REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

McCANN-ERICKSON (PHILIPPINES), INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5966

COMMISSIONER OF INTERNAL REVENUE, and/or Chief of the Assessment Division, Revenue Region No. 8,
Respondents.

Promulgated:

MAR 13 2003

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DECISION

This case is an appeal for the cancellation of the deficiency income tax and value-added tax (VAT) assessments issued by the respondent against petitioner in the respective amounts of P657,106,024.00 and P50,370,879.00 for taxable year 1995.

The material antecedents follow.

Petitioner is a corporation duly organized and existing under the laws of the Philippines with principal office located at 118 Eurovilla II Bldg., Herrera St., Legaspi Village, Makati City. Being an advertising agency, petitioner mainly derives its income from the commissions and fees it receives for the advertising contracts placed by its clients with the media companies (print, radio and television). Such income is generally at the rate of 15% of the gross charges of media and advertising production costs which petitioner recognizes when media placements appear and production costs are incurred (*page 386, BIR records*).

For taxable year 1995, petitioner filed its annual income tax return on April 12, 1996, wherein it reported a taxable income of P53,038,342.00 and paid an income tax due of P18,563,419.00, computed as follows *(page 395, BIR records)*:

Gross Income		
Sale of Services		
Commissions on billings	P 203,010,466.00	
Other operating revenues	24,208,629.00	P 227,219,095.00
Realized Foreign Exchange Gain		1,157,069.00
Total		P 228,376,164.00
Less: Deductions		175,337,822.00
Taxable Income		P 53,038,342.00
Income Tax Due (35%)		P 18,563,419.00
Less: Tax Credits/Payments		14,773,153.00
Tax Payable		P 3,790,266.00

Likewise, for the same taxable year 1995, petitioner filed its monthly and quarterly VAT returns in which it reported an aggregate gross receipts of P211,928,308.00, detailed as follows:

	Commissions on billings and other operating revenues (exclusive of interest and dividend income)	P 227,219,095.00
Add:	Accrued commissions receivable, beginning	28,511,835.00
	Billed commissions receivable, beginning	14,692,799.00
Less:	Accrued commissions receivable, end	(17,553,003.00)
	Billed commissions receivable, end	(40,942,418.00)
		P 211,928,308.00

For the aforesaid gross receipts of P211,928,308.00, petitioner paid the corresponding 10% output VAT of P21,192,830.82 *(pp. 4-103, 383, BIR records)*.

On April 7, 1999, petitioner received from the respondent two (2) Assessment Notices (Nos. 000903-95-99-491 and 02-334-95B-99-B2-491) with the corresponding demand letters, all dated March 29, 1999, covering deficiency income tax of

P657,106,024.00 and deficiency VAT of P50,370,879.93, both inclusive of surcharges, interests and compromise penalties, for the taxable year 1995 (*pp. 564-575, BIR records*).

The 1995 deficiency income tax of P657,106,024.00 arose from the alleged undeclared income of petitioner amounting to P938,687,178.44, computed as follows (*page 572, BIR records*):

DEFICIENCY INCOME TAX

Billed Charges/Sales -1995		Remaining balance of billed charges after payment to media is taxable income
Accounts Receivable – client		P 222,072,959.06
Accounts Receivable – client (Non-VAT)		17,974,339.62
Unbilled Charges – Media	P1,569,177,477.00	
Less: Accounts Receivable – Media	658,129,016.14	
Balance – to McCann-Erickson		911,048,460.86
GROSS INCOME		P 1,151,095,759.54
Add: VAT separately billed (A/R – client/VAT)		18,495,230.90
TOTAL Gross Income		P 1,169,590,990.44
Less: Declared Gross Income per F/S		230,903,812.00
Undeclared Income		P 938,687,178.44
Basic income tax deficiency		P 328,540,512.00
25% Surcharge		82,135,128.00
20% Interest (33)		246,405,384.00
Compromise penalty		25,000.00
Total income tax deficiency		P 657,106,024.00

The 1995 deficiency VAT of P50,370,879.93 resulted from the alleged undeclared gross receipts of petitioner amounting to P242,236,747.31 (the difference between P454,165,055.31 as computed by respondent and P211,928,308.00 as declared by petitioner). Below is the detailed computation of the deficiency VAT assessment of P50,370,879.93:

