REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

GX INTERNATIONAL, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5956

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 05 2003

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DECISION

This case involves assessments for alleged deficiency income tax, value-added tax and expanded withholding tax in the total amount of P7,680,781.01 for the calendar year ended December 31, 1995.

Petitioner is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines with principal place of business in Buencamino Street, Alabang-Zapote Road, Muntinlupa City. It is registered with the Securities and Exchange Commission and is engaged in the wholesale and retail sale of pharmaceutical products *(Paragraph 1, Facts Admitted, Joint Stipulation of Facts and Issues, page 62, CTA records).*

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On April 15, 1996, petitioner filed its Corporation Annual Income Tax Return for the calendar year ended December 31, 1995 (*Exhibit "B", inclusive of submarkings*).

On January 12, 1999, petitioner received three (3) assessment notices together with their corresponding demand letters, all numbered 000325-95-99-465 and all dated January 8, 1999, issued by Revenue Region No. 8 of the Bureau of Internal Revenue, through the Chief of its Assessment Division, Ma. Nieva A. Guerrero, covering the following deficiency tax assessments:

Particular	Exh.	Basic	Interest	Compromise	Total
Deficiency Income Tax	SS, SS-1	P 3,273,479.55	P 1,800,413.75	P 25,000.00	P 5,098,893.30
Deficiency VAT	TT, TT-1	935,279.87	561,167.92	25,000.00	1,521,447.79
Deficiency Expanded Withholding Tax	UU, UU-1	647,149.95	388,289.97	25,000.00	1,060,439.92
Totals		P 4,855,909.37	P 2,749,871.64	P 75,000.00	P 7,680,781.01

On February 4, 1999, petitioner, through its external auditors, filed its protest letter dated February 3, 1999, with the respondent's Assessment Division, Revenue Region No. 8 (Makati), Bureau of Internal Revenue, contesting each of the aforementioned deficiency tax assessments *(Paragraph 5, Petition for Review, Admitted by respondent in paragraph 3 of his Answer, page 16, CTA records).*

On October 29, 1999, after obtaining no decision from the respondent with respect to the protest, petitioner filed the instant petition for review pursuant to Section 228 of the Tax Code, as amended.

On December 28, 1999, respondent filed his Answer through registered mail, claiming by way of Special and Affirmative Defenses that:

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"7. The Assessments in question were issued in accordance with laws and regulations;

8. All presumptions are in favor of the correctness of the tax assessments (Interprovincial Autobus Inc. vs. CIR, 98 Phil. 290);

9. Under Section 105 in relation to Section 108 of the Tax Code, it is provided that "...xxx The phrase sale or exchange of services mean the performance of all kinds of services in the Philippines for others for a fee, renumeration or consideration ...xxx" A person is subject to VAT only if he renders services in the course of trade or business (Section 105). This implies that the rendering of services is done with regularity and continuity, and not just occasionally. Although the distribution service was not carried out by GX International, it was made for and in behalf of the latter therefor subject to VAT;

10. As per contract, GX International do not manufacture medicines as stated in their By-Laws but somebody is manufacturing it for them, Hizon's Laboratories. Since GX International is using the professional expertise of Hizon Laboratories to produce medicine, the toll fee which was being paid to Hizon Laboratories is considered professional fees which is subject to 10% Expanded Withholding tax."

The issues for this court's determination are as follows:

1. Whether or not Petitioner has unreported taxable income for the calendar year ended December 31, 1995 in the total amount of P9,352,798.71?;

2. Whether or not Petitioner has undeclared taxable gross sales for the calendar year ended December 31, 1995 subject to value-added tax?; and

3. Whether or not the service payment to Hizon Laboratories, Inc. for manufacturing and processing of the pharmaceutical products of Petitioner for the year 1995 was subject to expanded withholding tax?

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We rule on the first issue.

The assessment for deficiency income tax was anchored on the examiners' belief that petitioner underdeclared its sales to Metro Drug Distribution (Metro) by 15%. Their basis was the Distribution Agreement entered into between petitioner and Metro, specifically number 11 thereof which states: (*page 50, BIR records*)

> 11. Metro will seek a "basic" distribution fee pegged at 15.0%, based on sales after/net-of-returns and calculated against price-to-trade, exclusive of VAT. Computation of VAT will be consistent with the BIR regulations.

Consequently, the examiners concluded that the recorded collection of sales by petitioner from Metro represents only 85% of its actual sales, hence, depriving the government of the corresponding income tax for the 15% of the alleged unrecorded sales. The unreported sales are computed as follows: (*page 493, BIR records*)

Sales to Metro Drug as reported	P52,999,190.29
Divided by	85%
Grossed-up sales	P62,351,989.00
Add: In house sale	8,524,163.71
Total sales per investigation	P70,876,152.71
Less: Reported sales	61,523,354.00
Unreported Sales per Investigation	P 9,352,798.71

Petitioner, on the other hand, argues that the assessment lacks factual and legal bases. The assessment must be based on factual circumstances and not on mere conjectures nor presumptions (***The Collector of Internal Revenue vs. Benipayo, 4 SCRA 182, January 31, 1962***). Petitioner further avers that the distribution fee of 15% was not part of the selling price to its distributor and was reflected in the Distribution Agreement as a separate item and for the purpose merely to reflect the computation in arriving at the selling price by Metro to drugstores.

We do not agree with the petitioner.

Attached to the Agreement is an illustration made by Metro in computing the 15% distribution fee as well as the VAT component, hereunder reproduced for easy reference:

	Exclusive Of VAT	+10% VAT Component	Inclusive of VAT
Price to Drugstore	P 296.44	P 29.64	P 326.08
15% Metro Distribution Fee	44.47	4.44	48.91
Price to Metro	P 251.97	P 25.20	P 277.17

The above computation is the figurative translation of what Metro meant in stipulation number 11 of the Agreement. The 15% distribution fee is based "on sales after/net-of-returns and calculated against price-to-trade, exclusive of VAT".

It is clear from stipulation number eleven (11) that Metro is seeking 15% distribution fee in exchange for its distribution of petitioner's pharmaceutical products. It is the cause of the contract between petitioner and Metro. Therefore, petitioner is obliged to pay Metro 15% distribution fee *based* *"on sales after/net-of-returns and calculated against price-to-trade, exclusive of VAT"*. Since the distribution fee is based on sales after/net-of-returns and calculated against price-to-trade, petitioner must record the sales of medicine to Metro based on the price of sales to drugstore. Otherwise, if petitioner will record the sales based on price to Metro, the transaction will not be accurately reflected on petitioner's books.

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Inasmuch as the 15% distribution fee is the consideration sought by Metro in distributing petitioner's pharmaceutical products which formed part of the price of sales to drugstores, it must likewise form part of petitioner's sales. Nonetheless, said fee may at the same time be claimed by the latter as an expense.

However, petitioner in the case at bar recorded the sales to Metro net of the distribution fee. The question now is: With this kind of recording, was the government deprived of income taxes?

We answer in the negative.

Distribution fee is an income on the part of Metro and an expense on the part of petitioner. If petitioner will record its sales inclusive of the 15% distribution fee, it will also claim the same as an operating expense. Thus, the end result would be the same as when the sales price is recorded net of the distribution fee, to wit:

	Actual	Per BIR Computation	Per Court Evaluation
Sales Price	P 277.17	P 277.17	P 277.17
Add: Distribution Fee	0	48.91	48.91
Gross Sales	P 277.17	P 326.08	P 326.08
Less: Distribution Fee	0	0	48.91
Taxable Sales	P 277.17	P 326.08	P 277.17

It is to be noted from the above table that the view of the examiners is one-sided. It recognized the 15% distribution fee as part of petitioner's revenue but failed to consider it as a deductible business expense. Clearly, whether the selling price is reported inclusive of the 15% distribution fee (Per Court's Evaluation) or net (Actual), the taxable sales will be the same.

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The preceding analysis is explicit – even if there was an underdeclaration of sales, it will result to no underdeclaration of income and therefore, there was no deficiency income tax due.

The principle, however, applies only to income tax but will not apply to petitioner's value-added tax liability. As we have ruled earlier, the sales to Metro should have been recorded at gross (i.e., inclusive of the 15% distribution fee). Inasmuch as petitioner recorded its sales to Metro net of the 15% distribution fee and considering that under Section 100 of the 1995 Tax Code, the value-added tax is based on the ***gross selling price*** or ***gross value in money of the goods sold***, it follows that the government was deprived of the corresponding 10% value-added tax on the unrecorded 15% distribution fee. Therefore, we rule to uphold the deficiency value-added tax assessed by respondent against petitioner in the amount P1,521,447.79 per assessment notice. However, out of the latter amount, we shall exclude the sum of P25,000.00 representing compromise penalty. Well-settled is the rule that this court has no jurisdiction to compel a taxpayer to pay compromise penalty because by its very nature it implies a mutual agreement between the parties in respect to the thing or subject matter which is so compromised ***(Briñas vs. Collector of Internal Revenue, CTA. Case No. 16, September 14, 1955 and Central Azucarera de Tarlac vs. Collector of Internal Revenue, CTA Case No. 90, July 9, 1956, both cited in The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et al., G.R. Nos. L-12928 & L-12932, March 31, 1962)*** and the choice of paying or not paying it distinctly belongs to the taxpayer ***(Cosmos Kapok Factory vs. Araneta, CTA Case No. 125, March 29, 1957)***.

The term actors and actresses shall not include "bit players," "extras" and "radio talents or character players" whose roles or performances in a movie, television or radio program or stage presentation are subordinate to the actors or actresses and to whom payments are made per role or performance, or where the aggregate payment by the same payor in a taxable year does not exceed two thousand pesos (P2,000.00)

(3) Professional athletes including basketball players, pelotaris and jockeys;

(4) All directors involved in movies, stage, radio, television, and musical productions;

(5) Insurance agents and Insurance adjusters;

(6) Management and technical consultants;

(7) Business and bookkeeping agents and agencies;

(8) Other recipients of talent fees;

The amounts subject to withholding under this paragraph shall include not only fees, but also per diems, allowances and any other form of income payments. In the case of professional entertainers, athletes, and all recipients of talent fees, the amount subject to withholding tax shall also include amounts paid to them in consideration for the use of their names or pictures in print, broadcast or other media or for public appearances, for purposes of advertisements or sales promotion."

(b) *Professional fees, talent fees, etc., paid to taxable juridical persons.* — On the gross professional, promotional and talent fees, or any other form of remuneration enumerated in the preceding sub-paragraph paid to taxable juridical persons - *five per centum* (5%).

The term "professional" includes lawyers, accountants, doctors, engineers, architects, nurses, clergymen, teachers, lecturers, scientists, authors, composers, actors, singers, entertainers, athletes, and military officers (***6 MERTENS Law of Federal Income Taxation 396, §25.174***).

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Anent the third issue, the examiners opined that: (page 492, BIR records)

> We have also found out as per contract that GX International, do not manufacture medicine as stated in their By-Laws but somebody was manufacturing for them, the Hizon Laboratories.
>
> Since GX International is using the ***professional expertise*** of Hizon Laboratories to produce medicine, the toll fee which was being paid to Hizon Laboratories ***is considered Professional fee*** which is subject to 10% EWT. (underscoring supplied)

We do not subscribe to the examiners' ratiocination.

First, to be subject to expanded withholding tax as a "professional" under Sec. 1(a) and (b) of Revenue Regulations No. 6-85, as amended, the service must have been rendered by an individual "*professional*" or if a juridical person, it is engaged in the practice of a "*profession*", to quote:

> **SECTION 1. *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 therein specified for each class of payee from the following items of income payments to persons residing in the Philippines:
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> (a) *Professional fees, talent fees, etc., paid to individuals.* — On the gross professional, promotional and talent fees or any other form of remuneration paid to the following individuals - *ten per centum* (10%):
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> "(1) Those individually engaged in the practice of professions or callings: Lawyers; certified public accountants; doctors of medicine; architects, civil, electrical, chemical, mechanical, structural, industrial, mining, sanitary, metallurgical and geodetic engineers and marine surveyors; doctors of veterinary science; dentists, professional appraisers; connoisseurs of tobacco; actuaries; and interior decorators;
>
> (2) Professional entertainers such as actors and actresses, singers and emcees.

"Professional" is that which pertains to a profession. To constitute a "profession," something more than a mere employment or vocation is essential. The employment or vocation must be such as exacts the use or application of special learning or attainments of some kind, so that, while an insurance agency is an occupation or vocation, the entries in the policy register kept by the agent are not made in a professional capacity or in the course of professional conduct, and hence are inadmissible. (***Cummins v. Pennsylvania Fire Ins. Co., 134 N.W. 79, 82, 153 Iowa, 579, 37 L.R.A., N.S., 1169, Ann.Cas.1913E, 235, cited on page 207, 34 Words and Phrases, Permanent Edition***).

Based on the BIR records, Hizon is "*engaged in the **manufacture** of private label pharmaceutical products for duly established drug establishments*" (*page 43, BIR records*). By the nature of its business, Hizon cannot be called a "professional" or a juridical person engaged in the practice of profession but a manufacturer of medicine. Its expertise in the field of manufacturing of medicine will not change its status as a manufacturer of medicine to "professional" subject to 10% expanded withholding tax.

Second, the contract entered into between petitioner and Hizon Laboratories is a nominate contract, that is, a "Contract to Manufacture Pharmaceutical Products" (*pages 40 to 43, BIR records*). From the title alone, it is clear that the contract was for the manufacture of pharmaceutical products and not for the engagement of "professional service". The agreement to manufacture was manifested in the terms, conditions and stipulations of the parties in the contract.

Lastly, the primary purpose of the petitioner is "[t]o manufacture, compound and repack, **through toll manufacturing**, drugs, medicines, and pharmaceutical preparations of all kinds and descriptions" xxx. (*page 388, BIR records*). We do not believe that business purpose of the petitioner will make Hizon a "professional" subject to the 10% expanded withholding tax. As discussed earlier, to be considered a "profession" something more than a mere employment or vocation is essential.

In view of the foregoing, the 1995 deficiency tax assessments for income and expanded withholding tax issued against petitioner are hereby **CANCELLED** and **WITHDRAWN** for lack of factual and legal bases. However, petitioner is **DIRECTED** to **PAY** the respondent the sum of P1,496,447.79, as deficiency value-added for the year 1995 plus 20% delinquency interest from February 12, 1999 until fully paid pursuant to Section 249(c) of the Tax Code.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

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

LOVELL R. BAUTISTA
Associate Judge

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CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge