Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

EAST ASIA POWER RESOURCES, CORP., Petitioner,

CTA CASE No. 8182

Present:

-versus-

Castañeda, Jr., *Chairperson,*
Casanova, and
Cotangco-Manalastas, *JJ.*

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Promulgated:

JAN 15 2014 4:30 p.m.

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DECISION

CASTAÑEDA, JR., *J.*:

THE CASE

This case involves a Petition for Review filed by East Asia Power Resources Corporation to seek the cancellation of the Assessment Notices issued by the Commissioner of Internal Revenue for alleged deficiency internal revenue taxes (income tax, value-added tax, and expanded withholding tax) and compromise penalty covering taxable year 2006 in the aggregate amount of ₱31,618,493.25, inclusive of increments, broken down as follows:[1]

Tax Type	Basic Tax Due	Increments	Total
Income Tax	₱18,301,577.49	₱10,098,459.47	₱28,400,036.96
Value-added tax	1,733,339.18	956,423.32	2,689,762.50
Expanded withholding tax	314,485.52	189,208.27	503,693.79
Compromise penalty for non-submission of alphalist of employees	-	25,000.00	25,000.00
TOTAL	**₱20,349,402.19**	**₱11,269,091.06**	**₱31,618,493.25**

[1] Exhibits "F" to "F-7".

THE FACTS

Petitioner East Asia Power Resources Corporation is a corporation organized and existing under and by virtue of the laws of the Philippines, with principal place of business at Ground Floor PFDA Building, Navotas Fish Port Complex, Navotas City.[2]

On the other hand, respondent is the Commissioner of the Bureau of Internal Revenue (BIR), who is duly appointed and empowered to perform the duties of her office, including, among others, the power to decide, cancel, and abate tax liabilities as provided by law. She holds office at the 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City.

On April 27, 2007, petitioner filed its income tax return for calendar year 2006 with the BIR Revenue District Office (RDO) No. 43-A, Pasig City, reporting a total tax overpayment of ₱26,105,588.00.[3]

On October 1, 2007, petitioner received Letter of Authority (LOA) No. 00009166 dated September 7, 2007 from respondent Commissioner, through Regional Director Merlinda Ordoyo of BIR RDO No. 43-A, Pasig City, authorizing Revenue Officers Olivia S. Sison and Elvira U. Gatchalian to examine the books of petitioner covering calendar year 2006. The LOA had an attached letter dated September 28, 2007, containing the list of documents requested by BIR RDO No. 43-A to be made available for examination.[4]

Petitioner received from respondent, through Revenue District Officer Rey Asterio L. Tambis of Revenue District Office No. 43-A, a Notice of Informal Conference dated May 7, 2009 attaching therewith a schedule of computation of deficiency taxes showing the tax liabilities of petitioner for the year 2006 and requiring its representative to appear at BIR RDO No. 43-A at Pasig City on May 22, 2009 to present its side of the case.[5]

On May 22, 2009, petitioner attended the said informal conference as requested by respondent in the said Notice of Informal Conference.[6]

On December 14, 2009, petitioner received a Pre-Assessment Notice (PAN) dated November 20, 2009 from respondent, through the Regional Director of BIR Revenue Region No. 7, informing the former of the deficiency tax findings for calendar year 2006 on income tax, value-added tax (VAT), expanded withholding tax (EWT), and compromise penalty in the amount of ₱27,788,313.00, ₱2,631,826.23, ₱493,182.22, and ₱25,000.00, inclusive of interest as of November 18, 2009, respectively.[7]

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[2] Par. 8, Petition for Review, docket, p. 9.
[3] Par. 1.1, Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI), docket, p. 548; Exhibit "A".
[4] Par. 1.2, Stipulated Facts, JSFI, docket, p. 549; Exhibits "B" and "B-1".
[5] Par. 1.3, Stipulated Facts, JSFI, docket, p. 549; Exhibit "D".
[6] Exhibit "HH".
[7] Par. 1.4, Stipulated Facts, JSFI, docket, p. 549; Exhibit "E".

On January 12, 2010, petitioner received, through registered mail, Formal Letter of Demand No. F43-332 dated December 18, 2009 with attached Assessment Notices issued by BIR Revenue Region No. 7, through Regional Director Antonio F. Montemayor, assessing petitioner for alleged deficiency income tax in the amount of ₱28,400,036.96, deficiency VAT of ₱2,689,762.50, and deficiency EWT of ₱503,693.79 inclusive of interests as of January 15, 2010 and compromise penalty of ₱25,000.00, or a total of ₱31,618,493.25 for calendar year 2006,[8] broken down as follows:

I. Deficiency Income Tax			
Taxable Income (Loss) Per ITR			₱ 54,709,732.00
Add: Adjustments per Investigation:			
Undeclared Sales		₱ 15,293,127.92	
Unaccounted Source of Cash		1,636,271.35	
Professional Fee not Subjected to Withholding Tax		2,096,570.13	19,025,969.40
Taxable Income Per Investigation			₱ 73,735,701.40
Income Tax Due Thereon (35%)			₱ 25,807,495.49
Less: Allowable tax credits/payments:			
Prior Year's Excess Credits other than MCIT		₱ 30,795,244.00	
Creditable Withholding Tax		14,458,750.00	
Total		₱ 45,253,994.00	
Less: Unsupported prior year's excess credits	₱11,642,488.00		
Excess tax credits carried over to the succeeding period	26,105,588.00	37,748,076.00	7,505,918.00
Deficiency Income Tax			**₱ 18,301,577.49**
Add: 20% Interest per annum from 04-17-07 to 01-18-10			**10,098,459.47**
TOTAL AMOUNT DUE			**₱ 28,400,036.96**

II. Deficiency Value- Added Tax			
Taxable Gross Sales per VAT Returns			₱ 97,909,523.96
Add: Adjustments per Investigation			
Unaccounted Source of Cash			1,636,271.35
Total Sales			**99,545,795.31**
Output Tax Due			₱ 11,784,842.66
Less: Tax Credits / Payments			
Input Tax per Return		₱ 1,536,986.65	
Payments		10,051,503.48	
Total		11,588,490.13	
Less: Unsupported Input Tax		1,536,,986.65	10,051,503.48
Deficiency Value-Added Tax Due			₱ 1,733,339.18
Add: 20% Interest per annum from 01-26-07 to 01-18-10			956,423.32
TOTAL AMOUNT DUE			**₱ 2,689,762.50**
III. Deficiency Expanded Withholding Tax			

[8] Par. 1.5, Stipulated Facts, JSFI, docket, pp. 549 to 550; Exhibits ""F" to "F7".

	Amount	*Tax Rate*	*Tax Due*
Professional Fees	₱ 2,096,570.13	15.00%	₱ 314,485.52
Deficiency Expanded Withholding Tax			314,485.52
Add: 20% Interest per annum from 01-16-07 to 01-18-10			189,208.27
TOTAL AMOUNT DUE			**₱ 503,693.79**
Compromise Penalty for:			
Non-submission of Alphalist of Employees			**₱ 25,000.00**

On February 11, 2010, petitioner sent a letter of protest dated February 10, 2010 to respondent Commissioner, through BIR Revenue Region No. 7, disputing the assessments and praying for reconsideration thereof.[9]

On March 25, 2010, petitioner received a letter dated March 12, 2010 from BIR Revenue Region No. 7, Assessment Division, Billing Section signed by OIC-Assistant Regional Director Jonas DP. Amora, informing petitioner that its protest of the internal revenue tax liabilities for calendar year 2006 will be forwarded to BIR RDO No. 43-A.[10]

On May 11, 2010, petitioner received from respondent, through Revenue Region No. 7, Revenue District Office No. 43-A, a Tax Verification Notice No. TVN 2003 00123414 dated March 22, 2010 informing petitioner that Revenue Officer Renato Atos is authorized to verify supporting documents and/or pertinent records relative to reinvestigation covering taxable period 2006. Attached to the Tax Verification Notice is a pre-signed Waiver of the Defense of Prescription Under the Statute of Limitations of the National Internal Revenue Code.[11]

On June 10, 2010, petitioner submitted the documents requested per Tax Verification Notice No. 00123414 to respondent, through Revenue District Officer Florante R. Aninag of Revenue District Office No. 43-A.[12]

On September 22, 2010, petitioner received a Letter dated September 3, 2010 from the Assessment Division of Revenue Region No. 7, stating that its case was returned by the investigating officer recommending the reiteration of the assessments issued against it on the ground that petitioner failed to submit documents in support of its protest. In the said Letter, petitioner was also requested to pay immediately its tax liabilities as stated in the Final Assessment Notice/Demand Letter No. F43-332 dated December 18, 2009. The Letter is deemed a denial of petitioner's protest.[13]

The contents of the Letter dated September 3, 2010 are quoted below: *gr*

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[9] Par. 1.6, Stipulated Facts, JSFI, docket, p. 550; Exhibits "G".
[10] Par. 1.7, Stipulated Facts, JSFI, docket, p. 550; Exhibit "H".
[11] Exhibits "I" and "I-1".
[12] Exhibit "J".
[13] Par. 1.8, Stipulated Facts, JSFI, docket, pp. 550 to 551; Exhibit "K".

"**EAST ASIA POWER RESOURCES CORP.**
20/F Magnificent Mile, San Miguel Ave.,
San Antonio, Pasig City
TIN: 004-504-281-000

Attention: Honorio S. Cruz
Officer-in-Charge

Sir:

This refers to your internal revenue tax liabilities for the calendar year 2006 for which you have filed a protest letter dated June 10, 2010.

Please be informed that your case was returned by the investigating officer of Revenue District Office No. 43A, East Pasig City, recommending for the reiteration of the assessments issued against you considering that you failed to submit documents in support of your protest.

In view thereof, it is requested that your tax liability per Final Assessment Notice/Demand Letter No. F43-322 dated December 18, 2009 be paid immediately with the authorized agent bank in which you are enrolled and to submit to this office the proof/s of payment.

If we fail to hear from you within (15) days from receipt thereof, we will be constrained to forward the case to the Collection Section, RDO 43A East, Pasig City, this region, for collection enforcement."

Hence, the instant Petition for Review and Amended Petition for Review.

In her Answer[14] to the Petition for Review, respondent interposed the following Special and Affirmative Defenses:

"8. All presumptions are in favor of the correctness of the Assessment;

9. The Assessment/Demand Letter No. 43-332 dated 18 December 2009 for the year 2006 against the petitioner was issued in compliance with the provisions of section 228 of the National Internal Revenue Code and in accordance to existing Revenue Rules and Regulations relative to the right of the taxpayer/petitioner to be informed of the factual and legal bases upon which the assessment was made. *Jz*

[14] Docket, pp. 233-236.

10. The herein Petitioner was fully appraised of the facts and the law on which the Final Assessment was issued. The Final Assessment Notice, Demand Letter and Details of Discrepancies which were all together sent at the same time to the Petitioner, contained, in detail, the manner of computation, the facts on which the assessment was based and the provisions of the law used in arriving at such deficiency assessment.

11. The herein petitioner failed to submit documents in support of their protest.

12. Verification disclosed that the sales of the petitioner per ITR is understated by P15,293,127.92 thereby resulting to an understatement of taxable income thus assessed pursuant to Section 31 in relation to Section 32 of the NIRC of 1997, as amended.

13. Verification likewise disclosed that certain income payments were not reported in the financial statements thus considered unaccounted source of cash assessed pursuant to Section 31 of the NIRC, as amended.

14. The petitioner failed to subject income payments to withholding tax as required under RR No. 2-98, as amended, thus disallowed as deductions from gross income pursuant to Section 34(K) of the NIRC, as amended.

15. Verification likewise disclosed that the prior years of petitioner excess credit which were claimed per FS/ITR were not supported with documentary evidence hence disallowed pursuant to Section 2.58.3 of RR No. 2-98.

16. The deficiency value-added tax assessment is premised on the finding that the petitioner has an undeclared income, assessed pursuant to the provisions of Sec. 106 and 108 of the NIRC.

17. The 20% interest per annum has been imposed pursuant to the provisions of Section 249 (B) of the NIRC.

18. The 25% surcharge has been imposed pursuant to the provisions of Section 248(A) of the NIRC."

On July 7, 2011, this Court appointed Zeus A. Aboy, Audit Partner of R.S. Bernaldo and Associates, as Independent Certified Public Accountant (CPA).[15] Subsequently, on October 3, 2011, this Court upon petitioner's filing of its Very Urgent Motion for Substitution of Independent Certified Public Accountant[16], ~~

[15] Minutes of the Hearing dated July 7, 2011, docket, p. 560.
[16] Docket, pp. 598 to 602.

appointed Romeo A. De Jesus, Jr., Partner of R.S. Bernaldo and Associates as Independent CPA.[17]

During trial, petitioner presented Jaime B. Robles, its former Controller[18], and Romeo De Jesus, Jr., the Independent CPA[19] as witnesses. Petitioner filed its Formal Offer of Exhibits[20] on May 7, 2012, submitting Exhibits "A" to "S", "HH" to "XX", and "ZZZ" to "TTTT" inclusive of sub-markings; which this Court admitted except Exhibits "AAAA", "AAAA-1", "BBBB-4", "OO-33", "PP-33", "PP-133", "PP-488" and "DDDD-9" in the Resolutions dated July 27, 2012[21] and September 19, 2012[22].

On the other hand, respondent presented as witnesses Revenue Officers Hannah Thea M. Tulio and Renato M. Atos.[23] Thereafter, respondent filed her Formal Offer of Evidence[24], submitting Exhibits "1" to "12", inclusive of sub-markings; which this Court admitted in the Resolution[25] dated February 7, 2013.

The case was submitted for decision on April 17, 2013, taking into consideration the Memorandum for Petitioner filed through registered mail on March 25, 2013 and received by this Court on April 11, 2013 and respondent's Memorandum filed on April 12, 2013.[26]

THE ISSUES

The following are the parties' jointly stipulated issues[27] submitted for this Court's resolution:

> "2.1. Whether or not petitioner EAPRC is liable to pay the following assessed deficiency taxes, inclusive of interests as of January 15, 2010:
>
> a. deficiency income tax in the amount of Php28,400,036.96;
>
> b. deficiency value added tax ('VAT') of Php2,689,762.50;
>
> c. deficiency expanded withholding tax ('EWT') of Php503,693.79; and
>
> d. Compromise Penalty of Php25,000.00."

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[17] Minutes of the Hearing dated October 3, 2011, docket, p. 619.
[18] Minutes of Hearing dated July 13, 2011 and March 28, 2012, docket, pp. 586 and 797.
[19] Minutes of Hearing dated December 7, 2011 and February 8, 2012, docket, pp. 643 and 653.
[20] Docket, pp. 803 to 867.
[21] Docket, pp. 873 to 875.
[22] Docket, pp. 900 to 901.
[23] Minutes of Hearing dated October 10, 2012 and December 5, 2012, docket, pp. 937 and 939.
[24] Docket, pp. 943 to 947.
[25] Docket, pp. 954 to 955.
[26] Docket, p. 1011.
[27] Stipulated Issues, JSFI, docket, p. 551.

The above-enumerated issues can be summarized in the following manner:

"Whether or not petitioner is liable to pay the aggregate amount of ₱31,618,493.25 inclusive of interest and compromise penalty, representing deficiency income tax, VAT and EWT for taxable year 2006."

THE COURT'S RULING

At the outset, the Court would declare that the compromise penalty imposed by respondent in the amount of ₱25,000.00[28] cannot be sustained. Under Revenue Memorandum Order No. 01-90, compromise penalties are only amounts suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. It is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[29] Absent a showing that herein petitioner consented to the compromise penalty, its imposition should be deleted. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[30]

The Court will now address the deficiency income tax assessment.

Deficiency Income Tax

Respondent assessed petitioner of deficiency income tax for calendar year 2006 in the amount of ₱28,400,036.96, computed as follows:[31]

Taxable Income (loss) per ITR			₱ 54,709,732.00
Add: Adjustments per investigation			
Undeclared Sales		₱15,293,127.92	
Unaccounted Source of Cash		1,636,271.35	
Professional Fee not subjected to withholding tax		2,096,570.13	19,025,969.40
Taxable income per investigation			₱73,735,701.40
Income tax due thereon (35%)			₱25,807,495.49
Less: Allowable tax credits/payments:			
Prior year's Excess Credits other than MCIT		₱30,795,244.00	
Creditable Withholding Tax		14,458,750.00	
Total		₱45,253,994.00	
Less: Unsupported prior year's excess credits	₱11,642,488.00		
Excess tax credits carried over to the succeeding period	26,105,588.00	37,748,076.00	7,505,918.00
Deficiency Income Tax			₱18,301,577.49

[28] Exhibit "F-7".
[29] *The Philippines International Fair, Inc. v. The Collector of Internal Revenue, et al.,* G.R. Nos. L-12928 and L-12932, March 31, 1962.
[30] *Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc., et al.,* G.R. No. L-35266, January 21, 1991.
[31] Exhibit "F".

Add: 20% Interest p.a. 4.17.07 to 01.18.10	10,098,459.47
TOTAL AMOUNT DUE	**₱28,400,036.96**

The determination of whether or not the assessment is correct shall depend on the propriety of the income imputed as well as the expense deductions and tax credits disallowed by respondent, namely:

a. Undeclared sales	₱15,293,127.92
b. Unaccounted source of cash	1,636,271.35
c. Professional fee not subjected to withholding tax	2,096,570.13
d. Unsupported prior year's excess credits	11,642,488.00
e. Excess tax credits carried over to the succeeding period	26,105,588.00

a. Undeclared sales - ₱15,293,127.92

In the Details of Discrepancies[32] attached to respondent's Formal Letter of Demand[33], the computation of petitioner's undeclared sales is as follows:

Income per VAT Returns			₱ 97,909,523.96
Sales per FS			
Managerial Service Fee	₱ 96,391,667.00		
Others	147,553.00	₱ 96,539,220.00	
Add: Accounts Receivable-Trade, beg. (net of VAT)		6,979,258.18	
Total		₱103,518,478.18	
Less: Accounts Receivable-Trade, end. (net of VAT)		20,902,082.14	82,616,396.04
Undeclared sales			**₱15,293,127.92**

In its Protest Letter, petitioner argued that respondent's examiner erroneously compared its sales per VAT Returns and per financial statements (FS), and presented the following reconciling items:[34]

1. Book value of fixed asset (Mitsubishi Pajero-2004) sold in 2006 (₱1,517,857.14) - should be excluded from sales per VAT Returns "since it is not presented in the FS as sales or income";

2. Gain on sale of fixed asset (₱147,553.00) - should not be included in total sales per financial statements because it was recorded as "other gains";

3. Accounts Receivable balances (₱7,631,007.00 and ₱23,374,979.16 per audited financial statements) - respondent's examiner included non-trade receivable balances in the computation such as Advances to Officers and Employees and Dividends Receivable; and

[32] Exhibit "F-1".
[33] Exhibit "F".
[34] Exhibit "G", pp. 3-7.

4. Uncollected management fees for 2006 (₱15,743,972.16) -recorded as part of the sales account per 2006 income tax return but not included in 2006 VAT Returns because it was not yet subjected to VAT.

On the other hand, the Court-commissioned Independent CPA examined petitioner's sales transaction per Annual Income Tax Return[35] and VAT Returns[36] for the year 2006 and found that it consisted of the following:

Exhibit	Invoice No.	Invoice Date	Amount
1. Sales to East Asia Diesel Power Corp.			
HH-1	056	1/19/2006	₱2,677,546.30
HH-4	058	2/15/2006	2,677,546.30
HH-7	060	3/14/2006	2,677,546.30
HH-10	062	4/19/2006	2,677,546.30
HH-13	064	5/12/2006	2,677,546.30
HH-15	066	6/14/2006	2,677,546.30
HH-17	068	7/14/2006	2,677,546.30
HH-20	070	8/16/2006	2,677,546.30
HH-23	072	9/13/2006	2,677,546.30
HH-26	074	10/12/2006	2,677,546.30
HH-27	076	11/23/2006	2,677,546.30
HH-28	078	12/11/2006	2,677,546.30
	Sub-total		*₱32,130,555.60*
2. Sales to Duracom Mobile Power Corp.			
II-1	055	1/19/2006	₱5,355,092.59
II-3	057	2/15/2006	5,355,092.59
II-5	059	3/14/2006	5,355,092.59
II-6	061	4/19/2006	5,355,092.59
II-7	063	5/12/2006	5,355,092.59
II-8	065	6/14/2006	5,355,092.59
II-10	067	7/14/2006	5,355,092.59
II-12	069	8/16/2006	5,355,092.59
II-14	071	9/13/2006	5,355,092.59
II-17	073	10/12/2006	5,355,092.59
II-18	075	11/23/2006	5,355,092.59
II-19	077	12/11/2006	5,355,092.59
	Sub-total		*₱64,261,111.08*
Total sales for income tax			**₱ 96,391,666.68**
Selling price of fixed asset sold *(Exh. "L" and "M")*			1,517,857.28
Total sales for VAT			**₱ 97,909,523.96**

The Independent CPA noted that the BIR has assumed that income reflected per VAT Return is collected revenue. However, income per VAT Returns is on accrual basis of accounting and not on collection.[37]

This Court finds the Independent CPA findings in order. The various sales invoices issued by petitioner as well as the journal voucher and official receipt related to the sale of petitioner's fixed asset for taxable year 2006 show that petitioner

[35] Exhibit "A".

[36] Exhibits "T", "U", "V" to "V-2", "Y" to "Y-5", "Z" to "Z-4", "AA" to "AA-10", "BB" to "BB-4", "CC" to "CC-4", "DD" to "DD-6", "EE" to "EE-3", "FF" to "FF-5", and "GG" to "GG-7".

[37] Exhibit "WW", p. 5.

reports its income on accrual basis of accounting both for income tax and VAT purposes.

Under the accrual method, income is recognized in the period it is earned regardless of whether it has been received or not. The employment of such method of accounting, or any method for that matter, as long as it clearly reflects income, is recognized for income tax purposes in Section 43 of the NIRC of 1997, as amended, which provides:

> "SEC. 43. *General Rule.* - The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. If the taxpayer's annual accounting period is other than a fiscal year, as defined in Section 22(Q), or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the taxable income shall be computed on the basis of the calendar year."

Petitioner has fully accounted for its sales of managerial services for the year 2006 based on the sales invoices it issued for the said year whether or not payments have been received for the said services. As indicated in its ITR for 2006, petitioner's total sales amounted to ₱96,391,667.00.[38]

Likewise, pursuant to Section 32(A)(2) of the NIRC of 1997, petitioner properly reported the gain derived from its sale of fixed asset for the year 2006 in the amount of ₱147,553.00 as part of its "Non-Operating and Other Income" of ₱158,999.00.[39] It is to be noted that per petitioner's VAT returns, the proceeds from the sale of the fixed asset in the amount of ₱1,517,857.28 was reported instead of the gain on the said sale of ₱147,553.00.

Evidently, the deficiency income tax assessment on the alleged undeclared sales of ₱15,293,127.92 was a mere result of respondent's erroneous comparison of the income per petitioner's VAT returns against its collections for the year 2006.

b. Unaccounted source of cash - ₱1,636,271.35

Upon comparison of the expenses reflected in petitioner's ITR[40] and financial statements[41] *vis-à-vis* the amount shown in its alphalist, respondent's examiner found the following discrepancies:[42]

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[38] Exhibit "A", line 15C.
[39] Exhibit "A", Line 18 and Schedule 4.
[40] Exhibit "A", Schedule 3 of Section A and Section D.
[41] Exhibit "10", BIR Records, p. 42.

	Per Alphalist	Per FS/ITR	Difference
Rent	₱ 2,125,548.24	₱ 2,058,919.00	₱ 66,629.24
Income payments on purchase of services/contractors/sub-contractors			
Repairs & Maintenance		₱ 1,513,558.00	
Utilities		1,493,168.00	
Security & Janitorial Services		606,331.00	
Entertainment & Representation		254,719.00	
Sub-total	4,016,420.87	₱ 3,867,776.00	148,644.87
Payments to local regular supplier of goods			
Office Supplies	1,751,055.24	330,058.00	1,420,997.24
Unaccounted expenses	**₱ 7,893,024.35**	**₱6,256,753.00**	**₱1,636,271.35**

It should be noted that respondent's examiner actually used petitioner's Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) (BIR Form No. 1601-E)[43] for the year 2006 to arrive at the amounts that were purportedly taken from petitioner's alphalist.

An examination of petitioner's Alphabetical List of Payees From Whom Taxes Were Withheld[44] (alphalist) for the year 2006 reveals that, although the total amount of creditable taxes withheld of ₱1,214,779.26 tallies, there is a discrepancy between the income payments reported therein and in the BIR Forms No. 1601-E for the same year, to wit:

Income Payments	Per Alphalist[45]	Per Monthly Remittances (BIR Form No. 1601-E)[46]	Difference
Rent (5%)	₱ 2,168,555.09	₱ 2,125,548.24	₱ 43,006.85
Income payments on purchase of services/contractors/sub-contractors (2%)	4,740,053.92	4,016,420.87	723,633.05
Payments to local regular supplier of goods (1%)	1,945,834.33	1,751,055.24	194,779.09
Professional fees (15%)	6,603,814.49	5,475,546.87	1,128,267.62
Other payments (20%)	10,000.00	10,000.00	-
TOTAL	**₱15,468,257.83**	**₱ 13,378,571.22**	**₱2,089,686.61**

Be that as it may, by comparing petitioner's expenses as reported in its ITR and FS with its alphalist, respondent concluded that petitioner has unaccounted source of cash or undeclared income because the income payments per alphalist were greater than the expenses per ITR and FS. This conclusion lacks merit because assuming that there is unaccounted source of cash or undeclared income, there are also payments or expenses which were unreported. If this is the case, the undeclared income would be effectively offset with the consideration of the related expenses. Consequently, no taxable income will result from the said transactions, as illustrated below:

Unaccounted source of cash from understatement of:		
Rent	₱ 66,629.24	

jc

[42] Exhibit "F-1".
[43] BIR Records, pp. 70-100.
[44] Exhibit "Q".
[45] Exhibit "Q"; See Annex "A" for details.
[46] BIR Records, p. 213.

Income payments on purchase of services/contractors/sub-contractors	148,644.87	
Payments to local regular supplier of goods	1,420,997.24	₱1,636,271.35
Less: Undeclared expenses		
Rent	₱ 66,629.24	
Income payments on purchase of services/contractors/sub-contractors	148,644.87	
Payments to local regular supplier of goods	1,420,997.24	1,636,271.35
Taxable Income		₱ -

While it is axiomatic that all presumptions are in favor of the correctness of tax assessments, the assessment itself should not be based on presumptions no matter how logical the presumption might be. In order to stand the test of judicial scrutiny, the assessment must be based on actual facts.[47] For lack of factual basis, the deficiency income tax assessment arising from petitioner's alleged unaccounted source of cash should be cancelled.

c. Professional fee not subjected to withholding tax - ₱2,096,570.13

In the same manner, respondent's examiner found the following discrepancy between petitioner's professional fees as reported per FS and per monthly remittance returns:[48]

	Professional Fees
Per FS	₱ 7,582,117.00
Per Alphalist	5,485,546.87
Difference	**₱ 2,096,570.13**

The said difference was not allegedly subjected to withholding tax as required under Revenue Regulations (RR) No. 2-98, as amended. Consequently, the subject professional fees were disallowed as deductions from petitioner's gross income pursuant to Section 34(K) of the NIRC of 1997, as amended and petitioner was assessed of deficiency income tax.[49]

Petitioner avers that the amount of ₱7,582,117.00 professional fees per its FS/ITR is comprised of the following:[50]

Professional Fees - Others[51]	₱6,307,343.91	
Retainer Fees – PR Cruz Law Offices[52]	120,000.00	₱ 6,427,343.91
Payments to General Professional Partnerships (GPPs) – Law Offices/Firms[53]		1,154,772.71
Total		**₱7,582,116.62**

[47] *Collector of Internal Revenue v. Benipayo,* G.R. No. L-13656, January 31, 1962.
[48] Exhibit "F-1".
[49] *Ibid.,* Exhibits "F-2", "F-3" and "F-5".
[50] Memorandum for Petitioner, docket, pp. 988-989.
[51] Exhibit "WW", p. 11 and Annex "M".
[52] *Ibid.*
[53] Exhibit "WW", p. 11 and Annex "N".

As can be seen from petitioner's alphalist[54] for taxable year 2006, petitioner withheld and remitted the EWT due of ₱964,101.59 on the professional fees of ₱6,427,343.90, detailed as follows:

Payee	Income Payments	EWT
Bernardo M. Villegas	₱29,411.76	₱4,411.76
Business Process Outsourcing International	61,150.00	9,172.50
Equitable PCI Banking Corp.	131,904.00	19,785.60
Institutional Synergy Inc.	50,000.00	7,500.00
Mercer Human Resource Consulting Inc.	95,000.00	14,250.00
Noche Maria Concepcion Sison	988,235.28	148,235.29
PR Cruz Law Offices	120,000.00	18,000.00
Villareal Augusto Tan	4,891,642.86	733,746.43
Watson Wyatt Philippines Inc.	60,000.00	9,000.00
TOTAL	**₱6,427,343.90**	**₱964,101.59**

Regarding the amount of ₱1,154,772.71 professional fees allegedly paid by petitioner to GPPs, Section 26 of the NIRC of 1997, as amended, and Section 2.57.5 of RR No. 2-98, as amended, explicitly exempt income payments made to a general professional partnership from income tax and consequently from expanded withholding tax, to wit:

> "SEC. 26. *Tax Liability of Members of General Professional Partnerships.* - **A general professional partnership as such shall not be subject to the income tax** imposed under this Chapter. Persons engaging in business as partners in a general professional partnership shall be liable for income tax only in their separate and individual capacities.
>
> For purposes of computing the distributive share of the partners, the net income of the partnership shall be computed in the same manner as a corporation.
>
> Each partner shall report as gross income his distributive share, actually or constructively received, in the net income of the partnership." *(Emphasis supplied)*
>
> "SECTION 2.57.5. *Exemption from Withholding.* -The withholding of creditable withholding tax prescribed in these Regulations shall not apply to income payments made to the following:
>
> xxx xxx xxx
>
> (B) Persons enjoying exemption from payment of income taxes pursuant to the provisions of any law, general or special, such as but not limited to the following:
>
> xxx xxx xxx

[54] Exhibit "Q".

(4) **General professional partnerships**" *(Emphasis supplied)*

However, out of petitioner's claimed income payments to GPPs of ₱1,154,772.71, only the amount of ₱1,148,272.71[55] was proven to have been paid to GPPs as evidenced by the accounts payable vouchers, sales invoices/statements of account and official receipts[56] submitted by petitioner. As to the remaining amount of ₱6,500.00, this Court cannot ascertain the nature thereof for lack of documentary proof. Thus, the Court will uphold respondent's disallowance of the amount of ₱6,500.00.

Consequently, out of the total professional fees of ₱7,582,116.00 reflected in petitioner's ITR and financial statements, the amount of ₱7,575,616.00 represents petitioner's valid deduction from gross income, while the remaining professional fees of ₱6,500.00 should be denied pursuant to Section 34(K) of the NIRC of 1997, as amended, which states that:

> "(K) *Additional Requirements for Deductibility of Certain Payments*. - Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section, Sections 58 and 81 of this Code."

Therefore, petitioner should be assessed of the corresponding deficiency income tax on the disallowed professional fees of ₱6,500.00.

d. Unsupported prior year's excess credits - ₱11,642,488.00

Respondent's examiner found that petitioner's prior year's excess credits amounting to ₱11,642,488.00, which was claimed in the income tax return, were not supported with documentary evidence; hence, disallowed as deduction from petitioner's income tax liability.[57]

Petitioner counter-argues that respondent "did not provide EAPRC the factual basis for such findings. Such non-disclosure...of the factual basis of findings of unsupported prior year's excess credits is contrary to *Sec. 3.14 of Revenue Regulations No. 12-99* which states, among others, that for the Formal Letter of Demand and Assessment Notice to be valid, it must among others, <u>contain the facts upon the assessment is based, otherwise, the same shall be void.</u> Consequently, EAPRC is being deprived of its right to intelligently explain such findings xxx."[58]

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[55] Exhibit "WW", Annex "N".
[56] Exhibits "VV-1" to "VV-96".
[57] Exhibit "F-2".
[58] Exhibit "G", p. 12; Memorandum for Petitioner, docket, p. 991.

The Court disagrees with petitioner.

It is true that petitioner's ITR for taxable year 2006 shows that its prior year's excess tax credits amounted to ₱30,795,244.00.[59] Thus, it can only be deduced that respondent's findings of ₱11,642,488.00 formed part of the said prior year's excess tax credits. While respondent did not show how the amount of ₱11,642,488.00 was computed, petitioner could have easily refuted respondent's findings by substantiating its entire prior year's excess credits amounting to ₱30,795,244.00 by submitting Certificates of Creditable Taxes Withheld at Source (BIR Form No. 2307) for the year 2005 and prior years. However, examination of the documents offered in evidence shows that petitioner failed to do so.

e. Excess tax credits carried over to the succeeding period -₱26,105,588.00

Respondent did not explain why petitioner's excess tax credits for the year 2006 amounting to ₱26,105,588.00 which was carried over to the succeeding period was deducted from the total available tax credits. This Court could only surmise that respondent intends to regain the benefit in the form of tax credit that has been forwarded by petitioner to the succeeding taxable year given that respondent's audit of petitioner resulted in a deficiency income tax assessment for the year 2006.

Respondent's disallowance of the ₱26,105,588.00 excess tax credits carried over to the succeeding year is improper because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2007. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year.

In fine, considering that petitioner has enough tax credits for the year 2006 even when its income is adjusted to include the disallowed professional fees not subjected to withholding tax and the unsupported prior year's excess credits, petitioner is not liable for any deficiency income tax, as determined below:

Taxable Income per ITR		₱ 54,709,732.00
Add: Adjustments Per Investigation		
Professional Fee Not Subjected to Withholding Tax		6,500.00
Taxable Income Per Investigation		₱ 54,716,232.00
Income Tax Due Thereon (35%)		₱ 19,150,681.20
Less: Allowable Tax Credits		
Prior Year's Excess Credits Other than MCIT	₱ 30,795,244.00	
Creditable Withholding Tax	14,458,750.00	
Total	₱ 45,253,994.00	
Less: Unsupported Prior Year's Excess Credits	11,642,488.00	33,611,506.00
Excess Tax Credits		**₱(14,460,824.80)**

[59] Exhibit "A", Line 28A.

Deficiency Expanded Withholding Tax

Upon investigation, it was found by respondent that petitioner failed to withhold and remit the EWT on the amount of ₱2,096,570.13 professional fees as required under RR No. 2-98, as amended. As a result, respondent assessed petitioner for deficiency EWT in the amount of ₱503,693.79, inclusive of interest, detailed as follows:

	Amount	Tax Rate	Tax Due
Professional Fees	₱2,096,570.13	15%	₱ 314,485.52
Deficiency Expanded Withholding Tax			314,485.52
Add: 20% Interest p.a. from 01.16.07 to 01.18.10			189,208.27
TOTAL AMOUNT DUE			**₱503,693.79**

As earlier discussed, petitioner failed to withhold and remit the EWT corresponding to its income payments for professional fees of ₱6,500.00. Therefore, petitioner is liable to pay basic deficiency EWT in the amount of ₱975.00, computed as follows:

Professional fees	₱ 6,500.00
Tax rate	15%
Basic Deficiency EWT	**₱ 975.00**

Deficiency Value-added Tax

Respondent computed the deficiency VAT assessment of ₱2,689,762.50 by adding the alleged unaccounted source of cash in the amount of ₱1,636,271.35 to petitioner's gross taxable sales per VAT returns for the year 2006 and disallowing petitioner's claimed input taxes in the amount of ₱1,536,986.65, as shown below:

Taxable Gross Sales per VAT Returns		₱ 97,909,523.96
Add: Adjustments per Investigation		
Unaccounted Source of Cash		1,636,271.35
Total Sales		₱ 99,545,795.31
Output Tax Due		₱ 11,784,842.66
Less: Tax Credits/Payments		
Input Tax per Return	₱ 1,536,986.65	
Payments	10,051,503.48	
Total	₱ 11,588,490.13	
Less: Unsupported Input Tax	1,536,986.65	10,051,503.48
Deficiency Value-Added Tax		₱ 1,733,339.18
Add: 20% Interest p.a. 01.26.07 to 01.18.10		956,423.32
TOTAL AMOUNT DUE		**₱ 2,689,762.50**

a. Unaccounted Source of Cash - ₱1,636,271.35

As previously discussed, this assessment was based on the finding that petitioner had significant amounts of expenses, the sources of which were not accounted for in its financial statements and ITR. Respondent concluded that petitioner had earned income which it failed to declare.

The assessment is devoid of merit. As also discussed earlier, even if the expenses per alphalist were to be considered as income subject to output VAT, the same shall be offset by treating the equivalent payments as purchases for which input tax credits may be claimed. Hence, no VAT-able income will result from the said transactions.

b. Unsupported input tax - ₱1,536,986.65

Invoking Section 110 in relation Sections 113 and 237 of the NIRC of 1997, as amended, respondent disallowed as deduction from petitioner's VAT liability the input taxes claimed per VAT returns in the aggregate amount of ₱1,536,986.65 for being unsupported by documentary evidence.[60]

Again, petitioner avers that respondent's findings did not state the facts from which it was based nor was it informed of the basis of such findings and the breakdown or computation on how respondent arrived at such amount. Consequently, such assessment should be considered void pursuant to Section 3.1.4 of RR No. 12-99 as it deprives petitioner of its rights to intelligently explain the discrepancies found.[61]

Moreover, petitioner asserts that it has presented to respondent all the supporting documents of its input taxes upon submission of its Monthly VAT Declaration and Quarterly VAT Returns.[62]

This Court finds petitioner's position untenable.

Examination of petitioner's VAT Returns for taxable year 2006 revealed the following:

Exh.	Period	Output Tax	Input Taxes			VAT Paid
			Domestic Purchases of Goods	Domestic Purchases of Services	Total	
T	Jan-06	₱ 803,263.89	₱ 7,354.75	₱ 150,562.76	₱ 157,917.51	₱ 645,346.38
U	Feb-06	963,916.67	5,110.32	111,059.05	116,169.37	847,747.30
V	Mar-06	963,916.67	8,419.00	90,438.07	98,857.07	865,059.60
	1st Qtr	**₱ 2,731,097.23**	**₱ 20,884.07**	**₱ 352,059.88**	**₱ 372,943.95**	**₱ 2,358,153.28**
Y	Apr-06	963,916.67	12,743.96	118,756.98	131,500.94	832,415.73
Z	May-06	963,916.67	8,613.22	105,086.83	113,700.05	850,216.62
AA	Jun-06	963,916.66	11,433.27	115,959.40	127,392.67	836,523.99
	2nd Qtr	**₱ 2,891,750.00**	**₱ 32,790.45**	**₱ 339,803.21**	**₱ 372,593.66**	**₱ 2,519,156.34**
BB	Jul-06	963,916.67	108,516.61	111,722.33	220,238.94	743,677.73
CC	Aug-06	963,916.67	4,683.86	94,630.31	99,314.17	864,602.50

[60] Exhibit "F-2".
[61] Exhibit "G", p. 14.
[62] Exhibit "G", p. 14; Memorandum for the Petitioner, docket, p. 994.

DD	Sep-06	963,916.67	10,603.84	85,107.71	95,711.55	868,205.12
	3rd Qtr	**₱ 2,891,750.01**	**₱123,804.31**	**₱ 291,460.35**	**₱ 415,264.66**	**₱ 2,476,485.35**
EE	Oct-06	963,916.67	5,775.09	111,794.40	117,569.49	846,347.18
FF	Nov-06	963,916.67	23,852.00	95,345.36	119,197.36	844,719.31
GG	Dec-06	1,146,059.53	7,385.18	132,032.33	139,417.51	1,006,642.02
	4th Qtr	**₱ 3,073,892.87**	**₱ 37,012.27**	**₱ 339,172.09**	**₱ 376,184.36**	**₱ 2,697,708.51**
TOTAL		**₱11,588,490.11**	**₱214,491.10**	**₱1,322,495.53**	**₱1,536,986.63**	**₱10,051,503.48**

It is safe to deduce that the amount of ₱1,536,986.65 found by respondent's examiner to be unsupported would pertain to the input taxes from domestic purchases of goods and services for the current taxable period. Hence, petitioner only needs to submit the corresponding invoices and/or official receipts to refute respondent's assessment.

Further, in the letter dated April 13, 2010, respondent's bureau specifically requested petitioner to submit invoices and/or official receipts, to wit:[63]

> "x x x We need the following documents/records to validate your submitted schedules.
>
> 5. Unsupported input tax credits 1,536,986.65. Please submit purchases invoices and official receipts."

Petitioner failed to comply with the foregoing. As a consequence, for failure to substantiate input taxes for the year 2006 in the amount of ₱1,536,986.65, the same should be disallowed in accordance with Sections 110(A)(1), 113(A)(1) and (2), and 237 of the NIRC of 1997, as amended, which require that input tax on purchases of goods and services must be supported by duly registered VAT invoices and VAT official receipts, respectively. For easy reference, Sections 110(A)(1), 113(A)(1) and (2) and 237 of the NIRC of 1997, as amended, are quoted hereunder:

> "SEC. 110. *Tax Credits.* –
>
> (A) *Creditable Input Tax.* -
>
> (1) Any input tax evidenced by a VAT invoice or official receipt issued in accordance with Section 113 hereof on the following transactions shall be creditable against the output tax:"
>
> "SEC. 113. *Invoicing and Accounting Requirements for VAT-Registered Persons.* -
>
> (A) *Invoicing Requirements.* - A VAT-registered person shall issue: ge

[63] Exhibit "7".

(1) A VAT invoice for every sale, barter or exchange of goods or properties; and

(2) A VAT official receipt for every lease of goods or properties, and for every sale, barter or exchange of services."

"SEC. 237. *Issuance of Receipts or Sales or Commercial Invoices.* – All persons subject to an internal revenue tax shall, for each sale or transfer of merchandise or for services rendered valued at Twenty-five pesos (₱25.00) or more, issue duly registered receipts or sale or commercial invoices, prepared at least in duplicate, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service xxx."

Accordingly, petitioner should be made to pay basic deficiency VAT in the amount of ₱1,536,986.65.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. The deficiency income tax assessment issued by respondent against petitioner covering taxable year 2006 in the amount of ₱28,400,036.96 and the compromise penalty for non-submission of alphalist of employees in the amount of ₱25,000.00 are hereby **CANCELLED**. However, the deficiency expanded withholding tax and VAT assessments for taxable year 2006 are hereby **UPHELD** in part. Accordingly, petitioner is hereby **ORDERED TO PAY** respondent the amount of **₱1,922,452.06**, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Tax Type	Basic Tax	Surcharge (25%)	Total
EWT	₱ 975.00	₱ 243.75	₱ 1,218.75
VAT	1,536,986.65	384,246.66	1,921,233.31
TOTAL	**₱1,537,961.65**	**₱ 384,490.41**	**₱1,922,452.06**

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

(a) Deficiency interest at the rate of twenty percent (20%) per annum pursuant to Section 249(B) of the NIRC of 1997 on the following:

1. Basic deficiency EWT of ₱975.00 computed from January 15, 2007 until full payment thereof; and

2. Basic deficiency VAT of ₱1,536,986.65 computed from January 25, 2007 until full payment thereof.

(b) Delinquency interest at the rate of 20% per annum on the total amount due of ₱1,922,452.06 representing deficiency EWT and deficiency VAT (inclusive of 25% surcharge) and on the deficiency interest which have accrued as aforestated in par. (a) computed from January 18, 2010 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

CAESAR A. CASANOVA
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
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.

ROMAN G. DEL ROSARIO
Presiding Justice