DEFICIENCY VAT

Accounts Receivable – client	P 209,642,376.61
Accounts Receivable - client (VAT)	18,000,524.00
Accounts Receivable - client (Non-VAT)	17,442,511.02
Unbilled Charges Media	
(P1,550,109,558.00 x 15%)	232,516,433.70
Total	P 477,601,845.33
Less: Gross Receipts not subject to VAT	
Collections from Accounts Receivable - client (VAT)	(18,000,524.00)
Accounts Receivable - client (Non-VAT)	(17,442,511.02)
Balance	P 442,158,810.31
Add: Customers Credit Balances	12,006,245.00
Gross Receipts subject to VAT	P 454,165,055.31

(*page 449, BIR records*)

Output tax (P454,165,055.31 x 10%)	P 45,416,505.53
Less: output tax per VAT returns	21,192,830.82
Vat deficiency – Basic	P 24,223,674.71
25% Surcharge	6,055,918.68
Interest (.6627)	20,066,286.54
Compromise penalty	25,000.00
Total VAT deficiency	P 50,370,879.93

(*page 567, BIR records*)

On May 7, 1999, petitioner seasonably filed a protest letter to the two (2) assessment notices, together with all the supporting documents, disputing against the respondent's income and VAT assessments for lack of factual and legal bases (*Admitted, par. 1, Respondent's Answer*).

Respondent failed to act on the protest filed by petitioner within the period of one hundred eighty (180) days from May 7, 1999 or until November 3, 1999. Hence, Petitioner filed the instant Petition for Review on December 2, 1999 or within thirty (30) days from the last day of the aforesaid 180-day period pursuant to Section 228 of the Tax Code.

Respondent, in his Answer filed on January 28, 2000, interposed the following Special and Affirmative Defenses:

"4. The petitioner undeclared its income and revenues subject to income and value-added tax;

5. By reason of petitioner's undeclaration, it gives rise to deficiency assessments on income and value-added taxes;

6. The assessments in question were made and issued in accordance with existing laws, rules and regulations;

7. All presumptions are in favor of the correctness of the tax assessment **(Interprovincial Autobus, Inc. vs. Collector of Internal Revenue, 98 Phil. 290)**.

In their Amended Joint Stipulation of Facts and Issues filed on April 23, 2001 and approved by this court on April 30, 2001, the parties have agreed to limit the issues to be resolved by this court to the following:

1. In so far as assessment notice no. 000903-95-99-49, the only issue in this case is the legal issue of whether or not a debit to each of the following accounts in the books/accounting records of petitioner in taxable year 1995, constitute a taxable revenue which should form part of petitioner's gross income for income tax purposes:
   a. Accounts Receivable-Client
   b. Accounts Receivable-Client (Non-VAT)
   c. (Un)billed charges-Media; and
   d. Accounts Receivable-Client (VAT); and

2. In so far as assessment notice no. 02-334-95B-99-B2-491 is concerned, the only issue is the legal issue of whether or not a credit to each of the following accounts in the books/accounting records of petitioner in taxable year 1995 should be treated as part of petitioner's gross receipts subject to 10% VAT:
   a. Accounts Receivable-Client
   b. Unbilled Charges-Media; and
   c. Customer Credit Balances

3. Pursuant to the admissions in paragraphs 5, 7, 9, 11 and 13 under the caption "Stipulation of Facts" above-mentioned, the parties hereby admit that the nature of each and every transaction which was recorded as a debit to the following accounts is not at issue in so far as assessment notice no. 000903-95-99-49:
   a. Accounts Receivable-Client
   b. Accounts Receivable-Client (Non-VAT)

c. Unbilled Charges-Media; and
d. Accounts Receivable-Client (VAT)

4. Pursuant to the admissions in paragraphs 19, 20 and 21 under the caption "Stipulation of Facts" above-mentioned, the parties hereby admit that the nature of each and every transaction which was recorded as a credit to the following accounts is not at issue with respect to assessment notice no. 02-334-95B-99-B2-491:
   a. Accounts Receivable-Client
   b. Unbilled Charges-Media; and
   c. Customer Credit Balances

Simply put, the sole issue in the instant case is whether or not the 1995 deficiency income tax assessment of P657,106,024.00 and deficiency VAT assessment of P50,370,879.93 issued by the respondent to petitioner are valid.

