REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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BUSINESS ONE, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6832

Members:

ACOSTA, *Chairperson*
BAUTISTA, and
CASANOVA, *JJ.*

Promulgated:
OCT 07 2008 , 2:30 p.m.

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DECISION

CASANOVA, *J.*:

THE CASE

Before this Court is a Petition for Review filed by petitioner praying for a modification of the assessment for deficiency taxes by excluding therein the Value-Added Tax (VAT) on the initial payment of royalty occurred in the year 1997.

THE FACTS

Petitioner is a corporation duly organized and existing under the laws of the Republic of the Philippines; with principal office address at 1326 Pioneer St., FMF Business Center, Mandaluyong City.[1] It is primarily engaged in the business of trading of goods such as office equipment, furnitures, tools, and supplies, and related products on wholesale/retail basis.[2]

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[1] Par. 1 of the Summary of Admitted Facts; Docket, pp. 92-94.
[2] Exhibit B.

Respondent is vested by law to decide disputed assessment, and to enforce the provisions of the Tax Reform Act of 1997 ("Tax Code of 1997"), as amended, and other tax laws; with office at the BIR National Building, Diliman, Quezon City.[3]

On March 18, 2001, petitioner received an Audit Notice stating that Revenue Officers Mariza Uy Rabago and Ma. Cristina Legaspi are authorized to examine the books of accounts, and other accounting records for all internal revenue taxes for the period January 31, 1998 to December 31, 1998.[4]

Subsequently, petitioner received a Post Reporting Notice dated July 16, 2001 with a Pre-Assessment Computation in the amount of P8,549,205.29.[5]

Another re-investigation was conducted with the petitioner submitting further documentary evidence to refute the assessed amount.[6]

On May 24, 2002, petitioner received a Notice for an Informal Conference dated May 23, 2002 with a Pre-Assessment Computation in the amount of P1,467,432.97.[7]

On June 13, 2002, petitioner through its duly authorized representative Edna D. Lee, duly executed a Waiver of the Statute of Limitations under the Tax Code.[8]

On August 1, 2002, petitioner received a Preliminary Assessment Notice dated July 30, 2002, with Details of Discrepancies, for deficiency Value-Added Tax in the amount of P1,183,399.05; and for deficiency Expanded Withholding Tax in the amount of P82,641.14, computed as follows:[9]

Deficiency Value-Added Tax

Gross Sales		P 42,282,662.00
Less: Exempt Sales		120,595.00
Taxable Sales		P 42,162,067.00
Add: Royalty paid to Office 1 Superstores		6,759,036.00
Taxable sales/receipts per audit		P 48,921,103.00
Output Tax due thereon		P 4,892,110.30
Less: Carry over from 1998	P 3,106,658.42	
Input tax	4,718,541.80	

[3] Par. 2 of the Summary of Admitted Facts; *Id.*, p. 92.
[4] Par. 3 of the Summary of Admitted Facts; *Id.* Also, Exhibit C.
[5] Par. 4 of the Summary of Admitted Facts; *Id.*
[6] Par. 5 of the Summary of Admitted Facts; *Id.*, p. 93.
[7] Par. 6 of the Summary of Admitted Facts; *Id.* Also, Exhibit E.
[8] Par. 12 of the Summary of Admitted Facts; *Id.* Also, Exhibit D.
[9] Par. 7 of the Summary of Admitted Facts; *Id.* Also, Exhibit F.

Disallowed input tax allocated to exempt sales	(13,457.75)	7,811,742.47
Excess creditable input tax per investigation		(P 2,919,632.17)
Less: Excess creditable input tax carry over to 1999		3,608,993.52
VAT still due		P 689,361.35
Add: 20% Interest (01.25.99 to 08.25.02)		494,037.70
Total Amount Due		P 1,183,399.05

Deficiency Expanded Withholding Tax

Expanded Withholding Tax due for the month of December	P 42,021.06
Add: 25% Surcharge	10,505.27
20% Interest (01.25.99 to 08.25.02)	30,114.81
Total Amount Due	P 82,641.14

On September 2, 2002, petitioner received an Assessment Notice for deficiency VAT in the amount of P1,196,781.70 and Expanded Withholding Tax in the amount of P83,456.90 for the calendar year 1998,[10] with Formal Assessment Notice and Details of Discrepancies.[11] The deficiency taxes are computed as follows:

Deficiency Value-Added Tax

Gross Sales		P 42,282,662.00
Less: Exempt Sales		120,595.00
Taxable Sales		P 42,162,067.00
Add: Royalty paid to Office 1 Superstores		6,759,036.00
Taxable sales/receipts per audit		P 48,921,103.00
Output Tax due thereon		P 4,892,110.30
Less: Carry over from 1998	P 3,106,658.42	
Input tax	4,718,541.80	
Disallowed input tax allocated to exempt sales	(13,457.75)	7,811,742.47
Excess creditable input tax per investigation		(P 2,919,632.17)
Less: Excess creditable input tax carry over to 1999		3,608,993.52
VAT still due		P 689,361.35
Add: 20% Interest (01.25.99 to 09.30.02)		507,420.35
Total Amount Due		P 1,196,781.70

Deficiency Expanded Withholding Tax

Expanded Withholding Tax due for the month of December	P 42,021.06
Add: Surcharge	10,505.27
	P 52,526.33
Interest (01.25.99 to 09.30.02)	30,930.57
Total Amount Due	P 83,456.90

On September 25, 2002, petitioner filed its administrative protest against the said Assessment Notice alleging, among others, that the audit conducted regarding the 1997 activity subject to VAT is beyond the authority of the auditing officers; and that such right to

[10] Par. 8 of the Summary of Admitted Facts; *Id.* Also, Exhibit G and H.
[11] Exhibit I.

assess on the initial royalty paid in 1997 has prescribed.[12] Petitioner, however, admits that it failed to pay the VAT on the initial royalty fee paid in 1997.

On November 5, 2003, petitioner received a notice that the internal revenue tax liabilities of the company for the year 1998, in the amount of P1,306,738.60 representing deficiency VAT and Expanded Withholding Tax under Formal Assessment Notice No. 002930-98-02-059 has become final, executory, and demandable.[13]

Construing the said Notice of November 5, 2003 as a denial of petitioner's protest, petitioner filed before this Court a Petition for Review on December 5, 2003.[14]

On February 9, 2004, respondent filed her Answer and raised the following Special and Affirmative Defenses:[15]

> "5. He reiterates and repleads the preceding paragraphs of this answer as part of his Special and Affirmative Defenses;
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> 6. Section 228 of the Tax Code, partly provides:
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> > `Sec.228. Protesting of Assessment.-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.'* (Emphasis supplied)
>
> Considering the failure of petitioner to submit all relevant supporting documents within sixty (60) days from filing its protest, the assessments have already become final by operation of law.
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> 7. Since the assessments have become final, this Honorable Court has no jurisdiction to act on the instant petition.
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> 8. Assuming arguendo that this Honorable Court has jurisdiction to act on the instant petition, petitioner was assessed for deficiency VAT on Royalty payments for the reason that petitioner failed to subject to VAT the royalty fees paid to the Office 1 Superstores International L.P. amounting to P6,759,036.00 reflected in the Alpha list of payees in violation of Section 108 of the Tax Code, as amended.
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> 9. Petitioner's claimed creditable input tax in the amount of P13,457.75 was disallowed pursuant to Section 110(A)(3)(b) of the 1997 Tax

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[12] Par. 14 of the Summary of Admitted Facts; *Id.*
[13] Par. 10 of the Summary of Admitted Facts; *Id.*
[14] Par. 11 of the Summary of Admitted Facts; *Id.*
[15] *Id.*, pp. 47-50.

Code, which provides that `*A VAT- registered person who is also engaged in transactions not subject to the value-added tax shall be allowed tax credit xxx (b) A ratable portion of any input tax which cannot be directly attributed to either activity'.*

10. Petitioner was assessed for deficiency Expanded withholding tax due for the month of December, 1998 for the reason that the amount of P42,021.06 was offsetted from the excess withholding tax on compensation. Thus, under Revenue Regulations No. 4-93, only withholding tax due on compensation can be offsetted on excess withholding tax on compensation.

11. Petitioner's due execution of the waiver of the defense of prescription under the NIRC prescribed under Sections 203 and 222 of the Tax Code, on July 23, 2001 and June 20, 2003, respectively, suspend the running of the prescriptive period within which the BIR may assess the petitioner for all internal revenue taxes for taxable year 1998.

12. Petitioner was assessed for the compromise penalty for the reason that it failed to file its VAT returns (Foreign currency sales/local sales); quarterly schedule of sales and purchases, taxpayer's identification number (TIN) of its employees and failed to pay the expanded withholding tax for the month of December, 1998 in violation of Section 255 of the Tax Code.

13. In the instant case, the deficiency tax assessment issued by the BIR are within the bounds and limit of the law since it was petitioner itself who filed the alpha list of payees subject to final tax as of December 31, 1998, wherein the BIR examiners based the assessment on VAT .

14. However, assuming for the sake of argument but without conceding that the 1998 deficiency VAT assessment on royalty issued to petitioner were made beyond the three (3) year prescriptive period, said assessments were still valid and effective pursuant to Section 222 (a) of the Tax Code, as amended, which partly provides:

> `(a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud, or omission x x x'

15. The VAT return filed/submitted by petitioner to the BIR for taxable year 1997 and 1998 is clearly a FALSE VAT RETURN since it was disclosed that the Royalty payments in issue were not among those reported in the said VAT return of petitioner, hence, prescription does not set in as the same falls within the exception aforestated above.

16. The Supreme Court in the case of **Aznar vs. Court of Tax Apppeals** (58 SCRA 518) ruled that 'the filing of a false return, even without intent to evade tax, is embraced under the ten (10) year statute of limitations within which to assess.'

17. Under Section 114 (C) of the Tax Code, it is provided that 'the payment for lease or use of property rights to NON-RESIDENT OWNERS shall be subject to ten (10%) percent WITHHOLDING TAX at the time of payments. For this purpose the payor or person in control of the payment shall be considered as withholding agent. The value-added tax withheld under this section shall be remitted within ten (10) days following the end of the month the withholding was made.'

18. Based upon the foregoing, the fact that petitioner failed to file the withholding VAT return and remit the withholding VAT on royalty payments within the period prescribed by law, prescription does not set in as the same falls within the exception aforestated above.

19. Moreover, assuming arguendo, but without conceding that Revenue Memorandum Order No. 24, Series of 2000, cited by petitioner in its protest was intended to delimits the Audit Program, the same is considered VOID and of no effect for it is contrary to the law and existing jurisprudence on the matter. Settled is the rule that administrative actions/pronouncement must be in harmony with the provisions of the law. In case of discrepancy between the basic law and the implementing rule or regulations, the former prevails. Such rules and regulations must not override, but must remain constant and in harmony with the law they seek to apply. They must neither supplant nor modify the law.

20. The assessments issued against petitioner for deficiency VAT, Expanded Withholding Tax and Compromise penalty, all for taxable year 1998, covered under Assessment Notice No. MC-002930-98-02-059, VT-002930-98-02-059 and WE-002930-98-02-059, all dated August 30, 2002 were made in accordance with law and regulations.

21. The deficiency tax assessment issued by the BIR to petitioner is presumed true, correct and made in good faith. The taxpayer has the burden of proof that the said assessments is illegal or improper."

In petitioner's Reply filed on March 10, 2004, it counters:[16]

a.) Assessment did not attain finality by operation of law as petitioner submitted the relevant documents as annexes of the protest filed with the BIR and no final notice of assessment has been issued.

b.) The Court of Tax Appeals has jurisdiction over the instant case as the assessments are not final and executory.

c.) The waiver of the defense of prescription excludes the deficiency VAT on initial royalty paid by the petitioner in 1997.

d.) Revenue Memorandum Order No. 24, Series of 2000 is valid.

e.) The deficiency tax assessed by the respondent is incorrect.

[16] *Id.*, pp. 58-65.

During the pre-trial held on July 23, 2004, counsel for petitioner manifested that petitioner is willing to settle the deficiency expanded withholding tax, including charges and penalties, for December, 1998; but contests the assessment for deficiency VAT.[17]

Thereafter, the trial proceeded and the parties presented their respective testimonial and documentary evidence. Upon receipt of petitioner's Memorandum filed on December 3, 2007, and for failure to file her Memorandum despite notice; this Court issued a Resolution dated January 3, 2008 submitting the above-captioned case for decision.[18]

THE ISSUES

The following issues, as stipulated by the parties, are submitted for this Court's resolution:

1. whether or not the assessment made on the initial royalty fee is outside the scope of the Audit Notice dated March 18, 2001;

2. whether or not the disputed VAT assessed on the initial royalty fee has already prescribed;

3. whether or not the deficiency VAT assessed by the BIR on petitioner for taxable year 1998, has already become final, executory and demandable, pursuant to Section 228 of the Tax Code; and

4. whether or not the VAT Returns filed by the petitioner for the taxable year 1997 and 1998 are "false returns."

THE COURT'S RULING

As borne by evidence and admitted by petitioner and its witnesses, petitioner paid Office 1 royalty fees in the year 1997 but failed to pay the value-added taxes due thereon.[19]

Petitioner's liability to pay VAT is incontrovertible. Secs. 99 and 100 (a)(1)(B), of the National Internal Revenue Code of 1977, as amended, ("Tax Code of 1977") provide:

> "**SEC. 99. *Persons Liable.*** - Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders

[17] TSN, July 23, 2004, pp. 5-7.
[18] Docket, p. 295.
[19] TSN, July 23, 2004, p. 22; December 14, 2004, pp. 11, 13-14; February 24, 2005, p. 14; April 6, 2006, p. 6.

services, and any person who imports goods shall be liable to the value-added tax (VAT) imposed in Sections 100 to 102 of this Code.

xxx "

"SEC. 100. *Value-added tax on sale of goods or properties.* - *(a) Rate and base of tax.* - There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to 10% of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor.

"(1) The term 'goods or properties' shall mean all tangible and intangible objects which are capable of pecuniary estimation and shall include:

"(A) Real properties held primarily for sale to customers or held for lease in the ordinary course of trade or business;

"(B) The right or the privilege to use patent, copyright, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;

"(C) The right or the privilege to use in the Philippines of any industrial, commercial or scientific equipment;

"(D) The right or the privilege to use motion picture films, films, tapes and discs; and

"(E) Radio, television, satellite transmission and cable television time.

"The term 'gross selling price' means the total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax. The excise tax, if any, on such goods or properties shall form part of the gross selling price.

xxx."

Further, the Master Franchise Agreement already pointed out petitioner's liability to pay taxes which may be imposed by the National or Local Government. As stipulated in the Master Franchise Agreement, petitioner was liable to pay Office 1 a Master Franchise Fee of U.S.$225,000.00;[20] initial franchise fees, whenever applicable;[21] a monthly non-refundable royalty fee on "net sales"[22] from the operations of all the Company Superstores;[23] service

[20] Par. 8.1 of the Master Franchise Agreement; BIR Records, p. 30.
[21] Par. 8.2 of the Master Franchise Agreement; *Id.*, p. 30.
[22] Defined as gross sales less VAT or other local taxes levied at the cash register or added to the invoice total.
[23] Par. 8.3 of the Master Franchise Agreement; BIR Records, p. 30.

fees, software usage fees, and other fees.[24] Petitioner was also "liable for payment of turnover, sales, **value added**, consumption, and all similar taxes that may be imposed upon the operations of all superstores in the Region by any federal or local government or other taxing authorities of the Region. xxx"[25] (Emphasis supplied)

Petitioner's claim that it has no knowledge of its obligation to pay VAT is not a valid defense from complying therewith.

As petitioner's liability to pay value-added tax on the royalty fees paid in the year 1997 was established, the query now is whether respondent's right to assess and to collect the same has prescribed.

The period of limitation for the Bureau of Internal Revenue ("BIR") to assess and to collect taxes is found in Section 203 of the "Tax Code of 1997", that reads:

> **"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 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."

Said section must be taken in relation to Section 222 of the same Code, to wit:

> **"SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes.**—
>
> (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years from the discovery of the falsity, fraud or omission: *Provided,* That in a fraud assessment which has became final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.
>
> xxx."

[24] Par. 8.5 of the Master Franchise Agreement; *Id.*, p. 29.
[25] Par. 8.9 of the Master Franchise Agreement; *Id.*, pp. 26-30.

In *Commissioner of Internal Revenue v. Arturo Tulio,*[26] the Supreme Court ruled that "Section 223 [now Section 222] specifies three (3) instances when the running of the three-year prescriptive period does not apply. These are: (1) filing a false return; (2) filing a fraudulent return with intent to evade tax; or (3) failure to file a return. The period within which to assess tax is ten years from discovery of the fraud, falsification or omission." Further, "in case of failure to file a return, the tax may be assessed at any time **within ten years after the omission** [.]"[27]

In the present case, petitioner filed VAT returns for the years 1997 and 1998. It was not reflected in the said VAT returns that petitioner paid Office 1 the royalty fees and paid the VAT due thereon. For filing a false return, the ten-year prescriptive period shall apply and has commenced running on the date when respondent, through the revenue officer who conducted the audit, discovered that petitioner did not reflect in the returns the royalty fees paid to Office 1 in the amount of P6,759,036.00 and no VAT payments were made.[28]

Based from the facts of the case, both the Preliminary Assessment Notice and the Formal Assessment Notice under protest were issued within the prescriptive period. Thus, respondent's right to assess and to collect has not prescribed.

Notwithstanding the absence of an Audit Notice to conduct a tax investigation for the year 1997, the power of the respondent to assess petitioner for deficiency VAT is valid. The power to make assessment proceeds from Section 6 of the Tax Code, which reads:

> **"SEC. 6. Power of the Commissioner to Make assessments and Prescribe additional Requirements for Tax Administration and Enforcement. –**
>
> (A) *Examination of Returns and Determination of Tax Due.* - After a return has been filed as required under the provisions of this Code, the Commissioner or his duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax: Provided, however; That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer.

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[26] G.R. No. 139858, October 25, 2005.
[27] *Id.,* citing *Marcos II vs. Court of Appeals,* G.R. No. 120880, June 5, 1997, 273 SCRA 47.
[28] Exhibit 6; BIR Records, pp. 568-572.

The tax or any deficiency tax so assessed shall be paid upon notice and demand from the Commissioner or from his duly authorized representative.

Any return, statement of declaration filed in any office authorized to receive the same shall not be withdrawn: Provided, That within three (3) years from the date of such filing, the same may be modified, changed, or amended: Provided, further, That no notice for audit or investigation of such return, statement or declaration has in the meantime been actually served upon the taxpayer.

(B) *Failure to Submit Required Returns, Statements, Reports and other Documents.* - When a report required by law as a basis for the assessment of any national internal revenue tax shall not be forthcoming within the time fixed by laws or rules and regulations or when there is reason to believe that any such report is false, incomplete or erroneous, the Commissioner shall assess the proper tax on the best evidence obtainable.

In case a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise files a false or fraudulent return or other document, the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise, which shall be prima facie correct and sufficient for all legal purposes.

xxx."

However, there is no merit in respondent's contention that the assessment became final and executory for petitioner's failure to submit relevant supporting documents within 60 days from filing of its protest pursuant to Sec. 228 of the Tax Code. In *Standard Chartered Bank – Philippine Branches v. Commissioner of Internal Revenue*,[29] this Court pointed out that relevant supporting documents refers to such documents which the taxpayer feels would be necessary to support the protest and not what the respondent feels should be submitted; otherwise, the taxpayer would always be at the mercy of the BIR which may require production of such documents which taxpayer could not produce. Besides, the BIR should inform the taxpayer to submit whatever documents are lacking in order that a complete determination of the propriety of the assessment may be had. Further, this Court reiterated that the requirement on the submission of all the relevant supporting documents within the 60-day period from filing protest is merely directory.

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[29] C.T.A. Case No. 5696, August 16, 2001.

In affirming the assessment for deficiency taxes, this Court must point out that tax assessments are presumed correct and made in good faith, and the taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments.[30]

IN VIEW OF THE FOREGOING, the Petition for Review is hereby **DISMISSED** for lack of merit. Accordingly, petitioner is hereby **ORDERED to PAY** deficiency value-added tax in the amount of P1,196,781.70 and expanded withholding tax in the amount of P83,456.90.

In addition, petitioner is likewise hereby **ORDERED TO PAY** twenty-five percent (25%) surcharge for late payment as provided in Section 248(3) of the NIRC of 1977, as amended; and twenty percent (20%) delinquency interest pursuant to Section 249(C)(3) of the NIRC of 1977, as amended, computed from October 1, 2002 until full payment thereof.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

[30] *Bonifacia Sy Po v. Hon. Court of Tax Appeals and Hon. Court of Tax Appeals,* G.R. No. 81446, August 18, 1988.

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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.

ERNESTO D. ACOSTA
Presiding Justice
Chairman, First Division