REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

DUVAZ CORPORATION as the surviving company after its merger with RDR Property Holdings, Inc.,
Petitioner,

- versus -

C.T.A. CASE NO. 5954

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
SEP 05 2001

x - x

DECISION

This is an appeal for the declaration of nullity of Assessment Notice No. 060376-94-99-478, dated January 28, 1999, issued against RDR Property Holdings, Inc. (RDR for brevity), a corporation whose entire assets and liabilities were transferred to and absorbed by Petitioner by virtue of the Articles of Merger and the Plan of Merger executed by and between Petitioner and RDR and approved by the Securities and Exchange Commission on February 5, 1997. The assessment was for RDR's alleged internal revenue tax liabilities for 1994 in the following amounts, inclusive of interest and compromise penalty:

Income Tax	P1,085,285.86
Expanded Withholding Tax	607.60
Total	P1,085,893.46

The facts are as hereunder stated:

Petitioner is a corporation organized and existing under the laws of the Philippines with office address at the 10th Floor, The Peak Condominium, 107 Alfaro St., Salcedo

Village, Makati. RDR was a domestic corporation duly organized and existing under the laws of the Philippines with the same office address.

On April 17, 1995, RDR filed its Corporation Annual Income Tax Return for the year ended December 31, 1994 reflecting a taxable income of P35,829,916.00 and the tax due thereon in the amount of P12,540,471.00 (Annex A, Petition for Review).

On February 5, 1997, the Securities and Exchange Commission approved the merger of Petitioner and RDR, as mentioned earlier.

On September 16, 1998, Petitioner received a letter from Revenue District Officer Edmundo A. Vasquez of Revenue District No. 50, South Makati, informing Petitioner that the report of examination submitted by Revenue Officer Luzviminda A. Pedrosa shows that the sum of P4,650,031.26 deficiency income tax and withholding taxes for the taxable year 1994 is due from it. In the said letter, Petitioner was given ten (10) days from receipt thereof to refute the said findings by submitting a written protest and documentary evidence (pages 373-376, BIR Records).

Petitioner responded on September 25, 1998 through a letter dated September 24, 1998, and protested the findings of the Revenue Officer (Exhibit 2, p. 382, BIR Records).

After considering the protest-letter and the evidence submitted by Petitioner, Respondent issued Pre-assessment Notices to RDR on November 11, 1998 but reduced the amounts of deficiency income and expanded withholding taxes to P1,172,285.68 and P596.96, respectively, inclusive of interest and compromise penalty (pages 401-402, BIR Records).

On December 1, 1998, Petitioner filed another protest letter in response to the Pre-Assessment Notices and requested for the cancellation of the assessment relative to the disallowed interest expense of P1,955,712.69 (pp. 404, 405, BIR Records).

On February 22, 1999, Petitioner received from Respondent Assessment Notice No. 060376-94-99-478 dated January 28, 1999, for RDR's alleged internal revenue tax liabilities for 1994 in the following amounts:

Income Tax	P1,085,285.86	
Expanded Withholding Tax	607.60	
Total	P1,085,893.46	(pp. 438, 439, BIR Records)

Petitioner, through counsel, protested the said assessment on March 19, 1999, questioning the validity of the issuance of the assessment notice on the basis of Section 228 of the National Internal Revenue Code, as amended, and at the same time advancing its own arguments anent the disallowances made by Respondent.

As there was no action on the part of the Respondent, Petitioner elevated its case before Us on October 15, 1999.

Instead of filing an Answer, Respondent moved to dismiss the instant petition on the ground of lack of jurisdiction. Respondent argued that the petition failed to show on its face compliance with the conditions *sine qua* non prescribed in Section 228 of the Tax Code, particularly the submission of relevant supporting documents. This failure on the part of the Petitioner to comply with the requirement of Section 228 of the Tax Code rendered the assessment final, according to Respondent (pp. 29-31, CTA Records)

Petitioner opposed said motion on December 7, 1999, alleging that the reservation it made in its protest letter of March 16, 1999 did not make it mandatory on its part to submit additional memoranda and/or evidence and that all relevant documents were already in the possession of Respondent at the time the protest was filed, thereby preventing the assessment from becoming final and dispensing with the need to submit additional evidence (pp. 36-39, CTA Records).

On January 10, 2000, the Court denied Respondent's motion for lack of merit.

Thus, on January 27, 2000, Respondent filed his Answer and raised the following Special and Affirmative Defenses:

> "5. In a letter dated September 14, 1998, petitioner was informed of the report of examination on which the assessment are based which petitioner refuted in a letter dated September 24, 1998. Furthermore, in Pre-Assessment Notices dated November 11, 1998, petitioner was informed of the proposed assessments which it protested in a letter dated December 1, 1998. Hence, the requirement under Section 228 of the Tax Code that the taxpayer shall be informed of the law and the facts on which the assessment is made, is deemed to have been complied with;
>
> 6. The amount of P1,955,712.69 being claimed by RDR Property Holdings, Inc. as interest expense was paid to Duvaz Corporation, the sole stockholder of RDR Property Holdings, hence, not allowed as deductible expense under Section 29 (b) (2) (ii) in relation to Section (b) (3) of the Tax Code;
>
> 7. The commission expense of P4,500.32 was not subjected to the 5% expanded withholding tax under Revenue Regulations No. 6-85;
>
> 8. The assessments were issued in accordance with law and regulations;
>
> 9. All presumptions are in favor of the correctness of tax assessments." (pp. 49-51, CTA Records)

In their "Joint Stipulation of Facts and Restatement of Issues," filed on April 4, 2000, the parties submitted the following issues for resolution:

1. Whether or not, in issuing the Assessment Notice against Petitioner, the Respondent complied with the requirement in

Section 228 of the Tax Code that the taxpayer shall be informed of the law and the facts on which the assessment is made.

2. Whether or not the amount of P1,955,712.69 claimed as interest by Petitioner is a valid and deductible expense.

3. Whether or not the Commission Expense of P4,500.32 is subject to Expanded Withholding Tax (EWT) under Revenue Regulations No. 6-85, as amended.

4. Whether or not the Commission Expense of P4,500.32 was subjected to EWT under Revenue Regulations No. 6-85, as amended. (p. 74, CTA Records)

Before We resolve the first issue, the Court finds it necessary to ascertain the facts leading to the issuance of the questioned assessment.

Petitioner was first informed of its deficiency income and withholding taxes on September 16, 1998 through a letter from Revenue District No. 50 dated September 14, 1998 (pages 373-376, BIR Records). In the said letter, Petitioner was informed that the sum of P4,650,031.26 as deficiency income tax and withholding taxes for the taxable year 1994 is due from it in view of the following discrepancies and disallowances:

1. Interest expense amounting to P4,145,171.88 was incurred and due Duvaz Corporation, the sole stockholder of RDR Property Holdings, Incorporated under Section 29 (b) and Section 30 (b) of NIRC, such is not allowed as deductible expense.

2. Non-payment of expanded withholding tax on commission, under Revenue Regulations No. 6-85 (Section 9) dated May 02, 1985 is a valid reason for disallowances:

Commission per F/S	P14,312,811.00
Commission per alpha list (BIR Form No. 1743IR)	13,413,866.20
Discrepancy	P 898,944.80

3. Disallowances of creditable withholding tax was computed as follows:

Tax Credit claimed per return	P11,285,632.00
Tax Credit with supporting valid documents	10,375,945.05
Disallowed	P 909,686.95

4. Assessment of withholding tax was based on the following reconciliation:

Salaries & Wages per F/S	P 4,822.574.00
Salaries & Wages per alpha list (BIR Form 1743IR)	4,245,550.99
Discrepancy	P 577,023.01
Tax rate	1%
Tax due	P 5,770.23

5. Computation of income tax due of Ms. Judith Vazquez:

Salaries & Wages	P 866,068.21
Director's Fee	90,000.00
TOTAL	P 956,068.21
Less: Exemption	18,000.00
Net taxable income	P 938,068.21
Tax Due – 1st P500,000.00	P 122,175.00
Excess of P438,068.21 x 35%	153,323.87
TOTAL	P 275,498.87
Less: Tax Paid (P9,000.00 + P254,095.60)	263,095.60
Tax still due	P 12,403.27

6. Assessment of expanded withholding tax is a result of the following reconciliation: (NIRC Section 50; RR No. 13-78 as amended by RR No. 6-78 & 5-82 Section 1 (i).

Commission per F/S	P14,312,811.00
Commission per alpha list (BIR Form No. 1743ir)	13,413,866.20
Discrepancy	P 898,944.80
Rate of tax	5%
EWT Still Due	P 44,947.24

Petitioner then protested the said findings on September 25, 1998 (pages 380-382, BIR Records) and gave the following explanations:

"(a) **Disallowance of Interest Expense – P4,145,171.88**

Before we contest the disallowance of interest expense mentioned above, first of all, we would like to rectify the typographical error on the amount of interest paid to Duvaz Corporation (Duvaz) as shown in the Alpha List of income payments not subject to withholding tax for the year ended December 31, 1994 marked as Annex B-1. **As shown in the records of RDR, the correct amount of interest paid to Duvaz is P1,955,712.69 and NOT P4,145,171.88 as indicated in the Alpha List.** A Schedule of Interest Expense with a balance of P536,109.22 as of December 31, 1994 is attached and marked as Annex B-2, the total amount of which agrees with the amount of interest expense (net) per RDR's 1994 Audited Financial Statement. **If you will notice in the Alpha List (Annex B-1) two (2) amounts of P4,145,171.88 are reported, one for Bank of Commerce and the other for Duvaz. The amount of interest reported for Duvaz is INCORRECT due to typographical error.**

We are contesting the disallowance of interest paid to Duvaz because it is an allowable ordinary and necessary business expense deductible from the gross income of RDR pursuant to Section 29(b) And Section 30(b) of the Tax Code. Citing these provisions of the Tax Code, we find no basis for your Revenue Officer to disallow the interest paid to Duvaz by RDR. As a matter of fact, the interest of P1,955,712.69 received from RDR was properly recorded in the books of Duvaz and both reported in its income tax return and audited financial statements during the year. As proof that the income to Duvaz was also taken up in the same year, we are submitting the Schedule of Interest Income and Audited Financial Statements of Duvaz for the year ended December 31, 1994 marked as Annex B-3 and Annex B-3a, respectively. Since the disallowance of P4,145,171.88 is without basis following the foregoing provisions of the Tax Code, we therefore request that the same be cancelled.

(b) **Disallowance of Commission Expense – P898,944.80**

Similarly, we are also contesting the disallowance of commission amounting to P898,944.80 paid to Duvaz because P894,362.90 of this amount included a ten percent (10%) value-added tax which is not subject to 5% withholding tax. **The only amount to be disallowed therefore is P4,580.32 being the difference between the amount disallowed by your Revenue Officer and the 10% VAT of commission per Alpha List (P898,944.80 - P8,943,629.00), which was not subjected to 5%**

withholding tax. Shown in Annex B-4 are the Schedule and Reconciliation of Commission Expense indicating the reasons for discrepancy in the amounts per Alpha List and per ITR/FS as of December 31, 1994. **Since RDR is willing to pay the 5% withholding tax plus interest and penalties due on the amount of P4,580.32, we therefore request that the disallowance of commission of P898,944.80 be also cancelled.**

(c) Disallowance of Tax Credits – P909,686.95

On the matter of tax credits disallowed by your Revenue Officer, we are submitting the reconciliation of tax credits claimed per return and tax credits with supporting valid documents per the examination of your Revenue Officer marked as Annex B-5. Likewise, we are attaching copies of Capital Gains Tax Returns, Application for Certification Authorizing Registration, Monthly Remittance Return Income Taxes Withheld, Certificate Authorizing Registration and Certificates of Creditable Tax Withheld at Source all marked as Annex B-5 to support the tax credits of P909,686.95 disallowed by your Revenue Officer. In view of the foregoing documentary evidence, we request that the same be cancelled.

DEFICIENCY WITHHOLDING TAX – P121,909.07

(a) Assessment of Withholding Tax on Salaries and Wages

In our September 11, 1998 letter to your Revenue Officer, which was received by Girlie on September 14, 1998, we explained the discrepancy of P577,023.01 in salaries and wages per Alpha List and per ITR/FS as non-taxable benefits which were excluded from the gross compensation income pursuant to Revenue Regulation No. 2-95 implementing Republic Act No. 7833. A copy of our said September 11, 1998 letter along with the Reconciliation Schedule of Salaries and Wages per ITR/FS and per Alpha List duly backed up by 1994 Alpha Lists and Annual Information Return of Income Tax Withheld on Compensation, Expanded and Final Withholding Taxes (BIR Form 1743-IR) is attached and marked as Annex B-6 for your reference. Since the discrepancy of P577,023.01 represents non-taxable benefits, we request that the assessment for deficiency withholding tax on salaries and wages amounting to P5,770.23 be cancelled.

(b) Assessment of Income Tax on Directors' Fee Paid to Ms. Judith D. Vazquez

Your Revenue Officer included the directors' fee of P90,000.00 paid to Mrs. Judith Vazquez as part of her compensation income subject to the provision of withholding tax on compensation, thereby resulting in underpayment of withholding tax in the amount of P12,403.27. Our verification of the income tax filed by Mrs. Vazquez for 1994 showed that the amount of P90,000.00 was indeed reported in the said tax return. A copy of Mrs. Vazquez Income Tax Return for the year 1994 is attached and marked as Annex B-7 for your reference and evaluation. Since the director's fee of P90,000.00 has been properly reported and already been subjected to income tax, we request that the assessment for deficiency withholding tax of P12,403.27 be likewise cancelled.

(c) Assessment of Expanded Withholding Tax on Commission

As contested in foregoing item (b) of Deficiency Income Tax pertaining to disallowance of Commission Expense of P898,944.80, **RDR is willing to pay the 5% withholding tax on the commission amount of P4,580.32 only equivalent to P229.02 (P4,580.32 x 5%),** thus the remaining balance of P44,718.22 (P44,947.24 – P229.02) of your assessment be therefore cancelled." (Emphasis supplied)

After taking into consideration the explanations and documentary evidence submitted by Petitioner, Respondent reduced the disallowed interest expense from P4,145,171.88 to P1,955,712.69 and the disallowed commission expense from P898,944.80 to P4,500.32 and cancelled the rest of the assessments made (Exhibit 3).

Consequently, on November 11, 1998, Respondent issued to RDR Pre-Assessment Notices for deficiency income and expanded withholding taxes (EWT) (pages 407-408, BIR Records) amounting to P1,172,285.68 and P596.96, respectively, inclusive of interest and surcharge, detailed as follows:

INCOME TAX

Net Income per return as audited		P35,829,916.00
Proposed unallowable deductions and additional income		
Interest Expense	**P1,955,712.69**	
Section 29 (g) of NIRC		
Net Income subject to tax		P37,785,628.69
Income tax due thereon		P13,224,970.04
Less: Tax Credit		12,540,471.00
Deficiency income tax		**P 684,499.04**

Add: Interest	467,786.64
Compromise	20,000.00
Total deficiency taxes	P 1,172,285.68

EXPANDED WITHHOLDING TAX

Commission Expense	**P4,500.32**
Sec. 72(a) of NIRC	x 5%
Def. EWT	P 229.01
Interest	167.95
Compromise	200.00
	P 596.96

Petitioner wrote another protest letter to Respondent on December 1, 1998 (pages 404-405, BIR Records), this time no longer questioning the amount disallowed by the latter as interest expense but reiterating its previous stand that the interest being claimed for deduction by RDR is ordinary and necessary expense connected with the operation of the business that require immediate working capital and operational funds. Petitioner cited the provisions of Section 29(b) of the National Internal Revenue Code [NIRC] (now amended by Section 34(b) of the Tax Code of 1997), which states in part:

> "**Sec.29**. *Deductions from gross income*
>
> (b) Interest
> (1) In general – The amount of interest paid or accrued within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business, except on indebtedness incurred or continued to purchase or carry obligation the interest upon which is exempt from taxation as income."

On January 28, 1999, Assessment Notice No. 060376-94-99-478 was issued for P1,085,285.86 deficiency income tax and P607.60 deficiency EWT, inclusive of interest and surcharge, computed as follows:

INCOME TAX

Net Business Income	P35,829,916.00
Add: **Interest Expense Section 29 (b)**	**1,955,712.69**
Total	P37,785,628.69
Less: Tax Withheld	13,224,970.04
Tax Paid	12,540,471.00
Deficiency Tax	**P 684,499.04**
Interest	380,786.82
Compromise	20,000.00
Total deficiency taxes	P1,085,285.86

EXPANDED WITHHOLDING TAX

Commission Expense	P4,500.32
Rate of Tax	x 5%
Tax Due	**P225.01**
Interest	182.59
Compromise	200.00
	P607.60

From all the foregoing exchange of communications between Petitioner and Respondent, this Court believes that Petitioner knew very well the law and the facts on which the assessments were made at the time it received the assessment notices in question. In fact, it was because of Petitioner's protest letter of September 25, 1998 explaining that '(t)he amount of interest reported for Duvaz is **INCORRECT** due to typographical error' that Respondent reduced the amount of disallowed interest expense from P4,145,171.88 to P1,955,712.69. Petitioner also stated in the said letter its willingness to pay the 5% withholding tax plus interest and penalties due on the amount of P4,580.32. We find it difficult, therefore, to agree with Petitioner that Respondent failed to comply with the requirement in Section 228 of the Tax Code that the taxpayer must be informed in writing of the law and the facts on which the assessment is made.

Likewise, the Court believes that the discrepancies appearing in the pre-assessment notices and assessment notices mentioned by Petitioner in its memorandum are mere errors in typing which could not give rise to confusion as to the real basis of the assessments.

As to whether or not the amount of P1,955,712.69 claimed by Petitioner is a valid and deductible expense, We rule in the affirmative

Respondent disallowed the said amount on the ground that the same was incurred and due Duvaz Corporation (herein Petitioner), the sole stockholder of RDR Property Holdings, Inc. and, therefore, not allowed under Sections 29 (b) and 30(b) of the NIRC.

For clarity, We quote the above provisions relied upon by Respondent:

> SEC. 29. **Deductions from gross income.-**
>
> (b) *Interest*
>
> (1) *In general.* - xxx
>
> (2) No deduction shall be allowed in respect of interest under the succeeding sub-paragraphs:
> (i) xx
>
> **(ii) If both the taxpayer and the person to whom the payment has been made or is to be made are persons specified under Section 30 (b).**
>
> SEC. 30. **Items not deductible.**- (a) *General rule.*- In computing taxable income no deduction shall in any case be allowed in respect of -
>
> xxx
>
> **(b)** Losses from sales or exchanges of property.- In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly -

> (3) Except in the case of distributions in liquidation, **between two corporations more than fifty *per centum* in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;**

Clearly from the above, in cases where two corporations are involved in the payment of interest, the same cannot be allowed as a deduction if more than 50% in value of the outstanding stock of each corporation is owned, directly or indirectly, by or for the same individual. In the present case, Respondent showed no proof that, indeed a particular stockholder of RDR owned more than 50% in value of the outstanding stock of Petitioner. On the contrary, Petitioner's General Information Sheet as of December 3, 1994 showed that no stockholder owned more than 50% of the outstanding stock of each corporation (Exhibit D-1). Thus, in the absence of evidence that RDR's interest payment to Petitioner falls under Section 30 (b) of the NIRC, the same must be allowed as a deduction.

With reference to the issue on whether or not the commission expense of P4,500.32 is subject to expanded withholding tax, again, We rule in the affirmative.

Under Revenue Regulations No. 6-85, amounts paid to brokers and agents shall be subject to 5% creditable withholding tax. Moreover, it is significant to note that in protesting the disallowance of commission expense amounting to P898,944.80, Petitioner admitted that only the amount of P4,580.32 ought to be disallowed, being the difference between the amount disallowed by the Revenue Officer and the 10% VAT of commission per Alpha List (P898,944.80-P894,362.90) and therefore, was not subjected to 5%

withholding tax. Petitioner even signified its willingness to pay the 5% withholding tax plus interest and penalties due thereon. Thus, its belated assertion that the assessment notice and the pre-assessment notice pertaining to the EWT provided no explanation or basis deserves scant consideration.

Finally, since there is no evidence on record that the commission expense of P4,500.32 had already been subjected to EWT and considering further the statement of Petitioner that it is willing to pay the 5% withholding tax, this Court believes that the commission expense of P4,500.32 was not subjected to EWT.

WHEREFORE, in the light of all the foregoing, Assessment Notice No.060376-94-99-478, dated January 28, 1999, pertaining to the assessment on income tax in the amount of P1,085,285.86 is hereby **CANCELLED**. However, insofar as Assessment Notice No. 060376-94-99-478 pertains to expanded withholding tax in the amount of P225.01, the same is hereby **UPHELD.** Petitioner is **ORDERED to PAY** to Respondent the amount of P225.01 plus 25% surcharge and 20% annual interest from the date prescribed for payment until fully paid.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding 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