REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

TRINITY FRANCHISING AND MANAGEMENT CORPORATION, Petitioner,	**CTA CASE NO. 9177**
	Members:
- versus -	**CASTAÑEDA, JR.**, Chairperson, **CASANOVA**, and **MANAHAN**, *JJ.*
THE COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: JUN 13 2018 3:11 p.m.

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DECISION

CASTAÑEDA, JR., *J.*:

THE CASE

In this Petition for Review, petitioner Trinity Franchising and Management Corporation seeks for the cancellation of the deficiency taxes stated in the Final Decision on Disputed Assessment (FDDA)[1] issued by the Commissioner of Internal Revenue, covering taxable year 2011 in the total amount of ₱135,476,175.51,[2] inclusive of surcharge and interest, computed as follows:

Tax Type	Basic	Surcharge	Interest	Compromise	Total

[1] Exhibit "P-1-15", docket, vol. I, pp. 384-393.
[2] Should be ₱135,476,175.52.

Income Tax	₱ 59,925,336.72		₱ 42,423,854.82	₱ 50,000.00	₱ 102,399,191.53[3]
Value-Added Tax	639,700.13		481,264.81	20,000.00	1,140,964.94
Expanded Withholding Tax	494,251.95		605,676.09	20,000.00	1,119,928.04
Withholding Tax on Compensation	1,622,438.47		1,229,497.20	25,000.00	2,876,935.67
Final Withholding Tax	2,348,160.00		1,785,888.26	25,000.00	4,159,048.26
Fringe Benefits Tax	11,765,322.35	₱ 2,941,330.59	8,948,091.74	50,000.00	23,704,744.68
Documentary Stamp Tax	25,015.00	6,253.75	19,093.64	25,000.00	75,362.39
Total	**₱76,820,224.62**	**₱2,947,584.34**	**₱55,493,366.56**	**₱215,000.00**	**₱135,476,175.51**[4]

THE FACTS

Petitioner Trinity Franchising and Management Corporation is a corporation duly organized and existing under the laws of the Philippines, with principal office at No. 7 Mercury Ave. cor. E. Rodriguez Jr., Bagumbayan, Quezon City, Metro Manila.[5] It is registered under the jurisdiction of Revenue District Office (RDO) No. 116 of the Large Taxpayers Service (LTS).[6]

On the other hand, respondent is the incumbent Commissioner of Internal Revenue who holds office at the Bureau of Internal Revenue (BIR) National Office Building, Diliman, Quezon City, where he may be served with summons.[7]

Petitioner is engaged in rendering management services. In 2011, it managed the drug stores owned by Central Luzon Drug Corporation, Southern Luzon Drug Corporation, Northern Luzon Drug Corporation, Cagayan Valley Drug Corporation, and Bicolandia Drug Corporation.[8]

Respondent issued an electronic Letter of Authority (LOA) No. LOA-125-2012-00000055, SN: eLA201100007162 dated November 19, 2012, authorizing the examination of the books of accounts of

[3] Should be ₱102,399,191.54.
[4] Should be ₱135,476,175.52.
[5] Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Issues (JSFI), docket, vol. II, p. 541.
[6] Par. 2, Summary of Admitted Facts, JSFI, docket, vol. II, p. 539.
[7] Par. 1, Summary of Admitted Facts, JSFI, docket, vol. II, p. 539.
[8] Par. 2, Stipulation of Facts, JSFI, docket, vol. II, p. 541.

petitioner for taxable year 2011.[9] The LOA was received by petitioner on November 21, 2012.[10]

On September 17, 2013, petitioner sent a letter to respondent informing the latter that it has submitted the mandatory requirements on November 28, 2012, and requesting that the examination and audit of its books of accounts and check vouchers be conducted in petitioner's office considering the volume of the documents and its books of accounts which are in loose leaf form.[11]

Subsequently, a waiver was executed by petitioner on March 24, 2014, which was accepted by Assistant Commissioner – LTS Alfredo V. Misajon on March 27, 2014.[12] The accepted waiver was stamped received by "MGCI-FINANCE" on April 25, 2014.[13]

Respondent issued to petitioner the Preliminary Assessment Notice (PAN) dated August 22, 2014, stating that after investigation, respondent found petitioner liable for deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT), withholding tax on compensation (WTC), final tax, fringe benefit tax (FBT), and documentary stamp tax (DST) in the aggregate amount of ₱115,338,526.50.[14]

On September 3, 2014, petitioner requested that it be allowed "to face the examination one at a time," and further requested for the deferment of the issuance of the FAN for taxable year 2011 until after the 60-day substantiation period for the examination of its books of accounts for taxable year 2010. To support its request, petitioner stated that it is willing to execute a waiver of the defense of prescription under the statute of limitations until June 30, 2015.[15]

Hence, another waiver was executed by petitioner on September 10, 2014, which was accepted by Assistant Commissioner – LTS Nestor S. Valeroso on September 16, 2014.[16] The accepted

[9] Par. 3, Summary of Admitted Facts, JSFI, docket, vol. II, pp. 539-540.
[10] Par. 3, Stipulation of Facts, JSFI, docket, vol. II, p. 541.
[11] Exhibit "R-3", BIR Records, p. 358.
[12] Exhibit "P-1-2-B", docket, vol. III, p. 1179; Exhibit "R-4", BIR Records, p. 361.
[13] Exhibit "P-1-2-C", docket, vol. III, p. 1179; Exhibit "R-4", BIR Records, p. 361.
[14] Par. 4, Summary of Admitted Facts, JSFI, docket, vol. II, p. 540.
[15] Exhibit "R-8", BIR Records, p. 478.
[16] Exhibit "P-1-4-B", docket, vol. III, p. 1180; Exhibit "R-9", BIR Records, p. 480.

waiver was received by a certain "Nelyn Madjus" on October 16, 2014.[17]

Respondent issued a Formal Assessment Notice (FAN) on December 1, 2014, reiterating the assessments in the PAN, and likewise issued the Assessment Notices all dated December 1, 2004 assessing petitioner for deficiency income tax, VAT, EWT, WTC, final tax, FBT, and DST, in the aggregate amount of ₱123,003,996.86 for the taxable year ended December 31, 2011.[18]

Petitioner received the FAN and the Assessment Notices on December 9, 2014.[19]

On January 8, 2015, petitioner filed with respondent its protest to the FAN through a letter dated January 7, 2015.[20]

Respondent issued the Final Decision on Disputed Assessment, which reiterated the assessments in the PAN and the FAN, alleging that petitioner is liable for the deficiency taxes in the aggregate amount of ₱135,476,175.51.[21]

Petitioner received a copy of the FDDA by personal service on October 2, 2015.[22]

On October 30, 2015, petitioner filed with this Court the instant Petition for Review to appeal the FDDA.

In his Answer filed on February 19, 2016, respondent interposed the following Special and Affirmative Defenses:

"**SPECIAL AND AFFIRMATIVE DEFENSES**

Income Tax Liability ✓

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[17] Exhibit "P-1-4-C", docket, vol. III, p. 1180; Exhibit "R-9", BIR Records, p. 480.
[18] Par. 5, Summary of Admitted Facts, JSFI, docket, vol. II, p. 540.
[19] Par. 4, Stipulation of Facts, JSFI, docket, vol. II, p. 541.
[20] Exhibit "P-1-13", docket, vol. I, pp. 359-374; Exhibit "R-12", BIR Records, pp. 580-595.
[21] Par. 6, Summary of Admitted Facts, JSFI, docket, vol. II, pp. 541-542.
[22] Par. 5, Stipulation of Facts, JSFI, docket, vol. II, p. 542.

4. After audit, the respondent found petitioner liable for income tax in the amount of P102,399,191.53.

5. Petitioner's allegation that the provident fund contribution in the amount of P14,418,038.00 should not have been disallowed because it was able to submit supporting documents is false.

6. Verification disclosed that petitioner failed to provide supporting documents and it also failed to disclose the schedule of retirement benefit expense to its audited financial statements in violation of PAS 19 Employee Benefits, hence the said deduction was disallowed pursuant to Section 34 of the NIRC.

7. Although petitioner has transmitted some documents such as the confirmatory ruling/certificates issued to Mercury Group of Companies, Inc., Retirement Plan, however, petitioner failed to provide the supporting documentation on the **actual transfer of funds to the said retirement plan.** Hence, the deduction was disallowed.

8. On the issue on the disallowance of expenses due to non-withholding in the amount of P20,289,735.13, verification of petitioner's account shows that it failed to withhold and remit the correct withholding tax on various income payments pursuant to Section 57 and 58 of the NIRC, hence disallowed pursuant to Section 34(K) of the same code. It is worthy to note that petitioner was able to submit some vouchers to prove that they paid certain expenses and was allowed to be deducted, but for the rest of the tax liability, no such document was submitted.

9. On the issue of the disallowance of salaries and wages (not subjected to withholding) in the amount of P4,967,482.58, a comparison of petitioner's personal services per FS/ITR as against personal services subjected to withholding per BIR Form 1601-C returns yielded a discrepancy amounting to P4,967,482.58, hence disallowed pursuant to Section 34(K) of the NIRC.

10. Petitioner contends that there was a discrepancy due to (1) timing difference between recording of profit bonus and imposition of withholding tax on compensation and (2) de minimis benefits and other charges to employee's welfare.

11. Respondent has considered these arguments and has in fact adjusted its tax assessments to reflect the corrected amounts and also to reflect the accrued and paid profit bonus. On the issue of other employee benefits not subject to expanded withholding tax, respondent finds no merit in considering this as an adjustment on the computation of disallowed salaries and wages for the reason that these alleged de minimis benefits should be properly reflected as non-taxable compensation under various schedules on the alphalist.

12. On the issue of the final tax on royalties in the amount of P48,022,760.00, verification disclosed that petitioner has classified royalties received from related parties as part of its regular income subject to 35% (with benefit of deductions). Under Section 27(D)(1) of the National Internal Revenue Code (NIRC) in relation to Section 42(A)(4) of the same code. The said royalties is subject to a special rate of 20% final tax. The said royalties were therefore assessed with deficiency income tax.

13. The imposition of the 20% Final Tax for royalties is prescribed under Section 27(D)(1) of the NIRC. The management contracts submitted by petitioner to respondent cannot be honoured for the reason that (1) it was not notarized (2) it was executed between related parties and/or wholly-owned subsidiaries. Moreover, petitioner failed to assail respondent's contention that the income received was passive.

14. Regarding petitioner's excess credits carried over to succeeding year in the amount of P77,911,056.75, the same was deducted from total allowable tax credit considering that the said amount has been credited against estimated quarterly income tax liabilities for the

taxable quarter/s of the succeeding years pursuant to Section 76 of the NIRC.

VAT Liability

15. Verification disclosed that petitioner has income from related parties amounting to P240,113,800.00 and receipts (i.e. decrease in trade receivables) amounting to ₱5,000,000.00. The same was compared to the Vatable receipts booked per VAT returns and the resulting discrepancy was subjected to deficiency VAT pursuant to Section 108 of the NIRC.

16. Petitioner argued that the ₱5 million discrepancy is actually a payment made by Mercury Group of Companies, Inc. which is booked as advances and deposits, however, petitioner failed to provide documents supporting the said assertion. Thus the assessment imposing VAT on the P5milion receipt was retained.

17. Regarding miscellaneous income not subjected to VAT in the amount of P23,256.00, verification disclosed that petitioner has recorded miscellaneous income amounting to P23,256.00 as disclosed under Note 19 of petitioner's audited financial statements. The same is subject to VAT pursuant to Sections 106 and 108 of the NIRC.

18. Petitioner argued that the miscellaneous income is the accumulated net balance of cashiers' cash shortages and overages, however, petitioner failed to cite a legal basis for the non-imposition of VAT on these cash receipts. Accordingly, the assessment on miscellaneous income not subjected to VAT was reiterated.

19. Petitioner was also disallowed input VAT in the amount of P36,909.41 representing coalesce masterfile matching. A comparison of coalesced masterfile of Summary List of Sales (SLS) of all large taxpayers as against your Summary List of Purchases (SLP) disclosed that petitioner has claimed excessive input taxes. Mercury Drug Corporation on its submitted SLS disclosed that it transacted only P339,789.24 to petitioner, however,

petitioner has claimed P647,367.41 as purchases. The resulting input tax discrepancy of P36,909.41 was therefore disallowed pursuant to Section 110 of the NIRC. During reinvestigation, petitioner claimed that their records show purchases for valid input tax with valid documents such as sales invoice or official receipts. However, petitioner failed to provide these records thereby reiterating the assessment.

Expanded Withholding Tax Liability

20. Petitioner was assessed P463,137.18 for deficiency expanded withholding tax. Verification of petitioner's account shows that there were discrepancies on the expenses per ITR/FS as against expenses subjected to withholding in violation of Section 2.57.2 of RR No. 2-98. This assessment was adjusted when petitioner was able to provide supporting documents in the form of petty cash payments/liquidations booked under 'Transportation and travelling' and 'Representation and entertainment' amounting to P72,420.55 and P7,171.25, respectively.

21. Petitioner is liable for withholding tax on matching of Summary List of Purchase and Monthly Alphalist of Payees amounting to P29,156.95. Comparison of amounts declared per SLP as against MAP disclosed that petitioner has not paid the correct expanded withholding tax on its income payments in violation of Section 2.57.2 of RR 2-98. Petitioner individually explained the sources of the discrepancies on its SLP vs MAP entries but it failed to support it with source documents. In view thereof, the assessment on the deficiency withholding tax on matching of SLP and MAP was sustained.

22. A comparison of petitioner's expenses subjected to expanded withholding tax (MAP) as against expenses with claimed input VAT per Summary List of Purchases (SLP) disclosed that petitioner is liable in the amount of P231,127.90 for late remittance of expanded

withholding tax pursuant to Section 2.57.2 of RR 2-98 in relation to Section 249 of the NIRC.

Withholding Tax on Compensation Liability

23. The disallowed salaries and wages not subjected to withholding is still subjected to withholding tax on compensation pursuant to Section 2.78.1 and 2.80 or *(sic)* of RR 2-98. The amount of disallowed salaries and wages not subjected to withholding amounts to P4,967,482.58 thus petitioner is liable in the amount of P1,589,594.43 as Deficiency withholding tax on compensation.

24. Petitioner is liable in the amount of P10,634,16 representing the discrepancy on tax withheld per alphalist as against actual remittance. Comparison of tax withheld per annual alphalist of employees as against actual remittance of withholding taxes per BIR Form 1601-C disclosed a discrepancy. The discrepancy is assessed for deficiency withholding tax on compensation pursuant to Section 2.80 of RR No. 2-98.

25. Recomputation of taxes due per employee using the annual alphalist revealed an aggregate discrepancy of P22,209.88 representing underremittance of withholding tax on compensation. This amount was assessed pursuant to Sec. 2.80 of RR No. 2-98.

Final Tax Liability

26. Verification of petitioner's account revealed that it incurred royalties amounting to P11,740,800.00 which were paid to parent companies. The same is subject to withholding of final tax in the amount of P2,348,160.00 pursuant to Section 2.57.1(G)(2) of RR No. 2-98.

Fringe Benefit Tax Liability

27. Verification of petitioner's account revealed that it incurred Transportation and Travelling expense in the amount of P25,001,310.00. Thus petitioner is liable for fringe benefit tax on transportation and traveling in the amount of P11,765,322.35.

28. Petitioner failed to provide respondent with a breakdown and supporting documents on transportation and traveling for determination if these were ordinary and necessary expenses not subject to FBT.

Documentary Stamp Tax

29. Verification of petitioner's account revealed that it made advances to related parties as disclosed under Note 7 of its notes to its audited financial statements. The receivables are subject to DST pursuant to Section 179 of the NIRC, as affirmed by the Supreme Court in the case of CIR vs. Filinvest Development Corp (G.R. No. 167689 dated July 19, 2011).

Period to assess has not prescribed due to the execution of a valid waiver

30. Petitioner made mention that respondent can no longer assess petitioner for deficiency VAT for 2011 because prescription has set in.

31. Petitioner, however, also admits that it has executed at least two (2) Waivers of the right to assess tax deficiency. By virtue of these waivers, prescription has not set in.

32. Petitioner contends that these waivers were not valid as it failed to indicate the date of acceptance by it.

33. Respondent maintains that the waivers executed are valid. In any case, the petitioner is estopped from questioning the validity of its Waivers. This is because petitioner executed a series of Waivers and

delivered them to respondent, one after the other. It allowed respondent to rely on them and did not raise any objection against their validity until respondent assessed taxes and penalties against it.

34. 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.

35. More so, 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. As between the parties, it would be more equitable if respondent's lapses, if any, were allowed to pass and consequently uphold the Waivers in order to support this principle and public policy.

36. Moreover, the execution of the waivers were for the benefit of the petitioner who wishes to contest the initial findings of the respondent. Respondent only agreed with the execution of the waivers as petitioner wanted to contest the initial findings. Understandably, by contesting the initial findings of the respondent, the latter would require more time to audit petitioner's deficiency taxes. Petitioner cannot now come into this Honorable Court and demand that the execution of the waivers were invalid when in the first place, it was a contract between the petitioner and respondent.

Final discussions

37. Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. 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.

38. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise the presumption of correctness of tax assessment stands. The presumption in favor of the correctness of tax assessment stands where evidence to the contrary is wanting. Hence, the assessment issued against petitioner is imbued with factual and legal bases.

39. All presumptions are in favor of the correctness of tax assessments. Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice."

A Notice of Pre-Trial Conference was issued by the Court on March 1, 2016, setting the case for pre-trial conference on April 14, 2016.[23] Accordingly, petitioner filed its Pre-Trial Brief[24] on April 11, 2016, while the Pre-Trial Brief for the Respondent[25] was filed on April 13, 2016.

The Pre-trial conference ensued. The parties submitted their Joint Stipulation of Facts and Issues[26] on April 29, 2016. Thereafter, the Court issued the Pre-Trial Order[27] on May 10, 2016.

Meanwhile, upon petitioner's motion[28], this Court commissioned Mr. Michael L. Aguirre, as Independent Certified Public Accountant (ICPA) for the case.[29]

During trial, petitioner presented the following as its witnesses: (1) Mr. Cyre M. Clores[30], petitioner's Finance and Administration Manager; (2) Mr. Ronaldo R. Rañada[31], petitioner's Operations

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[23] Docket, vol. I, pp. 141-142.
[24] Docket, vol. I, pp. 502-510.
[25] Docket, vol. I, pp. 511-516.
[26] Docket, vol. II, pp. 539-547.
[27] Docket, vol. II, pp. 553-559.
[28] Motion to Commission Independent Certified Public Accountant, filed on April 14, 2016, docket, vol. II, pp. 519-521.
[29] Minutes of the Hearing dated June 22, 2016, docket, vol. II, p. 589.
[30] Exhibit "P-2", docket, vol. I, pp. 239-257.
[31] Exhibit "P-3", docket, vol. I, pp. 145-170.

Manager; (3) Ms. Adelia R. Sarmiento[32], petitioner's Accounting Manager; and (4) Mr. Michael L. Aguirre[33], the ICPA.

Petitioner filed its Formal Offer of Evidence[34] on August 30, 2016. In the Resolution[35] dated November 7, 2016, the Court admitted all of petitioner's evidence except for Exhibits "P-18-AICPA", "P-31-A-ICPA", "P-31-C-ICPA", "P-31-W-ICPA", "P-31-BT-ICPA", "P-31-HW-ICPA", "P-32-A-ICPA", "P-32-FY-ICPA", "P-39-BK-ICPA", "P-39-BU-ICPA", "P-39-KJ-ICPA", "P-39-RI-ICPA", "P-39-RJ-ICPA", "P-39-XT-ICPA", "P-39-AHA-ICPA", "P-39-AYF-ICPA", "P-39-AYG-ICPA", "P-39-BPO-ICPA", "P-39-BPP-ICPA", "P-39-BZY-ICPA", "P-39-CCV-ICPA", "P-39-CDG-ICPA", "P-39-CFB-ICPA", "P-39-CGA-ICPA", "P-39-CGB-ICPA", "P-39-CKK-ICPA", "P-39-CKL-ICPA", "P-39-CKM-ICPA", "P-39-CKN-ICPA", "P-39-CKO-ICPA", "P-39-COR-ICPA", "P-39-CVH-ICPA", "P-39-DDS-ICPA", "P-39-DNL-ICPA", "P-39-DNM-ICPA", "P-39-DNN-ICPA", "P-39-DRN-ICPA", "P-39-ENM-ICPA", "P-39-EOH-ICPA", "P-39-EON-ICPA", "P-39-FOZ-ICPA", "P-39-FPA-ICPA", "P-39-FRM-ICPA", "P-39-GBM-ICPA", and "P-39-GEX-ICPA".

On the other hand, respondent presented its lone witness, Revenue Officer John Raymond R. Tan[36].

Respondent filed a Motion to Admit Attached Formal Offer of Evidence[37] on December 9, 2016, which the Court granted in the Resolution[38] dated April 10, 2017. Hence, respondent's Formal Offer of Evidence[39] was admitted. In the same Resolution, the Court admitted all of respondent's evidence.

The Court declared the case submitted for decision on June 27, 2017,[40] considering respondent's Memorandum[41] and petitioner's Memorandum[42], both filed on June 16, 2017. gr

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[32] Exhibit "P-1", docket, vol. I, pp. 290-39; Minutes of the Hearing dated August 3, 2016, docket, vol. III, p. 1122.
[33] Exhibit "P-4", docket, vol. II, pp. 1099-1115; Minutes of the Hearing dated August 3, 2016, docket, vol. III, p. 1122.
[34] Docket, vol. III, pp. 1213-1254.
[35] Docket, vol. III, pp. 1315-1318.
[36] Judicial Affidavit of Revenue Officer John Raymond R. Tan, docket, vol. III, pp. 1300-1306; Minutes of the Hearing dated November 16, 2016, docket, vol. III, p. 1323.
[37] Docket, vol. III, pp. 1325-1328.
[38] Docket, vol. III, pp. 1348-1349.
[39] Docket, vol. III, pp. 1330-1337.
[40] Docket, vol. III, p. 1493.
[41] Docket, vol. III, pp. 1361-1373.

THE ISSUES

The parties submitted the following issues for this Court's resolution:[43]

1. Whether or not petitioner is liable to pay for deficiency income tax, VAT, expanded withholding tax, withholding tax on compensation, final tax, fringe benefit tax, and documentary stamp tax, inclusive of increments, in the aggregate amount of ₱135,476,175.51 for the taxable year 2011.

2. Whether or not respondent's right to assess petitioner for deficiency VAT, expanded withholding tax, and withholding tax on compensation for taxable year 2011 and/or portions thereof has already prescribed.

DISCUSSION/RULING

Prescription

It is jointly stipulated that respondent issued the FAN on December 1, 2014.[44]

For Deficiency VAT, EWT, and WTC, petitioner raises the issue that respondent can no longer assess these deficiency taxes because prescription has already set in.

The counting of the period for assessment of deficiency taxes shall be reckoned from the date the return of the subject tax was actually filed pursuant to Section 203 of the National Internal Revenue Code (NIRC) of 1997, as amended, which provides:

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

[42] Docket, vol. III, pp. 1376-1489.
[43] Proposed Stipulation of Issues, JSFI, docket, vol. II, p. 542.
[44] Par. 5, Summary of Admitted Facts, docket, vol. II, p. 540.

internal revenue 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."

Value-added Tax

Section 114(A) of the NIRC of 1997, as amended, and Section 4.114.1 of Revenue Regulations (RR) No. 16-2005, respectively, provide for the proper time to file VAT returns, thus:

"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: xxx"

"(3) SECTION 4(3.3) of Revenue Regulations No. 1-98 is hereby amended to read as follows:

'SECTION 4. *Filing of Returns and Payment of Taxes.* –

xxx xxx xxx

3. *When to File and Pay*

3.3. Value-Added Tax (VAT)

> Monthly VAT declarations of Large Taxpayers shall be filed, and taxes paid, not later than the 10th day following the end of each month; provided, however, that with respect to Large Taxpayers who availed of the electronic filing and payment system (EFPS), the deadline for electronically filing the monthly VAT declaration and paying the tax due thereon via the EFPS shall be five (5) days later than the deadline set above. The quarterly VAT returns of Large Taxpayers shall be filed, and the taxes paid, not later than the 25th day following the end of each quarter."

Based on the afore-quoted provisions, a VAT taxpayer has twenty-five (25) days following the close of each taxable quarter within which to file a VAT return. In relation thereto, the CIR has three (3) years from the day the return was filed within which to assess. It is likewise provided that if a return is filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed.

An examination of petitioner's Quarterly VAT Returns shows the following:

Taxable Quarter (2011)	**Date Filed**	**Last Day to File Return**	**Last Day of the 3-year Period to Assess**
1st Quarter[45]	April 20, 2011	April 25, 2011	April 25, 2014
2nd Quarter[46]	July 22, 2011	July 25, 2011	July 25, 2014
3rd Quarter[47]	October 21, 2011	October 25, 2011	October 25, 2014
4th Quarter[48]	January 24, 2012	January 25, 2012	January 25, 2015

Expanded Withholding Tax and Withholding Tax on Compensation

For purposes of EWT and WTC, Section 2.58(A)(2)(a) of RR No. 2-98, as amended by RR No. 17-2003, provides for the proper time to file withholding returns, to wit:

[45] Exhibit "P-8-H-ICPA", Folder 1, Box 1.
[46] Exhibit "P-8-X-ICPA", Folder 1, Box 1.
[47] Exhibit "P-8-AN-ICPA", Folder 1, Box 1.
[48] Exhibit "P-8-BE-ICPA", Folder 1, Box 1.

"(2) WHEN TO FILE —

(a) For both large and non-large taxpayers, the withholding tax return, whether creditable or final xxx shall be filed and payments should be made within ten (10) days after the end of each month except for taxes withheld for the month of December of each year which shall be filed on or before January 15 of the following year. xxx"

As petitioner is not a large taxpayer, respondent's 3-year period to assess deficiency expanded withholding tax and withholding tax on compensation fall on the following dates:

Expanded Withholding Tax

Taxable Period (2011)	Date Filed	Last Day to File Return	Last Day of the 3-year Period to Assess
January	February 10, 2011	February 10, 2011	February 10, 2014
February	March 10, 2011	March 10, 2011	March 10, 2014
March	April 10, 2011	April 10, 2011	April 10, 2014
April	May 10, 2011	May 10, 2011	May 10, 2014
May	June 11, 2011	June 10, 2011	June 11, 2014
June	July 11, 2011	July 10, 2011	July 11, 2014
July	August 9, 2011	August 10, 2011	August 10, 2014
August	September 11, 2011	September 10, 2011	September 11, 2014
September	October 7, 2011	October 10, 2011	October 10, 2014
October	November 9, 2011	November 10, 2011	November 10, 2014
November	December 9, 2011	December 10, 2011	December 10, 2014
December	January 14, 2012	January 15, 2012	January 55, 2015

Withholding Tax on Compensation

Taxable Period (2011)	Date Filed	Last Day to File Return	Last Day of the 3-year Period to Assess
January	March 29, 2011	February 10, 2011	March 29, 2014
February	March 10, 2011	March 10, 2011	March 10, 2014
March	April 12, 2011	April 10, 2011	April 12, 2014
April	May 10, 2011	May 10, 2011	May 10, 2014
May	June 11, 2011	June 10, 2011	June 11, 2014
June	July 11, 2011	July 10, 2011	July 11, 2014
July	August 9, 2011	August 10, 2011	August 10, 2014
August	September 11, 2011	September 10, 2011	September 11, 2014
September	October 7, 2011	October 10, 2011	October 10, 2014

October	November 9, 2011	November 10, 2011	November 10, 2014
November	December 9, 2011	December 10, 2011	December 10, 2014
December	January 14, 2012	January 15, 2012	January 15, 2015

Petitioner executed two waivers on March 24, 2014[49] (first waiver) and September 10, 2014[50] (second waiver), pursuant to Section 222(b) of the Tax Code, extending the period to assess until June 30, 2015.

However, petitioner argues that the two waivers are defective because they were not furnished to petitioner, and were delivered instead to Mercury Group of Companies, Inc. (MGCI) on April 25, 2014. In addition, petitioner avers that the waiver did not specify the taxes covered and amount of tax due contrary to the requirements of Revenue Memorandum Order (RMO) No. 20-90.

Due to the foregoing reasons, petitioner argues that the first and second waivers are defective and inoperative. Hence, petitioner avers that prescription has already set in for the assessment for deficiency VAT for the first, second and third quarters of 2011, and for deficiency EWT and WTC for the months of January to October 2011, as illustrated above.

On the other hand, respondent avers that petitioner is estopped from questioning the validity of the waivers since petitioner allowed respondent to rely on them and did not raise any objection against their validity until respondent assessed taxes and penalties against it, despite executing two waivers, one after the other.

Respondent maintains that 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. Moreover, respondent contends that the execution of the waivers are for the benefit of petitioner who wishes to contest the initial findings of respondent, and respondent only agreed with the execution of the waivers because petitioner wanted to contest the findings.

The Court finds for respondent. Je

[49] Exhibit "P-1-2-b", docket, vol. II, p. 1179.
[50] Exhibit "P-1-4-b", docket, vol. II, p. 1180.

Records show that the accepted first waiver was received by MGCI-Finance. Ms. Adelia Sarmiento, petitioner's witness, testified[51] that it was Ms. Alma Andales who received the first waiver, while the accepted second waiver was received by Ms. Nelyn Madjus, both accounting assistants of MGCI – Finance.

Ms. Sarmiento further testified[52] that petitioner is a subsidiary of MGCI, and that the two companies shared the same address in 2014. It can then be surmised that respondent mistakenly thought that it has successfully delivered the accepted waivers when it delivered the same to MGCI-Finance.

RMO No. 20-09 requires that the fact of receipt by the taxpayer of his/her file copy should be indicated in the original copy. However, respondent delivered the waivers to MGCI-Finance, instead of to petitioner. Evidently, a delivery to MGCI-Finance cannot be considered a delivery to petitioner without any evidence that MGCI-Finance subsequently forwarded the waivers to the latter.

On the other hand, it was petitioner who prepared the two waivers wherein the phrase "All Internal Tax Liabilities for the calendar year ending 2011" was indicated, instead of specifying the kind and amount of tax due as required by RMO No. 20-09. Clearly, this infirmity is attributable to petitioner.

Moreover, records show that it was petitioner who volunteered to execute the second waiver in the letter dated September 3, 2014.

In the case of *Commissioner of Internal Revenue vs. Next Mobile, Inc. (formerly Nextel Communications Phils., Inc.)*[53], the five waivers executed by Next Mobile were found to be defective due to the following flaws: (1) they were executed without a notarized board authority; (2) the dates of acceptance by the BIR were not indicated therein; and (3) the fact of receipt of Next Mobile's copy of the second waiver was not indicated on the face of the original

[51] Exhibit "P-1", docket, vol. I, pp. 298-301.
[52] Transcript of Stenographic Notes taken during hearing on August 3, 2016, pp. 9-10.
[53] G.R. No. 212825, December 7, 2015.

second waiver. However, the Supreme Court ruled that the waivers are valid, to wit:

> "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.
>
> xxx xxx xxx

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, 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. 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.

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, respondent should not be allowed to benefit from their own wrongdoing. Following the foregoing principle, 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.

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. 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. 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, the Court cannot tolerate this highly suspicious situation. 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. "

The above-quoted case may be applied to the instant case. Since both petitioner and respondent caused the infirmities in the two waivers, and considering that petitioner benefited from the flaws of the waivers which it voluntarily executed, the Court resolves to uphold the validity of the subject waivers. Hence, the Court finds that prescription has not set in for respondent's assessments for deficiency VAT for the first, second, and third quarters of 2011, and for deficiency EWT and WTC for the months of January to October 2011.

DEFICIENCY INCOME TAX

Petitioner was assessed for deficiency income tax for taxable year 2011 amounting to ₱102,399,191.54, inclusive of increments, as follows:[54]

Taxable income/(loss) per ITR			₱ 7,365,856.98
Add:	Adjustment/disallowances per investigation		
	Disallowed deduction - provident fund contribution	₱ 14,418,038.00	
	Disallowed expenses due to non-withholding (Schedule 1)	20,289,735.13	
	Disallowed salaries and wages not subjected to withholding (Schedule 2)	4,967,482.58	39,675,255.71
Taxable Income per Investigation			₱ 47,041,112.69
Basic Income Tax Due at Regular Rate (30%)			₱ 14,112,333.81
Add:	Final tax on royalties (Schedule 3)		48,022,760.00
Total Basic Income Tax Due			₱ 62,135,093.81
Less:	Allowable tax credits/payments:		
	Prior year's excess credits other than MCIT	₱ 44,103,743.84	
	Creditable tax withheld per return	36,017,070.00	
	Subtotal	₱ 80,120,813.84	
	Less: Excess credits carried over to succeeding periods	77,911,056.75	2,209,757.09
Total Basic Deficiency Income Tax Due			₱ 59,925,336.72
Add:	Interest (04.16.12 to 10.30.15)	₱ 42,423,854.82	
	Compromise Penalties	50,000.00	42,473,854.82
TOTAL AMOUNT DUE			**₱102,399,191.54**

As can be gleaned from above, the following items for deficiency income tax are to be resolved by the Court:

A	Disallowed deduction - provident fund contribution	₱ 14,418,038.00
B	Disallowed expenses due to non-withholding	20,289,735.13
C	Disallowed salaries and wages not subjected to withholding	4,967,482.58
D	Disallowed final tax on royalties	48,022,760.00
E	Disallowed excess credits carried over to succeeding periods	77,911,056.75

A. Disallowed Provident Fund contribution – ₱14,418,038.00

Respondent's verification disclosed that petitioner claimed as deduction the provident fund contribution amounting to ₱14,418,038.00. However, petitioner allegedly failed to provide supporting documents on the said deduction and failed to disclose

[54] Exhibit "P-1-15", docket, vol. I, p. 384.

the schedule of retirement benefit expense in petitioner's Audited Financial Statements (AFS) in violation of Philippine Accounting Standard (PAS) 19 Employee Benefits; hence, the said deduction was disallowed.[55]

Respondent acknowledges the receipt of confirmatory ruling/certificates issued to Mercury Group of Companies, Inc., Retirement Plan. However, petitioner failed to provide the supporting documentation on the actual transfer of funds to the said retirement plan. Hence, the assessment remains.[56]

Petitioner contends that respondent's allegation is completely false. During investigation and reinvestigation, petitioner submitted BIR confirmation letters dated December 23, 1970[57], April 27, 1978[58], and February 28, 2012[59] regarding the qualification of the Mercury Drug Group of Companies, Inc. Retirement Plan. Among other things, the said letters stated that the subject retirement plan is qualified under Republic Act No. 4917 and that it is a reasonable retirement plan as contemplated under Section 32(B)(6)(a) of the National Internal Revenue Code of 1997, as amended. Consequently, contributions to the retirement fund are deductible from the employer's gross income in accordance with the Tax Code.

Moreover, petitioner provided the following supporting documents, which were examined by the Independent Certified Public Accountant:[60]

- Schedule of provident fund contribution;[61]
- Official Receipts for the provident fund contributions;[62]
- 2011 Financial Statements;[63] and
- 2011 Annual and Quarterly Income Tax Return.[64]

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[55] Annex A-1, Details of Discrepancies, Exhibit "P-1-15", docket, vol. I, p. 387.
[56] *Id.*
[57] Exhibits "P-14-A.4-ICPA" to "P-14-A.5-ICPA", Folder 2, Box 1.
[58] Exhibits "P-14-A.1-ICPA" to "P-14-A.3-ICPA", Folder 2, Box 1.
[59] Exhibits "P-14-A.6-ICPA" to "P-14-A.7-ICPA", Folder 2, Box 1.
[60] Michael L. Aguirre of UHY M.L. Aguirre & Co. CPAs.
[61] Annex A-ICPA, Exhibit "P-5".
[62] Exhibits "P-15-A.1-ICPA" to "P-15-BC.2-ICPA", Folder 2, Box 1.
[63] Exhibits "P-13-A-ICPA" to "P-13-AD-ICPA", Folder 2, Box 1.
[64] Exhibits "P-5-A-ICPA" to "P-5-U-ICPA", Folder 1, Box 1.

The ICPA reports that a review of petitioner's financial statements showed that necessary disclosures for the provident fund did not conform to the requirements of PAS 19,[65] however, the said requirements are relevant for financial reporting purposes only.[66]

The deduction for retirement fund contributions for income tax purposes is covered by Section 34(J) of the NIRC of 1997, as amended, which reads:

> "SEC. 34. *Deductions from Gross Income.* –
>
> xxx xxx xxx
>
> (J) *Pension Trusts.* – An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under Subsection (A)(1) of this Section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowed as a deduction, and (2) is apportioned in equal parts over a period of ten (10) consecutive years beginning with the year in which the transfer or payment is made."

Section 34 of the NIRC of 1997, as amended, likewise provides for the general requirements for the allowable deductions from the taxpayer's gross income:

a) Section 34(A)(1)(a) – Must be ordinary and necessary trade, business or professional expenses paid or incurred during the taxable year which are directly attributable to the development, management, operation and/or conduct of the trade, business or exercise of profession;

b) Section 34(A)(1)(b) – Must be substantiated with sufficient evidence, such as official receipts or other adequate records: (i) Je

[65] Exhibit "P-5", p. 10.
[66] Exhibit "P-5", p. 11.

the amount of the expense being deducted, and (ii) the direct connection or relation of the expense to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer;

c) Section 34(A)(1)(c) – Must not be contrary to law, morals, public policy or order (*e.g.*, bribes, kickbacks and other similar payments); and

d) Section 34(K) – Additional requirements for deductibility of certain payments: the tax required to be deducted and withheld therefrom has been paid to the BIR.

While the fourth requirement does not apply to the subject expense, it is undisputed that contributions to the Mercury Group Provident Fund are ordinary and necessary to petitioner's trade or business. Moreover, the same is not contrary to law, morals, public policy or order. In fact, Republic Act Nos. 4917 and 7641 provide for the retirement benefits of employees.

Further, petitioner provided receipts and vouchers representing its contributions to the Mercury Group Provident Fund, which were examined and summarized by the ICPA in Annex A-ICPA. The ICPA found that the actual transfer of funds to the retirement plan amounting to ₱14,418,038.00 is properly supported. The Court agrees. Therefore, the disallowance of petitioner's provident fund contributions for the year 2011 for failure to disclose the same in the AFS in violation of PAS 19 has no legal basis. Accordingly, the disallowance in the amount of ₱14,418,038.00 should be cancelled.

B. Disallowed expenses due to non-withholding – ₱20,289,735.13

Per Schedule 1 found in the Details of Discrepancies[67], respondent disallowed the following as deductions from petitioner's taxable gross income due to non-withholding of the applicable tax:

[67] Annex A-1, Details of Discrepancies, Exhibit "P-1-15", docket, vol. I, p. 387.

Schedule 1	**Per FS**[68]	**Per Alphalist**[69]	**Discrepancy**
Purchase of Services			
Transportation and travelling	₱ 25,001,310.00		
Insurance	1,961,229.00		
Miscellaneous	1,014,720.00		
Representation and entertainment	904,772.00		
Communication	751,533.00		
Less: Petty cash payments/liquidations	(79,591.80)		
Subtotal	₱ 29,553,972.20	₱ 9,705,333.07	₱ 19,848,639.13
Professional Fees			
Outside services	₱ 12,192,686.00		
Professional Talent Fee (subject to 10%)	-	₱ 2,300.00	
Professional Talent Fee (subject to 15%)	-	11,749,290.00	
Subtotal	₱ 12,192,686.00	₱ 11,751,590.00	441,096.00
Disallowed Expenses due to Non-withholding			**₱20,289,735.13**

It should be noted that the amount of ₱9,705,333.07 is the sum of all income payments which are subjected to EWT at the rate of 2%, while the total amount of ₱11,751,590.00 is the sum of all income payments classified as professional fee which are subjected to withholding taxes at the rates of 10% and 15% per alphalist of payees for taxable year 2011.

Per ICPA report, petitioner withheld taxes from the following income payments:[70]

	1%	**2%**	**5%**	**Total**
Transportation & travelling[71]		₱ 3,442,449.22	₱ 606,625.31	₱ 4,049,074.53
Insurance[72]		1,961,229.47		1,961,229.47
Miscellaneous[73]	₱ 110,489.11	96,434.39		206,923.50
Representation & entertainment[74]	-	-	-	-
Communication[75]		675,092.44		675,092.44
TOTAL	**₱ 110,489.11**	**₱ 6,175,205.52**	**₱ 606,625.31**	**₱6,892,319.94**

[68] Note 18 – Operating Expenses, Notes to Financial Statements, Exhibit No. "P-1-17", docket, vol. I, p. 431.
[69] Exhibit "P-7-A-ICPA".
[70] Exhibit "P-5", p. 16.
[71] Exhibit "P-5", pp. 12-13 and Annex B-ICPA.
[72] Exhibit "P-5", p. 13 and Annex C-ICPA.
[73] Exhibit "P-5", pp. 13-14 and Annex D-ICPA.
[74] Exhibit "P-5", p. 14 and Annex E-ICPA.
[75] Exhibit "P-5", p. 14-15 and Annex F-ICPA.

Based on the foregoing, the total amount of income payments subjected to withholding taxes of ₱6,892,319.94 is even lesser than the amount of ₱9,705,333.07 considered by respondent's examiner. Hence, petitioner failed to prove that the discrepancy of ₱19,848,639.13 was subjected to withholding tax. Consequently, the Court finds no reason to disturb respondent's findings.

Nevertheless, it is noteworthy that petitioner's transportation and travelling expense account includes the amounts of ₱14,651,550.50 and ₱1,511,500.00 as payments for employees' transportation allowance and bonuses, respectively. The ICPA reports:[76]

Particulars	Amount	Reference Annex	Reference Exhibits
I. Business expense: xxx			
xxx xxx xxx	xxx		
II. Transportation Allowance			
A. Managerial employees	10,073,641.00	Annex-B-ICPA	
B. Rank and file employees	4,577,909.50	Annex-B-ICPA	
III. Employee Bonus	1,511,500.00	Annex-B-ICPA	
	₱25,001,310.00		

xxx xxx xxx

> Further review of the transportation account revealed that it includes the pre-computed transportation allowance given to all employees. This allowance was given to the employees through the payroll in addition to their regular compensation. Examination of the check vouchers, payroll worksheets, authority to debit, cleared checks, bank statements and cash disbursement book entries showed that allowances amounting to ₱14,651,550.50 [₱10,073,641.00 plus ₱4,577,909.50] were duly supported as payments to both rank and file and managerial employees.
>
> xxx xxx xxx
>
> xxx The bonuses [₱1,511,500.00] had been disbursed in cash to all the employees as compensation and not as fringe benefit.

Anent the employee bonuses amounting to ₱1,511,500.00, petitioner admitted that the same was inadvertently included in transportation and travelling account.[77]

[76] Exhibit "P-5", pp. 39-41.
[77] Par. 105, Memorandum for the Petitioner, docket, vol. III, p. 1442.

Petitioner is correct in saying that these payments to employees are not subject to EWT. Pertinent to this, Section 2.78.1(A)(6)(a) of RR No. 2-98 provides:

> "SECTION 2.78.1. *Withholding of Income Tax on Compensation Income.* —
>
> (A) *Compensation Income Defined.* — In general, the term 'compensation' means all remuneration for services performed by an employee for his employer under an employer-employee relationship, unless specifically excluded by the Code.
>
> xxx xxx xxx
>
> (6) Fixed or variable transportation, representation and other allowances —
>
> (a) **IN GENERAL, fixed or variable transportation, representation and other allowances which are received by a public officer or employee or officer or employee of a private entity, in addition to the regular compensation fixed for his position or office, is compensation subject to withholding.**
>
> (b) **Any amount paid specifically, either as advances or reimbursements for travelling, representation and other bonafide ordinary and necessary expenses incurred or reasonably expected to be incurred by the employee in the performance of his duties are not compensation subject to withholding**, if the following conditions are satisfied:
>
> (i) It is for ordinary and necessary travelling and representation or entertainment expenses paid or incurred by the employee in the pursuit of the trade, business or profession; and

(ii) The employee is required to account/liquidate for the foregoing expenses in accordance with the specific requirements of substantiation for each category of expenses pursuant to Sec. 34 of the Code. The excess of actual expenses over advances made shall constitute taxable income if such amount is not returned to the employer. Reasonable amounts of reimbursements/advances for travelling and entertainment expenses which are pre-computed on a daily basis and are paid to an employee while he is on an assignment or duty need not be subject to the requirement of substantiation and to withholding." *(Emphasis supplied)*

However, the ICPA made no mention of whether or not the said payments to employees were subjected to withholding tax on compensation which may be applicable in this case.

With regard to the outside services account, the ICPA found that the following income payments were subjected to withholding taxes:[78]

Name	Tax Rate	Income Payment
Dr. Efren Colcol	10%	₱ 2,300.00
Mercury Group of Cos., Inc.	15%	11,740,800.00
The Better Business Linkages, Inc.	2%	362,831.51
TOTAL		**₱12,105,931.51**

Further, the alleged payments to a general professional partnership (GPP) which is not subject to withholding tax pertain to payments to Reyes Galang King and Company in the total amount of ₱64,710.00.[79]

However, petitioner did not submit supporting documents for its payments to The Better Business Linkages, Inc. Such documents are essential to prove that the applicable tax was withheld from the subject income payments, more so since the amount found by the ICPA is different from that which is reflected in the alphalist.

[78] Exhibit "P-5", p. 15 and Annex G-ICPA.
[79] *Id.*

Even though petitioner submitted the amended Articles of Partnership of Reyes Galang King and Company,[80] petitioner likewise failed to submit documents for the alleged income payments to the GPP. Without any other supporting documents such as official receipts from the income payee, the Court cannot verify the truthfulness of these claims.

Moreover, the ICPA found that ₱22,044.20 of the outside services expense is unsubstantiated.[81]

Thus, from the foregoing, the total unsupported outside services expense amounts to ₱449,585.71, computed as follows:

Particulars	**Amount**
Payments to The Better Business Linkages, Inc.	₱ 362,831.51
Payments to GPP	64,710.00
Payment without supporting document provided	22,044.20
TOTAL	**₱ 449,585.71**

Since the amount computed by the Court exceeds the disallowed professional fees/outside services expense per respondent's assessment of ₱441,096.00, the Court is constrained to uphold the said disallowance.

In fine, the disallowance of petitioner's expenses in the amount of ₱20,289,735.13 due to non-withholding of the applicable taxes for the taxable year 2011 should be sustained for petitioner's failure to submit sufficient evidence to overturn respondent's findings.

C. Disallowed salaries and wages not subjected to withholding tax – ₱4,967,482.58

The disallowed salaries and wages in the amount of ₱4,967,482.58 was arrived at by comparing petitioner's claimed salaries and allowances and employees welfare and development

[80] Exhibit "P-44-ICPA", Folder 25, Box 3.
[81] Exhibit "P-5", p. 15.

expenses per FS/ITR[82] as against alphalist of employees subjected to WTC for the year 2011,[83] computed as follows:[84]

Salaries and wages claimed as deductions				
Salaries and allowances		₱ 150,736,000.00		
Employees, welfare and development		14,037,767.00	₱164,773,767.00	
Add:	Profit bonus accrued in 2010 paid in 2011		1,740,370.83	
Less:	Profit bonus accrued in 2011 paid in 2012		1,836,532.23	₱164,677,605.60
Salaries and wages per alphalist				
Schedule 7.1				
	Non-taxable	₱2,284,661.02		
	Taxable	10,641,745.13	₱12,926,406.15	
Schedule 7.2				
	Non-taxable	₱78,005.92		
	Taxable	274,440.65	352,446.57	
Schedule 7.3				
	Non-taxable	₱20,300,417.54		
	Taxable	123,435,724.83	143,736,142.37	
Schedule 7.4				
	Non-taxable	₱62,877.72		
	Taxable	2,632,250.21	2,695,127.93	159,710,123.02
Disallowed salaries and wages due to non-withholding				**₱4,967,482.58**

Petitioner explains that the disallowed income payments which are included in the employees' welfare and development expenses are ordinary and necessary business expenses of petitioner. However, such expenses do not form part of the taxable compensation income of the employees under existing regulations.

For instance, the cost of training and development of employees and cost of uniforms which are not paid to the employees but paid to service providers are not taxable income to the employees because it is incurred for the convenience and advantage of the employer.

Moreover, employee benefits such as service awards, medical and hospitalization and *de minimis* benefits granted to promote the

[82] Note 17, Audited Financial Statements for the year 2011, Exhibit "P-1-17", docket, vol. I, p .431.
[83] Exhibits "P-11-A-ICPA" to "P-11-T-ICPA".
[84] Schedule 2, Annex A-1 Details of Discrepancies, Exhibit "P-1-15", docket, vol. I, p. 388.

goodwill and contentment of the employees are expressly excluded from taxable compensation under the Withholding Tax Regulations.

The difference of the profit bonus accrued in 2010 and paid in 2011 and the profit bonus accrued in 2011 and paid in 2012 of ₱96,161.40 (₱1,740,370.83 less ₱1,836,532.23) is merely due to timing difference which self-corrected in 2012 when the corresponding withholding on the accrual was remitted and paid. In this regard, respondent issued BIR Ruling No. 2-98 dated May 17, 1998 allowing the withholding of the tax on the bonus of cash basis.[85]

According to the ICPA, the benefits that were not included as part of the compensation declared in the alphalist are the following:[86]

Particulars	Amount per FS
Training and development	₱ 683,920.00
Service awards	1,867,048.00
Medical and hospitalization	768,439.12
Employees welfare	1,648,075.46
	₱ 4,967,482.58

1. Training and development (₱683,920.00)

Training and development account consists of payments made to the resorts/conference centers where employee trainings were conducted. Verification showed that the amount of ₱683,920.00 was properly supported by check vouchers, worksheets, official receipts and invoices.[87] These payments were properly subjected to 2% withholding tax.[88]

The ICPA concludes that expenses in this account are clearly not payments to the employees as compensation but are official business expenses, thus, should not be subjected to withholding tax on compensation.[89]

[85] Par. 30, Petition for Review, docket, vol. I, pp. 17-18. ₱93,161.40 should be ₱96,161.40.
[86] Exhibit "P-5", p. 19.
[87] Exhibits "P-16-A-ICPA" to "P-16-NS-ICPA".
[88] Exhibits "P-11-A-ICPA" to "P-11-T-ICPA".
[89] Exhibit "P-5", p.19.

The Court agrees with the ICPA's findings.

Per Annex I.3 – ICPA of the Report, the ICPA showed the breakdown of the expenses comprising the alleged training and development expenses of ₱683,920.00, as follows:[90]

			PER ICPA Report			
OR No.	**OR Date**	**Vendor / Payee**	**Amount (A)**	**Tax Rate**	**Withholding Tax (B)**	**Exhibit Reference**
23709	6/28/2011	FEMAR GARDEN RESORT & CONFERENCE CENTER	₱ 172,800.00	2%	₱ 3,456.00	P-16-NP-ICPA
24481	8/16/2011	BOSO-BOSO HIGHLANDS RESORT & HOTEL	173,520.00	2%	3,470.40	P-16-NS-ICPA
23719	9/21/2011	FEMAR GARDEN RESORT & CONFERENCE CENTER	168,000.00	2%	3,360.00	P-16-NQ-ICPA
23723	10/13/2011	FEMAR GARDEN RESORT & CONFERENCE CENTER	169,600.00	2%	3,392.00	P-16-NR-ICPA
			₱683,920.00		**₱ 13,678.40**	

The Court finds that the training and development expenses were properly supported, and the same prove that these expenses were not paid out to employees, therefore, not subject to WTC. Consequently, the Court cancels the disallowance of ₱683,920.00.

2. Service awards (₱1,867,048.00)

These are awards given to employees in relation to their number of years in service to the Company. Service awards are given in the form of cash. The 1997 NIRC, as amended, does not provide exemption from compensation withholding tax on services awards given in cash.

Service awards given amounting to ₱1,867,048.00, summarized by the ICPA under Annex "I.4 – ICPA" should therefore be included

[90] Annex I.3-ICPA, Exhibit "P-5".

as part of the employees' taxable compensation subject to income tax based on the income tax table.[91]

Under Section 2.78.1(A)(3) of RR No. 2-98, as amended by RR No. 5-2011, compensation for achievement awards such as for length of service is exempt from income tax and WTC if said compensation is in the form of a tangible property not exceeding ten thousand pesos (₱10,000.00), to wit:

> "SECTION 1. Section 2.78.1 (A)(3)(c) and (d) of RR 2-98, as last amended by RR 5-2008, is hereby further amended to read as follows:
>
> 'Sec. 2.78.1 *Withholding of Income Tax on Compensation Income.* —
>
> xxx xxx xxx
>
> The following shall be considered as 'de minimis' benefits not subject to income tax as well as withholding tax on compensation income of both managerial and rank and file employees:
>
> xxx xxx xxx
>
> > h) **Employees achievement awards, e.g., for length of service or safety achievement, which must be in the form of a tangible personal property other than cash or gift certificate, with an annual monetary value not exceeding P10,000 received by the employee under an established written plan which does not discriminate in favor of highly paid employees**;
> >
> > xxx xxx xxx
> >
> > All other benefits given by employers which are not included in the above enumeration shall not be considered as

[91] Exhibit "P-5", p.19.

> "de minimis" benefits, and hence, shall be subject to income tax as well as withholding tax on compensation income.' xxx" *(Emphasis supplied)*

Upon perusal, the Court finds that documents were not provided by petitioner to support these employee service awards.

Hence, the Court upholds the disallowance of ₱1,867,048.00 representing service awards in the form of cash paid out to petitioner's employees which were not subjected to WTC.

3. Medical and hospitalization (₱768,439.12)

The ICPA's audit yielded the following results:[92]

Particulars	**Amount**	**Reference Annex**	**Reference Exhibit**
Payments to supplier:			
Subjected to EWT	₱ 526,999.45	Annex I.2-ICPA	Exhibit P-11-A to P-11-T-ICPA
Payments to non-regular supplier	106,504.21	Annex I.2-ICPA	
Payments to suppliers without supporting documents	11,387.32	Annex I.2-ICPA	
Payments to employees:			
Medical assistance	34,196.65	Annex I.2-ICPA	
Unclassified payments	89,351.49	Annex I.2-ICPA	
	₱768,439.12		

The ICPA verified that ₱487,749.45 and ₱39,250.00 of this account pertain to purchases of medical supplies and services, which were correctly subjected to 1% and 2%, withholding tax, respectively.[93]

The amount of ₱106,504.21 was taken from petty cash fund and paid to non-regular suppliers. The Court examined the supporting documents, which show that these were payments to PhilHealthCare, Inc.[94] *gr*

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[92] Exhibit "P-5", p. 19.
[93] Exhibit "P-5", p. 20.
[94] Exhibit "P-16-NN-ICPA" to "P-16-NO-ICPA", Folder 1, Box 1.

The amount of ₱34,196.65 represents the reimbursements to the employees of their medical expenses as set in the Company's policy[95]. Examination of the breakdown of these medical expenses revealed that they do not exceed the *de minimis* limit of ₱10,000.00 per annum[96] based on Section 2.78.1(f) of RR No. 2-98, as amended by RR No. 5-2011, as previously quoted.

The Court finds the foregoing in order. Hence, payments made to suppliers and medical assistance given to employees based on petitioner's policy and do not exceed ₱10,000.00 per annum should not be subjected to WTC.

However, the amount of ₱11,387.32 representing medical benefits that were directly paid to suppliers with no invoices/receipts to substantiate such payments, and payments amounting to ₱89,351.49 that were not identified as payments to suppliers or employees due to the absence of supporting documents and lack of reference details to trace the said transactions, should be disallowed.

Thus, the Court upholds the disallowance on medical and hospitalization expenses in the modified amount of ₱100,738.81 (₱11,387.32 plus ₱89,351.49).

4. Employees welfare (₱1,648,075.46)

The ICPA's audit on these expenses resulted in the following:[97]

Particulars	Amount	Reference Annex	Reference Exhibit
Payments to supplier:			
Subjected to EWT	₱ 447,518.44	Annex I.1-ICPA	Exhibit P-11-A to P-11-I-ICPA
Payments to non-regular supplier	1,600.00	Annex I.1-ICPA	Exhibit P-16-N-ICPA
Payments to suppliers without supporting documents	1,071,922.14	Annex I.1-ICPA	
Payments to employees:			
Achievement award	12,223.00	Annex I.1-ICPA	

[95] TFMC Medical and Hospitalization Policy, Exhibits "P-43-A-ICPA" to "P-43-D-ICPA".
[96] Annex I.3-ICPA, Exhibit "P-5".
[97] Exhibit "P-5", p. 20. Total amount should be ₱1,648,075.50.

Paternity assistance	36,000.00	Annex I.1-ICPA	
Maternity Assistance	33,948.58	Annex I.1-ICPA	
Death aid	4,500.00	Annex I.1-ICPA	
Unclassified payments	40,363.34	Annex I.1-ICPA	
	₱1,648,075.46		

The ICPA observed during the audit that ₱220,169.25 and ₱227,349.18 for the sum of ₱447,518.43 from this account pertains to the purchases of vitamins and office uniforms which were duly subjected to 1% and 2%, respectively. The amount of ₱1,600.00 was taken from petty cash fund and paid to non-regular supplier.[98]

The Court finds the foregoing in order.

Moreover, based on inquiry, the amount of ₱1,071,922.14 represents employee benefits that are directly paid to suppliers. Such amounts of ₱122,112.00 and ₱949,810.14 were duly subjected to 1% and 2% withholding taxes per alphalist on EWT. However, no invoice or official receipt was presented to the ICPA to substantiate these transactions.[99]

Nonetheless, the Court finds that petitioner accounted for these amounts as reported and remitted to the BIR as evidenced by the Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) (BIR Form No. 1601-E)[100] and summarized in the Alphalist of Payees Subject to Expanded Withholding Tax (BIR Form 1604-E - Schedule 4),[101] to wit:

Supplier	Total Amount per Alphalist	Recorded as[102] Medical & Hospitalization	Employees Welfare	Total	Difference
Maria Katrina Fashion Wear Haus	₱ 1,002,350.50	₱ 60,187.50	₱ 942,203.00	₱ 1,002,390.50	₱ 40.00
Philusa Corporation	342,281.00	220,169.25	122,112.00	342,281.25	0.25
JDL Printing Services	9,839.00	2,232.14	7,607.14	9,839.28	0.28
TOTAL	**₱1,354,470.50**	**₱ 282,588.89**	**₱1,071,922.14**	**₱1,354,511.03**	**₱ 40.53**

Je

[98] *Id.*
[99] Exhibit "P-5", p. 20.
[100] Exhibits "P-6-A-ICPA" to "P-6-AN-ICPA", see Monthly Alphalist of Payees (MAP) for the months of February, June, July, September, November and December 2011, Folder 1, Box 1.
[101] Exhibits "P-7-A-ICPA" to "P-7-B-ICPA", Folder 1, Box 1.
[102] Annex I.1-ICPA, Page 1 of 14 and pp. 19-20 of Exhibit "P-5".

Albeit a difference of ₱40.53, the Court considers the same as immaterial and finds the foregoing reconciliation sufficient, since it proves that the payments were made to suppliers and properly subjected to EWT. Hence, the same will not be subject to WTC.

At a glance, payments for the paternity and maternity assistance to employees do not exceed ₱10,000.00 and seem to be within the purview of *de minimis* benefits contemplated in Section 2.78.1 of RR No. 2-98, as amended by RR No. 5-2011, to wit:[103]

Name	**Amount**		**Name**	**Amount**
Paternity Assistance			**Maternity Assistance**	
Arnold Llaneta	₱ 4,000.00		Charleen Lumaoang	₱ 2,488.21
Jackson Gotoc	4,000.00		Geomary Nisay	4,304.57
Rudy M. Cardenas	4,000.00		Abigail Guevarra	5,005.50
Randy Reyes	4,000.00		Jasmin Magalang	1,673.71
Crisol B. Banzuela	2,000.00		Mylene Eclarin	1,063.59
Kenny c. Pidlaon	4,000.00		Monica Lagliba	2,418.00
Joel C. Aquino	2,000.00		Ingrid Khristine Quiroz	1,492.50
Alvinson M. Gubi	4,000.00		Donna Luz Villamor	2,404.50
Mark Steven V. Espejo	2,000.00		Misty Rose B. Paguio	543.50
Eric G. Yumul	2,000.00		Ann Reonete B. Velo	2,951.50
Jose Alberto Dayap	4,000.00		Elaine Grace Quitaleg	9,190.50
Total	**₱36,000.00**		Reclassification, SSS Maternity of S. Del	412.50
			Total	**₱33,948.58**

However, per ICPA examination and per our review, petitioner did not provide supporting documents for the paternity and maternity assistance provided to its employees.

Payments to employees for achievement awards in the amount of ₱12,223.00 and death aid assistance of ₱4,500.00 cannot be considered as *de minimis* benefits pursuant to Section 2.78.1 of RR No. 2-98, as amended by RR No. 5-2011. The pertinent portions of the said regulation provide:

> "SECTION 1. Section 2.78.1 (A)(3)(c) and (d) of RR 2-98, as last amended by RR 5-2008, is hereby further amended to read as follows: *Je*

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[103] Annex I.1-ICPA, Pages 1 and 2 of 14, Exhibit "P-5".

> 'Sec. 2.78.1 *Withholding of Income Tax on Compensation Income.* —
>
> xxx xxx xxx
>
> The following shall be considered as "de minimis" benefits not subject to income tax as well as withholding tax on compensation income of both managerial and rank and file employees:
>
> xxx xxx xxx
>
> > h) **Employees achievement awards, e.g., for length of service or safety achievement, which must be in the form of a tangible personal property <u>other than cash or gift certificate</u>, with an annual monetary value not exceeding P10,000 received by the employee under an established written plan which does not discriminate in favor of highly paid employees**;
>
> xxx xxx xxx
>
> **All other benefits given by employers which are not included in the above enumeration shall not be considered as 'de minimis' benefits, and hence, shall be subject to income tax as well as withholding tax on compensation income.** xxx" *(Emphasis and underscoring supplied)*

Meanwhile, payments amounting to ₱40,363.34 were not identified as payments to suppliers or employees due to the absence of supporting documents and lack of reference details to trace the said transactions.

In fine, the Court upholds the disallowance of employee welfare expenses amounting to ₱127,034.92, broken down as follows:

Payments to employees:	
Achievement award	₱ 12,223.00
Paternity assistance	36,000.00
Maternity Assistance	33,948.58
Death aid	4,500.00
Unclassified payments	40,363.34
Total	**₱127,034.92**

To summarize, the Court affirms the disallowance of salaries and wages due to non-withholding for taxable year 2011 in the adjusted amount of ₱2,094,821.73, computed as follows:

Particulars	**Upheld Disallowances**
Training and development	₱ -
Service awards	1,867,048.00
Medical and hospitalization	100,738.81
Employees welfare	127,034.92
Disallowed salaries and wages due to non-withholding of tax on compensation	**₱2,094,821.73**

D. Final Tax on Royalties – ₱48,022,760.00

Respondent's verification disclosed that petitioner classified royalties received from related parties as part of regular income subject to 35% (with benefit of deductions). Under Section 27(D)(1) of the Tax Code, in relation to Section 42(A)(4) of the same Code, the said royalties is subject to a special rate of 20% final tax. The said royalties are enumerated, as follows:[104]

Schedule 3	
Royalties from:	
BICOLANDIA DRUG CORPORATION	₱ 33,679,300.00
CAGAYAN VALLEY DRUG CORPORATION	21,223,200.00
CENTRAL LUZON DRUG CORPORATION	75,000,100.00
NORTHERN LUZON DRUG CORPORATION	55,367,900.00
SOUTHERN LUZON DRUG CORPORATION	54,843,300.00
Royalties not subjected to special tax rate	₱ 240,113,800.00
Final tax rate	20%
Final tax on royalties	**₱ 48,022,760.00**

[104] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 388.

It is noted that the amount of the alleged final tax on royalties in the amount of ₱48,022,760.00, as computed above, was added by respondent to the basic income tax due for taxable year 2011 per BIR investigation.[105]

Petitioner maintains that it is principally engaged in the business of rendering management services. Pursuant to several management contracts entered into by petitioner with several entities, petitioner rendered management services and in consideration for such services, petitioner received management fees in the total amount of ₱240,113,800.00 in 2011. These management fees being income derived from the active pursuit of petitioner's primary purpose as a management company, were properly reported by petitioner as part of gross income subject to 30% corporate income tax.[106]

Petitioner's Amended Articles of Incorporation [107] states its primary purpose, to wit:[108]

> "To **act as agent or representative** of individuals, corporation, associations, partnerships and other entities **for the letting, franchising or lending of business names and/or goodwill**; to initiate, develop, promote and/or other undertake and engage in the **management of any industrial, commercial or agricultural enterprise or business of any nature whatsoever**; to **render technical service or assistance in matters of promotion, financing, operation, administration and management** to any person, corporation or other entity engaged in and undertake to the extent permitted by law the promotion, operation, administration and/or **general management of any business enterprise or establishment of any kind or nature, except management funds, securities portfolio or similar assets of such corporation or entity.**" *(Emphasis supplied)*

[105] Exhibit "P-1-15", docket, vol. I, p. 384.
[106] Par. 31, Petition for Review, docket, vol. I, p. 18.
[107] Exhibit "P-2-1", docket, vol. III, pp. 1181-1196.
[108] *Id.*, p. 1184.

It is represented that in taxable year 2011, petitioner rendered management services to Central Luzon Drug Corporation, Southern Luzon Drug Corporation, Northern Luzon Drug Corporation, Cagayan Valley Drug Corporation, and Bicolandia Drug Corporation ("Managed Companies") by providing management teams for the drug stores owned by the Managed Companies. The Managed Companies own and maintain Mercury Drug stores in various locations in the Philippines.[109]

The management services rendered by petitioner include regular visits by petitioner's operations managers and district managers of the branches, attendance in various meetings, and conference with members of the management team, clients, and counsels, and the deployment of branch managers or pharmacists in branches where the Managed Companies have not filled these positions. It also includes planning and implementation of business process improvements, policies, and procedures, survey of potential site for expansion, preparation of feasibility analyses and review of branch performance.[110] As proof, petitioner submitted Daily Activity Reports of its operations manager, Ronaldo R. Rañada,[111] and Actual Itinerary Schedules of Ronaldo R. Rañada, Crisanto M. Victorio and Frederick R. Rodriguez.[112]

Examination of the management contracts[113] shows, among others, that petitioner shall provide managers and supervisors to supervise the operations of the drugstores belonging to the aforementioned managed companies. These companies, in turn, pay petitioner a fixed amount of management fees within the contract period. Petitioner submitted official receipts for the management fees it earned during taxable year 2011 amounting to ₱240,113,800.00.[114] Upon perusal, it was found that the official receipts issued by petitioner are complete and reflect the 15% EWT withheld from every payment, in the sum of ₱36,017,070.00.[115]

Respondent countered that he cannot accept the management contracts for reinvestigation purposes because they are not notarized

[109] Pars. 5-6, Memorandum for Petitioner, docket, vol. III, p. 1377.
[110] Par. 7, Memorandum for Petitioner, docket, vol. III, pp. 1377-1378.
[111] Exhibits "P-3-1" to "P-3-30", docket, vol. I, pp. 171-200.
[112] Exhibits "P-3-31" to "P-3-66", docket, vol. I, pp. 201-236.
[113] Exhibits "P-2-2" to "P-2-6", docket, vol. I, pp. 273-285.
[114] Exhibits "P-25-A" to "P-25-BH-ICPA", Folder 4, Box 1.
[115] Annex J-ICPA, Exhibit "P-5".

and are executed between wholly-owned subsidiaries, hence, are of no legal value.[116]

On this score, petitioner's Finance and Administration Manager, Mr. Cyre M. Clores stated in his judicial affidavit[117]:

> "A36. The reason why the management contracts were not notarized is because according to the legal department of MGCI which provides legal assistance to the company, the contract is valid and/or binding even if it is not notarized as long as the two parties agree on the written terms and conditions."

The Court finds respondent's contention bereft of merit.

Notarization of a private document converts the document into a public one, renders it admissible in court without further proof of its authenticity, and is entitled to full faith and credit upon its face. However, the irregular notarization or, for that matter, the lack of notarization does not necessarily affect the validity of the contract reflected in the document.[118] The non-notarization of the document does not detract from the validity of the agreement, especially where the genuineness and due authenticity of the signatures in the contract were not assailed.[119] Moreover, related parties are not prohibited from entering into contracts between or among themselves. Thus, the contracts may be properly considered by the Court.

A perusal of petitioner's management contracts with Bicolandia Drug Corporation, Cagayan Valley Drug Corporation, Central Luzon Drug Corporation, Northern Luzon Drug Corporation, and Southern Luzon Drug Corporation shows that each was signed by petitioner's president and the presidents of the corresponding corporations.[120]

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[116] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 389.
[117] Exhibit "P-2", Judicial Affidavit of Cyre M. Clores, docket, vol. I, p. 248.
[118] *Bangayan vs. Rizal Commercial Banking Corporation*, G.R. No. 149193, April 4, 2011.
[119] *Ibid;* see *Mark Roche International, Inc. vs. Apacible*, CTA Case No. 4695, June 14, 1995.
[120] Exhibits "P-2-2-A" to "P-2-2-B", "P-2-3-A" to "P-2-3-B", "P-2-4-A" to "P-2-4-B", "P-2-5-A" to "P-2-5-B", and "P-2-6-A" to "P-2-6-B", docket, vol. I, pp.275, 278, 280, 283, and 285.

In the case of *Chamber of Real Estate and Builders Associations, Inc. vs. The Hon. Executive Secretary Alberto Romulo, The Hon. Acting Secretary of Finance Juanita D. Amatong, and The Hon. Commissioner of Internal Revenue Guillermo Parayno, Jr.*[121], the Supreme Court *En Banc* made the following discussion:

> "Section 57(A) expressly states that final tax can be imposed on certain kinds of income and enumerates these as passive income. **The BIR defines passive income by stating what it is not:**
>
> **...if the income is generated in the active pursuit and performance of the corporation's primary purposes, the same is not passive income...**[122]
>
> It is income generated by the taxpayer's assets. These assets can be in the form of real properties that return rental income, shares of stock in a corporation that earn dividends or interest income received from savings." *(Emphasis supplied)*

Considering the foregoing, it is clear that the management fees received by petitioner from related parties do not constitute royalties subject to final withholding tax. Hence, the Court cancels the addition of the final tax on royalties in the amount of ₱48,022,760.00 to the basic tax due per respondent's investigation.

E. Disallowed Excess Tax Credits Carried Over – ₱77,911,056.75

In computing of the deficiency income tax due, respondent excluded from the total creditable tax per return the amount of excess tax credits carried over to the succeeding period in the amount of ₱77,911,056.75 since the said amount has been credited against estimated quarterly income tax liabilities for the taxable quarters of the succeeding years pursuant to Section 76 of the Tax Code.

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[121] G.R. No. 160756, March 9, 2010.
[122] BIR Ruling No. DA-501-2004, September 24, 2004.

On the other hand, petitioner contends that respondent has no right to disallow the excess tax credits. In *East Asia Power Resources Corporation vs. Commissioner of Internal Revenue*[123], this Court unequivocally said that a disallowance of excess tax credits carried over to the succeeding year is improper because it would already involve a period beyond the coverage of the assessment:

> "Respondent did not explain why petitioner's excess tax credits for the year 2006 amounting to ₱26,105,588.00 which was carried over the succeeding period was deducted from the total available tax credits. This Court could only surmise that respondent intends to regain the benefit in the form of tax credit that has been forwarded by petitioner to the succeeding taxable year given that respondent's audit of petitioner resulted in a deficiency income tax assessment for the year 2006.
>
> Respondent's disallowance of ₱26,105,588.00 excess tax credits carried over to the succeeding year is improper because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2007. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year."[124]

In another case, the Court ruled:[125]

> "The Court finds the disallowance improper because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2007. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year."

Applying the foregoing Court decisions to the case at hand, the Court finds that in computing for deficiency income tax, the excess creditable withholding tax carried over to the succeeding taxable

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[123] CTA Case No. 8182, January 15, 2014.
[124] Par. 37, Petition for Review, docket, vol. I, pp. 20-21.
[125] *Victoria Manufacturing Corporation vs. Commissioner of Internal Revenue*, CTA Case No. 8187 (Special First Division), June 28, 2013.

period should not be deducted from the total allowable tax credits/payments.

After taking into consideration the foregoing items, petitioner has no deficiency income tax for taxable year 2011, as shown below:

Taxable income/(loss) per ITR		₱ 7,365,856.98
Add: Adjustments/disallowances per investigation		
Disallowed expenses due to non-withholding	₱ 20,289,735.13	
Disallowed salaries and wages not subjected to withholding	2,094,821.73	22,384,556.86
Taxable Income per Investigation		₱ 29,750,413.84
Basic Income Tax Due at Regular Rate (30%)		₱ 8,925,124.15
Less: Allowable tax credits/payments:		
Prior year's excess credits other than MCIT	₱ 44,103,743.84	
Creditable tax withheld per return	36,017,070.00	80,120,813.84
Total Basic Deficiency Income Tax Due		**₱(71,195,689.69)**

DEFICIENCY VALUE-ADDED TAX

Petitioner was assessed by respondent for deficiency VAT for taxable year 2011 amounting ₱1,140,964.94, inclusive of penalties, detailed as follows:[126]

Taxable Receipts per VAT Returns		₱240,113,800.00
Add: Adjustments		
Undeclared Vatable Receipts (Schedule 4)	₱ 5,000,000.00	
Miscellaneous Income Not Subjected to VAT	23,256.00	5,023,256.00
Taxable Receipts per Investigation		₱245,137,056.00
Output Tax thereon (12%)		₱ 29,416,446.72
Less: Credits/Payments		
Input VAT Capital Assets Deferred from Previous Periods	₱ 58,352.76	
Input Taxes per Returns	3,043,947.30	
VAT Payments	25,892,199.35	
Subtotal	₱28,994,499.41	
Less:		
Disallowed Input - Coalesce Masterfile Matching (Schedule 5)	₱ 36,909.41	
Deferred Input VAT - Capital Assets	180,843.41	
Subtotal	₱ 217,752.82	28,776,746.59
Total Basic Deficiency Value-Added Tax Due		₱ 639,700.13
Add: Interest (01.26.12 to 10.30.15)	₱ 481,264.81	
Compromise Penalties	20,000.00	501,264.81
TOTAL AMOUNT DUE		**₱1,140,964.94**

[126] Exhibit "P-1-15", docket, vol. I, pp. 384-385.

Undeclared VATable Receipts – ₱5,000,000.00

Verification disclosed that petitioner has income from related parties amounting to ₱240,113,800.00 and receipts (*i.e.* decrease in trade receivables) amounting to ₱5,000,000.00. The same were compared to the VATable receipts booked per VAT returns and the resulting discrepancy was subjected to deficiency VAT pursuant to Section 108 of the NIRC of 1997:[127]

Sales per FS		₱240,113,800.00
Add: Decrease in Trade Receivables - Related Parties (Note 7 of AFS)		
Related Party Receivables, Beginning	₱5,003,000.00	
Related Party Receivables, Ending	3,000.00	5,000,000.00
Vatable Receipts (Sales to Related Party) per Audit		₱245,113,800.00
Vatable Receipts per VAT Returns		240,113,800.00
Undeclared Vatable Receipts		**₱ 5,000,000.00**

Petitioner alleges that the decrease in receivables does not represent a taxable sale or receipt from the sale of goods or services but a repayment of an advance made by petitioner to a related party. The repayment of the advance was received by petitioner on March 22, 2011. Since the repayment does not involve a sale, barter or exchange in the ordinary course of business, the same is not subject to VAT.[128]

The ICPA finds that:

> "Based on the examination of transactions involving the decrease on 'Receivables – Related Party' account, the movement was attributable to a repayment of an advance given by TFMC to Mercury Group of Companies, Inc. (MGCI). The Company deposited the advances of ₱5,000,000.00 to MGCI's account on 20 December 2010 as supported by a deposit slip[129] and a check voucher[130] dated 17 December 2010. The amount was repaid by

[127] Annex A-1, Exhibit "P-1-15", docket, vol. I, pp. 389-390.
[128] Par. 48, Petition for Review, docket, vol. I, p. 23.
[129] Exhibit "P-26-B-ICPA".
[130] Exhibit "P-26-A-ICPA".

MGCI on 22 March 2011 as supported by an official receipt[131] and deposit slip.[132]"

Further, petitioner's notes to the financial statements disclose:[133]

"All receivables from related party are advances receivable which are on a 30 days' term.

Other receivables comprise of cash advances used in operations which are subject to proper liquidations and advances to employees and officers which are normally collected within one year,

All company's receivables are non-interest bearing."

However, the fact that petitioner issued a VAT official receipt provides evidence that it had transacted a sale or exchange of service pursuant to Section 113(A)(2) of the NIRC of 1997, which provides:

"SEC. 113. *Invoicing and Accounting Requirements for VAT-Registered Persons.* -

(A) Invoicing Requirements. - A VAT-registered person shall issue:

xxx xxx xxx

(2) A VAT official receipt for every lease of goods or properties, and for every sale, barter or exchange of services."

Thus, the deficiency VAT assessment on the decrease in receivables from related parties should be maintained.

Miscellaneous Income Not Subjected to VAT – ₱23,256.00

[131] Exhibit "P-27-A-ICPA".
[132] Exhibit "P-27-B-ICPA".
[133] Note 7, Notes to Financial Statements, Exhibit "P-1-17", docket, vol. I, p. 428.

Verification by respondent disclosed that petitioner has recorded miscellaneous income amounting to ₱23,256.00 as disclosed under Note 19 of the AFS. The same is subject to VAT pursuant to Sections 106 and 108 of the NIRC of 1997.[134]

Petitioner alleges that this item of miscellaneous income does not pertain to income involving a sale, barter or exchange of goods and services in the ordinary course of business. It represents the accumulated net balance of the cashier's cash overages. There is no buyer or seller and no goods or services are involved. Hence, the income is not subject to VAT.

The ICPA verification of the nature of the miscellaneous income through inquiry revealed that this is mainly composed of the proceeds from the sales of scrap office supplies.[135] As summarized by the ICPA, the amount of ₱23,256.00 is accounted as follows:[136]

Exhibit	OR No.	Date	Amount
"P-28-A-ICPA"	462	01-Feb-11	₱ 100.00
"P-28-B-ICPA"	477	04-Mar-11	1,310.00
"P-28-C-ICPA"	497	26-Apr-11	500.00
"P-28-D-ICPA"	491	08-Apr-11	13,500.00
"P-28-E-ICPA"	564	11-Oct-11	7,725.00
Without supporting document			121.00
Total			**₱ 23,256.00**

Pertinent to the matter at hand is Section 105 of the NIRC of 1997, as amended, which provides:

> "SEC. 105. *Persons Liable.* - Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.

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[134] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 390.
[135] Exhibit "P-5", p. 27.
[136] Annex K-ICPA, Exhibit "P-5".

> The value added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act 7716.
>
> **The phrase *'in the course of trade or business'* means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a non-stock, non-profit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.**
>
> The rule of regularity, to the contrary, notwithstanding, services as defined in this Code rendered in the Philippines by non-resident foreign persons shall be considered as being rendered in the course of trade or business." *(Emphasis supplied)*

From the foregoing, it is clear that the phrase "regular course of trade or business", for all intents and purposes, is not confined to the primary business that a taxpayer is engaged in but is an all-encompassing phrase pertaining to the pursuit of business opportunities that produce profits for petitioner (economic activity), including those which are merely incidental to petitioner's trade and industry.[137]

Consequently, petitioner's miscellaneous income from the sale of scrap office supplies is subject to VAT pursuant to Section 105 of the NIRC of 1997. The VAT assessment thereon should be upheld.

Disallowed Input Tax – Coalesce Masterfile Matching – ₱36,909.41

Comparison of coalesce masterfile of Summary List of Sales (SLS) of all large taxpayers as against petitioner's Summary List of

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[137] *AGM Packaging System Ltd. Corp. vs. Commissioner of Internal Revenue*, CTA Case No. 8947, June 9, 2017.

Purchases (SLP) disclosed that petitioner has claimed excessive input taxes. Mercury Drug Corporation on its submitted SLS disclosed that it transacted only ₱339,789.24 to petitioner, however, the latter claimed ₱647,367.68 as purchases. The resulting input tax deficiency of ₱36,909.41 was therefore disallowed pursuant to Section 110 of the NIRC of 1997, to wit:[138]

	Amount of Purchase	Input VAT
Mercury Drug Corporation (per SLP)	₱ 647,367.68	₱ 77,684.12
Mercury Drug Corporation (per Masterfile SLS)	339,789.24	40,774.71
Disallowed Input - Coalesce Masterfile Matching	**₱307,578.44**	**₱ 36,909.41**

Petitioner alleges that that it did not over-claim input tax. It consistently claims input tax credits based only on purchases which are properly substantiated. The discrepancy between the SLS of the seller and SLP of petitioner could have arisen from timing differences, that is, the seller reported the sale upon accrual of the sale or preparation of the sales invoice in a prior period while petitioner recognized the input tax on the purchase only when the appropriate VAT invoice or receipt was received from the seller.[139]

In the ICPA report, the ICPA performed a reconciliation of the SLP and SLS but opted to limit its verification on the difference of ₱307,578.44. The ICPA found that out of the ₱307,578.44, the amount of ₱123,614.67 was properly supported by official receipts and invoices, to wit:[140]

Particulars	Purchases	Input VAT	Reference
Services	₱ 52,042.07	₱ 6,245.05	Annex L.1-ICPA
Goods	71,572.60	8,588.71	Annex L.2-ICPA
Total	**₱ 123,614.67**	**₱ 14,833.76**	

The Court is not convinced.

Upon examination of the said purchases of goods and services, as enumerated in the ICPA report, it cannot be verified whether the

[138] Annex A-1, Exhibit "P-5", docket, vol. I, p. 390.
[139] Par. 53, Petition for Review, docket, vol. I, p. 24.
[140] Exhibit "P-5", p. 28.

same actually pertain to the difference assessed by respondent because there exists a possibility that they refer to the purchases per Masterfile SLS as part of the ₱339,789.24. Thus, for lack of merit, the disallowed input VAT of ₱36,909.41 should be sustained.

In sum, respondent's computed basic deficiency VAT in the amount of ₱639,700.13 should be upheld.

DEFICIENCY EXPANDED WITHHOLDING TAX

Petitioner was assessed for deficiency EWT for taxable year 2011 amounting to ₱1,119,928.04, inclusive of increments, as follows:[141]

Deficiency expanded withholding tax (Schedule 6)		₱ 463,137.18
Deficiency withholding tax on matching SLP and MAP (Schedule 7)		31,114.77
Total Basic Deficiency Expanded Withholding Tax Due		₱ 494,251.95
Add: Interest (01.16.12 to 10.30.15)	₱ 374,548.19	
Increments on late remittance of expanded withholding tax (Schedule 8)	231,127.90	
Compromise Penalty	20,000.00	625,676.09
TOTAL AMOUNT DUE		**₱1,119,928.04**

Deficiency Expanded Withholding Tax on Disallowed Deductions – ₱463,137.18

Schedule 6 elaborates on how the deficiency EWT on disallowed deductions was computed:[142]

	Discrepancy	Rate	EWT Still Due
Purchase of services	₱ 19,848,639.13	2%	₱ 396,972.78
Professional fees	441,096.00	15%	66,164.40
Deficiency expanded withholding tax	**₱20,289,735.13**		**₱463,137.18**

Clearly, the same is the reflection of the disallowed deductions for income tax purposes for petitioner's failure to withhold the

[141] Exhibit "P-1-15", docket, vol. I, p. 385.
[142] Annex A-1, Exhibit "P-5", docket, vol. I, p. 390.

applicable withholding tax, in violation of Section 34(K) of the Tax Code.

As previously discussed, the Court finds that petitioner failed to prove that the total disallowed expenses amounting to ₱20,289,735.13 were properly subjected to the applicable withholding tax.

