REPUBLIC OF THE PHILIPPINES
Court Of Tax Appeals
QUEZON CITY

SECOND DIVISION

JACINTO MARKETING AND TRADING CORPORATION, *Petitioner,*	**C.T.A. CASE NO. 6616**
	Members:
-versus-	CASTAÑEDA,JR., Chairperson UY, and PALANCA-ENRIQUEZ, JJ.
COMMISSIONER OF INTERNAL REVENUE, ***Respondent.***	**Promulgated:** FEB 14 2008 1:00 p.m.

x -- x

DECISION

PALANCA-ENRIQUEZ, J.:

THE CASE

This is a Petition for Review filed by Jacinto Marketing and Trading Corporation (hereafter "petitioner") praying for the cancellation of deficiency tax assessments covering income, value-added ("VAT"), final and expanded withholding taxes ("EWT") for the taxable year 1998.

THE FACTS

The facts of the case, as culled from the records, are as follows:

422

Petitioner is a corporation duly organized and existing under the laws of the Republic of the Philippines, with principal office at F. Jacinto House, 116 Rada Street, Legaspi Village, Makati City.

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue vested by law to decide disputed assessments and to enforce the provisions of the NIRC, and other tax laws, with office address at the BIR National Office Building, Diliman, Quezon City, where she may be served with summons and other court processes.

On September 21, 1999, respondent issued Letter of Authority No. 00018837 to petitioner, authorizing Revenue Officers Erlinda Ulgado and Frances Leonida to examine petitioner's books of accounts and other accounting records for all internal revenue taxes for taxable year 1998, addressed at No. 503 Culmat Bldg., Rodriguez Sr. Ave., Quezon City, Metro Manila. Subsequently, on October 21, 1999, Letter of Authority No. 00016620 was issued to petitioner authorizing Revenue Officer Ofelia Metrillo and Group Supervisor Emilia Combes to examine petitioner's accounting records, addressed at SEDCCO Bldg., Rada St., Legaspi Village, Makati City.

On December 2, 1999, respondent issued a Second Request for Presentation of Records to petitioner reiterating his request for the presentation of petitioner's records, pursuant to LA No. 00016620.

On July 5, 2000, petitioner received a Final Notice dated June 22, 2000 requesting petitioner to submit its books of accounts and other accounting records for taxable year 1998.

For petitioner's repeated failure to submit the required documents, on September 15, 2000, respondent issued to petitioner a *subpoena duces tecum* addressed at SEDDCO Bldg., Rada St., Legaspi Village, Makati City.

For petitioner's failure to comply with the *subpoena duces tecum*, the Chief Legal Division of the BIR Region 8 recommended an immediate assessment against petitioner based on the "Best Evidence Obtainable".

Hence, on April 22, 2002 respondent issued to petitioner a Preliminary Assessment Notice with attached Details of Discrepancies, assessing petitioner for deficiency income tax, VAT, final tax, EWT and compromise penalty.

Thereafter, petitioner received a Formal Assessment Notice, with Details of Discrepancies dated May 15, 2002, assessing petitioner of deficiency income tax, VAT, final tax and EWT, detailed as follows:

a) Deficiency Income Tax Tax Due Interest (04-26-99 to 06-10-02) Total Amount Due	 P26,113,138.05 16,460,819.23	 P42,573,957.28
b) Deficiency Value Added Tax Tax Due Surcharge (50%) Interest Total Amount Due	 P9,521,989.40 4,760,994.70 6,421,039.10	 P20,704,023.20
c) Deficiency Final Tax Tax Due Surcharge (50%) Interest (01-26-99 to 06-10-02) Total Amount Due	 P3,226,226.52 1,613,113.26 2,175,567.07	 P7,014,906.85
d) Deficiency Expanded Withholding Tax Tax Due Surcharge (50%) Interest (01-26-99 to 06-10-02) Total Amount Due	 P447,289.08 223,644.54 301,624.01	 P972,557.63
e) Compromise Penalty Non-filing of quarterly ITR Non-filing of VAT Returns Non-filing of Annual Information Return Non-filing of Alpha List EWT and Compensation Non-filing of 1601C, 1601E and 1603 Total	 P3,000.00 12,000.00 2,000.00 2,000.00 28,000.00	 P47,000.00

On June 24, 2002, petitioner filed its protest to aforesaid Formal Assessment Notices to which respondent issued a Tax Verification Notice on July 18, 2002.

In a Letter dated August 20, 2002, petitioner submitted documentary evidence in support of its protest.

On March 14, 2003, respondent issued a Preliminary Collection Letter to petitioner, which was received by petitioner on March 27, 2003.

Since respondent failed to act on the protest within the 180-day period, on March 20, 2003, petitioner elevated the case to this Court by way of a Petition for Review.

In his "Answer" filed on May 14, 2003, respondent, by way of special and affirmative defenses, alleged that based on *Section 223 of the NIRC of 1997, as amended*, the government's right to assess petitioner for deficiency income tax, VAT, final, EWT, and penalty taxes, all for taxable year 1998, under *Section 203 of the same Code,* has been suspended for the reason that petitioner cannot be located at the address given in the return it filed with the BIR and petitioner failed to inform the BIR of its new business address; petitioner failed to submit all relevant supporting documents within sixty (60) days from filing its protest, hence the assessments had become final and this Court has no jurisdiction to act on this petition; that petitioner was assessed for deficiency income tax of P42,573,957.28, inclusive of interest, for the reason that 50% of petitioner's claimed expenses were all disallowed as deduction from its income for its failure to present supporting documents/books of accounts, pursuant to *Section 6(B) of the NIRC of 1997, as amended*; petitioner claimed expenses were all disallowed as deduction from its income for its failure to subject said claimed expenses to EWT, pursuant to *Section 34(k) of the NIRC of 1997, as amended*; petitioner was assessed for deficiency VAT in the amount of P20,704,023.20 for its failure to present the required VAT returns; petitioner was subjected to 50% surcharge, pursuant to *Section 248(b) of the NIRC of 1997, as amended;* and petitioner was assessed a compromise penalty tax of P47,000.00 for violating *Section 255 of the NIRC of 1997, as amended*, for its failure to file its Quarterly Income Tax, VAT, and Annual Information Returns, Alpha List, EWT and Compensation (BIR Forms 1601C, 1601E, 1603) for the year 1998.

Petitioner presented Mela Rose Dimaguila, Controller of F. Jacinto Group, Inc., as witness, and formally offered documentary evidence, marked as *Exhibits "A"* to *"BB"*, inclusive of their submarkings, which were all admitted by this Court in a Resolution dated January 25, 2006, after petitioner filed a "Motion for Reconsideration" of the Resolution dated October 14, 2005.

On the other hand, respondent presented Revenue Officer Ofelia Metrillo as witness, and formally offered documentary evidence, marked

aal

422

as *Exhibits "1"* to *"27"*, inclusive of their submarkings, which were all admitted by this Court in a Resolution dated March 8, 2007.

Thereafter, both parties were granted thirty days from notice to file their simultaneous memoranda, afterwhich, the case shall be deemed submitted for decision.

For failure of both parties to file their respective memorandum, the case was deemed submitted for decision.

ISSUES

As stipulated upon by the parties, the following are the issues for this Court's consideration:

I

WHETHER OR NOT THE BIR'S RIGHT TO ASSESS PETITIONER FOR DEFICIENCY INCOME TAX, VALUE-ADDED TAX, EXPANDED WITHHOLDING TAX, FINAL TAX, AND PENALTY TAX, ALL FOR TAXABLE YEAR 1998, HAS BEEN SUSPENDED OR HAS ALREADY PRESCRIBED.

II

WHETHER OR NOT THE DEFICIENCY TAX ASSESSMENT ISSUED AGAINST PETITIONER FOR TAXABLE YEAR 1998, BASED ON THE BEST EVIDENCE OBTAINABLE UNDER RMC 23-2000 WAS PROPER.

III

WHETHER OR NOT PETITIONER'S CLAIMED EXPENSES IN THE FORM OF PURCHASES, INSTALLATION COST, ADVERTISING AND MARKETING, LOSSES, INSURANCE INTEREST, TRANSPORTATION AND TRAVEL, COMMUNICATION, LIGHT AND WATER, MISCELLANEOUS EXPENSE, OFFICE SUPPLIES, SALARIES AND WAGES, BAD DEBTS, EMPLOYEES BENEFITS AND REPRESENTATION AND ENTERTAINMENT EXPENSES SHOULD BE DISALLOWED AS DEDUCTIONS FROM PETITIONER'S GROSS INCOME FOR 1998, FOR FAILURE TO PRESENT ITS BOOKS OF ACCOUNTS AND OTHER SUPPORTING DOCUMENTS, PURSUANT TO SECTION 6(B) OF THE 1997 TAX CODE, AS IMPLEMENTED BY RMC 23-2000.

IV

WHETHER OR NOT PETITIONER'S CLAIMED EXPENSES IN THE FORM OF RENTAL COMMISSION, PROFESSIONAL FEES, REPAIRS AND MAINTENANCE, MANAGEMENT FEES SHOULD BE DISALLOWED AS DEDUCTIONS FROM PETITIONER'S GROSS INCOME FOR 1998, FOR ITS FAILURE TO SUBJECT THE SAID CLAIMED EXPENSES TO THE EXPANDED WITHHOLDING TAX PURSUANT TO SECTION 34(K) OF THE NIRC.

V

WHETHER OR NOT PETITIONER IS LIABLE FOR THE ASSESSED DEFICIENCY VAT IN THE AMOUNT OF P20,704,023.20 (INCLUSIVE OF INCREMENTS) FOR ITS FAILURE TO PRESENT THE REQUIRED VAT RETURNS FOR 1998, PURSUANT TO SECTION 106(A) OF THE NIRC.

VI

WHETHER OR NOT PETITIONER IS LIABLE FOR THE ASSESSED DEFICIENCY FINAL TAX IN THE AMOUNT OF P7,014,906.85 (INCLUSIVE OF INCREMENTS) FOR ITS FAILURE TO SUBJECT THE RECEIVED FRINGE BENEFITS IN THE AMOUNT OF P6,262,675.00 TO THE FRINGE BENEFITS TAX, PURSUANT TO REVENUE REGULATIONS NO. 3-98.

VII

WHETHER OR NOT PETITIONER IS LIABLE FOR THE ASSESSED DEFICIENCY EXPANDED WITHHOLDING TAX IN THE AMOUNT OF P972,557.63 FOR ITS FAILURE TO WITHHOLD THE CORRESPONDING TAXES ON INCOME PAYMENT ON RENTAL, COMMISSION, PROFESSIONAL FEE, REPAIRS AND MAINTENANCE AND MANAGEMENT FEES, PURSUANT TO SECTION 50 OF THE NIRC, AS IMPLEMENTED BY REVENUE REGULATIONS NO. 13-78, AS AMENDED BY REVENUE REGULATIONS NO. 6-85.

VIII

WHETHER OR NOT PETITIONER IS SUBJECT TO 50% SURCHARGE, PURSUANT TO SECTION 248(B) OF THE NIRC.

IX

WHETHER OR NOT PETITIONER IS LIABLE FOR THE ASSESSED COMPROMISE PENALTY TAX OF P47,000.00 FOR FAILURE TO FILE ITS QUARTERLY INCOME TAX RETURN, VAT RETURNS, ANNUAL INFORMATION RETURNS, ALPHA LIST, EXPANDED WITHHOLDING TAX RETURNS AND COMPENSATION (BIR FORMS 1601C, 1601E, 1603) FOR THE YEAR 1998.

