REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

PILMICO-MAURI FOODS CORP.,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. EB No. 97
(C.T.A. Case No. 6151)

Present:
Acosta, *P.J.,*
Castañeda, Jr.,
Bautista,
Uy,
Casanova,
Palanca-Enriquez, *JJ.*

Promulgated:

AUG 29 2006

x- -x

DECISION

CASTAÑEDA, JR., *J.:*

This is a Petition for Review before the Court of Tax Appeals *En Banc* (the Court *En Banc*) pursuant to Section 18 of Republic Act No. 1125 as amended by Section 11 of Republic Act No. 9282 seeking for the reversal of the Decision promulgated on December 15, 2004 by the First Division of the Court of Tax Appeals (the Court in Division) in C.T.A. Case No. 6151 entitled *"Pilmico-Mauri Foods Corporation vs. Commissioner of*

Internal Revenue" and the Resolution dated May 19, 2005 affirming the assailed Decision. The dispositive portion of the Decision reads as follows:

> "**WHEREFORE,** the petitioner is hereby ORDERED to PAY the respondent an aggregate sum of P2,804,920.36 (inclusive of surcharge and deficiency interest) representing petitioner's Income, VAT and Withholding Tax deficiencies for the taxable year 1996 plus 20% delinquency interest per annum on the above amount of P2,804,920.36 computed from July 4, 2000 until full payment thereof pursuant to Section 249 of the 1997 Tax Code, as amended.
>
> **SO ORDERED**."

THE FACTS

The facts of the case as found by the Court in Division are as follows:

> "Petitioner is a corporation, organized and existing under the laws of the Philippines, with principal place of business at Aboitiz Corporate Center, Banilad, Cebu City.
>
> The books of accounts of the petitioner pertaining to 1996 were examined by the respondent thru Revenue Officer Eugenio D. Maestrado of Revenue District No. 81 (Cebu City North District) for deficiency income, value-added (VAT) and withholding tax liabilities.
>
> As a result of the investigation, the following assessment notices were issued against the petitioner:
>
> (a) Assessment Notice No. 81-WT-13-96-98-11-126, dated November 26, 1998, demanding payment for deficiency withholding taxes for the year 1996 in the sum of P384,925.05 (inclusive of interest and other penalties);
>
> (b) Assessment Notice No. 81-VAT-13-96-98-11-127, dated November 26, 1998, demanding payment of deficiency value-added tax in the sum of P5,017,778.01 (inclusive of interest and other penalties);
>
> (c) Assessment Notice No. 81-IT-13-9698-11-128, dated November 26, 1998, demanding payment of deficiency income tax for the

year 1996 in the sum of P4,359,046.96 (inclusive of interest and other penalties).

The foregoing Assessment Notices were all received by the petitioner on December 1, 1998. On December 29, 1998, petitioner filed a protest letter against the aforementioned deficiency tax assessments through the Regional Director, Revenue Region No. 13, Cebu City.

In a final decision of the respondent on the disputed assessments dated July 3, 2000, the deficiency tax liabilities of the petitioner were reduced from P9,761,750.02 to P3,020,259.30, broken down as follows:

(a) Deficiency withholding tax from P384,925.05 to P197,780.67;
(b) Deficiency value-added tax from P5,017,778.01 to P1,642,145.79; and
(c) Deficiency Income Tax from P4,359,046.96 to P1,180,332.84.

The aforementioned decision of the respondent Commissioner, through the Regional Director of Revenue Region No. 13, Cebu City constitutes the final decision appealable to this court since it contains the instruction: "If you disagree, you may appeal this final decision with the Court of Tax Appeals within 30 days from date of receipt hereof, otherwise said deficiency taxes on income, VAT and withholding assessment shall become final, executory and demandable."

On the basis of the foregoing facts petitioner filed its Petition for Review on August 9, 2000. In the "Joint Stipulation of Facts" filed on March 7, 2001, the parties have agreed that the following are the issues to be resolved:

I. Whether or not petitioner is liable for the payment of deficiency income, value-added, expanded withholding, final withholding, and withholding tax (on compensation).

II. On the P1,180,382.84 deficiency income tax

A. Whether or not the P5,895,694.66 purchases of raw materials are unsupported.
B. Whether or not the cancelled invoices and expenses for taxes, repairs and freight are unsupported.
C. Whether or not commission, storage and trucking charges claimed are deductible.

D. Whether or not the alleged deficiency income tax for the year 1996 was correctly computed.

III. On the alleged deficiency value-added tax (P1,642,145.79) for the year 1996

A. Whether or not input taxes claimed from the purchases of raw materials, cancelled invoices, trucking/storage and truck charges are unsupported.

B. Whether or not petitioner ever claimed non-vatable transportation expenses. If the answer is positive, did the respondent inform the petitioner in writing on the alleged non-vatable transportation expenses being formally asked in its protest and as mandatorily required in the CTRP.

IV. On the deficiency withholding taxes

Whether or not the petitioner failed to observe the withholding tax laws on payments subject to EWT, Final Withholding Tax and Withholding Tax on Compensation;

V. Whether or not respondent's decision on the 1996 internal revenue tax liabilities of petitioner is contrary to law and the facts.

After trial on the merits, the Court in Division rendered the assailed Decision affirming the assessments but in the reduced amount of P2,804,920.36 (inclusive of surcharge and deficiency interest) representing petitioner's Income, VAT and Withholding Tax deficiencies for the taxable year 1996 plus 20% delinquency interest per annum until fully paid. The Court in Division ruled as follows:

"However, petitioner's contention that the NIRC of 1977 did not impose substantiation requirements on deductions from gross income is bereft of merit. Section 238 of the 1977 Tax Code [now Section 237 of the National Internal Revenue Code of 1997] provides:

SEC. 238. ***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 P25.00

> or more, issue receipts or sales or commercial invoices, prepared at least in duplicate, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service: Provided, That in the case of sales, receipts or transfers in the amount of P100.00 or more, or, regardless of amount, where the sale or transfer is made by persons subject to value-added tax to other persons also subject to value-added tax; or, where the receipt is issued to cover payment made as rentals, commissions, compensations or fees, receipts or invoices shall be issued which shall show the name, business style, if any, and address of the purchaser, customer, or client. **The original of each receipt or invoice shall be issued to the purchaser, customer or client at the time the transaction is effected, who, if engaged in business or in the exercise of profession, shall keep and preserve the same in his place of business for a period of three (3) years from the close of the taxable year in which such invoice or receipt was issued,** while the duplicate shall be kept and preserved by the issuer, also in his place of business for a like period. *(Emphasis supplied)*

From the foregoing provision of law, a person who is subject to an internal revenue tax shall issue receipts, sales or commercial invoices, prepared at least in duplicate. The provision likewise imposed a responsibility upon the purchaser to keep and preserve the original copy of the invoice or receipt for a period of three years from the close of the taxable year in which such invoice or receipt was issued. The rationale behind the latter requirement is the duty of the taxpayer to keep adequate records of each and every transaction entered into in the conduct of its business. So that when their books of accounts are subjected to a tax audit examination, all entries therein, could be shown as adequately supported and proven as legitimate business transactions. Hence, petitioner's claim that the NIRC of 1977 did not require substantiation requirements is erroneous.

In fact, in its effort to prove the above-mentioned purchases of raw materials, petitioner presented the following sales invoices:

Exhibit Number	Invoice No.	Date	Gross Amount	10% VAT	Net Amount
B-3	2072	04/18/96	P2,312,670.00	P210,242.73	P2,102,427.27
B-7, B-11	2026	Undated	2,762,099.10	251,099.92	2,510,999.18
			P5,074,769.10	P461,342.65	P4,613,426.45

The mere fact that petitioner submitted the foregoing sales invoices belies petitioner's claim that the NIRC of 1977 did not require that deductions must be substantiated by adequate records.

From the total purchases of P5,893,694.64 which have been disallowed, it seems that a portion thereof amounting to P1,280,268.19 (729,663.64 + 550,604.55) has no supporting sales invoices because of petitioner's failure to present said invoices.

A scrutiny of the invoices supporting the remaining balance of P4,613,426.45 (P5,893,694.64 less P1,280,268.19) revealed the following:

a) In Sales Invoice No. 2072 marked as Exhibit B-3, the name Pilmico Foods Corporation was erased and on top of it the name Pilmico Mauri Foods Corporation was inserted but with a countersignature therein;

b) For undated Sales Invoice No. 2026, petitioner presented two exhibits marked as Exhibits B-7 and B-11. Exhibit B-11 is the original sales invoice whereas Exhibit B-7 is a photocopy thereof. Both exhibits contained the word Mauri which was inserted on top and between the words Pilmico and Foods. The only difference is that in the original copy (Exhibit B-11), there was a countersignature although the ink used was different from that used in the rest of the writings in the said invoice; while in the photocopied invoice (Exhibit B-7), no such countersignature appeared. Petitioner did not explain why the said countersignature did not appear in the photocopied invoice considering it was just a mere reproduction of the original copy.

The sales invoices contain alterations particularly in the name of the purchaser giving rise to serious doubts regarding their authenticity and if they were really issued to the petitioner. Exhibit B-11 does not even have any date indicated therein, which is a clear violation of Section 238 of the NIRC of 1977 which required that the official receipts must show the date of the transaction.

Furthermore, petitioner should have presented documentary evidence establishing that Pilmico Foods Corporation did not claim the subject purchases as deduction from its gross income. After all, the records revealed that both petitioner and its parent company, Pilmico Foods Corporation, have the same AVP Comptroller in the person of Mr. Eugenio Gozon, who is in-charge of the financial records of both entities (see TSN, March 26, 2001, page 6).

Similarly, the official receipts presented by petitioner (Exhibits B-2, B-6, B-10, B-14 & B-17), cannot be considered as valid proof of petitioner's claimed deduction for raw materials purchases. The said receipts did not conform to the requirements provided for under Section 238 of the NIRC of 1977, as amended. First, the official receipts were not in the name of petitioner but in the name of Golden Restaurant. And second, these receipts were issued by PFC and not the alleged seller, JTE.

Likewise, petitioner's allegations regarding the offsetting of accounts between the petitioner, PFC and JTE is untenable. The following circumstances contradict petitioner's proposition: 1) the Credit Agreement itself does not provide for the offsetting arrangement; 2) the petitioner was not even a party to the credit agreement; and 3) the official receipts in question pertained to the year 1996 whereas the Credit Agreement (Exhibit M) and the Real Estate Mortgage Agreement (Exhibit N) submitted by petitioner to prove the fact of the offsetting of accounts, were both executed only in 1997.

Besides, in order to support its claim, petitioner should have presented the following vital documents, namely, 1) Written Offsetting Agreement; 2) proof of payment by Pilmico Mauri Foods Corporation to Pilmico Foods Corporation; and 3) Financial Statements for the year 1996 of Pilmico Foods Corporation to establish the fact that Pilmico Foods Corporation did not deduct the amount of raw materials being claimed by petitioner.

Considering that the official receipts and sales invoices presented by petitioner failed to comply with the requirements of Section 238 of the NIRC of 1977, the disallowance by the respondent of the claimed deduction for raw materials is proper."[1]

The petitioner filed a Motion for Partial Reconsideration on January 21, 2005 praying for the reconsideration of the assailed Decision but as stated at the outset, petitioner's Motion for Reconsideration was denied in a Resolution dated May 19, 2005 for lack of merit. Hence this appeal by way of a Petition for Review.

GROUNDS FOR APPEAL

In its Petition for Review, petitioner raised the following grounds for its appeal:

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1 Assailed Decision, pp. 7-11.

I. The Honorable Court of Tax Appeals First Division erred in sustaining the disallowance of Petitioner's purchases of raw materials resulting to deficiency income tax. The effect of said disallowance is a violation of the principle that it would be unfair to tax the revenue from an activity but not allow deductions for the expenses that produced it.

II. The quantum of evidence required by law to support petitioner's deduction of raw material was adequately presented. To completely disallow petitioner's purchase of raw materials is to draw a conclusion that nothing was spent to produce something.

III. The Honorable Court of Tax Appeals First Division assumed an executive function when it substituted a legal basis that Respondent failed to establish, contrary to law.

IV. The Decision of the Honorable Court of Tax Appeals First Division must conform to the pleadings and the theory of the action under which the case was tried. A judgment going outside the issues and purporting to adjudicate something on which the parties were not heard is invalid *(Lazo et al vs. Republic Surety & Insurance Co., Inc. L-27365, Jan. 30, 1970).* The legal basis cited by the Honorable Court which supported the validity of the assessment was never raised by the respondent, petitioner was deprived of its constitutional right to be apprised of the legal basis of the assessment.

PETITIONER'S ARGUMENTS

Petitioner argues that justice and equity dictates that where substantial proof has been presented, courts should allow the deduction claimed particularly when it is clearly shown that what is being claimed is an ordinary and necessary expense. With respect to substantiation, a taxpayer is only required to maintain records sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown on the tax return, consequently, absolute certainty in such matters is usually impossible and is not necessary. According to the petitioner, this is the principle behind the "Cohan Rule" which was adopted by the Supreme Court in the case of Visayan Cebu Terminal vs. Collector, 108 Phil 320 where the Honorable Court held that: "Where it is certain from the evidence adduced that the taxpayer did incur expenses but the actual amount thereof has not been established, the Commissioner should make a close approximate thereof, and his determination thereof shall bear heavily on the taxpayer for his own inexactitude. Petitioner was able to prove that the raw materials it was claiming as an expense was an ordinary and necessary expense, it proved that it had paid for, received the delivery of said raw materials used in the manufacture of its goods and incurred in year in issue said expense.

Petitioner avers that by imposing the provisions of Section 238 of the 1977 Tax Code as a measure of determining the deductibility of an expense, the Honorable Court of Tax Appeals in effect is performing judicial legislation and is resolving a legal issue which were not raised in the pleadings nor advanced by the respondent during the trial of the case. Section 238 is a provision of the Tax Code intended to govern the manner of the issuance of receipts and is primarily directed to the issuer who is the person who transacts a sale or transfer of merchandise or renders service. To sanction the purchaser for the mistake of the seller by absolutely denying the former the right to the deduction of an expense actually incurred is unjust and without basis in law.

Petitioner asserts that the basis of the disallowance made by respondent on the purchase of raw materials and the sole subject of petitioner's Motion for Reconsideration as stated in the former's Details of Assessment is Section 34b of the Tax Code of 1997. Having ruled on the erroneous application of the Tax Code of 1997, the Honorable Court extracted from the Tax Code Section 238 of the 1977 Tax Code to justify the correctness of the assessment. The Honorable Court by upholding the validity of an assessment which has no leg to stand on is in effect usurping the function of the Bureau of Internal Revenue to issue an assessment and a decision on a disputed assessment which are both an executive function. More so, by providing *locus standi* to a particular assessment through reference to other provisions of law or an entirely different law not stated in the assessment and decision of the Commissioner of Internal Revenue but only in the Court's Decision, it deprived the right to the petitioner to respond and defend itself and to adduce evidence in order to dispute the Court's own findings. After a decision has been rendered by the Court, a petitioner loses the opportunity to adduce additional evidence to defend itself against an issue which was never raised by the respondent. The Honorable Court has crossed the boundary of its judicial function and had exercised an executive power which is contrary to the separation of powers of the three divisions of government.

According to the petitioner, the Decision of the Honorable Court sustaining the validity of the assessment based on the disallowance of petitioner's purchase of raw materials is invalid. It violated the cardinal rule that a judgment must conform to and be supported by both the pleadings and the proofs, and should be in accordance with the theory of the action on which the pleadings were framed and the case was tried. Respondent never alleged as a basis Section 238 of the 1977 Tax Code, he relied entirely on the provisions of the 1997 Tax Code to the prejudice of Petitioner. The general rule is *allegata et probate* – a judgment must conform to the pleadings and the theory of the action under which the case was tried. But a court may also rule and render judgment on the basis of the evidence before it, even though the relevant pleading has not been previously amended, so long as no surprise or prejudice to the adverse party is thereby caused *(Vlason Enterprises Corporation vs. Court of Appeals and Duraproof Services, G.R. Nos 121662-64, July 6, 1999)*. The judgment of the Honorable Court of Tax Appeals is prejudicial to the right of the petitioner. It was based on legal presumptions which the petitioner had no prior knowledge of hence, no opportunity to properly defend or rebut during the same. The findings of the Court supporting petitioner's liability was based on a defect in the Official Receipt issued to Petitioner, not on whether or not an expense is deductible. Said finding is absent in the assessment made by the Respondent. The sole basis stated by respondent in his assessment is Section 34b of the 1997 Tax Code. On the other hand, the Honorable Court sustained the assessment based on Section 238 of the 1977 Tax Code which governs the proper issuance of an official receipt.

RESPONDENT'S ARGUMENTS

Respondent, in his Comment filed on September 9, 2005, argues that the issues raised by the petitioner in its Petition for Review have been extensively, sufficiently and squarely addressed and resolved by this Honorable Court in the assailed Decision. Consequently, petitioner does not raise any new issues or matters that have not already been considered and decided upon by this Honorable Court.

THIS COURT'S RULING

The Petition for Review is not meritorious.

The core of petitioner's appeal focuses on allegations that 1) it presented substantial proof that the cost of raw materials it was claiming as an expense was ordinary and necessary in carrying on its trade or business; and 2) that the Court in Division erred in affirming the assessments against it based on Section 238 of the 1977 Tax Code which is different from the basis used by the respondent Commissioner of Internal Revenue in its assessment which is Section 34b of the 1997 Tax Code. According to the petitioner, the Court in Division assumed the function of the Bureau of Internal Revenue to issue an assessment and deprived it of its right to respond and defend itself and by doing so, the Decision of the Court in Division violated the cardinal rule that judgment must conform to and be supported by both the pleadings and the proofs and should be in accordance with the theory of the action on which the pleadings were framed and the case was tried.

The foregoing allegations are bereft of merit.

Best Evidence to Prove Deductible Ordinary and Necessary Expenses Are the Official Receipts and Sales Invoices

The factual finding of the Court in Division that the official receipts presented by petitioner *(Exhibits B-2, B-6, B-10, B-14 & B-17)* did not conform to the requirements of Section 238 of the 1977 NIRC is supported by the evidence presented during the trial of the case. The Court in Division found that the official receipts were not in the name of petitioner but in the name of Golden Restaurant and that the same were issued by Pilmico Foods Corporation and not by the seller Jose Tan

Enterprises[2]. Indeed, in view of said findings, the official receipts cannot be used as supporting documents for the alleged purchases of raw materials claimed as deduction from the gross income of the petitioner. The receipts cannot also be used as valid VAT official receipts in claiming input taxes under the Value-added Tax (VAT) system[3].

The Court in Division did not err when it ruled that the disallowance by the respondent of the claimed deduction for purchases of raw materials is proper since the official receipts and sales invoices presented by petitioner failed to comply with the requirements of Section 238 of the 1977 NIRC. Section 238 of the 1977 NIRC, as amended, provides:

> **SEC. 238.** ***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 P25.00 or more, issue receipts or sales or commercial invoices, prepared at least in duplicate, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service: Provided, **That in the case of sales, receipts or transfers in the amount of P100.00 or more,** or, regardless of amount, where the sale or transfer is made by persons subject to value-added tax to other persons also subject to value-added tax; or, where the receipt is issued to cover payment made as rentals, commissions, compensations or fees, **receipts or invoices shall be issued which shall show the name, business style, if any, and address of the purchaser, customer, or client. The original of each receipt or invoice shall be issued to the purchaser, customer or client at the time the transaction is effected, who, if engaged in business or in the exercise of profession, shall keep and preserve the same in his place of business for a period of three (3) years** from the close of the taxable year in which such invoice or receipt was issued, while the duplicate shall be kept and preserved by the issuer, also in his place of business for a like period. *(Emphasis supplied)*

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2 Assailed Decision, p. 10.

3 *Atlas Consolidated Mining & Development Corporation v. Commissioner of Internal Revenue,* G.R. No. 134467, November 17, 1999.

The language of the above-cited provision of the 1977 NIRC, as amended, is clear. It requires that for each sale valued at P100.00 or more, the name, business style and address of the purchaser, customer or client shall be indicated and that the purchaser is required to keep and preserve the same in his place of business. The purpose of the law in requiring the preservation by the purchaser of the official receipts or sales invoices for a period of three years is two-fold: 1) ***to enable said purchaser to substantiate his claimed deductions from the gross income***, and 2) to enable the Bureau of Internal Revenue to verify the accuracy of the gross income of the seller from external sources such as the customers of said seller. Hence, petitioner's argument that there was no substantiation requirement under the 1977 NIRC is without basis.

Moreover, the Supreme Court had ruled that in claiming deductions for business expenses it is not enough to prove the business test but a claimant must substantially prove by evidence or records the deductions claimed under the law, thus:

> The principle is recognized that when a taxpayer claims a deduction, he must point to some specific provision of the statute in which that deduction is authorized and must be able to prove that he is entitled to the deduction which the law allows. As previously adverted to, the law allowing expenses as deduction from gross income for purposes of the income tax is Section 30 (a) (1) of the National Internal Revenue which allows a deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. An item of expenditure, in order to be deductible under this section of the statute must fall squarely within its language.

> We come, then, to the statutory test of deductibility where it is axiomatic that to be deductible as a business expense, three conditions are imposed, namely: (1) the expense must be ordinary and necessary; (2) it must be paid or incurred within the taxable year, and (3) it must be paid or incurred in carrying on a trade or business. **In addition, not only must the taxpayer meet the business test, he must substantially prove by evidence or records the deductions claimed under the law, otherwise, the same will be disallowed.** The mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction.[4] *(Emphasis supplied; citations omitted)*

And in proving claimed deductions from gross income, the Supreme Court held that invoices and official receipts are the best evidence to substantiate deductible business expenses. The Supreme Court said:

> We must support the CTA and the Court of Appeals in their foregoing rulings. A taxpayer has the burden of proving entitlement to a claimed deduction. In the instant case, even Picop's own vouchers were not submitted in evidence and the BIR Examiners denied that such vouchers and other documents had been exhibited to them. Moreover, cash vouchers can only confirm the fact of disbursement but not necessarily the purpose thereof. **The best evidence that Picop should have presented to support its claimed deduction were the invoices and official receipts issued by the Register of Deeds.** Picop not only failed to present such documents; it also failed to explain the loss thereof, assuming they had existed before. Under the best evidence rule, therefore, the testimony of Picop's employee was inadmissible and was in any case entitled to very little, if any, credence. [5] *(Emphasis supplied; citations omitted)*

The irregularities found on the official receipts and sales invoices submitted in evidence by the petitioner, *i.e.* not having been issued in the name of the petitioner as the purchaser and the fact that the same

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4 *Atlas Consolidated Mining & Development Corporation vs. Commissioner of Internal Revenue, G.R. No. L-26911, January 27, 1981 and Commissioner of Internal Revenue vs. Atlas Consolidated Mining & Development Corporation and Court of Tax Appeals, G.R. No. L-26924, January 27, 1981.*

5 *Paper Industries Corporation of the Philippines (PICOP) vs. Court of Appeals, Commissioner of Internal Revenue and Court of Tax Appeals, G.R. Nos. 106949-50, December 1, 1995.*

were not issued by the alleged seller himself directly to the purchaser, rendered the same of no probative value.

Parenthetically, the "Cohan Rule" which according to the petitioner was adopted by the Supreme Court in the case of Visayan Cebu Terminal v. Collector, 108 Phil 320, is not applicable because in both of these cases there were natural calamities that prevented the taxpayers therein to fully substantiate their claimed deductions. In the Visayan Cebu Terminal case, there was a fire that destroyed some of the supporting documents for the claimed expenses. There is no such circumstance in petitioner's case, hence, the ruling therein is not applicable. It is noteworthy that notwithstanding the destruction of some of the supporting documents in the aforementioned Visayan Cebu Terminal case, the Supreme Court in denying the appeal issued the following *caveat* noting the violation of the provision of the Tax Code committed by the petitioner therein:

> "It may not be amiss to note that the explanation to the effect that the supporting paper of some of those expenses had been destroyed when the house of the treasurer was burned, **can hardly be regarded as satisfactory, for appellant's records are supposed to be kept in its offices,** not in the residence of one of its officers." *(Emphasis supplied)*

From the above-quoted portion of the Supreme Court's Decision, it is clear that compliance with the mandatory record-keeping requirements of the National Internal Revenue Code should not be taken lightly. Raw materials are indeed deductible provided they are duly supported by official receipts or sales invoices prepared and issued in accordance with the invoicing requirements of the National Internal Revenue Code. Section 238 of the NIRC of 1977 requires that the name of the purchaser shall be indicated on the official receipt or sales invoice in case the amount of the transaction is one hundred pesos (P100.00) or more or in case of any sale, regardless of amount, if the purchaser and seller are both subject to VAT. Petitioner failed to show compliance with the requirements of Section 238 of the 1977 NIRC as shown by the fact that the sales invoices presented by petitioner were not in its name but in the name of Pilmico Foods Corporation.

The Issue of Proper Supporting Documents has been Properly Raised in the Proceedings

We also do not find merit in the third and fourth grounds relied upon by the petitioner. Petitioner alleges that the Court's reliance on Section 238 of the 1977 Tax Code as basis for the denial of the deduction of purchases of raw materials from gross revenues (in lieu of Section 34 (1) (b) of the 1997 Tax Code as indicated in the assessment notice) is erroneous and concludes that the judgment rendered by the Court in Division is not valid.

We do not agree.

In the Joint Stipulation of Facts filed on March 7, 2001, the parties have agreed that with respect to the deficiency income tax assessment, the following are the issues to be resolved:

a. **Whether or not the P5,895,694.66 purchases of raw materials are unsupported;**
b. Whether or not the cancelled invoices and expenses for taxes, repairs and freight are unsupported;
c. Whether or not commission, storage and trucking charges claimed are deductible;
d. Whether or not the alleged deficiency income tax for the year 1996 was correctly computed.

Clearly, the issue of proper substantiation of the deduction from gross income pertaining to the purchases of raw materials was properly raised even before the petitioner began presenting its evidence. Petitioner was aware that the respondent issued the assessment from the standpoint of lack of supporting documents for the claimed deduction and the fact that the assessments were not based on the deductibility of the cost of raw materials. There is no difference in the basis of the assessment and the issue presented to the Court in Division for resolution since both pertain to the issue of proper supporting documents for ordinary and necessary business expenses.

WHEREFORE, finding no cogent reason to disturb the findings and conclusions reached by the Court in Division in the assailed Decision dated December 15, 2004 as well as in the assailed Resolution dated May 19, 2005, the same are hereby **AFFIRMED**. Accordingly, the

Petition for Review filed with the Court *en banc* on July 5, 2005 is hereby **DISMISSED** for lack of merit.

SO ORDERED.

JUANITO C. CASTANEDA, JR.,
Associate Justice

We Concur:

ERNESTO D. ACOSTA
Presiding Justice

(with dissenting opinion)
LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

C E R T I F I C A T I O N

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of this Court before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

PILMICO-MAURI FOODS CORP.,
Petitioner,

C.T.A. EB NO. 97
(C.T.A. Case No. 6151)

Present:

-versus-

Acosta, P.J.
Castañeda, Jr.
Bautista,
Uy,
Casanova, and
Palanca-Enriquez, JJ.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

AUG 2 9 2006

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DISSENTING OPINION

With due respect to the conclusion reached by the *ponente* and concurred in by my esteemed colleagues, I differ from their opinion in disallowing petitioner's claimed raw materials purchases.

In the *ponencia,* the majority opinion upheld the ruling in the Court's Division which found the disallowance of the claimed deduction for raw materials purchases, proper. The official receipts and sales invoices presented by petitioner failed to comply with the requirements of Section 238 of the 1977 Tax Code on the issuance of official receipts or invoices.

The majority held that the purpose of the law in requiring the preservation by the purchaser of the official receipts or sales invoices for a period of three years is two-fold: 1) to enable said purchaser to substantiate his claimed deductions from the gross income and 2) to enable the Bureau of Internal Revenue to verify the accuracy of the gross income of the seller from external sources such as the customers of said seller. Thus, petitioner's argument that there was no substantiation requirements under the 1977 Tax Code has no leg to stand on.

I beg to differ. I maintain my position that no substantiation requirements were mentioned in the applicable law at the time the subject transactions occurred. An examination of Section 238 of the 1977 Tax Code discloses that a detailed description was never required. The law merely stated that the official receipt or commercial invoice must show the following details: *the date of the transaction, quantity, unit cost and description of merchandise or nature of service.*

The majority applied the rule laid down by the Supreme Court that in claiming deductions for business expense, it is not enough to prove the business test. The claimant must also substantially prove by evidence or records the deductions claimed under the law and the best evidence are invoices and official receipts.[1]

I do not agree. The governing provision on deductions from gross income is Section 29 of the 1977 Tax Code, which states:

> "SECTION 29. Deductions from gross income. — In computing taxable income subject to tax under Sections 21 (a), 24(a), (b) and (c); and 25 (a) (1), there shall be allowed as deductions the items specified in paragraphs (a) to (i) of this section; Provided, however, That in computing taxable income subject to tax under Section 21 (f) in the case of individuals engaged in business or practice of profession, only the following direct costs shall be allowed as deductions:
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> **(a) Raw materials, supplies and direct labor;**
> (b) Salaries of employees directly engaged in activities in the course of or pursuant to the business or practice of their profession;
> (c) Telecommunications, electricity, fuel, light and water;
> (d) Business rentals;
> (e) Depreciation;
> (f) Contributions made to the Government and accredited relief organizations for the rehabilitation of calamity stricken areas declared by the President; and
> (g) Interest paid or accrued within a taxable year on loans contracted from accredited financial institutions which must be proven to have been incurred in connection with the conduct of a taxpayer's profession, trade or business
>
> Xxx xxx xxx" (Emphasis supplied)

Clearly from the foregoing provision, raw materials are allowed as deductions from gross income. However, for an expense to be deductible from gross income, the Supreme Court has ruled that it must satisfy four requirements, to wit:

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[1] Commissioner of Internal Revenue v. Atlas Consolidated Mining and Development Corporation and Court of Tax Appeals, G.R. L-26911 and L-26924, January 27, 1981.

(1) the expense must be both ordinary and necessary;

(2) the expense must be paid or incurred within the taxable year;

(3) the expense must be incurred in carrying on a trade, business or profession; and

(4) the expense must be supported by receipts, records or other pertinent papers showing the amount of the expense being deducted and the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade or business.[2]

Ordinarily, an expense will be considered "necessary" where the expenditure is appropriate and helpful in the development of the taxpayer's business. It is "ordinary" when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term "ordinary" does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique or non-recurring to the particular taxpayer affected. ***(Atlas Consolidated Mining & Development Corporation vs. Commissioner of Internal Revenue, L-26911; Commissioner of Internal Revenue vs. Atlas Consolidated Mining & Development Corporation, L-26924, January 27, 1981, 102 SCRA 246)***

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[2] Zamora v. Collector, L-15280, May 31, 1952; Visayan Cebu Terminal v. Collector, L-12798, May 30, 1960; Commissioner of Internal Revenue v. Atlas Consolidated Mining and Development Corporation and Court of Tax Appeals, G.R. L-26911 and L-26924, January 27, 1981; Esso Standard Eastern, Inc. v. Commissioner of Internal Revenue, G.R. Nos. 28508-9, July 7, 1989.

There is no hard and fast rule on the right to a deduction. This depends in each case on the particular facts and the relation of the payment to the type of business in which the taxpayer is engaged. The intention of the taxpayer often may be the controlling fact in making the determination. ***[Eaton vs. Comm., 81F. (2d) 332 (CCA 9th, 1936), cited in Atlas Consolidated Mining & Development Corporation vs. Commissioner of Internal Revenue, supra; Commissioner of Internal Revenue vs. Atlas Consolidated Mining & Development Corporation, supra]***

In this case, the foregoing requirements were met by the petitioner. Petitioner is engaged in the business of manufacturing and marketing of yeast. The raw materials purchased by petitioner consist of molasses which are used as primary ingredients in the production of yeast. Consequently, petitioner's purchases of molasses qualify as legitimate business expenses as they are considered as necessary in carrying on its business. Hence, can be allowed as deductions from gross income.

The United States Tax Court explained:

> "As a general rule, if the record provides sufficient evidence that the taxpayer has incurred a deductible expense, but the taxpayer is unable to adequately substantiate the amount of the deduction to which he or she is otherwise entitled, the Court, in some situations, may estimate the amount of such expense and allow a deduction to that extent. Cohan v. Commissioner, 39 F.2d 540, 543-544 (2d Cir. 1930). However, in order for the Court to estimate the amount of an expense, there must be some basis upon which an estimate may be made. Vanicek v. Commissioner, 85 T.C. 731,743 (1985). Without such a basis, any allowance would amount to unguided largesse. Williams v. United States, 245 f.2d 559,560 (5th Cir. 1957) [***Michelle Bird Meyers v. Commissioner of Internal Revenue, T.C. Memo. 1996-219***]"

Moreover, in the case of ***Cohan v. Commissioner, 39 F.2d 540***, the U.S. Tax Court allowed the claimed deduction for being a deductible expense, even without any sufficient evidence, pertinent portion of which reads:

> " xxx xxx xxx
>
> In the production of his plays Cohan was obliged to be free-handed in entertaining actors, employees, and as he naively adds, dramatic critics. He has also to travel much, at times with his attorney. These expenses amounted to substantial sums, but he kept no account and probably could not have done so. At the trial before the Board he estimated that he had spent eleven thousand dollars in this fashion during the first six months of 1921, twenty-two thousand dollars, between July first, 1921, and June thirtieth, 1922, and as much for his following fiscal year, fifty-five thousand dollars in all. The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with the saying that something was spent. True, we do not know how many trips Cohan made, nor how large his entertainments were; yet there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any, even though it were the traveling expenses of a single trip. It is not fatal that the result will inevitable be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence.
>
> xxx xxx xxx"

As enunciated in the aforequoted case, it is clearly recognized that when there are evidence showing entitlement to the right of deductions, courts are duty bound to grant a favorable finding.

In this case, petitioner's purchases of molasses, a primary ingredient in the manufacture of yeast, to which it is commercially engaged and the same is essential in the furtherance of its business, is sufficiently supported by evidence. Petitioner has substantially proven these purchases with the presentation of official receipts, sales invoices, cash vouchers and other pieces of evidence which have considerably proven the fact that purchases of molasses were incurred in the year in which they were claimed as deductions from gross income.

As pointed out by petitioner, aside from the official receipts and commercial invoices, it presented pieces of evidence to prove that the purchases were received and used by the petitioner in its business. To further prove the fact of the transaction, it showed during the trial that molasses were purchased by petitioner from Mr. Jose B. Tan Enterprises/Golden Restaurant. These purchases were evidenced by sales invoices in the name of petitioner. The deliveries were evidenced by delivery receipts and "tare" receipts which showed the date of deliveries, the receipt and the volume of the molasses being delivered to petitioner as verified by its plant personnel upon receipt. (TSN, July 17, 2003, pages 9-12, CTA Case No. 6151)

Additionally, based on the records, petitioner has shown that the raw materials purchased were paid as evidenced by the cash vouchers, sales invoices and official receipts presented.

To reiterate, petitioner's primary ingredient in the production of yeast is molasses, therefore, the payments made for the purchase of raw materials consisting of molasses definitely constitute payment in carrying on its trade or business. Considering that petitioner has adequately met the statutory requirements for the deductibility of a business expense, petitioner's raw materials purchases for the year 1996 should be allowed as deductions from its gross income for the same year.

In view of the foregoing, I declare that petitioner can claim the raw materials as its ordinary and necessary business expenses, deductible from its gross income.

LOVELL R. BAUTISTA
Associate Justice