REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

CLASSIC FINE FOODS PHILIPPINES, INC., *Petitioner,*	**CTA Case No. 9391**
	Members:
-versus-	**DEL ROSARIO**, *P.J., Chairperson, and* **MANAHAN**, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Promulgated: DEC 17 2020 3:30 pm

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DECISION

MANAHAN, *J.:*

This is a *Petition for Review* filed by petitioner Classic Fine Foods Philippines, Inc. against respondent Commissioner of Internal Revenue on July 22, 2016, praying that judgment be rendered cancelling the amended assessment for deficiency income tax with interest in the aggregate amount of ₱9,529,413.91.[1]

THE FACTS

Petitioner Classic Fine Foods Philippines, Inc. is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office at the 26th Floor, Yuchengco Tower, Tower 1, RCBC Plaza, cor. Ayala and Sen. Gil Puyat Avenues, Makati City, and duly registered with the Bureau of Internal Revenue (BIR) under Tax Identification Number (TIN) 005-131-587-000.[2]

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[1] Statement of the Case, Pre-Trial Order dated November 15, 2018, Docket – Vol. IV, p. 2177.

[2] Par. 1, Stipulation of Facts, *Joint Stipulation of Facts and Issues* (JSFI), Docket – Vol. IV, p. 2147.

Respondent is the Commissioner of Internal Revenue, who is duly appointed to perform the duties of his office, including *inter alia*, the power to decide disputed assessments, with office address at 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City.[3]

The BIR issued the *Letter of Authority* (LOA) No. LOA 200700001593 dated February 21, 2008, authorizing Revenue Officer (RO) Lorna Dosado / Group Supervisor (GS) Antonio Punzalan, to examine the petitioner's books of accounts and other accounting records covering the period from January 1, 2006 to December 31, 2006.[4] The said LOA was received by petitioner on February 27, 2008.[5]

On December 29, 2009, petitioner received a copy of the *Preliminary Assessment Notice* (PAN) issued by the BIR on even date, assessing petitioner for alleged deficiency taxes for taxable year 2006 in the aggregate amount of ₱18,983,140.71, inclusive of interest up to January 13, 2010.[6] The said deficiency taxes, including the said interest, consist of the following:[7]

Income Tax	₱13,753,684.34
Value-added tax (VAT)	2,517,349.61
Withholding tax on compensation (WTC)	387,850.41
Fringe benefits tax (FBT)	2,071,716.82
Expanded withholding tax (EWT)	252,539.53
TOTAL	**₱18,983,140.71**

Thereafter, petitioner filed its *Reply* to the PAN on January 13, 2010, and paid the assessed withholding tax on compensation (WTC) and expanded withholding tax (EWT) in the amount of ₱387,850.41 and ₱252,539.53, respectively.[8]

On January 14, 2010, petitioner filed its supplement to the *Reply* to the PAN, and paid a substantial portion of the assessed deficiency valued-added tax (VAT) in the amount of ₱2,437,005.68.[9]

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[3] Par. 2, Stipulation of Facts, JSFI, Docket – Vol. IV, p. 2152.
[4] Exhibit "R-10", BIR Records, p. 5.
[5] Exhibit "R-10-b", BIR Records, p. 5.
[6] Par. 6, Stipulation of Facts, JSFI, Docket – Vol. IV, p. 2152.
[7] Exhibit "R-16", BIR Records, pp. 431 to 436.
[8] Par. 7, Stipulation of Facts, JSFI, Docket – Vol. IV, pp. 2152 and 2156.
[9] Par. 8, Stipulation of Facts, JSFI, Docket – Vol. IV, p. 2156.

On January 20, 2010, petitioner received a *Formal Assessment Notice* (FAN) with attached *Details of Discrepancies* issued by respondent on January 15, 2010 for deficiency taxes for taxable year 2006, assessing petitioner for deficiency taxes in the aggregate amount of ₱10,360,519.39, inclusive of interest up to February 25, 2010, broken down as follows:[10]

Income Tax	₱8,175,944.42
VAT	82,381.30
Fringe Benefits Tax (FBT)	2,102,193.67
TOTAL	**₱10,360,519.39**

Consequently, on February 19, 2010, petitioner filed its protest letter evenly dated.[11]

On April 20, 2010, within the required 60-day period for submission of supporting documents, petitioner submitted its supplemental letter, together with the supporting documents to complete its protest.[12]

On June 17, 2016, respondent issued the assailed *Final Decision on Disputed Assessment* (FDDA), with the *Amended Assessment* and *Details of Discrepancies* (Amended Assessment). The same was received by petitioner on June 22, 2016. Under the Amended Assessment, respondent cancelled the assessed VAT, WTC, EWT, and FBT, but sustained the assessment for the alleged deficiency income tax in the amount of **₱9,529,413.19**, which consists of ₱3,319,522.55 basic deficiency income tax due, and interest up to June 22, 2016, amounting to ₱6,209,891.36, for taxable year 2006, computed as follows:[13]

I. INCOME TAX		
Net Income/(Loss) per Return		
Add/Deduct Adjustments/Disallowances		
Disallowed Quality/Price Adjustments	₱121,074.00	
Unsupported Allowance for Inventory obsolescence	6,003,499.00	6,124,573.00
Adjusted Taxable Income		6,124,573.00

[10] Pars. 3 and 9, Stipulation of Facts, JSFI, Docket – Vol. IV, pp. 2152 and 2156, respectively; Exhibits "R-3", "R-3-a", and "R-3-b", BIR Records, pp. 538 to 542.
[11] Exhibits "R-4" and "P-5", Docket – Vol. II, pp. 998 to 1008.
[12] Par. 10, Stipulation of Facts, JSFI, Docket – Vol. IV, p. 2156; Exhibits "R-5" and "P-6", Docket – Vol. II, pp. 1009 to 1020.
[13] Pars. 4, 11 and 12, Stipulation of Facts, JSFI, Docket – Vol. IV, pp. 2152, 2156, and 2157, respectively.

