REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
Quezon City

Third Division

FIRST PHILIPPINE UTILITIES CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 9431

Members:

UY, *Chairperson*
RINGPIS-LIBAN, *and*
MODESTO-SAN PEDRO, *JJ.*

Promulgated:
SEP 29 2020
2:20 p.m.

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DECISION

RINGPIS-LIBAN, J.:

The Case

This is a *Petition for Review* filed by First Philippine Utilities Corporation against Respondent Commissioner of Internal Revenue on August 17, 2016, praying that judgment be rendered declaring the tax assessment notice for deficiency income tax, value-added tax ("VAT"), and documentary stamp tax ("DST"), for taxable year 2012 in the total amount of Php100,884,707.73, inclusive of interests and penalties, null and void.[1]

The Facts

Petitioner First Philippine Utilities Corporation is duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with

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1 Docket, Pre-Trial Order dated July 21, 2017, Statement of the Case, p. 330.

office address at 6th Floor, Benpres Building, Meralco Avenue cor. Exchange Road, Pasig City.[2]

On the other hand, Respondent is the Commissioner of the Bureau of Internal Revenue ("BIR"), the government agency tasked to, among others, collect all national internal revenue taxes. As Commissioner, Respondent has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code ("NIRC") of 1997, as amended, or other laws or portions thereof administered by the BIR. He holds office at the 5th Floor, BIR Building, Agham Road, Diliman, Quezon City.[3]

Respondent issued *Letter of Authority* ("LOA") No. LOA-43A-2013-00000272 dated July 12, 2013, authorizing the conduct of an audit of its taxable records for taxable year 2012.[4] The said LOA was signed by OIC-Regional Director Jonas DP. Amora,[5] and was received by Petitioner on July 16, 2013.[6]

Thereafter, Respondent issued the *Preliminary Assessment Notice* ("PAN") on December 04, 2015,[7] informing Petitioner that it was found liable for deficiency income tax in the amount of Php92,615,265.14, VAT amounting to Php1,312,835.88, and DST totalling Php5,863,690.07, inclusive of increments, for taxable year 2012.

Petitioner filed its reply to the PAN on December 17, 2015,[8] arguing that the preliminary assessment is bereft of legal and factual bases.

Respondent issued the *Formal Letter of Demand* with *Final Assessment Notice* ("FLD-FAN") on December 22, 2015.[9] The FLD-FAN contains deficiency tax assessments for income tax, VAT, and DST, for taxable year 2012, in the total amount of Php100,884,707.73, inclusive of interests and penalties, broken down as follows: [10]

Tax Type	Amount

[2] *Id.*, Joint Stipulation of Facts and Issues ("JSFI"), Facts Stipulated by the Parties, Par. 2, p. 270.
[3] *Id.*, JSFI, Summary of Admitted Facts, Par. 1, p. 269.
[4] *Id.*, JSFI, Facts Stipulated by the Parties, Par. 3, p. 270.
[5] *Id.*, Petition for Review, Par. 21, vis-à-vis Answer, Par. 8, pp. 18 and 210, respectively.
[6] Docket, Exhibit "P-7", p. 289; BIR Records, Exhibit "R-1", p. 1.
[7] Docket, JSFI, Facts Stipulated by the Parties, Par. 4, p. 270; Docket, "P-9", pp. 300 to 305; BIR Records, Exhibit "R-3", pp. 317 to 322.
[8] Docket, Exhibit "P-10", pp. 705 to 711.
[9] Docket, JSFI, Facts Stipulated by the Parties, Par. 5, p. 270; Docket, Exhibit "P-1", pp. 306 to 311; BIR Records, Exhibit "R-4", pp. 325 to 330.
[10] Docket, JSFI, Facts Stipulated by the Parties, Par. 6, p. 270.

Income tax	Php93,639,916.54
VAT	1,326,957.29
DST	5,917,833.90
Total	**Php100,884,707.73**

On January 20, 2016, Petitioner filed its *Protest to the Assessment,* arguing against the BIR's findings and praying that Respondent's deficiency tax assessments be cancelled, for lack of factual and legal bases.[11]

Claiming inaction on the part of Respondent, Petitioner filed the present *Petition for Review* on August 17, 2016.[12] The instant case was initially raffled to this Court's First Division.

Respondent then filed his *Answer* on December 05, 2016.[13]

On December 16, 2017, Respondent elevated the entire *BIR Records* of the present case consisting of one folder, pre-numbered from pages 1 to 525.[14]

The Pre-Trial Conference was initially set on March 30, 2017.[15] However, the same was reset to, and held on, May 24, 2017.[16] In the meantime, the *Pre-Trial Brief for Petitioner* was filed on March 24, 2017,[17] while *Respondent's Pre-Trial Brief* was submitted on March 27, 2017.[18]

The parties submitted their *Joint Stipulation of Facts & Issues* ("JSFI") on June 19, 2017,[19] which was approved by this Court in the Resolution dated June 23, 2017.[20] The Pre-Trial Order was issued on July 21, 2017,[21] deeming the termination of the Pre-Trial.

Trial ensued.

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11 *Id.*, Exhibit "P-11", pp. 712 to 740.
12 *Id.*, , pp. 12 to 61.
13 *Id.*, pp. 209 to 216.
14 *Id.*, Transmittal letter dated December 14, 2016, p. 218.
15 *Id.*, Notice of Pre-Trial Conference dated December 27, 2016, pp. 219 to 220.
16 *Id.*, Order dated March 27, 2017, pp. 236 to 237; Minutes of the Hearing held on, and Order dated, May 24, 2017, pp. 247 to 249, and 254 to 256.
17 *Id.*, pp. 227 to 233.
18 *Id.*, pp. 238 to 240.
19 *Id.*, pp. 269 to 274.
20 *Id.*, pp. 324 to 325.
21 *Id.*, pp. 330 to 336.

During trial, Petitioner presented its documentary and testimonial evidence. It offered the testimonies of the following individuals, namely: (1) Ms. Victoria A. Martinez,[22] former Vice President of Petitioner assigned to handle the accounting operations of the latter; and (2) Ms. Carminda B. Miranda,[23] Petitioner's accountant.

On August 03, 2018, Petitioner filed its *Formal Offer of Evidence.*[24] Respondent failed to file his comment thereto.[25] Thus, in the Resolution dated January 23, 2019,[26] this Court admitted all of Petitioner's exhibits.

Meanwhile, in the Order dated October 01, 2018,[27] the present case was transferred to the Third Division of this Court.

Respondent likewise presented his documentary and testimonial evidence. He offered the testimony of his sole witness, Revenue Officer Renato M. Atos.[28]

On April 10, 2019, Respondent filed his *Formal Offer of Evidence.*[29] Petitioner failed to file its comment thereto.[30] In the Resolution dated June 17, 2019,[31] the Court likewise admitted all of Respondent's formally offered exhibits.

Petitioner's *Memorandum* was filed on September 16, 2019.[32] Respondent, however, failed to file his memorandum.[33]

In the Resolution dated September 20, 2019,[34] the present case was deemed submitted for decision.

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22 *Id.*, Exhibit "P-30", pp. 347 to 364; Order dated February 01, 2018, pp. 552 to 553.
23 *Id.*, Exhibit "P-31", pp. 562 to 575; Order dated February 13, 2018, pp. 637 to 638.
24 *Id.*, pp. 678 to 689.
25 *Id.*, Records Verification dated September 27, 2018 issued by the Judicial Records Division of this Court, p. 821.
26 *Id.*, pp. 829 to 830.
27 *Id.*, p. 824.
28 *Id.*, Exhibit "R-9", pp. 282 to 288; Minutes of the hearing held on, and Order dated, March 14, 2019, pp. 831 to 833.
29 *Id.*, pp. 837 to 840.
30 *Id.*, Records Verification dated May 14, 2019 issued by the Judicial Records Division of this Court, p. 843.
31 *Id.*, pp. 853 to 854.
32 *Id.*, pp. 867 to 922.
33 *Id.*, Records Verification dated September 17, 2019 issued by the Judicial Records Division of this Court, p. 923.
34 *Id.*, p. 925.

The Issues

The following issues were stipulated by the parties for this Court's resolution, to wit:

> "1. Whether or not the right of Respondent to assess Petitioner with deficiency taxes for taxable year 2012 has already prescribed.
>
> 2. Whether or not Petitioner is liable for deficiency income tax, value-added tax and documentary stamp tax for taxable year 2012 in the total amount of One Hundred Million Eight Hundred Eighty-Four Thousand Seven Hundred Seven Pesos and Seventy-Three Centavos (Php100,884,707.73), inclusive of interests and penalties."[35]

Petitioner's Arguments

Petitioner argues that the assessment is void due to the lack of authority of the *Officer-In-Charge* Regional Director to issue the LOA, pursuant to Section 10(C) of the NIRC of 1997, as amended; that the delegated authority of the Regional Director to issue LOA under the said Section cannot be further delegated to the *Officer-In-Charge*; and that a valid assessment must stem from a valid LOA, otherwise, it is like allowing fruit of a poisonous tree to work further damage to an already invalid process/procedure.

Moreover, Petitioner avers that Respondent violated Petitioner's due process rights as it failed to comply with applicable rules and regulations issued by the BIR relative to the issuance of a valid assessment; that the audit was conducted beyond the one hundred twenty (120)-day period provided in the audit guidelines of the BIR and thus, the LOA is null and void because Respondent failed to revalidate the LOA as required by Revenue Audit Memorandum Order (RAMO) No. 1-00; that Respondent violated Petitioners' right to due process when the Respondent merely reiterated their findings when it issued the FLD-FAN without consideration to Petitioner's evidence; that Respondent relied on extrinsic documents only without considering the primary and secondary documents submitted by Petitioner; and that the FLD-FAN failed to inform Petitioner in writing of the law and facts on which the assessment was based.

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[35] *Id.*, JSFI, Issues to be Resolved, pp. 270 to 271.

Furthermore, Petitioner contends that prescription has set in against Respondent's right to assess Petitioner for taxable year 2012; and that it is not liable for the deficiency taxes assessed.

Respondent's Counter-arguments

On the other hand, in his *Answer*, Respondent maintains that the deficiency tax assessments were done in accordance with law, rules and regulations; that the 120-day period is merely directory and is only intended to enhance the efficiency while at the same time ensure quality audit; and that it does not in any way affect the right of the government to issue assessment notices within the period provided for by law.

Discussion/Ruling

After due consideration of the arguments and evidence presented by the parties, this Court finds merit in the present *Petition for Review*.

The LOA is valid even though issued by a Regional Director who is only an "Officer-in-Charge".

Indeed, Section 6(A)[36] of the NIRC of 1997, as amended, mandates that an authority, in the form of an LOA, emanating from Respondent or his duly authorized representative is required before an examination and an assessment may be made against a taxpayer. Relative thereto, Section 13 of the same Code provides that the authority of a revenue officer to examine or to recommend the assessment of any deficiency tax due must be exercised pursuant to an LOA, to wit:

> "SEC. 13. *Authority of a Revenue Officer.* – Subject to the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, a Revenue Officer

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[36] "SEC. 6. Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. –

(A) Examination of Returns and Determination of Tax Due. - After a return has been filed as required under the provisions of this Code, **the Commissioner or his duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax**: Provided, however, That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer." (Emphasis supplied) assigned to perform assessment functions in any district may, **pursuant to a Letter of Authority issued by the Revenue Regional Director,** examine taxpayers within the jurisdiction of the district in order to collect the correct amount of tax, or to recommend the assessment of any deficiency tax due in the same manner that the said acts could have been performed by the Revenue Regional Director himself." *(Emphasis added)*

In the present case, the question posed by Petitioner is whether Mr. Jonas DP Amora, a mere OIC-Regional Director of Revenue Region No. 7, may sign and issue an LOA.

We answer in the positive.

Under Section 13(c), Rule IV of the Civil Service Commission's *2017 Omnibus Rules on Appointments and Other Human Resource Actions (Revised July 2018)*[37] promulgated on July 03, 2018, "x x x Officials designated as Officer-in-Charge (OIC) enjoy limited powers which are **confined to functions of administration and ensuring that the office continues its usual activities**. The OIC may not be deemed to possess the power to appoint employees as the same involves the exercise of discretion which is beyond the power of an OIC, unless the designation order issued by the proper appointing officer/authority expressly includes the power to issue appointments. x x x"

Accordingly, issuing LOAs is a function of administration of a Regional Director. Considering that Mr. Jonas DP Amora was holding the position of OIC-Regional Director when he issued LOA No. LOA-43A-2013-00000272 (SN: eLA201100027982) on July 12, 2013,[38] it is only logical to conclude that he issued the same with full authority in the same way that the same could have been signed by the Regional Director if he were then present and in the actual discharge of his functions, so as to ensure that the office continues its usual activities.

Furthermore, Revenue Memorandum Order ("RMO") No. 09-16,[39] clarifies that, "[f]or the uniform understanding of all concerned, it is hereby reiterated and clarified that all internal revenue personnel holding positions in an OIC capacity shall exercise authority and discharge duties and assume responsibilities as if they are holding the employment item for the particular office, x x x. Accordingly, the person holding an **OIC-Regional Director**

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[37] Re: Amendments and Additional Provisions to CSC Resolution No. 1701009 (June 16, 2017).

[38] BIR Records, Exhibit "R-1", p. 1; Docket, Exhibit "P-7", p. 298.

[39] SUBJECT: Duties and Responsibilities of Personnel Holding Position in an Officer-In-Charged (OIC) Capacity.

position is equally authorized to and responsible as that of a regular Regional Director for issuing electronic Letters of Authority (eLA) and assessment/demand notices, among others." *(Emphasis supplied)*

Failure to revalidate the LOA after 120 days will not nullify it.

The issue of revalidation after expiration of the 120-day period within which to conduct audit of a taxpayer's books of accounts, has long been settled. There already has been a plethora of cases promulgated by this Court which provides that failure of the RO to request for revalidation of LOA, or the expiration of the revalidation period, will not automatically nullify the LOA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued.[40]

Moreover, Revenue Memorandum Circular ("RMC") No. 23-09 [41] provides that, *viz.*:

> **I. Revalidation of LAs**
>
> The revalidation of LA shall give rise to the extension of the period within which the Revenue Officer (RO) assigned to the case shall submit the report of investigation to higher authorities for review and approval, without the imposition of applicable administrative sanctions. Depending on the classification of the pending tax case, said extension period shall be equivalent to the original prescribed number of days within which to report the case under existing revenue issuances. **Failure on the part of the RO to request for the revalidation of LA or the expiration of the 'revalidation period' does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued.** However, this shall be

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[40] Telstar Manufacturing Corporation v. Commissioner of Internal Revenue, CTA EB No. 1797 (CTA Case No. 8900), April 15, 2019; Commissioner of Internal Revenue v. Total (Philippines) Corporation, CTA EB No. 1616 and 1621, November 06, 2018; AFP General Insurance Corporation v. Commissioner of Internal Revenue, CTA EB No. 1223 (CTA Case No. 8191), January 4, 2016; Bissaza Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 9372, March 07, 2018; Ritegroup, Incorporated vs. Commissioner of Internal Revenue, CTA Case No. 8651, January 25, 2017.

[41] SUBJECT: Reiteration of Policies and Procedures Relative to Revalidation of Letters of Authority, Issuance of Subpoena Duces Tecum, and Review of Cases by the Assessment Division.

> considered as a ground for the imposition of disciplinary action and demerit in the performance rating of the concerned RO, including the reassignment of the case to another RO if the Regional Director, upon recommendation of the Revenue District Officer, deems it necessary. *(Emphasis added)*

It is noteworthy that RAMO No. 01-00,[42] which was relied on by Petitioner regarding the mandatory revalidation of LOAs, have long been superseded by the above RMC No. 23-09, which was issued on April 16, 2009. As such, considering that the subject LOA herein was issued on July 12, 2013 and received by Petitioner on July 16, 2013, it clearly falls within the ambit of the said RMC.

Portions of Respondent's deficiency VAT assessment for taxable year 2012 have already prescribed.

Section 203 of the NIRC of 1997, as amended, provides:

> "SEC. 203. *Period of Limitation upon Assessment and Collection.* — Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in 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."

In the case of *Commissioner of Internal Revenue v. FMF Development Corporation,*[43] the Supreme Court held that the government must assess internal revenue taxes within the prescribed period of time so as not to deprive the taxpayer of the assurance that it will no longer be subjected to further investigation for taxes after the expiration of the said period, in this wise:

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[42] SUBJECT: Updated Handbook on Audit Procedures and Techniques Volume I (Revision — Year 2000)", dated March 17, 2000.
[43] G.R. No. 167765, June 30, 2008.

> "Under Section 203 of the NIRC, internal revenue taxes must be assessed within three years counted from the period fixed by law for the filing of the tax return or the actual date of filing, whichever is later. This mandate governs the question of prescription of the government's right to assess internal revenue taxes primarily to safeguard the interests of taxpayers from unreasonable investigation. Accordingly, the government must assess internal revenue taxes on time so as not to extend indefinitely the period of assessment and deprive the taxpayer of the assurance that it will no longer be subjected to further investigation for taxes after the expiration of reasonable period of time."

Apparently, the BIR only has three (3) years, save for certain exceptions, counted from the date of actual filing of the return or from the last day prescribed by law for the filing of such return, whichever comes later, to assess a national internal revenue tax. Accordingly, an assessment notice issued after the said three-year prescriptive period is no longer valid and effective.[44]

Since the present case involves deficiency income tax, VAT, and DST, the last day fixed by law for the filing of the corresponding tax returns differs. Thus, the basis of the three-year prescriptive period varies accordingly.

As to the income tax, Section 77(B)[45] of the NIRC of 1997, as amended, provides that the final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be.

In the case of VAT, the filing of quarterly VAT returns must be made within twenty-five (25) days after the close of each taxable quarter for each taxpayer in accordance with Section 114(A)[46] of the NIRC of 1997, as

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[44] Commissioner of Internal Revenue v. Kudos Metal Corporation, G.R. No. 178087, May 05, 2010.

[45] SEC. 77. Place and Time of Filing and Payment of Quarterly Corporate Income Tax.–

x x x

(B) Time of Filing the Income Tax Return. – The corporate quarterly declaration shall be filed within sixty (60) days following the close of each of the first three (3) quarters of the taxable year. The final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be."

[46] "SEC. 114. Return and Payment of Value-Added Tax. –
(A) In General. – Every person liable to pay the value-added tax imposed under this Title shall file a quarterly return of the amount of his gross sales or receipts within twenty-five

amended, and its implementing rules, Revenue Regulations ("RR") No. 16-2005.[47]

With regard to the DST, Section 5 of RR No. 6-2001[48] provides that the filing of the DST returns shall be within five (5) days after the close of the month when the taxable document was made, signed, accepted or transferred.

Applying the foregoing provisions of law and regulations, a table is provided hereafter for the following pertinent dates to the subject deficiency tax assessments, *viz*:

Exhibit No.	Period Covered	Date Return was filed	Last Day to file Return	Last day to Assess	Date of Receipt of FLD-FAN	Status
Income Tax						
"P-2"; "P-2-a"[49]	Taxable year 2012	April 15, 2013	April 15, 2013	April 15, 2016	December 22, 2015	Not Prescribed
Value-added Tax						
"P-3"; "P-3-a"[50]	1st quarter of 2012	April 25, 2012	April 25, 2012	April 25, 2015	December 22, 2015	Prescribed
"P-4"; "P-4-a"[51]	2nd quarter of 2012	July 25, 2012	July 25, 2012	July 25, 2015		Prescribed
"P-5"; "P-5-a"[52]	3rd quarter of 2012	October 25, 2012	October 25, 2012	October 25, 2015		Prescribed
"P-6"; "P-6-a"[53]	4th quarter of 2012	January 25, 2013	January 25, 2013	January 25, 2016		Not Prescribed
Documentary Stamp Tax						
*(allegedly failed to file return)						

(25) days following the close of each taxable quarter prescribed for each taxpayer: Provided, however, That VAT-registered persons shall pay the value-added tax on a monthly basis.

Any person, whose registration has been cancelled in accordance with Section 236, shall file a return and pay the tax due thereon within twenty-five (25) days from the date of cancellation of registration: Provided, That only one consolidated return shall be filed by the taxpayer for his principal place of business or head office and all branches."

47 SUBJECT: Consolidated Value-Added Tax Regulations of 2005.

48 SUBJECT: Amending Pertinent Provisions of Revenue Regulations nos. 1-98, 2-98, as Amended, and 7-95, as Amended, and Revenue Memorandum Circular No. 1-98 Relative to the Inclusion of Additional Taxpayers to be Subject to Final Withholding Tax, Revision of the Withholding Tax Rates on Certain Income Payments Subject to Creditable Withholding Tax, Time for the Filing of Various Tax Returns and Payment of the Taxes Due Thereon And Others.

49 Docket, pp. 690 to 695.

50 *Id.*, p. 696.

51 *Id.*, p. 700.

52 *Id.*, p. 703.

53 *Id.*, p. 704.

A quick look at the above table would readily show that portions of the deficiency assessment for the 1st to 3rd quarters of VAT for calendar year 2012 under the FLD-FAN were issued beyond the three-year prescriptive period mandated under Section 203 of the NIRC of 1997.

Accordingly, only the remaining unexpired portions of Respondent's deficiency assessments shall be discussed by this Court hereafter.

To recall, Petitioner received the FLD-FAN on December 22, 2015,[54] assessing it for deficiency income tax, VAT and DST for the taxable year 2012, in the aggregate amount of Php100,909,707.72, inclusive of interests and penalties, summarized as follows:

Tax	Basic Tax	Surcharge	Interest	Compromise	Total
Income tax	Php 60,322,219.44	Php -	Php 33,317,697.09	Php -	Php 93,639,916.53
VAT	831,341.25	-	495,616.04	-	1,326,957.29
DST	3,187,500.00	796,875.00	1,933,458.90	-	5,917,833.90
Failure to file DST	-	-	-	25,000.00	25,000.00
Total	**Php64,341,060.69**	**Php796,875.00**	**Php35,746,772.03**	**Php25,000.00**	**Php100,909,707.72**

DEFICIENCY INCOME TAX

Respondent assessed Petitioner of deficiency income tax for taxable year 2012 amounting to Php93,639,916.53, detailed as follows:

Taxable Income per Income Tax Return (ITR)				Php(165,722,261.00)
Add:	Adjustments per investigation:			
	Undeclared Service Income (Schedule 1)		Php 1,624,544.75	
	Interest income not subjected to Income Tax		179,288,707.67	
	Non-deductible Expenses (Schedule 2)		19,537,817.72	200,451,070.14
Total				Php 34,728,809.14
Add:	Net Operating Loss Carry-Over (NOLCO)			165,722,261.00
Adjusted Taxable Income				Php 200,451,070.14
Income Tax Due (30%)				Php 60,135,321.04
Less:	Allowed Tax Credits/Payments			
	Unexpired Excess Prior Year's MCIT over NIT		Php 229,914.00	
	Creditable tax withheld		325,655.00	
	Total		Php 555,569.00	
	Less: Unsupported Creditable Withheld	Php186,898.40		

[54] BIR Records, Exhibits "R-4" to "R-8", pp. 325 to 334; Docket, Exhibit "P-1", pp. 306 to 315.

Excess MCIT over NCIT carried forward to succeeding period	123,060.00		
Excess tax credits carried forward to succeeding period	432,509.00	742,467.40	(186,898.40)
Deficiency Income Tax			Php 60,322,219.44
Add: Interest (4/16/13 to 1/18/16)			33,317,697.09
TOTAL AMOUNT DUE			**Php93,639,916.53**

From the foregoing, the following items comprise the deficiency income tax assessment:

A. Undeclared service income	Php1,624,544.75
B. Interest income not subjected to income tax	Php179,288,707.67
C. Non-deductible expenses	Php19,537,817.72
D. Net operating loss carry-over (NOLCO)	Php165,722,261.00
E. Unsupported creditable tax withheld	Php186,898.40
F. Excess MCIT over NCIT carried forward to succeeding period	Php123,060.00
G. Excess tax credits carried forward to succeeding period	Php432,509.00

A. Undeclared service income - Php1,624,544.75

Respondent's comparison of the amount of revenue reported in Petitioner's books against the purported receipts declared in the latter's Annual Income Tax Return ("ITR") disclosed a discrepancy of Php1,624,544.75, as shown below, which was considered by Respondent as undeclared service income, hence, assessed pursuant to Section 32 of the NIRC of 1997, as amended,[55] thus:

Service Income - Unicapital per books	Php 6,927,843.75
Less: Gross Receipts per ITR	5,303,299.00
Undeclared Service Income	**Php1,624,544.75**

Petitioner asserts, through its witness, Ms. Carminda B. Miranda,[56] that it does not have any form of undeclared service income as it correctly reported all its receipts and/or revenues in its ITR; that the variation between the actual reported income in its ITR (which includes accrued income) and the gross receipts reported in its books (which only pertains to income that has been actually received) is due to the difference in accounting methods used as it reports income in its ITR on accrual basis while it reports receipts in its books on cash basis, which Respondent failed to consider; and that the alleged

[55] BIR Records, Exhibit "R-4" (Details of Discrepancies), p. 328.
[56] Docket, Exhibit "P-31" (Q&A Nos. 7 and 8), pp. 564 to 565.

discrepancy between its net income per ITR and receipts per books may be reconciled as follows:

Interest Income - Unicapital per ITR		Php 5,303,299.00
Interest Income - Unicapital per BIR Audit		6,927,843.75
Discrepancy		***(Php1,624,544.75)***
Reconciling items:		
Interest income (June 17, 2011 to Dec 14, 2011)		Php (2,515,312.00)
Interest income (Dec 14 to 31, 2011)		(241,931.46)
Interest income (Oct 15 to Dec 17, 2012)		934,492.01
Accrual of interest from Dec 17 to 31, 2012		188,206.69
Difference in amount:		
Per BIR audit	Php908,669.27	
Per BIR Form 2307 (3rd Quarter)	918,669.27	10,000.00
Total reconciling items		***(Php1,624,544.76)***

Petitioner further contends that, assuming *arguendo*, there was under declaration of service income, the same does not necessarily translate to corresponding undeclared income, citing the cases of *Commissioner of Internal Revenue v. Philippine Daily Inquirer, CTA E.B. Case No. 905 (CTA Case No. 7853), November 04, 2013 ("PDI* case" hereafter), wherein this Court ruled that 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 under declaration of purchases. And also, the case of *Agrinurture, Inc. v. Commissioner of Internal Revenue, CTA Case No. 8345, May 29, 2013 ("Agrinurture* case" hereafter), wherein this Court ruled that mere reliance on the fact that there is under declared purchase is not enough basis for the court to uphold the Respondent's assessment subject deficiency income tax.

Unfortunately, We are not persuaded.

As gleaned from the Reconciliation of Service Income,[57] Petitioner may have been able to account for the alleged discrepancy of Php1,624,544.75. However, the said reconciliation and the facts indicated therein remain to be self-serving and are mere unsupported allegations absent any corroborating evidence to prove the same. Petitioner's bare allegations are far from sufficient proof for this Court to rule in its favor. Bare allegations which are not supported by any evidence, documentary or otherwise, sufficient to support a claim, fall short to satisfy the degree of proof needed.[58]

[57] *Id.*, Exhibit "P-18", p. 756.

[58] LNS International Manpower Services v. Armando C. Padua, Jr., G.R. No. 179792, March 05, 2010.

Moreover, even assuming that the interest income per BIR audit, in the amount of Php6,927,843.75, includes income already accrued in taxable year 2011 but received only in current taxable year 2012 amounting to Php2,757,243.46 (total of Php2,515,312.00 and Php241,931.46), as alleged by Petitioner, the latter still failed to establish that the said income of Php2,757,243.46 was indeed reported and subjected to income tax in taxable year 2011 when the same was earned or accrued.

Furthermore, Petitioner's reliance on the cited cases is rather misplaced. It must be stressed that this item of assessment arose from its under declaration of service income from Unicapital in the amount of Php1,624,544.75. Clearly, what is being assessed herein is an undeclared income, and **not** an undeclared expense or purchase imputed with income as ruled in the *PDI case* and *Agrinurture case*. As such, the ruling in the *PDI* and *Agrinurture* cases cannot be similarly applied herein.

For Petitioner's failure to satisfactorily refute Respondent's deficiency income tax assessment on undeclared income amounting to Php1,624,544.75, the same must be upheld.

B. Interest income not subjected to income tax - Php179,288,707.67

Respondent's verification disclosed that the interest income from investments on money market placements to various banks for calendar year ending December 31, 2012 was not justified to have been subjected to twenty percent (20%) final tax withheld as required under Section 2.28(B)[59] of RR No. 02-98,[60] and hence, was assessed of income tax on regular rate under Section 32(A)(2) of the NIRC of 1997, as amended.

Petitioner claims that had a proper examination of the relevant bank statements and other documents submitted by Petitioner was made by the BIR, they would have seen that interest from the money market placements to various banks have indeed been subject to final withholding tax.

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[59] Should be Section 2.57.1(G)(1) of RR No. 2-98.

[60] SUBJECT: Implementing Republic Act No. 8424, "An Act Amending The National Internal Revenue Code, as Amended" Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes.

Below is the breakdown of Petitioner's interest income that had already been subjected to final withholding tax as computed by independent external auditors:[61]

Short-term cash investments	Php 174,003,788.99
Cash deposit in banks	17,153.06
Total interest income subject to final tax	**174,020,942.05**
Add: Interest income from Unicapital Corporation	5,303,297.70
Total interest income per audited financial statements	**Php179,324,239.75**

Petitioner stresses that a review of its records[62] will readily show that the interest income now in issue came from cash deposits and short-term cash investments with banks such as Bank of the Philippine Islands (BPI), Philippine National Bank (PNB), Rizal Commercial Banking Corporation (RCBC), and Union Bank. Such being the case, it is clear from the NIRC of 1997, as amended, that such income should be subjected to final tax at the rate of twenty percent (20%) under Section 24(B)(1)[63] of the same code.

Petitioner also claims that Respondent erred in subjecting the interest income form Unicapital Corporation amounting to Php5,303,298.70 to further income tax. According to Petitioner, said amount had already been subjected to two percent (2%) and twenty percent (20%) creditable withholding tax as evidenced by its BIR Form 2307.[64]

Nonetheless, given that the glaring issue in this certain instance is improper withholding of taxes, Petitioner maintains that it is the withholding agent which should be held liable by the BIR and not Petitioner. Petitioner continues that an improper withholding should be taken up with the withholding agent, and not with Petitioner, as it is the withholding agent's responsibility to withhold and remit the said income under Sec. 2.57 of the RR No. 02-98, the same Revenue Regulation cited by Respondent in claiming deficiency income tax on Petitioner's interest income.

We agree with Petitioner.

Respondent does not dispute the fact that the assessed interest income amounting to Php179,288,707.67 arose from investments on money market placements to various banks for calendar year ending December 31, 2012.

[61] Docket, Exhibit "P-31" (Q&A No. 13), p. 566.
[62] *Id.*, Exhibit "P-19", p. 757.
[63] Should be Section 27(D)(1).
[64] Docket, Exhibits "P-22" to "P-25", pp. 810 to 813.

However, it was erroneous for Respondent to subject the said amount to regular income tax when in fact the same is subject to twenty percent (20%) final withholding tax, pursuant to Section 27(D)(1) of the NIRC of 1997, as amended, which provides:

> "SEC. 27. *Rates of Income tax on Domestic Corporations.–*
>
> xxx xxx xxx
>
> (D) *Rates of Tax on Certain Passive Incomes.–*
>
> (1) *Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes and from Trust Funds and Similar Arrangements, and Royalties.–* A final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of interest on currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements received by domestic corporations x x x"

Relative to the above provision, Section 2.57.1(G)(1) of its implementing rules RR No. 2-98, further provides that:

> "SECTION 2.57.1. *Income Payments Subject to Final Withholding Tax.*— The following forms of income shall be subject to final withholding tax at the rates herein specified;
>
> xxx xxx xxx
>
> (G) *Income Payment to a Domestic Corporation.* — The following items of income shall be subject to a final withholding tax in the hands of a domestic corporation, based on the gross amount thereof and at the rate of tax prescribed therefor:
>
> (1) Interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust fund and similar arrangements derived from sources within the Philippines — Twenty Percent (20%)."

The interests from money market placements issued by banks have consistently been subjected to a final tax of twenty percent (20%) pursuant to various BIR Rulings.[65] These rulings, however, were based on Section 24(cc) of the old NIRC, which was amended and now numbered as Section 27(D)(1) of the present NIRC of 1997. There being no subsequent law, regulation or ruling issued to modify or repeal said interpretation, the same remain to be binding up to this date.

Furthermore, it may be deduced in the *Details of Discrepancy*, that Respondent acknowledges the interest income from money market placements from various banks is subject to final tax of twenty percent (20%), only that Petitioner failed to justify or prove that the banks indeed withheld said final tax, which led Respondent to imposed Petitioner with thirty percent (30%) regular income tax on the interest income as an alternative.

Since the interest from money market placement is subject to final tax of twenty percent (20%), it is the withholding agent-bank who has the responsibility and liability for the payment of the tax imposed on the interest income from banks as provided in Section 2.57(A) of RR No. 2-98, to wit:

> "SECTION 2.57. *Withholding of Tax at Source.* —
>
> (A) *Final Withholding Tax.* — Under the final withholding tax system the amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income tax due from the payee on the said income. **The liability for payment of the tax rests primarily on the payor as a withholding agent. Thus, <u>in case of his failure to withhold the tax or in case of under withholding, the deficiency tax shall be collected from the payor/withholding agent</u>.** The payee is not required to file an income tax return for the particular income." (*Emphasis and underscoring added*)

In the present case, the banks are the withholding agents for the final tax imposed on the interest income from money market placements earned by Petitioner. As such, and as correctly pointed out by Petitioner, it was improper for Respondent to assess Petitioner with deficiency income tax thereon since Petitioner is not the proper party liable for the payment of the income tax due on interest from money market placements.

Therefore, Respondent's deficiency income tax assessment on interest from money market placements must be cancelled.

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65 *See* BIR Ruling No. 125-83 dated July 08, 1983; BIR Ruling No. 075-83 dated May 04, 1983; BIR Ruling No. 185-82 dated May 24, 1982.

C. Non-deductible expenses - Php19,537,817.72

Respondent's verification disclosed that per audit, the gross income came from three (3) different method of taxation, *i.e.*: (a) regular income tax of thirty percent (30%); (b) Meralco shares traded in the Stock Exchange, of final tax rate at ½ of 1% pursuant to Sec. 5(a) of RR No. 6-2008; and (c) Inter-corporate Dividend not subject to tax under Section 27(D)(4). Therefore, expenses should be determined on a pro-rata basis under Sec. 50 of the NIRC, as amended, as implemented under RR No. 04-11.[66] Hence, this amount was disallowed as deduction from gross income for income tax purposes pursuant to Section 34(K) of the NIRC of 1997, as amended,[67] as determined below:

Professional fees	Php 513,300.00
Transportation and travel	15,503.00
Taxes and licenses	38,176.00
Charitable contributions	20,000,000.00
Miscellaneous	7,158.00
Total	**20,574,137.00**
Less: Allowable expenses*	
*(₱20,574,137.00*5.037%)*	1,036,319.28
Non-deductible expenses	**Php19,537,817.72**

**pursuant to Sec. 50 of the NIRC, as amended, as implemented under RR No. 4-2011*

		Ratio
Total taxable income per audit		
Service income	Php 6,927,843.75	
Interest income	179,288,707.67	
Total	Php 186,216,551.42	*5.037%*
Add: Revenues subject to final tax	3,511,089,951.00	*94.963%*
Total gross income	Php 3,697,306,502.42	

Petitioner repudiates the above assessment and explained that Respondent's use of RR No. 04-11 is misplaced since it is clear from its title *"Proper Allocation of Costs Amongst Income Earnings of Banks and Other Financial Institutions for Income Tax Reporting Purposes"*, that the said RR is made applicable to Banks and Other Financial Institutions only.

Petitioner counters that it is important to note the definition of "Banks" and "Financial Institutions". Republic Act ("RA") No. 8791 otherwise known as *The General Banking Act* defines "Banks" as those entities engaged in the lending of funds obtained in the form of deposits. On the other hand,

[66] SUBJECT: Proper Allocation of Costs and Expenses Amongst Income Earnings of Banks and Other Financial Institutions for Income Tax Reporting Purposes.

[67] BIR Records, Exhibit "R-4" (Details of Discrepancy), p. 328.

"Financial Institution" and "Banking Institution" are defined under RR No. 09-04[68], as follows:

> "2.1 *Financial Institution* - Shall refer to banks, non-bank financial intermediaries performing quasi-banking functions, and other non-bank financial intermediaries including finance companies. This does not however include insurance companies.
>
> 2.2 *Banks or Banking Institution* - shall refer to those entities as defined in Section 3 of Republic Act No. 8791, as amended, otherwise known as the General Banking Law of 2000. The term 'banks' or 'banking institutions' are synonymous and interchangeable and specifically include universal banks, commercial banks, thrift banks (savings and mortgage banks, stock savings and loan associations, and private development banks), cooperative banks, rural banks, Islamic banks, and other classifications of banks as may be determined."

In the present case, Petitioner's Amended Articles of Incorporation categorically states that the primary purpose of the corporation is as follows:[69]

> "To acquire by purchase, exchange, assignment, gift or otherwise, and to hold, own and use for investment or otherwise, and to sell, assign, transfer, exchange, mortgage, pledge, deal, deal in and with otherwise to enjoy and dispose of, real and personal property including but not limited to bonds, debentures, promissory notes, shares of capital stock, or other securities or obligations, created, negotiated or issued by any corporation, association or entity, foreign or domestic, and while the owner thereof, to exercise all rights, powers and privileges of ownership, including the right to receive, collect, and dispose of any and all dividends, interest and income, derived from said securities, and the right to vote on any shares of capital stock, and upon any bonds, debentures, or other securities, having voting power as owned, and to issue proxies for the exercise of the right to vote, but only to the extent permitted by law, **without acting as a stock broker or dealer in securities or an investment company defined under Republic Act No. 2629**." *(Emphasis added)*

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68 SUBJECT: Implementing Certain Provisions of Republic Act No. 9238, Re-Imposing the Gross Receipts Tax on Banks and Non-Bank Financial Intermediaries Performing Quasi-Banking Functions and Other Non-Bank Financial Intermediaries Beginning January 1, 2004.

69 Docket, Exhibit "P-21", p. 800.

Evidently, the contention of Respondent that Petitioner should be subjected to Section 50 of the NIRC as implemented by RR No. 04-11 cannot stand as Petitioner does not fall under the above-mentioned definitions. Equally notable is that Petitioner's own Articles of Incorporation expressly prohibits Petitioner from acting or engaging in activities pertaining to financing institutions such as an investment company.

Furthermore, Respondent likewise maintains that the amount of Php19,537,817.72 should be disallowed as deduction from gross income for income tax purposes pursuant to Section 34(K) of NIRC of 1997, as amended.

Petitioner, however, argues that it is not Section 34(K) which should be applied, but rather Section 34(A) as the assailed expenses are ordinary and necessary expenses of Petitioner. According to Petitioner, the questioned expenses should be considered as deductible as provided in Sec. 34(A) of the NIRC of 1997, as amended, which states as follows:

> "SEC. 34. *Deductions from Gross Income.–* xxx
>
> (A) *Expenses.* -
>
> (1) *Ordinary and Necessary Trade, Business or Professional Expenses.-*
>
> (a) *In General.* - There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession x x x."

Based on the above provision, Petitioner claims that the items of professional fees, taxes and licenses, and transportation and travel should all be considered as ordinary and necessary expenses as these were all used for the operation and/ conduct of Petitioner's trade or business.

Lastly, Petitioner disagrees with Respondent's disallowance of Petitioner's expense in the amount of Php20,000,000.00, representing Petitioner's donation to various charitable organizations, because it was allegedly not a necessary expense in relation to the taxpayer's business.

According to Petitioner, donations to accredited non-governmental organizations ("NGOs") are valid deductions to gross income pursuant to Section 34(H)(2)(c) of the NIRC of 1997, as amended. In fact, Section 1(d) of RR No. 13-98[70] provides for the Philippine Council for NGO Certification, Inc. (PCNC) as the accrediting entity of the NGOs as designated by the Secretary of Finance. Petitioner continues that the recipient of its Php20,000,000.00 donation is the Eugenio Lopez Foundation, which is an NGO that is duly accredited by the PCNC, as evidenced by an official receipt issued by the relevant NGO.[71]

We find the assessment proper.

It appears that Respondent laid down two (2) legal bases in disallowing Petitioner's expense amounting Php19,537,817.72, to wit:

> (1) Expenses should be determined on a pro-rata basis under Sec. 50 of the NIRC, as amended, as implemented under RR No. 04-11; and,
>
> (2) Amount was disallowed as deduction from gross income for income tax purposes pursuant to Section 34(K) of the NIRC, as amended.

To address the first legal basis of the assessment, We find that Petitioner must be subject to the allocation of income and deductions as provided in Section 50 of the NIRC of 1997, as amended, to wit:

> "SEC. 50. *Allocation of Income and Deductions.*– In the case of two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, if he determined that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization, trade or business."

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70 SUBJECT: Implementing Republic Act No. 8424, "An Act Amending the National Internal Revenue Code, as Amended" Specifically Section 34 (H) Relative to the Deductibility of Contributions or Gifts Actually Paid or Made to Accredited Donee Institutions in Computing Taxable Income.

71 Docket, Exhibit "P-26", p. 814.

Respondent applied the above provision in Petitioner's case by supplementing it with RR No. 04-11 entitled, *"Proper Allocation of Costs and Expenses Amongst Income Earnings of Banks and Other Financial Institutions for Income Tax Reporting Purposes."* The objective thereof is to clearly set the rules on the allocation of cost and expenses between the Regular Banking Unit ("RBU") or Foreign Currency Deposit Unit ("FCDU")/Expanded Foreign Currency Deposit Unit ("EFCDU") or Offshore Banking Unit ("OBU") operations of a depository bank considering that the RBU and FCDU/EFCDU or OBU is governed by different income taxation regime in the NIRC of 1997, as amended, and is likewise applicable to other financial institutions which are subject to or exempt from both regular income and final taxes with reference to proper allocation of costs and expenses.

Notably, RR No. 04-11 was made applicable specifically only to banking institutions or other financial institutions. It is thus imperative that Petitioner must be classified as either of these two (2) institutions in order for Respondent's assessment to prosper on this ground.

In this regard, the term "bank" under Section 22(V) of the NIRC of 1997, as amended, means every banking institution, as defined in Section 2 of RA No. 337, otherwise known as the *General Banking Act*, as amended by RA No. 8791, otherwise known as *The General Banking Law of 2000.*

Perforce, under Sections 3.1 and 3.2 of the RA No. 8791, "banks" shall refer to entities engaged in the lending of funds obtained in the form of deposits. Banks shall be classified into: (a) Universal banks; (b) Commercial banks; (c) Thrift banks, composed of: (i) Savings and mortgage banks, (ii) Stock savings and loan associations, and (iii) Private development banks, as defined in Republic Act No. 7906 ("Thrift Banks Act"); (d) Rural banks, as defined in Republic Act No. 7353 ("Rural Banks Act"); (e) Cooperative banks, as defined in Republic Act No. 6938 ("Cooperative Code"); (f) Islamic banks as defined in Republic Act No. 6848, otherwise known as the "Charter of Al Amanah Islamic Investment Bank of the Philippines"; and (g) Other classifications of banks as determined by the Monetary Board of the Bangko Sentral ng Pilipinas.

On the other hand, RMC No. 46-11 [72] clarified the definition of "Financial Institutions" as used in RR No. 04-2011, adopting the definition under RR No. 09-04, to refer to banks, non-bank financial intermediaries performing quasi-banking functions, and other non-bank financial

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[72] SUBJECT: Clarification on the Definition of "Financial Institutions" as Used in Revenue Regulations (RR) No. 4-2011 on the "Proper Allocation of Costs and Expenses Amongst Income Earnings of Banks and Other Financial Institutions for Income Tax Reporting Purposes".

intermediaries including finance companies, but does not, however, include insurance companies.

The definition of "financial institutions" as used in RR No. 04-2011 mentions the terms non-bank financial intermediaries, quasi-banking, and finance companies. Since this definition was adopted from RR No. 09-04, We may rely on the same in determining the definitions of non-bank financial intermediaries, quasi-banking, and finance companies.

Thus, Respondent was justified to apply the method of allocation in Petitioner's case pursuant to RR No. 04-11, with reference to allocating cost and expenses among income earnings derived from active business operation which are subject to regular income tax, passive activities which are subject to final tax and other activities producing income which are exempt from income taxes as provided in Section 3 thereof.

Moreover, Section 3 of RR No. 04-11 further states that that only costs and expenses attributable to the operations of the RBU can be claimed as deduction to arrive at the taxable income of the RBU subject to regular income tax. Thus, as applied to other financial institutions, to which Petitioner belong particularly as non-bank financial intermediary, only costs and expenses attributable to the operations of the financial institution can be claimed as deduction to arrive at the taxable income of the financial institution subject to regular income tax.

Petitioner also claimed the following expenses in its ITR for taxable year 2012,[73] totaling in the amount of Php20,574,137.00 as follows:

Charitable contributions	Php 20,000,000.00
Miscellaneous	7,158.00
Professional fees	513,300.00
Taxes and licenses	38,176.00
Transportation and travel	15,503.00
Total	**Php20,574,137.00**

Out of the above claimed expenses, only the professional fees, taxes and licenses, and transportation and travel may be presumed to be attributable to the operations of Petitioner as a non-bank financial intermediary.

[73] Docket, Exhibit "P-2" (Lines 5C, 18C, 21C, 31C, and 34C), p. 693.

Unfortunately, however, the same does not hold true for miscellaneous expenses, especially since Petitioner failed to explain or show the nature of these expenses so as to be able to determine whether or not the same is attributable to its operations as a non-bank financial intermediary. While as for the charitable contribution, it is far from being considered as an expense attributable to Petitioner's operations as a non-bank financial intermediary.

As such, the miscellaneous expense and charitable contribution amounting to Php7,158.00 and Php20,000,000.00, respectively, cannot be claimed as a deductible expense pursuant to RR No. 04-11. Consequently, this leaves the allowable expenses down to Php566,979.00.[74]

To recall, the interest income amounting to Php179,288,707.67 is subject to final tax and not regular income tax, leaving the interest income amounting to Php6,927,843.75 from Unicapital, Inc. and other taxable income not subject to final tax amounting to Php849,690.00[75] as the only ones subject to regular income tax. Thus, the computation of the allocation must be corrected as follows:

			Ratio to Total Gross Income
Total taxable income per audit			
Service income	Php 6,927,843.75		
Other taxable income not subject to final tax	849,690.00	Php 7,777,533.75	*0.210%*
Add: Revenues subject to final tax	3,511,089,951.00		
Interest income subject to final tax	179,288,707.67	3,690,378,658.67	*94.942%*
Total gross income		**Php3,698,156,192.42**	

Hence, out of the allowable expenses amounting to Php566,979.00, only 0.210% of which is allocable to income subject to regular income tax, or only the amount of Php1,192.40 may be claimed as deductions from Petitioner's gross income. Accordingly, out of the total claimed expenses of Php20,573,074.62, only Php1,192.40 is allowable as a deduction while Php20,572,944.60 is non-deductible.[76]

Moving on with the second legal basis of Respondent's assessment, Petitioner's expenses amounting to Php19,537,817.72 was disallowed as deduction from gross income for income tax purposes pursuant to Section 34(K) of the NIRC of 1997, as amended, which provides that:

[74] Php20,574,137.00 less Php7,158.00 and Php20,000,000.00.
[75] Docket, Exhibit "P-2" (Line 19C), p. 690.
[76] Php20,574,137.00 less Php1,192.40.

"SEC. 34. *Deductions from Gross Income.* – xxx

xxx xxx xxx

(K) *Additional Requirements for Deductibility of Certain Payments.* – Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section 58 and 81 of this Code."

The legal basis for the assessment is clear. Thus, Petitioner must refute this assessment by proving that it withheld the corresponding withholding taxes from its deductible expenses as required under Section 34(K) of the NIRC of 1997, as amended. Petitioner cannot assume that Respondent erred in citing Section 34(K) and simply dictate or insist that the proper legal basis for assessing it should be Section 34(A)(1) of the same Code and present its arguments based on the latter. To accede to Petitioner's argument would undermine Respondent's power to determine the tax due as expressly vested in him under to Section 6(A)[77] of the same Code.

Since Petitioner did not present any proof that the proper taxes were accordingly withheld from the claimed expenses, the assessment on this ground must not be disturbed.

Considering the foregoing, Petitioner's non-deductible expenses should be Php20,572,944.60. However, the amount disallowed in the FLD-FAN is only Php19,537,817.72. Accordingly, the amount to be assessed from Petitioner should not go beyond what is stated in the assessment. In excess of such stated therein, Petitioner was not informed in writing of the facts and law on which the amount is made, thus, the taxpayer has no opportunity to dispute the said amount, in violation of its right to due process of law. N

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77 "SEC. 6. Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. -

(A) Examination of Return and Determination of Tax Due. After a return has been filed as required under the provisions of this Code, the Commissioner or his duly authorized representative may authorize the examination of any taxpayer and the **assessment of the correct amount of tax.**" (Emphasis added)

Furthermore, as the said excess amount was not indicated in the FLD-FAN, it should be considered as not assessed by Respondent, hence, already beyond the prescriptive period for it to be included only at this time of judicial trial.

Verily, Respondent's assessment must be upheld and Petitioner is not allowed to deduct expenses amounting to Php19,537,817.72.

D. Net Operating Loss Carry Over (NOLCO) - Php165,722,261.00

Respondent's investigation disclosed that Petitioner's operation showed taxable income instead of net operating loss as previously claimed in its ITR. The tax benefit of this amount has already been forwarded to succeeding periods as provided for under Section 34(D)(3) of the NIRC of 1997, as amended.[78]

Petitioner again argues that this assessment is another instance of the Respondent's failure to comply with the mandate under Section 228 as there is no supporting provision of the Tax Code, or any BIR issuance, that imposes income tax on the amount claimed as NOLCO or any regulation for that matter that will justify its inclusion as taxable income under Secs. 27 and 31 of the NIRC of 1997, as amended.

The assessment must be cancelled.

Section 34(D)(3) of the NIRC of 1997, as amended, provides:

> "SEC. 34. *Deductions from Gross Income.–* Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), **there shall be allowed the following deductions from gross income**:
>
> (D) *Losses.* – x x x

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[78] BIR Records, Exhibit "R-4" (Details of Discrepancy), p. 327; Docket, Exhibit "P-1", p. 309.

> (3) *Net Operating Loss Carry-Over.* - The net operating loss of the business or enterprise for any taxable year immediately preceding the current taxable year, which had not been previously offset as deduction from gross income **shall be carried over as a deduction from gross income for the next three (3) consecutive taxable years immediately following the year of such loss.**
>
> x x x
>
> For purposes of this Subsection the term 'net operating loss' shall mean the excess of allowable deduction over gross income of the business in a taxable year." *(Emphases supplied)*

Records of the case show that the amount of NOLCO disallowed by Respondent is Php165,722,261.00. However, the NOLCO actually claimed as deduction by Petitioner in its ITR for taxable year 2012 amounts only to Php151,301,113.00,[79] representing the net operating loss it sustained in taxable years 2009 and 2010, the said amounts of which were detailed in Petitioner's ITR for 2012 as follows:[80]

Year Incurred	Net Operating Loss	Applied Previous Year	Applied Current Year	Expired	Net Operating Loss (Unapplied)
2009	Php 50,766,794.00	Php -	Php 50,766,794.00	Php -	Php -
2010	100,534,319.00	-	100,534,319.00	-	-
2011	-	-	-	-	-
2012	14,421,148.00	-	14,421,148.00	-	-
Total			**Php165,722,261.00**		

Notably, the same details are also disclosed in Petitioner's Audited Financial Statements ("AFS") for taxable year 2012, also the net operating loss incurred in taxable year 2012 is presented as Additions.[81] Needless to say, Petitioner sufficiently disclosed the NOLCO information in its 2012 ITR and AFS. As such, it can validly claim as deduction the NOLCO it sustained in the immediately preceding taxable year. Correspondingly, Petitioner is correct in claiming the NOLCO from taxable years 2009 and 2010 with an aggregate amount of Php151,301,113.00.

[79] Docket, Exhibit "P-2", Line 24C, p. 690.
[80] *Id.*, Exhibit "P-2" (Schedule 1A), p. 692.
[81] *Id.*, Exhibit "P-20" (Note 10), p. 783.

With regard the disallowed NOLCO in the amount of Php14,421,148.00, representing the net loss it sustained in taxable year 2012,[82] Respondent's argument that Petitioner already benefitted therefrom as the same was forwarded to the succeeding periods is of no moment since the taxable year 2013 is beyond the scope of the current assessment. Stated simply, the NOLCO can only be subject to assessment when the same was claimed as deduction for the succeeding year 2013 until 2015, and not in the year 2012. Therefore, adding back the net loss of Php14,421,148.00, when in fact the same was not deducted by Petitioner from its gross income, for the taxable year 2012 is indeed erroneous. Hence, the assessment must be cancelled for lack of factual basis.

E. Unsupported creditable withholding tax - Php186,898.40

Respondent's verification disclosed that Petitioner's claimed creditable tax withheld per its ITR in the amount of Php186,898.40 actually pertains to twenty percent (20%) final tax withheld on interest income earned, and shall not be allowed as credit on regular income tax pursuant to Section 2.58.3(B) of RR No. 2-98, as amended.[83]

In its defense, Petitioner asserts that it properly withheld all taxes due on its income during the taxable year 2012. It explains that the creditable tax withheld of Php186,898.40 pertains to the interest income of Php934,492.01 with a tax rate of twenty percent (20%), which is creditable in nature pursuant to Section 7 of RR No. 14-12,[84] to wit:

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[82] *Id.*, Exhibit "P-2" (Lines 16C to 22C), p. 690, as may be computed as follows:

Sales/Revenues/Receipts/Fees	Php 5,303,299.00
Less: Cost of Sales/Services	-
Gross Income from Operations	**5,303,299.00**
Add: Other Taxable Income not Subjected to Final Tax	849,690.00
Total Gross Income	**6,152,989.00**
Less: Allowable Deductions	20,574,137.00
Net Taxable Income (Loss)	**Php(14,421,148.00)**

[83] BIR Records, Exhibit "R-4" (Details of Discrepancy), p. 327.

[84] SUBJECT: Proper Tax Treatment of Interest Income Earnings on Financial Instruments and Other Related Transactions.

> "SECTION 7. *Tax Treatment of Interest Income Derived from All Other Instruments.* — Unless otherwise provided by law or regulations, interest income derived from any other debt instruments not within the coverage of 'deposit substitutes'; and these Regulations shall be subject to a Creditable Withholding Tax (CWT) at the rate of twenty percent (20%). x x x"

According to Petitioner, while the line item "Unsupported 2307" can be found in Respondent's computation for deficiency income tax, there was no explanation, both in the body of the FLD-FAN or in the attached annexes, as to how the disputed figure was computed. As such, Petitioner claims that this lack of information prevented it from fully understanding the basis of the assessment, in violation of Section 228 of the NIRC of 1997, as amended, which mandates 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."

Also, under the expanded withholding tax system, the payor is constituted as the government's agent. The payor is mandated to deduct and withhold from his payments a specified percentage as indicated in RR No. 2-98 and, thereafter, to remit the same to the government. Having done so, the payee is then entitled to claim a tax credit on his tax due.

Furthermore, Section 2.58(B) of the said regulation likewise provides that the payor is required to "furnish each payee, whether individual or corporate, with a withholding tax statement, using the prescribed BIR Form 2307, showing the income payments made and the amount of taxes withheld therefrom." The issuance of BIR Form 2307 is critical because it is the document that establishes the fact of withholding by the payor.

While We partly agree with Petitioner's contentions, We however uphold the deficiency assessment.

At the onset, We cannot subscribe to Petitioner's contention that Respondent failed to comply with Section 228 of the NIRC of 1997, as amended, since Petitioner was clearly informed of the nature of the assessment as it was intelligently able to account for the amount being disallowed and was given opportunity to refute the same. As early as the *Reply to the Preliminary Assessment Notice,*[85] Petitioner was already assertive in explaining the source of the disallowed creditable withholding tax and its corresponding income payment, and even submitted thereto the BIR Form 2307 in support of the

[85] Docket, Exhibit "P-10" (pp. 5 to 6), pp. 709 to 710.

disallowed creditable withholding tax. In fact, this was even reiterated in Petitioner's *Protest to the FLD.*[86] Thus, Petitioner cannot feign ignorance as to how Respondent arrived at the disputed assessment.

However, it was erroneous for Respondent to presume that the mere fact of withholding of twenty percent (20%) on interest income is already a final tax. As correctly pointed out by Petitioner, the withholding of twenty percent (20%) income tax from interest income from financial instruments was in compliance with Section 7 of RR No. 14-12, which expressly states that the tax withheld is a creditable withholding tax, not a final tax.

Moreover, Q3 and A3 of RMC No. 77-12[87] clarified that the twenty percent (20%) creditable withholding tax imposed on interest income derived from any other debt instrument not within the coverage of "deposit substitutes", and under RR No. 14-12 (now Section 2.57.2[Y] of Revenue Regulations No. 2-98), shall apply to each interest payment to be made beginning on November 23, 2012 or upon the RR's effectivity irrespective of when the instruments or securities were issued. This covers interest income from current outstanding instruments, securities, or accounts as of November 23, 2012.

However, in the present case, Petitioner did not present any proof as to when the alleged interest income related to the disallowed creditable withholding tax was paid, so that the provision of RR No. 14-12 may be applied and that the tax withheld be creditable against its income tax.

More so, a perusal of Petitioner's ITR for 2012 shows that Petitioner had total tax credits during that year in the total amount of Php325,655.00,[88] which consisted of the following:

Creditable tax withheld from previous quarters	Php 120,226.00
Creditable tax withheld per BIR Form 2307 for the fourth quarter	205,429.00
Total tax credits during the TY 2012	**Php325,655.00**

And as culled from the records of the case, the said amount is comprised of the following: N

[86] *Id.*, Exhibit "P-11" (p. 25), p. 736.
[87] SUBJECT: Clarifying Certain Provisions of Revenue Regulations No. 14-2012 on the Proper Tax Treatment of Interest Income Earnings on Financial Instruments and Other Related Transactions.
[88] Docket, The sum of Php120,226.00 and Php205,429.00, per Exhibit "P-2", Lines 33F and 33H, p. 691.

Reference	Payor's Name	Period Covered	Income Payments	Tax Withheld
Exhibit "P-22"	Unicapital, Inc.	December 2011	Php 1,280,812.58	Php 25,616.25
Exhibit "P-23"	Unicapital, Inc.	March 2012	1,296,502.53	25,930.05
Exhibit "P-24"	Unicapital, Inc.	June 2012	918,669.28	18,373.39
BIR Records, p. 63	Unicapital, Inc.	June 2012	1,265,312.00	25,306.24
BIR Records, p. 63	Unicapital, Inc.	June 2012	1,250,000.00	25,000.00
	sub-total		**Php6,011,296.39**	**Php120,225.93**
Exhibit "P-25"	Unicapital, Inc.	August 2012	Php 926,546.87	Php 18,530.94
BIR Records, pp. 55, 62, 345	Unicapital, Inc.	December 2012	934,492.00	186,898.40
	sub-total		**Php1,861,038.87**	**Php205,429.34**
	TOTAL		**Php7,872,335.26**	**Php325,655.27**

As can be gleaned above, the disallowed amount of Php186,898.40 with related income payments of Php934,492.00 pertains to the alleged creditable tax withheld by Unicapital, Inc. for the month of December 2012. However, Petitioner was able to present only the following BIR Forms No. 2307 to prove the fact of withholding from its interest income paid by Unicapital, Inc.:

Exhibit No.[89]	Income Payment	Tax Withheld
"P-22"	Php 1,280,812.58	Php 25,616.25
"P-23"	1,296,502.53	25,930.05
"P-24"	918,669.28	18,373.39
"P-25"	926,546.87	18,530.94
	Php4,422,531.26	**Php88,450.63**

Unfortunately, Petitioner failed to offer as evidence during trial the BIR Form No. 2307 purportedly supporting the item subject of the assessment.

It also bears stressing that Petitioner's creditable withholding tax amounting to Php186,898.40 was disallowed by Respondent for being unsupported, pursuant to Section 2.58.3(B) of RR No. 2-98, which provides as follows:

> "SECTION 2.58.3. *Claim for Tax Credit or Refund.* — xxx
>
> (B) **Claims for tax credit** or refund of any creditable income tax which was deducted and withheld on income

[89] *Id.*, pp. 810 to 813.

> payments **shall be given due course only when** it is shown that the income payment has been declared as part of the gross income and **the fact of withholding is established by a copy of the withholding tax statement** duly issued by the payor to the payee showing the amount paid and the amount of tax withheld therefrom.
>
> Proof of remittance is the responsibility of the withholding agent." *(Emphases added)*

Accordingly, for failure to support the creditable withholding tax in the amount of Php186,898.40, Petitioner is, therefore, precluded to claim the same as creditable. As such, the disallowance is sustained.

F. Excess MCIT over NCIT carried forward to succeeding period - Php123,060.00; and

G. Excess tax credits carried forward to succeeding period - Php432,509.00

In his verification, the excess Minimum Corporate Income Tax ("MCIT") paid over Normal Corporate Income Tax ("NCIT") was not allowed by Respondent as tax credit against the computed deficiency income tax, considering that the said amount shall be carried over and credited against the NCIT for the three (3) immediately succeeding taxable year in compliance with the provision imposed under Section 27(E)(2) of the NIRC of 1997, as amended.[90]

Similarly, an excess tax credit per ITR in the amount of Php432,509.00 was deducted from the total allowable tax credit, considering that the said amount has been carried over to succeeding period and credited against the estimated quarterly Income Tax Liabilities for the taxable quarter of the succeeding taxable years pursuant to Section 76 of NIRC of 1997, as amended.[91]

In assailing the said deficiency assessment, Petitioner insists that Respondent merely stated the provisions from the Tax Code without explaining how they may be made applicable in the present case. Having no

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90 BIR Records, Exhibit "R-4" (Details of Discrepancy), p. 327.
91 *Id.*

sufficient basis in the assessment, Petitioner claims it was not given the opportunity to refute Respondent's allegations therein.

Furthermore, Petitioner claims that Section 76 of the NIRC of 1997, as amended, affords taxpayers a choice of whether or not to have the excess amount refunded or carried-over and applied to future tax liability which they must indicate in their final adjustment return.

Petitioner asserts that in the present case, there is no showing that it has chosen to carry-over the excess tax credit instead of having it credited or refunded outright. Without proof that Petitioner has chosen the carry-over option, Respondent has no basis in disallowing the excess tax credit amounting to Php432,509.00.

The assessment must be cancelled.

With respect to the disallowed excess MCIT over NCIT amounting to Php123,060.00 carried forward to succeeding period, Section 27(E)(1) and (2) of the NIRC of 1997, as amended, provides as follows:

> "SEC. 27. *Rates of Income Tax on Domestic Corporations.*— xxx.
>
> (E) *Minimum Corporate Income Tax on Domestic Corporations.*—
>
> (1) *Imposition of Tax.*— A minimum corporate income tax of two percent (2%) of the gross income as of the end of the taxable year, as defined herein, is hereby imposed on a corporation taxable under this Title, beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations, when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year.
>
> (2) *Carry Forward of Excess Minimum Tax.*— Any excess of the minimum corporate income tax over the normal income tax as computed under Subsection (A) of this Section shall be carried forward and credited against the normal income tax for the three (3) immediately succeeding taxable years."

Implementing the above provision is Section 2.27 (E) of RR No. 9-98,[92] as amended by RR No. 12-07, which states:

> "Sec. 2.27 (E) MINIMUM CORPORATE INCOME TAX (MCIT) ON DOMESTIC CORPORATIONS. —
>
> (1) *Imposition of the Tax.*— A minimum corporate income tax (MCIT) of two percent (2%) of the gross income as of the end of the taxable year (whether calendar or fiscal year, depending on the accounting period employed) is hereby imposed upon any domestic corporation beginning on the fourth (4th) taxable year immediately following the taxable year in which such corporation commenced its business operations. The MCIT shall be imposed whenever such corporation has zero or negative taxable income or whenever the amount of minimum corporate income tax is greater than the normal income tax due from such corporation.
>
> xxx xxx xxx
>
> The taxpayer shall pay the MCIT whenever it is greater than the regular or normal corporate income tax which is imposed under Sec. 27 (A) and Sec. 28 (A) (1) of the Code. The final comparison between the normal income tax payable by the corporation and the MCIT shall be made at the end of the taxable year and the payable or excess payment in the Annual Income Tax Return shall be computed taking into consideration corporate income tax payment made at the time of filing of quarterly corporate income tax returns whether this be MCIT or normal income tax."

It is clear from the foregoing provisions that the two percent (2%) MCIT on gross income shall be imposed whenever the taxpayer-corporation has zero or negative taxable income, or whenever the amount of MCIT is greater than the normal or regular income tax due from such taxpayer-corporation. In other words, it is imposed in lieu of the normal or regular corporate income tax of thirty percent (30%).

In its annual ITR for taxable year 2012,[93] Petitioner declared a net loss of Php165,722,261.00.[94] Consequently, Petitioner reported and paid an MCIT due of Php123,060.00[95] on the gross income of Php6,152,989.00.[96]

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92 SUBJECT: Implementing Republic Act No. 8424, 'An Act Amending the National Internal Revenue Code, as Amended' Relative to the Imposition of the Minimum Corporate Income Tax (MCIT) on Domestic Corporations and Resident Foreign Corporations.

Since the deficiency assessments made by Respondent, as discussed above, are substantially untenable, We sustain the findings that Petitioner had net loss from its operations and therefore, the MCIT still applies. Considering further that the MCIT will be credited against the normal income tax for the next three (3) immediately succeeding taxable years, pursuant to Section 27(E)(2) of the NIRC of 1997, as amended, its benefit will redound on the succeeding years. Thus, it is inappropriate to disallow the same at this time for such is beyond the scope of the present assessment.

With respect to the excess tax credits amounting to Php432,509.00 carried forward to succeeding period, the same is automatically allowed as a tax credit against Petitioner's income tax due for the taxable quarters/years immediately succeeding the taxable quarters/years in which the excess credit arose. This is true even if Petitioner did not choose the carry-over option in its ITR, pursuant to Sec. 2.58.3(C) of the RR No. 2-98, which provides that:

> "SECTION 2.58.3. *Claim for Tax Credit or Refund.* — xxx
>
> (C) *Excess Credits* — An individual or corporate taxpayer's excess expanded withholding tax credits for the taxable quarter/year shall **automatically be allowed as a credit against his income tax due for the taxable quarters/years immediately succeeding the taxable quarters/years in which the excess credit arose**, provided he submits with his income tax return, a copy of the first page of his income tax return for the previous taxable period showing the amount of his excess withholding tax credits, **and on which return he has not opted for a cash refund or tax credit certificate**." (*Emphasis added*)

In the present case, Petitioner did not choose any option[97] on what action shall be made on its excess tax credits in its 2012 ITR in the amount of Php432,509.00. Thus, applying the above provision, these excess credits shall be automatically be carried forward to the succeeding taxable quarters/years.

Conversely, it was improper for Respondent to disallow said excess credits because any tax benefit derived by Petitioner from the carry-over of the said amount redounds to the succeeding year, 2013. Since the tax benefit will

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93 Docket, Exhibit "P-2", p. 691.
94 *Id.*, Exhibit "P-2", Line 26C, p. 691.
95 *Id.*, Exhibit "P-2", Line 32, p. 691.
96 *Id.*, Exhibit "P-2", Line 20C, p. 690.
97 *Id.*, Exhibit "P-1" (Line 37), p. 691.

be in the succeeding year, at most, Petitioner may only be assessed in the said succeeding year.

Clearly then, the disallowances of the excess MCIT over NCIT carried forward to succeeding period amounting to Php123,060.00 and the excess tax credits carried forward to succeeding period amounting to Php432,509.00 lack of factual and legal bases and therefore must be cancelled.

In view of the foregoing, Petitioner's operations for taxable year 2012 results to a net taxable income before allowance for NOLCO amounting to Php6,741,214.47, as shown below:

Sales/Revenues/Receipts/Fees	Php 6,927,843.75
Less: Cost of Sales/Services	-
Gross Income from Operations	**6,927,843.75**
Add: Other Taxable Income not Subjected to Final Tax	849,690.00
Total Gross Income	**7,777,533.75**
Less: Allowable Deductions	1,036,319.28
Net Taxable Income	**Php6,741,214.47**

Since Petitioner has available and un-expired NOLCO sustained in taxable years 2009 and 2010 in the aggregate amount of Php151,301,113.00, the same may be applied against Petitioner's net taxable income of Php6,741,214.47 for taxable year 2012, thereby resulting to a net loss of Php144,559,898.53, as computed below:

Sales/Revenues/Receipts/Fees		Php 6,927,843.75
Less: Cost of Sales/Services		-
Gross Income from Operations		**6,927,843.75**
Add: Other Taxable Income not Subjected to Final Tax		849,690.00
Total Gross Income		**7,777,533.75**
Less: Allowable Deductions	Php 1,036,319.28	
Allowance for NOLCO	151,301,113.00	152,337,432.28
Net Loss		**Php(144,559,898.53)**

Since Petitioner reported a net loss, it cannot be made liable for regular corporate income tax of thirty percent (30%). Nonetheless, Petitioner is still liable to pay the MCIT in the amount of Php155,550.68, since it is higher than the regular corporate income tax due which amounted to nil, in accordance to Sec. 27(E)(1)[98] of the NIRC of 1997, as amended, to wit:

[98] "SEC. 27. Rates of Income tax on Domestic Corporations. – x x x

Sales/Revenues/Receipts/Fees	Php 6,927,843.75
Less: Cost of Sales/Services	-
Gross Income from Operations	**6,927,843.75**
Add: Other Taxable Income not Subjected to Final Tax	849,690.00
Total Gross Income	**7,777,533.75**
Multiply by MCIT rate	2%
MCIT due	**Php 155,550.68**

On the other hand, Petitioner has available tax credits amounting to Php368,670.60, computed as follows:

Prior Year's Excess Credits Other than MCIT[99]	Php 229,914.00
Creditable Tax Withheld from Previous Quarter/s[100]	120,226.00
Creditable Tax Withheld per BIR Form No. 2307 for the Fourth Quarter[101]	205,429.00
Total Tax Credits	**555,569.00**
Less: Unsupported CWTs	186,898.40
Total Available Tax Credits/Payments	**Php368,670.60**

Apparently, the amount of available tax credits as computed above is sufficient to cover Petitioner's MCIT due for taxable year 2012 amounting to Php155,550.68. Thus, Petitioner has no income tax payable for taxable year 2012.

In sum, Petitioner has no deficiency income tax liability for taxable year 2012, and thus, the entire deficiency income tax assessment must be cancelled.

DEFICIENCY VALUE-ADDED TAX

(E) Minimum Corporate Income Tax on Domestic Corporations. -

(1) Imposition of Tax. - **A minimum corporate income tax of two percent (2%) of the gross income as of the end of the taxable year**, as defined herein, is hereby **imposed on a corporation taxable under this Title**, beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations, **when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year**." (Emphasis supplied)

99 Docket, Exhibit "P-2" (Line 33A), p. 691.
100 *Id.*, Exhibit "P-2" (Line 33F), p. 691.
101 *Id.*, Exhibit "P-2" (Line 33H), p. 691.

In his verification, Respondent assessed Petitioner of deficiency VAT for taxable year 2012 in the total amount of Php1,326,957.29, with the following details:[102]

Vatable Sales per Returns		Php	-
Add: Adjustments per investigation:			
Service Income not subjected to VAT (Schedule 3)			6,927,843.75
Adjusted Vatable Sales		Php	6,927,843.75
Output Tax Due (12%)		Php	831,341.25
Less: Allowed Tax Credits/Payments			
Input tax carried over from previous period	Php 23,048.57		
Input tax on current purchases	858,359.57		
Total	Php881,408.14		
Less: Excess input tax carried forward to succeeding period	881,408.14		-
Deficiency Value-Added Tax		Php	831,341.25
Add: Interest (1/26/13 to 1/18/16)			495,616.04
TOTAL AMOUNT DUE			**Php1,326,957.29**

As such, the following items comprise the deficiency VAT assessment:

A. Service income not subjected to VAT	Php6,927,843.75
B. Excess input tax carried forward to succeeding period	Php881,408.14

A. *Service income not subjected to VAT - Php6,927,843.75*

Respondent's comparison of the gross receipts per books as against the amount of receipts subjected to VAT per returns, showed that there are receipts not subjected to VAT amounting to Php6,927,843.75. As such, it was assessed under Title IV, Sections 105 and 108 of the NIRC of 1997, as amended.[103]

In assailing the assessment, Petitioner argues that there was no undeclared income, and even assuming that there was any, the same does not necessarily translate to an undeclared income that can be subject to tax. Moreover, Respondent must not be allowed to extract the payment of alleged VAT deficiency based on a faulty assumption that Petitioner has undeclared service income. Petitioner contends that Section 108 of the NIRC of 1997, as

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[102] BIR Records, Exhibit "R-1", p. 330.
[103] BIR Records, Exhibit "R-4" (Details of Discrepancy), p. 327.

amended, provides that the tax base for VAT is gross receipts, not undeclared income or unaccounted income.

Petitioner further claims that it is fundamental that VAT is only imposed when actual sale or exchange of services occurs. Absent such sale or exchange of services, no VAT could possibly be imposed. Stated simply, a sale or exchange of services must first be proven before any VAT could be ascribed. Petitioner insists that in the present case, no proof of sale or exchange of services has been presented on a basis of the said deficiency VAT.

We find the assessment untenable.

To recall, based on its arguments in refuting the deficiency income tax assessment, Petitioner admitted that it has service income in the amount of Php6,927,843.57. However, the same was not fully declared in the annual ITR for the taxable year 2012 because of the timing differences between interest accrual and its subsequent collection. Referring to the reconciliation submitted by Petitioner to account this timing differences, the amount of Php6,927,843.57 apparently comprises the gross receipts from interest income during taxable year 2012.

However, according to Respondent, Petitioner failed to subject these gross receipts to VAT since it did not declare any VATable sale in its Quarterly VAT Returns for the taxable year 2012.[104]

Apparently, the issue that needs to be resolved herein is whether or not said gross receipts must be subject to VAT.

We rule in the negative.

Pursuant to Section 4.108-3(g) of RR No. 16-05, lending investors shall be subject to VAT on the basis of their gross receipts. Accordingly, a "lending investor" includes all persons other than banks, non-bank financial intermediaries, finance companies and other financial intermediaries not performing quasi-banking functions who make a practice of lending money for themselves or others at interest.

To reiterate, as stated in its Amended Articles of Incorporation, Petitioner is primarily engaged *to acquire by purchase, exchange, assignment, gift or otherwise, and to hold, own and use for investment or otherwise, and to sell, assign, transfer,*

[104] Docket, Exhibits "P-3" to "P-6" (Lines 15A and 15B), pp. 696, 700, 703, and 704.

exchange, mortgage, pledge, deal, deal in and with otherwise to enjoy and dispose of, real and personal property including but not limited to bonds, debentures, promissory notes, shares of capital stock, or other securities or obligations, created, negotiated or issued by any corporation, association or entity, foreign or domestic, and while the owner thereof, to exercise all rights, powers and privileges of ownership, including the right to receive, collect, and dispose of any and all dividends, interest and income, derived from said securities, and the right to vote on any shares of capital stock, and upon any bonds, debentures, or other securities, having voting power as owned, and to issue proxies for the exercise of the right to vote, but only to the extent permitted by law, without acting as a stock broker or dealer in securities or an investment company defined under Republic Act No. 2629.[105]

Based above, Petitioner's primary purpose makes it fall outside the scope of RR No. 16-05.

Instead, it is RR No. 09-04, re-imposing gross receipts tax on banks and non-bank financial intermediaries performing quasi-banking functions and other non-bank financial intermediaries beginning January 01, 2004, which must be applied in Petitioner's case since banks, non-bank financial intermediaries, finance companies, and quasi-banking are defined under RR No. 09-04, as follows:

> "SECTION 2. *Definition of Terms.* — For purposes of these Regulations, the terms enumerated hereunder shall have the following meaning:
>
> xxx xxx xxx
>
> 2.2. *Banks or Banking Institutions* — shall refer to those entities as defined in Section 3 of Republic Act No. 8791, as amended, otherwise known as the General Banking Law of 2000. The term 'banks' or 'banking institutions' are synonymous and interchangeable and specifically include universal banks, commercial banks, thrift banks (savings and mortgage banks, stock savings and loan associations, and private development banks), cooperative banks, rural banks, Islamic banks and other classifications of banks as may be determined by the Monetary Board of the Bangko Sentral ng Pilipinas.
>
> 2.3. *Non-bank Financial Intermediaries* — shall refer to persons or entities whose principal functions include the lending, investing or placement of funds or evidences of indebtedness or

[105] *Id.*, Exhibit "P-21", p. 800.

equity deposited with them, acquired by them or otherwise coursed through them, either for their own account or for the account of others. This includes all entities regularly engaged in the lending of funds or purchasing of receivables or other obligations with funds obtained from the public through the issuance, endorsement or acceptance of debt instruments of any kind for their own account, or through the issuance of certificates of assignment or similar instruments with recourse, trust certificates, or of repurchase agreements, whether any of these means of obtaining funds from the public is done on a regular basis or only occasionally.

2.4. *Quasi-banking Activities* — shall refer to the borrowing of funds from twenty (20) or more personal or corporate lenders at any one time, through the issuance, endorsement or acceptance of debt instruments of any kind other than deposits for the borrower's own account, or through the issuance of certificates of assignment or similar instruments, with recourse, or of repurchase agreements for purposes of relending or purchasing receivables and other similar obligations. Provided, however, that commercial, industrial and other non-financial companies, which borrows funds through any of these means for the limited purpose of financing their own needs or the needs of their agents or dealers, shall not be considered as performing quasi-banking functions.

xxx xxx xxx

2.7. Financing Companies — shall refer to corporations except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organized or operating under other special laws, which are primarily organized for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or factoring commercial papers or accounts receivables, or by buying and selling contracts, leases, chattel mortgages, or other evidences of indebtedness, or by financial leasing of movable as well as immovable properties (R.A. No. 5980 as amended by R.A. No. 8556)."

Considering that the interest income being assessed by VAT allegedly arose from the promissory note entered into by Petitioner and Unicapital, Inc.

on December 14, 2011, together with its subsequent adjustments for interest,[106] the income in the amount of Php6,927,843.75 was earned pursuant to Petitioner's primary purpose as a non-bank financial intermediary, which must not be subject to VAT but rather with GRT. Accordingly, the deficiency VAT assessment on the matter is misplaced and must be cancelled.

B. Excess input tax carried forward to succeeding period - Php881,408.14

Notably, Respondent did not provide any legal basis for disallowing Petitioner's excess input tax carried forward to succeeding period amounting to Php881,408.14. As such, the same must be cancelled in violation of Section 228 of the NIRC of 1997, as amended, which requires 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.

Furthermore, even assuming that there was legal basis provided, it was improper for Respondent to disallow said excess input tax because any tax benefit derived by Petitioner from the carry-over of the said amount redounds to the succeeding quarter in 2013. Since the tax benefit will be in the succeeding quarter, at most, Petitioner may only be assessed in the said succeeding quarter.

Considering the cancellation of the two (2) assessment items comprising the deficiency VAT assessment, Petitioner no longer has any deficiency VAT liability to speak of, and thus must be cancelled *in toto*.

DEFICIENCY DOCUMENTARY STAMP TAX

In his verification, Respondent assessed Petitioner of deficiency DST for taxable year 2012 in the total amount of Php5,917,833.90, detailed as follows:[107]

Basic Documentary Stamp Tax Due (Schedule 4)		Php 3,187,500.00
Add: 25% Surcharge	Php 796,875.00	
Interest (1/06/13 to 1/18/16)	1,933,458.90	2,730,333.90
TOTAL AMOUNT DUE		**Php5,917,833.90**

[106] *Id.*, Exhibits "P-12" to "P-15", pp. 741 to 748.
[107] BIR Records, Exhibit "R-1", p. 329.

Respondent claims that Petitioner failed to file and pay the documentary stamp tax due on the preferred stock redeemed, hence, assessed pursuant to Section 175 of the NIRC, as amended, computed as follows:

Preferred stock redeemed	Php850,000,000.00
DST rate (Php0.75 for every P200.00 or a fractional part thereof)	0.375%
DST tax due	**Php3,187,500.00**

Petitioner argues that Respondent erred in assessing deficiency tax on its redemption of preferred shares as this particular redemption formed part of the decrease of authorized capital stock of the Petitioner, as evidenced by a Certificate of Approval of Decrease in Capital Stock issued by the Securities and Exchange Commission ("SEC") on November 10, 2014.[108]

In fact, as further explained by its witness, Ms. Victoria A. Martinez, the redemption does not constitute a sale, assignment or transfer because Petitioner is not taking title to the surrendered shares, and the shares are retired and not retained as treasury shares. Hence, this redemption of preferred shares by Petitioner should not be subject to DST.[109]

Lastly, Petitioner claims to have relied on numerous BIR Rulings regarding redemption of shares – such as BIR Ruling No. DA-318-2005 dated July 15, 2005, wherein it was stated that: "The surrender of redeemed shares for cancellation is not subject to DST. The surrender of the shares does not constitute a sale, assignment or transfer because the liquidating corporation is not taking title to the surrendered shares and the shares are retired and not retained as treasury shares." This principle was reiterated in BIR Ruling No. DA-C-272683-09 dated November 20, 2009 and further states that no documentary stamp tax under Section 175 of the NIRC of 1997, as amended, is due on the surrender of the shares and the subsequent cancellation thereof considering that it does not realize any benefit, as owner or otherwise, from its receipt of the shares, hence, there is no basis to impose the DST on the transfer.[110]

The assessment must be cancelled.

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108 Docket, Exhibit "P-17", pp. 749 to 755.
109 *Id.*, Exhibit "P-30" (Q&A No. 47), p. 359.
110 *Id.*, Exhibit "P-30" (Q&A No. 48), p. 359 to 360.

Perforce, Respondent assessed Petitioner's redeemed preferred stock amounting to Php850,000,000.00, with DST pursuant to Section 175 of the NIRC of 1997, as amended, which provides as follows:

> "SEC. 175. Stamp *Tax on Sales, Agreements to Sell, Memoranda of Sales, Deliveries or Transfer of Due-bills, Certificates of Obligation, or Shares of Certificates of Stock.*– On all sales, or agreements to sell, or memoranda of sale, or deliveries, or transfer of due-bills, certificates of obligation, or shares of certificates of stock in any association, company, or corporation, or transfer of such securities by assignment in blank, or by delivery, or by any paper or agreement, or memorandum or other evidences of transfer or sale whether entitling the holder in any manner to the benefit of such due-bills, certificates of obligation or stock, or to secure the future payment of money, or for the future transfer of any due-bill, certificate of obligation or stock, there shall be collected a documentary stamp tax of Seventy five centavos (Php0.75) on each Two hundred pesos (Php200) or fractional part thereof, of the par value of such due-bill, certificate of obligation or stock; *Provided*, That only one tax shall be collected on each sale or transfer of stock or securities from one person to another, regardless of whether or not a certificate of stock or obligation is issued, indorsed, or delivered in pursuance of such sale or transfer: and *Provided, further*, That in the case of stock without par value the amount of documentary stamp tax herein prescribed shall be equivalent to twenty-five percent (25%) of the documentary stamp tax paid upon the original issue of said stock."

As culled from the records of the case, Petitioner's capital stock is divided into redeemable shares and common shares both of which are divided into Class A and Class B shares. The redeemable shares shall be redeemed at the fair market value of such shares at specific times and circumstances as determined by the Board of Directors ("BoD").[111]

On April 23, 2012, the BoD approved the redemption of 8,500,000 preferred shares owned by First Philippine Holdings Company (Parent Company) at a redemption price equivalent to their issue value in the total amount of Php3.1 billion,[112] with the issue value broken down as follows:[113]

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[111] *Id.*, Exhibit "P-20" (Note 8), p. 780.
[112] *Id.*, Exhibit "P-20" (Note 8), p. 781.
[113] *Id.*, Exhibit "P-20" (Statement of Changes in Equity), p. 764.

Par value	Php 850,000,000.00
Additional Paid-in Capital	2,281,029,570.00
Total issue value	**Php3,131,029,570.00**

The assessed redemption of preferred shares transpired in taxable year 2012. However, it is different from the redemption of shares pursuant to a decrease in authorized capital stock (ACS) approved by the BoD on December 10, 2013, as ratified by Petitioner's stockholders on February 06, 2014, and thereafter approved by the SEC on November 10, 2014.[114] Apparently, the same transpired in the succeeding years and not in taxable 2012.

Nevertheless, the fact remains undisputed that the assessed amount of Php850,000,000.00 pertains to redeemed preferred stock.

As correctly pointed out by Petitioner, redemption of redeemable shares is not subject to DST. It has been consistently held by Respondent in various BIR Rulings[115] that the surrender of shares does not does not constitute a sale, assignment or transfer because the liquidating corporation is not taking title to the surrendered shares and the shares are retired and not retained as treasury shares. In effect, the liquidating corporation does not realize any benefit, as owner or otherwise, from its receipt of the shares. Such being the case, considering that the shares will be considered retired and no longer issuable upon redemption, no DST is due on the surrender and cancellation of the redeemable, preferred shares.

It can be deduced from the various BIR Rulings that the main rationale for not imposing DST on redemption of shares is because there was no benefit realized by the corporation redeeming the shares, nor was there any transfer of title because the corporation does not take title over the redeemed shares as it is already retired.

Indeed, Petitioner did not realize any benefit from the redemption of preferred shares amounting to Php850,000,000.00 as it already retired the same and did not recognize it as treasury shares, which demonstrates that Petitioner does not take title to it and even precludes the possibility of being eventually re-issued later on. In fact, Petitioner's Statement of Changes in Equity for taxable year 2012,[116] shows that the redemption resulted in the outright

[114] *Id.*, Exhibit "P-17", p. 751.

[115] BIR Ruling No. 386-19 dated July 18, 2019; BIR Ruling [DA-(C-305) 754-09] dated December 8, 2009; BIR Ruling [DA-(C-176) 539-08] dated December 16, 2008; BIR Ruling [DA-(C-118) 385-08] dated November 3, 2008; BIR Ruling [DA-391-08] dated June 30, 2008; BIR Ruling [DA-360-06] dated June 9, 2006; BIR Ruling [DA-318-05] dated July 15, 2005; BIR Ruling [DA-174-03] dated June 3, 2003; BIR Ruling No. 039-02 dated November 11, 2002.

[116] Docket, Exhibit "P-20", p. 764.

reduction from Petitioner's capital stock, and was not re-classified as treasury shares, as shown below:

Capital Stock	Redeemable	Common	Total
Balances at January 1, 2012	Php1,242,600,000.00	Php 6,200,000.00	Php1,248,800,000.00
Redemption of preferred stock	(850,000,000.00)	-	(850,000,000.00)
Balances at December 31, 2012	**Php392,600,000.00**	**Php6,200,000.00**	**Php398,800,000.00**

As demonstrated above, Petitioner clearly retired the redeemed preferred stock proving that it did not take title therefrom and had no intention of benefiting from any possible re-issuance later on.

Accordingly, the redemption of preferred stock amounting to Php850,000,000.00, where Petitioner did not derive any benefit therefrom, does not constitute a sale, assignment or transfer of shares subject to DST. Hence, Respondent's deficiency DST must be cancelled.

COMPROMISE PENALTY OF Php25,000.00

Finally, Respondent imposed compromise penalty in the amount of Php25,000.00 as prescribed under RMO No. 01-90,[117] as amended by RMO No. 19-07,[118] in relation to Sections 7(C) and 204(B) of the NIRC of 1997, as amended, for Petitioner's failure to file DST.[119]

We rule that the imposition of compromise penalty must be cancelled.

It must be stressed that a compromise penalty is imposed to avoid prosecution for violation of the provisions of the Tax Code.[120] Under the BIR's latest issuance on the matter – RMO NO. 07-15,[121] compromise penalties are amounts only suggested in settlement of criminal liability, and may not be

[117] SUBJECT: Amendments to the Provisions of a "Revised Schedule of Compromise Penalties" for Internal Revenue Violations as Prescribed in RMO 26-86.
[118] SUBJECT: The Consolidated Revised Schedule of Compromise Penalties for Violations of the National Internal Revenue Code.
[119] BIR Records, Exhibit "P-1", FLD Part II, p. 325.
[120] The Philippine International Fair, Inc. v. The Collector of Internal Revenue, et. al. G.R. Nos. L-12928 and L-12932, March 31, 1962.
[121] SUBJECT: The Revised Consolidated Schedule of Compromise Penalties for Violations of the National Internal Revenue Code.

imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. 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.[122] Absent a showing that 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.[123]

In the present case, there is nothing in the records which would show that Petitioner consented to the compromise penalty. Henceforth, the imposition of which in the alleged deficiency DST in the amount of Php25,000.00 cannot be sustained.

Verily, in balancing the scales between the power of the State to tax and its inherent right to prosecute perceived transgressors of the law on one side, and the constitutional rights of a citizen to due process of law and the equal protection of the laws on the other, the scales must tilt in favor of the individual, for a citizen's right is amply protected by the Bill of Rights under the Constitution. Thus, while "taxes are the lifeblood of the government", the power to tax has its limits, in spite of all its plenitude.[124]

WHEREFORE, in light of the foregoing considerations, the instant *Petition for Review* is **GRANTED**. Consequently, Respondent's deficiency assessments for income tax, VAT, DST, and compromise penalty against Petitioner in the amount of Php100,884,707.73, inclusive of penalties and interest, for taxable year 2012, are **CANCELLED** and **SET ASIDE**.

SO ORDERED.

Ma. Belen

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

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[122] Phil. International Fair, Inc. v. The Collector of Internal Revenue, G.R. Nos. L-12928 and L-12932, March 31, 1962.
[123] Commissioner of Internal Revenue v. Liangga Bay Logging Co., Inc., G.R. No. 35266, January 21, 1999.
[124] Commissioner of Internal Revenue v. Metro Star Superama, Inc., G.R. No. 185371, December 08, 2010.

WE CONCUR:

ERLINDA P. UY
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice

ATTESTATION

I attest that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ERLINDA P. UY
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice