REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION
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PARITY PACKAGING CORPORATION, Petitioner,	**CTA Case No. 8825**
	Members:
- versus -	**DEL ROSARIO,** *P.J., Chairperson,* **UY,** and **MINDARO-GRULLA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	***Promulgated:*** SEP 19 2017 ; 1:51 pm

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DECISION

UY, *J.*:

Before this Court is an *Amended Petition for Review* filed on October 20, 2014 by petitioner Parity Packaging Corporation, against respondent Commissioner of Internal Revenue, assailing the Assessment Notices issued against it for deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT), and documentary stamp tax (DST), in the aggregate amount of ₱326,675,902.19, including increments, for taxable year 2010.

THE FACTS

Petitioner Parity Packaging Corporation is registered with the Bureau of Internal Revenue (BIR) under Taxpayer Identification Number 004-464-749-000. Its registered address is No. 24 Fortune Avenue, Brgy. Fortune, Marikina City 1809.[1]

Respondent, on the other hand, is the duly appointed Commissioner of Internal Revenue who holds office at the BIR

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[1] Exhibit "P-2", Docket—Vol. II, p. 1002.

National Office Building, Agham Road, Diliman, Quezon City.[2]

On December 15, 2011, petitioner received Letter of Notice No. 116-RLF-10-00-00073 dated December 13, 2011, showing (per PTB of respondent) that petitioner had an under-declaration of sales for taxable year 2010, purportedly on the basis of a computerized matching conducted by respondent on the information/data provided by third party sources against declaration on VAT returns.[3]

Subsequently, a Letter of Authority No. 116-2012-00000016 dated July 3, 2012 was received by petitioner, thereby authorizing revenue officers Vivien Guillermo and Shella Samaniego to conduct examination of the books of accounts and other accounting records of petitioner for all internal revenue taxes for taxable year 2010.[4]

Petitioner received a *Notice of Informal Conference* dated September 13, 2013 signed by Alfredo V. Misajon, OIC-Assistant Commissioner (OIC-ACIR), Large Taxpayer Service of the BIR, informing petitioner of the initial audit findings on the basis of the audit conducted.[5]

On October 24, 2013, a *Preliminary Assessment Notice* (PAN) dated October 24, 2013, together with the Details of Discrepancies, both signed by OIC-ACIR Alfredo V. Misajon, were served to petitioner.[6]

On November 26, 2013, petitioner received a *Formal Letter of Demand* (FLD) dated November 26, 2013, with the Audit Result/ Assessment Notices Nos. IT-116-LOA-0000016-10-13-224, VT-116-LOA-0000016-10-13-225, WE-116-LOA-0000016-10-13-226, DS-116-LOA-0000016-10-13-227 and DS-116-LOA-0000016-13-228, for deficiency income tax, VAT, EWT and DST for the year ending December 31, 2010.[7] A "Details of Discrepancies" accompanied the said FLD and Assessment Notices showing the description of the deficiency assessments issued against petitioner.[8]

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[2] Par. 3, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), Docket—Vol. I, p. 618.
[3] Par. 9, Admitted Facts, JSFI, Docket—Vol. I, pp. 618 to 619.
[4] Par. 4, Admitted Facts, JSFI, Docket—Vol. I, p. 618.
[5] Par. 5, Admitted Facts, JSFI, Docket—Vol. I, p. 618.
[6] Par. 6, Admitted Facts, JSFI, Docket—Vol. I, p. 618.
[7] Par. 7, Admitted Facts, JSFI, Docket—Vol. I, p. 618.
[8] Par. 8, Admitted Facts, JSFI, Docket—Vol. I, p. 618.

On April 25, 2014, a *Final Decision on the Disputed Assessment* (FDDA) signed by OIC-ACIR Alfredo V. Misajon with even date, was received by petitioner.[9] In the said FDDA, respondent requested from petitioner the payment of ₱326,675,902.19, as total deficiency tax assessments due and collectible (including increments), broken down as follows:[10]

Tax Type	Amount
Income tax	₱ 200,123,786.58
VAT	113,075,438.11
EWT	188,576.27
DST	13,288,101.23
Total	**₱ 326,675,902.19**

Thus, on May 23, 2014, petitioner filed a *Petition for Review* before this Court. On May 29, 2014, the corresponding *Summons* was issued by the Court to respondent[11] which was received by respondent's counsel on June 3, 2014.[12]

However, on July 21, 2014, petitioner filed a *Motion to Strike Out Entries in the Petition for Review,*[13] praying for the striking out of Paragraphs 5.59 and. 5.140 from the said *Petition for Review* for being inadvertently inserted.

In the Resolution dated October 7, 2014,[14] the Court granted the said *Motion to Strike*. Nevertheless, for an orderly administration of justice and in conformity with the granting of the same *Motion to Strike*, petitioner was granted ten (10) days from receipt of the said Resolution within which to file its *Amended Petition for Review*.

On the other hand, respondent filed several *Motions*[15] to extend the period within which to file his *Answer*, which were all granted by the Court.[16] However, inspite of all the extensions given, respondent failed to file the said *Answer*.

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[9] Par. 10, Admitted Facts, JSFI, Docket—Vol. I, p. 619.
[10] Exhibit "P-1", Docket—Vol. II, pp. 978 to 1001.
[11] Docket—Vol. I, p. 263.
[12] *Supra*.
[13] Docket—Vol. I, pp. 270 to 275-B.
[14] Docket—Vol. I, pp. 294 to 296.
[15] Motion for Additional Time, Docket—Vol. I, pp. 265 to 267; Second Motion for Extension of Time to File Answer, Docket—Vol. I, pp. 278 to 281; and Urgent Motion for Additional Time, Docket—Vol. I, pp. 287 to 289.
[16] Order dated June 24, 2014, Docket—Vol. I, p. 269; Resolution dated August 11, 2014, Docket—Vol. I, p. 286; and Order dated August 22, 2014, Docket, Vol. I, p. 291.

Subsequently on October 15, 2014, respondent filed a *Motion for Leave to Admit Attached Answer.*[17] Said motion was granted by the Court and respondent's *Answer*[18] was admitted on October 21, 2014 in the Resolution dated October 21, 2014 in the interest of justice.[19]

In the *Answer*, respondent interposes the following special and affirmative defenses, to wit:

"**SPECIAL AND AFFIRMATIVE DEFENSES**

Respondent incorporates and repleads all the foregoing averments and by way of special and affirmative defenses further states:

The Assessments Issued Against Petitioner Have Factual and Legal Bases.

5. Petitioner is liable to pay deficiency Income Tax, Value-Added Tax, Expanded Withholding Tax, and Documentary Stamp tax for taxable year 2010 in the aggregate amount of Three Hundred Twenty Six Million Six Hundred Seventy Five Thousand Nine Hundred Two and 19/100 Pesos (Pph 326,675,902.19).

6. Per investigation made, petitioner is liable for deficiency income tax in the amount of Two Hundred Million One Hundred Twenty Three Thousand Seven Hundred Eighty Six and 58/100 pesos (Php 200,123,786.58)

6.a Undeclared Sales to FTC per matching of SLP AITEID (Letter Notice No. 116-RLF-10-00-00073), Sales Journal & SAWT, P73,902,383.38

6.a.1 Data per Letter Notice No. 116-RLF-10-00-00073 dated 13 December 2011 revealed that Fortune Tobacco Corporation (FTC) made purchases from petitioner in the total amount of ₱73,902,383.38. The

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[17] Docket—Vol. I, pp. 297 to 300.
[18] Docket—Vol. I, pp. 302 to 316.
[19] Docket—Vol. I, p. 318.

Summary Alphalist of Withholding Taxes (SAWT), and confirmed from the Certificates of Creditable Withholding Taxes (BIR Form 2307) petitioner have submitted disclosed sales made to FTC in the amount of ₱2,251,218.07. Upon verification from petitioner's Sales Journal as well as its Sales Invoices issued for 2010, it was revealed that the sales/revenues per FS/ITR did not include any sales made to FTC.

6.a.2. It must be stress (sic) that, petitioner's contention that the discrepancy as appearing in the Letter Notice is attributable to timing difference, whereby the purchases recorded by FTC in 2010 were already recorded by PPC in 2009, does not hold water. It must be emphasized that the invoices and official receipts issued to FTC which petitioner have submitted were (sic) all pertained to 2009. Thus, petitioner cannot invoke timing difference since the OR's supposed to have been utilized by FTC for reporting the same in 2010 were all issued in 2009.

6.a.3. Also, while FTC claimed the input tax attributable to the depreciable assets sold to it, there still remains income from FTC in the amount of ₱2,251,218.07 which was not declared in petitioner's income tax return. This is bolstered by the fact that there were no more outstanding receivables from FTC as of 31 December 2010.

6.a.4 Per LN No. 116-RLF-10-00-00073 as regards purchase declarations made by FTC:

Particulars	January 10	February 10	Total for 2010
Purchase of Services		2,251,218.07	2,251,218.07
Purchase of Capital Goods	1,235,378.57	70,415,786.74	71,651,165.31
Gross Purchases	1,235,378.57	72,667,004.81	73,902,383.38
Input VAT	148,245.43	8,720,040.58	8,868,286.01

From the above summary of the LN details, it is clear that the amount attributable to sale of services although declared per petitioner's VAT Returns was not declared for income tax purposes.

<u>6.b. Undeclared Income from PMFTC, Inc., ₱785,765.11</u>

6.b.1. The assessment of the undeclared income in the amount of ₱785,765.11 was assessed pursuant to Section 32(A) of the NIRC.

6.b.2. Also, photocopy of OR No. 33 originally submitted during audit did not have a marking 'cancelled' across its face. Hence, assessment of the undeclared income was reiterated in respondent's FDDA.

<u>6.c. Undeclared Income from Unreceipted Collections from Tanduay Distillers, Inc. -- ₱4,059,135.17</u>

6.c.1. Petitioner failed to account in its financial statements actual cash inflows to PPC based on the analysis of FS accounts and source documents submitted. This simply shows falsity of petitioner's financial statements since it is not reflective of the correct result of transactions that transpired during the taxable year.

6.c.2. Unreflected sources of funds not accounted for in the taxpayer's returns leads to the inference that part of its income has not been reported, hence, assessed pursuant to Section 32(A) of the NIRC.

<u>6.d. Gross Profit on Undeclared/Unaccounted Purchases per matching of SLP, EWT Alphalist and SLS-AITEID; ₱315,974.75</u>

6.d.1. It must be stressed that no schedule is necessary since petitioner's importations were culled from its financial statements and VAT return declarations, and were verified from the importation documents and vouchers submitted by the petitioner.

6.d.2. Now, as to petitioner's Prepaid Importation, while it submitted a Deed of Assignment of Raw Materials executed by PPC to FTC, it is not however clear that the same pertain or even included the said Prepaid Importation.

6.d.3. Also, the goods/materials that were supposedly covered by the Deed of Assignment should not have been included in the year-end financial statements for 2009 anymore since petitioner claims that Sales Invoices were already issued thereof, and the Deed of Assignment dated 29 October 2009 has absolutely transferred and conveyed ownership over the goods including all rights to the insurance policy, as clearly stated therein. Neither was there a disclosure in the Financial Statements that the said Prepaid Importation were subject of a Deed of Assignment of FTC.

6.d.4. In the alternative, although the Sales Invoice issued were dated 30 October 2009, the same had not been reported yet for tax purposes in 2009 since the inventory covered by the same only arrived and was still part of petitioner's assets in 2010. Thus, it was correctly assessed in 2010 since it was not included in petitioner's tax declarations. Also, petitioner miserably failed to explain how said Prepaid Importation were eventually cancelled or closed in its books.

6.d.5. Moreover, the Cost of Sales was underdeclared because the amount reported per petitioner's FS and ITR did not include the prepaid as well as the current importations, as shown below:

Inventory beginning per TB/FS	25,420,033.87
Add: Debits to Inventory/December	652,946.43
Total Goods Available For Sale	26,072,980.30
Less: Inventory End per TB/FS	6,994784.00
Raw Material Used	19,078,196.30
DL Per FS	12,800,283.00
Manufacturing Overhead per FS	3,861,654.00
Cost of Goods Sold per FS/ITR	35,740,133.30

6.e. Unsupported Compensation/Direct Labor; ₱163,924.27

6.e.1. Reconciliation of the Direct Labor account per FS against its details per Trial Balance disclosed a discrepancy of ₱163,924.27, hence, said amount was disallowed as deduction from gross income pursuant to Section 34(A)(1)(b) of the NIRC

6.e.2. The vouchers submitted by petitioner do not reconcile with the discrepancy. Petitioner failed to explain and reconcile to which particular FS account the said discrepancy was booked.

6.e.3. Also, the voucher was not a valid expense that can be claimed by PPC as it clearly states "FAO – Fortune Tobabcco Corp"

6.f. Disallowed expense for failure to subject to withholding tax; ₱5,881,105.46

6.f.1. Here, petitioner failed to subject withholding tax in accordance with the prescribed withholding tax rates under Section 2.57.2 of Revenue Regulation No. 2-98, various income payments aggregating ₱5,881,105.46, hence disallowed as deduction from gross income, pursuant to Section 2.58.5 of the same Regulation, in relation to Section 34(k) of the NIRC.

6.f.2. Clearly, Revenue Memorandum Circular 39-2007 provides: However, in order to comply with the requirement for deductibility

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under Section 34(k), in relation to Section 58 and 81 of the NIRC, as amended, the Security Agency must furnish its client, on or before January 31 of the year following the year of withholding, a notarized certification indicating the names of the guards employed by the client, their respective TIN's, the amount of their salaries and the amount of tax withheld from each. This certification together with the covering Non-VAT Acknowledgement Receipt must be kept on file by the client as substantiation for the claim of the expense.

6.f.3. As here, De Caliber Security Service Corporation is not the only security service provider that petitioner had transacted with but also with Sigasig Security Services Corporation as well. Hence, the certification submitted that petitioner have submitted does not suffice. Likewise, the certification submitted does not specify for which taxable year it was issued for.

6.f.4. Also, the said certification was notarized only on 18 November 2013 which was way beyond 31 January 2011, and petitioner was not able to present the Non-VAT Acknowledgement Receipts as required by Revenue Memorandum Circular 39-2007.

<u>6.g. Gain on Disposal/ Transfer of Real Property; ₱279,737,876.77</u>

6.g.1. It was disclosed that petitioner disposed of land and land improvements in 2010 in favor of Fortune Landequities Resources, Inc. (FLRI) in exchange for shares of the latter. Simultaneously, petitioner again exchange the shares of stocks in FLRI for shares of stocks in PMFTC, Inc. Considering that petitioner was not able to secure a favorable ruling that confirms both transfers as tax-free exchanges, it was assessed of income tax on the gain realized from the transfer of the real property in exchange for the shares of stocks in FLRI.

6.g.2. Even assuming without admitting that, all the requirements for a tax-free exchange were met in the first transaction with FLRI, petitioner must still be assessed for income tax on the gain realized from the second transaction whereby the 29,522 shares of stocks in FLRI with total par value of ₱2,952,200.00 was exchanged for 2,410 shares of stocks of PMFTC, Inc. with total par value of ₱2,140,000.00. The subsequent transaction whereby PMFTC, Inc. recognized the APIC on the shares issued from petitioner's first transaction with FLRI has given effect to a realization of the paper gain that has been booked in petitioner's financial statement.

6.g.3. Further, the real properties disposed is considered as ordinary asset as it were used in trade/business. Hence, it must be subject to the ordinary income tax in accordance with Section 4.a(ii) of the same Regulation which provides: 'The sale of real property located in the Philippines, classified as ordinary assets, shall be subject to the creditable withholding tax (expanded) under Section 2.57.2(J) of Rev. Regs. No. 2-98, as amended, based on the gross selling price/total amount of consideration of fair market value determined in accordance with Section 6(E) of the Code, whichever is higher, and consequently, to the ordinary income tax imposed under Section 24(A)(1)(c) or 25(A)(1) of the Code, as the case may be, based on net taxable income.' The net taxable income realized from the disposal of real properties is therefore assessed pursuant to Section 32(A) of the NIRC.

6.g.4. It is clear therefore that, the transaction does not fall under the purview of Section 40(C)(2) of the NIRC. The Deed of Absolute Sale dated and notarized on 25 February 2010 whereby PPC sold, transferred, and conveyed ownership to FLRI over the same property subject of petitioner's application for a tax-free exchange ruling, for and in consideration of 27,677 common shares (for a value of ₱317,625,000.00) of the latter.

6.g.5. As stated in the Deed of Absolute Sale, PPC divested itself of ownership over the property in favor of FLRI. However, and which must be emphasized, that this document was not the same document that petitioner had attached to its application for tax-free exchange ruling since what petitioner had submitted was a Deed of Transfer dated 25 February 2010 but notarized only on 03 June 2010.

6.g.6. The first Deed was never cancelled. This shows that the true intent of PPC and FLRI was that of an absolute sale which is bolstered in the subsequent transaction likewise a subject of an application for tax-free exchange ruling.

6.g.7. Now, in the second application for tax-free exchange ruling, PPC, along with other corporations, exchanged all of its existing properties, including its newly acquired shares of stocks in FLRI, in consideration of 1,605 Class 'A' common shares with par value of ₱1,000and full payment of the unpaid subscriptions of 535 Class 'A' common shares previously acquired in PMFTC. Total shareholding of PPC in PMFTC after this transaction became 2,140 Class 'A' common shares with total par value of ₱2,140,000.00.

6.g.8. While PPC along with other shareholders not exceeding four (4), have gained control over FLRI on the first transaction, PPC immediately divested itself of such control since it disposed of all its shareholdings in the latter on the same day.

<u>6.h. Disallowed Creditable Withholding Taxes; ₱30,547.20</u>

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6.h.1. As disclosed, creditable withholding taxes from Tanduay Distillers, Inc. in the amount of ₱30,547.20 pertain to sales/revenues made for the taxable period March 2009 amounting to ₱3,054,720.00, hence, was disallowed as income tax credit pursuant to Section 2.58.3 of Revenue Regulation 2-98, as amended.

7. Petitioner is likewise liable for deficiency VAT in the amount of One Hundred Thirteen Million Seventy Five Thousand Four Hundred Thirty Eight and 11/100 pesos (₱113,075,438.11).

<u>7.a Undeclared VAT receipts from PMFTC, Inc. ₱3,037,003.58</u>

7.a.1. After comparison of the total sum of all Official Receipts issued to PMFTC, Inc. against the total vatable receipts declared per Summary List of Sales attached to petitioners VAT returns. Thus, pursuant to Section 108 of the NIRC the said vatable receipts were assessed.

7.a.2. Upon re-evaluation of the photocopies of the official receipts submitted by petitioner, it cannot be denied that photocopy of the official receipt 33 which was originally submitted to respondent bears no 'cancelled' marking on its face. Hence, it cannot be presumed and assumed that the sale made to PMFTC was already cancelled.

<u>7.b. Undeclared Income from Unreceipted Collections from Tanduay Distillers, Inc.; ₱4,059,135.17</u>

7.b.1. Analysis of the invoice and or summaries and AR Balances disclosed a discrepancy on collections from Tanduay Distillers, Inc. Hence, such discrepancy connote undeclared revenues, unreflected sources of funds not accounted for in the taxpayer's returns leads to the inference that part of its income has not been reported.

7.c. Undeclared Gross Sales on Undeclared/ Unaccounted Purchases per matching of SLP, EWT Alphalist and SLS-AITEID; ₱732,049.51

7.c.1. In determining undeclared gross vatable sales attributable to such undeclared/ unaccounted purchases, the cost rate per FS/ITR has been utilized.

7.c.2. The undeclared gross sales was assessed pursuant to Sections 106 and 108 of the NIRC.

7.d. Undeclared Sales on Undeclared /Unaccounted Cost of Goods Sold; ₱53,571,715.53

7.d.1. As disclosed per analysis conducted on inventory balances, per Trial Balance, prepaid importation and current purchases/importation disclosed undeclared/unaccounted cost of goods sold.

7.d.2. The undeclared vatable sales were therefore assessed pursuant to Sections 106 of the NIRC, as amended. The cost rate of 56.84% per FS/ITR was applied.

7.d. Disposal of Real Properties; ₱377,65,490.00

7.d.1. Since the real property involved in this case was used in business, its transfer in exchange of shares of stocks of FLRI, whether resulting in corporate control or not, is subject to VAT pursuant to Section 2(b)(1) of Revenue Regulation 10-2011. Also, pursuant to Section 106(A) of the NIRC, as amended, the disposal of real property is subject to VAT.

8. Another, for failure of petitioner to withhold the creditable withholding taxes due on various income payments in accordance with the prescribed withholding tax rates as provided under Section 2.57.2 of RR-2-98, in violation to Section 57(B) of the NIRC, petitioner was assessed Expanded Withholding Tax in the amount of

One Hundred Eighty Eight Thousand Five Hundred Seventy Six and 27/100 pesos (₱188,576.27).

9. Likewise, petitioner cannot and should not argue that the transactions with Fortune Landequities Resources, Inc. (FLRI) and PMFTC were tax-free exchanges as these transactions do not fall under Section 40(C)(2), hence, it was assessed DST on the original issuance of shares to stocks in FLRI and PMFTC pursuant to Section 174 of the NIRC, as amended and on the assignment of shares in FLRI to PMFTC, pursuant to Section 175, of the NIRC, as amended.

The Right of Respondent to Assess Petitioner the Subject Deficiency Taxes has not yet Prescribed

10. Here, when petitioner's Accounting Records and pertinent documents were examined, by virtue of Letter of Authority No. 116-2012-00000016 dated **03 July 2012,** it was revealed that, there was a falsity in the cost of goods sold declared per petitioner's tax returns by merely reconciling the same against details in petitioner's financial statement. Also, it has been found out that the circumstance underlying the alleged tax-free exchange is an evident scheme to evade payment of taxes.

11. For the Documentary Stamp Tax assessments that arose from the alleged tax-free exchanges, no DST returns were filed and no stamp taxes were paid.

12. Since prescription is one of the affirmative defenses set up by petitioner herein, it was incumbent upon the latter to prove that it had submitted said returns, and that, having failed to do so, the conclusion must be that no such returns had been filed and that the Government had 10 years within which to make the corresponding assessments, as it did in this case.

13. Further, the 10 year prescriptive period will still apply even if what was filed was a wrong return. This is true even if the information embodied in the wrong return could enable the BIR to assess the tax liability of the taxpayer.

14. Section 222(A) of the NIRC, explicitly provides:

> "SEC. 222. **Exception as to Period of Limitation of Assessment and collection of Taxes.—**
>
> (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of falsity, fraud or omission..."

15. Hence, for willfully filing false returns and neglect to file related documentary stamp tax returns, 50% surcharge was imposed against petitioner.

16. Even assuming without conceding that petitioner has filed all the necessary returns, still, respondent's right to assess has not prescribed.

17. The Waiver of the Defense of Prescription executed by petitioner on 19 April 2013, extending the period within which to issue an assessment until 31 December 2014 is effective, valid, and binding.

18. It was executed before prescription has set in, duly notarized, and accepted by the respondent through OIC-ACIR Alfredo V. Misajon on 2 May 2013 per RDAO No. 05-01, which acceptance was made known to petitioner.

The Withholding Tax Assessment has not Prescribed

19. **Section 203 of the NIRC of 1997** states that:

> "**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 a return is filed beyond the period prescribed by law, the three (3)-year shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last prescribed by law for the filing thereof shall be considered as filed on such last day." (*Emphasis supplied*)

20. A cursory reading of the above-quoted provision of law would reveal that the period of limitation to conduct an assessment extends only to assessment of **"all internal revenue taxes"** as distinguished from assessment of **"penalties"** on the withholding agent for its failure to remit the proper amount of tax withheld.

21. Petitioner was assessed by respondent for deficiency withholding tax under the NIRC of 1997. **As such, it is being held liable in its capacity as a withholding agent and not in its personality as a taxpayer**. It need not be stressed that in an assessment for deficiency withholding taxes, the amount sought to be collected from petitioner is not the tax itself. Logically, it would be ridiculous to collect the said tax from petitioner when no income flowed into its person and jurisprudence affirms the same. It is merely an agent and not the statutory taxpayer. In **Commissioner of Internal Revenue vs. The Court of Appeals, Court of Tax Appeals and A. Soriano Corp,** it was provided:

> "In the operation of the withholding tax system, the withholding agent is the payor, a separate entity acting no more than an agent of the government for the collection of the tax in order to ensure its payments; the payer is the taxpayer – he is the person subject to tax imposed by law; and the payee is the taxing authority. **In other words, the withholding agent is merely a tax collector, not a taxpayer.** Under the withholding system, however, the agent-payor becomes a payee by fiction of law. His (agent) liability is direct and independent from the taxpayer, because the income tax is still impose on and due from the latter. **The agent is not liable for the tax as no**

> **wealth flowed into him – he earned no income**. xxx." *(Emphasis supplied)*

22. A withholding agent merely holds in trust the amount of tax it withheld and as trustee, it is duty bound to remit to the government the proper amount of tax withheld. Thus:

> **Section 58(A) of the NIRC of 1997** succinctly provides that:
>
> "xxx xxx xxx
>
> The taxes deducted and withheld by the withholding agent shall be held as a special fund in trust for the government until paid to the collecting officers.
>
> xxx xxx xxx"

23. Since the liability of the withholding agent (petitioner herein) is a penalty for failure to withhold and remit funds to the government, then the period of limitation provided in Section 203 of the NIRC of 1997 finds no application. The said provision prescribes a limitation only as to the **assessment of taxes, not penalties**.

The Assessments are Valid and Lawful

24. Assessments are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously **(Marcos II vs. Court of Appeals G.R. No. 120880 June 5, 1997)**

25. 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 **(Commissioner of Internal Revenue vs. Hantex**

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Trading Co.Inc, G.R No. 136975, March 31, 2005). The presumption in favor of the correctness of tax assessment stands where evidence to the contrary is wanting. Hence, the assessment issued against respondent is imbued with factual and legal bases.

26. All presumptions are in favor of the correctness of tax assessments *(Sy Po vs. Court of tax Appeals, 164 SCRA 524).* Dereliction on the part of respondent to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice."

On October 20, 2014, petitioner filed its *Amended Petition for Review.*[20] In the Resolution dated November 12, 2014,[21] the Court granted respondent fifteen (15) days from receipt thereof to file an *Amended Answer*, with a clarification that the *Answer* earlier filed may serve as the *Answer* to the said *Amended Petition for Review* if no new *Answer* is filed after the lapse of the period given. Respondent did not file an Amended Answer as per Records Verification dated January 22, 2015.[22] Thereafter, respondent forwarded the BIR Records of the instant case on February 20, 2015.[23]

After the Pre-Trial Conference held on April 30, 2015,[24] the parties submitted their *Joint Stipulation of Facts and Issues* on May 20, 2015,[25] and the same was approved in the Resolution dated May 25, 2015.[26] Subsequently, the Court issued its Pre-Trial Order on June 8, 2015.[27]

On May 21, 2015, petitioner filed a *Motion for the Appointment of An Independent Certified Public Accountant*,[28] praying for the appointment of Mr. Prudencio F. Tatunay, Certified Public Accountant (CPA), as an officer of this Court and as an Independent CPA, for the

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[20] *Amended Petition for Review* filed in compliance with this Court's Resolution dated October 7, 2014, Docket—Vol. I, pp. 319 to 367.
[21] Docket—Vol. I, pp. 570 to 571.
[22] Records Verification dated January 22, 2015 issued by the Judicial Records Division of this Court, Docket—Vol. I, p. 572.
[23] Undated Transmittal Letter from Ms. Faith M. Farochilen, Asst. Chief, Litigation Division, Docket—Vol. I, p. 579.
[24] Notice of Pre-Trial Conference dated January 28, 2015, Docket—Vol. I, p. 573.
[25] Docket—Vol. I, pp. 617 to 624.
[26] Docket—Vol. I, p. 654.
[27] Docket—Vol. I, pp. 661 to 671.
[28] Docket—Vol. I, pp. 636 to 639.

purpose of performing audit functions as the Court may direct in relation to the instant case. At the hearing held on June 11, 2015, the Court granted the said *Motion*,[29] and Mr. Tatunay took his *Oath of Commission*.[30]

During trial, petitioner presented two (2) witnesses, namely: Evita Pantaleon and Prudencio F. Tatunay, a Certified Public Accountant (CPA) duly commissioned by this Court as Independent CPA. On the other hand, the Court ruled that respondent waived his opportunity to present evidence for failure of respondent's counsel to appear despite due notice during the supposed initial presentation of respondent's evidence on June 23, 2016.[31]

In the Resolution dated September 23, 2016,[32] this case was submitted for decision, taking into consideration the *Memorandum* of petitioner filed on September 16, 2016,[33] and the *Manifestation* of respondent filed on August 23, 2016,[34] stating that he is adopting the arguments raised in his *Answer* as his *Memorandum.*

Hence, this Decision.

THE ISSUES

The parties presented the following issue for this Court's resolution, to wit:

> "WHETHER OR NOT PETITIONER IS LIABLE TO PAY DEFICIENCY INCOME TAX, VAT, EWT, AND DST ASSESSMENTS FOR TAXABLE YEAR 2010 IN THE AGGREGATE AMOUNT OF P326,675,902.19, INCLUSIVE OF INCREMENTS".[35]

Petitioner's arguments:

Petitioner argues that it is not liable to pay: (1) the deficiency

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[29] Minutes of the Hearing held on June 11, 2015, Docket—Vol. I, pp. 672 to 675.
[30] Docket—Vol. I, p. 676.
[31] Minutes of the Hearing held on June 23, 2016, Docket—Vol. II, pp. 1163 to 1164; and Order dated June 23, 2016, Docket—Vol. II, pp. 1165 to 1166.
[32] Docket—Vol. II, p. 1225.
[33] Docket—Vol. II, pp. 1183 to 1219.
[34] Docket—Vol. II, pp. 1173 to 1174.
[35] Issues, JSFI, Docket—Vol. I, p. 619.

income tax amounting to ₱200,123,786.58; (2) the deficiency VAT amounting to ₱113,075,438.11; (3) the deficiency EWT amounting to ₱188,576.27; and (4) the deficiency DST amounting to ₱13,288,101.23.

According to petitioner, respondent's right to assess petitioner for alleged deficiency VAT for the 1st Quarter of 2010 has already prescribed.

Lastly, petitioner stresses that in the present case, it has complied with the burden of proof by presenting documentary and testimonial evidence, and thus, the burden of evidence was shifted to the respondent. For his part, respondent, after the burden of evidence was shifted to him, failed to discharge the burden of proving his case against petitioner by presenting greater weight of evidence that will overcome petitioner's evidence thus established. In fact, respondent did not present any witness or document in his behalf.

Respondent's counter-arguments:

Respondent counter-argues that the assessments issued against petitioner have factual and legal bases and that the assessments are valid and lawful. Since prescription is one of the affirmative defenses set up by petitioner herein, it was incumbent upon the latter to prove that it had submitted said returns, and that, having failed to do so, the conclusion must be that no such returns had been filed and that the Government had 10 years within which to make the corresponding assessments, as it did in this case.

Hence, respondent's right to assess petitioner for deficiency taxes has not yet prescribed.

THE COURT'S RULING

The instant *Petition for Review* is partly meritorious.

We shall first address the issue of prescription.

Section 203 of the National Internal Revenue Code (NIRC) of 1997 provides that respondent shall make an assessment for deficiency taxes within three (3) years from the last day prescribed by law to file the tax return or the actual date of filing of such return, whichever comes later, to wit:

> "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 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."

Anent the issuance of deficiency VAT assessments, pursuant to Section 114(A) of the same Code, every person liable to pay VAT shall file quarterly return of the amount of his quarterly gross sales or receipts within twenty-five (25) days following the close of the taxable quarter.

Relative thereto, the following are the dates pertinent to the issuance of the subject deficiency VAT assessment, to wit:

ICPA Report (Exh. "P-41) Annex	Taxable Period 2010	Date of Filing	Last Day of Filing under Section 114(A)	Last Day to Assess under Section 203	Date of FAN
IC-16 (I)	1st Quarter	15- Apr-10	26-April-10[36]	26-April-13	26-Nov-13
IC-17 (I)	2nd Quarter	19-Jul-10	26-July-10[37]	26-Jul-13	26-Nov-13
IC-18 (I)	3rd Quarter	19-Oct-10	25-Oct-10	25-Oct-13	26-Nov-13
IC-19 (I)	4th Quarter	25-Jan-11	25-Jan-11	27-Jan-14[38]	26-Nov-13

With reference to the issuance of the deficiency EWT assessment, pursuant to Revenue Regulations (RR) No. 26-2002, the taxpayers classified under Group B, such as herein petitioner, are required to file the Monthly Withholding Tax Returns within fourteen (14) days following the end of the month.

In this connection, the following are the dates pertinent to the issuance of the subject deficiency EWT assessment:

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[36] April 25, 2010 fell on a Sunday.
[37] July 25, 2010 fell on a Sunday.
[38] January 25, 2014 fell on a Saturday.

ICPA Report Annex	Taxable Period 2010	Date of Filing	Last Day to File Return under RR No. 26-2002	Last Day to Assess under Section 203	Date of FAN
IC-20 (I)	January	08-Feb-10	15-Feb-10[39]	15-Feb-13	26-Nov-13
IC-21 (I)	February	05-Mar-10	15-Mar-10[40]	15-Mar-13	26-Nov-13
IC-22 (I)	March	07-Apr-10	14-Apr-10	14-Apr-13[41]	26-Nov-13
IC-23 (I)	April	08-May-10	14-May-10	14-May-13	26-Nov-13
IC-24 (I)	May	08-Jun-10	14-Jun-10	14-Jun-13	26-Nov-13
IC-25 (I)	June	09-Jul-10	14-Jul-10	15-Jul-13[42]	26-Nov-13
IC-26 (I)	July	09-Aug-10	16-Aug-10[43]	16-Aug-13	26-Nov-13
IC-27 (I)	August	07-Sep-10	14-Sep-10	16-Sep-13[44]	26-Nov-13
IC-28 (I)	September	07-Oct-10	14-Oct-10	14-Oct-13	26-Nov-13
IC-29 (I)	October	08-Nov-10	15-Nov-10[45]	15-Nov-13	26-Nov-13
IC-30 (I)	November	08-Dec-10	14-Dec-10	16-Dec-13[46]	26-Nov-13
IC-31 (I)	December	10-Jan-11	14-Jan-11	14-Jan-14	26-Nov-13

Based on the foregoing tables, the assessments for deficiency VAT covering the first to third quarters of 2010 and deficiency EWT covering January to October 2010 were issued beyond the 3-year prescriptive period mandated in Section 203 of the NIRC of 1997.

However, Section 222 (b) of the NIRC of 1997 provides that the prescriptive period under Section 203 of the same Code may be extended by way of a written agreement between the taxpayer and respondent executed before the lapse of the said 3-year prescriptive period, thus:

> "SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.-*
>
> xxx xxx xxx
>
> (b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement

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[39] February 14, 2010 fell on a Sunday.
[40] March 14, 2010 fell on a Sunday.
[41] April 14, 2013 fell on a Sunday.
[42] July 14, 2013 fell on a Sunday.
[43] August 14, 2010 fell on a Saturday.
[44] September 14, 2013 fell on a Saturday.
[45] November 14, 2010 fell on a Sunday
[46] December 14, 2013 fell on a Saturday.

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made before the expiration of the period previously agreed upon."

Records disclose that petitioner executed a Waiver[47] of the Defense of Prescription on April 19, 2013 which was accepted by respondent on May 2, 2013.

We note that respondent's right to assess deficiency VAT for the first quarter of 2010 was only until April 25, 2013, while that of deficiency EWT for January to March 2010 was only until April 14, 2013. Thus, when the said Waiver became effective on May 2, 2013, respondent's right to assess petitioner of deficiency VAT for the first quarter of 2010 and deficiency EWT for the months of January to March 2010 had already prescribed.

Accordingly, petitioner was validly assessed of deficiency taxes for taxable year 2010, except for the deficiency VAT covering the first quarter and deficiency EWT for the months of January to March.

The Court shall now look into the merits of the case. Each deficiency taxes shall be discussed one by one.

I. DEFICIENCY INCOME TAX – ₱200,123,786.58

Respondent assessed petitioner of deficiency income tax in the amount of ₱200,123,786.58, as computed below:

Taxable income per return		₱	9,475,017.79
Add: Adjustments			
1 Undeclared sales to FTC per matching of SLP-AITEID vs sales journal vs SAWT			2,251,218.07
2 Undeclared service income from PMFTC			785,765.11
3 Undeclared income from unreceipted collections from Tanduay Distillers, Inc.			4,059,135.17
4 Gross profit on undeclared/unaccounted purchases			
Undeclared purchases per matching of SLP vs EWT vs SLS-AITEID	₱ 416,126.15		
Divide by COS rate	56.84%		
Gross sales	732,100.90		
Multiply by gross profit rate per FS	43.16%		315,974.75
5 Gross profit on undeclared/unaccounted cost of goods sold			
Undeclared cost of goods per analysis of inventory balances, current & prepaid importation	30,450,163.11		
COS rate	56.84%		
Gross sales	53,571,715.53		
Multiply by gross profit rate per FS	43.16%		23,121,552.42

[47] BIR Records, p. 612.

6 Unsupported compensation/direct labor			
Per comparison of TB vs FS/ITR			163,924.27
7 Disallowed expenses for failure to subject to EWT			5,881,105.46
8 Gain on disposal of real property			279,737,876.77
Subtotal			316,316,552.02
Total sales/income per audit			325,791,569.81
Multiply by rate			30%
Income tax due per audit			97,737,470.94
Less: Allowable credits/payments			
Prior years' excess credits		28,638,577.20	
Add: Claimed CWT	₱ 1,672,537.02		
9 Out of period CWT	30,547.20	1,641,989.82	
Subtotal		30,280,567.02	
Less: Excess income tax credit carried forward		27,468,608.88	2,811,958.14
Basic deficiency income tax due			94,925,512.80
Add: Penalties			
50% Surcharge		47,462,756.40	
Interest		57,735,517.38	105,198,273.78
Total Deficiency Income Tax Due			**₱ 200,123,786.58**

1. Undeclared sales to FTC – ₱2,251,218.07

Respondent's audit disclosed that Fortune Tobacco Corporation (FTC) made purchases from petitioner in the total amount of ₱73,902,383.38, as shown hereunder, with the corresponding input VAT, to wit:

Particulars	Jan-10	Feb-10	Total for 2010
Purchase of services	₱ -	₱ 2,251,218.07	₱ 2,251,218.07
Purchase of capital goods	1,235,378.57	70,415,786.74	71,651,165.31
Gross purchases	1,235,378.57	72,667,004.81	**73,902,383.38**
Input VAT	148,245.43	8,720,040.58	8,868,286.01

In its letter of protest dated December 23, 2013, petitioner claimed that there were no undeclared sales to FTC, explaining the matter in this wise:

> "x x x On October 29, 2009 and November 12, 2009, the Company sold depreciable assets consisting of building, machineries and equipments to FTC for a total purchase price of P74,122,713.60 plus output VAT of P8,894,725.65. x x x
>
> Consequently, the input tax that can be claimed by the buyer or FTC is also P8,894,725.65. However, since these are depreciable assets, Section 110 (A) of the NIRC applies.
>
>> '*Provided*, that the input tax on goods purchased or imported in a calendar month for use in trade or business for which deduction for depreciation is allowed under this Code shall be spread evenly over the a month of acquisition and the fifty-nine (59) succeeding months if the aggregate acquisition cost

> for such goods, excluding the VAT component thereof, exceeds One million pesos (P1,000,000): *Provided, however*, That if the estimated useful life of the capital good is less than five (5) years, as used for depreciation purposes, then the input VAT shall be spread over such a shorter period: *Provided, finally*, that in the case of purchase of services, lease or use of properties, the input tax shall be creditable to the purchases, lessee or licensee upon payment of the compensation, rental, royalty or fee.'
>
> Thus, the input tax claimed by FTC in its 2009 VAT return for this transaction was P296,585.00 and not the entire P8,894,725.65.
>
> The tax base or purchases for the claimed input tax of P296,585.00 in 2009 was P2,471,548.60. In the middle of 2010, FTC disposed of, these purchased assets from the Company, hence, the claim of the remaining input tax in the amount of P8,598,139 equivalent to a tax base of P71,651.165. This was reflected in FTC's *Summary List of Purchases*.
>
> Simply put, claim of input tax on depreciable asset exceeding P1M does not mean purchase of that particular asset (source of input tax) during the year the input tax is claimed because of the above quoted provision of Section 110(A) of the NIRC."[48]

While conceding to petitioner's protest with regard to the assessment of ₱71,651,165.31, respondent maintains that the sales of ₱2,251,218.07 had not been declared in petitioner's ITR.

Petitioner reiterates that the amount of ₱2,251,218.07 relates to sales of services to FTC as evidenced by Official Receipt (O.R.) Nos. 0031 and 0032[49]. These sales were already reported by petitioner in 2010 as part of its taxable revenue.

A perusal of the audited Financial Statements (FS) discloses that petitioner has reported revenue for taxable year 2010 in the total amount of ₱62,874,076.00, consisting of sales in the amount of ₱49,545,304.00 and service income in the amount of ₱13,328,772.00.[50] Based on the trial balance, the details of which are as follows:[51]

Month	Sales	Service Income	Total
January	₱ -	₱ 1,315,388.27	₱ 1,315,388.27
February	3,294,469.64	935,829.80	4,230,299.44

[48] Exhibit "P-18", Docket—Vol. II, pp. 1037 to 1038.
[49] Exhibits "P-23" and "P-24", Docket—Vol. II, pp. 1066 to 1067.
[50] BIR Records, pp. 498 and 536.
[51] BIR Records, p. 477.

March	904,776.71	785,785.51	1,690,562.22
April	-	633,664.03	633,664.03
May	11,565,000.00	908,178.56 (785,785.51)	11,687,393.05
June	3,775,925.00	-	3,775,925.00
July	1,556,334.29	852,016.80	2,408,351.09
August	848,034.54	952,279.00	1,800,313.54
September	7,903,247.43	-	7,903,247.43
October	-	1,057,284.23	1,057,284.23
November	-	1,267,032.84	1,267,032.84
December	19,697,516.82	5,407,098.07	25,104,614.89
Total	**₱49,545,304.43**	**₱13,328,771.60**	**₱62,874,076.03**

Further, examination of the transaction listings[52] for the months of January and February shows sales to FTC in the total amount of ₱2,251,218.07, to wit:

Taxable Month	Customer	Amount
January	Fortune Tobacco Corporation	₱ 1,315,388.27
February	Fortune Tobacco Corporation	935,829.80
	Total	**₱ 2,251,218.07**

Clearly, the sales to FTC form part of the service income for the months of January and February. Indeed, petitioner has reported the alleged undeclared sales in the total amount of ₱2,251,218.07 as part of its taxable revenue. Hence, respondent's assessment shall be cancelled.

2. Undeclared service income from PMFTC – ₱785,765.11

Respondent's reconciliation of petitioner's actual collections from PMFTC, Inc. against its accounts receivable therefrom disclosed undeclared income in the amount of ₱785,765.11, thus assessed pursuant to Section 32(A) of the NIRC of 1997, as amended:

Actual collections per OR summary		₱12,207,565.23
Less: 12% VAT		1,307,953.42
Actual collections, net of VAT		10,899,611.81
Add: Ending Accounts Receivable AR (gross)	₱3,600,738.72	
Less: 12% VAT	385,793.43	3,214,945.29
Total		14,114,557.10
Less: Beginning AR (gross)	-	
Less: 12% VAT	-	-
Accrued service income per audit and analysis		14,114,557.10

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[52] Exhibit "P-41-2", Annexes "IC-35 (V.a)" and "IC-36 (V.a)", pp. 192 to 193.

Less: Accrued service income per FS/Income Tax Return (ITR)	13,328,772.00
Undeclared service income	**₱ 785,785.10**

In its protest to the FLD, petitioner claimed that the alleged undeclared service income pertains to cancelled O.R. No. 33. In support, petitioner submitted the photocopies of said O.R.

Respondent nonetheless did not agree that the O.R. No. 33 was cancelled. While the photocopy of the O.R. attached to the protest has a marking "cancelled" across its face, the original copy submitted during audit did not have such marking.

Petitioner formally offered in evidence the four (4) copies (original, duplicate, triplicate and quadruplicate) of the O.R. No. 33[53] dated March 31, 2010 with marking "cancelled" across its face. The complete set of the copies of the O.R. remained intact with the petitioner.

As a rule, the original of the receipt or invoice is issued to the purchaser, customer or client for each sale and transfer of goods and services.[54] Petitioner herein had not issued O.R. No. 33. Correspondingly, no sale had effected between petitioner and FTC. Hence, the assessment in the amount of ₱785,765.11 must be cancelled.

3. Undeclared income from unreceipted collections from Tanduay Distillers, Inc. – ₱4,059,135.17

Respondent's analysis of the petitioner's invoices, O.R. summaries and AR balances disclosed a discrepancy on collections from Tanduay Distillers, Inc. (TDI). The discrepancy allegedly connotes undeclared revenues, following the doctrine held in the case of *Eugenio Perez vs. The Court of Tax Appeals and The Collector of Internal Revenue*[55] which states that unreflected sources of funds not accounted for in the taxpayer's returns lead to the inference that part of his income has not been reported. Thus, the discrepancy in the amount of ₱4,059,135.17 was assessed pursuant to Section 32(A) of the NIRC of 1997, as amended, to wit:

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[53] Exhibits "P-25" and "P-25-a" to "P-25-c", Docket—Vol. II, pp. 1068 to 1071.
[54] Section 237, NIRC of 1997, as amended.
[55] G.R. No. L-10507, May 30, 1958.

Beginning AR, gross		₱58,066,445.06
Less: 12% VAT		6,221,404.83
Beginning AR, net of VAT		₱51,845,040.23
Add: Vatable sales		44,770,952.30
	Total	₱96,615,992.53
Less: Ending AR, gross	₱75,732,305.25	
Less: 12% VAT	8,114,175.56	67,618,129.69
Collections per analysis		₱28,997,862.84
Actual collections		24,938,727.67
Undeclared income from unreceipted collections		**₱ 4,059,135.17**

Petitioner alleges that all sales made to TDI for taxable year 2010 were reported and reflected in the tax returns filed. It emphasizes that mere discrepancy noted by respondent in its analysis does not necessarily translate to undeclared sales. This is especially true if the discrepancy can be reasonably explained and justified.

As verified by the Court-commissioned ICPA, the assessment relates to the unrecorded collections of TDI's 2009 Accounts Receivable, to wit:[56]

Schedule of Accounts Receivable					
	2009	2010			
		A/R (Sales + Output VAT)	AJE	Official Receipt Balance	Balance
Fortune Tobacco Corp.	₱125,911,466.16	₱ 0.00	₱ 0.00	₱125,911,466.16	₱ 0.00
Tanduay Distillers Inc.	**58,066,445.96**	**50,143,466.56**	**(4,546,332.30)**	**(27,931,374.96)**	**75,732,205.26**
Papercon	0.00	5,347,274.40	0.00	0.00	5,347,274.40
PMFTC	0.00	0.00	3,600,738.72	0.00	3,600,738.72
	₱183,977,912.12	**₱55,490,740.96**	**₱ (945,593.58)**	**₱ 97,980,091.20**	**₱ 84,680,218.38**

Annex "IC-38 (V.a)"

From the Schedule of Accounts Receivable, we have noted that this represents an auditor's audit adjustment on December 2010 on unrecorded collections from TDI from 2009 Accounts Receivable, amounting to **P4,546,332.30 less (12% VAT) P487,102.03 or P4,059,225.27**; The following adjusting entry was noted in the General Journal Register of the Company.

Auditor's Adjusting Entry:

Cash	5,471,807.65	
Accounts Receivable – TDI		**4,546,332.30**
Creditable tax withheld – net		925,475.35

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[56] Exhibit "P-41", pp. 17 to 18.

Annex "IC-38.1 (V.a)"

The sales amounting to P50,143,466.56 and the total collection of P27,931,374.96 was traced against Sales invoices and Official Receipts, respectively.

Sales Invoice No.	Date	Amount	Official Receipt No.	Date	Amount	EWT	Net Collection
2612	02/01/10	₱ 1,574,148.00	0123	08/23/10	₱ 42,479.20	₱ 379.28	₱ 42,099.92
2613	02/03/10	343,072.00	0124	08/23/10	85,267.68	761.32	84,506.36
2614	02/23/10	42,338.40	0125	08/23/10	1,011,466.80	9,030.96	1,002,435.84
2615	02/25/10	1,730,247.60	0126	08/23/10	124,325.00	1,110.04	123,214.96
2618	03/09/10	748,115.68	0127	08/23/10	262,500.00	2,343.75	260,156.25
2619	03/10/10	138,504.08	0128	08/23/10	2,339,444.16	20,887.89	2,318,556.27
2620	03/13/10	126,730.16	0129	08/23/10	2,870,650.80	25,630.81	2,845,019.99
2621	05/04/10	1,715,040.00	0130	08/23/10	147,599.76	1,317.86	146,281.90
2622	05/04/10	-cancelled-	0131	08/23/10	468,125.00	4,179.69	463,945.31
2623	05/04/10	1,715,040.00	0132	08/23/10	982,224.00	8,769.86	973,454.14
2624	05/08/10	2,044,800.00	0133	08/23/10	1,146,528.00	10,236.86	1,136,291.14
2625	05/15/10	1,854,912.00	0134	08/23/10	838,141.76	7,483.40	830,658.36
2626	05/18/10	1,789,248.00	0135	08/23/10	571,257.36	5,100.51	566,156.85
2627	05/19/10	547,680.00	0136	08/23/10	1,180,413.36	10,539.40	1,169,873.96
2628	05/22/10	985,824.00	0137	08/23/10	806,883.84	7,204.32	799,679.52
2629	05/27/10	1,643,040.00	0138	08/23/10	862,732.56	7,702.97	855,029.59
2630	05/29/10	657,216.00	0139	08/23/10	1,384,976.00	12,365.86	1,372,610.14
2631	06/06/10	547,680.00	0140	08/23/10	2,296,056.00	20,500.50	2,275,555.50
2632	06/08/10	1,542,240.00	0141	08/23/10	847,991.20	7,571.35	840,419.85
2633	06/10/10	1,314,432.00	0142	08/23/10	1,449,629.76	12,943.12	1,436,686.64
2634	06/17/10	516,236.00	0143	08/23/10	686,016.00	6,125.14	679,890.86
2635	06/28/10	308,448.00	0144	08/23/10	2,063,138.40	18,420.87	2,044,717.53
2636	07/07/10	210,772.80	0145	08/23/10	13,492.80	120.47	13,372.33
2637	07/21/10	160,289.60	0146	08/23/10	152,468.64	1,361.33	151,107.31
2638	07/27/10	1,372,032.00	0147	08/23/10	3,193,742.88	28,515.56	3,165,227.32
2639	08/02/10	949,798.68	0148	08/23/10	657,216.00	5,868.00	651,348.00
2651	09/05/10	328,608.00	0149	08/23/10	1,446,608.00	12,916.14	1,433,691.86
2652	09/07/10	328,608.00					
2653	09/15/10	1,306,250.72					
2654	09/22/10	1,540,896.00					
2655	12/06/10	1,182,384.00					
2656	12/06/10	947,076.80					
2657	12/06/10	785,250.12					
2658	12/06/10	308,448.00					
2659	12/06/10	2,199,456.00					
2660	12/06/10	3,037,824.00					
2661	12/06/10	4,089,600.00					
2662	12/06/10	1,485,428.72					
2663	12/06/10	3,257,280.00					
2664	12/06/10	1,760,599.20					
2666	12/08/10	3,007,872.00					
		₱ 50,143,466.56			**₱ 27,931,374.96**	**₱ 249,387.26**	**₱ 27,681,987.70**

Annexes "IC-38.2(V.a) to IC-38.42(V.a)"
Annexes "IC-38.43(V.a) to IC-38.56(V.a)"

Be that as it may, the journal entry merely establishes the recording of the collection of receivable from TDI. Moreover, the foregoing invoices and receipts merely substantiate the total sales to and collections from TDI for taxable year 2010. However, the same do not prove that the unreceipted collections of ₱4,059,135.17 have already been reported as part of petitioner's taxable revenue.

At the very least, petitioner should have provided either the breakdown schedule of its Accounts Receivables' beginning balance and the corresponding invoice of the unreceipted collections. In such case, the Court can ascertain that the unreceipted collections relate to petitioner's accounts receivable from year 2009 and not the year 2010, subject period of the present assessment. In the absence of the said documents, respondent's assessment on this item must be upheld.

4. Gross profit on undeclared/ unaccounted purchases – ₱315,974.75

Respondent compared the purchases reported on the Summary List of Sales (SLS) submitted by suppliers, on the one hand, with those reported on petitioner's Summary List of Purchases (SLP), disclosing undeclared/unaccounted purchases in the total amount of ₱416,126.15. Citing again the case of *Eugenio Perez vs. The Court of Tax Appeals and The Collector of Internal Revenue*[57], the gross profit thereon, as computed below, was assessed pursuant to Section 32(A) of the NIRC of 1997, as amended:

Unaccounted/undeclared purchases		₱416,126.15
Divided by: Cost rate per ITR/FS		
Cost of sales	₱35,740,133.50	
Gross sales/revenues	62,874,076.03	56.84%
Undeclared gross sales		₱732,100.90
Multiply by: Gross profit rate per ITR/FS		
Gross Profit	27,133,942.53	
Gross sales/revenues	62,874,076.03	43.16%
Undeclared gross profit		**₱315,974.75**

Respondent's assessment is unwarranted.

The three (3) elements on the imposition of income tax are: (1) there must be gain or profit, (2) that the gain or profit is realized or received, actually or constructively, and (3) it is not exempted by law or treaty from income tax.[58] Income tax is assessed on income received from any property, activity or service.[59] Such being the case, in the imposition or assessment of income tax, it must be clear that there was an income, and such income was received by the taxpayer, not when there is an underdeclaration of purchases.

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[57] *Supra.*
[58] *Commissioner of Internal Revenue vs. Court of Appeals, et. al.*, G.R. No. 108576, January 20, 1999.
[59] *Supra.*

Furthermore, it must be emphasized that for income tax purposes, a taxpayer is free to deduct from its gross income a lesser amount, or not a claim any deduction at all. What is prohibited by the income tax law is to claim a deduction beyond the amount authorized therein.[60] Hence, respondent's imposition or assessment of the subject income tax does not hold water, for it simply relies on the fact that there is **underdeclared purchases**.

Hence, the supposed *"Gross profit on undeclared/unaccounted purchases"* in the computed amount of ₱315,974.75 must not be considered in the subject deficiency tax assessment.

5. Gross profit on undeclared/ unaccounted cost of goods sold – ₱23,121,552.42

Respondent's analysis of petitioner's inventory balances per trial balance, prepaid importation and current purchases/importation allegedly disclosed undeclared/unaccounted cost of goods sold. Citing further the case of *Eugenio Perez vs. The Court of Tax Appeals and The Collector of Internal Revenue*[61], the gross profit thereon, as computed below, was assessed pursuant to Section 32(A) of the NIRC of 1997, as amended:

Inventory beginning per Trial Balance (TB)/FS		₱25,420,033.87
Add: Purchases		
Current importation	₱17,637,975.00	
Prepaid importation & related expenses	13,465,134.54	31,103,109.54
Total goods available to sale		₱56,523,143.41
Less: Inventory end per TB/FS		6,994,784.00
Cost of goods sold/used per audit		₱49,528,359.41
Less: Materials/goods used/sold per FS/ITR		19,078,196.30
Undeclared cost of goods sold/used		₱30,450,163.11
Divided by: Cost of rate per ITR/FS		
Cost of sales	₱35,740,133.50	
Gross sales/revenues	62,874,076.03	56.84%
Undeclared gross sales		₱53,571,715.53
Multiplied by: Gross profit rate per ITR/FS		
Gross Profit	₱27,133,942.53	
Gross sales/revenues	62,874,076.03	43.16%
Undeclared gross profit		**₱23,121,552.42**

[60] *Commissioner of Internal Revenue vs. Phoenix Assurance Co. Ltd.*, G.R. No. L-19727, May 20, 1965.
[61] *Supra.*

To reiterate, the three (3) elements for the imposition of income tax are: (1) there must be gain or profit, (2) that the gain or profit is realized or received, actually or constructively, and (3) it is not exempted by law or treaty from income tax. Thus, the income tax is assessed only when there was an income, and such income was received or realized by the taxpayer, not when there is an underdeclaration of cost of goods sold.

Assessment should not be based on mere presumptions no matter how reasonable or logical said presumptions may be. The assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption.[62]

Therefore, the alleged *"Gross profit on undeclared/unaccounted cost of goods sold"* in the determined amount of ₱23,121,552.42 must not be considered in the computation of the subject deficiency income tax assessment.

6. Unsupported compensation/ direct labor – ₱163,924.27

Respondent's reconciliation of the direct labor per FS against that per trial balance disclosed a discrepancy of ₱163,924.27, as determined below; thus, said amount was disallowed as deduction from gross income pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended:

Per FS/ITR		
Note 14 Direct labor		₱12,800,283.00
Per TB		
Payroll – DL	₱ 10,747,240.63	
SSS	342,733.30	
Medicare	71,800.00	
ECOM	9,610.00	
HDMF	32,475.00	
Sick/Maternity leave	364,114.13	
Vacation leave	267,962.96	
13th Month pay	601,922.71	
Employee benefits	198,500.00	12,636,358.73
Unsupported direct labor/salaries		**₱ 163,924.27**

[62] *Commissioner of Internal Revenue vs. Island Garment Manufacturing Corporation and the Court of Tax Appeals*, G.R. No. L-46644, September 11, 1987.

Petitioner avers that the alleged discrepancy pertains to separation pay made by petitioner in 2010.

Based on the Alphalist of Terminated Employees before December 31, 2010[63], a certain Ricardo Y. Arcillas, who was hired on May 2, 1996 and terminated on January 13, 2010, was paid the amount of ₱163,924.27. Same finding was noted by the ICPA, to wit:[64]

> "The said separation pay of P163,924.27 of Arcillas, Ricardo, was reported and traced from the Alphalist of Terminated Employees before December 31, 2010 of PPC ***Annex "IC – 59 (V.a)"***. The withholding tax was also remitted to the BIR as per Paying Voucher Batch 103 representing cash transfer (ATM) to employees inclusive of Gratuity pay of P163,924.10, thru FTC. ***Annex "IC – 60 (V.a)"***
>
> The amount of P163,924.10 was originally recorded as 'Separation Pay' and ultimately closed to 'Direct Labor' account as for AFS presentation. The following is the Journal Entry from its General Journal Register:

Direct Labor	12,800,282.83	
Direct Labor (Payroll)		10,562,012.69
Rice Subsidy		185,227.94
SSS		342,733.30
Medicare		71,800.00
ECOM		9,610.00
HDMF		32,475.00
13th month		601,922.71
SL		364,114.13
VL		267,962.96
Employees Benefit		198,500.00
Separation Pay		163,924.10

Annex "IC – 60.1 (V.a)"

Be that as it may, the alphalist merely proves that petitioner had withheld and remitted the corresponding tax on separation pay. The withholding of tax, couple with a voucher, does not necessarily indicate that petitioner had indeed paid the separation pay in the amount of ₱163,924.27 in 2010. Petitioner should have presented the corresponding receipt to show that the said separation pay was received by the named payee.

This must be so because a voucher is simply a documentary record of a business transaction as held in the case of *Towne & City Development Corporation vs. Court of Appeals*[65], to wit:

[63] BIR Records, Folder No. 1, p. 71.
[64] Exhibit "P-41", p. 24.
[65] G.R. No. 135043, July 14, 2004.

"x x x [A]s correctly pointed out by the trial court which the appellate court upheld, vouchers are *not* receipts.

> It should be noted that a voucher is *not necessarily* an evidence of payment. It is merely a way or method of recording or keeping track of payments made. A procedure adopted by companies for the orderly and proper accounting of funds disbursed. Unless it is supported by an actual payment x x x, a voucher remains a piece of paper having no evidentiary weight.

A receipt is a written and signed acknowledgment that money has been or goods have been delivered, while a voucher is documentary record of a business transaction.

The references to alleged check payments in the vouchers presented by the petitioner do not vest them with the character of receipts. x x x" *(Citations omitted)*

Accordingly, petitioner failed to substantiate the discrepancy. Thus, the subject item in the amount of ₱163,924.27 must be maintained and considered in the deficiency income tax assessment.

7. Disallowed expenses for failure to subject to withholding tax – ₱5,881,105.46

Respondent's verification disclosed that petitioner failed to withhold tax, in accordance with Section 2.57.2 of RR No. 2-98, on various income payments. Thus, the amount of ₱5,881,105.46 was disallowed as deduction from gross income pursuant to Section 2.58.5 of the same Regulation, in relation to Section 34(K) of the NIRC of 1997, as amended:

Total income payments per FS subject to EWT	₱16,571,702.46
Less: Income payments subjected to EWT per alphalist	10,690,597.00
Total income payments not subjected to EWT	**₱ 5,881,105.46**

Petitioner posits that majority of the expenses subject of the deficiency income tax assessment refer to the salaries paid to security guards. According to petitioner, it is not constituted as the withholding agent for the salaries of the security guards, but it is the security agency which has physical control over the payments of the salaries. Despite this fact, it is petitioner which claims the payments as deductible expenses.

The ICPA's analysis shows that the assessment relates primarily to security services and casual purchases, to wit:[66]

"Our Analysis:

					DEFICIENCY PER FS/ITR vs. 1604-E	
	PER FS/ITR	**EWT**	**1604E**	**EWT**	**AMOUNT**	**EWT**
15%	31,300.00	4,695.00	31,300.00	4,695.00	-	-
10%	45,500.00	4,550.00	45,500.00	4,550.00	-	-
5%	-	-	-	-	-	-
2%	**13,828,456.46**	**276,569.13**	**9,263,342.84**	**185,266.85**	**4,565,113.62**	**91,302.29**
1%	**2,666,446.00**	**26,664.46**	**1,350,447.43**	**13,504.47**	**1,315,900.57**	**13,159.99**
TOTAL	**16,571,702.46**	**312,478.59**	**10,690,598.27**	**208,016.42**	**5,881,105.46**	**104,461.28**

	PER FS	***ALPHALIST**	**DIFFERENCE**	**AMOUNT NOT SUBJECT TO EWT**	**BIR EWT Assessment on Difference**
PROFESSIONAL FEE	31,300.00	31,300.00	-	-	-
BROKERAGE	45,500.00	45,500.00	-	-	-
INSURANCE	124,980.00	221,994.29	(97,014.29)	-	-
SECURITY SERVICES	**5,642,393.00**	**1,007,708.00**	**4,634,685.00**	**4,634,685.00**	**91,997.99**
OTHERS-IMPORT CHARGES	397,264.00	368,630.36	28,633.64	-	-
FINANCE CHARGES	7,663,919.46	7,665,019.45	(1,099.99)	-	-
MACHINE PARTS	**1,968,946.00**	**-**	**1,968,946.00**	-	-
INDIRECT MATERIALS	**697,500.00**	**697,500.00**	**-**	-	-
DIRECT MATERIALS (COS)	**-**	**652,946.43**	**(652,946.43)**	-	-
CASUAL PURCHASES	-	-	-	**1,246,519.36**	**12,465.19**
TOTAL	**16,571,802.46**	**10,690,598.53**	**5,881,204.36**	**5,881,204.36**	**104,463.18**

*__*Annexes "IC – 61 (V.a)"*__*

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[66] Exhibit "P-41", pp. 25 to 26.

> **The machine parts** represents a 2009 importation amounting to P1,968,946.00 and importation is not subject to withholding tax. While purchases subjected to 1% EWT were Direct Materials and Indirect Materials and not purchases of machine parts. ***Annexes "IC – 61.1 (V.a) to IC – 61.2 (V.a)"***
>
> **Insurance expense** of P124,980.00 reported as per AFS – represents the amortized (expense) portion, while the amount of 221,994.29 per Alpha List – represents income payment.
>
> **Security services**. Verification from the summary of acknowledgement receipts and vouchers of De Caliber Security Services Corporation – ***Annexes "IC – 62 (V.a)"*** and Sigasig Security Services Incorporated – ***Annexes "IC – 63 (V.a)"*** disclosed that the amount of P4,634,685.00 represents payment to Security Agents. The basis of withholding is 2% from its management fees totaled P1,007,708.00 also presented the vouchers (in accordance to – RMC No. 39 – 2007 dated January 22, 2007 Security Agencies are subject only on their management fees).
>
> We have verified that De Caliber Security Services Corporation issued an (unregistered) Acknowledgement Receipt representing the Security Guards salaries, - ***Annexes "IC – 63.1 (V.a) to IC – 63.23 (V.a)"***
>
> We have verified the (duly Notarized) Certifications issued by De Caliber – ***Annex "IC – 64 (V.a)"*** and Sigasig Security Services Inc. – ***Annex "IC – 65 (V.a)"*** We have noted the difference represents the gross payments to said agencies, including that of the security guard.
>
> **Other import charges** are casual expenses incurred during the process of import documentation."

With regard to security services, Sections IV and V of Revenue Memorandum Circular No. 39-2007 dated January 22, 2007 clarify the tax treatment of the salaries of security guards, to wit:

> "**SUBJECT :** **Clarifying the Income Tax and VAT Treatment of Agency Fees/Gross Receipts of Security Agencies Including the Withholding of Taxes Due thereon.**
>
> x x x x x x x x x
>
> **IV. MANNER OF ISSUING RECEIPT FOR THE ENTIRE CONTRACT PRICE. –**
>
> x x x x x x x x x
>
> With respect to the security guards' salaries which are mandated by law to be paid by the Client through the

Security Agency, the amount so paid representing salaries must be covered by a Non-VAT Acknowledgement Receipt. This document, coupled with the notarized certification of the expanded withholding taxes prescribed in Paragraph V hereunder, shall be a sufficient substantiation for the expense that will be claimed as a deduction from gross income by the Client.

V. WITHHOLDING TAX COMPLIANCE. –

x x x x x x x x x

Insofar as the Agency Fee is concerned, the Client is constituted as the withholding agent of the EWT following the rule above-mentioned. However, with respect to the portion of the Contract Price representing the amount segregated and earmarked as salaries of the security guards, the Security Agency shall be the one responsible for the withholding of the tax on compensation income. This is so because while it is the Client who claims the payment as an expense, it is the Security Agency who physically controls the payment to the salaries of the Security Guards. x x x" *(Underscoring supplied)*

Relying on the Circular, petitioner submitted the notarized Certifications[67] issued by De Caliber Security Services Corporation and Sigasig Security Services, Inc. on November 18, 2013 and August 10, 2011, respectively.

As per the said Certifications, the security agencies certify that they have religiously complied with their obligation as withholding agents pursuant to Sections 79, 80 and 81 of the NIRC of 1997, as amended, and its Implementing Regulations, and that they have withheld and remitted the correct tax on wages paid to security guards assigned for duty to petitioner in the total amount of ₱3,457,650.00, as shown below:

De Caliber Security Services Corporation	₱ 2,887,650.00
Sigasig Security Services, Inc.	570,000.00
Total	**₱ 3,457,650.00**

[67] Exhibits "P-28" and "P-29", Docket—Vol. II, pp. 1076 to 1078.

On the other hand, the casual purchases in the amount of ₱1,246,519.36 originated mainly from the importation of spare parts, to wit:

Machine parts	₱1,968,946.00
Insurance	(97,014.29)
Others – import charges	28,633.64
Finance charges	(1,099.99)
Direct materials (COS)	(652,946.43)
Total	**₱1,246,518.93***

**Due to rounding-off*

As evidenced by the Paying Voucher No. 3913 and the Import Entry & Internal Revenue Declaration No. C1 33735, petitioner imported spare parts costing USD43,148.35 or ₱1,968,945.51. In this connection, Section 2.57.2 of RR No. 02-98 provides that the EWT imposed therein applies only on income payments to persons residing in the Philippines. Hence, the amount of ₱1,246,519.36 must not be considered in determination of the deficiency income tax assessment.

Accordingly, only the amount pertaining to the remaining income payments of ₱1,176,936.10, as computed below, must be sustained:

Total income payments not subjected to EWT per assessment	₱5,881,105.46
Less: Security services supported by Certifications	3,457,650.00
Machine parts not subject to withholding tax	1,246,519.36
Total Income Payments Not Subjected to EWT per audit	**₱1,176,936.10**

8. Gain on disposal of real properties – ₱279,737,876.77

Respondent's verification disclosed that petitioner has disposed of land and land improvement in favor of Fortune Landequities Resources, Inc. (FLRI) in exchange for shares of stocks of the latter. Simultaneous to the said transfer, petitioner again swapped/exchanged the shares of stocks in FLRI for shares of stocks in PMFTC, Inc.

Considering that it was not able to secure a favorable ruling that confirms both transfers as tax-free exchanges, petitioner is allegedly liable for income tax on the gain realized from the transfer of its real properties in exchange for the shares of stocks in FLRI.

Further, granting that all the requirements for a tax-free exchange are met in the first transaction with FLRI, respondent posits that petitioner is still liable for income tax on the gain realized from the second transaction whereby the 29,522 shares of stocks in FLRI with total par value of ₱2,952,200.00 were exchanged for 2,410 shares of stocks in PMFTC, Inc. with total par value of ₱2,140,000.00. Respondent is of the view that the subsequent transaction, whereby PMFTC, Inc. recognized the Additional Paid-In Capital on the shares issued from petitioner's first transaction with FLRI, has given effect to a realization of the paper gain that has been booked in petitioner's financial statements.

According to respondent, since the properties disposed were used in the business, the same are considered ordinary assets within the definition set forth under RR No. 7-2003. Consequently, the disposal of the properties is subject to the ordinary income tax in accordance with Section 4.a(ii) of the same Regulation which provides: *"The sale of real property located in the Philippines, classified as ordinary assets, shall be subject to the creditable withholding tax (expanded) under Sec. 2.57.2(J) of Rev. Regs. No. 2-98, as amended, based on the gross selling price/total amount of consideration or fair market value determined in accordance with Section 6(E) of the Code, whichever is higher, and consequently, to the ordinary income tax imposed under Sec. 24(A)(1)(c) or 25(A)(1) of the Code, as the case may be, based on net taxable income."* The net taxable income realized from the disposal of real properties was therefore assessed pursuant to Section 32(A) of the NIRC.

However, petitioner contends that the transfer of real properties to FLRI in exchange for the latter's shares of stocks, as well as the subsequent transfer of such shares of stocks to PMFTC, Inc. as payment for the subscribed shares, constitute tax-free exchange as contemplated under Section 40(C)(2) of the NIRC of 1997.

The Court agrees with petitioner.

Section 40(C)(2) of the NIRC of 1997 provides as follows:

"SEC. 40. *Determination of Amount and Recognition of Gain or Loss. –*

x x x x x x x x x

(C) *Exchange of Property.* –

(1) *General Rule.* – Except as herein provided, upon the sale or exchange of property, the entire amount of the gain or loss, as the case may be, shall be recognized.

(2) *Exception.* – No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation –

(a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or

(b) A shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock of another corporation also a party to the merger or consolidation; or

(c) A security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such corporation, solely for stock or securities in such corporation, a party to the merger or consolidation.

No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation: *Provided,* That stocks issued for services shall not be considered as issued in return for property." *(Emphasis supplied)*

As used in this provision, the term "control" is defined as "ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote."[68]

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[68] Section 40(C)(6)(c) of the NIRC of 1997.

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There is nothing in the law which requires that the absence of a confirmatory ruling would result in a deficiency income tax assessment. Thus, there can be no merit in respondent's argument to the effect that considering that petitioner was not able to secure a favorable ruling from the BIR that the subject transfers or exchanges are tax-free, petitioner's income tax liability must be maintained.

Furthermore, based on the aforequoted Section 40, the requisites for the non-recognition of gain or loss are: (a) the transferee is a corporation; (b) the transferee exchanges its shares of stock for property/ies of the transferor; (c) the transfer is made by a person, acting alone or together with others, not exceeding four (4) persons; and, (d) as a result of the exchange the transferor, alone or together with others, not exceeding four (4), gains control of the transferee.[69]

After careful study and analysis of the case, the Court finds that petitioner's exchange transactions with FLRI and PMFTC, Inc. satisfied all of the above requisites.

8.1 Tax-free exchange with FLRI

As can be gleaned from the General Information Sheet (GIS)[70] filed with Securities and Exchange Commission (SEC) on June 3, 2010, FLRI is a domestic corporation with an authorized capital stock of ₱96,000,000.00 consisting of 960,000 common shares with a par value of ₱100 per share.

Records show that petitioner, together with FTC, Northern Tobacco Redrying Co. Inc., Dominium Realty and Construction Corporation and Orecla Realty, Inc., transferred properties in exchange for FLRI's shares of stocks.[71]

Petitioner, for its part, transferred its title and ownership over the land, covered by Transfer Certificate of Title No. 188550, located in Marikina, Metro Manila, as evidenced by a Deed of Transfer.[72]

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[69] *Commissioner of Internal Revenue vs. Filinvest Development Corporation*, G.R. Nos. 163653 and 167689, July 19, 2011.
[70] Exhibit "P-41-2", Annex "IC-77 (V .a)", pp. 519 to 525.
[71] Exhibit "P-41-2", Annex "IC-71 (V .a)", p. 487 to 496.
[72] Exhibit "P-41-2", Annex "IC-70 (V .a)", pp. 484 to 486.

The transferors are the existing shareholders of FLRI prior to the exchange. The capital structure of FLRI prior to the exchange is as follows:

Subscriber	No. of Shares	% of Ownership	Amount Subscribed	Amount Paid
Fortune Tobacco Corporation	83,575	34.8222%	₱8,357,500.00	₱2,089,375.00
Parity Packaging Corporation	7,380	3.0749%	738,000.00	184,500.00
Northern Tobacco Redrying Co. Inc.	1,430	0.5958%	143,000.00	35,750.00
Dominium Realty and Construction Corporation	3,615	1.5062%	361,500.00	90,375.00
Orecla Realty, Inc.	144,000	59.9989%	14,400,000.00	3,600,000.00
Harry Tan	1	0.0004%	100.00	100.00
Lucio Tan	1	0.0004%	100.00	100.00
Chris Nelson	1	0.0004%	100.00	100.00
Varinia Elero	1	0.0004%	100.00	100.00
R. Miranda	1	0.0004%	100.00	100.00
Total	**240,005**	**100%**	**₱24,000,500.00**	**₱6,000,500.00**

The aforesaid capital structure reveals that the transferors are the controlling stockholders of FLRI by owning 99.998% of its total voting stocks.

After the exchange, the capital structure of FLRI is as follows:

Subscriber	No. of Shares	% of Ownership	Amount Subscribed
Fortune Tobacco Corporation	334,295	34.8224%	₱33,429,500.00
Parity Packaging Corporation	29,522	3.0752%	2,952,200.00
Northern Tobacco Redrying Co. Inc.	5,722	0.5960%	572,200.00
Dominium Realty and Construction Corporation	14,459	1.5062%	1,445,900.00
Orecla Realty, Inc.	575,997	59.9997%	57,599,700.00
Harry Tan	1	0.0001%	100.00
Lucio Tan	1	0.0001%	100.00
Chris Nelson	1	0.0001%	100.00
Varinia Elero	1	0.0001%	100.00
R. Miranda	1	0.0001%	100.00
Total	**960,000**	**100%**	**₱96,000,000.00**

It can be gleaned from the above tables that petitioner's number of common shares increased from 7,380 to 29,522, which resulted in an increase of 22,142 shares.[73]

The result of the transfer of assets, in exchange for new additional shares and payment of unpaid original subscriptions of stock, is that the transferors continue to collectively control FLRI by owning 99.9995% of its total voting stocks.

8.2 Tax-free exchange with PMFTC, Inc.

Records show that PMFTC, Inc. is a domestic corporation.[74]

Petitioner, together with Philip Morris Philippines Manufacturing Inc., FTC, Northern Tobacco Redrying Co. Inc., and Dominium Realty and Construction Corporation, transferred assets including accounts payables and accrued expenses and syndicated loans to PMFTC, Inc., in exchange for the latter's shares of stocks.[75]

Prior to the exchange, the transferors are the controlling stockholders of PMFTC, Inc. by owning 99.9956% of its voting stocks, as shown below:

Subscriber	No. of Shares	% of Ownership	Amount Subscribed	Amount Paid
Philip Morris Philippines Manufacturing, Inc.	124,988	49.9980%	₱124,988,000.00	₱31,247,000.00
Fortune Tobacco Corporation	123,977	49.5936%	123,977,000.00	30,994,250.00
Parity Packaging Corporation	535	0.2140%	535,000.00	133,750.00
Northern Tobacco Redrying Co. Inc.	105	0.0420%	105,000.00	26,250.00
Dominium Realty and Construction Corporation	370	0.1480%	370,000.00	92,500.00
Lucio Tan	1	0.0004%	1,000.00	1,000.00
Carmen Tan	1	0.0004%	1,000.00	1,000.00
Harry Tan	1	0.0004%	1,000.00	1,000.00
Lucio K. Tan	1	0.0004%	1,000.00	1,000.00
Michael Tan	1	0.0004%	1,000.00	1,000.00
Chris Nelson	1	0.0004%	1,000.00	1,000.00
Douglas Werth	1	0.0004%	1,000.00	1,000.00

[73] Exhibit "P-41-2", Annexes "IC-75 (V .a)", "IC-75.1 (V .a)" and "IC-70 (V .a)", pp. 484-486 and 516-517.
[74] Exhibit "P-41-2", Annex "IC-81 (V.a)", pp. 548 to 555.
[75] Exhibit "P-41-2", Annex "IC-80 (V.a)", pp. 539 to 547.

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Mitchell Gault	1	0.0004%	1,000.00	1,000.00
Raymond Miranda	1	0.0004%	1,000.00	1,000.00
Varinia Elero	1	0.0004%	1,000.00	1,000.00
Vincent Nguyen	1	0.0004%	1,000.00	1,000.00
Total	**249,986**	**100%**	**₱249,986,000.00**	**₱62,504,750.00**

After the exchange, the transferors continued to collectively control PMFTC, Inc. by owning 99.9989% of its total voting stock, as shown below:

Subscriber	No. of Shares	% of Ownership	Amount Subscribed
Philip Morris Philippines Manufacturing, Inc.	499,895	49.9995%	₱499,895,000
Fortune Tobacco Corporation	495,854	49.5954%	495,854,000
Parity Packaging Corporation	2,140	0.2140%	2,140,000
Northern Tobacco Redrying Co. Inc.	420	0.0420%	420,000
Dominium Realty and Construction Corporation	1,480	0.1480%	1,480,000
Lucio Tan	1	0.0001%	1,000
Carmen Tan	1	0.0001%	1,000
Harry Tan	1	0.0001%	1,000
Lucio K. Tan	1	0.0001%	1,000
Michael Tan	1	0.0001%	1,000
Chris Nelson	1	0.0001%	1,000
Douglas Werth	1	0.0001%	1,000
Mitchell Gault	1	0.0001%	1,000
Raymond Miranda	1	0.0001%	1,000
Varinia Elero	1	0.0001%	1,000
Vincent Nguyen	1	0.0001%	1,000
Total	**999,800**	**100%**	**₱ 999,800,000**

In sum, the subject exchange transactions are tax-free pursuant to Section 40(C)(2) of the NIRC of 1997.

Moreover, the subject transactions are in the nature of stock subscriptions and not sales of assets. In the case of *Delpher Trades Corporation and Delfin Pacheco vs. Intermediate Appellate Court and Hydro Pipes Philippines, Inc.*[76], the Supreme Court ruled:

> "After incorporation, one becomes a stockholder of a corporation by subscription or by purchasing stock directly from the corporation or from individual owners thereof (Salmon, Dexter & Co. v. Unson, 47 Phil. 649, citing Bole v. Fulton [1912], 233 Pa., 609). In the case at bar, in

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[76] G.R. No. L-69259, January 26, 1988.

> exchange for their properties, the Pachecos acquired 2,500 original unissued no par value shares of stocks of the Delpher Trades Corporation. Consequently, the Pachecos became stockholders of the corporation by subscription. **'The essence of the stock subscription is an agreement to take and pay for original unissued shares of a corporation, formed or to be formed.'** (Rohrlich 243, cited in Agbayani, Commentaries and Jurisprudence on the Commercial Laws of the Philippines, Vol. III, 1980 Edition, p. 430) It is significant that the Pachecos took no par value shares in exchange for their properties.
>
> xxx xxx xxx
>
> **The 'Deed of Exchange'** of property between the Pachecos and Delpher Trades Corporation **cannot be considered a contract of sale. There was no transfer of actual ownership interests** by the Pachecos **to a third party**. The Pacheco family **merely changed their ownership from one form to another. The ownership remained in the same hands**. x x x" *(Emphasis supplied).*

In the instant case, petitioner entered into an exchange transaction with FLRI, whose shares of stocks were, thereafter, assigned to PMFTC, Inc. Thus, there was no sale since petitioner's assets were only transformed into another form of asset. The assets merely changed from land, building, *etc.* to one of an intangible asset – shares of stock. Since the subject transactions do not constitute sales, it necessarily follows that the same are not subject to income tax.

In its audited FS, petitioner reported gain on exchange of assets, as part of its other comprehensive income, not to recognize income but to present the fair value of its assets as of a certain period in accordance with the Philippine Accounting Standards 16. For purposes of recording the shares of stocks received on account of the transfer of assets, such shares were valued at fair market value of the land given up. What was compared for purposes of determining the "gain" was the historical cost of the land given up as against the fair market value of the same. This is mere appraisal increase in the recorded value of the asset given up in the exchange and not actual income, as when the shares of stocks received in the exchange have higher value than that of the asset given up.[77]

Even assuming that the subject transactions are taxable, petitioner suffered loss if the appraised value of the assets given up was compared against the par value of the shares of stocks acquired. Thus, no realized gain may be taxed.

The gain on exchange of assets is merely a theoretical gain considering that petitioner did not, actually or constructively, receive said gain. Though reflected in petitioner's books as gain, it is an unrealized gain for purposes of computing the income tax. In order that the same may be subjected to income tax, such income must be realized or received during the taxable year.

Clearly, petitioner's transfer of assets, in exchange for shares in FLRI and PMFTC Inc., qualifies as tax-free exchange and need not require prior BIR ruling in order that the same may be exempted from income tax. Accordingly, the income tax assessment referring to the gain on exchange of assets in the amount of ₱279,737,876.77 must be cancelled.

9. Disallowed creditable withholding taxes – ₱30,547.20

Respondent's verification disclosed that creditable taxes withheld from Tanduay Distillers, Inc. in the amount of ₱30,547.20 relate to sales/revenues for March 2009, thus disallowed as income tax credit pursuant to Section 2.58.3 of RR No. 2-98, as amended.

Total creditable withholding taxes claimed per ITR	₱1,672,537.02
Less: CWT pertaining to taxable year 2009	30,547.20
Allowable creditable withholding taxes	**₱1,641,989.82**

An examination of the Certificate of Creditable Tax Withheld at Source (BIR Form No. 2307) [78] confirms respondent's finding.

As a matter of fact, petitioner may utilize its prior years' excess credits to offset against income tax due. A perusal of its 2010 Annual

[77] Exhibit "P-41-2", Annex "IC-85 (V .a)", pp. 573, 590 and 592.
[78] Exhibit IC-86 (V.a), Binder, p. 601.

ITR shows that petitioner had prior years' excess credits in the total amount of ₱28,638,577.20.[79] However, petitioner failed to show that the assessed amount forms part of the prior years' excess credits. Accordingly, the disallowance must be upheld.

10. Excess income tax credit carried forward – ₱27,468,608.88

Following the computation, respondent disallowed petitioner's excess income tax credit carried over to the succeeding period. However, no legal and factual bases were provided in the Details of Discrepancies[80] to justify the disallowance of such amount.

Despite petitioner's failure to refute the same, the Court finds it improper to uphold an assessment which is already void on its face. Section 228 of the NIRC of 1997 provides that 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.

In sum, petitioner is not liable for any deficiency income tax for taxable year 2010, as determined below:

Taxable income per return		₱ 9,475,017.79
Add: Adjustments		
Undeclared income from unreceipted collections from Tanduay Distillers, Inc.		4,059,135.17
Unsupported compensation/direct labor		163,924.27
Disallowed expenses for failure to subject to EWT		1,176,936.10
Total sales/income per audit		₱14,875,013.33
Income tax due per audit		₱ 4,462,504.00
Less: Credits/payments		
Prior years' excess credits	₱28,638,577.20	
Add: Allowable CWT	1,641,989.82	30,280,567.02
Basic Deficiency Income Tax		**(₱25,818,063.02)**

[79] BIR Records, Folder 1, p. 523.
[80] Exhibits "P-1", Annex A and "P-17", Docket—Vol. II, pp. 981 to 990 and 1012 to 1019.

II. DEFICIENCY VALUE-ADDED TAX – ₱113,075,438.11

Respondent assessed petitioner of deficiency VAT in the amount of ₱113,075,438.11, as computed below:

Vatable receipts per VAT returns		₱ 59,659,130.74
Add: Audit findings		
1 Undeclared VAT sales to FTC per matching of SLS vs SAWT vs SLP AITEID		-
2 Undeclared VAT receipts from PMFTC, Inc.		-
3 Undeclared income from unreceipted collections from Tanduay Distillers		4,059,135.17
4 Undeclared gross sales on undeclared purchases		
Undeclared purchases per matching of SLP vs EWT vs SLS-AITEID	₱ 416,126.15	
Divided by COS rate	56.84%	732,100.90
5 Undeclared sales on undeclared cost of goods sold		
Undeclared cost of goods sold	₱30,450,163.11	
COS rate	56.84%	53,571,715.53
6 Disposal of real property		377,655,490.00
	Subtotal	₱436,018,441.60
Total sales/receipts per audit		₱ 495,677,57234
Multiply by VAT rate		12%
Output VAT due per audit		₱ 59,481,308.68
Less: Allowable credits/payments		
Current input taxes		
Importation	₱2,116,800.08	
Local purchases	363,008.48	
Total	₱2,479,808.55	
Add: VAT payments made for 2010	4,458,489.42	6,938,297.97
Basic deficiency VAT		₱52,543,010.71
Add: Penalties		
50% Surcharge	₱26,271,505.35	
Interest	34,260,922.05	60,532,427.40
Total Deficiency VAT Due		**₱113,075,438.11**

In relation to the deficiency income tax assessment, the following items were likewise assessed for deficiency VAT pursuant to Sections 106 and 108 of the NIRC of 1997, as amended.

1. Undeclared income from unreceipted collections from TDI – ₱4,059,135.17

To reiterate, as in the deficiency income tax assessment, petitioner failed to prove that the said unreceipted collections indeed relate to petitioner's accounts receivable from year 2009. Thus, the deficiency VAT assessment pertaining to the said amount must likewise remain.

2. **Undeclared gross sales on undeclared purchases – ₱732,100.90**

3. **Undeclared sales on undeclared cost of goods sold – ₱53,571,715.53**

The deficiency VAT assessment on the alleged ₱732,100.90 undeclared gross sales on undeclared purchases and ₱53,571,715.53 undeclared sales on undeclared cost of goods sold must likewise be cancelled.

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

> "The total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax. The excise tax, if any, on such goods or properties shall form part of the gross selling price."

What is critical to be shown in the imposition or assessment of VAT in the sale of goods or properties is that the taxpayer is paid or ought to be paid in an amount of money or its equivalent, in consideration of such sale, and not when said taxpayer purchases or disburses an amount of money to purchase goods or properties. Simply put, the VAT is imposed when one sells, not when one purchases. Here, respondent merely imputed undeclared sales from petitioner's alleged undeclared purchases and undeclared cost of goods sold.

Thus, respondent's assessment on these items must also be cancelled for lack of factual basis.

4. Disposal of real property – ₱377,655,490.00

As held earlier, petitioner's transfers of properties, in exchange for the controlling shares in FLRI and PMFTC, Inc., do not constitute sales transactions but are merely stock subscriptions. Thus, the same are not subject to VAT. Consequently, respondent's assessment on this item must be cancelled as well.

In sum, petitioner is liable to pay deficiency VAT in the amount of ₱707,893.93, as computed below:

Vatable receipts per returns		₱ 59,659,130.74
Add: Undeclared income from unreceipted collections from TDI		4,059,135.17
Total sales/receipts per audit		₱ 63,718,265.91
Output VAT due per audit		₱ 7,646,191.91
Less: Credits/payments		
Importation of goods other than capital goods	₱2,116,800.08	
Local Purchases	363,008.48	
Payments made for 2010	4,458,489.42	6,938,297.97
Basic Deficiency Value-Added Tax		**₱ 707,893.93**

III. DEFICIENCY EXPANDED WITHHOLDING TAX – ₱188,576.27

Respondent assessed petitioner of deficiency EWT in the amount of ₱188,576.27, as computed below, to wit:

Basic Deficiency EWT		₱ 104,461.59
Add: Penalties		
Interest (1.16.11 to 4.30.14)	₱ 68,114.68	
Compromise	16,000.00	84,114.68
Total Deficiency EWT Due		**₱ 188,576.27**

As discussed earlier, the assessment relates to security services and casual purchases in the amounts of ₱4,634,685.00 and ₱1,246,519.36, respectively. And as already noted, the security agencies certified that they have withheld the tax on the salaries of the guards in the amount of ₱3,457,650.00. Furthermore, the

4. Disposal of real property – ₱377,655,490.00

As held earlier, petitioner's transfers of properties, in exchange for the controlling shares in FLRI and PMFTC, Inc., do not constitute sales transactions but are merely stock subscriptions. Thus, the same are not subject to VAT. Consequently, respondent's assessment on this item must be cancelled as well.

In sum, petitioner is liable to pay deficiency VAT in the amount of ₱707,893.93, as computed below:

Vatable receipts per returns		₱ 59,659,130.74
Add: Undeclared income from unreceipted collections from TDI		4,059,135.17
Total sales/receipts per audit		₱ 63,718,265.91
Output VAT due per audit		₱ 7,646,191.91
Less: Credits/payments		
Importation of goods other than capital goods	₱2,116,800.08	
Local Purchases	363,008.48	
Payments made for 2010	4,458,489.42	6,938,297.97
Basic Deficiency Value-Added Tax		**₱ 707,893.93**

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As discussed earlier, the assessment relates to security services and casual purchases in the amounts of ₱4,634,685.00 and ₱1,246,519.36, respectively. And as already noted, the security agencies certified that they have withheld the tax on the salaries of the guards in the amount of ₱3,457,650.00. Furthermore, the importation of spare parts is not subject to EWT. Accordingly, only the security services in the remaining amount may be assessed.

However, as We have already ruled, respondent's right to assess petitioner of deficiency EWT for the months of January to March 2010 have already prescribed. Thus, the following security services in the amount of ₱668,848.83 can no longer be assessed, to wit:[81]

1/28/2010	SIGASIG 12/1-15	17220	₱ 28,644.20
2/17/2010	SIGASIG 12/16-31	17254	28,644.20
2/17/2010	SIGASIG 1/1-15	17296	28,644.20
3/8/2010	SIGASIG 1/16-31	17330	28,644.20
3/22/2010	SIGASIG 2/1-15	17369	28,644.20
3/23/2010	SIGASIG 2/16-28	17412	28,644.20
1/31/2010	DE CALIBER 12/1-15	58-00040	165,661.21
2/27/2010	DE CALIBER 1/1-15	58-00042	165,661.21
2/23/2010	DE CALIBER 12/16-31	970	165,661.21
		Total	**₱668,848.83**

Moreover, the compromise penalty imposed in the amount of ₱16,000.00 may not be maintained. Pursuant to Revenue Memorandum Order No. 19-2007, *"compromise penalties are only amounts suggested in settlement of criminal liability, and may not therefore be imposed or exacted on the taxpayer"* in the event that a taxpayer refuses to pay the same. Moreover, it is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[82] Absent a showing that herein petitioner consented to the compromise penalty, its imposition should be deleted. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[83]

In fine, the petitioner is liable to pay deficiency EWT in the amount of ₱10,163.72, as computed below:

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[81] Exhibit "P-41-2", Annex "IC-62 (V.a)", p. 368.
[82] *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et. al.*, G.R. Nos. L-12928 and L-12932, March 31, 1962.
[83] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et. al.*, G.R. No. L-35266, January 21, 1991.

Security services not subjected to EWT per assessment	₱ 4,634,685.00
Less: Supported by Certifications	3,457,650.00
Prescribed transactions	668,848.83
Security services not subjected to EWT per audit	508,186.17
EWT rate	2%
Basic Deficiency Expanded Withholding Tax	**₱ 10,163.72**

IV. DEFICIENCY DOCUMENTARY STAMP TAX – ₱13,288,101.23

Respondent assessed petitioner of deficiency DST in the amount of ₱13,288,101.23, as computed below, pursuant to Sections 174, 175 and 196 of the NIRC of 1997, as amended:

1 DST on original issuance of shares of FLRI (29,522 shares @ ₱100 par value @ ₱1.00/₱200)		₱ 14,761.00
2 DST on assignment of shares in FLRI to PMFTC (29,522 shares @ ₱100 par value @ ₱0.75/₱200.00)		11,070.75
3 DST on original issuance of shares of PMFTC (2,140 shares @ ₱1,000 par value @ ₱100/₱200.00)		10,700.00
4 DST on disposal of real property (₱377,655,490.00 @ ₱15.00/₱1,000.00)		5,664,840.00
Basic deficiency documentary stamp tax due		₱ 5,701,371.75
Add: Penalties		
50% Surcharge	₱2,850,685.88	
Interest	4,736,043.60	7,586,729.48
Total Deficiency Documentary Stamp Tax Due		**₱13,288,101.23**

As stated earlier, the need to secure a prior BIR ruling is not a condition to the availment of tax exemption. Section 199 of the NIRC of 1997, as amended by Section 9 of Republic Act (RA) No. 9243, explicitly exempts from DST transfers of properties by virtue of tax-free exchanges under Section 40(C)(2) of the NIRC of 1997, to wit:

> "SEC. 199. *Documents and Papers Not Subject to Stamp Tax.* – The provisions of Section 173 to the contrary notwithstanding, the following instruments, documents and papers shall be exempt from the documentary stamp tax:
>
> x x x x x x x x x

(m) Transfer of property pursuant to Section 40 (C)(2) of the National Internal Revenue Code of 1997, as amended."

The exemption on transfer of property pursuant to Section 40(C)(2) referred to above pertains to the DST due on the deed transferring the property.

Moreover, the original issuance of shares of stocks in exchange of the said property is subject to the DST pursuant to Section 174 of the NIRC of 1997, as amended by RA No. 9243, to wit:

"SEC. 174. *Stamp Tax on Original Issue of Shares of Stock.* – On every original issue, whether on organization, reorganization or for any lawful purpose, of shares of stock by any association, company or corporation, there shall be collected a documentary stamp tax of One peso (P1.00) on each Two hundred pesos (P200), or fractional part thereof, of the par value, of such shares of stock: *Provided,* That in the case of the original issue of shares of stock without par value, the amount of the documentary stamp tax herein prescribed shall be based upon the actual consideration for the issuance of such shares of stock: *Provided, further*, That in the case of stock dividends, on the actual value represented by each share."

However, Revenue Memorandum Ruling No. 01-01[84] clearly provides that it is the transferee corporations, *i.e.,* FLRI and PMFTC Inc., which are liable to pay the DST, and not the transferor-petitioner, to wit:

"II. TAX CONSEQUENCE.

x x x x x x x x x

4. *Documentary Stamp Tax.* – The documentary stamp tax consequences of the transfer are as follows:

x x x x x x x x x

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[84] SUBJECT: Tax Consequences of Tax-Free Exchange of Property for Shares of Stock of a Controlled Corporation Pursuant to Section 40(C)(2) of the National Internal Revenue Code of 1997.

> 4.2 The transferee is subject to documentary stamp tax on the original issuance of its shares (Section 175, Tax Code of 1997), at the following rate, depending on whether such shares are par or no-par shares: x x x"

Accordingly, petitioner is not liable to pay DST on the disposal of properties and on the original issuances of shares.

As regards the assignment of shares in FLRI to PMFTC, Inc., petitioner did not controvert the assessment. In this connection, it is a well-settled rule that the determination of respondent is presumed correct and it behooves the taxpayers to rebut such presumption.[85] Thus, the deficiency DST assessment on the assignment of shares must be upheld.

In sum, petitioner is liable to pay deficiency DST in the amount of ₱11,070.75, as computed below:

Assignment of shares in FLRI to PMFTC, Inc.	
(29,522 shares @ ₱100 par value)	₱ 2,952,200.00
DST rate	₱0.75/200.00
Basic Deficiency DST	**₱ 11,070.75**

WHEREFORE, in light of the foregoing considerations, the instant *Amended Petition for Review* is **PARTIALLY GRANTED**.

Accordingly, the subject deficiency income tax assessment is hereby **CANCELLED** and **SET ASIDE**.

However, petitioner is ordered to pay **NINE HUNDRED ELEVEN THOUSAND FOUR HUNDRED TEN PESOS AND FIFTY CENTAVOS (₱911,410.50)** for the taxable year 2010, inclusive of the 25% surcharge imposed under Section 248(3) of the NIRC of 1997, computed as follows:

Tax Type	Basic	25% Surcharge	Total
VAT	₱ 707,893.93	₱ 176,973.48	₱ 884,867.41

[85] *Tan Guan vs. Court of Tax Appeals, et al.*, G.R. No. L-23676, April 27, 1967; *Perez vs. Court of Tax Appeals, et al.*, G.R. No. L-10507, May 30, 1958; and *Collector of Internal Revenue vs. Bohol Land Transportation Co.*, G.R. Nos. L-13099 and L-13462, April 29, 1960.

EWT	10,163.72	2,540.93	12,704.65
DST	11,070.75	2,767.69	13,838.44
Total	**₱ 729,128.40**	**₱ 182,282.10**	**₱ 911,410.50**

In addition, petitioner is ordered to pay delinquency interest at the rate of 20% per annum on the said total amount of ₱911,410.50, computed from April 30, 2014 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice
Chairperson, 1st Division