X

WHETHER OR NOT PETITIONER HAS UNDERDECLARED INCOME IN THE AMOUNT OF P3,742,274.00 FOR TAXABLE YEAR 1998.

XI

WHETHER OR NOT PETITIONER'S COMPLIANCE ON THE REPORTORIAL REQUIREMENTS UNDER THE EVAT REGULATIONS WAS INCOMPLETE.

XII

WHETHER OR NOT PETITIONER'S CLAIMED EXPORT SALES WERE DULY SUPPORTED BY INWARD REMITTANCES.

XIII

WHETHER OR NOT PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX, VALUE-ADDED TAX, FINAL WITHHOLDING TAX, EXPANDED WITHHOLDING TAX, AND COMPROMISE PENALTY TAX ASSESSMENTS IN THE AMOUNTS OF P42,573,957.28, P20,704,023.20, P7,014,906.85, P972,557.63 AND P47,000.00, RESPECTIVELY, ALL FOR TAXABLE YEAR 1998.

The foregoing issues boil down into three main issues, to wit:

I

WHETHER OR NOT THE BIR'S RIGHT TO ASSESS PETITIONER FOR DEFICIENCY INCOME TAX, VAT, FINAL TAX, EWT, AND COMPROMISE PENALTY, ALL FOR TAXABLE YEAR 1998, HAS BEEN SUSPENDED OR HAS ALREADY PRESCRIBED.

431

II

WHETHER OR NOT PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX, VAT, FINAL TAX, EWT, AND COMPROMISE PENALTY ASSESSMENTS IN THE AMOUNTS OF P42,573,957.28, P20,704,023.20, P7,014,906.85, P972,557.63 AND P47,000.00, RESPECTIVELY, ALL FOR TAXABLE YEAR 1998.

III

WHETHER OR NOT PETITIONER IS SUBJECT TO 50% SURCHARGE, PURSUANT TO SECTION 248(B) OF THE NIRC.

THE COURT'S RULING

The Petition is partly meritorious.

First Issue

Petitioner Jacinto's Argument

Respondent's right to issue assessment against it had already prescribed. The final assessment notices cover deficiency assessment for taxable year 1998. However, petitioner received the FAN for the said deficiency taxes only on May 27, 2002. Petitioner, therefore, was assessed beyond the 3-year prescriptive period.

Respondent Commissioner's Counter-Argument

Respondent counters that the government's right to assess petitioner for deficiency income tax, VAT, final tax, EWT, and penalty tax, all for taxable year 1998, has been suspended for the reason that petitioner cannot be located at the address given in the return it filed with the BIR, at the time the assessment notices were served to petitioner, and petitioner failed to inform the BIR of its new business address.

Section 203 of the NIRC of 1997, as amended, provides the general rule for the period of limitation upon assessment and collection of taxes, as follows:

> "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 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."

Section 222 of the same Code, on the other hand, provides for the exceptions as to the period of limitation of assessment and collection of taxes, to wit:

> "SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. –
>
> (a) In 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

ore

433

> omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.
>
> xxx xxx."

Pursuant to the above provisions, respondent has three years from the filing of the returns to assess petitioner of any internal revenue tax. The exceptions are when there is a finding of falsity, or fraud with intent to evade the tax, or omission in the filing of said returns, in which cases, the prescriptive period to assess is ten years from the discovery of said falsity, fraud or omission.

Prescription as to Deficiency Income Tax

Petitioner was assessed for deficiency income tax for taxable year 1998 on the ground that 50% of petitioner's purchases, installation cost, expenses for advertising and marketing, losses, insurance, interest, transportation and travel, communication, light and water, miscellaneous expense, office supplies, salaries and wages, bad debts, employees benefits, and representation and entertainment were disallowed for petitioner's failure to present supporting documents/books of accounts, despite receipt of the *subpoena duces tecum*. Respondent's disallowance of 50% of said expenses of petitioner was based on *Section 6(B) of the*

NIRC of 1997, as amended, as implemented by *RMC 23-2000,* specifically *Section 24(C) thereof (Exhibit "14").*

In other words, the aforesaid expenses of petitioner were disallowed due to petitioner's failure to substantiate the amount of said expenses.

In this regard, *Section 34 (A) (1) (b) of the NIRC of 1997, as amended*, provides that one of the requirements for the deductibility of an expense is:

> "SEC. 34. Deductions from Gross Income. – xxx
>
> (A) Expenses. –
>
> (1) Ordinary and Necessary Trade, Business or Professional Expenses. –
>
> (b) Substantiation Requirements. – No deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer."

BIR Ruling No. 027-01 dated June 20, 2001, citing the cases of *Zamora vs. Collector (8 SCRA 163)* and *Visayan Cebu Terminal Co., Inc. vs. Collector (180 Phil. 320)* expressly provides that for an expense to be deductible, it must be substantiated by official receipts or adequate records; that generally, the BIR only accepts the original copy of the receipt/s, which a taxpayer presents to substantiate deductible expense; nevertheless, the absence of original receipts or records does not prevent a taxpayer from proving by other evidence that the claimed deduction was really paid or incurred.

However, a scrutiny of the evidence on record reveals that petitioner failed to present any supporting evidence to substantiate the amount and the direct connection to petitioner's trade or business of said expenses.

Record shows that respondent repeatedly requested petitioner to present its books of accounts and other accounting records to substantiate the aforesaid expenses. In fact, as early as September 21, 1999, through Letter of Authority No. 00018837 *(Exhibit "26")*, petitioner was informed of the BIR's examination of its accounting records for all internal revenue taxes for taxable year 1998. Thereafter, on October 25, 1999, petitioner received another Letter of Authority No. 00016620 *(Exhibit "22")*, authorizing Revenue Officer Ofelia Metrillo and Group Supervisor Emilia Combes to examine petitioner's accounting records for all internal revenue taxes for taxable year 1998. Again, on December 2, 1999, respondent issued a Second Request for Presentation of Records, which

OAL

was received by petitioner on December 7, 1999, reiterating its request for the presentation of petitioner's records, pursuant to Letter of Authority No. 00016620 and petitioner's promise to present said records last October 26, 1999 *(Exhibit "23")*.

However, despite the second request for presentation of records, petitioner still failed to present its books of accounts and accounting records. Hence, on June 22, 2000, respondent issued a Final Notice to petitioner, which was received by petitioner on July 5, 2000, appealing for the last time to allow respondent's examiner to have access to petitioner's accounting records, or otherwise explain to respondent either by telephone or personal visit, why presentation of accounting records cannot be done *(Exhibit "24")*. But, again, respondent's appeal was to no avail.

Finally, on September 15, 2000, respondent issued a *subpoena duces tecum* to petitioner, received by petitioner on October 5, 2000, requiring its Treasury Manager to appear and to bring with her the following documents for calendar year 1998: General Ledger, Sales Journal, Purchases Journal, Cash Disbursement Book, Cash Receipts Book, General Journal, Trial Balance of General Ledger Accounts and

Official Receipts/Invoices *(Exhibit "1")*. Again, petitioner failed to comply.

On the basis of the foregoing facts and circumstances, it is clear that petitioner willfully and deliberately refused to submit its books of accounts and other accounting records to respondent. The Court finds that petitioner's claimed expenses in its 1998 Income Tax Return were not duly substantiated. Petitioner did not and was not able to substantiate the aforesaid expenses because there was nothing to support the same. Evidently, there is a willful overstatement of petitioner's expenses. Hence, respondent's assessment for deficiency income tax against petitioner by disallowing 50% of said expenses has legal basis.

Another ground of the assessment for deficiency income tax against petitioner was petitioner's failure to subject to EWT , petitioner's expenses for rental, commission, professional fee, repairs and maintenance, and management fees, pursuant to *Section 34 (K) of the NIRC of 1997, as amended (Exhibit "14")*. A perusal of the records clearly shows that petitioner failed to subject to EWT said rental, commission, professional fee, repairs and maintenance, and management fees. Accordingly, petitioner cannot legally deduct the same as business expenses, pursuant to *Section 34 (K) of the NIRC of 1997, as amended*, in

OHL

relation to *Section 57 of the same Code*. Thus, making petitioner's 1998 Income Tax Return, showing said commission, professional fee, repairs and maintenance and management fees as deductions, a false return.

Indeed, *Section 248 (B) of the NIRC of 1997, as amended*, expressly provides "That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute ***prima facie*** evidence of false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein."

In this case, upon a careful verification of the records, the Court finds that there is a substantial overstatement of petitioner's deduction (50.22% for its cost of sales and 61.38% for its selling and administrative expenses), as appearing in its 1998 Annual Income Tax Returns *(Exhibits "20" and "R")*, computed as follows:

Cost of Sales

Purchases	P 38,339,321.00
Installation Cost	2,580,173.50
Amount of Cost of Sales to be disallowed	P40,919,494.50
Divided by Total Cost of Sales (BIR Records, p. 170)	81,476,442.00
Percentage	**50.22%**

Selling and Administrative Expenses

Advertising and Marketing	P 88,523.00
Losses	100,000.00
Insurance	70,688.50
Interest	946,231.00
Representation & Entertainment	1,039,639.50
Supplies	114,081.50
Communication	277,839.00
Transportation & Travel	322,061.50
Miscellaneous	144,937.00
Commission	2,259,523.00
Management Fee	1,447,631.00
Professional Fee	389,103.00
Rental	728,557.00
Repairs & Maintenance	123,553.00
Bad Debts	2,576,338.00
Employees Benefits	6,262,675.00
Amount of Expenses to be disallowed	P16,891,381.00
Divided by: Selling and Administrative Expenses (BIR Records, p. 169)	27,521,075.00
Percentage	**61.38%**

Since there is a substantial overstatement of deductions (cost of sales and selling & administrative expenses), the same constitutes as *prima facie* evidence of a fraudulent and false return, which was not rebutted by petitioner. More importantly, the obtaining circumstances clearly establish that there was a deliberate intent on the part of the petitioner to cover up its overstated expenses. Hence, the prescriptive period to assess the deficiency income tax is ten years, pursuant to *Section 222 of the NIRC of 1997, as amended.*

Considering that petitioner filed its Annual Income Tax Return for taxable year 1998 *(Exhibits "20"* and *"R")* on April 15, 1999, the Assessment Notice for deficiency income tax against petitioner issued on May 15, 2002 *(Exhibits "8"* and *"A"),* was well within the ten-year prescriptive period.

The question, therefore, as to whether petitioner's different addresses shown in its return indicating changes of business/registered addresses have the effect of suspending the running of the statute of limitation, has been rendered moot and academic by the above findings of this Court.

Prescription as to Deficiency VAT

Respondent assessed petitioner of deficiency VAT in the amount of P20,704,023.20, pursuant to *Section 106(A) of the NIRC of 1997, as amended (Exhibit "14").* Since petitioner failed to present the required VAT returns, the total gross revenue per income statement was subjected to the 10% output tax.

A perusal of the records reveals that petitioner filed its 1st Quarter VAT Return on April 27, 1998 *(Exhibit "L")*, and 2nd Quarter VAT Return on July 27, 1998 *(Exhibit "J")*. However, there is no evidence showing that petitioner filed its 3rd and 4th Quarters VAT Returns.

On the basis of petitioner's 1st and 2nd Quarters VAT Returns *(Exhibits "L" and "J", respectively)*, the total amount of its sales subject to 10% output tax amounting to P95,201,721.64 was determined. Comparing the same with petitioner's gross receipts per financial statements in the amount of P95,219,894.00, the Court finds that there is an undeclared sales for VAT purposes amounting to P18,172.36. A perusal of the 1st and 2nd Quarters VAT Returns for 1998, however, does not show said undeclared amount of P18,172.36. Therefore, said undeclared sales may pertain to either the 3rd or 4th quarter only.

For failure of petitioner to file its 3rd and 4th quarters VAT returns, resulting to an underdeclaration of its VAT liabilities, the applicable provision on the period of assessment and collection of taxes is *Section 222 of the NIRC of 1997, as amended.* Petitioner, therefore, may be validly assessed for deficiency VAT, within 10 years from the discovery of said omission.

Considering that petitioner filed its 1st Quarter VAT Returns on April 27, 1998, and its 2nd Quarter VAT Returns on July 27, 2001 and the discovery of the omission of filing of the 3rd and 4th Quarters VAT

OAL

Returns was made thereafter, in the course of the examination of petitioner's tax liability, the Formal Assessment Notice issued to petitioner on May 15, 2002, was well within the ten-year prescriptive period.

Prescription as to Deficiency Final Tax and EWT

Respondent assessed petitioner of deficiency final tax on the ground that fringe benefits amounting to P6,262,675.00 were not subjected to fringe benefit tax, in violation of *Revenue Regulations No. 3-98*.

While, respondent assessed petitioner of deficiency EWT on the ground that petitioner did not withhold the corresponding taxes on rental, commission, professional fees, repairs and maintenance and management fees.

A review of the records reveals that petitioner filed its Monthly Remittance Return of Income Taxes Withheld only for the months of January, February, March, April, May, and July 1998 *(BIR Records, pp. 235-240)*. However, there is no showing that petitioner filed its Monthly Remittance Return of Income Taxes Withheld for the months of June, August, September, October, November and December. This is a clear

ael

case of omission to file the return under *Section 222 of the NIRC of 1997, as amended.*

A further review of the records shows that there is no proof that the employee benefits of P6,262,675.00 were subjected to fringe benefits tax. Nor is there evidence that the income payments on rental, commission, professional fee, repairs and maintenance, and management fees, were subjected to withholding tax. Only the certificate of income tax withheld at source for the following income payments, namely: suppliers, payment to contractors and payment on purchases of goods are found in the BIR Records *(BIR Records, pp. 24-49, 52-57)*. Thus, making petitioner's Remittance Return of Income Taxes Withheld falsified.

Accordingly, petitioner may be validly assessed for deficiency final tax and EWT, within ten years from the discovery of said omission and falsity. Considering that petitioner's Monthly Remittance Return of Income Taxes Withheld for the month of January was filed on February 10, 1998 *(BIR Records, p. 235)*, for the month of February was filed on March 10, 1998 *(BIR Records, p. 236)*, for the month of March was filed on April 13, 1998 *(BIR Records, p. 237)*, for the month of April was filed on May 12, 1998 *(BIR Records, p. 238)*, for the month of May was filed on June 10, 1998 *(BIR Records, p. 239)*, and for the month of July was filed on

August 12, 1998 *(BIR Records, p. 240)*, and the discovery of the omission for the months of June, August, September, October, November and December was made thereafter, while the Formal Assessment Notice was issued on May 15, 2002, it is clear that petitioner was assessed for deficiency final tax and EWT within the ten-year prescriptive period.

Second Issue

Proceeding now to the second issue, whether or not petitioner is liable for deficiency income tax, VAT, final tax, EWT, and compromise penalty assessments in the amounts of P42,573,957.28, P20,704,023.20, P7,014,906.85, P972,557.63 and P47,000.00, respectively, all for taxable year 1998, We find as follows:

Deficiency Income Tax

As heretofore discussed, petitioner deliberately refused to submit its books of accounts and other accounting records; thus, respondent assessed petitioner on the basis of the "Best Evidence Obtainable" Rule, as provided under *Section 6 (B) of the NIRC of 1997, as amended*, which states:

> "SEC. 6. Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. –
>
> xxx xxx.

OAL

> (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 Commission 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."

Corollary thereto, *Revenue Memorandum Circular No. 23-000*, implementing the above provision provides that in an assessment, the burden of proof is upon the taxpayer-claimant to show clearly that the assessment is erroneous. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment *(Section 2.4. (a) of RMC No. 23-000)*. Moreover, in the absence of receipt to prove actual amount of expense deduction, it is the duty of the BIR to make an estimate of the deduction that may be allowable in computing the taxpayer's taxable income, bearing heavily against the taxpayer whose inexactitude is of his own making. Thus, the disallowance of 50% of the taxpayers claimed deduction is valid *(Section 2.4. (c) of RMC No. 23-000)*.

For a taxpayer cannot be permitted to hide its taxable income and evade the payment of taxes with impunity by the simple expediency of conveniently losing its books of accounts and paying the minimal compromise penalty therefore. Otherwise, it would be impossible to collect income taxes due from a dishonest taxpayer *(Section 2.4. (f) of RMC No. 23-000)*.

Since investigation of the respondent reveals that petitioner incurred the following expenses, but petitioner failed to substantiate the amount of each expense, respondent's disallowance of 50% of each expense has legal basis. Accordingly, the following disallowance of petitioner's claimed expenses by the respondent is hereby upheld:

Expenses	Amount of Expenses per ITR (*Exhibits "20"* and *"R"*)	Amount of Disallowed Expenses
Purchases	(50% of 76,678,642.00)	P38,339,321.00
Installation Cost	(50% of 5,160,347.00)	2,580,173.50
Advertising and Marketing	(50% of 177,046.00)	88,523.00
Losses	(50% of 200,000.00)	100,000.00
Insurance	(50% of 141,377.00)	70,688.50
Interest	(50% of 1,892,462.00)	946,231.00
Representation & Entertainment	(50% of 2,079,279.00)	1,039,639.50
Supplies	(50% of 228,163.00)	114,081.50
Communication	(50% of 555,678.00)	277,839.00
Transportation & Travel	(50% of 644,123.00)	322,061.50
Miscellaneous	(50% of 289,874.00)	144,937.00

While, respondent's disallowance of 100% of the expenses enumerated hereunder has sufficient legal basis:

Expenses taken from *Exhibits "20"* and *"R"*	Amount of Disallowed Expenses
Commission	2,259,523.00
Management Fee	1,447,631.00
Professional Fee	389,103.00
Rental	728,557.00
Repairs & Maintenance	123,553.00
Employees Benefits	6,262,675.00

Pursuant to *Section 34 (K) of the NIRC of 1997, as amended*, in relation to *Section 57 of the same Code*, an expense can be deducted if it is shown that the tax required to be deducted and withheld therefrom has been paid to the BIR.

Absent any scintilla of evidence to prove that the foregoing incurred expenses of petitioner were subjected to expanded withholding tax, respondent's disallowance of the same has legal basis.

As regards the bad debts expense amounting to P2,576,338.00, records show that petitioner failed to comply with the following requirements for valid deduction of bad debts from gross income, as provided in *Section 3 of Revenue Regulations No. 05-99*:

> "(1) There must be an existing indebtedness due to the taxpayer which must be valid and legally demandable;
>
> (2) The same must be connected with the taxpayer's trade, business or practice of profession;

> (3) The same must not be sustained in a transaction entered into between related parties enumerated under Sec. 36(B) of the Tax Code of 1997;
>
> (4) The same must be actually charged off the books of accounts of the taxpayer as of the end of the taxable year; and
>
> (5) The same must be actually ascertained to be worthless and uncollectible as of the end of the taxable year."

In this case, petitioner failed to prove that the foregoing requisites have been satisfied. Hence, the amount of P2,576,338.00, as petitioner's bad debt expense, cannot be allowed as a deduction.

On the other hand, respondent's disallowance of petitioner's salaries and wages amounting to P5,708,467.00 has no legal basis since the same is duly supported by an Annual Information Return of Income Tax Withheld, with attached alphalist *(Exhibit "Q")*. Thus, petitioner can validly deduct the same for the full amount of P5,708,467.00 from its gross income.

Deficiency VAT

As previously discussed, respondent assessed petitioner of deficiency VAT because petitioner failed to file the required VAT Returns, hence, pursuant to *Section 106 of the NIRC of 1997, as amended*, respondent subjected to 10% output tax, the gross revenue per income statement of petitioner in the amount of P95,219,894.00.

However, after a careful examination of the evidence on record, the Court finds that the total amount of sales subjected to 10% output tax, based on the 1st and 2nd quarters VAT Returns of petitioner *(Exhibits "L" and "J", respectively)* is P95,201,721.64. Therefore, there is only an undeclared sales for VAT purposes amounting to P18,172.36 (P95,219,894,00 less P95,201,721.64). Applying the 10% output tax rate, this Court rules that petitioner's deficiency VAT, exclusive of surcharge and interest, amounts to P1,817.24 only.

Deficiency Final Tax

As heretofore discussed, respondent assessed petitioner of deficiency final tax in the amount of P7,014,906.85 (inclusive of increments) for petitioner's failure to subject the received fringe benefits in the amount of P6,262,675.00 to fringe benefit tax.

Revenue Regulations No. 03-98, implementing *Section 33 of the NIRC of 1997, as amended*, provides for the imposition of fringe benefit tax, to wit:

> "SEC. 2.33. SPECIAL TREATMENT OF FRINGE BENEFITS

(A) *Imposition of Fringe Benefits Tax* — A final withholding tax is hereby imposed on the grossed-up monetary value of fringe benefit furnished, granted or paid by the employer to the employee, except rank and file employees as defined in these Regulations, whether such employer is an individual, professional partnership or a corporation, regardless of whether the corporation is taxable or not, or the government and its instrumentalities except when: (1) the fringe benefit is required by the nature of or necessary to the trade, business or profession of the employer; or (2) when the fringe benefit is for the convenience or advantage of the employer. The fringe benefit tax shall be imposed at the following rates:

Effective January 1, 1998-	34%
Effective January 1, 1999-	33%
Effective January 1, 2000-	32%

The tax imposed under Sec. 33 of the Code shall be treated as a final income tax on the employee which shall be withheld and paid by the employer on a calendar quarterly basis as provided under Sec. 57 (A) (Withholding of Final Tax on certain Incomes) and Sec. 58 A (Quarterly Returns and Payments of Taxes Withheld) of the Code.

The grossed-up monetary value of the fringe benefit shall be determined by dividing the monetary value of the fringe benefit by the following percentages and in accordance with the following schedule:

Effective January 1, 1998-	66%
Effective January 1, 1999-	67%
Effective January 1, 2000-	68%

xxx xxx."

In the instant case, petitioner, declared in its 1998 Annual Income Tax Return Employees' Benefits – subject to withholding tax in the amount of P6,262,675.00 *(Exhibits "R" and "20")*. However, a review of the records reveals that petitioner did not subject said amount to fringe benefit tax. Applying therefore, *Revenue Regulations No. 03-98*, this Court finds petitioner liable for deficiency fringe benefit tax, computed as follows, exclusive of surcharge and interest:

Employees Benefits	6,262,675.00
Divided by	66%
Gross up monetary value	9,488,901.52
Fringe benefits tax, exclusive of surcharge and interest	P3,226,226.52

<u>Deficiency EWT</u>

As heretofore discussed, petitioner did not withhold the corresponding expanded withholding tax to commission, management fees, professional fees, rental, and repairs and maintenance, hence petitioner was made liable to pay deficiency EWT.

Said income payments are subject to withholding tax, pursuant to *Section 2.57.2 of Revenue Regulations No. 2-98.*

Pursuant to law and settled jurisprudence, petitioner is constituted as a withholding agent for purposes of the creditable tax required to be withheld on income payments enumerated in *Section 2.57.2 (Section 2.57.3 of Revenue Regulations No. 2-98)*. Under the withholding system, the agent-payor becomes a payee by fiction of law. His (agent) liability is direct and independent from the taxpayer *(Commissioner of Internal Revenue vs. The Court of Appeals, 301 SCRA 170-171).*

As such, petitioner's non-compliance with said obligation to withhold will make it personally liable for the tax arising from the breach of its legal duty.

Respondent's assessment for deficiency withholding tax against the petitioner is, therefore, valid. Thus, this Court hereby sustains the following assessments, exclusive of surcharge and interest:

	From *Exhibits "20"* and *"R"*	Tax Rate	EWT Payable
Commission	2,259,523.00	10%	225,952.30
Management Fee	1,447,631.00	10%	144,763.10
Professional Fee	389,103.00	10%	38,910.30
Rental	728,557.00	5%	36,427.85
Repairs and Maintenance	123,553.00	1%	1,235.53
Total deficiency EWT due & collectible, exclusive of surcharge and interest			P447,289.08

Compromise Penalty Tax Assessment

In a Letter dated May 15, 2002, respondent assessed petitioner of compromise penalty in the amount of P47,000.00, consisting of the following: P3,000.00 for non-filing of Quarterly ITR, P12,000.00 for non-filing of VAT Returns, P2,000.00 for Annual Information Return, P2,000.00 for Alpha List EWT and Compensation, and P28,000.00 for non-filing of (1601C, 1601E, 1603), in lieu of instituting criminal action against the petitioner.

423

The Court finds that the imposition of the compromise penalty is without legal basis considering that petitioner did not agree to enter into compromise settlement with petitioner. *Revenue Memorandum Order No. 1-90* expressly provides that "compromise penalties are only amounts suggested in settlement of criminal liability, and may not therefore be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the suggested compromise penalty". Since, petitioner did not pay the compromise penalty imposed by the respondent, it did not agree to settle the same. Thus, the compromise penalty amounting to P47,000.00 is hereby cancelled.

Third Issue

As regards the third issue of whether or not petitioner is liable to 50% surcharge, under *Section 248(B) of the NIRC of 1997, as amended*, petitioner argues that both in the FAN and Demand Letter respondent never averred that fraud was employed by the petitioner in the preparation and filing of the pertinent tax returns and respondent miserably failed to establish that petitioner employed actual fraud.

Taking into consideration the circumstances attendant in this case, this Court finds that the imposition of 50% surcharge on petitioner's deficiency assessments is valid. Petitioner declared in its 1998 Income

Tax Return expenses, which are not duly substantiated. A careful perusal of the records of this case discloses that petitioner indeed overstated its declared expenses, resulting to an understatement of petitioner's declared income. In its 1998 Annual Income Tax Return petitioner declared the Employees' Benefits amounting to P6,262,657.00, as subject to withholding tax. After a careful examination of the evidence on record, however, the Court finds that petitioner did not subject the same to final tax. Worse, petitioner claimed said amount of P6,262,675.00 as deduction, notwithstanding its non-withholding of the final tax. Petitioner also claimed as deductions from its gross income the expenses, namely, rental amounting to P728,557.00, commission amounting to P2,259,523.00, professional fee amounting to P389,103.00, repairs and maintenance amounting to P123,553.00, and management fee amounting to P1,447,631.00, without substantiating the same and without withholding the corresponding EWT due thereon. Petitioner willfully refused to submit its books of accounts and accounting records, despite repeated requests and demands of the respondent and despite the threat for criminal prosecution. Petitioner used three different addresses in its returns and documents submitted to the respondent, making it difficult for the respondent where to send the communications relative to the assessment for tax deficiencies against the petitioner. In its audited Financial Statements for calendar years 1997 and 1998 *(Exhibit "25")*, petitioner's business address is at No. 503 Culmat Bldg., Rodriguez Sr. Ave., Quezon City, Metro Manila. Using said address, respondent issued the first Letter of Authority No. 00018837 *(Exhibit "26")* to petitioner. While in its 2000 Annual Income Tax Return, stamped received by respondent on April 17, 2001 *(Exhibit "T")*, the Application for Registration, stamped received by respondent on March 5, 1997 *(Exhibit "U")*, BIR Form 19.53, stamped received by respondent on August 3, 1995 *(Exhibit "V")*, VAT Registration Certificate dated January 1, 1988 *(Exhibit "W")*, Certificate of Registration dated June 28, 1994 *(Exhibit "X")*, Payment Form (BIR Form No. 0605), stamped received by respondent on January 29, 1999 *(Exhibit "Y")*, petitioner's registered/business address is at F. Jacinto House, 116 Rada Street, Legaspi Village, Makati City. On the other hand, in petitioner's 1998 Annual Income Tax Returns *(Exhibit "20")*, 1999 Annual Income Tax Returns *(Exhibit "21")*, and VAT Registration Certificate dated January 1, 1998 *(Exhibit "19")*, petitioner's registered/business address indicated therein is at SEDCCO Bldg., Rada Street, Legaspi Village, Makati City, which prompted petitioner to address the second Letter of Authority No. 00016620 *(Exhibit "22")*, Second Request for Presentation of Records dated December 2, 1999 *(Exhibit "23")*, Final Notice dated June 22, 2000 *(Exhibit "24")*, and *Subpoena Duces Tecum* dated September 15, 2000 *(Exhibit "1")* at SEDCCO Bldg., Rada St., Legaspi Village, Makati City. Yet, in petitioner's Protest Letter dated June 24, 2002 *(Exhibit "AA")*, petitioner categorically stated that its registered address for the immediate past three years is at G/F. Jacinto House, 116 Rada Street, Legaspi Village, Makati City. However, per respondent's verification from its Data Registration System, it was discovered that petitioner failed to inform respondent of any of said change in its business/registered address. In addition, records show that petitioner did not file its Monthly VAT Returns for the months of July, August, September, October, November and December and its Quarterly VAT Returns for the 3rd and 4th quarters of 1998. Also, petitioner did not file its Monthly Remittance Return of Income Taxes Withheld for the months of June, August, September, October, November and December. Without said returns and without petitioner's books of accounts and accounting records, respondent would never know what are the other incomes not disclosed and declared by petitioner. All the foregoing circumstances clearly show petitioner's willful intent to evade the payment of its tax liabilities for the year 1998. Thus, the imposition

ul

of 50% surcharge in its income tax, VAT, final tax and EWT deficiency assessments has legal basis.

Though, this Court is aware that fraud contemplated by law is actual and not constructive, this Court is also cognizant of the settled rule that fraud, being a state of mind, need not be proved by direct evidence, but may be inferred from the circumstances of the case *(Republic vs. Gonzales, 13 SCRA 641).*

In sum, petitioner is liable to pay deficiency income tax, VAT, final tax and EWT, computed as follows:

Deficiency Income Tax

Net Income per ITR		P13,589,671.00
Add: Disallowed Expense:		
Purchases	P38,339,321.00	
Installation Cost	2,580,173.50	
Advertising and Marketing	88,523.00	
Losses	100,000.00	
Insurance	70,688.50	
Interest	946,231.00	
Representation & Entertainment	1,039,639.50	
Supplies	114,081.50	
Communication	277,839.00	
Transportation & Travel	322,061.50	
Miscellaneous	144,937.00	
Commission	2,259,523.00	
Management Fee	1,447,631.00	
Professional Fee	389,103.00	
Rental	728,557.00	
Repairs & Maintenance	123,553.00	
Bad Debts	2,576,338.00	
Employees Benefits	6,262,675.00	57,810,875.50
Taxable Income		P71,400,546.50
Income tax due thereon		P24,276,185.81

W

40

Less: Tax withheld/paid	103,926.54
Deficiency Income Tax	P24,172,259.27
Add: Surcharge (50%)	12,086,129.64
Interest (4-16-99 to 6-10-02)	15,258,324.76
Total amount due	**P51,516,713.67**

Deficiency VAT

Undeclared gross receipts	P18,172.36
Output tax due thereon	P1,817.24
Add: Surcharge (50%)	908.62
Interest (01-26-99 to 06-10-02)	1,226.76
Total amount due	**P3,952.62**

Deficiency Final Tax

Employees Benefits	P6,262,675.00
Divided by	66%
Gross up monetary value	P9,488,901.52
Fringe benefits tax	P3,226,226.52
Add: Surcharge (50%)	1,613,113.26
Interest (01-26-99 to 06-10-02)	2,175,567.07
Total amount due	**P7,014,906.85**

Deficiency Expanded Withholding Tax

		Tax Rate	Tax Payable
Commission	P2,259,523.00	10%	P225,952.30
Management Fee	1,447,631.00	10%	144,763.10
Professional Fee	389,103.00	10%	38,910.30
Rental	728,557.00	5%	36,427.85
Repairs and Maintenance	123,553.00	1%	1,235.53
Total deficiency EWT due & collectible			P447,289.08
Add: Surcharge (50%)			223,644.54
Interest (01-26-99 to 06-10-02)			301,624.01
Total amount due			**P972,557.63**

WHEREFORE, premises considered, the present Petition For Review is **PARTIALLY GRANTED**. Accordingly, petitioner is hereby **ORDERED** to pay respondent Commissioner of Internal Revenue the amounts of FIFTY ONE MILLION FIVE HUNDRED SIXTEEN THOUSAND SEVEN HUNDRED THIRTEEN and 67/100 PESOS

(P51,516,713.67), representing deficiency income tax, THREE THOUSAND NINE HUNDRED FIFTY TWO AND 62/100 PESOS (P3,952.62), representing deficiency VAT, SEVEN MILLION FOURTEEN THOUSAND NINE HUNDRED SIX AND 85/100 PESOS (P7,014,906.85), representing deficiency final tax, NINE HUNDRED SEVENTY TWO THOUSAND FIVE HUNDRED FIFTY SEVEN AND 63/100 PESOS (P972,557.63), representing deficiency EWT, or the total amount of FIFTY NINE MILLION FIVE HUNDRED EIGHT THOUSAND ONE HUNDRED THIRTY AND 77/100 PESOS (P59,508,130.77), broken down as follows:

	DEFICIENCY TAX DUE				
	Income Tax	**VAT**	**Final Tax**	**EWT**	**Total**
Basic	P24,172,259.27	P1,817.24	P3,226,226.52	P447,289.08	P27,847,592.11
Surcharge	12,086,129.64	908.62	1,613,113.26	223,644.54	13,923,796.06
Interest	15,258,324.76	1,226.76	2,175,567.07	301,624.01	17,736,742.60
Total	**P51,516,713.67**	**P3,952.62**	**P7,014,906.85**	**P972,557.63**	**P59,508,130.77**

In addition, petitioner is hereby **ORDERED** to pay respondent 20% delinquency interest per annum on the total amount of P59,508,130.77 reckoned from June 17, 2002 *(Exhibit "F",* in relation to *Exhibits "A", "B", "C" and "D"),* until full payment thereof, pursuant to *Section 249(C) of the NIRC of 1997, as amended.*

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

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

ERLINDA P. UY
Associate Justice

A T T E S T A T I O N

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

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

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

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

ERNESTO D. ACOSTA
Presiding Justice