Republic Of The Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

AVON PRODUCTS MFG., INC.,
Petitioner,

- versus -

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 5908

Members:

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

Promulgated:

JAN 20 2005

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DECISION

CASTAÑEDA, JR., *J.*

The appeal before Us seeks the cancellation and withdrawal of the Assessment Notices issued by respondent against petitioner for deficiency income tax, expanded withholding tax, and deficiency value-added tax in the aggregate amount of P9,568,677.83, excluding increments, for the taxable year 1994.

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines with principal business address at No. 150 E. Rodriguez Jr. Avenue, Libis, Quezon City.

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On January 28, 1998, petitioner received two separate demand letters and two assessment notices both numbered 000569, all dated January 9, 1998. Respondent assessed petitioner and at the same time demanded payment for alleged 1994 deficiency expanded withholding tax (EWT) in the amount of P97,681.60 and alleged 1994 deficiency final withholding tax of P14,113,722.38.

On February 11, 1998, petitioner received another demand letter and another Assessment Notice No. 000569, both dated January 13, 1998, demanding payment for alleged 1994 deficiency value-added tax (VAT) in the amount of P18,113,204.75.

On February 18, 1998, petitioner filed its protest-letter with the respondent protesting the expanded withholding tax, final withholding tax, and value-added tax assessments.

Thereafter, petitioner received another demand letter and assessment notice, this time for alleged deficiency income tax for the year 1994. On February 24, 1998, petitioner received the demand letter and Assessment Notice No. 000569 dated February 16, 1998, demanding payment of P33,445,557.68 as alleged 1994 deficiency income tax.

On March 5, 1998, petitioner protested the afore-mentioned assessment for deficiency income tax.

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In a letter dated March 16, 1998 which petitioner received on April 1, 1998, respondent informed the petitioner that its request for reinvestigation and reconsideration of the deficiency income, value-added tax, expanded and final withholding tax assessments had been granted.

Consequently, respondent conducted a reinvestigation of the deficiency income, value-added tax, expanded withholding tax and final withholding tax assessments. On August 21, 1998, petitioner wrote a supplemental letter to respondent further explaining the grounds of petitioner's protests against the assessments.

As a result of the reinvestigation made by the concerned revenue examiners, respondent cancelled the deficiency final withholding tax assessment and revised the basic income tax deficiency assessment to P7,244,939.16, the basic value-added tax deficiency assessment to P2,288,166.16 and the basic expanded withholding tax deficiency assessment to P35,572.51. The foregoing cancellation of the deficiency final withholding tax and revisions of the deficiency income, value-added tax, and expanded withholding tax were contained in a letter dated June 3, 1999 which was received by the petitioner on June 16, 1999. The respondent demanded the settlement of the deficiency tax assessments within fifteen (15) days from petitioner's receipt of said letter.

On July 15, 1999, petitioner filed the present Petition for Review with this Court.

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The parties stipulated on the following facts at the pre-trial proceedings:

1. That Petitioner filed its Monthly Remittance Return of Income Taxes Withheld for the year 1994.

2. That Petitioner filed its Quarterly Value Added Tax Returns for the first three VAT quarters of 1994.

During Pre-trial, the parties stipulated on the issues *(Joint Stipulations of Facts and Issues, CTA Records, pp. 169-170)* involved in the present controversy, as follows:

A. General Issues

1. Whether or not Respondent's letter dated June 3, 1999 is the decision of Respondent on the protested assessments appealable to this Honorable Court.

2. Whether or not the failure of Respondent to inform petitioner in writing of the law and the facts on which the said deficiency tax assessments were based rendered the said deficiency tax assessments void.

3. Whether or not the right of Respondent to issue the deficiency expanded withholding tax and deficiency value added tax assessments had prescribed.

B. Deficiency Expanded Withholding Tax Assessment

4. Whether or not Petitioner has paid the deficiency expanded withholding tax assessment.

C. Deficiency Value-added Tax Assessment

5. Whether or not Petitioner underdeclared its sales subject to 10% VAT for the taxable year 1994.

6. Whether or not the disallowed value-added input taxes in the total amount of P789,634.46 are properly substantiated.

D. Deficiency Income Tax Assessment

7. Whether or not the disallowances are proper.

8. Whether or not Petitioner has underdeclared its income.

Petitioner relies upon the following arguments to support its position on the general issues agreed upon by the parties:

1. Respondent's letter dated June 3, 1999 is the decision of the respondent on the protested assessments appealable to this Honorable Court. Respondent clearly and expressly stated in its letter to the petitioner dated June 3, 1999 that it will take the necessary action to enforce collection by summary remedies as provided by law, without further notice to the petitioner (Exhibit K-1; TSN, p. 32-33, October 30, 2000). Such unequivocal statement of the respondent in said letter, further making reference to the reinvestigation it conducted, constitutes the "final decision" of the respondent on the disputed assessments, which is thus appealable to this Honorable Court.

2. The deficiency income, expanded withholding tax and VAT assessments are void because petitioner was not informed in writing of the law and the facts on which the said assessments were made, in contravention of Section 228 of the NIRC. Respondent failed to inform petitioner in writing of the law and the facts on which the deficiency tax assessments were based. The only documents received by the petitioner from the respondent were the assessment notices and the demand letters. It was not clear from these documents how the respondent arrived at the deficiency tax assessments. The bases and reasons for the disallowance of certain amounts were not apparent from documents. Petitioner attempted to seek clarification on the disallowed amounts. However, its efforts were futile.

   Section 228 of the National Internal Revenue Code ("NIRC") clearly 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. The requirement under Section 228 of the NIRC is a matter of due process. As thus worded, the respondent has the bounden duty to inform the taxpayer not only of the law but more importantly, the surrounding circumstances supporting the assessment, for it is only through a detailed appraisal of its basis that the taxpayer may be able to dispute the imposition or agree with it *(Abbott Laboratories, Inc. vs. CIR, CTA Case No. 5718, February 16, 2001)*.

3. Assuming *arguendo* that the deficiency expanded with-holding tax assessment is valid, the right of respondent to assess petitioner for deficiency expanded withholding tax for the months of January 1994 to November 1994 had already prescribed. It is settled that the right of the respondent to assess deficiency expanded withholding tax shall prescribe three (3) years reckoned from the due date for the filing/payment thereof. In case of the monthly expanded withholding tax, this Honorable Court has consistently explained that the prescriptive period shall be determined on a monthly basis.

   Assuming *arguendo* that the deficiency expanded withholding tax assessment is valid and is not barred by prescription, the said assessment is devoid of factual and/or legal basis. Petitioner's comptroller explained in her testimony that the basis of said assessment was not explained to them by the Respondent. She further testified that the right to assess the same had already prescribed, except for the December 1994 transactions.

4. Assuming *arguendo* that the deficiency VAT assessment is valid, the right of respondent to assess petitioner for deficiency VAT had already prescribed. This Honorable Court consistently held that with respect to the VAT, the prescriptive period to issue an assessment shall prescribe quarterly citing *HPCO Agridev Corporation vs. CIR, CTA Case No. 6355, July 18, 2002*, and *Mirant (Navotas II) Navotas Corp. vs. CIR, CTA Case No. 5950, January 13, 2003.*

   Moreover, the deficiency VAT assessment for the fourth quarter had likewise prescribed. It is clear from the Demand Letter for deficiency VAT dated January 13, 1998 (*Exhibit "C"*) that the assessment arose purely from "Undeclared source of Cash". However, upon reinvestigation, respondent modified the VAT assessment to include "Sales and Services Subject to VAT" and

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> "Disallowed Input Tax" (*Exhibit "K, p. 2*). Respondent made the new assessment for the first time in the results of reinvestigation issued by respondent only on June 3, 1999. Thus, the deficiency VAT assessment, as modified, is invalid and of no force and effect since it was issued beyond the last day of the statute of limitations for issuing a VAT assessment for the 4th quarter of 1994 which fell on January 19, 1998. Granting, for the sake of argument, that the Waiver of the Statute of Limitations issued by petitioner on February 16, 1998 to expire on June 20, 1998 is valid and in accordance with Revenue Memorandum Order No. 20-90, prescription had already set in when the Waiver was issued on February 16, 1998. The last day of the 3-year prescriptive period fell on January 19, 1998. Hence, the new deficiency VAT assessment contained in the results of reinvestigation was issued out of time citing *Commissioner of Internal Revenue vs. B.F. Goodrich Phils., Inc., 303 SCRA 554 (1999)*.

Respondent, in his answer, interposed the following special and affirmative defenses:

9. Assessments are prima facie presumed correct and made in good faith. The taxpayer has the duty in proving otherwise;

10. Petitioner's right to contest subject assessment before this Honorable Court is premature;

11. Petitioner failed to exhaust all administrative remedies before filing this petition for review;

12. Petitioner has no cause of action.

On July 22, 2003, the respondent filed a Motion to Submit Case for Decision on the Basis of BIR Records (*CTA Records, p. 312*) which was denied by the Court in a Resolution promulgated on November 4, 2003. The Court would like to point out, however, that respondent did not file his Formal Offer of Evidence as well as his memorandum within the extended period granted to him.

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The Court agrees with the petitioner that respondent's letter dated June 3, 1999 (*Exhibit K*) is the decision of the respondent referred to in the last paragraph of Section 228 that is appealable to this Court. The letter particularly referred to petitioner's requests for reinvestigation dated January 9, 1998, January 13, 1998 and February 16, 1998. It also made a demand for the settlement of the reduced deficiency tax liabilities of the petitioner within fifteen (15) days from receipt thereof as well as its enforcement thru summary remedies without any further notice (*Exhibit K-1*). The tenor of the letter clearly conveys that it is the final decision of the respondent concerning petitioner's protested assessments.

We shall now discuss the second issue raised by the petitioner that the deficiency income, expanded withholding tax and VAT assessments are void because petitioner was not informed in writing of the law and the facts on which the said assessments were made in contravention of Section 228 of the NIRC.

A review of the assailed Assessment Notices and the accompanying Demand Letters *(Exhibits A, B, C, D, E, and F)* shows that respondent substantially complied with Section 228 of the NIRC of 1997 which provides that:

> "The taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void".

In the demand letter for deficiency Expanded Withholding Tax, respondent indicated that the deficiencies arose from "Leasehold Improvements and Auto. Equip." indicating the corresponding amounts as well as the withholding tax rate. In the demand letter for deficiency VAT, respondent indicated that the deficiency arose from "undeclared source of cash" and in the demand letter for deficiency Income Tax, respondent indicated in separate schedules the "various disallowances and undeclared income", "disallowed salaries and wages" and "undeclared source of cash" consisting of "professional fees and rent".

Likewise, a review of petitioner's protest-letters dated February 16, 1998 and March 4, 1998 (*Exhibits G* and *H*, respectively) shows that petitioner had knowledge of the details of the Assessment Notices since it was able to present its position clearly and intelligently on each item of the assessments except for salaries and wages and undeclared source of cash consisting of professional fees and rent in the deficiency Income Tax Assessment.

Petitioner wrote another letter (*Exhibit J*) dated August 21, 1998, addressed to the respondent, containing its findings and contentions as agreed upon in the informal conference with respondent's representative held on August 12, 1998. In said letter, petitioner explained its position on the different items of the assessments. At the informal conference, the petitioner had the opportunity to inquire and discuss the details of the assessments from the respondent's revenue examiner. Petitioner, in fact, in item 3 of Section II of its letter explained that the "Other Disallowed Input VAT" amounting to P789,634.46 were supported by invoices and most of the invoices contained "C" for customers/cash which has been a practice for most establishments. Hence, petitioner was able to refute the respondent's findings and explain its side in its letter dated August 21, 1998.

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This Court has ruled that the requirement of stating the law and the facts upon which the assessment is made is deemed complied with when the petitioner was able to refute the findings of the revenue examiner's stated in the Assessment Notices, thus:

> The fact that petitioner knew (and even admitted) of the previous factual and legal bases appearing in the Assessment Notice and Formal Letter of Demand is sufficient compliance with Section 228. Whatever other reasons raised (or might be raised) during the trial will be considered as a defense in support of the deficiency assessment.
>
> It bears stressing that the purpose of Section 228 of the National Internal Revenue Code of 1997 in requiring that "(t)he taxpayer be informed of the law and facts on which assessment is made" is to give the taxpayer the opportunity to refute the findings of the examiner and give a more accurate and detailed explanation regarding the assessment(s) (ING Bank N.V. Manila Branch vs. Commissioner of Internal Revenue, CTA Case No. 6187, August 9, 2004 citing Belle Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5930, April 4, 2002). The purpose of the said law having been served in the instant case, Section 228 of the National Internal Revenue Code of 1977 is deemed to have been complied with. Therefore, the assessment is not null and void *(SONY PHILIPPINES, INC. vs. COMMISSIONER OF INTERNAL REVENUE, C.T.A. CASE NO. 6185, OCTOBER 26, 2004).*

Considering the circumstances in the present controversy, We see no reason to depart from the aforementioned ruling. The assailed assessment notices substantially complied with the requirement of Section 228, hence, the same are valid and binding upon the petitioner.

With respect to the third issue raised by the petitioner pertaining to the prescription of the right of respondent to assess the petitioner for deficiency expanded withholding and value added taxes, the Court finds merit in petitioner's arguments.

This Court has consistently ruled that the three (3)-year prescriptive period for expanded withholding tax shall commence to run from the last day for filing of the Monthly Remittance Return of Income Taxes Withheld or from the date of filing thereof if filed after such last day (*CORPORATE INFORMATION SOLUTIONS, INC. vs. COMMISSIONER OF INTERNAL REVENUE, C.T.A. CASE NO. 5919, December 1, 2003*; *MIRANT (NAVOTAS II) CORPORATION [formerly Southern Energy Navotas II Power, Inc.] vs. COMMISSIONER OF INTERNAL REVENUE, C.T.A. CASE NO. 5950, January 13, 2003; HPCO AGRIDEV CORPORATION vs. COMMISSIONER OF INTERNAL REVENUE, C.T.A. CASE NO. 6355, July 18, 2002)*. The foregoing rulings are in accordance with Sections 51 and 203 of the old NIRC. Section 51 thereof provides:

> "**Sec. 51**. *Returns and payment of taxes withheld at source. —*
>
> (a) *Quarterly returns and payment of taxes withheld. —* Taxes deducted and withheld under Section 53 (now 50) shall be covered by a return and paid to the Revenue District Officer, Collection Agent, or duly authorized Treasurer of the city, or municipality where the withholding agent has his legal residence or principal place of business, or where the withholding agent is a corporation, where the principal office is located. 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. The Commissioner of Internal Revenue may, with the approval of the Secretary of Finance, require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the Government. The return for final withholding tax shall be filed and the payment made within 25 days from the close of each calendar quarter, while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which the withholding was made."

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In implementing the aforesaid provision, Revenue Regulations No. 5-85 dated March 19, 1985 was issued by the then Minister of Finance. Said regulations provided for the synchronization of the time and manner of taxes withheld under Sections 53, 54 and 93 of the NIRC. Section 2 thereof provides:

> "**SECTION 2**. *MONTHLY RETURN AND REMITTANCE OF TAXES WITHHELD.* — Taxes deducted and withheld on:
>
> (i) compensation income,
> (ii) income payments subject to the creditable (expanded) withholding taxes, and
> (iii) income subject to final withholding taxes,
>
> shall be remitted within ten (10) days after the end of each calendar month with the filing of the appropriate returns, xxx xxx xxx".

Subsequently, Revenue Regulations 6-85 entitled Revised Consolidated Expanded Withholding Tax Regulations dated May 2, 1985 was issued. Section 5 thereof provides:

> "**Section 5**. – *Monthly return and payment of taxes withheld at source*. - (a) The taxes herein deducted and withheld shall be paid upon filing a return in duplicate under BIR Form _______ with the Revenue District Officer or the Collection Agent of the City or duly authorized Treasurer of the Municipality where the withholding agent has his legal residence or principal place of business except in cases where the Commissioner of Internal Revenue allows otherwise. **The required return shall be filed within ten (10) days after the end of each month**." (Emphasis supplied)

From the above-cited provisions, the filing and payment of the creditable expanded withholding taxes is due on or before the 10th day of the following month. Hence, the three-year prescriptive period shall be reckoned from the respective monthly due dates.

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In the case at bar, petitioner filed its Monthly Remittance Return of Income Taxes Withheld and paid the taxes due under said returns for the year 1994 as follows:

Month	Date of Filing/Payment (Exhibit No.)	Last day of Statute of Limitation
January	February 10, 1994 ("M-a")	February 10, 1997
February	March 25, 1994 ("M-1-a")	March 24, 1997
March	April 25, 1994 ("M-2-a")	April 24, 1997
April	May 25, 1994 ("M-3-a")	May 26, 1997
May	June 27, 1994 ("M-4-a")	June 26, 1997
June	July 25, 1994 ("M-5-a")	July 24, 1997
July	August 25, 1994 ("M-6-a)	August 25, 1997
August	September 26, 1994 ("M-7-a")	September 25, 1997
September	October 25, 1994 ("M-8-a")	October 24, 1997
October	November 25, 1994 ("M-9-a")	November 24, 1997
November	December 26, 1994 ("M-10-a")	December 26, 1997
December	January 25, 1995 ("M-11-a")	January 26,1998

Since the assessment for deficiency expanded withholding taxes was issued only on January 9, 1998 (*Exhibits A and B*), the assessment pertaining to the months of January up to November 1994 was beyond the prescriptive period, hence, null and void. Only the assessment for deficiency expanded withholding tax for the month of December was issued within the prescriptive period.

The same principle applies to VAT assessments, although the applicable provision of the old NIRC is Section 110 as implemented by Section 2 Revenue Regulations No. 5-93, thus, "the taxpayer is required to file a quarterly VAT return not later than twenty days following the close of each quarter. For each quarter, the taxpayer is mandated to file an adjusted and complete return. A final or adjustment return is not required in the case of value-added tax, unlike in the case of an annual Income Tax Return filed for income tax purposes. In other words, each taxable quarter shall have its own prescriptive period and not just after twenty days following the close of the last quarter for the taxable year as what respondent espouses" (*HPCO AGRIDEV CORPORATION vs. COMMISSIONER OF INTERNAL REVENUE, supra*).

The dates of filing of petitioner's 1994 Quarterly VAT Return and their respective prescriptive periods are as follows:

Quarter	Date Filed/Paid (Exhibit No.)	Last Day of Statute of Limitations
1st	April 20, 1994 ("N-1")	April 21, 1997
2nd	July 20, 1994 ("0-1")	July 21, 1997
3rd	October 20, 1994 ("P-1")	October 20, 1997
4th	January 20, 1995 ("Q-1")	January 19, 1998

Considering that the assessment for deficiency VAT was issued by respondent only on January 13, 1998, it follows that the deficiency VAT assessments for the 1st to the 3rd quarters of 1994 were already barred due to the prescription of respondent's right to make an assessment pursuant to Section 203 of the old NIRC. Only the deficiency VAT assessment for the 4th Quarter of 1994 was issued within the prescriptive period.

Petitioner argues that although the 4th quarter VAT assessment was issued within the prescriptive period, nevertheless, the deficiency VAT assessment therefor had likewise prescribed. It contends:

> Moreover, the deficiency VAT assessment for the fourth quarter had likewise prescribed. It is clear from the Demand Letter for deficiency VAT dated January 13, 1998 (*Exhibit "C"*) that the assessment arose purely from "Undeclared source of cash". However, upon reinvestigation, respondent modified the VAT assessment to include "Sales and Services Subject to VAT" and "Disallowed Input Tax" (*Exhibit "K, p. 2*). Respondent

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> made the new assessment for the first time in the results of reinvestigation issued by respondent only on June 3, 1999. Thus, the deficiency VAT assessment, as modified, is invalid and of no force and effect since it was issued beyond the last day of the statute of limitations for issuing a VAT assessment for the 4th quarter of 1994 which fell on January 19, 1998. Granting for the sake of argument that the Waiver of the Statute of Limitations issued by petitioner on February 16, 1998 to expire on June 20, 1998 is valid and in accordance with Revenue Memorandum Order No. 20-90, prescription had already set in when the Waiver was issued on February 16, 1998. The last day of the 3 year prescriptive period fell on January 19, 1998. Hence, the new deficiency VAT assessment contained in the results of reinvestigation was issued out of time citing *Commissioner of Internal Revenue vs. B.F. Goodrich Phils., Inc., 303 SCRA 554 (1999).*

Stated differently, it is petitioner's contention that since the waiver was issued only after the lapse of the prescriptive period, it cannot anymore extend the already lapsed prescriptive period. Consequently, no new assessment can be issued by the respondent.

We are not persuaded.

Firstly, a deficiency VAT assessment was already issued against the petitioner on January 13, 1998. Said assessment was issued within the prescriptive period.

Secondly, the petitioner requested for a reinvestigation of the January 13, 1998 deficiency VAT assessment on February 18, 1998 through a protest-letter dated February 16, 1998. Petitioner actively participated in the reinvestigation conducted by the respondent. It even submitted invoices on August 24, 1998 (*Exhibit J, item 3 and rubber stamp marking*) to prove that the disallowed input VAT were legitimate transactions. Hence, the revised assessment contained in

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respondent's letter dated June 3, 1999 is not a new assessment since it only resulted only from petitioner's request for reinvestigation.

Thirdly, the disallowed input tax pertains to petitioner's deficiency VAT assessment that is covered by its request for reinvestigation (*Exhibit G*). As stated above, the respondent reinvestigated petitioner's VAT transactions which necessarily includes both output and input VAT. Hence, it cannot be said that there has been a new kind of tax that was assessed against the petitioner.

Lastly, the case cited by the petitioner, *Commissioner of Internal Revenue vs. B.F. Goodrich Phils., Inc., 303 SCRA 554,* is not applicable in the case at bar because the private respondent therein paid the *deficiency income tax* assessment issued against it for the taxable year 1994, thereafter, another assessment was issued on October 10, 1980 for *deficiency donor's tax* and another assessment on March 16, 1981 increasing the amount demanded. In the above-cited case, unlike in the case at bar, there was no pending request for reinvestigation of the original deficiency income tax assessment since private respondent therein paid its deficiency income tax. Moreover, the second and third assessments were issued for a *different kind of tax* than the one previously assessed and clearly beyond the five-year prescriptive period.

We shall now determine the merits of each of the assessments.

I. DEFICIENCY EXPANDED WITHHOLDING TAX

After reinvestigation, petitioner was assessed for deficiency expanded withholding tax in a reduced amount of P35,572.51 (*Exhibit K*), computed as follows:

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Leasehold Improvements	P 3,557,251.00
Expanded Withholding Tax Rate (RR No. 6-85)	1%
Basic Expanded Withholding Tax Deficiency (Excluding Increments)	P 35,572.51

Petitioner in order to prove that even the December transactions for "Leasehold Improvements" were properly posted and subjected to expanded withholding tax, presented the general ledger for the account "Leasehold Improvement" (*Exhibit EEE*), a summary of the accounting entries affecting the said account for the month of December 1994 (*Exhibit FFF*) and the supporting journal vouchers which were prepared in the regular course of its business (*Exhibits FFF-1 to FFF- 4*).

During trial, petitioner's witness, Ms. Emlano explained that the taxes due on the payments to contractors were withheld. She further stated that "all the Journal Entries in the Voucher have been posted and recorded in General ledger and the General Ledger is the basis of our payment of our Monthly Withholding Tax" (*TSN, March 22, 2001, pp. 27-30*).

However, a review of the 1994 Annual Information Return of Income Tax Withheld on Compensation, Expanded and Final Withholding Taxes (*BIR Records, p. 703*) and the Summary of Withholding Tax-Suppliers (*BIR Records, pp. 696-702*) reveals that not all taxes withheld from payments to contractors were remitted to the Bureau of Internal Revenue. A total amount of P23,452.52 was not remitted, computed as follows:

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	PER JOURNAL VOUCHER		PER SUMMARY OF WITHHOLDING TAX		
Suppliers	**Exhibit**	**Amount Withheld**	**Exhibit**	**Amount Remitted**	**Under Remittance**
Arthom Contruction	FFF	P10,830.91	BIR Records, p. 702	P39.54	P10,791.37
DCDC	FFF	12,661.15	BIR Records, pp. 696-702	-	12,661.15
TOTAL		**P23,492.06**		**P39.54**	**P23,452.52**

In view thereof, petitioner is liable for deficiency expanded withholding taxes for income payments made in the month of December 1994 in the reduced amount of P43,759.84, computed as follows:

Leasehold Improvements		P2,349,206.36
Expanded Withholding Tax Rate		1%
Deficiency Expanded Withholding Tax	P	23,492.06
Less: Tax Paid Per Summary of Withholding Tax		39.54
Basic Deficiency Expanded Withholding Tax	P	23,452.52
Add: 25% Surcharge		5,863.13
20% Interest from 1-11-95 to 2-8-98		14,444.18
TOTAL AMOUNT DUE & PAYABLE	**P**	**43,759.84***

*Plus 20% delinquency interest from July 1, 1999 until amount is fully paid pursuant to Section 249 of the National Internal Revenue Code.

II. DEFICIENCY VALUE-ADDED TAX

The respondent reduced the 1994 deficiency value-added tax to P2,288,166.16 after the reinvestigation, broken down as follows (*Exhibit K*):

Sale of Scrap	P	266,913.65
Sale of Properties and Equipment		103,583.00
Domestic Sales		492,993,305.12
Other Sales		791,106.47
Sales of Promo Literature		43,305,306.63
Service Fees		6,660,000.00
Total Sales & Services Subject to VAT	P	544,120,214.87
Less: Total Sales and Services per VAT Return		529,134,897.90
Sales & Service Still Subject to VAT	P	14,985,316.97

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VAT Due Thereon		P 1,498,531.70
Add: Disallowed Input Tax [per Rev. Reg. 6-89 and Sec. 108(a) of NIRC]		
1. Purchases from Digitel Color Processing Delivered and Invoiced to AVON COSMETIC, INC.	P 14,829.60	
2. VAT-exempt Invoices and Invoices Not in Subject Taxpayer's Name	754,143.74	
3. Amount Paid to Individual	20,661.12	789,634.46
Basic Value Added Tax Deficiency (Excluding Increments)		P 2,288,166.16

The deficiency VAT arose from:

A. The alleged undeclared sales of P14,985,36.97, composed of:

Undeclared Sales	P14,090,627.50	
Export Sales	791,106.47	
Sales of Property & Equipment	103,583.00	P14,985,316.97

B. The disallowed input taxes	789,634.46
Total	P15,774,951.43

A. UNDECLARED SALES – P14,985,316.97

1. Undeclared Sales – P14,090,627.50

In arriving at the underdeclared sales of P14,090,627.50, respondent compared the total amount of income allegedly subject to VAT in the amount of P544,120,214.87 consisting of the following:

Sale of Scrap	P 266,913.65
Sale of Properties and Equipment	103,583.00
Domestic Sales	492,993,305.12
Other Sales	791,106.47
Sales of Promo Literature	43,305,306.63
Service Fees	6,660,000.00
Total Sales & Services Subject to VAT	**P 544,120,214.87**

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and the total amount per VAT returns of P529,134,897.90 (Exhibits *N to Q*) which results to a discrepancy in the amount of P14,985,316.97, accounted for as follows:

Export Sales	P 791,106.47
Sales of Property & Equipment	103,583.00
Undeclared Sales	14,090,627.50
Total Undeclared Sales	P14,985,316.97

Petitioner explained that the undeclared sales in the amount of P14,090,627.50 stemmed from the erroneous presentation of the sales and purchases in the fourth quarter VAT return as follows:

	Per VAT Return	Should be	Return Over (Under) by	Effect on VAT payable Over (Under) by
Sales	P165,521,350.70	P179,611,978.20	(P14,090,627.50)	(P1,409,062.75)
Purchases	53,560,243.80	67,650,871.30	(14,090,627.50)	1,409,062.75
Net Effect			Zero	Zero

Petitioner stressed that the erroneous presentation of sales in the VAT return did not result in the underpayment of VAT because the understatement in sales was automatically corrected by the understatement in purchases in the same amount. Consequently, no deficiency VAT should result.

We do not agree with petitioner.

In his report dated August 6, 2001 (*Exhibit VVV*), the commissioned independent CPA found that petitioner has a deficiency VAT payable for the fourth quarter of 1994 in the amount of P302,879.19, computed as follows:

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Total revenues per books for the fourth quarter of 1994	P179,677,817.64
Total revenues per fourth quarter VAT return	165,521,350.70
Under declaration of revenue in the fourth quarter VAT return (A)	P 14,156,466.94
Output VAT payable (B) (10% x A)	P 1,415,646.69
Total input VAT per fourth quarter per VAT return	P 5,356,024.38
Total input VAT per fourth Schedule filed with the BIR	6,468,791.88
Input VAT not claimed against output tax payable for the fourth quarter (C)	P 1,112,767.50
Deficiency VAT payable for the fourth quarter of 1994 (A - C)(sic)	P 302,879.19

Thereofore, petitioner is liable for deficiency VAT for undeclared sales for the 4th quarter of 1994 in the amount of P302,879.19, considering that the above report was prepared by the commissioned independent CPA and duly supported by the evidence on record, particularly *Exhibits VVV-290* to *VVV-340*.

2. Export Sales – P791,106.47

Per respondent's assessment, petitioner failed to include the amount of P791,106.47 as part of its 1994 total income subject to value-added tax, although said amount formed part of petitioner's gross income that petitioner declared in its annual income tax return. Thus, respondent opined that petitioner under declared its income for VAT purposes.

Petitioner, in its memorandum, explained that the sum of P791,106.47 pertains to the general ledger balance of "Sales-Others-Export" (*Exhibit YY*). The said export sales are subject to VAT at zero percent. In support thereof, petitioner presented the Summary of Export Sales showing the export invoice number, the date and the country of destination (*Exhibit SS*), together with copies of the export invoices (*Exhibits SS-1 to SS-40*), the proof of inward remittance of the export sales proceeds (*Exhibits TT and UU*) and the Certification issued by Avon Indonesia regarding its importation of goods from petitioner for the 4th quarter of 1994 (*Exhibit GGG*).

The Court finds that indeed the sum of P791,106.47 represents export sales subject to VAT at zero percent (0%) pursuant to Section 100(a)(2) of the old NIRC. Thus, the respondent's inclusion of the said amount in the 1994 deficiency VAT is erroneous.

3. Sales of Property & Equipment – P103,583.00

Respondent also found that petitioner under declared its income for VAT purposes in the amount of P103,583.00 representing sales of property and equipment. Respondent noted that the said income was not included in the Schedule of Income for VAT purposes while the same was declared in its 1994 Annual Income Tax Return

Petitioner explained that the amount of P103,583.00 represents sales of used automobiles and equipment and obsolete defective computer equipment, inclusive of 10% VAT, which were not booked as sales but reported under the

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"Gain on sale of asset". Petitioner claimed that the VAT on the said sales were already paid as follows:

Date of Transaction	Nature	Exhibit	Tax Base (A)	VAT Paid (B)	Total
March-94	Sale of obsolete/defective computer	VV; S-1	P 4,772.73	P 477.27	P 5,250.00
May-94	Sale of used automotive equipment	WW; S-2	87,090.90	8,709.18	95,800.08
August-94	Sale of obsolete/defective computer	XX; S-3	2,303.00	230.30	2,533.30
	TOTAL [(A) + (B)]		P94,166.63	P9,416.75	P103,583.38

We find petitioner's explanation sufficient as they are supported by evidence. Even assuming that the amount was not supported, the disallowance should be nullified because the transactions occurred during the 1st up to 3rd quarters of taxable year 1994, which as earlier discussed were already barred by prescription.

B. Disallowed Input VAT – P789,643.46

Respondent disallowed the input VAT of P789,643.46 because the invoices and receipts evidencing the purchases of goods and services were not in the name of the company. Instead of showing the name of the purchaser, the invoices and receipts reflected either the letter "C" or the word "Cash".

Petitioner reasoned out in its letter dated August 21, 1998 to the Bureau of Internal Revenue (*Exhibit J & BIR Records, pp. 1050 to 1052*), that the invoices addressed to "C" for customers/cash has been the usual practice in most establishments.

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While We agree with the respondent that the invoices and official receipts in question are not in the name of the petitioner, hence, should not give rise to input VAT credits pursuant to Sections 104, 108 and 238 of the old NIRC, nonetheless, the transactions occurred during the first three quarters of taxable year 1994. As determined in the discussion of the general issues above, only the transactions made during the 4th quarter of 1994 remained covered by the assessment due to prescription.

In sum, petitioner is only liable to deficiency VAT in the reduced amount of P564,475.53, computed as follows:

Deficiency VAT Payable for the 4th Quarter 1994	P 302,879.19
Add: 25% Surcharge	75,719.80
20% Deficiency Interest from 1-20-95 to 2-13-98	185,876.54
VAT Due & Payable	**P 564,475.53***

*Plus 20% delinquency interest from July 1, 1999 until amount is fully paid pursuant to Section 249 of the National Internal Revenue Code of 1997.

III. DEFICIENCY INCOME TAX

The original assessment for deficiency income tax in the amount of P33,445,557.66 was reduced to P7,244,939.16 in the letter of respondent dated June 3, 1999 (*Exhibit K*). The assessment was recomputed as follows:

Income Tax		
Net Income per return		P 53,351,840.00
Add: Findings per investigation		
1. Expenses not ordinary, unnecessary and unsupported expense (Sec. 29, NIRC)		
a. Taxes withheld from the 50% rent, water electricity expenses of Mr. Lau & Gibson shouldered by the company. Said tax was charged to employee relation expense account (P1,983,744.60 x 50% x 35%)	P 347,155.30	

b. Executive bonus-unsupported		4,546,903.71	
c. Cost of Promo literature discrepancy			
Per return -	P32,560,380.93		
Per reinvestigation-	30,176,690.34	2,383,690.59	
2. Unreported income (Sec. 28)			
Undeclared income from sale of scrap		7,109.37	
3. Allocation of income and deduction (Sec. 43)			
Undeclared export sales due to transfer pricing		14,234,420.96	
4. Unaccounted salaries and related expenses discrepancy (Sec. 28)			
Per financial statement -	P95,715,005.19		
Per alpha list -	95,741,331.93	26,326.74	21,545,606.67
Taxable income per reinvestigation			P 74,897,446.67
Income tax due thereon (35%)			P 26,214,106.33
Less: Payments			18,969,167.17
Basic income tax deficiency (EXCLUDING INCREMENTS)			P 7,244,939.16

On June 30, 1999, petitioner filed with the Bureau of Internal Revenue (BIR) another letter-request for reconsideration of the revised assessment for deficiency income tax for taxable year 1994 on the ground that the items disputed therein were fully supported by documents (*Exhibit NN*).

1. DISALLOWED EXPENSES – P7,277,749.60

A. Employee Relations Expense – P347,155.30

Respondent disallowed the withholding taxes on the 50% rent, water and electricity provided by petitioner to its expatriate employees, Mr. Lau and Mr. Gibson. Petitioner shouldered the payment of the tax and recorded the same as "Employee Relation Expense". Respondent stated that the expense was not ordinary and necessary and therefore not deductible under Section 29 of the old NIRC (*TSN, November 27, 2002, pp. 27-28*).

Petitioner countered that the taxes assumed by it were ordinary and necessary, thus, deductible from gross income. That said deduction was in accordance with Revenue Memorandum Order 1-87 which require employers to withhold taxes on 50% of the rent and housing related expenses it had furnished to its expatriate employees. "The 50% withholding tax was booked as Employee Relations Expense" (*Exhibit NN*). For purposes of clarity, examples of the journal entries are hereby reproduced:

Employee Relations	P11,400.13	
Income Tax Withheld-Employee		P11,400.13

To take up 35% withholding tax of 50% Rent and other expenses of K. Gibson. (*Exhibit 7*)

Employee Relations	P16,041.97	
Income Tax Withheld-Employee		P16,041.97

To take up 35% withholding tax of 50% of Rent and Utilities expenses of V. Lau. (*Exhibit 7-b*)

We disagree with petitioner.

Pertinent portion of Revenue Audit Memorandum Order No. 1-87 (RAMO 1-87) pertaining to the treatment of employees' housing and meals is reproduced below for reference:

REVENUE AUDIT MEMORANDUM ORDER NO. 1-87

SUBJECT : Guidelines in the Verification of Housing, Travel Representation, Entertainment and Advertising Expenses, and other deductions from taxable income.

TO : All Internal Revenue Officers and Others Concerned

3. xxx xxx xxx

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2. Housing and Meals

2.1 If an employee receives a remuneration for services, salaries and/or allowances and in addition thereto living quarters and/or meals, the value to such person of the quarters and meals so furnished shall be added to the remuneration otherwise paid for the purpose of determining the amount of compensation subject to withholding tax.

2.2 The value of lodging furnished to an employee by or on behalf of the employer shall be excluded from the employee's gross income, if the lodging is furnished in the business premises of the employer; and the employee is required to accept such lodging as a condition of his employment.

2.3 The value of meals furnished to an employee by or on behalf of his employer shall be excluded from the employee's gross income if the meals are furnished on the business premises of the employer and the meals are furnished for the convenience of the employer. Meals furnished without charge to an employee as regarded as furnished for the convenience of the employer where they are furnished to the employee during his work day to have the employee available for work during his meal period.

2.4 Business premises of the employer means the place where the employee performs a significant portion of his duties or where the employer conducts a significant portion of his business. In case of doubt, the criteria to be used shall be (a) time, more than 50% of the employee's work time or (b) value of business, more than 50% of the production of the said employee.

2.5 Notwithstanding the provisions of the preceding paragraphs, if an employee is provided by his employer with company housing or living quarters outside the business premises, and such employee, because of his position in the employer-company, also uses said house or living quarters for the benefit of the latter, like entertaining and putting up houseguests and guest of the employer-company, **then fifty percent (50%) of such allowance, rental value, or depreciation if the living quarters are owned by the employer, shall be added to the compensation paid to such employee and be subject to the withholding tax on wages**. The employer may deduct the said housing expense as a business expense. (Emphasis supplied)

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As a general rule, if in addition to an employee's salary, living quarters and meals are provided by the employer, the monetary value of such quarters and meals are added to an employee's salary. However, if living quarters located outside the business premises of the employer are provided for the employee because of his position in the employer-company and such employee uses said living quarters for the benefit of the latter, then fifty percent (50%) of such value shall be added to the employee's compensation and the housing expense shall be treated as a business expense of the employer. The amount added to the employee's compensation shall be subjected to withholding tax on wages.

In the case at bar, petitioner failed to establish compliance with the conditions stated in RAMO 1-87. It deducted the cost of the housing and related expenses as a business expense and at the same time deducted, also as a business expense, the tax it paid on the 50% share of the employee. Under the aforementioned RAMO, petitioner should have withheld the corresponding tax on the 50% share of the employee from the employee's compensation. It did not do so but instead paid the corresponding tax itself.

Notwithstanding petitioner's defense that it assumed the payment of the tax, nevertheless, the amount paid cannot be allowed as a deduction from gross income. This is so because even if the petitioner assumed the payment of the tax, the tax assumed would constitute employee's additional compensation which should have been subjected to withholding tax pursuant to Section 29 (j) of the old NIRC. In the absence of any proof that the tax assumed has been subjected to withholding tax, said tax assumed cannot be deducted as a business expense.

B. Executive Bonus – P4,546,903.71

Respondent disallowed the executive bonus expense for being unsupported. The amount was arrived at by the examiner by comparing the payroll and general ledger balances (*Exhibit PP*), as follows:

Per Books			P5,319,938.66
Less: Per Payroll Sheet			
Management Bonus			
	Feb 15	P102,504.00	
	28	294,761.72	P 397,265.72
	Jun 30		45,000.00
	Jul 31		230,769.23
	Aug		00,000.00
	Total		P 773,034.95
Unreported Executive Bonus			P4,546,903.71

Petitioner, in its protest letter dated August 21, 1998 (*BIR Records, p. 1051*) claimed that the total executive bonus in 1994 was P5,319,938.66. Out of the aforesaid sum, petitioner alleged that the amount of P3,755,138.66 was paid in 1994 with the corresponding tax also remitted. The balance in the amount of P1,564,800.00 was paid in March 1995.

To prove that the executive bonus was properly documented, petitioner engaged the services of a commissioned independent CPA pursuant to CTA Circular 1-95, as amended. In the report dated August 6, 2001 (*Exhibit VVV*), the independent CPA found that petitioner's executive bonus was properly supported.

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Pertinent portions of the findings and observations of the commissioned independent CPA are reproduced as follows:

> "Findings and Observation:
>
> Based on the procedures we performed, we present below our findings and observation. We have also attached the related supporting documents and schedules we reviewed.
>
> 1. Comparison of amounts per income tax return and per general ledger
>
>   We ascertained that the amount recorded in the general ledger was the same amount shown in the return.
>
> 2. Inspection of supporting documents
>
>   We verified that all the transactions comprising the executive bonus balance as of December 31, 1994 were properly supported and such amount agreed with the payroll register and other supporting documents/accounting records (i. e. JVs and CM).
>
> 3. Disbursement from APMI's funds
>
>   We ascertained that the net cash amounts due to employees (executive bonus less deductions) were debited against APMI's cash accounts.
>
> We attached exhibits VVV 100 to 254 representing our working papers for the audit of executive bonus account."

A scrutiny of the documents presented by petitioner (*Exhibits VVV-100 to VVV-254*) convinced us that the executive bonus expense was indeed fully substantiated. Hence, a valid business expense.

C. Cost of Promo Literature – P2,383,690.59

Respondent disallowed the discrepancy of P2,383,690.59 (*Exhibit QQ*) after reinvestigation. He claimed that petitioner's actual Cost of Promo Literature

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should only be P30,176,690.34 but the amount reflected in its annual income tax return is P32,560,380.93.

On the other hand, petitioner contended that the assessment is null and void for failure of respondent to include the same in the original assessment, it nevertheless made an accounting for the entire amount of P32,560,380.93 as true cost of promo literature as follows (*page 8 of Exhibit NN*):

Account Title	Ref.	Annex	Amount
Campaign Event Promo	GL	J-2	P 2,661,425.00
Showcase Brochure		J-3	14,418,939.56
Incentive Program Literature		J-4	297,927.51
Recognition Literature		J-5	374,296.87
Catalog Cost		J-1	5,431,954.70
Subtotal			P23,184,543.64
Overhead Expenses			
Salaries & Wages		J-6	P 3,000,869.61
Employee Benefits		J-7	1,167,271.60
Conference & Travel		J-8	313,618.07
Uniform		J-9	40,909.09
Books/Subscription		J-10	46,402.91
Office Supplies		J-11	188,419.75
Samples		J-12	88,309.67
Depreciation Expenses		J-13	34,146.66
Facility Services Alloc-In		J-14	2,312,235.81
Alloc-In Net		J-15	2,152,792.08
Miscellaneous		J-16	30,862.04
Subtotal			P 9,375,837.29
Total		J	P 32,560,380.93

Likewise, petitioner presented various documents (*Exhibits VVV-270 to VVV-289*) which were examined by the commissioned independent CPA who expressed an opinion thereon, to wit:

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"Based on the procedures we performed, we present below our findings and observation. We have also attached the related supporting documents and schedules we reviewed.

Comparison of amounts per income tax return and per general ledger

We ascertained that the amount recorded in the general ledger was the same amount shown in the return.

1. Comparison of cost of sales promo per general ledger against the amount per BIR investigation

The discrepancy between the amount per APMI's return and the amount per BIR investigation is as follows:

Per APMI's books	P 32,560,380.93
Per BIR audit	30,176,690.34
Difference	P 2,383,690.59

Our investigation disclosed that the above difference substantially represents various allocations of expenses from other manufacturing expense accounts and therefore represents valid expenses of APMI for the year 1994.

The difference was accounted for as follows:

Particulars	Amount
Facility allocation per JV 12-64 which was deducted from Manufacturing cost	P 230,898.51
Various allocations from other expense accounts:	
JV 1-52	308,000.00
JV 2-55	308,000.00
JV 3-57	308,000.00
JV 4-63	309,000.00
JV 5-63	309,000.00
JV 6-63	310,000.00
JV 7-63	310,000.00
JV 8-63	310,000.00
JV 9-63	310,000.00
JV 10-63	310,000.00
JV 11-63	310,000.00
JV 12-63	310,000.00
JV 12-63a	286,946.15
Total	P 3,998,946.15
Adjusted balance of sales promo Expenses	(1,846,154.07)
Net difference	P 2,152,792.08

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Inasmuch as the "Cost of Promo Literature" was properly accounted for and fully supported by documents, it is an allowable deduction from gross income considering that it is a legitimate business expense.

2. UNREPORTED INCOME FROM SALE OF SCRAP – P7,109.37

Respondent noted that petitioner declared in its VAT return as Sales of Scrap the amount of P266,913.65 while in its books the amount declared was only P259,804.28. Thus, according to respondent, petitioner underdeclared its sales of scrap in the amount of P7,109.37 (*Exhibit RR*) for income tax purposes.

To dispute such findings, petitioner presented the testimony of its Comptroller, Ms. Mildred Emlano. She testified that the discrepancy represents the gains on sale of equipment which were properly reported in a "Gain on sale of assets" account and not in the "Sales of scrap" account (*TSN, March 22, 2001, pp. 37 - 40*). The amounts of P4,772.73 and P2,303.00 were recorded in the "Gain on sale of assets" account (*Exhibits VV, VV-2, XX, & XX-2*) for a total other income of P7,109.37. The "sales of scrap" were recorded as Miscellaneous income in the General Ledger and in the Income Tax Return (*BIR Records, pp. 1050 - 1052*).

We find that the testimony of petitioner's witness is supported by the available documents (*BIR Records, p. 836*) and sufficiently proves that petitioner has no unreported income from sale of scrap.

3. TRANSFER PRICING – P14,234,420.96

Respondent averred that petitioner did not declare all its export sales. He maintained that petitioner's manufactured products sold to its foreign affiliated companies were lower in price than the price of its local sales. Such being the case, respondent computed the "short" export sales as follows (*BIR Records, p. 1058*):

Export Sales per Book	P50,408,726.01
Divided by	77.98%
Export Sales	P64,643,146.97
Sacrifice Sales Percentage	22.02%
Undeclared Export Sales Due to Transfer Pricing	P14,234,420.96

Petitioner, in its memorandum, cited five reasons why the prices offered to its foreign affiliates were lower than that of the local market:

> *First*, the export prices at which petitioner sells its products to its affiliates in Asia represent the fair market price of the products, as shown by the testimony below of Mr. Simeon – Petitioner's witness.
>
> *Second*, the domestic selling price is not a benchmark price for export sales because the export and domestic markets are two different markets. For one, the export market is competitive while the domestic market is a captured market. Mr. Simeon explained that:
>
> A : For our local market, our sole customer is Avon Cosmetics, Inc. While for the export market, we sell our products to countries such as Malaysia, Thailand, Indonesia, India and Fiji.
>
> Q : Mr. Witness, from the marketing point of view, can you tell us if there is a difference between the local market and the export market?
>
> A : **There is a big difference between the local and export market. Local market is a captured market because we have an exclusive Supply Agreement with AVON Cosmetics, Inc. While export market is very competitive in the sense that, we have to compete with the best in the world. We have to compete with AVON Manufacturing plants in US, Europe and Japan because these plants also supply to the export market where we also sell our products.**

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Q : In terms of mark up or profit margin, can you also tell us if there is a difference between the local market and the export market?

A : **The difference between pricing in our local and export market is that, for our local market, we have a commitment with the BIR not to lower our profit margin by 25%. So, that is the minimum mark up that we can sell locally. However, for export market, there is no cap.**

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Third, in applying Section 43 of the NIRC, the comparison is normally made between the prices at which the products are sold to an unrelated taxpayer and the prices at which the same products are sold to a related taxpayer. Here, the purchasers in both domestic and export sales are affiliates of the Petitioner – Avon Cosmetics, Inc. and the different Avon companies in Malaysia, Thailand, US, Europe and Japan (TSN, p. 9, June 6, 2001). Hence, it is clear that the difference in prices is not attributable to the relationship of the Petitioner with the buyers but to the competitiveness of the market. Accordingly, Section 43 finds no application in the instant case.

Fourth, the export sales prices are determined at arm's length. The practice of Avon companies worldwide is that a buying Avon company requests for price quotations from various companies producing a particular Avon product. The company with the best price gets the business. To beat the price quotations of other Avon companies with lower cost of production than the Philippines, petitioner offers the export products at a lower mark-up as compared to domestic sales in order to get the business and in the process maximize the utilization of its production facilities which were not fully utilized. This was adequately explained in the following testimony of Mr. Simeon:

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Fifth, the Petitioner further explained that despite the cut-throat competition in the export market, it continues to penetrate the export market for the following reasons:

(a) Under the terms of its registration with the Board of Investments ("BOI"), it has to meet its export sales quota of USD2M annually (TSN, pp. 22-24, June 6, 2001; Exhibit KKK and KKK-1), and if such quota is not met, the Petitioner's Certificate of Authority may be revoked or cancelled, to the detriment of its business. (TSN, pp. 33-34, Exhibit KKK-3). In 1994, the export market was very competitive and Petitioner had difficulty in meeting its export sales quota. Consequently, to get export sales contracts, Petitioner had to lower its export price. Mr. Simeon testified:

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> (b) Petitioner **needs dollars** to fund its importations of raw materials. The foreign exchange proceeds of export sales cushion the impact of foreign exchange fluctuations. (*TSN, pp. 35-36, June 6, 2001);*
>
> (c) Export sales **maximize the productivity** level of Petitioner, which in turn results to lower unit cost of production as the fixed overhead is spread over a larger number of product units. Whenever an export supply contract is awarded to Petitioner is assured of sales volume for the next one or two years. For this additional sales volume, Petitioner used its excess capacity.

This Court finds petitioner's evidence sufficient to establish its position that the prices of its export sales may be lower than its local sales, taking into account respondent's lack of evidence to support his assertion.

4. UNACCOUNTED SALARIES AND RELATED EXPENSES – P26,236.74

Respondent found a discrepancy of P26,326.74 on petitioner's salaries expense by comparing various expense accounts in the financial statement relating to compensation amounting to P95,715,005.19 as against the salaries in the alpha list in the amount of P95,741,331.93.

Petitioner considered respondent's findings as arbitrary and baseless since the total taxable compensation subject to withholding tax is greater than the amount of salary expenses claimed by petitioner in its financial statements.

We agree with petitioner that the disallowance has no leg to stand on.

Indeed, petitioner reported a salary expense which is lower than the actual salary expense. In fact, it can even be presumed that petitioner even remitted to the Bureau of Internal Revenue a higher withholding tax than the correct amount corresponding to the compensation deducted from its gross income.

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In sum, only the amount of P347,155.30 representing Employee Relations Expense should have been disallowed by the respondent. Petitioner is therefore liable for deficiency income tax in the reduced amount of P222,851.36, computed as follows:

Net Income Per Return		P53,351,840.00
Add: Taxes withheld from the 50% rent, water & electricity expenses of Mr. Lau & Gibson shouldered by the company.		347,155.30
Taxable Income Per Court's Verification		P53,698,995.30
Income Tax Due Thereon (35%)		P18,794,648.36
Less: Payments/Credits		
Quarterly payments (BIR Records, pp. 479-483)	P17,532,156.51	
Creditable Tax Withheld (BIR Records, p. 482)	1,140,988.00	18,673,144.51
Basic Income Tax Deficiency		P 121,503.84
Add: 25% Surcharge		30,375.96
20% Interest from 4-16-95 to 3-16-98		70,971.55
TOTAL AMOUNT DUE & PAYABLE		**P 222,851.36***

*Plus 20% delinquency interest from July 1, 1999 until amount is fully paid pursuant to Section 249 of the National Internal Revenue Code of 1997.

WHEREFORE, in view of the foregoing, the deficiency EWT, VAT and Income Tax Assessments issued against the petitioner for the taxable year 1994 are hereby **UPHELD** but in the reduced amounts of P43,759.84, P564,475.53, and P222,851.36, respectively, plus 20% delinquency interest from July 1, 1999 until the total amount is fully paid pursuant to Section 249 of the National Internal Revenue Code of 1997.

SO ORDERED.

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

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WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

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

Juanito C. Castaneda, Jr.
JUANITO C. CASTANEDA, JR.
Chairman

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