REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

****

TAIAN (SUBIC) ELECTRIC, INC.,
Petitioner,

C.T.A. CASE NO. 6314

Members:

- versus -

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

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

MAR 1 7 2006

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DECISION

CASTAÑEDA, JR., J.:

This case seeks for the cancellation of Final Assessment Notice No. 019-24-97-00560 dated April 10, 2001 assessing petitioner of deficiency income taxes and documentary stamp taxes in the aggregate amount of **TWO MILLION FOUR HUNDRED THIRTY THOUSAND THREE HUNDRED EIGHT AND 87/100 PESOS (P2,430,308.87)** inclusive of surcharges, interests and penalties for the taxable year 1997.

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

Petitioner is a domestic corporation duly registered with the Securities and Exchange Commission and the Subic Bay Metropolitan Authority (SBMA) as a Freeport enterprise, with principal business address at Phase I, Subic Bay Industrial Park, Argonaut Highway Cor. Braveheart St., Subic Bay Freeport Zone. Respondent is the Commissioner of Internal Revenue, duly appointed to perform the duties of his office, including, among others, the power to decide, cancel and abate tax liabilities pursuant to Section 204 (B) of the Tax Code, as amended by Republic Act 8424, otherwise known as the "Tax Reform Act of 1997".

On April 17, 2001, petitioner received from respondent Final Assessment Notice No. 019-24-97-00560 dated April 10, 2001, assessing it of deficiency internal revenue taxes for the taxable year 1997 in the aggregate amount of P2,430,308.87 inclusive of interests and penalties, of which the amount of P1,242,808.87 represents deficiency income taxes while the P1,187,500.00 represents deficiency documentary stamp taxes.

A protest letter requesting for a reconsideration of the deficiency internal revenue tax assessments was filed by petitioner on May 15, 2001 through the Regional Director of Revenue Region No. 4, Mr. Antonio F. Montemayor.

On June 11, 2001, respondent issued his Decision denying petitioner's protest for its failure to disprove the deficiency internal revenue tax findings of the Revenue Officer, Ramon Deniega.

Upon receipt of the Decision of the respondent and in view of the provisions of Republic Act 9282, otherwise known as the Act Expanding the Jurisdiction of the Court of Tax Appeals, petitioner then elevated this appeal to this Court through a Petition for Review on July 5, 2001.

On August 31, 2001, respondent filed his Answer, raising the following as his Special and Affirmative Defenses:

> 4. He reiterates and repleads the preceding paragraph of this Answer as part of his Special and Affirmative Defenses.

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5. The assessments in question were issued in accordance with law and pertinent regulations.

6. After pertinent documents of the petitioner relative to the examination of accounting records were reviewed, scrutinized, test checked and reconciled with the financial statements and income tax returns, it was found out that certain items in the financial statements were of unexplained sources, documentary stamp taxes were not paid and certain income payments per documents presented were not subjected to withholding taxes.

7. In view of the foregoing, there is still found due a deficiency 5% income tax of P1,213,730.00 and deficiency documentary stamp tax of P1,187,500.00 computed as follows:

Sales per return		P 7,124,419.00
Add: Undeclared Revenue	P 3,074,909.00	
Unexplained Payables	12,366,836.50	15,441,745.50
Total Sales per Investigation		P 22,566,164.50
Less: Allowable Deduction		8,199,035.50
Gross Income per Investigation		14,447,129.50
Tax due Thereon		P 722,356.00
20% Interest p.a.		421,374.33
Compromise Penalty – for non-filing Of ITR (2nd Qtr)		50,000.00
- late payment		25,000.00
Total Deficiency Income Tax		P 1,213,730.00
Issued Capital Stocks		P 95,000,000.00
Documentary Stamp Tax Due		950,000.00
Add: 25% Surcharge		237,500.00
Total Deficiency Doc. Stamps Tax		P 1,187,500.00

8. There were undeclared sales because there was already a deficiency on trade receivables amounting to P112,021.00 computed as follows:

Trade Account Receivables	P 7,236,440.00
Declared Sales	7,124,419.00
Undeclared Sales (Trade)	P 112,021.00

9. It was assumed that certain unverified receivables were income or sales not declared since no documents were submitted by the petitioner concerning the non-trade receivables. Therefore, the total revenue accumulated from these findings amounted to P3,074,909.00 computed as follows:

Undeclared Trade Receivables as sales	P 112,021.00
Accounts Receivables – others	2,962,888.00
	P 3,074,909.00

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10. Unexplained Accounts Payable and Accrued Expense were computed as follows:

Accounts Payable and Accrued Expense per return		P25,243,790.00
Less: Explained payables and accrued expense		
Per notes to FS No. 6	P18,100,000.00	
Per Documents on Accrued Expense Submitted	343,606.50	18,443,606.50
		P 6,800,183.50

No documents were submitted by petitioner to support said unexplained accounts. Hence, the same are included as part of the undeclared revenues.

11. No documents were submitted by petitioner to support the Accounts Due to Parent Company in the amount of P5,566,653.00

12. Unallowable deductions were as follows per Revenue Regulations No. 1-95:

Interest Expense	P	777,351.00
Repairs and Maintenance		7,038.00
	P	789,389.00

13. Petitioner was informed of the law and the facts on which the assessments are made in compliance with Section 228 of the Tax Code.

14. All presumptions are in favor of the correctness of tax assessments.

Upon the filing of the parties' respective Memoranda, this case was deemed submitted for decision on September 20, 2005.

The issues as stipulated by the parties are as follows:

1. Whether or not the herein designated assessment was issued in accordance with law and regulations such that it stated the factual and legal basis pursuant to Section 228 of the Tax Code as implemented by Section 3.1.4 of Revenue Regulations No. 12-99;

2. Whether or not the following expenses in the amounts herein indicated are valid deductions from petitioner's gross income for taxable year 1997: a) interest expense in the amount of P777,351.00; b) repairs and maintenance in the amount of P7,038.00;

3. Whether or not the other receivables account of the petitioner represents advances to employees and officers for purchases of supplies, deposit for connection of telephone line and down payment for purchases of equipment;

4. Whether or not the Due to Parent Co. account in the amount of P5,566,653.00 actually represents cash advances from its parent company in Taiwan to finance its operations;

5. Whether or not the amount of P6,800,183.50 actually represents accounts payable and accrued expenses;

6. Whether or not petitioner is exempt from payment of DST on its original issuance of shares;

7. Whether or not there were undeclared sales by the petitioner in the amount of P112,021.00 for the year 1997;

8. Whether or not petitioner have undeclared trade receivables and account receivables in the amount of P3,074,909.00 for the year 1997;

9. Whether or not petitioner is liable for the alleged deficiency income and documentary stamp tax for the year 1997 in the total amount of P2,0430,308.87; and

10. Whether or not the disputed income tax and documentary stamp tax are null and void and are without factual and legal basis therefore should be cancelled and withdrawn.

As regards the first and last issues which question the validity of the assailed assessment notices, it is petitioner's contention that the Preliminary and Final Assessment Notices issued by herein respondent are void for they failed to state the factual and legal bases for the assessments, in violation of Section 228 of the Tax Code as implemented by Section 3.1.4 of Revenue Regulations No. 12-99. Accordingly, Section 228 of the Tax Code speaks of the law and facts on which the assessments were based are to be specifically shown in detail, otherwise the formal letter of demand and assessment notices shall be void.

This Court finds petitioner's argument untenable.

Section 228 of the 1997 National Internal Revenue Code of 1997 provides that "the taxpayer shall be informed in writing of the law and the facts on which the assessment is made, otherwise the assessment shall be void". The phrase "in writing" under the said section does not exclusively mean written words. Writings consists of letters, words, or numbers, or their equivalent, set down by handwriting, typewriting, printing, photostatting, photography, magnetic impulse, mechanical or electronic recording or other form of date compilation *(Sevilla, et al. vs. Commissioner of Internal Revenue, CTA Case No. 6211, October 4, 2004 citing Subic Power Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6059, May 8, 2003).* Indubitably, figures are also "writings" and if this numerical presentation is understandable enough, then there is no reason why this Court should automatically reject the same as adequate compliance with the law.

In the case at bar, respondent attached a copy of the Schedule of Assessment Computations to the Formal Letter of Demand and Assessment Notice detailing the factual bases of the disallowances as per the investigation report. Based on these documents, there is no question that petitioner was able to intelligently argue its case and expound the reasons and arguments raised for the assessment. Thus, it cannot contradict itself by asserting that it was not informed of the law and facts on which the assailed assessments were based. In the case of *Camara Steel Industries, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5960, February 19, 2004*, this Court reiterated its previous ruling in the case of Belle Corporation vs. CIR, CTA Case No. 5930, April 4, 2002, "that a taxpayer's actual knowledge of the bases of the assessments, such that it or he was able to intelligently protest the assessments, is sufficient compliance with the requirement of Section 228 of the Tax Code that 'the taxpayer shall be informed of the law and the facts on which the assessment is made'. Thus, the assessments are not null and void, even if the same failed to state the law and facts on which they were based."

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Finding that the assailed assessments sufficiently comply with Section 228 of the National Internal Revenue Code of 1997, this Court will now resolve the factual issues raised.

A. DEFICIENCY INCOME TAX

Respondent assessed the petitioner for deficiency 5% gross income tax[1] on the basis of the following:

	PER ITR	ADJUSTMENTS	PER AUDIT
Sales	P 7,124,419.00	#1 P 3,074,909.00	P10,199,328.00
Other		#2 12,366,836.50	12,366,836.50
Less: Allowable deductions	(8,903,424.00)	#3 784,389.00	(8,119,035.00)
Gross Income	(P1,779,005.00)	P16,226,134.50	P14,447,129.50
Tax Rate			5%
Income tax due			P 722,356.00
Less: Taxes paid			-
Deficiency Basic Tax			P 722,356.00
Interest p.a. (4-16-98 to 5-15-01)			445,452.87
Compromise Penalty - for non-filing of ITR (2nd qtr)			50,000.00
Late payment			25,000.00
Income Tax due and collectible			P 1,242,808.87

Note:

#1

Total Receivables	P10,199,328.00
Less: Sales per ITR	7,124,419.00
Undeclared Revenue (adjustments to Sales)	P 3,074,909.00

#2

Unexplained Accounts Payable & Accrued Expense	P 6,800,183.50
Unexplained Due to Parent Co,	5,566,653.00
	P12,366,836.50

#3 Non-allowable deductions per RR No. 1-95

Interest Expense	P777,351.00
Repairs & Maintenance	7,038.00
	P784,389.00

A.1. Undeclared Revenue

In concluding that petitioner has undeclared revenue, respondent's examiner compared petitioner's trade accounts receivables with declared sales. He found a difference of P112,021.00,[2] shown as follows:

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[1] BIR Records, p. 32
[2] BIR Records, p. 94

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Trade Accounts Receivables	P7,236,440.00
Declared Sales	7,124,419.00
Undeclared Sales (Trade)	P 112,021.00

Moreover, respondent assumed that the amount of P2,962,888.00 under the account "Accounts Receivables – others" was undeclared income or sales, after failure to verify the nature of the same due to the lack of documents submitted during the investigation by his examiner.

Thus, the total undeclared revenue found amounted to P3,074,909.00, computed as follows:

Undeclared Trade Receivables as sales	P 112,021.00
Accounts Receivable – others	2,962,888.00
Total Undeclared Revenue	P3,074,909.00

On the other hand, petitioner contends that it has no undeclared revenue. The amount of P112,021.00 which was described as "Adjustment on Foreign Exchange Loss" referred to unrealized foreign exchange gain. This arose because the sales made by petitioner were paid in US dollars (US$), while its sales were recorded in Philippine pesos (PhP). Its sales in the amount of US$180,387.86 at the booking rate of PhP39.495 to US$1.00 equals to PhP7,124,418.57. Hence, the amount of PhP112,021.00 was really the gain resulting from the fluctuation of foreign exchange rate, the peso-dollar rate being PhP40.116 to US$1.00, pending the collection of the receivable. Although this had not been collected, the same had to be recorded for accounting purposes. However, since the receivable had not been collected, in effect, the gain is still unrealized, and this being the case, such gain is not subject to tax.

This Court agrees with petitioner.

In BIR Ruling No. 144-85, dated August 26, 1985, the BIR stated that annual increase in value of an asset is not taxable income because such increase has not yet been realized. The increase in value, *i.e.,* the gain, could only be taxed when a disposition of the property occurred which was of such a nature as to "*constitute a realization of such gain,* *that is, a severance of the gain from the original capital invested in the property"*. The same conclusion obtains as to losses. The annual decrease in the value of property is not normally allowable as a loss. Hence, *"to be allowable the loss must be realized"*. Foreign exchange gains and losses can only be recognized for tax purposes when they are actually realized. *(Surrey and Warren, Federal Income Taxation (1950), pp. 422-4)*

In addition, the ruling stated that when foreign currency acquired in connection with a transaction in the regular course of business is disposed of, ordinary gain or loss results from the fluctuations (Prentice-Hall Federal Taxes, Vol. 1, par. 6261). The loss is deductible only for the year it is *actually sustained*. It is sustained during the year in which the loss occurs as evidenced by closed and completed transaction and as fixed by identifiable events occurring in that year. *(par. 6570, 34 Am Jur 2d, 1976)* A closed transaction is a taxable event which has been consummated. *(Black's Law Dictionary, Fifth Edition, p. 231)*

In BIR Ruling DA-359-03, dated October 10, 2003, the BIR ruled that there is an actual foreign exchange gain or loss realized depending on the appreciation/depreciation of the Philippine Peso to the US dollar between the time income/expense or the asset/liability is recorded in its books and the time the same is collected/paid. Recording in the books as an asset or income (*i.e.,* accounts receivables, advance payments to sub-contractors, construction income) an amount before the foreign exchange fluctuated will realize a gain when the peso depreciated at the time of collection.

Thus, while for financial accounting purposes, foreign currency accounts (*e.g.,* receivables, liabilities, and deposits) are periodically restated at the rate of exchange prevailing at year-end, any foreign gains/(losses) arising from this restatement shall be taxable or deductible only in the year of collection, payment, or actual conversion into pesos as the case may be.

In the present case, it can be seen in the report of the Court commissioned Independent Certified Public Accountant (CPA) Firm, CGM & Co., (*Exhibit AA-1*) and petitioner's supporting invoices (*pre-marked Exhibits S-1 to S-4*), that the amount of PhP112,020.86 or PhP112,021.00 pertains to the difference between the foreign exchange rate (PhP39.495 to US$1.00) used by petitioner in recognizing its US dollar sales of 180,387.76 and the foreign exchange rate (PhP40.116 to US$1.00) used by the external auditor in the revaluation of petitioner's dollar revenues, computed as follows:

Date	Invoice No.	Exhibit No.	Amount in U.S. Dollars	Booking Rate	Recorded Amount in Peso
11/12/97	TA-001	S-1	$ 44,923.98	39.495	P1,774,272.59
11/12/97	TA-001A	S-2	1,714.91	39.495	67,730.37
12/07/97	TA-002	S-3	95,938.83	39.495	3,789,104.09
12/23/97	TA-003	S-4	37,810.14	39.495	1,493,311.48
Sales as Recorded per Audited Financial Statements			$180,387.86		P7,124,418.53
Foreign exchange rate used by the external auditor in the Revaluation			40.116		
Total Accounts Receivable - as restated					7,236,439.39
Unrealized foreign exchange gain					P 112,020.86

Considering that the foreign exchange gain of P112,021.00 had not been realized because the related sales had not been collected by petitioner as of December 31, 1997, it was erroneous for the respondent to charge the amount of P112,021.00 as part of petitioner's taxable income for 1997.

With regard to the "Accounts Receivable - Others", petitioner contends that it was composed of different kinds of receivables, which were duly supported by documents, as follows:

Deposits Paid	P2,911,438.57
Advances to Employees	43,409.82
Advances to Officers	9,760.00
Prepaid Expenses	(1,720.56)
Total	P2,962,887.53

2/1

The Court commissioned Independent CPA Firm, CGM & Co., in its report dated January 21, 2003 (*Exhibit AA*), provided summaries detailing the composition of each of the above accounts with the corresponding documents that it had examined (*Exhibits AA-2, AA-3, AA-4*).

However, upon verification of the report and the supporting documents (*pre-marked Exhibits T to T-13 for Deposits Paid, U to U-11 for Advances to Employees, V to V-1 for Advances to Officers, and W for Prepaid Expenses*), this Court found that in the case of Deposits Paid, only P17,000.00 of the P2,911,438.57 was duly supported by official receipts (*pre-marked Exhibits T-3 & T-5*). The amount of P2,884,438.57 from the claimed amount was supported only by photocopied general vouchers and debit notes (*pre-marked Exhibits T-6 to T-13*), thus, the determination as to whether the same deposits had been actually paid cannot be properly ascertained. Likewise, the amount of P10,000.00 from the claimed amount was supported by an official receipt dated in 1999 (*pre-marked Exhibit T-2*). The situation is the same with Advances to Employees and Advances to Officers. The documents submitted to support the advances were merely general vouchers which were not even in their originals (*pre-marked Exhibits U-1 to U-11, V-1*). It could not be ascertained as to whether these advances were actually given to employees and officers. Moreover, the amount of P600.00 out of the P9,760.00 under Advances to Officers did not have any supporting documents. The Prepaid expenses in the amount of P(1,720.56) also did not have any supporting documents, but since this was in the negative amount, the same was disregarded.

For petitioner's failure to substantiate the "Accounts Receivable – Others" in the amount of P2,945,887.53 (P2,962,887.53 - P17,000.00), the same is a proper adjustment to petitioner's taxable income.

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A.2. Unexplained payables

A.2.a. Unexplained payables and accrued expenses

In concluding that petitioner has unexplained payables and accrued expenses, respondent's examiner came up with the following computation:[3]

Accounts Payable & Accrued Expense per return		P25,243,790.00
Less: explained payables & accrued expenses		
Per Notes to FS No. 6	P18,100,000.00	
Per documents on Accrued Expenses submitted	343,606.50	18,443,606.50
Unexplained Accounts Payable & Accrued Expenses		P 6,800,183.50

On the other hand, petitioner maintains that the entire accounts payable and accrued expense per return in the amount of P25,243,790.00 is duly substantiated and can be broken down as follows:[4]

Accounts Payable – Trade	P18,815,038.96
Other Payable	5,891,575.59
Withholding Income Taxes from Employees	9,219.18
Withholding SSS Contribution from Employees	20,135.00
Withholding HDMF/PAG-IBIG Contribution from Employees	6,963.30
Accrued Expenses	343,606.50
Accrued Payroll	157,251.79
Total	P25,243,790.32

A review of the documents submitted showed that the amount of P2,370,980.44 from the P18,815,038.96 "Accounts Payable – Trade" have no supporting documents (*Exhibit JJ-2*). However, since respondent, in his computation, had admitted that the value of petitioner's "Accounts Payable – Trade" was P18,100,000.00, only P715,038.96 (P18,815,038.96 - P18,100,000.00) should be considered as unsupported and assessed as unexplained payables. In addition, upon verification of the "Account Payable – Others", it was found that the amount of P5,397,193.72 (*pre-marked Exhibits DD-19 to DD-22, DD-32 to DD-33*) was not supported by proper billing invoices to support the accrual of the payable account.

In sum, petitioner had unexplained payables in 1997 in the amount of P6,112,232.68 (P715,038.96 + P5,397,193.72).

[3] BIR Records, p. 99
[4] pre-marked Exhibit BB

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A.2.b. Due to Parent Co.

Respondent considered the account Due to Parent Company in the amount of PhP5,566,653.00 as unexplained payables because no supporting documents were submitted by the taxpayer to contradict their findings.

However, petitioner asserts that the Due to Parent Company account represents cash advances from Taian Electric (Taiwan) ("TE Taiwan"), a corporation duly organized and existing by virtue of the laws of Taiwan which wholly owns petitioner corporation, to finance its operations, the analysis of which is as follows:

Received Cash from Taian Electric ($3,630,000.00@ 26.30) last March 10, 1997		P95,469,000.00
Set-up Initial Capital (subscription of 9.5M shares @ 10 par value		95,000,000.00
Remaining outstanding liability for cash received		P 469,000.00
Received Capital Increase from Taian Electric		
Cash in Bank ($2,150,000.00@39.495	P84,914,250.00	
Subscription on additional shares of 7,631,159@10.50		
Capital issued 7,631,159@10 par value	(76,311,590.00)	
Capital surplus 7,631,159@0.50	(3,815,579.50)	
Remaining balance from remittances of $2,150,000.00	P 4,787,080.50	4,787,080.50
Year to Date Balance		P 5,256.080.50
Loss on Exchange		235,302.48
Restatement		75,269.54
A/P due to parent company		P 5,566,652.52

Petitioner submits that since it is a wholly owned company by TE Taiwan, the latter infused cash to petitioner in the amount of US$3,630,000.00, equivalent to PhP95,469,000.00 at an exchange rate of PhP26.30 to US$1.00 on March 10, 1997 (*t.s.n., May 29, 2002, p.10*). And, out of the total PhP95,469,000.00, the amount of PhP95,000,000.00 was converted to equity as subscribed and paid up capital for petitioner, as reflected in petitioner's Articles of Incorporation (*Exhibits I-6 to I-7*) and documented by the Bangko Sentral ng Pilipinas (*Exhibit O*). The difference in the amount of PhP469,000.00 (PhP95,469,000.00 - PhP95,000,000.00) was treated as an outstanding liability to TE Taiwan.

TE Taiwan subsequently infused additional money to petitioner through Chinatrust inward remittance (*Exhibit N*) in the amount of US$2,150,000.00, or equivalent to PhP84,914,250.00 at a conversion rate of PhP39.495 to US$1.00 on December 29, 1997. Of

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this total amount, PhP80,127,169.00 was converted to equity when petitioner increased its authorized capital stock, which increase was duly approved by the Securities and Exchange Commission (*Exhibits R to R-4*). The difference of PhP4,787,080.50 (PhP84,914,250.00 - PhP80,127,169.00) was likewise treated as an outstanding liability to TE Taiwan.

In this regard, the sum of the two differences amounts to PhP5,256,080.50 (PhP469,000.00 + PhP4,787,080.50). However, considering that there had been fluctuations of the foreign exchange rate from the time of the first infusion of cash by TE Taiwan, pending the payment of the payable, foreign exchange losses and restatements have to be taken into account. Thus, adjustments for foreign exchange loss of PhP235,302.48 and restatement of PhP75,269.54 were made to the due to parent company account. Thus, the total amount payable to TE Taiwan in petitioner's book is PhP5,566,652.52 (PhP5,256,080.50 + PhP235,302.48 + PhP75,269.54).

This Court agrees with petitioner.

Petitioner has sufficiently established the nature and basis of the Due to Parent Company account in the amount of PhP5,566,652.52. Supporting documents sufficiently confirming petitioner's claims (*i.e.,* inward remittances from banks, articles of incorporation, etc.), as well as, the testimony of Mr. Michael Tan during the hearing conducted on May 29, 2002 (*t.s.n., May 29, 2002, p.10*) were submitted. Thus, the Due to Parent Company account in the amount of PhP5,566,652.52 cannot be considered as unexplained payable.

A.3. Unallowable Deductions

Respondent disallowed the following deductions per Revenue Regulations (RR) No. 1-95:

Interest Expense	P777,351.00
Repairs and Maintenance	7,038.00
	P784,389.00

On the other hand, petitioner avers that the above expenses are properly supported and should be allowed as deductions.

Petitioner is registered with the Subic Bay Metropolitan Authority (SBMA) as a freeport enterprise, for the purpose of engaging in the business of manufacturing magnetic relays and circuit breakers (*Exhibit K*). Petitioner supposedly pays 5% final tax on its gross income earned from its SBMA registration.

RR No. 1-95, dated January 24, 1995, provides for the rules and regulations to implement the tax incentives provisions under paragraphs (b) and (c) of Section 12, Republic Act No. 7227, otherwise known as the Bases Conversion and Development Act of 1992. Section 3(o)(1) provides for the allowable deductions of a manufacturing enterprise to determine the gross income subject to 5% tax, to wit:

> "1. Direct salaries, wages or labor expenses
> 2. Production supervision salaries
> 3. Raw materials used in the manufacture of Products Goods in process (Intermediate goods)
> 4. Finished goods
> 5. Supplier and fuels used in production
> 6. Depreciation of machineries and equipment used in production, and buildings owned and or constructed by SBMA-registered enterprise
> 7. Rent and utility charges associated with building, equipment and warehouses, or handling of goods
> 8. Financing charges associated with fixed assets"

It must be emphasized that repairs and maintenance and interest expense are not among those mentioned under the RR No. 1-95 as deductible for purposes of the 5% gross income tax. While it may be argued that interest expense fall under financing charges, the requirement for the same to be deductible is that it should be associated with fixed assets. Unfortunately, the documents submitted by petitioner (*Exhibits X-1 to X-8*) did not show whether the interest expense indeed pertained to fixed assets. Hence, interest expense and repairs and maintenance cannot be considered as deductible from gross income subject to 5% final tax.

Consequently, based on the above discussion, the petitioner is still subject to deficiency income tax of P651,707.87, inclusive of interest, computed as follows:

	PER ITR	PER COURT'S VERIFICATION ADJUSTMENTS	TOTAL
Sales	P 7,124,419.00	P2,945,887.53	P10,070,306.53
Unexplained Payables		6,112,232.68	6,112,232.68
Less: Allowable deductions	(8,903,424.00)	784,389.00	(8,119,035.00)
Gross Income	(P1,779,005.00)	P9,842,509.21	P8,063,504.21
Tax Rate			5%
Income tax due			P 403,175.21
Less: Taxes paid			-
Deficiency Basic Tax			P 403,175.21
Interest p.a. (4-16-98 to 5-15-01)			248,532.66
Income Tax due and collectible			**P 651,707.87**

It should be noted that the compromise penalty imposed by respondent is cancelled. Compromise penalties are amounts collected by the BIR in lieu of criminal prosecution for violations committed by taxpayers, the payment of which is based on a compromise agreement validly entered into between the taxpayer and the Commissioner of Internal Revenue. *(Collector of Internal Revenue v. UST, 104 Phil. 1062.*) A compromise implies mutual agreement. *(Rightfield Property Ventures, Inc. [now known as Universal Rightfield Property Holdings, Inc.] vs. Commissioner of Internal Revenue, CTA Case No. 5972, October 16, 2003.)* Absent a showing that petitioner in the present case 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. *(Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc., G.R. No. 35266, January 21,1991)*

B. DEFICIENCY DOCUMENTARY STAMP TAX

Respondent assessed petitioner of deficiency documentary stamp tax (DST) on the basis of the following:[5]

	Number of Shares	DST Due
Capital Stocks - P10 par value authorized and issued	9,500,000.00	
(P2.00 for every P200.00 or fractions thereof under Sec.175 of the Tax Code		P 950,000.00
Add: 25% Surcharge		237,500.00
Total Deficiency DST		P1,187,500.00

[5] BIR Records, p. 33

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On the other hand, petitioner avers that it is exempt from paying DST by reason of its registration as a Subic Bay Freeport Enterprise.

We agree with the petitioner. Section 12 (c) of Republic Act (RA) No. 7227, otherwise known as the "Bases Conversion and Development Act of 1992", provides:

> "(c) **The provisions of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed within the Subic Special Economic Zone. In lieu of paying taxes**, three percent (3%) of the gross income earned by all business and enterprises within the Subic Special Economic Zone shall be remitted to the National Government, one percent (1%) each to the local government units affected by the declaration of the zone in proportion to their population area, and other factors. In addition, there is hereby established a development fund of one percent (1%) of the gross income earned by all businesses and enterprises within the Subic Special Economic Zone to be utilized for the Municipality of Subic, and other municipalities contiguous to be base areas." *(Emphasis supplied)*

In implementing the above law, Section 6 (a) of RR No. 1-95, dated January 24, 1995 provides:

> "a. Pursuant to Section 12(c) of the Act, registered enterprises within the Secured Area in the Zone shall, **in lieu of local and national taxes**, be liable to the payment of the following, **based on gross income earned.**

(1)	To the National Government	3%
(2)	To the Local Government units affected by the declaration of the Zone	1%
(3)	To the Special Development Fund to be utilize for the development of municipalities outside the City of Olongapo and the Municipality of Subic and other municipalities contiguous to the base area	1%

(Emphasis supplied)

Based on the foregoing, registered enterprises within the Subic Special Economic Zone (SSEZ) are only liable to pay 5% tax on gross income earned on their registered activity. In lieu thereof, they are exempt from paying all other taxes, local or national. Petitioner, as a SSEZ registered enterprise, is therefore subject to 5% gross income tax. And in lieu thereof, it is exempt from all local and national taxes, including documentary stamp tax.

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IN VIEW OF THE FOREGOING, the subject Petition for Review is hereby ***PARTIALLY GRANTED.*** The Demand Letter and Assessment Notice No. LA #132858-FY95-99-540 assessing petitioner of deficiency documentary stamp taxes is hereby **CANCELLED and SET ASIDE**. However, petitioner is liable for deficiency income taxes recomputed as follows:

		PER COURT'S VERIFICATION	
	PER ITR	ADJUSTMENTS	TOTAL
Sales	P 7,124,419.00	P2,945,887.53	P10,070,306.53
Unexplained Payables		6,112,232.68	6,112,232.68
Less: Allowable deductions	(8,903,424.00)	784,389.00	(8,119,035.00)
Gross Income	(P1,779,005.00)	P9,842,509.21	P8,063,504.21
Tax Rate			5%
Income tax due			P 403,175.21
Less: Taxes paid			-
Deficiency Basic Tax			P 403,175.21
Surcharge			100,793.80
Interest p.a. (4-16-98 to 5-15-01)			248,532.66
Income Tax due and collectible			**P 752,501.67**

Accordingly, petitioner is hereby **ORDERED to PAY** the respondent the amount P752,501.67 as deficiency income taxes for the taxable year 1997. In addition, petitioner is **ORDERED to PAY** 20% delinquency interest computed from May 18, 2001 until the same amount is fully paid, pursuant to Section 249 (C)(3) of the National Internal Revenue Code of 1997.

SO ORDERED.

Juanito C. Castaneda, Jr.
JUANITO C. CASTANEDA, JR.
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

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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's Division.

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

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice

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