Tax Due Thereon (35%)			₱2,143,600.55
Less: Tax Credits/Payments			
Prior Year's Excess Credits		₱1,614,081.00	
Creditable Income Tax Withheld		1,175,922.00	
Total		₱2,790,003.00	
Less: Unsupported Creditable Income Tax Withheld	₱1,175,922.00		
Amount Carried Forward to Succeeding Year	1,793,055.00		
Excess Minimum Corporate Income Tax (MCIT)	996,948.00	3,965, 925.00	(1,175,922.00)
Basic Deficiency Income Tax			**3,319,522.55**
Add: Interest (04.16.07 to 07.22.16)			**6,209,891.36**
Total Amount Due			**₱9,529,413.91**

Petitioner filed the instant *Petition for Review* on July 22, 2016.[14] Respondent posted his *Answer* on September 29, 2016,[15] interposing his special and affirmative defenses. Petitioner filed its *Reply (Re: Respondent's Answer dated 28 September 2016).*[16]

The pre-trial conference was initially set on February 23, 2017.[17] Respondent submitted the *BIR Records* on December 6, 2016.[18] Subsequently, a *Motion to Set Case for Preliminary Hearing to Resolve Issue on Prescription (with Motion to Set Commissioner's Hearing)* was filed by petitioner on December 9, 2016.[19] Respondent did not comment on the said *Motion to Set.*[20]

In the Resolution dated February 8, 2017,[21] the Court granted petitioner's *Motion to Set Case for Preliminary Hearing to Resolve Issue on Prescription* and *Motion to Set Commissioner's Hearing,* and cancelled the scheduled pre-trial conference.

During the preliminary hearing on the issue of prescription, petitioner presented testimonial and documentary evidence. Petitioner offered the sole testimony of its former Finance Manager, Mr. Ernesto V. Zubiri.[22]

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[14] Docket – Vol. I, pp. 9 to 44.
[15] Docket – Vol. II, pp. 604 to 615.
[16] Docket – Vol. II, pp. 593 to 602.
[17] Resolution dated November 8, 2016, Docket – Vol. II, p. 618.
[18] *Transmittal Letter* dated December 5, 2016, Docket – Vol. II, p. 623.
[19] Docket – Vol. II, pp. 626 to 641.
[20] Records Verification dated January 30, 2017, Docket – Vol. II, p. 670.
[21] Docket – Vol. II, pp. 678 to 679.
[22] Exhibit "P-13", Docket - Vol. II, pp. 683 to 698; Minutes of the hearing held on, and Order dated, March 9, 2017, Docket – Vol. II, pp. 868 to 873.

Thereafter, petitioner filed its *Formal Offer of Evidence* with respect to the issue on prescription on March 20, 2017.[23] Respondent failed to file his comment thereon.[24]

In the Resolution dated May 11, 2017,[25] petitioner's Exhibits were admitted, *except* for Exhibits "P-11" and "P-11-1" for being mere photocopies. Petitioner then filed its *Motion for Reconsideration (To Admit Exhibits "P-11" and "P-11-1")* on May 19, 2017.[26] Respondent posted his *Comment/Opposition (to Petitioner's Motion for Reconsideration)* on May 24, 2017.[27]

In the Resolution dated June 21, 2017,[28] the Court denied petitioner's *Motion for Reconsideration.*

Respondent likewise presented his testimonial and documentary evidence as regards the issue on prescription. Respondent proffered the sole testimony of Ms. Felinor A. Pascua,[29] respondent's Revenue Officer.

Subsequently, respondent submitted his *Formal Offer of Evidence* on November 23, 2017.[30] Petitioner then filed its *Comment/Opposition (Re: Respondent's Formal Offer of Evidence)* on December 12, 2017.[31]

Respondent's Exhibits were all admitted by the Court in the Resolution dated January 24, 2018.[32]

Petitioner posted its *Memorandum* on March 1, 2018.[33] On the other hand, respondent did not file his memorandum.[34]

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[23] Docket – Vol. II, pp. 876 to 888.
[24] Records Verification dated April 12, 2017, Docket – Vol. II, p. 1056.
[25] Docket – Vol. II, pp. 1067 to 1068.
[26] Docket – Vol. II, pp. 1069 to 1072.
[27] Docket – Vol. II, pp. 1076 to 1078.
[28] Docket – Vol. II, pp. 1081 to 1034.
[29] Exhibit "R-9", Docket – Vol. II, pp. 1046 to 1053; Minutes of the hearing held on, and Order dated, September 28, 2017, Docket – Vol. II, pp. 1072 to 1075.
[30] Docket – Vol. II, pp. 1080 to 1085.
[31] Docket – Vol. II, pp. 1089 to 1095.
[32] Docket – Vol. II, pp. 1101 to 1102.
[33] Docket – Vol. II, pp. 1103 to 1135.
[34] Records Verification dated March 16, 2018, Docket – Vol. II, p. 1138.

However, respondent submitted his *Manifestation with Motion to Admit.*[35]

In the Resolution dated June 13, 2018,[36] the Court granted respondent's *Manifestation with Motion to Admit.* In the same Resolution, the Court ruled that the period to assess and collect petitioner's deficiency taxes for taxable year 2006 has not yet prescribed. Thus, petitioner's prayer to cancel and set aside the assessment and collection for deficiency taxes for taxable year 2006 was denied by this Court.

Thus, the Pre-Trial Conference was set anew on July 12, 2018.[37] However, because of the separate motions of the parties,[38] the Pre-Trial Conference was reset to and held on August 30, 2018.[39] Prior thereto, *Respondent's Pre-Trial Brief* was filed on August 16, 2018;[40] while *Petitioner's Pre-Trial Brief* was submitted on August 28, 2018.[41]

In the meantime, petitioner filed its *Motion for Reconsideration (of the Resolution dated 13 June 2018)* on July 13, 2018.[42] Respondent failed to file his comment thereon.[43] In any event, the Court denied the said *Motion for Reconsideration* in Resolution dated December 21, 2018.[44]

On September 28, 2018, the parties posted their *Joint Stipulation of Facts and Issues*,[45] which the Court approved in the Resolution dated October 29, 2018,[46] thereby deeming the

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[35] Docket – Vol. II, pp 1142 to 1146.
[36] Docket – Vol. II, pp. 1148 to 1158.
[37] Resolution dated June 13, 2018, Docket – Vol. II, pp. 1148 to 1158; *Notice of Pre-Trial Conference* dated June 19, 2018, Docket – Vol. II pp. 1159 to 1160.
[38] Respondent's *Urgent Ex Parte Motion to Reset Pre-Trial Conference* filed on July 2, 2018, Docket – Vol. II, pp. 1161 to 1162; and petitioner's *Motion to Reset Pre-Trial Conference* filed on July 5, 2018; Docket – Vol. II, pp. 1165 to 1168.
[39] Order dated July 3, 2018, Docket – Vol. II, p. 1163; Order dated July 12, 2018, Docket – Vol. II, p. 1170; Minutes of the hearing held on, and Order dated, August 30, 2018, Docket – Vol. IV, pp. 2124 to 2129.
[40] Docket – Vol. II, pp. 1200 to 1203.
[41] Docket – Vol. III, pp. 1240 to 1256; cf: *Motion to Admit (Pre-Trial Brief and Judicial Affidavit of Vencent Q. David)*, Docket – Vol. III, pp. 1235 to 1238; Order dated August 30, 2018, Docket – Vol. IV, pp. 2127 to 2129.
[42] Docket – Vol. II, pp. 1172 to 1196.
[43] Records Verification dated October 18, 2018, Docket – Vol. IV, p. 2165.
[44] Docket – Vol. IV, pp. 2208 to 2211.
[45] Docket – Vol. IV, pp. 2147 to 2162.
[46] Resolution dated October 29, 2018, Docket – Vol. IV, p. 2173.

Pre-Trial terminated. The Court then issued the Pre-Trial Order dated November 15, 2018.[47]

Trial on the merits ensued.

Petitioner presented its documentary and testimonial evidence. The testimony of Mr. Vencent Q. David,[48] petitioner's Accountant - Finance Manager, was offered. Moreover, petitioner adopted the testimony of Mr. Ernesto V. Zubiri offered during the preliminary hearing on the issue of prescription, as part of its testimonial evidence on the main case.[49]

On March 13, 2019, petitioner's *Formal Offer of Evidence* was filed.[50] Respondent posted his *Comment/Opposition (Petitioner's Formal Offer of Evidence)* on March 27, 2019.[51] In the Resolution dated May 6, 2019,[52] petitioner's Exhibits were admitted by the Court, *except* for Exhibits "P-20", "P-20-1", and "P-22-0" to "P-22-298", for failure to present the originals for comparison.

Thus, petitioner filed its *Motion for Reconsideration (to Admit Exhibits "P-20", "P-20-1" and "P-22-0 to P-22-298")* on June 4, 2019.[53] Respondent's *Comment/Opposition (To Petitioner's Motion for Reconsideration)* was posted on June 6, 2019.[54]

In the Resolution dated July 17, 2019,[55] the Court partially granted petitioner's *Motion for Reconsideration*, and admitted Exhibits "P-20" and "P-20-1", but still denied Exhibits "P-22-0" to "P-22-298", for failure to comply with the requisites for admissibility as secondary evidence.

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[47] Docket – Vol. IV, pp. 2177 to 2186.

[48] Exhibit "P-23", Docket – Vol. IV, pp. 1700 to 1713; Minutes of the hearing held on, and Order dated, February 26, 2019, Docket – Vol. V, pp. 2256 to 2258.

[49] Per *Petitioner's Formal Offer of Evidence*, Docket – Vol. V, pp. 2262 to 2275, at p. 2273. Refer also to Exhibit "P-13", Docket – Vol. II, pp. 683 to 698; and Minutes of the hearing held on, and Order dated, August 30, 2018, Docket – Vol. IV, pp. 2124 to 2129.

[50] Docket – Vol. V, pp. 2262 to 2275.

[51] Docket – Vol. V, pp. 2715 to 2716.

[52] Docket – Vol. V, pp. 2721 to 2722.

[53] Docket – Vol. V, pp. 2723 to 2733.

[54] Docket – Vol. V, pp. 2735 to 2737.

[55] Docket – Vol. V, pp. 2742 to 2749.

Respondent likewise presented his documentary and testimonial evidence. He proffered the testimony of Ms. Leticia Lorna L. Dosado,[56] a Revenue Officer of the BIR. The testimony of Ms. Felinor A. Pascua at the preliminary hearing to resolve the issue of prescription had been adopted by respondent, also as part of his testimonial evidence.[57]

Thereafter, respondent filed his *Supplemental Formal Offer of Evidence* on September 25, 2019.[58] Petitioner filed its *Comment/Opposition (re: Respondent's Supplemental Formal Offer of Evidence)* on October 14, 2019.[59] Respondent's exhibits were admitted in evidence, in the Resolution dated November 8, 2019.[60]

Petitioner's *Memorandum* was posted on December 20, 2019,[61] while respondent failed to file his memorandum.[62]

On January 31, 2020, this case was submitted for decision.[63]

Petitioner filed *via courier* a *Manifestation of Availment of Tax Amnesty with Motion to Defer Promulgation of Decision* on September 9, 2020.[64] The Court noted petitioner's *Manifestation of Availment of Tax Amnesty*, but denied the *Motion to Defer Promulgation of Decision.*[65]

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[56] Exhibit "R-17", Docket – Vol. II, pp. 1206 to 1213; Minutes of the hearing held on, and Order dated, September 3, 2019, Docket – Vol. V, pp. 2750 to 2752.

[57] Exhibit "R-9", Docket – Vol. II, pp. 1046 to 1053; Refer also to the Minutes of the hearing held on, and Order dated, August 30, 2018, Docket – Vol. IV, pp. 2124 to 2129.

[58] Docket – Vol. V, pp. 2755 to 2762.

[59] Docket – Vol. V, pp. 2764 to 2771.

[60] Docket – Vol. V, pp. 2777 to 2778.

[61] Docket – Vol. V, pp. 2779 to 2830.

[62] Records Verification dated January 17, 2020 issued by the Judicial Records Division of this Court, Docket – Vol. V, p. 2833.

[63] Resolution dated January 31, 2020, Docket – Vol. V, p. 2835.

[64] Docket – Vol. V, p. 2835-2838.

[65] Resolution dated September 24, 2020, Docket – Vol. V, p. 2845-2846.

THE ISSUE

"Whether or not the deficiency assessment for income tax for taxable year 2006 should be cancelled for lack of legal and factual basis."[66]

Petitioner's arguments:

Petitioner argues that the right of the Government to collect the assessed tax had prescribed pursuant to Section 203, in relation to Section 222 of the Tax Code; that the protest filed, being in the nature of a request for reconsideration, did not toll the running of the prescriptive period; that even assuming that the protest was in the nature of a request for reinvestigation, the prescriptive period to collect the tax assessed continued to run due to the BIR's failure to grant the request for reinvestigation; that sustaining the right of the BIR to collect the assessed taxes is tantamount to oppression of petitioner as taxpayer, contrary to the intention of Sections 203, 222, and 223 of the Tax Code and the policy for strict construction of statutes of limitations; and that the deficiency assessment for income tax for taxable year 2006 should be cancelled for lack of legal and factual basis.

Respondent's counter-arguments:

In his *Answer*, respondent contends that the filing by petitioner of its letter dated April 20, 2010 in protest of the FAN was clearly beyond the 30-day reglementary period from receipt thereof on January 20, 2010; that petitioner's judicial appeal has already prescribed, and as such, the subject deficiency income tax assessment for taxable year 2006 has already become final, executory and demandable, pursuant to Section 228 of the 1997 Tax Code; that *assuming arguendo* that petitioner has filed the alleged protest letter dated February 19, 2010 to the FAN on the said date, and submitted certain documents in support thereof on April 20, 2010, the issuance by respondent of the assailed FDDA and Amended Assessment Notice, both dated June 17, 2016, does not support the theory and allegations of petitioner that the right of the BIR to collect its deficiency income tax has already prescribed; that petitioner failed to properly substantiate or

[66] Issue, JSFI, Docket – Vol. IV, p. 2157.

controvert by substantial evidence the BIR factual findings; that respondent fully complied with the due process requirement mandated under Section 228 of the 1997 Tax Code, as implemented by Revenue Regulations (RR) No. 12-99, as amended; and that the prescriptive period for assessment and collection of taxes is interrupted or suspended when the taxpayer files a request for reinvestigation which was granted by the BIR.

RULING OF THE COURT

We rule in favor of petitioner.

Notably, petitioner, once again, raises the issue of prescription, and substantially presents the same arguments relative thereto. However, this Court has already extensively addressed the same issue in the Resolution dated June 13, 2018.[67] Thus, We shall not belabor to reiterate the ruling We made therein.

The Court shall now proceed to determine whether the deficiency assessment for income tax for taxable year 2006 should be cancelled for lack of legal and factual basis.