On the alleged deficiency income tax of P657,106,024.00, the respondent imputed against petitioner an undeclared income of P938,687,178.44 which was derived from the total debits of each of the following accounts (*pages 566 & 571, BIR records*):

a. "Accounts Receivable – Client (Revenue)" amounting to P222,072,959.06;
b. "Accounts Receivable – Client (Non-VAT)" amounting to P17,974,339.62;
c. "Unbilled Charges – Media" of P1,569,177,477.00 less total debits to "Accounts Receivable – Media" of P658,129,016.14, resulting in a net amount of P911,048,460.86; and
d. "Accounts Receivable – Client (VAT)" amounting to P18,495,230.90.

Petitioner, on the other hand, argued that the alleged deficiency income tax of P657,106,024.00 was a mere result of the respondent's erroneous computation of petitioner's taxable gross income.

The court finds for the petitioner.

It is evident from the records that the total debits to Accounts Receivable – Client (Non-VAT) amounting to P17,974,339.62 and Accounts Receivable – Client (VAT) amounting to P18,495,230.90, which respondent included in his computation of petitioner's taxable gross income, do not at all constitute taxable revenue on the part of petitioner.

Respondent admitted that the total debits to "Accounts Receivable – client (Non-VAT) of P17,974,339.62 represents out-of-pocket expenses incurred by petitioner's employees to render services to its clients subject to the latter's reimbursement at cost and without profit (*par. 5, Amended Joint Stipulation of Facts*). As testified by petitioner's witnesses, these reimbursable out-of-pocket expenses were not recorded by petitioner in its books of accounts as expenses and that the related expense vouchers, invoices and official receipts were submitted by petitioner to its clients upon billing the latter (*pp.40-41, TSN, July 10, 2000; pp. 5–8, TSN, October 4, 2000*). Therefore, it would be improper for the respondent to treat these reimbursements as petitioner's taxable gross income. As correctly pointed out by petitioner in its protest letter (*page 593, BIR records*), even if these reimbursements are to be considered as income, the same will be offset by recording the equivalent advances as expenses. Hence, no taxable income will result from the said transactions.

Respondent likewise conceded that the total debits to "Accounts Receivable - client (VAT)" amounting to P18,495,230.90 pertains to the 10% value-added tax (VAT) on the commission income payable to petitioner by its clients (*par. 13, Amended Stipulation of Facts*). Pursuant to Section 99 of the 1995 Tax Code, VAT is an indirect tax which may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. Records show that petitioner separately indicated in its invoices the 10% VAT on its commission income (*Exhibit G-2; pp. 9-11 , TSN,October 4, 2000*) but such separate billing does not mean an undeclared income for petitioner. The 10% VAT is payable to the BIR by the petitioner and does not form part of its gross income.

As to the account "Unbilled Charges – Media", evidence forwarded to this court reveal that the said account is debited to record the cost of advertisements placed by petitioner on behalf of its clients which have already been aired or published but have not been billed by the media suppliers at the end of each month (*Exhibits A to F & J*). The corresponding credits are made to "Accounts Payable-Accrued Advertising" for the 85% of advertisement costs and to "Commissions & Fees" for the remaining 15% thereof. To illustrate, the advertisement placed by petitioner on behalf of Caltex Phils, Inc. with the Manila Broadcasting Company for the month of April 1995 amounting to P308,000.00 as shown by Broadcast Order No. 1114 dated March 13, 1995 (*Exhibit B*) is recorded at the end of April 1995 as follows:

April 30, 1995	Debit	Unbilled Charges – Media	308,000.00	
	Credit	Accounts Payable – Accrued Advtg		261,800.00
	Credit	Commissions & Fees		46,200.00

The initial debits to Unbilled Charges – Media are later reversed at the beginning of each month following the month of entry. Thus, the reversing entry at the beginning of May 1995 for the above sample transaction will be as follows:

May 1, 1995	Debit	Accounts Payable – Accrued Advtg.	261,800.00	
	Debit	Commissions & Fees	46,200.00	
	Credit	Unbilled Charges – Media		308,000.00

The above reversing entry is made to avoid double take-up of revenue when petitioner receives an invoice from Manila Broadcasting Company and sends billing to its client, Caltex Phils., Inc.. However, when an invoice from Manila Broadcasting Company is not yet received and petitioner is unable to bill its client, Caltex Phils., Inc. at the end of May, 1995, the Unbilled Charges – Media is again debited to recognize the accrual of a liability and income from the previous month, thus the following entry:

May 31, 1995	Debit	Unbilled Charges – Media	308,000.00	
	Credit	Accounts Payable – Accrued Advtg.		261,800.00
	Credit	Commissions & Fees		46,200.00

Again, the above entry is reversed at the beginning of June 1995, thus:

June 1, 1995	Debit	Accounts Payable – Accrued Advtg.	261,800.00	
	Debit	Commissions & Fees	46,200.00	
	Credit	Unbilled Charges – Media		308,000.00

Upon receipt of invoices from media suppliers, petitioner sends billings to its clients and records the transactions by debiting Accounts Receivable-Client (Revenue) for the 15% commission, Accounts Receivable – Client (VAT) for the 10% VAT on commissions earned, Accounts Receivable – In Trust Media for the 85% advertisement cost payable to media suppliers and crediting the corresponding accounts of Commissions & Fees, VAT Payable and Accounts Payable – In Trust Media.