However, as found by the ICPA, ₱16,163,050.50 of the ₱25,001,310.00 disallowed transportation and travelling expense pertains to transportation allowance and employee bonus in the amounts of ₱14,651,550.50 and ₱1,511,500.00, respectively. As these payments were made to petitioner's employees, they are not subject to EWT.

Thus, petitioner is liable for basic deficiency EWT amounting to ₱139,876.17, computed as follows:

	Per FS	**Per Alphalist**	**Discrepancy**
Purchase of Services			
Transportation and travelling	₱ 25,001,310.00		
Less: Transportation allowance	(14,651,550.50)		
Employee bonus	(1,511,500.00)		
	₱ 8,838,259.50		
Insurance	1,961,229.00		
Miscellaneous	1,014,720.00		
Representation and entertainment	904,772.00		
Communication	751,533.00		
Less: Petty cash payments/liquidations	(79,591.80)		
Subtotal	₱ 13,390,921.70	₱ 9,705,333.07	₱ 3,685,588.63
Professional Fees			
Outside services	₱ 12,192,686.00		
Professional Talent Fee (subject to 10%)	-	₱ 2,300.00	
Professional Talent Fee (subject to 15%)	-	11,749,290.00	
Subtotal	₱ 12,192,686.00	₱ 11,751,590.00	441,096.00
Expenses not subjected to withholding tax			**₱4,126,684.63**

	Discrepancy	**Rate**	**EWT Due**
Purchase of services	₱ 3,685,588.63	2%	₱ 73,711.77
Outside services	441,096.00	15%	66,164.40
TOTAL	**₱ 4,126,684.63**		**₱ 139,876.17**

Deficiency withholding tax on matching SLP and MAP – ₱31,114.77

First, it is noted that the deficiency withholding tax on matching petitioner's SLP against its Monthly Alphalist of Payees (MAP) amount to ₱31,114.77 per FDDA.[143] However, the attached Details of Discrepancies show the amount ₱29,156.95, computed as follows:[144]

Registered Name	MAP	SLP	Discrepancy	Rate	EWT Due
Queen J Catering and Food Service	₱ -	₱ 212,484.83	₱ 212,484.83	2%	₱ 4,249.70
Star Plaza Hotel Inc	-	79,602.76	79,602.76	2%	1,592.06
Vicente E. Reyes and Associates	-	72,794.00	72,794.00	15%	10,919.10
Century Resort Hotel Corporation	-	68,852.01	68,852.01	2%	1,377.04
Central Luzon Drug Corporation	120,982.00	182,155.25	61,173.25	2%	1,223.47
Sun Garden Hotel	-	58,557.01	58,557.01	2%	1,171.14
Legaspi Tourist Inn	-	56,102.76	56,102.76	2%	1,122.06
Hotel Graceland	-	53,995.01	53,995.01	2%	1,079.90
Nagaland Hotel	-	42,888.66	42,888.66	2%	857.77
Mikka Resources Inc	-	40,894.92	40,894.92	2%	817.90
Village Inn Cabanatuan	-	31,693.84	31,693.84	2%	633.88
New Carig Plaza Hotel and Restaurant	-	27,847.92	27,847.92	2%	556.96
A and P Suites and Inn	-	25,809.83	25,809.83	2%	516.20
Queen Jennifer Hotel Inc.	-	22,397.42	22,397.42	2%	447.95
Subic Mirage Beach Hotel and Restaurant	-	19,911.75	19,911.75	2%	398.24
JISB 14K Corporation	-	17,161.58	17,161.58	2%	343.23
Hotel Mayi	-	15,227.83	15,227.83	2%	304.56
Moraville Hotel and Restaurant	-	14,798.99	14,798.99	2%	295.98
Crown Royale Hotel and Resort Corp	-	12,879.50	12,879.50	2%	257.59
Hotel Vico and Coffee Shop	-	11,575.91	11,575.91	2%	231.52
Total Management and PC Technologies	32,545.00	42,522.25	9,977.25	2%	199.55
MMP Awards Specialist	17,285.00	26,890.00	9,605.00	2%	192.10
Toyota Dagupan City Inc.	1,416,071.00	1,424,018.42	7,947.42	2%	158.95
Philamcare and Health Systems Inc.	1,992,344.50	2,000,107.00	7,762.50	2%	155.25
Southern Luzon Drug Corporation	56,592.00	59,336.42	2,744.42	2%	54.89
Deficiency withholding on matching of MAP and SLP					**₱29,156.95**

The difference of ₱1,957.82 (₱31,114.77 less ₱29,156.95) should be cancelled for lack of basis. *jc*

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[143] Exhibit "P-1-15", docket, vol. I, p. 385.
[144] Annex A-1, Exhibit "P-1-15", docket, vol. I, pp. 390-391.

Anent the foregoing list, respondent pointed out that while petitioner has already explained each item, petitioner failed to provide the supporting documents.[145]

On the other hand, the ICPA found that one of the suppliers, Vicente E. Reyes and Associates, was identified as a GPP based on its Articles of Partnership,[146] hence payments to the same of ₱72,794.00 should be exempt from withholding tax.[147]

However, as to the rest of the income payees on the list, the ICPA reported that due to incomplete schedule of the amounts per SLP, his review was limited to the available documents and schedules.[148] Thus, the remaining assessment of deficiency EWT on discrepancy between MAP and SLP amounting to ₱18,237.85 (₱31,114.77 less ₱1,957.82 less ₱10,919.10) should be sustained.

Increments on late remittance of expanded withholding tax –₱231,127.90

For this item of assessment, respondent compared the income payments subjected to EWT per MAP of Federal Phoenix Assurance Company and Philamlife Insurance Company, Inc. against the purchases in the SLP from the same payees. The discrepancy was then subjected to interest for late remittance of EWT. The increment was computed as follows:[149]

	MAP	SLP	Discrepancy
Federal Phoenix Assurance Company	₱ 1,040,695.00	₱ 58,267.00	₱ 982,428.00
Philam Insurance Co Inc.	173,211.50	-	173,211.50
Total discrepancy			₱1,155,639.50
Interest rate			20%
Increments on late remittance of EWT			**₱231,127.90**

At a glance, the foregoing comparison is of no bearing when determining whether or not the remittance of a particular type of tax

[145] *Id.*
[146] Exhibit "P-44-ICPA".
[147] Exhibit "P-5", p. 30.
[148] *Id.*
[149] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 391.

is late. One simply has to examine the tax returns - in this case, BIR Forms No. 1601-E Monthly Remittance Return of Creditable Income Taxes Withheld (Expanded)[150] - and determine the date of filing thereof.

Clearly, respondent's computation of the increment for late remittance of EWT has no factual basis and should be cancelled.

To summarize, the Court finds petitioner liable for basic deficiency EWT in the modified amount of ₱158,114.02 computed as follows:

Deficiency expanded withholding tax	₱ 139,876.17
Deficiency withholding tax on matching SLP and MAP	18,237.85
Total Basic Deficiency Expanded Withholding Tax	**₱ 158,114.02**

DEFICIENCY WITHHOLDING TAX ON COMPENSATION

Petitioner was assessed by respondent for deficiency WTC for taxable year 2011 amounting to ₱2,876,935.67, inclusive of increments, as follows:[151]

Deficiency withholding tax on compensation (Schedule 9)		₱ 1,589,594.43
Discrepancy on tax withheld per alphalist as against actual remittance (Schedule 10)		10,634.16
Under remittance of withholding tax on compensation (Schedule 11)		22,209.88
Total Basic Deficiency Withholding Tax on Compensation Due		₱ 1,622,438.47
Add: Interest (01.16.12 to 10.30.15)	₱ 1,229,497.20	
Compromise Penalty	25,000.00	1,254,497.20
TOTAL AMOUNT DUE		**₱2,876,935.67**

Deficiency WTC on Disallowed Salaries – ₱1,589,598.43

Schedule 9 shows how the deficiency WTC in disallowed salaries is computed, thus:[152] Jz

[150] Exhibits "P-6-A-ICPA" to "P-6-AN-ICPA".
[151] Exhibit "P-1-15", docket, vol. I, p. 385.
[152] Annex A-1, Exhibit "P-1-15", docket, vol. I, pp. 391-392.

Disallowed salaries and wages not subjected to withholding	₱ 4,967,482.58
Withholding tax rate (max)	32%
Deficiency withholding tax on compensation	**₱ 1,589,598.43**

It could be gleaned from Schedule 9 that respondent lifted the amount of disallowed salaries and wages per deficiency Income Tax assessment and subjected the same to the highest rate for WTC of 32%.

Considering that we have already resolved the issues as far as the disallowed salaries and wages are concerned, we find that petitioner is liable for basic deficiency WTC amounting to ₱670,342.95, arising from sustained disallowances of ₱2,094,821.73, computed as follows:

Particulars	**Upheld Disallowances**
Service awards	₱ 1,867,048.00
Medical and hospitalization	100,738.81
Employees welfare	127,034.92
Disallowance due to non-withholding on salaries and wages	₱ 2,094,821.73
Rate	32%
Basic Deficiency WTC	**₱ 670,342.95**

Discrepancy on tax withheld per alphalist as against actual remittance – ₱10,634.16

With regard to this finding, petitioner claims that the amount of tax withheld per alphalist used by respondent in the computation is wrong. Using the correct amount, the discrepancy should only be ₱8,102.36, which was computed by the ICPA as follows:[153]

Particulars	**Per BIR**	**Per ICPA**	**Difference**	**Exh. Ref.**
Tax withheld per Alphalist				
Schedule 7.1	₱ 1,596,755.35	₱ 1,596,755.35	₱ -	Exhibits "P-11-O" to "P-11-Q-ICPA"
Schedule 7.3	22,659,069.12	22,640,332.60	18,736.52	BIR Records, pp. 135-143
Schedule 7.4	736,405.72	736,405.72	-	
	₱24,992,230.19	₱24,973,493.67	₱ 18,736.52	
Remittances per BIR Form 1601C				

Jc

[153] Exhibit "P-5", p. 33.

January	₱ 2,631,625.30	₱ 2,631,625.30	₱ -	
February	2,902,656.64	2,902,656.64	-	
March	1,733,695.36	1,733,695.36	-	
April	2,104,648.38	2,104,648.38	-	
May	2,942,608.25	2,942,608.25	-	
June	1,849,828.90	1,849,828.90	-	Exhibit "P-10-A" to "P-10-AS-ICPA"
July	1,712,840.78	1,712,840.78	-	
August	2,055,814.91	2,055,814.91	-	
September	1,776,650.25	1,776,650.25	-	
October	1,612,963.69	1,612,963.69	-	
November	1,536,782.76	1,536,782.76	-	
December	2,121,480.81	2,121,480.81	-	
	₱24,981,596.03	₱24,981,596.03	₱ -	
Discrepancy on tax withheld per alphalist as against actual remittance	**₱ 10,634.16**	**₱ (8,102.36)**	**₱18,736.52**	

The ICPA observed that respondent mistakenly used the amount of ₱22,659,069.12 instead of ₱22,640,332.60 per alphalist of employees without previous employer. Further, the total remittance for the month of January 2011 of ₱2,631,625.30 includes payment for penalties in the total amount of ₱8,154.59, detailed as follows:[154]

Surcharge (Line 24A)	₱ 3,804.38
Interest (Line 24B)	350.21
Compromise (Line 24C)	4,000.00
TOTAL (Line 24D)	**₱ 8,154.59**

Thus, if we recompute respondent's findings, it will result in a discrepancy of only ₱52.23, to wit:

Tax withheld per Alphalist		₱ 24,973,493.67
Remittances per BIR Form 1601C	₱24,981,596.03	
Less: Penalties	8,154.59	24,973,441.44
Discrepancy on tax withheld per alphalist as against actual remittance		**₱ 52.23**

Under remittance of WTC - ₱22,209.88

[154] Line 24, Exhibit "P-10-C-ICPA", Folder 1, Box 1.

Respondent computed the under remittance of withholding on compensation amounting to ₱22,209.88 in the following manner:[155]

Employee	Taxable Income	Tax Due per BIR Audit	Tax Withheld per Alphalist	Discrepancy
Arevalo, Jonalyn	₱ 147,050.64	₱ 24,262.66	₱ 23,910.13	₱ 352.53
Gamilla, Carolandre	59,049.00	6,857.35	-	6,857.35
Pua, Lydia	371,695.76	86,508.73	71,508.73	15,000.00
Total				**₱22,209.88**

The ICPA's re-computation of the tax withheld disclosed that:[156]

- petitioner over-withheld taxes from Jonalyn Arevalo;
- no withholding tax was due from Carolandre Gamilla because he had no taxable compensation income in 2011 after removing the personal and additional exemptions; and
- the tax withheld from Lydia Pua was correct.

The Court finds the ICPA report in order. Hence, the Court cancels the deficiency WTC assessment on the supposed under-remittance of withholding tax on compensation in the amount of ₱22,209.88.

In summary, the Court finds petitioner liable for basic deficiency WTC in the modified amount of ₱670,395.18, computed as follows:

Deficiency withholding tax on compensation	₱ 670,342.95
Deficiency on tax withheld per alphalist as against actual remittance	52.23
Total Basic Deficiency Withholding Tax on Compensation Due	**₱ 670,395.18**

DEFICIENCY FINAL TAX ON ROYALTIES

Respondent's verification disclosed that petitioner have allegedly incurred royalties amounting to ₱11,740,800.00 which were paid to its parent company, specifically to MGCI. The same is subject to withholding of final tax pursuant to Section 2.57.1(G)(2) of RR No. *fe*

[155] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 392.
[156] Exhibit "P-5", pp. 35-36.

2-98, as amended.[157] Thus, the assessment of the basic deficiency final tax of ₱2,348,160.00.

Petitioner argued that the service contract is for management service on financial, administrative and personnel matters and that all fees were subjected to EWT. Cyre M. Clores, petitioner's Finance and Administration Manager, stated:[158]

> "Q60: Why do you say that the management fees paid by petitioner to Mercury Group of Companies, Inc. are not royalties?
>
> A60: The management fees paid by the company to Mercury Group of Companies, Inc. are not royalties because MGCI rendered management services.
>
> Q61: Please describe the management services rendered by Mercury Group of Companies, Inc. to petitioner in 2011.
>
> A61: Mercury Group of Companies, Inc. is engaged in management services by providing guidance on administrative, finance, marketing, legal and personnel assistance.
>
> Q62: What are specific examples of administrative assistance rendered by Mercury Group of Companies, Inc. to petitioner in 2011?
>
> A62: Mercury Group of Companies, Inc. conducts management seminars for the company's employees and assists in conducting on-site investigation for erring employees.
>
> Q63: What are specific examples of finance assistance rendered by Mercury Group of Companies, Inc. to petitioner in 2011?
>
> A63: Mercury Group of Companies, Inc. provides quarterly business reviews of its performance on

[157] Annex A-1, Exhibit "P-1-15", docket, vol. I, pp. 392-393.
[158] Exhibit "P-2", docket, vol. I, p. 253.

sales, expenses and income, it also provides annual internal audit services.

Q64: What are specific examples of marketing assistance rendered by Mercury Group of Companies, Inc. to petitioner in 2011?

A64: Mercury Group of Companies, Inc. conducts research on viability of locations and provide demographics of the area as basis for putting up additional stores in the locality.

Q65: What are specific examples of legal assistance rendered by Mercury Group of Companies, Inc. to petitioner in 2011?

A65: Mercury Group of Companies, Inc. assists in legal matters like review of contract of lease, bank documents and assists in reviewing findings of investigation for erring employees, notarization of documents."

However, respondent is not convinced that the payments made to MGCI do not pertain to passive income.[159]

Per its Amended Articles of Incorporation, MGCI's primary purpose is:[160]

> "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 every kind and description, including shares of stock, bonds, debentures, notes, evidences of indebtedness and other securities and obligations of any corporation or corporations, association or associations, domestic or foreign, for whatever lawful purpose or purposes the same may have been organized and to therefor money or by exchanging therefor stocks, bonds or other evidence of indebtedness or other securities of

[159] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 393.
[160] Exhibits "P-42-A" to "P-42-L-ICPA".

this or any other corporation while the owner or holder of any such real or personal property, stocks, bonds, debentures, contracts or obligations, to receive, collect and dispose of the interest, dividends and income arising from such property and to possess and exercise in respect thereof all the rights, powers and privileges of ownership and to carry on **and manage any business, industry or enterprise.**" *(Emphasis supplied)*

Examination of petitioner's management services agreement with MGCI [161] shows the following salient features of the agreement:[162]

- The agreement states that MGCI shall extend to petitioner TFMC administrative, finance, marketing, legal and personal assistance through their managers who will give guidance in any area of their operation; and

- TFMC shall pay MGCI a fixed amount of ₱978,400.00 per month for the above-mentioned services.

From the foregoing, it is clear that MGCI provides the services of its managers, in a consultation basis, to guide petitioner in its operations. In return, petitioner pays MGCI a fixed monthly management fee. Hence, contrary to respondent's contention, MGCI's fees from this engagement is not passive income but constitute an income earned in the active pursuit of its business.

Further, petitioner submitted official receipts and debit memos issued by MGCI for the management fees received from petitioner,[163] BIR Form No. 2307 Certificates of Creditable Tax Withheld at Source issued to MGCI,[164] which was reflected in the Alphalist of Payees Subject to Expanded Withholding Tax, showing the total amount of ₱11,740,800.00 from which 15% EWT amounting to ₱1,761,120.00 was withheld.[165]

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[161] Exhibit "P-1-19", docket, vol. I, p. 286.
[162] Exhibit "P-5", p. 37.
[163] Exhibits "P-30-A.1-ICPA" to "P-30-L.2-ICPA", Summarized by the ICPA in Annex O-ICPA, Exhibit "P-5".
[164] Exhibits "P-24-A-ICPA" to "P-24-T-ICPA", Folder 4, Box 1.
[165] Exhibits "P-7-A" to "P-7-B-ICPA".

Considering the foregoing, the Court cancels the assessment for Deficiency Final Tax on Royalties in the amount of ₱2,348,160.00.

FRINGE BENEFITS TAX

Petitioner was assessed by respondent for deficiency FBT for taxable year 2011 amounting ₱23,704,744.68, inclusive of penalties, detailed as follows:[166]

Total Basic Deficiency Fringe Benefits Tax Due (Schedule 13)		₱ 11,765,322.35
Add: Interest (01.11.12 to 10.30.15)	₱ 8,948,091.74	
Surcharge (25%)	2,941,330.59	
Compromise Penalty	50,000.00	11,939,422.33
TOTAL AMOUNT DUE		**₱ 23,704,744.68**

The total basic deficiency FBT due of ₱11,765,322.35 was computed as follows:[167]

Transportation and Travelling	₱ 25,001,310.00
Divided by:	68%
Gross-up Monetary Value	36,766,632.35
Multiplied by:	32%
Fringe Benefits Tax on Transportation and Travelling	**₱11,765,322.35**

As previously discussed, petitioner's transportation and travelling expense account amounting to ₱25,001,310.00 is composed of (i) business expenses relating to transportation and travelling, (ii) transportation allowances given to petitioner's employees, and (iii) employee bonus, to wit:[168]

Particulars	**Amount**	**Reference Annex**
I. Business Expense		
A. Subjected to Withholding		
5%	₱ 606,625.31	Annex B-ICPA
2%	3,442,449.22	
B. Payments from Petty Cash Fund	3,039,082.40	Annex B-ICPA
C. Payments Traced to Cash Disbursement Book	1,053,277.72	Annex B-ICPA

[166] Exhibit "P-1-15", docket, vol. I, p. 385.
[167] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 393.
[168] Exhibit "P-5", pp. 39-41.

D. Payments Without Supporting Document	696,824.85	Annex B-ICPA
II. Transportation Allowance		
A. Managerial Employees	10,073,641.00	Annex B-ICPA
B. Rank and File Employees	4,577,909.50	Annex B-ICPA
III. Employee Bonus	1,511,500.00	Annex B-ICPA
TOTAL	**₱25,001,310.00**	

Thus, it is clear that petitioner's transportation and travelling expenses do not fall within the definition of fringe benefit under Section 33(B) of the NIRC of 1997, as amended. The said provision is quoted hereafter for easy reference:

"SEC. 33. *Special Treatment of Fringe Benefit.* –

xxx xxx xxx

(B) *Fringe Benefit Defined.* – For purposes of this Section, the term 'fringe benefit ' means any good, service or other benefit furnished or granted in cash or in kind by an employer to an individual employee (except rank and file employees as defined herein) such as, but not limited to, the following:

(1) Housing;
(2) Expense account;
(3) Vehicle of any kind;
(4) Household personnel, such as maid, driver and others;
(5) Interest on loan at less than market rate to the extent of the difference between the market rate and actual rate granted;
(6) Membership fees, dues and other expenses borne by the employer for the employee in social and athletic clubs or other similar organizations;
(7) Expenses for foreign travel;
(8) Holiday and vacation expenses;
(9) Educational assistance to the employee or his dependents; and
(10) Life or health insurance and other non-life insurance premiums or similar amounts in excess of what the law allows.

(C) *Fringe Benefits Not Taxable.* – The following fringe benefits are not taxable under this Section:

(1) Fringe benefits which are authorized and exempted from tax under special laws;

(2) Contributions of the employer for the benefit of the employee to retirement, insurance and hospitalization benefit plans;

(3) Benefits given to the rank and file employees, whether granted under a collective bargaining agreement or not; and

(4) *De minimis* benefit s as defined in the rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

The Secretary of Finance is hereby authorized to promulgate, upon recommendation of the Commissioner, such rules and regulations as are necessary to carry out efficiently and fairly the provisions of this Section, taking into account the peculiar nature and special need of the trade, business or profession of the employer."

Clearly, business expenses paid to suppliers are subject to EWT.

While there are payments made to petitioner's employees, such payments representing reimbursements of transportation expenses in the performance of their official duties, these expenses from reimbursements which were found as ordinary, necessary and substantiated by receipts and invoices are not considered compensation subject to withholding as provided in Section 2.78.1(6)(b) of RR No. 2-98.

Similarly, the transportation allowance given to petitioner's managerial and rank and file employees and employee bonus may be subject to WTC, not FBT.[169]

[169] Annex B-ICPA, Page 119 of 119, Exhibit "P-5".

Thus, respondent's assessment of deficiency FBT is bereft of factual basis and should be cancelled.

DOCUMENTARY STAMP TAX

Petitioner was assessed by respondent for deficiency DST for taxable year 2011 in the amount of ₱75,362.39, inclusive of penalties, detailed as follows:[170]

Total Basic Deficiency Benefits Tax Due (Schedule 14)		₱ 25,015.00
Add: Interest (01.06.12 to 10.30.15)	₱ 19,093.64	
Surcharge (25%)	6,253.75	
Compromise Penalty	25,000.00	50,347.39
TOTAL AMOUNT DUE		**₱75,362.39**

Verification by respondent revealed that petitioner has advances to related parties as disclosed under Note 7 of the notes to AFS. The receivables are subject to DST pursuant to Section 179 of the NIRC of 1997, to wit:[171]

Beginning Balance – Receivables Related Party	₱ 5,003,000.00
DST Rate	₱1/₱200
Deficiency DST on Related Party Receivables	**₱ 25,015.00**

The subject assessment pertains to petitioner's advances to MGCI, which was deposited to MGCI's account on December 20, 2010 as evidenced by a deposit slip[172] and a check voucher[173] dated December 17, 2010. Clearly, it was incurred prior to the taxable year 2011.

Hence, it is erroneous on the part of respondent to assess petitioner for deficiency DST on a transaction that happened in the year 2010 for such is beyond the scope of the present assessment. Consequently, respondent's deficiency DST assessment should be cancelled.

[170] Exhibit "P-1-15", docket, vol. I, p. 385.
[171] Annex A-1, Exhibit "P-1-15", docket, vol. I, p. 393.
[172] Exhibit "P-26-B-ICPA".
[173] Exhibit "P-26-A-ICPA".

COMPROMISE PENALTIES

Included in the deficiency tax assessments issued by respondent covering taxable year 2011 are the following compromise penalties in the sum of ₱215,000.00:[174]

Tax Assessment	Compromise Penalty
Deficiency Income Tax	₱ 50,000.00
Deficiency VAT	20,000.00
Deficiency EWT	20,000.00
Deficiency WTC	25,000.00
Deficiency FWT	25,000.00
Deficiency FBT	50,000.00
Deficiency DST	25,000.00
Total	**₱ 215,000.00**

It must be stressed that compromise penalty is imposed to avoid prosecution for violation of the provision of the Tax Code.[175] Pursuant to RMO No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Clearly, the compromise penalty implies a mutual agreement between the parties in respect of the thing or subject matter which is so compromised. The imposition of the compromise penalty without the conformity of the taxpayer is illegal and unauthorized.[176]

There is nothing in the records which would show that petitioner consented to the compromise penalty. Thus, the same should not be imposed and must be cancelled.

WHEREFORE, premises considered, the Petition for Review is **PARTIALLY GRANTED**. Accordingly, the assessments issued by respondent against petitioner for taxable year 2011 covering deficiency income tax, deficiency final withholding tax, deficiency fringe benefits tax, deficiency documentary stamp tax, and

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[174] Exhibit "P-1-15", docket, vol. I, pp. 384-385.

[175] *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et. al.*, G.R. Nos. L-12928 and L-12932, March 31, 1962.

[176] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.,* G.R. No. 35266, January 21, 1991.

compromise penalties are hereby **CANCELLED** and **WITHDRAWN**. On the other hand, the assessments covering deficiency value-added tax, deficiency expanded withholding tax, and deficiency withholding tax on compensation are hereby **AFFIRMED** but with modifications. Petitioner is **ORDERED TO PAY FIVE MILLION ONE HUNDRED NINETY-FIVE THOUSAND SEVENTY-ONE PESOS AND 15/100 (₱5,195,071.15)** for taxable year 2011, inclusive of the total basic deficiency taxes, twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, and twenty percent (20%) deficiency interest and 20% delinquency interest imposed under Section 249(B) and (C), respectively, computed until December 31, 2017, which is prior to its amendment under Republic Act No. 10963, otherwise known as the "Tax Reform for Acceleration and Inclusion (TRAIN) Law", computed as follows:

	VAT	EWT	WTC	Total
Basic	₱ 639,700.13	₱ 158,114.02	₱ 670,395.18	₱ 1,468,209.33
Surcharge (25%)	159,925.03	39,528.51	167,598.80	367,052.33
Subtotal	**₱ 799,625.16**	**₱ 197,642.53**	**₱ 837,993.98**	**₱1,835,261.66**
Deficiency Interest (20%)				
VAT - 1/25/12 to 12/31/17 (₱639,700.13 x 20% x 5.9370yrs)	₱ 759,579.93			
EWT - 1/15/12 to 12/31/17 (₱158,114.02 x 20% x 5.9644yrs)		₱ 188,611.05		1,747,891.99
WTC - 1/15/12 to 12/31/17 (₱670,395.18 x 20% x 5.9644yrs)			₱ 799,701.00	
Subtotal	**₱1,559,205.10**	**₱ 386,253.58**	**₱1,637,694.98**	**₱3,583,153.65**
Delinquency Interest (20%)				
VAT - 10/2/15 to 12/31/17 (₱1,559,203.34 x 20% x 2.2493yrs)	₱ 701,424.00			
EWT - 10/2/15 to 12/31/17 (₱386,253.06 x 20% x 2.2493yrs)		₱ 173,760.03		1,611,917.50
WTC - 10/2/15 to 12/31/17 (₱1,637,692.77 x 20% x 2.2493yrs)			₱ 736,733.46	
TOTAL	**₱2,260,629.10**	**₱ 560,013.61**	**₱2,374,428.44**	**₱5,195,071.15**

In addition, petitioner is hereby **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 unpaid amount in the sum of ₱3,583,153.65 (sum of basic tax, surcharge and deficiency interest computed above) from January 1, 2018 until full payment thereof pursuant to the relevant provision of the TRAIN law.

SO ORDERED.

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

WE CONCUR:

CAESAR A. CASANOVA
Associate Justice

(On Official Business)
CATHERINE T. MANAHAN
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.

ROMAN G. DEL ROSARIO
Presiding Justice