REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

HOLIDAY INN PHILS. INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5929

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
APR 21 2003

x - x

DECISION

This is a judicial appeal from the inaction of the respondent on petitioner's administrative protest against the assessments for deficiency income tax, deficiency expanded withholding tax, deficiency branch profit remittance tax and deficiency value-added tax in the aggregate amount of P5,931,312.15 covering the period from October 1, 1994 to September 30, 1995.

Based on the records of the case, the antecedent facts are as follows:

Petitioner, HOLIDAY INNS (PHILS), INC. (HIPI for short) is a domestic corporation duly organized and existing under Philippine laws. It is engaged in hotel management business with principal office address at Ma. Orosa Street corner U. N. Avenue, Ermita, Manila *(par. 1, Joint Stipulations of Facts).*

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On January 15, 1996, petitioner filed its Corporate Annual Income Tax Return for the year ended September 30, 1995 *(Exhibit A; paragraph 3, Joint Stipulations of Facts).*

On October 17, 1996, the Letter of Authority No. 107937 was issued by the Revenue District Officer, Revenue District No. 33, Revenue Region No.6, authorizing Eleuterio Voluntad as Examiner and Vivencio Gapasin as Group Supervisor, to examine the books and accounts and other accounting records for all internal revenue taxes for the period commencing October 01, 1994 up to September 30,1995 *(Exhibit I).*

On December 8, 1998, petitioner received from respondent Pre-Assessment Notice dated November 13, 1998 notifying the former that it is liable to pay deficiency income tax in the amount of P3,120,022.85; deficiency value-added tax of P26,996.80; expanded withholding tax on royalty of P377,787.88 and branch profit remittance tax of P421,225.00 *(paragraph 4, Joint Stipulations of Facts).*

On December 22, 1998, petitioner objected to the proposed deficiency assessment, in a letter December 17, 1998 (*paragraph 5, Joint Stipulations of Facts*).

Petitioner received from respondent several assessment notices bearing No. 33-1-000078-95 and No. 33-1-000778-95. The assessments are summarized as follows:

Kinds of Tax	Basic Tax Due	Interest	Amount Due	Exh.	Compromise Penalty	Exh.	TotalTax Due
Income	P3,120,022.18	P1,663,908.18	P4,783,931.03	B;15	P 25,000	17	P4,808,931.03
EWT	377,787.88	226,672.73	604,460.61	21	25,000	23	629,460.61
Branch profit	274,718.36	146,507.30	421,225.66	24	20,000	26	441,225.66
VAT	26,996.80	16,198.08	43,194.88	18	8,500	20	51,694.88
Total	**P3,799,525.22**	**P2,053,286.29**	**P5,852,812.18**		**P 78,500**		**P5,931,312.18**

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On the same date, petitioner received letters from respondent demanding the payment of the alleged deficiency assessments *(Exhibits C;16, D;17, G;19, H;20, J;22, K;23, P;25, and Q;26)*.

On January 4, 1999, petitioner wrote the Commissioner of Internal Revenue protesting and/or requesting for the reconsideration of the aforementioned assessments (*Exhibits R;27*). The receipt of the protest was acknowledged in a letter dated January 22, 1998, issued by the Revenue District Officer and directed the petitioner to submit within ten (10) days the necessary documents to refute the assessments *(Exhibit 28)*.

On February 15, 1999, petitioner submitted the relevant documents to support its protest on the alleged deficiency assessments (*Exhibit 29*).

On July 26, 1999, respondent issued a Final Notice Before Seizure whereby respondent granted petitioner the last opportunity to settle the adverted assessments, otherwise, respondent will be constrained to enforce collection by summary remedies of Warrant of Levy on Real Property, Distraint of Personal Property or Warrant of Garnishment and/or simultaneous court action *(Annex L, Petition for Review; Exhibit 33)*.

Unable to obtain an affirmative response from the respondent on the protest, petitioner, on September 13, 1999, elevated the case to this court through a Petition for Review.

Respondent filed his Answer and subsequently filed a Motion to Dismiss alleging that petitioner's Petition for Review is already barred by Statute of Limitations pursuant to Section 229 of the 1986 Tax Code. In a Resolution dated January 12, 2000, the court denied the Motion to Dismiss having found the Petition for Review to be seasonably filed with the court.

After trial on the merits, the case was submitted for decision on August 2, 2002.

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The parties jointly stipulated the issues to be resolved in this case, to wit:

a) Whether or not Revenue Regulations No. 16-86 dated September 26, 1986 insofar as it prescribes the manner of apportionment of home office expense is applicable in this case;

b) Whether or not the withholding taxes on royalty payments amounting to P1,888,939.40 have been remitted to BIR;

c) Whether or not the "HIPI" paid VAT in the amount of P269,968.00;

d) Whether or not the "HIPI's" operation in 1995 incurred a loss;

e) Whether or not Assessment Notice No. 33-1-000078-95 dated December 9, 1998 is valid.

On the first issue, petitioner claimed that the amount of P8,680,685.00 is a proper deduction from gross income since it represents home office expense paid by Holiday Inn – Philippines, Inc. to its mother company, Holiday Inns – Hongkong.

On the other hand, respondent argued that petitioner failed to prove the share in the home office expense as an item of deduction. While petitioner presented the "Report on Factual Findings dated November 10, 1995 *(CTA Records, pp. 43 and 44)* issued by DELOITTE TOUCHE TOHMATSU, an accounting firm from Hongkong, attesting to the allocation of general and administrative expenses by Holiday Inn Asia-Pacific, the said Report cannot be taken into consideration for not being duly authenticated by the Philippine Embassy in Hongkong.

Petitioner refuted respondent's view on the basis of Revenue Regulations No. 02 as amended by Revenue Regulations No. 16-86 and Section 37 (b) of the Tax Code, which set forth the requirements in claiming home office expense as a deductible expense by a branch of a foreign corporation. According to petitioner, nothing in the aforementioned laws requires

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the External Auditor's Certification to be authenticated by the Philippine Embassy or Consulate.

Revenue Regulations No. 16-86 provides the following:

> Pursuant to Sections 4 and 277 of the National Internal Revenue Code, the first paragraph of Section 160 Revenue Regulations No. 2, otherwise known as the Income Tax Regulations, is hereby amended to read as follows:
>
> **Sec. 160.** (a) *Apportionment of deductions.* – From the items specified in Section 37(a) as being derived specifically from sources within the Philippines, there shall be deducted the expenses, losses, and other deductions properly allocated thereto and a ratable part of any other expenses, losses and other deductions effectively connected with the business or trade conducted exclusively within the Philippines which cannot definitely be allocated to some items or class of gross income. The remainder shall be included in full as net income from sources within the Philippines. The ratable part shall be based upon any of the following ratios consistently followed from year to year:
>
> 1. Gross income from sources within the Philippines to the total gross income.
> 2. Net sales in the Philippines to total net sales.
> 3. If any other method of allocation is adopted, a written permission from the Commissioner of Internal Revenue shall first be secured.
>
> (b*) External Auditor's Certificate*. – The income tax return to be filed should be accompanied by a certification from an independent and reputable Certified Public Accountant containing the following information:
>
> 1. The home office deductions for the year involved have been examined in accordance with generally accepted auditing standards and accordingly included such tests of accounting records and such other auditing procedures as were considered necessary in the circumstances.
>
> 2. The deductions pro-rated to the Philippine branch do not include –
>
>   a. net losses of any operating unit or branch;
>   b. income tax payment;
>   c. capital expenditures; and
>   d. expenses directly chargeable to any branch.

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3. The amount of allocable overhead expenses used in the pro-rata allocation to the Philippine branch is the same amount used in the pro-ration to all branches worldwide and the amount disallowed in other countries because of governmental requirement is not added back to the allocable amount.

4. Should there be an exception or qualification on the above- requested certification, an explanation with supporting documents should be submitted.

The court noted that Section 37 of the 1986 Tax Code as relied upon by petitioner is not in any way related to the point in issue because the said provision speaks of the general rule as regards accounting period.

While we may agree with petitioner's observation that the authentication of External Auditor's Certificate with the Philippine Embassy in Hongkong is not required in the above Revenue Regulation, however, we decline to allow the home office expense as deduction, since petitioner was not able to substantiate its claim. The Report of Factual Findings submitted by petitioner *(CTA Records, pages 43 and 44)*, shows that such report is a disclaimer of an opinion on petitioner's expenses. The pertinent portions of which read as follows:

> "Because the above procedures do not constitute either an audit or a review made in accordance with the International Standard on Auditing, we do not express any assurance on the allocable overhead expenses for the year ended September 29, 1995.
>
> Had we performed additional procedures or had we performed an audit or review of the financial statement in accordance with the International Standard on Auditing, other matters might have come to our attention that would have been reported to you.
>
> Our report has been prepared at your request and is prepared solely for presentation to the Bureau of Internal Revenue of the Philippines. This report relates only to the items specified above and does not extend to any financial

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statements of Holiday Inn Philippines, Inc.-Philippine Branch, taken as a whole."

Time and again this court always points out that it is elementary that the tax assessment is presumed to be correct unless the contrary is shown, and the burden is in the taxpayer to overcome the presumption *(Chemfields, Inc. vs. The Commissioner of Internal Revenue, CTA Case No. 4840, promulgated on April 22, 1996).*

On the second issue on whether or not the withholding taxes on royalty payment amounting to P1,888,939.40 have been remitted to the BIR, respondent postulated that the imposition of deficiency expanded withholding tax arose because petitioner under-declared the royalty fee it paid to Holiday Inn-Hongkong as well as the amount of tax withheld therefrom in the amount of P1,888,939.40 and P377,787.88, respectively. He computed petitioner's deficiency expanded withholding tax as follows:

Per Financial Statements	2,311,153.00 x 20%	=	P462,230.60
Per Withholding returns	422,213.60 x 20%	=	88,442.72
Unremitted tax on Royalty fee	1,888,939.40 x 20%	=	377,787.88
Add: Interest & Surcharge			226,672.73
Total withholding tax due			**P 604,460.61**

(*Exhibits 12 & 13*)

Petitioner, on the contrary, countered that it withheld and remitted all the taxes corresponding to the royalty fees it paid to Holiday Inn - Hongkong, its mother company. Petitioner claimed that the certificates of creditable tax withheld at source for the taxable period involved as well as the monthly remittance returns attest to the fact that taxes on royalty fees have been withheld and remitted to the Bureau of Internal Revenue *(Exhibits A-14, A-15, A-16, A-17, L, M and N).*

Below is a table of petitioner's royalty fees with the corresponding taxes withheld and remitted to the BIR as per petitioner's schedules attached to Exhibits L, M and N:

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Period Involved	Date Remitted	Royalty Fee	25% Tax*	Withholding Tax
October-94	01/10/95	P 166,147.38	P 41,536.85	P 41,536.85
November-94		177,770.36	44,442.59	
December-94	05/09/97	187,681.95	46,920.49	46,920.49
January 95 to September 95	02/08/96	1,779,552.81	444,888.20	444,888.20
Total		**P 2,311,152.50**	**P 577,788.13**	**P 533,345.54**

*Pursuant to RP-US Tax Treaty

After verification of the records, the court finds that petitioner remitted the withholding taxes on its royalty payment for taxable year 1995, except for the amount of P44,442.59 corresponding to the royalty fee in the amount of P177,770.36. However, petitioner alleged that said royalty fee was not paid to its mother company, thus, it should not be held liable for the tax corresponding to that amount.

Notwithstanding petitioner's claim that it did not remit the royalty fee to its mother company, it cannot be given credence since in its Income Tax Return, it declared the whole amount of P2,311,152.50 as deduction from its gross income. Hence, petitioner is still liable for deficiency expanded withholding tax computed as follows:

Royalty fees	P 177,770.36
Basic tax due (20%)	P 35,554.07 *
Interest (20%)	21,332.44
Total Deficiency withholding tax	**P 56,886.51**

- Note: The amount was computed based on the tax rate of 20% used by respondent in computing the deficiency withholding tax.

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ending September 30, 1995 *(Exhibits E;7-C)*, which shows on its face that it paid an aggregate amount of P269,966.62 value-added tax.

On the other hand, respondent maintained that petitioner is liable for deficiency value-added tax. It erroneously deducted from the management fee the amount of 10% VAT due thereon. Having deducted the VAT payment from the management fee, the gross income for the fiscal year was reduced by P269,966.00 resulting to the under declaration of income, as a consequence, petitioner should be held liable for deficiency VAT.

Respondent further explained that VAT payment should not be deducted from the management fee because petitioner, as seller of services, is mandated to pay 10% VAT based on the gross receipts but not to be taken from the management fee received from the hotel owner, otherwise, it would amount to exempting petitioner from the payment of VAT on the portion of the management fee used for payment thereof.

We find respondent's view proper.

The records reveal that petitioner in its 1995 quarterly VAT returns reported taxable sales and the corresponding output VAT payments amounted to P11,165,164.98 and P1,116,516.50, respectively, broken down as follows:

Period Involved	Exhibit	Taxable Sales	Output VAT
1st Quarter	7	P 3,372,585.32	P 337,258.53
2nd Quarter	7-a	2,814,866.60	281,486.66
3rd Quarter	7-b	2,278,046.90	227,804.69
4th Quarter	7-c	2,699,666.16	269,966.62
	Total	**P11,165,164.98**	**P 1,116,516.50**

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However, in its 1995 Annual Income Tax Return, petitioner's declared gross income from sale of services representing management fees amounted to P11,435,132.00, which was higher than the taxable sales reported in its VAT returns by P269,967.02. Due to the discrepancy of P269,967.02, petitioner was assessed a deficiency value-added tax in the amount of P43,194,88.00, inclusive of 20% interest per Assessment Notice No. 33-1-000778-95 (*Exhibit 18*). The court took notice that respondent's computation of the deficiency VAT of P43,194.88 was based on the amount of P269,968.00 instead of P269,967.02 (*Exhibit 2-C*).

The court finds the deficiency VAT assessment correct. It is very clear from the petitioner's 1995 quarterly VAT returns and Income Tax Return that it had under-declared its taxable sales for VAT purposes in the amount of P269,967.02.

On the fourth issue, respondent claimed that petitioner did not incur a net operating loss but a net operating income due to the disallowance of the following expenses: a) VAT payable; b) Share in the Home Office Expense and c) Miscellaneous Expense.

Respondent's computation showing a net operating income is hereunder illustrated:

Net Income disclosed by the returns as audited		P(290,453.00)
Add:		
VAT payable – not deductible	P 269,967.02	
Share in the Home Office Expenses	8,680,685.00	
Miscellaneous Expense	254,152.00	9,204,804.00
Net income per investigation		**P 8,914,351.02**

Since the item referring to home office expense has already been discussed earlier, we now dwell on the second and third items, the value-added tax and miscellaneous expense.

Petitioner declared the VAT paid in the amount of P269,967.02 which represents the VAT on management fee as one of its deductions from gross income in the income tax return pursuant to Section 29 (c) of the 1986 Tax Code which provides:

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> **Section 29.** *Deductions from gross income.* In computing taxable income subject to tax under Sections 21(a); 24(a), (b) and (c); and 25 (a)(1), there shall be allowed as deductions the items specified in paragraphs (a) to (i) of this section: xxx
>
> **(c).** *Taxes.- (1) In general.-* Taxes paid or accrued within the taxable year in connection with the taxpayer's profession, trade or business, except:
>
> (A) The income tax provided for under this Title;
> (B) Income, war profits, and excess profits taxes imposed by authority of foreign country; but this deduction shall be allowed in the case of the taxpayer who does not signify in his return his desire to have to any extent the benefits of paragraphs (3) of this subsection (relating to credits for taxes of foreign countries);
> (C) Estate and gift taxes;
> (D) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; and
> (E) Electric energy consumption tax imposed by Batas Pambansa Blg. 36.

Respondent, on the other hand, averred that petitioner cannot claim VAT as an item of deduction. It cannot be considered as allowable deduction from the gross income under the category of taxes since it was not incurred in the course of business.

The court agrees with the petitioner that value-added tax is indeed a deductible item. All taxes, national or local, paid or accrued within the taxable year, in connection with the taxpayer's trade, business or profession are deductible from gross income and these include business taxes, that is, value-added tax, other percentage taxes and excise taxes *(Teodoro and De Leon, The Law on Income Taxation, 11 Ed., page 119).*

Nevertheless, in the case at bar, we decline to allow the value-added tax as an item of deduction for lack of substantiation. Petitioner failed to convince the court that it did not pass on the value-added tax to the hotel owners. No evidence was submitted to the court to buttress its claim. We cannot base our decision merely on the allegation of petitioner that the hotel owners refused to pay the value-added tax which should be passed-on to the latter.

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On the miscellaneous expenses, petitioner alleged that these expenses are items of deductions because they are ordinary and necessary in their business like bank charges, audit fees, legal fees, etc. But respondent contended that petitioner failed to substantiate the miscellaneous expenses it declared in its annual income tax return. Therefore, he disallowed said expenses in the amount of P254,154.00. Petitioner failed to present documents in support of the expenses despite demand. Mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction. Petitioner should have submitted supporting documents. ***(Esso Standard Eastern, Inc., (formerly, Standard-Vacuum Oil Company) vs. The Commissioner of Internal Revenue, 175 SCRA 149, July 7, 1989***). Hence, the amount of P254,154.00 which represents petitioner's miscellaneous expenses should be disallowed.

However, it should be noted that the miscellaneous expense deduction claimed by petitioner in its income tax return was only P227,314.00 and not P254,152.00 as found by respondent. Consequently, only the amount of P227,314.00 should be disallowed.

Considering all the foregoing, petitioner is liable to pay deficiency income tax in the amount of P4,771,705.74, computed as follows:

Net income per ITR			P (290,453.00)
Add:	Disallowances		
	VAT payable - not deductible	P 269,967.02	
	Share in the Home Office Expenses	8,680,685.00	
	Miscellaneous	227,314.00	9,177,966.02
Taxable Income			P 8,887,513.02
Basic income tax due (P8,887,513.02 x 35%)			P 3,110,629.56
Add:	20% Interest		1,661,076.18
Total deficiency income tax			**P 4,771,705.74**

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On the fifth issue as to whether or not Assessment Notice No. 33-1-000078-95 dated December 9, 1998 is valid, our answer is affirmative. Section 203 of the Tax Code, as amended, provides :

> **Section 203**. *Period of Limitation Upon Assessment and Collection.*- Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, three year period shall be counted from the day the return was filed. For the purposes of this section a return filed beyond the last day prescribed by law , of the three (3) year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

The records show that on January 15, 1996, petitioner filed its Corporate Annual Income Tax Return for the year ended December 31, 1995 *(Exhibit A)*. On December 17, 1998, petitioner received from respondent Assessment Notice No. 33-1-000078-95. It is clear then that the assessment done by the respondent falls within the three (3)-year period prescribed by law to assess, reckoned from the date of filing of the Corporate Annual Income Tax Return.

At this point, the court finds it necessary to rule on the assessment on branch profit remittance tax although the parties failed to include it in the joint stipulations of issues. The records disclose that petitioner was assessed of deficiency branch profit remittance as follows:

Debit to Home Office	P 1,831,455.76
Tax Rate	15%
Tax Due	P 274,718.16
Add: 20% Interest	146,507.30
Total Tax Due	**P 421,225.46**

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Petitioner asserted that it was impossible for it to remit branch profit to its mother company considering that it incurred net operating loss for the fiscal year ending September 30, 1995. What was declared in Section G- Analysis of Changes in Retained Earnings for Corporation in the Income Tax Return was merely a reconciling item and it represents petitioner's share in the home office expense. Therefore, respondent erred in its assessment.

The court finds the assessment in order.

It is clear from petitioner's Income Tax Return for the taxable year 1995 *(CTA Records, pp.36-38)*, that petitioner debited to its retained earnings remittances to home office. Without any satisfactory explanation and evidence from petitioner, we are constrained to conclude that petitioner indeed is liable for deficiency branch profit remittance tax. All presumptions are in favor of the correctness of the tax assessments, the good faith of the tax assessor and the validity of their actions are presumed. Petitioner failed to rebut the presumption of the correctness of the tax assessment, thus, liable for the tax assessed.

IN THE LIGHT OF ALL THE FOREGOING, the deficiency assessments on income, VAT, expanded withholding and branch profit remittance taxes issued against petitioner covering the period from October 1, 1994 to September 30, 1995 are hereby **UPHELD**. Accordingly, petitioner is **ORDERED** to **PAY** the respondent the amount of P5,293,012.59, computed as follows:

DEFICIENCY INCOME TAX	P 4,771,705.74
DEFICIENCY VAT	43,194.88
DEFICIENCY WITHHOLDING TAX	56,886.51
DEFICIENCY BRANCH PROFIT REMIT TAX	421,225.46
TOTAL AMOUNT PAYABLE	**P 5,293,012.59**

Petitioner is likewise ORDERED to PAY the 20% delinquency interest to be computed from April 16, 1996 until full payment thereof.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Judge

LOVELL R. BAUTISTA
Associate Judge

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

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