REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION
****

FIRST FILIPINAS INSURANCE BROKERS CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6569

Members:

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

Promulgated:

JUL 04 2007, 2:05 pm

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DECISION

ACOSTA, P.J.:

The instant petition seeks the cancellation of the disputed assessments covering deficiency income tax in the amount of P10,639,996.39 and deficiency expanded withholding taxes in the amount of P55,138.18, issued against petitioner for taxable year 1997.

First Filipinas Insurance Brokers Corporation (Petitioner) is a domestic corporation created and formed under Philippine Laws with business address at 11/F Valero Tower, Valero Street, Salcedo Village, Makati City.

The Commissioner of Internal Revenue (Respondent) is the duly appointed officer of the Bureau of Internal Revenue (BIR) authorized to carry all its functions,

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duties, and responsibilities including, *inter alia*, the power to decide, cancel, and abate tax liabilities under Section 204(B) of the National Internal Revenue Code (NIRC), as amended.

On December 9, 1998, petitioner received Letter of Authority (LA) No. 00007590 dated November 9, 1998 issued by the BIR which authorized its revenue officers to examine for all internal revenue purposes the books of accounts and accounting records of petitioner for the period January 1, 1997 to December 31, 1997.[1]

Petitioner received a Preliminary Assessment Notice (PAN) dated January 22, 2001 with Details of Discrepancies issued by respondent, stating that petitioner had alleged deficiency income and expanded withholding taxes for taxable year 1997.[2] Within fifteen (15) days from receipt thereof or on February 8, 2001, petitioner presented its side of the case in a letter dated February 7, 2001.[3]

Then, petitioner received a Demand Letter and Assessment Notice No. LA#00007590-97-01-801 dated April 6, 2001 with computations, assessing petitioner the amounts of P17,177,363.09 and P65,692.25 as deficiency income and expanded withholding taxes, respectively.[4] On April 30, 2001, petitioner protested and requested reinvestigation of the findings which gave rise to that assessment.[5]

On July 9, 2001, petitioner received a letter dated July 4, 2001 from respondent replying to petitioner's request for reinvestigation and reduced petitioner's deficiency income tax to P13,270,982.63.[6] In the same letter, as well as

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[1]Exhibit "1", "1-a", "1-b", BIR Records, page 31; paragraph 1 of Joint Stipulation of Facts ad Issues (JSFI), *Rollo,* page 84
[2]Exhibit "6", "6-1", "7", "7-1", BIR Records, pages 200-202; paragraph 2 of JSFI, *Rollo,* page 84
[3] Exhibit "8", BIR Records, page 306-307
[4] Paragraph 3 of JSFI, *Rollo,* page 84
[5] BIR Records, pages 327-328
[6] BIR Records, pages 335-337

Em-in the letters dated August 3, 2001[7] and September 3, 2001[8], respondent requested petitioner to submit relevant supporting documents necessary for the conduct of reinvestigation.

On November 12, 2001, respondent informed petitioner in a letter dated November 7, 2001 that the report of reinvestigation has been submitted for approval and requested petitioner to verify the details of the assessment so that it may present its side of the case.[9] The deficiency income tax was reduced to P9,849,813.74. In a letter dated November 15, 2001, petitioner reiterated its protest against some of the findings made during the reinvestigation.[10]

In a letter dated December 21, 2001, replying to petitioner's protest and received by petitioner on December 26, 2001, respondent further reduced petitioner's deficiency income tax to P9,818,784.11 and informed the latter that his assessment shall be forwarded to a higher authority for final disposition.[11]

On October 21, 2002, petitioner received the Final Decision on Disputed Assessment dated September 17, 2002 which amended the assessments for deficiency income and expanded withholding taxes to P10,639,996.39 and P55,138.18, respectively.[12]

Hence, the instant Petition for Review was filed on November 18, 2002.

During trial, both parties presented their documentary and testimonial evidence in support of their respective stands. Upon termination of the trial, both parties were ordered to submit their respective memorandum.[13] Only petitioner filed

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[7] BIR Records, page 339
[8] BIR Records, page 444
[9] BIR Records, page 448-450
[10] BIR Records, pages 470-471
[11] Exhibit "15", "15-1", "15-2"; BIR Records, pages 501-502
[12] Exhibit "17", "17-1"; BIR Records, pages 555-558, paragraph 4 of JSFI; *Rollo,* page 85
[13] *Rollo,* pages 312-313

its Memorandum on July 3, 2006.[14] Thus, the case was submitted for decision on July 11, 2006 without respondent's Memorandum.

The issues, as jointly agreed by both parties to be resolved by this Court, are the following:

> "1. Whether or not the January 22, 2001 pre-assessment notice (PAN) is validly issued due to the alleged non-compliance with Section 228 of the 1997 Tax Code on the legal basis of the assessment;
>
> 2. Whether or not the January 22, 2001 PAN is void for not stating the details/breakdown and actual facts relative to disallowances of expenses in the amount of P17,763,832.38 as expressly required under Section 228 of the 1997 Tax Code;
>
> 3. Whether or not Petitioner was denied of procedural due process for alleged failure of Revenue District Office No. 50 – South Makati, to inform in writing its findings of discrepancies for purposes of holding an informal conference prior to the submission of the case-docket to the Assessment Division for issuance of pre-assessment notice (PAN), in accordance with Section 3.1.1 of Revenue Regulations No. 12-99 dated September 6, 1999;
>
> 4. Whether or not Petitioner failed to prove that the disallowed expenses/deductions in its 1997 financial statements are duly supported;
>
> 5. Whether or not Petitioner's alleged reimbursable expenses to various affiliates were subject to expanded withholding tax;
>
> 6. Whether or not Petitioner is liable for the 1997 deficiency income tax assessment in the amount of P10,639,996.39 covered under Revised Assessment Notice No. IT-7590-97-02-060 dated September 17, 2002, as well as the reduced deficiency expanded withholding tax amounting to P55,138.18 for taxable year 1997, together with the corresponding interest, surcharge and penalties thereto."

Validity of the PAN and Due Process

Since the first, second, and third issues deal with due process, the Court shall discuss these issues jointly.

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[14] *Rollo,* pages 322-347

Petitioner claims that the PAN is void because it did not comply with Section 228 of the 1997 NIRC, *i.e.*, lack of legal and factual basis. According to petitioner, the assessments contained in the PAN do not have any legal basis because respondent did not specify what provisions of the NIRC are applicable. Petitioner also adds that the disallowed expenses in the amount of P17,763,832.38 contained in the PAN do not have any factual basis because respondent failed to show how the disallowed amount was arrived.

The Court disagrees.

Before a deficiency tax assessment is issued against a taxpayer, the Commissioner or his duly authorized representative must observe Section 228 of the 1997 NIRC which in part provides:

> "**SEC. 228.** *Protesting of Assessment.* — When the Commissioner of his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: x x x
>
> 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.
>
> x x x"

Contrary to petitioner's claim that the PAN has no legal basis, a perusal thereof shows that respondent indicated the applicable provisions of the NIRC in its Details of Discrepancies attached thereto.[15] The claim that petitioner does not know which NIRC (1977 or 1997 which took effect on January 1, 1998) should apply is simply untenable. Since the taxable year involved is 1997, petitioner ought to know that respondent is clearly referring to none other than the 1977 NIRC.

As for the PAN's lack of factual basis, a meticulous search of the records reveals otherwise. Petitioner was informed by respondent of the factual basis of the

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[15] Exhibit "7" & "7-1", BIR Records, page 200

PAN in a letter dated and received on December 12, 2000.[16] To fully apprise petitioner of the basis of his findings, respondent attached to the same letter the *Schedule of Disallowed Expenses for the Year 1997*[17] wherein the breakdown of the disallowed expenses in the amount of P17,763,832.38 was shown with clarity. In the same letter, petitioner was even given a chance to refute respondent's findings before the PAN is issued on January 22, 2001 in compliance with Section 3.1.1 of Revenue Regulations No. 12-99, to wit:

> "**SECTION 3.** *Due Process Requirement in the Issuance of a Deficiency Tax Assessment.* —
>
> 3.1 *Mode of procedures in the issuance of a deficiency tax assessment:*
>
> 3.1.1 *Notice for informal conference.* — The Revenue Officer who audited the taxpayer's records shall, among others, state in his report whether or not the taxpayer agrees with his findings that the taxpayer is liable for deficiency tax or taxes. If the taxpayer is not amenable, based on the said Officer's submitted report of investigation, the taxpayer shall be informed, in writing, by the Revenue District Office or by the Special Investigation Division, as the case may be (in the case Revenue Regional Offices) or by the Chief of Division concerned (in the case of the BIR National Office) of the discrepancy or discrepancies in the taxpayer's payment of his internal revenue taxes, for the purpose of "Informal Conference," in order to afford the taxpayer with an opportunity to present his side of the case. If the taxpayer fails to respond within fifteen (15) days from date of receipt of the notice for informal conference, he shall be considered in default, in which case, the Revenue District Officer or the Chief of the Special Investigation Division of the Revenue Regional Office, or the Chief of Division in the National Office, as the case may be, shall endorse the case with the least possible delay to the Assessment Division of the Revenue Regional Office or to the Commissioner or his duly authorized representative, as the case may be, for appropriate review and issuance of a deficiency tax assessment, if warranted.
>
> x x x"

Based on the foregoing reasons, the PAN issued is not void because it was legally and factually supported. Also, petitioner was afforded due process when it was given a chance to dispute the findings of respondent.

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[16] Exhibit "3", "3-a", "3-b", "3-c", BIR Records, page 175-177
[17] Exhibit "3-c", BIR Records, page 175

Validity of Income Tax Assessments

The fourth and fifth issues shall be jointly discussed because both involve the question of whether or not petitioner is liable to pay deficiency income tax in the amount of P10,639,996.39 for taxable year 1997 covered under Revised Assessment Notice No. IT-7590-97-02-060 dated September 17, 2002.

Under Assessment Notice No. LA#00007590-97-01-801 and its corresponding Letter of Demand, both dated April 6, 2001,[18] petitioner was assessed deficiency income tax in the amount of P17,177,363.09 for taxable year 1997, computed as follows:

DEFICIENCY INCOME TAX

Taxable Income Per Return			P 3,490,248.00
Add:	Discrepancies		
	Unreported Commission Income	P 4,374,001.47	
	Unreported Interest Income	147,945.21	
	Disallowances	17,763,832.38	
	Unaccounted Salaries & Wages	1,230,504.95	
	Advertising	360,000.00	
	Repairs & Maintenance	117,432.00	
	Rent	35,847.00	
	Depreciation	449,514.75	24,479,077.76
Taxable Net Income			P 27,969,325.76
Income Tax Due (35%)			P 9,789,264.02
Less: Tax Paid Per Return			1,285,886.00
Deficiency Income Tax			P 8,503,378.02
Add:	Surcharge		2,125,844.50
	Interest 04-16-98 to 05-10-01		6,523,140.57
	Suggested Compromise Penalty		25,000.00
TOTAL AMOUNT DUE			**P 17,177,363.09**

However, respondent cancelled some discrepancies and included an additional disallowance of P749,808.41 pertaining to unaccounted salaries and wages as follows:

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[18] BIR Records, pages 322 and 324

	Per Original Assessment	Per Revised Assessment Cancelled	Per Revised Assessment Retained
Discrepancies:			
Unreported Commission Income	P 4,374,001.47	P 4,374,001.47	-
Unreported Interest Income	147,945.21	147,945.21	-
Disallowances	17,763,832.38	3,097,217.00	P 14,666,615.38
Unaccounted Salaries & Wages	1,230,504.95	395,805.55	834,699.40
Advertising	360,000.00	360,000.00	-
Repairs & Maintenance	117,432.00	117,432.00	-
Rent	35,847.00	35,847.00	-
Depreciation	449,514.75	449,514.75	-
Unaccounted Salaries & Wages			749,808.41
Total	**P 24,479,077.76**	**P 8,977,762.98**	**P 16,251,123.19**

As a result of the cancellations, the deficiency income tax assessment was reduced to P10,639,996.39 in his Final Decision on Disputed Assessment and Revised Assessment Notice No. IT-7590-97-02-060, both dated September 17, 2002,[19] computed as follows:

DEFICIENCY INCOME TAX

Taxable Income Per Investigation			P 27,969,325.76
Less:	Allowed items per reinvestigation		
	Commission income	P 4,374,001.47	
	Interest income on advances	147,945.21	
	Various accrued expenses	3,097,217.00	
	Salaries and wages	395,805.55	
	Advertising	360,000.00	
	Repairs – maintenance	117,432.00	
	Rent	35,847.00	
	Depreciation	449,514.78	8,988,763.01[20]
Net income			P 18,991,562.75
Add:	Salaries and wages		749,808.41
Net taxable income per reinvestigation			P 19,741,371.16
Tax due thereon (35%)			P 6,909,479.91
Less:	Tax paid per return		1,285,886.00
Deficiency income tax			P 5,623,593.92
Add:	Interest (04/16/98 - 09/30/02)		5,016,402.47
TOTAL AMOUNT DUE			**P 10,639,996.39**

[19] BIR Records, pages 556 & 563
[20] Should be P8,977,763.01

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Now, the Court shall determine whether the disallowance of the accrued expenses of P14,666,615.28 and salaries and wages of P1,584,507.81 (sum of P834,699.40 and P749,808.41) were valid.

I. Unsupported accrued expenses of P14,666,615.28

Petitioner maintains that it was not informed by respondent of the breakdown of the various disallowed accrued expenses from the original amount of P17,763,832.28 to the reduced amount of P14,666,615.28 as found during re-investigation.

The Court disagrees.

As earlier discussed, petitioner cannot claim that it was not informed of the factual basis of the disallowed accrued expense in the amount of P17,763,832.28 because it received a *Schedule of Disallowed Expenses for the Year 1997*[21] from respondent. The expense accounts, its corresponding disallowed amounts, and the reasons for their disallowance were all enumerated in the schedule as shown below:

REFERENCE	ACCOUNT NAME	AMOUNT	REASONS
JV#169	Postage	500,000.00	Unsupported
	Utility Expense	4,600,000.00	Unsupported
	Advertising	1,140,000.00	Unsupported
JV#169	Postage	500,000.00	Unsupported - add'l accruals
	Representation	1,055,000.00	Unsupported - add'l accruals
	Travelling	2,500,000.00	Unsupported - add'l accruals
	Repairs	700,000.00	Unsupported - add'l accruals
	Stationeries	1,500,000.00	Unsupported - add'l accruals
	Miscellaneous	1,000,000.00	Unsupported - add'l accruals
	Fuel & Lubricant	900,000.00	Unsupported - add'l accruals
JV#169	Representation	2,000,000.00	Unsupported - reclassification entry; advances to officers – ROC
JV#172	Representation	226,779.32	Unsupported - Debit memo dtd 12-24-97
JV#173	Depreciation	47,727.25	excessive acquired only on 12/31/97

[21] Exhibit "3-c", BIR Records, page 175

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JV#174	Utilities	618,400.00	Unsupported - no legal basis of shared Expenses
JV#174	Representation	252,804.20	Unsupported - cash advances of O/E RCC
JV#181	Salaries & Wages	223,121.61	Prior expense; understated shared expenses 1994, 1995, 1996 & 1997
		17,763,832.38	

Likewise, petitioner cannot claim ignorance of the factual basis of the revised assessment. In reducing the amount of disallowed expenses to P14,666,615.28, respondent clearly laid down his basis in the Final Decision on Disputed Assessment dated September 17, 2002[22] where respondent explained:

> "5) Disallowance of Various Accrued Expenses (P17,763,832.28) – Verification disclosed that only P3,097,217.00 were properly supported by billing/statements of accounts.

Disallowed accrued expenses per investigation		P 17,763,832.28
Less: Supported expenses paid to the following		
a) Quezon Avenue Auto Center, Inc.	P 1,328,417.20	
b) Balintawak Auto Center, Inc.	1,500,000.00	
c) Prestige Cars North, Inc.	268,800.00	3,097,217.00
Unsupported Accrued Expenses per reinvestigation		**P14,666,615.28"**

Petitioner clearly understood the factual basis of the revised assessment when it alleged in paragraph 24 of its Petition for Review that:

> "24. Respondent in his final decision revised his previous assessment on disallowed accrued expenses by allowing the deduction of P3,097,217.00 as supported expenses paid to the following:

a) Quezon Avenue Auto Center, Inc.	P 1,328,417.20
b) Balintawak Auto Center, Inc.	1,500,000.00
c) Prestige Cars North, Inc.	268,800.00
	P 3,097,217.20

> claiming that per his reinvestigation he found that only said P3,097,217.00 were properly supported by billing/statement of accounts but other various expenses claimed the remaining amount of which is P14,666,615.38, should still be disallowed for being "lacking in proof of payment to be allowed as deductions."

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[22] Exhibit "17", "17-1", BIR Records, pages 555-558

Evidently from the foregoing, petitioner was not left to speculate on how the disallowed expense of P14,666,615.28 was computed. In disallowing the expenses, respondent even invoked Section 29 of the NIRC as its legal basis.

Petitioner argues that the provisions of the 1997 NIRC applies in this case because the taxable year under consideration is 1997. Hence, petitioner concludes, Section 29 of the 1997 NIRC cannot be used as legal basis for the disallowance because that provision dwells on the imposition of Improperly Accumulated Earnings Tax, not Allowable Deductions from Gross Income.

Petitioner further avers that even assuming *arguendo* that respondent really meant Section 29 of the 1977 Tax Code, as amended, pertaining to Allowable Deductions from Gross Income, still the legal basis is vague as there are several subsections enumerated therein. The invocation of Section 29 of the 1977 NIRC is allegedly confusing because that provision refers to deductions from gross income while under respondent's Final Decision on Disputed Assessment, the findings under the caption "I. Deficiency Income Tax", Item No. 5 thereof pertains to "Disallowance of Various Accrued Expenses – P14,666,615.28." Petitioner alleges that an Accrued Expense which is strictly a payable or liability account cannot be covered by the deductions mentioned in Section 29 of the 1977 NIRC.

Contrary to petitioner's claim, Section 29 of the 1977 NIRC, as amended, governs transactions for taxable year 1997 because the 1997 NIRC (Republic Act No. 8424) took effect only on January 1, 1998. Section 29 of the 1977 NIRC provides:

> "**SECTION 29.** *Deductions from gross income*. – x x x
>
> x x x
>
> (a) *Expenses*.-(1) *Business expenses*.-(A) In general.-All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services

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> actually rendered; traveling expenses while away from home in the pursuit of a trade, profession or business, rentals or other payments required to be made as a condition to the continued use or possession, for the purpose of the trade, profession or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

The requisites for the deductibility of ordinary and necessary trade, business, or professional expenses are: (a) the expense must be ordinary and necessary; (b) it must have been paid or incurred during the taxable year; (c) it must have been paid or incurred in carrying on the trade or business of the taxpayer; and (d) it must be supported by receipts, records or other pertinent papers.[23]

After carefully verifying the disallowed expenses in the schedule, the Court observed and concluded that:

a) Depreciation in the amount of P47,727.25 (JV#173) disallowed by respondent's examiner for being excessive shall be sustained since petitioner failed to present documents proving otherwise.

b) Salaries and wages in the amount of P223,121.61 (JV#181) disallowed by respondent shall likewise be upheld because petitioner failed to prove that its salaries and wages pertain to taxable year 1997 and not to prior years as found by the examiner. Under Section 29 of the NIRC of 1977, as amended, deductions from gross income are allowed only to those expenses paid or incurred during the taxable year.

c) The remaining expenses, namely, postage, utility expense, advertising, representation, traveling, repairs, stationeries, miscellaneous and fuel and lubricant in their total amount of P17,492,983.52, were disallowed by respondent for being

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[23] Commissioner of Internal Revenue v. General Foods (Phils.), Inc. (G.R. No. 143672, April 24, 2003, 401 SCRA 545, 551) as cited in Commissioner of Internal Revenue vs. Isabela Cultural Corporation, (G.R. No. 172231, February 12, 2007)

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unsupported. As found by the examiner, these alleged unsupported expenses were credited to either of the following accounts:[24]

Accrued Expenses Payable	P 6,895,000.00
Accounts Payable – Others	8,118,400.00
Advances to Officers	2,252,804.20
Cash	226,779.32
Total	**P17,492,983.52**

To prove that the expenses booked under its "Accrued Expense Payable" account were duly supported, petitioner presented before this Court various billings/statement of accounts, check vouchers, official receipts, temporary receipts, which were summarized by petitioner in its Memorandum, as follows:

Exhibit	Date/Particulars	Amount
N	May 25, 1998 - payment to Balintawak Autocenter, Inc. for January 1997 expenses	P 150,000.00
O and O-1	May 25, 1998 - payment to Balintawak Autocenter, Inc. for February 1997 expenses	150,000.00
P	June 15, 1998-payment to Balintawak Autocenter, Inc. for March 1997 expenses	150,000.00
Q	July 3, 1998 - payment to Balintawak Autocenter, Inc. (April, May and June 1997 expenses)	450,000.00
R	August 11, 1998 - payment to Balintawak Autocenter, Inc. for July and August 1997 expenses	300,000.00
S	September 14, 1998 - payment to Balintawak Autocenter, Inc. for Sept and Oct 1997 expenses	300,000.00
T	Nov. 10, 1998 - payment to Balintawak Autocenter, Inc. for Nov and Dec 1997 expenses	300,000.00
RR, RR-1	Aug. 31, 2000 - payment to Quezon Avenue Autocenter, Inc. for 1997 shared expenses	1,328,417.20
E	Oct. 1, 1997-Statement of Account (Prestige Cars Makati, Inc.)	420,000.00
F	Nov. 1, 1997-Statement of Account (Prestige Cars Makati, Inc.)	420,000.00
G	Dec. 1, 1997-Statement of Account (Prestige Cars Makati, Inc.)	420,000.00
XX	1997 Statement of Account (Prestige Cars Makati, Inc.) Note: Of the P1,137,500 billing, only P801,659.75 was booked for 1997	801,659.74
YY	Feb to April 1997 Statement of Account (Prestige Cars Makati, Inc.)	1,137,500.00
U, U-1, U-2 and U-3	May 20, 1998-Check issued to Prestige Cars North, Inc.	134,400.00

[24] BIR Records, pages 170-171

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	for payment of May, June and July 1997 expenses	
V, V-1	May 25, 1998 - payment to Prestige Cars North, Inc. for Aug., Sept., and Oct., 1997 expenses Note: Total payments of P268,800.00 to Prestige Cars North, Inc. for 1997 accrued expenses allowed by the BIR per re-investigation although Exhibits U, U-1, U-2 and U-3 were not admitted for failure to present the originals thereof.	134,400.00
W, W-1	May 6, 1998 - payment to Prestige Cars Makati Inc. (Libis Branch), for 1997 advances on shared expenses	16,024.36
Y, Y-1	May 7, 1998 - payment to Prestige Cars Makati Inc. (Libis Branch), for 1997 advances on shared expenses	131,963.59
PPP	Recording of adjustment of accrued expenses for shared expenses/salaries and wages with affiliate company still to be reimbursed.	223,121.61
ZZ, AAA	Provision for 13th month pay - (1996 -P70,782.35; 1997-P229,923.14)	300,495.49
ZZ	Various adjustments not yet taken up in other accounts/entries	1,110,635.11
		P 8,378,617.10
	(JV#165 - P3,000.00; JV#173 - P27,022.04; JV#178-P840,613.07, JV#184 - P120,000.00)	

Likewise, payments and adjustment of Accrued Expenses were taken up during the year namely:

1) Payment of 13th month pay - (Exh. ZZ, AAA)	P 299,882.42
2) Reversal of accruals	2,000,000.00
3) Payment of accrued expenses	875,062.66
Total	**P3,174,945.08**

Upon scrutiny of these documents, the Court did not consider the official receipt marked as *Exhibit "N"*[25] as valid support of petitioner's claimed expenses because it was not issued to petitioner but to First Filipinas Capital Corporation (FFCC). However, the official/provisional receipts, statement of accounts covering the following expenses in the total amount of P2,926,666.87 represent petitioner's valid deductions from gross income:

Exhibit No.	Paid/Payable to	Particulars	Period Covered	Amount
T	Balintawak Autocenter, Inc.	share of utility expenses	Nov - Dec '97	P 300,000.00
S	Balintawak Autocenter, Inc.	share of utility expenses	Sept - Oct '97	300,000.00
R	Balintawak Autocenter, Inc.	share of utility expenses	July - Aug '97	300,000.00
Q	Balintawak Autocenter,	share of utility expenses	Apr - June '97	

[25] *Rollo*, page 211

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	Inc.			450,000.00
P	Balintawak Autocenter, Inc.	share of utility expenses	March '97	150,000.00
O	Balintawak Autocenter, Inc.	share of utility expenses	Feb '97	150,000.00
RR-1	Quezon Avenue Center	share of utility expenses	1997	1,328,417.20
E	Prestige Cars Makati, Inc.	rental of office space & share in adv & promo	Oct-97	420,000.00
F	Prestige Cars Makati, Inc.	rental of office space & share in adv & promo	Nov-97	420,000.00
G	Prestige Cars Makati, Inc.	rental of office space & share in adv & promo	Dec-97	420,000.00
XX	Prestige Cars Makati, Inc.	rental of office space & share in adv & promo	Jan '97	379,166.67
YY	Prestige Cars Makati, Inc.	rental of office space & share in adv & promo	Feb to Apr '97	1,137,500.00
U, U-1 to U-3	Prestige Cars North, Inc.	share on janitorial and security services	May - July '97	134,400.00
V, V-1	Prestige Cars North, Inc.	share on janitorial and security services	Aug-Oct '97	134,400.00
	Total accrued expenses			P 6,023,883.87
	Less: Amount allowed by respondent per revised assessment			3,097,217.00
	Net allowable accrued expenses			**P 2,926,666.87**

As previously discussed, the assessment against petitioner was reduced from P17,763,832.38 to P14,666,615.28 because respondent allowed the deduction of some accrued expenses in the amount of P3,097,217.00. Since petitioner was able to support its accrued expenses to the extent of P6,023,883.87 and that the latter amount included the deduction of P3,097,217.00 allowed by respondent in his Final Decision on Disputed Assessment, the amount of P3,097,217.00 shall be deducted therefrom. Thus, petitioner has a net allowable accrued expenses in the amount of P2,926,666.87.

As for the other expenses credited to "Accounts Payable – Others", "Advance to Officers", and "Cash" in the amounts of P8,118,400.00, P2,252,804.20, and P226,779.32, respectively, the Court finds the disallowance thereof to be in order because petitioner failed to substantiate the same with proper documents.

To recapitulate, the Court finds that out of the total disallowed accrued expenses of P14,666,615.28, petitioner can only claim the amount of P2,926,666.87 as deduction from its gross income as it was duly supported to that amount. Hence,

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petitioner shall be held liable to pay for deficiency tax corresponding to the unsupported accrued expenses of P11,739,948.41.

II. Salaries and wages not subjected to withholding tax in the amount of P1,584,507.81

The deduction for salaries and wages by petitioner in the amount of P1,584,507.81 was disallowed based on the examiner's finding that the salaries and wages were not subjected to withholding tax in violation of Section 73(a) of the NIRC and Section 9 of Revenue Regulations (RR) No. 6-85 dated May 2, 1985, as amended by RR 8-90 dated October 13, 1990. Below is the detailed computation of the disallowance of P1,584,507.81:

Salaries & wages per amended income tax return	P 3,487,436.43
Overtime	94,933.98
13th Month Pay	298,808.06
Staff Benefits	165,579.39
Total	P 4,046,757.86
Less: Salaries & wages per Alphalist	2,462,250.05
Salaries & wages not subjected to withholding tax	**P 1,584,507.81**

Petitioner counters that P1,584,507.81 represents shared salary expenses with its affiliate, First Filipinas Capital Corporation (FFCC), in the amount of P1,362,629.87 with the balance pertaining to non-taxable staff benefits. Thus, total salaries and wages of P3,487,436.43 composed of the basic pay of P2,124,806.56 and the shared expenses of P1,362,629.87 are summarized below:

		SHARED EXPENSES			
MONTH	BASIC PAY	AMOUNT	JV No.	Exhibit No.	TOTAL
January	142,823.36	95,659.17	137	"FFF". "FFF-1"	238,482.53
February	153,914.42	103,152.93	141	"GGG" , "GGG-1"	257,067.35
March	162,300.87	102,932.45	143	"HHH", "HHH-1"	265,233.32
April	170,447.30	97,388.01	145	"III", "III-1"	267,835.31
May	167,492.21	96,709.09	147	"JJJ", "JJJ-1"	264,201.30
June	164,940.94	96,934.07	149	"KKK", "KKK-1"	261,875.01
July	180,172.22	97,233.52	151	"LLL", "LLL-1"	277,405.74
August	169,805.62	93,201.24	153. 154	"RRR", "RRR-1". "QQQ", "QQQ-1"	263,006.86
September	244,877.87	89,162.98	156	"SSS", "SSS-1", "SSS-2"	334,040.85
October	182,358.45	88,603.80	159	"MMM", "MMM-1"	270,962.25

November	196,405.26	89,265.51	162	"NNN", "NNN-1"	285,670.77
December	189,268.04	88,976.68	165	"OOO", "OOO-1"	278,244.72
		223,121.61	181	"PPP", "PPP-1"	223,121.61
		288.81	184	"TTT-1"	288.81
TOTAL	**2,124,806.56**	**1,362,629.87**			**3,487,436.43**

Petitioner points out that the total basic pay of P2,124,806.56 and cost of overtime expenses of P94,933.98 which totalled to P2,219,740.54 when compared with the amount per Alphalist of P2,300,114.48 will result in a difference of P80,373.94 representing the proportionate share of the taxable 13th month pay.

Petitioner further explains that the reimbursement of the subject "shared expenses" was a result of the "sharing agreement" of operational expenses between petitioner and First Filipinas Capital Corporation on a "90:10 basis", with the former bearing 90% burden and the latter for 10% thereof.[26] Petitioner clarifies that FFCC initially pays the bill of the operational costs and reflects said costs in its books. FFCC later sends out a statement to petitioner for its proportionate share and in so doing, FFCC becomes responsible for the taxes to be withheld being the original payor. Eventually, a bill is allegedly sent to petitioner for reimbursement of the operational costs, who in turn treats the reimbursement of "shared expenses" to its salaries and wages account.

Invoking Section 57(B) of the 1997 NIRC and Sections 2(b) and (3) of Revenue Regulations No. 6-85, petitioner posits that it could not be tasked to do the withholding because not being the payor, it has no direct participation in the income payments to various recipients thereto.

The Court finds the disallowance improper and erroneous.

Indisputably, the salaries and wages in the amount of P1,584,507.81 was reimbursed by petitioner to FFCC in 1997 as supported by pertinent records or

[26] Paragraph 11, JSFI, *Rollo*, page 66

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documents. The issue now is whether or not the shared salary expenses are subject to withholding tax.

Section 50(b) of the NIRC of 1977, as amended, provides as follows:

> "**SEC. 50.** *Withholding of tax at source.*
>
> x x x
>
> (b) *Withholding of creditable tax at source.* – The Secretary of Finance may upon the recommendation of the Commissioner of Internal Revenue, require also the withholding of a tax on the items of income payable to persons (natural or juridical) residing in the Philippines by payor-corporation/persons as provided for by law at the rate of not less than 2 ½% but not more than 35% thereof which shall be credited against the income tax liability of the taxpayer for the taxable year.

Implementing the foregoing provision is Section 7 of Revenue Regulations No. 6-82 which provides:

> "**SEC. 7.** *Requirement of withholding.* – Every employer or any person who pays or controls the payment of compensation to an employee, whether resident citizen or alien, non-resident citizen, or non-resident alien engaged in trade or business in the Philippines, must withhold from such compensation paid, an amount computed in accordance with these regulations."

Clear from the foregoing is that the obligation to withhold rests upon the payor of the income. Under the expense sharing scheme of petitioner with FFCC, the salaries and wages accruing to the individual employees of FFCC do not pass to nor come under petitioner's control. Being the payor in control of the income payment, FFCC, and not petitioner, shall be responsible for withholding the tax on the "shared salary expenses" in question and remitting the same to the BIR.

Considering that petitioner is not required to withhold tax on the shared salary expense of P1,584,807.81, the same may be validly deducted from its gross income for taxable year 1997.

In fine, petitioner is liable to pay respondent deficiency income tax for taxable year 1997 in the amount of P8,803,916.71, computed as follows:

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Net income per amended return	P	3,560,741.00
Add: Disallowed accrued expenses		11,739,948.41
Net taxable income	P	15,300,689.41
Income tax due	P	5,355,241.29
Less: Tax paid per return		1,246,259.00
Deficiency income tax	P	4,108,982.29
Add: 25% Surcharge		1,027,245.57
20% Interest (04/16/98 – 09/30/02)		3,667,688.85
TOTAL AMOUNT DUE	**P**	**8,803,916.71**

Validity of Expanded Withholding Tax Assessment

In his Final Decision on Disputed Assessment, respondent demanded from petitioner the payment of P55,138.18 allegedly representing deficiency expanded withholding tax for taxable year 1997, computed as follows:

Expanded withholding tax due per original investigation	P 28,652.28
Allowed items per reinvestigation	
Rent - ornamental plants & computer (P29,328.00 x 1%)	293.28
Deficiency EWT per reinvestigation	P 28,359.00
Add: Interest (01/11/98 - 09/30/02)	26,779.18
TOTAL AMOUNT DUE	**P 55,138.18**

Petitioner, however, contends that respondent's right to assess deficiency expanded withholding tax for taxable year 1997 had already prescribed when it issued the Formal Letter of Demand and Assessment Notice.

The Court agrees with petitioner.

Section 203 of the NIRC of 1977, as amended, provides as follows:

> "**SEC. 203.** *Period of limitation upon assessment and collection.* — Except as provided in the succeeding section, internal revenue taxes shall be assessed within three 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-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."

In relation thereto, Section 5 of Revenue Regulations No. 6-85, as amended, reads as follows:

> "**SECTION 5.** *Monthly return and payment of taxes withheld at source.* — (a) The taxes herein deducted and withheld shall be paid upon filing a return in duplicate under BIR form — with the Revenue District Officer or the Collection Agent of the City or duly authorized Treasurer of the Municipality where the withholding agent has his legal residence or principal place of business except in cases where the Commissioner of Internal Revenue allows otherwise. The required return shall be filed within ten days (10) after the end of each month.
>
> The taxes deducted and withheld by the withholding agents shall be considered trust funds and shall be maintained in a separate account and not commingled with any other fund of the withholding agent and held in trust for the government until paid to the collection officer. xxx"

Pursuant to Section 203 of the 1997 NIRC, as amended, the three-year period to assess commences from the date of actual filing of the return or from the last date prescribed by law for the filing of such return, whichever comes later. In the case of expanded withholding taxes, the return is required to be filed within ten (10) days after the end of each month. Hence, if the return was filed earlier than the last day allowed by law, the period to assess shall still be counted from the last day prescribed by law for filing of the return. However, if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed.

Petitioner filed its Monthly Remittance Returns of Income Taxes Withheld for the taxable year 1997 on the following dates:

1997	Date of Remittance	Amount Remitted	Page No. BIR Records
January	10-Feb-97	P 2,700.38	159
February	05-Mar-97	2,581.52	158
March	08-Apr-97	3,141.91	157
April	13-May-97	2,955.16	156
May	10-Jun-97	2,915.29	154
June	09-Jul-97	3,133.73	152

July	11-Aug-97	170.18	150
August	05-Sep-97	167.70	148
September	10-Oct-97	2,846.18	146
October	06-Nov-97	2,976.66	144
November	09-Dec-97	2,999.18	142
December	26-Jan-98	2,996.73	140
		P 29,584.62	

The last return filed by petitioner covering its expanded withholding tax payments for taxable year 1997 was for the month of December which was filed on January 26, 1998. Hence, the three-year period for the BIR to assess petitioner of deficiency expanded withholding tax for December 1997 lapsed on January 26, 2001. Since the Formal Demand Letter and the Assessment Notice were issued only on April 6, 2001, the subject assessment for 1997 deficiency expanded withholding tax in the amount of P55,138.18 is already barred under the three-year prescriptive period provided by law.

IN VIEW OF THE FOREGOING, the instant Petition for Review is **PARTIALLY GRANTED.** The amount of P55,138.18 representing deficiency expanded withholding tax assessment for taxable year 1997 is hereby **CANCELLED AND/OR WITHDRAWN** due to prescription. However, petitioner is **ORDERED TO PAY** respondent the amount of P8,803,916.71 representing deficiency income tax for taxable year 1997, plus 20% delinquency interest per annum, pursuant to Section 249 of the NIRC, commencing from October 17, 2002 until such time the said amount is fully paid.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

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