**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

***SECOND DIVISION***

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|---|---|
| **TS TECH PHILIPPINES, INC. represented by TS TECH TRIM PHILIPPINES, INC.,** *Petitioner,* | **CTA Case No. 8178** |
| | **Members:** |
| - versus- | **Castañeda, Jr.,** *Chairperson* **Casanova,** and **Cotangco-Manalastas,** *JJ.* |
| **COMMISSIONER OF INTERNAL REVENUE,** *Respondent.* | **Promulgated:** APR 06 2015 11:08 a.m. |

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# DECISION

**COTANGCO-MANALASTAS, *J.:***

This resolves the Petition for Review filed by TS Tech Philippines, Inc. on October 12, 2010 to seek the cancellation and setting aside of the Formal Letter of Demand (FLD) dated July 29, 2008, the Assessment Notices, and the Collection Letter dated August 23, 2010 covering the alleged deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT), and withholding tax on compensation (WTC) in the total amount of ₱75,514,965.24 for taxable year 2005.

## FACTS

TS Tech Trim Philippines, Inc. (representing TS Tech Philippines, Inc.) is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office at 102 East Main Avenue, Laguna Technopark, Special Export Processing Zone, Biñan, Laguna.[1]

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[1] Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Simplification of Issues (JSFSI), docket, pp. 82-83.

Petitioner TS Tech Philippines, Inc. is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office at 111 East Science Avenue, Laguna Technopark, Biñan, Laguna, and engaged in the manufacture, export, and sale of car seats and interior components of cars and other motorized vehicles to the local market. It is registered with the Philippine Economic Zone Authority (PEZA) as an Economic Zone Facilities Enterprise enjoying five percent (5%) preferential tax in lieu of all national and local taxes. It is now merged with TS Tech Trim Philippines, the latter being the surviving corporation, and the former being the absorbed and dissolved corporation. Accordingly, TS Tech Philippines Inc. is herein represented by TS Tech Trim Philippines, Inc. Petitioner is also duly registered with the Bureau of Internal Revenue (BIR).[2]

On the other hand, respondent Commissioner of Internal Revenue is the chief of the Bureau of Internal Revenue, the government agency officially responsible for the assessment and collection of all national internal revenue taxes, fees and charges and the enforcement of all forfeitures, penalties, and fines connected with such taxes. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On July 14, 2006, Letter of Authority No. 00040861 dated July 4, 2006 was served to petitioner, authorizing the examination of petitioner's books of accounts and other accounting records for all internal revenue taxes for the period from January 1, 2005 to December 31, 2005.[3]

Pursuant to the Letter of Authority, an undated Preliminary Assessment Notice (PAN)[4] was issued and received by petitioner, stating that petitioner is liable for deficiency income tax, deficiency VAT, and deficiency withholding tax for taxable year 2005 to which petitioner filed its protest[5] on July 16, 2008.

On August 1, 2008, petitioner received a Formal Letter of Demand[6] dated July 29, 2008 issued by respondent, assessing

[2] Par. 2, Stipulation of Facts, JSFSI, docket, p. 83.
[3] Exhibit "1".
[4] Exhibit "B", "8", and "8-a".
[5] Exhibit "C".
[6] Exhibits "D" and "10".

petitioner deficiency income tax in the amount of ₱45,871,886.04, deficiency VAT in the amount of ₱26,944,168.37, deficiency EWT in the amount of ₱1,112,671.95, and deficiency WTC in the amount of ₱1,586,238.88.

Petitioner filed its protest letter to the Formal Letter of Demand on September 1, 2008.[7]

Subsequently, petitioner filed a Supplemental Letter Protest[8] against the FLD on October 31, 2008 and a Second Supplemental Letter Protest[9], also against the FLD, on December 2, 2008.

However, on September 13, 2010, petitioner received a Collection Letter wherein respondent requested petitioner to pay the amount reflected in the Assessment Notice and FLD.[10]

Petitioner then appealed the Collection Letter by filing the instant Petition for Review on October 12, 2010.

In her Answer[11] filed on November 12, 2010, respondent interposed the following defenses:

> 7. Petitioner TS Tech Philippines, Inc., is liable to pay its deficiency income tax, value-added tax, expanded withholding tax and withholding tax on compensation in the total amount of Seventy Five Million, Five Hundred Fourteen Thousand, Nine Hundred Sixty Five and 24/100 (₱75,514,965.24).
>
> 8. Petitioner claims that it was denied due process for failure to be informed in writing of the law and facts on which the assessment is based. However, the formal letter of demand and assessment notices indicated not merely the tax, compromise, and interest due thereon but likewise sufficiently stated the facts, the law, rules and regulations on which the assessment was based upon. Thus, petitioner cannot impugn the validity of assessment on the supposed omission.

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[7] Exhibit "E".
[8] Exhibit "G".
[9] Exhibit "H".
[10] Exhibit "F".
[11] Docket, pp. 49-62.

9. Comprehensive study of petitioner's books of accounts and pertinent accounting records disclosed that it is liable to pay the total deficiency income tax assessment.

It is liable for the payment of ₱24,155.99 pursuant to Section 32 of the NIRC quoted as follows:

xxx xxx xxx

The foregoing represents gross income derived by applying the gross profit method based on the difference between the reported importation per VAT returns and the importation data furnished by the Bureau of Customs to the Audit Information, Tax Exemption and Incentives Division (AITEID) of the respondent.

The amount of ₱51,337,432.79 represents income payments not subjected to Expanded Withholding Tax and the amount of ₱2,212,105 represents purchases excluded in the summary list of purchases. While the amount of ₱3,457,910 represents excess purchases claimed by petitioner upon comparison of VAT returns and purchases as reflected on the information of the Bureau of Customs provided by AITIED [*sic*]. In addition, the amount of ₱406,120.00 representing importation dated December 6, 2004 was assessed. The foregoing were properly disallowed pursuant to Section 34 (K) of the NIRC which provides:

xxx xxx xxx

The amount of 3,199,403.68 representing unaccounted salaries and allowances is subjected to tax pursuant to Section 32 of the NIRC and Section 44 which provides:

xxx xxx xxx

While the amount of ₱34,891,665.67 representing the difference between the summary sales per VAT returns and alphalist of income payments subjected to Expanded Withholding Tax acquired through third party information was assessed pursuant to Section 32 of the NIRC.

10. Petitioner is liable to pay the amount of ₱221,210.50 which represents input tax from purchases not included in the summary list of purchases submitted to respondent. It was properly disallowed pursuant to Section 110 and Section 113 of the NIRC, hereunder quoted:

xxx xxx xxx

While the amount of ₱345,791.00 represents excess input tax claimed by petitioner on VAT return as compared to the information of the Bureau of Customs furnished by AITIED [*sic*]. The amount of ₱40,612.00 refers to input tax from importation dated December 6, 2004. The foregoing were assessed pursuant to Section 110 of the NIRC, which provides:

xxx xxx xxx

Discrepancy in importation per schedule submitted by petitioner and Bureau of Customs data from AITEID disclosed that the amount of ₱4,736,468.99 represents unaccounted sales and assessed pursuant to Section 105 of the NIRC which provides:

xxx xxx xxx

Moreso, the amount of ₱34,891,665.67 representing the difference between the summary of sales per VAT returns and alphalist of income payments subjected to Expanded Withholding Tax derived from customers was assessed pursuant to Section 106 of the NIRC. The respective amounts of ₱6,597,104.64 representing unsupported exempt sales, ₱90,960,855.70 representing unsupported zero-rated sales and ₱33,736,894.62 representing discrepancy between sales subjected to VAT as appearing on returns and sales as reflected on Audited Financial Statement were likewise assessed pursuant to Section 106 of the NIRC.

11. With respect to withholding tax, petitioner is liable to pay the amount of ₱716,538.38 representing basic deficiency expanded withholding tax assessed pursuant to Section 57(B) of the NIRC which provides:

xxx xxx xxx

The amount of ₱3,199,403.68 representing the discrepancy between compensation as appearing in Audited Financial Statement and alphalist was assessed pursuant to Section 79 and 80 of the NIRC.

12. Petitioner claims that the Final Assessment Notices received on August 1, 2008 was formally protested within the reglementary period of 30 days. However, it did not aver the fact of submission of necessary documents in support of its protest. Upon investigation, it was revealed that indeed, petitioner failed to submit necessary documents within 60

days from the filing of protest. This omission is fatal to the administrative claim.

xxx xxx xxx

13. With respect to the issue of prescription of the right to assess and collect withholding tax on compensation, expanded withholding tax and value-added tax, it must be noted that the taxpayer must raise the issue of prescription at the earliest possible time. It cannot, as a rule, be raised for the first time on appeal. Since prescription is one of the affirmative defenses of the taxpayer, it is incumbent upon him to positively establish when the prescriptive period started to run and when the same ended. He must prove that he has submitted the required returns. If he fails to do so, the conclusion must be that no such returns have been filed and the Government has ten (10) years within which to make the corresponding assessments pursuant to Section 222 of the NIRC. **(Taligaman Lumber Co. vs. Collector, G.R. No. L-15716, March 31, 1962)** In this foregoing case, petitioner never raised the issue of prescription in the administrative level and to be allowed to allege it without specifically pleading the facts appurtenant thereto, before this Honorable Court would be offensive to the basic rules of fair play, justice and due process.

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

15. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise the presumption of correctness of tax assessment stands **(Commissioner of Internal Revenue vs. Hantex Trading Co. Inc., G.R. No. 136975, March 31, 2005)**

16. Petitioner has not pointed out any provision or item in the assessment notice which bears a trace of falsity. The averments were based on conjectures, surmises and speculations. These cannot supply the basis for the charge of impropriety of the assessments made.

The case was set for pre-trial conference on December 3, 2010.[12] Petitioner's Pre-Trial Brief[13] was filed on November 30, 2010; while respondent's Pre-Trial Brief[14] was filed on November 26, 2010.

On December 16, 2010, the parties filed with the Court their Joint Stipulation of Facts and Simplification of Issues[15]. Then a Pre-Trial Order[16] was issued by the Court on January 19, 2011.

Trial ensued, giving both parties the opportunity to present their documentary and testimonial evidence.

After the presentation of the parties' respective evidence, petitioner filed its Memorandum[17] on April 4, 2014; while respondent filed her Memorandum[18] through registered mail on April 7, 2014. Thereafter, the case was submitted for decision on April 23, 2014.[19]

## ISSUES

The parties submitted the following issues[20] for this Court's disposition:

1. Whether or not the subject assessments are null and void.

2. Whether or not petitioner is liable for the deficiency income tax, value-added tax, expanded withholding tax and withholding tax on compensation assessments in the amount of ₱75,514,965.24 inclusive of interest and penalty for the calendar year 2005.

[12] Notice of Pre-Trial Conference issued on November 12, 2010, docket, p. 64.
[13] Docket, pp. 73-77.
[14] Docket, pp. 66-71.
[15] Docket, pp. 82-85.
[16] Docket, pp. 90-93.
[17] Docket, pp. 1366-1410.
[18] Docket, pp. 1412-1434.
[19] Docket, p. 1461.
[20] Stipulated Issues, Pre-Trial Order, docket, p. 91.

## DISCUSSION/RULING

The Court shall first address the issue on jurisdiction of the Court over the instant case in relation to respondent's allegation that the subject assessment has already attained finality.

Respondent alleges that the Formal Letter of Demand/Final Assessment Notice (FLD/FAN) was received by petitioner on August 1, 2008; thus, petitioner had thirty (30) days or until August 31, 2008 within which to protest the same. However, according to respondent, the protest to the FLD/FAN was received by the BIR only on September 1, 2008, or one (1) day after the lapse of the period to protest. In view thereof, the assessment against petitioner has attained finality by the mere lapse of time and is no longer open to dispute and discussion.

While it is true that petitioner had until August 31, 2008 to file its protest on the FLD/FAN, the said date fell on a Sunday. Thus, the last day shall be on the next working day, which is September 1, 2008. Clearly, petitioner filed its protest within the period provided by law.

Respondent likewise contends that petitioner failed to submit documents to support its protest within the sixty (60)-day period fixed by law.

It must be noted that petitioner in its Supplemental Protest filed on October 31, 2008[21] mentioned that it is submitting for consideration the following documents:

1. As Annex A, BIR Form No. 2550Q filed by TTPI for calendar year (CY) 2005;
2. As Annex B, Reconciliation Schedule of Sales not subject to VAT;
3. As Annex C, Breakdown of Scrap Sales per Audited Financial Statement (AFS);
4. As Annex D, PEZA Certificate of Registration/PEZA Certification issued to Automotive Interiors Corporation and Honda Cars Philippines, Inc.;
5. As Annex E, sample Sales Invoices issued to Honda Cars Philippines, Inc.;
6. As Annex F, Schedule of TTPI's Rental Payments;

[21] Exhibit "G".

7. As Annex G, BIR Form No. 1601-E filed for CY 2005; and
8. As Annex H, reconciliation schedule on the salaries and employees' benefits given to TTPI employees.

Accordingly, petitioner is considered to have complied with the submission of supporting documents as required under Section 228 of the National Internal Revenue Code (NIRC) of 1997. Therefore, respondent's allegation that the sixty-day period to submit supporting documents already lapsed and made the FAN final and executory deserves scant consideration.

Furthermore, it must be noted that despite the submission of the documents previously mentioned, the undated Memorandum[22] presented by respondent referred to the protest letter of petitioner and stated that petitioner failed to submit the required documents to refute the subject assessment within sixty (60) days as provided under Section 228 of the NIRC of 1997, as amended and implemented by Revenue Regulations (RR) No. 12-99. In the same Memorandum, it was recommended that the assessment be reiterated and that the docket be forwarded to the Large Taxpayers Collection Enforcement Division (LTCED) in order to enforce collection.

In other words, respondent failed to consider the documents submitted by petitioner and immediately recommended the reiteration of the assessment.

Respondent likewise alleged in her Memorandum[23] that petitioner's refusal to present its Books of Accounts and other Accounting Records for examination by Revenue Officer Ma. Catalina G. Benedicto caused the initial assessment to be issued based on discrepancies as found in Tax Reconciliation Schedules or data furnished by the Bureau of Customs or third-party documents.

According to respondent, she arrived at the assessment using the "best evidence obtainable", which is based on Revenue Memorandum Circular (RMC) No. 23-2000; which provides that in the absence of accounting records or other records necessary for the determination of taxpayer's internal

[22] Exhibit "13".
[23] Docket, p. 1440.

revenue tax liabilities, the tax should be determined on the best evidence available.

In this regard, the Court finds relevant Section 6(B) of the NIRC of 1997, as amended, which requires that the assessment of the tax be determined based on the Best Evidence Obtainable in the absence of accounting records or other records. Section 6(B) of the NIRC of 1997, as amended, reads:

> "SEC. 6. *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.* –
>
> xxx xxx xxx
>
> (B) *Failure to Submit Required Returns, Statements, Reports and other Documents.* – When a report required by law as a basis for the assessment of any national internal revenue tax shall not be forthcoming within the time fixed by laws or rules and regulations or when there is reason to believe that any such report is false, incomplete or erroneous, the Commissioner shall assess the proper tax on the **best evidence obtainable.**
>
> In case a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise files a false or fraudulent return or other document, the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise, which shall be *prima facie* correct and sufficient for all legal purposes." *(Emphasis supplied)*

In obtaining the best evidence, respondent is given vast powers which she could exercise under Section 5 of the NIRC of 1997, as amended, which provides:

> "SEC. 5. *Power of the Commissioner to Obtain Information, and to Summon, Examine, and Take Testimony of Persons.* – In ascertaining the correctness of any return, or in making a return when none has been made, or in determining the liability of any person for any internal revenue tax, or in collecting any such liability, or in evaluating tax compliance, the Commissioner is authorized:

(A) To examine any book, paper, record, or other data which may be relevant or material to such inquiry;

(B) To obtain on a regular basis from any person other than the person whose internal revenue tax liability is subject to audit or investigation, or from any office or officer of the national and local governments, government agencies and instrumentalities, including the Bangko Sentral ng Pilipinas and government-owned or -controlled corporations, any information such as, but not limited to, costs and volume of production, receipts or sales and gross incomes of taxpayers, and the names, addresses, and financial statements of corporations, mutual fund companies, insurance companies, regional operating headquarters of multinational companies, joint accounts, associations, joint ventures or consortia and registered partnerships, and their members;

(C) To summon the person liable for tax or required to file a return, or any officer or employee of such person, or any person having possession, custody, or care of the books of accounts and other accounting records containing entries relating to the business of the person liable for tax, or any other person, to appear before the Commissioner or his duly authorized representative at a time and place specified in the summons and to produce such books, papers, records, or other data, and to give testimony;

(D) To take such testimony of the person concerned, under oath, as may be relevant of material to such inquiry; and

(E) To cause revenue officers and employees to make a canvass from time to time of any revenue district or region and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care, management or possession of any object with respect to which a tax is imposed.

The provisions of the foregoing paragraphs notwithstanding, nothing in this Section shall be construed as granting the Commissioner the authority to inquire into bank deposits other than as provided for in Section 6(F) of this Code."

The power of the Commissioner to assess based on the best evidence obtainable was elaborated in the case of

*Commission of Internal Revenue vs. Hantex Trading Co. Inc.*[24], wherein the High Court ruled as follows:

> "The law allows the BIR access to all relevant or material records and data in the person of the taxpayer. It places no limit or condition on the type or form of the medium by which the record subject to the order of the BIR is kept. The purpose of the law is to enable the BIR to get at the taxpayer's records in whatever form they may be kept. Such records include computer tapes of the said records prepared by the taxpayer in the course of business. In this era of developing information-storage technology, there is no valid reason to immunize companies with computer-based, record-keeping capabilities from BIR scrutiny. *The standard is not the form of the record but where it might shed light on the accuracy of the taxpayer's return.*
>
> In *Campbell, Jr. v. Guetersloh,* the United States (U.S.) Court of Appeals (5th Circuit) declared that it is the duty of the Commissioner of Internal Revenue to investigate any circumstance which led him to believe that the taxpayer had taxable income larger than reported. Necessarily, this inquiry would have to be outside of the books because they supported the return as filed. He may take the sworn testimony of the taxpayer; he may take the testimony of third parties; he may examine and subpoena, if necessary, traders' and brokers' accounts and books and the taxpayer's book accounts. The Commissioner is not bound to follow any set of patterns. The existence of unreported income may be shown by any practicable proof that is available in the circumstances of the particular situation. Citing its ruling in *Kenney v. Commissioner,* the U.S. appellate court declared that where the records of the taxpayer are manifestly inaccurate and incomplete, the Commissioner may look to other sources of information to establish income made by the taxpayer during the years in question.
>
> xxx xxx xxx
>
> The rule is that in the absence of the accounting records of a taxpayer, his tax liability may be determined by estimation. The petitioner is not required to compute such tax liabilities with mathematical exactness. Approximation in the calculation of the taxes due is justified. To hold otherwise would be tantamount to holding that skillful concealment is an invincible barrier to proof. **However, the rule does not apply where the estimation is arrived at arbitrarily and capriciously.**" *(Emphasis supplied)*

[24] G.R. No. 136975, March 31, 2005.

Simply put, while respondent has the power to assess petitioner based on the best evidence obtainable and may resort to the exercise of its powers under Section 5 of the NIRC of 1997 and to approximation in the calculation of the taxes due, the same should not be arrived at arbitrarily and capriciously.

As a general rule, tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment. It is to be presumed, however, that such assessment was based on sufficient evidence. Upon the introduction of the assessment in evidence, a *prima facie* case of liability on the part of the taxpayer is made. If a taxpayer files a Petition for Review before this Court and assails the assessment, the *prima facie* presumption is that the assessment made by the BIR is correct, and that in preparing the same, the BIR personnel regularly performed their duties. This rule for tax initiated suits is premised on several factors other than the normal evidentiary rule imposing proof obligation on the petitioner-taxpayer: the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the Tax Code. However, the *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious. Where the BIR has come out with a "naked assessment," *i.e.*, without any foundation character, the determination of the tax due is without rational basis.[25]

As already mentioned, petitioner attached supporting documents to its Supplemental Protest against the FAN, which was filed on October 31, 2008[26], the last day for submission of relevant supporting documents. Furthermore, petitioner submitted additional documents attached to its Second Supplemental Protest dated December 2, 2008[27]. Even though belatedly filed, respondent could have at least verified the said documents to show that the subject assessment recommended to be upheld in a Memorandum[28], which resulted in the issuance of the Collection Letter, was based on the best evidence obtainable. For failure to establish that the

[25] *Commission of Internal Revenue vs. Hantex Trading Co. Inc., supra.*
[26] Exhibit "G".
[27] Exhibit "H".
[28] Exhibit "13".

assessment was based on the best evidence obtainable, the determination by this Court must rest on all the evidence introduced and its ultimate determination must find support in credible evidence.

Accordingly, the Court shall now proceed to discuss the validity of the assessment issued by respondent against petitioner.

Petitioner was assessed by respondent of deficiency income tax, VAT, EWT, and WTC for taxable year 2005 in the total amount of ₱75,514,965.24 inclusive of interest and compromise penalty, broken down as follows:

| DEFICIENCY TAX | AMOUNT |
|---|---|
| Income Tax | ₱ 45,871,886.04 |
| Value-added Tax | 26,944,168.37 |
| Expanded Withholding Tax | 1,112,671.95 |
| Withholding Tax - Compensation | 1,586,238.88 |
| **Total** | **₱ 75,514,965.24** |

For orderly presentation of the discussion, the Court shall first discuss the propriety of the assessment on deficiency EWT, followed by deficiency WTC, deficiency income tax, and deficiency VAT.

## I. DEFICIENCY EXPANDED WITHHOLDING TAX – ₱1,112,671.95

Respondent computed the deficiency EWT assessment against petitioner for taxable year 2005 in the amount of ₱1,112,671.95, as follows:[29]

| | | |
|---|---|---|
| Income payments subject to EWT | | ₱ 67,255,977.33 |
| Add: | | |
| Purchase of Goods not subjected to 1% | ₱ 40,669,945.46 | |
| Purchase of Services not subjected to 2% | 7,451,181.53 | |
| Rental not subjected to 5% | 3,216,305.80 | 51,337,432.79 |
| Income payments subject to EWT | | ₱ 118,593,410.12 |
| Tax Due thereon | | ₱ 1,821,904.81 |
| Less: Tax Paid | | 1,105,366.43 |
| Tax Still due | | ₱ 716,538.38 |

[29] Exhibit "10", BIR Records, p. 885.

| | | |
|---|---|---|
| Interest (Jan. 16, 2006 to August 31, 2008)(958 days) | ₱ 376,133.57 | |
| Compromise Penalty | 20,000.00 | 396,133.57 |
| **Expanded Withholding Tax Deficiency** | | **₱ 1,112,671.95** |

Upon comparison of petitioner's expense items/income payments as reflected in its Annual Income Tax Return (ITR) and Audited Financial Statements (AFS) with those shown in its Alphalist for the year 2005, respondent found that the amounts of ₱40,669,945.46, ₱7,451,181.53, and ₱3,216,305.80 were not subjected to one percent (1%) EWT of ₱406,699.45, two percent (2%) EWT of ₱149,023.63, and five percent (5%) EWT of ₱160,815.29, respectively, pursuant to Section 57(B) of the NIRC of 1997, as amended, in relation to RR No. 2-98, as amended. Below is the breakdown of the said amounts per respondent's computation schedule:[30]

| | **Per ITR (or AFS)** | | | | | |
|---|---|---|---|---|---|---|
| **Account Title** | **Special Rate** | **Exempt & Regular Rate** | **Per Audit** | **Per Alphalist** | **Difference** | |
| | **In Philippine Peso** | | | | | |
| Cost of Sales | | | | | | |
| Mdse. Invty beg. | | 75,559,114.00 | | | | |
| Add: Purchases | | | | | | |
| Importation | | 46,025,439.90 | | | | |
| Domestic | | 75,050,298.10 | 75,050,298.10 | 53,530,886.91 | 21,519,411.19 | a |
| Total Goods Available | | 196,634,852.00 | | | | |
| Less: Mdse. Invty end | | 8,983,912.00 | | | | |
| Factory tools & supplies | | 1,181,263.00 | 1,181,263.00 | | 1,181,263.00 | b |
| Others | | 1,189,991.00 | 1,189,991.00 | | 1,189,991.00 | c |
| Deductions | | | | | | |
| Office supplies | | 839,676.00 | 839,676.00 | | 839,676.00 | d |
| Representation & Entertainment | | 710,039.00 | 710,039.00 | | 710,039.00 | e |
| Transportation & travel | | 1,880,920.00 | 1,880,920.00 | | 1,880,920.00 | f |
| Miscellaneous | | 13,197,118.00 | 13,197,118.00 | | 13,197,118.00 | g |
| Increase in assets | | 151,527.27 | 151,527.27 | | 151,527.27 | h |
| **Total** | | 299,819,596.37 | 94,200,832.37 | 53,530,886.91 | **40,669,945.46** | |
| **1% EWT Due** | | | 942,008.32 | 535,308.87 | **406,699.45** | |
| | | | | | | |
| Cost of Sales | | | | | | |
| Mdse. Invty beg. | | 75,559,114.00 | | | | |
| Add: Purchases | | | | | | |
| Importation | | 46,025,439.90 | 2,195,981.00 | | 2,195,981.00 | i |
| Domestic | | 75,050,298.10 | | | | |
| Total Goods Available | | 196,634,852.00 | | | | |
| Less: Mdse. Invty end | | 8,983,912.00 | | | | |
| Direct Labor | | 2,305,150.00 | 2,305,150.00 | | 2,305,150.00 | j |
| Indirect labor | | 5,472,423.00 | 5,472,423.00 | 2,816,794.20 | 2,655,628.80 | k |
| Deductions | | | | | | |
| Repairs & Maint.-Labor | | 276,107.00 | 276,107.00 | | 276,107.00 | l |

[30] BIR Records, p. 782.

| | | | | | | |
|---|---|---|---|---|---|---|
| Insurance | | 258,954.00 | 258,954.00 | 240,639.27 | 18,314.73 | m |
| **Total** | | | 10,508,615.00 | 3,057,433.47 | **7,451,181.53** | |
| **2% EWT Due** | | | 210,172.30 | 61,148.67 | **149,023.63** | |
| | | | | | | |
| Cost of Sales | | | | | | |
| Mdse. Invty beg. | | 75,559,114.00 | | | | |
| Add: Purchases | | | | | | |
| Importation | | 46,025,439.90 | | | | |
| Domestic | | 75,050,298.10 | | | | |
| Total Goods Available | | 196,634,852.00 | | | | |
| Less: Mdse. Invty end | | 8,983,912.00 | | | | |
| Depreciation | 1,469,768.00 | | | | | |
| Rental | 1,594,819.00 | | 1,594,819.00 | 365,794.20 | 1,229,024.80 | n |
| Rental | | 5,024,547.00 | 5,024,547.00 | 5,024,547.00 | - | o |
| Deductions | | | | | | |
| Rental | | 1,987,281.00 | 1,987,281.00 | | 1,987,281.00 | p |
| **Total** | | | 8,606,647.00 | 5,390,341.20 | **3,216,305.80** | |
| **5% EWT** | | | 430,332.35 | 269,517.06 | **160,815.29** | |

From the above table, the items reflected on the lines designated as "a" to "p" are the accounts affected by the assessment for deficiency expanded withholding tax.

According to petitioner, the alleged domestic purchases of goods not subjected to 1% EWT in the amount of ₱21,519,411.19[31] were derived by respondent in the following manner:

| | |
|---|---|
| Purchase of Merchandise/Cost of Goods Manufactured per ITR[32] | ₱ 121,075,738.00 |
| Less: Importations per VAT returns[33] | 46,025,439.90 |
| **Balance** | **75,050,298.10** |
| Less: Purchases of goods subjected to 1% EWT per 1604-E[34] | 53,530,886.91 |
| **Alleged domestic purchases not subjected to EWT** | **₱21,519,411.19** |

The Court-commissioned Independent Certified Public Accountant (ICPA) noted that in arriving at the said finding, respondent used the entire amount of Cost of Goods Manufactured without considering its components. The breakdown of the Cost of Goods Manufactured as presented in Note 15 of the AFS[35] is shown below:

| | |
|---|---|
| Purchases of direct materials | ₱ 95,052,439.00 |
| Direct Labor | 2,305,150.00 |

[31] Item "a" of respondent's computation schedule.
[32] Exhibit "T", Line 43.
[33] Exhibit "TTT", Annex "E".
[34] Exhibit "BB".
[35] Exhibit "U", p. 23, Note 15-Cost of Sales.

| | |
|---|---|
| Depreciation[36] | 9,129,925.00 |
| Indirect Labor | 5,472,423.00 |
| Rental[37] | 3,429,728.00 |
| Communication, Light, Water | 1,882,914.00 |
| Royalties | 1,431,906.00 |
| Factory tools and supplies | 1,181,263.00 |
| Others | 1,189,991.00 |
| **Total** | **₱121,075,738.00** |

In addition to this, the ICPA observed the following:

1. The purchases of raw materials consist of importation in the amount of ₱46,025,439.90 that is not subject to expanded withholding tax;
2. The purchase of goods subjected to expanded withholding tax per 1604E involved goods purchased and paid during the year;
3. The usage of the goods was not only attributable to Cost of Sales but also allocated to administrative expenses and inventory; and
4. The "Purchase of Merchandise/Cost of Goods Manufactured" also includes expenses subjected to 2% and 5% EWT.

The Court concurs with the observation of the ICPA with regard to the fact that components of the Cost of Goods Manufactured include purchase of services since the manufacturing process does not only entail the usage of material goods but also the employment of necessary labor, facilities and utilities to process such materials. Accordingly, the costs of direct labor, depreciation, indirect labor, rental, communication, light, water, royalties, factory tools and supplies and other costs mentioned in the above table must not be considered in computing the alleged deficiency EWT from domestic purchases.

In addition, the Court noted that the amounts representing Factory Tools and Supplies and Others have been separately included in the deficiency EWT assessment. Considering the same in this finding will doubly subject the said accounts to deficiency EWT. Thus, the Court deems it

[36] Difference with Depreciation per Note 15 of Notes to FS is ₱1,469,678, which is the amount reflected as part of Cost of Sales (Service) under special rate in the AITR (Exhibit "T", Line 49).
[37] Difference with Rental per Note 15 of Notes to FS is ₱1,594,819, which is the amount reflected as part of Cost of Sales (Service) under special rate in the AITR (Exhibit "T", Line 50).

proper to disregard said amounts in computing the domestic purchases allegedly not subjected to withholding.

Based on the above table as well as the observations stated herein, petitioner's domestic purchases of goods subject to 1% EWT shall be recomputed as follows:

| | |
|---|---|
| Purchase of Merchandise/Cost of Goods Manufactured per ITR (includes only of Purchase of Direct Materials per breakdown above) | ₱ 95,052,439.00 |
| Less: Importations per VAT returns | 46,025,439.90 |
| **Domestic purchases of goods subject to 1% EWT** | **₱49,026,999.10** |

Likewise, the Court noticed that respondent erroneously imposed 2% EWT on petitioner's importations from various foreign companies[38] in the amount of ₱2,195,981.00. Pursuant to Section 2.57.2(M) of RR No. 02-98, as amended by RR No. 17-03, the mandated 2% EWT applies only to income payments made to local/resident suppliers of services.

Also, respondent erroneously charged 2% EWT on direct labor in the amount of ₱2,305,150.00[39] and indirect labor in the amount of ₱5,472,423.00[40]. As can be seen from petitioner's Trial Balance[41], the breakdown of such amounts comprised of salaries and wages, hence, must be assessed under the deficiency withholding tax on compensation.

In addition, respondent erred in doubly subjecting the rental amount of ₱1,594,819.00[42] to 5% EWT. In the Notes to AFS, particularly Note 15[43], it was indicated that the total rental charged to Cost of Sales amounted to ₱5,024,547.00, which was partly charged to petitioner's revenues from lease of properties in the amount of ₱1,594,819.00, while the remaining portion in the amount of ₱3,429,728.00 was charged to its sales of goods. In arriving at the deficiency 5% EWT assessment, respondent imposed 5% EWT on both amounts of ₱1,594,819.00 and ₱5,024,547.00; hence, the erroneous double imposition of 5% EWT on the rental of ₱1,594,819.00.

[38] Exhibit "TTT", Annex "E".
[39] Item "j" per BIR's computation schedule.
[40] Item "k" per BIR's computation schedule.
[41] Exhibit "KKK", p. 10.
[42] Item "n" per BIR's computation schedule.
[43] Exhibit "U", p. 23.

Taking into account all the foregoing, petitioner is liable to pay basic deficiency 1% EWT in the amount of ₱146,466.46 and deficiency 5% EWT in the amount of ₱81,074.34 totalling ₱227,540.80, computed as follows:

| | Per ITR (or AFS) | | Income Payments Per Court's Examination subject to EWT | | | |
|---|---|---|---|---|---|---|
| **Account Title** | **Special Rate** | **Exempt & Regular Rate** | **1%** | **2%** | **5%** | **10%** |
| | **In Philippine Peso** | | | | | |
| Mdse. Invty beg. | | 75,559,114.00 | | | | |
| Add: Purchases | | | | | | |
| Importation | | 46,025,439.90 | | | | |
| Domestic | | 75,050,298.10 | 49,026,999.10 | | | |
| **Total Goods Available** | | **196,634,852.00** | | | | |
| Less: Mdse. Invty end | | 8,983,912.00 | | | | |
| Depreciation | 1,469,768.00 | | | | | |
| Rental | 1,594,819.00 | | | | - | |
| Dec. (inc.) in RM Invty | | | | | | |
| Direct Labor | | 2,305,150.00 | | - | | |
| Depreciation | 1,469,768.00 | 9,129,925.00 | | | | |
| Indirect labor | | 5,472,423.00 | | - | | |
| Rental | 1,594,819.00 | 3,429,728.00 | | | 5,024,547.00 | |
| Com. Lights & Water | | 1,882,914.00 | | 1,882,914.00 | | |
| Royalties | | 1,431,906.00 | | | | |
| Factory tools & supplies | | 1,181,263.00 | 1,181,263.00 | | | |
| Others | | 1,189,991.00 | 1,189,991.00 | | | |
| Dec. in WIP invty | | | | | | |
| Dec. in FG invty | | | | | | |
| **Cost of Sales** | | | | | | |
| Salaries & Allowances | | 14,035,522.00 | | | | |
| Rental | | 1,987,281.00 | | | 1,987,281.00 | |
| Repairs & Maint.-Labor | | 276,107.00 | | 276,107.00 | | |
| Office supplies | | 839,676.00 | 839,676.00 | | | |
| Insurance | | 258,954.00 | | 258,954.00 | | |
| Representation & Entertainment | | 710,039.00 | 710,039.00 | | | |
| Transportation & travel | | 1,880,920.00 | 1,880,920.00 | | | |
| Com. Lights & Water | | 1,422,589.00 | | 1,422,589.00 | | |
| Taxes & Licenses | | 3,477,575.00 | | | | |
| Depreciation | | 2,270,497.00 | | | | |
| Amortization of pension trust | | 1,510,491.00 | | | | |
| Miscellaneous | | 13,197,118.00 | 13,197,118.00 | | | |
| Research & devt | | 1,535,346.00 | | | | 1,535,346.00 |
| **Deductions** | | **43,402,115.00** | | | | |
| Increase in assets | | 151,527.27 | 151,527.27 | | | |
| **TOTAL** | | | **68,177,533.37** | **3,840,564.00** | **7,011,828.00** | **1,535,346.00** |
| Less: Amount remitted per 1604E | | | 53,530,886.91 | 6,657,358.02 | 5,390,341.20 | 1,673,933.20 |
| **Not subjected to EWT** | | | **14,646,646.46** | **-** | **1,621,486.80** | **-** |
| **EWT Rate** | | | **1%** | | **5%** | |
| **Deficiency EWT Due** | | | **146,466.46** | | **81,074.34** | |
| | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | |
| **Recapitulation:** | **Income Payments Not Subjected to EWT** | **EWT Due** | | | | |
| **Deficiency 1% EWT** | **14,646,646.46** | **146,466.46** | | | | |
| **Deficiency 5% EWT** | **1,621,486.80** | **81,074.34** | | | | |
| **Total** | | **227,540.80** | | | | |

## II. DEFICIENCY WITHHOLDING TAX ON COMPENSATION - ₱1,586,238.28

In respondent's Formal Letter of Demand[44], the deficiency assessment on withholding tax on compensation was computed as follows:

| | |
|---|---|
| Taxable compensation per return[45] | ₱ 10,722,624.38 |
| Add: Salaries & Wages not subjected to withholding tax | 3,199,403.68 |
| **Taxable compensation per audit** | **13,922,028.06** |
| Tax Due | 2,467,360.09 |
| Less: Tax Paid[46] | 1,443,551.51 |
| **Tax Still due** | **1,023,808.58** |
| Interest (Jan. 16, 2006 to August 31, 2008)(958 days) | 537,429.70 |
| Compromise Penalty | 25,000.00 |
| **Compensation Withholding Tax Deficiency** | **₱ 1,586,238.28** |

The amount of salaries and wages not subjected to withholding tax was broken down as follows:[47]

| | |
|---|---|
| Salaries and wages per AITR/AFS[48] | ₱ 14,035,522.00 |
| Salaries and wages per 1601-C[49] | 10,836,118.32 |
| | **₱3,199,403.68** |

Contrary to respondent's computation, the total amount of taxable compensation declared in the BIR Form No. 1601C only amounted to ₱10,609,130.44, broken down as follows:

| **Exhibit** | **Period Covered** | **Taxable Compensation** |
|---|---|---|
| "EE.1" | January 2005 | ₱ 1,782,555.19 |
| "EE.2" | February 2005 | 1,728,413.30 |
| "EE.3" | March 2005 | 1,507,023.65 |

[44] Exhibit "D".
[45] Exhibits "EE.1" to "EE.12".
[46] Exhibit "PPP".
[47] BIR Records, p. 870.
[48] Exhibits "T" and "U".
[49] Exhibits "EE.1" to "EE.12".

| | | |
|---|---|---|
| "EE.4" | April 2005 | 1,629,817.51 |
| "EE.5" | May 2005 | 2,987,074.12 |
| "EE.6" | June 2005 | 861,006.98 |
| "EE.7" | July 2005 | 113,239.69 |
| | **Total** | **₱10,609,130.44** |

The ICPA presented the computation of salaries, wages and benefits that petitioner presented to him for examination, as follows:[50]

| | | |
|---|---|---|
| **Salaries and wages - administrative per ITR[51] and FS[52]** | | |
| Salaries, Wages, 13th month and bonus | ₱ 5,429,446.90 | |
| Employee benefits | 1,656,396.63 | |
| SSS, HDMF, PhilHealth | 116,870.05 | |
| Separation pay | 6,832,807.67 | ₱ 14,035,521.25 |
| | | |
| **Cost of Sales - salaries and wages per ITR and FS** | | |
| Direct labor-salaries, wages, 13th month & bonus | | 2,305,150.58 |
| Indirect labor | | |
| Salaries, wages, 13th month and bonus | ₱ 2,922,220.58 | |
| Employee benefits | 2,215,391.56 | |
| SSS, HDMF, PhilHealth | 334,811.58 | 5,472,423.72 |
| | | **₱21,813,095.55** |

Petitioner claims that the total salaries and wages-administrative expenses were reflected not only in the AFS but more so in the Annual ITR that amounted to ₱14,035,521.25. This supposedly includes the salaries and wages, 13th month pay, employee benefits, and SSS and Pag-ibig contributions.

According to petitioner, respondent failed to consider the direct and indirect labor costs that were recorded and reflected in the AFS and Annual ITR amounting to ₱5,227,371.16 (₱2,305,150.58 plus ₱2,922,220.58) and instead, considered only the salaries and wages in administrative expense which apparently and evidently include non-taxable compensation (*i.e.*, SSS, Philhealth, HDMF contributions), whereas the direct and indirect labor costs under cost of sales were erroneously considered in the assessment of deficiency EWT.

[50] Exhibit "TTT", p. 35.
[51] Exhibit "T", Line 76.
[52] Exhibit "U", Notes to Financial Statements, Note 15.

In addressing this assessment, the Court shall be guided by Section 2.78.1(B) of RR No. 2-98, which reads:

"SECTION 2.78.1. *Withholding of Income Tax on Compensation Income. –*

xxx xxx xxx

(B) ***Exemptions from withholding tax on compensation.*** – The following income payments are exempted from the requirement of withholding tax on compensation:

(1) *Remunerations received as an incident of employment, as follows:*

xxx xxx xxx

(b) Any amount received by an official or employee or by his heirs from the employer due to death, sickness or other physical disability or **for any cause beyond the control** of the said official or employee, such as retrenchment, redundancy, or cessation of business.

The phrase 'for any cause beyond the control of the said official or employee' **connotes involuntariness on the part of the official or employee**. The separation from the service of the official or employee must not be asked for or initiated by him. The separation was not of his own making. **Whether or not the separation is beyond the control of the official or employee, being essentially a question of fact, shall be determined on the basis of prevailing facts and circumstances.** It shall be duly established by the employer by competent evidence which should be attached to the monthly return for the period in which the amount paid due to the involuntary separation was made.

Amounts received by reason of involuntary separation remain exempt from income tax even if the official or the employee, at the time of separation, had rendered less than ten (10) years of service and/or is below fifty (50) years of age.

Any payment made by an employer to an employee on account of dismissal, constitutes compensation regardless of whether the employer is legally bound by contract, statute, or otherwise, to make such payment.

xxx xxx xxx

(e) Payments of benefits made under the Social Security System Act of 1954 as amended; and

xxx xxx xxx

(11) ***Thirteenth (13th) month pay and other benefits.*** –

(a) Thirteenth (13th) month pay equivalent to the mandatory one (1) month basic salary of officials and employees of the government, (whether national or local), including government-owned or controlled corporations, and or private offices received after the twelfth (12th) month pay; and

(b) Other benefits such as Christmas bonus, productivity incentive bonus, loyalty award, gifts in cash or in kind and other benefits of similar nature actually received by officials and employees of both government and private offices. xxx

The above stated exclusions (a) and (b) shall cover benefits paid or accrued during the year provided that the total amount shall not exceed thirty thousand pesos (₱30,000.00) which may be increased through rules and regulations issued by the Secretary of Finance, upon recommendation of the Commissioner, after considering, among others, the effect on the same of the inflation rate at the end of the taxable year.

(12) ***GSIS, SSS, Medicare and other contributions.*** – GSIS, SSS, Medicare and Pag-Ibig contributions, and union dues of individual employees. xxx" *(Emphasis supplied)*

Petitioner contends that the separation pay given to employees must not be subject to withholding tax. Even though it did not specifically invoke that such separation pay was on account of the dismissal of the employees beyond their control, the facts and the circumstances of petitioner proved to be so. As can be deduced from Note 1 of the AFS[53], TS Tech Philippines, Inc., by approval of its Board of Directors on May 16, 2005, had ceased its manufacturing operations effective June 20, 2005 and consequently separated all its employees and paid separation cost of ₱6,832,808.00. Further, as jointly admitted by the parties, TS Tech Philippines, Inc. is now merged with TS Tech Trim Philippines, Inc.[54]. As such, it can

[53] Exhibit "U".
[54] Par. 2, JSFI, docket, p. 83.

be said that TS Tech Philippines, Inc. is now dissolved; hence, the dismissal of the employees was beyond its control.

Consequently, all costs of separation paid to said employees are not subject to withholding tax on compensation. However, from the claimed amount of ₱6,832,808.00, only the amount of ₱5,588,224.93 was duly supported by evidence (journal entries, separation pay computation, Release, Waiver and Quit Claim)[55]. The remaining unsupported portion amounting to ₱1,244,583.07 shall be disallowed by this Court.

Petitioner was correct in stating that payments on account of SSS, 13th month pay, bonuses, and other employee benefits (not exceeding P30,000.00) to its employees are exempt from withholding tax. But then, it is incumbent upon petitioner to prove that those amounts actually pertain to payments on account of those exempted from withholding tax as provided by RR No. 2-98.

On this point, petitioner failed to satisfy the Court with such fact. It did not submit the accompanying schedules on its BIR Form No. 1601C from January to December 2005 for the Court to verify if the amounts presented in the breakdown above were among those non-taxable income payments as contemplated in RR No. 2-98. Neither did it submit any evidence proving the remittance of the contributions to SSS, HDMF, Philhealth, the monthly salary computation schedule or other supporting documents that can provide for the breakdown of the 13th month pay, the bonuses, and the other employee benefits.

Furthermore, while petitioner submitted Exhibit "OOO" purporting to provide the breakdown of the 13th month pay attributable to those Employees Terminated Before December 31, verification of the said document shows however that it actually contains a summary of the amount of withholding tax on compensation remitted from January to December 2005 and not as what petitioner had intended to present. Hence, this document failed to support petitioner's claim that those amounts actually pertain to payments on account of those exempted from withholding tax as provided by RR No. 2-98.

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[55] Exhibits "SSS.1" to "SSS.79".

In view of the foregoing, the Court upholds the assessment with the following revised computation of the deficiency WTC in the amount of ₱764,116.41:

| | | |
|---|---|---|
| Salaries and wages – admin | | |
| Salaries and wages including benefits | ₱7,202,713.58 | |
| Unsupported separation pay | 1,244,583.07 | ₱ 8,447,296.65 |
| Salaries and wages - cost of sales | | |
| Direct Labor | ₱2,305,150.58 | |
| Indirect Labor | 5,472,423.72 | 7,777,574.30 |
| **Total taxable compensation** | | **₱16,224,870.95** |
| Less: Compensation subjected to income tax per BIR Form No. 1601C | | 10,609,130.44 |
| **Salaries and wages not subject to withholding tax** | | **₱ 5,615,740.51** |
| Withholding tax rate per BIR Form No. 1601C[56] | | 13.6066902% |
| **Deficiency withholding tax on compensation** | | **₱ 764,116.41** |

## III. DEFICIENCY INCOME TAX – ₱45,871,886.04

According to the FLD, the assessed amount for deficiency income tax was computed as follows:[57]

| | | |
|---|---|---|
| Taxable Income per ITR | | ₱ - |
| Add: Unaccounted Sales (Per TRS LN vs. CWT vs. ITR) | | 34,891,665.67 |
| Unaccounted Purchases (Per BOC Data) | | 24,155.99 |
| Taxable Income | | ₱ 34,915,821.66 |
| Add: Disallowance | | |
| Unsupported purchases (Local) | ₱ 2,212,105.00 | |
| Unsupported purchases (Importation) | 3,475,910.00 | |
| Disallowed Purchases (out of period) | 406,120.00 | |
| Salaries and Wages not subjected to WT-Compensation | 3,199,403.68 | |
| Payment to suppliers not subjected to 1% EWT | 40,669,945.46 | |
| Payment of services not subjected to 2% EWT | 7,451,181.53 | |
| Rental expense not subjected to 5% EWT | 3,216,305.80 | 60,630,971.47 |
| **Taxable Income per Audit** | | **₱ 95,546,793.13** |
| Tax Due | | ₱ 31,052,707.77 |
| Less: Tax Paid | | - |
| **Tax Still Due** | | **₱ 31,052,707.77** |
| Interest (April 16, 2006 to August 31, 2008) (868 days) | | 14,769,178.27 |

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56

| | |
|---|---|
| Total Taxes Withheld | ₱ 1,443,551.51 |
| Total Taxable Compensation | ÷ ₱10,609,130.44 |
| WTC Rate per BIR Forms No. 1601C | 13.6066902% |

57 Exhibit "10".

| | | |
|---|---|---|
| Compromise Penalty | | 50,000.00 |
| **Income Tax Deficiency** | | **₱ 45,871,886.04** |

## A. Unaccounted Sales (per ITR vs. CWT vs. BIR TRS-LN) – ₱34,891,665.67

The unaccounted sales were derived by the BIR as follows:[58]

| Customer | Per TS Tech Schedule | Per TRS-LN | Per CWT | Discrepancy |
|---|---|---|---|---|
| Automotive Interiors Corp. | ₱ 6,597,104.64 | ₱ 8,331,880.99 | ₱ 8,327,865.04 | ₱ (1,734,776.35) |
| Honda Cars Phils., Inc. | 114,514,101.81 | 137,859,856.00 | 136,302,585.00 | (23,345,754.19) |
| Isuzu Phils. | 144,644.91 | 5,476,703.00 | 9,867,609.00 | (9,722,964.09) |
| Kawasaki Motors | (213,683.69) | 88,171.04 | 16,510.00 | (88,171.04) |
| **Unaccounted Sales** | | | | **(₱34,891,665.67)** |

The resulting discrepancy as found in the above table was computed by choosing the greater amount of income between TRS-LN (Tax Reconciliation System-Letter Notice) and per CWT, and then subtracting the same from the income reflected in the schedules of petitioner.

As described in the Details of Discrepancy[59], this finding is based on the difference between the summary of sales per VAT Returns and the Alphalist of Income Payment subjected to Expanded Withholding Tax submitted by the Customers/Payors provided by the third-party information per TRS-LN.

Petitioner provided sales invoices[60] as evidence of the total amount of sales revenue that it allegedly earned for CY 2005. The summary of invoices[61] would show that petitioner's total revenue based on sales invoices for CY 2005 amounted to ₱194,557,361.84. This is slightly greater than the amount of income subject to regular corporate income tax rate reported in the Annual ITR[62] and the AFS[63] for CY 2005 both

[58] Exhibit "TTT", p. 3.
[59] Exhibit "10-c", BIR Records, p. 884.
[60] Exhibits "V.1" to "V.649".
[61] Exhibit "TTT", Annex "A".
[62] Exhibit "T".

amounting to ₱188,353,868.00[64]. The resulting difference is ₱6,203,493.84.

Petitioner alleged in its Memorandum[65] that said discrepancy is due to petitioner's sales to its affiliate, TS Tech Trim Philippines, Inc. (TTTPI), wherein said sales per Statement of Accounts amounted to ₱69,930,447.49 instead of ₱64,259,658.00, and the remaining discrepancy in the amount of ₱532,705.65 is merely due to timing difference in the withholding and remittance of the corresponding and applicable taxes.

Meanwhile, the Court-commissioned Independent CPA noted that the discrepancy amounting to ₱6,203,493.84 can be considered as undeclared sales. The said difference in the amount of petitioner's sales to TTTPI indicated that the sales were under-reported; likewise, the remaining balance amounting to ₱532,705.65 appeared to be represented by debit memos that were not substantiated by petitioner.

The Court conducted its own examination of all related documents, and considered as basis that which respondent used in arriving at the discrepancy above. Petitioner provided original copies of the creditable withholding tax certificates issued to it by its clients. The Court summarized the CWTs per customer, detailed below:

| **Supplier** | **Covered Period** | **Income payment** | **Tax Withheld** | **Exhibit No.** |
|---|---|---|---|---|
| Automotive Interiors Corporation | 1/1/05 to 3/31/05 | ₱ 1,956,941.75 | ₱ 39,219.16 | **Y.1** |
| | 4/1/05 to 6/30/05 | 6,370,923.29 | 127,418.46 | **Y.7** |
| **Subtotal** | | **8,327,865.04** | **166,637.62** | |
| | | | | |
| Honda Cars Philippines Inc. | 1/1/05 to 3/31/05 | ₱ 18,286,208.00 | ₱ 182,862.08 | **Y.2** |
| | 1/1/05 to 3/31/05 | 55,649,416.00 | 556,494.16 | **Y.3** |
| | 4/1/05 to 6/30/05 | 45,877,225.00 | 458,772.25 | **Y.8** |
| | 4/1/05 to 6/30/05 | 10,604,103.00 | 106,041.03 | **Y.9** |
| | 7/1/05 to 9/30/05 | 3,460,565.00 | 34,605.65 | **Y.14** |
| | 7/1/05 to 9/30/05 | 2,425,068.00 | 24,250.68 | **Y.15** |
| **Subtotal** | | **₱136,302,585.00** | **₱1,363,025.85** | |
| | | | | |
| Isuzu Philippines Corporation | 1/1/05 to 3/31/05 | ₱ 3,778,005.00 | ₱ 37,780.05 | **Y.4** |
| | 1/1/05 to 3/31/05 | (202,756.00) | (2,027.56) | **Y.5** |
| | 1/1/05 to 3/31/05 | (907.90) | (90.79) | **Y.6** |

[63] Exhibit "U".
[64] Exhibit "T", Line 15B.
[65] Petitioner's Memorandum, docket, pp. 1370-1380.

| | | | | |
|---|---|---|---|---|
| | 4/1/05 to 6/30/05 | 143,950.00 | 1,439.50 | **Y.10** |
| | 4/1/05 to 6/30/05 | 4,963,791.00 | 49,637.91 | **Y.11** |
| | 4/1/05 to 6/30/05 | (132,466.00) | (1,324.66) | **Y.12** |
| | 7/1/05 to 9/30/05 | 1,114,329.00 | 11,143.29 | **Y.16** |
| **Subtotal** | | **₱ 9,663,945.10** | **₱ 96,557.74** | |
| | | | | |
| Kawasaki Motors Phils. Inc. | 7/1/05 to 9/30/05 | **16,510.00** | **165.10** | **Y.13** |
| **Total CWTs for CY 2005** | | **₱154,310,905.14** | **₱1,626,386.31** | |

It is noteworthy that respondent had factual basis of comparison, since the income payments made by each supplier based on the CWT certificates they issued to petitioner tally with the amounts found under "per CWT" of the table depicting how the assessment was arrived at.

Furthermore, petitioner failed to adequately defend itself out of the assessment. Petitioner also neglected to offer a reconciliation of the discrepancy noted by respondent to shed light on the right amount of sales subject to income tax.

As noted, respondent based her assessment by comparing the higher amount per TRS-LN or CWT against the amount reflected in the sales schedule of petitioner. In most of the instances, the amounts per TRS-LN were higher than the amounts reflected in the CWT, thus were mostly used in arriving at the discrepancy.

However, the Court finds this as inappropriate basis to derive the discrepancy for purposes of determining the amount to be assessed as deficiency income tax.

It must be pointed out that petitioner attempted to reconcile the discrepancy despite respondent's failure to provide a copy of the TRS-LN. Also, respondent failed to present to this Court a copy of the TRS-LN in order to assess the veracity of the amounts claimed to have been obtained from the said source. Hence, the Court finds it equitable that the determination of the amount of discrepancy must be based on the available evidence presented for verification, pertaining to the CWTs provided by petitioner, which the total income payments and tax withheld amounted to ₱154,310,905.14 and ₱1,626,386.31, respectively.

In addition to this, the Court agrees with the ICPA's finding that there were undeclared sales from noted unsupported difference between the total amount of invoices presented for verification and the total amount per AFS and Annual ITR. Consequently, this shall be added to the assessment on deficiency income tax.

Considering the foregoing, the said finding of the ICPA is upheld, with revisions, however, on the amount of discrepancy from ₱34,891,665.67 to ₱39,472,231.31, computed as follows:

| Customer | Per TS Tech Schedule | Per CWT | Discrepancy |
|---|---|---|---|
| Automotive Interiors Corporation | ₱ 6,597,104.64 | ₱ 8,327,865.04 | ₱ 1,730,760.40 |
| Honda Cars Philippines Inc. | 114,514,101.81 | 136,302,585.00 | 21,788,483.19 |
| Isuzu Philippines Corporation | 144,644.91 | 9,663,945.10 | 9,519,300.19 |
| Kawasaki Motors Phils. Inc. | (213,683.69) | 16,510.00 | 230,193.69 |
| **Total Discrepancy** | **₱121,042,167.67** | **₱154,310,905.14** | **₱33,268,737.47** |
| Add: Unsupported difference noted by ICPA | | | 6,203,493.84 |
| **Total Unaccounted Sales** | | | **₱39,472,231.31** |

**B. Undeclared gross profit due to unaccounted importation – ₱24,155.99**

The alleged undeclared gross income from unaccounted importation was derived by respondent as follows:[66]

| | | |
|---|---|---|
| Gross profit rate used: | | |
| Sales per ITR | ₱191,693,868.00 | 100.00% |
| Less: Cost of Sales per ITR | 190,715,528.00 | 99.49% |
| Gross Profit per ITR | ₱ 978,340.00 | 00.51% |

| | |
|---|---|
| Assessed gross income: | |
| Unaccounted importation per BOC data | ₱ 4,712,313.00 |
| Divided by | 99.49% |
| **Unaccounted Sales per BOC data** | **₱4,736,468.99** |
| | (4,712,313.00) |
| **Undeclared gross income** | **₱ 24,155.99** |

Based on the Details of Discrepancy[67], this amount represents the gross income derived by applying the gross

[66] Exhibit "TTT", p. 5.
[67] Exhibit "10-c".

profit rate method on the difference between the reported importation per VAT returns and the importation data furnished by the Bureau of Customs to the AITEID-BIR. The above amount was allegedly assessed pursuant to Section 32 of the NIRC of 1997, as amended.

The unaccounted importation based on BOC's data is composed of the following:[68]

| Date | Import Entry No. | Purchases | Input Tax |
|---|---|---|---|
| 2/14/2005 | 17075 | ₱ 1,149,778.00 | ₱ 114,977.80 |
| 5/6/2005 | 48799 | 141,595.00 | 14,159.50 |
| 6/10/2005 | 63574 | 613,181.00 | 61,318.10 |
| 6/16/2005 | 65645 | 2,619,466.00 | 261,946.60 |
| 6/17/2005 | 65740 | 188,293.00 | 18,829.30 |
| | | **₱4,712,313.00** | **₱471,231.30** |

Records indicate that both parties did not dwell significantly on the matter. Petitioner even failed to present necessary pieces of evidence to dispute the same. Thus, the Court finds no basis in disturbing this particular item of assessment.

It was noted, however, that in computing for the gross profit rate, respondent used as basis the combined amounts of sales/revenues and cost of sales/services under the Special Rate and Regular Rate in the Annual ITR:[69]

| | Special Rate | Regular Rate | Total | Percentage |
|---|---|---|---|---|
| Item 15 - Sales/Revenues/Receipts/Fees | ₱3,340,000.00 | ₱188,353,868.00 | ₱191,693,868.00 | 100.00% |
| Item 16 - Cost of Sales/Services | (3,064,587.00) | (187,650,940.00) | (190,715,527.00) | 99.49% |
| Item 17 - Gross Income from Operation | 275,413.00 | 702,928.00 | 978,341.00 | 0.51% |

The Court finds this improper. Based on Schedule 1, Item 38 of the Annual ITR, the sales subject to Special Rate pertain to Lease of Properties. Therefore, it cannot be logical for a property leasing operation to require an importation of goods for it to sustain leasing income. It must not be considered in the computation of gross profit for purposes of

[68] BIR Records, p. 871.
[69] Exhibit "T".

determining the amount of deficient income tax and to use only the amounts under the Regular Rate as basis.

To recompute it from the same source, the Court finds the following as the appropriate rates to be used:

| | Regular Rate | Percentage |
|---|---|---|
| Item 15 - Sales/Revenues/Receipts/Fees | ₱ 188,353,868.00 | 100.0000000% |
| Item 16 - Cost of Sales/Services | (187,650,940.00) | 99.6268046% |
| Item 17 - Gross Income from Operation | 702,928.00 | 0.3731954% |

Hence, the amount to be assessed from undeclared gross profit due to unaccounted importations is revised to ₱17,652.01:

| | |
|---|---|
| Unaccounted importation per BOC data | ₱ 4,712,313.00 |
| Divided by | ÷ 99.6268046% |
| Unaccounted Sales per BOC data | ₱ 4,729,965.01 |
| | (4,712,313.00) |
| **Undeclared gross income** | **₱ 17,652.01** |

**C. Disallowed purchases for lack of supporting documents – ₱2,212,105.00**

Upon comparison of the purchases as reflected in petitioner's summary of purchases and as declared in petitioner's VAT Returns, respondent found that petitioner has unsupported expenses in the amount of ₱2,212,105.00, computed as follows:[70]

| | |
|---|---|
| Domestic Purchases per Summary List of Purchases | ₱ 61,813,615.32 |
| Import Purchases per Summary List of Importations | 46,025,439.90 |
| Total Purchases per Summary Lists | 107,839,055.22 |
| Total Purchases per VAT returns | 110,051,160.22 |
| **Discrepancy** | **(₱2,212,105.00)** |

Petitioner avers that ₱1,776,532.40 of the discrepancy was properly documented and the corresponding withholding taxes were paid and remitted.

[70] Exhibit "TTT", p. 5.

Furthermore, the findings of the ICPA[71] show that the amount of ₱1,776,532.40 represents accrual of expenses which was subjected to EWT and was reported in the Alphalist of Payees Subject to Expanded Withholding Tax[72] and BIR Form No. 1604-E[73]. Said amount is substantiated by journal vouchers (JV), invoices, and official receipts[74].

It must be noted that the particular item was declared by respondent to be unsupported. This means that petitioner must present valid supporting documents in order to refute the same.

However, instead of presenting invoices or official receipts, petitioner merely established the fact of withholding by submitting JVs and tracing it to the BIR Returns. Petitioner then concludes that the alleged unsupported purchases are allowable deductions.

The Court finds petitioner's position misplaced.

Even though the fact of withholding is essential for it to be valid as a deduction for income tax purposes, the same should have been adequately proven by presenting the pertinent return reflecting the amount withheld for the transaction. Petitioner only presented the Annual Return for Expanded Withholding Tax (BIR Form No. 1604-E) and the corresponding Alphalist of Payees. The Alphalist, however, merely showed the total amount of income payments to payees throughout the year. Thus, the Court cannot establish if the transactions, which allegedly embody this particular assessment item, were actually included in those total amounts of payment per payee.

Nevertheless, upon re-examination of the submitted pieces of evidence, the Court finds that only ₱1,688,690.03 was supported by JVs and of this amount, only ₱139,412.46 was supported by valid invoices or official receipts, computed as follows:

---

[71] Exhibit "TTT", p. 6.
[72] Exhibit "BB".
[73] Exhibit "CC".
[74] Exhibits "AA.1" to "AA.11".

| Payee | Income payments | Tax Withheld | JV Exh No. | Invoice/OR Exh. No. |
|---|---|---|---|---|
| BPI/MS Insurance Corp | ₱ 62,534.10 | ₱ 1,189.40 | **AA.1** | **AA.1.1** |
| BPI/MS Insurance Corp | 71,493.66 | 3,645.42 | **AA.2** | **AA.2.1** |
| Laguna TS Land, Inc. | 398,704.68 | 19,935.23 | **AA.3** | none |
| Magic Genie Shuttle Service | 6,818.18 | 136.36 | **AA.4** | none |
| VISSCOR | 102,442.67 | 2,253.74 | **AA.5** | none |
| VISSCOR | 102,442.67 | 2,253.74 | **AA.6** | none |
| Tri-R Allied Industries, Inc. | 5,384.70 | 53.85 | **AA.7** | **AA.7.1** |
| Laguna TS Land, Inc. | 398,704.68 | 19,935.23 | **AA.8** | none |
| VISSCOR | 102,142.99 | 2,247.15 | **AA.9** | none |
| VISSCOR | 39,317.02 | 864.97 | **AA.10** | none |
| TS Tech Philippines Inc | 398,704.68 | 19,935.23 | **AA.11** | none |
| | **₱1,688,690.03** | **₱ 72,450.32** | | |

Due to the foregoing, the Court finds that petitioner should be granted allowable deduction but only to the extent of ₱139,412.46 (the sum of ₱62,534.10, ₱71,493.66 and ₱5,384.70), while the disallowance of ₱2,072,692.54 should be upheld.

**D. Disallowed importation due to lack of supporting documents – ₱3,475,910.00**

Respondent disallowed petitioner's claimed deduction for importation in the amount of ₱3,475,910.00 for being unsupported.

In the Formal Letter of Demand, respondent explained that this particular disallowance represents excess purchases claimed per petitioners VAT Return as compared to the purchases reflected per BOC furnished by AITEID; hence, assessed pursuant to Section 34 of the NIRC of 1997, as amended.

From the BIR Records, it appears that the amount was derived by grossing up the VAT paid for the following items[75], which formed part of the disallowed input tax arising from the same allegation:

[75] BIR Records, p. 871.

| Date | Import Entry No. | Input Tax |
|---|---|---|
| 1/15/2005 | 001205 | ₱ 7,469.00 |
| 1/24/2005 | 12163 | 13,530.00 |
| 4/4/2005 | 39460 | 324,792.00 |
| | | **₱345,791.00** |

The gross value of the above amount is only ₱3,457,910.00 (₱345,791.00 divided by 10% VAT rate) and not ₱3,475,910.00.

On the other hand, petitioner alleges that the imported purchases amounting to ₱3,457,910.00 has been duly accounted for and substantiated with supporting documents that include, but not limited to, bill of lading, commercial invoices, and Bureau of Customs assessment form[76].

A summary of the findings of this Court after examination of the documents shows:

| | | | **Exhibit Nos.** | | | | |
|---|---|---|---|---|---|---|---|
| **Date** | **IEIRD No.** | **Input Tax** | **Invoice** | **Bill of Lading** | **IEIRD** | **BOC Assessment Notice** | **Tax Base per IEIRD** |
| 1/15/2005 | 1205 | ₱ 7,469.00 | none | none | none | none | ₱ - |
| 1/24/2005 | 12163 | 13,530.00 | none | none | **DD.2** | none | 135,298.43 |
| 4/4/2005 | 39460 | 4,389.53 | none | none | **DD.4** | **DD.4.1** | 43,895.29 |
| 4/4/2005 | 39460 | 1,960.61 | none | none | **DD.4** | **DD.4.1** | 19,606.06 |
| 4/4/2005 | 39460 | 2,828.19 | none | none | **DD.4** | **DD.4.1** | 28,281.96 |
| 4/4/2005 | 39460 | 8,797.43 | none | none | **DD.4** | **DD.4.1** | 87,974.81 |
| 4/4/2005 | 39460 | 306,815.83 | none | none | **DD.3** | **DD.4.1** | 3,068,158.25 |
| | | **₱345,790.59** | | | | | **₱3,383,214.80** |

Despite the insufficiency of the submitted documents to warrant support on the existence of the transaction, the Court has already given credence to petitioner's presentation of the IEIRD alone since the said document sufficiently laid out the details of the importation (*i.e.*, importer, nature and quantity of goods imported, and tax due).

As for IEIRD No. 1205, petitioner presented BOC Form No. 38-A, which is an Official Receipt issued by the BOC with Reference No. 12040318[77] indicating a VAT amount of

[76] Exhibits "DD.1" to "DD.4".
[77] Exhibit "DD.1".

₱7,687.00. However, the Court cannot consider the said evidence since the document does not indicate that the payment actually referred to IEIRD No. 1205.

All the foregoing considered, the Court finds that petitioner should be allowed to deduct the supported importation amounting to ₱3,383,214.80 and should only be disallowed the amount of ₱74,695.20 for failure of petitioner to account for and support the same.

**E. Disallowed purchases for being out-of-period - ₱406,120.00**

In its Memorandum, petitioner avers that the disallowed purchase in the amount of ₱406,120.00 for being outside the period of claim (*i.e.*, taxable year 2005) appears to be not substantiated and remained to be a mere allegation.

Relevantly, Section 34 of the NIRC of 1997, as amended, provides for the general definition of allowable deductions in a taxable year, to wit:

> "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 t ax 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:
>
> (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 xxx." *(Emphasis supplied)*

An examination of the Summary List of Importation[78] shows that Import Entry No. C 146084 with a landed cost of ₱406,120.00 was imported on December 6, 2004 with the corresponding payment of VAT in the amount of ₱40,612.00 made on December 15, 2004. Further, the ICPA Report mentions that petitioner was amenable to the said fact.[79]

Considering that the evidence and the ICPA Report confirms that the disallowed amount of ₱406,120.00 is outside the period of the subject assessment, *viz.*, taxable year 2005, the Court shall not disturb the said item of assessment.

**F. Disallowed expenses due to non-withholding**

**1. Salaries and Wages (Non-withholding of WTC) - ₱3,199,403.68**

Respondent claims that the account salaries and wages for the year 2005 in the amount of ₱3,199,403.68 was not subjected to withholding tax pursuant to Section 32 in relation to Section 44 of the NIRC of 1997, as amended. As a consequence of the alleged non-withholding, respondent disallowed the said amount from petitioner's claimed deductible expenses.

As earlier discussed under the deficiency WTC assessment, petitioner failed to prove that it withheld and remitted the withholding tax due on the salaries and wages in the amount of ₱5,615,740.51. Section 34(K) of the NIRC of 1997, as amended, which provides for the *Additional Requirement for Deductibility of Certain Payments* states that "Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income xxx 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".

Out of the ₱5,615,740.51 salaries and wages for which petitioner failed to withhold and remit the corresponding tax,

[78] Exhibit "TTT", Annex E.
[79] Exhibit "TTT", p. 7.

the amount of ₱244,550.00[80] was not claimed as deduction from petitioner's taxable gross income. As a result, only the remaining amount of ₱5,371,190.51 shall be disallowed as deduction.

**2. Income payments and rental expense not subjected to EWT**

Based on the finding that petitioner failed to withhold and remit the EWT on certain income payments/expenses pursuant to RR No. 2-98, as amended, as discussed under the deficiency EWT assessment, respondent disallowed the following income payments/expenses as deductions from petitioner's taxable gross income:

| | |
|---|---|
| Payment to suppliers not subjected to 1% EWT | ₱40,669,945.46 |
| Payment of services not subjected to 2% EWT | 7,451,181.53 |
| Rental expense not subjected to 5% EWT | 3,216,305.80 |

As earlier discussed, petitioner failed to prove that it properly withheld and remitted the 1% EWT due of ₱146,466.46 on its income payments of ₱14,646,646.46 and the 5% EWT of ₱81,074.34 on rental payments of ₱1,621,486.80. However, of the ₱14,646,646.46 income payments subject to 1% EWT, the following amounts were not claimed by petitioner as deductible expenses:

| | | **Amount** | **Exhibit "T" Section D** |
|---|---|---|---|
| Office Supplies | | ₱ 14,630.00 | Line 91 |
| Representation and Entertainment | | 12,371.00 | Line 96 |
| Transportation and Travel | | 32,772.00 | Line 97 |
| Miscellaneous | | 20,907.00 | Line 108 |
| **Subtotal** | | **₱80,680.00** | |
| | | | |
| Increase in Assets: | | | |
| Machinery and Factory | ₱ 47,727.00 | | |
| Office furniture, fixtures and equipment | 103,800.00 | | |
| Total Increase in Assets[81] | ₱151,527.00 | | |
| Less: Depreciation for 2005 | | | |
| Machinery and Factory | | | |
| (₱47,727 ÷ 15 years[82]) | ₱ 3,181.80 | | |

[80] Exhibit "T", Section E, line 76.
[81] Exhibit "U", Notes to Financial Statements, Note 11, p. 21.
[82] Exhibit "U", Notes to Financial Statements, Note 2.6, p. 10.

| | | | |
|---|---|---|---|
| Office furn., fixtures and equipment | | | |
| (₱103,800 ÷ 3 years[83]) | 34,600.00 | | |
| Total Depreciation | ₱ 37,781.80 | | |
| Unamortized Increase in Assets | | 113,745.20 | |
| **Total Unclaimed Deduction** | | **₱194,425.20** | |

Consequently, only the amounts of ₱14,452,221.26 and ₱1,621,486.80 representing income payments to suppliers not subjected to 1% EWT and rental expense not subjected to 5% EWT, respectively, shall be disallowed from petitioner's claimed deductible expenses pursuant to Section 34(K) of the NIRC of 1997, as amended, detailed below:

| | |
|---|---|
| Payment to supplier not subjected to 1% | ₱ 14,646,646.46 |
| Less: Unclaimed Deductions | 194,425.20 |
| Disallowed Payments to suppliers not subjected to 1% EWT | ₱ 14,452,221.26 |
| Disallowed Rental Expense not subjected to 5% EWT | 1,621,486.80 |
| **Total Disallowed Deductions** | **₱16,073,708.06** |

In summary, petitioner is liable to pay basic deficiency income tax for taxable year 2005 in the amount of ₱5,166,024.81, computed as follows:

| | | |
|---|---|---|
| Taxable income (loss) | | (₱29,401,455.00) |
| Income items not subjected to income tax/disallowed expenses: | | |
| Unaccounted sales | ₱39,472,231.31 | |
| Unaccounted gross income | 17,652.01 | |
| Unsupported purchases (local) | 2,072,692.54 | |
| Unsupported purchases (importation) | 74,695.20 | |
| Disallowed Purchases (out of period) | 406,120.00 | |
| Salaries and Wages not subjected to WTC | 5,371,190.51 | |
| Payment to suppliers not subjected to 1% EWT | 14,452,221.26 | |
| Rental expense not subjected to 5% EWT | 1,621,486.80 | 63,488,289.63 |
| **Taxable income** | | ₱34,086,834.63 |
| Income Tax rate | | 35% |
| **Income tax due thereon** | | ₱11,930,392.12 |
| Less: Creditable withholding tax | | |
| Excess credits carried forward from previous years | ₱ 5,137,981.00 | |
| Current year tax credits | 1,626,386.31 | 6,764,367.31 |
| **Basic deficiency income tax due** | | **₱5,166,024.81** |

[83] Exhibit "U", Notes to Financial Statements, Note 2.6, p. 10.

## IV. DEFICIENCY VALUE-ADDED TAX – ₱26,944,168.37

Respondent computed the deficiency VAT assessment as follows:[84]

| | | | |
|---|---|---|---|
| Vatable Sales per Return | | | ₱ 93,094,968.04 |
| Add: Unaccounted Sales per BOC data | | ₱ 4,736,468.99 | |
| Unaccounted Sales per TRS LN vs. CWT vs. ITR | | 34,891,665.67 | |
| Exempt Sales (Unsupported) | | 6,597,104.64 | |
| Zero-Rated Sales (Unsupported) | | 90,960,855.70 | |
| Sales not subjected to VAT (Audited F/S vs. VAT returns) | | 33,736,894.62 | 170,922,989.62 |
| **Vatable Sales per Audit** | | | **₱264,017,957.66** |
| Output Tax Due | | | ₱ 26,401,795.77 |
| Less: Available Input Tax | | | |
| Carried over from previous quarter | | ₱ 5,931,497.59 | |
| Input Tax (local) | | 6,402,572.03 | |
| Input Tax (importation) | | 4,602,543.99 | |
| Available Input Tax | | ₱ 16,936,613.61 | |
| Less: Input Tax forwarded to next quarter | | 7,627,116.81 | |
| **Available Input Tax** | | **₱9,309,496.80** | |
| Less: Disallowed Input Tax | | | |
| Unsupported Input Tax | ₱221,210.50 | | |
| Input Tax not found per BOC data | 345,791.00 | | |
| Input Tax - out of period | 40,612.00 | 607,613.50 | 8,701,883.30 |
| **Output Tax Due** | | | **₱ 17,699,912.47** |
| Interest (Jan. 26, 2006 to August 31, 2008) | | ₱ 9,194,255.90 | |
| Compromise Penalty | | 50,000.00 | 9,244,255.90 |
| **VAT deficiency** | | | **₱ 26,944,168.37** |

As can be seen from the above computation, the assessment arose from the following items:

| | | |
|---|---|---|
| A. Unaccounted Sales per BOC data | | ₱ 4,736,468.99 |
| B. Unaccounted Sales per TRS LN vs. CWT vs. ITR | | 34,891,665.67 |
| C. Exempt Sales (Unsupported) | | 6,597,104.64 |
| D. Zero-Rated Sales (Unsupported) | | 90,960,855.70 |
| E. Sales not subjected to VAT (Audited F/S vs. VAT returns) | | 33,736,894.62 |
| F. Input Tax forwarded to next quarter | | 7,627,116.81 |
| G. Disallowed Input Taxes | | |
| Unsupported Input Tax | ₱221,210.50 | |
| Input Tax not found per BOC Data | 345,791.00 | |
| Input Tax – Out of Period | 40,612.00 | 607,613.50 |

[84] Exhibit "10", BIR Records, p. 886.

The Court shall determine the propriety of each of the aforesaid items.

**A. Unaccounted sales per BOC data - ₱4,736,468.99**

The alleged unaccounted sales per BOC data in the amount of ₱4,736,468.99 was derived by dividing the unaccounted importation per BOC in the amount of ₱4,712,313.00 by the gross profit rate of 99.49%.

As earlier discussed under item III(B), the finding of the deficiency income tax for undeclared gross income should be upheld for lack of supporting documents. Accordingly, the said finding shall extend to this particular item of assessment under deficiency VAT. However, as discussed therein, due to the improper usage of percentage by respondent, the Court revised the amount to ₱4,729,965.01.

**B. Unaccounted sales per TRS-LN - ₱34,891,665.67**

The circumstances of this particular item have already been laid down in item III(A) above, pertaining to the Court's discussion on petitioner's deficiency income tax. The Court's finding that petitioner had unaccounted sales in the revised amount of ₱39,472,231.31 shall remain and petitioner shall be liable for the corresponding deficiency VAT.

**C. Unsupported exempt sales - ₱6,597,104.64**

In the FLD and the Details of Discrepancy[85], respondent found that petitioner failed to substantiate VAT-exempt sales in the amount of ₱6,597,104.64, hence, was subjected to 10% deficiency VAT pursuant to Section 106 of the NIRC of 1997, as amended.

The Court finds the assessment in order.

As stated in its Articles of Incorporation[86], petitioner is primarily engaged in the manufacture of car seats and interior components of cars and other similar motorized vehicles.

[85] Exhibit "10" and submarkings.
[86] Exhibit "J".

While petitioner did not indicate any amount in *Line 21 – Exempt Sales/Receipts* of its Quarterly VAT Returns[87] for taxable year 2005, petitioner reported in its Summary List of Sales[88] VAT-exempt sales transactions to Automotive Interiors Corporation (AIC), a PEZA-registered entity, with Registration Certificate No. 99-08 dated February 10, 1999[89], in the amount ₱6,597,104.64, broken down as follows:

| **Period Covered** | **VAT-Exempt Sales** |
|---|---|
| January 2005 | ₱3,267,311.69[90] |
| March 2005 | 865,944.56[91] |
| April 2005 | 1,168,889.09[92] |
| May 2005 | 1,294,959.30[93] |
| **Total** | **₱6,597,104.64** |

Under Executive Order (E.O.) No. 226, otherwise known as the "Omnibus Investments Code of 1987", sales by a VAT taxpayer from the customs territory to entities located in export processing zones are considered export sales, to wit:

> "ARTICLE 23. 'Export Sales' shall mean the Philippine port F.O.B. value, determined from invoices, bills of lading, inward letters of credit, landing certificates, and other commercial documents, of exports products exported directly by a registered export producer or the net selling price of export products sold by a registered export producer to another export producer, or to an export trader that subsequently exports the same: *Provided,* That sales of export products to another producer or to an export trader shall only be deemed export sales when actually exported by the latter, as evidenced by landing certificates or similar commercial documents: *Provided, further,* **That without actual exportation the following shall be considered constructively exported for purposes of this provision:** (1) sales to bonded manufacturing warehouses of export-oriented manufacturers; (2) **sales to export processing zones**; xxx" *(Emphasis supplied)*

> "ARTICLE 77. *Tax Treatment of Merchandise in the Zone.* – (1) Except as otherwise provided in this Code, foreign and domestic merchandise, raw materials, supplies, articles, equipment, machineries, spare parts and wares of every

[87] Exhibits "FF-1" to "FF-12",
[88] BIR Records, pp. 740, 741, 742, and 744.
[89] Exhibit "M" or "HH".
[90] BIR Records, p. 744.
[91] BIR Records, p. 742.
[92] BIR Records, p. 741.
[93] BIR Records, p. 740.

description, except those prohibited by law, brought into the zone to be sold, stored, broken up, repacked, assembled, installed, sorted, cleaned, graded, or otherwise processed, manipulated, manufactured, mixed with foreign or domestic merchandise whether directly or indirectly related in such activity, shall not be subject to customs and internal revenue laws and regulations nor to local tax ordinances, the provisions of law to the contrary notwithstanding.

(2) **Merchandise purchased by a registered zone enterprise from the customs territory and subsequently brought into the zone, shall be considered as export sales and the exporter thereof shall be entitled to the benefits allowed by law for such transaction.**" *(Emphasis supplied)*

Section 106(A)(2)(a)(5) of the NIRC of 1997, as amended, treats export sales governed by Executive Order No. 226 and other special laws as subject to zero percent VAT, to wit:

"SEC. 106. *Value-added Tax on Sale of Goods or Properties.* –

(A) *Rate and Base of Tax.* – There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor: *Provided*, That the President, upon the recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of value-added tax to twelve percent (12%), after any of the following conditions has been satisfied:

xxx xxx xxx

2) The following sales by VAT-registered persons shall be subject to zero percent (0%) rate:

(a) *Export Sales.* – The term **'export sales'** means:

xxx xxx xxx

(5) Those considered export sales under Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987, and other special laws."

Moreover, the Supreme Court in the case of *Commissioner of Internal Revenue vs. Toshiba Information Equipment (Phils.), Inc.*[94] explained thus:

> "Section 8 of Rep. Act No. 7916, as amended, mandates that the PEZA shall manage and operate the ECOZONES as a separate customs territory; thus, creating the fiction that the **ECOZONE is a foreign territory**. As a result, sales made by a supplier in the Customs Territory to a purchaser in the ECOZONE shall be treated as an exportation from the Customs Territory. Conversely, sales made by a supplier from the ECOZONE to a purchaser in the Customs Territory shall be considered as an importation into the Customs Territory.
>
> Given the preceding discussion, what would be the VAT implication of sales made by a supplier from the Customs Territory to an ECOZONE enterprise?
>
> The Philippine VAT system adheres to the **Cross Border Doctrine**, according to which, no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority. Hence, **actual export of** goods and **services from the Philippines to a foreign country must be free of VAT**; while, those destined for use or consumption within the Philippines shall be imposed with ten percent (10%) VAT." *(Emphasis supplied)*

Similarly, in the case of *Commissioner of Internal Revenue vs. Sekisui Jushi Philippines, Inc.*[95], the Supreme Court elucidated that:

> "Notably, while an ecozone is geographically within the Philippines, it is deemed a separate customs territory and is regarded in law as foreign soil. Sales by suppliers from outside the borders of the ecozone to this separate customs territory are deemed as exports and treated as export sales. These sales are zero-rated or subject to a tax rate of zero percent."

After examination of AIC's Certificate of Registration with the PEZA[96], the Court finds that the same is not sufficient to prove that AIC was PEZA-registered in taxable year 2005. Considering that the registration is subject to the provisions

[94] G.R. No. 150154, August 9, 2005.
[95] G.R. No. 149671, July 21, 2006.
[96] Exhibit "M" or "HH".

and rules and regulations of Republic Act No. 7916 as well as the terms and conditions of the Registration Agreement, the PEZA registration may be revoked if an entity violates any of the afore-mentioned. It is therefore imperative for petitioner to prove that AIC is registered with PEZA in the year 2005, when the subject sales of goods were made to AIC, to justify the imposition of VAT at zero percent (0%). Absent the required PEZA certification, the Court is constrained to uphold the deficiency VAT assessment.

**D. Unsupported zero-rated sales – ₱90,960,855.70**

Respondent alleged that petitioner failed to substantiate zero-rated sales amounting to ₱90,960,855.70; hence, petitioner was assessed 10% deficiency VAT on the said amount.

While petitioner did not report any zero-rated sale in *Line 20 – Zero-rated Sales/Receipts* of its Quarterly VAT Returns[97] for taxable year 2005, petitioner claims that it made zero-rated sales to the following companies in the amount of ₱90,960,855.70:

| Customer | Amount |
|---|---|
| TS Tech Trim Philippines, Inc. (TTTPI) | ₱ 65,946,656.00 |
| Honda Cars Philippines, Inc. (HCPI) | 25,014,199.70 |
| **Total** | **₱90,960,855.70** |

To prove that sales to the above entities are zero-rated VAT, petitioner presented statements of accounts[98] and sales invoices[99] issued to TTTPI and HCPI, respectively, as well as Certificate of Registration No. 94-94 dated January 20, 1998[100] and Certificate of Registration No. 00-040 dated May 17, 2000[101] issued by PEZA to TTTPI and HCPI, respectively.

Again, the Court finds the PEZA certificates insufficient to prove that TTTPI and HCPI were PEZA-registered in taxable year 2005. Since the registration is subject to the provisions and rules and regulations of Republic Act No. 7916 as well as

[97] Exhibits "FF-1" to "FF-12".
[98] Exhibits "KK.1" to "KK.6".
[99] Exhibits "JJ.1" to "JJ.25".
[100] Exhibit "L".
[101] Exhibit "N".

the terms and conditions of the Registration Agreement, the PEZA registration may be revoked if an entity violates them. Hence, it is necessary for petitioner to prove that TTTPI and HCPI are registered with PEZA in the year 2005, when the subject sales of goods were made to TTTPI and HCPI, to justify the imposition of VAT at zero percent.

Moreover, the statements of accounts presented to prove zero-rated transactions with TTTPI are unacceptable proof of transactions for not being compliant with Section 113(A)(1) and B(2)(c) of the NIRC of 1997, as amended, requiring a **VAT zero-rated invoice** for every zero-rated sale, barter or exchange of goods and properties.

Absent the required PEZA certifications for TTTPI and HCPI and VAT compliant zero-rated sales invoices issued to TTTPI, the Court is constrained to uphold the deficiency VAT assessment.

## E. Sales not subject to VAT – ₱33,736,894.62

According to the Formal Letter of Demand[102], the assessment came from the discrepancy between the sales subjected to VAT per VAT Returns and the sales per AFS. Respondent computed the sales not subjected to VAT as follows:

| | | |
|---|---|---|
| Sales per ITR (Regular rate) | | ₱ 188,353,868.00 |
| Add: Proceeds from sales of fixed assets per cash flow statement | ₱18,649,930.00 | |
| Income from scrap sales FS | 13,698,725.00 | |
| Rental income per FS | 3,340,000.00 | |
| Other income per FS | 347,300.00 | 36,035,955.00 |
| Vatable Sales/ Receipts | | ₱ 224,389,823.00 |
| Less: Adjustments | - | |
| Unsupported Exempt Sales | ₱ 6,597,104.64 | |
| Unsupported Zero-rated sales | 90,960,855.70 | 97,557,960.34 |
| Sales subject to VAT per audit | | ₱ 126,831,862.66 |
| Sales subject to VAT per return | | 93,094,968.04 |
| **Sales not subjected to VAT** | | **₱33,736,894.62** |

[102] Exhibit "10".

As can be deduced from the above table, the assessment is composed of several findings to be discussed individually as follows:

**1. Proceeds from sales of fixed assets per cash flow statement (₱18,649,930)**

Petitioner disposed most of its personal assets in 2005 in preparation for the merger with TTTPI. The total proceeds of ₱18,649,930.00 were reflected in the Statement of Cash Flow[103].

The sales of assets not subjected to VAT were derived by respondent as follows:

| Classification | Transferee | Transfer Price | Net Book Value |
|---|---|---|---|
| Machineries & Equipment | Yashima Sangyo Phils., Inc. | ₱ 11,896,414.78 | ₱ 11,896,414.78 |
| Vehicle | TS Tech Trim Phils, Inc. | 3,025,860.47 | 3,025,860.47 |
| Vehicle | TS Tech Trim Phils, Inc. | 1,909,043.45 | 1,909,043.45 |
| Vehicle | TS Tech Trim Phils, Inc. | 992,646.73 | 992,646.73 |
| Vehicle | Employees of TS Tech | 825,964.57 | 478,864.37 |
| **Total** | | **₱18,649,930.00** | **₱18,302,829.80** |

Based on the Report of the ICPA, the sale of machineries and equipment to Yashima Sangyo Phils., Inc. (YSMI) is evidenced by a contract of sale[104]. YSMI is a PEZA-registered entity under PEZA Registration No. 05-50[105].

On the other hand, vehicles sold to TTTPI, which is also a PEZA-registered entity under PEZA Certification No. 94-94, were supported by journal vouchers enumerated below:

| Amount | Voucher No. | Exhibit No. |
|---|---|---|
| ₱3,025,860.47 | 3282 | **PP.1** |
| 1,909,043.45 | 3284 | **PP.2** |
| 992,646.73 | 3334 | **PP.3** |

Likewise, the vehicles sold to petitioner's employees were supported by Journal Voucher No. 3386[106]. The resulting gain

[103] Exhibit "TTT", Findings and Observations e.1, p. 15.
[104] Exhibit "NN".
[105] Exhibit "OO".
[106] Exhibit "PP.4".

on the sale in the amount of ₱347,100.20 was reported as part of Other Operating Income in the Financial Statements.

In the Petition for Review, petitioner contends that said sales and/or transactions are not made in the course of business of petitioner, thus, are not subject to VAT imposed under Section 106 of the Tax Code.[107]

The Court finds this averment untenable.

Significantly, in *CS Garments, Inc. vs. Commissioner of Internal Revenue*[108], this Court sitting *En Banc* held that sales or transactions in the ordinary course of trade or business include transactions incidental thereto pursuant to Section 105 of the Tax Code, to wit:

> "xxx It further alleged that since its primary business is to engage in the manufacture of garments for sale abroad, the sale of its used company car does not have a direct relevance to petitioner's primary business of manufacturing of garments.
>
> The argument is without merit.
>
> Section 105 of the NIRC of 1997, as amended, states that:
>
>> 'SEC. 105. *Persons Liable*. – Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to value-added tax (VAT) imposed in Sections 106 to 108 of this Code.
>>
>> xxx xxx xxx
>>
>> 'The phrase 'in the ordinary course of trade or business' means the regular conduct or pursuit of a commercial or an economic activity, **including transactions incidental thereto**, by any person regardless of whether or not the person engaged therein is a non-stock, non-profit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively

[107] Par. 26, Petition for Review, docket, p. 9.
[108] CTA EB No. 287 (CTA Case No. 6520), January 14, 2008.

to members or their guests), or government entity. *(Emphasis supplied)*

Based on the foregoing, the VAT is imposed on a sale or transaction entered into by a person in the course of any trade or business. A transaction will be characterized as having been entered into by a person in the course of trade or business if it is: (1) regularly conducted; and (2) undertaken in pursuit of a commercial or economic activity. Likewise, transactions that are made incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business. 'Incidental' means something else as primary; something necessary, appertaining to, or depending upon another, which is termed the principal. Hence, an isolated transaction is not necessarily disqualified from being made incidentally in the course of trade or business.

Here, petitioner's primary business is the manufacturing of garments for sale abroad. In carrying-out its business, petitioner acquired and eventually sold a Mercedes Benz to its General Manager Mr. Sudhoff. Prior to the sale, the motor vehicle formed part of petitioner's capital assets, specifically under the account, 'Property, Plant and Equipment'. The Rules on International Accounting Standards (IAS)16 defines Property, Plant and Equipment as follows:

'6. Definitions

Property, plant and equipment are tangible assets that:

(a) are held by an enterprise **for use in the production or supply of goods or services**, for rental to others, or **for administrative purposes**; and
(b) are expected to be used during more than one period.' *(Emphasis supplied)*

Therefore, the sale of the motor vehicle is an incidental transaction because the said vehicle was purchased and used in furtherance of petitioner's business."

Applying the foregoing, petitioner's sales of vehicles, machineries and equipment were clearly made in the course of its trade or business subject to the 10% VAT.

On the other hand, petitioner also anchors its averments on the fact that it is an entity existing under Republic Act No. 7916. Same is the case with its vendees (TTTPI and YSMI) of machineries and equipment. Then again, as stated earlier, it cannot be ascertained from TTTPI's PEZA Certification of Registration whether it is still duly registered with the PEZA in 2005.

As regards YSMI's PEZA Certification of Registration, the same shows that YSMI was duly registered with the PEZA when the sale transaction occurred in August 2005. However, the sale cannot qualify for VAT zero-rating under Section 106(A)(2)(a)(5) of the NIRC of 1997, as amended, as it is unsupported by VAT zero-rated sales invoice.

**2. Income from scrap sales per FS (₱13,698,725)**

The ICPA verified the income from scrap sales presented in the AFS[109] in the amount of ₱13,698,725.00 and discovered that the account does not consist solely of scrap sales but also includes various income recorded in petitioner's books, broken down as follows:[110]

| Classification | Amount |
|---|---|
| Write-off of long outstanding payables | ₱ 6,067,257.31 |
| Negative balance of bad debts expense | 4,591,772.60 |
| Reversal of accruals | 1,589,928.40 |
| Negative balance of support fees | 1,347,768.66 |
| Scrap sales | 56,023.99 |
| Insurance claim | 25,174.07 |
| Amortization of car loan | 18,000.00 |
| Scrap sales to associate | 2,200.00 |
| Divided income | 600.00 |
| **TOTAL** | **₱13,698,725.03** |

Petitioner submitted General Journal Entries in support of the write-off of long outstanding payables in the amount of ₱6,067,257.31[111], net credit balance of bad debts expense in the amount of ₱4,591,772.60[112], reversal of accruals in the

[109] Exhibit "U", Notes to Financial Statements, Note 17.
[110] Exhibit "TTT", p. 16.
[111] Exhibits "QQ.1" to "QQ.6".
[112] Exhibits "RR.1" to "RR.3".

amount of ₱1,500,000.00[113] and the credit balance of support fees expense amounting to ₱54,590.81[114].

Petitioner argues that the nature of the above transactions is not VATable for it is not a sale or service in the ordinary course of business.

However, these general journals merely showed that the accounting transactions were taken up in the books and eventually presented in the AFS. They are insufficient to prove the existence and the details of the said transactions. Hence, the Court cannot verify the nature and actual circumstances of the said items to be able to arrive at a reasonable understanding of their possible tax consequences. For this reason the Court upholds this particular assessment item.

**3. Rental Income per FS not subjected to VAT (₱3,340,000.00)**

Petitioner entered into a contract of sublease on August 31, 2005 with YSPI, a PEZA-registered entity and is subject to 5% preferential tax rate. The contract of sublease[115] covers the period August 31, 2005 to August 31, 2015 with a contract price of ₱10,020,000 annually, divided by twelve equal monthly installments, payable on the 10th day of each month.

Respondent's assessment was based on petitioner's treatment of the said rental income as a VAT-exempt sale, on account of both petitioner and YSPI being PEZA-registered entities.

It was noted that per the Annual ITR[116], the amount of ₱3,340,000.00 was reported as income subject to 5% Gross Income Tax (GIT) based on the incentives granted by PEZA. For VAT purposes, such rental income is VAT-exempt pursuant to Section 109(K) of the NIRC of 1997, as amended, which states:

[113] Exhibit "SS".
[114] Exhibit "TT".
[115] Exhibit "UU".
[116] Exhibit "T".

"SEC. 109. *Exempt Transactions.* – (1) Subject to the provisions of Subsection (2) hereof, the following transactions shall be exempt from the value-added tax:

xxx xxx xxx

(K) Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, except those under Presidential Decree No. 529;"

Considering the foregoing, the deficiency VAT assessment on rental income in the amount of ₱3,340,000.00 shall be cancelled.

**4. Other income per FS (₱347,300.00)**

The other income allegedly not subjected to VAT is broken down as follows:

| | |
|---|---|
| Gain on sale of transportation equipment to TS Tech employees | ₱ 347,100.00 |
| Dividend Income | 200.00 |
| **Total** | **₱347,300.00** |

As correctly pointed out by the ICPA, the amount of gain on sale of transportation equipment to TTTPI was already covered by the deficiency VAT assessment on the proceeds on sale of assets not subject to 10% VAT.[117] As a result, this item of assessment in the amount of ₱347,100.00 should be canceled.

Anent the dividend income of ₱200.00, since the same is neither a sale of good nor sale of service, the deficiency VAT assessment thereon shall be cancelled.

In fine, the sales not subjected to VAT shall be re-computed as follows:

[117] Exhibit "TTT", Findings and Observations, e.4, p. 18.

| | |
|---|---|
| Proceeds from sales of fixed assets | ₱ 18,649,930.00 |
| Income from scrap sales | 13,698,725.00 |
| **Sales not subjected to VAT** | **₱32,348,655.00** |

### F. Input Tax forwarded to next quarter – ₱7,627,116.81

Petitioner contends that respondent failed to account for the excess input tax as of the end of CY 2005 in the amount of ₱7,627,116.81 reflected in Line 31 of the Quarterly VAT Return for the fourth quarter of CY 2005.[118] Looking at the deficiency VAT computation presented at the beginning of the report, respondent deducted the same from the total available input VAT to be credited against the output VAT liability. Since respondent was not able to provide the factual and legal bases for disallowing such excess input VAT, the Court finds it proper to cancel such disallowance.

### G. Disallowed Input Taxes – ₱607,613.50

The breakdown for the disallowed input taxes as assessed by respondent is illustrated as follows:

| | |
|---|---|
| Unsupported input tax | ₱ 221,210.50 |
| Input tax not found per BOC data | 345,791.00 |
| Input tax - out of period | 40,612.00 |
| **Total** | **₱607,613.50** |

It is observed that these disallowed input VAT arose from the corresponding assessment for deficiency income tax as earlier discussed in items III(C), (D), and (E). Hence, the Court's findings for such items shall extend to the corresponding input VAT assessment.

As a result, the disallowed input tax is revised as follows:

| | **Revised Amount per Deficiency IT Assessment** | **Revised Input Tax** |
|---|---|---|
| Unsupported input tax | ₱ 2,072,692.54 | ₱ 207,269.25 |
| Input tax not found per BOC data | 74,695.20 | 7,469.52 |

[118] Exhibits "FF.11" to "FF.12".

| | | |
|---|---|---|
| Input tax - out of period | 406,120.00 | 40,612.00 |
| | **₱2,553,507.74** | **₱255,350.77** |

In light of the foregoing discussions, petitioner is liable to pay basic deficiency VAT for taxable year 2005 in the amount of ₱10,039,115.13, computed as follows:

| | | | | | |
|---|---|---|---|---|---|
| Vatable Sales per Return | | | | | ₱ 93,094,968.04 |
| Add: | Unaccounted Sales per BOC data | | | ₱ 4,729,965.01 | |
| | Unaccounted Sales per TRS LN vs. CWT vs. ITR | | | 39,472,231.31 | |
| | Exempt Sales (Unsupported) | | | 6,597,104.64 | |
| | Zero-rated Sales (Unsupported) | | | 90,960,855.70 | |
| | Sales not subjected to VAT (Audited F/S vs. VAT returns) | | | 32,348,655.00 | 174,108,811.66 |
| **Vatable Sales per verification** | | | | | **₱ 267,203,779.70** |
| Output Tax Due | | | | | ₱ 26,720,377.97 |
| Less: | Available Input Tax | | | | |
| | Carried over from previous quarter | | | ₱ 5,931,497.59 | |
| | Input Tax (local) | | | 6,402,572.03 | |
| | Input Tax (importation) | | | 4,602,543.99 | |
| | **Available Input Tax** | | | **₱16,936,613.61** | |
| | Less: | Disallowed Input Tax | | | |
| | | Unsupported input tax | ₱207,269.25 | | |
| | | Input tax not found per BOC data | 7,469.52 | | |
| | | Input tax - out of period | 40,612.00 | 255,350.77 | 16,681,262.84 |
| **Basic deficiency VAT** | | | | | **₱ 10,039,115.13** |

## V. COMPROMISE PENALTIES

As regards the imposed compromise penalties, it must be stressed that compromised penalty is imposed to avoid prosecution for violation of the provisions of the Tax Code.[119] Pursuant to Revenue Memorandum Order (RMO) No. 01-90, later amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on a taxpayer in the event that a taxpayer refuses to pay the same. Clearly, the compromise penalty implies a mutual agreement between the parties in respect to the thing or subject matter which is so compromised. The imposition of the compromise penalty without the conformity of the taxpayer is illegal and unauthorized.[120]

[119] *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et al.*, G.R. Nos. L-12928 and L-12932, March 31, 1962.
[120] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.*, G.R. No. 35266, January 21, 1991.

There was nothing in the records which would show that petitioner consented to the compromise penalty. Consequently, the compromise penalty should not be imposed and must be cancelled.

**WHEREFORE**, premises considered, the instant Petition for Review is hereby **DENIED**. The assessments issued by respondent against petitioner for taxable year 2005 covering deficiency expanded withholding tax, withholding tax on compensation, income tax, and value-added tax are hereby **AFFIRMED** but with modifications. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of ₱20,245,996.43 representing deficiency expanded withholding tax, withholding tax on compensation, income tax, and value-added tax, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

| **Deficiency Tax** | **Basic Tax** | **25% Surcharge** | **Total** |
|---|---|---|---|
| Expanded Withholding Tax | ₱ 227,540.80 | ₱ 56,885.20 | ₱ 284,426.00 |
| Withholding Tax on Compensation | 764,116.41 | 191,029.10 | 955,145.51 |
| Income Tax | 5,166,024.81 | 1,291,506.20 | 6,457,531.01 |
| Value-Added Tax | 10,039,115.13 | 2,509,778.78 | 12,548,893.91 |
| **TOTAL** | **₱16,196,797.15** | **₱4,049,199.28** | **₱20,245,996.43** |

In addition, petitioner is **ORDERED TO PAY** the following:

a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency expanded withholding tax, withholding tax on compensation, income tax, and value-added tax computed from the dates indicated below until full payment thereof pursuant to Section 249(B) of the NIRC, as amended;

| | **Basic Tax** | **20% Deficiency Interest Computed from** |
|---|---|---|
| Expanded Withholding Tax | ₱ 227,540.80 | January 15, 2006 |
| Withholding Tax on Compensation | 764,116.41 | January 15, 2006 |
| Income Tax | 5,166,024.81 | April 15, 2006 |
| Value-Added Tax | 10,039,115.13 | April 25, 2006 |

b) Delinquency interest at the rate of 20% per annum on the total amount of ₱20,245,996.43 and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from August 31, 2008 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

**SO ORDERED.**

**AMELIA R. COTANGCO-MANALASTAS**
Associate Justice

**WE CONCUR:**

**JUANITO C. CASTAÑEDA, JR.**
Associate Justice

**CAESAR A. CASANOVA**
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's Division.

**JUANITO C. CASTAÑEDA, JR.**
Associate Justice
Chairperson

## CERTIFICATION

Pursuant to Section 13, Article VIII 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