

REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

FIRST DIVISION

STAR PERFORMANCE, INC.,

Petitioner,

C.T.A. CASE NO. 6818

Members:

- versus -

ACOSTA, *Chairperson*

UY, *and*

FABON-VICTORINO, JJ.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

Promulgated:

FEB 03 2010 3:05pm

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D E C I S I O N

UY, J.:

This case involves an Amended/Supplemented Petition for Review¹, seeking the cancellation and withdrawal of Formal Assessment Notice and Assessment Notice Nos. WE-000751-99-02-198, IT-000751-99-02-198, and VT-000751-99-02-198, assessing petitioner for alleged deficiency expanded withholding tax (EWT) in the sum of ₱ 428,465.76, deficiency income tax in the

¹ Docket, pp. 217 to 231.

sum of ₱ 19,179,880.43, and deficiency valued-added tax (VAT) in the amount of ₱ 2,939,214.08, respectively, for taxable year 1999.

THE FACTS

Petitioner Star Performance, Inc. is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines, with principal address at J.Y. & Sons Industrial Compound, Phividec Industrial Complex, Taguig, Metro Manila. It is also a duly registered taxpayer.²

On the other hand, respondent is the duly-appointed Commissioner of the Bureau of Internal Revenue (BIR) who is vested with authority to administer and enforce national internal revenue laws, with office at the Bureau of Internal Revenue (BIR) National Office, Agham Road, Diliman, Quezon City.³

On November 28, 2002, petitioner availed of the Voluntary Assessment and Abatement Program (VAAP) of the BIR on its EWT by paying the amount of ₱ 318,463.25 as evidenced by the VAAP Payment Form No. 0611.⁴

On January 29, 2003, petitioner received a Formal Assessment Notice⁵ and Assessment Notice Nos. WE-000751-99-02-198⁶, IT-000751-99-02-198⁷, and VT-000751-99-02-198⁸, assessing petitioner for alleged deficiencies in expanded withholding tax, income tax, and valued-added tax, respectively, for

² Par. 2, JSFIT, Docket, p. 436.

³ Par. 1, Facts, Joint Stipulation of Facts and Issues for Trial (JSFIT), Docket, p. 436. Cf: Pars. 1 to 2, Amended/Supplemented Petition for Review, Docket, p. 217; and Par. 1, Amended Answer, Docket, p. 423.

⁴ Par. 14, JSFIT, Docket, p. 439.

⁵ Exhibit "E", Docket, pp. 944 to 947.

⁶ Exhibits "B" to "B-2", Docket, p. 941.

⁷ Exhibits "C" to "C-2", Docket, p. 942.

⁸ Exhibits "D" to "D-2", Docket, p. 943.

taxable year 1999 in the aggregate amount of ₱ 22,547,560.27,⁹ detailed as follows:

I. Deficiency Income Tax

Net Income Per Return		₱ 5,847,436.00
Add: Discrepancies per investigation		
Undeclared revenue (per general ledger as against financial statements) ¹⁰	₱ 20,713,344.05	
Disallowed income payments expenses on land leasing fees	5,307,720.88	
Non-deductible salaries and wages	4,388,893.91	
Disallowed provisions for obsolescence claimed as expenses for samples/disposal – raw materials	2,906,232.46	
Non-deductible loss on disposal of surplus raw materials	3,626,540.12	36,942,731.42
Taxable income per investigation		₱ 42,790,167.42
Income tax due thereon (33%)		₱ 14,120,755.25
Less: Tax paid per return		1,929,654.00
Deficiency after tax paid		₱ 12,191,101.25
Add: Unsupported tax credit		9,840.50
Deficiency income tax		₱ 12,200,941.75
Add: Interest (4/16/00 to 02/25/03)		6,978,938.68
Total Amount Due		₱ 19,179,880.43

II. Deficiency EWT

Land Leasing Fees	₱ 5,307,720.88
Multiply by: Tax Rate	5%
Expanded Withholding Tax due per audit	₱ 265,386.04
Less: Payments	--
Deficiency Expanded Withholding Tax	₱ 265,386.04
Add: Interest (4/16/00 to 02/25/03)	163,079.72
Total Amount Due	₱ 428,465.76

III. Deficiency VAT

Taxable Sales per return	₱ 321,643,834.54
Add: Transferred Costs and services (₱ 19,335,147.21 x 10/11)	17,577,406.55
Taxable sales per audit	₱ 339,221,241.09
Output tax due thereon	₱ 33,922,124.11
Less: Allowable input tax	₱ 19,306,989.22
Payments	12,841,937.44
	32,148,926.66

⁹ Pars. 3 to 4, JSFIT, Docket, pp. 436 to 437.

¹⁰ Par. 8, JSFIT, Docket, p. 437.

Deficiency VAT before input tax carry over to 1 st Quarter 2000	₱ 1,773,197.45
Add: Input tax carry over to 1 st quarter 2000	47,312.98
Basic deficiency VAT	₱ 1,820,510.43
Add: Interest (4/16/00 to 02/25/03)	1,118,703.65
Total Amount Due	₱ 2,939,214.08

On February 28, 2003, petitioner filed a Protest against the deficiency assessments before the BIR Revenue Region No. 8, on ground of lack of legal and factual bases.¹¹

On April 28, 2003, petitioner filed a Supplemental Protest Letter, and attached thereto complete relevant documents, in support of its position against the alleged deficiency tax assessments.¹²

On October 29, 2003, petitioner received respondent's Final Decision on Disputed Assessment and Amended Assessment Notices dated October 21, 2003, amending the assessments for deficiency income tax, expanded withholding tax, and value-added tax, computed as follows:¹³

I. Deficiency Income Tax¹⁴

Taxable income per original investigation	₱ 42,790,167.42
Less: Deductions allowed and supported	
Income payment on land leasing fees	₱ 5,307,720.88
Salaries and wages	4,388,893.91
	9,696,614.79
Taxable income per Reinvestigation	₱ 33,093,552.63
Income tax due	₱ 10,920,872.40
Less: Tax Credit/Payment	1,929,654.00
Deficiency after tax paid	₱ 8,991,218.40
Add: Unsupported tax credit	9,840.50
Deficiency income tax	₱ 9,001,058.90
Add: Interest (4-16-00 to 11-14-03)	6,428,556.26
Total Amount Due	₱ 15,429,615.16

¹¹ Par. 5, JSFIT, Docket, p. 437. Exhibits "F" to "F-3", Docket, pp. 948 to 959.

¹² Par. 6, JSFIT, Docket, p. 437. Exhibits "G" to "G-2", Docket, pp. 960 to 971.

¹³ Pars. 16 to 17, JSFIT, Docket, p. 439. Exhibits "H", "I", and "J", Docket, pp. 980 to 985.

¹⁴ Exhibit "H-1", Docket, p. 982.



II. Deficiency VAT¹⁵

Taxable Sales per return		₱ 321,643,834.54
Add: Transferred Costs and services (₱ 19,335,147.21 x 10/11)		17,577,406.55
Taxable sales per audit		₱ 339,221,241.09
Output tax due thereon (10%)		₱ 33,922,124.11
Less: Allowable input tax	₱ 19,306,989.22	
Add: Re-allowed input tax	62,769.78	₱ 19,369,759.00
Less: Input tax carry forward		47,312.98
		₱ 19,322,446.02
Payments	12,841,937.44	32,164,383.46
Deficiency Value Added Tax		₱ 1,757,740.65
Add: Interest (1/26/00 to 11/14/03)		1,334,652.47
Total Amount Due		₱ 3,092,393.12

As regards the deficiency expanded withholding tax, respondent acknowledged petitioner's availment of the Voluntary Assessment and Abatement Program of the BIR pursuant to Revenue Regulations No. 12-2003,¹⁶ and stated in the Final Decision that "the audit and reinvestigation on this assessment case shall be suspended and the docket thereof shall be transmitted to the Technical Working Group – Final Validation of Discrepancy (TWG-FVD) for evaluation pursuant to RMO 23-2002 dated September 30, 2002."¹⁷ It was also stated in the Final Decision on Disputed Assessment that petitioner may appeal the same with the Court of Tax Appeals within thirty (30) days from date of receipt; otherwise, the Final Decision shall become final, executory, and demandable.¹⁸

On same date, petitioner likewise received respondent's Amended Assessment Notice No. IT-751-99-03-413 for deficiency income tax,¹⁹ and

¹⁵ Exhibit "H-3", Docket, p. 983.

¹⁶ Exhibit "H", Docket, p. 982

¹⁷ Par. 15, JSFIT, Docket, p. 439. Exhibit "H-2", Docket, p. 982.

¹⁸ Exhibit "H", Docket, p. 983.

¹⁹ Exhibits "I" and "I-1", Docket, p. 984.

Amended Assessment Notice No. VT-751-99-03-413 for deficiency value-added tax.²⁰

On November 21, 2003, petitioner filed a Petition for Review before this Court.

Thereafter, petitioner filed on November 28, 2003 a Protest Letter against the amended deficiency assessments for income tax and VAT, and requested the cancellation and withdrawal of the said deficiency tax assessments.²¹ And on January 27, 2004, petitioner filed a Supplemental Protest Letter dated January 26, 2004, with attached complete relevant supporting documents.²²

On February 9, 2004, respondent filed his Answer²³ to the Petition for Review.

In a letter dated May 31, 2004, respondent, through Acting Regional Director Anselmo G. Adriano, denied petitioner's protest on the amended assessments for petitioner's purported failure to submit documentary evidence in support of its claim.²⁴ Such letter was received by petitioner on July 2, 2004.²⁵

During pre-trial held on July 16, 2004, petitioner's motion to amend the Petition for Review was granted by the Court without respondent's objection but with a reservation to file an amended answer.

²⁰ Exhibits "J" and "J-1", Docket, p. 985.

²¹ Exhibits "K" to "K-3", Docket, pp. 986 to 993.

²² Exhibits "L" to "L-2", Docket, pp. 994 to 1001.

²³ Docket, pp. 201 to 203.

²⁴ Exhibit "M", Docket, p. 1010.

²⁵ Exhibit "M-1", *Id.*



On July 26, 2004, petitioner filed an Amended/Supplemented Petition for Review²⁶ highlighting the following matters: (i) the existence and details of the Final Decision on Disputed Assessment; (ii) the existence and receipt by petitioner of the Amended Assessment Notice Nos. IT-751-99-03-413 and VT-751-99-03-413 for deficiency income taxes and VAT in the total amount of ₱ 18,822,008.28, inclusive of interest; and (iii) the letter-request for reconsideration and reinvestigation of petitioner with respect to the foregoing amended assessment and respondent's denial letter dated May 31, 2004.²⁷

In his Amended Answer²⁸ filed on August 10, 2004, respondent raises the following Affirmative and Special Defenses:

"3. He hereby reiterates and incorporates herein all the AFFIRMATIVE AND SPECIAL DEFENSES stated in the original Answer not inconsistent herewith;

4. The amended assessments have already become final, executory and demandable for failure on the part of the petitioner to appeal the final decision on disputed assessment to this Honorable Court within thirty (30) days from receipt thereof;

5. Records will show that petitioner filed the original petition for review on November 21, 2003 or about twenty three (23) days after it received on October 29, 2003 the final decision on disputed assessment and amended assessments, all dated October 21, 2003, hence, it should have been the appealable act of respondent since there was really no inaction on the part of the respondent because the amended assessments were already issued before the alleged 180-day period expired;

6. The protest letters dated November 25, 2003 and January 26, 2004 are already moot considering that the final decision on disputed assessment is very explicit in its advise to petitioner that the same is the final decision of respondent and if

²⁶ Docket, pp. 217-232

²⁷ Par. 18, JSFIT, Docket, pp. 439 to 440.

²⁸ Docket, pp. 423 to 424.



petitioner is not agreeable, it may appeal the decision with the Court of Tax Appeals within thirty (30) days from receipt thereof, otherwise the decision shall become final, executory and demandable;

7. Furthermore, the protest letters were procedurally defective for being addressed to the Regional Director, who issued the final decision on the disputed assessment, instead of elevating the same to the higher authority, which is the respondent herein, in accordance with regulations (Revenue Regulations No. 12-99, par. 3.1.5);”

After issues were joined, trial proceeded. Petitioner presented evidence, both documentary and testimonial, in support of its claim. On the other hand, respondent failed to appear during the scheduled presentation of respondent's evidence on November 12, 2008.²⁹ Respondent was declared to have waived his right to present evidence and both parties were directed to submit their respective Memorandum in the Resolution dated November 20, 2008.³⁰

Only petitioner filed its Memorandum on December 24, 2008 while respondent failed to file the same within the prescribed period. This case was submitted for decision on February 9, 2009.³¹

Hence, this Decision.

THE ISSUES

The issues as stipulated by the parties³² are as follows:

- “1. whether or not SPI has an undeclared revenue in the amount of P20,713,344.05;
2. whether or not SPI's payment on land leasing amounting to P5,307,720.88 is an allowable deduction from gross income;

²⁹ Minutes of the hearing held on November 12, 2008, Docket, p. 1202

³⁰ Docket, p. 1204.

³¹ Resolution dated February 9, 2009, Docket, p. 1260.

³² *JSFIT*, Docket, pp. 440 to 442.



3. whether or not the amount of P4,399,893.91 is an allowable deduction from SPI's gross income;
4. whether or not the amount of P2,906,232.46 represents adjustments to inventories;
5. whether or not SPI has properly supported its tax credits for taxable year 1999;
6. whether or not SPI is liable to deficiency withholding tax in the amount of P428,465.76;
7. whether or not respondent's right to assess SPI for deficiency value added tax for taxable year 1999 has already prescribed;
8. whether or not SPI is liable to deficiency value added tax in the amount of P2,939,214.08;
9. whether or not SPI is liable for the deficiency income tax assessment for the year 1999;
10. whether or not SPI is entitled to allowance of the deductions claimed in its 1999 Income Tax Return;
11. whether or not SPI's availment of the voluntary assessment and abatement program already absolved SPI from payment of the deficiency expanded withholding tax assessment;
12. whether or not SPI is liable to the deficiency value added tax assessment for the year 1999;
13. whether or not respondent erroneously added to SPI's vatiable gross sales the amount of P17,577,406.55 as transferred cost and services;
14. whether or not the amended assessments have already become final, executory and demandable for failure on the part of SPI to appeal the final decision on disputed assessment to the Honorable Court within thirty (20) days from receipt thereof; and
15. whether or not the protest letters dated November 25, 2003 and January 26, 2004 are already moot and procedurally defective."

The foregoing issues are summarized into four main issues, namely:

1. Whether petitioner timely filed the Petition for Review;
2. Whether respondent's right to assess petitioner for deficiency value-added tax has prescribed;
3. Whether petitioner is still liable for deficiency expanded withholding tax in spite of its availment of the Voluntary Assessment and Abatement Program; and
4. Whether the deficiency income tax assessment should be cancelled considering the claimed deductions of petitioner.

Petitioner's Arguments

Petitioner maintains that the instant petition was filed within the reglementary period provided by law and that it is not liable for (i) deficiency income tax in the amount of ₱ 19,179,880.43, and (ii) deficiency EWT in the amount of ₱ 428,465.76.

Petitioner likewise contends that respondent's right to assess petitioner for deficiency VAT for the first, second and third quarters of taxable year 1999 has already prescribed; and that in any event, it is not liable for deficiency VAT in the amount of ₱ 2,939,214.08.

Respondent's Counter-Arguments

Respondent claims that the amended assessments have already become final, executory and demandable for failure on the part of petitioner to appeal the final decision on the disputed assessment of respondent within thirty (30) days from receipt thereof.

THE COURT'S DISCUSSIONS AND RULING

***Petitioner's timely filing of the
Petition for Review***



Section 228 of the National Internal Revenue Code (NIRC) of 1997 provides:

“SEC. 228. *Protesting of Assessment.* - When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however,* That a preassessment notice shall not be required in the following cases:

xxx

xxx

xxx

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.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.”

The above-quoted section provides the taxpayer a remedy to dispute a tax assessment and/or to file an appeal within a certain period of time. As stipulated by the parties, petitioner received the Formal Assessment Notice dated January 24, 2003, and the Assessment Notice Nos. WE-000751-99-02-198, IT-000751-

99-02-198, and VT-000751-99-02-198 on January 29, 2003. It filed its Protest within the 30-day period, particularly, on February 28, 2003. Petitioner also filed a Supplemental Protest and attached complete relevant supporting documents on April 28, 2003. Counting from April 28, 2003, respondent had until October 28, 2003 to decide on petitioner's protest.

Records indicate that petitioner actually received the October 21, 2003 Final Decision on Disputed Assessment on October 29, 2003. Petitioner filed an appeal with this Court on November 21, 2003, which is within thirty (30) days from the lapse of the 180-day period under the afore-quoted NIRC provision and/or from the receipt of respondent's Final Decision on Disputed Assessment.

Inasmuch as petitioner filed the original Petition for Review within the thirty (30) day reglementary period, the assessments for deficiency income tax, VAT, and expanded withholding tax did not become final, executory, and demandable.

In the same light, the amended assessments did not become final. This must be so because petitioner was able to file the instant Amended/Supplemented Petition for Review (on July 26, 2004)³³ likewise within the reglementary period of thirty (30) days from receipt of the denial of the protest on the amended assessments on July 2, 2004.³⁴

***Respondent's right to assess petitioner
for deficiency VAT has prescribed***

Section 203 of the NIRC of 1997 states as follows:

"SEC. 203. Period of Limitation Upon Assessment and Collection. – Except as provided in Section 222, internal revenue

³³ Docket, p. 217.

³⁴ Exhibit "M-1", Docket, p. 1010.



taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.”

Pursuant to the above-quoted tax provision, the three-year period to assess commences from the date of actual filing of the return, or from the last date prescribed by law for the filing of such return, whichever comes later.

The period to assess deficiency VAT shall be counted from the last day of the prescribed period for filing of the return, which is twenty-five (25) days following the close of each taxable quarter.³⁵ However, if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed.

The records of the case show the following:

Exhibit	VAT Returns	Date of Filing	Last Day to Assess
“MM”	1st Quarter	April 26, 1999	April 26, 2002
“NN”	2nd Quarter	July 26, 1999	July 26, 2002
“OO”	3rd Quarter	October 25, 1999	October 25, 2002
“PP”	4th Quarter	January 25, 2000	January 25, 2003

³⁵ Section 114(A) of the NIRC of 1997 provides as follows:

“SEC. 114. *Return and Payment of Value-added Tax.*—

(A) *In General.*— Every person liable to pay the value-added tax imposed under this Title shall file a **quarterly return of the amount of his gross sales or receipts within twenty-five (25) days following the close of each taxable quarter** prescribed for each taxpayer: *Provided, however*, That VAT-registered persons shall pay the value-added tax on a monthly basis.

xxx

xxx

xxx” (Emphasis supplied)

From the foregoing, respondent's right to assess petitioner for deficiency VAT had lapsed, considering that the Final Assessment Notice and the corresponding Assessment Notice for deficiency VAT were only received by petitioner on January 29, 2003.

Deficiency expanded withholding tax assessment deemed moot.

The resolution of the issue regarding the assessment for deficiency expanded withholding tax is deemed moot after respondent acknowledged petitioner's availment of the Voluntary Assessment and Abatement Program of the BIR pursuant to Revenue Regulations No. 12-2003, as stipulated by the parties³⁶ and as stated in the Final Decision on Disputed Assessment.³⁷ The foregoing is likewise corroborated and justified by respondent's deletion of the assessment pertaining to petitioner's alleged deficiency expanded withholding tax, and the allowance of the previously disallowed expense reflected in the original assessment representing income payment on land leasing fees.

Deficiency income tax assessment

The original deficiency income tax assessment dated January 24, 2003, in the amount of ₱ 19,179,880.43, was computed as follows:³⁸

Net Income Per Return	₱ 5,847,436.00
Add: Discrepancies per investigation	
Undeclared revenue (per general ledger as against financial statements) ³⁹	₱ 20,713,344.05
Disallowed income payments expenses on land leasing fees	5,307,720.88

³⁶ Pars. 14 to 16, JSFIT, Docket, p. 439.

³⁷ Docket, p. 274

³⁸ Exhibit "E-2", Docket, p. 944.

³⁹ Par. 8, JSFIT, Docket, p. 437.

Non-deductible salaries and wages	4,388,893.91	
Disallowed provisions for obsolescence claimed as expenses for samples/disposal – raw materials	2,906,232.46	
Non-deductible loss on disposal of surplus raw materials	3,626,540.12	36,942,731.42
Taxable income per investigation		₱ 42,790,167.42
Income tax due thereon (33%)		₱ 14,120,755.25
Less: Tax paid per return		1,929,654.00
Deficiency after tax paid		₱ 12,191,101.25
Add: Unsupported tax credit		9,840.50
Deficiency income tax		₱ 12,200,941.75
Add: Interest (4/16/00 to 02/25/03)		6,978,938.68
Total Amount Due		₱ 19,179,880.43

On October 21, 2003, respondent issued the Final Decision on Disputed Assessment, reducing the deficiency income tax to ₱ 15,429,615.16, details of which are shown below:⁴⁰

Taxable income per original investigation		₱ 42,790,167.42
Less: Deductions allowed and supported		
Income payment on land leasing fees	₱ 5,307,720.88	
Salaries and wages	4,388,893.91	
Taxable income per Reinvestigation		₱ 33,093,552.63
Income tax due		₱ 10,920,872.40
Less: Tax Credit/Payment		1,929,654.00
Deficiency after tax paid		₱ 8,991,218.40
Add: Unsupported tax credit		9,840.50
Deficiency income tax		₱ 9,001,058.90
Add: Interest (4-16-00 to 11-14-03)		6,428,556.26
Total Amount Due		₱ 15,429,615.16

The resolution of whether the imposition of the 1999 deficiency income tax assessment of ₱ 15,429,615.16 is correct basically hinges on the propriety or impropriety of the income imputed as well as the expense deductions and tax credits disallowed by respondent, namely:

⁴⁰ Exhibit "H-1", Docket, p. 982.

Undeclared revenue	₱ 20,713,344.05
Disallowed provisions for Obsolescence claimed as expenses for samples/disposal-raw materials	₱ 2,906,232.46
Non-deductible loss on disposal of surplus raw materials	₱ 3,626,540.12
Unsupported Tax Credit	₱ 9,840.50

1. Undeclared Revenue – ₱ 20,713,344.05

The alleged undeclared revenues of petitioner in the amount of ₱ 20,713,344.05 were based on the examiner's finding that:⁴¹

"Verification disclosed that Revenues in the General Ledger amounting to P20,713,344.05 were not included in the Revenues per Financial Statement in violation of Section 32 of the National Internal Revenue Code of 1997 which states that gross income means all income derived from whatever source."

Petitioner, on the other hand, argues⁴² that the amount of ₱ 20,713,344.05 is not an undeclared income but actually consisted of the following accounts:

Profit on foreign exchange	₱ 453,503.95
Unrealized profit on foreign exchange	258,047.90
bank interest income	156,875.13
All other income	298,078.76
Carriage outward recovered	211,691.19
Transferred cost & services (applied landing charges) representing customs duties, carriage and insurance inward on imported materials which have already been considered as part of inventory cost	19,335,147.21
TOTAL	<u>₱ 20,713,344.05</u>

As presented by petitioner's external auditor, SGV & Co., at the administrative level,⁴³ and as testified to by petitioner's Accounting Manager, Jennely O. Barrera,⁴⁴ the first four accounts listed above have been included in

⁴¹ Details of Discrepancies attached to Exhibit "E", Docket, p. 946.

⁴² Par. 33, Petitioner's Memorandum, Docket, p. 1220. Exhibit "F", Docket, pp. 950 to 951.

⁴³ Exhibit "F", Docket, p. 951.

⁴⁴ Exhibit "QQ", Docket, pp. 925 to 926.

the caption "Miscellaneous-Net" under the Statement of Income and Retained Earnings in petitioner's Financial Statement⁴⁵, which is broken down as follows:⁴⁶

Loss on Disposal of Surplus Materials	P 3,623,540.12
Loss on Foreign Exchange	995,317.04
Profit on Foreign Exchange	(453,503.95)
Unrealized Profit on Foreign Exchange	(258,047.90)
Bank Interest Income	(156,875.13)
All Other Income	(298,078.76)
Miscellaneous - Net Per Audited FS	<u>P 3,452,351.42</u>

Furthermore, the Profit on Foreign Exchange of P 453,503.95 and All Other Income of P 298,079.00 were allegedly declared in petitioner's Annual Income Tax Return under item no. 17, with caption "Non-Operating & Other Income" amounting to P 751,583.00,⁴⁷ and supported by Schedule 4 of the Return,⁴⁸ to wit:

Miscellaneous	P 298,079.00
Foreign Exchange gains	453,504.00
Total Other Income	<u>P 751,583.00</u>

The unrealized Profit on Foreign Exchange of P 258,047.90 and Bank Interest Income of P 156,875.13 were also allegedly declared in the Annual Income Tax Return as a reconciling item of net income per books against taxable income,⁴⁹ to wit:

Net Income/(Loss) per books	P 2,005,806.00
Add: Non-deductible Expenses/Other Taxable Income	
Provision for retirement cost	2,651,577.00
Provision for inventory obsolescence	369,250.00
Non-deductible interest	76,477.00
Unrealized foreign exchange gain in 1998 realized in 1999	30,082.00
Total	<u>P 5,133,192.00</u>

⁴⁵ Exhibit "N-2", Docket, p. 1014.

⁴⁶ Exhibit "O", Docket, p. 1020.

⁴⁷ Exhibit "A", Docket, p. 895.

⁴⁸ Exhibit "A", Docket, p. 896.

⁴⁹ Exhibit "A", Docket, p. 897.

Less: Non-taxable Income and Income subject to Final Tax	
Unrealized foreign exchange gain in 1999	258,048.00
Interest Income	156,875.00
Charges to allowance for inventory	86,253.00
Provision for Income Tax	(1,215,420.00)
Total	<u>₱ (114,244.00)</u>
Net Taxable Income	<u>₱ 5,847,436.00</u>

Based on the foregoing, We find for petitioner.

Clearly, the said four revenue accounts were properly declared by petitioner in its 1999 Income Tax Return. Consequently, the corresponding deficiency income tax assessment on these items should be cancelled.

As to the carriage outward recovered account, this supposedly represents courier/freight charges on the raw materials sold to other affiliates of petitioner's alleged regional headquarters, Triumph International, which were eventually recovered by petitioner from the latter.

Petitioner contends that the amount of ₱ 211,691.19 is not a revenue account but rather a recovered expense account.⁵⁰ These charges were allegedly taken up by petitioner as deduction from its total Operating Expenses.

However, this Court finds that petitioner failed to prove that the amount of ₱ 211,691.19 was actually deducted from its total Operating Expenses for it did not provide convincing proof to that effect. Thus, petitioner's Operating Expenses shall be considered to have been overstated by ₱ 211,691.19. Accordingly, petitioner should be assessed of the corresponding deficiency income tax.

As to the transferred cost and services (applied landing charges) representing customs duties, carriage and insurance inward on imported

⁵⁰ Pars. 37 to 38, Petitioner's Memorandum, Docket, pp. 1221 to 1222.

materials which have already been considered as part of inventory cost in the amount of ₱ 19,335,147.21, petitioner submitted a Summary of Transferred Cost and Services⁵¹ supported by journal entries in petitioner's journal book for taxable year 1999, showing debits to an inventory account "Stock of Raw Materials at Warehouse" and credits to "Transferred Cost"⁵² as testified upon and explained by petitioner's accountant, Jennely Barrera.⁵³ Moreover, petitioner presented Import Entry and Internal Revenue Declarations (IEIRDs)⁵⁴ and other documents⁵⁵ to prove its importation of goods and the transferred costs and services therewith.

Additionally, the Court notes that the Court commissioned Independent Certified Public Accountant (ICPA), Jerome Antonio B. Constantino of Constantino Guadalquiver & Co., stated in his Report that out of the total transferred costs and services, only ₱ 15,483,806.64 is properly substantiated by supporting documents.⁵⁶ The amount of ₱ 3,851,340.57 is supported by photocopies or not properly substantiated.⁵⁷ On the other hand, petitioner claims that only ₱ 1,355,941.57 of the transferred costs and services are unsubstantiated.⁵⁸ Anent the portion of the total transferred costs and services amounting to ₱ 2,495,399.00⁵⁹, petitioner obtained a summary of importations

⁵¹ Exhibit "RR", Docket, p. 1036.

⁵² Exhibits "SS" to "SS-17", Docket, pp. 1037-1053.

⁵³ Exhibits "QQ" and "ZZ", Docket, pp. 918-940 and 1079-1089, respectively.

⁵⁴ Exhibits "CCC-1" to "CCC-770".

⁵⁵ Exhibits "CCC-2-1" to "CCC-4-895".

⁵⁶ Page 4 of Exhibit "BBB".

⁵⁷ Page 5 of "Exhibit BBB" and Annex "F-8".

⁵⁸ Par. 52, Petitioner's Memorandum, Docket, pp. 1228 to 1229.

⁵⁹ The difference between ₱ 3851,340.57 and ₱ 1,355,941.57.

made in the year 1999⁶⁰ through Ms. Nancy D. Reyes of the Management Information System Technologies Group (MISTG) of the Bureau of Customs (BOC).⁶¹

Verification showed that ₱ 17,996.00 of the claimed transferred costs and services were not included in the summary of importations retrieved from the BOC's database. Hence, the unsubstantiated transferred costs and services on importation of goods should be increased by ₱ 17,996.00, detailed as follows:

Date of Payment	BOC Import Entry No.	Amount
3-Nov-99	95357	₱ 757.00
27-Nov-99	93485	17,239.00
TOTAL		₱ 17,996.00

To recapitulate, petitioner's undeclared revenue amounts to ₱ 1,585,628.76, as detailed below:

Carriage outward recovered		₱ 211,691.19
Transferred cost and services		
Unsubstantiated as admitted by petitioner	₱ 1,355,941.57	
Additional Unsubstantiated per this Court's findings	17,996.00	1,373,937.57
TOTAL		₱ 1,585,628.76

2. Disallowed provisions for Obsolescence claimed as expenses for samples/disposal-raw materials - ₱ 2,906,232.46

It is petitioner's contention that the amount of ₱ 2,906,232.46 represents the adjustments to inventories in order to tie up with the results of the actual physical count of the inventories, which was conducted at the end of taxable year 1999. This is illustrated in the Comparative Inventory – per general ledger

⁶⁰ Exhibits “LLL” to “YYY”, Docket, pp. 1120-1132.

⁶¹ Exhibit “ZZZ”, Docket, pp. 1113 to 1119. Pars. 46 to 51, Petitioner's Memorandum, Docket, pp. 1225-1226.

versus per physical count prepared by petitioner, the pertinent portion of the computation is as follows:⁶²

	Per General Ledger	Per Physical Count	Adjustment GL over (under)
STOCK OF RAW & AUX MAT.			
At warehouse	P 42,443,151.83	P 44,213,226.27	P (1,770,074.44)
At production	10,764,747.93	6,088,441.03	4,676,306.90
TOTAL	P 53,207,899.76	P 50,301,667.30	P 2,906,232.46

Since the result of the physical count was less than the amount in the general ledger, an adjustment in order to reflect the true amount of inventory present at year-end was made by petitioner by taking it up as an expense, as shown below:

Expense for Samples/ Disposal of Raw Materials	2,906,232.46	
Provision for Raw Materials Obsolescence		2,906,232.46

On the other hand, respondent contends that the entry made by petitioner does not affect any inventory account, which petitioner claimed is tying up with the physical count. Furthermore, based on the above entry, the "Provision for Raw Materials Obsolescence" is a non-deductible accounting estimate and by petitioner's accounting entries, it reclassified a non-deductible accounting estimate to a tax-deductible expense.

Petitioner's witness, Jennely O. Barrera, explained petitioner's accounting records in her Supplemental Judicial Affidavit in this wise:⁶³

"A13: The BIR's analysis is wrong because it has selected a particular entry to the exclusion of other related entries which would answer the concerns raised. I refer to the Summary of Journal Entries on Year End

⁶² Exhibit "T", Docket, p. 1026.

⁶³ Exhibit "ZZ", Docket, pp. 1084 to 1085.

Inventory Adjustments. The entries to tie up inventory on record with physical count are:

Raw Materials at Warehouse	1,770,074.44	
Provision for Raw Materials Obsolescence		1,770,074.44
Provision for Raw Materials Obsolescence	4,676,306.90	
Raw Materials at Production		4,676,306.90

The inventory accounts affected are 'Raw Materials at Warehouse' and 'Raw Materials at Production'.

xxx

xxx

xxx

The net effect of the above transactions is a decrease in the inventory account of P2,096,232.46. (Increase of P1,770,074.44 less Decrease of P4,676,306.90).

I also note the account 'Provision for Raw Materials Obsolescence' used in estimating that portion of the inventory which may be considered obsolete. The BIR considers Provision as a non-deductible accounting estimate since there is no physical disposal of the inventory

On the other hand, the actual count done, which I supervised personally, showed a physical absence of inventory in the net amount of P2,096,232.46. It has nothing to do with obsolescence or estimation.

The proper account for deficiency in physical count is 'Expenses for Samples/Disposal of Raw Materials'. In order to conform to this proper account, a reclassification was made from the account 'Provision for Raw Materials Obsolescence' to the account 'Expenses for Samples/Disposal of Raw Materials'. Hence, from the Summary of Journal Entries on Year-End Inventory Adjustments,

Expense for Samples/ Disposal of Raw Materials	2,906,232.46	
Provision for Raw Materials Obsolescence		2,906,232.46"

We agree with the explanation of petitioner. Moreover, under the express mandate of Section 34(D)(1) of the NIRC of 1997, a taxpayer may claim the losses it actually sustained during a taxable year provided they are incurred in the course of trade or business and the losses are not compensated by insurance or other forms of indemnity, to quote:

"SEC. 34. *Deductions from Gross Income.* – xxx.

xxx

xxx

xxx

(D) *Losses.* –

(1) *In General.* - Losses actually sustained during the taxable year and not compensated for by insurance or other forms of indemnity shall be allowed as deduction:

(a) If incurred in trade, profession or business;"

Considering that the physical absence of the inventory fulfills the requirements of Section 34 (D) (1) of the NIRC of 1997, the amount of ₱ 2,906,232.46 should be allowed.

3. Non-deductible loss on disposal of surplus raw materials-₱ 3,626,540.12

Petitioner claimed the amount of ₱ 3,623,540.12 (not ₱ 3,626,540.12 as found by the BIR) as the supposed actual loss it sustained when it sold its surplus raw materials to its parent company, Triumph Hongkong (Triumph HK) at only ten percent (10%) of its book value.

In disallowing the said amount, respondent said thus:

"You claimed that P3,626,540.12 represents actual loss on surplus materials sold to TR International Overseas of Kowloon Hong Kong on October 30, 1999 per sales invoice nos. 4029⁶⁴ and 4037⁶⁵ amounting to P725,363.42 and P3,291,852.20, respectively, with the total of P4,017,215.62 but taxpayer's export sale for 1999 taxable year per VAT returns was declared only at actual selling price at a loss. Since the cost of these Raw Materials forms part of Cost of Goods Sold and they declared its selling price at actual selling price, to permit Loss on Disposal of Surplus will result in double deduction of the cost of these raw materials, that is why it was disallowed."⁶⁶

⁶⁴ Exhibit "W", Docket, p. 1029.

⁶⁵ Exhibit "X", Docket, p. 1030.

⁶⁶ Exhibit "H", Docket, p. 982.

However, petitioner was able to sufficiently address said finding, again, through its witness, Jennely O. Barrera. Thus:

"A18: First, I note that the amount involved is P3,623,540.12, and not P3,626,540.12 as claimed by the BIR (or a difference of P3,000). This P3,623,540.12 is the sum of the 90% sale discount of P 3,615,494.06 and an earlier entry of P 8,046.06, as can be gathered from the Summary of Journal Entries on Sale of Surplus Stocks.

What is involved here is a sale of raw materials inventory per se and not raw materials as forming part of finished goods inventory. This is what distinguishes this sale discount of P3,615,494.06 from the earlier physical deficiency deduction of P2,906,235.46.

The original value of the surplus stock sold to Triumph HK is P4,017,215.62. (90% of this is P3,615,494.06). The Summary of Journal Entries on Sale of Surplus Stocks would show an entry:

Cost of Raw Materials Sold	4,017,215.62
Raw Materials at Stocklot	4,017,215.62

At this point, it would appear that the BIR is making sense in its claim that P3,615,494.06 (which is part of P4,017,215.62) has already been claimed as Cost of Goods Sold (BIR uses the term 'deduction from revenue'; SPI uses the term 'Cost of Materials Sold'). Thus, to claim P3,615,494.06 further as Loss on Disposal of Surplus Raw Materials will be a double deduction.

However, the BIR missed one very important point. The Cost of Raw Materials Sold in the amount of P3,615,494.06 had been reversed in SPI's books. The Summary of Journal Entries on Sale of Surplus Stocks would show:

Allowance for Obsolescence – Raw Materials	3,615,494.06
Cost of Raw Materials	3,615,494.06

This means that only the net amount of P401,721.56 (4,017,215.62 less P3,615,494.06) actually went to Cost of Raw Materials Sold. Only the amount of P401,721.56 had been claimed as deduction. Hence, the amount corresponding to P3,615,494.06 had not yet been claimed as a deduction 'Loss on Disposal of Surplus Raw Materials' is not a double deduction."⁶⁷

⁶⁷ Exhibit "ZZ", Docket, pp. 1086 to 1087.

Thus, We see no cogent reason to disallow the said amount of ₱ 3,626,540.12 as a deduction from petitioner's gross income for taxable year 1999.

4. Unsupported Tax Credit = ₱ 9,840.50

Respondent denied petitioner's claimed tax credits in the amount of ₱ 9,840.50 for not being supported by withholding tax certificates (BIR Form No. 2307), in violation of Section 2.58.3(B) and (C) of Revenue Regulations No. 2-98.

Considering petitioner's failure to refute respondent's finding, the disallowance of the amount of ₱ 9,840.50 shall be upheld.

In sum, the income tax still due and the corresponding surcharge is computed as follows:

Net Income Per Return		₱ 5,847,436.00
Add: Undeclared Revenue		1,585,628.76
Taxable Income Per Investigation		₱ 7,433,064.76
Income Tax Due (33%)		₱ 2,452,911.37
Less: Tax Paid Per Return	₱ 1,929,654.00	
Less: Unsupported Tax Credit	9,840.50	1,919,813.50
Deficiency Income Tax		₱ 533,097.87
Add: 25% Surcharge		133,274.47
Total Amount Due		₱ 666,372.34

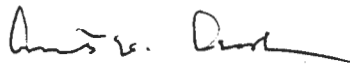
WHEREFORE, premises considered, the instant Amended/Supplemented Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the deficiency expanded withholding tax and value-added tax assessments are hereby **CANCELLED** and **WITHDRAWN**. However, petitioner is hereby **ORDERED TO PAY** deficiency income tax, including surcharge, in the amount of **SIX HUNDRED SIXTY SIX THOUSAND THREE HUNDRED SEVENTY TWO PESOS AND THIRTY FOUR CENTAVOS (₱ 666,372.34)**.

In addition to said amount, petitioner is likewise **ORDERED TO PAY** (i) a deficiency interest, also on the same tax base, at the rate of twenty percent (20%) per annum from April 16, 2000 until fully paid in accordance with Section 249(B) of the NIRC of 1997; and (ii) a delinquency interest, likewise on the same tax base, at the rate of twenty percent (20%) per annum from January 24, 2003 until fully paid, pursuant to Section 249(C)(3) of the NIRC of 1997.

SO ORDERED.


ERLINDA P. UY
Associate Justice

WE CONCUR:


ERNESTO D. ACOSTA
Presiding Justice


ESPERANZA R. FABON-VICTORINO
Associate Justice

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.


ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division