

**REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY**

RIGHTFIELD PROPERTY VENTURES, INC.
(now known as Universal Rightfield Property
Holdings, Inc.),

Petitioner,

- versus -

C.T.A. CASE NO. 5972

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

OCT 16 2003

Art. Palma

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DECISION

This case is an appeal for the cancellation and withdrawal of the assessments issued by the respondent against petitioner involving deficiency income, withholding and documentary stamp taxes in the total amount of P336,422,062.14, inclusive of the compromise penalty for the non-submission of alpha list for taxable year 1995.

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office located at 3rd Floor, Globe Telecom Plaza Bldg., Pioneer St., Mandaluyong City (*par 1, Joint Stipulation of Facts*). It was incorporated on September 2, 1994 primarily to engage in the real estate business and started commercial operations in 1995 (*item no. 1, Notes to 1995 Financial Statements, Exhibit D*).

On April 15, 1996, petitioner filed its 1995 income tax return wherein it declared a taxable income of P286,066,857.00 and paid the corresponding income tax due of P100,123,400.00 (*Exhibit D*).

On January 30, 1996, a Plan of Merger was executed by and between herein petitioner and Universal Petroleum Equity & Property Ventures, Inc., as the absorbed corporations, and Universal Petroleum Exploration, Inc., as the surviving corporation (*page 221, CTA records*).

On May 3, 1996, the Securities and Exchange Commission (SEC) approved the merger and correspondingly issued the Certificate of Filing of the Articles of Merger (*Exhibit G*).

On even date, the SEC also approved the amendments to Article 1 of the Articles of Incorporation of Universal Petroleum Exploration, Inc. changing the latter's corporate name to Universal Rightfield Property Holdings, Inc. and issued the Certificate of Filing of Amended Articles of Incorporation (*Exhibit V*).

On August 14, 1996, petitioner received from the respondent Letter of Authority No. 131643 dated August 6, 1996, authorizing Revenue Officer Ricardo C. Navarro and Group Supervisor Flordeliza P. Villegas to examine petitioner's books of accounts/accounting records for any liability on income, withholding, VAT and documentary stamp taxes for taxable year 1995 (*Exhibit I*).

As a result of the examination, the respondent issued to petitioner on May 29, 1998 a Post Reporting Notice dated May 26, 1998 informing the latter about the proposed deficiency tax assessment involving its income, withholding and documentary stamp tax liabilities for taxable year 1995 in the aggregate sum of P82,954,031.14 [inclusive of

increments] (*Exhibit 3*). Attached to the Post Reporting Notice was the examiner's report of investigation (*Exhibit 2*) detailing the factual and legal bases as well as the computations of the proposed 1995 deficiency tax assessment of P82,954,031.14.

On January 5, 1999, the respondent issued a preliminary assessment notice to petitioner (*Exhibit 8*) for the following alleged deficiency taxes for taxable year 1995:

Compromise Penalty for non-filing of BIR Form 1701B <i>[Alpha list of income payments not subjected to withholding tax] (Exhibit 8-1)</i>		P	25,000.00
Deficiency Income Tax (Exhibit 8-2)			
Basic Tax Due			204,088,679.45
Deficiency Withholding Tax (Exhibits 8-3; 8-3-c)			
Basic Tax Due			10,878,517.46
Deficiency Documentary Stamp Tax (Exhibit 9)			
Basic Tax Due			<u>2,003,333.33</u>
Total		P	<u>216,995,530.24</u>

On February 16, 1999 (*par. 3, Joint Stipulation of Facts*), petitioner received four formal assessment notices, all numbered 000693 and dated January 19, 1999, with accompanying demand letters covering the following alleged deficiency taxes for taxable year 1995 (*Exhibits 10 to 17*):

Deficiency Income Tax (Exhibit 10)			
Basic Tax Due		P	204,088,679.45
Add: Interest (01/26/96 to 01/22/99)			<u>112,922,266.34</u>
Total Amount Payable		P	<u>317,010,945.79</u>
Deficiency Withholding Tax (Exhibit 12)			
Basic Tax Due		P	10,878,517.46
Add: Interest (01/26/96 to 01/22/99)			<u>6,504,265.59</u>
Total Amount Payable		P	<u>17,382,783.05</u>
Deficiency Documentary Stamp Tax (Exhibit 14)			
Basic Tax Due		P	<u>2,003,333.33</u>

Compromise Penalty for non-filing of BIR Form 1701B
[Alpha list of income payments not subjected
to withholding tax] (Exhibit 16)

P 25,000.00

Total

P 336,422,062.17

On March 17, 1999 or within the time prescribed by law, petitioner timely filed a protest against the said formal assessment notices which for reasons stated therein requested for the cancellation and/or consideration and/or reinvestigation of the said tax assessments (*par. 4, Joint Stipulation of Facts*).

On May 17, 1999 or within the period prescribed by law, petitioner timely filed the relevant documents supporting its protest letter (*par. 5, Joint Stipulation of Facts*).

As of November 10, 1999, respondent failed to either cancel or modify the assessment or otherwise act on the protest letter filed by petitioner (*par. 6, Joint Stipulation of Facts*).

On December 9, 1999, or within the time prescribed by law, petitioner filed the instant Petition for Review (*par. 7, Joint Stipulation of Facts*).

Respondent, in his Answer filed through registered mail on January 13, 2000, interposed the following Special and Affirmative Defenses:

- “4. Petitioner failed to submit all relevant documents in support of its protest. For instance, it did not submit the corresponding documents to justify the alleged commission expenses and management fees. For its failure to submit all relevant supporting documents, the assessment has become final. (**Section 22** (sic), **1997 National Internal Revenue Code**);
5. For an expense to be deductible, the following requisites must be satisfied: (1) it must be ordinary and necessary expense; (2) it must be paid or incurred during the taxable year in carrying on the trade or business; (3) the amount must be reasonable; (4) it must be substantiated by adequate proof; (5) it must not be against law or public policy. The commission expenses and the management fees were not sustained by adequate proof. The corporation must not only meet the business test (Numbers 1 and 2). It must substantially

prove by evidence or records, the deductions claimed under the law; otherwise, the same will be disallowed. The mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction. (**Esso Standard Eastern, Inc. vs. Commissioner of Internal Revenue, 175 SCRA 149, July 07, 1989**);

6. The management fees and commission expenses are disguised dividends paid to the taxpayer's own stockholders and/or employees. Granting *arguendo* that there were services rendered by the employees, the Petitioner is not justified in categorizing said cash distribution to its employees as management fees. The scheme employed by the Petitioner was intended to reduce its taxable income by increasing the amount of its expenses. Management fees are allowed only as such if the recipient thereof is an outsider to the business of the Petitioner;
7. The disallowance of the claimed liabilities of the Petitioner for taxable year 1995 was not merely an assumption made by the Respondent;
8. The assessment was issued in accordance with law and regulations; and
9. All presumptions are in favor of the correctness of tax assessments. (**Commissioner of Internal Revenue vs. Avelino, 8 SCRA 572**)

As jointly stipulated by the parties, the issues to be resolved by this court are:

1. Whether or not the assessment was issued in accordance with law and regulations such that it stated the factual and legal bases on which it is based;
2. Whether or not the following expenses in the amounts herein indicated are valid deductions from petitioner's gross income for taxable year 1995: a) commission expenses in the amount of P42,616,929.41; b) management fee expenses in the amount of P20,377,400.29;
3. Whether or not the claimed liabilities of petitioner for taxable year 1995 is overstated;
4. Whether or not there was failure to withhold and remit the 7.5% expanded withholding tax (EWT) due on the sale of real property by Yarn Ventures Resources, Inc. to petitioner;
5. Whether or not there was failure on the part of the petitioner to withhold and remit the corresponding EWT due on the commission paid to Donald Dee pertaining to the sale of real property by Yarn Ventures Resources Inc. to the petitioner;

6. Whether or not petitioner failed to withhold the corresponding EWT on the professional fees paid to various individuals, fees to contractors, rental and purchases of supplies and materials;
7. Whether or not there was underpayment by petitioner of the documentary stamp tax due on the original issuance of shares by petitioner in the amount of P2,003,333.33; and
8. Whether or not petitioner submitted the Alpha List for 1995 together with BIR Form 1701-B being required by the BIR.

Anent the first issue, petitioner submits that the assessments issued by the respondent are void pursuant to Section 228 of the Tax Code in relation to Revenue Regulations No. 12-99 and BIR Ruling No. 22-98. According to petitioner, the preliminary and formal assessment notices merely contained short computations of the alleged deficiency taxes and short notations referring to certain provisions of the Tax Code. However, no explanation was allegedly given as to how these provisions were violated.

We disagree.

Section 228 of the Tax Code clearly states that “the taxpayer shall be informed in writing of the facts and the law on which the assessment is made; otherwise, the assessment shall be void.” The taxpayer ought to know the nature of the assessment so it can properly refute or agree with the assessment. The underlying reason of the law is the basic constitutional requirement that “no person shall be deprived of his property without due process of law” (*Subic Power Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6059, May 8, 2003*).

In the case at bar, records would disclose that even before the issuance of the Pre-Assessment Notice on January 5, 1999, petitioner was already furnished a copy of the

examiner's investigation report, which was received by a certain Jennette on May 29, 1998 (*Exhibit 2*). The examiner's investigation report showed in detail the facts and the law on which the proposed deficiency tax assessments were based. The adjustments made by the examiner in computing the proposed deficiency tax assessments were clearly explained in the investigation report. These adjustments formed the very bases of the formal assessment notices that were subsequently issued. Evidently, petitioner was not left to speculate as to how and why certain amounts of deficiency taxes were being assessed against it for it was properly informed in writing through the examiner's investigation report prior to the conference held on June 9, 1998.

In the case of *Philippine Mining Service Corp. vs. Commissioner of Internal Revenue*, CTA Case No. 5725, July 25, 2002, this court held that the mere issuance by the respondent to petitioner of the examiner's investigation report detailing the factual and legal bases of the assessment constitutes sufficient compliance of Section 228 of the Tax Code, thus we quote:

"It is undisputed that on December 5, 1997, the BIR sent a letter to the petitioner informing the latter that a report of investigation on its income and business tax returns had been submitted to Revenue District Officer Hernani S. Arboleda for appropriate action. Attached thereto were the report of investigation and the memorandum of Revenue Officer Celestino Mejia recommending, among others, the issuance of an assessment notice for the alleged deficiency taxes (par. 3, Joint Stipulation of Facts). The attached investigation report of Revenue Officer Celestino Mejia (pages 425 to 433, BIR records) contained the detailed findings made by the latter, the facts and the law on which the recommended assessments were based. The recommended assessments were basically the same amounts that were finally assessed against petitioner. They differed only because of the period covered for the imposition of interest charges. Moreover, in its protest letters dated May 9, 1998 and June 2, 1998, petitioner was able to effectively contest the subject assessments and submit documents to support its claim that the assessments were erroneous. Indeed, at the time the assessments were issued, petitioner

knew very well the law and the facts on which they were based. Since the requirement under Section 228 of the 1997 Tax Code that the "taxpayer shall be informed in writing of the law and the facts on which the assessment is based" has been sufficiently met, it follows then that the assessments dated April 6, 1998 were not null and void."

In sum, this court believes that for as long as the taxpayer is informed *in writing* of the factual and legal bases of the assessment, there is sufficient compliance with Section 228 of the 1997 Tax Code. Thus, the four assessment notices numbered 000693 and dated January 19, 1999 were issued in accordance with the said law.

We proceed to the second and third stipulated issues, which relate to the determination of the correctness of the alleged 1995 deficiency income tax of P317,010,945.79, computed as follows (*Exhibits 10 & 11*):

Net taxable income per return		P 286,066,857.00
Add: Disallowances		
Commission expenses	P 42,516,929.41	
Management fees	20,377,400.29	
Overstatement of liabilities	<u>529,201,086.00</u>	<u>592,095,415.70</u>
Adjusted taxable income		<u>P 878,162,272.70</u>
		P 307,356,795.45
Less: Tax withheld	P 36,784,099.00	
Tax paid	<u>66,484,017.00</u>	<u>103,268,116.00</u>
Basic deficiency income tax due		P 204,088,679.45
Add: Interest		<u>112,922,266.34</u>
Total deficiency income tax due		<u>P 317,010,945.79</u>

The disallowance of the commission expenses and management fees was based on the following findings by the respondent's examiner as stated in Exhibits 2-A and 2-B:

"IV. Income Tax

A. Disallowances

- 1. Commission Expense – P42,516,929.41 - represents overriding commission given to stockholders (see board resolution). Verification disclosed that the company employed the services of real estate brokers agent who in turn collects a regular commission of 5% to 8% of sales and to claim an overriding*

commission is not ordinary and necessary since the stockholders exerted no effort for the perfection of sales.

2. *Management Fees – P20,377,400.29 – represent overriding management fee given to stockholders. Verification disclosed that the company employed the services of engineers for architectural, mechanical, management, plumbing, sanitary and other services and to claim overriding management fee is not ordinary and necessary in the pursuit of business.*

Under BIR Ruling No. 474 dated October 31, 1960, the following were cited:

“Extraordinary unusual and extravagant amount paid by corporation to its officers stockholders in guise and form of compensation for their services, but having no substantial relation to the measure of services, and being utterly disproportionate to their value are not in reality payment of services and cannot be regarded as ordinary and necessary expenses so as to be deducted from gross income and such amount do not become part of the ordinary and necessary expenses merely because the payments are in accordance with agreement between corporation and its officers.”

As to whether or not the commission expenses of P42,616,929.41 and management fees of P20,377,400.29 are valid deductions from petitioner's gross income for taxable year 1995, we rule in the affirmative.

Section 29 of the 1995 Tax Code provides, thus:

SECTION 29. Deductions From Gross Income. — In computing taxable income subject to tax under Sections 21 (a), 24(a), (b) and (c); and 25 (a) (1), there shall be allowed as deductions the items specified in paragraphs (a) to (i) of this section: x x x

xxx

xxx

xxx

(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 actually rendered**; travelling 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.”(emphasis supplied)

Relative thereto, Section 65 of Revenue Regulations No. 2 states that:

SEC. 65. Business expenses. – Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer’s trade or business. xxx Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of transportation, x x x. (emphasis supplied)

The foregoing provisions clearly allow compensation for personal services actually rendered such as management fees and commissions as deductible business expenses provided the following conditions are met:

- 1.) that the expenses are ordinary and necessary;
- 2.) that they must be paid or incurred within the taxable year;
- 3.) that they must be paid or incurred in carrying on a trade or business; and
- 4.) that they are supported by pertinent records or documents [*ESSO STANDARD EASTERN, INC., (formerly, Standard-Vacuum Oil Company), vs. THE COMMISSIONER OF INTERNAL REVENUE, G.R. Nos. 28508-9, July 7, 1989*]

The fact that the commissions and management fees were paid or incurred in 1995 and that the same are supported by pertinent records or documents is not disputed. What is put into issue is whether or not the said expenses are “ordinary and necessary in carrying on a trade or business” under the circumstances.

In the case of *Atlas Consolidated Mining & Development Corporation vs. Commissioner of Internal Revenue, G.R. No. L-26911 dated January 27, 1981*, the Supreme Court held that ordinarily, an expense will be considered “necessary” where the expenditure is appropriate and helpful in the development of the taxpayer’s business and

“ordinary” when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term “ordinary” does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique or non-recurring to the particular taxpayer affected.

Further, Section 70 of Revenue Regulations No. 2 provides that in order for compensation payments for personal services actually rendered to be deductible as ordinary and necessary, the same must be: 1) reasonable and 2) are in fact, payments purely for service.

After a careful evaluation of the evidence and arguments of the parties, this court is convinced that the commissions and management fees paid to its stockholders, SPL Capital Markets Corp. (SPL) and DMC Urban Property Developers, Inc. (DMC) in 1995 are ordinary and necessary expenses normally incurred by entities engaged in the real estate business. Likewise, it was established that the subject commissions and management fee expenses were reasonable considering the actual efforts exerted or services rendered by SPL and DMC.

In 1995, petitioner was able to generate sales revenues amounting to P1,618,966,602.00 (*page 146, BIR records*) because of the marketing efforts done by SPL and DMC. Records show that petitioner did not have any in-house marketing arm and did not have any regularly employed brokers or sales agent that would receive fixed compensation plus commissions (*Exhibit W*). Rather, petitioner utilized a network of independent brokers and sales agents who were actually sales force or personnel of its stockholders, SPL and DMC. These two stockholders trained, developed, and provided

the logistics for their respective personnel. However, the two stockholders and their respective sales force were not receiving any other fixed compensation from the petitioner but were paid their respective commissions for the sales they generated. As explained by petitioner, the sales agents of SPL and DMC received 9% commissions on the sales they made while SPL and DMC received more or less 3% overriding commissions for the sales generated by their respective sales agents/personnel (*pages 15-17, TSN, November 21, 2000*). These commission payments were subjected to the required withholding taxes (*Exhibit X*). In other words, the commission payment to SPL and DMC amounting to P42,616,929.41 which represents about 3% of the total sales of P1,618,966,602.00 generated by SPL and DMC for petitioner is only but fair and in normal proportion.

The same holds true as regards the management fees of P20,377,400.29 paid by petitioner to SPL and DMC. It was shown that SPL and DMC actually rendered management services in overseeing the implementation of petitioner's realty development project and dealing with all matters arising therefrom such as the negotiations of the supply contracts and other agreements which are necessary for the execution of its Construction Agreement with the contractor, D.M. Consunji, Inc.; reviewed and monitored the works of the contractor and subcontractor; handled the overall marketing and financial aspects of the project; dealt with banks and other creditors and took charge of petitioner's Initial Public Offering (IPO) to generate funds; and administered the day to day operations of the project (*pages 15 – 17, TSN, February 6, 2001*). Considering the actual management work done by SPL and DMC, this court finds the management fees totalling P20,377,400.29 divided equally between SPL and DMC

and which is equivalent to 1% of petitioner's reported total sales of P2,037,740,029.00 as reasonable compensation.

It bears emphasis that the nature, extent and scope of work performed are material factors in the determination of the reasonableness of the compensation payment. In the case of *Commissioner of Internal Revenue vs. Algue, Inc. and The Court of Tax Appeals, G.R. No. L-28895, February 17, 1988*, the Supreme Court ruled:

“We agree with the respondent court that the amount of the promotional fees was not excessive. The total commission paid by the Philippine Sugar Estate Development Co. to the private respondent was P125,000.00. After deducting the said fees, Algue still had a balance of P50,000.00 as clear profit from the transaction. The amount of P75,000.00 was 60% of the total commission. **This was a reasonable proportion, considering that it was the payees who did practically everything, from the formation of the Vegetable Oil Investment Corporation to the actual purchase by it of the Sugar Estate properties.** In the present case, however, we find that the onus has been discharged satisfactorily. **The private respondent has proved that the payment of the fees was necessary and reasonable in the light of the efforts exerted by the payees in inducing investors and prominent businessmen to venture in an experimental enterprise and involve themselves in a new business requiring millions of pesos. This was no mean feat and should be, as it was, sufficiently recompensed.**” (emphasis supplied)

Respondent cannot outrightly assume that the commissions and management fees paid by petitioner to its stockholders, SPL and DMC do not represent payments for services rendered but are dividend distributions to its stockholders. Although the burden is upon the taxpayer to show the nature and amount of the services in order “to remove any stockholder sinecural tinge”, nevertheless, that burden must not be unfairly or arbitrarily laid upon the taxpayer. Similarly, suspicion is not an adequate substitute for evidence to aid the respondent in establishing its case (*page 13, Chapter 25E, Volume 6, MERTENS, Law of Federal Income Taxation*). As correctly pointed out by petitioner

in its memorandum, to raise the presumption that the payments constitute dividends, two conditions must be established: 1) the compensation is not reasonable considering the services rendered, and 2) the excessive payment is in proportion to the stockholding of the shareholder. The pertinent provisions of Section 70, Revenue Regulations No. 2 read as follows:

SEC. 70. Compensation for personal services. – x x x

x x x (a) An ostensible salary paid by a corporation **may be** a distribution of dividend on stock. This is likely to occur in the case of a corporation having a few shareholders, practically all of whom draw salaries. **If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payment correspond or bear a close relationship to the stockholdings of the officers or employees,** it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock.

Since we rule that the commissions and management fees paid by petitioner to SPL and DMC were reasonable in amounts in relation to the value of the services that they rendered, the same cannot be considered dividend distributions even if the said payments may be in direct proportion to their respective shareholdings. It bears stressing that both two conditions stated in Section 70 of Revenue Regulations No. 2 must be present; otherwise, the compensation payment to a stockholder is purely for services rendered which is deductible by the taxpayer-corporation from its gross income.

As to the third issue of whether or not petitioner overstated its liabilities or cost of sales in 1995 by P529,201,086, this court rules in the negative.

The respondent alleged that petitioner's cost of sales in 1995 was overstated by P529,201,086.00 when compared with the cost of sales in 1996. In computing the amount of P529,201,086.00, the respondent multiplied petitioner's 1995 reported gross

sales of P2,037,740,029.00 by 25.97% , the difference between the percentages of the cost of sales to total sales in 1995 of 72.48% and in 1996 of 46.55%.

However, records show that petitioner uses the percentage-of-completion method of accounting for its revenues (*see item no. 2, Notes to 1995 Financial Statements, page 161, CTA records*). This method is recognized by the Tax Code and is described under Revenue Audit Memorandum Order No. 2-95 as follows:

“D. *Percentage of Completion Basis* is a method applicable in the case of a building, installation or construction contract covering a period in excess of one year whereby gross income derived from such contract may be reported upon the basis of percentage of completion. In determining the percentage of completion of a contract, generally one of the following methods is used:

- a. The costs incurred under the contract as of the end of the tax year are compared with the estimated total contract costs; or
- b. The work performed on the contract as of the end of the tax year is compared with the estimated work to be performed.

In such case, the return should be accompanied by a certificate of the architect or engineer showing the percentage of completion during the taxable year of the entire work performed under contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the materials and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.”

Inasmuch as the percentage of completion of method deals with estimated costs and revenues which may be subject to revisions, it is not unusual that the cost ratio (percentage of cost of sales to total sales) of a particular year may differ with that of another year. The respondent cannot simply determine that there was overstatement of costs in a given year not until and when the project is finally completed. It is to be noted that the estimates used by petitioner in 1995 were obtained from the most available data

in the said year and certified to by petitioner's Architect, Mr. Pedro M. Raralio, Jr. (*Exhibits O & P*). It may then be concluded that the alleged 1995 overstatement of petitioner's liabilities or cost of sales of P529,201,086.00 was a mere result of the respondent's arbitrary and erroneous computation. Settled is the rule that an assessment should not be based on mere presumptions no matter how reasonable or logical said presumptions may be. The assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption (*Collector of Internal Revenue vs. Benipayo, 4 SCRA 182, January 31, 1962, cited in Commissioner of Internal Revenue vs. Island Garment Manufacturing Corp., 153 SCRA 665, September 11, 1987*).

We shall now discuss the fourth, fifth and sixth stipulated issues which all refer to the alleged 1995 deficiency withholding tax of P17,382,783.05 computed as follows (*Exhibits 12 & 13*):

Professional Fees	P 2,282,500.00	10%	P 228,250.00
	52,734,000.00	5%	<u>2,636,700.00</u>
Rental	66,473.70	5%	3,323.69
Purchases	19,782,050.00	1%	197,820.50
Yarn Property Ventures	102,141,000.00	7.5%	7,660,575.00
Others			
Contractors	15,028,259.84	1%	150,282.60
Repairs Services	55,000.00	1%	550.00
Security Services	101,568.00	1%	<u>1,015.68</u>
Total Deficiency Basic Tax Due			P 10,878,517.46
Add: Interest (01/26/96 to 01/22/99)			<u>6,504,265.59</u>
Total Amount Due and Payable			<u>P 17,382,783.05</u>

A perusal of the examiner's investigation report and the audit computation sheets attached to the preliminary assessment notice (*Exhibits 2-A; 8-3-B & 8-3-C*) shows that the alleged deficiency withholding tax of P17,382,783.05 is further broken down as follows:

Schedule I

Income Payment			EWT	W/holding
Nature/Payee	Reference	Amount	Rate	Tax Due
1.) Professional Fees				
Pedro Parallo	CV#037	P 20,000.00	10%	P 2,000.00
Jerome Lara	JV#027/028	291,500.00	10%	29,150.00
Gener Francia	JV#030/032	1,850,000.00	10%	185,000.00
Guevarra	JV#034	120,000.00	10%	12,000.00
A. Mapangalan	CV#1243	1,000.00	10%	100.00
Roces, Inc.	CV#809	500,000.00	5%	25,000.00
Donald Dee		52,234,000.00	5%	2,611,700.00
		<u>P 55,016,500.00</u>		<u>P 2,864,950.00</u>
2.) Rental				
Avis Industries	CV#214	P 28,973.70	5%	P 1,448.69
Strategical Planners	CV#389	12,500.00	5%	625.00
CRC		25,000.00	5%	1,250.00
		<u>P 66,473.70</u>		<u>P 3,323.69</u>
3.) Purchases				
Peaksun	various	<u>P 19,782,050.00</u>	1%	<u>P 197,820.50</u>
4.) Yarn Property Ventures		<u>P 102,141,000.00</u>	7.5%	<u>P 7,660,575.00</u>
5.) Others				
Contractors				
Maple Leap	CV#065	P 432,000.00	1%	P 4,320.00
DMCI	CV#141	18,586.81	1%	185.87
R. K. Dev.	CV#089	125,000.00	1%	1,250.00
D.M. Consunji	various	14,452,673.03	1%	144,526.73
Repairs				
Phil. Software	CV#213/281	55,000.00	1%	550.00
Security Services				
Royal Star	CV#764	101,568.00	1%	1,015.68
		<u>P 15,184,827.84</u>		<u>P 151,848.28</u>
		Basic withholding tax due		P 10,878,517.46
		Interest (Jan 26, 1996 to Jan. 22, 1999)		<u>6,504,265.59</u>
		Total deficiency withholding tax due		<u>P 17,382,783.05</u>

With reference to the fourth issue of whether or not there was failure to withhold and remit the 7.5% expanded withholding tax due on the sale of real property by Yarn Ventures Resources, Inc. to petitioner, the answer is in the negative.

As can be seen from the Deed of Conditional Sale (*pages 84-87, BIR records*) and Certificate Authorizing Registration {CAR} (*Exhibit T*), Yarn Ventures Resources, Inc. sold real property to petitioner in 1995 for a total consideration of P138,621,000.00 which was higher than its market/zonal value of P93,943,080.00. The corresponding 7.5% withholding tax due on the said sale based on the gross selling price of P138,621,000.00 (being the higher amount as against the market/zonal value) amounted to P10,396,575.00.00. As testified to by petitioner's Vice-President for Comptrollership, Mr. Willard Mosquito, the withholding tax due of P10,396,575.00 was remitted to the BIR by Yarn Ventures Resources, Inc. on behalf of petitioner in order to facilitate the immediate issuance of the CAR (*page 39, TSN, February 6, 2001*). The remittance of the P10,396,575.00 withholding tax is clearly reflected in the machine validated Monthly Remittance Return of Income Taxes Withheld filed by Yarn Ventures Resources, Inc. on January 25, 1996 (*Exhibit S*).

Apparently, it was erroneous on the part of the respondent's examiner to charge petitioner of the deficiency 7.5% withholding tax of P7,660,575.00 (*see item no. 4 of Schedule I above*) which was computed based on the amount of P102,141,000.00 representing the balance of the gross selling price of P138,621,000.00 after deducting therefrom the initial down payment of P36,480,000.00 (*page 86, BIR records*).

Regarding the fifth issue, the respondent's examiner imputed against petitioner a deficiency 5% withholding tax due on the commission paid to Donald Dee pertaining to the sale of real property by Yarn Ventures Resources, Inc. to the petitioner. The examiner believed that the commission paid to Donald Dee in the amount of P52,234,000.00 for acting as broker on the sale of real property between Yarn Ventures

Resources, Inc. and petitioner (*page 104, BIR records*) should be classified as professional fees and subjected to a higher withholding tax rate of 10% instead of only 5% (*page 94, BIR records; Exhibit 2-a*), hence, the alleged deficiency 5% withholding tax of P2,611,700.00 (*see last item under no. 1 of Schedule I above*)

This court rules in favor of petitioner.

Section 1(a) of Revenue Regulations No. 6-85, as amended, enumerates the income payments that fall under “Professional fees, talent fees, etc., paid to individuals” as follows:

SECTION 1. Income payments subject to creditable withholding tax and rates prescribed thereon. — Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines:

(a) Professional fees, talent fees, etc., paid to individuals. — On the gross professional, promotional and talent fees or any other form of remuneration paid to the following individuals - ten per centum (10%):

"(1) Those individually engaged in the practice of professions or callings: Lawyers; certified public accountants; doctors of medicine; architects, civil, electrical, chemical, mechanical, structural, industrial, mining, sanitary metallurgical and geodetic engineers and marine surveyors; doctors of veterinary science; dentists, professional appraisers; connoisseurs of tobacco; actuaries; and interior decorators;

(2) Professional entertainers such as actors and actresses, singers and emcees.

The term actors and actresses shall not include "bit players," "extras" and "radio talents and character players" whose roles or performances in a movie, television or radio program or stage presentation are subordinate to the actors or actresses and to whom payments are made per role or performance, or where the aggregate payment by the same payor in a taxable year does not exceed two thousand pesos (P2,000.00)

(3) Professional athletes including basketball players, pelotaris and jockeys;

- (4) All directors involved in movies, stage, radio, television, and musical productions;
- (5) Insurance agents and Insurance adjusters;
- (6) Management and technical consultants;
- (7) Business and bookkeeping agents and agencies;
- (8) Other recipients of talent fees;

The amounts subject to withholding under this paragraph shall include not only fees, but also per diems, allowances and any other forms of income payments. In the case of professional entertainers, athletes, and all recipients of talent fees, the amount subject to withholding tax shall also include amounts paid to them in consideration for the use of their names or pictures in print, broadcast and other media or for public appearances, for purposes of advertisements and sales promotion."

The commission amount of P52,234,000.00 was paid to Donald Dee on account of the latter's efforts in bringing about the sale of real property between Yarn Ventures Resources, Inc. and petitioner. Hence, the said amount cannot be classified as income payment to an individual in the practice of a profession or calling such as the legal or medical practice. Neither does it pertain to fees paid to professional entertainers, athletes, directors in movies, stage, television and musical productions, insurance agents/adjusters, management and technical consultants, business and bookkeeping agents and other recipients of talent fees. The commission payment of P52,234,000.00 properly fall under income payments classified as "Amounts paid to certain Brokers and Agents" subject to 5% withholding tax as provided under Section 1(g) of Revenue Regulations No. 6-85, as amended, to wit:

SECTION 1. Income payments subject to creditable withholding tax and rates prescribed thereon. — Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines.

xxx xxx

(g) Amounts paid to certain Brokers and Agents. — On gross payments to customs, insurance, **real estate and commercial brokers** and agents of professional entertainers — five per centum (5%).” [emphasis supplied]

With respect to the sixth issue of whether or not petitioner failed to withhold the corresponding withholding tax on the professional fees paid to various individuals, fees to contractors, rental and purchases of supplies and materials, this court rules in the affirmative.

Petitioner failed to prove that it withheld and remitted the required withholding tax on the said income payments. Some of the individuals/entities for which certain income payments were made were not included in the “Alphabetical List of Withholding Tax” (*Exhibit X*) attached to the 1995 Annual Information Return of Income Tax Withheld filed by petitioner, to wit:

Income Payment				EWT Rate	W/holding Tax Due
Nature/Payee	Reference	Amount			
1.) Professional Fees					
Pedro Parallo	CV#037 P	20,000.00	10%	P	2,000.00
Jerome Lara	JV#027/028	291,500.00	10%		29,150.00
A. Mapangalan	CV#1243	1,000.00	10%		100.00
Roces, Inc.	CV#809	500,000.00	5%		25,000.00
2.) Rental					
Avis Industries	CV#214	28,973.70	5%		1,448.69
Strategical Planners	CV#389	12,500.00	5%		625.00
CRC		25,000.00	5%		1,250.00
3.) Purchases					
Peaksun	various	19,782,050.00	1%		197,820.50
				P	<u>257,394.19</u>

Moreover, although the names of the following payees were included in the “Alphabetical List of Withholding Tax”, this court cannot ascertain whether the related

income payments actually formed part of the gross income payments indicated in the alpha list as subjected to withholding tax:

Income Payment			EWT	W/holding
Nature/Payee	Reference	Amount	Rate	Tax Due
1.) Professional Fees				
Gener Flancia	JV#030/032 P	1,850,000.00	10%	P 185,000.00
Guevarra	JV#034	120,000.00	10%	12,000.00
5.) Others				
Contractors				
Maple Leaf	CV#065	432,000.00	1%	4,320.00
DMCI	CV#141	18,586.81	1%	185.87
R. K. Dev.	CV#089	125,000.00	1%	1,250.00
D.M. Consunji	various	14,452,673.03	1%	144,526.73
Repairs				
Phil. Software	CV#213/281	55,000.00	1%	550.00
Security Services				
Royal Star	CV#764	101,568.00	1%	1,015.68
				<u>P 348,848.28</u>

Petitioner should have submitted additional proofs such as disbursement or journal vouchers, invoices/receipts and a reconciliation schedule itemizing all income payments made per payee with proper indication as to the related voucher number, name of payee, amount of income payment and withholding tax.

For petitioner's failure to establish that it withheld and remitted the withholding taxes of P606,242.47 (the sum of P257,394.19 and P348,848.28), the total deficiency withholding tax of P968,991.39 (inclusive of interest) shall be assessed against petitioner, thus:

Basic deficiency withholding tax due	P 606,242.47
Add: Interest (01/26/96 to 01/22/99)	<u>362,748.92</u>
Total amount due and payable	<u>P 968,991.39</u>

With regards to the seventh issue of whether or not there was underpayment by petitioner of the documentary stamp tax due on the original issuance of shares by petitioner in the amount of P2,003,333.33, the answer is in the negative.

The examiner's computation of the alleged 1995 deficiency documentary stamp tax was based on petitioner's subscribed capital stock of P421,000,000.00 as shown below (*Exhibit 2*):

Subscribed	421,000,000/200 x P2	P 4,210,000.00
Less: Payment		<u>2,206,666.67</u>
Balance of the Tax Due		<u>P 2,003,333.33</u>

However, Section 175 of the 1993 Tax Code, as amended, provides as follows:

"Sec. 175. Stamp tax on original issue of certificates of stock.
— On **every original issue**, whether on organization, reorganization or for any lawful purpose, **of certificates of stock** by any association, company, or corporations, there shall be collected a documentary stamp tax of Two pesos (P2.00) on each two hundred pesos, or fractional part thereof, of the par value of such certificates: Provided, That in the case of the original issue of stock without par value the amount of the documentary stamp tax herein prescribed shall be based upon the actual consideration received by the association, company, or corporation for the issuance of such stock, and in the case of stock dividends on the actual value represented by each share." (emphasis supplied)

Based on the foregoing provisions of law, the documentary stamp tax attaches upon the original issuance of the certificates of stock. In the case of *Commissioner of Internal Revenue vs. Construction Resources of Asia, Inc. and The Court of Tax Appeals, G.R. No. L-68230, November 25, 1986*, the Supreme Court held that:

"It is clear from the above-quoted provision that for the aforesaid tax to attach, the certificates of stocks only need to be issued but not delivered. As to the what the word "issue" contemplates in the context of Section 224, we cite the case of *Philippine Consolidated Coconut Ind., Inc. v. Coll. of Int Rev.* (70 SCRA 22, 26-28), wherein we ruled:

"A cursory perusal of the above provision clearly shows that the documentary stamp tax is imposed on every original issue of a certificate of stock (the document evidencing ownership of shares of stock in the corporation), and that a documentary stamp tax is in the nature of an excise tax because it is levied upon the privilege, the opportunity and the facility of issuing certificates of stock. It being a levy on the original issue of a certificate of stock (sic). The documentary stamp tax under this provision of the law may be levied only once, that is upon the original

issue of the certificate. The crucial point therefore, in the case before Us is the proper interpretation of the word 'issue.' In other words, when is the certificate of stock deemed 'issued' for the purpose of imposing the documentary stamp tax? Is it at the time the certificates of stock are printed, at the time they are filled up (in whose name the stocks represented in the certificate appear as certified by the proper officials of the corporation), at the time they are released by the corporation or at the time they are in the possession (actual or constructive) of the stockholders owning them?

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"Ordinarily, when a corporation issues a certificate of stock (representing the ownership of stocks in the corporation to fully paid subscription) the certificate of stock can be utilized for the exercise of the attributes of ownership over the stocks mentioned on its face. The stocks can be alienated; the dividends or fruits derived therefrom can be enjoyed, and they can be conveyed, pledged or encumbered. The certificate as issued by the corporation, irrespective of whether or not it is in the actual or constructive possession of the stockholder, is considered issued because it is with value and hence the documentary stamp tax must be paid as imposed by Section 212 of the National Internal Revenue Code, as amended.

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"Predicated on the above reasons, We are firmly convinced that the Government stands to lose nothing in imposing the documentary stamp tax only on those stock certificates duly issued, or wherein the stockholders can freely exercise the attributes of ownership and with value at the time they are originally issued. As regards those certificates of stocks temporarily subject to suspensive conditions they shall be liable for said tax only when released from said conditions, for then and only then shall they truly acquire any practical value for their owners."

Considering that the alleged 1995 deficiency documentary stamp tax of P2,003,333.33 was computed based on petitioner's subscribed capital stock and not on issued capital stock, the same is erroneous and should be cancelled.

As to the last issue, the respondent imposed a compromise penalty of P25,000.00 on account of petitioner's alleged failure to submit BIR Form 1701-B (Annual Return of

Income Payments Not Subjected to Withholding Tax) together with the corresponding Alphabetical List for the taxable year 1995, citing the following provisions of Section 254 of the 1995 Tax Code:

"Section 254. *Failure to file return, supply correct and accurate information, pay tax, withhold and remit tax and refund excess taxes withheld on compensation.* — Any person required under this Code or by regulations promulgated thereunder to pay any tax, make a return, keep any record, or supply correct and accurate information, who willfully fails to pay such tax, make such return, keep such record, or supply such correct and accurate information, or withhold or remit taxes withheld, or refund excess taxes withheld on compensation, at the time or times required by law or regulations shall, in addition to other penalties provided by law, upon conviction thereof, be fined not less than ten thousand pesos (P10,000) and imprisonment of not less than one (1) year but not more than ten (10) years.
x x x"

A scrutiny of petitioner's list of attachment to its 1995 annual income tax return (*page 152, CTA records*) proves that petitioner did not actually submit the required BIR form. Nevertheless, this court strikes down the compromise penalty of P25,000.00 imposed by the respondent since a compromise implies mutual agreement. Such being the case, in the absence of a showing that petitioner consented thereto, the compromise penalty cannot be validly imposed (*UST vs. Collector, 104 Phil 1062*). Similarly, in the case of *Atlas Consolidated Mining and Development Corporation (doing business under the name Atlas-Itochu Consortium) vs. Commissioner of Internal Revenue, CTA Case No. 5671, August 29, 2002*, this court ruled:

xxx Section 254 of the Tax Code clearly provides that the penalties provided by law shall only be imposed upon conviction, which fact is wanting in the present case. Moreover, as facts would demonstrate, there is no showing that petitioner voluntarily entered into a compromise with the respondent. It even set up the defense that it has complied with the requirements, which, of course is belied by the documentary evidence available. It has been judicially held that compromise penalties being an

imposition based upon mutual agreement or consent by petitioner, cannot be compulsorily imposed to those who do not agree to its imposition. Thus, as held by the Supreme Court in an old case entitled *The Philippine International Fair, Inc. vs. Collector, G.R. Nos. L-12928 and L-12932, March 31, 1962 (4 SCRA 774)*,

"This Court has no jurisdiction to compel a taxpayer to pay the sum (compromise penalty) because by its nature it implies a mutual agreement between the parties in respect to the thing or subject matter which is so compromised."

It can be inferred from the foregoing pronouncement that the imposition of the compromise penalty against a taxpayer presupposes consent on the part of both parties in the absence of which the compromise penalty is not binding nor cannot be mandatorily enforced. In the case at bar, it is evident that petitioner did not concur with the compromise penalty imposed by the respondent. Necessarily, this court cannot compel petitioner to pay the compromise penalty against its will.

However, it must be noted that in situations like this, respondent is not left without a remedy. Violation of the reportorial requirements prescribed by law carries with it criminal sanctions. The compromise penalty incident to the violation is suggested merely in lieu of criminal prosecution. As clearly worded in RMO 1-90, thus:

"III. Guidelines and Instructions

(5) Since compromise penalties are only amounts suggested in settlement of criminal liability and may not therefore be imposed or exacted in the event that a taxpayer refuses to pay the suggested compromise penalty, the violation shall be referred for criminal action as above-mentioned."

WHEREFORE, the assessments for 1995 deficiency income tax of P317,010,945.79, documentary stamp tax of P2,003,333.33 and compromise penalty of P25,000.00 for non-filing of BIR Form 1701-B together with Alpha list of income payments not subjected to withholding tax are hereby **CANCELLED** and **WITHDRAWN**. However, petitioner is **ORDERED** to **PAY** the amount of P968,991.39 representing 1995 deficiency withholding tax (*inclusive of 20% interest*)

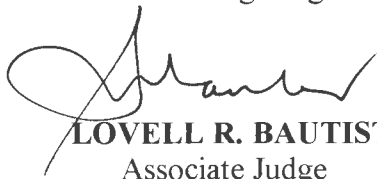
plus 20% delinquency interest computed from March 17, 1999 until fully paid pursuant to Section 249(c)(3) of the 1995 Tax Code.

SO ORDERED.


JUANITO C. CASTAÑEDA, JR.
Associate Judge

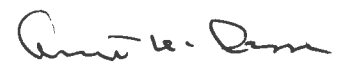
WE CONCUR:


ERNESTO D. ACOSTA
Presiding Judge


LOVELL R. BAUTISTA
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.


ERNESTO D. ACOSTA
Presiding Judge