THIRD DIVISION

RITEGROUP INCORPORATED,
Petitioner,

CTA CASE NO. 8651

-versus-

Members:

BAUTISTA, Chairperson;
FABON-VICTORINO, and
RINGPIS-LIBAN, ***JJ.***

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

JAN 25 2017 10:00 a.m.

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DECISION

RINGPIS-LIBAN, J.

THE CASE

This Petition for Review filed by Ritegroup Incorporated seeks the invalidation and cancellation of the Final Assessment Notice and the Formal Letter of Demand No. 043A-B0282-08 dated January 13, 2012 issued by the Commissioner of Internal Revenue for taxable year (TY) 2008, assessing it for alleged deficiency income tax – ₱7,770,554.22, deficiency value-added tax (VAT) – ₱3,005,918.88, deficiency expanded withholding tax (EWT) – ₱44,763.11, deficiency fringe benefit tax (FBT) – ₱108,087.37, and compromise penalty – ₱12,000.00; or in the aggregate amount of Ten Million Nine Hundred

THE FACTS

Petitioner Ritegroup Incorporated is a domestic corporation duly organized under Philippine laws, engaged in the business of supplying medical and laboratory products. Its principal office is located at Unit 2202 Prestige Tower, Ortigas Jr. Road, Ortigas Center, San Antonio, Pasig City.[1]

On the other hand, respondent is the Commissioner of the Bureau of Internal Revenue (BIR), vested by law with authority to perform the duties of said office, including, among others, the power to assess and collect all national internal revenue taxes, fees and charges, and to enforce all forfeitures, penalties, and fines connected therewith. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On November 23, 2009, respondent issued a Letter of Authority (LA) No. LOA 2008 0049704 and received by petitioner on December 1, 2009, authorizing revenue officers to examine petitioner's books of accounts and other accounting records for all internal revenue taxes covering the period from January 1, 2008 to December 31, 2008.[2]

On July 18, 2011, petitioner received a Notice of Informal Conference dated July 6, 2011.[3] Subsequently, petitioner received a Preliminary Assessment Notice[4] (PAN) on January 4, 2012.

On January 13, 2012,[5] petitioner received a Formal Letter of Demand[6] (FLD) dated January 13, 2012 with Detail of Discrepancies[7] and Final Assessment Notices (FAN)[8], assessing it for alleged deficiency taxes for TY 2008 in the aggregate amount of ₱10,941,323.58, computed as follows:[9]

TYPE	AMOUNT DUE
Deficiency Income Tax	₱ 7,770,554.22
Deficiency Value-added Tax	3,005,918.88
Deficiency Expanded Withholding Tax	44,763.11
Deficiency Fringe Benefit Tax	108,087.37

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1 Par. 1, The Parties, Petition for Review, docket, vol. 1, p. 9
2 Exhibit "P-1", docket, vol. 4, p. 2418; Exhibit "R-2", BIR records, p. 247
3 Par. 2, JSFI, docket, vol. 4, p. 2158; Exhibit "R-3", BIR records, p. 499
4 Par. 3, JSFI, docket, vol. 4, p. 2158; Statement of Material Dates/Facts, Petition for Review, docket, vol. 1, p. 7; Exhibit "R-6", BIR records, pp. 557 to 558
5 Statement of Material Dates/Facts, Petition for Review, docket, vol. 1, p. 7
6 Exhibit "P-26", docket, vol. 4, pp. 2586 to 2588
7 Exhibit "P-26.1", docket, vol. 4, pp. 2589 to 2590
8 Exhibit "P-3", docket, vol. 1, pp. 38 to 42; Exhibit "R-7", BIR records, pp. 564 to 568
9 Par. 5, JSFI, docket, vol. 4, p. 2159

Petitioner disputed the aforesaid FAN on January 26, 2012.[10]

On September 25, 2012, petitioner received a letter dated September 7, 2012 issued by Mr. Jonas DP. Amora, OIC-Regional Director of Revenue Region No. 7, Quezon City, stating that the investigating officer of Revenue District Office (RDO) No. 43A-Pasig City recommended the reiteration of the assessments issued against petitioner.[11] The letter also requested the payment of petitioner's tax liabilities and indicated that it was a final decision.

On October 9, 2012, petitioner filed with the BIR a Letter of Appeal dated October 7, 2012.[12]

Due to inaction of respondent, petitioner filed this Petition for Review on May 7, 2013.[13]

In the Answer[14] filed on July 19, 2013, respondent interposed the following special and affirmative defenses:

> "4. Tax assessments by tax examiners are presumed correct and made in good faith, and all presumptions are in favor of the correctness of a tax assessment unless proven otherwise. *Rizal Commercial Banking Corporation v. Commissioner of Internal Revenue*, G.R. No. 168498, April 24, 2007, 522 SCRA 144;
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> 5. The Petitioner failed to submit ALL RELEVANT SUPPORTING DOCUMENTS to its protest. Hence, the same had become final and demandable under Section 228 of the National Internal Revenue Code of 1997 which states:
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> Sec. 228 Protesting of Assessment.
>
> 'xxx xxx xxx
>
> Such assessment may be protested administratively by filing a request for

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[10] Exhibit "P-4", docket, vol. 4, pp. 2422 to 2425.

[11] Par. 6, JSFI, docket, vol. 4, p. 2159; Exhibit "P-5", docket, vol. 1, p. 52.

[12] Par. 7, JSFI, docket, vol. 4, p. 2159; Exhibit "P-6", docket, vol. 4, pp. 2429 to 2435.

[13] Par. 8, JSFI, docket, vol. 4, p. 2159.

[14] Docket, vol. 2, pp. 1054 to 1058.

by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final. **xxx xxx xxx**'

As a matter of fact, the protest of the Petitioner was denied by Regional Director Jonas DP. Amora in his letter the Petitioner dated September 7, 2012, the basis of which is the Petitioner's failure to submit documents in support of its protest. The Petitioner's Petition for Review even confirmed this fact.

No documentary evidence was presented by the Petitioner to prove that the supporting documents were submitted in the course of the audit investigation. Further, there is likewise no documentary evidence to prove that the supporting documents to the protest were submitted within the sixty day period provided under Section 228 of the National Internal Revenue Code of 1997.

6. The herein Petitioner was fully appraised of the facts and the law on which the Final Assessment was issued. The Final Assessment Notice, Demand Letter and Details of Discrepancies which were all together sent at the same time to the Petitioner, contained, in detail, the manner of computation, the facts on which the assessment was based and the provisions of the law used in arriving at such deficiency assessment. There appears a glaring disparity in the purchases account as declared in the Financial Statement of the Petitioner and that found in the books of accounts of the Petitioner. Nothing in the Financial Statement submitted had explained the aforesaid discrepancy in the purchases account, not even the Notes to the Financial Statement. The Petitioner did not submit any supporting document with respect to its purchases. The discrepancy in the purchases accounts mentioned above should therefore be considered as an overstatement of purchases, which should be disallowed and said disallowance bears several tax consequences;

7. There also appeared a discrepancy in the alphalist submitted by the Petitioner and the Financial Statement/ITR submitted with respect to the Legal and

8. There were no supporting documents submitted to substantiate Meeting and Conference Expense, contrary to the allegations of the Petitioner that it did make available the said documents during the audit investigation. Assuming, without necessarily admitting, that supporting documents were submitted to substantiate the Meeting and Conference Expense, the proofs submitted by the Petitioner does not even bear the company name of the Petitioner as the entity to whom the Official Receipts were issued.

9. The part of the factual basis for assessing the Petitioner deficiency value-added tax is the disallowed input tax commensurate to the disallowed purchases. With the disallowance of the overstated purchases of the Petitioner, it follows that Petitioner should not be allowed to claim input tax deductions for said disallowed purchases.

10. There is no evidence on record to prove that the plane ticket which was subjected to Fringe Benefit Tax is not a First Class Plane Ticket. There is neither any evidence submitted to prove that the purchase of the plane ticket was made for the travel of an employee of the Petitioner to prove actual occurrence of an official business meeting or convention to which Petitioner's representative is an attendee"

Petitioner filed, through registered mail, its Reply[15] on July 31, 2013 and received by the Court on August 5, 2013.

Petitioner filed its Pre-Trial Brief[16] on August 27, 2013; while respondent's Pre-Trial Brief[17] was submitted on September 27, 2013.

On November 14, 2013, petitioner moved to commission Mr. Sonny Bonilla as the Independent Certified Public Accountant for the case,[18] which the Court granted on November 28, 2013.[19]

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[15] Docket, vol. 2, pp. 1060 to 1065.
[16] Docket, vol. 2, pp. 1073 to 1091.
[17] Docket, vol. 3, pp. 2097 to 2101.
[18] Motion for Appointment and/or Commissioning of Independent Certified Public Accountant, docket, vol. 4, pp. 2149 to 2152.
[19] Minutes of the Hearing, docket, vol. 4, p. 2175.

During trial, petitioner presented Mr. Sonny Bonilla, Ms. Mhay Madlangbayan, and Ms. Mayzl Domingo as its witnesses. Thereafter, petitioner formally offered its documentary evidence, which were all admitted by the Court.[22]

On the other hand, respondent presented the following witnesses: Revenue Officers John Byron Jakes T. Lasam and Leyte C. Portugal. Respondent formally offered his documentary evidence, which were all admitted on December 1, 2015.[23]

After the Court considered petitioner's Trial Memorandum (For: Petitioner Ritegroup, Incorporated)[24] filed on February 5, 2016 and the Records Verification Report[25] of the Judicial Records Division dated February 9, 2016 stating that respondent failed to file his Memorandum, the case was declared submitted for decision on February 11, 2016.[26]

THE ISSUES

The parties submitted the following issues[27] to be resolved by this Court:

1. Whether there is basis for respondent in assessing petitioner for the alleged deficiency income taxes;

2. Whether petitioner submitted all the required documents requested;

3. Whether the assessment has become final due to petitioner's failure to submit supporting documents in the reinvestigation and protest;

4. Whether there is basis for respondent in assessing petitioner for the alleged deficiency VAT from the alleged sale of a company vehicle, disallowed input tax, and unaccounted expenses;

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20 Docket, vol. 4, pp. 2158 to 2173.
21 Docket, vol. 4, pp. 2178 to 2186.
22 Resolution dated October 4, 2014, docket, vol. 4, pp. 2531 to 2532 and Resolution dated December 18, 2014, docket, vol. 5, pp. 3482 to 3483.
23 Resolution, docket, vol. 6, pp. 3537 to 3538.
24 Docket, vol. 6, pp. 3549 to 3616.
25 Docket, vol. 6, p. 3617.
26 Resolution, docket, vol. 6, p. 3619.
27 Par. II, JSFI, docket, vol. 4, p. 2160.

has already been paid and settled by the latter;

6. Whether respondent committed grave error in concluding that petitioner is liable for the alleged deficiency FBT for the purchase of a business class ticket for a legitimate business conference, and the use of a company car by the company's sales manager; and

7. Whether petitioner is liable for the alleged deficiency taxes assessed for TY 2008.

The above-enumerated issues can be summarized into two main issues, to wit:

1. Whether the assessment has become final due to petitioner's failure to submit supporting documents in the reinvestigation and protest; and

2. Whether petitioner is liable for the alleged deficiency income tax, VAT, EWT, FBT, and compromise penalty for TY 2008.

RULING OF THE COURT

Before proceeding to the main issue, the Court shall resolve first the timeliness of the filing of this Petition for Review.

Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, provides:

> "SEC. 228. *Protesting of Assessment.* – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however*, That a preassessment notice shall not be required in the following cases:
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> xxx xxx xxx
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> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

duly authorized representative shall issue an assessment based on his findings.

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable."

Relative thereto are Sections 3.1.4 and 3.1.5 of Revenue Regulations (RR) No. 12-99 implementing the aforesaid provision, to wit:

"3.1.4 *Formal Letter of Demand and Assessment Notice.* – The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, *otherwise, the formal letter of demand and assessment notice shall be void* (see illustration in ANNEX B hereof). The same shall be sent to the taxpayer only by registered mail or by personal delivery. If sent by personal delivery, the taxpayer or his duly authorized representative shall acknowledge receipt thereof in the duplicate copy of the letter of demand, showing the following: (a) His name; (b) signature; (c) designation and authority to act for and in behalf of the taxpayer, if acknowledged received by a person other than the taxpayer himself; and (d) date of receipt thereof.

3.1.5 *Disputed Assessment.* – The taxpayer or his duly authorized representative may protest administratively against the aforesaid formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof. xxx the Commissioner or his duly authorized representative, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from date of receipt of the said decision, otherwise, the assessment shall become final, executory and demandable; Provided, however, that if the taxpayer elevates his protest to the Commissioner within (30) days from date of receipt of the final decision of the Commissioner's duly authorized representative, the latter's decision shall not be considered final, executory and demandable, in which case, the protest shall be decided by the Commissioner.

If the Commissioner or his duly authorized representative fails to act on the taxpayer's protest within one hundred eighty (180) days from date of submission, by the taxpayer, of the required documents in support of his protest, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from the lapse of the said 180-day period, otherwise, the assessment shall become final, executory and demandable."

In the present case, petitioner received on September 25, 2012,[28] a copy of the denial of the protest to the FAN issued by OIC-Regional Director Jonas DP. Amora of Revenue Region No. 7, Quezon City. Petitioner then appealed the said denial before respondent on October 9, 2012,[29] which was within the thirty (30)-day period from receipt of such denial by the latter's duly authorized representative. Accordingly, respondent had one hundred eighty (180) days from October 9, 2012 or until April 7, 2013 within which to act on petitioner's protest. However, respondent failed to act on the same; thus, petitioner had thirty (30) days from April 7, 2013 or until May 7, 2013 within which to appeal such inaction.

Since petitioner filed this Petition for Review on May 7, 2013, the same was timely filed.

The Court shall now proceed to resolve the main issues.

Petitioner contends that it is the taxpayer's prerogative to submit documents and to determine what documents should be submitted. Petitioner likewise argues that if the taxpayer chose to submit the protest without supporting documents, it does not invalidate the properly filed protest.

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[28] Exhibit "P-5", docket, vol. 1, p. 52.

[29] Exhibit "P-6", docket, vol. 4, pp. 2429 to 2435.

A perusal of the Protest Letter dated January 26, 2012 shows that petitioner attached a Summary of Comparative Computations. Likewise, further scrutiny of the records reveals that respondent did not require petitioner to submit additional supporting documents pertinent to the protest.

The Court emphasizes that respondent cannot demand from petitioner what type of supporting documents that should be submitted, pursuant to the Supreme Court decision in the case of *Commissioner of Internal Revenue vs. First Express Pawnshop Company, Inc.*[30], which states:

> "The term 'relevant supporting documents' should be understood as those documents necessary to support the legal basis in disputing a tax assessment as determined by the taxpayer. **The BIR can only inform the taxpayer to submit additional documents. The BIR cannot demand what type of supporting documents should be submitted.** Otherwise, a taxpayer will be at the mercy of the BIR, which may require the production of documents that a taxpayer cannot submit." *(Emphasis supplied)*

It is clear from the foregoing that the FAN has not become final due to petitioner's purported failure to submit supporting documents.

Nonetheless, before the Court resolves the main issue of whether petitioner is liable for the deficiency taxes, the Court shall settle first the issue which petitioner presented in its Memorandum.

Petitioner claims that the LA, by virtue of which the subject FAN was issued, was not revalidated after 120 days from the date of its issuance. Petitioner posits that under Revenue Memorandum Order (RMO) No. 38-88 and Revenue Memorandum Circular (RMC) No. 40-2006, a revenue officer is allowed only one hundred twenty (120) days from the date of receipt of the LA by the taxpayer to conduct the audit and submit the required report of investigation; and if the revenue officer is unable to submit such report within the 120-day period, he must then submit a progress report to his Head of Office and surrender the LA for revalidation.

Section 13 of the NIRC of 1997, as amended, states:

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[30] G.R. Nos. 172045-46, June 16, 2009.

assigned to perform assessment functions in any district may, pursuant to a Letter of Authority issued by the Revenue Regional Director, examine taxpayers within the jurisdiction of the district in order to collect the correct amount of tax or to recommend the assessment of any deficiency tax due in the same manner that the said acts could have been performed by the Revenue Regional Director himself."

Corollary thereto is RMC No. 23-09 which provides that failure of the revenue officer to request for revalidation of LA or the expiration of the revalidation period does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued, to wit:

"I. *Revalidation of LAs*

The revalidation of LA shall give rise to the extension of the period within which the Revenue Officer (RO) assigned to the case shall submit the report of investigation to higher authorities for review and approval, without the imposition of applicable administrative sanctions. Depending on the classification of the pending tax case, said extension period shall be equivalent to the original prescribed number of days within which to report the case under existing revenue issuances. Failure on the part of the RO to request for the revalidation of LA or the expiration of the 'revalidation period' does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued. However, this shall be considered as a ground for the imposition of disciplinary action and demerit in the performance rating of the concerned RO, including the reassignment of the case to another RO if the Regional Director, upon the recommendation of the Revenue District Officer, deems it necessary."

It is noteworthy that RMC No. 23-09 was issued on April 16, 2009 and the subject LA was issued on November 23, 2009 and received by petitioner on December 1, 2009.

The Court shall now proceed to determine whether petitioner is liable for deficiency taxes.

amount of ₱10,941,323.58, inclusive of surcharge, interest and compromise penalty, broken down as follows:

Tax Type	Basic	Surcharge	Interest	Total
Income Tax	₱ 4,960,217.37		₱ 2,810,336.85	₱ 7,770,554.22
VAT	1,867,189.23		1,138,729.65	3,005,918.88
EWT	27,701.82		17,061.29	44,763.11
FBT	57,877.05	₱ 14,469.26	35,741.06	108,087.37
Compromise Penalty				12,000.00
Total	**₱ 6,912,985.47**	**₱ 14,469.26**	**₱ 4,001,868.85**	**₱ 10,941,323.58**

I. Deficiency Income Tax – ₱7,770,554.22 and Deficiency EWT – ₱44,763.11

Respondent found petitioner liable for deficiency income tax for TY 2008 in the amount of ₱7,770,554.22, computed as follows:[32]

Taxable income per ITR		₱ 692,012.00
Add: Adjustments per investigation:		
Disallowed purchases	₱ 12,511,344.83	
Disallowed meetings & conferences expense	662,134.85	
Non-deductible representation expense	83,151.32	
Unaccounted expenses	430,364.97	
Income payments not subjected to withholding tax	524,031.00	
Disallowed donation	48,557.65	
Disallowed expenses	27,348.00	14,286,932.62
Taxable income per investigation		₱ 14,978,944.62
Income tax due thereon (35%)		₱ 5,242,630.62
Less: Allowed tax credits/payments:		
Prior year's excess credits	₱ 19,029.00	
Payments	82,907.25	
Creditable withholding tax	180,477.00	282,413.25
Deficiency Income Tax		₱ 4,960,217.37
Add: 20% Interest p.a. (04.16.09 to 2.13.12)		2,810,336.85
TOTAL AMOUNT DUE		**₱ 7,770,554.22**

In order to determine whether petitioner is liable for deficiency income tax, the Court shall scrutinize the propriety of each of the following items:

1. Disallowed Purchases	₱12,511,344.83
2. Disallowed Meetings and conferences expense	662,134.85

[31] Exhibit "P-3", docket, vol. 1, pp. 38 to 47.

[32] Exhibit "P-3", docket, vol. 1, p. 44.

6. Disallowed Donation		48,557.65
7. Disallowed expenses	₱	27,348.00

1. Disallowed Purchases – ₱12,511,344.83

Respondent's verification disclosed that the purchases reported in petitioner's financial statements (FS) in the amount of ₱20,771,606.00 were overstated by ₱12,511,344.83 as compared to the amount of ₱8,260,261.17 recorded in petitioner's books. Thus, respondent disallowed the discrepancy of ₱12,511,344.83 as deduction from petitioner's gross income pursuant to Section 34(A) of the NIRC of 1997, as amended.

In his Answer to the instant Petition, respondent has stated that nothing in petitioner's FS, not even in the Notes to FS, explained the discrepancy on purchases, and petitioner did not submit any document to support the said purchases.

On the other hand, petitioner argues that it was not informed that lack of supporting documents for the purchases was the basis for disallowance, or the fact of payment for purchases was ever put into question. According to petitioner, it should have been informed that the assessment was due to failure to present supporting documents relative to the purchases. It is only now before this Court that respondent raised for the first time the issue of substantiation of unrecorded purchases. Allegedly, respondent's failure to inform petitioner violated petitioner's right to due process; hence, the FAN must be cancelled outright.

Petitioner also contends that the disallowed purchases were, in large part, importations of products for resale, and as such, were ordinary and necessary expenses directly attributable to the conduct of its trade. Even though these purchases were not recorded in its books, the accurate and complete figures representing the same were purportedly reported in its FS and were duly substantiated.

The Court finds that the assessment should be partially upheld.

Contrary to its claim, petitioner knew from the time the Notice for Informal Conference[33] until the PAN[34] and the FANs/FLD[35] were issued that the basis of respondent's assessment is the issue of substantiation of its

[33] Exhibit "R-3", BIR records, pp. 496 to 499.
[34] Exhibit "R-6", BIR records, pp. 554 to 558.
[35] Exhibit "R-7", BIR records, pp. 559 to 568.

and/or official receipts in support of the disallowed purchases of ₱12,511,344.83 were available for examination and substantiation. Petitioner has further indicated therein that the sales invoices and/or official receipts sufficiently meet the substantiation requirements as prescribed by Section 34(A)(1)(b) of the NIRC of 1997, as amended. In view thereof, petitioner cannot argue now that it was denied of due process.

Petitioner has been properly informed in writing of the factual and legal bases of the subject assessment pursuant to Section 228 of the NIRC of 1997, as amended. It is clearly stated in the Details of Discrepancies attached to the PAN and FANs/FLD that respondent disallowed the amount of ₱12,511,344.83 representing the overstatement/difference found in petitioner's claimed purchases per FS *vis-à-vis* those reflected in its books citing as legal basis Section 34(A) of the NIRC of 1997, as amended, the pertinent portions of which state:

> "SEC. 34. *Deductions from Gross Income.* – xxx, there shall be allowed the following deductions from gross income:
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> (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, including:
>
> xxx xxx xxx
>
> (b) *Substantiation Requirements.* – No deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management,

[36] BIR records, pp. 507 to 510.
[37] Exhibit "P-4", docket, vol. 4, pp. 2422 to 2428.
[38] Exhibit "P-6", docket, vol. 4, pp. 2429 to 2435.

Based on the above provision, ordinary and necessary business expense, such as purchases in the instant case, shall be allowed as deduction from gross income, provided that the same is supported by sufficient evidence such as official receipts or other adequate records.

Records show that petitioner erred in reflecting the amounts of ₱13,883,739.00 and ₱11,475,415.00 as Merchandise Inventory–January 1, 2008 and Purchases for the year 2008, respectively, in Note 10[39] of its Notes to FS. The amount of ₱20,771,606.00 (rounded off) has been used by respondent as purchases in computing the correct amount of petitioner's Merchandise Inventory–January 1, 2008; and it was based on the latter's General Ledger-Trial Balance[40], thus:

Merchandise Inventory, Dec. 31, 2008	₱ 10,855,944.01
Add: Cost of Sales	14,503,210.38
Cost of Goods Available for Sale	25,359,154.39
Less: Merchandise Inventory, Jan. 1, 2008	4,587,548.05
Purchases for 2008	**₱20,771,606.34**

In support of its purchases for TY 2008, petitioner has submitted various sales invoices, official receipts, Bureau of Customs (BOC) Import Entry and Internal Revenue Declarations (IEIRDs), Import Entry Declarations (IEDs) and other documents[41] which were examined by the Court-commissioned Independent Certified Public Accountant (ICPA), Mr. Sonny S. Bonilla. The latter has accounted petitioner's purchases covering TY 2008 amounting to ₱20,645,983.65 as follows:[42]

Findings	Amount	Exhibit No.
A. Allowed Purchases with supporting documents		
Importation with IED-original	₱ 7,179,607.36	"P-35" to "P-35.14"
Importation with IED-photocopy only	4,955,880.78	"P-36" to "P-36.22"
Importation with BOC Form-original	715,851.85	"P-37" to "P-37.9"
Difference of landed cost between actual docs versus schedule per VAT	*20,647.11	"P-36.1", "P-37.8", "P-36.18"
Other importation charges	1,203,270.71	"P-39" to "P-39.131B"
Local purchases for resale	5,021,159.27	"P-32" to "P-32.267"
Subtotal	**₱ 19,096,417.08**	
B. Exceptions noted		
Unsubstantiated importation	₱ 109,758.34	
Double take up of input of importation	610,683.33	"P-36.18"

39 Exhibit "P-29", docket, vol. 4, p. 2595.

40 BIR records, pp. 369 to 404.

41 Exhibits "P-32" to "P-32.267", "P-35" to "P-35.14", "P-36" to "P-36.23", "P-37" to "P-37.9", and "P-39" to "P-39.131B."

42 Exhibit "P-67", docket, vol. 4, p. 2287.

Unsubstantiated other charges of importation	403,704.58	
Subtotal	**₱ 1,549,566.57**	
Grand Total	**₱ 20,645,983.65**	

**The amount per ICPA's summary is 20,606.74 but the correct amount stated above was based on page 5 of the ICPA Report.*

Of the exceptions noted by the ICPA, the local purchases with variance of ₱10,761.03[43] pertained to the amounts included per supporting documents but not part of petitioner's claimed purchases per schedule, and are also included in the ₱5,021,159.27 local purchases for resale allowed by the ICPA. As a result, the amount of ₱10,761.03 has been erroneously accounted twice by the ICPA. Since the amount of ₱10,761.03 is duly supported with sales invoices, it is properly included in the amount of ₱5,021,159.27 local purchases for resale allowed by the ICPA, hence, reducing the exceptions noted by the ICPA to ₱1,538,805.54 and the total purchases as accounted for by the ICPA to ₱20,635,222.62.

Aside from the recommended disallowed purchases by the ICPA in the amount of ₱1,538,805.54, the amount of ₱136,383.38, representing the difference between petitioner's claimed purchases of ₱20,771,606.00 and the amount of ₱20,635,222.62 purchases accounted by the ICPA, shall be disallowed as deductions from gross income for being unsupported.

Further verification of the ICPA's findings on purchases with valid documents reveals that purchases amounting to ₱2,247,981.74 should also be disallowed for the reasons stated hereunder:

Reason for disallowance	Reference / Exhibit No.	Disallowed Purchases
Importation with original copy of IED	Annex "C", Exhibit "P-67" (Brown Envelope)	
Amount per IED (₱407,423.31) is lower than the amount of purchase per schedule (₱423,253.79) /overclaim	"P-35.5"	₱ 15,830.48
Subtotal		**₱ 15,830.48**
Importations with photocopied IEDs	Annex "D",Exhibit "P-67" (Docket,Vol.5, p. 3032)	
Supported by Land Bank of the Philippines (LBP) OR but VAT amount was not separately shown; amount of purchase cannot be determined therefrom	"P-36.A"	₱ 333,321.43
Supported by LBP OR but VAT amount was not separately shown; amount of purchase cannot be determined therefrom	"P-36.2.D"	425,956.39
Supported by LBP OR but VAT amount was not separately shown; amount of purchase cannot be determined therefrom	"P-36.3.B"	113,907.69

43 Exhibit "P-67", docket, vol. 4, p. 2265.

Supported by LBPOR but VAT amount was not separately shown; amount of purchase cannot be determined therefrom	"P-36.20.B"		162,813.40
Supported by LBP OR but VAT amount was not separately shown; amount of purchase cannot be determined therefrom	"P-36.21-B"		165,768.14
Supported by photocopies of IEDs and copy of computation only	"P-36.23" to "P-26.23.A"		50,957.86
Subtotal		**₱**	**1,924,187.55**
Importation with original copies of BOC Form (Official Receipt)	Annex "E" of Exhibit "P-67" (Brown Envelope)		
Unreadable BOC OR but with LBP OR; amount of purchase based on LBP OR (₱154,133.33) is lower the amount indicated per schedule (₱221,533.33) /overclaim	"P-37" to "P-37.A"	₱	67,400.00
BOC OR not dated	"P-37.3"		14,875.00
Subtotal		**₱**	**82,275.00**
Other importation charges	Annex "G" of Exhibit "P-67" (Brown Envelope)		
Discrepancy in the total amount of purchases per summary (₱1,203,270.71) and per schedule of the same ICPA Report (₱1,169,424.10)	Page 8; Annex "G" of Exhibit "P-67" (Docket, Vol. 4, p. 2267; Brown Envelope)	₱	33,846.61
Supported by Debit/Credit Note dated outside the taxable year 2008	"P-39.1"		676.20
Supported by unreadable invoice	"P-39.10"		3,649.56
Supported by OR issued not in the name of petitioner	"P-39.75"		2,634.45
Purchases listed twice per schedule	"P-39.56" ,"P-39.93"		8,600.00
Supported by documents dated outside the taxable year 2008	"P-39.106" to "P-39.106.B"		12,995.37
VAT amount was included in the amount of purchase per schedule; supported by VAT OR without TIN and address of petitioner and VAT amount was not separately shown	"P-39.107.A", "P-39.107"		1,419.60
Subtotal		**₱**	**63,821.79**
Local purchases for resale	Annex "F" of Exhibit "P-67" (Brown Envelope)		
Supported by document with unreadable details	"P-32.20"	₱	24,720.00
Supported by document with unreadable details	"P-32.53"		32,208.00
Supported by document with unreadable details	"P-32.75"		43,323.25
Supported by VAT invoice not dated and without TIN of petitioner	"P-32.101"		4,944.00
Supported by VAT invoice with unreadable date and without TIN of petitioner	"P-32.165"		19,776.00
Supported by document with unreadable details	"P-32.232"		4,187.31
Supported by document with unreadable details	"P-32.239"		3,908.36
Supported by document with unreadable details	"P-32.240"		28,800.00
Subtotal		**₱**	**161,866.92**
Total		**₱**	**2,247,981.74**

In sum, petitioner's purchases for TY 2008 that shall be disallowed as deductions from gross income would amount only to ₱3,923,170.66, computed as follows:

purchases of ₱20,635,222.62 accounted by the ICPA	150,965.58
Additional disallowances per the Court's further verification	2,247,981.74
Total Disallowed Purchases	**₱3,923,170.66**

2. Disallowed meetings and conferences expense – ₱662,134.85

Respondent disallowed the meetings and conferences expense of ₱662,134.85 for petitioner's failure to fully substantiate the same with necessary documentary evidence, pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended. The disallowance was derived as follows:[44]

Meetings and conferences per F/S	₱1,344,695.00
Meetings and conferences with proper documents	682,560.15
Disallowed Meetings and conferences expense	**₱662,134.85**

Petitioner asserts that during trial, it presented Exhibit "P-10"[45] consisting of official receipts, invoices and other proof of payments for expenses incurred during meetings and conferences. The said supporting documents are allegedly made available to the revenue officers during their audit, and even submitted for the convenience of respondent as Annexes to the Letter[46] Appeal dated October 7, 2012.

According to petitioner, even assuming for the sake of argument that it has failed to fully substantiate these expenses, it is not proper to have the entire amount of expenses disallowed. Citing the cases of *Mariano Zamora vs Collector of Internal Revenue and Court of Tax Appeals*[47] and *Visayan Cebu Terminal Co., Inc. vs Collector of Internal Revenue*[48], petitioner prays that at least fifty percent (50%) of the expenses be allowed as valid deduction.

The Court finds the assessment in order.

As provided by Section 34(A)(1)(b) of the NIRC of 1997, as amended, the substantiation requirement for deductibility of expenses requires sufficient evidence, such as official receipts or other adequate records.

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44 Exhibit "P-3", Detail of Discrepancies, Item I.b, docket, vol. 1, p. 46.
45 Docket, vol. 4, pp. 2438 to 2439.
46 Exhibit "P-6", docket, vol. 4, pp. 2429 to 2435.
47 G.R. No. L-15290, May 31, 1963.
48 G.R. No. L-12798, May 30, 1960.

construed against the taxpayer, who must prove by convincing evidence that he is entitled to the deduction claimed.[50]

A perusal of Exhibit "P-10" shows that it is not what petitioner purports it to be, but it is a mere schedule or summary of expenses which is self-serving. It is not, in itself, sufficient to prove petitioner's claimed meetings and conferences expenses, unless it is accompanied by pertinent invoices and/or official receipts, which petitioner failed to submit before this Court.

Likewise, the Court finds no merit in petitioner's invocation of the "50% rule, in the absence of receipts to prove actual amount of expense deduction", which was enunciated in the cases of *Mariano Zamora* and *Visayan Cebu Terminal Co., Inc.*, and reiterated in Section 2.4(c) of Revenue Memorandum Circular No. 23-00 as follows:

> "2.4 *Existing Revenue Procedures and Jurisprudence Governing Assessment Based on the Best Evidence Obtainable.* – Provided hereunder are the existing revenue procedures and jurisprudence governing issuance of a deficiency tax assessment based on the best evidence obtainable:
>
> xxx xxx xxx
>
> (c) *Assessment Based on Estimate; 50% Rule, in the Absence of Receipts to Prove Actual Amount of Expense Deduction.* — The Court held in the Mariano Zamora case that, if there is a showing that expenses have been incurred but the exact amount thereof cannot be ascertained due to absence of documentary evidence, it is the duty of the BIR to make an estimate of the deduction that may be allowable in computing the taxpayer's taxable income, bearing heavily against the taxpayer whose inexactitude is of his own making. That disallowance of 50% of the taxpayer's claimed deduction is valid."

Based on Section 2.4(c) of RMC No. 23-00, the "50% rule" is to be resorted to by respondent when no invoices or receipts are submitted by the taxpayer to prove its claimed expense deduction. In the instant case, petitioner has presented documents supporting its claimed meetings and conferences expenses up to a certain extent, which respondent ascertained to be amounting

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49 *H. Tambunting Pawnshop, Inc. vs. Commissioner of Internal Revenue*, G.R. No. 173373, July 29, 2013.

50 *Philex Mining Corporation vs. Commissioner of Internal Revenue*, G.R. No. 148187, April 16, 2008.

thereof in the amount of ₱682,560.15 as substantiated. Only the remaining 49% amounting to ₱662,134.85 has been disallowed by respondent for being unsupported. Even if the Court applies the 50% rule, the amount of ₱682,560.15 allowed by respondent as deduction from petitioner's gross income is even greater than the amount of ₱672,347.50 representing 50% of the total claimed expense of ₱1,344,695.00.

In fine, petitioner has failed to discharge its burden of proof as to the substantiation of its meetings and conferences expense in the amount of ₱662,134.85; hence, the disallowance of the same is sustained.

