REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

ING BARINGS SECURITIES PHILIPPINES, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6188

Members:

CASTAÑEDA, JR., ***Chairman***
UY, and
PALANCA-ENRIQUEZ, ***JJ.***

Promulgated :
JAN 14 2005

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DECISION

UY, *J.*:

This is a petition for the cancellation and withdrawal of deficiency income tax, withholding and value added tax assessments for the taxable years ended December 31, 1994 and 1997 in the aggregate amount of P110,085,228.23 inclusive of interest and compromise penalties filed on October 26, 2000 by petitioner Ing Barings Securities Philippines, Incorporated against the Commissioner of Internal Revenue as respondent.

Petitioner is a domestic corporation duly organized and existing under the laws of the Philippines with principal office at the 20th Floor Tower I, Ayala Triangle, Makati City. It is engaged primarily, among others, "in the business of stock and sharebrokers, dealers in securities in all transactions relating to the sale, transfer, exchange, of every

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description of stock, shares, debentures, bonds, obligations, commodities and other debt or equity securities, and all transactions and negotiations on commission or otherwise relating to such business and to do all activities directly or indirectly connected therewith or incidental thereto" *(page 30, BIR records).*

On the other hand, respondent Commissioner of Internal Revenue is the government official empowered to perform the duties of the Bureau of Internal Revenue, including, among others, the power to cancel disputed assessments, with office address at BIR National Office Building, Diliman, Quezon City.

It appears that for the calendar years 1996 and 1997, petitioner seasonably filed its Corporation Annual Corporation Returns on April 14, 1997 with Equitable Bank Ayala Triangle Branch, Makati City *(Exhibit "K", inclusive of submarkings),* and on April 15, 1998 with Traders Royal Bank, Atrium Branch, Makati City *(Exhibit "L", inclusive of submarkings)*, respectively.

Likewise for the same period, the following returns were timely filed, to wit:

Quarterly VAT Returns:

	1996		1997	
	Exh.	Date Filed	Exh.	Date Filed
1st Quarter	M	04-22-96	Q	04-18-97
2nd Quarter	N	07-17-96	R	07-18-97
3rd Quarter	O	10-18-96	S	10-16-97
4th Quarter	P	01-20-97	T	01-19-98

Monthly Remittance Returns of Income Taxes Withheld:

	1996		1997	
	Exh.	Date Filed	Exh.	Date Filed
January	KK	02-12-96	WW	02-11-97
February	LL	03-11-96	XX	03-10-97
March	MM	04-10-96	YY	04-10-97

	1996		1997	
	Exh.	Date Filed	Exh.	Date Filed
April	NN	05-20-96	ZZ	05-13-97
May	OO	06-10-96	AAA	06-10-97
June	PP	07-10-96	BBB	07-10-97
July	QQ	08-09-96	CCC	08-11-97
August	RR	09-10-96	DDD	09-10-97
September	SS	10-10-96	EEE	10-10-97
October	TT	11-11-96	FFF	11-10-97
November	UU	12-10-96	GGG	12-10-97
December	VV	01-10-97	HHH	01-09-98

On September 10, 1998, petitioner received Letter of Authority No. 000019164 authorizing the Special Team created pursuant to RSO 673-98 composed of Revenue Officers E. Gesmundo, W. Gopez, R. Calo, JR Bungabong, R. Suba & R. Canido, to be supervised by Group Head JC Simpao, to examine petitioner's books of accounts and other accounting records for all internal revenue taxes for the period from 1997 and unverified prior years *(page 1, BIR records)*.

On January 17, 2000, petitioner received the Final Notice with Details of Discrepancies and six (6) Assessment Notices, all dated December 29, 1999, issued by the Enforcement Service of the Bureau of Internal Revenue through its Assistant Commissioner Percival T. Salazar *(Exhibits "A" to "G", inclusive of submarkings)*, covering the following deficiency tax assessments:

	Basic Tax	Interest	Compromise	Total
Deficiency Income Tax				
1997 (ST-Income-97-0090-2000)	P32,180,202.40	P11,527,563.14	P 25,000.00	P 43,732,765.55
1996 (ST-Income-96-0089-2000)	13,268,656.54	7,406,817.51	25,000.00	20,700,474.05
Deficiency Value-Added Tax				
1997 (ST-VAT-97-0088-2000)	16,361,018.99	5,816,005.21	25,000.00	22,202,024.20
1996 (ST-VAT-96-0087-2000)	14,641,534.79	8,133,070.96	25,000.00	22,799,605.75
Deficiency Expanded Withholding Tax				
1997 (ST-EWT-97-0086-2000)	231,740.07	95,235.62	16,000.00	342,975.69
1996 (ST-EWT-96-0085-2000)	182,114.37	109,268.62	16,000.00	307,382.99
Totals	P76,865,267.16	P33,087,961.06	P 132,000.00	P110,085,228.23

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On February 15, 2000, petitioner through its tax counsel, Laya Mananghaya & Co., filed its protest requesting the reinvestigation and cancellation of the above deficiency tax assessments *(Exhibit "H", inclusive of submarkings).*

On March 30, 2000, petitioner submitted the relevant documentary evidence in support of its protest pursuant to Section 228 of the 1997 Tax Code *(Exhibits "J" and "J-2").*

There being no action on the protest, petitioner filed the instant Petition for Review on October 26, 2000, the thirtieth day from the lapse of one hundred eighty (180) day (*i.e.*, September 26, 2000) period provided by law for respondent to decide on the protest reckoned from March 30, 2000, the day when petitioner submitted its supporting documents pursuant to Section 228 of the 1997 Tax Code.

PETITIONER'S CLAIM

Petitioner claims that the present assessments for deficiency income, withholding and donor's taxes are null and void for having been issued without stating the law and the facts from which the assessments were made as provided for under Section 228 of the 1997 Tax Code and Section 3.1.4. of Revenue Regulations No. 12-99.

Further, petitioner states that the six (6) assessment notices failed to fully explain the details of assessments, reasons for disallowance or imputation of additional income despite having issued the Details of Discrepancies citing specific legal provisions and regulations upon which the assessments were based. In the case of deficiency income tax assessment, the assessment notice did not show how the computation was arrived at

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as required in Annex B of Revenue Regulations No. 12-99 but merely provided for the basic tax due, interest and compromise penalty.

To support its protest against respondent's assessments for deficiency VAT and deficiency withholding tax were computed, petitioner cites the following decisions promulgated by this Court: *Australia Cylinder Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6014, August 14, 2002; Sunnyvale Development Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5730, January 4, 2001, EVA Airways Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5692, September 20, 2001),* as well as Revenue Regulations No. 6-2000, Revenue Memorandum Order No. 22-01. Moreover, petitioner maintains that an intelligent protest filed against the assessment will not render the latter valid. The alleged failure of respondent to comply with the requirements under Section 228 of the 1997 Tax Code makes the assessments void. Allegedly, a void act has no legal force and effect *(Mathay Jr. vs. Macalincag, et al., G.R. No. 97618, December 16, 1993)*.

RESPONDENT'S DEFENSES

In respondent's Answer filed on December 8, 2000, the following Special and Affirmative Defenses were raised, *viz*:

> "4. The assessments in question were issued in accordance with law and pertinent regulations;
>
> 5. Petitioner claims that there is no basis for imputation of additional commission for arms-length transaction. The contention of the petitioner is without factual and legal basis. Investigation disclosed that upon verification of petitioner's sales and purchases books, the January to October 1996 transactions relating to its commission income on its affiliate (ING Baring Hongkong) and other clients in

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Hongkong was charged at .005. However, from November, 1996 to December 1997, most of its transactions in Hongkong were done by its affiliate (ING Baring Hongkong) and relatively charged at a reduced commission of only .003. Since they were inter-related transactions, they must be considered as arms-length transactions under RAMO 1-98 and correspondingly subject to income tax. Furthermore, the Commission Income in question was not fully substantiated by the necessary documents;

6. With regard to the disallowed deductions for taxable year 1996, investigation also disclosed that the amount of P24,454,212.00 that represents part of the P50,951,761.50 losses claimed by the taxpayer in relation to the buy back of shares should be disallowed and subjected to income tax or failure (sic) on the part of the petitioner to substantiate the same in accordance with Section 29 of the 1997 Tax Code;

7. Petitioner also claims the commission for sale of securities subject to VAT must be at zero percent. Such sale commission should be subject to 10% VAT and should not be treated as zero-rated sales for the reason that the same were income from sales consummated in the Philippines. Since payments made to ING Hongkong from the sale of these securities were net of commission income and such commission was not inwardly remitted to acceptable foreign currency and accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas as provided for under Section 102 of the 1997 Tax Code, such should be treated as income subject to 10% VAT;

8. Petitioner also contends that the VAT assessment on the commission income is erroneous for lack of actual and legal basis. The commission income must be subject to VAT on the ground that the petitioner failed to fully substantiate the same as provided for in Section 2.4 of RAMO 1-98 in relation to Section 50 of the 1997 Tax Code. Submitted photocopies of Contract Note bears no commission that can be traced or matched with the Summary of Foreign Purchases. Furthermore, petitioner did not submit photocopies of sales invoices in support of its foreign purchases which reflects the amount of commission and commission rates. Lastly, petitioner failed to submit photocopies of contract and/or agreement between ING Baring Philippines and ING Baring Hongkong;

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9. There is discrepancy between the revenue reported in the VAT returns and the amount reported in the income tax return resulting in an undeclared revenue of P9,481,314.85;

10. The petitioner is still liable to pay the deficiency expanded withholding tax assessments for the years 1996 and 1997 with respect to transactions where the same is due in accordance with Revenue Regulations No. 6.85, as amended by Revenue Regulations No. 12-94. Petitioner failed to subject to Expanded Withholding Tax (EWT) in full its deductible expenses claimed that resulted to the said deficiency EWT;

11. The subject VAT assessments were issued within the 3-year prescriptive period as provided in Section 203 of the 1997 Tax Code; and

12. All presumptions are in favor of the correctness of tax assessments *(Answer, Records, pp. 38 – 39)*"

THE ISSUES

In the Joint Stipulation of Facts submitted on February 5, 2001, and duly approved by this Court on February 8, 2001, the following issues were stipulated by the parties:

1. Whether the assessment was issued in accordance with law and regulations such that it stated the factual and legal bases on which it is based;

2. Whether the expenses relating to the purchase of street certificates which petitioner claimed in its income tax return are valid deductions from petitioner's gross income for taxable year;

3. Whether the imputation of additional commission income arising from transfer pricing issues is proper for income tax and VAT purposes since commissions charged by petitioner were varied;

4. Whether the commission on sales transactions on various securities with ING Hongkong, a non-resident foreign affiliate and paid for in foreign currency is subject to VAT;

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5. Whether the VAT assessment on the basis of discrepancy between the reported revenue in the income tax return and VAT returns as well as the discrepancy between the Input Tax claimed and the schedule submitted by petitioner was proper;

6. Whether there was failure to withhold and remit the proper expanded withholding tax (EWT) due on various transactions of the petitioner; and

7. Whether the alleged deficiency VAT assessments for the quarters ended March 31, 1996, June 30, 1996 and September 30, 1996 had already prescribed *(Joint Stipulation of Facts, Records, pp. 63-68)*.

THIS COURT'S RULING

Anent the first issue as to whether assessment was issued in accordance with law and regulations such that it stated the factual and legal bases on which it is based, the Court rules in the affirmative. The Court finds that petitioner has been duly informed of the law and facts on which the assessments were made pursuant to Section 228 of the 1997 Tax Code and Section 3.1.4. of Revenue Regulations No. 12-99. Said provisions read as follows:

> "**SEC. 228.** ***Protesting of Assessment.*** — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however*, That a pre-assessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void."
>
> xxx xxx xxx
>
> "**Section 3.1.4.** ***Formal Letter of Demand and Assessment Notice.*** - The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand

> calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void."

A perusal of the records reveals that prior to the issuance of Final Notice, petitioner was informed of the law and the facts from which the assessments were based as its authorized representative was invited to an informal conference held on December 8, 1999 *(Exhibits "5" and "5-A")*. The purpose of the said conference was clearly indicated in the invitation letter *(Exhibits "3", "3-A" and "3-B")*. To quote:

> "In accordance with the policy of this Office to afford every taxpayer the opportunity to give its side of the case, you or your authorized representative are respectfully invited to an informal conference at Room 310-Enforcement Service, BIR National Office Bldg., Diliman, Quezon City, to interpose your objections and/or present documentary evidence to disprove the proposed assessment. *(Underlining supplied)."*

In said meeting, petitioner was represented by its external auditor, KPMG-Laya, Mananghaya & Co., through Nestor V. Custodio, Ailyn B. Perocho, Rose L. David, and Manny Salvador *(page 548, BIR records)* . The conference was for the discussion/ clarification of the following proposed deficiency taxes:

	1996	1997	Total
Income Tax	P 28,848,113.42	P 51,964,537.93	P 80,812,651.35
Value-Added Tax	21,717,775.09	27,129,548.70	48,847,323.79
Withholding Tax-Expanded	1,099,564.57	647,600.68	1,747,165.25
Stock Transaction Tax	73,324,509.08	48,051,241.54	121,375,750.62
Totals	P124,989,962.16	P127,792,928.85	P252,782,891.01

(pages 540-547, BIR records)

Since the issues were not settled in full, both parties had agreed for the issuance of Pre-assessment Notice for the years 1996 and 1997 internal revenue taxes as indicated in the 'Remarks' in the conference sheet that the parties signed.

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Consequently, petitioner received on December 12, 1999 the Pre-Assessment Notice dated December 15, 1999 informing it of the following adjusted proposed deficiency tax assessments, to wit:

	1996	1997	Total
Income Tax	P 38,295,860.50	P 45,676,982.09	P 83,972,842.59
Value-Added Tax	25,491,909.90	25,210,509.32	50,702,419.22
Withholding Tax-Expanded	387,144.37	333,346.33	720,490.70
Totals	P 64,176,910.77	P 71,222,834.74	P 135,395,752.51

(Exhibits "6" and "6-A")

Petitioner was then requested to clarify the issues arising from the review of its tax assessments within fifteen (15) days from its receipt of the pre-assessment notice, otherwise, the inaction would be construed as concurrence with the proposed assessments and a letter of demand will be sent correspondingly upon approval of the report of investigation.

There being no response within the period given, on January 17, 2000, respondent served a letter of demand to petitioner.

From the above narration of facts, this Court is convinced that petitioner was informed of the bases in fact and in law of the deficiency assessments which resulted in its revision after the informal conference held on December 8, 1999. The very details of the assessments were learned and discussed with the representatives of petitioner during the informal conference. Moreover, the Court notes that the proposed deficiency assessment for stock transaction tax included in the original proposed deficiency tax assessments was eliminated and the other proposed deficiency taxes were correspondingly adjusted. The remaining proposed deficiency assessments are now the subjects of the present appeal.

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We now proceed to the merits of the disputed assessments itemized in the rest of the stipulated issues mentioned in the Joint Stipulation of Facts by both parties.

DEFICIENCY INCOME TAX

The assessments for deficiency income taxes for the years 1996 and 1997 arose from two items of discrepancies. The first is the imputation of additional commission income for the years 1996 and 1997 in the amounts of P13,456,234.82 and P91,943,434.73, respectively, and the second is the alleged unsupported loss related to the buy back of shares in the year 1996 in the sum of P24,454,212.00. The deficiency income taxes for the years 1996 and 1997 were computed as follows:

			1996		1997
Taxable Income per ITR			P 185,365,049.00		P 15,508,115.00
Add:Adjustments/Disallowance					
a. Arms-length transaction (ING Hongkong-Commission)					
	Commission Base				
1996	6,728,117,410.00				
1997	45,971,717,363.33				
	Should be (.005)	P 33,640,587.05		P 229,858,586.82	
	Reported as (.003)	20,184,352.23	13,456,234.82	137,915,152.09	91,943,434.73
(RAMO 1-98 & Rev. Reg. No. 2)					
b. Unsupported Loss					
(Sec. 29, NIRC)			24,454,212.00		-
Taxable Income Per Investigation			P 223,275,495.82		P 107,451,549.73
Income Tax Due –35%			P 78,146,423.54		P 37,608,042.40
Less: Payments			64,877,767.00		5,427,840.00
Basic Deficiency Income Tax			P 13,268,656.54		P 32,180,202.40
Add: Interest and Penalty					
20% interest			7,406,817.51		11,527,563.14
Compromise Penalty			25,000.00		25,000.00
Total Deficiency Income Tax Due			P 20,700,474.05		P 43,732,765.54

(pages 556, BIR records and Exhibits "B", "B-1", "E" and "E-1")

We will discuss the above items of discrepancies in the order of the jointly stipulated issues.

1. Unsupported Loss. 1996 P24,454,212.00

Respondent explains in the Details of Discrepancies that the sum of P24,454,212.00 represents part of the P50,951,761.50 *(Exhibits "II", inclusive of submarkings)* losses related to the buy back of shares which are still unrecovered and was disallowed for failure of petitioner to substantiate the same as required under Section 29 of the Tax Code.

Petitioner, on the other hand, maintains that the amount claimed as losses in the income tax return were not losses but rather ordinary and necessary business expenses pursuant to Section 34(A)(1)(a) of the 1993 Tax Code. The expenses were incurred to purchase stocks to prevent possible litigation for non-delivery of stock to its buying clients. Petitioner insists that it had sufficiently established the said expense. It further explains that in the years 1994 and 1995, there was a boom in the stock market that resulted to increased trading activity. During the said years, petitioner's records were inefficient and unreliable to keep tract of the increased level of activity because its transactions were recorded manually. It eventually led to an inventory shortfall which means that its total physical certificates were less than the actual certificates on record. To avoid possible lawsuit and loss of reputation, petitioner purchased certain stocks to cover the inventory shortage since its clients demanded the delivery of their certificates *(TSN, pp. 13-24, September 26, 2001)*.

To prove that the expense was necessary and ordinary business expense pursuant to Section 34(A)(1)(a) of the Tax Code, petitioner presented various documents comprising of samples of Demand Letters from its clients *(Exhibit "HH")*, Schedule of Loss per Income Tax Return *(Exhibits "II", "II-1" and "II-2")*, Summary of Shares Purchased-1996 *(Exhibit "JJ", inclusive of submarkings)*, Daily Transaction Report-Form ABC *(Exhibits "MMM" to "PPP" and "TTT")* and Contract Notes *(Exhibits "VVV-1" to "VVV-24")*.

Under Section 34(A) of the Tax Code, deductions for business expenses paid or incurred during the taxable year in carrying on, or which are directly attributable to, the development, management, operation and/or conduct of the trade or business are allowed if it is ordinary, necessary and properly substantiated. We quote:

> "**SEC. 34**. ***Deductions from Gross Income***. – Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Section 24(A); 25(A); 26; 27(A), (B) and (C); and 28 (A)(1), there shall be allowed the following deductions from gross income:
>
> (A) *Expenses*. –
> (1) *Ordinary and Necessary Trade, Business or Professional Expenses*. –
> (a) *In General*. – There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession x x x"

Simply put, to be deductible from gross income, the expense must comply with the following requisites: (a) the expense must be both ordinary and necessary; (b)it must be paid or incurred within the taxable year; (c) it must have been paid or incurred in carrying on the trade or business of the taxpayer; and (d) it must be supported by receipts, records or other pertinent papers ***(Commissioner of Internal Revenue vs. General Foods (Phils.) Inc., 401 SCRA 544).***

Although there is no exact definition of the terms "ordinary and necessary", the Supreme Court held that 'an expense will be considered "necessary" where the expenditure is appropriate and helpful in the development of the taxpayer's business. It is "ordinary" when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term "ordinary" does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique and non-recurring to the particular taxpayer affected ***(Atlas Consolidated Mining and Development Corporation vs. Commissioner of Internal Revenue, 102 SCRA 246).***

With the above pronouncement, We find the documents submitted by petitioner substantial and relevant to prove its claimed "losses" during the year 1996. From the said evidence, We can trace, among others, the amount of discrepancy of stocks, the date when petitioner purchased shares to cover the inventory shortfall and their subsequent delivery to various clients.

The commissioned independent CPA, Mr. Wilfredo Z. Palad, in his report dated January 31, 2002, likewise concluded that:

> "Conclusion
>
> Based on the review performed and the information provided to us, we noted that a deficit existed between the stock position per books and the physical inventory. The purchases were supported by the contract notes, a pre-numbered continuous document registered with the BIR to support the

transactions entered by the broker in behalf of its customers *(Exhibit "SSS")*."

Thus, the Court finds the documents presented by petitioner adequate to substantiate the necessity of the expense and correspondingly finds respondent's denial of the same improper. The expense is deductible from gross income.

b. Commission Income. 1996 P13,456,234.82
1997 P91,943,434.73

After verification of petitioner's sales and purchases books, respondent made the following findings: the commission income charged by petitioner from January to October 1996 to its affiliate, ING Barings Hongkong, and other foreign clients in Hongkong was 0.005; petitioner's transactions from November 1996 to December 1997 in Hongkong were done by its affiliate and petitioner charged the latter a reduced commission income of 0.003 *(pages 241 to 429, BIR records)*. Consequently, respondent assessed petitioner an additional income of 0.002 which was captioned as "Arms-length transaction" in the amounts of P13,456,234.82 and P91,943,434.73 for the years 1996 and 1997, respectively *(page 556, BIR records)*.

Respondent opines that petitioner's transaction with its affiliate is an inter-related transaction and must be considered as arms-length transaction, subject to income tax in accordance with RAMO 1-98 and Revenue Regulations No. 2, and thus, made the sale transactions of petitioner with its affiliate and that of its foreign clients equal.

Respondent derived the additional income for petitioner by using the "comparable uncontrolled price method" described in RAMO 1-98. Under this method, the arms length pricing of a sale between group members (controlled sale) is equal to the price paid in comparable sales in which the sellers and the buyers are not members of the same controlled group (uncontrolled sales), with certain adjustment *(Vol. 12 Merten's Law of Federal Income Taxation, $451.55, p. 164).*

Petitioner, on the contrary, submits that while the respondent is given power to allocate income and deduction to ascertain the correct tax, such power should not be exercised arbitrarily. The power should be exercised only when the common control or the fact of being related parties is being used to escape or reduce tax. Petitioner cited the case of *Filinvest Development Corporation vs. Commissioner of Internal Revenue, CA-G.R. SP No. 72992, dated December 16, 2003 as its case law.*

To settle the controversy, We define "arms-length pricing".

Arms-length pricing is the price an unrelated party would have paid under similar circumstances for the property involved in a transaction between two or more organizations, trades or businesses owned or controlled directly or indirectly by the same interests ***(Cyanamid Philippines, Inc. vs. The Commissioner of Internal Revenue, CTA Case No. 4724 dated August 28, 1995, citing Vol. 12, Merten's Law of Federal Income Taxation, $451. 26, 451.27, pp. 80-84)***.

From the above definition, if the respondent's basis for the assessment of additional income was that the commission income charged by petitioner to its foreign affiliate is at arms-length, then there can be no additional income because the amount earned by petitioner from its affiliate was already at "arms-length price".

While We agree that there will be no basis for the imposition of additional income if the commission earned by petitioner with its affiliate in Hongkong was already at arm's length, however, such logic is opposed to the very basis of respondent's assessment. The "arm's length" transaction was elaborated by respondent's witness on cross examination, thus:

> "ATTY. ANG:
> Q: Mr. Witness, last January 9, 2003 you mentioned that one of the basis (sic) for your deficiency income tax assessment was for the arms length transaction, is that correct?
>
> MR. BUNGABONG:
> A: Not an arms length transaction.
>
> ATTY. ANG:
> Q: Mr. Witness, how would you define an arms length transaction, what was your basis for saying that it was an arms length transaction?
>
> MR. BUNGABONG:
> A: We found out that the transaction was not an arms length for the reason that they gave other foreign clients the different rate. Whereas, the related taxpayer they gave a reduce (sic) rate for the particular transaction.
>
> ATTY. ANG:
> Q: Just because the petitioner does make it not arms length?
>
> MR. BUNGABONG:
> A: Based on the submitted schedules, Ma'am, we were able to come up with that finding." *(TSN, pp. 22-23, July 9, 2003)*.

From the above-quoted testimony, the basis of the imposition of additional commission income by the respondent is that the price given by petitioner to its foreign affiliate is not at par with its other foreign clients. Hence, leading Us to determine whether or not such imposition is proper.

We rule in the negative.

We are not convinced that the manner of imposing "imaginary" income against petitioner is justifiable under the present situation. As correctly explained by petitioner, there are factors to be considered in determining the application of arm's length pricing.

In the case of *Cyanamid, supra,* this Court had the occasion to rule in this wise:

> [U]ncontrolled sales are considered comparable to controlled sales if the physical property and circumstances involved in the uncontrolled sales are identical to the physical property and circumstances involved in the controlled sales, or if such properties and circumstances are so nearly identical that any differences either have no effect on price, or such differences can be reflected by a reasonable number of adjustments to the price of uncontrolled sales. xxx Some of the differences which may affect the price of property are differences in the quality of the product, terms of sale, intangible property associated with the sale, time of sale, and the level of the market and the geographic market in which the sale takes place."

Petitioner expounds that the difference in the commission charged was a business decision. It has to course through ING Barings Hongkong all its foreign transactions to simplify procedures for administration. This has been elucidated by petitioner's witness, Mr. Custodio, in his rebuttal testimony:

"ATTY. IMON:
Q. Mr. Witness, are you aware of the testimony given by Mr. Bungabong, BIR Revenue Examiner on January 9, 2003 with respect to this matter?

MR. CUSTODIO:
A. Yes, I was able to read the testimony of the BIR Examiner.

ATTY. IMON:
Q. Did you recall, Mr. Witness, that in his testimony said witness stated that the basis of their assessment for the non-arms length related part transaction arises from the Schedule of Foreign Commissions given by petitioner. Which I am showing to you and compared to foreign trades the commission for Ing Hongkong was still lower. Mr. Witness, I am showing to you Exhibit "12" for the respondent, how would you explain that?

MR. CUSTODIO:

A. Well, I've seen actually the document which you've given to me. The difference on the commission for the foreign trades from the Ing Securities Hongkong rates was basically due to the fact that Ing Barings based in Hongkong limited actually was performing other duties for Manila office in terms of marketing, research and execution of the transactions. Actually, if you look at the schedules of the transactions, from January to October 1996 you will notice that a lot of foreign trades transactions were recorded in the book directly in the foreign clients name or the foreign clients account. As I have previously mentioned this source of transactions and the activity in the market we decided to extreme line the operation and decided that in coordination with Ing Barings Hongkong Limited to actually booked (sic) all of these foreign trades under the name of Ing Barings Hongkong Limited. This would obviously result in Ing Barings Hongkong Limited from a lot of administrative functions from the Manila office. And therefore, on these basis (sic) we are therefore able to match the commission rates in terms of the foreign clients compared to Ing Barings Hongkong Limited because of these administrative functions that they are given (sic) to us. Also, I recall, during that time in line with the extreme lining of the operations, we actually produced a new computer system in Ing Barings Manila. And actually this computer system was developed in Hongkong and was rolled (sic) out in Manila office involving to the on-going transactions. So, the fact that we make them work for us, providing us the systems also necessitated an adjustment in the commission that we have to charge in trades (TSN, pp. 8-11, April 20, 2004)"..

Clearly, there was no similarity of facts to conclude that the foreign clients and petitioner's affiliate should have the same rate of commission. Respondent cannot create an additional income without examining meticulously the circumstances surrounding the disparity of the commission rate. Inasmuch as the standing of petitioner's affiliate and that of its foreign client is not comparable, then We are satisfied that the lower rate of commission income charged by petitioner to its affiliate in Hongkong is justifiable.

DEFICIENCY VALUE ADDED TAX

Respondent computed the deficiency value-added tax for the years 1996 and 1997 as follows:

		1996		1997
Adjusted revenue reported per Quarterly VAT Returns		P 68,918,004.98		P 64,582,402.61
Add: Revenues not subjected to VAT per Investigation				
a. Commission from Sale-Foreign (Not inwardly remitted) (Sec.102, NIRC)		136,457,599.60		76,556,749.72
b. Commission from Arms-length transaction (RAMO 1-98 & Rev. Reg. No. 2)		13,456,234.82		91,943,434.73
c. Underdeclared revenue (Sec.102, NIRC)		9,481,314.85		-
d. Sale of BMW 316i (Sec. 100, NIRC)		-		710,000.00
Total Revenue per Investigation		P 228,313,154.25		P 233,792,587.06
Multiply by VAT Rate		1/11		1/11
Output VAT		P 20,755,741.30		P 21,253,871.55
Less: Creditable Input Tax				
Input Tax per VAT return (net)	P 8,422,028.82		P 4,192,084.52	
Less: Disallowed Input Tax (Annex "C") (Sec. 104, NIRC)	3,556,792.41	4,865,236.41	814,788.95	3,377,295.57
VAT Payable		P 15,890,504.89		P 17,876,575.98
Less: VAT Payments		1,248,970.10		1,515,556.99
Basic Deficiency VAT		P 14,641,534.79		P 16,361,018.99
Add: Interest & Compromise Penalty				
20% Interest		8,133,070.96		5,816,005.21
Compromise Penalty		25,000.00		25,000.00
Total Deficiency VAT Due		P 22,799,605.75		P 22,202,024.20

(Exhibit 19, page 555, BIR records and Exhibits "C", "C-1", "F" and F-1)

Before discussing the validity of the above assessment, this Court finds it necessary to delve first on the jointly stipulated issue of whether or not the alleged deficiency VAT assessment for the quarters ended March 31, 1996, June 30, 1996 and September 30, 1996 has already prescribed. Because if it has, then the law prohibits respondent to assess petitioner for the said periods and such has a material effect on the outcome of the present case.

Petitioner avers that the right of respondent to assess the deficiency VAT for the first, second and third quarters of taxable year 1996 had already prescribed inasmuch as the Final Notice was issued beyond the three year period allowed under Section 203 of the 1997 Tax Code which provides:

> "**Sec. 203**. ***Period of Limitation Upon Assessment and Collection***. — Except as provided in Section 222, 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 case where the return is filed beyond the period prescribe 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."

As correctly pointed out by petitioner, the counting of the three-year period is reckoned from the respective dates of filing of the quarterly VAT returns. Inasmuch as its VAT returns for the first, second and third quarters of 1996 were filed on April 22, July 17 and October 8, 1996, respectively, then the assessment notice issued on December 29, 1999 was already beyond the period allowed by law.

Section 110(a) of the 1993 Tax Code mandates the filing of quarterly VAT return and payment of the value-added tax, as follows:

> "**Sec. 110.** ***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 (20) days following the close of each taxable quarter prescribed for each taxpayer: **Provided**, that any person whose registration has been cancelled in accordance with Section 107 hereof, shall file a return and pay the tax due thereon within twenty (20) days from the date of cancellation of registration. Only one consolidated return shall be filed by the taxpayer for his principal place of business or head office and all branches."

Based on Section 203 in relation to Section 110(a) of the Tax Code of 1997 and 1993, respectively, the period given to respondent to assess a taxpayer commences after the last day prescribed by law for the *filing of the return*. If the return was filed earlier than the last day allowed by law, the period to assess shall still be counted from the last day prescribed for filing of such return. However, if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. Applying the rule to the case of petitioner, the last day to file and pay VAT is on the twentieth (20th) day following the close of each taxable quarter.

Presented below is a table showing the period within which respondent is permitted by law to examine petitioner's 1996 liability for VAT:

1996	Exh.	Date Filed	Last Day to file Return	Last Day to Issue Assessment
1st Quarter	M	04-22-96	04-22-96	04-22-99
2nd Quarter	N	07-17-96	07-22-96	07-22-99
3rd Quarter	O	10-18-96	10-21-96	10-21-99
4th Quarter	P	01-20-97	01-20-97	01-20-00

Considering that the assessment notice was issued only on December 29, 1999, the right of respondent to assess deficiency VAT for the first three quarters of the year 1996 had already prescribed.

As regards the findings of respondent, We will now address the afore-quoted disallowances chronologically.

a. Commission from Sale-Foreign.   ***1996***   ***P136,457,599.60***
1997   ***P 76,556,749.72***

It is respondent's stand that the commission income earned by petitioner on sales transactions on various securities with ING Barings Hongkong are subject to VAT at

10% on the basis that the sales were consummated in the Philippines. There were no inward remittances for the said sales. Likewise, the payments made to ING Barings Hongkong from the sale of securities were net of the commission *(pp. 508-509 & 814, BIR records)*.

Conversely, petitioner asserts that the commission paid for by a non-resident clients for the services rendered in the Philippines are subject to VAT at zero per cent (0%) pursuant to Section 102(b)(2) of the 1993 Tax Code. Petitioner advances the view that the former VAT Law, particularly E.O. No. 273 dated July 25, 1987, requires three conditions in order for a foreign currency sale to be subjected to VAT at zero percent. Section 102(a)(2) of the former VAT law provides:

> "(2) Services other than those mentioned in the preceding sub-paragraph, [1] the consideration for which is paid for in acceptable foreign currency which is [2] remitted inwardly to the Philippines and [3] accounted for in accordance with the rules and regulations of the Central Bank of the Philippines."

However, upon the effectivity of R.A. No. 7916, otherwise known as the Expanded VAT Law (EVAT) on January 1, 1996, the requirement that the payment of acceptable foreign currency should be *inwardly* remitted was deleted. Pertinent portions of Section 102(b)(2) of the 1993 Tax Code read as follows:

> "(2) Services other than those mentioned in the preceding sub-paragraph, [1] the consideration for which is paid for in acceptable foreign currency and [2] accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP)."

Petitioner's stand is well taken.

Under the EVAT law, the requirement that the acceptable foreign currency be remitted inwardly was indeed deleted. The law only requires two proofs. First, that the consideration is paid for in acceptable foreign currency and second, accounted for in accordance with the rules and regulations of Bangko Sentral ng Pilipinas *(VAT Ruling No. 018-01; VAT Ruling No. 025-01 and VAT Ruling No. 003-99)*. Therefore, the assessment of respondent has no basis in law.

b. Commission from Arms-length Transaction. 1996 P13,456,234.82
1997 P91,943,434.73

This particular assessment stemmed from the same issue that was earlier discussed in the deficiency income tax assessment, particularly in Item b. As We have ruled that there is no additional commission income that should be recognized on the difference of commission rates between petitioner's affiliate ING Barings Hongkong and its foreign clients, there is likewise no basis for the above assessment.

c. Underdeclared Revenue. 1996 P9,481,314.85

Respondent found a discrepancy between the income reported in the income tax return and revenue declared in the quarterly VAT returns for the year 1996 in the amount of P9,481,314.85, computed as follows:

Commission reported per ITR	P 342,598,661.00
Less: Commission from foreign transactions	304,089,121.49
Net Commission subject to VAT	P 38,509,539.51
Add: Other Income	39,889,780.32
Total Vatable revenue	P 78,399,319.83
Less: VAT Returns per taxpayer's reconciliation	68,918,004.98
Revenues still subject to VAT	P 9,481,314.85

(Exhibit "19-A" and pp. 236-237, BIR records)

Petitioner alleges that the discrepancy represents the amount of gain from the sale of street certificates. These certificates were the ones purchased by petitioner to cover the deficiency in inventory shortfall as earlier discussed. Since not all clients eventually

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claimed the stocks, petitioner sold the same. To prove further that there was no underdeclared sales, petitioner referred to the report of the commissioned independent CPA who explained that the discrepancy represents gain on dealership which was mistakenly reported as other income, thus:

> "Our review indicates that the gross receipts from recoveries of shares amounting to Php12,321,471 was erroneously recorded as "Other income" instead of a "Gain on dealership" in the income tax returns.
>
> The income, as gain on dealership should be subject to VAT on the basis of the net gain and not on the gross sales. The net gain on recoveries of shares amounted to Php1,162,318 which was the amount subjected to VAT by IBSPI. To further illustrate:

Gross sales (inclusive of VAT)	Php12,427,136
of shares Less cost	11,264,818
Net gain (income subjected to VAT)	Php1,162,318

(Exhibit "SSS").

Additionally, petitioner poses the view that as a stock broker, it is liable to VAT based on the net gain from the sale of shares of stock, pursuant to Section 25(a)(6)(C) in relation to Section 102 of the 1993 Tax Code.

Without delving on the veracity of above ratiocinations of both parties, We hold that the finding of respondent is not proper. We ruled previously that the right of respondent to assess petitioner for the deficiency VAT for the first three quarters of 1996 has already prescribed. Hence, what remains to be resolved is the propriety of the assessment for fourth quarter of 1996. However, after a recomputation based on the available evidence, We found that petitioner has no under-declared revenue for the fourth quarter of 1996, as shown in the table below:

Commission reported per ITR	P 61,389,996.69
Less: Commission from foreign transactions	53,562,027.57
Net Commission subject to VAT	P 7,827,969.12
Add: Other Income (P39,889,780.32 / 4)	9,972,445.08
Total Vatable revenue	P 17,800,414.20
Less: VAT Returns per taxpayer's reconciliation	35,513,882.25
Revenues still subject to VAT	(P 17,713,468.05)

The negative value in the above table means that the bulk of the underdeclared income was derived from the first three quarters of 1996 and as earlier discussed, was already beyond review. It follows that the present assessment has no factual basis and must be cancelled.

d. Sale of BMW 316i. 1997 P710,000.00

Respondent maintains that the sale of petitioner of BMW 316i in the year 1997 is subject to 10% VAT pursuant to Section 100 of the 1993 Tax Code –

> "**Sec. 100.** ***Value-added tax on sale of goods or properties.*** – (a) **Rate and base of tax.** – There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to 10% of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor."

On the contrary, petitioner argues that the sale of the said car is not subject to VAT because the transaction was not done in the course of trade or business in accordance with Section 99 of the same Code, to wit:

> "**Sec. 99.** ***Person liable.*** - Any person who, in the course of trade or business, sells, barters or exchanges goods, or properties, renders services, and any person who imports goods shall be liable to the value-added tax (VAT) imposed in Sections 100 to 102 of this Code.
>
> xxx xxx xxx
>
> The phrase "in the course of trade or business" means the regular conduct or pursuit of a commercial or an economic activity, *including the 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. *(Emphasis supplied).*

Upon a careful scrutiny of the records in this case, We note that in the Amended Articles of Incorporation of ING Baring Securities (Philippines), Inc., petitioner has incidental powers *(p. 28, BIR records)*, among which powers is:

"(d) To acquire, **purchase**, own, hold, operate, develop, lease, mortgage, pledge, exchange, **sell**, transfer or otherwise invest, trade or deal in, in any manner permitted by law, real and **personal property of very kind and description** or any interest therein." *(Emphasis supplied).*

From the foregoing, the sale of the subject BMW is also in petitioner's course of trade or business. The phrase "in the course of trade or business" having been defined by VAT law as "the regular conduct or pursuit of a commercial or an economic activity, *including the transactions* ***incidental*** *thereto*". Thus, pursuant to Section 100 of the 1993 Tax Code, petitioner is liable to 10% output VAT on its sale of said car.

e. Disallowed Input Tax. 1996 P4,865,236.41
1997 P3,377,295.57

Lastly, respondent also found that a discrepancy exists between the input taxes claimed by petitioner per VAT returns and the schedule of input taxes submitted by petitioner in the course of investigation, the breakdown of which are detailed below:

	1996	1997
Input Tax claimed per VAT returns (Net)	P8,422,028.82	P4,192,084.52
Less: Schedule of Input Tax Submitted		
January	P 243,061.05	P 661,736.41
February	116,895.44	89,894.08
March	163,104.78	149,345.79
April	1,392,291.41	641,546.31
May	294,832.94	85,474.98
June	500,053.41	81,490.98
July	360,809.50	484,490.76

August	258,414.39	436,302.20
September	176,750.23	109,136.60
October	643,501.15	489,690.98
November	335,543.54	60,011.71
December	379,978.57	88,174.77
Total	P4,865,236.41	P 3,377,295.57
Disallowed Input Tax per Investigation	P3,556,792.41	P 814,788.95

(p. 537, BIR records and Exhibits "M" to "T", inclusive of submarkings)

Petitioner contends that there was no discrepancy of input taxes claimed. As explained by its witness, Ms. Perocho, the discrepancy was brought by the mistake in the preparation of the quarterly VAT returns for both years 1996 and 1997. In 1996, the input VAT was erroneously accumulated in the quarterly VAT returns, while in 1997 there was double inclusion of both input and output VAT in the VAT returns *(TSN, pp. 21-35, June 27, 2001)*. Petitioner likewise reconciled the figures stated in its quarterly VAT returns with that of the input taxes claimed in its schedule *(Exhibits "LLL" and "KKKK", inclusive of submarkings)*.

After a careful perusal of the reconciliation made by petitioner with the evidence on record, as well as the report of the commissioned independent CPA, this Court agrees with the petitioner that there was an error in the presentation of input taxes in the year 1996 and an erroneous double inclusion of input and output taxes in the year 1997. However, this Court will further verify the authenticity of the input VAT claimed by petitioner in its schedule of input taxes. For the year 1996, We will examine only the input taxes for the fourth quarter because the first three quarters are already barred by prescription.

Upon verification of input taxes claimed by petitioner for the fourth quarter of 1996, the following input taxes are not qualified based on the evidence submitted and as reported by the commissioned independent CPA, to wit:

Input VAT claimed on unsupported purchases	P384,691.00
Input claimed on purchases from non-VAT Suppliers	36,208.00
Non-VAT pre-printed official receipts	34,482.00
Total	P 445,381.00

For the year 1997, this Court ascertained that the discrepancy between the input taxes claimed by petitioner in its VAT return as against the input taxes listed in the schedule was sufficiently accounted for and explained. Based on the 1997 Input VAT analysis, We were able to trace the cause of the disparity which was already corrected by petitioner and corroborated by the report of the independent CPA.

In sum, petitioner's deficiency VAT for the fourth quarter of 1996 and for the year 1997 are recomputed as follows:

	4th Qtr. 1996	1997
Discrepancy verified by the Court		
a. Disallowed Input VAT	P 445,381.00	
b. Sale of BMW		P 64,545.45
Add: Interest	244,959.55	22,590.90
Total Deficiency VAT Due	P 690,340.55	P 87,136.35

DEFICIENCY WITHHOLDING TAX – EXPANDED

The deficiency expanded withholding tax arose from the finding of the respondent that petitioner underwithheld taxes on various income payments by comparing the items listed in the income tax return and those in the alphalist. The details of the deficiency assessments are as follows:

	1996 EWT Base	1997 EWT Base	EWT Rate	1996 EWT Due	1997 EWT Due
Income Payments Per ITR					
Commission Expenses	P 3,384,050.66	P 4,934,702.05	5%	P169,202.53	P 246,735.10
Rental and Occupancy	11,705,287.78	15,482,510.82	5%	585,264.39	774,125.54
Machine Rentals	901,972.76	757,145.35	5%	45,098.64	37,857.27
Promotions and Advertising (15%)	204,232.14	210,554.06	5%	10,211.61	10,527.70
Temporary Staff	2,218,725.32	2,530,330.00	1%	22,187.25	25,303.30
Contractual Service-Others	8,180,639.56	556,109.00	1%	81,806.40	5,561.09
Professional Fees-Others	300,000.00	79,625.00	5%	15,000.00	3,981.25
Staff Housing Rental		100,000.00	5%		5,000.00
Sub-total				P928,770.82	P1,109,091.25
Less: Income Payments Subject to					
Withholding Tax Per Alphalist	Date	EWT Base		EWT Remitted	
January	02-12-96			P 18,292.42	
February	03-11-96			57,568.67	
March	04-10-96			8,850.00	
April	05-20-96			236,617.24	
May	06-10-96			8,071.76	
June	07-10-96			177,695.57	
July	08-09-96			15,282.64	
August	09-10-96			5,417.55	
September	10-10-96			12,456.26	
October	11-11-96			189,745.54	
November	12-10-96			9,416.47	
December	01-10-97			7,242.33	
Subjected to 1%		P 3,166,064.00	1%		31,660.64
Subjected to 5%		16,913,731.00	5%		845,686.55
Sub-total				P746,656.45	P 877,347.19
Basic Deficiency Withholding Tax				P182,114.37	P 231,744.06
Add: Interest and Penalty					
20% Interest				109,268.62	95,235.62
Compromise Penalty				16,000.00	16,000.00
Total Deficiency Expanded Withholding Taxes				P307,382.99	P 342,975.70

(Exhibits "24" & "26", inclusive of submarkings, pp. 535-536, BIR records)

Petitioner claims that the assessment for deficiency expanded withholding tax for the months of January 1996 to November 1996 has already prescribed since the corresponding assessment notice was issued beyond the three-year period reckoned from the respective filing of the Monthly Remittance Return of Income Taxes Withheld.

After a careful examination of the records of the case, the applicable law and jurisprudence, We agree with the petitioner that respondent's right to assess its expanded withholding tax liabilities for the months of January to November 1996 had already prescribed, to wit:

1996	Exh.	Date Filed	Last Day to file Return	Last Day to Issue Assessment
January	KK	02-12-96	02-12-96	02-11-99
February	LL	03-11-96	03-11-96	03-11-99
March	MM	04-10-96	04-10-96	04-12-99
April	NN	05-20-96	05-10-96	05-20-99
May	OO	06-10-96	06-10-96	06-10-99
June	PP	07-10-96	07-10-96	07-12-99
July	QQ	08-09-96	08-12-96	08-12-99
August	RR	09-10-96	09-10-96	09-10-99
September	SS	10-10-96	10-10-96	10-11-99
October	TT	11-11-96	11-11-96	11-11-99
November	UU	12-10-96	12-10-96	12-13-99
December	VV	01-10-97	01-10-97	01-10-00

The assessment notice for deficiency expanded withholding tax for the year 1996 was issued only on December 29, 1999. In view thereof, this Court will only examine the veracity of respondent's assessments for the month of December 1997 and for the calendar year 1997.

Petitioner asserts that the expanded withholding taxes for the remaining period were correctly withheld and remitted. Petitioner even contended that its remittance was more than the amount per respondent's computation, to wit:

	Per Respondent's Computation Based on ITR	Per Petitioner's Computation Based on Returns
1996		
January to December	P 928,770.82	P 1,272,237.85
1997		
January to December	1,109,091.25	1,836,684.15
Total	P 2,037,862.07	P 3,108,922.00

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We do not agree with petitioner.

After verification, this Court found that the total amount based on the returns referred to by petitioner was inclusive of the remittance for corporate final tax, presented below for easy appreciation:

1996	Exh.	Expanded	Final Tax	Total
January	KK	P 18,292.42	P 25,432.52	P 43,724.94
February	LL	57,568.67	22,416.59	79,985.26
March	MM	8,850.00	17,251.44	26,101.44
April	NN	236,617.24	-	236,617.24
May	OO	8,071.76	130,514.79	138,586.55
June	PP	177,695.57	68,769.39	246,464.96
July	QQ	15,282.64	26,686.02	41,968.66
August	RR	5,417.55	165,242.88	170,660.43
September	SS	12,456.26	-	12,456.26
October	TT	169,976.64	19,768.90	189,745.54
November	UU	9,416.47	6,759.17	16,175.64
December	VV	7,242.33	62,508.63	69,750.96
Total		P 726,887.55	P 545,350.33	P 1,272,237.88

1997	Exh.	Expanded	Final Tax	Total
January	WW	P 234,051.54	P 12,399.89	P 246,451.43
February	XX	5,803.61	167,028.89	172,832.50
March	YY	6,017.01	72,790.34	78,807.35
April	ZZ	218,863.89	451,865.41	670,729.30
May	AAA	1,159.99	35,284.05	36,444.04
June	BBB	12,834.21	102,092.13	114,926.34
July	CCC	196,522.82	52,501.87	249,024.69
August	DDD	4,303.37	2,343.74	6,647.11
September	EEE	924.05	38,220.13	39,144.18
October	FFF	192,463.00	(351.11)	192,111.89
November	GGG	2,985.13	703.74	3,688.87
December	HHH	1,422.56	24,454.31	25,876.87
Total		P 877,351.18	P 959,333.39	P 1,836,684.57

It should be stressed that respondent's assessment centered mainly on petitioner's liability for creditable portion of expanded withholding tax and did not include petitioner's liability for final withholding tax at source. Therefore, for failure of petitioner to overcome the presumption of correctness of the assessment in question, this

Court affirms respondent's finding that indeed discrepancy exists between the amount that should have been withheld and remitted based on the income tax return and the actual expanded withholding tax remitted.

For the month of December 1996, this Court is of the view that the assessment should be cancelled. We have observed that the remittance of petitioner as verified by respondent per alphalist in the amount of P746,656.45 is more than the amount of remittance reflected in the monthly remittance returns of petitioner in the amount of P726,887.55. However, for the year 1997, We affirm the assessment for the deficiency expanded withholding tax as computed by the respondent except for the compromise penalty which should not be imposed without the consent of petitioner ***(Industrial Inspection (Int'l) Incorporated vs. Liwayway Vinzons-Chato, in her capacity as The Commissioner of the Bureau of Internal Revenue, CTA Case No. 5152, May 19, 1997)***.

WHEREFORE, in view of the foregoing considerations, the Petition for Review is hereby ***PARTIALLY GRANTED***. The assessments for deficiency income tax for the years 1996 and 1997 and deficiency expanded withholding tax for the year 1996 are hereby **CANCELLED** and **WITHDRAWN** for lack of merit.

However, the assessments for 1996 and 1997 deficiency value added tax and for 1997 deficiency expanded withholding tax are hereby **UPHELD** in the following amounts:

	1996	1997
Deficiency Value-Added Tax		
Basic	P 445,381.00	P 64,545.45
Interest	244,959.55	22,590.90
Sub Total	P 690,340.55	P 87,136.35
Deficiency Expanded Withholding Tax		
Basic	P -	P 231,744.06
Interest	-	95,235.62
Sub Total	P -	P 326,979.68
TOTALS	P 690,340.55	P 414,116.03

Accordingly, petitioner is ***ORDERED*** to ***PAY*** the respondent the aggregate amount of P1,104,456.58, plus 20% delinquency interest per annum from February 17, 2000 until fully paid, pursuant to Section 249(C) of the 1997 Tax Code.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

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

JUANITO C. CASTAÑEDA, JR.
Chairman