REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PNZ MARKETING, INCORPORATED,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C. T. A. Case No. 5726

Promulgated:
DEC 14 2001

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DECISION

This Petition for Review filed by herein Petitioner on January 29,1999, seeks for the cancellation and withdrawal of the deficiency income tax assessment issued by the Respondent against Petitioner in the total amount of P678,441.00 for taxable year 1994.

The facts of the case are as follows:

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, engaged in business as importer and dealer of powdered and skimmed milk and other related products, with principal office at 415 Arayat Street, Mandaluyong City.[1]

On April 8, 1998, Petitioner received formal assessment notice no. 000023 (Exhibit A) and Demand letter no. 41-66 (Exhibit B) from herein Respondent stating therein Petitioner's alleged deficiency income tax liability for the year 1994 in the total amount of P678,441.00. As admitted, the alleged deficiency income tax assessment

[1] Joint Stipulation of Facts and Issues, Item No. 1, CTA docket p.38

issued against the Petitioner arose from the following adjustments to Petitioner's income tax return, to wit:

(a) Disallowance of the interest expense in the amount of P1,053,885.00;

(b) Disallowance of the salary expense in the amount of P489,865.35; and

(c) Imputation of unrecorded income in the a nount of P394,625.58.[2]

The alleged deficiency income tax assessment is computed as follows:

Net Business Income			P77,771,848.57
Add: Discrepancies			
Interest Expense (no supporting documents)		P1,053,885.00	
Unrecorded Income			
Professional Fees			
Per alpha list	P 491,467.58		
Per ITR	96,815.00	394,652.58	
Salary Discrepancy			
Per F/S	P2,097,101.00		
Per Alpha List	1,067,235.65	489,865.35	1,938,402.93
Total Income			77,710,251.50
Tax Due			27,198,588.00
Less:			
Tax withheld at Source		1,546,772.00	
Tax Paid per return		24,968,825.00	
Tax Paid per investigation		4,550.00	26,520,147.00
Total Deficiency Tax			P 678,441.00

On May 7,1998, Petitioner, through its external auditor, Sycip Gorres Velayo and Company (SGV & Co.), duly filed with the Bureau of Internal Revenue (BIR) an administrative protest letter.[3] On July 6, 1998, Petitioner filed with the BIR a supplemental protest letter, reiterating its disagreement to the subject income tax assessment.[4]

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[2] *ibid.*, Item No. 4, CTA docket pp.38-39
[3] *ibid.*, Item No. 5, CTA docket p.39, Exhibit C
[4] *ibid.*, Item No. 6, CTA docket p.39, Exhibit D

As no action was undertaken by the Respondent on the aforesaid protest letters, Petitioner filed an appeal with this Court on January 29,1999 in order to toll the running of the prescriptive period.

For his part, Respondent, on March 22, 1999 filed his Answer[5] and raised the following Special and Affirmative defense, thus:

1. That he reiterates and repleads the preceding paragraphs of this answer as part of his Special and Affirmative defenses;

2. That investigation of the Petitioner's internal tax liabilities for the year 1994 revealed a tax obligation of P67,441.00 as deficiency income tax;

3. That the subject deficiency income tax assessment no. 000-059-612 dated April 3,1998 was issued in accordance with law and pertinent regulations;

4. That the disallowance of interest expense in the amount of P1,053,885.00 from gross income for taxable year 1994 was due to the fact of lack of documentation or proof as required under Section 29 of the National Internal Revenue Code;

5. That the disallowance of salary expense in the amount of P489,865.35 was due to the discrepancy between salaries reported per Petitioner's audited financial statements for taxable year 1994 and those reported per alpha list and due to the lack of documentation or proof as required under Section 29 of the National Internal Revenue Code;

6. That Petitioner has unrecorded income in the amount of P394,652.58 as can be seen from the discrepancy arising from the Professional fees reported per Alpha list and that reported per the Petitioner's Income tax return for taxable year 1994;

7. That all presumptions are in favor of the correctness of tax assessments (*CIR vs. Construction Resources of Asia, Inc., 145 SCRA 671*) and the burden of proof to prove otherwise is upon the Petitioner.

As stipulated by the Parties, the issues brought before this Court for consideration are the following:

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[5] Respondent's answer, CTA docket p.25

1. Whether or not the subject income tax assessment is void for failing to comply with the requirements under Section 228 of the Tax code requiring that the law and the facts upon which the assessment is made should be clearly stated;

2. Whether or not Petitioner's interest expense in the amount of P1,053,885.00 is sufficiently supported to qualify as a valid item of deduction from its gross income for the taxable year 1994;

3. Whether or not salary expense in the amount of P489,865.35 should be disallowed as a deductible expense of Petitioner for taxable year 1994 on the alleged ground that said amount was not subjected to withholding tax on compensation for said taxable year;

4. Whether or not Petitioner has unrecorded income for taxable year 1994 in the amount of P394,652.58 which amount represents the difference between the professional fees reported per alpha list for said taxable year and the professional fees reported per the annual corporate Income tax return of Petitioner for said year.

The first issue deals mainly with the sufficiency of the assessment notice insofar as compliance with Section 228 of the Tax Code is concerned. It must be stressed that Section 228 requires the Respondent to inform the taxpayer in writing of the laws and the facts on which the assessment is made, otherwise the assessment shall be void. Simply put, it is incumbent upon the Respondent to show clearly the legal and the factual bases which led him to issue the said deficiency income tax assessment in the first place. The strictness of this rule runs parallel to the due process clause as it obliges the Respondent not only to lay down the law from which the assessment is based but more importantly, the surrounding circumstances supporting the assessment. For it is believed that it is only through a detailed appraisal of its basis that the taxpayer may be able to dispute the imposition or agree with it. (**Abbott Laboratories, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5718, February 16, 2001**)

The case at bar is no exception to the rule. A perusal of the records indicates a successful attempt on Respondent's part to comply with the rules. The assessment notice, while vague at first glance is subsequently cured by the demand letter which shows the legal and factual basis relied upon by the Respondent in issuing the assessment. The demand letter, as thus worded contains the reasons why a deficiency income tax assessment was issued against the Petitioner. It reflects some notable disallowance on the Business expense of the Petitioner for reasons such as the following:

a) interest income has no supporting document pursuant to Section 29;

b) that the income is unrecorded which is factual; and

c) that there is discrepancy in the declared salary expense as provided in Revenue Regulations No. 4-93.

To our mind, these explanations are sufficient compliance with the requirements of Section 228 of the Tax Code.

With regard to the second issue, we rule in favor of the Petitioner. The question of whether the interest expense is a valid item of expense or not has become moot and academic. It must be noted that the Respondent, at the outset disallowed said items on the ground that they were unsupported by pertinent documents. However, Respondent eventually changed its stance. This is evident from the fact that the Respondent, upon receipt of the protest letter filed by the Petitioner issued a revised deficiency income tax assessment for 1994. (see Exhibits J and L) Said revised assessment notice no longer included the disallowance of the alleged unsupported interest expense. Said revision in the assessment notice made us conclude that Respondent was convinced that Petitioner's interest expense for 1994 was fully substantiated and supported by pertinent documents.

As the propriety of the deductibility of the said expense is not being questioned by the Respondent, we have more reason to believe that the interest expense incurred by the Petitioner is indeed a deductible expense.

The third issue involves the discrepancy in the salary expenses declared in the Financial statement vis-a- vis the alpha list. In the case at bar, Respondent disallowed the salary expense in the amount of P489,865.35 for the reason that it doubted the discrepancy between salaries reported per Petitioner's audited financial statements and those reported per alpha list. Respondent, in recommending the said disallowance, theorized that some of the items of the salary expense were not subjected to withholding tax.

This Court does not agree with the Respondent.

Petitioner explained that the amount which Respondent disallowed as an item of deductible expense were for the following:

SSS, Medicare, & Employees Compensation	P 30,046.70
Contractual Services	364,712.87
Medical Expense	11,962.81
13th Month Pay	47,680.86
Vacation Leave	35,462.04
T O T A L	P489,865.28

Logically, these items of expense cannot be included in the Alpha List of salaries subjected to withholding tax due on compensation because some of the items may be exempt from tax and some are subject to expanded withholding tax, thus:

1) SSS, Medicare & Employees compensation contributions are not subject to withholding tax. They are not considered income to the employees because

they correspond to the contributions made by the Employer to the employees. They are however considered deductible expenses on the part of the Employer;

2) The Contractual Services were paid to the contractor JC's Manpower International, Inc., who had the obligation to withhold the tax on the compensation of their workers. It bears stressing that the said amount was not paid to Petitioner's employees but was paid to an employment agency. Petitioner did not pay withholding taxes on employee's compensation but paid corresponding proper expanded withholding tax on contractual services rendered by the agency as evidenced by Exhibits G and G-1;

3) The Medical Expenses are likewise not subjected to withholding tax because of the insignificant amount involved. They are considered falling under Revenue Regulations No. 6-82 which excluded *"de minimis"* from the coverage of the term compensation;

4) The 13th month pay paid to the employees during taxable year 1994 is likewise not subject to tax pursuant to Republic Act No. 7833;

5) And lastly, the monetized Vacation Leaves were properly subjected by the Petitioner to withholding tax as evidenced by the check voucher submitted to this Court.(Exhibit "Q")

We now proceed to the fourth issue.

Respondent maintains that Petitioner has an unrecorded income in the amount of P394,652.58 as can be seen from the discrepancy arising from the Professional Fees reported per Alpha List and that reported per the Petitioner's Income Tax Return for taxable year 1994. The marked discrepancy between what is contained in the Alpha List in the amount of P491,467.58 and that which is reported in the Income Tax Return of P96,815.00 was treated by Respondent as undeclared income in the amount of P394,652.58 (P491,467.58 – P96,815.00).

We find Respondent's findings as to the alleged undeclared income bereft of merit.

First, we would like to point out that there is a big difference between what is considered as an undeclared income from an undeclared expense. The facts of this case clearly show that the professional fees being referred to by Respondent are deductible expense and not income. Petitioner derives its income from importing and selling milk products. It never earned its income from the exercise of profession nor did it render services from which it derived professional fees. Respondent seems to have misconstrued the term expense as being similar to income and this is where his assessment fails. Being considered as an expense and not as income, it would be illogical to conclude that with the underdeclaration of professional fees as business expense, that there would be a corresponding underdeclaration of income. In fact, the Petitioner would even be prejudiced with any reduction to its deductible expense because this would necessarily mean an increase in tax base, and as the tax base increases, the amount of tax payable to the government would likewise increase.

Be that as it may, the question of whether or not the amount of P491,467.58 declared in the Alpha List was also declared in Petitioner's Income Tax Return for taxable year 1994 was answered in the affirmative by the documents submitted as evidence.

The documents disclose that a portion of the P491,467.58 pertained to the professional fees paid to Edna Syquia in the amount of P24,000.00 which was included in the category of "Professional Fees" in the 1994 ITR (Exhibit "R"). The remaining balance of P467.467.58 was included in the ITR under a different category called "Trade Support," the details of which are specified hereunder:

Dina de Jesus (Exhibit W)	-	P 3,600.00
Feliza Idmilao (Exhibit EE)		28,700.00
Ginger Biscocho (Exhibit CC)	-	4,444.45
Manuelita Revilla (Exhibits X, Z & BB)	-	50,900.00
Ma. Josefina A. Pacis (Exhibit BB)	-	222,222.22
Odette Quesada (Exhibit AA)	-	11,111.11
Rosanna M. Marabut (Exhibits V, W & DD)		13,889.80
Sammy Idmilao (Exhibits X, Z & CC)	-	132,600.00
T O T A L		P467,467.58

The imputation of alleged undeclared income is based on a mere presumption that since there were alleged undeclared expenses, there was likewise undeclared income which corresponds to it. While axiomatic is the fact that all presumptions are in favor of the correctness of tax assessments, the assessment in itself should not be based on presumptions no matter how logical the presumption might be. In order to stand the test of judicial scrutiny the assessment must be based on actual facts. In the case at bar, the Court is convinced that the questioned professional fees were validly claimed as expenses.

It seems well-settled that in cases of disputed or contested deficiency assessments, the taxpayer or the Petitioner has the burden of proof to show not only that the assessment issued by the Commissioner of Internal Revenue is wrong but also that he (the taxpayer) is right (**Tan Guan vs Court of Tax Appeals, L-23676, April 27,1967**). And if the taxpayer fails to present evidence or proof in support of his allegations in the Petition for Review, the assessment is much likely to be sustained on appeal. Fortunately, in this case, the presumption in favor of the correctness of the assessment has been overcome by the Petitioner. It was able to establish, at least by the preponderance of evidence that the assessment issued by herein Respondent is indeed erroneous. Respondent, for his part miserably failed to support or at least defend the findings of the examiner embodied in the assessment notice and demand letter. Neither did it submit any BIR records, which would sufficiently substantiate the assessment. Gestures of that sort can be construed as lack of interest on their part to pursue the case against the Petitioner.

WHEREFORE, in view of the foregoing, the instant Petition is hereby **GRANTED**. Accordingly, the questioned Assessment particularly Assessment Notice No. 000023 issued against the Petitioner for the alleged deficiency Income tax of P678,441.00 is deemed **CANCELLED and WITHDRAWN**. Respondent is hereby **ORDERED TO DESIST** from collecting the asses ed Income Tax Deficiency of Petitioner for taxable year 1994.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

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

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge