Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SPECIAL SECOND DIVISION

MERCURY SYSTEMS CORPORATION, Petitioner,	**CTA Case No. 8131** *For: Cancellation of Deficiency Income Tax, Deficiency Value-Added Tax, and Deficiency Expanded Withholding Tax*
-versus-	Members: **CASTAÑEDA, JR.,** Chairperson **CASANOVA, and MINDARO-GRULLA, JJ.**
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: MAY 16 2013 3:20 p.m.

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DECISION

MINDARO-GRULLA, J.:

This is a Petition for Review filed on July 14, 2010 by Mercury Systems Corporation seeking cancellation of the assessment issued against it for alleged deficiency income tax, deficiency value-added tax (VAT), and deficiency expanded withholding tax, including penalties and interest, in the total amount of ₱427,506.85.

Petitioner Mercury Systems Corporation is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines and duly registered with the Securities and Exchange Commission (SEC)[1].

Respondent is the Commissioner of the Bureau of Internal Revenue (BIR), who is duly appointed and empowered to perform the duties of her office, including, among others, the power to decide, cancel, and abate tax

[1] Exhibit "A".

liabilities pursuant to Section 204(B) of the National Internal Revenue Code (NIRC) of 1997, as amended by Republic Act (RA) No. 8424, otherwise known as the "Tax Reform Act" of 1997. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On November 20, 2009, petitioner received from respondent, through the Officer-in-Charge (OIC)-Assistant Regional Director of Revenue Region No. 7, a Formal Letter of Demand with Assessment Notice No. F43-284 dated November 16, 2009[2], covering the taxable year 2006, which stated that petitioner has deficiency taxes in the total amount of ₱427,506.85, broken down as follows[3]:

	BASIC TAX	INTEREST	SUB-TOTAL
Deficiency Income Tax	170,014.47	90,736.49	260,750.96
Deficiency Value-added Tax	94,678.48	54,731.94	149,410.42
Deficiency Expanded Withholding Tax	849.65	495.82	1,345.47
Compromise Penalty			16,000.00
	265,542.60	145,964.25	427,506.85

On December 16, 2009, petitioner filed with respondent, through the OIC-Assistant Regional Director of Revenue Region No. 7, its protest letter[4] pursuant to Section 228 of the NIRC of 1997, as amended. The protest letter specified the legal and factual bases of the protest and requested a reinvestigation or reconsideration of the findings and computations contained in the Assessment Notices. Petitioner likewise reserved the right under Section 228 of the NIRC of 1997, as amended, to submit additional supporting documents within sixty (60) days from December 16, 2009.[5]

On February 8, 2010, petitioner received from respondent, through the OIC-Assistant Regional Director of Revenue Region No. 7, a letter in reply to petitioner's December 16, 2009 protest letter, informing petitioner that the case will be forwarded to the Revenue District Office No.

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[2] Exhibits "D". "E", "F", "G", "H", and "I".
[3] Par. 3, Petition for Review (Petition), Docket, p. 5.
[4] Exhibit "J".
[5] Par. 4, Petition, Docket, pp. 5-6.

43A-Pasig City for appropriate action, and directing petitioner to address succeeding communications to the Revenue District Office No. 43A-Pasig City.[6]

On June 14, 2010, the one hundred eighty (180)-day period from the filing of petitioner's protest, which was on December 16, 2009, had lapsed without petitioner receiving any decision from respondent; thus granting petitioner thirty (30) days or until July 14, 2010 to file a Petition for Review.

On July 14, 2010, petitioner filed the instant Petition for Review before this Court.

On September 6, 2010, respondent filed her Answer[7], with the following Special and Affirmative Defenses:

> "7. All presumptions are in favor of the correctness of the Assessment;
>
> 8. The Assessment for deficiency income tax, value-added tax, expanded withholding tax and compromise penalty for the calendar year December 31, 2006 was issued in compliance to the provisions of Section 228 of the National Internal Revenue code and in accordance to existing revenue rules and regulations relative to the right of the petitioner to be informed of the factual and legal bases upon which the assessment was made;
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> 9. The Deficiency Income Tax was based on the following grounds:
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> a. Failure of petitioner to subject income payments to withholding tax as required under Revenue Regulations No. 2-98 as amended, thus disallowed as deductions from gross income pursuant to Section 34(K) of the NIRC.
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> b. The existence of unrecorded sales, assessed pursuant to Section 31, in relation to Section 32 of the NIRC.

[6] Par. 3, Joint Stipulation of Facts and Simplification of Issues, Docket, p. 88.
[7] Docket, pp. 62-65.

c. The failure of the petitioner to support with appropriate documentary evidence claimed creditable withholding tax, hence, disallowed and assessed pursuant to Section 2.58.3 of Revenue Regulation No. 2-98.

10. The Deficiency Value-Added Tax assessment was assessed by reason of the existence of unrecorded sales subject to 12% VAT Pursuant to Section 106 and 108 of the NIRC and Pursuant to Republic Act 9337 in relation to Revenue Memorandum Circular No. 8-2006;

11. The Deficiency Expanded Withholding Tax was imposed by reason of income payments not subject to expanded withholding tax pursuant to Revenue Regulation No. 2-98.

12. The 20% interest per annum has been imposed pursuant to the provisions of Section 24(B) of the NIRC

13. The 23% surcharge has been imposed pursuant to the provisions of Section 248(A) of the NIRC;"

On October 14, 2010, the case was set for pre-trial conference.[8]

Respondent filed her Pre-Trial Brief on October 11, 2010;[9] while petitioner filed its Pre-Trial Brief on November 5, 2010.[10]

On November 25, 2010, the parties filed with this Court their "Joint Stipulation of Facts and Simplification of Issues";[11] which was later approved in a Resolution[12] dated November 26, 2010. In the same Resolution, the pre-trial conference was deemed terminated.

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[8] Notice of Pre-Trial Conference, Docket, p. 66.
[9] Docket, pp. 67-70
[10] Docket, pp. 78-83.
[11] Docket, pp. 87-90.
[12] Resolution dated November 26, 2010, Docket, p. 92.

Trial proceeded during which petitioner presented Susanita B. Laxamana as witness, as well as documentary evidence.

On August 23, 2011, petitioner filed its Formal Offer of Evidence, offering Exhibits "A" to "OOO", inclusive of submarkings; which this Court admitted in a Resolution dated October 10, 2011.

The documentary evidence formally offered and admitted are as follows:

Exhibits	Description
A	SEC Certificate of Incorporation and Articles of Incorporation and By-Laws
B	Preliminary Assessment Notice dated October 15, 2009
C	Letter of Protest dated November 9, 2009 to the Preliminary Assessment Notice
D	Formal Letter of Demand issued on November 16, 2009
E	Assessment Notice for Deficiency Income Tax
F	Assessment Notice for Deficiency Value-Added Tax
G	Assessment Notice for Deficiency Expanded Withholding Tax
H	Formal Letter of Demand for the Compromise Penalties
I	Assessment Notice for Compromise Penalties
J	Letter of Protest dated December 15, 2009 to Final Assessment Notice
K	Letter to the BIR Revenue Region No. 7 dated August 17, 2010
N	Quarterly Value-Added Tax Return for the 1st taxable quarter of 2005 duly filed with the Bureau of Internal Revenue, Revenue District Office No. 43, Pasig City [BIR Form No. 2550Q]

O	Quarterly Value-Added Tax Return for the 2nd taxable quarter of 2005 with attached Security Bank BTR-BIR Deposit Slip in the amount of ₱30,726.13 [BIR Form No. 2550Q]
P	Quarterly Value-Added Tax Return for the 3rd taxable quarter of 2005 duly filed with the Bureau of Internal Revenue, Revenue District Office No. 43, Pasig City [BIR Form No. 2550Q]
Q	Quarterly Value-Added Tax Return for the 4th taxable quarter of 2005 with attached Security Bank BTR-BIR Deposit Slip in the amount of ₱2,835.00 [BIR Form No. 2550Q]
R	Quarterly Value-Added Tax Return for the 1st taxable quarter of 2006 with attached Security Bank BTR-BIR Deposit Slip in the amount of ₱27,662.49 [BIR Form No. 2550Q]
S	Quarterly Value-Added Tax Return for the 2nd taxable quarter of 2006 with attached Security Bank BTR-BIR Deposit Slip in the amount of ₱63,744.02 [BIR Form No. 2550Q]
T	Quarterly Value-Added Tax Return for the 3rd taxable quarter of 2006 with attached Land Bank of the Philippines BTR-BIR Deposit Slip in the amount of ₱32,015.64 [BIR form No. 2550Q]
U	Quarterly Value-Added Tax Return for the 4th taxable quarter of 2006 with attached Security Bank BTR-BIR Deposit Slip in the amount of ₱18,330.70 [BIR Form No. 2550Q]
V	Invoice No. 0254 in the amount of ₱17,640.00
W	Invoice No. 0255 in the amount of ₱100,184.00
Z	Official Receipt No. 0308 in the amount of ₱117,740.00
X	Invoice No. 0269 in the amount of ₱588,000.00
Y	Official Receipt No. 0305 in the amount of ₱577,500.00
BB	Affidavit of Ms. Susanita Laxamana dated January 11, 2011
BB-1	Signature of Ms. Susanita Laxamana

CC	Service Report No. 1342 amounting (to) ₱1,700.00
CC-1	Official Receipt No. 18704 amounting (to) ₱1,700.00
EE	Petty Cash Voucher in the amount of ₱1,000.00
LL	Sales Invoice No. 4130 amounting (to) ₱270.00
SS	Retail Invoice No. 36306 amounting (to) ₱190.00
DD	Official Receipt No. 11596 amounting (to) ₱2,290.00
FF	Part Sales Invoice No. 0095653 amounting (to) ₱4,000.06
GG	Official Receipt No. 77395 amounting (to) ₱540.00
HH	Official Receipt No. 77460 amounting (to) ₱1,836.00
II	Retail Invoice No. 40918 amounting (to) ₱600.00
JJ	Official Receipt No. 081040 amounting (to) ₱1,000.00
KK	Cash Sales No. 151746 amounting (to) ₱400.00
NN	Sales Invoice No. 42962 amounting (to) ₱1,800.00
OO	Cash Invoice No. 417889 amounting (to) ₱150.00
QQ	Cash Invoice No. 288866 amounting (to) ₱1,040.00
RR	Cash Sales Invoice No. 122361 amounting (to) ₱2,604.00
TT	Cash Invoice No. 289316 amounting (to) ₱500.00
XX	Sales Invoice No. 160082 amounting (to) ₱11,968.00
YY	Sales Invoice No. 166341 amounting (to) ₱11,787.00
ZZ	Affidavit of Ms. Susanita Laxamana dated March 22, 2011
ZZ-1	Signature of Ms. Susanita Laxamana.

AAA-1 to AAA-26 AAA-29 to AAA-49	Official Receipts and/or Invoices for the expenses classified as meals and snacks amounting to ₱150,128.13

BBB-1 to BBB-5,
BBB-7 to BBB-10,
BBB-13 to BBB-16,
BBB-18 toBBB-20,
BBB-22 to BBB-26,
BBB-29 to BBB-34,
BBB-36 to BBB-37,
BBB-39 to BBB-42,
BBB-44 and BBB-45

CCC-1 to CCC-10,
CCC-12 to CCC-20,
CCC-22, CCC-24,
CCC-25, CCC-28,
CCC-31 and CCC-32

DDD-1 to DDD-18
DDD-20, DDD-21,
DDD-23 to DDD-28

EEE-1, EEE-2,
EEE-4 to EEE-7
EEE-9 to EEE-111,
EEE-13 to EEE-20,
EEE-22 to EEE-35

FFF-1 to FFF-20,
FFF-22 to FFF-35,
FFF-37 to FFF-48,
FFF-50 to FFF-55,
GGG-1 to GGG-3,
GGG-5 to GGG-20,
GGG-22 to GGG-28,
GGG-30 to GGG-40

HHH-1 to HHH-16,
HHH-18 to HHH-25,
HHH-27, HHH-28 and
HHH-29

III-2 to III-6,
III-8 to III-18

JJJ-1 toJJJ-27,
JJJ-29 and JJJ-30

KKK-2 to KKK-17,
KKK-19 to KKK-27

and KKK-29	
LLL-1 to LLL-14, LLL-16 to LLL-26	
AAA-27	Official Receipts and/or Invoices for the expenses classified as drinking water amounting to ₱4,913.22
BBB-6, BBB-17, BBB-28, BBB-38 and BBB-43	
CCC-11, CCC-23 and CCC-30	
DDD-19 and DDD-22	
EEE-3,EEE-8, EEE-12 and EEE-21	
FFF-21, FFF-36 and FFF-49	
GGG-4, GGG-21 and GGG-29	
HHH-26 and HHH-17	
III-1 and III-7	
JJJ-19 and JJJ-28	
KKK-1, KKK-18 and KKK-28	
LLL-15, LLL-20 and LLL-24	Official Receipts and/or Invoices for the expenses incurred during Christmas Party in the amount of ₱6,363.91
BBB-35	Official Receipts and/or Invoices for the expenses classified as Team Building in the amount of ₱8,322.56
AAA-28, AAA-50,	Official Receipts and/or Invoices for the expenses covering the Chest x-ray in the amount of ₱3,373.57
BBB-11, BBB-12, BBB-21, BBB-27	
CCC-21, CCC-26 and CCC-27	

MMM	Income Tax Return for 2006
AAA	Schedule of expenses for the month of January 2006
BBB	Schedule of expenses for the month of February 2006
CCC	Schedule of expenses for the month of March 2006
DDD	Schedule of expenses for the month of April 2006
EEE	Schedule of expenses for the month of May 2006
FFF	Schedule of expenses for the month of June 2006
GGG	Schedule of expenses for the month of July 2006
HHH	Schedule of expenses for the month of August 2006
III	Schedule of expenses for the month of September 2006
JJJ	Schedule of expenses for the month of October 2006
KKK	Schedule of expenses for the month of November 2006
LLL	Schedule of expenses for the month of December 2006
NNN	Income Tax Return for 2007
OOO	Affidavit of Ms. Susanita Laxamana dated July 5, 2011
OOO-1	Signature of Ms. Susanita Laxamana

Respondent, on her part, presented Hannah Thea M. Tulio and Albert G. Espejo as witnesses, as well as documentary evidence.

On April 30, 2012, respondent filed her Formal Offer of Evidence, offering Exhibits "1" to "13-a", inclusive of submarkings. This Court denied all of respondent's exhibits in a Resolution dated May 24, 2012.

On June 11, 2012, respondent filed a Motion for Reconsideration which this Court granted in a Resolution dated July 12, 2012 admitting the previously denied exhibits of respondent, consisting of Exhibits "1" to "13-a", inclusive of submarkings.

Respondent's documentary evidence which were formally offered and admitted are as follows:

Exhibits	Description
1	Letter of Authority No. 2007-00025881 dated June 17, 2008 and revalidated on November 12, 2008
2	Notice of Informal Conference dated May 21, 2009
3	Memorandum Report dated June 15, 2009 of Revenue Officer Hannah Thea M. Tulio
4	RO Hannah Thea M. Tulio's signature
5	Preliminary Assessment Notice dated October 15, 2009
6	Formal Letter of Demand issued on November 16, 2009
6-a	Assessment Notice for Deficiency Income Tax
6-b	Assessment Notice for Deficiency Value-Added Tax
6-c	Assessment Notice for Deficiency Expanded Withholding Tax
6-d	Assessment Notice for Compromise Penalty
7	Tax Verification Notice No. 00123369 dated February 15, 2010
8	Petitioner Mercury Systems Corporation Financial Statements for 2005 and 2006
9	Petitioner Mercury Systems Corporation Alpha List of Employees as of December 31, 2006
10	Petitioner Mercury Systems Corporation Annual Income Tax Return

11	Judicial Affidavit of RO Hannah Thea M. Tulio dated 8 February 2012
11-a	Signature of RO Hannah Thea M. Tulio
12	Undated Memorandum Report of RO Albert G. Espejo
12-a	Signature of RO Albert G. Espejo
13	Judicial Affidavit of RO Albert G. Espejo dated 12 April 2012
13-a	Signature of RO Albert G. Espejo

On August 31, 2012, the instant case was deemed submitted for decision upon submission of petitioner's Memorandum[13] on August 10, 2012 and respondent's Memorandum[14] on August 28, 2012.

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

"1. Whether or not the questioned assessment complied with the provisions of Section 228 of the NIRC.

2. Whether or not petitioner is liable for deficiency income tax for taxable year 2006.

3. Whether or not petitioner is liable for deficiency Value Added Tax for taxable year 2006.

4. Whether or not petitioner has unrecorded sales, thus assessed pursuant to Section 31 in relation to Section 32 of the NIRC.

5. Whether or not petitioner failed to support with appropriate documentary evidence claimed creditable withholding tax, thus

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[13] Docket, pp. 578-590.
[14] Docket, pp. 594-600.

disallowed pursuant to the provisions of Revenue Regulation 2-98.

6. Whether or not there are unrecorded sales subject to 12% pursuant to Sections 106 and 108 of the NIRC and Republic Act 9337 in relation to Revenue Regulation 2-98.

7. Whether or not there are income payments not subjected to expanded withholding tax pursuant to Revenue Regulation 2-98."[15]

Before addressing the other issues raised by the parties, this Court shall resolve first the issue pertaining to respondent's compliance with the due process requirement under Section 228 of the NIRC of 1997, as amended.

Petitioner claims that it was denied due process when respondent did not give due course to the timely submission of its Reply to the Preliminary Assessment Notice (PAN). The allegation of denial of due process is supposedly bolstered by the fact that the disputed Formal Letter of Demand did not contain any direct or indirect reference to any argument or explanation petitioner mentioned in its written reply to the PAN, and the figures representing basic taxes, as well as the details of discrepancies in the PAN and the Formal Letter of Demand with Assessment Notices are exactly similar. Hence, petitioner asserts that it was essentially deprived of one stage or remedy in the assessment process where its explanations and documents could have been thoroughly reviewed and considered.

On the other hand, respondent avers that the questioned assessments were issued in compliance with the provisions of Section 228 of the NIRC of 1997, as amended, and in accordance with existing revenue rules and regulations relative to the right of petitioner to be informed of the factual and legal bases upon which the assessments were made. Further, respondent states that the Formal

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[15] Docket, pp. 88-89.

Letter of Demand and Assessment Notices dated November 16, 2009 contained not only a detailed computation of petitioner's tax deficiencies but also the details of the specified discrepancies, explaining the legal and factual bases of the assessment.

Section 228 of the NIRC of 1997, as amended, provides that:

> "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 pre-assessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> 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.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his 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."

To implement this provision, the BIR issued Revenue Regulations (RR) No. 12-99, Section 3 of which states:

> "Section 3. *Due Process Requirement in the Issuance of a Deficiency Tax Assessment*. –
>
> xxx xxx xxx

> 3.1.2. *Preliminary Assessment Notice (PAN)*. – If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, the said Office shall issue to the taxpayer, at least by registered mail, a Preliminary Assessment Notice (PAN) for the proposed assessment, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based xxx
>
> xxx xxx xxx
>
> 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* xxx"

The foregoing provisions of law and regulations clearly illustrate the process to be followed in assessment cases in order that the taxpayer will be afforded due process.

Here, petitioner received the PAN dated October 15, 2009 on October 26, 2009. Petitioner then filed its Reply to the PAN on November 10, 2009. On November 20, 2009, petitioner received the FAN with Audit Result/Assessment Notices dated November 16, 2009 from respondent. Thereafter, petitioner filed its Protest to the Final Assessment Notice, which respondent failed to act upon.

Applying the above-quoted provisions of law and rules to the instant case, this Court finds that respondent has substantially complied with the requirements of due process, considering that petitioner was able to refute not only the PAN but also it was able to exercise its option to file a Protest to the FAN issued by respondent although the same was not acted upon by respondent within the period prescribed by law.

Time and again, it has been held that the essence of due process is found in the reasonable opportunity to be heard and to submit any evidence one may have in support of one's defense. What the law proscribes is the lack of opportunity to be heard. As long as the party is given the opportunity to defend his interests in due course, he would have no reason to complain, for this is the opportunity to be heard that makes up the essence of due process. [16] Undoubtedly, petitioner was afforded due process.

The Court will discuss now the other issues raised by the parties.

As may be recalled, a Formal Letter of Demand[17] dated November 19, 2009 was issued by respondent against petitioner for deficiency income tax, VAT, and expanded withholding tax and compromise penalty, in the total amount of ₱427,506.85, computed as follows:

	BASIC	INTEREST	SUB-TOTAL
Income Tax	₱ 170,014.47	₱ 90,736.49	₱ 260,750.96
Value-added Tax	94,678.48	54,731.94	149,410.42
Expanded Withholding Tax	849.65	495.82	1,345.47
Compromise Penalty	-	-	16,000.00
TOTAL	**P 265,542.60**	**P 145,964.25**	**P 427,506.85**

The foregoing deficiency tax assessments will each be addressed in detail and *in seriatim*.

A. Deficiency Income Tax - ₱260,750.96

As alleged by respondent, petitioner's income tax deficiency amounting to ₱260,750.96 resulted from (1) disallowed income payments due to non-withholding; (2)

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[16] *Estares, et. al. vs. Court of Appeals, et. al.*, G.R. No. 144755, June 8, 2005.
[17] Exhibit "D".

unrecorded sales; and (3) disallowed unsupported income tax credits, computed as follows:

Taxable income (loss) per ITR			₱ 741,491.28
Add: Adjustments per investigation			
Income payments not subjected to withholding tax		₱ 213,259.16	
Unrecorded sales		247,394.00	460,653.16
Taxable income per investigation			1,202,144.44
Income tax due thereon			₱ 420,750.55
Less: Allowance tax credits/payments			
Creditable withholding tax claimed per ITR		₱ 15,632.57	
Prior year's excess credit		619,042.86	
Total		₱ 634,675.43	
Less: Excess tax credits carried over	₱ 375,153.48		
Unsupported creditable withholding tax	8,785.87	383,939.35	250,736.08
Deficiency Income Tax			₱ 170,014.47
Add: 20% interest per annum (4.17.07 to 12.15.09)			90,736.49
Total Amount Due			**260,750.96**

1. Disallowed Income Payments - ₱213,259.16

Based on the comparison between the total income payments reflected in the Audited Financial Statements (AFS) and shown in the Returns/Alphalist, respondent found a discrepancy in the amount of ₱213,259.16; which allegedly was not subjected to withholding tax. Hence, respondent disallowed the same, pursuant to Section 34(K) of the NIRC of 1997, as amended.

The disallowed income payments are as follows:

Income Payments	Per FS	Per Returns /Alphalist	Difference
Advertising expense	₱ 21,209.78	-	₱ 21,209.78
Repairs and maintenance	21,272.42	-	21,272.42
Salaries and wages	3,082,808.41	2,912,031.45	170,776.96
Total	**P3,125,290.61**	**P 2,912,031.45**	**P213,259.16**

(a) Advertising Expense - ₱21,209.78

According to petitioner, the advertising expense account pertains to expenses for food and beverages on two occasions when petitioner's technical managers and staff conducted a software product demonstration to its potential clients. In the course of such product demonstration, petitioner spent ₱10,685.71 and ₱10,524.11 (net of VAT) on May 31, 2006[18] and November 29, 2006[19], respectively. Petitioner maintains that the said income payments were not made to contractors or subcontractors enumerated in RR No. 2-98.

This Court agrees with petitioner. The items included in petitioner's advertising expense account are valid expenses incurred in the course of its business, which are not among those enumerated under RR No. 2-98 as subject to expanded withholding tax. Thus, the disallowance of advertising expense is erroneous.

(b) Repairs and Maintenance - ₱21,272.42

Petitioner explains that the amount of repairs and maintenance pertains to the following expenses:

Janitorial services	₱ 3,315.00	Paid to one (1) individual who rendered cleaning service for 1 hour twice or thrice a week over a period of 5 months. Such individual was a marginal income earner and not a contractor engaged in business.
Repair of office equipment/ facilities	2,957.49	Repair of microwave oven and grease trap/plumbing fixture. Performed by a marginal income earner and not a contractor engaged in business.
Repair of vehicles used for official business	14,999.93	Various expenses incurred for reconditioning of the vehicles and the purchase of spare parts.
Total	**₱ 21,272.42**	

[18] Exhibit "XX".
[19] Exhibit "YY".

The above-enumerated figures are broken down as follows:

Janitorial Services

Exhibit	Payee	For the Period	Amount
MM	Albert San Buenaventura	June 14-30, 2006 (11 days at P65.00)	₱ 715.00
MM	Albert San Buenaventura	July 1-31, 2006 (12 days at P65.00)	780.00
PP	Albert San Buenaventura	August 1-31, 2006 (8 days at P65.00)	520.00
UU	Albert San Buenaventura	Sept. to Oct. 2006 (10 days at 65.00)	650.00
VV	Albert San Buenaventura	November 1-30, 2006 (10 days at 65.00)	650.00
		Total	**₱3,315.00**

Repair of Office Equipment/Facilities

Exhibit	Supplier	Date	Amount
CC-1	Sure-Shot Service Corporation	2/24/2006	₱ 1,517.85
EE	Rolando Acosta	3/15/2006	1,000.00
LL	Sucat Business Service Branch	7/28/2006	270.00
SS	AH Hardware 2000	9/8/2006	169.64
	Total		**P 2,957.49**

Repair of Vehicles used for Official Business

Exhibit	Supplier	Date	Amount
DD	Delta Motor Sales Corporation	3/4/2006	₱ 2,044.64
FF	Honda Cars Makati, Inc.	4/5/2006	3,571.43
GG	Romy's Car Accessories & Gen. Merchandise	5/4/2006	482.14
HH	Romy's Car Accessories & Gen. Merchandise	5/7/2006	1,639.29
II	Arayat Motor Parts	5/25/2006	535.71
JJ	Romy's Car Accessories & Gen. Merchandise	6/5/2006	892.86
KK	Nissan Parts Center	6/8/2006	357.14
NN	Intergroup Inc.	8/8/2006	1,607.14
OO	Toyorama Motor Corp.	8/8/2006	133.93
QQ	Coitline Auto Parts Corp.	9/7/2006	928.57
RR	United Bearing Industrial Corp.	9/7/2006	2,325.00
TT	Carline Parts Center	9/8/2006	446.43
	Total		**P 14,964.28**

Petitioner asserts that it did not withhold taxes on costs of janitorial services because the same were directly paid to an individual (Albert San Buenaventura) employed by petitioner and not to an agency, in the same way that it did not withhold taxes on costs of repairs of office equipment/facilities and vehicles because the said costs were indispensable minor and regular expenses for maintenance and were not paid to a contractor that warrants the withholding of taxes.

A scrutiny of records shows that the amounts declared under Repairs and Maintenance account are indeed income payments made to persons who are not among those enumerated under RR No. 2-98. Such being the case, the income payments made by petitioner to them are not subject to expanded withholding tax. Hence, the assessment should be cancelled.

(c) Salaries and Wages - ₱170,776.96

According to petitioner, the amount of salaries and wages refers to the following expenses:

Meals	₱ 126,928.29
Snacks	16,101.16
Drinking Water	4,879.47
Christmas Party	6,363.91
Team Building	13,102.73
Chest x-ray	3,401.41
Total	**₱ 170,776.96**

Petitioner considered these expenses as *"de minimis"* benefits or those for the promotion of general welfare of the employees, which are not subject to income tax and withholding tax on compensation income for rank and file employees pursuant to Revenue Regulations No. 10-2000.

Section 1 of Revenue Regulations No. 10-2000 reads as follows:

> "SECTION 1. Section 2.78.1(A)(3), (6)(b)(ii) and (7) of Revenue Regulations No. 2-98, as last amended by Revenue Regulations No. 8-2000, is hereby further amended to read as follows:
>
> xxx xxx xxx
>
> The following shall be considered as *'de minimis'* benefits not subject to income tax as well as withholding tax on compensation income of both managerial and rank and file employees:

a. Monetized unused vacation leave credits of private employees not exceeding ten (10) days during the year and the monetized value of leave credits paid to government officials and employees;

b. Medical cash allowance to dependents of employees not exceeding ₱750.00 per employee per semester of ₱125 per month;

c. Rice subsidy of ₱1,000.00 or one (1) sack of 50-kg. rice per month amounting to not more than ₱1,000.00;

d. Uniform and clothing allowance not exceeding ₱3,000 per annum;

e. Actual yearly medical benefits not exceeding ₱10,000 per annum;

f. Laundry allowance of ₱300 per month;

g. Employees achievement awards, *e.g.,* for length of service or safety achievement, which must be in the form of a tangible personal property other than cash or gift certificate, with an annual monetary value not exceeding ₱10,000 received by the employee under an established written plan which does not discriminate in favor of highly paid employees;

h. Gifts given during Christmas and major anniversary celebrations not exceeding ₱5,000 per employee per annum;

i. Flowers, fruits, books, or similar items given to employees under special circumstances, *e.g.,* on account of illness, marriage, birth of baby, etc.; and

j. Daily meal allowance for overtime work not exceeding twenty five percent 25% of the basic minimum wage."

As may be gleaned from the above provision, RR No. 10-2000 provides for the acceptable ceiling for each "*de minimis"* benefits (*e.g.*, rice subsidy should not exceed P1,000.00 per month). Applying the same to the instant case, this Court finds the expenses incurred for meals, snacks, and drinking water that were treated by petitioner as "daily meal allowance for overtime work not exceeding twenty-five percent (25%) of the basic minimum wage" in accordance with Section 1(j).

Allegedly, petitioner had nine (9) employees from January to June 2006, and eight (8) employees from July to December 2006. The basic minimum wage in 2006 per employee was ₱350.00 per day and petitioner had 299 workdays (365 days in year, less 52 Sundays and 14 non-working holidays) in 2006.

Petitioner's computation of total allowable daily meal allowance is as follows:

8 employees x ₱350.00 a day	₱ 2,800.00
Multiplied by 299 workdays	837,200.00
Multiplied by 25% (Allowable daily meal allowance for 8 employees for 2006)	**P 209,300.00**

Based on the foregoing, it is apparent that petitioner's purported actual expenses for meals, snacks, and drinking water totaling ₱147,908.92 is less than its allowable daily meal allowance for 8 employees for 2006 amounting to ₱209,300.00. However, this Court cannot ascertain whether the actual expenses for meals, snacks, and drinking water were actually incurred for 299 workdays by all of its 8 employees.

It must be emphasized that it is important to determine if the benefits received by each employee did not exceed the limit or threshold amount for the said benefit since as provided under RR No. 10-2000, each *de minimis* benefit has a maximum amount for each employee per annum in order for such benefit to be not subjected to income tax and withholding tax on compensation income of both managerial and rank and file employees. Hence, the disallowance of the income payments of ₱147,908.92 due to non-withholding is proper.

With respect to the expenses incurred for team building activity and Christmas party, petitioner treated the same as "gifts given during Christmas and major anniversary celebrations not exceeding ₱5,000.00 per employee per annum" in accordance with Section 1(h) of RR No. 10-2000. However, a perusal of the records shows that, out of the total ₱19,466.64 claimed as *de minimis*, only the amount of ₱8,322.56 is duly supported by evidence[20] and determined to be actually pertaining to expenses incurred during its team building.

Anent the expenses incurred for chest x-rays, petitioner treated the same as "actual yearly medical benefits not exceeding ₱10,000 per annum" in accordance with Section 1(e).

Based on the records, petitioner's actual expenses for chest x-rays amounted to ₱3,401.41; which is duly supported by receipts[21] in the name of petitioner. Since it is less than the allowable amount of ₱10,000, the same shall be exempt from tax.

In view of the foregoing, this Court finds that out of the alleged income payments not subjected to withholding taxes amounting to ₱213,259.16, only the amount of ₱159,053.00 should be disallowed, to wit:

Meals	₱ 126,928.29
Snacks	16,101.16
Drinking Water	4,879.47
Christmas Party	6,363.91
Team Building	4,780.17
TOTAL	**₱ 159,053.00**

2. Unrecorded Sales - ₱247,394.00

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[20] Exhibit "BBB-35".

[21] Exhibits "AAA-28", "AAA-50", "BBB-11", "BBB-12", "BBB-21", "BBB-27", "CCC-21", "CCC-26" and "CCC-27".

Respondent posits that as per verification, petitioner's service income reported per ITR is understated by ₱247,394.00. As a consequence, she assessed petitioner pursuant to Sections 31 and 32 of the NIRC of 1997, as amended.

The understatement is comprised of the following:[22]

NAME OF CLIENT	PERIOD COVERED	AMOUNT
Mansfield International	Oct.-Dec. 2006 billed Jan. 18, 2007[23]	₱ 131,250.00
Grocers Central Alliance		
EC Link Network (Service)	Oct.-Dec. 2006 billed Jan. 18, 2007	98,504.00
EC Order Software (Maintenance)	Oct.-Dec. 2006 billed Jan. 18, 2007[24]	17,640.00
TOTAL		**₱ 247,394.00**

Petitioner counter-argues that for the period covering October to December 2006, it did not actually render any services to Mansfield International. Petitioner ceased rendering services to the latter at the end of August 2006 as the latter did not renew subscription with petitioner. There being no services rendered for the said period, no billing was ever recorded from Mansfield.

However, a careful scrutiny of the records proves that there was a billing[25] made by petitioner for Mansfield for which petitioner insists that it pertains to a Reinstatement Fee equivalent to renewing a full year subscription of Mansfield to petitioner's annual software maintenance program, accruing to the year 2007 and not to be accrued to the last quarter of the year 2006. On the contrary, the same Billing Invoice No. 269 dated June 18, 2007 referred to by petitioner as Reinstatement Fee shows that it was an actual billing for software maintenance fee for the period August 12, 2006 to August 11, 2007 amounting to ₱588,000.00 (inclusive of VAT). Further, petitioner received payment for the whole amount on September 7, 2007, as

[22] Exhibit "2", Annex B.
[23] Exhibit "X".
[24] Exhibit "V".
[25] Exhibit "X".

evidenced by Official Receipt No. 0305.[26] Evidently, petitioner's allegation is negated by what is stated on the face of the documentary evidence presented before this Court. Thus, the findings of respondent should be sustained.

With respect to its services to Grocers Central Alliance, petitioner alleges that the service income was recorded in the following year when the collections were made on September 14, 2007.[27] Petitioner states further that the amount actually billed to client for Mercury EC Link network service fee was ₱100,184.00[28] and not ₱98,504.00. Nevertheless, it admitted that it inadvertently failed to accrue the service income in 2006. However, petitioner also claims that the corresponding taxes were already paid and remitted in the year of collection in 2007.

This Court finds petitioner's allegation to be without merit.

As found by this Court, the manner of recording of the said sales transaction by the taxpayer is upon billing to its customers. For tax purposes, however, recording of income should be on accrual basis. Thus, services rendered for the year 2006 should be recorded as revenue for the year even if billed and paid for in the subsequent year. Likewise, petitioner fell short in proving that the subject income was reported and the corresponding income tax was paid in the subsequent year. Thus, the findings of respondent shall remain.

3. Disallowed Unsupported Income Tax Credits - ₱8,785.87

The discrepancy found by respondent's examiners was based on the comparison of the income tax credits supported by Certificate of Creditable Tax Withheld At

[26] Exhibit "Y".
[27] Exhibit "Z".
[28] Exhibit "W".

Source (BIR Form No. 2307) against the amount reflected in the Annual Income Tax Return for the taxable year 2006, as follows:

Creditable Tax Withheld for the year 2006	₱ 15,632.57
Less: Amount supported by certificates	6,846.70
Difference	**₱ 8,785.87**

The alleged total amount supported by certificates is as follows:

Payor	For the Period	Tax Withheld (in Peso)	Tax Withheld (in US Dollar)	Reference
Grocers Central Alliance, Inc.	04-01-06 to 04-30-06	₱ 73.66	-	BIR Records, p. 119
Grocers Central Alliance, Inc.	06-01-06 to 06-30-06	73.66	-	BIR Records, p. 118
Occidental Data Corporation	07-01-06 to 09-30-06	-	$ 35.00	BIR Records, p. 117
Mansfield International, Inc.	09-01-06 to 09-30-06	2,625.00	-	BIR Records, p. 116
Grocers Central Alliance, Inc.	10-01-06 to 10-31-06	4,000.00	-	BIR Records, p. 115
Occidental Data Corporation	01-01-06 to 03-31-06	-	39.38	BIR Records, p. 114
Total		**P 6,772.32**	**$ 74.38**	

A perusal of the records reveals that respondent inadvertently added the peso and dollar amounts of withholding taxes to come up with the amount of ₱6,846.70 that was used in comparison with the creditable tax withheld reflected in the ITR. Nonetheless, the disputed unsupported amount of ₱8,785.87 being claimed by petitioner as amounting to ₱8,780.00 was explained by petitioner as referring to the difference between the withholding taxes credited in its 2005 ITR (₱185,138.34) as against the taxes actually withheld (₱193,918.34) from petitioner in the same previous year 2005. The difference of ₱8,780.00 was then reflected and claimed as creditable withholding tax for the next year 2006.

The difference was supposedly withheld by Mansfield International as follows:

PERIOD	INCOME PAYMENT	RATE	AMOUNT
June 2005	₱ 191,727.27	2%	₱ 3,834.55
June 2005	247,272.73	2%	4,945.45
TOTAL			**₱ 8,780.00**

However, since the claimed tax credit of ₱8,780.00 pertains to year 2005 and for which the related income payments should have been reported in the same year 2005, this Court is constrained to disallow the amount of ₱8,780.00 as tax credit for the year 2006.

In view of the foregoing, petitioner is liable to pay basic deficiency income tax for the taxable year 2006 in the amount of ₱151,042.32, computed as follows:

Taxable income (loss) per ITR			₱741,491.28
Add: Adjustments per investigation			
Income payments not subjected to withholding tax		₱159,053.00	
Unrecorded sales		247,394.00	406,447.00
Taxable income			₱1,147,938.28
Income tax due thereon			₱ 401,778.40
Less: Allowance tax credits/payments			
Creditable withholding tax claimed per ITR		₱ 15,632.57	
Prior year's excess credit		619,042.86	
Total		634,675.43	
Less: Excess tax credits carried over	₱375,153.48		
Unsupported creditable withholding tax	8,785.87	383,939.35	250,736.08
Deficiency Income Tax			**₱151,042.32**

B. Deficiency Value-Added Tax - ₱149,410.92

Respondent asserts that the assessment for deficiency VAT amounting to ₱149,410.92 arose from: (1) an alleged ₱247,394.00 worth of unrecorded sales; and (2) the use of 10% VAT rate in the computation of VAT liability from February to December 2006, computed as follows:

Taxable Sales/Receipts per VAT return		₱4,168,310.06
Add: Adjustment per investigation		
Unrecorded sales		247,394.00
Total taxable sales/receipts per investigation		₱4,415,704.06
Output tax due thereon (12%)		₱ 529,884.49
Less: Allowable tax credits/payments		
Excess input tax carried over from previous year	₱ 13,178.64	
Payments	282,657.45	
Input tax	139,369.92	435,206.01
Total		₱ 94,678.48
Add: 20% interest per annum (4.17.07 to 12.15.09)		54,731.94
Total Amount Due		**₱ 149,410.42**

1. Unrecorded Sales - ₱247,394.00

As discussed earlier, part of the income tax assessment rests on the finding that there are unrecorded sales in the amount of ₱247,394.00. Respondent's theory is that since there was an undeclared income, the same should translate to taxable income for income tax purposes, and taxable gross receipts for VAT purposes.

This Court disagrees with respondent.

It must be remembered that the 12% VAT is assessed on the "gross receipts derived from the sale of services" by petitioner to Mansfield International and Grocers Central Alliance. However, even if petitioner is held liable for deficiency income tax on the instant sales transactions, this Court finds it inappropriate to hold petitioner liable for deficiency VAT for the same sale transactions.

The law defines "gross receipts" as "the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments **actually or constructively received during the taxable quarter for**

the services performed or to be performed for another person, excluding value-added tax."[29]

In the imposition or assessment of VAT, what is critical to be shown is that the taxpayer received an amount of money or its equivalent. Petitioner is a provider of services. Its service income is subject to output VAT which is due at the time of collection and not at the time the revenue was earned. Thus, it was erroneous on the part of respondent to impose a deficiency VAT on the unrecorded sales of ₱247,394.00, which were collected in 2007 as reflected in the official receipts. Such being the case, the imposition of 12% VAT on said unrecorded sales is not valid.

2. The use of 10% VAT rate in the computation of VAT liability from February to December 2006.

Respondent's verification disclosed that petitioner was still using 10% value-added tax rate in the computation of VAT liability from February to December 2006. Since the effective VAT rate for that particular period has been set at 12% pursuant to Republic Act No. 9337 in relation to Revenue Memorandum Circular (RMC) No. 8-2006, petitioner was assessed for the discrepancy based on the afore-mentioned tax provision.

Petitioner argues that since it is a service provider, its service income is subject to output VAT which is due at the time of collection and not at the time of billing. Petitioner further avers that it applied the 10% VAT rate in billings for January 2006, and applied the 12% VAT rate on billings for February to December 2006, and that it remitted the output taxes according to the dates when the service incomes were collected.

Petitioner's Quarterly VAT Returns disclose the following:

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[29] Section 108 of the NIRC of 1997, as amended.

Exhibit	Period	VATable Sales/Receipt	Output VAT Paid	Tax Rate
R	1st Quarter	₱ 801,906.48	₱ 80,190.65	10.00%
S	2nd Quarter	1,188,181.82	126,693.18	10.66%
T	3rd Quarter	1,708,421.76	172,592.18	10.10%
U	4th Quarter	469,800.00	55,730.00	11.86%
Total		**₱ 4,168,310.06**	**₱ 435,206.01**	

The allegation of petitioner that it applied the 10% VAT rate on billings for January 2006 and 12% on billings for February to December 2006 does not match with the above presentation. Evidently, no output tax for any quarter in the year 2006 was subjected to 12% rate. In the absence of any supporting source document, this Court cannot ascertain the veracity of petitioner's claim.

In addition, the tax treatment for services rendered before or after the effectivity of RA No. 9337 is governed by RMC No. 08-2006, in relation to the transitory and other provisions of Revenue Regulations No. 16-2005. Failure to comply with the set conditions shall automatically subject the gross receipts received on or before February 1, 2006 to the 12% VAT. Hence, respondent's computation of the 12% VAT due is affirmed.

In sum, petitioner is liable to pay basic deficiency value-added tax for the taxable year 2006 in the amount of ₱64,991.20, computed as follows:

Taxable Sales/Receipts per VAT return		₱ 4,168,310.06
Output tax due thereon (12%)		500,197.21
Less: Allowable tax credits/payments		
Excess input tax carried over from previous year	₱ 13,178.64	
Payments	282,657.45	
Input tax	139,369.92	435,206.01
Deficiency Value-added Tax		**P 64,991.20**

C. Deficiency Expanded Withholding Tax - ₱1,345.47

Per investigation of respondent's examiner, the following income payments were allegedly not subjected to expanded withholding taxes, prompting respondent to issue the deficiency EWT assessment in the amount of ₱1,345.46, computed as follows:

	AMOUNT	TAX RATE	TAX DUE
Advertising	₱ 21,209.78	2%	₱ 424.20
Repairs and maintenance	21,272.42	2%	425.45
Expanded withholding tax			₱ 849.65
Add: 20% interest per annum (4.17.07 to 12.15.09)			495.82
Total Amount Due			**₱1,345.47**

As earlier discussed, petitioner is not liable for the deficiency EWT since such income payments are not subject to expanded withholding tax as those were income payments not included among those enumerated under RR No. 2-98. Therefore, respondent's deficiency EWT assessment for the year 2006 should be cancelled.

D. Compromise Penalty - ₱16,000.00

As to the compromise penalty charged by respondent against petitioner in the amount of ₱16,000.00, for the latter's alleged non-filing of Alphalist of Employees, the same shall be cancelled there being no compromise agreement between the parties.

WHEREFORE, the Petition for Review is hereby **PARTIALLY GRANTED**. The assessment issued by respondent against petitioner for the taxable year 2006 covering deficiency EWT in the amount of ₱1,345.46 is hereby **CANCELLED** and **WITHDRAWN** for lack of merit. However, the assessments for deficiency income tax and VAT for the taxable year 2006 are hereby **AFFIRMED with MODIFICATIONS**. Accordingly, petitioner is hereby **ORDERED TO PAY** the amount of ₱270,041.90 for the following deficiency taxes, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended:

	Basic	**25% Surcharge**	**Total**
Deficiency Income tax	₱ 151,042.32	₱ 37,760.58	₱ 188,802.90
Deficiency VAT	64,991.20	16,247.80	81,239.00
TOTAL	**₱ 216,033.52**	**₱ 54,008.38**	**₱ 270,041.90**

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

(a) deficiency interest at the rate of twenty percent (20%) per annum on the total basic deficiency income tax and VAT in the amounts of ₱151,042.32 and ₱64,991.20 computed from April 15, 2007 and January 25, 2007, respectively, until full payment thereof pursuant to Section 249(B) of the NIRC of 1997; and

(b) delinquency interest at the rate of 20% per annum on the total deficiency taxes of ₱270,041.90 and on the 20% deficiency interest which have accrued as afore-mentioned in (a), computed from December 15, 2009 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

The compromise penalty charged by respondent against petitioner in the amount of ₱16,000.00 is excluded there being no compromise agreement between the parties.

SO ORDERED.

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

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

CAESAR A. CASANOVA
Associate Justice

A T T E S T A T I O N

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

Juanito C. Castañeda, Jr.
JUANITO C. CASTANEDA, JR.
Associate Justice
Chairperson

C E R T I F I C A T I O N

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

ROMAN G. DEL ROSARIO
Presiding Justice