REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL SECOND DIVISION

MERCURY GROUP OF COMPANIES, INC., *Petitioner,*	**CTA Case No. 9531**
	Members:
-versus-	**CASTAÑEDA, JR.**, *Chairperson, and* **MANAHAN**, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Promulgated: SEP 06 2019 4:30 p.m.

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DECISION

MANAHAN, *J.:*

This is a Petition for Review filed on February 2, 2017 by Mercury Group of Companies, as petitioner, against the Commissioner of Internal Revenue, as respondent before the Court in Division.

Petitioner seeks the cancellation and setting-aside of respondent's Formal Letter of Demand (FLD) dated April 2, 2014 and the Final Decision on the Disputed Assessment (FDDA) dated January 4, 2017 which found petitioner liable for alleged deficiency income tax, value-added tax (VAT) and expanded withholding tax (EWT) for taxable year ending December 31, 2009 in the total amount of ₱231,430,704.91.[1]

THE PARTIES

Petitioner is a domestic corporation duly organized under Philippine laws with principal office at No. 7, Mercury Avenue,

[1] Summary of the Case, Pre-Trial Order, docket, volume (vol.) II, p. 474.

Bagumbayan, Quezon City and is primarily organized to invest in, purchase, or otherwise acquire and own, hold, use, sell, assign, transfer, mortgage, pledge, exchange, or otherwise dispose of real and personal property of any kind and description, including shares of stocks, bonds, debentures, notes, evidences of indebtedness and other securities and obligation of any corporation or corporations, association or associations, domestic or foreign, for whatever legal purpose or purposes the same may have been organized and to pay thereof in money or by exchanging therefor stocks, bonds and other evidence of indebtedness or securities of this or any other corporation and while the owner or holder of any such real or personal property, stocks, bonds, debenture, contracts or obligations, to receive, collect and dispose of the interest, dividends and income arising from such property and exercise all the powers and privileges of ownership and carry on and manage any business, industry or enterprise.[2]

Petitioner is registered with the Bureau of Internal Revenue (BIR) with Tax Identification Number (TIN) 000-389-266-000, as evidenced by BIR Certificate of Registration No. OCN 8RC0000017125.[3]

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue, vested by law to implement and enforce the provisions of the National Internal Revenue Code (Tax Code) and other tax laws.[4]

FACTS

The BIR issued a Letter of Authority (LOA) dated May 15, 2010, authorizing its revenue officers Olivia Sison, Walter Batoon, Reynoso Bravo, Daniella Gabao, Julieta Tubilla and Maribel Serafica and Group Supervisor Erlinda Ulgado of the Large Taxpayers Audit Division I to conduct a tax audit investigation of the books of accounts and other financial records of petitioner for taxable year ended December 31, 2009. This was received by the petitioner on May 19, 2010.[5]

Four (4) Waivers of the Defense of Prescription were executed between the petitioner and respondent, detailed as follows:

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[2] Exhibits "P-1" and "P-2", docket, vol. III, pp. 1041-1073.
[3] Exhibit"P-3", docket, vol. II, p. 529.
[4] Par. 2, Joint Stipulation of Facts and Issues (JSFI), docket, vol. II, p. 464.
[5] Exhibit "R-1", BIR Records, p. 1.

Waiver	Date Executed	Extension of Period
1st	June 14, 2012	June 30, 2012
2nd	March 22, 2013	December 31, 2013
3rd	October 16, 2013	June 30, 2014
4th	March 12, 2014	December 31, 2014

Petitioner transmitted to the BIR the documents it requested in relation to the 2009 tax audit investigation. The BIR received the same on July 31, 2013.[6]

On February 27, 2014 respondent's Large Taxpayers Service issued a Preliminary Assessment Notice (PAN) which petitioner received on the same day. Respondent assessed petitioner deficiency income tax, VAT, EWT, withholding tax on compensation (WTC), documentary stamp tax (DST) and improperly accumulated earnings tax (IAET) for the total amount of Nine Hundred Eighty One Million Four Hundred Eighty Two Thousand Nine Hundred Seventy One and 93/100 Pesos (₱981,482,971.93), inclusive of penalties, interest and surcharges for taxable year 2009.[7]

On April 2, 2014, petitioner received respondent's FLD of even date assessing the former with deficiency income tax, VAT, EWT, WTC, DST, IAET and other miscellaneous tax, aggregating ₱999,385,542.38, for the TY 2009, broken down as follows:[8]

Tax Type	Amount
Income Tax	₱ 570,294,505.13
VAT	163,283,304.39
EWT	1,234,462.73
WTC	3,804,913.25
DST	12,058,652.72
IAET	248,699,704.16
Other miscellaneous tax	10,000.00
Total	**₱999,385,542.38**

[6] Exhibit"P-47", docket, vol. II, p. 736.
[7] Exhibits "P-48" and "P-48-a", docket, vol. II, pp. 737-740; pp. 741-744.
[8] Exhibit "P-49", Docket, Vol. II, pp. 745 to 752.

Petitioner filed its protest to the FLD on April 10, 2014.[9] A supplemental protest was also filed on April 30, 2014,[10] while the last batch of documents in support of its protest to the FLD was transmitted to respondent thru a letter dated June 30, 2014.[11]

Meanwhile, petitioner paid a portion of the deficiency income tax, VAT, EWT, WTC, DST, and other miscellaneous tax on the following dates as shown in the respective BIR Forms No. 0605.[12] The following summarizes petitioner's partial settlement of deficiency taxes:

Tax Type	Date Paid	Basic Tax	Surcharge	Interest	Compromise	Total
Income Tax	April 30, 2014	₱ 34,418.40	₱ -	₱ 27,817.61	₱ 8,500.00	₱ 70,736.01
VAT	April 30, 2014	268,830.24	-	229,205.40	16,000.00	514,035.64
EWT	April 30, 2014	237,005.83	-	231,476.28	16,000.00	484,482.11
WTC	April 30, 2014	100,939.43	-	86,614.33	16,000.00	203,553.76
DST	April 07, 2014	148,325.96	37,081.49	126,056.75	-	311,464.20
	April 30, 2014	-			16,000.00	16,000.00
Other miscellaneous tax	April 30, 2014	-	-	-	10,000.00	10,000.00
Total		**₱789,519.86**	**₱37,081.49**	**₱701,170.37**	**₱82,500.00**	**₱1,610,271.72**

On January 5, 2017, petitioner received respondent's FDDA dated January 4, 2017, stating that after considering petitioner's protest, it has been found that petitioner is still liable to pay deficiency income tax, VAT, and EWT in the aggregate amount of ₱230,361,451.14, inclusive of interests, surcharges, and compromise penalties, broken down as follows:[13]

	Total
Income Tax	₱ 220,882,888.62
VAT	9,174,355.64
EWT	304,206.88
Total	**₱230,361,451.14**

The deficiency assessment on the IAET was no longer included in the FDDA issued by the respondent.

[9] Exhibit "P-50", Docket, Vol. II, p. 753.
[10] Exhibit "P-51", Docket, Vol. II, p. 786.
[11] Exhibit "P-53", Docket, Vol. II, p. 886.
[12] Exhibits "P-52-a" to "P-52-u", Docket, Vol. II, pp. 858 to 885.
[13] Exhibit "P-54", Docket, Vol. II, pp. 887 to 896.

On January 27, 2017, petitioner paid the deficiency EWT still due amounting to ₱304,206.88 as shown in BIR Form No. 0605, detailed as follows:[14]

Basic tax	₱ 118,022.69
Interest	183,184.19
Compromise	3,000.00
Total	**₱304,206.88**

Petitioner filed a Petition for Review with the Court of Tax Appeals (CTA) on February 2, 2017 [15] praying for the cancellation and setting aside of the assessments per respondent's FDDA but in the increased amount of P231,430,704.91. The difference of P1,069,253.77 (as distinguished from the total amount embodied in the FDDA of ₱230,361,451.14) pertains to basic tax, interest and compromise penalties paid by petitioner on April 30, 2014, which were already credited by respondent in the FDDA, as detailed below:

	Assessed Amount per FDDA	Less: April 30, 2014 Payment	Deficiency Tax Still Due
Income tax:			
Basic tax	₱ 97,811,112.78	₱ 34,418.40	₱ 97,776,694.38
Interest up to 4.30.2014	79,052,817.18	27,817.61	79,024,999.57
Interest from 5.1.2014 to 7.31.2016	44,039,694.67	-	44,039,694.67
Compromise	50,000.00	8,500.00	41,500.00
Subtotal	***₱220,953,624.63***	***₱ 70,736.01***	***₱ 220,882,888.62***
VAT:			
Basic tax	₱ 4,311,122.06	₱ 268,830.24	4,042,291.82
Interest up to 4.30.2014	3,531,576.70	229,205.40	3,302,371.30
Interest from 5.1.2014 to 7.31.2016	1,820,692.53	-	1,820,692.53
Compromise	25,000.00	16,000.00	9,000.00
Subtotal	***₱ 9,688,391.29***	***₱ 514,035.64***	***₱ 9,174,355.65***
EWT:			
Basic tax	₱ 355,028.52	₱ 237,005.83	₱ 118,022.69
Interest up to 4.30.2014	304,643.65	231,476.28	73,167.37
Interest on late remittance	72,858.10	-	72,858.10
Interest from 5.1.2014 to 7.31.2016	53,158.72	-	53,158.72
Compromise	3,000.00	16,000.00	(13,000.00)
Subtotal	***₱ 788,688.99***	***₱ 484,482.11***	***₱ 304,206.88***
Grand total	**₱231,430,704.91**	**₱1,069,253.76**[16]	**₱230,361,451.15**[17]

[14] Exhibits "P-56-a" to "P-56-c", Docket, Vol. II, pp. 923 to 925.
[15] Docket, vol. I, pp. 10-43.
[16] Minimal difference of ₱0.01.
[17] Minimal difference of ₱0.01.

Respondent then filed his Answer to the Petition for Review on March 1, 2017.

A Notice of Pre-Trial Conference[18] was issued by the Court on March 6, 2017, setting the case for pre-trial conference on March 16, 2017. Accordingly, respondent filed its Pre-Trial Brief[19] on March 9, 2017.

Petitioner filed an Omnibus Motion[20] on March 9, 2017 requesting the Court to deny respondent's Motion to Defer Transmittal of BIR Records and to defer the previously scheduled Pre-Trial Conference. The Court had previously granted respondent's motion in an Order dated March 6, 2017.[21]

During the trial on March 16, 2018, petitioner moved to reset the Pre-Trial to May 11, 2017 on the ground that respondent is yet to return to the Court the BIR Records of this case. The Court granted the same, without objection from respondent's counsels. However, the Court held that should the parties file a Joint Stipulation of Facts and Issues (JSFI) on or before April 17, 2017, the pre-trial scheduled on May 11, 2017 will be cancelled and the initial presentation of the evidence for petitioner will be on May 24, 2017.[22]

Petitioner also filed a Reply to respondent's Answer on March 16, 2018.[23]

Per Records Verification dated April 21, 2017, the parties failed to file the JSFI.[24]

Petitioner filed its Pre-Trial Brief on April 25, 2017.[25]

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[18] Docket, vol. I, p. 108.
[19] Docket, vol. I, pp. 410-415.
[20] Docket, vol. I, pp. 416-420.
[21] Docket, vol. I, p. 409.
[22] Minutes of the Hearing dated March 16, 2017, docket, vol. I, p. 423.
[23] Docket, vol. I, pp. 425-440.
[24] Docket, vol. I, p. 446.
[25] Docket, vol. I, pp. 454-461.

The parties submitted their Joint Stipulation of Facts and Issues (JSFI)[26] on May 3, 2017. Hence, the Court cancelled the May 11, 2017 setting for continuation of Pre-Trial Conference. Instead, the Court issued the Pre-Trial Order[27] on May 9, 2017, approving and adopting the joint stipulations filed by the parties and the pre-trial was deemed terminated.

Petitioner filed a Motion[28] on May 16, 2017, requesting the Court to reset the initial presentation of its evidence to the next scheduled hearing in the Pre-Trial Order, or on June 26, 2017 and to grant petitioner four (4) commissioner's hearings. The Court granted petitioner's Motion in an Order dated May 18, 2017.[29]

During trial, petitioner presented its witness, Mr. Mario L. Montellano, the Vice President of Mercury Group of Companies.[30] Thereafter, petitioner formally offered its evidence[31] on August 10, 2017. The Court admitted all of petitioner's exhibits except for Exhibits "P-51-j-31", "P-51-j-32", "P-51-j-33", "P-51-j-34", "", "P-51-j-36", "P-51-j-37", "P-51-j-38", "P-51-j-39", "P-51-j-40", "P-51-j-41", "P-51-j-42", "P-51-j-43", "P-51-j-44", "P-51-j-45", "P-51-j-46", "P-51-j-47", "P-51-j-48", "P-51-j-49", "P-51-j-50", "P-51-j-51", "P-51-j-52", "P-51-j-53", "P-51-j-54", "P-51-j-55", "P-51-j-56", "P-51-j-57" and Exhibit "P-59" for failure to submit the original for comparison and Exhibit "P-58" for failure to identify.[32]

Meanwhile, respondent presented its sole witness, Revenue Officer Olivia Sison.[33] Thereafter, respondent formally offered its evidence[34] on October 10, 2017. The Court admitted all of respondent's exhibits.[35]

Respondent filed his Memorandum on August 7, 2018 while petitioner filed its Memorandum on August 28, 2018.

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[26] Docket, vol. II. pp. 464-471.
[27] Docket, vol. II, pp. 474-480.
[28] Docket, vol. II, pp. 485-487.
[29] Docket, vol. III, p. 933.
[30] Minutes of the Hearing dated July 24, 2017, docket, vol. III, pp. 987-988.
[31] Docket, vol. III, pp. 992-1040.
[32] Resolution dated September 19, 2017, docket, vol. III, pp. 1094-1096; Resolution dated July 4, 2018 docket, vol. III, pp. 1156-1158.
[33] Minutes of the Hearing dated September 20, 2017, docket, vol. III, p. 1097.
[34] Docket, vol. III, pp. 1112-1118.
[35] Resolution dated July 4, 2018 docket, vol. III, pp. 1156-1158.

On August 29, 2018, petitioner filed a Motion to File and Admit Attached Reply-Memorandum.

In view of the filing of respondent's Memorandum[36] on August 7, 2018 and petitioner's Memorandum[37] filed through registered mail on August 15, 2018 and received by the Court on August 28, 2018 and petitioner's Reply Memorandum[38] on August 29, 2018, the case was submitted for decision on September 7, 2018.[39]

ISSUES

The parties submitted the following issues[40] for the Court's resolution:

1. Whether or not the FLD dated April 2, 2014 and the Final Decision on the Disputed Assessment dated January 4, 2017 which assessed petitioner deficiency internal revenue taxes for taxable year ended December 31, 2009 is void for having been issued beyond the prescriptive period.

2. Whether or not the right to assess petitioner for taxable year 2009 has already prescribed.

3. Whether or not the assessments have bases both in fact and in law.

4. Whether or not petitioner is liable to deficiency income tax, VAT and EWT for taxable year ended December 31, 2009.

5. Whether or not petitioner is liable for deficiency income tax and VAT on undeclared service income (SLS/Relief/LN) of ₱2,893,704.25.

6. Whether or not petitioner is liable for deficiency VAT on undeclared service income of ₱2,358,089.89.

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[36] Docket, vol. III, pp. 1160-1178.
[37] Docket, vol. III, pp. 1182-1230.
[38] Docket, vol. III, pp. 1235-1249.
[39] Resolution dated September 7, 2018, docket, vol. III, p. 1251.
[40] Issues, JSFI, docket, vol. II, pp. 496-497.

7. Whether or not petitioner is liable for deficiency income tax and VAT on undeclared management services of ₱4,925,000.00.

8. Whether or not petitioner is liable for deficiency income tax and VAT on unaccounted source of cash of ₱13,536,000.00.

9. Whether or not petitioner is liable for deficiency income tax on disallowed Optional Standard Deduction (OSD) of ₱297,018,816.80

10. Whether or not petitioner is liable for deficiency income tax and VAT on undeclared purchases of ₱1,647,659.04 and undeclared purchases of ₱12,213,223.00.

11. Whether or not petitioner is liable for deficiency income tax and EWT on expenses not subjected to EWT of ₱5,901,134.50.

12. Whether or not petitioner is liable for deficiency interest on VAT for taxable year ended December 31, 2009.

Petitioner's Arguments

Petitioner initially challenges the validity of the FLD and FDDA issued by respondent on the ground that the revenue officers failed to revalidate the LOA. Petitioner cites Revenue Memorandum Circular (RMC) No. 36-99 which provides that the revenue officers are given only 120 days from the date of receipt of the LOA by the taxpayer to conduct the audit and submit the required report of investigation. It further asserts that if the revenue officers fail to submit the final report of investigation within the 120-day period, they must submit a progress report and surrender the LOA for revalidation. Failure to do this, renders the FLD void because it stems from a lapsed LOA.

Aside from the lapsed LOA, petitioner submits that the FLD and FDDA are both void for having been issued beyond the prescriptive period pursuant to Section 203 of the 1997 National Internal Revenue Code (NIRC), as amended, which requires that respondent only has three (3) years from the last day prescribed for the filing of a return within which to assess and collect internal revenue taxes. In the instant case, petitioner maintains that the right of the BIR to assess its deficiency internal revenue taxes for taxable year ended December 31, 2009 has prescribed.

As to the substantive aspects of the FLD, petitioner disagrees with the findings contained in the FDDA and denies any tax liabilities on the following:

1. Alleged deficiency income tax and VAT on Undeclared Service Income of P2,893,704.25.
2. Alleged deficiency VAT on Undeclared Service Income of P2,358,089.
3. Alleged deficiency income tax and VAT on Undeclared Management Services of P4,925,000.
4. Alleged deficiency income tax and VAT on Unaccounted Source of cash in the amount of P3,536,000.
5. Alleged deficiency income tax on Disallowed Optional Standard Deduction of P297,018,816.80.
6. Alleged deficiency income tax and VAT on Undeclared Purchases of P1,647,659.04.
7. Alleged deficiency income tax and VAT on Undeclared Purchases of P1,647,659.04 and Undeclared Purchases of P12,213,223.
8. Alleged deficiency income tax on disallowed creditable withholding tax of P34,417.58.

Respondent's Arguments

In his Answer[41], respondent interposed the following Special and Affirmative Defenses:

> **"RESPONDENT MAINTAINS THAT HIS RIGHT TO ASSESS PETITIONER FOR TAXABLE YEAR 2009 HAS NOT YET PRESCRIBED**
>
> 5. Petitioner alleged that respondent's right to assess petitioner's taxes for taxable year 2009 has prescribed pursuant to the three (3) year limitation period provided for under Section 203 of the NIRC. It further alleged that the Formal Letter of Demand (FLD) was issued only on 2 April 2014, which is more than

[41] Docket, vol. I, pp. 384-401.

three (3) years from the date of filing of petitioner's returns for taxable year 2009.

6. Petitioner's contention is bereft of merit.

7. True as it may that Section 203 provides for such limitation, however, petitioner failed to consider that such provision is not without exception. Section 222 of the NIRC provides:

> "Sec.222. **Exceptions as to Period of Limitation of Assessment and Collection of Taxes.-**
>
> (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.
>
> (b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon.

8. Petitioner's assessment is that (*sic*) for taxable year 2009. Thus, pursuant to Section 203 of the NIRC respondent only has three (3) years from the date prescribed by law for the filing of the return for the applicable tax to make its assessment if it does not fall within the exceptions provided under Section 222.

9. Assuming arguendo that petitioner regularly filed its Tax Returns for taxable year 2009 within the period required by law, respondent interposes that his right to assess petitioner for deficiency income tax, value-added tax and withholding tax-expanded for taxable year ended 31 December 2009 did not prescribe.

10. On 14 June 2012, Ms. Josefina P. Romero, petitioner's Vice-President for Finance and authorized

signatory, executed a waiver ("first waiver) of the defense of prescription under the statute of limitations of the National Internal Revenue Code extending the period to assess petitioner for its internal revenue tax liabilities for taxable year 2009 until 30 June 2013.

11. On 22 March 2013, before the first waiver loses its validity, Mr. Mario L. Montellano, petitioner's Chief Accountant and authorized signatory, executed another waiver ("second waiver"') of the defense of prescription under the statute of limitations of the National Internal Revenue Code extending the period to assess petitioner for its internal revenue tax liabilities for taxable year 2009 until 31 December 2013.

12. Then on 16 October 2013, before the second waiver loses its validity, Mr. Mario L. Montellano, petitioner's Chief Accountant and authorized representative, again executed another waiver ("third waiver") of the defense of prescription under the statute of limitations of the National Internal Revenue Code extending the period to assess petitioner for its internal revenue tax liabilities for taxable year 2009 until 30 June 2014.

13. On 12 March 2014, before the third waiver loses its validity, Mr. Mario L. Montellano, petitioner's Chief Accountant and authorized representative, again executed another waiver ("fourth waiver") of the defense of prescription under the statute of limitations of the National Internal Revenue Code extending the period to assess petitioner for its internal revenue tax liabilities for taxable year 2009 until 31 December 2014.

14. Petitioner interposed that the waivers are defective for it failed to specify the type of tax and the amount of tax due, that there is no proof of acceptance of the waivers by respondent and that there is no proof that the person who signed the waivers on behalf of petitioner were authorized in writing. On these grounds, allegedly the waivers are defective and consequently, the assessment is void.

15. Respondent differs. The waiver's failure to state specifically the specific type of tax and the amount of tax due subject of the waiver will not render invalid the waivers executed by petitioner. This has already

been clarified in the recent Revenue Memorandum Order (RMO)No.14-2016, viz:

> Except for waiver of collection of taxes which shall indicate the particular taxes assessed, the waiver need not specify the particular taxes to be assessed nor the amount thereof, and it may simply state "all internal revenue taxes" considering that during the assessment stage, the Commissioner of Internal Revenue or her duly authorized representative is still in the process of examining and determining the tax liability of the taxpayer.

16. Clearly, the waivers were executed by petitioner while the audit examination is being conducted. Hence, it would be impossible to specify which taxes petitioner may be subsequently assessed. Further, the Letter of Authority which authorized the examination of petitioner is not only for a particular kind of tax but a comprehensive audit for all internal revenue taxes.

17. Petitioner also argued that the date of execution by the taxpayer and the date of acceptance by the BIR should be before the expiration of the period of prescription. Hence, as alleged, a waiver is defective if the same is executed after the prescription had already set in. Save for the audit assessment for deficiency income taxes, petitioner questioned the validity of the waiver *(sic)* based on the date of its execution which accordingly are already beyond the last day to assess petitioner for deficiency Value-Added Tax (VAT) and Expanded Withholding Tax(EWT).

18. In addition to the waivers executed in relation to this case, respondent interpose *(sic)* that the three-year period within which to make the necessary assessment will not apply squarely to the case at hand. On the matter of the assessment of Expanded Withholding Tax (EWT), the same are imprescriptible.

19. Withholding tax assessments are NOT an assessment for an internal revenue tax as a statutory taxpayer but rather such assessments were issued for failure of petitioner to withhold the correct taxes it is duty bound to collect as agent. Thus the assessments issued for Deficiency Expanded Withholding Tax are imprescriptible. This obligation of petitioner to withhold

and remit the correct tax is its duty as an agent of the government in the collection of taxes and not as a statutory taxpayer.

20. By operation of law, the relationship between the Government and the withholding agent is one of agency for which reason the withholding agent only holds the funds withheld by him in trust for the Government.

21. Clearly, the liability of petitioner as taxpayer is different from its liability as withholding agent. This is the reason why liabilities arising from withholding taxes were never covered by tax amnesty programs. Basically, these liabilities arose from a different source of obligation.

22. The liability of a withholding agent is further established under Section 251, Title X of the Tax Code, which provides:

> Section 251. Failure of a Withholding Agent to Collect and Remit Tax.- Any person required to withhold, account for, and remit any tax imposed by this code or who willfully fails to withhold such tax, or account for and remit such tax, or aids or abets in any manner to evade any such tax or the payment thereof, shall, in addition to other penalties provided for under this Chapter, be liable upon conviction to a penalty equal to the total amount of the tax not withheld, or not accounted for and remitted.

23. In *Filipinas Synthetic Fiber Corporation vs. Court of Appeals and the Commissioner of Internal Revenue*, the Honorable Supreme Court ratiocinated:

> "The law sets no condition for the personal liability of the withholding agent to attach. The reason is to compel the withholding agent to withhold the tax under all circumstances. In effect, the responsibility for the collection of the tax as well as the payment thereof is concentrated upon the person over whom the Government has jurisdiction. Thus, the withholding agent is constituted the agent of both the government and the taxpayer. With respect to the collection and/or withholding of the tax, he is the Government's agent. In regard to the filing of the necessary income tax return and the payment of the tax to the Government, he is the agent of the taxpayer. The withholding agent, therefore, is no ordinary government agent especially because

> under Section 53(c) he is held personally liable for the tax he is duty bound to withhold; whereas, the Commissioner of Internal Revenue and his deputies are not made liable to law."

24. The Tax Code only makes petitioner, as withholding agent personally liable for the tax arising from the breach of its legal duty to withhold as distinguished from its duty to pay tax, since the government's cause of action against the withholding agent is not for the collection of income tax, but for the enforcement of the withholding provision of Section 57 of the Tax Code, compliance with which is imposed on the withholding agent and not upon the taxpayer.

25. Accordingly, the tax deducted and withheld by withholding agents under the said provision shall be held as a special fund in trust for the government until paid to the collecting officer. It bears emphasis that petitioner as a withholding agent merely holds in trust the amount of tax it withheld and as trustee, it is duty bound to remit to the government the proper amount of tax withheld and this duty is imprescriptible.

26. Further, in Section 58(A) of the Tax Code it is specifically provided that:

x x x

> The taxes deducted and withheld by the withholding agent shall be held as special fund in trust for the government until paid to the collecting officers.

x x x

27. It is clear that the assessed deficiency withholding tax as a penalty to petitioner does not fall within the ambit of the period of limitation provided in Section 203 of the Tax Code, as amended.

28. In the same way, the period of limitation (three years) does not also apply squarely to petitioner's liability for Value-Added Tax (VAT).

29. To reiterate, Section 222(a) of the Tax Code which specifically provides:

x x x

30. In the instant case, audit of petitioner disclosed that there were undeclared service income (SLS vs RELIEF vs LN), management services and undeclared purchases which resulted in output tax per audit in the amount of ₱137,611,590.82.

31. The Honorable Supreme Court in the case of *Aznar vs. CTA*, had the occasion to define fake or fraudulent return in this wise:

> That there is a difference between 'false return' and 'fraudulent return' cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.

32. Since the correct sales of petitioner did not appear in its VAT returns, there can only be one inevitable conclusion-that there was a substantial under-declaration of sales in its VAT returns.

33. To reiterate, a false return implies deviation from the truth, whether intentional or not. Although the Aznar case distinguishes what constitute "false returns" referring to mistake, carelessness or ignorance, from that of "fraudulent returns" referring to intent to evade taxes, the same case does not make a distinction as regards the prescriptive period of 10 years. Indeed, in the same case of Aznar, the Supreme Court ruled in favor of the CIR for an extension of 10 year to assess the taxpayer, thus:

> The ordinary period of prescription of 5 years (now 3 years) within which to assess tax liabilities under Sec. 331 of the National Internal Revenue Code should be applicable to normal circumstances, but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent return intended to evade payment of tax or failure to file returns, the period of 10 years provided for in Section 332(a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.
>
> There being undoubtedly false tax returns in this case, We affirm the conclusion of the respondent CTA that Section 332(a)(now Sec.222) of the NIRC should apply and that the period of 10 years within which to assess

> petitioner's tax liability had not expired at the time said assessment was made.

34. It is, therefore clear from the statutory provision in Section 222 of the NIRC of 1997 in the three different case *(sic)* of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may begin without assessment, at any time within 10 years after the discovery of the (1) falsity, (2) fraud, (3) omission. The discrepancy of 75.56% in petitioner's return manifests an evident substantial under declaration which eloquently demonstrate *(sic)* the falsity or fraudulence of the VAT returns with an intent to evade the payment of tax. Respondent, could therefore, rightfully invoke Section 222 because her right to assess has not yet prescribed.

35. Finally, petitioner attacked the validity of the waivers it executed by arguing that while the waivers were accepted by the BIR, there is no proof when such acceptance was communicated by the BIR to petitioner.

36. Respondent differs. To emphasize, waivers are executed at the instance of the taxpayer. This means it is petitioner who initiated the execution of the subject waiver and that he merely submits the same to the respondent for acceptance. Thus, it is no longer necessary for respondent to appear before a notary public when she accepts the subject waiver. The acknowledgment of the waiver before the notary public is for petitioner to attest that the signatory is duly authorized to execute the same and that the same is his voluntary act.

37. To reiterate this has also been clarified in RMO No.14-2016, viz:

> x x x
>
> 4. <u>The waiver may be notarized. However, it is sufficient that the waiver is in writing as specifically provided by the NIRC, as amended.</u>
>
> <u>5. Considering that the waiver is a voluntary act of the taxpayer, the waiver shall take legal effect and be</u> an

> binding on the taxpayer upon its execution thereof. (Underscoring ours)

38. In the case of *Spouses Palada vs. Solid Bank et.al.,* the Honorable Supreme Court emphasized:

> "Besides, any irregularity in the notarization or even the lack of notarization does not affect the validity of the document. Absent any clear and convincing proof to the contrary, a notarized document enjoys the presumption of regularity and is conclusive as to the truthfulness of its contents."

PETITIONER IS ESTOPPED FROM ASSAILING THE VALIDITY OF THE WAIVERS IT EXECUTED

39. It is noteworthy to pinpoint petitioner's conduct amounting to false representation or concealment of material facts calculated to convey the impression that the facts are otherwise than, and inconsistent with, those which the party subsequently attempts to assert.

40. Respondent put emphasis that petitioner executed not only one waiver, but four (4) Waivers of Statute of Limitations. This fact alone will prove that if upon the execution of the first waiver, petitioner believed that the same was invalid, it should not have executed the second, third and fourth waivers. It can be deduced from the succeeding acts of petitioner that it was its clear intention to give force and effect to the waivers.

41. Article 1431 of the Civil Code provides that in order that estoppel may apply to the person, to whom representations have been made and who claims the estoppel in his favor must have relied or acted on such representations. Article 1431 states that:

> 'Art.1431. Through estoppel an admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as against the person relying thereon.'

42. On the other hand, Section 2(a) of Rule 131 of the Rules of Court, on burden of proof and presumptions, states as follows:

'SEC.2 Conclusive presumptions.-The following are instances of conclusive presumptions:

(a)Whenever a party has, by his own declaration, act or omission, intentionally and deliberately led another to believe a particular thing true, and to act upon such belief he cannot in any litigation arising out of such declaration, act or omission, be permitted to falsify it;

43. Respondent humbly submits, that by petitioner's acts or representation, and after benefiting from the effects of the waiver of the defense of prescription petitioner should not be the first to impugn the validity of such agreement. Petitioner should not be allowed to profit from its misdoings. It must be noted that in the FDDA, a substantial portion of respondent's findings were reiterated with minor modifications reducing the amount of the assessments after petitioner was able to submit and prove the correctness of its claims. This can be seen on the matrix of changes from FLD to FDDA. Petitioner benefited from the extension of the period to assess pursuant to the waivers it executed. It was allowed to submit the necessary documents in support of its protest and the same were considered in the evaluation of the protest.

44. Had it been that the parties intended not to extend the Statute of Limitations, petitioner should have not been allowed to submit additional supporting documents in its favor. In the same way, respondent should have issued the FDDA based on already existing audit findings. Based on the foregoing, both parties with all good faith intended that the Statute of Limitations be extended by virtue of the waivers executed. Further, the execution of a subsequent waivers before a prior waiver losses validity is a clear indication of such intention by the parties.

THE ASSESSMENTS HAVE BASES BOTH IN FACT AND IN LAW.

45. Petitioner argued that the deficiency tax assessments imposed upon it for taxable year 2009 should be declared null and void for having been arbitrarily made and lacking factual and legal basis. an

46. Respondent strongly submits that the assessments have bases both in fact and in law which can be gleaned from the following discussion.

PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX AND VALUE-ADDED TAX ON UNDECLARED SERVICE INCOME OF ₱2,893,704.25 and ₱2,358,089.89.

47. Reconciliation of service income per books as against the data from third party information (Relief) and Letter Notice (LN) shows that was a discrepancy on the service income, hence should be added to the computation of income tax pursuant to Section 32 of the NIRC.

PETITIONER IS LIABLE FOR DEFIENCY INCOME TAX AND VAT ON UNDECLARED MANAGEMENT SERVICES OF ₱4,925,000.00.

48. Verification of management fees per contract and financial statement declaration shows a discrepancy which should be added in the computation of income tax pursuant to Section 32 of the NIRC.

PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX AND VAT ON UNACCOUNTED SOURCE OF CASH OF ₱13,536,00.00.

49. Per verification of rental expense shows that the account was unaccounted per remittance of expanded withholding tax as against the expense incurred amounting to P322,781.00. Verification of investment in associates shows that professional fees account was claimed in the amount of P13,536,000.00. The said findings were disallowed in the income statement account pursuant to Section 32 of the NIRC.

PETITIONER IS LIABLE FOR INCOME TAX ON DISALLOWED OPTIONAL STANDARD DEDUCTION OF ₱297,018,816.80

50. Verification of the quarterly income tax returns for the 1st to the 3rd quarters shows that petitioner opted to file an itemized deduction and for the an

annual return it opted to use the optional standard deduction. The difference between the itemized deduction and optional standard deduction was disallowed pursuant to Section 34(L) of the NIRC and per Revenue Memorandum Circular No.16-2010.

PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX AND VAT ON UNDECLARED PURCHASES OF ₱1,647,659.04 and ₱12,213,223.00

51. Reconciliation of purchases/expenses claimed per financial statement and claimed by third party (SLS-AITEID) shows that some of the suppliers were not declared/claimed hence, should be added in the income statement pursuant to Section 34 of the NIRC.

52. On a final note, the decision of the Honorable Supreme Court in the case of *Commissioner of Internal Revenue vs. Bank of the Philippine Islands* can be well use *(sic)* as a guide, to wit:

> 'Tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. <u>In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments.'</u>

85. *(sic)* All presumptions are in favor of the correctness of tax assessments. The good faith of tax assessors and the validity of their actions are presumed. They will be presumed to have taken into consideration all the facts to which their attention was called (*CIR vs. Construction Resources of Asia,Inc. 145 SCRA 671*). It is incumbent upon the taxpayer to prove the contrary (*Mindanao Bus Company vs.CIR,1 SCRA 538; CIR vs. Tuazon, Inc., 173 SCRA 397*) and failure to do so shall vest legality on respondent's actions and assessments.

86. Failure to present proof of error in the assessment will justify judicial affirmation of said assessment (*Delta Motors Co. vs. Commissioner, CTA Case No.3782, 21 May 1986; Commissioner of Internal Revenue vs. Court of Appeals, et al., G.R. Nos. 104151 and 105563, 10 March 1995*)."

RULING OF THE COURT

The Court shall first tackle the issue of the timeliness of filing an appeal with the Court as this will be determinative of whether or not it has jurisdiction to take cognizance of the other issues raised by the parties.

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

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

The Revised Rules of the Court of Tax Appeals (RRCTA), Section 3(a) (1), Rule 4 further provides as follows:

> Sec.3. Cases within the jurisdiction of the Court in Divisions. –
>
> The Court in Division shall exercise:
>
> (a) Exclusive original or appellate jurisdiction to review by appeal the following:
>
> (1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or *other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue.* (italics ours).

The instant case involves a Final Decision on a Disputed Assessment (FDDA).

The facts and records show that on February 27, 2014, respondent issued a PAN for deficiency income tax, VAT, EWT, WTC, DST and IAET for a total amount of Nine Hundred Eighty One Million Four Hundred Eighty Two Thousand Nine Hundred Seventy One and 93/100 Pesos (₱981,482,971.93), inclusive of penalties, interest and surcharges for taxable year 2009.

Petitioner received the PAN also on February 27, 2014.

Respondent then issued an FLD on April 2, 2014 which petitioner received on the same day reiterating the findings of tax deficiencies embodied in the said PAN but with adjustments on the amount of interests.

On April 10, 2014, [42] petitioner filed its protest to the FLD.

On January 5, 2017, petitioner received a Final Decision on Disputed Assessment (FDDA) dated January 4, 2017, which reduced the total assessment to Two Hundred Thirty Million Three Hundred Sixty-One Thousand Four Hundred Fifty One Pesos and 14/100 Pesos (₱230,361,451.14) representing assessments for deficiency income tax, VAT and EWT, including interest, surcharge and penalties for taxable year ending December 31, 2009.

Hence, petitioner filed a Petition for Review with the Court of Tax Appeals (CTA) on February 2, 2017.[43]

Pursuant to Republic Act 9282, this Court acquires jurisdiction over a decision of the Commissioner of Internal Revenue (CIR) on a "disputed assessment" which in turn is elevated by a taxpayer to this Court via a Petition for Review. In this case, the decision on the disputed assessment came in the form of an FDDA. Section 11 of the RRCTA provides that a taxpayer, may file an appeal within thirty (30) days after receipt of such decision or ruling, and we quote, thus:

> "Section 11.- *Who may Appeal; Mode of Appeal; Effect of Appeal.* - Any party adversely affected by a decision, ruling or inaction of the Commissioner of Internal Revenue, the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade and Industry or the Secretary of Agriculture or the Central Board of Assessment Appeals or the Regional Trial Courts may file an

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[42] Exhibit "P-50", docket, vol. II, pp. 753-785.
[43] Docket, vol. I, pp. 10-43.

appeal with the CTA **within thirty (30) days after receipt of such decision or ruling or after the expiration of the period fixed by law for action as referred to in Section 7 (a) (2) herein."** (emphasis supplied)

xxx xxx xxx

The facts show that petitioner elevated its appeal to this Court on February 2, 2017 via a Petition for Review within thirty (30) days from January 5, 2017, the date when it received the FDDA, hence giving this Court the requisite jurisdiction to take cognizance of the case.

We now proceed to the other issues raised in the Petition for Review.

On the issue of whether or not the assessments have basis both in fact and in law, petitioner flagged down the validity of the LOA issued to authorize the revenue examiners to conduct the audit examination of its books of account and other accounting records.

Petitioner argues that the assessments should be cancelled as both the FLD and the FDDA are void for having been issued without a revalidated LOA and for having been issued beyond the period allowed by law for respondent to issue an assessment for taxable year ended December 31, 2009.

At the outset, it has been well-settled that the Court has jurisdiction to decide whether or not an LOA is invalid. The Supreme Court in a case decided in 2017 [44] confirmed the jurisdiction of the Court to resolve the issue on the authority of revenue officers to conduct the audit under the phrase "other matters" under Section 7 of Republic Act (R.A.) No. 1125 or its amendment, R.A. No. 9282, as follows:

> "The law vesting unto the CTA its jurisdiction is Section 7 of Republic Act No. 1125 (R.A. No. 1125) which in part provides:
>
> > Section 7. Jurisdiction. — The Court of Tax Appeals shall exercise exclusive appellate jurisdiction to review by appeal, as herein provided:
> >
> > (1) Decisions of the Collector of Internal Revenue in cases involving disputed

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[44] *Commissioner of Internal Revenue vs. Lancaster Philippines, Inc.*, G.R. No. 183408, July 12, 2017.

> assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto, or **other matters** arising under the National Internal Revenue Code or other law or part of law administered by the Bureau of Internal Revenue;
>
> xxx xxx xxx
>
> (emphasis supplied)

Under the afore-cited provision, the jurisdiction of the CTA is not limited only to cases which involve decisions or inactions of the CIR on matters relating to assessments or refunds but also includes other cases arising from the NIRC or related laws administered by the BIR. Thus, for instance, we had once held that the question of whether or not to impose a deficiency tax assessment comes within the purview of *'other matters arising under the National Internal Revenue Code.'*

The jurisdiction of the CTA on such ***other matters arising under the NIRC*** was retained under the amendments introduced by R.A. No. 9282. Under R.A. No. 9282, Section 7 now reads:

> 'Sec. 7. Jurisdiction. — The CTA shall exercise:
>
> a. Exclusive appellate jurisdiction to review by appeal, as herein provided:
>
> 1. Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or **other matters** arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;
>
> 2. Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or **other matters** arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period of action, in which case the inaction shall be deemed a denial;
>
> xxx xxx xxx
>
> (emphasis supplied)

Is the question on the authority of revenue officers to examine the books and records of any person cognizable by the CTA? *ccm*

It must be stressed that the assessment of internal revenue taxes is one of the duties of the BIR. Section 2 of the NIRC states:

> Sec. 2. Powers and Duties of the Bureau of Internal Revenue. — The Bureau of Internal Revenue shall be under the supervision and control of the Department of Finance and its powers and duties shall comprehend the ***assessment*** and collection of all national internal revenue taxes, fees, and charges, and the enforcement of all forfeitures, penalties, and fines connected therewith, including the execution of judgments in all cases decided in its favor by the Court of Tax Appeals and the ordinary courts.
>
> The Bureau shall give effect to and administer the supervisory and police powers conferred to it by this Code or other laws. (emphasis supplied)

In connection therewith, the CIR may authorize the examination of any taxpayer and correspondingly make an assessment whenever necessary. Thus, to give more teeth to such power of the CIR, to make an assessment, the NIRC authorizes the CIR to examine any book, paper, record, or data of any person. The powers granted by law to the CIR are intended, among other things, to determine the liability of any person for any national internal revenue tax.

It is pursuant to such pertinent provisions of the NIRC conferring the powers to the CIR that the petitioner (CIR) had, in this case, authorized its revenue officers to conduct an examination of the books of account and accounting records of Lancaster, and eventually issue a deficiency assessment against it.

From the foregoing, it is clear that the issue on whether the revenue officers who had conducted the examination on Lancaster exceeded their authority pursuant to LOA No. 00012289 may be considered as covered by the terms 'other matters' under Section 7 of R.A. No. 1125 or its amendment, R.A. No. 9282. The authority to make an examination or assessment, being a matter provided for by the NIRC, is well within the exclusive and appellate jurisdiction of the CTA." (Emphasis supplied)

In the recent case of *GS MTE Grains Corporation vs. Commissioner of Internal Revenue*[45], this Court stressed that "the validity of the assessment relies heavily upon the validity

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[45] CTA Case No. 8837, March 19, 2018.

of the authority of the Revenue officer to conduct the audit pursuant to a valid LOA. The revenue officer's authority to make an examination goes into the issue of the validity of the assessment itself. Thus, the Court has the power to resolve the validity of the LOA from which the revenue officer derives his/her authority to conduct the audit and investigation of the taxpayer, that ultimately led to the issuance of the deficiency tax assessments, under the phrase "other matters" arising under the NIRC or other laws administered by the BIR."

Petitioner cites Revenue Memorandum Order (RMO) No. 36-99 which provides that revenue officers are allowed only 120 days from the date of the receipt of the LOA by the taxpayer to conduct the audit and submit the required report of investigation. Hence, in the event that the revenue officer will not be able to complete his/her final report within the 120-day period, the revenue officer must submit a progress report to the head office and surrender the LOA for revalidation. Petitioner asserts that respondent's revenue officer not only submitted the final report beyond the 120-day period prescribed by the rules, but also failed to have the initial LOA revalidated thereby making the assessments void.

We are not convinced.

It is clear from RMC 23-2009 issued on April 16, 2009 that failure on the part of the revenue officer to request for revalidation does not nullify the LOA but can be a ground for disciplinary action against the said revenue officer. We quote portions of RMC 23-2009:

> "I. Revalidation of LA
>
> The revalidation of LA shall give rise to the extension of the period within which the Revenue Officer (RO) assigned to the case shall submit the report of investigation to higher authorities for review and approval, without the imposition of applicable administrative sanctions. Depending on the classification of the pending tax case said extension period shall be equivalent to the original prescribed number of days within which to report the case under existing revenue issuances. **Failure on the part of the RO to request for revalidation of LA or the expiration of the "revalidation period" does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued.** However, this shall be considered as a ground for the imposition of disciplinary action and demerit in the performance rating of the concerned RO, including the reassignment of the case to another RO if the

> Regional Director, upon the recommendation of the Revenue District Officer, deems it necessary." (emphasis supplied)

In the recent CTA *En Banc* decision in the case of *Telstar Manufacturing Corporation vs. Commissioner of Internal Revenue*[46], the Court *En Banc* had the opportunity to rule on the subject matter, thus:

> "As to Telstar's contention that the LOA is invalid for failure of the revenue officer to submit a progress report of investigation after 120 days from its date of receipt by the taxpayer, to his Head of Office and surrender the LOA for revalidation, a plethora of cases promulgated by this Court is in order. RMC No. 23-09 which provides that failure of the revenue officer to request for revalidation of LOA or the expiration of the revalidation period does not nullify the LOA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued, to wit:
>
> 'I. Revalidation of LAs
>
> The revalidation of LA shall give rise to the extension of the period within which the Revenue Officer (RO) assigned to the case shall submit the report of investigation to higher authorities for review and approval, without the imposition of applicable administrative sanctions. Depending on the classification of the pending tax case, said extension period shall be equivalent to the original prescribed number of days within which to report the case under existing revenue issuances. <u>Failure on the part of the RO to request for the revalidation of LA or the expiration of the 'revalidation period' does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued</u>. However, this shall be considered as a ground for the imposition of disciplinary action and demerit in the performance rating of the concerned RO, including the reassignment of the case to another RO if the Regional Director, upon the recommendation of the Revenue District Officer, deems it necessary.' (Underlining supplied.)"

More so, it is also noteworthy that RMC No. 23-09 was issued on April 16, 2009 and the subject LOA herein was issued on May 15, 2010 and received by petitioner on May 19, 2010. Clearly then, RMC No. 23-09 has already been in full effect at that time.

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[46] CTA EB Nos. 1797 & 1879 (CTA Case No. 8900), April 15, 2019.

As regards the validity of the waivers executed for the extension of the period to assess, petitioner claims that the waivers are defective for the following reasons:

a) It failed to specify the type of tax and the amount of tax due;
b) There is no proof of acceptance of the waivers by respondent;
c) Assuming that the waivers were accepted by the BIR, there is no proof when such acceptance was communicated by the BIR to petitioner; and, there is no proof that the person who signed the waivers on behalf of petitioner were authorized in writing.

Petitioner, in its Reply Memorandum insists that the foregoing grounds are sufficient to render the waivers defective and consequently make the subject assessment void.

We find for the respondent.

Records show that Four (4) Waivers of the Defense of Prescription were executed by petitioner and respondent, detailed as follows:

Waiver	Date Executed	Extension of Period
1st	June 14, 2012	June 30, 2012
2nd	March 22, 2013	December 31, 2013
3rd	October 16, 2013	June 30, 2014
4th	March 12, 2014	December 31, 2014

It is well-settled that the execution of the waivers must strictly abide by the procedures and guidelines provided in RMO No. 20-90[47] and Revenue Delegation Authority Order (RDAO) No. 05-01[48], otherwise the waiver is considered invalid and will not extend the period of assessment. This was the ruling enunciated by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Kudos Metal Corporation*[49], to wit:

"Section 222 (b) of the NIRC provides that the period to assess and collect taxes may only be extended upon a written

[47] Proper Execution Of The Waiver Of The Statute Of Limitations Under The National Internal Revenue Code, dated April 4, 1990.
[48] Delegation of Authority to Issue and Sign Certificate of Exemption for Audit/Investigation for Availments of the No Audit Program as Implemented by Revenue Regulations No. 6-2005, as Amended, dated January 18, 2006.
[49] G.R. No. 178087, May 5, 2010, citing, *Philippine Journalist, Inc. vs. Commissioner of Internal Revenue*, G.R. No. 162852, December 16, 2004.

agreement between the CIR and the taxpayer executed before the expiration of the three-year period. RMO 20-90 issued on April 4, 1990 and RDAO 05-01 issued on August 2, 2001 lay down the procedure for the proper execution of the waiver, to wit:

1. The waiver must be in the proper form prescribed by RMO 20-90. The phrase 'but not after ______ 19 ___', which indicates the expiry date of the period agreed upon to assess/collect the tax after the regular three-year period of prescription, should be filled up.

2. The waiver must be signed by the taxpayer himself or his duly authorized representative. **In the case of a corporation, the waiver must be signed by any of its responsible officials**. In case the authority is delegated by the taxpayer to a representative, such delegation should be in writing and duly notarized.

3. The waiver should be duly notarized.

4. The CIR or the revenue official authorized by him must sign the waiver indicating that the BIR has accepted and agreed to the waiver. The date of such acceptance by the BIR should be indicated. **However, before signing the waiver, the CIR or the revenue official authorized by him must make sure that the waiver is in the prescribed form, duly notarized, and executed by the taxpayer or his duly authorized representative**.

5. Both the date of execution by the taxpayer and date of acceptance by the Bureau should be before the expiration of the period of prescription or before the lapse of the period agreed upon in case a subsequent agreement is executed.

6. The waiver must be executed in three copies, the original copy to be attached to the docket of the case, the second copy for the taxpayer and the third copy for the Office accepting the waiver. The fact of receipt by the taxpayer of his/her file copy must be indicated in the original copy to show that the taxpayer was notified of the acceptance of the BIR and the perfection of the agreement.

x x x

Due to the defects in the waivers, the period to assess or collect taxes was not extended. Consequently, the assessments were issued by the BIR beyond the three-year period and are void." *(Emphases Supplied)*

Then, on April 4, 2016, the BIR issued RMO No. 14-16[50] which effectively repealed the very strict requirements for a valid

[50] Guidelines For The Execution Of Waivers From The Defense Of Prescription Pursuant To Section 222 Of The National Internal Revenue Code Of 1997, as Amended.

waiver prescribed in RMO No. 20-90 and RDAO No. 05-01, and instead prescribed revised guidelines on the execution of waivers. The changes are significant in that they effectively relax the requirements in executing waivers by the parties concerned.

However, considering that the subject waivers were executed prior to the issuance of RMO No. 14-16, the governing BIR issuances in force at that time shall be observed.

Notably, in the case of *Commissioner of Internal Revenue vs. Next Mobile, Inc. (Formerly Nextel Communications Phils., Inc.)*,[51] the Supreme Court had the opportunity to rule that a waiver must faithfully comply with the provisions of RMO No. 20-90 and RDAO 05-01 in order to be valid and binding. Nonetheless, an exception must be made when the circumstances warrant, in keeping with the lifeblood theory of taxation, the High Court explains, to wit:

> "To be sure, both parties in this case are at fault.
>
> Here, respondent, through Sarmiento, executed five Waivers in favor of petitioner. <u>However, her authority to sign these Waivers was not presented upon their submission to the BIR. In fact, later on, her authority to sign was questioned by respondent itself, the very same entity that caused her to sign such in the first place. Thus, it is clear that respondent violated RMO No. 20-90 which states that in case of a corporate taxpayer, the waiver must be signed by its responsible officials 13 and RDAO 01-05(*sic*) which requires the presentation of a written and notarized authority to the BIR.</u>
>
> <u>Similarly, the BIR violated its own rules and was careless in performing its functions with respect to these Waivers</u>. It is very clear that under RDAO 05-01 it is the duty of the authorized revenue official **to ensure that the waiver is duly accomplished and signed by the taxpayer or his authorized representative** before affixing his signature to signify acceptance of the same. It also instructs that **in case the authority is delegated by the taxpayer to a representative, the concerned revenue official shall see to it that such delegation is in writing and duly notarized**. Furthermore, it mandates that **the waiver should not be accepted by the concerned BIR office and official unless duly notarized**.
>
> Vis-a-vis the five Waivers it received from respondent, <u>the BIR has failed, for five times, to perform its duties in relation thereto: to verify Ms. Sarmiento's authority to execute them, demand the presentation of a notarized document evidencing the same, refuse acceptance of the Waivers when no such document was presented</u>, affix the dates of its acceptance on each waiver,

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[51] G.R. No. 212825, December 7, 2015.

and indicate on the Second Waiver the date of respondent's receipt thereof.

Both parties knew the infirmities of the Waivers yet they continued dealing with each other on the strength of these documents without bothering to rectify these infirmities. In fact, in its Letter Protest to the BIR, respondent did not even question the validity of the Waivers or call attention to their alleged defects.

In this case, respondent, after deliberately executing defective waivers, raised the very same deficiencies it caused to avoid the tax liability determined by the BIR during the extended assessment period. It must be remembered that by virtue of these Waivers, respondent was given the opportunity to gather and submit documents to substantiate its claims before the CIR during investigation. It was able to postpone the payment of taxes, as well as contest and negotiate the assessment against it. Yet, after enjoying these benefits, respondent challenged the validity of the Waivers when the consequences thereof were not in its favor. In other words, respondent's act of impugning these Waivers after benefiting therefrom and allowing petitioner to rely on the same is an act of bad faith.

On the other hand, the stringent requirements in RMO 20-90 and RDAO 05-01 are in place precisely because the BIR put them there. Yet, instead of strictly enforcing its provisions, the BIR defied the mandates of its very own issuances. Verily, if the BIR was truly determined to validly assess and collect taxes from respondent after the prescriptive period, it should have been prudent enough to make sure that all the requirements for the effectivity of the Waivers were followed not only by its revenue officers but also by respondent. The BIR stood to lose millions of pesos in case the Waivers were declared void, as they eventually were by the CTA, but it appears that it was too negligent to even comply with its most basic requirements.

The BIR's negligence in this case is so gross that it amounts to malice and bad faith. Without doubt, the BIR knew that waivers should conform strictly to RMO 20-90 and RDAO 05-01 in order to be valid. In fact, the mandatory nature of the requirements, as ruled by this Court, has been recognized by the BIR itself in its issuances such as Revenue Memorandum Circular No. 6-2005, among others. Nevertheless, the BIR allowed respondent to submit, and it duly received, five defective Waivers when it was its duty to exact compliance with RMO 20-90 and RDAO 05-01 and follow the procedure dictated therein. It even openly admitted that it did not require respondent to present any notarized authority to sign the questioned Waivers. The BIR failed to demand respondent to follow the requirements for the validity of the Waivers while it had the duty to do so, most especially because it had the highest interest at stake. If it was serious in collecting taxes, the BIR should have meticulously complied with the foregoing orders, leaving no stone unturned.

The general rule is that when a waiver does not comply with the requisites for its validity specified under RMO No. 20-90 and RDAO 01-05 (*sic*), it is invalid and ineffective to extend the prescriptive period to assess taxes. However, due to its peculiar circumstances, We shall treat this case as an exception to this rule and find the Waivers valid for the reasons discussed below.

First, the parties in this case are *in pari delicto* or 'in equal fault.' *In pari delicto* connotes that the two parties to a controversy are equally culpable or guilty and they shall have no action against each other. However, although the parties are *in pari delicto,* the Court may interfere and grant relief at the suit of one of them, where public policy requires its intervention, even though the result may be that a benefit will be derived by one party who is in equal guilt with the other.

Here, to uphold the validity of the Waivers would be consistent with the public policy embodied in the principle that taxes are the lifeblood of the government, and their prompt and certain availability is an imperious need. Taxes are the nation's lifeblood through which government agencies continue to operate and which the State discharges its functions for the welfare of its constituents. <u>As between the parties, it would be more equitable if petitioner's lapses were allowed to pass and consequently uphold the Waivers in order to support this principle and public policy</u>.

Second, the Court has repeatedly pronounced that parties must come to court with clean hands. Parties who do not come to court with clean hands cannot be allowed to benefit from their own wrongdoing. Following the foregoing principle, <u>respondent should not be allowed to benefit from the flaws in its own Waivers and successfully insist on their invalidity in order to evade its responsibility to pay taxes</u>.

Third, respondent is estopped from questioning the validity of its Waivers. While it is true that the Court has repeatedly held that the doctrine of estoppel must be sparingly applied as an exception to the statute of limitations for assessment of taxes, the Court finds that the application of the doctrine is justified in this case. Verily, the application of estoppel in this case would promote the administration of the law, prevent injustice and avert the accomplishment of a wrong and undue advantage. <u>Respondent executed five Waivers and delivered them to petitioner, one after the other. It allowed petitioner to rely on them and did not raise any objection against their validity until petitioner assessed taxes and penalties against it</u>. Moreover, the application of estoppel is necessary to prevent the undue injury that the government would suffer because of the cancellation of petitioner's assessment of respondent's tax liabilities.

Finally, <u>the Court cannot tolerate this highly suspicious situation</u>. In this case, the taxpayer, on the one hand, after voluntarily executing waivers, insisted on their invalidity by raising the very same defects it caused. On the other hand, the BIR miserably failed to exact from respondent compliance with its rules. The BIR's negligence in the performance of its duties was so gross that it amounted to malice and bad faith. Moreover, the BIR was so lax such that it seemed that it consented to the mistakes in the Waivers. Such a situation is dangerous and open to abuse by unscrupulous taxpayers who intend to escape their responsibility to pay taxes by mere expedient of hiding behind technicalities.

It is true that petitioner was also at fault here because it was careless in complying with the requirements of RMO No. 20-90 and RDAO 01-05. Nevertheless, petitioner's negligence may be addressed by enforcing the provisions imposing administrative liabilities upon the officers responsible for these errors. The BIR's right to assess and collect taxes should not be jeopardized merely because of the mistakes and lapses of its officers, especially in cases like this where the taxpayer is obviously in bad faith. *(Underscoring supplied)*

In the instant case, we find that both parties are at fault hence the application of the ruling in the aforequoted *Next Mobile* case is proper.

By petitioner's act of and after benefiting from the effects of the waiver of the defense of prescription, it should not be the first to impugn the validity of such agreement. It must be noted that by virtue of having the period extended, petitioner was able to submit the necessary documents in support of its protest and the same were considered in the evaluation thereof which ultimately resulted in reducing the amount of the assessment. Indeed, petitioner should not be allowed to profit from its misdoings.

That having been settled, this Court shall now proceed to the substantive merits of the subject assessments.

I. Deficiency EWT - ₱304,206.88

Respondent's verification disclosed that petitioner failed to pay the corresponding EWT on its income payments, as shown below, pursuant to Section 2.57.2 of Revenue Regulations (RR) No. 02-98, as amended.[52]

Income Payments		Per ITR/FS	Per Alphalist	Discrepancy	Rate	EWT Due
Professional fee (15%)	4,437,327.80	4,437,327.80	4,437,327.80	-		
Professional fee (10%)	1,863,682.50	1,863,682.50	1,863,682.50	-		

[52] Details of Discrepancies ("DOD"), FLD and FDDA, Exhibits "P-49-a" and "P-54-a", Docket, Vol. II, pp. 750 to 751 and 890.

Rental	23,573,164.00	23,573,164.00	23,573,164.00	-		
Contractor						
Outside services per Cost of services	15,771,133.00					
Insurance per Cost of services	4,558,299.00					
Outside services per Operating expenses	2,085,654.00					
Insurance per Operating expenses	148,321.00	22,563,407.00	6,687,188.50	15,876,218.50	0.02	317,524.36
Less: Payment		9,975,083.50		9,975,083.50		199,501.67
		12,588,323.50		5,901,135.00		118,022.69
Supplier of TOP 10T Corp. (services)						
Repairs and maintenance – cost	909,450.50					
Transportation and travel	5,278,385.00					
Miscellaneous	3,304,324.00					
Communication, light and water	1,779,873.00					
Repairs and maintenance - Operating expenses	807,570.00	12,079,602.50	12,079,602.50	-		
Supplier of TOP 10T Corp. (goods)						
Repairs and maintenance – cost	777,836.50					
Office supplies	491,530.00					
Property and equipment	3,720,978.00	4,990,344.50	1,239,929.00	3,750,415.50	0.01	37,504.16
Less: Payment		3,750,415.50		3,750,415.50		(37,504.16)
		1,239,929.00				
Total		**55,782,029.30**	**49,880,894.30**	**5,901,135.00**		**118,022.69**

As mentioned earlier, petitioner had already paid the basic deficiency EWT, as well as the deficiency interest and compromise penalty imposed thereon, on April 30, 2014 and January 27, 2017 as evidenced by the BIR Forms No. 0605.

With these payments, petitioner now asserts that the assessment for deficiency EWT must be cancelled.

Indeed, the basic deficiency EWT assessment must be cancelled in view of the settlement made by petitioner. However, petitioner is not totally relieved from its liability as it is required to pay the increments thereon, such as the 25% surcharge and the 20% delinquency interest imposed under Sections 248(A)(3) and 249(C) of the NIRC of 1997, which provide:

"SEC. 248. *Civil Penalties.* —

"(A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:

xxx xxx xxx

"(3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment;"

"SEC. 249. *Interest.* –

xxx xxx xxx

"(C) *Delinquency Interest.* – In case of failure to pay:

xxx xxx xxx

"(3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax."

The law is clear. The imposition of surcharge is mandatory because the intention of the law is precisely to discourage delay in the payment of taxes due to the government. The delay in the payment of the deficiency tax within the time prescribed for its payment in the notice of assessment justifies the imposition of a 25% surcharge, pursuant to Section 248(A) (3) of the 1997 NIRC, as amended.[53]

On the other hand, the imposition of delinquency interest is also proper.

Section 249(C)(3) of the 1997 NIRC, as amended, mandates the imposition of such interest in the event that the taxpayer is held liable for deficiency taxes. Based on established doctrine, these charges incident to delinquency are compensatory in nature and are imposed for the taxpayer's use of the funds at the time when the State should have control of said funds. Collecting such charges is mandatory.[54]

II. Deficiency Income Tax - ₱835,117,452.83

Respondent assessed petitioner with deficiency income tax, computed as follows:[55]

Taxable income per return		₱ 545,201,191.00
Add (less) adjustment:		
Undeclared service income (SLS/Relief/LN)	₱ 2,893,704.25	
Undeclared management services	4,925,000.00	

[53] *Felisa L. Vda. de San Agustin vs. CIR*, 364 SCRA 810.
[54] *Bank of the Philippine Islands vs. Commissioner of Internal Revenue, G.R. No. 137002, July 27, 2006, 496 SCRA 601, 620.*
[55] FDDA, Exhibit "P-54", Docket, Vol. II, p. 887.

Unaccounted source of cash	13,536,000.00	
Disallowed OSD	297,018,816.80	
Undeclared purchases	1,647,659.04	
Expenses not subjected to EWT	5,901,134.50	325,922,314.59
Adjusted net income		**₱871,123,505.59**
Tax due		**₱261,337,051.68**
Less: Payments	₱163,560,356.48	
Disallowed creditable withholding tax	34,417.58	163,525,938.90
Tax still due and payable		**₱ 97,811,112.78**
Less: Payment as of 4.30.2014		34,418.40
Amt. still due		**₱ 97,776,694.38**
Add: Interest computation up to 4.30.2014	₱ 79,052,817.18	
Compromise penalty	50,000.00	
Total	79,102,817.18	
Less: Increments paid on 4.30.2014	36,317.61	
Balance	79,066,499.57	
Add: Interest computation from 5.1.2014 to 7.31.2016	44,039,694.67	123,106,194.24
Total amount due		**₱220,882,888.62**

The above assessment is comprised of the following items which the Court shall discuss herein individually:

A.	Undeclared service income (SLS/Relief/LN)	₱ 2,893,704.25
B.	Undeclared management services	4,925,000.00
C.	Unaccounted source of cash	13,536,000.00
D.	Disallowed OSD	297,018,816.80
E.	Undeclared purchases	1,647,659.04
F.	Expenses not subjected to EWT	5,901,134.50
G.	Disallowed creditable withholding tax	34,417.58

A. Undeclared service income - ₱2,893,704.25
E. Undeclared purchases - ₱1,647,659.04

Respondent's reconciliation of petitioner's service income per books as against the data from third party information (RELIEF) and Letter Notice (LN) shows a discrepancy in the amount of ₱2,893,704.25, broken down below, which respondent subjected to income tax pursuant to Section 32 of the 1997 NIRC, as amended.[56]

<u>Schedule 1[57]</u>

[56] DOD, FLD, Exhibit "P-49", Docket, Vol. II, p. 74.
[57] DOD, FDDA, Exhibit "P-54", Docket, Vol. II, p. 889.

Philamlife Insurance Corp.	₱ 2,733,663.75
Philplans First Inc.	160,040.50
Total	**₱2,893,704.25**

The aforesaid amount was likewise subjected to deficiency VAT.

On the other hand, respondent's reconciliation of purchases per petitioner's Summary List of Purchases with the Summary List of Sales of third parties (SLS-AITEID) shows an alleged amount of ₱1,647,659.04 undeclared purchases upon which an income tax was imposed pursuant to Section 34 of the 1997 NIRC, as amended.[58]

Schedule 2 attached to the FLD shows the details of the alleged undeclared purchases of ₱1,647,659.04 as follows:[59]

Third Party	MGCI SLP	Third Party SLS	Discrepancy
MAA General Assurance Phils., Inc.	₱ -	₱ 1,788,004.42	₱ 1,788,004.42
ARM Resources, Inc.	-	89,275.52	89,275.52
Reliance Printing Corporation	-	80,669.64	80,669.64
IBM Philippines, Inc.	-	65,952.50	65,952.50
CIBI Information, Inc.	12,500.00	14,000.00	1,500.00
Diamond Motors Corporation	-	528.22	528.22
		Total	**₱2,025,930.30**
		Gross Profit Rate	0.813285158
		Undeclared Purchases	**₱1,647,659.04**

Petitioner contends that the BIR Records reveal that the BIR did not verify the third-party information on which these alleged discrepancies were based. The failure to validate this information from third parties renders the assessment void for lack of factual basis.[60]

We agree with petitioner.

It is undisputed that the assessments arose from discrepancies found by conducting a third party verification through the RELIEF (Reconciliation of Listing for Enforcement) system pursuant to Section 5 of the 1997 NIRC, as amended.

[58] DOD, FLD, Exhibit "P-49", Docket, Vol. II, p. 749.
[59] BIR Records, p. 830.
[60] Par. 72, Petitioner's Memorandum, Docket, Vol. III, p. 1198.

In line with the implementation of the RELIEF system, RMO No. 04-03 requires the verification of the amounts reflected in the quarterly report with other externally sourced data in ascertaining the taxpayer's under declaration of revenues or overstatement of costs and expenses, if any, to wit –

> "The Bureau of Internal Revenue is reengineering its work processes in order to increase revenue collections and to pursue quality audit by making use of available internal and external information resources. In order to strengthen and enhance its assessment functions, the utilization of information technology has been identified as an effective tool to improve tax administration through the development of the Reconciliation of Listings for Enforcement (RELIEF) System.
>
> The RELIEF System was created to support third party information program and voluntary assessment program of the Bureau through the cross-referencing of third party information from the taxpayers' Summary Lists of Sales and Purchases prescribed to be submitted on a quarterly basis pursuant to Revenue Regulations Nos. 7- 95, as amended by RR 13-97, RR 7-99 and RR 8-2002.
>
> The RELIEF System shall cover all VAT taxpayers above threshold limits set by RR 8-2002 to submit Summary Lists of Sales and Purchases in magnetic form based on a prescribed electronic format. The consolidation and matching of information **with other externally sourced data** will detect underdeclaration of revenues/overdeclaration of cost and expenses, thus resulting to greater tax potential." (*Emphasis supplied*)

Examination of the BIR Records shows that the only basis for the subject assessments are the discrepancies found in the working papers summarizing the comparison between petitioner's SLS and SLP *vis-à-vis* Third Party SLS and SLP.[61] Respondent failed to verify the amounts reflected per the Third Party SLS and SLP with the relevant customers/suppliers. Without the confirmation from third parties, the finding casts doubts as to the reliability and correctness of the assessments on the alleged undeclared service income or undeclared purchases.

While it is true that tax assessments have the presumption of correctness and regularity in its favor, it is also equally true that assessments should not be based on mere presumptions

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[61] BIR Records, pp. 361 to 368 and 741 to 742.

no matter how reasonable or logical the presumption might be.[62] This was highlighted in the case of *Commissioner of Internal Revenue vs. Hantex Trading Co., Inc.*[63]; the pertinent portions of which are quoted as follows:

> "We agree with the contention of the petitioner that, as a general rule, tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment. It is to be presumed, however, that such assessment was based on sufficient evidence. Upon the introduction of the assessment in evidence, a *prima facie* case of liability on the part of the taxpayer is made. If a taxpayer files a petition for review in the CTA and assails the assessment, the *prima facie* presumption is that the assessment made by the BIR is correct, and that in preparing the same, the BIR personnel regularly performed their duties. This rule for tax initiated suits is premised on several factors other than the normal evidentiary rule imposing proof obligation on the petitioner-taxpayer: the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the NIRC.
>
> However, the *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious. Where the BIR has come out with a 'naked assessment,' *i.e.*, without any foundation character, the determination of the tax due is without rational basis. In such a situation, the U.S. Court of Appeals ruled that the determination of the Commissioner contained in a deficiency notice disappears. **Hence, the determination by the CTA must rest on all the evidence introduced and its ultimate determination must find support in credible evidence**."(emphasis supplied)

Accordingly, the imposition of income tax on the alleged undeclared service income of ₱2,893,704.25 and undeclared purchases of ₱1,647,659.04 on the basis of unverified third party information is without merit and must be cancelled. Consequently, the VAT assessment on the alleged undeclared service income of ₱2,893,704.25 must likewise be cancelled.

B. Undeclared management services - ₱4,925,000.00

[62] *Commissioner of Internal Revenue vs. Fax N Parcel Incorporated*, CTA EB No. 883, February 14, 2013.
[63] G.R. No. 136975, March 31, 2005.

Respondent's verification of the management fees per contract and financial statement declaration shows a discrepancy in the amount of ₱737,398.00, as shown below, which should be added in the computation of income tax pursuant Section 32 of the 1997 NIRC, as amended.[64]

	Breakdown of FS Management Service Contract *(as provided by petitioner to BIR examiners)*[65]	**BIR's Alleged Contract Amounts** *(as audited by the BIR examiners)*[66]	**Variance**
Mercury Drug Corporation	₱ 574,800,000.00	₱ 574,800,000.00	₱ -
Tropical Hut Food Market, Inc.	17,832,000.00	17,832,000.00	-
Philusa Corp	46,512,000.00	46,512,000.00	-
Trinity Franchising and Mgt. Corp.	13,416,000.00	13,416,000.00	-
Medical Center Trading Corp	15,672,000.00	15,672,000.00	-
Elta Industries Inc.	710,400.00	710,400.00	-
Telstar Mfg. Corp	5,244,000.00	5,244,000.00	-
Pacifica Agrivet Supplies Inc	29,112,000.00	29,112,000.00	-
Milestone Devt Corp	17,800.00	213,600.00	195,800.00
Mercury Group Provident Fund	4,187,602.00	-	(4,187,602.00)
MGCI - Trinity Division	-	2,916,000.00	2,916,000.00
MGCI - Insurance Division	-	1,813,200.00	1,813,200.00
	₱707,503,802.00	**₱708,241,200.00**	**₱ 737,398.00**

In its protest, petitioner submitted the Management Service Agreement between petitioner and Mercury Provident Fund which states that an annual management fee of ₱4,187,604.00 will be collected by petitioner for taxable year 2009.[67]

Since the contract with Mercury Provident Fund in the amount of ₱4,187,604.00 was not included in the list of management fees per BIR's audit, the same was added to the originally assessed amount of ₱737,398.00 per FLD, thus reflecting a total amount of ₱4,925,000.00 undeclared management fees per FDDA, as shown below: [68]

Per contract	₱708,241,200.00
Per FS declaration	707,503,802.00
Difference	₱ 737,398.00
Add: Contract from Mercury Provident fund re management fee	4,187,602.00[69]
Undeclared management fee	₱ 4,925,000.00

[64] DOD, FLD, Exhibit "P-49", Docket, Vol. II, p. 749.
[65] BIR Records, p. 736.
[66] BIR Records, p. 746.
[67] Exhibit "P-50-b"; Docket, Vol. II, p. 756.
[68] DOD, FDDA, Exhibit "P-54", Docket, Vol. II, p. 889.
[69] With minimal discrepancy of ₱2.00.

The above assessment was likewise subjected to deficiency VAT.

Petitioner contends that it was an error for the BIR to include in its computation of undeclared management service fees the amount of ₱4,187,602.00 as it pertains to the indicated cost for the management contract with Mercury Provident Fund, a department of petitioner. Lastly, BIR is not allowed to include in the FDDA an item of assessment which was not present during the FLD, as this is in violation of petitioner's due process rights.[70]

The assessment must be partially upheld.

Contrary to petitioner's claim, the assessed amount of ₱4,925,000.00 does not include the management service fees from Mercury Provident Fund and pertains only to the following:

	Breakdown of FS Management Service Contract *(as provided by petitioner to BIR examiners)*[71]	**BIR's Alleged Contract Amounts** *(as audited by the BIR examiners)*[72]	**Variance**
Milestone Devt Corp	₱ 17,800.00	₱ 213,600.00	₱ 195,800.00
MGCI - Trinity Division	-	2,916,000.00	2,916,000.00
MGCI - Insurance Division	-	1,813,200.00	1,813,200.00
	₱17,800.00	**₱4,942,800.00**	**₱4,925,000.00**

What respondent did in the FDDA was to merely correct the assessment computation per FLD upon finding that the management fee from Mercury Provident Fund was not included in the list of management fees per contracts in the total amount of ₱708,241,200.00.

Milestone Development Corp. - ₱195,800.00. In its protest to the FLD, petitioner explained that while its management contract with Milestone Development Corp. is for the total amount of ₱213,600.00, the latter was only able to pay ₱17,800.00.[73]

Petitioner's argument is untenable.

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[70] Par. 81, Petitioner's Memorandum, Docket, Vol. III, p. 1202.
[71] BIR Records, p. 736.
[72] BIR Records, p. 746.
[73] Q&A No. 48(a), Judicial Affidavit of Mr. Mario L. Montellano, Exhibit "P-60", Docket, Vol. II, p. 504.

Petitioner follows the accrual method of accounting for its income, which means that income is recognized once it has been earned or realized, regardless of when it is collected. This is disclosed in its 2009 Audited Financial Statements ("AFS") which states that:[74]

> "Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:
>
> **Management fees** from financial, administrative, marketing, legal and personnel matters are **recognized when earned.**
>
> Service fees are recognized when the services are rendered.
>
> Interest income is recognized as the interest accrues.
>
> Dividend income is recognized when the shareholder's right to receive the payment is established.
>
> Income from other sources are recognized when earned." (Emphasis supplied)

The same method must be adopted in the computation of its taxable income pursuant to Sec. 43 of the 1997 NIRC, as amended, which provides that the taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year), as the case may be, in accordance with the method of accounting regularly employed in keeping the books of such taxpayer.

Verily, in this case, the whole amount of ₱213,600.00 as the value of the management service rendered by petitioner to Milestone during TY 2009 had been fully realized in TY 2009. The same must already be taxable in the same year. And following the accrual method, the time of collection is irrelevant for income tax purposes. Hence, the undeclared amount of ₱195,800.00 must indeed be subjected to deficiency income tax.

We also extend the same ruling in the corresponding deficiency VAT assessment. Petitioner, as a service entity, is VATable on its gross receipts, which is defined in Section 108 of the 1997 NIRC, as amended, as follows:

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[74] Note 2, Exhibit "P-8", Docket, Vol. II, p. 562.

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

Clearly, VAT on sale of services is imposed upon collection regardless of when the services were rendered. However, petitioner did not present any proof that the assessed amount of ₱195,800.00 was not collected during TY 2009.

Petitioner did not present the breakdown of its trade receivables as of 2009 to show that the amount of ₱195,800.00 is still collectible by year end. As such, we have no way of verifying if the amount of ₱195,800.00 is still outstanding as of the year ended 2009 to warrant the cancellation of the deficiency VAT assessment.

MGCI – Trinity and Insurance Divisions - ₱2,916,000.00 and ₱1,813,200.00. Petitioner explained that these are inter-division accounts used to keep track of the expenses of each department. These are not transactions of the company with customers, but rather part of an internal control mechanism. These divisions are considered profit centers and in order to determine the profitability of each division, it has been a practice of petitioner to have something in writing to track the division's profitability.[75]

In the Judicial Affidavit of Mr. Mario L. Montellano, petitioner's Treasurer and Vice-President, he explained the effect of the transactions with inter-division accounts:[76]

> 49. Q: What then is the effect of this inter-division accounts to MGCI's income?
>
> A: It has no effect because these transactions (management fee income vs. management fee expense of the two divisions) were "washed-out" internally as shown in the working papers for the consolidated income statement and operating expenses for year 2009.
>
> xxx xxx xxx
>
> 51. Q: Showing to you a copy of the General Ledger, can you please explain to us how these documents are able to

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[75] Q&A No. 48(c), Judicial Affidavit of Mr. Mario L. Montellano, Exhibit "P-60", Docket, Vol. II, p. 505.

[76] Exhibit "P-60", Docket, Vol. II, p. 505.

show that no income is attributable to the cost-sharing scheme of MGCI's Trinity and Insurance Division?

A: As shown in the working papers under the row "management fee" and column "Account WASH-OUT", the total amount of ₱4,729,200.00 was deducted in the income.[77] Correspondingly, under the schedule of operating expenses for row "Outside Services" and column "Wash-out", the same amount was deducted under expenses.[78] The amount of ₱4,729,200.00 is the sum of the MGCI-Trinity division's management fee of ₱2,916,000.00 and MGCI-Insurance Division's management fee of ₱1,813,200.00.

Petitioner's argument is meritorious.

Records show that subject assessments are mere intra-company transactions of petitioner with its profit-center divisions for proper monitoring of each division's operations. However, for financial reporting and income tax purposes, petitioner and its divisions are treated only as one entity. Hence, there is a need to eliminate the internal transactions to properly reflect the true income and expense of petitioner for financial reporting and income tax purposes.

This practice is likewise disclosed in petitioner's 2009 Audited Financial Statements ("AFS") which provides that revenue comprises the fair value of the consideration received for the sale of services in the ordinary course of the company's activities. Revenue is shown net of value-added tax, returns, rebates, and discounts, and **after eliminating sales within the group.**[79]

Petitioner's working paper shows that the total income for 2009 amounted to ₱1,122,715,280.00. However, after deducting the washed-out income of ₱6,013,183.00, which includes the management fee of ₱4,729,200.00 from Trinity and Insurance Divisions, the true income of petitioner is only ₱1,116,702,092.00.[80] The computation is demonstrated as follows:

Management fee		₱ 712,233,002.00
Service fee		77,936,385.00
Rent		296,029,093.00
Commission		33,992,018.00
Miscellaneous income		2,524,782.00
Total income		**₱1,122,715,280.00**

[77] Exhibit "P-58", Docket, Vol. II, p. 927.
[78] *Id.* at p. 928.
[79] Note 2 to 2009 AFS, Exhibit "P-8", Docket, Vol. II, p. 562.
[80] Exhibit "P-58", Docket, Vol. II, p. 927.

Less: Washed-out income		
Management fee from Trinity and Insurance Divisions	₱4,729,200.00	
Rent	837,384.00	
Commission	446,604.00	6,013,188.00
Total income after eliminating intra-company transactions		**₱1,116,702,092.00**

The total income after eliminating intra-company transactions amounting to ₱1,116,702,092.00 was accordingly traced to both the 2009 AFS[81] and ITR,[82] declared as follows:

2009 ITR Line Item	Description	Amount
Line 15C	Gross income from sales	₱ 1,114,177,310.00
Line 18B	Other income from non-operating activities	2,524,782.00
Total income from operations		**₱1,116,702,092.00**

Indeed, the amount of management fee ₱4,792,200.00 from Trinity and Insurance Divisions was not declared as part of its income for both financial reporting and income tax purposes.

Since these transactions are intra-company transactions, the elimination of income must also have corresponding elimination of costs/expenses. Hence, it is expected that the intra-company costs which must also be deducted from the total costs must amount to ₱6,013,188.00, which is the same amount of income eliminated from petitioner's total income.

Based on the same working paper, the total direct costs amounted to ₱208,870,825.00. However, it is noticed that only the amount of ₱837,384.00 was deducted therefrom resulting to the true direct cost of ₱208,033,441.00 as declared in the 2009 AFS[83] and ITR.[84] This only corresponds to the eliminated rent income.

This means that petitioner was still able to claim deductions to the extent of ₱4,729,200.00 and ₱446,604.00, or a total of ₱5,175,804.00, corresponding to the eliminated management fee and commission income.

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[81] Exhibit "P-8", Docket, Vol. II, p. 555.
[82] Exhibit "P-7", Docket, Vol. II, p. 545.
[83] Exhibit "P-8", Docket, Vol. II, p. 555.
[84] Line 16C, Exhibit "P-7", Docket, Vol. II, p. 545.

It is however noted that the amount of ₱5,175,804.00 was eliminated from the operating expenses. But since petitioner opted for the optional standard deduction ("OSD") as a mode of deduction, said elimination is rendered irrelevant for income tax purposes.

We find this treatment by petitioner erroneous. It is to be noted that petitioner recognized the amount of ₱5,175,804.00 as part of its income, albeit later on eliminated. But then, it must necessarily incur cost to enable petitioner to directly generate said income. Hence, in this case, the amount of outside services and insurance expense amounting to ₱4,729,200.00 and ₱446,604.00,[85] respectively, should have been classified as part of direct costs in order to generate the management fee and commission income. As such, the elimination of the amounts ₱4,729,200.00 and ₱446,604.00 should have been made in the direct costs, and not in the operating expenses.

Nevertheless, correcting the computation of gross income by reclassifying the management fee and insurance expenses as part of direct costs and later on eliminating the same leads us to the same gross income of ₱208,033,441.00, as demonstrated below:

Total direct costs		₱ 208,870,825.00
Add:		
Outside services	₱4,729,200.00	
Insurance	446,604.00	5,175,804.00
Should be total direct costs		**₱214,046,629.00**
Less: Washed-out expense		
Outside services	₱4,729,200.00	
Rent	837,384.00	
Insurance	446,604.00	6,013,188.00
Should be direct costs after eliminating intra-company transactions		**₱208,033,441.00**

In the end, it can be verified that there was no resulting gain or profit from the transaction which must be subjected to income tax. As such, the assessment must be cancelled.

As for the VAT implication of the transaction, we find that the management fees from Trinity and Insurance Divisions cannot be subjected to VAT because the related services were not rendered to another person.

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[85] Exhibit "P-58", Docket, Vol. II, p. 928.

As mentioned earlier, Sec. 108 of the 1997 NIRC, as amended, defines gross receipts as the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the **services performed or to be performed <u>for another person</u>**, excluding value-added tax.

As explained earlier, the management fee from Trinity and Insurance Divisions are only recorded for monitoring purposes as intra-company transactions. However, petitioner and these divisions are treated as one entity for financial reporting and income tax purposes. Being considered as one and the same entity, the services rendered by petitioner to these divisions are not "services performed for another person" as contemplated in the 1997 NIRC, as amended, for the same to be subjected to VAT.

As such, petitioner cannot be made liable for VAT on the management fee amounting to ₱4,729,200.00.

C. Unaccounted source of cash - ₱13,536,000.00

Respondent's "[v]erification of Investment in associates shows that Professional fees accounts was claimed in the amount of ₱13,536,000.00. The said findings were disallowed in the income statement pursuant to Section 32 of the 1997 NIRC, as amended."[86]

The same was likewise assessed with deficiency VAT.

In petitioner's protest, said amount was the company's investment in Professional Services, Inc. as of 2009 as evidenced by the enclosed photocopy of its General Information Sheet (GIS) from Securities and Exchange (SEC).

Nevertheless, respondent reiterates his position to disallow the professional fees since the GIS was for the year 2014, and the amount petitioner is claiming was not the amount mentioned in the assessment.[87]

Petitioner contends that when the BIR asked for the breakdown of the Investment in Securities amounting to

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[86] DOD, FLD, Exhibit "P-49", Docket, Vol. II, p. 749.
[87] DOD, FDDA, Exhibit "P-54", Docket, Vol. II, p. 890.

₱2,027,500,609.00 [88] as declared in the 2009 AFS, [89] the examiners noted an amount of ₱13,536,000.00 for shares of stock purchased by petitioner in Professional Services, Inc. For one reason or the other, the BIR alleged that this investment was actually a professional fee payment and was treated as an unaccounted source of cash since this was not disclosed as one of petitioner's professional fee payments in its tax returns.

The ₱13,536,000.00 pertaining to Professional Services, Inc., which was the basis of the BIR's assessment, was not an income payment, but an investment in the form of purchase of stock in Professional Services, Inc.

The assessment must be cancelled.

First, based on the FLD, the unaccounted source of cash amounting to ₱13,536,000.00 was imputed with taxable income under Section 32 of the 1997 NIRC, as amended. We find this erroneous.

Concluding that there is unaccounted income from a finding of unaccounted source of cash lacks merit because assuming that there is indeed undeclared income, there are also payments or expenses which were unreported. If this is the case, the undeclared income would be effectively offset with the consideration of the related expenses. Consequently, no taxable income will result from said transactions.[90]

Verily, even when taxable income is imputed in the amount of ₱13,536,000.00 on unaccounted source of cash, petitioner is also entitled to claim the corresponding deduction in the same amount in the nature of direct cost or operating expense. Thus, no gain or profit would result from the transaction that can be subjected to income tax.

Second, based on the FDDA, the basis of the assessment was suddenly changed into a disallowance of professional fees. This implies that respondent alleges that the amount of ₱13,536,000.00 was claimed by petitioner as an expense.

We find the same erroneous as well. As discussed under the assessment for "Disallowed OSD", item II.D, petitioner opted for the optional standard deduction ("OSD") as a mode of

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[88] BIR Records, p. 738.
[89] Exhibit "P-8", Docket, Vol. II, p. 554.
[90] *East Asia Power Resources, Corp. vs. Commissioner of Internal Revenue*, CTA Case No. 8182, January 15, 2014.

deduction for purposes of computing its taxable income. Hence, assuming that there was a professional fee incurred during TY 2009 amounting to ₱13,536,000.00, the same cannot be disallowed because petitioner did not claim the same as a deduction from gross income in the first place. The disallowance of a particular expense is tenable only when the taxpayer opted for the itemized deduction, not when it opted for OSD.

Third and lastly, on account of the factual basis of the assessment, it is clear from the FLD that the assessed amount was lifted from the Investment in Associates account in the 2009 AFS, particularly in Note 9 thereof.[91]

According to Note 9, the Investment in Associates amounted to ₱2,027,500,609.00 for both years ended 2009 and 2008. This means that petitioner made no additional investment throughout TY 2009. This information can be confirmed from petitioner's Statement of Cash Flows for 2009 where it declared nil cash in/outflow for the Acquisition of Investment.[92]

Based on this information, it can only be deduced that the assessed amount of ₱13,536,000.00 did not transpire during TY 2009 but in prior years, which is already outside the scope of respondent's power to assess pursuant to its Letter of Authority ("LOA") which covers only the TY 2009.[93]

Due the foregoing discussions, and with the more compelling fatal defect that the assessed amount is already outside the scope of the LOA, both the deficiency income tax and VAT assessments must fail outright, thus must be cancelled. Hence, the disposition of the issue as to whether or not the assessed amount is in the nature of an investment or a taxable income is no longer necessary.

D. Disallowed OSD - ₱297,018,816.80

Respondent's verification of the quarterly ITR shows that for the first (1st) to third (3rd) quarters, petitioner opted to file an itemized deduction and for the annual return petitioner opted to use OSD. The difference between the itemized deduction and

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[91] Exhibit "P-8", Docket, Vol. II, p. 565.
[92] Exhibit "P-8", Docket, Vol. II, p. 557.
[93] Exhibit "R-1", BIR Records, p. 1.

OSD was disallowed pursuant to Sec. 34(L) of the 1997 NIRC, as amended and per RMC No. 16-2010.[94]

In contrast, petitioner posits that it is an eFPS filer for the taxable year ended December 31, 2009. When petitioner filed its Quarterly Income Tax Returns for the 1st to 3rd Quarters, the BIR's eFPS system has not been updated to include the option for OSD. As such, petitioner was allegedly constrained to file its Quarterly and Annual Income Tax Returns in the manner that it did under the system then in force and available.

It was further averred that petitioner's duly filed 2009 Quarterly Income Tax Returns will show that the deductions claimed are exactly forty percent (40%) of the gross income declared. Thus, in essence, petitioner elected OSD in its tax returns.

Lastly, it was pointed out that the 40% OSD provided for under Section 34(L) of the 1997 NIRC, as amended, was established by Republic Act No. 9504. The BIR's initial implementing regulation for the OSD was RR No. 16-08. Petitioner is an eFPS filer. The rule that the election of OSD/Itemized Deductions during the 1st quarter shall be binding for the rest of the taxable period only came about when the BIR enacted RR No. 02-10 on February 18, 2010. By that time, petitioner had already filed its Quarterly Tax Returns for 2009. As already clarified by this Court, in the very similar case of *COL Financial Group, Inc. vs. Commissioner of Internal Revenue* (*CTA Case No. 8454, April 15, 2014*), the BIR is proscribed from applying RR No. 2-2010 retroactively if it results to the prejudice of the taxpayer.[95]

We find for petitioner.

The OSD as a mode of deduction from gross income for income tax purposes is anchored from Section 34(L) of the 1997 NIRC, as amended, which provides to wit –

> "SEC. 34. *Deductions from Gross Income.* — Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B), (C); and 28(A)(1), there shall be allowed the following deductions from the gross income:

[94] DOD, FLD, Exhibit "P-49", Docket, Vol. II, p. 749.
[95] Pars. 92, 94 and 95, Petitioner's Memorandum, Docket, Vol. III, pp. 1214 to 1216.

> (A) Expenses. — x x x
>
> (L) *Optional Standard Deduction.* — In lieu of the deductions allowed under the preceding Subsections, an individual subject to tax under Section 24, other than a nonresident alien, may elect a standard deduction in an amount not exceeding forty percent (40%) of his gross sales or gross receipts, as the case may be. In the case of a corporation subject to tax under Sections 27(A) and 28(A)(1), it may elect a standard deduction in an amount not exceeding forty percent (40%) of its gross income a defined in Section 32 of this Code. Unless the taxpayer signifies in his return his intention to elect the optional standard deduction, he shall be considered as having availed himself of the deductions allowed in the preceding Subsections. Such election when made in the return shall be irrevocable for the taxable year for which the return is made: x x x"

To implement the above provision, respondent issued the following RRs and Revenue Memorandum Circular (RMC) on the following dates:

1. RR No. 16-08 dated November 26, 2008 - *Implementing the Provisions of Section 34 (L) of the Tax Code of 1997, as Amended by Section 3 of Republic Act No. 9504, Dealing on the Optional Standard Deduction (OSD) Allowed to Individuals and Corporations in Computing Their Taxable Income*

2. RR No. 02-10 dated February 18, 2010 - *Amendment to Sections 6 and 7 of Revenue Regulations No. 16-2008 with Respect to the Determination of the Optional Standard Deduction (OSD) of General Professional Partnerships (GPPs) and the Partners Thereof, as well as the Manner and Period for Making the Election to Claim OSD in the Income Tax Returns*; and,

3. RMC No. 016-10 dated February 26, 2010 - *Disclosure of Election to Use the Optional Standard Deduction for Taxable Year 2009.*

The legal implications and binding effect of the above RRs and RMC were discussed in depth in *COL Financial Group, Inc. vs. Commissioner of Internal Revenue*,[96] in the following wise –

> "In response to the amendment, the BIR, on November 26, 2008 issued RR No. 16-2008, implementing Section 3 of

[96] CTA Case No. 8454, April 15, 2014.

RA 9504. Under the said regulation, taxpayers had the option of using either Itemized or OSD method in preparing their quarterly ITRs, provided only one method shall be applied in preparing the annual ITR. This regulation allowed the taxpayers to shift from the two deduction options from quarter to quarter.

On February 24, 2010, BIR issued Revenue Regulations No. 2-2010 (RR No. 2-2010), which amended Sections 6 and 7 of RR No. 16-2008. To clarify the period of applicability of the new regulation, **BIR issued Revenue Memorandum Circular No. 016-10 on February 26, 2010, stating that the RR 2-2010 will also apply to taxable year 2009.**

Under these two issuances, BIR curtailed the taxpayer's option to choose the deduction method from quarter to quarter, which was previously allowed under RR No. 16-2008. Instead, the BIR required taxpayers to choose during its first quarterly filing, by indicating on the form whether it will opt for the Itemized or OSD Deduction. The choice of deduction method during the 1st quarter obligates the taxpayer to use the same method throughout the taxable year, as well as in preparation of the annual ITR.

In the present case, **it is undeniable that during the period wherein petitioner was required to file its quarterly income tax return for the taxable year 2009, the regulation which was in effect was RR No. 16-2008.** Thus taxpayers could shift from the two deduction methods from quarter to quarter, and **only during the filing of the final adjustment income tax return is the taxpayer required to make a choice as to what method of deduction it or he shall employ for the purpose of determining its/his taxable net income for the entire year.**

xxx xxx xxx

While it is true that when petitioner filed its final adjustment return on April 12, 2010, when RR No. 2-2010 had already been in effect, thus applying the new regulation for the filings done almost a year prior to its effectivity would result in an undue prejudice against the taxpayer. As such, RMC No. 16-2010 cannot be applied in this specific case.

xxx xxx xxx

As correctly pointed out by petitioner, **to apply RR No. 2-2010 and RMC No. 16-2010, would effectively move the deadline given to the taxpayer for electing a deduction to an earlier date.** In this case, **instead of having until April 15, 2010 to decide on the deduction method, petitioner will only have until May 30, 2009, or when the first quarterly income tax return was due.** It is also important to point out that **when petitioner filed its first quarterly**

> **return, no such policy to commit to a deduction method at the first quarter filing existed. The Court cannot support a stance wherein a taxpayer shall be penalized for merely complying with the effective regulation at that time, simply because a new regulation was issued after.**
>
> The principle is well entrenched that statutes, including administrative rules and regulations, operate prospectively only, unless the legislative intent to the contrary is manifest by express terms or by necessary implication. Even then, there can be no retroactive application if it will prejudice the interest of the taxpayer, as stated in Section 246 of the 1997 NIRC, as amended. This principle is based on the familiar legal maxim *"lex prospicit, non respicit."* The rationale is simple, the retroactive application of a law usually divests rights that have already become vested or impairs the obligations of contract and hence, is unconstitutional. To rule otherwise would be contrary to the tenets of good faith, equity, and fair play.
>
> As applied to this case, the application of RR No. 2-2010, in relation to RR No. 16-2010, clearly shows a prejudice in the case of petitioner. In fact, petitioner has paid under protest the additional income tax due, which if the Court allows respondent's stance, will cost it a total of Php8,960,245.00. The detrimental effect it will have on petitioner cannot be any clearer." (Emphasis supplied)

The above ruling was upheld by the CTA Court *En Banc*[97] and was rendered final and executory by the Supreme Court in its resolution on G.R. No. 222170 dated August 1, 2016, which denied respondent's Petition for Review for failure to show any reversible error in the challenged CTA *En Banc* decision.

The Court finds that the *COL Financial* case is on all fours with petitioner's case herein, involving the same TY 2009 which opted for the OSD as a mode of deduction for purposes of computation of taxable income. Hence, on this basis alone, the assessment must be cancelled.

Indeed, petitioner cannot be forced to comply with RR No. 02-10 in the practical sense that it will already be too late to amend the quarterly ITRs in TY 2009. More so, in petitioner's case as an eFPS filer, the electronic Quarterly ITR forms are not updated which is why petitioner was not able to properly choose OSD as its mode of deduction. And even if it initially chose itemized deductions in its quarterly ITRs, it is still entitled to change its choice to OSD in its final adjustment return for TY 2009 as it is explicitly allowed in RR No. 16-08 which was in effect at the particular taxable year involved.

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[97] CTA E.B. Case No. 1187, December 15, 2015.

Further, even assuming that RR No. 2-10 and RMC No. 16-10 are to be given retroactive effect to TY 2009, the Court finds that petitioner is substantially compliant therein because its intention to use the OSD as a mode of deduction was manifest in and consistent from the 1st Quarterly ITR through the 3rd Quarterly ITR for TY 2009, as can be demonstrated below:

Exhibit No.[98]	Quarter	Date Electronically Filed	Gross Income (Line 19C)	40% OSD (Line 20C)
P-4	1st	May 30, 2009	₱194,714,323.00	₱77,885,729.00
P-5	2nd	August 28, 2009	250,750,995.00	100,300,398.00
P-6	3rd	November 27, 2009	217,113,237.00	86,845,295.00
P-7	Annual	April 15, 2010	908,668,651.42	363,467,460.57

The only constraint which faced petitioner was how to manifest such choice in its ITR e-filing being a mandatory eFPS filer and the BIR had been remiss in updating the eFPS forms despite the fact that the options of OSD and Itemized Deduction were already reflected as early as the July 2008 version of the manual BIR Form No. 1702.

Since the eFPS BIR Form No. 1702 for 2009 which was still in the September 2005 version, does not yet reflect the choices of OSD and Itemized Deduction, what petitioner did as an alternative, was to declare the OSD for TY 2009 amounting to ₱363,467,460.57 in Section D – Itemized Deductions in Line 109 – Others and specifically labeled it as OSD.[99]

Further, a copy of the manual BIR Form No. 1702 accomplished by petitioner as found in the BIR Records shows that it chose OSD as a mode of deduction by forwarding the amount of ₱363,467,460.57 as computed in Schedule 6 (Computation of Optional Standard Deduction) to Line 22C in the Computation of Tax.[100]

All of these circumstances warrant petitioner's entitlement to claim OSD as a mode of deduction for purposes of computing its taxable income for TY 2009. The Court finds that petitioner substantially complied with the prevailing regulations implementing Sec. 34(L) of the 1997 NIRC, as amended, and cannot be penalized by mere failure in complying with the form

[98] Docket, Vol. II, pp. 530, 535, 540 and 545.
[99] Exhibit "P-7", Docket, Vol. II, pp.545 and 550.
[100] BIR Records, pp. 711 and 713.

prescribed in manifesting its option of OSD. Hence, the disallowance herein must be cancelled.

E. Expenses not subjected to EWT - ₱5,901,134.50

This assessment is a consequence of the deficiency EWT assessed by respondent as discussed under the deficiency EWT assessment. Accordingly, the income payments amounting to ₱5,901,134.50 wherein petitioner failed to remit the corresponding EWT were disallowed as expenses for income tax purposes pursuant to Section 34(K) of the 1997 NIRC, as amended, which states –

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

It can be recalled that the deficiency EWT was already settled by petitioner, hence resulting to its cancellation. However, it does not result to a parallel cancellation of the consequential disallowance of the income payments as expenses for income tax purposes pursuant to Section 2.58.5 of RR No. 2-98, as amended by RR No. 14-02, which clarified that a deduction is allowed even when no tax was withheld **only** when the corresponding deficiency withholding taxes were paid at the time of the audit/investigation or reinvestigation/reconsideration, not at the time when the audit/investigation or reinvestigation/reconsideration had already been concluded by the issuance of the FLD or FDDA.

However, the Court shall still cancel the assessment based on a different ground.

It must be recalled that petitioner opted for OSD as a mode of deduction for income tax purposes. Pursuant to Sec. 34(L) of the 1997 NIRC, as amended, granting such option to the taxpayer, it shall be "**in lieu** of the deductions allowed under the preceding Subsections".

On the other hand, the requirement of withholding of the corresponding tax prior to being allowed as an expense for income tax purposes as laid down in Sec. 34(K) of the 1997 NIRC, as amended, pertains to "**any amount paid or payable** which is otherwise deductible". This phrase pertains to itemized deductions because the nature of which is either actually paid or is payable pursuant to a valid business transaction.

It is different with the OSD which is merely computed as a percentage of gross income and does not really connote a "paid or payable" amount. Hence, there may be instances when the OSD is bigger than the actual itemized deductions during TY 2009.

As such, the requirement of withholding prior to allowing OSD as a deduction from gross income would be absurd and even unfair to the taxpayer because it may result to instances where the taxpayer may be forced to withhold taxes on expenses which was not actually paid for just for the sake that the whole OSD amount claimed may be allowed for income tax purposes.

Since petitioner opted for OSD as a mode of deduction, it cannot be disallowed due to non-withholding of EWT pursuant to Section 34(K) of the 1997 NIRC, as amended. With this, the disallowance of expenses not subjected to EWT is no longer necessary, hence must be cancelled.

F. Disallowed creditable withholding tax- ₱34,417.58

The FDDA states that petitioner already paid the deficiency tax on disallowed creditable withholding tax. This payment is evidenced by BIR Form No. 0605 filed on April 30, 2014 showing a basic income tax amounting to ₱34,418.40.

While the FDDA still reflects the amount disallowed, it was nevertheless offset by the above payment deducted from the assessed income tax due. As such, there is no need to delve further into this assessment item.

Considering the foregoing, petitioner's deficiency income tax must be reduced to ₱93,158.40, as computed below:

Taxable income per return		₱ 545,201,191.00
Add (less) adjustment:		
Undeclared service income (SLS/Relief/LN)	₱ -	
Undeclared management services	195,800.00	
Unaccounted source of cash	-	
Disallowed OSD	-	
Undeclared purchases	-	
Expenses not subjected to EWT	-	195,800.00
Adjusted net income		**₱545,396,991.00**

an

Tax due		**₱163,619,097.30**
Less: Payments	₱163,560,356.48	
Disallowed creditable withholding tax	34,417.58	163,525,938.90
Basic deficiency income tax due		**₱ 93,158.40**

III. Deficiency Value-Added Tax - ₱9,174,355.65

Respondent assessed petitioner with deficiency VAT computed as follows:[101]

Sales per VAT returns		₱1,110,837,239.66
Add: Other income/adjustment		
Undeclared service income	₱ 2,358,089.89	
Undeclared service income (SLS/Relief/LN)	2,893,704.25	
Undeclared management services	4,925,000.00	
Undeclared purchases	12,213,223.00	
Unaccounted source of cash	13,536,000.00	35,926,017.14
Total		₱1,146,763,256.80
Rate		0.12
Output tax per audit		₱ 137,611,590.82
Input tax per audit		5,449,383.99
VAT payable per audit		**₱132,162,206.83**
Less: VAT paid per return		127,851,084.77
Deficiency tax		**₱ 4,311,122.06**
Less: Payment made 4.30.2014		268,830.24
Balance		**₱ 4,042,291.82**
Add: Interest computation up to 4.30.2014	₱ 3,531,576.70	
Compromise penalty	25,000.00	
Total	3,556,576.70	
Less: Increments paid on 4.30.2014	245,205.40	
Balance	3,311,371.30	
Add: Interest computation from 5.1.2014 to 7.31.2016	1,820,692.53	5,132,063.83
Total amount due		**₱ 9,174,355.65**

The above assessment is comprised of the following items:

A. Undeclared service income	₱ 2,358,089.89
B. Undeclared service income (SLS/Relief/LN)	2,893,704.25
C. Undeclared management services	4,925,000.00
D. Undeclared purchases	12,213,223.00
E. Unaccounted source of cash	13,536,000.00

Items B, C, and E are already aptly discussed under the deficiency income tax assessment wherein items B and E are

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[101] FDDA, Exhibit "P-54", Docket, Vol. II, pp. 887 to 888.

accordingly cancelled, while item E is partially upheld. This leaves the remaining items Items A and D for discussion.

D. Undeclared service income - ₱2,358,089.89

Respondent's verification disclosed that some of the income items were not subjected to VAT which is in violation of the provisions of Section 106, 107 and 108 of the 1997 NIRC, as amended,[102] and which is computed as follows:[103]

AR beg.		₱ 1,425,888.00
Service income	₱1,114,177,310.00	
Add: Output tax	133,701,277.20	1,247,878,587.20
Total		₱1,249,304,475.20
AR end		2,525,706.00
Gross collection		₱1,246,778,769.20
Net collection		₱1,113,195,329.64
Less: Service income per VAT return		1,110,837,239.66
Undeclared service income		₱ 2,358,089.98

Petitioner contends that the BIR was incorrect in imputing output VAT of ₱133,701,277.20 on the service income of ₱1,114,177,310.00 since based on its bookkeeping practice, the take up of the 12% output VAT is upon collection or issuance of Official Receipt.[104]

We uphold the assessment.

Petitioner implies that the amount recorded in its trade receivables are net of VAT as it only records the 12% output VAT upon collection. However, petitioner did not present any supporting documents to prove the same. Hence, we have no way of verifying petitioner's allegations.

It is basic in the rule of evidence that bare allegations, unsubstantiated by evidence, are not equivalent to proof. In short, mere allegations are not evidence.[105]

Further, petitioner impliedly admitted to respondent's finding when it already settled the assessment on April 30, 2014

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[102] DOD, FLD, Exhibit "P-49", Docket, Vol. II, p. 750
[103] DOD, FDDA, Exhibit "P-54", Docket, Vol. II, p. 891
[104] Q&A No. 70, Judicial Affidavit of Mr. Mario L. Montellano, Exhibit "P-60", Docket, Vol. II, p. 513.
[105] *Real vs. Belo*, G.R. No. 146224, January 26, 2007.

after filing its Protest to the FLD, albeit in a lower basic deficiency VAT amounting to ₱268,830.00,[106] with a lower base amount of ₱2,240,252.00.[107] This implies that petitioner no longer intends to present evidence to dispute the assessment.

But then, as ruled above, we shall uphold the total assessment of ₱2,358,089.98 due to petitioner's failure to effectively dispute the same with supporting documents.

D. Undeclared purchases - ₱12,213,223.00

The FLD and FDDA did not provide the factual and legal bases for this particular assessment, hence must be voided instantly pursuant to Section 228 of the 1997, NIRC, as amended.[108]

However, tracing its origin from the FLD, the original assessed amount for this particular item was ₱1,647,659.04,[109] which was likewise assessed for deficiency income tax (see discussion under the deficiency income tax assessment, II.E) .

Assuming that this particular assessment is valid in compliance with Section 228 of the 1997 NIRC, as amended, it must still be cancelled for lack of legal basis.

It must be pointed out that under Section 106(A) of the 1997 NIRC, as amended, VAT is assessed on the *"gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor"*.

Also, under Section 108 of the 1997 NIRC, as amended, VAT is assessed on the *"gross receipts derived from the sale or exchange of services"*. Significantly, the law defines "gross selling price" and "gross receipts" as follows:

> ". . . '**gross selling price**' means the total amount of money or its equivalent which the purchaser pays or is obligated to pay the seller in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax."

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[106] Exhibit "P-52-d", Docket, Vol. II, p. 862.
[107] Protest Letter to FLD, Exhibit "P-50-m", Docket, Vol. II, p. 776.
[108] SEC. 228. *Protesting of Assessment.* – x x x
The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
[109] Exhibit "P-49", Docket, Vol. II, p. 746.

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

Clearly, VAT can be imposed only when it is shown that the taxpayer received an amount of money or its equivalent from its sale, barter or exchange of goods or properties, or from sale or exchange of services, and not when there are undeclared purchases. In other words, the VAT is imposed when one sells, not when one purchases.

At this juncture, it must be pointed out that in order to stand the test of judicial scrutiny, the assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption.[110] Hence, assessment should not be based on mere presumptions no matter how reasonable or logical said presumptions may be.[111]

Consequently, the presumption of correctness of the assessment does not apply in the present case considering that respondent's conclusion, *i.e.,* the undeclared purchase is translated and would automatically result in undeclared income which would in turn increase petitioner's VAT liabilities, is not based on actual facts and thus, is a mere presumption.

As such, the finding that petitioner had undeclared purchases which were imputed with VATable sales cannot be enforced against petitioner; otherwise, the Court stands to tax petitioner arbitrarily. Accordingly, the deficiency VAT assessment on the alleged undeclared purchases should be cancelled and withdrawn.

Considering the foregoing, petitioner's deficiency VAT is upheld but in the reduced basic amount of ₱306,466.79, as computed below:

Sales per VAT returns		₱1,110,837,239.66
Add: Other income/adjustment		

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[110] *Collector of Internal Revenue vs. Alberto D. Benipayo*, G.R. No. L-13656, January 31, 1962, 4 SCRA 182; *Commissioner of Internal Revenue vs. Island Garment Manufacturing Corporation and the Court of Tax Appeals*, G.R. No. L-46644, September 11, 1987, 153 SCRA 665.

[111] *Ibid.*

Undeclared service income	₱2,358,089.89	
Undeclared service income (SLS/Relief/LN)	-	
Undeclared management services:		
Milestone Development Corp.	195,800.00	
Undeclared purchases	-	
Unaccounted source of cash	-	2,553,889.89
Total		₱1,113,391,129.55
Rate		0.12
Output tax per audit		₱ 133,606,935.55
Input tax per audit		5,449,383.99
VAT payable per audit		**₱128,157,551.56**
Less: VAT paid per return		127,851,084.77
Basic deficiency VAT due		**₱ 306,466.79**

WHEREFORE, premises considered, the Petition for Review is **PARTIALLY GRANTED**. The assessments issued by respondent against petitioner for the taxable year ended December 31, 2009 covering deficiency income tax, VAT, and EWT are **UPHELD IN PART**. Accordingly, petitioner is **ORDERED TO PAY** respondent the aggregate amount of **ONE MILLION THREE HUNDRED NINETY-SEVEN THOUSAND FOUR HUNDRED SIXTY PESOS AND NINETY-SEVEN CENTAVOS (₱1,397,460.97)**, inclusive of the 25% surcharge, 20% deficiency interest and 20% delinquency interest imposed under Sections 248(A)(3), 249(B) and (C) of the 1997 NIRC, as amended, respectively, computed until December 31, 2017, as follows:

	Income Tax	VAT	EWT	Total
Basic tax due	₱ 93,158.40	₱306,466.79	₱ 614,399.43	₱ 1,014,024.62
Surcharge (25%)	23,289.60	76,616.70	153,599.86	253,506.15
Deficiency interest:				
IT - (04/15/2010 to 04/30/2014 to 07/31/2016)				
(₱93,158.40 x 20% x 1,476/365 days)	75,343.45			75,343.45
[(₱93,158.40 - ₱34,418.40) x 20% x 823/365days]	26,489.33			26,489.33
VAT - (01/25/2010 to 04/30/2014 to 07/31/2016)				
(₱306,466.79 x 20% x 1,556/365 days)		261,294.42		261,294.42
[(₱306,466.79 - ₱268,830.24) x 20% x 823/365days]		16,972.54		16,972.54
EWT - (01/15/2010 to 04/30/2014 to 07/31/2016)				
(₱614,399.43 x 20% x 1,566/365 days)			527,205.21	527,205.21
[(₱614,399.43 - ₱237,005.83) x 20% x 823/365days]			170,189.00	170,189.00
Amount due as of July 31, 2016	***₱218,280.78***	***₱661,350.44***	***₱1,465,393.50***	***₱2,345,024.72***
Deficiency interest from 08/01/2016 to 12/31/2017:				
IT [₱93,158.40 - ₱34,418.40) x 20% x 518/365 days]	16,672.50			16,672.50
VAT [₱306,466.79 - ₱268,830.24) x 20% x 518/365 days]		10,682.59		10,682.59
Deficiency interest on EWT from 08/01/2016 to 01/27/2017				

[(₱614,399.43 - ₱237,005.83) x 20% x 180/365 days]			37,222.38	37,222.38
Delinquency interest from 08/01/2016 to 12/31/2017:				
IT [(₱218,280.78 - ₱34,418.40 - 27,817.61) x 20% x 518/365 days]	44,291.06			44,291.06
VAT [₱661,350.44 - ₱268,830.24 - ₱229,205.40) x 20% x 518/365 days]		46,354.56		46,354.56
Delinquency interest on EWT from 08/01/2016 to 01/27/2017				
[(₱1,465,393.50 - 237,005.83 - ₱231,476.28) x 20% x 180/365days]			98,325.51	98,325.51
Delinquency interest on EWT from 01/27/2017 to 12/31/2017				
[(₱1,465,393.50 - ₱237,005.83 - ₱118,022.69 – ₱231,476.28 - ₱183,184.19) x 20% x 180/365days]			128,848.29	128,848.29
Total amount due	**₱279,244.34**	**₱718,387.59**	**₱1,729,789.68**	**₱2,727,421.61**
Less: Payments on April 30, 2014				
Basic tax	34,418.40	268,830.24	237,005.83	540,254.47
Interest	27,817.61	229,205.40	231,476.28	488,499.29
Less: Payment on January 27, 2017				
Basic tax	-	-	118,022.69	118,022.69
Interest	-	-	183,184.19	183,184.19
Remaining deficiency tax due on December 31, 2017	**₱217,008.33**	**₱220,351.95**	**₱ 960,100.69**	**₱1,397,460.97**

In addition, petitioner is **ORDERED TO PAY** delinquency interest at the rate of twelve percent (12%), which is double the legal interest rate for loans or forbearance of any money, on the total unpaid income tax, VAT, and EWT of ₱156,044.77, ₱163,314.80, and ₱996,911.39, respectively, representing basic deficiency tax, surcharge, and deficiency interest until July 31, 2016, net of payments made on April 30, 2014, as shown below, computed from January 1, 2018 until full payment thereof pursuant to Section 249(C) of the 1997 NIRC, as amended by Republic Act No. 10963, also known as Tax Reform for Acceleration and Inclusion (TRAIN) Law,[112] and as implemented by RR No. 21-2018.

	Income Tax	VAT	EWT	Total
Amount due as of July 31, 2016	₱ 218,280.78	₱ 661,350.44	₱1,465,393.50	₱ 2,345,024.72
Less: Payments on April 30, 2014				
Basic tax	34,418.40	268,830.24	237,005.83	540,254.47
Interest	27,817.61	229,205.40	231,476.28	488,499.28
Total unpaid tax as of July 31, 2016	**₱156,044.77**	**₱163,314.80**	**₱996,911.39**	**₱1,316,270.96**

SO ORDERED.

Catherine T. Manahan

CATHERINE T. MANAHAN
Associate Justice

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[112] *Alpha 245, Inc., (formerly ARC Worldwide Philippines Co., Inc.) vs. Commissioner of Internal Revenue*, CTA Case No. 9225, April 6, 2018.

I CONCUR:

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

ATTESTATION

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

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice