REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

FIRST SUMIDEN CIRCUITS, INC., *Petitioner,*

CTA Case No. 8924

Members:

-versus-

CASTAÑEDA, JR., *Chairperson*
CASANOVA, *and*
MANAHAN, *JJ.*

COMMISSIONER OF INTERNAL REVENUE, *Respondents.*

Promulgated:
JAN 03 2018

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DECISION

MANAHAN, *J.:*

This involves a Petition for Review[1] under Section 3(a), Rule 8[2], in relation to Section 3(a)(1), Rule 4[3] of the Revised Rules of the Court of Tax Appeals. The petition is filed by First Sumiden Circuits, Inc. seeking to annul, reverse and set aside the Final Decision on Disputed Assessment (FDDA) dated October 9, 2014, issued by respondent Commissioner of Internal Revenue, which held petitioner liable for deficiency income tax, inclusive of interest, in the aggregate amount of Php17,655,764.08 for calendar year 2009.

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[1] Docket, CTA Case No. 8924, Vol. 1, pp. 6-28.
[2] Rule 8 Procedure in Civil Cases
Sec. 3. Who may appeal; period to file petition. – (a) A party adversely affected by a decision, ruling or the inaction of the Commissioner of Internal Revenue on disputed assessments or claims for refund of internal revenue taxes, ... may appeal to the Court by petition for review filed within thirty days after receipt of a copy of such decision or ruling, or expiration of the period fixed by law for the Commissioner of Internal Revenue to act on disputed assessments.
[3] Rule 4 Jurisdiction of the Court
Sec. 3. Cases within the jurisdiction of the Court in Divisions. – The Court in Divisions shall exercise:
(a) Exclusive original or appellate jurisdiction to review by appeal the following:
(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;

FACTS

Petitioner is a corporation duly organized under Philippine law, with principal office at Ampere St. corner Main Avenue, Light Industry Science Park of the Philippines I, Special Export Processing Zone, Bo. Diezmo, Cabuyao, Laguna, Philippines.[4] Petitioner is a Philippine Export Processing Zone Authority (PEZA)-registered Ecozone Export Enterprise engaged in the manufacture of flexible printed circuits, flip chip on flex, flexible printed circuits for 1.8" HDD and car radio, lead-free flexible printed circuits for industrial image sensor, and flexible circuit assembly using surface mount technology.[5]

Respondent is the Commissioner of the Bureau of Internal Revenue, the government agency charged with, among other powers and duties, the responsibility of collecting all national internal revenue taxes.[6]

On April 14, 2010, petitioner filed its Annual Income Tax Return (ITR)[7] for calendar year 2009, and paid the corresponding income tax due of Php6,681,145.85.[8]

On May 15, 2013, petitioner received the Preliminary Assessment Notice (PAN)[9] dated May 15, 2013.[10] Petitioner filed its protest[11] to the PAN on May 30, 2013; supplemental protest[12] to the PAN on June 18, 2013; and, position paper[13] on PAN on October 22, 2013.[14]

On June 28, 2013, petitioner paid[15] a portion of the assessed deficiency tax, inclusive of interest, in the amount of Php5,667,715.55.[16]

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[4] Docket, Vol. 2, Joint Stipulation of Facts and Issues (JSFI), p. 638.
[5] *Id.* at 638-639.
[6] *Id.* at 639.
[7] Docket, Vol. 3, Exhibit "P-4", pp. 946-951.
[8] Docket, Vol. 2, JSFI, p. 639.
[9] Docket, Vol. 3, Exhibit "P-5", pp. 952-976.
[10] Docket, Vol. 2, JSFI, p. 639.
[11] Docket, Vol. 3, Exhibit "P-6", pp. 977-1003.
[12] Docket, Vol. 3, Exhibit "P-7", pp. 1004-1040.
[13] Docket, Vol. 3, Exhibit "P-8", pp. 1041-1082.
[14] Docket, Vol. 2, JSFI, p. 639.
[15] Docket, Vol. 3, Exhibit "P-14", pp. 1152-1155.
[16] Docket, Vol. 2, JSFI, p. 639. *am*

Petitioner received the Formal Letter of Demand (FLD)[17] on May 19, 2014.[18] The summary of deficiency taxes[19] shows:

Tax Type	Basic Tax	Interest	Compromise Penalty	Total
Income Tax	21,533,459.00	20,637,241.18	50,000.00	42,220,700.18
VAT	-	-	12,000.00	12,000.00
EWT	4,237,108.43	4,793,579.00	25,000.00	9,055,687.43
Misc – Others	-	-	75,000.00	75,000.00
Total	**25,770,567.43**	**25,430,820.18**	**162,000.00**	**51,363,387.61**

Petitioner filed its protest[20] on June 18, 2014.[21]

On October 9, 2014, petitioner received the Final Decision on Disputed Assessment (FDDA)[22].[23] The FDDA contained the following assessments:

		Special Rate 5%		Regular Rate 30%
Taxable income per return	Php	317,847,439.00	Php	8,717,173.00
Add: Adjustments				
Unreported sales/revenue				
Discrepancy (sales per ITR vs sales per VAT returns)		1,665,752.28		
Discrepancy (sales per SLS vs SLP/AITIED)		20,367.42		
Discrepancy – Management Fees per OR register vs Schedule of Other Income				813,577.17
Realized forex gain not subjected to tax		13,728,945.86		
Disallowed Direct Cost/Deductions		37,652,012.84		
Unsupported Importations		164,795,672.00		
Taxable Income per audit	Php	535,710,189.39	Php	9,530,750.17
Tax Due Special Rate (5%)	Php	26,785,509.47		
Less: Paid to Other Agencies (RA 7916/8748)		6,356,949.00		
Tax Due to BIR under Special Rate (5%)	Php	20,428,560.47		
Tax Due to BIR under Regular Rate (30%)			Php	2,859,225.05
Aggregate Income Tax Due			Php	23,287,785.52
Less: Tax payments/Credits per return	Php	12,150,574.85		
Less: Disallowed Income Tax Credit		1,623,753.00		10,526,821.85
Basic Deficiency Income Tax			Php	**12,760,963.67**
Less: Basic Deficiency Tax Paid 6/28/2013			*	**3,458,555.03**

[17] Docket, Vol. 3, Exhibit "P-9", pp. 1083-1106.
[18] Docket, Vol. 2, JSFI, p. 639.
[19] Docket, Vol. 3, Exhibit "P-9", p. 1085.
[20] Docket, Vol. 3, Exhibit "P-10", pp. 1107-1121.
[21] Docket, Vol. 2, JSFI, p. 639.
[22] Docket, Vol. 1, Exhibit "P-11", pp. 29-45.
[23] Docket, Vol. 2, JSFI, p. 639.

				9,302,408.64
Add: Interest - 4/16/2010 to 9/30/2014	Php	8,303,355.44		
Compromise Penalty		50,000.00		8,353,355.44
***Interest paid**	**Php**	**2,219,160.52**		
TOTAL AMOUNT DUE			**Php**	**17,655,764.08**

Within thirty days from receipt of the FDDA, petitioner filed the subject Petition for Review on November 7, 2014. After two extensions of time[24], respondent filed an Answer[25] on February 4, 2015. On February 26, 2015, the Court received petitioner's Reply[26], filed via registered mail on February 20, 2015.

Thereafter, respondent and petitioner filed their Pre-Trial Briefs on March 12, 2015[27] and March 16, 2015[28], respectively. The parties filed their Joint Stipulation of Facts and Issues (JSFI)[29] on April 16, 2015, which was approved in the Court's Pre-Trial Order[30] dated April 30, 2015.

Meanwhile, on March 16, 2015, petitioner filed its Motion for Commissioning of Independent Certified Public Accountant.[31] Consequently, Mr. George V. Villaruz was appointed as Independent Certified Public Accountant (ICPA), who was granted a period of 45-days or until May 3, 2015 within which to file the ICPA Report.[32]

Pursuant to the Pre-Trial Order, presentation of petitioner's witnesses commenced on May 25, 2015. Petitioner presented the following witnesses: Ms. Ana Liza B. Arciaga[33], Ms. Liz M. Fernandez[34], Ms. Mary Lou Cuyo[35], Ms. Arnilda

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[24] Docket, Vol. 1, pp. 120 and 126.
[25] Docket, Vol. 1, pp. 127-143.
[26] Docket, Vol. 1, pp. 145-156.
[27] Docket, Vol. 1, Respondent's Pre-Trial Brief, pp. 177-186.
[28] Docket, Vol. 1, Petitioner's Pre-Trial Brief, pp. 218-237.
[29] Docket, Vol. 2, pp. 638-647.
[30] Docket, Vol. 2, pp. 649-656.
[31] Docket, Vol. 1, pp. 187-190.
[32] Docket, Vol. 2, Resolution dated March 19, 2015, pp. 621-622.
[33] Docket, Vol. 1, Judicial Affidavit, pp. 242-262.
[34] Docket, Vol. 2, Judicial Affidavit, pp. 662-670; with Supplemental Judicial Affidavit, Vol. 3, pp. 855-859.
[35] Docket, Vol. 2, Judicial Affidavit, pp. 575-583.

Regarde[36], Mr. George V. Villaruz[37], and Ms. Carol M. Defeo-Javid[38].

Petitioner filed its Formal Offer of Documentary Evidence (FOE)[39] on November 11, 2015, with respondent's Comment[40], filed on December 3, 2015. The Court resolved petitioner's FOE on January 20, 2016, with several exhibits being denied admission.[41] This prompted petitioner's filing of Omnibus Motion[42], praying for partial reconsideration, re-opening of the presentation of petitioner's evidence, and re-marking of evidence, which the Court granted[43], despite respondent's Comment/Opposition[44]. Thus, petitioner recalled its witnesses: Ms. Liz M. Fernandez, Ms. Mary Lou M. Cuyo, and Mr. George V. Villaruz[45].[46]

Petitioner filed its Amended FOE[47] on August 8, 2016, to which respondent failed[48] to comment. On September 22, 2016, the Court resolved petitioner's Motion for Partial Reconsideration[49] and Amended FOE, thereby admitting all of petitioner's exhibits.[50]

Respondent presented his lone witness, Ms. Josa C. Gomez[51], on October 24, 2016.[52] Thereafter, respondent filed his FOE[53] on November 2, 2016, with petitioner's Comment/Opposition[54]. On December 2, 2016, the Court resolved respondent's FOE and admitted all of the offered exhibits.[55]

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[36] Docket, Vol. 2, Judicial Affidavit, pp. 495-508.
[37] Docket, Vol. 2, Judicial Affidavit, pp. 711-752.
[38] Docket, Vol. 3, Judicial Affidavit, pp. 844-851.
[39] Docket, Vol. 3, pp. 880-923.
[40] Docket, Vol. 4, pp. 1268-1273.
[41] Docket, Vol. 4, Resolution, pp. 1285-1307.
[42] Docket, Vol. 4, pp. 1326-1341.
[43] Docket, Vol. 4, Resolution dated March 28, 2016, pp. 1359-1360.
[44] Docket, Vol. 4, pp. 1352-1357.
[45] Docket, Vol. 4, Supplemental Judicial Affidavit, pp. 1370-1378.
[46] Docket, Vol. 4, pp. 1363 and 1432.
[47] Docket, Vol. 4, pp. 1434-1478.
[48] Docket, Vol. 4, Records Verification dated August 31, 2016, p. 1487.
[49] Filed on February 11, 2016
[50] Docket, Vol. 4, Resolution, pp. 1491-1495.
[51] Docket, Vol. 1, Exhibit "R-19" Judicial Affidavit, pp. 164-176.
[52] Docket, Vol. 4, p. 1502.
[53] Docket, Vol. 4, pp. 1504-1515.
[54] Docket, Vol. 4, pp. 1516-1521.
[55] Docket, Vol. 4, Resolution, pp. 1523-1524.

Respondent and petitioner filed their Memoranda on January 4, 2017[56] and January 9, 2017[57], respectively. Hence, the case was deemed submitted for decision on January 16, 2017.[58]

ISSUES[59]

The parties submit the following issues for resolution:

I. Whether petitioner is liable for deficiency income taxes in the amount of Php17,655,764.08 for the calendar year ending December 31, 2009;

1. Whether respondent correctly assessed petitioner for "Realized forex gain not subjected to tax";

2. Whether respondent correctly disallowed direct costs/deductions listed in Schedule 5.1 of the FDDA;

3. Whether respondent correctly disallowed as deductions the importations listed in Schedule 6.1.1 of the FDDA;

4. Whether petitioner claimed importations in the amount of Php164,795,672.00 as deductions from its sales/revenue in its ITR for calendar year 2009; and

5. Whether respondent's right to assess deficiency income tax for CY 2009 has already prescribed.

Petitioner's Arguments[60]

Petitioner argues that the assessment for realized foreign exchange (forex) gains is entirely new, appearing only for the first time on the FDDA and was not covered by the PAN and FLD. Said assessment is therefore void for failure to comply with the due process requirements. Petitioner further argues that the

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[56] Docket, Vol. 4, Respondent's Memorandum, pp. 1525-1542.
[57] Docket, Vol. 4, Petitioner's Memorandum, pp. 1543-1564.
[58] Docket, Vol. 4, Resolution, p. 1565.
[59] Docket, Vol. 2, JSFI, pp. 640-641.
[60] Docket, Vol. 1, Petition for Review, pp. 13-24; *Id.*, Petitioner's Reply, pp. 145-152; also, Vol. 4, Petitioner's Memorandum, pp. 1547-1560.

assessment for realized forex gains has no factual and legal basis.

Petitioner also alleges the fact of its payments of the following items of assessment which was not considered in the FDDA:

a) Discrepancy (sales per income tax return (ITR) vs. sales per VAT returns) in the amount of Php1,665,752.28;

b) Discrepancy (sales per Summary List of Sales (SLS) vs. Summary List of Purchases (SLP)/Audit Information Tax Exemption and Incentive Division(AITEID)) in the amount of Php20,367.42;

c) Discrepancy – Management Fees per OR register vs. Schedule of Other Income in the amount of Php813,577.77; and

d) A portion of the Disallowed Direct Cost/Deductions equivalent to Php30,128,457.58.

Petitioner also contests the disallowance of direct cost/deductions in the amount of Php7,523,555.26. Petitioner argues that these costs/deductions are allowable deductions under Revenue Regulations No. (RR) 02-2005, as amended by RR 11-05, and that the list provided in said RRs are not all-inclusive.

As to the assessment for alleged unsupported importations, petitioner argues that the Import Entry & Internal Revenue Declaration (IEIRD) is not the only document that can substantiate the importation. Petitioner argues that it will prove its importations with other documents. Further, petitioner argues that respondent failed to show that the alleged unsupported importations were reported as cost of goods sold and were claimed as deductions.

Finally, petitioner argues that the assessment has prescribed considering the waivers executed were invalid due to defects on the notarization and absence of the signatory's notarized authority.

Respondent's Counter-Arguments[61]

Respondent argues that the prescriptive period to assess was extended due to the valid execution of the waivers. Respondent submits that petitioner's president, Mr. Hisahiro Miyake, has held himself out as petitioner's authorized representative; that Mr. Miyake has executed an SPA designating petitioner's authorized representative to deal with the BIR, and therefore, respondent did not question Mr. Miyake's authority to sign the waivers. Respondent further argues that the waivers were already notarized when submitted to them, as such, the choice of the notary public was with the petitioner. Finally, respondent argues that petitioner should not profit from its misdeeds when it caused the defects in its own waivers, and only raised said defects when it received an adverse decision on its assessments.

Respondent argues that the issuance of the assessment complied with the requirements of RR 12-99[62], in that the LOA, Notices, PAN, FAN and FLD, and FDDA were properly issued. Respondent further states that tax assessments are presumed correct and made in good faith.

RULING OF THE COURT

The petition has partial merit.

The Court has jurisdiction over the petition for review.

It is undisputed that on May 19, 2014, petitioner received the FAN of even date, and that petitioner filed its protest thereto on June 18, 2014.[63]

On October 9, 2014, petitioner received the FDDA, reiterating the assessment and requesting the payment of the alleged deficiency taxes stated therein. Pursuant to Rule 8,

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[61] Docket, Vol. 1, Answer, pp. 128-140; Vol. 4, Respondent's Memorandum, pp. 1527-1539.

[62] 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.

[63] Docket, Vol. 2, JSFI, p. 639.

Section 3(a)[64] of the Revised Rules of the Court of Tax Appeals (RRCTA), it has until November 8, 2014 to file its appeal with the Court. Thus, the Petition for Review filed on November 7, 2014[65] was timely filed.

The waivers validly extended the period of prescription.

Under Section 203[66] of the National Internal Revenue Code of 1997 (NIRC), internal revenue taxes must be assessed within three years counted from the period fixed by law for the filing of the tax return or the actual date of filing, whichever is later. In relation thereto, Section 77(B) of the NIRC provides that the final adjustment return shall be filed on or before the 15th day of April, or on or before the 15th day of the fourth month following the close of the fiscal year, as the case may be.

The instant case involves an assessment for deficiency income tax. Petitioner filed its Annual Income Tax Return for calendar year ending December 31, 2009 on April 14, 2010.[67] Thus, following Section 203, respondent had until April 15, 2013 to assess petitioner for deficiency income taxes. Respondent issued the FLD and assessment notices on May 19, 2014[68], clearly beyond the three-year prescriptive period.

Section 222(b) of the NIRC provides for an exception to the three-year prescriptive period, a provided below:

> Sec. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. –

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[64] Rule 8 Procedure in Civil Cases
Sec. 3. Who may appeal; period to file petition. – (a) A party adversely affected by a decision, ruling or the inaction of the Commissioner of Internal Revenue on disputed assessments or claims for refunds of internal revenue taxes,...may appeal to the Court by petition for review filed within thirty days after receipt of a copy of such decision or ruling, or expiration of the period fixed by law for the Commissioner of Internal Revenue to act on the disputed assessments...

[65] Docket, Vol. 1, Petition for Review, p. 6.

[66] Sec. 203. Period of Limitation Upon Assessment and Collection. – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For the purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

[67] Docket, Vol. 3, Exhibit "P-4", pp. 946-951.

[68] Docket, Vol. 3, Exhibit "P-9", pp. 1083-1091.

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(b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon.

Petitioner and respondent executed five waivers. For ease of discussion, the waivers and pertinent dates are presented below:

	Date Executed	Date Accepted by CIR/ Representative	Date Accepted Waiver was Received by Taxpayer	Period Extended Until
1st Waiver[69]	December 17, 2012	December 21, 2012	December 27, 2012	June 30, 2013
2nd Waiver[70]	May 17, 2013	May 31, 2013	June 5, 2013	December 31, 2013
3rd Waiver[71]	July 30, 2013	August 6, 2013	September 13, 2013	March 31, 2014
4th Waiver[72]	October 24, 2013	October 30, 2013	November 15, 2013	June 30, 2014
5th Waiver	March 13, 2014	March 19, 2014	April 22, 2014	December 31, 2014

Respondent asserts that the prescriptive period was validly extended by virtue of the five waivers[73] executed, the last of which extended the period up to December 31, 2014[74]. Petitioner, on the other hand, questions the validity of the waivers on the ground that its president, Mr. Hisahiro Miyake, was not authorized by the Board of Directors to sign such waivers. Further, petitioner alleges that Mr. Miyake did not personally appear before the Notaries Public, and that for the 1st and 4th waivers, the Notaries Public did not have jurisdiction.

The execution of the waivers must strictly follow the procedures and guidelines provided in Revenue Memorandum Order No. (RMO) 20-90 and Revenue Delegation Authority

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69 BIR Records, Folder 1, Exhibit "R-6", pp. 769-771.
70 BIR Records, Folder 1, Exhibit "R-9", p. 832.
71 BIR Records, Folder 1, Exhibit "R-11", p. 865.
72 BIR Records, Folder 1, Exhibit "R-12", p. 866.
73 BIR Records, Folder 1, Exhibits "R-6", "R-9", "R-11", "R-12", and "R-13", pp. 769-771, 832, 865, 866, and 867, respectively.
74 BIR Records, Folder 1, Exhibit "R-13", p. 867.

Order No. (RDAO) 05-01, otherwise, the waiver is invalid and does not extend the period for assessment.[75] However, in Commissioner of Internal Revenue v. Next Mobile, Inc. (Next Mobile),[76] the Supreme Court held that while faithful compliance with the provisions of RMO 20-90 and RDAO 05-01 must be observed in order for a waiver to be valid and binding, an exception must be made when the circumstances warrant, in keeping with the lifeblood theory of taxation. The Supreme Court explains:

> To be sure, both parties in this case are at fault.
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> Here, respondent, through Sarmiento, executed five Waivers in favor of petitioner. However, her authority to sign these Waivers was not presented upon their submission to the BIR. In fact, later on, her authority to sign was questioned by respondent herself, the very same entity that caused her to sign such in the first place. Thus, it is clear that respondent violated RMO No. 20-90 which states that in case of a corporate taxpayer, the waiver must be signed by its responsible officials and RDAO 01-05(*sic*) which requires the presentation of a written and notarized authority to the BIR.
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> Similarly, the BIR violated its own rules and was careless in performing its functions with respect to these Waivers. It is very clear that under RDAO 05-01 it is the duty of the authorized revenue official to ensure that the waiver is duly accomplished and signed by the taxpayer or his authorized representative before affixing his signature to signify his acceptance of the same. It also instructs that in case the authority is delegated by the taxpayer to a representative, the concerned revenue official shall see to it that such delegation is in writing and duly notarized. Furthermore, it mandates that the waiver should not be accepted by the concerned BIR office and official unless duly notarized.
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> Vis-à-vis the five Waivers it received from respondent, the BIR has failed for five times, to perform its duties in relation thereto: to verify Ms. Sarmiento's authority to execute them, demand the presentation of a notarized document evidencing the same, refuse acceptance of the Waivers when no such document was presented, affix the dates of its acceptance on each

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[75] Commissioner of Internal Revenue v. Kudos Metal Corporation, G.R. No. 178087, May 5, 2010, in relation to Philippine Journalists, Inc. v. Commissioner of Internal Revenue, G.R. No. 162852, December 16, 2004.
[76] G.R. No. 212825, December 7, 2015.

waiver, and indicate on the Second Waiver the date of respondent's receipt thereof.

Both parties knew the infirmities of the Waivers yet they continued dealing with each other on the strength of these documents without bothering to rectify these infirmities. In fact, in its Letter Protest to the BIR, respondent did not even question the validity of the Waivers or call attention to their alleged defects.

In this case, respondent, after deliberately executing defective waivers, raised the very same deficiencies it caused to avoid the tax liability determined by the BIR during the extended assessment period. It must be remembered that by virtue of these Waivers, respondent was given the opportunity to gather and submit documents to substantiate its claims before the CIR during investigation. It was able to postpone the payment of taxes, as well as contest and negotiate the assessment against it. Yet, after enjoying these benefits, respondent challenged the validity of the Waivers when the consequences thereof were not in its favor. In other words, respondent's act of impugning these Waivers after benefiting therefrom and allowing petitioner to rely on the same is an act of bad faith.

On the other hand, the stringent requirements in RMO 20-90 and RDAO 05-01 are in place precisely because the BIR put them there. Yet, instead of strictly enforcing its provisions, the BIR defied the mandates of its very own issuances. Verily, if the BIR was truly determined to validly assess and collect taxes from respondent after the prescriptive period, it should have been prudent enough to make sure that all the requirements for the effectivity of the Waivers were followed not only by its revenue officers but also by respondent. The BIR stood to lose millions of pesos in case the Waivers were declared void, as they eventually were by the CTA, but it appears that it was too negligent to even comply with its most basic requirements.

The BIR's negligence in this case is so gross that it amounts to malice and bad faith. Without doubt, the BIR knew that waivers should conform strictly to RMO 20-90 and RDAO 05-01 in order to be valid. In fact, the mandatory nature of the requirements, as ruled by this Court, has been recognized by the BIR itself in its issuances such as Revenue Memorandum Circular No. 6-2005, among others. Nevertheless, the BIR allowed respondent to submit, and it duly received, five defective Waivers when it was its duty to exact compliance with

RMO 20-90 and RDAO 05-01 and follow the procedure dictated therein. It even openly admitted that it did not require respondent to present any notarized authority to sign the questioned Waivers. The BIR failed to demand respondent to follow the requirements for the validity of the Waivers when it had the duty to do so, most especially because it had the highest interest at stake. If it was serious in collecting taxes, the BIR should have meticulously complied with the foregoing orders, leaving no stone unturned.

The general rule is that when a waiver does not comply with the requisites for its validity specified under RMO No. 20-90 and RDAO 01-05 (*sic*), it is invalid and ineffective to extend the prescriptive period to assess taxes. However, due to its peculiar circumstances, We shall treat this case as an exception to this rule and find the Waivers valid for the reasons discussed below.

First, the parties are *in pari delicto* or "in equal fault." *In pari delicto* connotes that the two parties to a controversy are equally culpable or guilty and they shall have no action against each other. However, although the parties are *in pari delicto*, the Court may interfere and grant relief at the suit of one of them, where public policy requires its intervention, even though the result may be that a benefit will be derived by one party who is in equal guilt with the other.

Here, to uphold the validity of the Waivers would be consistent with the public policy embodied in the principle that taxes are the lifeblood of the government, and their prompt and certain availability is an imperious need. Taxes are the nation's lifeblood through which government agencies continue to operate and which the State discharges its functions for the welfare of its constituents. As between the parties, it would be more equitable if petitioner's lapses were allowed to pass and consequently uphold the Waivers in order to support this principle and public policy.

Second, the Court has repeatedly pronounced that parties must come to court with clean hands. Parties who do not come to court with clean hands cannot be allowed to benefit from their own wrongdoing. Following the foregoing principle, respondent should not be allowed to benefit from the flaws in its own Waivers and successfully insist on their invalidity in order to evade its responsibility to pay taxes. cm

> Third, respondent is estopped from questioning the validity of its Waivers. While it is true that the Court has repeatedly held that the doctrine of estoppel must be sparingly applied as an exception to the statute of limitations for assessment of taxes, the Court finds that the application of the doctrine is justified in this case. Verily, the application of estoppel in this case would promote the administration of the law, prevent injustice and avert the accomplishment of a wrong and undue advantage. Respondent executed five Waivers and delivered them to petitioner, one after the other. It allowed petitioner to rely on them and did not raise any objection against their validity until petitioner assessed taxes and penalties against it. Moreover, the application of estoppel is necessary to prevent the undue injury that the government would suffer because of the cancellation of petitioner's assessment of respondent's tax liabilities.
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> Finally, the Court cannot tolerate this highly suspicious situation. In this case, the taxpayer, on the one hand, after voluntarily executing waivers, insisted on their invalidity by raising the very same defects it caused. On the other hand, the BIR miserably failed to exact from respondent compliance with its rules. The BIR's negligence in the performance of its duties was so gross that it amounted to malice and bad faith. Moreover, the BIR was so lax such that it seemed that it consented to the mistakes in the Waivers. Such a situation is dangerous and open to abuse by unscrupulous taxpayers who intend to escape their responsibility to pay taxes by mere expedient of hiding behind technicalities.
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> It is true that petitioner was also at fault here because it was careless in complying with the requirements of RMO No. 20-90 and RDAO 01-05(*sic*). Nevertheless, petitioner's negligence may be addressed by enforcing the provisions imposing administrative liabilities upon the officers responsible for these errors. The BIR's right to assess and collect taxes should not be jeopardized merely because of the mistakes and lapses of its officers, especially in cases like this where the taxpayer is obviously in bad faith. (Underscoring supplied)

In the instant case, petitioner and respondent executed five waivers. Similar to the Next Mobile case, the waivers were executed without a written and notarized authority of petitioner's signatory. Petitioner failed for five times to submit the written and notarized authority of its signatory, and respondent also failed for five times to demand petitioner's compliance with the strict requirements for the validity of the waivers. Yet the parties continued to deal with each other.

Further, petitioner argues that the waivers were not validly notarized since Mr. Miyake did not personally appear before the notaries public.[77] On the other hand, respondent argues that the waivers were already notarized when submitted to respondent for acceptance.[78] Under RDAO 05-01, the waiver should not be accepted by the concerned BIR office and official unless duly notarized. Thus, the Court agrees with respondent that when petitioner submitted the notarized waivers, respondent cannot be faulted for relying in good faith on the validity and due execution of said notarized waivers.[79]

The Court finds petitioner in bad faith when it impugns the due notarization of the waivers, considering that the alleged defects therein were caused by petitioner. It must be remembered that by virtue of these waivers, petitioner was given the opportunity to gather and submit documents to substantiate its claims before the CIR; it was able to postpone the payment of taxes, contest and negotiate the assessment against it. Petitioner only challenged the validity of said waivers before this Court. In other words, petitioner's act of impugning these Waivers after benefiting therefrom and allowing respondent to rely on the same is an act of bad faith.

Considering the foregoing, the Court finds that the waiver validly extended the period to assess.

The Court will now look into the merits of the assessment.

The assessment should be partially cancelled.

The FDDA contains the following assessment for deficiency income tax:

		Special Rate 5%		Regular Rate 30%
Taxable income per return	Php	317,847,439.00	Php	8,717,173.00
Add: Adjustments				
Unreported sales/revenue				

[77] Docket, Vol. 1, Petition for Review, pp. 10 and 23.
[78] Docket, Vol. 1, Answer, p. 131.
[79] *Id.*

Discrepancy (sales per ITR vs sales per VAT returns)		1,665,752.28		
Discrepancy (sales per SLS vs SLP/AITIED)		20,367.42		
Discrepancy – Management Fees per OR register vs Schedule of Other Income				813,577.17
Realized forex gain not subjected to tax		13,728,945.86		
Disallowed Direct Cost/Deductions		37,652,012.84		
Unsupported Importations		164,795,672.00		
Taxable Income per audit	Php	535,710,189.39	Php	9,530,750.17
Tax Due Special Rate (5%)	Php	26,785,509.47		
Less: Paid to Other Agencies (RA 7916/8748)		6,356,949.00		
Tax Due to BIR under Special Rate (5%)	Php	20,428,560.47		
Tax Due to BIR under Regular Rate (30%)			Php	2,859,225.05
Aggregate Income Tax Due			Php	23,287,785.52
Less: Tax payments/Credits per return	Php	12,150,574.85		
Less: Disallowed Income Tax Credit		1,623,753.00		10,526,821.85
Basic Deficiency Income Tax			Php	**12,760,963.67**
Less: Basic Deficiency Tax Paid 6/28/2013			*	**3,458,555.03**
				9,302,408.64
Add: Interest – 4/16/2010 to 9/30/2014	Php	8,303,355.44		
Compromise Penalty		50,000.00		8,353,355.44
***Interest paid**	**Php**	**2,219,160.52**		
TOTAL AMOUNT DUE			**Php**	**17,655,764.08**

The items of assessment and petitioner's defenses are as follows:

	Assessment	Amount	Petitioner's arguments
1.	Discrepancy (sales per ITR vs sales per VAT returns	Php 1,665,752.28	The deficiency tax on this item was already paid.
2.	Discrepancy (sales per SLS vs SLP/AITIED)	20,367.42	The deficiency tax on this item was already paid.
3.	Discrepancy-Management Fees per OR register vs Schedule of Other Income	813,577.17	The deficiency tax on this item was already paid.
4.	Realized forex gain not subjected to tax	13,728,945.86	Lack of due process as this item of assessment was only presented at the FDDA level.
5.	Disallowed Direct Cost/Deductions	37,652,012.84	The deficiency tax pertaining to Php30,128,457.58 was already paid, thereby reducing the disallowed direct

			cost to only Php7,523,555.26.
6.	Unsupported Importations	164,795,672.00	The importations are supported by IEIRD, or other documents such as purchase invoices, bank remittances, PEZA Import Permits and PEZA Certificates of Delivery.
7.	Disallowed Income Tax Credit	1,623,753.00	The deficiency tax on this item was already paid.
8.	Compromise Penalty	50,000.00	The deficiency tax on this item was already paid.

Alleged Payments of Deficiency Taxes

It is undisputed that on June 28, 2013 petitioner paid a portion of the assessed deficiency income tax, inclusive of interest, in the amount of Php5,677,715.55.[80] Based on the FDDA, the basic tax paid was Php3,458,555.03, with interest amounting to Php2,219,160.52. As garnered from the BIR Records[81], the payment was computed as follows:

Income Tax	For Payment	
	Special Rate 5%	Regular Rate 30%
Taxable Income per return	317,847,439.00	8,717,173.00
Add: Adjustments		
Unreported sales/revenue		
Discrepancy (sales per ITR vs sales per VAT returns)	1,665,752.67	
Discrepancy (sales per SLS vs SLP/AITIED)	20,367.42	
Discrepancy-Management Fees OR Register vs Schedule of Mgt Fees		813,577.17
Disallowed Cost/Deductions		
Unallowable Deductions/Cost of Sales	30,128,457.58	
Taxable Income per audit	349,662,016.67	9,530,750.17
Tax Due Special Rate (5%)	17,483,100.00	
Less: Paid to Other Agencies	6,356,949.00	
Tax Due to BIR under Special Rate	11,126,151.83	
Tax Due to BIR under Regular Rate		2,859,225.05
Aggregate Income Tax Due		13,985,376.88
Less: Tax Payments/Credits per return	12,150,574.85	

[80] Docket, Vol. 2, JSFI, p. 639.
[81] BIR Records, Folder 1, p. 912.

Less: Disallowed Income Tax Credit	1,623,753.00	10,526,821.85
Basic Deficiency Income Tax		3,458,555.03
Add: Interest (4/16/2010 to 5/31/2013)		2,219,160.52
TOTAL AMOUNT DUE		5,677,715.55

To cancel the assessments due to the alleged payment of the applicable deficiency tax, the Court must determine if the payment properly included the attendant interests thereon. Upon verification, the Court finds that the interest was computed from April 15, 2010 until its payment on June 28, 2013, or 1,171 days, thus, the interest of Php2,219,160.52 (Php3,458,555.03 x 20% x 1,171/365).

Considering that petitioner already paid the basic income tax deficiency amounting to Php3,458,555.03 and the said interest of Php2,219,160.52 or in the aggregate amount of Php5,677,715.55, the above items of assessment are hereby cancelled.

Realized forex gain not subjected to tax

The FDDA contained an adjustment to taxable income for realized forex gain not subjected to tax, in the amount of Php13,728,945.86.

Petitioner argues that this assessment item is void for violating its right to due process, since the same did not appear in the PAN nor in the FLD. Respondent did not specifically refute this argument, but merely reiterated that the assessment complied with the requirements of RR 12-99.

An examination of the PAN[82], FLD[83], and FDDA[84], does show that the assessment item for "realized forex gain not subjected to tax" only appears in the FDDA.

[82] Docket, Vol. 3, Exhibit "P-5", pp. 952-962.
[83] Docket, Vol. 3, Exhibit "P-9", pp. 1083-1090.
[84] Docket, Vol. 1, Exhibit "P-11", pp. 29-35.

Section 228[85] of the NIRC provides that the taxpayer shall be informed in writing of the law and the facts on which the assessment is made, otherwise, the assessment shall be void.

In Fluor Daniel Philippines, Inc. v. Commissioner of Internal Revenue (Fluor Daniel)[86], the Court had occasion to rule that changing the assessment from expanded withholding tax (EWT) to final withholding tax (FWT) only in the issuance of the FDDA would certainly deprive the taxpayer of the reasonable opportunity to be heard and submit evidence in support of its defense, which is a clear violation of the due process requirements. The taxpayer involved therein was aware that an assessment was being made on its software maintenance fees for deficiency EWT, as contained in the FLD. In the FDDA, the assessment on the same software maintenance fees was changed to FWT. The Court found that said change of assessment rendered the assessment void for failure to comply with due process.

In the instant case, an entirely new assessment item in the form of "Realized forex gain not subjected to tax" was included in the FDDA. Thus, with more reason, the said assessment item should be rendered void. There was a failure of due process as the said assessment item was not contained in the FLD, but was only disclosed to the petitioner when the FDDA was issued. Considering that the FDDA constitutes respondent's final decision on the assessment, petitioner was therefore, not given the chance to refute within the administrative level the said assessment for "realized forex gain not subjected to tax".

Based on the foregoing, this item of assessment should be cancelled.

<u>Disallowed direct cost/ deductions</u>

Per FLD,[87] respondent disallowed various costs and deductions aggregating to Php40,410,245.58 from being

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[85] Section 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: 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.

xxx xxx xxx

[86] CTA Case No. 7793, April 17, 2012.

[87] Docket, Vol. 3, Exhibit "P-9", pp. 1080-1106.

included in the Cost of Sales in computing petitioner's gross income subject to 5% special income tax rate pursuant to Revenue Regulations Nos. (RR) 2-2005 and 11-2005 and Section 24 of Republic Act No. (RA) 7916, otherwise known as "The Special Economic Zone Act of 1995" (PEZA Law).

But in the FDDA,[88] the cost in the amount of Php2,758,232.74 pertaining to "Office Supplies Total" erroneously added to "Seminars and Training Total" were deducted from the total disallowed cost as shown in Schedule 5 below:

Schedule 5 – Disallowed Direct Cost/Deduction	
Disallowed Direct Cost per FLD	Php 40,410,245.58
Less: Office Supplies Total erroneously added to Seminar & Training Total	2,758,232.74
ADDITIONAL UNALLOWABLE DEDUCTION/COST OF SALES – ***Schedule 5.1***	Php 37,652,012.84

Petitioner argues that the disallowed expenses are direct costs incurred in the performance of its PEZA-registered activity. Further, the disallowed deductions, by their nature, fall under the allowable deductions under Rule XX Section 4(1) of the PEZA Law IRR. Therefore, the same should be allowed as deductions for purposes of computing its gross income.

Respondent notes that even if petitioner was not agreeable on this item of assessment, it nevertheless paid the deficiency tax pertaining to disallowed costs in the amount of Php30,128,457.58 on June 28, 2013.[89]

The Court notes that respondent recognized said payment, and reduced the amount of disallowed direct cost to only Php7,523,555.26 per Details of Discrepancies attached to the FDDA.[90] However, it failed to reflect the same on the FDDA itself.[91]

One of the incentives available to ECOZONE Export Enterprises is the imposition of the preferential tax rate of five

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[88] Docket, Vol. 1, Exhibit "P-11", pp. 29-45.
[89] Docket, Vol. 1, Exhibit "P-11", Details of Discrepancies, pp. 29-45.
[90] Docket, Vol. 1, Exhibit "P-11, Details of Discrepancies, p. 32.
[91] Docket, Vol. 1, Exhibit "p-11", p. 29.

percent (5%) on gross income earned as provided under Section 24 of RA 7916, as amended by RA 8748, which states:

> SECTION 24. Exemption from National and Local Taxes. – Except for real property taxes on land owned by developers, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu thereof, five percent (5%) of the gross income earned by all business enterprises within the ECOZONE shall be paid and remitted as follows:
>
> (a) Three percent (3%) to the National Government;
>
> (b) Two percent (2%) which shall be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located.

"Gross income" has been defined in Section 3 of RR 11-2005. Likewise, the same regulation provides for the deductible expenses for PEZA-registered entities, to wit:

> Section 3. *Gross Income Earned.* – For purposes of implementing the tax incentive of registered Special Economic Zone (ECOZONE) enterprises in Section 24 of Republic Act No. 7916, the term "gross income earned" shall refer to gross sales or gross revenues derived from business activity within the ECOZONE, net of sales discounts, sales returns and allowances and minus costs of sales or direct costs but before any deduction is made for administrative, marketing, selling and/or operating expenses or incidental losses during a given taxable period.
>
> For purposes of computing the total five percent (5%) tax rate imposed, **the following direct costs are included in the allowable deductions** to arrive at gross income earned for specific types of enterprises:
>
> 1. ECOZONE Export Enterprises, Free Trade Enterprises and Domestic Market Enterprises
>
> -Direct salaries, wages or labor expenses
> -Production supervision salaries
> -Raw materials used in the manufacture of products
> -Decrease in Goods in Process Account (Intermediate goods)
> -Decrease in Finished Goods Account

> -Supplies and fuels used in production
> -Depreciation of machinery and equipment used in production, and of that portion of the building owned or constructed that is used exclusively in the production of goods
> -Rent and utility charges associated with building, equipment and warehouses used in production
> -Financing charges associated with fixed assets used in production the amount of which were not previously capitalized (*Emphasis supplied*)

In the case of *East Asia Utilities Corporation v. Commissioner of Internal Revenue*,[92] it has been held that the enumeration of direct costs under RR 11-05 is not an exclusive or closed list of expenses that may be deducted by PEZA-registered enterprises from their gross sales for the purpose of computing the 5% gross income tax (GIT). Instead, the enumeration of direct costs is intended as a guide in determining the items that may be considered direct costs or costs of sales. RR 11-05 also amended Section 7 of RR 02-05 by deleting the words "**consist only**" and restating the pertinent phrase to "**the following direct costs are included in the allowable deductions xxx**". The Court further ruled that:

> It is clear from the amendment made under RR No. 11-05 that the list is not meant to be all-inclusive but merely enumerates the expenses that can be considered as direct costs. PEZA-registered enterprises may be allowed deduct expenses which are in the nature of direct costs even though the same are not included in the list.
>
> The criteria in determining whether the item of cost or expense should be part of direct cost is the direct relation of such item in the rendition of the PEZA-registered services. If the item of cost or expense can be directly attributed in providing the PEZA-registered services, then it should be treated as direct cost.

Section 27(A) of the NIRC also defines the terms "gross income" and "costs of goods sold", as follows:

> For purposes of this Section, the term "**gross income**" derived from business shall be equivalent to gross sales less sales returns, discounts and allowances and cost of goods sold. "**Cost of goods sold**" shall include

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[92] CTA Case No. 8179, May 21, 2014.

all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

xxx xxx xxx

For a manufacturing concern, "**cost of goods manufactured and sold**" shall include all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums, and other costs incurred to bring the raw materials to the factory or warehouse.

Based on the foregoing, for purposes of computing the 5% preferential tax, gross sales/revenues may be reduced only by sales discounts, sales returns and allowances, cost of sales or direct costs or any of the enumerated allowable deductions under RR 11-05. Corollary thereto, in determining whether an expense is part of direct cost, said expense must be directly attributed to the performance of the taxpayer's PEZA-registered activity, *i.e.*, manufacturing and exporting of flexible printed circuits.

The Court will now determine whether the disallowed expenses are direct costs or costs of sales which can be considered as valid deductions from petitioner's gross income.

Per the FDDA's Details of Discrepancies, respondent reduced the amount of disallowed direct cost to only Php7,523,555.26 consisting of the following:[93]

	Reference	**Remaining Alleged Disallowed Direct Cost/Deduction**
Indirect labor – welfare – others	Annex $B_{1.1}$	Php 6,404,096.75
Indirect labor – welfare – retirement fund (VERP/VSP)	Annex $B_{1.2}$	3,072,560.87
Office supplies	Annex $B_{1.3}$	2,758,232.74
Repairs & Maintenance – plant – nonstock	Annex $B_{1.4}$	1,251,545.74
Minor equipment	Annex $B_{1.5}$	909,406.97
Repairs & maintenance – plant - outsourced	Annex $B_{1.6}$	(6,872,287.81)
Total		**Php 7,523,555.26**

[93] ICPA Report, p. 3.

a. Indirect Labor – welfare – others – Php6,404,096.75

According to petitioner, this expense refers to the international assignment fees paid by petitioner to Sumitomo Electric Industries, Ltd. (SEI) for the assignment of SEI's engineers at petitioner's plant. The assignment fee is equivalent to the salaries and wages of the SEI engineers assigned to petitioner. Without the payment of the assignment fee, the SEI engineers whose skills are needed to carry out essential production engineering work at petitioner's plant will not be assigned to petitioner. Thus, this direct labor expense is actually a necessary cost incurred in the production of petitioner's goods. The recording of this labor expense under the account "indirect labor" is done merely to differentiate it from labor expenses incurred for the engineers and staff with employment contracts executed with petitioner. Thus, this direct labor expense should be allowed as deduction.

To support its claim, petitioner presented in evidence Certifications from SEI invoicing petitioner for additional personnel expense, petitioner's application for foreign remittance and various invoices issued by SEI,[94] which were examined by the ICPA, Mr. George Villaruz of Villaruz Villaruz & Co., CPAs.

As ascertained by the ICPA, this account is classified under Cost of Goods Sold for the year ended December 31, 2009. This pertains to billings made by SEI to petitioner for the compensation and allowances of Japanese personnel assigned to petitioner based on the Secondment Agreement between the said parties.

Allegedly, the parties agreed that SEI shall dispatch Japanese personnel to be assigned to petitioner for its business needs relative to the conception, invention, improvement, discovery formula, methodology, know how, etc. performed during the dispatch.[95]

However, petitioner failed to present the Secondment Agreement that could prove that the Japanese employees were expatriated to the Philippines to perform functions that are

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[94] Exhibits "P-34-1" to "P-34-12".
[95] Exhibit "P-36-1", ICPA Report, p. 4. *om*

directly related to petitioner's PEZA-registered activity. Furthermore, the supporting documents did not disclose names or designations or department of the assigned employees. Instead, the Certifications from SEI merely indicated "Executive A, B, C" and so on. Considering the foregoing, the Court finds that petitioner failed to provide adequate proof that these costs are direct costs. As such, the assessment for deficiency income tax relating to the amount of Php6,404,096.75 is upheld.

b. Indirect Labor – welfare – Retirement fund – Php3,072,560.87

According to petitioner, this expense refers to the actual payment of retirement benefits and/or separation pay to production supervisory employees who voluntarily retired or resigned from the company and should be allowed as deduction.

Based on the ICPA Report,[96] the indirect labor-welfare-retirement fund amounting to Php3,072,560.87 is composed of the following:

		Amount
a	Accrual of retirement benefits, supported by JV only	Php 2,216,913.42
b	Actual retirement benefits paid to resigned employees	509,291.45
c	Final pay of resigned employee but without supporting documents	346,356.00
	Total	**Php 3,072,560.87**

As indicated above, the accrual of retirement benefits in the amount of Php2,216,913.42 is supported by Journal Voucher (JV) dated March 31, 2009 per SAP document number 101211127[97] only.

The amount of Php509,291.45 pertains to actual retirement benefits paid to resigned employees which are supported by Final Accountability computations, Employee Clearance Forms, Application for Voluntary Separation Program (VSP), Quit Claim, and Payroll Routing Slip which contain information about the employee's position, division and department.[98] These resigned employees were under Facilities

[96] Exhibit "P-36-1".
[97] Exhibit "P-34-13".
[98] Exhibits "P-34-14" to "P-34-18".

Engineering, Engineering – IE, and Quality Assurance Department, all of which are under the registered activity of petitioner.

On the other hand, the final pay of resigned employees amounting to Php346,356.00 are without supporting documents.

Subsequently, petitioner submitted additional documents[99] supporting the Indirect Labor-Welfare-Retirement Fund which was previously supported by JV only and the final pay of resigned employee but without supporting documents amounting to Php2,563,269.42 (Php2,216,913.42 plus Php346,356.00).

Upon verification of the documents, such as the Final Accountability computation, Employee Clearance Forms, Application for Voluntary Separation Program (VSP), Quit Claim, Payroll Routing Slip and Bank Statement which contain information about the employees' position, division and department, the Court finds that out of the retirement fund of Php2,563,269.42, the amount of Php2,500,098.09 was indeed paid to resigned employees who were under Facilities Engineering, Engineering-IE and Quality Assurance Departments, all of which are under the registered activity of petitioner.

However, the retirement benefits of Php63,171.33 was paid to resigned employees whose position or division/department where they belong cannot be ascertained from the supporting documents provided, thus, the disallowance of the same should be sustained.

Therefore, the retirement fund in the total amount of Php3,009,389.54 should not be disallowed as direct cost.

c. Office Supplies – Php2,758,232.74

According to petitioner, this expense refers to production supplies including protective clothing worn by production line workers or technicians, pens and papers used to make work

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[99] Exhibits "P-34-117" to "P-34-195". 𝒶𝓂

orders, and photocopying services to reproduce production supplies such as Work Order Sheets, Certificates of Inspection, and check sheets which are directly used by the technical and engineering employees in the production of flexible printed circuit assemblies, flip chips on flex and other goods. This account is segregated from the office supplies used for administrative work which are recorded under "62" series for selling costs and administrative costs.

Based on the ICPA Report, this item of assessment consists of the following:

		Amount
a	Supported by sales invoices, billing statement and/or official receipts[100]	Php 1,535,916.61
b	Supported by journal vouchers only[101]	253,088.43
c	Without supporting documents	969,227.70
	Total	**Php 2,758,232.74**

Petitioner submitted additional documents[102] supporting the Office Supplies account which was previously unsupported and those supported by JV only amounting to Php1,222,316.13 (Php969,227.70 plus Php253,088.43).

Based on the Report, a substantial portion of this account pertains to **photocopying charges of work orders and other forms that are being used for production planning purposes**, while other supplies are used for quality control procedures of products being manufactured.

The ICPA referred to *BIR Ruling No. DA (C-056) 192-08 dated September 2, 2008*, which held, *"Consumable supplies and office supplies needed for production are deductible under "Supplies and fuels Used in Production" as specified in the Regulations. Other supplies such as test disc, spare parts, other equipment & tolls which are considered as non-capitalized expenditures used for analysis, testing and quality control also qualify as supplies under in production deductible from gross income."*

Considering that the amount of Php2,691,421.24 (Php1,535,916.61 plus Php1,155,504.63) was duly supported

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100 Exhibits "P-34-19" to "P-34-24", "P-34-26" to "P-34-26" to "P-34-75".
101 Exhibit "P-34-25".
102 Exhibits "P-34-196" to "P-34-205".

by invoices, billing statement and/or official receipts, only the said amount shall be included in the deductions in the computation of its gross income, while the remaining amount of Php66,811.50 shall be disallowed.

d. Repairs and Maintenance–Plant–Nonstock – Php1,251,545.74

This expense refers to supplies used in production such as pipes, tubes, bushings, halogen lamps, angle bars, and nickel nodes. These supplies are bought only when necessary and are not stocked by petitioner, thus, the costs for these supplies are expensed outright. This also includes facility charges and labor expenses incurred for the installation of these supplies and servicing of the machine and equipment. Since these supplies and related services under this account are used in production, petitioner posits that this expense should be allowed as deduction.

As ascertained by the ICPA, repairs and maintenance includes mostly supplies used in the maintenance and machineries in the production department. It also includes the year-end accrual of repairs and maintenance expense incurred for petitioner's annual shutdown of machineries.

To support, *BIR Ruling DA-(C-191) 486-09 dated September 9, 2009* states: *"2. Repairs and Maintenance – Expenses for labor and materials for the maintenance of machines and facility used in production are manufacturing costs deductible from gross income."*

As such, the office and maintenance of Php1,250,723.24 (Php309,254.24[103] plus Php941,469.00[104]) supported by sales invoices, billing statement and/or official receipts, journal voucher, application for foreign remittance, and airway bill[105] shall be allowed as deductible expense in computing petitioner's gross income. Thus, only the amount of Php822.50 shall be disallowed.

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[103] See Annex B1.4 of Exhibit "P-36-1".
[104] See Annex A3 of Exhibit "P-36-2".
[105] Exhibits "P-34-76" to "P-34-89", "P-206".

e. Minor Equipment – Php909,406.97

This expense refers to minor production machines and equipment that are not capitalized such as digital cameras, computers and peripheral devices, and control panels used in the production line. These minor equipment are fabricated and calibrated to fit the specifications of the production unit and which costs are included in this account.

The supporting documents presented by petitioner proved that the account consists of accessories such as digital cameras, laptops, CPUs, desktops and USBs, and that these amounts are supported by sales invoices/official receipts, journal vouchers, and payment checks.[106]

Of the total Minor Equipment duly supported by documents amounting to Php909,406.97, Php834,386.00 pertains to the purchase of computer, computer parts and laptop used by the Production Managers and Line Supervisors in the monitoring of inventory movements, transfer of inventory within the production area, monitoring of good and defective inventories and preparation of quality assurance reports. The remaining minor equipment duly supported by documents amounting to Php75,020.47 (including the Php33,712.00 from the Supplemental ICPA report) pertains to digital cameras, laptops, other equipment and spare parts which are used for the quality control and evaluation of the products.

BIR Ruling Da-(C-056) 192-08 states that *"Other supplies needed for production consumption like test disc, spare parts, other equipment & tolls which are considered as non-capitalized expenditures used for analysis, testing & quality control are considered costs."*

Considering that these minor equipment are directly used by employees involved in production of petitioner's PEZA-registered product, the assessment pertaining thereto should be cancelled.

[106] Exhibits "P-34-90" to "P-34-116".

f. Repairs and Maintenance – Plant Outsourced– (Php6,872,287.81)

Based on the ICPA Report, this item consists of the following:

	Per BIR's FLD	Per FSCI's Basis in the Payment of Deficiency Income Tax	Variance
Calibration	Php 495,538.30	Php 495,538.30	Php -
Freight	669,103.65	669,103.65	-
Installation Cost	(46,491.50)	(46,491.50)	-
Preventive Maintenance	1,319,630.25	1,319,630.25	-
Supplies	-	6,872,287.81	(6,872,287.81)
Supply of Labor & Materials	11,167,370.53	11,167,370.53	-
Uncapitalized PPE	3,725,500.00	3,725,500.00	-
Various Repairs & Services	950,003.82	950,003.82	-
Total	**Php18,280,655.05**	**Php25,152,942.86**	**Php(6,872,287.81)**

Based on the foregoing, petitioner has overpaid its deficiency income tax since Supplies amounting to Php6,872,287.81 was not included in the BIR's FLD, but included in the amounts upon which petitioner's payment was based.

It is noted that per PAN, respondent disallowed petitioner's Repairs & Maintenance-Plant-Outsourced amounting to Php73,776,450.20[107] which includes the amount of Php55,495,795.15[108] pertaining to supplies. However, per FLD, the said supplies account was no longer included in the assessment.[109] Nevertheless, petitioner already paid a portion of the assessment on the said Supplies amounting to Php6,872,287.81.

Thus, upon initial settlement of its deficiency Income Tax on June 28, 2013, it paid in excess of the assessed items in this specific account based on the FLD issued by respondent on May

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[107] Docket, Vol. 3, Schedule 2.1 of Exhibit "P-5", p. 968.
[108] BIR Records, p. 884.
[109] Docket, Vol. 3, Exhibit "P-9", p. 1083.

19, 2014,[110] which may be applied against the total disallowed direct cost/deductions as determined by this Court.

In fine, petitioner's direct cost should not be subjected to deficiency income tax considering that it still had an overpayment of Php337,385.73, as computed below:

	Disallowed Direct Cost/Deduction
Indirect labor – welfare – others	Php 6,404,096.75
Indirect labor – welfare – retirement fund (VERP/VSP)	63,171.33
Office supplies	66,811.50
Repairs & Maintenance – plant – nonstock	822.50
Repairs & maintenance – plant - outsourced	(6,872,287.81)
Total	**Php (373,385.73)**

Unsupported Importations

Based on the Details of Discrepancies attached to the FLD,[111] claimed importations amounting to Php375,500,519.53 were not supported by Import Entry Internal Revenue Declarations (IEIRD), and therefore disallowed.

Per petitioner's protest dated June 18, 2014,[112] petitioner manifested that its importation for taxable year 2009 were substantiated as it submitted its schedule of importations, photocopies of the supporting IEIRDs, PEZA import permits and related invoices to support said importations. However, as per FDDA, respondent claimed that there were importations in the amount of Php164,795,672.00 which remained unsupported and still disallowed. The details are shown in Schedule 6, as follows:

Schedule 6 – Unsupported Importations[113]	
IMPORTATIONS PER SUMMARY LIST (SLI)	Php 2,317,207,520.10
LESS: SUPPORTED WITH IED/PEZA IMPORT PERMIT	2,152,411,848.10
DISCREPANCY – ***Schedule 6.1***	Php 164,795,672.00

110 Docket, Vol. 3, Exhibit "P-14", pp. 1152-1155.
111 Docket, Vol. 3, Exhibit "P-9", p. 1087.
112 Docket, Vol. 3, Exhibit "P-10", p. 1118.
113 Docket, Vol. 3, Exhibit "P-11" Schedule 6.1, pp. 1135-1138.

According to Ms. Liz M. Fernandez, Senior Accounting Supervisor of petitioner, of the seven (7) duplicate originals, four (4) copies are given to the Bureau of Customs (BOC) for distribution to various government offices. However, despite diligent search for petitioner's copies of the IEIRDs in its premises, the same could not be found. Neither could the broker's copies be found.

Petitioner then sent Letter-Requests[114] to the BOC, Philippine Statistics Authority (PSA), BIR, and Tariff Commission (TC) requesting for certified true copies of the IEIRDs to support its importations during taxable year 2009. However, as evidenced by the replies[115] of the PSA and TC to petitioner's request, the IEIRDs were not made available to them for the purposes of this case. On the other hand, no response was received from the BOC while the BIR allegedly refused to receive petitioner's request-letter.

Petitioner claims that contrary to respondent's allegations, it properly substantiated its importations pursuant to Section 34(A)(1)(b) of the NIRC, which provides:

> SEC. 34. Deductions from Gross Income. – Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), there shall be allowed the following deductions from gross income:
>
> (A) Expenses. --
>
> (1) Ordinary and Necessary Trade, Business or Professional Expenses. –
>
> (a) In General. xxx
>
> (b) Substantiation Requirements. – No deduction from gross income shall be allowed under Section (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts <u>or other adequate records</u>: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management,

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[114] Exhibits "P-27", "P-28", "P-29", and "P-30".
[115] Exhibits "P-28-1", and "P-31".

operation and/or conduct of the trade, business or profession of the taxpayer. (*Underscoring supplied*)

Believing that the IEIRD is not the only document required, petitioner presented other documents to substantiate its importations, such as, but not limited to, purchase invoices, bank remittances and advices, PEZA Import Permits, and PEZA Certificates of Delivery.

Here, in lieu of the IEIRD, Authority to Release Goods (ATRIG), or Official Receipt from the BOC evidencing the importation and payment of the attendant tariffs and taxes, petitioner submitted PEZA Import Permits, PEZA Certification, Commercial Invoices, Airway Bills, Packing List and Application for Foreign Remittances, as well as General Ledger Entries showing clearing account entries and journal entries reflecting petitioner's payments to suppliers,[116] and which were duly examined by the ICPA.

Based on the ICPA Report, petitioner was able to substantiate with valid supporting documents the importations amounting to Php149,177,940.47.[117] Consequently, only the remaining amount of Php15,617,731.53 shall be subjected to deficiency tax.

Compromise Penalty

Respondent imposed compromised penalty amounting to ₱50,000.00 against petitioner for its failure to file/or an internal revenue tax at the time or times required by law or regulation pursuant to Section 255 of the NIRC of 1997, as amended, as determined using the schedule of suggested compromise penalties prescribed under Revenue Memorandum Order No. 19-2007.

However, such imposition cannot be sustained. Under Revenue Memorandum Order No. 01-90, compromise penalties are only amounts suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. It is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or

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116 Exhibits "P-35-1" to "P-35-102".
117 Annex B2.3 of Exhibit "P-36-1".

subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[118] Absent a showing that herein petitioner consented to the compromise penalty, its imposition should be deleted. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[119]

In view of the foregoing, petitioner is liable for basic deficiency income tax in the amount of Php780,886.58, computed as follows:

	Special Rate	Regular Rate
	5%	**30%**
	Php 317,847,439.00	Php 8,717,173.00
Taxable income per return		
Add: Adjustment		
Unsupported Importations	15,617,731.53	
Taxable Income per audit	Php 333,465,170.53	₱ 8,717,173.00
Tax Due Special Rate (5%)	Php 16,673,258.53	
Less: Paid to Other Agencies (RA 7916/8748)	6,356,949.00	
Tax Due to BIR under Special Rate (5%)	**Php 10,316,309.53**	
Tax Due to BIR under Regular Rate (30%)		Php 2,615,151.90
Aggregate Income Tax Due		Php 12,931,461.43
Less: Tax payments/Credits per returns		12,150,574.85
Basic Deficiency Income Tax		**Php 780,886.58**

WHEREFORE, premises considered, instant petition for review is **PARTIALLY GRANTED**. The assessment issued by respondent against petitioner for taxable year 2009 covering deficiency income tax is hereby **AFFIRMED but with modifications**. Accordingly, petitioner First Sumiden Circuits, Inc. is **ORDERED TO PAY** respondent the total amount of **₱976,108.23** representing basic deficiency Income Tax and the twenty five percent (25%) surcharge imposed under Section 248(A) (3) of the NIRC of 1997, as amended, computed as follows:

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[118] *Phil. International Fair, Inc. vs. The Collector of Internal Revenue*, G.R. Nos. L-12928 and L-12932, March 31, 1962, 4 SCRA 781.

[119] *Commissioner of Internal Revenue vs. Liangga Bay Logging Co., Inc.*, G.R. No. 35266, January 21, 1999, 193 SCRA 92-93.

Basic Deficiency Income Tax Due	Php 780,886.58
Add: 25% Surcharge	195,221.65
Total Tax Due	**Php 976,108.23**

In addition, petitioner is hereby **ORDERED to PAY**:

a) Deficiency interest at the rate of 20% per annum on the basic deficiency Income Tax of Php780,886.58 computed from the April 15, 2010 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended;

b) Delinquency interest at the rate of 20% per annum on the total amount of Php976,108.23 and on the 20% deficiency interest which have accrued as aforestated in (a) computed from September 30, 2014 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

WE CONCUR:

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

CAESAR A. CASANOVA
Associate Justice

ATTESTATION

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

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

CERTIFICATION

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