In the sample transaction, the invoice from Manila Broadcasting Company dated May 5, 1995 (*Exhibit I-2*) was received by petitioner on June 1, 1995. Petitioner sent the corresponding billing to Caltex Phils., Inc. on June 13, 1995 and made the following entry:

June 13, 1995	Debit	Accounts Receivable –Client (Revenue)	46,200.00	
	Debit	Accounts Receivable –Client (VAT)	4,620.00	
	Debit	Accounts Receivable – In Trust Media	261,800.00	
	Credit	Commissions & Fees		46,200.00
	Credit	VAT Payable		4,620.00
	Credit	Accounts Payable – In Trust Media		261,800.00

From the foregoing sample transaction entries, we can conclude that the total debits to Unbilled Charges Media amounting to P1,569,177,477.00 do not consist entirely of petitioner's income. The substantial portion thereof or 85% in the amount of P1,333,800,855.00 represents petitioner's accrual of a liability payable to the media suppliers in behalf of its clients while the remaining 15% amounting to P235,376,621.50 represents petitioner's accrual of commission income. Nevertheless, these amounts are not representative of petitioner's actual accrued liability and income, the reason being that the repetitious cycle of setting-up and making reversals for Unbilled Charges - Media results to several debits to a single transaction. Hence, the amounts of P1,333,800,855.00 and P235,376,621.50 representing 85% and 15% of the total debits to Unbilled Charges - Media should be offset against the corresponding total credits to Unbilled Charges – Media of P1,317,593,124.30 and P232,516,433.70, respectively (*p. 566, BIR Records*). The resulting figures of P16,207,731.15 and P2,860,187.85 were petitioner's actual accrued liability payable to the media suppliers and accrued commission income, respectively, which were included in the account Unbilled Charges – Media.

The amounts payable to the media suppliers in the amount of P16,207,731.15 which were billable to petitioner's clients cannot be treated as gross income on the part of petitioner under Section 28 of the 1995 Tax Code. The collections therefrom represent compensation for services rendered by the media suppliers, i.e., the selling of radio/tv airtime, ad space in newspapers/magazines, etc., and are only held in trust by petitioner for the account of the former. This is recognized by the respondent in his BIR Ruling No. 102-84 dated May 25, 1984, which states in pertinent part:

> " . . . Moreover, for income tax purposes, 15% of said income payments exclusive of the amount that goes to the media, shall also be subject to the 3% expanded withholding tax under Section 1(e)(2)(g) of Revenue Regulations No. 13-78, as amended by Revenue Regulations No. 6-79 implementing Presidential Decree No. 1351, now Section 53(f) of the Tax Code, as amended. In other words, that portion of the amount received by Link Advertising, Inc. corresponding to compensation paid for services rendered by the media, i.e., Times Journal, Daily Express and Bulletin Today should not be included as part of its gross receipts subject to the withholding provisions of Revenue Regulations No. 4-83 implementing Republic Act No. 1051."

Consequently, only the amount of P2,860,187.85 pertains to petitioner's actual accrued 15% commission income which was included in the account Unbilled Charges – Media.

With reference to the total debits to Accounts Receivable – Client (Revenue) amounting to P222,072,959.06, the same generally represents petitioner's 15% commissions/fees on the gross charges of media/advertising production costs and other operating revenue. As shown in the schedule prepared by petitioner reconciling its income reported in the audited financial statements/income tax return with the total debits to Accounts Receivable – Client (Revenue), some items such as cancelled bills for 1995 amounting to P3,131,820.26, cancellation of 1994 bills of P433,749.90, various credit memos of P183,099.21 and other reclassifications/adjustments of P151,963.21 do not form part of petitioner's commission income and other operating revenue (*pp. 599-605, BIR records*). These adjustments were not taken into consideration by the respondent in his computation.

In fine, this court finds the deficiency income tax assessment of P657,106,024.00 erroneous and without legal and factual bases.

We shall now determine whether or not the alleged 1995 deficiency VAT assessment of P50,370,879.93 is valid.

The alleged deficiency VAT of P50,370,879.93 emanated from the respondent's computation of petitioner's gross receipts in the amount of P454,165,055.31 which was obtained from the following accounts:

a. Total credits to "Accounts Receivable – client (Revenue)" amounting to P209,642,376.61;
b. "Unbilled Charges – Media" amounting to P232,516,433.70 representing 15% of the total credits to the same account in the amount of P1,550,109,558.00; and
c. "Customer Credit Balances" amounting to P12,006,245.

Again, petitioner averred that the respondent's computation is inaccurate and that the deficiency VAT assessment of P50,370,879.93 is without merit.

We rule in favor of petitioner.

Records show that the respondent erroneously included the total credits to Unbilled Charges – Media amounting to P1,550,109,558.00 and Customer Credit Balances amounting to P12,006,245.00 as part of petitioner's taxable gross receipts.

As earlier discussed, the total credits to Unbilled Charges – Media amounting to P1,550,109,558.00 represent reversals of the original entries debiting the said account upon petitioner's placement of the advertising orders with the media suppliers on behalf of its clients. The account "Unbilled Charges – Media" is credited to allow the recording of Accounts Receivable when the client is billed for media costs and commission, to avoid double take-up of revenue. Thus, the amount of P232,516,433.70 representing 15% of the total credits to Unbilled Charges – Media of P1,550,109,558.00 does not represent collection.

As to the Customer Credit Balances amounting to P12,006,245.00, the respondent admitted that the same represent advances from petitioner's clients for payment to media networks (*par. 20, Amended Stipulation of Facts*). Since these customer credit balances of P12,006,245.00 do not pertain to advance payments for the services performed or to be performed by petitioner but are merely held in trust for payment to the media networks, the same do not fall within the definition of gross receipts under Section 102 of the 1995 Tax Code, to wit:

> "The term 'gross receipts' means the total amount of money or its equivalent representing the contract price, compensation or service fee, including the amount charged for materials supplied with the services and deposits and **advance payments actually or constructively received during the taxable quarter for the service performed or to be performed for another person,** excluding value-added tax." (*Emphasis supplied*)

Moreover, in the case of ***Commissioner of Internal Revenue vs. Tours Specialists, Inc. and The Court of Tax Appeals, 183 SCRA 402***, the Supreme Court held that:

> "As demonstrated in the above-mentioned case, *gross receipts* subject to tax under the Tax Code do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to the taxpayer's benefit; and it is not necessary that there must be a law or regulation which would exempt such monies and receipts within the meaning of gross receipts under the Tax Code. Parenthetically, the room charges entrusted by the foreign travel agencies to the private respondent do not form part of its gross receipts within the definition of the Tax Code. The said receipts never belonged to the private respondent. The private respondent never benefited from their payment to the local hotels. As stated earlier, this arrangement was only to accommodate the foreign travel agencies."

Finally, while the total credits to "Accounts Receivable – Client (Revenue)" amounting to P209,642,376.61 ordinarily represents income collections, respondent failed to take into account that the same included non-collection related transactions such as cancellation of invoices amounting to P3,131,820.25, various credit memos issued to clients in the amount of P183,099.21 and other reclassifications/adjustments amounting to P151,963.21 in the aggregate sum of P3,466,882.67 (*pp. 599 to 605, BIR records*).

In other words, this court finds the alleged deficiency VAT of P50,370,879.93 invalid.

It bears stressing also that the BIR Chief, Assessment Division, Ms. Ma. Nieva A. Guerrero, in her memorandum for the Regional Director, Revenue Region No. 8, Makati City, recommended for the cancellation of the deficiency income tax assessment of P657,106,024.00 and deficiency VAT assessment of P50,370,879.93 for taxable year 1995 and the issuance of a termination letter to the taxpayer (*page 609, BIR records*).

WHEREFORE, in view of all the foregoing, the court finds the instant petition meritorious. Accordingly, Assessment Notice No. 000903-95-99-491 for deficiency income tax in the amount of P657,106,024.00 and Assessment Notice No. 02-334-95B-99-B2-491 for deficiency VAT assessment in the amount of P50,370,879.93, both dated March 29, 1999, are hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Judge

LOVELL R. BAUTISTA
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge