)	6,088,630.00	
Doc Stamp due Sec. 179		30,444.00
Operating lease (Note 24 f/s)	3,225,087.00	
Doc Stamp due Sec. 194		3,227.00
Doc Stamp Due		33,671.00
25% Surcharge		8,417.75
Interest 01.05.08-03.15.2012	0.82	27,610.22
Compromise penalty		3,000.00
Total amount due		72,698.97
Total Deficiency Tax Payable		9,757,132.89

Petitioner protested[14] the FAN on April 11, 2012.[15]

On November 28, 2012, petitioner received a copy of the Final Decision on Disputed Assessment[16] (FDDA), denying its protest against the FAN and upholding, in its entirety, the deficiency tax assessments for taxable year 2007 as indicated in the FDL and the FAN.[17]

On December 26, 2012, petitioner filed the instant Petition for Review.

In her Answer[18], respondent invokes the tenet that in the absence of proof of any irregularities in the performance of duties, the assessment prepared by the BIR examiner, and approved by higher officer will not be disturbed. Respondent contends that the disallowance of the salaries and wages expense incurred during the taxable year 2007 was the result of the discrepancy between petitioner's audited Financial Statements (AFS) and the Alphalist. Petitioner erroneously applied the exchange rate stipulated in its lease contract as basis in calculating the withholding taxes due on such payments since income and expenses denominated in functional currency other than Philippine Peso shall be translated based on the average exchange rate during the month under the Philippine Dealing System. Further, as a top 10,000 private corporation, petitioner was

[14] Exhibit "B", docket, pp. 709 to 712
[15] Par. 8, JSFI, docket, p. 263
[16] Exhibit "A", docket, pp. 706 to 708; Exhibit "6", BIR records, pp. 810 to 815
[17] Par. 9, JSFI, docket, pp. 263 to 264
[18] Docket, pp. 60 to 66

liable to pay the one percent (1%) withholding tax on income payments to suppliers of agricultural products. Lastly, petitioner was liable for FWT on its foreign currency denominated loan as the evidence submitted in the administrative level failed to show that the subject tax was remitted on time.

After the pre-trial conference, the parties filed their Joint Stipulation of Facts and Issues (JSFI)[19] on the basis of which a Pre-Trial Order[20] was issued on August 6, 2013.

In support of its case, petitioner presented its Commercial Manager, **Roy Dayag,** who declared[21] that he caused the preparation of petitioner's protest letter dated April 11, 2012 against the FLD issued by respondent. He emphasized that petitioner does not assail respondent's disallowance of the alleged over-claimed interest expense amounting to ₱434.19 but disputes the disallowance of the salaries and wages expense amounting to ₱6,151,861.21, for lack of factual and legal bases. He explained that petitioner entered into a Shared Services Agreement[22] with its parent company - Kerry Food Ingredients Philippines, Inc. (KFIPI), under which, employees of KFIPI would be assigned to petitioner to assist and supplement petitioner's operations in the areas of Site Management, Finance, Human Resource and Supply Chain activities. Although KFIPI's employees performed services for petitioner, their salaries and the corresponding withholding tax thereon were paid by KFIPI.

The discrepancy alleged by respondent pertains to the amount reimbursed by petitioner to KFIPI, which petitioner presented in its financial statements as "salaries and wages expense" to characterize the part of the expense declared for its cost in shared services with KFIPI. The witness claimed that the reimbursements petitioner made to KFIPI were not subject to withholding tax by virtue of various BIR Rulings[23] that "being mere reimbursements of actual costs and expenses incurred for the provision of common

/

---

[19] Docket, pp. 262 to 269
[20] Docket, pp. 273-281.
[21] Exhibit "I", docket, pp. 817-828.
[22] Exhibit "D", docket, pp. 753-757.
[23] BIR Ruling [DA-(TAR-001) 046-10] dated April 13, 2010; BIR Ruling [DA-(C-095) 306-09] dated June 18, 2009; BIR Ruling [DA-(C-077) 259-09] dated May 27, 2009; BIR Ruling No. DA-489-05 dated December 6, 2005.

operational, maintenance and general administrative requirements among affiliated parties, such reimbursements should not be subject to income tax and consequently to withholding tax".

Moreover, petitioner was not obliged to convert its rental expenses paid in US dollars to Philippine Pesos pursuant to Revenue Regulations (RR) No. 6-2006, since petitioner did not adopt a functional currency other than the Philippine Peso.

Further, petitioner does not also question, in fact even agrees with respondent's findings on the alleged deficiency EWT on rental payments and payments to professionals. It however rejects the alleged deficiency EWT on payments to agricultural suppliers since the 1% withholding tax on purchases of marine products from agricultural suppliers has been suspended by virtue of RR No. 3-2004.

Petitioner concedes to respondent's finding on the alleged deficiency WTC. Moreover, it is willing to settle the alleged Deficiency DST on compromise payments.

As regards the alleged deficiency FWT on the interest income that petitioner received from its foreign-currency denominated loan with Citibank N.A. - Philippine Branch, the tax due thereon had already been paid as indicated in the Certification dated March 27, 2012, issued by Citibank.

When recalled, witness Dayag declared[24] that on May 23, 2013, petitioner voluntarily paid the BIR the following conceded items in their Protest Letter dated April 11, 2012 *via* Electronic Filing and Payment System (EFPS) as evidenced by the Payment Forms (BIR Form No. 0605), inclusive penalties, to wit: (a) Interest Arbitrage Limit of ₱434.19; (b) VAT compromise penalty of ₱25,000.00; (c) EWT on rental payments of ₱2,753.97 and payments to professionals of ₱73,392.00; WTC of ₱1,781.88; and DST of ₱78,132.45.

[24] Exhibit "N", docket, pp. 459-467.

In support of her position, respondent presented its lone witness Revenue Officer **Ferly Ann B. Paez**. She testified[25] that she was one of the revenue examiners who conducted the investigation/examination of petitioner's internal revenue tax liabilities for taxable year 2007 pursuant to LOA No. 00007531 dated May 31, 2010.

After the investigation, they prepared a report on the result of such investigation a copy of which was furnished the petitioner together with a Notice of Informal Conference. During the informal conference, petitioner presented some reconciliation documents to refute their findings.

According to the witness, petitioner executed a Waiver of the Defense of Prescription and Statute of Limitations on November 17, 2011.

Upon their recommendation, a PAN was issued and personally served upon petitioner on February 3, 2012, to which petitioner filed a protest. On this ground, they recommended the issuance of a Final Letter of Demand with Details of Discrepancies and Final Assessment Notices (FAN). Petitioner also filed a protest assailing the FAN.

Due to the insufficiency of the evidence to validate petitioner's claim, the assessments remained the same except for the corresponding surcharges and interests for late payment. Finally, they prepared a Memorandum for the issuance of a FDDA.

Respondent rested her case with all her exhibits admitted in the Resolution[26] dated October 16, 2014.

As directed, petitioner filed its Memorandum[27] on January 5, 2015, while respondent, on January 30, 2015.[28]

THE ISSUES

[25] Exhibit "7", docket, pp. 855-862.
[26] Docket, pp. 881-882.
[27] Docket, pp. 898 to 914
[28] Resolution, docket, p. 951.

The parties raise the following issues[29] for the resolution of the Court:

1. Whether or not petitioner's claimed salaries and wages expense can be deducted from its income for taxable year 2007;

2. Whether or not petitioner was required to convert rental payments made in foreign currency to Philippine pesos for purposes of tax deduction;

3. Whether or not the assessed compromise penalty may be waived;

4. Whether or not income payments that petitioner made to its supplier of agricultural goods are subject to the 1% withholding tax applicable to a top 10,000 corporation for purchases of goods in taxable year 2007; and

5. Whether or not petitioner should be held liable for FWT on interest payments made on its foreign currency denominated loan for taxable year 2007.

The afore-quoted issues may be simplified as follows:

WHETHER PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX, VAT, EXPANDED WITHHOLDING TAX, WITHHOLDING TAX ON COMPENSATION, FINAL WITHHOLDING TAX, AND DST FOR TAXABLE YEAR 2007 AS ASSESSED BY RESPONDENT.

---

[29] JSFI, docket, p. 267

THE COURT'S RULING

First, the Court shall determine if the present petition was seasonably filed for it to acquire jurisdiction over the petition.

Pursuant to Section 228 of the NIRC of 1997, as amended, petitioner had thirty (30) days from receipt of the FDDA, or until December 28, 2012, within which to appeal the same to the Court of Tax Appeals. Clearly, petitioner timely filed the instant Petition for Review with the Court on December 26, 2012.[30]

The Court shall now determine whether petitioner is liable to the assessed deficiency taxes. On this regard, it is worth to note that petitioner, except for some items, accepted the veracity and validity of the assessment and even voluntarily paid some items therein indicating concurrence with the finding of respondent as contained in the FDDA and attachments.

As earlier stated, petitioner was assessed for the alleged deficiency income tax, VAT, EWT, WTC, FWT and DST for taxable year 2007 in the total amount of ₱10,496,763.36[31], inclusive of increments, broken down as follows:

	Basic	**Increment**	**Total**
I. Income Tax	₱ 2,424,936.46	₱ 2,269,228.87	₱ 4,694,165.33
II. Value-added Tax	0.00	25,000.00	25,000.00
III. Expanded Withholding Tax	2,438,819.70	2,388,684.42	4,827,504.12
IV. Withholding Tax - Compensation	902.06	879.82	1,781.88
V. Final Withholding Tax	441,132.70	429,046.87	870,179.57
VI. Documentary Stamp Tax	33,671.00	44,461.45	78,132.45
TOTAL	**₱5,339,461.92**	**₱5,157,301.43**	**₱10,496,763.36**[32]

---

[30] Sec. 7. *Jurisdiction.* — The CTA shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue or other laws administered by the Bureau of Internal Revenue; xxx

[31] Exhibit "A", docket, p. 708

[32] Should be ₱10,496,763.35

I. DEFICIENCY INCOME TAX – ₱4,694,165.33

Respondent computed the deficiency income tax assessment, including increments, for taxable year 2007 in the amount of ₱4,694,165.33, as follows:[33]

Taxable Income per Return		₱ -
Adjustments:		
(1) Disallowed Interest Expense	₱ 434.19	
(2) Disallowed Salaries	6,151,861.21	
(3) Rental Expense - Overclaimed	776,094.49	6,928,389.89
Taxable Income per Investigation		₱ 6,928,389.89
Income Tax Due (35%)		₱ 2,424,936.46
Less: Payments/Credits		
Deficiency Income Tax Due		₱ 2,424,936.46
Add: Interest 04/16/2008 to 11/30/2012	₱2,244,228.87	
Compromise Penalty	25,000.00	2,269,228.87
Deficiency Income Tax Due		**₱4,694,165.33**

The deficiency income tax assessment in the amount of ₱4,694,165.33 was based on respondent's disallowance of three (3) deductible expenses, namely:

ACCOUNT	AMOUNT
1. Interest Expense	₱ 434.19
2. Salaries and Wages Expense	6,151,861.21
3. Rental Expense	776,094.49
TOTAL	**₱6,928,389.89**

A. Disallowed Interest Expense – ₱434.19

Due to a discrepancy in petitioner's claimed deductible interest expense in the amount of ₱434.19, respondent disallowed it pursuant to Section 34(B) of the NIRC of 1997, as amended. Below is the computation of the disallowance:[34]

Interest Income Subjected to Final Tax	₱ 34,685.00
Interest Arbitrage: Interest income/.80 x 43%	₱ 18,643.19

[33] Exhibit "A", docket, p. 707
[34] "Computation of Deficiency Tax Due", BIR records, p. 586

(₱34,685/.80 x 43%)	
Total Interest Expense/Finance Cost	₱4,168,543.00
Less: Interest Arbitrage as Computed Above	(18,643.19)
Deductible Interest Expense	₱4,149,899.81
Interest Claimed as Deduction per ITR	4,150,334.00
Difference	₱ (434.19)

The use of forty-three percent (43%) as the interest arbitrage limitation runs counter to Section 34(B)(1) of the NIRC of 1997, as amended, which prescribes that the allowable deduction for interest expense should be reduced by forty-two percent (42%) of the interest income subjected to final tax. Using 42% as the interest arbitrage would yield a deficiency of ₱0.63 instead of ₱434.19, as computed below:

Interest Income Subjected to Final Tax	₱ 34,685.00
Interest Arbitrage: Interest income/.80 x 42% (₱34,685/.80 x 42%)	₱ 18,209.63
Total Interest Expense/Finance Cost	₱4,168,543.00
Less: Interest Arbitrage as Computed Above	(18,209.63)
Deductible Interest Expense	₱4,150,333.38
Interest Claimed as Deduction per ITR	4,150,334.00
Deficiency	₱ (0.63)

However, petitioner consistently conceded to the veracity of the said disallowance not only in its protest letter but all throughout the proceeding through its witness, up to the filing of its Memorandum. Petitioner, in fact, paid a total amount of ₱25,588.65, comprised of basic tax due of ₱434.19, interest of ₱154.46 and compromise penalty of ₱25,000.00,[35] a strong indication of its concurrence with the assessment on the said item.

B. Disallowed Salaries and Wages Expense – ₱6,151,861.21

Per reconciliation of petitioner's Audited Financial Statements with its Alphalist, respondent noted a

[35] Exhibit "M-1", docket, pp. 830-832

discrepancy amounting to ₱6,151,861.21 in petitioner's salaries and wages expense account. Respondent claimed that the amount claimed per Financial Statements was overstated compared with the amount per Alphalist. In addition, petitioner failed to reconcile and substantiate with supporting documents the noted discrepancy. Hence, it was disallowed.

On this regard, petitioner, in its Memorandum explains that the discrepancy of ₱6,151,861.21 is comprised of the following:[36]

Reimbursements to parent company	₱4,909,160.00
De Minimis benefits	139,412.00
Accruals	344,001.00
Effect of Change in Inventory	759,288.00
Total	₱6,151,861.00

The perceived difference pertains to reimbursements made to KFIPI, its parent company, for shared services rendered by KFIPI employees to it in the areas of Site Management, Finance, Human Resource, and Supply Chain pursuant to the Shared Services Agreement.

According to petitioner an examination and reconciliation of the parent company's financial statements *vis-à-vis* its tax returns would explain the unaccounted difference of ₱6,151,861.21.

The Court disagrees with petitioner.

Section 34(A)(1)(b) of the NIRC of 1997, as amended, requires substantiation with supporting documents in order that expenses can be considered as allowable deductions, to wit:

> SEC. 34. *Deductions from Gross Income*. – xxx
>
> (A) *Expenses*. –

[36] Par. 28, petitioner's Memorandum, docket, p. 906

> (1) *Ordinary and Necessary Trade, Business or Professional Expenses.*
>
> xxx xxx xxx
>
> (b) *Substantiation Requirements.* – No deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer.

Clearly, no deduction from gross income shall be allowed unless the taxpayer shall substantiate with sufficient evidence the amount of expense being deducted, and the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer.

Reconciliation of KFIPI's Audited Financial Statements for 2007[37] and Monthly Remittance of Income Taxes Withheld on Compensation[38] shows that KFIPI claimed a higher salaries expense in its returns than in the financial statements as the difference between the salaries claimed in the return (₱13,487,222.26) and in the financial statements (₱10,341,574.00) amounted to ₱3,144,648.26. The said reconciliation does not yield to the discrepancy being claimed by petitioner. Also, it cannot be ascertained whether the discrepancy really pertains to the amounts reimbursed by petitioner to KFIPI, since the said discrepancy does not coincide with petitioner's allegations. There were no other supporting documents submitted by petitioner to support its claim, such as but not limited to billings, receipts or other adequate records. Even petitioner's Commercial Manager Roy A. Dayag testified that petitioner did not

[37] Exhibit "G", docket, pp. 785 to 815
[38] Exhibits "E-1" to "E-12", docket, pp. 758 to 781

receive such documents from its parent company but only used historical experience as basis for cost allocation.[39]

In the case of *Paper Industries Corporation of the Philippines (PICOP) vs. Court of Appeals, et al.*[40], the Supreme Court emphasized the importance of maintaining adequate records and other substantiation requirements for a taxpayer to validly claim a deduction.

The Highest Tribunal further ruled in the case of *H. Tambunting Pawnshop, Inc. vs. Commissioner of Internal Revenue*[41] that:

> "The rule that tax deductions, being in the nature of tax exemptions, are to be construed *in strictissimi juris* against the taxpayer is well settled. Corollary to this rule is the principle that when a taxpayer claims a deduction, he must point to some specific provision of the statute in which that deduction is authorized and must be able to prove that he is entitled to the deduction which the law allows. An item of expenditure, therefore, must fall squarely within the language of the law in order to be deductible. xxx"

In view of petitioner's failure to substantiate with sufficient evidence the above-mentioned expense, the disallowance made by respondent should be sustained.

C. Disallowed Rental Expense – ₱776,094.49

Respondent claims that the disallowance on rental expense was due to petitioner's failure to convert the rental expense, which was paid in US Dollar, to Philippine Pesos using the average exchange rate during the month under

---

[39] Transcript of Stenographic Notes (TSN), August 12, 2013, pp. 11 to 16
[40] G.R. Nos. 106949-50 and 106984-85, December 1, 1995
[41] G.R. No. 173373, July 29, 2013

the Philippine Dealing System as required by Section 7 of Revenue Regulations (RR) No. 6-2006[42].

Petitioner however counters that RR No. 6-2006 applies only to taxpayers who use a functional currency other than the Philippine Peso in their financial statements and books of accounts. Since it used Philippine Peso as its functional currency, it was not covered by RR No. 6-2006.

Section 1 of RR No. 6-2006 sets out the scope to which such regulation shall apply, *viz:*

> SECTION 1. *Scope.* – Pursuant to Section 244, in relation to Section 6 (H), of the National Internal Revenue Code (NIRC) of 1997, these Regulations are hereby promulgated to prescribe the guidelines and procedures in adopting the use of functional currency other than the Philippine peso in financial statements that will be submitted and books of accounts that will be maintained for internal revenue tax purposes.

The Court agrees with petitioner that RR No. 6-2006 applies only to an entity that uses a functional currency other than Philippine peso in reporting its financial statements, as well as, in maintaining its books of accounts.

A revisit of the evidence submitted by petitioner indicates that its functional currency was Philippine peso. The Audited Financial Statements[43] of petitioner also indicated that the Philippine peso was used primarily by petitioner. This was also confirmed by petitioner's Commercial Manager Roy A. Dayag[44]. Petitioner also did not undergo any process for the use of a foreign currency other than the Philippine peso[45] as prescribed in Section 5 of RR No. 6-2006.

---

[42] "Regulating the Use of Functional Currency Other than the Philippine Peso in the Financial Statements that will be Submitted and in the Books of Accounts that will be Maintained for Internal Revenue Tax Purposes", March 16, 2006

[43] Exhibit "C", docket pp. 725 to 752

[44] Par. A22, Exhibit "I", docket, p. 823

[45] Pars. 36 to 37, petitioner's Memorandum, docket, pp. 907 to 908

Considering that petitioner's rent expense was reported in Philippine peso in its books of account, the Court finds respondent's finding devoid of any basis. Accordingly, this item of assessment should be cancelled and set aside.

In sum, considering the valid disallowances from petitioner's claimed allowable deductions, petitioner is liable to pay for basic deficiency income tax in the amount of ₱2,153,151.42, computed as follows:

Additional Taxable Income (Disallowed Salaries and Wages)	₱ 6,151,861.21
Basic Deficiency Income Tax Due (35%)	**₱2,153,151.42**

II. VALUE-ADDED TAX – ₱25,000.00

The amount of ₱25,000.00 was imposed as a compromise penalty on account of petitioner's alleged failure to supply correct information on its schedule of purchases.

Compromise penalties are amounts 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, pursuant to RMO No. 01-90, as amended by RMO No. 19-2007. Thus, the Court cannot compel a taxpayer to pay the compromise penalty because the imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[46]

The record however reveals that petitioner agreed to the imposition and paid the compromise penalty[47] *pendente lite*.

III. EXPANDED WITHHOLDING TAX (EWT) – ₱4,827,504.12

[46] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.*, G.R. No. L-35266, January 21, 1991
[47] Exhibit "M-2", docket, pp. 833 to 835

Respondent assessed petitioner of deficiency EWT in the amount of ₱4,827,504.12,[48] including increments, upon finding that income payments for certain expenses, as determined below, were not subjected to EWT in accordance with Section 2.57.2 of RR No. 2-98, as amended by RR No. 17-2003:

Withholding Tax - Expanded			
		Income Payment	***Withholding Tax***
Income Payments not Subjected to EWT			
5%	Rentals	₱ 55,079.40	₱ 2,753.97
10%	Professionals	733,920.00	73,392.00
1%	Purchases from Top 10T (Goods)	236,267,373.09	2,362,673.73
	TOTAL	₱237,056,372.49	₱ 2,438,819.70
Add:	Interest 01/16/2008 to 11/30/2012	2,378,684.42	
	Compromise Penalty (No MAP Jan, Feb, Mar, July, Dec 2007)	10,000.00	₱ 2,388,684.42
Total Amount Due			**₱4,827,504.12**

The three items assessed of deficiency EWT were (1) rental payments, (2) payments to professionals, and (3) payments made by top ten thousand corporations to their regular domestic suppliers.

A. Rental Payments (₱2,753.97) and Payments to Professionals (₱73,392.00)

Petitioner was assessed for deficiency withholding taxes on rentals and payments to professionals amounting to ₱2,753.97 and ₱73,392.00, respectively, computed as follows:[49]

	Rentals	**Professionals**	**Total**
Per F/S	₱8,127,136.00	₱779,520.00	₱8,906,656.00
Per Return	8,072,056.40	45,600.00	8,117,656.40
Difference	55,079.60	733,920.00	788,999.60
Withholding Tax Rate	5%	10%	
Deficiency EWT	**₱ 2,753.97**	**₱73,392.00**	**₱ 76,145.97**

[48] Exhibit "A", docket, p. 707
[49] EWT Reconciliation, BIR records, p. 583

Note that from the time of the filing of the Protest up to the submission of the Memorandum, petitioner did not assail the veracity of this assessment. In fact, during the pendency of this case, petitioner even paid a total amount of ₱167,340.52[50], for the following:

Basic Tax Due	₱ 76,145.97
Interest	81,194.55
Compromise	10,000.00
Total	**₱167,340.52**

B. Purchases by Top 10,000 Corporations – ₱2,362,673.73

Petitioner also advances the position that it was not required to withhold EWT on its income payments to its agricultural supplier of goods for taxable year 2007. It theorizes that the 1% withholding tax on income payments by taxpayers to suppliers of agricultural products under Section 2.57.2(S) of RR No. 2-98, as amended, was indefinitely suspended pursuant to Section 3 of RR No. 3-2004. By virtue of such suspension, it did not apply the 1% withholding tax on its purchases of marine products from its agricultural suppliers.

Moreover, petitioner was not informed of the clarifications made in Revenue Memorandum Circular (RMC) No. 44-2007 issued in July 2007, with respect to payments to agricultural suppliers as it was addressed and directed only to all internal revenue officers for compliance. Besides, petitioner was not liable for the 1% withholding tax rate on income payments made by a Top 10,000 corporation to its regular supplier of goods under Section 2.57.2(M) of RR No. 2-98, as amended, as said Section clearly states that it applies to a supplier of goods *"other than those covered by other rates of withholding tax"*.

Petitioner's argument is impressed with merit.

[50] Exhibit "M-3", docket, pp. 836 to 838

Section 2.57.2(M) and (S) of RR No. 2-98, as amended, provides:

> Sec. 2.57.2. *Income payments subject to creditable withholding tax and rates prescribed thereon.* - Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines:
>
> xxx xxx xxx
>
> (M) **Income payments made by the top ten thousand (10,000) private corporations to their local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax.** - Income payments made by any of the top ten thousand (10,000) private corporations, as determined by the Commissioner, to their local/resident supplier of goods and local/resident supplier of services, including non-resident alien engaged in trade or business in the Philippines
>
> Supplier of goods - One percent (1%)
> Supplier of services - Two percent (2%)
>
> xxx xxx xxx
>
> (S) Income payments made to suppliers of agricultural products. - **Income payments made to regular agricultural suppliers such as those**, but not limited to, **payments made by** hotels, restaurants, resorts, caterers, food processors, canneries, supermarket, livestock, poultry, **fish and marine food products dealers** and all other establishments, except for income payments to casual agricultural suppliers where the annual gross purchases

> therefrom do not exceed P20,000 - One Percent (1%)
>
> The term 'regular agricultural suppliers' refers to suppliers with whom the taxpayer has transacted at least six (6) transactions, regardless of amount per transaction, either in the previous or current year. The term 'casual agricultural supplier' refers to suppliers who did not qualify as regular agricultural supplier as defined in the preceding statement.
>
> The term 'agricultural suppliers' refers to suppliers/sellers of agricultural and marine food products, livestock and poultry of a kind generally used as, or yielding or producing foods for human consumption; and breeding stock and genetic materials therefor. 'Livestock' shall include cows, bulls and calves, pigs, sheep, goats and other animals similar thereto. 'Poultry' shall include fowls, ducks, geese, turkey and others similar thereto. 'Marine food products' shall include fish and crustaceans, such as but not limited to, eels, trout, lobsters, shrimps, prawns, oysters, mussels and clams." *(Emphasis supplied)*

In relation thereto, Section 3 of RR No. 3-2004 provides, thus:

> SECTION 3. *Suspension*. - In view of the foregoing, the implementation of the above-quoted Section 2.57.2 (S) of Revenue Regulations No. 2-98, as amended, is hereby suspended until further notice.

However, on July 6, 2007, RMC No. 44-2007 was issued for the purpose of *"Clarifying the Taxability of Agricultural Suppliers for Withholding Tax Purposes in Respect to Sales Made to Top 10,000 Corporations and to the Government in Relation to Revenue Regulations No. 3-2004 Which Suspended the Implementation of Withholding*

Tax on Income Payments Made to Suppliers of Agricultural Products Under Section 2.57.2 (S) of Revenue Regulations (RR) No. 2-98, as amended". The said circular explicitly states that "*there is no ground by which agricultural suppliers can claim that they are exempt from the imposition of withholding tax on their sales to top 10,000 private corporations and/or to the government by virtue of the suspension granted by RR No. 3-2004. In fine, RR No. 3-2004 did not in any way affect the taxability of agricultural suppliers for withholding tax purposes, insofar as their dealing with the top 10,000 private corporations and/or with the government is concerned*".

When an administrative rule is merely interpretative in nature, its applicability needs nothing further than its bare issuance, for it gives no real consequence more than what the law itself has already prescribed. When, on the other hand, the administrative rule goes beyond merely providing for the means that can facilitate or render least cumbersome the implementation of the law but substantially increases the burden of those governed, it behooves the agency to accord at least to those directly affected a chance to be heard, and thereafter to be duly informed, before that new issuance is given the force and effect of law.[51]

The income payments made to agricultural suppliers by the top 10,000 private corporations prior to the effectivity of RR No. 3-2004, were subject to Section 2.57.2(S) of RR No. 2-98, as amended. But with the effectivity of RR No. 3-2004 and RMC No. 44-2007, the above-mentioned income payments are now subject to Section 2.57.2(M) of RR No. 2-98, as amended, pursuant to RMC No. 44-2007. Clearly, this is not interpretative in nature. Thus, it was incumbent upon the taxing power to duly inform taxpayers directly affected by it and accord them the opportunity to be heard on this imposition or burden.

There is however no indication in the record or in any of the documentary and testimonial evidence presented by any of the parties that respondent complied with such basic requirement insofar as RMC No. 44-2007 was concerned.

[51] *Commissioner of Internal Revenue vs. Michel J. Lhuillier Pawnshop, Inc.*, G.R. No. 150947, July 15, 2003

Thus, the assessment of EWT on income payments made by petitioner to its suppliers of agricultural products should be cancelled and set aside.

IV. WITHHOLDING TAX ON COMPENSATION – ₱1,781.98

Upon comparison of petitioner's tax due per Alphalist with the amount remitted per Returns (BIR Form No. 1601-C), respondent found a deficiency of WTC in the amount of ₱1,781.88, including increments, as follows:[52]

Withholding Tax - Compensation		
Taxable Basis per audit		₱7,483,687.97
Tax Due		₱ 928,783.52
Less:	Tax Paid	927,881.46
Deficiency Withholding Tax - Compensation		902.06
Add:	Interest 01/16/2008 to 11/30/2012	879.82
Amount Payable		₱ 1,781.88

Again, petitioner conceded to the validity of this assessment and paid the total amount of ₱1,863.93 consisting of basic tax of ₱902.06 and interest of ₱961.87[53].

V. FINAL WITHHOLDING TAX – ₱870,179.57

This assessment stemmed from the interest paid by petitioner from bank borrowings on foreign currency denominated loans through Citibank in the amount of ₱870,179.57, including increments, pursuant to Section 27(D)(3) of the NIRC of 1997, as amended, based on the following computation:[54]

Withholding Tax - Final		
Interest Paid on Foreign Denominated Loans		₱4,411,327.00
Rate		10%
Deficiency Tax - Final		₱ 441,132.70
Add:	Interest 01/21/2008 to 11/30/2012	429,046.87
Total Amount Due		₱ 870,179.57

[52] Exhibit "A", docket, p. 707
[53] Exhibit "M-4", docket, pp. 839 to 841
[54] Exhibit "A", docket, p. 708

Petitioner argues that per its loan agreement with Citibank, the obligation for the payment of withholding tax rested either with petitioner or its transacting bank. Petitioner claims that the transacting bank remitted and paid the required withholding tax on the loan transaction as evidenced by the Certification[55] it issued. Petitioner admits that it had the duty to withhold and remit the proper taxes, but since the bank was the ultimately recipient of the income, hence, the one subject to tax, the bank took on the obligation to remit and pay the taxes due as it did in compliance with the law. Therefore, the act of self-withholding and the subsequent remittance of the proper taxes over the loan agreement effectively relieved petitioner of the duty to withhold and remit the same.

There is no question as to the separate liabilities of the taxpayer and the withholding agent. The Supreme Court, in *Commissioner of Internal Revenue vs. The Court of Appeals, et al.*[56], has clearly outlined this distinction, to wit:

> In the operation of the withholding tax system, the withholding agent is the payor, a separate entity acting no more than an agent of the government for the collection of the tax in order to ensure its payments; the payer is the taxpayer - he is the person subject to tax impose by law; and the payee is the taxing authority. In other words, the withholding agent is merely a tax collector, not a taxpayer. Under the withholding system, however, the agent-payor becomes a payee by fiction of law. His (agent) liability is direct and independent from the taxpayer, because the income tax is still impose on and due from the latter. The agent is not liable for the tax as no wealth flowed into him - he earned no income. The Tax Code only makes the agent personally liable for the tax arising from the breach of its legal duty to withhold as distinguish from its duty to pay tax since:

[55] Exhibit "H", docket p. 816
[56] G.R. No. 108576, January 20, 1999

> the government's cause of action against the withholding agent is not for the collection of income tax, but for the enforcement of the withholding provision of Section 53 of the Tax Code, compliance with which is imposed on the withholding agent and not upon the taxpayer.

As admitted by petitioner, it was under legal obligation to withhold the corresponding tax for the loan transaction. Petitioner therefore had the burden of proving that proper taxes had actually been withheld and subsequently remitted to respondent. The Certification presented, standing alone, was not sufficient to establish compliance with such requirements.

Section 20, Rule 132 of the Rules on Evidence provides a standard on the acceptance and authentication of private documents. As pointed out by respondent, the Certification must be testified to and authenticated by a competent witness to establish the truth of the contents of the document in the spirit of fair play.[57] This did not occur in the present case. Hence, the assessment of final withholding tax should be upheld.

VI. DOCUMENTARY STAMP TAX – ₱78,132.45

DST was assessed against petitioner in the amount of ₱78,132.45, including increments, from two items, namely: (a) advances made to petitioner's parent company; and (b) operating lease undertaken by petitioner, as computed below:[58]

Documentary Stamp Tax		
	Tax Base	*DST Due*
Advances to Parent	₱6,088,630.00	₱30,444.00

[57] *PNOC Shipping and Transport Corporation v. Honorable Court of Appeals and Maria Efigenia Fishing Corporation*, G.R. No. 107518, October 8, 1998.
[58] Exhibit "A", docket, p. 708

Operating Lease		3,225,087.00	3,227.00
Doc Stamp Due			₱33,671.00
Add:	Penalties and Interest		
	25% Surcharge	₱ 8,417.75	
	Interest 01/05/2008 to 11/30/2012	33,043.70	
	Compromise Penalty	3,000.00	₱44,461.45
Total Amount Due			₱78,132.45

For respondent DST must be imposed on the advances made by petitioner to its parent company in the amount of ₱6,088,630.00 pursuant to Section 179 of the NIRC of 1997, as amended. Also, the assessed amount of operating lease for 2007 totaling ₱3,225,087.00 must as well be subject to DST in accordance with Section 194 of the NIRC of 1997, as amended. Petitioner again accepted the assessment and paid during the pendency of this case the total amount of ₱81,195.13, consisting of the following:[59]

Basic Tax Due	₱ 33,671.00
Surcharge	8,417.75
Interest	36,106.38
Compromise	3,000.00
Total	**₱81,195.13**

WHEREFORE, the instant Petition for Review is hereby **PARTIALLY GRANTED**. The assessments for deficiency Value-Added Tax, Expanded Withholding Tax and Documentary Stamp Tax are **CANCELLED** in view of petitioner's payment of the same during the pendency of this case; while, the deficiency Income Tax and Final Withholding Tax assessments for taxable year 2007 are **UPHELD**. Accordingly, petitioner is **ORDERED TO PAY** the modified amount of ₱3,242,855.16, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

	BASIC	**SURCHARGE**	**TOTAL**
Income Tax	₱ 2,153,151.42	₱ 538,287.86	₱ 2,691,439.28
Final Withholding Tax	441,132.70	110,283.18	551,415.88
Total	**₱2,594,284.12**	**₱ 648,571.04**	**₱3,242,855.16**

[59] Exhibit "M-5", docket, pp. 842 to 844

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

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax and FWT from the dates indicated below until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended:

	BASIC	DEFICIENCY INTEREST COMPUTED FROM
Income Tax	₱2,153,151.42	April 15, 2008
Final Withholding Tax	₱ 441,132.70	January 14, 2008

(b) Delinquency interest at the rate of 20% per annum on the total amount of ₱3,242,855.16 and on the 20% deficiency interests which have accrued as afore-mentioned in (a), computed from November 28, 2012 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We concur:

LOVELL R. BAUTISTA
Associate Justice

Ma. Belen
MA. BELEN M. RINGPIS-LIBAN
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.

LOVELL R. BAUTISTA
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice