REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

SURIGAO MICRO CREDIT CORPORATION,
Petitioner,

-versus-

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 9108

Members:

CASTAÑEDA, JR.,
Chairperson
CASANOVA, *and*
MANAHAN, *JJ.*

Promulgated:
JAN 09 2018
2:50 p.m.

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D E C I S I O N

MANAHAN, *J.:*

This involves a Petition for Review filed on July 17, 2015 by Surigao Micro Credit Corporation, as petitioner, against the Commissioner of Internal Revenue, as respondent, before the Court in Division.

Petitioner seeks the cancellation and withdrawal of the deficiency income tax (IT), value-added tax (VAT) and documentary stamp tax (DST) assessments issued against it for taxable year 2007 detailed as follows:

I. IT	₱	137,007.85
II. VAT		74,217.19
IV. DST		2,279.57
VI. Compromise Penalties		24,600.00
TOTAL	**₱**	**238,104.61**

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THE PARTIES

Petitioner is a domestic corporation organized and existing under the laws of the Philippines. It is duly registered with the Securities and Exchange Commission (SEC) as a lending investor with principal place of business at Roxas corner Gimena Streets, Surigao City.

Respondent is the duly appointed Commissioner of Internal Revenue (CIR), head of the Bureau of Internal Revenue (BIR) who is vested with the powers and duties, among others, to assess and collect all national internal revenue taxes and to decide, approve and grant tax protests. He holds office at the 5th floor, BIR National Office Building, BIR Road, Diliman, Quezon City.

FACTS

As stated in the Joint Stipulation of Facts and Issues (JSFI)[1] filed with this Court on 11 December 2015, the factual antecedents are as follows:

> "2. On September 8, 2008, Letter of Authority (LOA) No. 00078811 was issued authorizing Revenue Officer Ma. Lanie B. Literato of Revenue District Office (RDO) No. 105-Surigao City to examine the books of accounts and other records of the petitioner for taxable year 2007.
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> 3. A Preliminary Assessment Notice (PAN) dated June 23, 2009 was issued by the BIR OIC Regional Director Eduardo T. Bajador and served on the petitioner for a total due and collectible tax of Php250,708.25.
>
> 4. An amended PAN dated April 29, 2010 was issued by the BIR OIC Regional Director Bajador and likewise served on the petitioner.
>
> 5. Regional Director Bajador issued a Formal Letter of Demand (FLD) dated July 9, 2010 and an Audit Results/Assessment Notice with Assessment Number 105-R-108-04-000984.
>
> 6. Respondent Commissioner of Internal Revenue issued the Decision dated June 5, 2015 denying Petitioner's protest.
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> 7. The existence and genuineness of the following documents:

[1] Joint Stipulation of Facts and Issues ("JSFI"), Docket, pp 291-299.

a. Letter of Authority No. LOA -2000-00078811 dated September 8, 2008;
b. Amended Post-Reporting Notice dated November 09, 2009 with attached Details of Discrepancies and Computations;
c. Preliminary Assessment Notice (PAN) dated June 23, 2009;
d. Amended Preliminary Assessment Notice dated April 19, 2010 with Attached Details of Discrepancies;
e. Formal Letter of Demand dated July 09, 2010 with Attached Details of Discrepancies;
f. Audit Result/Assessment Notice for deficiency income tax;
g. Audit Result/Assessment Notice for deficiency Income Tax;
h. Audit Result/Assessment Notice for deficiency Compromise Penalty;
i. Audit Result/Assessment Notice for deficiency Documentary Stamp Tax;
j. Final Decision on Disputed Assessment dated June 05, 2015."

Records also show that pending the issuance of the final decision of the respondent on its appeal, the Revenue District Officer issued a warrant of distraint and/or levy[2] and warrants of garnishment on several bank accounts belonging to the petitioner.

On 12 October 2015, respondent filed her Answer[3] interposing the following Special and Affirmative Defenses:

"RESPONDENT OBSERVED BOTH PROCEDURAL AND SUBSTANTIVE DUE PROCESS IN ISSUING THE ASSESSMENT.

4. The assessment for deficiency Income Tax, VAT, Documentary Stamp Tax and Compromise Penalties in the amount of P238,104.61 for calendar year 2007 was made in accordance with law, rules and jurisprudence.

5. Respondent accorded procedural and substantial due process to petitioner in issuing the assessment subject of this case. The Letter of Authority (LOA), Post Reporting Notice, Preliminary Assessment Notice with attached Details of Discrepancies, Formal Letter of Demand with

[2] Exhibit "P15", Docket, page 269.
[3] Docket, pp. 139-154.

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Attached Details of Discrepancies as well as Audit Result/Assessment Notice and Final Decision on Disputed Assessment were issued in accordance with law, rules and jurisprudence.

6. Petitioner was also informed of the factual and legal basis of the assessment. The Preliminary Assessment Notice with attached Details of Discrepancies, Formal Letter of Demand with attached Details of Discrepancies as well as Audit Result/Assessment Notice and Final Decision on Disputed Assessment indicated not only the deficiency tax involved, surcharge and interest due thereon, but also sufficiently stated the facts, the law, rules and regulations on which the assessment is based.

7. In the instant case, petitioner was able to protest on the assessment since the Preliminary Assessment Notice with attached Details of Discrepancies, Formal Letter of Demand with attached Details of Discrepancies as well as Audit Result/Assessment Notice and Final Decision on Disputed Assessment sufficiently stated the facts and the law on which the assessments were based.

8. In the case of *Agrinurture Inc. vs. Commissioner of Internal Revenue,* the Honorable Court of Tax Appeals held, to wit:

> "The law requires that the taxpayers should be informed of the legal and factual bases of the assessment. However, the assessment notices need not be a full narration of the facts and laws on which the assessment is based. Thus, so long as the parties are notified and given the opportunity to explain their side, the requirements of due process are satisfactorily complied with."

THE ASSESSMENT ISSUED AGAINST PETITIONER IS VALID AND LAWFUL.

9. Assessments are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is prima facie valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously. *(Marcos II vs. Court of Appeals G.R. No. 120880 June 5, 1997)*

10. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only

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that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise, the presumption of correctness of tax assessment stands (*Commissioner of Internal Revenue vs. Hantex Trading Co. Inc., G.R. No. 136975. March 31, 2005*). The presumption in favor of the correctness of tax assessment stands where evidence to the contrary is wanting. Hence, the assessment issued against petitioner is imbued with factual and legal bases.

11. All presumptions are in favor of the correctness of tax assessments (*Sy Po vs. Court of Tax Appeals, 164 SCRA 524*). Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice.

PETITIONER IS LIABLE TO PAY DEFICIENCY INCOME TAX, VAT, DOCUMENTARY STAMP TAX AND COMPROMISE PENALTIES IN THE AGGREGATE AMOUNT OF P238,104.61.

12. The Revenue Officers performed a comprehensive audit procedure taking into account relevant documents. Consequently, petitioner is liable to pay deficiency Income Tax, VAT and Documentary Stamp Tax for calendar year 2007 in the aggregate amount of P213,504.61."

Respondent and petitioner filed their respective Pre-trial Briefs [4] on November 4, 2015 and December 7, 2015, respectively.

On December 11, 2015, the parties filed their JSFI by registered mail and a Pre-Trial Order[5] was issued on January 19, 2016.

During trial proper, petitioner presented Mr. Florido Casuela, a Director and Corporate Secretary of petitioner.

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[4] Docket, pp 158-164; pp 169-177.
[5] Docket, pp. 310-316.

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On March 21, 2016, petitioner filed its Formal Offer of Evidence (FOE) with Motion to Substitute Exhibit "P-5"[6] via courier to which respondent filed her Comment on same date.

On April 20, 2016, the Court resolved[7] petitioner's FOE admitting some of the documentary evidence but denied the admission of several exhibits for failure to submit the originals for comparison.

Upon Partial Motion for Reconsideration filed by petitioner on May 10, 2016, the Court granted the admission of some evidence but still retained its resolve to deny a few other exhibits in its Resolution dated June 9, 2016.[8]

Respondent presented witnesses, Lanie Literato, the revenue officer who conducted the audit investigation of the books of accounts and other accounting records of petitioner for the taxable year 2007 and Olivia Rosales, the revenue officer who reviewed the findings/recommendation of Lanie Literato and who prepared the PAN and the FLD/FAN.

On August 2, 2016, respondent filed her Formal Offer of Documentary Evidence [9] to which petitioner filed its Comments/Objections on November 16, 2016.[10]

On December 2, 2016, the Court admitted Exhibits "R-1","R-2", "R-3", "R-4","R-5", "R-6", "R-7", "R-8", "R-9", "R-10", "R-11", "R-12", "R-14", "R-14a", "R-15", "R-15-a", "R-15-b", "R-15-c", "R-15-d", "R-19", "R-20", "R-21", "R-22", "R-22-a", "R-23", and "R-23-a".

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[6] Docket, pp. 343- 348.
[7] Docket, pp. 358-359.
[8] Docket, pp. 389-393.
[9] Docket, pp. 413-422.
[10] Docket, pp. 437-440.

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In the same Resolution admitting respondent's evidence on December 2, 2016, the Court directed the parties thirty (30) days from receipt to file their respective memoranda[11].

Respondent filed his Memorandum[12] on January 03, 2017, followed by petitioner's Memorandum[13] filed on January 26, 2017. The case was deemed submitted for decision on January 31, 2017.[14]

ISSUES

The issues raised by the parties in their JSFI are as follows:

a. Whether or not the Petitioner is liable to pay the assessed IT, VAT, DST and Compromise Penalties for taxable year 2007 in the aggregate amount of P238,104.61 as well as deficiency and delinquency interest as provided in Sections 248 and 249 of the National Internal Revenue Code (NIRC), as amended;

b. Whether or not the Petitioner was informed of the legal bases for the assessments made.

Petitioner's Arguments

Petitioner preliminarily raises the issue of failure of the BIR Regional Director to properly indicate in the final assessment the legal bases of his findings in violation of the provisions of Section 228 of the NIRC and Revenue Regulations (RR) No. 12-99. Petitioner claims that the assessments were not supported by any jurisprudence, rules and regulations, or any accepted accounting convention to justify the method of computation made by his revenue examiners.

On the substantive aspect of the assessment, petitioner argues that the findings of the revenue examiner stemmed from the erroneous approach of the revenue examiner in appreciating the figures appearing in its audited financial statements for taxable year 2007. The assessments for IT and VAT arose from

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[11] Docket, pp. 447- 448.
[12] Docket, pp. 449-463.
[13] Docket, pp.469-484.
[14] Docket, p. 487.

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the difference in the preparation of Petitioner's Statement of Cash Flows for the taxable year 2007 prepared by the Independent Certified Public Accountant (ICPA) as compared with the recasted Statement of Cash Flows prepared by the revenue officer who conducted the audit. The resulting difference arose from the alleged undeclared cash receipts originating from the treatment of loans written off for taxable year 2006, which was not the taxable year being audited.[15] The recasted Statement of Cash Flows by the revenue examiners showed a total increase of Php3,180,829.83 from Loans and Discounts account.

As shown in the Details of Statement of Cash Flows Per Audit prepared by the revenue officer, the total increased amount of Php3,180,829.83 was computed as follows:

Per BIR

	2006	**2007**	**Increase (Decrease)**
Loans Receivable, Salary (Current)	₱ 2,099,145.13	₱ 518,262.27	
Loans Receivable, Individual (Current)	4,009,109.33	6,139,021.23	
Loans Receivable, Micro (Current)	2,092,205.32	1,713,764.10	
Past Due Loans	17,314,607.37	18,710,347.87	
Accounts Receivable	163,901.43	135,924.73	
Employee Advances	26,219.77	31,971.67	
Total	**₱25,705,188.35**	**₱27,249,291.87**	
Add: Accounts Actually Written-Off	441,510.50	2,078,236.81	
Total	**₱26,146,698.85**	**₱29,327,528.68**	**₱3,180,829.83**

To illustrate the difference, the details of the computation of petitioner of its Cash Flows for 2007 are provided below, thus:

Per petitioner

	2006	**2007**	**Increase (Decrease)**
Loans Receivable, Salary (Current)	₱ 2,099,145.13	₱ 518,262.27	
Loans Receivable, Individual (Current)	4,009,109.33	6,139,021.23	
Loans Receivable, Micro (Current)	2,092,205.32	1,713,764.10	
Past Due Loans	17,314,607.37	18,710,347.87	
Accounts Receivable	163,901.43	135,924.73	
Employee Advances	26,219.77	31,971.67	
Total	**₱25,705,188.35**	**₱27,249,291.87**	
Add: Accounts Actually Written-Off		2,078,236.81	
Total	**₱26,146,698.85**	**₱29,327,528.68**	**₱3,622,340.33**
Variance			**₱ 441,510.50**

[15] Memorandum, Docket, page 474.

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To compare the two versions of the computation (BIR vs. petitioner), there is a discrepancy of Php441,510.50 which petitioner attributes to the accounts written off for 2006 which were added back by the revenue officer in her computation of the increase/decrease in the receivables account to compute its cash flows for 2007. Petitioner maintains that amounts written off in 2006 should no longer be added back to the receivables account to compute the cash flows of 2007 in accordance with the Philippines Accounting Standards (PAS) 7 governing the preparation of the Statement of Cash Flows.

According to petitioner, the 2006 books were already closed after the adjusting and closing entries were made. Petitioner maintains that the 2007 balance for the loans and discounts account already considered the effects of the write-offs for 2006.[16] Hence, adding back the accounts already written off during the previous taxable year is erroneous and does not conform to the aforecited PAS 7 and to the basic framework of the financial reporting standards of the Financial Reporting Standards Council (FRSC) of the Philippines. Petitioner claims that the revenue officer only added back the accounts actually written off for 2006 without making the necessary adjustments to the allowance for doubtful accounts making it appear that there are so-called unrecorded cash receipts for 2007 of the accounts written-off in 2006 when there was actually none.

Petitioner also noticed that there were items in the Statement of Cash Flows (as prepared by petitioner) that were not considered by the revenue officer in her recasted Statement of Cash Flows and there were no explanations as to why they were excluded. A portion of the beginning balance of impairment losses was reclassified to past due receivables in the amount of Php1,510.50 which also increased the contra-account, impairment allowance by the same amount.[17]

Another discrepancy in the amount of Php17,370.50 in the cash used in investing activity is illustrated below:

<u>Cash Flows from Financing Activities</u>

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[16] Paragraph 29, Petition for Review, Docket, page 20.
[17] Paragraph 30, Petition for Review, Docket, page 21.

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Per petitioner	Php127,022.50
Per BIR audit	109,652.00
Variance	**17,370.50**

The amount of Php127,022.50 represents the net acquisition of fixed assets as declared by the petitioner. The discrepancy was explained by the petitioner as being a mere difference in the classification of certain accounts and treatment expenses.

Petitioner further submits that the revenue officer's computation of the cash used for investing activity is correct. However, the revenue officer should have correspondingly adjusted the amounts and affected accounts by reclassification which resulted to an unaccounted outflow in the amount of Php17,370.50. This variance, according to petitioner may be accounted for by the following:

Purchase of Office Equipment	(315.00)
Amortization of Miscellaneous Assets	1,884.00
Leasehold expenditures	15,801.50
Total	**17,370.50**

A small item (office equipment) costing Php315.00 was recorded by petitioner as a miscellaneous expense as part of the operating activities and accounted for under the "Other Assets" account. According to petitioner, the revenue officer re-classified this as a "fixed asset" which is an investing activity. To follow the re-classification done by the revenue examiner, the "Other Assets" account for 2007 must be decreased by Php315.00 while the "Fixed Assets" account should be increased by the same amount in petitioner's cash flow statement for 2007. Such reclassification must have no effect on cash and subsequently there is no unrecorded cash receipt if necessary adjustments in the aforesaid account balances were made.[18] Petitioner then posits the query that if there is no unrecorded cash receipt how can there be income subject to IT and VAT.

Overall, petitioner claims that it has no unrecorded cash receipts during taxable year 2007 and attributes the contrary conclusion of the revenue examiner to the latter's failure to follow the fundamental principles of accounting. It is petitioner's theory that the assessed deficiency IT and VAT are

[18] Memorandum, Docket, page 481.

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only due to the difference in the preparation of cash flows and classification of accounts as described above.

Respondent's Counter-Arguments

Respondent, on the other hand, submits that assessments are presumed correct and made in good faith and that in the absence of proof of any irregularities in the performance of official duties, an assessment must not be disturbed.[19]

As to the substantive elements of the assessment in question, respondent stands firm in her belief that the revenue officers performed a comprehensive audit procedure taking into account relevant documents. Consequently, petitioner is liable to pay deficiency IT, VAT and DST for calendar year 2007 in the aggregate amount of Php213,504.61.

RULING OF THE COURT

Jurisdiction of the Court of Tax Appeals

Before we delve into the issues raised by both parties in this case, this Court finds it proper to discuss the jurisdiction of this Court to take cognizance of the instant petition.

As a court of special or limited jurisdiction, the CTA can only take cognizance of matters that are within its jurisdiction as provided by Republic Act (R.A.) 1125 as amended by R.A. 9282, thus:

> "Section 7. Jurisdiction. – The CTA shall exercise:
>
> (a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
>
> (1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National

[19] Memorandum, Docket, page 452.

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Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;"

xxx xxx xxx

It is well-settled that the perfection of an appeal in the manner and within the period pursuant to the relevant provisions of the law is not only mandatory but jurisdictional and non-compliance with these legal requirements is fatal to a party's cause.[20]

Section 228 of the NIRC of 1997, as amended, provides:

"**SEC. 228. Protesting of Assessment.** - When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: Provided, however, That a pre-assessment notice shall not be required in the following cases:

(a) When the finding for any deficiency tax is the result of mathematical error in the computation of the tax as appearing on the face of the return; or

(b) When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent; or

(c) When a taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year; or

(d) When the excise tax due on excisable articles has not been paid; or

(e) When the article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, traded or transferred to non-exempt persons.

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[20] *Team Pacific Corporation vs. Daza*, G.R. No. 167732, July 11, 2012.

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> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, *the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision*, or from the lapse of one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable." (italics ours)

Based on the foregoing facts as stated, petitioner received the Final Decision on the Disputed Assessment (FDDA) dated June 5, 2015[21] on July 1, 2015.[22] The FDDA concluded its discourse in the following manner:

> "Consequently, Surigao Micro Credit Corporation is hereby ordered to pay the aforestated amounts, plus increments that have accrued thereon until the actual date of payment, to the Collection Service, BIR, National Office, Diliman, Quezon City, within thirty days from receipt hereof, otherwise collection thereof will be effected through the summary remedies provided by law.
>
> This constitutes the Final Decision on the matter."

Petitioner then had thirty (30) days from receipt of the FDDA on July 1, 2015 or until August 3, 2015 within which to appeal such FDDA.

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[21] Exhibit "P19", Docket, pp. 273 to 286.
[22] Paragraph 19, Petition for Review, Docket, page 15.

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Since the Petition for Review was filed on July 31, 2015, the petition was timely filed.

The Court shall now proceed with the main issues of this case.

Petitioner was sufficiently informed of the law and the facts upon which the assessment is based.

Petitioner primarily asserts that the Final Assessments should be canceled because it did not contain facts and statements that would sufficiently apprise it of the legal bases of the alleged deficiency taxes in violation of Section 228 of the NIRC and RR No.12-99.

We disagree.

The aforequoted Section 228 of the NIRC in part provides that the taxpayers shall be informed in writing of the law and the facts on which the assessment is made otherwise the assessment is void. This was further implemented by Section 3.1.4 of RR No. 12-99 in this way:

> "3.1.4- Formal Letter of Demand and Assessment Notice.- The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. *The letter of demand calling for the payment of taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void."* (italics ours)

Based on the above provisions of the law and regulations, a taxpayer has the right to be fully informed of the law and the facts upon which an assessment is based, the purpose being that the taxpayer should be given the opportunity to refute the findings of the examiners and give its own version or explanation with respect to the alleged findings of deficiencies or discrepancies. This stems from the basic constitutional principle that no person shall be deprived of his property without due process of law.

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Records show that the FLD dated July 9, 2010[23] contains a complete computation on how the examiner arrived at the total tax deficiencies of petitioner supported by details of discrepancies which would sufficiently apprise the petitioner of the facts and basis of the assessments. In fact, the petitioner was able to effectively prepare a protest letter[24] in response to the FLD where it provided its own rebuttal against the findings of the revenue examiners and asserted its own interpretation on how the items in the financial statements should be treated and analyzed. The Supreme Court in the case of *Samar I-Electric Cooperative vs. CIR*[25], took note of the fact that taxpayer was able to effectively prepare a protest letter that belied its allegation that it was not fully informed of the basis of the assessment, and we quote:

> "Respondent had fully informed petitioner in writing of the factual and legal bases of the deficiency taxes assessment, which enabled the latter to file an "effective protest", much unlike the taxpayer in Enron. Petitioner's right to due process was thus not violated."

It is worthy to emphasize that assessment notices need not be a *full* narration of the facts and the laws on which the assessment is based. It is sufficient that the taxpayer be substantially informed of the law and the facts on which the assessment for a tax liability is made. In the case of *Calma et.al. vs. Court of Appeals* [26], the Supreme Court said that "administrative due process requires notice and an opportunity to be heard before judgment is rendered. So long as the parties are given the opportunity to explain their side, the requirements of due process are satisfactorily complied with."

An analysis of the of the protest filed against the FLD shows that petitioner knew the basis of the assailed assessment and in fact refuted the findings of the respondent claiming that it was due to the latter's incorrect reconciliation of the Statement of Cash Flows resulting to the discrepancies mentioned in the assessments.

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[23] Exhibit P7, Docket, pp 223-225.
[24] Exhibit P8, Docket, pp 226-227.
[25] G.R. No. 193100, December 10, 2014.
[26] G.R. No. 122787, February 9, 1999.

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Based on the above, we give no merit to petitioner's contentions that the assessments failed to mention the legal bases in violation of Section 228 of the NIRC and RR No.12-99.

Alleged Deficiency IT, VAT and DST

I. IT

Respondent assessed petitioner for deficiency IT in the total amount of Php137,007.85, inclusive of surcharge and interest, for taxable year ended December 31, 2007, detailed as follows:[27]

Net Taxable Income (Loss) per return		₱ (985,939.56)
Add (Less): Adjustments		
Undeclared gross receipts (P460,391.50 – P20,380.88)	₱ 440,010.62	
Disallowed Interest & Financing expenses	8,559.97	
Disallowed Impairment Loss	2,956,100.00	
Bad Debts Written-Off	(2,078,236.81)	1,326,433.78
Net Taxable Income per audit		**₱ 340,494.22**
Tax Due		₱ 119,172.98
Less: Payments for the 1st three (3) quarters	₱ 12,270.21	
Tax Paid per Annual ITR (OR #04089467 dated 04/10/08)	26,725.38	38.995.59
Income Tax Still Due		₱ 80,177.39
Add: 25% Surcharge	₱ 20,044.35	
Interest (04/15/08 – 07/31/10)	36,786.11	56,830.46
Total Income Tax Deficiency		**₱ 137,007.85**

As can be seen from the above figures, a major portion of the IT deficiency stems from the adjustments made by the revenue examiner on the following items:

A.	Undeclared gross receipts	₱ 440,010.62
B.	Disallowed Interest & Financing expenses	8,559.97
C.	Disallowed Impairment Loss (₱2,956,100.00 less ₱2,078,236.81)	877,863.19

We shall discuss each item *in seriatim.*

A. Underdeclared gross receipts

[27] Formal Letter of Demand, Exhibit "P7", Docket, page 223.

A substantial portion of the IT assessment resulted from the alleged underdeclared gross receipts of petitioner as found by the revenue examiner through a re-computation of the Statement of Cash Flows based on petitioner's financial statements and accounting records for taxable year 2007. According to petitioner, this amount represents the accounts written off for 2006 which was added back by the revenue officer in her computation of the increase/decrease in the receivables account to compute petitioner's cash flows for 2007. A portion of the beginning balance of impairment losses allowance was reclassified to past due receivables in the amount of ₱1,510.50 resulting to the amount of ₱441,510.50 representing the accounts actually written off for 2006.

Petitioner argues that the amount written off in 2006 should no longer be added back to compute the 2007 cash flows. The 2006 books were already closed after the adjusting and closing entries were made. It further asserts that the 2007 balance for the loans and discounts account already considered the effects of the write-offs for 2006.

In the earlier portion of this decision, we provided a comparative table of the computation of the revenue examiners vs. that of the petitioner where there was a variance in the amount of 441,510.50 resulting from the addition of the accounts written off in 2006 to compute the cash flows for 2007. Petitioner objects to this method as it was made to appear that there were collections/recoveries in 2007 where there was actually none.

Respondent in her Answer quoted the pertinent portion of the final decision on the protest filed by petitioner to the FLD and maintains that there is no merit in the allegation of petitioner that there was a mistake in computing the increase in loans and discounts by adding back the accounts written-off for the year 2006 amounting to ₱441,510.50 because the increase in loans and discounts per BIR and that of the petitioner are almost the same, as shown below:

Increase in Loans and Discounts	
Per BIR Statement of Cash Flows	₱ 3,180,829.83
Per SMCC's Statement of Cash Flows	(3,172,237.31)
Discrepancy	**₱ 8,592.52**

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We agree with the petitioner.

Having been determined as uncollectible, the Accounts Written-Off in the amount of Php441,510.50 no longer formed part of the Accounts Receivable of Php25,705,188.35 as of the beginning of 2007. Thus, collections during the year 2007 would only come from either the Accounts Receivable of Php25,705,188.35 or from the credit sales during the year 2007. To add back the said amount makes it appear that there were collections/recoveries in 2007 when in fact there was actually none.

B. Disallowed interest expense

Another source of the IT deficiency of petitioner was respondent's disallowance of petitioner's interest expense in the amount of Php8,559.97 pursuant to Section 34 (B) (1) of the NIRC, which states as follows:

> "Section 34. Deductions from gross income.-
>
> (B) Interest –
>
> > (1) In General – The amount of interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business shall be allowed as deduction from gross income: Provided, however, That the taxpayer's otherwise allowable deduction for interest expense shall be reduced by forty-two per cent (42%) of the interest income subjected to final tax: That effective January 1, 2009, the percentage shall be thirty-three per cent (33%)."

Based on the above provision of law, respondent computed the disallowance as follows:[28]

42% of Interest Income from Bank Deposits	
Interest Income	₱ 20,380.88
Rate	42%
Disallowed Interest expense	**₱ 8,559.97**

[28] Post Reporting Notice, Details of Discrepancy, Annex B-1 of the Petition for Review, Docket, pp.46-48.

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A perusal of the records of this case reveals that petitioner failed to refute the above disallowance made by the respondent in any of its protests nor raise it as an issue during the trial.

It is a basic principle in taxation that assessments are presumed correct and made in good faith and that the taxpayer has the burden of proving otherwise. The Supreme Court had the occasion to reiterate this basic doctrine in the case of *Marcos II vs. Court of Appeals, et.al.*[29], thus:

> "In the absence of proof of any irregularities in the performance of official duties, an assessment will not even be disturbed. xxx xxx xxx the burden of proof is upon the complaining party to show clearly that the assessment is erroneous. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessments."

Due to the failure of petitioner to dispute this particular findings/readjustment, we shall not disturb the conclusion of the respondent's revenue examiners as to the disallowed interest expense of Php8,559.97.

C. Disallowed Impairment Loss

Respondent found that out of petitioner's claimed deduction for Impairment Loss of Php2,956,100.00, only the amount of Php2,078,236.81 representing Bad Debts Written-Off is deductible pursuant to Section 34(D) of the NIRC. Hence, respondent disallowed the remaining claimed Impairment Loss in the amount of Php877,863.19.

Again, petitioner failed to refute this disallowance in its protests to the PAN[30] as well as to the FLD[31] and during trial of this case.

Similar to our conclusion in letter (b) on disallowance of interest expense above, we rule that the disallowance of impairment losses shall remain as it is undisputed.

Notwithstanding the foregoing conclusions, petitioner still incurred a net loss for taxable year 2007 in the amount of Php99,516.40, as computed below:

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[29] G.R. No. 120880, June 5, 1997.
[30] Annex F, Petition or Review, Docket, pp. 64-69.
[31] Annex "I", Petition for Review, Docket, pp. 10-27.

Net Loss per return		₱ (985,939.56)
Add (Less): Adjustments		
Disallowed Interest & Financing expenses	₱ 8,559.97	
Disallowed Impairment Loss	877,863.19	886,423.16
Adjusted Net Loss		**₱ (99,516.40)**

Thus, petitioner's income tax liability was still at the minimum corporate income tax (MCIT) rate of two percent (2%) based on its gross income for taxable year 2007. However, petitioner's MCIT liability per its 2007 Annual Income Tax Return shall be adjusted to reflect only the disallowed Interest & Financing Expenses of Php8,559.97 considering that the claimed Impairment Loss was not deducted by petitioner in determining its MCIT for 2007[32]. Hence, petitioner is liable for basic deficiency income tax in the amount of Php171.20, computed as follows:

Gross Income per 2007 ITR		₱1,949,779.50
Add: Disallowed Interest & Financing		8,559.97
Adjusted Gross Income		₱ 1,958,339.47
Income Tax Due (2%)		₱ 39,166.79
Less: Tax Credits/Payment		
Prior Year's Excess Credits other than MCIT	₱12,270.21	
Tax Payment	26,725.38	38,995.59
Basic Deficiency Income Tax		**₱ 171.20**

II. VAT

Respondent assessed the petitioner of deficiency VAT in the aggregate amount of Php74,217.20, detailed as follows:

Gross revenue per return		₱ 5,171,126.66
Add: Undeclared receipts		440,010.62
Gross taxable sales per audit		₱ 5,611,137.28
Output tax		₱ 673,336.47
Less: Input tax		27,182.62
VAT Payable		646,153.85
Less: Tax payments-Surigao City	₱ 596,097.56	

[32] Reconciliation of Net Income Per Books Against Taxable Income, BIR Records, p. 19.

Paranaque Branch	7,726.43	603,823.99
VAT Still due		42,329.86
Add: 25% Surcharge	₱ 10,582.47	
Interest (01/25/08 - 07/31/10)	21,304.87	31,887.34
Total Value-Added tax deficiency		**₱ 74,217.20**

The deficiency VAT arose from the unaccounted variance of undeclared gross receipts discussed earlier under the IT portion of this decision. Adjustments made to the gross revenue/receipts by the revenue examiners resulted to a deficiency VAT pursuant to Section 108 of the NIRC.

Accordingly and as earlier discussed, petitioner avers that it has no undeclared gross receipts for taxable year 2007 and that such variance was due mainly to the unique accounting adjustments made by the revenue examiners.

Considering that we have already ruled in favor of the petitioner relative to the alleged undeclared gross receipts, we find that the VAT assessment should likewise be canceled and withdrawn as this is mainly the result of the findings of under declaration of gross receipts by the revenue examiners which was debunked by the petitioner and upheld by this Court.

III. DST

Respondent claims that petitioner belatedly filed its DST returns for the months of January and February 2007 and failed to file DST returns for the months of April to June, August to December 2007.[33] Hence, respondent assessed petitioner for deficiency DST in the amount of Php2,279.57 and compromise penalties in the amount of Php4,100.00, detailed as follows:[34]

	Date Filed	Basic Tax	25% Surcharge	20% Interest	Total
January	2/9/2007	₱ 3,707.37	₱ 926.84	₱ 2.03	₱ 928.87
February	3/9/2007	5,391.00	1,347.75	2.95	1,350.70
Total Deficiency DST		**₱ 9,098.37**	**₱2,274.59**	**₱ 4.98**	**₱2,279.57**

Compromise Penalties	**Total**
Late filing of DST	₱ 2,500.00
Non-filing of DST Returns	1,600.00
	₱ 4,100.00

[33] Exhibit "P7", Details of Discrepancies, Docket, p. 225.
[34] Exhibit "P7", Docket, p. 224.

Petitioner conceded to the assessment by paying both the amounts of Php2,279.57[35] and Php4,100.00[36] on July 30, 2010. With the aforesaid payments, the Court cancels the deficiency DST assessment of Php2,279.57 and compromise penalties of Php4,100.00.

IV. Compromise Penalties

In addition to the above deficiency taxes, respondent also imposed compromise penalties for late payment of IT and VAT in the amount of Php20,500.00, broken down as follows:

Late payment of IT	₱ 12,000.00
Late payment of VAT	8,500.00
Total	**₱ 20,500.00**

We find the imposition of compromise penalties in the amount of Php20,500.00 bereft of merit. It is well-settled that the imposition of compromise penalties is based on mutual agreement between the parties in respect to the thing or subject matter so compromised and lack of conformity on the part of the taxpayer makes such imposition illegal and unauthorized.[37]

Since petitioner did not pay the compromise penalty imposed by the respondent, it did not agree to settle the same.

We therefore cancel the compromise penalties imposed by respondent in the amount of Php20,500.00 for lack of legal bases.

Wherefore, premises considered, the Petition for Review is **PARTIALLY GRANTED.** The assessments issued by respondent against petitioner for taxable year 2007 covering deficiency VAT in the amount of Php74,217.19 and compromise penalties for late payment of IT and VAT in the amount of Php20,500.00 are **CANCELLED**. However, the assessment for deficiency IT is **PARTIALLY UPHELD**. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **TWO HUNDRED FOURTEEN PESOS (Php214.00)** representing basic deficiency IT and the 25% surcharge imposed under Section 248(A)(3) of the NIRC, computed as follows:

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[35] Exhibits "P10" and "P10-A", Docket, pp. 234-235.
[36] Exhibits "P9" and " P9-A", Docket, pp. 232-233,
[37] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., and the Court of Tax Appeals, G.R. No. L-35266*, January 21, 1991.

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Basic Deficiency Income Tax	₱ 171.20
Add: 25% Surcharge	42.80
Total	**₱ 214.00**

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

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency Income Tax of Php171.20 computed from April 15, 2008 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) Delinquency interest at the rate of 20% per annum on the total amount of Php214.00, and on the 20% deficiency interest which have accrued as aforestated in (a), computed from August 1, 2015, until full payment thereof pursuant to Section 249 (C) of the 1997 NIRC, as amended.

SO ORDERED.

CATHERINE T. MANAHAN
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice