**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

## FIRST DIVISION

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**SOLID CEMENT CORPORATION,**
Petitioner,

- versus -

**COMMISSIONER OF INTERNAL REVENUE,**
Respondent.

**C.T.A. CASE NO. 6248**

Members:

**ACOSTA,** *Chairperson*
**BAUTISTA,** and
**CASANOVA,** *JJ.*

**Promulgated:**

JAN 30 2009, 9:05 am

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# DECISION

**CASANOVA, *J.*:**

### Nature of the Case

The Petition for Review seeks the cancellation of Assessment Notices dated January 18, 2000 for petitioner's alleged deficiency income tax, value-added tax (VAT), expanded withholding tax and final withholding tax liabilities for the year 1997.

### Statement of the Facts

Petitioner, Solid Cement Corporation, is a domestic corporation with principal address at 25th Floor, Petron Mega Plaza Building, Sen. Gil Puyat Avenue, Makati City, Metro Manila.[1] Petitioner is engaged in the manufacture of cement.[2]

[1] Paragraph 1, Page 1, Petition for Review; Page 1, CTA Records
[2] Paragraph 2, Page 1, Joint Stipulation of Facts and Issues (JSFI); Page 99, CTA Records

While respondent, Commissioner of Internal Revenue, is the duly appointed head of the Bureau of Internal Revenue (BIR), charged with the duty of assessing and collecting internal revenue taxes, and holds office at the BIR National Office Building, Diliman, Quezon City.[3]

On January 18, 2000, petitioner received from the BIR Enforcement Service a Formal Letter of Demand[4] and Assessment Notices for alleged deficiency income tax, value-added tax (VAT), expanded withholding tax and final withholding tax;[5] which are as follows:

| **Assessment Notice No.** | **Tax** | **Exhibit** |
|---|---|---|
| ST-INC-97-0107-2000 | P68,729,978.07 | "B" |
| ST-VAT-97-0108-2000 | P214,619.60 | "B-1" |
| ST-EWT-97-0109-2000 | P6,503,754.09 | "B-2" |
| ST-FT-97-0110-2000 | P1,506,333.28 | "B-3" |

Consequently, petitioner filed a Protest on February 17, 2000.[6]

On April 17, 2000, petitioner submitted a Supplemental Memorandum, as well as, documentary evidence in support of the protest filed on February 17, 2000.[7]

On February 13, 2001, petitioner, though its counsel, received a Letter dated February 6, 2001 from respondent, signed by its Chief of the Appellate Division, Atty. Rodulfo L. Salazar. The letter reciting that upon reinvestigation, the Bureau affirmed all the findings made by the revenue officers in the original examination; hence, upholding the assessments.[8]

As a result of the denial, petitioner filed the present Petition for Review on March 15, 2001.[9]

Respondent, in his Answer (To the Petition for Review dated 14 March 2001) filed on May 2, 2001,[10] and by way of Special and Affirmative Defenses averred the following:[11]

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[3] Paragraph 2, Page 1, Petition for Review; Page 1, CTA Records
[4] Exhibit "A"
[5] Paragraph 3, Pages 1-2, Petition for Review; Pages 1-2, CTA Records
[6] Paragraph 4, Page 2, Petition for Review; Page 2, CTA Records
[7] Paragraph 5, Page 2, Petition for Review; Page 2, CTA Records
[8] Paragraph 7, Pages 3-4, Petition for Review; Pages 3-4, CTA Records
[9] Pages 1-15, CTA Records
[10] Pages 68-74, CTA Records
[11] Paragraphs 7-12, Pages 2-6, Answer; Pages 69-73, CTA Records

"7. *On Deficiency Income Tax Assessment in the amount of* ***Php: 68,729,978.07.*** This figure represents the disallowed items such as:

7.1. *Overstatement of Cost of Sales by Write [O]ff of Parts and Supplies Inventories in the amount of* ***Php: 23,800,566.25.*** Petitioner contends that the parts and supplies inventories were written off due to loss in the useful value. Accordingly, the write off was made pursuant to provisions of the National Income Tax Code and the Income Tax Regulations. We disagree. The abovementioned amount was imposed against petitioner on the ground that it failed to comply with the substantiation requirements pursuant to Revenue Regulations 12-97;

7.2. *Write Off of Clinkers Inventories in the amount of* ***Php: 11,495,217.00.*** Petitioner argues that the clinkers inventories were written off because the same were rendered useless for use as raw materials in the production of cement and, as such, petitioner sustained an actual loss as a result of the clinkers losing their useful value. Such being the case, petitioner argue that it is entitled to claim the loss as deduction from gross income pursuant to Section 34 of the NIRC [Section 29(d)(2) old NIRC]. The alleged loss being claimed by petitioner is not properly substantiated for the reason that the Adjusting Journal Entries made by the subject taxpayer reduced the value of the Ending Inventory-Work in Process-Clinker that resulted to the overstatement of Cost of Sales in violation of Section 35 (old) of the NIRC, which provides that if a taxpayer, after having complied with the terms and conditions prescribed by the Commissioner, uses a particular method of valuing its inventory for taxable year, then such method shall be used in all subsequent taxable years, unless with the approval of the Commissioner, a change to a different method is authorized;

7.3. *Overstatement of Variable Cost of Sold Clinker in the amount of* ***Php: 24,076,347.49.*** Petitioner argues that the revenue officers failed to consider the 'hauling and loading' expenses in their computation of the variable costs of the clinker sold by them to Hi-Cement Corporation and Rizal Cement Company, which are deductible from gross income as business expense under the Tax Code. However, herein respondent finds that since the final figure used by the taxpayer in valuation of sold clinker was bloated, it is just right that the said transaction be subjected to a proper tax. The original amount of Clinker sold to Hi-Cement/Rizal was *Php: 168,515,845.22.* However, the taxpayer inadvertently valued it at *Php: 192,592,192.71* or a difference of *Php: 24,076,347.49* in violation of Section 29 (a)(1) of the NIRC;

7.4. *Unreconciled difference in the Salaries and Wages Account in the amount of* ***Php: 85,451,373.18.*** Petitioner argues that the above-cited amount of wages and salaries subjected to withholding tax as per petitioner's Alpha List and the amount of salaries and wages account per its financial statements consisting of director's bonuses expensed by them in 1996 but paid in 1997. Such position is without merit. The basis in imposing said amount was that the total amount of salaries and wages that were reported per Alpha List amounted to *Php: 222,923,304.11* while the total amount of salaries and wages and employee's benefits claimed per F/S amounted to only Php: 137,471,930.93 or a difference of ***Php:85,451,373.18*** in violation of Section 43 of the NIRC.

8. *On Deficiency Expanded Withholding Tax Assessment in the amount of* ***Php: 6,503,754.09.*** It is the contention of petitioner that the expense and increase in assets on which the revenue officers assessed deficiency expanded withholding tax in fact pertain to payments made to income tax-exempt payee and for the importation of equipment, materials, tools and supplies. On the contrary, respondent believes that petitioner is liable for said amount as the latter failed to withhold and remit the correct withholding tax due on its income payments made during the year under investigation which were claimed as expense and increase in assets as reported per ITR and audited F/S in violation of Section 50 of the NIRC in relation to RR 6-85 and RR 12-94;

9. *On Deficiency Final Withholding Tax Assessments in the amount of* ***Php: 1,506,333.28.*** Petitioner argues that the discrepancy between the royalty expense claimed by it per its financial statements versus its Alpha List, on which the revenue officers assessed deficiency final withholding tax, in fact pertains to expenses paid either in 1996 or 1998. We disagree. Petitioner's failure to fully subject to final tax [the] royalty expense claimed per F/S violates Section 22 (a)(2) in relation to Section 50 of the NIRC. As such, the imposition of deficiency final tax against petitioner is proper;

10. The assessments were issued in accordance with law and regulations;

11. All presumptions are in favor of the correctness of tax assessments; and

12. Since the assessment for deficiency VAT in the amount of *Php: 214,619.00* was not protested, the same has become final, executory and demandable."

The case was set for Pre-Trial on June 29, 2001.[12] Petitioner filed its Pre-Trial Brief on June 26, 2001,[13] while respondent filed its Pre-Trial Brief (For the Respondent) on June 29, 2001.[14]

However, petitioner filed a Motion on June 26, 2001, praying for the postponement of the scheduled pre-trial to consider the possibility of settlement between the parties;[15] which the Court granted on June 29, 2001.[16] Pre-Trial was scheduled on July 27, 2001.

[12] Page 76, CTA Records
[13] Pages 77-81, CTA Records
[14] Pages 82-86, CTA Records

On July 27, 2001, the Court ordered the parties to submit their Joint Stipulation of Facts and Issues.[17]

On September 27, 2001, respondent recanted its previous admissions of paragraphs 1 and 2 of petitioner's proposed stipulation of facts; while petitioner manifested that it decided to settle in full the VAT assessment and a portion of the income tax.[18]

In a Resolution dated November 9, 2001,[19] the Court approved the parties' Joint Stipulation of Facts and Issues filed on November 6, 2001.[20]

On February 3, 2003, the Court commissioned Mr. Antonio O. Maceda, Jr. as the Independent Certified Public Accountant (CPA) to examine petitioner's voluminous documentary evidence pursuant to CTA Circular No. 1-95, as amended by CTA Circular No. 10-97.[21]

On August 28, 2003, the Court-commissioned CPA filed its Compliance[22] attaching therewith the partial audit report.[23] However, upon Mr. Maceda, Jr.'s direct examination on September 1, 2003, he manifested that he is currently the audit partner in-charge of the current year's audit of petitioner. Hence, the Court ordered petitioner to substitute Mr. Maceda, Jr. and nominate another Independent Auditor.[24]

Consequently, on October 1, 2003, Ms. Emerita H. Escueta was commissioned by this Court as the Independent CPA.[25]

During trial on November 6, 2003, petitioner manifested that it had paid the VAT deficiency assessment and a portion of the income tax assessment; hence, petitioner stated that it will file the appropriate motion thereto.[26]

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[15] Pages 88-90, CTA Records
[16] Page 91, CTA Records
[17] Page 92, CTA Records
[18] Page 97, CTA Records
[19] Page103, CTA Records
[20] Pages 99-102, CTA Records
[21] Page 138, CTA Records
[22] Pages 171-172, CTA Records
[23] Pages 173-179, CTA Records
[24] Page 180, CTA Records
[25] Page 192, CTA Records

The Court-commissioned CPA submitted its Partial Reports dated October 30, 2003[27] and February 12, 2004,[28] on November 5, 2003 and February 13, 2004, respectively; a Final Report dated March 24, 2004 on March 26, 2004;[29] an Addendum to the Final Report dated July 1, 2004 on July 1, 2004;[30] and a Revised Annex B to the Addendum of the Final Report dated August 10, 2004 on August 10, 2004.[31]

On February 4, 2005, the Court-commissioned CPA submitted a Final Report dated February 3, 2005, for purposes of correcting the pre-markings made in the earlier reports.[32]

Petitioner filed its Offer of Documentary Evidence *Ad Cautelam* on August 8, 2008,[33] and its Additional Offer of Documentary Evidence on October 14, 2005;[34] which the Court determined in a Resolution dated December 20, 2005.[35]

On March 7, 2006, petitioner manifested that it filed for a compromise settlement of its income tax liability.[36] Further, on January 9, 2007, petitioner manifested that it had paid the VAT, and the abatement program for final withholding tax and expanded withholding tax; and has a pending application for compromise on the income tax liability.[37]

In a Manifestation filed on February 26, 2007, petitioner submitted copies of the receipts and proofs of payment for the abatement of its final withholding tax and expanded withholding tax.[38]

In a Resolution dated September 18, 2007,[39] in view of the absence of respondent's counsel despite due notice and upon oral motion of petitioner's counsel, respondent is deemed to have waived his right to present evidence.[40]

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26 Page 200, CTA Records
27 Pages 193-199, CTA Records; Exhibit "L"
28 Pages 205-211, CTA Records; Exhibit "N"
29 Pages 214-258, CTA Records; Exhibit "P"
30 Pages 268-274, CTA Records; Exhibit "Q"
31 Pages 276-277, CTA Records; Exhibit "R"
32 Pages 286-334, CTA Records; Exhibit "S"
33 Pages 340-354, CTA Records
34 Pages 542-548, CTA Records
35 Pages 587-588, CTA Records
36 Page 590, CTA Records
37 Page 598, CTA Records
38 Pages 601-608, CTA Records
39 Confirming the order in open court on September 13, 2007

Consequently, respondent filed a Motion for Reconsideration (Of the Resolution dated September 18, 2007") on September 25, 2007.[41] Petitioner filed its Opposition (To Respondent's "Motion for Reconsideration of the Resolution dated September 18, 2007) on October 15, 2007.[42] In a Resolution dated November 26, 2007, the Court denied respondent's motion and ordered the parties to submit their respective Memorandum.[43]

On February 7, 2007,[44] the case was submitted for decision taking into consideration the Memorandum filed by petitioner on February 4, 2008,[45] without respondent's Memorandum; hence, this decision.

## Issues

The following are the issues to be resolved and as agreed upon by the parties in their Joint Stipulation of Facts and Issues:[46]

I. Whether or not the losses arising from the obsolescence of petitioner's spare parts and supplies are deductible from gross income under the provisions of then Section 29(d)(2) [now Section 34(d)] of the NIRC and Section 98 of Revenue Regulations No. 2, or the Income Tax Regulation;

II. Whether or not Revenue Regulations No. 12-77 on the substantiation of casualty losses applies to write-offs of parts and supplies due to obsolescence, and clinker inventories due to damage resulting from improper storage;

III. Whether or not the losses sustained by petitioner by reason of the damaged clinker inventories, which were rendered useless as a result of its improper storage, may be claimed as deductions from its gross income;

IV. Whether or not the write-off or reduction by petitioner of the value of the damaged clinker inventories amounts to a change in inventory valuation method which requires the prior approval of the respondent under Section 35 [now Section 4] of the NIRC;

[40] Page 618, CTA Records
[41] Pages 619-623, CTA Records
[42] Pages 627-631, CTA Records
[43] Pages 634-635, CTA Records
[44] Page 673, CTA Records
[45] Pages 640-670, CTA Records
[46] Paragraphs 1-13, Pages 1-3, JSFI; Pages 99-101, CTA Records

V. Whether or not the hauling and loading expenses incurred by [the] petitioner in the course of its distribution and sale of goods to Hi-Cement Corporation and Rizal Cement Company, Inc. during the taxable year 1997 are deductible from gross income under then Section 29(a)(1) [now Section 34(A)(1)] of the NIRC;

VI. Whether or not the difference in the total amount of salaries and wages that are reported per Alpha List (P222,932,304.00) and the total amount of salaries and wages and employees' benefits claimed per F/S (P137,471,930.93), in the amount of P85,451,373.18, was properly treated by respondent as additional income of the taxpayer;

VII. Whether or not petitioner may validly treat as an expense in a prior year the payment of director's bonuses actually made in the succeeding taxable year, under the generally accepted accounting principle of matching costs and revenue;

VIII. Whether or not petitioner is required to withhold and remit withholding tax on its income payments to income tax-exempt payees, such as cooperatives under Republic Act No. 6938, or the Cooperative Code of the Philippines, and on payments for importation of equipment, materials, tools and supplies;

IX. Whether or not petitioner may validly treat as an expense in a taxable year the payment of royalties actually made in earlier or succeeding taxable year, under the generally acceptable accounting principle of matching costs and revenue;

X. Whether or not petitioner overstated its Variable Cost of Sold Clinker (referring to the sale of clinker to Hi-Cement/Rizal Corporation) in the amount of P24,076,347.49;

XI. Whether or not the amount of P1,461,569.00, which represents the difference between the amount of sales reported by petitioner in its Income Tax Return and the amount of sales evidenced by the Withholding Tax Certificates claimed in its Income Tax Return, was properly treated by respondent as taxable income;

XII. Whether or not the imposition of deficiency expanded withholding tax in the amount of P6,503,754.09 was proper; and

XIII. Whether or not petitioner's failure to subject to final tax royalty expense claimed renders it liable to deficiency final tax in the amount of P1,506,333.28.

## Court's Ruling

*Deficiency Income Tax*

Petitioner's deficiency income taxes are as follows:

| | | | |
|---|---|---|---|
| Net Income Per Return | | | P 629,089,396.00 |
| Adjustments to taxable income: | | | |
| A. | Overstatement of Cost of Sales by - | | |
| | A.1 Charging to Cost of Sales the Value of Obsolete Inventories (Fire Bricks) - Spare Parts Account (AJE 12-97-061, no substantiation as required by RR 12-77) | P23,800,566.25 | |
| | A.2 Reduction in Value of Work-in Process - Clinker, in Ending Inventory - (AJE 12-97-059, violates Sec. 35, NIRC) | 11,495,217.00 | |
| | A.3 Overstatement of variable cost of sold clinker (Sch. of VCO, Dec. 31, 1997, Sec. 29(a)1) | 24,076,347.49 | 59,372,130.74 |
| B. | Unreconciled difference in the Salaries and Wages Account - (Account Claimed per Alpha List is more than what was claimed per FS, Sec. 43, NIRC) | | 85,451,373.18 |
| C. | Undeclared Sales (Sec. 28, NIRC) | | |
| | Sales per ITR | 3,499,949,118.00 | |
| | Sales evidenced by withholding tax certificates claimed per ITR | 3,501,410,687.00 | 1,461,569.00 |
| Net Taxable Income per Investigation | | | P 775,374,468.92 |
| Income Tax Due | | | P 271,381,064.00 |
| Less: | Creditable tax withheld | P 35,014,106.87 | |
| | Quarterly tax payments | 185,167,182.13 | 220,181,289.00 |
| Deficiency Income Tax | | | P 51,199,775.00 |
| Add: | Increments | | |
| | 20% Interest - 4/16/98 to 12/31/99 | P 17,505,203.07 | |
| | Compromise Penalty | 25,000.00 | 17,530,203.07 |
| **TOTAL DEFICIENCY INCOME TAX** | | | **P 68,729,978.07** |

### *Obsolete inventories*

Petitioner attributed the write-off to the alleged loss in useful value of the spare parts and supplies. Cited are Section 34 (D) of the National Internal Revenue Code of 1997, as amended, and Section 98 of Revenue Regulations No. 2-40:

> "**SECTION 34.** *Deductions from Gross Income.* – xxx
>
> xxx
>
> (D) *Losses.* –

(1) *In General.* – Losses actually sustained during the taxable year and not compensated for by insurance or other forms of indemnity shall be allowed as deductions:"

"**SECTION 98.** *Loss of useful value.* – When through some change in the business conditions, *the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use of such business, he may claim as deduction the actual loss sustained.* In determining the amount of the loss, adjustment must be made, however, for improvements, depreciation and the salvage value of the property. This exception to the rule requiring a sale of other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowance are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use and to machinery only when its use as such is permanently abandoned. *Any loss to be deducted under this exception must be charged off in the books and fully explained in returns of income.*" (Italics supplied)

However, respondent disallowed the same for being unsubstantiated for failure to obtain a certification from the BIR verifying such loss of value on its inventory, and because of the argument that the said charging to cost of sales account resulted to an understatement of petitioner's reported gross profit.

Write-offs refer to losses resulting from the destruction of inventory which cannot be sold even at reduced price due to obsolescence or deterioration of the inventory.[47]

In the case of **Manotok Realty Incorporated vs. Commissioner of Internal Revenue,**[48] actual loss may be claimed as deduction from gross income when the following requirements concur:

a) The loss must be that of the taxpayer;
b) The loss must have been actually sustained and suffered within the taxable year;

[47] BIR Ruling [DA-476-03], December 10, 2003
[48] CTA Case No. 5485, October 18, 1999

c) The loss must be evidenced by a closed and completed transaction; and

d) The loss must not be compensated or otherwise.

And necessarily, the loss must be connected with the trade, business or profession of the taxpayer.[49]

In the case at bar, petitioner merely asserted that there was a loss of value of its inventories. No evidence was presented as to the reason for the loss, nor was the inventories discarded or destroyed permanently from use. In sum, no evidence was proffered to prove that petitioner had complied with the enumerated requisites. A mere allegation is neither proof nor evidence.[50]

A declaration of loss of value does not *ipso facto* entitle a taxpayer to deduct the same from its gross income. A taxpayer seeking a deduction must point to some specific provision of the statute authorizing the deduction[51] and be able to prove its entitlement thereto.

Petitioner ought to prove and substantiate its claim for the deductibility of the amount of P23,800,566.25 representing its alleged obsolete inventories. The evidence to be offered and submitted must necessarily include whatever that is required for the successful prosecution of its claim. To stress, petitioner must sustain that its claim should be granted.

Considering that petitioner failed to substantiate the inventory write-off in the amount of P23,800,566.25 the claimed deduction cannot be allowed.

*Reduction in value of clinkers*

Petitioner asserts that the write-off pertaining to clinker inventories were made due to its improper storage which resulted to the coagulation and hardening of the same, rendering it useless as raw material in the production of cement. Being considered actual

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[49] Section 34 (D)(1), NIRC of 1997, as amended
[50] Masagana Concrete Products vs. NLRC, 372 Phil. 459, 472 (1999)
[51] Basilan Estates, Inc. vs. Commissioner of Internal Revenue, L-22492, September 5, 1967

loss sustained and charged off during the taxable year, petitioner claimed the same as a deduction from its gross income.

Respondent, on the other hand, maintains that the same should be subject to income tax in as much as the Adjusting Journal Entries made by petitioner reduced the value of its "Ending Inventory – Work in Process – Clinker" which resulted to the overstatement of its Cost of Sales in violation of Section 35 [now Section 41] of the NIRC, as amended.

Section 41 of the NIRC of 1997, as amended, reads:

> "**SECTION 41.** *Inventories.* – Whenever in the judgment of the Commissioner, the use of inventories is necessary in order to determine clearly the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Secretary of Finance, upon recommendation of the Commissioner, may, by rules and regulations, prescribes as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.
>
> If a taxpayer, after having complied with the terms and conditions prescribed by the Commissioner, uses a particular method valuing its inventory for any taxable year, then such method shall be used in all subsequent taxable years unless:
>
> i. with the approval of the Commissioner, a change to a different method is authorized; or
>
> ii. the Commissioner finds that the nature of the stock on hand (*e.g.*, its scarcity, liquidity, marketability and price movements) is such that inventory gains should be considered realized for tax purposes and, therefore, it is necessary to modify the valuation method for purposes of ascertaining the income, profits, loss in a more realistic manner: *Provided, however,* That the Commissioner shall not exercise his authority to require a change in inventory method more often than once every three (3) years: *Provided, further,* That any change in an inventory valuation method must be subject to approval by the Secretary of Finance."

The Court does not agree.

As correctly pointed out by petitioner, the write-off or reduction of the value of the damaged clinker does not amount to a change in inventory valuation method, which requires prior approval of the Commissioner.

The write-off or reduction was made by petitioner pursuant to the alleged loss of useful life of its clinker. In treating such as a loss, a change in inventory valuation method was not necessary.

However, as previously discussed, in order for losses to be rightfully claimed as deductions, certain requisites must be complied with. This petitioner failed to meet.

Petitioner's write-off/reduction was not duly supported by evidence. Petitioner again merely asserted that the clinkers were rendered useless in the manufacture of cement considering its condition of being coagulated and hardened; thus, entitling it to claim as deduction from its gross income.

To stress, a mere declaration of loss does not automatically entitle a taxpayer to deduct the alleged loss from its gross income. Hence, for failure to support the same with competent evidence, petitioner's write-off/reduction of the clinker inventories in the amount of P11,495,217.00 cannot be allowed.

*Overstatement of variable cost of sold clinker*

Based on respondent's findings, in the Variable Cost of Sale (VCOS) – Sold Clinker dated December 31, 1997,[52] petitioner reflected the amount of P192,592,192.71. However, in its Income Tax Return,[53] the cost of clinker sold as declared by petitioner amounted to P168,515,845.22. Hence, a difference of P24,076,347.49.

Petitioner claims that the difference pertained to the hauling and loading fees incurred in the distribution and sale of goods, considered as business expense; hence, deductible from gross income in accordance with Section 29 (a)(1) [now Section 34 (A)(1)] of the NIRC, as amended.

Section 34 of the 1997 NIRC, as amended, provides:

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[52] Page 316, BIR Records
[53] Exhibit "J-2"

"**SECTION 34.** *Deductions from Gross Income. –*

(A) *Expenses. –*

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

(a) *In General.* – There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation, and/or conduct of the trade, business or exercise of a profession, including: xxx"

As discussed above, a taxpayer may claim deductions from its gross income, provided that he must clearly point to a specific provision of the statute in which such are authorized. He must prove further that he is entitled to the deductions which the law allows. Thus, in order to be deductible under the cited provision, an item of expenditure must fall squarely within its language.[54]

Based on the evidence on record, the Court finds for the respondent.

Petitioner proffered its Schedule of Hauling and Loading Expenses for Clinker Sale,[55] and the testimony of Mr. Benigno Suerte Felipe Borlongan that the hauling and loading costs were supported by invoices.[56] However, the Court finds the same to be insufficient for no records of documents were presented to support the said expenses. Without the supporting documents such as invoices, the schedule standing alone cannot prove the payments made by petitioner. Even the testimony will not suffice if no records were presented for proper marking and identification.

As petitioner failed to substantiate the deduction of P24,076,347.49, respondent's disallowance of the said amount is hereby sustained.

[54] Commissioner of Internal Revenue vs. Atlas Consolidated Mining & Development Corporation, G.R. No. L-26924, January 27, 1981
[55] Exhibit "L.2"
[56] Pages 6-12, TSN, April 22, 2003

*Unreconciled difference in salaries and wages account*

Respondent considered as petitioner's additional income the amount of P85,451,373.18, representing the difference between the amount of P222,923,304.11 as reported in its Alpha List, and the amount of P137,471,930.93 as claimed in its Income Statement.[57]

| | | |
|---|---|---|
| Claimed per Income Statement | | |
| Fixed and Semi-Variable Cost | P 130,314,556.93 | |
| Operating Expenses | 7,157,374.00 | |
| Total | | P 137,471,930.93 |
| Per Alpha List (subject to withholding taxes) | | 222,923,304.11 |
| **Discrepancy** | | **P 85,451,373.18** |

To contest the above findings, petitioner presented a Reconciliation[58] prepared by Mr. Roelito Torres, which is shown below:

| | |
|---|---|
| Director's Bonus recorded as expenses in 1996 paid in March 1997 | P 98,097,773.97 |
| Provision for Contingencies on Retrenchment | (24,522,936.31) |
| Shared Expenses | (8,174,657.26) |
| Double Take-up of confidential payroll (Error by BIR) | 20,092,742.78 |
| Non Taxable Portion of 7Ms | (41,550.00) |
| **Total** | **P 85,451,373.18** |

Petitioner argues that it shared certain administrative expenses with its sister companies. The actual payments to certain employees, as well as the withholding and remittance of taxes on their compensation, were made by its sister companies. Since petitioner reimburses the same to the payor, it considered the same as an expense account.

The Court finds that based on petitioner's Alpha List of Employees, as submitted to the respondent, the amount of P20,092,742.78 contained in Page 306 of the BIR Records is similar to that of reflected in Pages 308 to 311 of the same records. Hence, there is a double take-up of confidential payroll that the amount of P20,092,742.78 should indeed not form part in the final computation of the assessment.

[57] Page 312, BIR Records
[58] Exhibit "H"

Further, respondent merely considered the taxable income of certain employees in the amount of P101,000,441.28, and failed to account the non-taxable portion of compensation of certain employees as per petitioner's Alpha List.[59] Thus, the same should be excluded in the deficiency computation.

As to the Director's bonuses, provision for contingencies on Retrenchment, as well as the alleged shared expenses in the total amount of P65,400,180.40, the Court finds the same to be bereft of merit.

Petitioner's witness, Mr. Roelito Torres, claimed that the amount of P65,400,180.40 was the exact amount of Director's bonus and expense incurred in 1996 and paid in 1997.[60] However, the Court cannot ascertain the claim because petitioner presented no evidence to prove that it had indeed accrued as expense the director's bonuses in 1996, as well as, the withholding taxes paid thereto in 1997. Hence, for petitioner's failure to support it's claim, the assessment pertaining to the difference in the salaries and wages account is hereby upheld but in the reduced amount of P65,400,180.40.

*Undeclared sales*

Petitioner's reported sales in its Income Statement amounted to P3,499,949,118.00. Whereas, in its Withholding Tax Certificates claimed per Income Tax Return, petitioner declared the total sales of P3,501,410,687.00. A difference of P1,461,569.00, which respondent considered as petitioner's undeclared sales subject to income tax.[61]

However, on record, petitioner had paid the amount of P1,070,550.91,[62] which represents 35% of the its undeclared sales, plus increments thereof. Thus, petitioner's assessment for deficiency income tax on undeclared sales is deemed satisfied.

[59] Page 154, BIR Records
[60] Pages 12-19, TSN, May 20, 2002
[61] Page 444, BIR Records
[62] Exhibits "U" and "Y"

From the foregoing, the assessment for deficiency income tax is hereby revised, as follows:

| | | | |
|---|---|---|---|
| Net Income Per Return | | | P 629,089,396.00 |
| Adjustments to taxable income: | | | |
| A. | Overstatement of Cost of Sales by - | | |
| | A.1 Charging to Cost of Sales the Value of Obsolete Inventories (Fire Bricks) - Spare Parts Account | P 23,800,566.25 | |
| | A.2 Reduction in Value of Work-in Process - Clinker, in Ending Inventory | 11,495,217.00 | |
| | A.3 Overstatement of variable cost of sold clinker | 24,076,347.49 | 59,372,130.74 |
| B. | Unreconciled difference in the Salaries and Wages Account | | 65,400,180.40 |
| Net Taxable Income per Investigation | | | P 753,861,707.14 |
| Income Tax Due | | | P 263,851,597.50 |
| Less: | Creditable tax withheld | P 35,014,106.87 | |
| | Quarterly tax payments | 185,167,182.13 | 220,181,289.00 |
| Deficiency Income Tax | | | P43,670,308.50 |
| Add: | Increments | | |
| | Surcharges | P 10,917,577.12 | |
| | 20% Interest - 4/16/98 to 12/31/99 | 14,955,585.10 | 25,873,162.22 |
| **TOTAL DEFICIENCY INCOME TAX** | | | **P 69,543,470.72** |

Further, the compromise penalty of P25,000.00 cannot be imposed for want of compromise agreement between the parties.

Hence, petitioner is liable for the amount of P69,543,470.72 relating to its deficiency income tax.

*Deficiency Value-Added Tax*

Petitioner's deficiency VAT[63] are as follows:

| | | |
|---|---|---|
| GROSS SALES PER VAT RETURNS | | P 3,567,630,792.80 |
| Adjustments to Sales: | | |
| Undeclared Sales – (Sec. 100, NIRC) | | |
| Sales per ITR | P 3,499,949,118.00 | |
| Sales evidenced by Withholding tax certificates claimed per ITR | 3,501,410,687.00 | 1,461,569.00 |
| TOTAL VATABLE SALES PER INVESTIGATION | | P 3,569,092,361.80 |
| OUTPUT TAX DUE | | P 356,909,236.18 |
| LESS: ALLOWABLE INPUT TAXES | | |
| Claimed per returns | | 132,491,284.27 |
| VAT PAYABLE | | P 224,417,951.91 |
| LESS: TOTAL VAT PAYMENTS | | 224,271,795.01 |

[63] Supra, note 4

| | | |
|---|---|---|
| DEFICIENCY VALUE-ADDED TAX – (Basic) | | P 146,157.00 |
| ADD: INCREMENTS | | |
| 20% INTEREST (01/21/98 – 12/31/99) | 58,462.80 | |
| Compromise penalty | 10,000.00 | 68,462.80 |
| **TOTAL DEFICIENCY VALUE-ADDED TAX** | | **P214,619.80** |

Respondent maintains that the deficiency assessment was derived from subjecting to VAT the difference between petitioner's sales per its ITR as against the sales evidenced by withholding tax certificates claimed per ITR. Respondent further argues that since the assessment for deficiency VAT was not protested by petitioner, the same has become final, executory and demandable.

On January 9, 2007, petitioner manifested that it had paid the VAT, inclusive of penalties and surcharges;[64] and presented its BIR Payment Form (BIR Form No. 0605)[65] and BIR Tax Payment Deposit Slip issued by the Land Bank of the Philippines.[66]

Considering that Termination Letter and Authority to Cancel Assessment are relevant only in cases of Abatement of Penalties/Surcharges and Interest on disputed assessment, in accordance with Section 5 of Revenue Regulations No. 15-2007, the same is not required herein.

Since petitioner had settled the full amount of the assessment, Assessment Notice No. ST-VAT-97-0108-2000 is hereby deemed cancelled.[67]

*Deficiency Expanded Withholding Tax*

Petitioner's deficiency withholding taxes for the year 1997[68] are as follows:

| | Gross Amount | Tax Rate | Tax Due |
|---|---|---|---|
| Various Contractors | P 1,480,198,893.38 | 1% | P 14,801,988.93 |
| Management Fee | 33,800,768.00 | 5% | 1,690,038.40 |
| Professional & Director's Bonus | 5,306,404.70 | 10% | 530,640.47 |
| Rent Expense | 4,014,584.02 | 5% | 200,729.20 |
| Increase in Assets: | | | |
| Plant, Property & Equipment | 269,837,921.00 | 1% | 2,698,379.21 |

64 Page 598, CTA Records
65 Exhibit "W"
66 Exhibit "X"
67 Exhibit "B-1"
68 Supra, note 4

| | | | |
|---|---|---|---|
| Construction in Progress | 35,278,045.00 | 1% | 352,780.45 |
| EWT due per Investigation | | | P 20,274,556.66 |
| Less: Withheld and Remitted per 1743 IR | | | 16,572,411.47 |
| Deficiency Expanded Withholding Tax per Investigation | | | P 3,702,145.19 |
| Add: Increments | | | |
| 25% Surcharge - non withholding | | | 925,536.30 |
| 20% Interest from 1/26/98 to 12/31/99 | | | 1,851,072.60 |
| Compromise penalty | | | 25,000.00 |
| **TOTAL DEFICIENCY EXPANDED WITHHOLDING TAX** | | | **P 6,503,754.09** |

Respondent asserts that petitioner failed to withhold and remit the proper withholding tax due on its income payments made which were claimed as expense and as increase in assets.

Petitioner, on the other hand, maintains that the expenses and increases in assets actually pertained to payments made to tax-exempt payees and payments for the importation of equipment, materials, tools, and supplies. Hence, there is no basis for the assessment of deficiency expanded withholding tax.

Nevertheless, in a Manifestation filed on February 26, 2007, petitioner submitted copies of the receipts and proofs of payment for the abatement of its expanded withholding tax.[69] Petitioner paid the amount of P3,702,145.19 as its basic deficiency tax.[70]

However, petitioner presented neither Termination Letter nor Authority to Cancel the Assessment signed by the respondent Commissioner of Internal Revenue.[71] Hence, petitioner is still liable for the following, *viz*: surcharge in the amount of P925,536.30, and interest in the amount of P1,851,072.60; or an aggregate of P2,776,608.90.

Considering that an imposition of compromise penalty without the conformity of the taxpayer is illegal and unauthorized,[72] the same cannot be imposed in the present case.

Necessarily, petitioner is liable for the increments of its deficiency expanded withholding tax in the amount of P2,776,608.90.

[69] Pages 601-608, CTA Records
[70] Pages 606-608, CTA Records
[71] Section 5, Revenue Regulations No. 15-2007
[72] Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., G.R. No. 35266, January 21, 1991; Atlas Consolidated Mining and Development Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5671, August 29, 2002

*Deficiency Final Withholding Tax*

Petitioner's deficiency final tax[73] is as follows:

| | | |
|---|---|---|
| Claimed per F/S | | P 15,256,375.00 |
| Tax Rate | | 20% |
| Tax Due per Investigation | | P 3,051,275.00 |
| Less: | Withheld & Remitted | |
| | Per 1743 IR | 2,204,798.84 |
| Deficiency Final Tax | | P 846,476.16 |
| Add: | Increments | |
| | 25% Surcharge | 211,619.04 |
| | 20% interest from 1/26/98 to 12/31/99 | 423,238.08 |
| | Compromise Penalty | 25,000.00 |
| **TOTAL DEFICIENCY FINAL TAX** | | **P 1,506,333.28** |

For failure to fully subject to final tax the royalty expense claimed in its Audited Financial Statement, respondent assessed petitioner of deficiency final withholding tax.

Petitioner counters that it may treat as an expense in a taxable year, the payments of royalties actually made in an earlier or succeeding taxable year. Hence, the payments for the period subject to final tax are not necessarily the same amount as claimed as expenses in financial statements.

Nevertheless, in the same Manifestation filed by petitioner on February 26, 2007, it submitted copies of the receipts and proofs of payment for the abatement of its final withholding tax.[74] Petitioner paid the amount of P846,476.16 representing its basic deficiency tax.[75]

Yet, no Termination letter or Authority to Cancel the Assessment was presented.[76] Hence, for such failure, petitioner is still liable for the surcharge of P211,619.04 and the interest of P423,238.08; or an aggregate of P634,857.12.

[73] Supra, note 4
[74] Pages 601-608, CTA Records
[75] Pages 603-605, CTA Records
[76] Section 5, Revenue Regulations No. 15-2007

*Deficiency Tax Assessments*

In sum, the Court finds for respondent as to the deficiency tax assessments for income, expanded withholding, and final withholding, but in the reduced amount of P72,954,936.74, computed, as follows:

| | Basic Tax | Surcharges | Interest | Total | Payment per Abatement Program | Total Amount Due |
|---|---|---|---|---|---|---|
| Deficiency Income Tax | P 43,670,308.50 | P 10,917,577.12 | P 14,955,585.10 | P 69,543,470.72 | | **P 69,543,470.72** |
| Deficiency Expanded Withholding Tax | 3,702,145.19 | 925,536.30 | 1,851,072.60 | 6,478,754.09 | P3,702,145.19 | **2,776,608.90** |
| Deficiency Final Tax | 846,476.16 | 211,619.04 | 423,238.08 | 1,481,333.28 | 846,476.16 | **634,857.12** |
| TOTALS | P 48,218,929.85 | P 12,054,732.46 | P 17,229,895.78 | P 77,503,558.09 | P 4,548,621.35 | P 72,954,936.74 |

In addition, petitioner is liable to pay the 20% delinquency interest of the total deficiency tax due of P72,954,936.74, computed from February 17, 2000 until full payment thereof pursuant to Section 249(c) of the 1997 NIRC, as amended.

**WHEREFORE,** premises considered, the Petition for Review is hereby **DENIED.** Petitioner is hereby **ORDERED** to **PAY** the deficiency tax assessment of P72,954,936.74 plus 20% delinquency interest from February 17, 2000 until full payment thereof.

**SO ORDERED.**

**CAESAR A. CASANOVA**
Associate Justice

**WE CONCUR:**

**ERNESTO D. ACOSTA**
Presiding Justice

**LOVELL R. BAUTISTA**
Associate Justice

# CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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's Division.

**ERNESTO D. ACOSTA**
Presiding Justice
Chairman, First Division