To reiterate, as stated in the Amended Assessment,[68] respondent assessed petitioner for deficiency income tax for the taxable year 2006 in the amount of **₱9,529,413.91**, computed as follows:

Net Income/(Loss) per Return		₱ -
Add/Deduct Adjustments/Disallowances		
Disallowed Quality/Price Adjustments	₱ 121,074.00	
Unsupported Allowance for Inventory Obsolescence	6,003,499.00	6,124,573.00
Adjusted Taxable Income		₱ **6,124,573.00**
Tax Due thereon (35%)		₱ 2,143,600.55
Less: Tax Credits/Payments		
Prior year's excess credits	₱ 1,614,081.00	
Creditable Income Tax Withheld	1,175,922.00	
Total	2,790,003.00	

[67] Docket – Vol. II, pp. 1148 to 1158.

[68] Pars. 4, 11 and 12, Stipulation of Facts, JSFI, Docket – Vol. IV, pp. 2152, 2156, and 2157, respectively.

Less: Unsupported Creditable Income Tax Withheld	₱ 1,175,922.00		
Amount Carried Forward to Succeeding Year	1,793,055.00		
Excess Minimum Corporate Income Tax (MCIT)	996,948.00	3,965,925.00	(1,175,922.00)
Basic Deficiency Income Tax			₱ 3,319,522.55
Add: Interest (04.16.07 to 07.22.16)			6,209,891.36
Total Amount Due			**₱ 9,529,413.91**

Based on the foregoing, the deficiency income tax assessment arose from the following items, which shall be addressed one by one, to wit:

a. Disallowed Quality/Price Adjustments	₱ 121,074.00
b. Unsupported Allowance for Inventory Obsolescence	6,003,499.00
c. Unsupported Creditable Income Tax Withheld	1,175,922.00
d. Amount Carried Forward to Succeeding Year	1,793,055.00
e. Excess MCIT	996,948.00

a. Disallowed Quality/Price Adjustments - ₱121,074.00

As stated in the *Details of Discrepancies* attached to the FDDA,[69] respondent found petitioner liable for deficiency income tax on disallowed quality/price adjustments, *viz.*:

> "**Disallowed Price/Quality Adjustments, ₱121,074.00** – Verification per your Income Tax Return disclosed that you have claimed for a deduction to gross income due to price/quality adjustments booked under 'other expenses' in the amount of ₱121,074.00. However[,] since you did not present any corroborative evidence/documents relative to your claimed price/quality adjustments, the same is hereby disallowed as deduction to gross income pursuant to ***Section 34(A)(1)(b) of the Tax Code.***"

In the Judicial Affidavit of Mr. Vencent Q. David,[70] petitioner's Finance Manager explained where the quality/price adjustments of ₱121,074.00 came from, as follows:

> **"10. Q: For the Quality/Price Adjustments amounting to ₱121,074.00, can you tell us where it came from?**

[69] Exhibit "R-7-b", BIR Records, p. 581.
[70] Exhibit "P-23", Docket – Vol. IV, pp. 1703 to 1704.

A: As stated in our Protest **(Exhibit 'P-5')**, the quality/price adjustments of ₱121,074.00 in Item No. 105 of the 2006 ITR are due to the following:

i. Double invoicing, hence, second (2nd) invoice is reversed;

ii. Weight difference between Classic's weighing scale and the customer's. For example, Classic invoices 100 kg and the customer changes it to 95.5 kg;

iii. Discounts such as when the customer asks or insists for discounted rate;

iv. Mistake on pricing such as when Classic invoices 100kg instead of the agreed 90 kg since most meat products do not have equal weight per packaging;

v. Classic erroneously delivers more than what customer indicated on the Purchase Order, which is again due to unequal weight per packaging; and

vi. Customer rejects the product because of many reasons such as wrong order, lack of storage space, business slowing down, etc.

11. Q: What is the result of these quality/price adjustments on the Classic's tax liabilities?

A: The quality/price adjustments of ₱121,074.00 are included in the accounts receivable of ₱2,272,431.00 which was written off in Item No. 117 of the 2006 ITR. This means that the deduction of the quality/price adjustments from the gross income did not result in any tax benefit to Classic. Moreover, the quality/price adjustments, as described above, consist of sales returns, discounts, and allowances which are allowed as deductions for income tax purposes pursuant to Section 27(A) of the Tax Code."

Other than the testimony of petitioner's Finance Manager, no other evidence was provided by petitioner to corroborate the claim of quality/price adjustments of ₱121,074.00. The details of the alleged enumerated factors constituting the amount were not further explained nor supported by any document or any other evidence.

In addition, petitioner's claim that it was included in the accounts receivable written off in the amount of ₱2,272,431.00

cannot be given merit. Petitioner failed to provide the breakdown of the amount written off to show that indeed the quality/price adjustments of ₱121,074.00 were part of it.

In claiming a deduction from gross income, petitioner has the burden of proving that the amount of ₱121,074.00 representing quality/price adjustments complied with the substantiation requirements as set forth under Section 34(A)(1)(b) of the NIRC of 1997, as amended. Deductions for income tax purposes partake of the nature of tax exemptions and are strictly construed against the taxpayer, who must prove by convincing evidence that it is entitled to the deduction claimed.[71]

Considering the foregoing, the disallowance of quality/price adjustments of ₱121,074.00 should be upheld.

b. Unsupported Allowance for Inventory Obsolescence - ₱6,003,499.00

Based on the *Details of Discrepancies*,[72] respondent found petitioner liable for deficiency income tax on unsupported allowance for inventory obsolescence, detailed as follows:

> "**<u>Unsupported Provision of Inventory, ₱6,003,499.00</u>** – Verification of the reconciling item per your Income Tax Return noted a non-taxable sale of inventory previously provided for allowance. Hence, further verification was made to attest your claim if indeed permissible. However[,] since you cannot provide any corroborative evidence that your claim provision for inventory obsolescence was added back on your previous years income tax returns, said discrepancy is hereby disallowed as deduction to gross income pursuant to ***Section 34(A)(1)(b) of the Tax Code***."

Petitioner maintains that respondent incorrectly disallowed the said amount on the basis of alleged failure to provide any corroborative evidence. In its Letter dated April 20, 2010,[73] petitioner insists that it had submitted its Annual

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[71] *Philex Mining Corporation vs. Commissioner of Internal Revenue*, G.R. No. 148187, April 16, 2008.
[72] Exhibit "R-7-B", BIR Records, p. 580.
[73] Exhibit "P-6", Docket – Vol. II, pp. 1009 to 1020.

ITR and audited Financial Statements from year 2000 to 2005 as proof that deduction of the amount of ₱6,003,499.00 in 2006 as non-taxable sale of inventory did not result in any tax benefit for petitioner.

In the Judicial Affidavit of Mr. David,[74] he explained what the provision for inventory obsolescence was for, to wit:

"16. **Q: Can you explain what the provision for inventory obsolescence is for?**

A: As stated in Note 4 of Classic's 2006 Audited Financial Statement (**'2006 AFS'**), the Company's inventories include frozen meat, fish, and seafood products, dairy, fruits, vegetables, pastries and dry goods. The allowance for inventory obsolescence is a contra-asset account and it is intended to take into account possible reduction in market value of the inventory. The allowance for inventory obsolescence in the 2006 AFS is net of inventory items sold during the year amounting to Php6,003,499.00 which was provided with allowance in prior year.

17. **Q: Did Classic get any tax benefit from the provision for inventory obsolescence as assessed by the BIR in the FDDA?**

A: No, Classic did not get any tax benefit from the provision for inventory obsolescence. The provision for inventory obsolescence is only recorded in accordance with the Philippine Accounting Standard (**'PAS'**) but was considered a non-deductible expense for tax purposes. To illustrate, the movements in Classic's Allowance for Inventory Obsolescence account are shown in this table:

Year	Beginning Balance	Provision	Recovery	Net Provision	Ending Balance
2004	40,000.00	12,788,951.00		12,788,951.00	12,828,951.00
2005	12,818,651.00	3,417,073.00	3,309,348.00	107,725.00	12,926,676.00
2006	12,926,676.00	1,229,427.00	**6,003,499.00**	(4,774,072.00)	8,152,604.00
	Total	**17,395,451.00**	**9,312,847.00**		

18. **Q: Can you explain to us what the table means?**

A: The table shows that movements in Classic's Allowance for Inventory Obsolescence. The third row shows the provision for inventory obsolescence. For

[74] Exhibit "P-23", Docket – Vol. IV, pp. 1705 to 1707.

> CY 2006, the amount of Php1,229,427.00 was recorded as provision for inventory obsolescence in Item No. 115 (Non-deductible Expenses/Taxable Other Income) while the amount of Php6,003,499.00 is reflected in Item No. 117, which appears in Section E (Reconciliation of Net Income Per Books Against Taxable Income) of the 2006 ITR.
>
> Classic is required to record a provision for inventory obsolescence pursuant to Philippine Financial Reporting Standard (**'PFRS'**), but is not allowed to deduct the same under the Tax Code, a 'temporary difference' results between the net income reported in the AFS and the taxable income reported in the ITR. The timing difference does not affect the taxable net income reported in the AFS for the same years, which were decreased by the provision for inventory obsolescence. Because of this, Classic needed to reconcile the net income reported in the AFS with taxable income reported in the ITR by removing the effect of the provision for inventory obsolescence on net income reported in the AFS. Thus, the provisions for inventory obsolescence recorded by Classic in its AFS for the years 2003 to 2006 were reflected as a reconciling item, and added back to net income reported in the AFS."

The Court agrees with petitioner.

As indicated in the petitioner's AFS for years 2004[75], 2005[76], 2006[77], its inventories were valued at the lower of cost and net realizable value (NRV) in accordance with the applicable financial reporting standards in such years.[78] Pursuant to its accounting policies, petitioner set up a provision for inventory obsolescence and presented its ending inventories at NRV at the end of the accounting period. These provisions for inventory obsolescence were only taken into account in the AFS and were considered as non-deductible expenses for computing the taxable income per ITR. Accordingly, petitioner properly reflected in its Annual ITR for taxable years 2004[79], 2005[80], and 2006[81] the said provisions

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[75] Exhibit "P-16", Docket - Vol. V, pp. 2323 to 2339.
[76] Exhibit "P-17", Docket – Vol. V, pp. 2340 to 2362.
[77] Exhibit "P-18", Docket – Vol. V, pp. 2363 to 2386.
[78] See Note 2 Summary of Significant Account Policies of the Notes to Financial Statements.
[79] Exhibit "P-19", Docket – Vol. V, pp. 2387 to 2389.
[80] Exhibit "P-20", Docket – Vol. V, pp. 2390 to 2392.
[81] Exhibit "P-14", Docket – Vol V, pp. 2298 to 2300.

as reconciling items[82]. Consequently, upon recovery of the provision for inventory obsolescence in a subsequent period, the same has no effect on the taxable income reported in the Annual ITR because the same is only a reversal of the provision made in the previous year/s.

The Court finds the example given by Mr. David in his Judicial Affidavit informative. He shows that a timing difference occurs in the event that provision for inventory obsolescence is reported and when it is subsequently recovered, to wit:[83]

> "***Year 1***. Taxpayer reported sales of ₱1,000.00 and cost of goods of ₱700.00 in its AFS. The cost of goods sold includes the effect of a provision for inventory obsolescence of ₱200.00 which decreased ending inventory by ₱200.00 and in turn, increased cost of goods sold by ₱200.00.

	AFS	**ITR**
Sales	1,000.00	1,000.00
Cost of Goods Sold	700.00	500.00
Taxable Income	300.00	500.00

> The procedure to reconcile the net income reported in AFS with taxable income reported in AFS will be as follows:

Reconciliation of AFS and ITR	
Gross Income per AFS	300.00
Add: Non-deductible expense Provision for Inventory Obsolescence	200.00
Gross Income per ITR	500.00

> ***Year 2.*** Taxpayer reported regular sales of ₱1,000.00 including sale of goods that were written down due to provision for inventory obsolescence in the amount of ₱200.00.

	AFS	**ITR**
Sales	1,000.00	1,000.00
Cost of Goods Sold	500.00*	700.00
Taxable Income	500.00	300.00

> * *Under the AFS, the inventory previously deemed obsolete no longer has any value in Year 2 when it was*

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[82] See Section E - Reconciliation of Net Income Per Books Against Taxable Income of the Annual ITR.

[83] Exhibit "P-23", Docket – Vol. IV, pp. 1707 to 1708.

sold, thus, the cost of goods sold is only ₱500.00 instead of the ₱700.00 which is what is reflected in the ITR.

The procedure to reconcile the net income reported in AFS with taxable income reported in AFS will be as follows:

Reconciliation of AFS and ITR	
Gross Income per AFS	500.00
Less: Non-taxable income (recovery of inventory obsolescence)	200.00
Gross Income per ITR	300.00

As shown in my example, the cumulative net income and cumulative taxable income of the Corporation for Years 1 and 2 will be the same (₱800.00). This clearly shows that there is only a timing difference when the Corporation records provision for inventory obsolescence and the recovery of inventory obsolescence in the AFS but not in the ITR."

Furthermore, it is erroneous to disallow the allowance for inventory obsolescence sold in 2006 in the amount of ₱6,003,499.00 pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended, because the same was not claimed as deduction to gross income in the Annual ITR in the first place. Thus, the substantiation requirement is not applicable.

Hence, the Court is constrained to cancel this item of the subject income tax assessment.

c. Unsupported Creditable Income Tax Withheld - ₱1,175,922.00

Based on the *Details of Discrepancies*,[84] respondent explained the disallowance as follows:

"**Unsupported Creditable Income Tax Withheld , ₱1,175,922.00** – Since you failed to submit proof to support the claimed tax credit per income tax return in the amount of ₱1,175,922.00, such amount was disallowed pursuant to ***Section 2.58.3 of Revenue Regulations 2-98***, as amended."

[84] Exhibit "R-7-B", BIR Records, p. 580.

Petitioner maintains that the creditable withholding tax (CWT) in 2006 is supported by the *Certificates of Creditable Tax Withheld at Source* (BIR Form No. 2307) duly issued by its customers in 2006, albeit photocopies, as the original copies of the CWT certificates can no longer be located despite its diligent efforts.

In this Court's Resolution dated July 17, 2019[85], the Court ruled that petitioner failed to prove that the originals of the subject CWT certificates were duly executed. Hence, the photocopies of the CWT certificates marked as Exhibits "P-22-0" to "P-22-298" were not admitted as secondary evidence.

Hence, failure of the petitioner to substantiate the disallowed CWT in the amount of ₱1,175,922.00, the disallowance should be upheld.

d. Amount Carried Forward to Succeeding Year - ₱1,793,055.00

Based on the *Details of Discrepancies*,[86] the BIR explained the disallowance as follows:

> "**Amount Carried Forward to Succeeding Year, ₱1,793,055.00** – The excess credit carried-over of ₱1,793,055.00 per ITR cannot be credited against the deficiency income tax since said amount was already carried forward to the succeeding fiscal year pursuant to ***Section 2.58.3 of Revenue Regulation No. 2-98***, as amended. The said amount has been disallowed to recapture the tax benefit thereon."

This portion of the assessment should be cancelled.

The disallowance of petitioner's excess credits carried forward to the succeeding year in the amount of ₱1,793,055.00 was improper because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year or years. Since the tax benefit will be in the succeeding year or years, petitioner may only be assessed for the said succeeding year or years.

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[85] Docket – Vol. V, pp. 2742 to 2749.
[86] Exhibit "R-7-B", BIR Records, p. 580.

e. Excess MCIT - ₱996,948.00

Based on the *Details of Discrepancies*,[87] the BIR explained the disallowance as follows:

> "**Excess Minimum Corporate Income Tax (MCIT) ₱996,948.00** – The minimum corporate income tax was not allowed as tax credit against the computed deficiency income tax, considering that the said amount shall be carried over and credited against the normal income tax for the three (3) immediately succeeding taxable year in compliance with the provision imposed under Section 27(E)(1)(2) of the Tax Code."

The Court finds the disallowance untenable.

Section 27(E)(1) and (2) of the NIRC of 1997, as amended, provides:

> "SEC. 27. *Rates of Income Tax on Domestic Corporations.* —
>
> xxx xxx xxx
>
> (E) *Minimum Corporate Income Tax on Domestic Corporations.* —
>
> (1) *Imposition of Tax.* — A minimum corporate income tax of two percent (2%) of the gross income as of the end of the taxable year, as defined herein, is hereby imposed on a corporation taxable under this Title, beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations, when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year.
>
> (2) *Carry Forward of Excess Minimum Tax.* — Any excess of the minimum corporate income tax over the normal income tax as computed under Subsection (A) of this Section shall be carried forward and credited against the normal income tax for the three (3) immediately succeeding taxable years."

[87] Exhibit "R-7-B", BIR Records, p. 580.

Implementing the above-quoted provision is Section 2.27(E) of RR No. 09-98,[88] which, in part, reads:

> "Sec. 2.27(E). MINIMUM CORPORATE INCOME TAX (MCIT) ON DOMESTIC CORPORATIONS. —
>
> (1) *Imposition of the Tax.* — A minimum corporate income tax (MCIT) of two percent (2%) of the gross income as of the end of the taxable year (whether calendar or fiscal year, depending on the accounting period employed) is hereby imposed upon any domestic corporation beginning on the fourth (4th) taxable year immediately following the taxable year in which such corporation commenced its business operations. **The MCIT shall be imposed whenever such corporation has zero or negative taxable income or whenever the amount of minimum corporate income tax is greater than the normal income tax due from such corporation.**
>
> xxx xxx xxx
>
> (2) *Carry forward of excess minimum corporate income tax* — xxx
>
> xxx xxx xxx
>
> **The taxpayer shall pay the MCIT whenever it is greater than the regular or normal corporate income tax which is imposed under Sec. 27 (A) of the Code. The comparison between the normal income tax payable by the corporation and the MCIT shall be made at the end of the taxable year.** xxx." *(Emphases added)*

It is clear from the foregoing provisions that the 2% MCIT on gross income shall be imposed whenever the taxpayer-corporation has zero or negative taxable income or whenever the amount of MCIT is greater than the normal or regular income tax due from such taxpayer-corporation, as determined at the end of the taxable year. In other words, in such cases, the MCIT is imposed in lieu of the normal or regular corporate income tax of 35%.

In its Annual ITR for taxable year 2006,[89] petitioner declared a zero (0) taxable income.[90] Consequently, petitioner

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[88] SUBJECT: Implementing Republic Act No. 8424, "An Act Amending the National Internal Revenue Code, As Amended" Relative to the Imposition of the Minimum Corporate Income Tax (MCIT) on Domestic Corporation and Resident Foreign Corporations

[89] Exhibit "P-14", Docket – Vol. V, pp. 2298 to 2301.

[90] Line 21 of Annual ITR for Taxable Year 2006.

reported and paid MCIT in the amount of ₱996,948.00 on the gross income of ₱49,847,383.00.

As already discussed, the Court shall sustain only the disallowance of Quality/Price Adjustments in the amount of ₱121,074.00, which, consequently, should be treated as petitioner's taxable income for taxable year 2006. However, despite having a taxable income of ₱121,074.00, the application of the MCIT is still warranted because the MCIT of ₱996,948.00 is higher than the regular income tax of ₱42,375.00 (₱121,074.00 x 35%).

Since the MCIT will be credited against the normal income tax for the three (3) immediately succeeding taxable years, pursuant to Section 27(E)(2) of the NIRC of 1997, as amended, its benefit will redound to the succeeding year or years. Thus, it is inappropriate to disallow the same in taxable year 2006.

In sum, considering that only the disallowances of Quality/Price Adjustments amounting to ₱121,074.00 and the unsupported CWT amounting to ₱1,175,922.00 are sustained, a re-computation of the subject income tax assessment shows that petitioner has no deficiency income tax liability for taxable year 2006, since petitioner had enough prior year's excess credits in the amount of ₱1,614,081.00 (which was recognized by respondent or the BIR in the Amended Assessment as valid) to cover the MCIT due, to wit:

Net Income/(Loss) per Return		-
Add/Deduct Adjustments/Disallowances:		
Disallowed Quality/Price Adjustments		₱ 121,074.00
Adjusted Taxable Income		**121,074.00**
Tax Due thereon (35%)		42,375.90
MCIT		**₱ 996,947.66**
Less: Tax Credits/Payments		
Prior year's excess credits	₱1,614,081.00	
Creditable Tax Withheld	1,175,922.00	
Total	₱2,790,003.00	
Less: Unsupported Creditable Income Tax Withheld	1,175,922.00	₱ 1,614,081.00
Total Amount Due/(Overpayment)		**(₱617,133.34)**

WHEREFORE, in light of the foregoing considerations, the *Petition for Review* is **GRANTED.**

The assessment items for deficiency income tax are **PARTIALLY UPHELD**. Nevertheless, petitioner has no deficiency income tax liability and even incurred income tax overpayment as computed above. Accordingly, the assessment issued by respondent against petitioner for the taxable year 2006, covering deficiency income tax in the amount of ₱9,529,413.91, inclusive of interest, is **CANCELLED** and **SET ASIDE.**

SO ORDERED.

CATHERINE T. MANAHAN
Associate Justice

I CONCUR:

ROMAN G. DEL ROSARIO
Presiding 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.

ROMAN G. DEL ROSARIO
Presiding Justice