3. Non-deductible representation expense – ₱83,151.32

Finding that petitioner's representation expense per FS exceeded the statutory limit, the excess amount over the limitation was assessed by respondent as non-deductible, pursuant to RR No. 10-2002.[51]

According to respondent's tax audit, while the representation expense per FS was ₱127,684.00, there were expenses included as part of meetings and conferences and travel and transportation expenses which were in the nature of representation, thus, exceeding the limit amounting to ₱83,151.32.[52]

Petitioner, on the other hand, argues that the representation expense it claimed as deduction is well within the statutory limit. Allegedly, respondent has failed to provide the basis for his finding in all of his notices and communications sent to petitioner in violation of the latter's right to due process, as embodied in Section 228 of the Tax Code; hence, the assessment must be struck down for being void.

The Court agrees with petitioner.

A scrutiny of the notices and communications[53] issued by respondent to petitioner indicates that other than stating that the assessed amount of ₱83,151.32 is in excess of the prescribed limit, no further details have been provided. Respondent has never indicated how the amount of ₱83,151.32 was arrived at. Furthermore, respondent's finding that some expenses lodged in the meetings and conferences and travel and transportation expenses are in the nature of representation causing to exceed the limit, is a mere statement

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51 Exhibit "P-3", Detail of Discrepancies, Item I.c, docket, vol. 1, p. 46.

52 Exhibit "R-4", BIR records, p. 518.

53 Exhibits "R-3" to "R-4" and "R-6" to "R-7", BIR records, pp. 496 to 499, pp. 517 to 518, pp. 554 to 558, and pp. 559 to 568, respectively.

assessed amount of ₱83,151.32.

It is a mandatory requirement under Section 228 of the NIRC of 1997, as amended, as implemented by RR No. 12-99, that a taxpayer shall be informed not only of the law but also of the facts on which the assessment is made; otherwise, the assessment shall be void. This is in consonance with the due process requirement of the 1997 Philippine Constitution, which provides that "no person shall be deprived of his property without due process of law." The taxpayer needs to know the nature of the examiner's findings in order to be able to properly contest the same and submit supporting documents. In the case of *Commissioner of Internal Revenue vs. United Salvage and Towage (Phils.), Inc.*[54], the Supreme Court ruled as follows:

> "xxx Any short-cuts to the prescribed content of the assessment or the process thereof should not be countenanced, in consonance with the ruling in *Commissioner of Internal Revenue v. Enron Subic Power Corporation* to wit:
>
> xxx xxx xxx
>
> 'We disagree. ***The advice of tax deficiency, given by the CIR to an employee of Enron, as well as the preliminary five-day letter, were not valid substitutes for the mandatory notice in writing of the legal and factual bases of the assessment.*** These steps were mere perfunctory discharges of the CIR's duties in correctly assessing a taxpayer. ***The requirement for issuing a preliminary or final notice, as the case may be, informing a taxpayer of the existence of a deficiency tax assessment is markedly different from the requirement of what such notice must contain. Just because the CIR issued an advice, a preliminary letter during the pre-assessment stage and a final notice, in the order required by law, does not necessarily mean that Enron was informed of the law and facts on which the deficiency tax assessment was made.***

54 G.R. No. 197515, July 2, 2014 citing *Commissioner of Internal Revenue vs. Enron Subic Power Corporation*, G.R. No. 166387, January 19, 2009 and *Commissioner of Internal Revenue vs. Azucena T. Reyes*, G.R. No. 159694, January 27, 2006.

cannot be presumed. Otherwise, the express provisions of Article 228 of the NIRC and RR No. 12-99 would be rendered nugatory. The alleged 'factual bases' in the advice, preliminary letter and 'audit working papers' did not suffice. There was no going around the mandate of the law that the legal and factual bases of the assessment be stated in writing in the formal letter of demand accompanying the assessment notice.

> We note that the old law merely required that the taxpayer be notified of the assessment made by the CIR. This was changed in 1998 and the taxpayer must now be informed not only of the law but also of the facts on which the assessment is made. Such amendment is in keeping with the constitutional principle that no person shall be deprived of property without due process. In view of the absence of a fair opportunity for Enron to be informed of the legal and factual bases of the assessment against it, the assessment in question was void. xxx.'

In the same vein, we have held in *Commissioner of Internal Revenue v. Reyes*, that:

> 'Even a cursory review of the preliminary assessment notice, as well as the demand letter sent, reveals the lack of basis for – not to mention the insufficiency of – the gross figures and details of the itemized deductions indicated in the notice and the letter. ***This Court cannot countenance an assessment based on estimates that appear to have been arbitrarily or capriciously arrived at.*** Although taxes are the lifeblood of the government, their assessment and collection 'should be made in accordance with law as any arbitrariness will negate the very reason for government itself.'

Applying the aforequoted rulings to the case at bar, it is clear that the assailed deficiency tax assessment for the EWT in 1994 disregarded the provisions of Section 228 of the Tax Code, as amended, as well as Section 3.1.4 of Revenue Regulations No. 12-99 by not providing the legal and factual bases of the

Accordingly, insofar as the non-deductible representation expense of ₱83,151.32 is concerned, the assessment is void for respondent's failure to inform petitioner of the specific facts on which the said assessment was based in violation of Section 228 of the NIRC of 1997, as amended, and RR No. 12-99.

Nonetheless, the Court finds that petitioner's claimed representation expense in the amount of ₱127,684.00 is a valid deduction against its taxable gross income.

Sections 2 and 5 of RR No. 10-02, as quoted hereunder, provide for the limit on entertainment, amusement and recreation expense, including representation expense, which may be claimed as deductions:

> "SECTION 2. *Definition of Terms.* – For purposes of these Regulations, the term '*Entertainment, Amusement and Recreation Expenses'* includes representation expenses and/or depreciation or rental expense relating to entertainment facilities, as described below.
>
> The term '*Representation Expenses'* shall refer to expenses incurred by a taxpayer in connection with the conduct of his trade, business or exercise of profession, in entertaining, providing amusement and recreation to, or meeting with, a guest or guests at a dining place, place of amusement, country club, theater, concert, play, sporting event, and similar events or places. For purposes of these Regulations, representation expenses shall not refer to fixed representation allowances that are subject to withholding tax on wages pursuant to appropriate revenue regulations.
>
> xxx xxx xxx
>
> SECTION 5. *Ceiling on Entertainment, Amusement, and Recreation Expense.* – There shall be allowed a deduction from gross income for entertainment, amusement and recreation expense, as defined in Section 2 of these Regulations, in an amount equivalent to the actual entertainment, amusement and recreation expense paid or incurred within the taxable year by the taxpayer, but in no case shall such deduction exceed 0.50 percent (%) of net sales (*i.e.*,

Applying the above provision, petitioner being engaged in the sale of food and medical products to hospitals[55], its allowable representation expense shall not exceed 0.50% of its net sales of ₱26,190,642.00[56]. Therefore, its ceiling for representation expense amounts to ₱130,953.21 (₱26,190,642.00 x .005). Clearly, the claimed representation expense of ₱127,684.00[57] does not exceed or even reach the ceiling of ₱130,953.21. Consequently, the whole amount claimed shall be allowed as deduction from gross income.

4. Unaccounted expenses – ₱430,364.97

Based on respondent's verification, the following expenses per petitioner's alphalist were not fully reported in its FS/ITR resulting in an unaccounted source of cash which led to the inference that part of its income had not been declared:[58]

	Per Alphalist	**Per FS/ITR**	**Difference**
Legal and notarial expenses	₱318,166.63	₱233,331.00	₱ 84,835.63
Rent expense	₱586,489.34	₱240,960.00	345,529.34
Unaccounted expenses			**₱430,364.97**

The Court finds the assessment without merit.

It is worthy to note that the imputation of alleged undeclared income is based on a mere presumption that since there were undeclared expenses, there were corresponding undeclared income. Even if these alleged unaccounted expenses are to be treated as unaccounted sources of income, the same will be offset by recording the equivalent payments as expenses. As such, no taxable income will result from the said transactions.

While it is axiomatic that all presumptions are in favor of the correctness of tax assessments, the assessment 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.[59]

For lack of factual basis, the deficiency income tax assessment pertaining to the alleged undeclared income from unaccounted expenses of ₱430,364.97 is cancelled.

55 Notes to Financial Statements, Note 1, BIR records, p. 255.
56 Exhibit "P-27", Line 17C, docket, vol. 4, p. 2591.
57 Exhibit "P-28", docket, vol. 4, p. 2594.
58 Exhibit "P-3", Detail of Discrepancies, Item I.d, docket, vol. 1, p. 46.
59 *Collector of Internal Revenue vs. Benipayo*, G.R. No. L-13656, January 31, 1962.

Respondent disallowed the following income payments in the amount of ₱524,031.00 for petitioner's failure to subject the same to withholding tax, pursuant to RR No. 02-98, as amended; thus, petitioner was assessed for the corresponding deficiency EWT in the amount of ₱44,763.11, computed as follows:[60]

	Per FS	Per Alphalist	Difference
Payments to contractors/sub-contractors:			
Repairs and maintenance	₱107,162.00		
Delivery expenses	62,352.00		
Advertising and promotion	139,252.00		
Total	₱308,766.00	-	₱ 308,766.00
Incentives and commissions	215,265.00	-	215,265.00
Income payments not subjected to withholding tax			**₱524,031.00**
		Tax Rate	**Tax Due**
Payments to contractors/sub-contractors:	₱308,766.00	2%	₱ 6,175.32
Incentives and commissions	215,265.00	10%	21,526.50
Deficiency Expanded Withholding Tax			₱ 27,701.82
Add: 20% Interest p.a. (01.16.09 to 02.13.12)			17,061.29
Total Deficiency EWT			**₱ 44,763.11**

In its letter of appeal[61] to the BIR Commissioner, petitioner has pointed out that it already settled the related 2% deficiency EWT on the repairs and maintenance, delivery expenses and advertising and promotion; while the incentives and commissions amounting to ₱215,265.00 were properly reported in its BIR Form No. 1601E and BIR Form No. 1604E.

Petitioner has presented its Payment Form (BIR Form No. 0605) and the related Transaction Acknowledgement and EFPS Payment Form[62] proving that it paid on October 9, 2012, the amount of ₱6,175.32 representing 2% deficiency EWT due on the repairs and maintenance, delivery expenses and advertising and promotion in the total amount of ₱308,766.00. In view of the said payment, the deficiency income tax assessment on the disallowed expense deductions of ₱308,766.00 is cancelled. On the other hand, while the basic deficiency EWT assessment is cancelled, petitioner is still liable to pay the amount of ₱6,250.10, representing 25% surcharge, 20% deficiency and delinquency interest, pursuant to Sections 248(A)(3), 249(B) and (C) of the NIRC of 1997, as amended, computed as follows:

Basic deficiency EWT	₱ 6,175.32

[60] Exhibit "P-3", FLD and Detail of Discrepancies, Items I.3 and III, docket, vol. 1, pp. 44 and 46.
[61] Exhibit "P-6", docket, vol. 4, p. 2432.
[62] Exhibit "P-21", docket, vol. 4, pp. 2508 to 2512.

(₱6,175.32 x 20% x 1,349/365 days)	4,564.66
from Sept. 25, 2012 to Oct, 9, 2012	
(₱6,175.32 x 20% x 14/365 days)	47.37
20% Delinquency Interest from Sept. 25, 2012 to Oct. 9, 2012	
on basic deficiency EWT and surcharge	
[(₱6,175.32+₱1,543.83) x 20% x 14/365 days]	59.22
on deficiency interest due for Jan. 15, 2009 to Sept. 25, 2012	35.02
(₱4,564.66 x 20% x 14/365)	
Total Amount Due	12,425.42
Less: Payment on October 9, 2012	
Basic Tax	6,175.32
Amount Still Due	**₱6,250.10**

As to the incentives and commissions, petitioner has failed to prove that it properly withheld and remitted the EWT due thereon. The vouchers[63] presented by petitioner in support of the incentives and commissions do not prove the fact of withholding. Even though it can be gleaned from the second page of petitioner's Annual Information Return of Creditable Income Taxes Withheld (Expanded) [BIR Form No. 1604E][64] that the EWT of ₱21,526.47 was listed as part of the ₱61,141.13 taxes withheld and remitted to the BIR, there was no payee indicated therein, to which the said income payment may have been made. Moreover, nothing in its Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) [BIR Form No. 1601E][65] shows that it subjected an income payment in the nature of incentives and commissions with ATC WC515 amounting to ₱215,264.70. Thus, respondent's basic deficiency 10% EWT assessment in the amount of ₱21,526.50 is upheld pursuant to Section 2.57.2(O) of RR No. 02-98, as amended by RR No. 17-03, which provides:

> "(O) *Commissions of independent and/or exclusive sales representatives, and marketing agents of companies.* – On gross commissions, rebates, discounts and other similar considerations paid/granted to independent and/or exclusive sales representatives and marketing agents and sub-agents of companies, including multi-level marketing companies, on their sale of goods or services by way of direct selling or similar arrangements where there is no transfer of title over the goods from the seller to the agent/sales representative. — Ten percent (10%)"

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63 Exhibits "P-60" to "P-60.11", docket, vol. 4, pp. 2672 to 2683.

64 Exhibit "P-43-A", docket, vol. 4, p. 2638.

65 Exhibits "P-42" to "P-42.7" and "P-42.9" to "P-42.11", docket, vol. 4, pp. 2626 to 2636.

which states that:

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

6. Disallowed Donation – ₱48,557.65 and
7. Disallowed expenses – ₱27,348.00

Respondent disallowed petitioner's donation expense in the amount of ₱48,557.65, being in excess of the statutory limit pursuant to Section 34(H) of the NIRC of 1997, as amended. The amount of ₱48,557.65 was computed as follows:[66]

Donation per FS		₱ 87,535.00
Less: Limit (5% non-ind/10% ind)		
Taxable net income per FS	₱692,012.00	
Donation per FS	87,535.00	
Taxable net income before donation	₱779,547.00	
Multiply by rate	5%	38,977.35
Disallowed Donation		**₱48,557.65**

Likewise, the following expenses were disallowed as deductions from gross income pursuant to Section 34 of the NIRC of 1997, as amended:[67]

Provision for probable losses	₱ 21,420.00
Penalty charges	5,928.00
Disallowed expenses	**₱27,348.00**

Petitioner has not controverted the findings of respondent. However, petitioner maintains that it already settled the related 35% income tax deficiency on the disallowed donation and disallowed expenses on provision for probable losses and penalty charges. As such, said disallowances should be disregarded and cancelled.

66 Exhibit "P-3", Detail of Discrepancies, Item I.f, docket, vol. 1, p. 46.
67 Exhibit "P-3", Detail of Discrepancies, Item I.g, docket, vol. 1, p. 46.

Provision for probable losses	₱ 21,420.00
Penalty charges	5,928.00
Donations and Contributions	87,535.00
Total	114,883.00
Income Tax (₱114,883.00 x 35%)	**₱40,209.05**

However, as can be seen from the above computation, the amount of ₱87,535.00 donations and contributions that was subjected to the 35% income tax rate was more than the amount of ₱48,557.65 disallowed by respondent for the said expense. Thus, the income tax payment of ₱40,209.05 was more than the ₱26,566.98[69] basic deficiency income tax assessment on the subject disallowed expenses.

To properly account for the valid disallowance on the subject expenses and the payment made by petitioner, the assessed disallowances on donation and contributions in the amount of ₱48,557.65 and other expenses, namely, provision for probable losses and penalty charges, in the amount of ₱27,348.00 shall remain, and the income tax payment thereon in the amount of ₱40,209.05 shall be deducted to arrive at the total deficiency income tax still due from petitioner.

In sum, petitioner is liable to pay basic deficiency income tax in the amount of ₱1,626,348.56, deficiency EWT in the amount of ₱21,526.50, and increments amounting to ₱6,250.10 on the ₱6,175.32 deficiency EWT paid by petitioner on October 9, 2012, computed as follows:

Taxable income per ITR		₱ 692,012.00
Add: Adjustments per review		
Disallowed Purchases	₱3,923,170.66	
Disallowed Meetings and conferences expense	662,134.85	
Income payments not subjected to withholding tax	215,265.00	
Disallowed Donations and contributions	48,557.65	
Disallowed Provision for probable losses and Penalty charges	27,348.00	4,876,476.16
Adjusted Taxable income		₱ 5,568,488.16
Income tax due thereon (35%)		₱ 1,948,970.86
Less: Allowed tax credits/payments:		
Prior year's excess credits	₱ 19,029.00	
Payments	82,907.25	
Creditable withholding tax	180,477.00	282,413.25

68 Exhibits "P-13" to "P-13-A", docket, vol. 1, pp. 921 to 924.

69 ₱26,566.98 = (₱48,557.65 + ₱27,348.00) x 35%.

	Income Payment	Tax Rate	Tax Due
Payments to contractors/sub-contractors:	₱308,766.00	2%	₱ 6,175.32
Incentives and commissions	215,265.00	10%	21,526.50
Basic Deficiency EWT			₱ 27,701.82
Less: Payment made on October 9, 2012			6,175.32
Basic Deficiency EWT Still Due			**₱21,526.50**
Increments representing 25% surcharge, 20% deficiency and delinquency interest on the ₱6,175.32 deficiency EWT paid by petitioner on Oct. 9, 2012			**₱ 6,250.10**

II. Deficiency VAT – ₱3,005,918.88

Respondent computed the deficiency VAT assessment for TY 2008 in the amount of ₱3,005,918.89 by adding adjustments to petitioner's taxable sales/receipts per VAT returns consisting of proceeds from sale of fixed assets not subjected to VAT amounting to ₱449,812.00 and unaccounted expenses amounting to ₱430,364.97; and disallowing input tax amounting to ₱1,501,361.38 and input tax attributable to sale to government amounting to ₱255,960.12, as shown below:[70]

Taxable Sales/Receipts per VAT returns			₱ 26,190,392.92
Add: Adjustments per Investigation:			
Proceeds from sale of fixed assets not subjected to VAT		₱ 449,812.00	
Unaccounted expenses		430,364.97	880,176.97
Taxable Sales/Receipts per investigation			₱ 27,070,569.89
Output Tax Due thereon			₱ 3,248,468.39
Less: Allowed tax credits/payments:			
Input tax carried over from the previous period		₱ 93,819.00	
Payments		51,185.29	
Creditable VAT withheld		477,509.85	
Current input tax		2,516,086.51	
Total		₱3,138,600.65	
Less: Disallowed input tax	₱1,501,361.38		
Disallowed input tax attributable to sale to govt.	255,960.12	1,757,321.50	1,381,279.15
Deficiency Value-Added Tax			₱ 1,867,189.23[71]
Add: 20% Interest p.a. (01.27.09 to 02.13.12)			1,138,729.65
TOTAL AMOUNT DUE			**₱3,005,918.88**

[70] Exhibit "P-3", FLD, docket, vol. 1, p. 44.

[71] It should be ₱1,867,189.24.

1. Disallowed input tax attributable to sale to government –₱255,960.32

Respondent found that the input tax credits attributable to sales to government was overstated by ₱255,960.32, as computed below; therefore, respondent disallowed the same pursuant to RMC No. 65-05, as amended, and RR No. 4-07:[72]

Input tax attributable to sale to government			
Sale to government	₱10,002,179.40		
Total sales	26,190,401.25	0.38	
Amount of input tax per VAT returns		x ₱2,516,086.52	₱ 956,112.88
Less: Standard input tax to sale to government			700,152.56
Disallowed input tax (closed to expense)			**₱255,960.32**

Petitioner has agreed to the above findings of respondent. In fact, as can be seen from petitioner's computation of partial settlement of deficiency VAT as presented in Item II.2, petitioner has considered the amount of ₱255,960.32 as deduction to tax credits. Since petitioner did not refute the subject disallowance, the same is upheld.

2. Proceeds from sale of asset not subjected to VAT –₱449,812.00

Petitioner avers that the actual proceeds from the sale of its company vehicle were only ₱100,000.00 and that the amount of ₱449,812.00 assessed by respondent referred to the book value of the said company vehicle. Allegedly, the tax base for VAT purposes should only be ₱100,000.00.

The Court agrees with petitioner.

Section 106(A) of the NIRC of 1997, as amended, provides that a VAT rate of twelve percent (12%) shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, based on the gross selling price or gross value in money of the goods or properties sold. It further defines "gross selling price" as the total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale.

As such, petitioner's sale of its company vehicle shall be subjected to VAT based on the sales proceeds therefrom without regard to the vehicle's net

72 Exhibit "P-3", Detail of Discrepancies, Item II.d, docket, vol. 1, p. 47.

petitioner's Notes to FS. Notably, even during the audit investigation, Revenue Officer Leyte Portugal included in her findings per Memorandum dated September 2, 2011[75] that petitioner submitted proof that the proceeds from sale of fixed asset not subjected to VAT was only ₱100,000.00 and not ₱449,812.00.

In admitting its deficiency VAT liability on the ₱100,000.00 sales proceeds of its company vehicle and the ₱255,960.32 disallowed input tax attributable to sales to government, petitioner paid the amount of ₱126,798.99[76] on January 12, 2012, which was computed as follows:[77]

Taxable Sales/Receipts per VAT returns		₱26,190,401.25
Add: Adjustments per Investigation:		
Proceeds from sale of fixed assets not subjected to VAT		100,000.00
Taxable Sales/Receipts per investigation		₱26,290,401.25
Output Tax Due thereon		₱ 3,154,848.15
Less: Allowed tax credits/payments:		
Input tax carried over from the previous period	₱ 241,879.58	
Payments	526,043.71	
Current input tax	2,516,085.99	
Total	₱3,284,009.28	
Less: Input tax (excess over actual -sales to gov't)	255,960.12	3,028,049.16
Deficiency Value-added Tax		**₱ 126,798.99**

However, the said payment of ₱126,798.99 is lower by ₱141,161.13 as compared with the assessed deficiency VAT in the amount of ₱267,960.12[78], which was derived from the ₱100,000.00 proceeds from petitioner's sale of company vehicle and ₱255,960.12 disallowed input tax on sales to government.

Nevertheless, since the Court upholds the ₱267,960.12 deficiency VAT assessment, petitioner's partial payment of ₱126,798.99 shall be deducted therefrom.

3. Unaccounted expenses – ₱430,364.97

This assessment was based on the same finding under the deficiency income tax assessment that there were expenses per petitioner's alphalist, the

[73] Exhibit "P-14", docket, vol. 4, p. 2492.

[74] Exhibit "P-54" to "P-54.3", docket, vol. 4, p. 2661.

[75] Exhibit "R-4", par. 3, docket, vol. 3, p. 2114.

[76] Exhibit "P-15", docket, vol. 4, pp. 2493 to 2498.

[77] Attached to Exhibit "P-4", docket, vol. 4, p. 2426.

[78] ₱267,960.12 = [₱100,000.00 x 12%] + ₱255,960.12.

The assessment is devoid of merit. As discussed earlier (Item I.4), even if the expenses per alphalist were to be considered as income subject to output VAT, the same shall be offset by treating the equivalent payments as purchases for which input tax credits may be claimed. Hence, no VAT-able income will result from the said transactions.

4. Disallowed input tax – ₱1,501,361.38

Input taxes in the amount of ₱1,501,361.38[79] were disallowed in connection with the assessed disallowed purchases as discussed under the deficiency income tax assessment (Item I.1).

As determined earlier, petitioner's purchases amounting to ₱3,923,170.66 are found to be proper disallowances. Consequently, only the input VAT corresponding thereto, in the amount of ₱470,780.48 (₱3,923,170.66 x 12%) shall be disallowed as credits against petitioner's output tax due.

In fine, petitioner is still liable for basic deficiency VAT for TY 2008 in the amount of ₱616,188.11, computed as follows:

Taxable Sales/Receipts per VAT returns			₱26,190,392.92
Add: Adjustments per Investigation:			
Proceeds from sale of fixed assets not subjected to VAT			100,000.00
Taxable Sales/Receipts per investigation			₱26,290,392.92
Output Tax Due thereon			₱ 3,154,847.15
Less: Allowed tax credits/payments:			
Input tax carried over from the previous period		₱ 93,819.00	
Payments		51,185.29	
Creditable VAT withheld		477,509.85	
Current input tax		2,516,086.51	
Total		₱3,138,600.65	
Less: Disallowed input tax	₱470,780.48		
Disallowed input tax attributable to sale to government	255,960.12	726,740.60	2,411,860.05
Deficiency Value-Added Tax			₱ 742,987.10
Less: Payment made on January 12, 2012			126,798.99
Basic Deficiency Value-added Tax Still Due			**₱ 616,188.11**

[79] ₱1,501,361.38 = ₱12,511,344.83 x 12%.

appropriate return and to withhold and remit the FBT due on the following benefits, pursuant to Section 33 of the NIRC of 1997, as amended, and RR No. 03-98:[80]

Fringe benefits: Plane ticket (₱251,850.73 x 30%)		₱ 75,555.22
Car – Altis (₱94,867.00 x 50%)		47,433.50
Total		₱ 122,988.72
Divide by		68%
Grossed up monetary value		₱ 180,865.78
Applicable rate		32%
Deficiency Fringe Benefit Tax		₱ 57,877.05
Add: 25% Surcharge	₱14,469.26	
20% Interest p.a. (01.13.09 to 02.13.12)	35,741.06	50,210.32
TOTAL AMOUNT DUE		**₱108,087.37**

Petitioner claims that the subject plane ticket was merely a business class ticket and for a legitimate business trip, hence, not subject to FBT. Petitioner also alleges that the car in question was being used by its sales manager as a company vehicle, which has remained in the name of the company, and is limited to official sales operations that are necessary, beneficial and convenient to petitioner.

In the Answer[81], respondent states that there was no evidence on record to prove that the plane ticket was not a first class plane ticket. Allegedly, there is neither any evidence submitted to prove that the purchase of the same was made for an official business meeting or convention to which petitioner's representative was an attendee.

The assessment is partially upheld.

Section 33(A) of the NIRC of 1997, as amended, provides for the imposition of fringe benefits tax on the grossed-up monetary value of the fringe benefit granted by the employer to its managerial or supervisory employees as follows:

"SEC. 33. *Special Treatment of Fringe Benefit.* –

(A) *Imposition of Tax.* – A final tax of xxx thirty-two percent (32%) effective January 1, 2000 and thereafter, is hereby imposed

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[80] Exhibit "P-3", Detail of Discrepancies, docket, vol. 1, pp. 45 and 47.

[81] Par. 10, docket, vol. 2, pp. 1056 to 1057.

corporation (**unless the fringe benefit is required by the nature of, or necessary to the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer**). The tax herein imposed is payable by the employer which tax shall be paid in the same manner as provided for under Section 57(A) of this Code. The grossed-up monetary value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by xxx sixty-eight percent (68%) effective January 1, 2000 and thereafter: *Provided, however*, That fringe benefit furnished to employees and taxable under Subsections (B), (C), (D) and (E) of Section 25 shall be taxed at the applicable rates imposed thereat: *Provided, further*, That the grossed-up value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by the difference between one hundred percent (100%) and the applicable rates of income tax under Subsections (B), (C), (D) and (E) of Section 25." *(Emphasis supplied)*

Section 33(B) of the NIRC of 1997, as amended, defines Fringe Benefits as any good, service, or other benefit furnished or granted by an employer, in cash or in kind, in addition to basic salaries, to an individual employee such as, but are not limited to the following:

1. Housing;
2. Expense account;
3. Vehicle of any kind;
4. Household personnel, such as maid, driver and others;
5. Interest on loan at less than market rate to the extent of the difference between the market rate and actual rate granted;
6. Membership fees, dues and other expenses borne by the employer for the employee in social and athletic clubs or other similar organizations;
7. Expenses for foreign travel;
8. Holiday and vacation expenses;
9. Educational assistance to the employee or his dependents; and
10. Life or health insurance and other non-life insurance premiums or similar amounts in excess of what the law allows.

However, Section 2.33(C) of RR No. 03-98, implementing Section 33(A) of the NIRC of 1997, as amended, provides that no fringe benefit tax shall be imposed on the following:

"SEC. 2.33. SPECIAL TREATMENT OF FRINGE BENEFITS. –

general, the fringe benefits tax shall not be imposed on the following fringe benefits:

xxx xxx xxx

(5) If the grant of fringe benefits to the employee is required by the nature of, or necessary to the trade, business or profession of the employer; or

(6) If the grant of fringe benefit is for the convenience of the employer."

Corollary thereto, Section 2.33(B)(7) of RR No. 03-98, provides that:

"SEC. 2.33. SPECIAL TREATMENT OF FRINGE BENEFITS. –

xxx xxx xxx

(B) *Definition of Fringe Benefit.* – xxx

xxx xxx xxx

(7) *Expenses for foreign travel.* –

(a) Reasonable business expenses which are paid for by the employer for the foreign travel of his employee for the purpose of attending business meetings or conventions shall not be treated as taxable fringe benefits. In this instance, inland travel expenses (such as expenses for food, beverages and local transportation) except lodging cost in a hotel (or similar establishments) amounting to an average US$300.00 or less per day, shall not be subject to a fringe benefit tax. The expenses should be supported by documents proving the actual occurrences of the meetings or conventions.

The cost of economy and business class airplane ticket shall not be subject to a fringe benefit tax. However, 30 percent of the cost of first class airplane ticket shall be subject to a fringe benefit tax.

thereof shouldered by the employer shall be treated as taxable fringe benefits of the employee." *(Emphasis supplied)*

Petitioner has proffered before this Court the electronic ticket[82] and related communications[83] to prove that the plane ticket, subject of the present assessment, was merely business class and that the trip was business-related.

An examination of the foregoing documents shows that the flights were booked for petitioner's President and CEO, Ms. Marlene E. Orozco ("Ms. Orozco"), to travel from Manila to Amsterdam, Netherlands (connecting flight) to Dusseldorf, Germany (final destination) and back from Brussels, Belgium to Amsterdam, Netherlands to Manila via KLM Royal Dutch Airlines. All the flights are for "Restricted Business/Z" trips for a total cost of ₱169,890.00 as clearly indicated in the e-ticket. It has also been established that the said foreign travel of Ms. Orozco to Dusseldorf, Germany was for the purpose of visiting the Medica 2008 Exhibition for the furtherance of petitioner's business of buying and selling of food and medical products. Undoubtedly, the ₱169,890.00 cost of Ms. Orozco's plane ticket is not subject to FBT, pursuant to Section 2.33(B)(7)(a) and (b) of RR No. 03-98 in relation to Section 33(A) of the NIRC of 1997, as amended.

Nonetheless, petitioner has failed to explain the discrepancy between the assessed amount of ₱251,850.73 and the substantiated amount of ₱169,890.00. In view thereof, the assessment on the difference of ₱81,960.73 shall remain in line with the rule that tax assessments by tax examiners are presumed correct and made in good faith, with the taxpayer having the burden of proving otherwise. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.[84]

With reference to the deficiency FBT assessment on the Toyota Altis (1.8, Beige Mica) car, petitioner has presented an internal memorandum[85] signed by its President and CEO, Ms. Orozco, and addressed to its National Sales Manager, Ms. Gina T. Franco, assigning the said car to the latter for official use and hospital coverage effective July 18, 2008. It is likewise stated therein that the "car assignment is not permanent and may be assigned to another person in the future as the exigencies in operational efficiencies may require".

[82] Exhibit "P-16", docket, vol. 4, pp. 2499 to 2501.

[83] Exhibit "P-17", docket, vol. 4, pp. 2503 to 2506.

[84] *Marcos II vs. Court of Appeals, et al.*, G.R. No. 120880, June 5, 1997.

[85] Exhibit "P-18", docket, vol. 4, p. 2507.

products, the same is not subject to FBT pursuant to Section 2.33(C)(5) and (6) of RR No. 03-98 in relation to Section 33(A) of the NIRC of 1997, as amended.

In sum, petitioner is liable to pay basic deficiency FBT for TY 2008 in the reduced amount of ₱11,570.93, computed as follows:

Fringe benefits: Plane ticket (₱81,960.73 x 30%)	₱ 24,588.22
Divide by	÷ 68%
Grossed up monetary value	₱ 36,159.15
Multiply by applicable rate	x 32%
Deficiency Fringe Benefit Tax	**₱11,570.93**

IV. Compromise penalty – ₱12,000.00

It must be stressed that a compromise penalty is imposed to avoid prosecution for violation of the provisions of the Tax Code.[87] Pursuant to RMO No. 01-90, as 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 same without the conformity of the taxpayer is illegal and unauthorized.[88]

In this case, there is nothing in the records which would show that petitioner consented to the compromise penalty. Thus, the imposition of the amount of ₱12,000.00 compromise penalty cannot be sustained.

WHEREFORE, premises, considered, the instant Petition for Review is **PARTIALLY GRANTED**. The assessments covering deficiency income tax, VAT, EWT, and FBT for TY 2008 are **UPHELD** but in the modified amount of **₱2,844,542.63**, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, in the amount of **₱6,250.10**, twenty percent (20%) deficiency and delinquency interest on the partial deficiency EWT payment of ₱6,175.32 or in the aggregate sum of **₱2,850,792.73**, computed as follows:

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86 Exhibit "P-54", Notes to FS, Note 5, docket, vol. 4, p. 2661.

87 *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et al.,* G.R. Nos. L-12928 and L-12932, March 31, 1962.

88 *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc. et al.,* G.R. No. L-35266, January 21, 1991.

VAT	616,188.11	154,047.03	770,235.14
EWT	21,526.50	5,381.63	26,908.13
FBT	11,570.93	2,892.73	14,463.66
Subtotal	**₱ 2,275,634.10**	**₱ 568,908.53**	**₱2,844,542.63**
25% surcharge, 20% deficiency and delinquency interest on the ₱6,175.32 deficiency EWT paid by petitioner on Oct. 9, 2012			**₱ 6,250.10**
Subtotal			**₱ 6,250.10**
TOTAL			**₱2,850,792.73**

In addition, petitioner is liable to pay:

a) Deficiency interest at the rate of 20% per annum on the basic deficiency income tax, VAT, EWT, and FBT computed from the dates indicated below until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended:

Type of Tax	Basic Tax	Deficiency interest computed from
Income Tax	₱1,626,348.56	April 15, 2009
VAT	₱ 616,188.11	January 25, 2009
EWT	₱ 21,526.50	January 15, 2009
FBT	₱ 11,570.93	January 10, 2009

b) Delinquency interest at the rate of 20% per annum on the total amount of ₱2,844,542.63 and on the deficiency interest which have accrued as afore-stated in (a) computed from February 13, 2012 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

Ma. Belen S

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

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.

LOVELL R. BAUTISTA
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, is it 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