REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL FIRST DIVISION

LANCASTER COLORS INTERNATIONAL, INC., Petitioner,	**CTA CASE NO. 8933**
	Members:
- versus -	**DEL ROSARIO,** *P.J., Chairperson,* **UY,** *and* **MINDARO-GRULLA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: MAR 28 2019 ; 2:23 pm

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RESOLUTION

***MINDARO-GRULLA, J.*:**

For the Court's resolution is respondent's **Motion for Reconsideration (Re: Decision promulgated 1 October 2018)**, filed on October 19, 2018, with petitioner's **Comment/Opposition (To the Motion for Reconsideration dated 19 October 2018)**, filed via registered mail on December 3, 2018 and received by this Court on December 12, 2018.

Respondent seeks reconsideration of the Decision promulgated on October 1, 2018 (assailed Decision), the dispositive portion of which reads:

> "**WHEREFORE**, premises considered, the instant Petition for Review is **GRANTED**. Accordingly, the FDDA dated March 14, 2014, holding petitioner liable for deficiency income tax, VAT, and compromise penalty for

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taxable year 2009 in the total amount of ₱5,001,080.23, is **CANCELLED** for lack of merit.

SO ORDERED."

Respondent anchors his motion on two grounds, namely: (1) that this Court erred in ruling that petitioner timely filed the instant petition for review; and (2) that this Court erred in ruling that the discrepancy/undeclared expenses constitute an undeclared income.

In his motion, respondent contends that the instant petition was filed out of time, citing the cases *Philippine Electric Corporation vs. Commissioner of Internal Revenue*[1] *(CIR)* and *Fishwealth Canning Corporation vs. CIR*[2]. He avers that petitioner received the Final Decision on Disputed Assessment (FDDA) on March 28, 2014, and hence, it has until April 27, 2014 to file its motion for reconsideration to the CIR or to file an appeal before the Court of Tax Appeals (CTA). Respondent adds that in appealing to the CIR, the observance of the 30-day period within which to file a petition for review before the CTA is mandatory.

On the other hand, petitioner asserts that the applicable rule is Revenue Regulations (RR) No. 18-2013 which explicitly states that a taxpayer may elevate his protest through a request for reconsideration to the Commissioner within thirty days from the date or receipt of the decision of the Commissioner's duly authorized representative. Moreover, RMC No. 11-2014, which covers FDDAs, provides that taxpayers may elevate their protests to the Office of the Commissioner.

Petitioner also contends that it treated the absence of a definitive denial by respondent as an inaction on its request for reconsideration, and hence, the Petition for Review filed on November 24, 2014, was well within the thirty day period from the lapse of one hundred eighty day period from the filing of the request for reconsideration.

Respondent is clearly mistaken.

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[1] CTA Case No. 8793, October 10, 2017.
[2] G.R. No. 179343, January 21, 2010.

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Section 3.1.4 of Revenue Regulations (RR) No. 12-99[3], as amended by RR No. 18-2013[4], is clear that if the protest is denied by the Commissioner's duly authorized representative, the taxpayer may appeal to the Commissioner, and the Commissioner is given one hundred eighty days from filing of the protest to decide the same. The taxpayer may then either appeal to the CTA within thirty days after the expiration of the one hundred eighty-day period, or await the final decision of the Commissioner and appeal such final decision to the CTA within thirty days after the receipt of a copy of such decision. Section 3 of the said regulation provides:

> "SECTION 3. *Due Process Requirement in the Issuance of a Deficiency Tax Assessment.* –
>
> 3.1 Mode of procedure in the issuance of a deficiency tax assessment:
>
> xxx xxx xxx
>
> 3.1.4 *Disputed Assessment.* – xxx
>
> If the protest is denied, in whole or in part, by the Commissioner's duly authorized representative, the taxpayer may either: (i) appeal to the Court of Tax Appeals (CTA) within thirty (30) days from date of receipt of the said decision; or (ii) elevate his protest through request for reconsideration to the Commissioner within thirty (30) days from date of receipt of the said decision. No request for reinvestigation shall be allowed in administrative appeal and only issues raised in the decision of the Commissioner's duly authorized representative shall be entertained by the Commissioner.
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> If the protest is not acted upon by the Commissioner's duly authorized representative within one hundred eighty (180) days counted from the date of filing of the protest in case of a request for reconsideration; or

[3] Subject: Implementing the Provisions of the National Internal Revenue Code of 1997 Governing the Rules on Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extra-judicial Settlement of a Taxpayer's Criminal Violation of the Code Through Payment of a Suggested Compromise Penalty, issued on September 4, 1999.

[4] Subject: Amending Certain Sections of Revenue Regulations No. 12-99 Relative to the Due Process Requirement in the Issuance of a Deficiency Tax Assessment, issued on November 28, 2013.

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> from date of submission by the taxpayer of the required documents within sixty (60) days from the date of filing of the protest in case of a request for reinvestigation, the taxpayer may either: (i) appeal to the CTA within thirty (30) days after the expiration of the one hundred eighty (180)-day period; or (ii) await the final decision of the Commissioner's duly authorized representative on the disputed assessment.
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> If the protest or administrative appeal, as the case may be, is denied, in whole or in part, by the Commissioner, the taxpayer may appeal to the CTA within thirty (30) days from date of receipt of the said decision. Otherwise, the assessment shall become final, executory and demandable. <u>A motion for reconsideration of the Commissioner's denial of the protest or administrative appeal, as the case may be, shall not toll the thirty (30)-day period to appeal to the CTA.</u>
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> <u>If the protest or administrative appeal is not acted upon by the Commissioner within one hundred eighty (180) days counted from the date of filing of the protest, the taxpayer may</u> either: (i) <u>appeal to the CTA within thirty (30) days from after the expiration of the one hundred eighty (180)-day period</u>; or (ii) await the final decision of the Commissioner on the disputed assessment and appeal such final decision to the CTA within thirty (30) days after the receipt of a copy of such decision." *(Underscoring supplied)*

To recapitulate the facts in the present case, petitioner received the FDDA signed by Regional Director Tabule on March 28, 2014[5]. It filed its request for reconsideration with respondent on April 28, 2014[6].

Based on the above-quoted provision, it is clear that petitioner still has the remedy of appealing the FDDA to the Commissioner. It is the motion for reconsideration of the Commissioner's denial of the protest or administrative appeal which will not toll the thirty (30)-day period to appeal to the CTA.

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[5] As admitted by respondent in paragraph 6 of his Answer, docket, vol. I, pp. 230-238.

[6] April 27, 2014 fell on a Sunday.

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The case of *Philippine Electric Corporation vs. CIR* is not applicable to this case. In the said case, Philippine Electric appealed the FDDA to OIC-Assistant Commissioner Misajon, the person who issued the same, and not to the CIR. Hence, the Court's Third Division ruled that Philippine Electric's appeal to the OIC-Assistant Commissioner is not within the realm of, or sanctioned under Section 228 of the Tax Code, as implemented by RR No. 12-99.

The case of *Fishwealth* is likewise not applicable because in the said case, the FDDA was issued by respondent. Consequently, petitioner only has one remedy – to appeal respondent's denial of its protest to the CTA.

Respondent also asserts that petitioner's alleged undeclared expenses constitute undeclared revenue, citing the cases of *Perez vs. Court of Tax Appeals, et al.*[7], *Bureau of Internal Revenue, represented by the CIR vs. Spouses Antonio Villan Manly and Ruby Ong Manly*[8], and the US case of *U.S. vs. Johnson*[9].

Respondent argues that expenses are meticulously reflected by taxpayers as they have the effect of lowering the tax base. Thus, when expenses are undeclared in the books and returns, it is highly suspect and begs the question, where did the funds used to purchase them came from when such is not reflected in the books. Hence, respondent concludes that the amount is undeclared income.

Respondent avers that for failure of petitioner to provide supporting documents to rebut the findings of the revenue examiners, the assessment for deficiency income tax and VAT must stand.

On the other hand, petitioner avers that assuming that there are certain expenses that were subjected to withholding tax but were not reported in the financial statements as expense, the non-reporting of the expense or under-declaration of expense does not give rise to presumption of undeclared income. Petitioner contends that the findings of the Bureau of Internal Revenue (BIR) were merely based on presumptions and conjectures, and as admitted by respondent's witness Revenue Officer D'Joanna M. Diamante, the BIR imputed undeclared income against petitioner by the mere fact that

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[7] G.R. No. L-10507, May 30, 1958.
[8] G.R. No. 197590, November 24, 2014.
[9] 319 US 503, 7 June 1943.

the amounts of the items declared in petitioner's filed BIR Form 1601-E returns did not match the amounts of the said items in its audited financial statements.

Citing the cases of *Agrinurture, Inc. v. CIR*[10] and *CIR vs. Philippine Daily Inquirer*[11], petitioner avers that the under-declaration of purchase or unaccounted expense is not enough basis to sustain an assessment for deficiency income tax, and that it must be clear that there is income and that such income was received by the taxpayer, and not when there is an under-declaration of purchases or expenses.

Moreover, petitioner avers that there is no basis for the imputation of undeclared income considering that the alleged discrepancies between the expenses subjected to 2% expanded withholding tax per BIR Form No. 1601-E vis-à-vis expenses reported in petitioner's financial statements have been accounted for.

The Court finds respondent's arguments unmeritorious.

In the case of *Perez vs. Court of Tax Appeals* cited by respondent, the Supreme Court, quoting the CTA, explained the net worth technique for determining income as expressed in the following formula: Increase in Net Worth plus Non-Deductible Expenditures minus Non-Taxable Receipts equals Taxable Net Income. The net worth expenditures method is based on the accounting formula that an increase in net worth plus non-deductible disbursements, minus non-receipts equals taxable net income. It also quoted the decisions of the Supreme Court of the United States, and discussed the requisites for the use of the Inventory (or Net Worth) Method.

On the other hand, in *BIR vs. Spouses Manly*, the BIR used the expenditure method, which the Supreme Court explained as a method of reconstructing a taxpayer's income by deducting the aggregate yearly expenditures from the declared yearly income. Petitioner further clarified that the theory of this method is that when the amount of the money that a taxpayer spends during a given year exceeds his reported or declared income and the source of such money is unexplained, it may be inferred that such expenditures represent unreported or undeclared income.

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[10] CTA Case No. 8345, May 29, 2013.
[11] CTA EB Case No. 905, November 4, 2013.

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In the case at bar, the alleged undeclared income was not determined by using the Inventory (Net Worth) method nor the expenditure method. Instead, the BIR compared the expenses per BIR Form No. 1601-E with the expenses per petitioner's financial statements, and the discrepancy was alleged to result in undeclared income. In the assailed Decision, the Court explained the computation in more detail, to wit:

> "Based on the FLD with attached Details of Discrepancy, respondent listed down the expenses per petitioner's Financial Statements (FS) which he deemed subject to two percent (2%) EWT and compared the same to those income payments to prime contractors/subcontractors subjected to 2% EWT per BIR Form No. 1601-E. Respondent found the discrepancy as undeclared expenses resulting in undeclared income of ₱1,461,240.82 and assessed petitioner of undeclared income based on gross profit ratio amounting to ₱1,056,411.47, as computed below:

Schedule 1. Undeclared Income		
Expenses subject to 2% withholding tax (Prime Contractors/ Sub-Contractors) per BIR Form No. 1601-E after reinvestigation		₱ 4,371,861.82
Expenses subject to 2% withholding tax (Prime Contractors/ Sub-Contractors) per Financial Statements:		
Advertising Expenses	₱2,742,129.00	
Security Service	2,009.00	
Repairs and Maintenance – Labor	166,483.00	2,910,621.00
Undeclared Income		**₱1,461,240.82**
Schedule 2. Gross Profit Ratio		
Gross Profit per Return		₱ 49,922,613.00
Divide by Sales per Return		69,053,548.00
Gross Profit Ratio		**72.30%**
Schedule 3. Undeclared Income Based on Gross Profit Ratio		
Undeclared Income		₱ 1,461,240.82
Multiplied by Gross Profit Ratio		72.30%
Undeclared Income Based on Gross Profit Ratio		**₱1,056,411.47**

> Upon reinvestigation, respondent found a total undeclared income of ₱4,906,757.64 or an additional undeclared income based on gross profit ratio, in the amount of ₱2,491,174.31, computed as follows:

Expenses subject to 2% withholding tax (Prime Contractors/Sub-Contractors) per BIR Form No. 1601-E after reinvestigation		₱ 7,757,722.82
Expenses subject to 2% withholding tax (Prime Contractors/Sub-Contractors) per Financial Statements:		
Advertising Expenses	₱2,742,129.00	

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Security Service	2,009.00	
Repairs and Maintenance – Labor	166,483.00	2,910,621.00
Undeclared Income (Prime Contractors)		₱ 4,847,101.82
Add: Undeclared Income of Rental Expense		
Rent Expense per 1601E Basic Rent Only	₱8,472,791.60	
Less: Rent Expense per FS Basic Rent Only	8,413,135.78	59,655.82
Total Undeclared Income		**₱4,906,757.64**
Multiply by Gross Profit Rate (₱49,922,613.00/₱69,053,548.00)		72.30%
Undeclared Income per Reinvestigation		**₱3,547,585.77**
Less: Undeclared Income per FLD		1,056,411.47
Additional Undeclared Income		**₱2,491,174.31**

The Court reiterates its ruling that in the imposition or assessment of income tax, it must be clear that there was an income, and such income was received by the taxpayer. The pertinent portion in the assailed Decision is quoted below:

> "Respondent's allegation that petitioner had undeclared income arising from alleged undeclared expenses is without factual basis. It is worthy to note that the imputation of alleged undeclared was based on a mere presumption that since there were expenses not accounted for in petitioner's FS, it has earned income which it failed to declare.
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> As held in the case of *Commissioner of Internal Revenue vs. Agrinurture, Inc.*, a finding of under-declaration of purchase or expense does not by itself result in the imposition of income tax.
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> The three (3) elements in the imposition of income tax are: (1) there must be gain or profit; (2) that the gain or profit is realized or received, actually or constructively; and (3) it is not exempted by law or treaty from income tax. Income tax is assessed on income received from any property, activity or service.
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> Such being the case, in the imposition or assessment of income tax, it must be clear that there was an income, and such income was received by the taxpayer, and not when there is an under-declared purchase or expense.
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> In the instant case, said elements are not present. Respondent merely presumed that the alleged

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> discrepancy/undeclared expense constitute as undeclared income. Hence, respondent's assessment was not based on undeclared income actually received by petitioner.
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> Moreover, it must be emphasized that for income tax purposes, a taxpayer is free to deduct from its gross income a lesser amount, or not claim any deduction at all. What is prohibited by the income tax law is to claim a deduction beyond the amount authorized therein. Thus, even granting that there is an undeclared expense, the same is not prohibited by law.
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> 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.
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> Accordingly, mere reliance on the undeclared expenses is not enough basis to uphold respondent's assessment of the subject deficiency. Therefore, the deficiency income tax on the alleged undeclared income of ₱4,906,757.64 should be cancelled."

Similarly, the Court finds no basis to assess deficiency VAT on the alleged undeclared income since VAT is imposed when one sells, and it has not been shown that petitioner has undeclared sales.

Lastly, respondent avers that the compromise penalties were imposed for failure of petitioner to file BIR Form Nos. 1604-CF and 1604-E, and Alphalist of Employees, and for failure to submit the Summary List of Sales for four (4) quarters during the taxable year 2009.

The Court maintains its ruling that 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. There being no mutual agreement between the parties, the imposition of compromise penalties cannot be sustained.

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In view of the foregoing, the Court holds that there is no cogent reason or overriding justification to disturb the assailed Decision.

WHEREFORE, premises considered, respondent's **Motion for Reconsideration (Re: Decision promulgated 1 October 2018)** is **DENIED** for lack of merit.

SO ORDERED.

CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

(I reiterate my Separate Concurring Opinion.)
ROMAN G. DEL ROSARIO
Presiding Justice

ERLINDA P. UY
Associate Justice