REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY
FIRST DIVISION

WRIGLEY PHILIPPINES, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6197

MEMBERS:

ACOSTA, E., Chairman
BAUTISTA, and
CASANOVA, JJ.

Promulgated:
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DECISION

ACOSTA, PJ.:

The instant case involves deficiency income tax and deficiency withholding tax on compensation assessments issued against petitioner Wrigley Philippines, Inc. in the aggregate amount of P5,529,362.04 covering taxable year 1994.

The facts of the case as culled from the records are as follows:

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines, with office address at Marcos Highway, Sitio Puting Bato, Brgy. Inarawan, Antipolo City (*Paragraph 1, Joint Stipulation of Facts and Issues*).

On January 14, 2000, respondent issued two (2) Formal Assessment Notices and Formal Letter of Demand covering alleged deficiency income and withholding taxes on compensation against petitioner for the taxable year 1994. Petitioner received the same on January 21, 2000 *(Exhibits "A", "B" and "C"; Paragraph 5, Joint Stipulation of Facts and Issues).*

The investigation of the petitioner's internal tax liabilities for the year 1994 supposedly revealed a tax obligation of P5,529,362.04 as deficiency income and withholding tax.

The deficiency income tax assessed pursuant to the provisions of Section 29 of the NIRC was based on the finding that there is an overstatement of cost of sales (*Paragraph 10, Joint Stipulation of Facts and Issues*).

The revenue examiner claims that the resulting income tax deficiency pertains to the importation of Kopiko coffee candy (Inv. No. 3472) on December 29, 1994 which was booked as an adjustment to cost of sales. The reason for the non-reconsideration of the said item was explained thus:

> "However, the overstatement of cost of sales (JV 12.76.94) amounting to P2,623,016.53 which represents an entry for the importation of KOPIKO (Inv. No. 372) on December 29, 1994 was not reconsidered because the total cost of KOPIKO inventory in the INVENTORY LIST was found less than the amount in question which we therefore deny correctness of your contention per your position paper dated October 26, 1998. Accordingly, your company is still liable to the above deficiency income tax as a result of the overstatement of KOPIKO inventory cost"

The deficiency withholding tax assessment was purportedly based on the declaration that there is a discrepancy of P10,888,986.21 representing allocated-in fringe benefits which were not included as part of taxable compensation income subject to withholding tax per alpha list *(Paragraph 11, Joint Stipulation of Facts and Issues).*

On February 18, 2000, petitioner filed with the Assessment Division of the Bureau of Internal Revenue (BIR) – Revenue Region No. 07 – (Quezon City) a protest letter contesting the subject assessments. And on April 18, 2000, it submitted a supplemental protest attaching relevant documents, in support of its position *(Paragraph 6 and 7, Joint Stipulation of Facts and Issues)*.

However, as of October 15, 2000, which is the one hundred eightieth (180th) day from the date the petitioner filed its supporting documents, respondent has yet to render his decision on petitioner's protest. Hence, on November 14, 2000, which is thirty (30) days from October 15, 2000, petitioner filed the instant Petition for Review with this Court.

In his Answer filed on July 23, 2001, respondent asserted the following Special and Affirmative Defenses, to wit:

"1. That the investigation of petitioner's internal tax liabilities for the year 1994 revealed a tax obligation of P5,529,362.04 as deficiency income and withholding tax.

2. That the subject deficiency income and withholding tax (Assessment Notice No. 000757) was issued in accordance with law and pertinent regulations and has substantially complied with the provisions of Sections 228 of the National Internal Revenue Code relative to the taxpayer being informed in writing of the facts and law in which the assessment is based.

3. That the deficiency income tax has been assessed pursuant to Section 29 of the National Internal Revenue Code.

4. That the deficiency income tax assessment was based on the findings that there is an overstatement of cost of sales.

5. That the deficiency withholding tax has been assessed pursuant to Section 71 of the NIRC.

6. That the deficiency withholding tax assessment was based on the findings that there is a discrepancy of P10,888,986.21 representing allocated fringe-in benefits which were not included as part of taxable compensation income subject to withholding tax per alpha list.

7. The 20% per annum has been imposed pursuant to the provisions of Section 249(b) of the NIRC.

8. That the petitioner has not exhausted the administrative remedies required by law and jurisprudence on cases of this nature, hence, petitioner has no cause of action.

9. That all presumptions are in favor of the correctness of tax assessments and the burden of proof to prove otherwise is upon the petitioner.

During the course of the trial, the parties decided to stipulate the issues to be resolved by the court, namely:

1. Whether or not petitioner has an overstatement of KOPIKO inventory resulting to an overstatement of its cost of sales amounting to P2,623,016.53;
2. Whether or not petitioner has fully accounted for the alleged discrepancy of P10,888,986.21 as part of compensation income subject to withholding tax;
3. Whether or not Petitioner is liable for the alleged deficiency income and withholding tax amounting to P5,529,362.04. (*Joint Stipulation of Facts and Issues, page 94, CTA Records*)

Petitioner presented documentary and testimonial evidence to prove its case. On the other hand, respondent due to his counsel's absence for five (5) consecutive times was declared to have waived his right to present evidence. Respondent, similarly, failed to submit the BIR records and to file his memorandum.

After considering the attending facts, the evidence adduced and the applicable laws and jurisprudence, the court rejects the validity of the subject assessments.

We shall first discuss the issue of deficiency income tax.

The assessment for deficiency income tax arose from an alleged overstatement of cost by petitioner. The claimed overstatement of cost was explained in the Details of Discrepancies attached to the Formal Letter of Demand issued to petitioner, in the following manner:

> "**Overstatement of Cost of Sales (P2,623,016.53) – Verification disclosed that this portion of cost of sales, claimed as deduction from your gross income for the taxable year 1994, which represents an entry for the importation of KOPIKO inventory in the INVENTORY LIST was found less than the amount in question** which was denied correctness of your contention per your position paper dated October 26,1998. Accordingly, your company is still liable to the above mentioned deficiency income tax as a result of this overstatement of cost of sales pursuant to Section 29 of the NIRC, as amended." *(Emphasis supplied)*

The court disagrees with respondent's findings.

According to the CTA records and the evidence submitted by petitioner which respondent failed to refute by contrary evidence and by his reliance on mere allegations, petitioner did not overstate its cost of sales by P2,623,016.53. In fact, the total cost of Kopiko coffee candy inventory in the Inventory List is more than the amount in issue and such inventory has been properly accounted for.

Based on petitioner's Inventory Report *(Exhibit "F")* as of December 31, 1994, which was previously submitted to the BIR, petitioner's total inventory is P112,756,611.24, broken down as follows:

	Cost
Raw Materials	
Ingredients	P 30,226,089.22
Wrapping	14,935,673.40
Goods in Process	1,366,379.82
Finished Goods	18,010,246.21
Materials and Supplies	18,468,477.90
Materials and Supplies in Transit	29,449,004.49
Others	300,770.20
Total	**P 112,756,611.24**

The Finished Goods inventory include all types of products of petitioner such as Juicy Fruit, Doublemint, Big Boy Bubble Gum, Cool Air and imported Kopiko coffee candy. The Finished Goods Inventory amounting to P18,010,246.21 is further broken down in petitioner's Worksheet or Schedule of Finished Goods Inventory as of December 31, 1994 *(Exhibit "G")*, as follows:

Domestic Goods		
Juicy Fruit	P5,171,389.20	
Doublemint	1,990,694.03	
Big Boy Bubble Gum	299,239.63	
Cool Crunch	851,024.34	
Kopiko	5,775,241.99	P14,087,589.19
Inter-Company		
Hongkong	1,851,890.97	
Thailand	711,394.90	
Indonesia	1,350,371.15	P 3,922,657.02
Total		**P18,010,246.21**

The total inventory of Kopiko coffee candy as of December 31, 1994 in the amount of P5,775,241.99 was arrived at by adding the total beginning inventory as of November 25, 1994 *(Exhibit "G-7")* and the importation of Kopiko coffee candy *(under "Production" – Exhibit "G-8")* less sales for the month *(under "Shipments" – Exhibit "G-9")*, to wit:

Beginning Inventory (11/25/94)	P 3,008,833.58
Add: Importation	18,477,995.01
Total Inventory for December	P21,456,828.59
Less: Sales	15,681,071.33
Finished Goods Inventory as of December 31, 1994	**P 5,775,241.99**

The amount of P18,477,995.01 referred to above as importation pertains to six importations of Kopiko coffee candy for the month of December 1994 *(TSN, February 26, 2002, page 11)*. These importations are enumerated in petitioner's Schedule of Importations of Kopiko Coffee Candy for the Month of December 1994 *(Exhibit "T")*, as follows:

Exhibit No.	Purchase Order No.	Date of Arrival	Quantity Received (Cartons)	Landed Cost/BOC
J-1	37869	Dec. 8-10,1994	9270	P 2,877,479.00
J-2	37871	Dec. 13-14,1994	9536	3,482,000.00
J-3	37872	Dec. 20-22,1994	9384	2,797,610.00
J-4	37878	Dec. 26-28,1994	9488	2,826,850.00
J-5	37879	Dec. 28,1994	9411	2,826,860.00
J-6	37880	Dec. 19,1994	9492	2,836,770.00
Total				**P17,647,569.00**

The discrepancy between the landed cost as computed by the Bureau of Customs (BOC) of the six importations and the cost per books of petitioner was explained by Ms. Rosario G. Martin, petitioner's Controller, as the result of several factors such as difference in the exchange rate used, viz., the BOC adopts the last Friday rate for the current week transactions while petitioner adopts the foreign exchange rate published by the Central Bank on the day that the imported Kopiko coffee candy is received at the warehouse. In addition, the BOC merely estimates the broker's fee, insurance and other charges in order to arrive at the applicable customs duty and VAT while petitioner records the actual broker's fee and insurance cost *(TSN, February 26, 2002, page 13)*.

The above importations of petitioner are duly supported by their corresponding Import Entries and Internal Revenue Declarations (IEIRDs), Official Receipts issued by the BOC evidencing payment of duties and taxes on these importations and two (2) Certifications dated January 31, 2003 and March 25, 2003 *(Exhibits "X" and "Y")* signed by Ms. Merlita D. Tomas, Chief of the Collection Division of the BOC, Collection District II-B certifying that the six above-enumerated importations of Kopiko coffee candy enumerated above were received and processed by the Collection Division. These pieces of evidence positively confirm that petitioner actually made the six importations in December 1994, accordingly, it is justified in recording the importation under PO No. 37880. Hence, the amount of P2,623,016.53 is not an overstatement of cost of sales.

Regarding the ending inventory for Kopiko coffee candy for taxable year 1994 in the amount of P5,775,241.99, the composition of the ending inventory is enumerated in the Schedule of Ending Inventory for Kopiko coffee candy as of December 31, 1994 *(Exhibit "U")*, as follows:

Purchase Order No.	**Date of Arrival**	**Quantity (Cartons)**	**Cost per WPI Books**
37878	Dec. 16-28,1994	864	P 252,431.28
37879	Dec. 28, 1994	9411	2,749,572.64
37880	Dec. 29, 1994	9492	2,773,238.07
Total			**P5,775,241.99**

In order to determine the ending inventory, petitioner employs the first-in-first-out method *(TSN, February 26, 2002, page 18)*.

As can be seen from the foregoing, the total Kopiko Inventory as of December 31, 1994 is P5,775,241.99 which is more than the alleged overstatement of cost of sales in the amount of P2,623,016.53 as contended by respondent, and which is likewise duly accounted for.

We now proceed to the second issue.

Respondent contends that a reinvestigation of petitioner's internal revenue tax liabilities for 1994 discloses a discrepancy of P10,888,986.21 representing allocated in fringe benefits which supposedly were not included as part of taxable compensation income subject to withholding tax.

The court differs with respondent's opinion.

At this juncture, it must be pointed out that this court has previously ruled in a previous case entitled **Wrigley Philippines, Inc. vs. Commissioner of Internal Revenue**, *CTA Case No. 6196, November 4, 2003,* involving petitioner and the same issue of taxability of petitioner's allocated in account but covering a different taxable year (1995), that it was erroneous for respondent to assess petitioner for deficiency withholding tax on compensation on allocated in benefits. The court declared in part as follows:

> **"We agree with the petitioner that the "allocated in" and "allocated out" accounts are used merely for internal accounting purposes to properly charge the appropriate departments of accurate cost/expense and that the recorded salaries and wages, which already include those which have been allocated to other departments through the petitioner's internal allocation system, had been subjected to withholding tax.** Hence, it was erroneous on the part of the respondent to charge petitioner of deficiency withholding tax on the allocated benefits of P19,181,662.19." *(Emphasis supplied)*

The petitioner explains that the "Allocated In" and "Allocated Out" accounts in its books merely pertain to petitioner's internal accounting practice of charging its respective departments with the expenses attributed to its operations. This internal practice is embodied in petitioner's Corporate Manufacturing Report Procedures *(Exhibit "M")*.

"Allocated in Hours" refers to the hours worked by non-factory Wrigley personnel on manufacturing related tasks or projects. This includes hours from Cost Accounting, Information Services, Purchasing and Personnel Departments, which due to organizational reasons, are charged to other cost centers. On the other hand, "Allocated Out Hours" are the hours spent by factory personnel on non-manufacturing tasks or projects and subsequently charged to another factory or cost centers. This includes hours worked on capital jobs and stock part orders, finished gum handling and merchandising *(Exhibit "M-1")*.

As was done in the above-cited jurisprudence, petitioner submitted sample monthly Journal Vouchers *(Exhibits "N", "O", and "P")* and Summary of Allocated In/Out Expenses for 1994 *(Exhibit "L")* to prove its claim.

The accounting entries on allocation are reflected in petitioner's monthly Journal Vouchers. For illustration purposes, petitioner presented sample Journal Vouchers for the months of February, March and April of taxable year 1994 (*Exhibits "N", "O" and "P")*. Based on the aforesaid exhibits, the sum of all debit entries to "Allocated In" accounts is credited to the corresponding "Allocated Out" accounts, thereby canceling each other out.

Likewise, the petitioner presented sample journal vouchers for the months of February, March and April 1994 *(Exhibits "Q", "R" and "S")* to illustrate the procedure being followed by petitioner when recognizing salaries and wages and the corresponding withholding taxes. An examination of the entries shows that petitioner first records the accrued salaries and wages for the various departments. This is then followed by the recording of the deductions from the salaries and wages, including the required withholding tax under the "Income Tax Withheld-Wages" account. Thus, proving the fact that petitioner's entries to "Allocated In" and "Allocated Out" accounts were captured as compensation or salaries expense in its books of accounts and the fact of withholding.

Accordingly, the court renders a similar ruling that respondent's finding that "Allocated In" account should be subject to withholding tax is without any basis.

Inasmuch as the third issue has been resolved by the resolution of the first and second issues, the same will no longer be addressed.

WHEREFORE, this court cancels the deficiency income tax and withholding tax assessments issued against petitioner for taxable year 1994 in the total amount of P5,529,362.04.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

We concur:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice