REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

COMPOSITE MATERIALS, INC.,
Petitioner,

CTA CASE NO. 8306

-versus-

Members:

BAUTISTA, Chairperson;
FABON-VICTORINO, and
RINGPIS-LIBAN, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

OCT 10 2014
1:10 p.m.

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DECISION

RINGPIS-LIBAN, J.

STATEMENT OF THE CASE

This is a Petition for Review filed by Composite Materials, Inc. on July 4, 2011 praying for the cancellation and withdrawal of the assessment issued against it for alleged deficiency income tax and expanded withholding tax (EWT) covered by Formal Letter of Demand (FLD) No. 043-B32-07[1] dated June 28, 2010 in the amount of ₱4,093,805.74, inclusive of interest, for calendar year 2007.

[1] Exhibit "A", docket, volume (vol.) I, pp. 441-443.

STATEMENT OF FACTS

Petitioner Composite Materials, Inc. is a domestic corporation duly organized and existing under Philippine laws, with principal office at 11 Joe Borris St., Bo. Bagong Ilog, Pasig City and duly registered with the Bureau of Internal Revenue (BIR) under Tax Identification Number (TIN) 005-581-218.[2]

On the other hand, respondent is the duly appointed Commissioner of the BIR vested under appropriate laws with the authority to carry out the functions, duties and responsibilities of said Office, including, *inter alia,* the power to decide disputed assessments, and cancel and abate tax liabilities pursuant to the provisions of the National Internal Revenue Code (NIRC) of 1997 and other tax laws, rules and regulations.

On July 1, 2010, petitioner received respondent's Formal Letter of Demand (Demand No. 043-B32-07) dated June 28, 2010, with attached Details of Discrepancies and accompanying Assessment Notices,[3] assessing petitioner of deficiency income tax and EWT in the total amount of ₱4,093,805.74, inclusive of interest, for calendar year ending December 31, 2007.[4]

Petitioner filed its protest letter to the Formal Letter of Demand on July 7, 2010 and the same was duly received by respondent.[5]

However, respondent denied petitioner's protest by issuing the Final Notice Before Seizure[6], which was received by petitioner on June 2, 2011.[7]

Petitioner then appealed the Final Notice by filing the instant Petition for Review on July 4, 2011.[8]

On July 8, 2011, petitioner filed an Urgent Omnibus Motion (I) To Quash Warrant of Distraint and/or Levy, and (II) To Enjoin Collection of Taxes, praying, among others, for the suspension of collection of petitioner's alleged deficiency income tax, expanded withholding tax and interests for calendar year 2007 until the case is resolved with finality.[9]

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[2] Par. 2, Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI), docket, vol. I, p. 160.
[3] Par. 3, Stipulated Facts, JSFI, docket, vol. I, p. 160.
[4] Exhibit "A", docket, vol. I, pp. 441-445.
[5] Par. 5, Stipulated Facts, JSFI, docket, vol. I, p. 160; Exhibit "B", docket, vol. I, pp. 449-451.
[6] Par. 7, Stipulated Facts, JSFI, docket, vol. I, p. 160; Exhibit "C", docket, vol. I, p. 452.
[7] Par. 6, Stipulated Facts, JSFI, docket, vol. I, p. 160.
[8] Petition for Review, docket, vol. I p. 1.; The last day prescribed for filing the instant Petition for Review, which was on July 2, 2011, fell on a Saturday; See Section 1, Rule 22, The 1997 Rules of Civil Procedure.

[9] Docket, vol. I, pp. 25-30.

The omnibus motion was granted by this Court via Resolution[10] dated August 11, 2011, requiring petitioner to file a surety bond equivalent to double the amount sought to be collected by respondent.

Respondent filed her Answer[11] on August 26, 2011, interposing the following special and affirmative defenses:

> 4. Tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of the assessments. (*Commissioner of Internal Revenue vs. Bank of the Philippine Islands, G.R. No. 134062, April 17, 2007);*
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> 5. The Formal Letter of Demand and Assessment Notices (FAN) dated 28 June 2010 for calendar year ending 31 December 2007 against the petitioner was issued in compliance with the provisions of Section 228 of the National Internal Revenue Code (NIRC) and in accordance with existing Revenue Rules and Regulations relative to the right of the petitioner to be informed of the factual and legal bases upon which the assessment was made. Petitioner was informed in writing of the law and the facts on which the assessment is made, otherwise, they would not have filed their protest on July 7, 2010;
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> 6. Petitioner was assessed deficiency income tax because it failed to substantiate with sufficient evidence the deductibility of commissions and professional fees from gross income in violation of Section 34 (A) of the NIRC of 1997, as amended. In addition, petitioner's claimed purchases per Income Tax Return (ITR) is greater than the actual expenses incurred, therefore, the overstatement is added back to their taxable income pursuant to Section 34 of the aforesaid law;
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> 7. Petitioner was assessed deficiency withholding tax because it failed to fully withhold and remit the expanded withholding tax on income payments for commissions as required under Revenue Regulations No. 2-98, as amended;

[10] Docket, vol. I, pp. 46-51.
[11] Docket, vol. I, pp. 52-55.

8. The 20% per annum has been imposed pursuant to the provisions of Section 249(B) of the NIRC of 1997, as amended; and

9. The 25% surcharge has been imposed pursuant to the provisions of Section 248(A) of the NIRC of 1997, as amended.

The case was set for pre-trial conference on September 23, 2011.[12] Petitioner's Pre-Trial Brief[13] and respondent's Pre-Trial Brief[14] were both filed on September 20, 2011.

On October 17, 2011, petitioner filed its Compliance with the Resolution dated August 11, 2011, granting petitioner's Motion for Suspension of Collection of Taxes.[15] Thus, a Resolution was issued on October 25, 2011, which approved the surety bond attached to the said Compliance.[16] On the same date, an Amended Pre-Trial Brief was likewise filed by petitioner.[17] As a result, another Pre-Trial Brief was filed by respondent on October 20, 2011.[18]

On November 29, 2011, the parties filed with this Court their Joint Stipulation of Facts and Issues[19], which was approved in a Resolution[20] dated December 1, 2011. Thereafter, a Pre-Trial Order[21] was issued by the Court on January 5, 2012.

Trial ensued, giving both parties the opportunity to present their respective documentary and testimonial evidence.

On March 13, 2012, respondent submitted the BIR Records in the instant case, consisting of two hundred seventy-nine (279) pages representing the complete BIR Records of petitioner for calendar year 2007.[22]

After presentation, marking, identification and offer, the Court admitted as part of petitioner's documentary evidence Exhibits "A" to "X-1", with the exception of Exhibits "S-70" to "S-75", "S-74-a", "S-81-a", "S-76" to "S-107", and "S-108" to "S-118"; which were denied admission for petitioner's failure to present the originals for comparison.[23]

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[12] Notice of Pre-Trial Conference issued on September 1, 2011, docket, vol. I, p. 86.
[13] Docket, vol. I, pp. 93-105.
[14] Docket, vol. I, pp. 89-92.
[15] Docket, vol. I, pp. 115-117.
[16] Docket, vol. I, p. 155.
[17] Docket, vol. I, pp. 140-152.
[18] Docket, vol. I, pp. 118-121.
[19] Docket, vol. I, pp. 159-169.
[20] Docket, vol. I, p. 171.
[21] Docket, vol. I, pp. 173-181.
[22] Docket, vol. I, pp. 253-254.
[23] Resolution dated November 9, 2012, docket, vol. II, pp. 757-758.

When it was respondent's turn to present her evidence, she moved for the withdrawal of the BIR Records of the instant case, which was subsequently granted during the hearing held on January 22, 2013.[24] Respondent then proceeded to present, mark and identify her exhibits and thereafter returned the BIR Records of the instant case on June 26, 2013.[25]

An offer of respondent's exhibits was subsequently made. The Court, in a Resolution dated August 14, 2013, admitted as part of respondent's evidence Exhibits "1" to "15-a", with the exception of Exhibit "5"; which was denied admission for petitioner's failure to present its original for comparison.[26]

Petitioner submitted its Memorandum (With Manifestation Regarding the Pending Compromise Discussion Between the Parties)[27] on October 16, 2013; while respondent submitted her Memorandum[28] on October 21, 2013. Accordingly, the case was submitted for decision on October 25, 2013.[29]

On November 21, 2013, the parties filed their Joint Motion (For Withdrawal of BIR Records), praying that respondent be allowed to temporarily withdraw the BIR Records for this case for purposes of processing petitioner's payment of the compromise settlement amounts and the subsequent approval of its application for compromise.[30] This Joint Motion was granted by the Court in the Resolution dated January 14, 2014, giving a period of fifteen (15) days from notice to temporarily withdraw the BIR Records of this case. After which, respondent was directed to immediately return the BIR Records to the Court.[31]

STATEMENT OF ISSUES

The parties submitted the following issues[32] for this Court's disposition:

> A. Whether the right of Respondent to make an assessment for expanded withholding tax for taxable year 2007 has prescribed.
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> B. Whether Petitioner was denied due process of law.

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[24] Docket, vol. II, pp. 779-780.
[25] Docket, vol. II, pp. 857-858.
[26] Docket, vol. II, pp. 938-939.
[27] Docket, vol. II, pp. 964-1004
[28] Docket, vol. II, pp. 954-963.
[29] Docket, vol. II, p. 1006.
[30] Docket, vol. II, pp. 1008-1010.
[31] Docket, vol. II, pp. 1012-1013.
[32] Stipulated Issues, JSFI, docket, vol. I, p. 163.

C. Whether or not Petitioner failed to substantiate with sufficient evidence the claimed deductions.

i. Whether Petitioner's commissions and professional fees in the total amount of Php4,350,185.93 were supported with sufficient evidence.

ii. Whether or not Petitioner's purchases was overstated by Php2,693,487.55.

iii. Whether Petitioner's payments of commissions amounting to Php3,341,091.33 were not subjected to EWT.

THE COURT'S RULING

As to the first stipulated issue concerning prescription of the period to assess petitioner's deficiency EWT for calendar year 2007, petitioner alleged that respondent's right to issue an assessment for the alleged deficiency EWT for the period of January to May 2007 is already barred by prescription considering that the assessment was issued only on June 28, 2010.

Section 203 of the NIRC of 1997, as amended, specifically provides that respondent has three (3) years to assess and collect an internal revenue tax, to wit:

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

Pursuant to Section 203 of the NIRC of 1997, as amended, internal revenue taxes must be assessed within three years counted from the period fixed by law for the filing of the tax return or the actual date of filing, whichever is later. This rule governs the question of prescription of the government's right to assess internal revenue taxes primarily to safeguard the interests of taxpayers from unreasonable investigation. Accordingly, the government must assess internal revenue taxes on time so as not to extend indefinitely the period of assessment and deprive the taxpayer of the assurance that it will no longer be subjected to further investigation for taxes after the expiration of reasonable period of time.[33]

Thus, in determining the last day for respondent to assess petitioner of deficiency EWT for calendar year 2007, this Court shall apply the relevant provisions of Section 2.58 of Revenue Regulations (RR) No. 2-98, as amended by RR No. 06-01 and RR No. 17-03, which require the filing of the creditable withholding tax return and payment to be made within ten (10) days after the end of each month for the months of January until November, while for the month of December, the creditable withholding tax return should be filed and payment to be made on or before January 15 of the following year.

Since respondent issued the Formal Letter of Demand/Assessment Notices[34] on June 28, 2010, respondent's right to assess petitioner of deficiency EWT from January to May 2007 has already prescribed, illustrated as follows:

Month Covered (2007)	Date of Filing of BIR Form No. 1601-E[35]	Last Day to File BIR Form No. 1601-E as required by law	Last Day to Assess	Date of Issuance of FLD/ Assessment Notices	Remarks
January	02/12/07	2/10/2007	2/10/2010	6/28/2010	Prescribed
February	03/09/07	3/10/2007	3/10/2010		Prescribed
March	04/10/07	4/10/2007	4/10/2010		Prescribed
April	05/10/07	5/10/2007	5/10/2010		Prescribed
May	06/07/07	6/10/2007	6/10/2010		Prescribed
June	07/10/07	7/10/2007	7/10/2010		Not Prescribed
July	08/07/07	8/10/2007	8/10/2010		Not Prescribed
August	09/10/07	9/10/2007	9/10/2010		Not Prescribed
September	10/10/07	10/10/2007	10/10/2010		Not Prescribed
October	11/12/07	11/10/2007	11/10/2010		Not Prescribed
November	12/10/07	12/10/2007	12/10/2010		Not Prescribed
December	01/09/08	1/25/2008	1/25/2011		Not Prescribed

In the Details of Discrepancies, respondent stated that petitioner failed to fully withhold and remit the EWT on income payments for commissions, computed as follows:

	Per FS/Audit	Per Return	Difference
Commissions	₱3,805,872.73	₱464,781.40	₱3,341,091.33

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[33] *Commissioner of Internal Revenue vs. FMF Development Corporation*, G.R. No. 167765, June 30, 2008.
[34] Exhibit "A", docket, vol. I, pp. 441-445.
[35] BIR Records, pp. 50-65.

Based on the vouchers submitted by petitioner, the claimed commissions in the amount of ₱3,805,872.73 pertain to the following dates:

Exhibit	Date	Payee	Reference No.	Amount (in Php)
"R-71"	2/2/2007	Bendeline/Jose Manuel Buenavista	07-023	₱ 53,355.34
"R-72"	2/26/2007	Randy Centeno	07-041	9,047.75
"R-73"	4/3/2007	Randy Centeno	07-068	23,107.59
"R-74"	4/12/2007	Jose Manuel Buenavista	07-075	18,731.46
"R-75"	4/23/2007	Bendeline Buenavista	07-077	9,591.07
"R-76"	6/12/2007	Jose Manuel Buenavista	07-118	15,845.35
"R-77"	6/16/2007	Bendeline Buenavista	07-120	16,171.76
"R-78"	6/21/2007	Randy Centeno	07-123	21,581.74
"R-79"	6/27/2007	Jose Manuel Buenavista	07-131	20,039.75
"R-80"	7/12/2007	Jose Manuel Buenavista	07-135	13,829.99
"R-81"	7/27/2007	Bendeline Buenavista	07-152	11,353.17
"R-82"	8/28/2007	Jose Manuel Buenavista	07-168	21,197.27
"R-83"	8/28/2007	Bendeline Buenavista	07-169	1,947.42
"R-84"	8/28/2007	Randy Centeno	07-170	3,050.59
"R-85"	9/7/2007	Jose Manuel Buenavista	07-174	20,359.22
"R-86"	11/12/2007	Jose Manuel Buenavista	07-214	21,612.74
"R-87"	11/29/2007	Randy Centeno	07-232	3,051.13
"R-88"	12/18/2007	Carlos Montialto	07-246	1,169.50
"R-89"	12/31/2007	Accrued Commissions	JV-15	3,520,829.89
TOTAL				**₱3,805,872.73**

On the other hand, the commissions per return in the amount of ₱464,781.40 deducted by respondent in arriving at the commissions of ₱3,341,091.33 subject to deficiency ten percent (10%) EWT, comprised of the following:[36]

Payee	Amount of Income Payment	Amount of Tax Withheld and Remitted
Buenavista, Jose Manuel	₱ 158,694.09	₱ 15,869.42
Coloma, Bendeline	65,340.49	6,534.05
Centeno, Randy	59,838.82	5,983.88
Montialto, Carlo	1,169.50	116.95
Vertex Mercantile Services, Inc.	47,839.80	4,783.98
RNQ Customs Brokerage	114,398.70	11,439.87
Seaglobe Marine Surveyors	17,500.00	1,750.00
Total	**₱464,781.40**	**₱46,478.15**

[36] Per petitioner's Alphalist of Payees Subject to Expanded Withholding Tax attached to its Annual Information Return of Creditable Income Taxes Withheld (Expanded)/Income Payments Exempt from Withholding Tax (BIR Form No. 1604-E) for calendar year 2007, BIR Records, pp. 97-98.

From the foregoing, respondent erroneously deducted the income payments to Vertex Mercantile Services, Inc. (₱47,839.80), RNQ Customs Brokerage (₱114,398.70) and Seaglobe Marine Surveyors (₱17,500.00) totaling ₱179,738.50, as these do not form part of the claimed commissions of ₱3,805,872.73.

However, the remaining income payment of ₱285,042.84 (₱464,781.40 less ₱179,738.50) for which the 10% EWT of ₱28,504.30 was remitted to the BIR is properly deductible against the commissions of ₱3,805,872.73.

Consequently, **the commission expense of ₱3,341,091.33 subject of the 2007 deficiency EWT assessment actually pertains to the accrued commissions in December 2007** in the amount of ₱3,520,829.89 reduced by the amount of ₱179,738.50 income payments to Vertex Mercantile Services, Inc., RNQ Customs Brokerage and Seaglobe Marine Surveyors.

In other words, while respondent's right to assess petitioner of deficiency EWT for January to May 2007 has already prescribed,[37] **no part of the subject deficiency EWT assessment pertains to the said period**. Thus, respondent's assessment against petitioner for basic deficiency EWT for calendar year 2007 in the amount of ₱334,109.13 shall be upheld:

	Per FS/ Audit	**Per Return**	**Difference**
Commissions	₱3,805,872.73	₱464,781.40	₱3,341,091.33
Tax Rate			10%
Deficiency Expanded Withholding Tax			**₱334,109.13**

As to the second issue, petitioner avers that respondent violated petitioner's right to due process of law when she issued the assessment for alleged deficiency income tax and EWT for calendar year 2007.

On the item "non-deductible expense" which is part of the computation of deficiency income tax, petitioner alleged that respondent did not disclose which specific commissions and professional fees were not supported by evidence and during which month/quarter these fees were supposedly incurred. Petitioner further asserts that the assessment also failed to disclose which purchases were considered and which were found to be overstated. The assessment likewise failed to state which type of purchases (as petitioner had made various purchases of goods and services) were considered and audited for purposes of, and as bases for, the assessment.

As regards the assessment for deficiency EWT, the basis for the deficiency EWT was the purported failure of petitioner to fully withhold and

[37] Also alleged by petitioner in paragraph 55 of its Memorandum, docket, vol. II, p. 981.

remit the EWT on income payments and commissions as required under RR No. 2-98, as amended. Petitioner opposed the assessment, arguing that respondent did not list in sufficient detail the payees of these commissions. Respondent also allegedly failed to disclose when these commissions were paid and which particular EWT return of petitioner was found deficient. In view thereof, petitioner insisted that respondent did not provide sufficient information and opportunity to petitioner to intelligently answer respondent's findings.

Perusal of the assailed assessment with the Details of Discrepancies[38] shows that petitioner was duly informed of the factual and legal bases of the computation of its deficiency income tax and deficiency EWT liabilities.

It is true that the law requires that the taxpayers should be informed of the legal and factual bases of the assessment. However, the assessment notice is not required to be a full narration of the facts and laws on which the assessment is based. Thus, so long as the parties are notified and given the opportunity to explain their side, the requirements of due process are satisfied.[39]

Applying the foregoing, the mere fact that respondent failed to provide petitioner the details which it believes are necessary for it to be sufficiently informed of the factual basis of the assessment does not make the assessment null and void.

Furthermore, the Court cannot sustain petitioner's claim that respondent failed to provide sufficient information and opportunity to intelligently answer the assessment since the items "commissions" and "professional fees" indicated in the computation of petitioner's deficiency income tax liability **refer to the amounts which petitioner itself claimed as deduction from its gross income**, while the item "overstatement of purchases" pertaining to the same computation was arrived at by computing the difference between **petitioner's purchases as indicated in its own income tax return (ITR)** and the purchases as stated in respondent's audit.

Clearly, petitioner could have easily substantiated by evidence the said commissions and professional fees which petitioner itself claimed as deduction from its gross income, as well as the purchases which petitioner declared in its ITR in order to answer the assessment issued by respondent.

The same holds true with regard to the assessment for deficiency EWT, wherein petitioner could have established by substantial evidence that it fully

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[38] Exhibit "A", docket, vol. I, 441-445.

[39] *Calma, et al. vs. Court of Appeals, et al.*, G.R. No. 122787, February 9, 1999.

withhold and remit the EWT on income payments and commissions for calendar year 2007 in order to disprove the subject EWT assessment.

Similarly, a review of the records would show that petitioner was informed of the result of the tax audit conducted by respondent from which the deficiency tax assessment was based through the Notice for an Informal Conference, attaching thereto respondent's detailed findings on all of its internal revenue tax liabilities pursuant to Letter of Authority No. 0008746 dated September 9, 2008.[40]

Considering the foregoing, it cannot be said that petitioner was not given sufficient information to intelligently answer the assessment issued by respondent against it.

The Court will now address the third issue pertaining to petitioner's substantiation of its claimed deductions.

I. DEFICIENCY INCOME TAX - ₱3,590,536.70

Respondent computed the deficiency income tax assessment in the amount of ₱3,590,536.70, by adding adjustments to petitioner's taxable income per ITR for the year 2007, consisting of (1) non-deductible expense amounting to ₱4,350,185.93, and (2) overstatement of purchases amounting to ₱2,693,487.55, as shown below:

Taxable income per ITR		₱ 1,316,760.03
Add: Adjustments per investigation		
Non-deductible expense	₱4,350,185.93	
Overstatement of purchases	2,693,487.55	7,043,673.48
Taxable income per investigation		₱ 8,360,433.51
Income Tax due thereon		₱ 2,926,151.73
Less: Allowable payments/tax credit		
Payments	₱ 118,506.24	
Creditable Tax Withheld per ITR	342,359.76	460,866.00
Deficiency Income Tax		₱ 2,465,285.73
Add: 20% interest p.a. (04.16.08 to 07.28.10)		1,125,250.97
TOTAL AMOUNT DUE		**₱3,590,536.70**

The Court shall determine the validity of the assessment by looking into the propriety of each of the said adjustments.

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[40] Exhibit "3", BIR Records, pp. 178-181.

A. Non-deductible Expenses – ₱4,350,185.93

Per the Details of Discrepancies attached to respondent's FLD[41], the Non-deductible Expenses consisted of the following:

Commissions	₱ 3,805,872.73
Professional Fees	544,313.20
Non-deductible Expenses	**₱4,350,185.93**

Respondent disallowed the aforesaid expenses based on the examiner's findings as stated in Exhibit "3", to wit:

(1) DISALLOWED COMMISSION EXPENSES – ₱3,805,872.73

Verification disclosed that the taxpayer is an importer of resin and auxiliaries primarily used in the production of cleaning aids and chemicals. That 97% of its total sales were derived from its affiliate, POLYMER PRODUCTS PHILS., INC. where the taxpayer share the same office. There were no beginning and ending inventories which signify that all imported purchases were sold readily to its customers. Apparently, there is no need to employ the services of companies and/or individuals to market and promote its goods and pay for commission based on percentage of sales.

The taxpayer accrued Commission amounting to ₱3,520,829.89 at the end of 2007 without any valid explanation for such accrual. Allegedly, the payments for the payees were made in 2008. Examination of 2007 vouchers disclosed that the taxpayer paid for commission of various individuals. The sample of documents attached were detailed as follows:

Date 2007	Payee	Sales Invoice No.	Customer	Commission	Remarks
Feb. 2	Buenavista, Jose/ Coloma, Bendeline	Various S.I. series ranging from 72204-72286 issued in Oct & Nov. 2006	Various customers of POLYMER PROD. PHILS., INC.	26,277.00 27,078.34	5% & 10% commission for sales of custodial supplies & chemical products of POLYMER PRODUCTS PHILS. INC.
Nov 12	Buenavista, Jose	Various S.I. series ranging frm 86184-86191 issued in August 2007	Various customers of POLYMER PROD. PHILS., INC. (e.g. Ateneo, Sogo)	21,612.74	5% & 10% commission for sales of custodial supplies &

[41] Exhibit "A", docket, vol. I, pp. 441-443.

					chemical products of POLYMER PRODUCTS PHILS. INC.

Commission payments in 2007 totaling ₱285,042.90 including the above examples were erroneously and intentionally charged to the taxpayer even if it was clear that the services of these individuals were made for its affiliate, POLYMER PRODUCTS PHILS., INC.

Section 34 of the Tax code provides that in order that a business expense to be deductible, it must (1) be ordinary & necessary expense; (2) it must be paid or incurred during the taxable year in carrying on or directly attributable to operation and/or conduct of its trade or business; (3) it must be reasonable in amount and sustained by adequate proof; (4) & not contrary to law, morals & public policy or public order. The taxpayer failed to meet the standard set forth under this section, thus, its accrued and paid commission expenses amounting to ₱3,520,829.89 and ₱285,042.90 respectively, were disallowed.

(2) <u>DISALLOWED PROFESSIONAL FEES – P544,313.20</u>

The taxpayer paid professional fees to individuals amounting to ₱544,313.20. There were no explanation why the company needs the services and for what legal purpose. The payment of 10% expanded withholding tax for such services is not sufficient to justify that the payments can be claimed as part of deductible expenses. The rule set forth under Section 34 shall also be applied.

Petitioner disagreed with the disallowance of its commission expenses and professional fees for calendar year 2007, arguing that these were valid expenses incurred in the ordinary course of its business during the said year and are duly supported by vouchers.

Petitioner explained that its business involves trading in goods such as resin, fiberglass, and auxiliaries on wholesale or retail basis pursuant to its primary purpose stated in its Amended Articles of Incorporation. Since petitioner needs to sell its products in order to survive, it requires the services of agents who can convince customers to buy its products rather than those of its competitors, negotiate on the price and coordinate with customers on matters such as the volume of the order and time of delivery. Without these agents, petitioner might suffer serious financial losses due to insufficient sales.

These agents are paid commissions for their selling activities to petitioner's clients.[42]

Invoking the case of *Rightfield Property Ventures, Inc. (now known as Universal Rightfield Property Holdings, Inc.) vs. Commissioner of Internal Revenue*[43] *(Rightfield Property case)*, petitioner maintained that its claimed commissions and professional fees for calendar year 2007 in the total amount of ₱4,350,185.93 are valid business expenses.[44]

The Court finds the disallowance proper.

Section 34(A)(1)(a)(i) of the NIRC of 1997, as amended, provides:

> SEC. 34. ***Deductions from Gross Income.*** – Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), there shall be allowed the following deductions from gross income:
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> (A) *Expenses.* –
>
> (1) *Ordinary and Necessary Trade, Business or Professional Expenses.* –
>
> (a) *In General.* – There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession, including:
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> (i) A **reasonable allowance for** salaries, wages, and **other forms of compensation for personal services actually rendered**, including the grossed-up monetary value of fringe benefit furnished or granted by the employer to the employee: *Provided*, That the final tax imposed under Section 33 hereof has been paid; *(Emphasis supplied)*

[42] Exhibit "U", docket, vol. I, p. 696.
[43] CTA Case No. 5972, October 16, 2003.
[44] Petitioner's Memorandum, docket, vol. II, p. 986.

The foregoing provisions clearly allow compensation for personal services actually rendered such as commissions and professional fees 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.[45]

The fact that the disallowed commissions and professional fees were paid or incurred and supported by proper evidence is not disputed.

However, respondent contended that the subject commissions are not directly attributable to petitioner but to the latter's affiliate-corporation and thus, not "ordinary and "necessary" in the conduct of petitioner's business.

The same holds true with the disallowed professional fees. Respondent alleged that petitioner failed to establish the maintenance of professionals or consultants in the promotion of its goods or the importation of purchased goods or in its business operations.

The Supreme Court, in the case of *Atlas Consolidated Mining and Development Corporation vs. Commissioner of Internal Revenue*[46], explained 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.

As borne by the records of this case, it is evident that the commission expense is not ordinary and necessary since petitioner's main customer was just its **own affiliate company**, Polymer Products (Phils.), Inc. to whom it sold 97% of its products. As can be seen in its ITR for calendar year 2007, petitioner's net sales amounted to ₱35,208,298.93[47], which consisted of the following:[48]

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[45] *Esso Standard Eastern, Inc. (formerly Standard-Vacuum Oil Company) vs. The Commissioner of Internal Revenue*, G.R. Nos. L-28508-9, July 7, 1989.
[46] G.R. Nos. L-26911 and L-26924, January 27, 1981.
[47] Exhibit "4", line 15C, BIR Records, p. 15.
[48] BIR Records, p. 126.

Name of Customer	Amount of Taxable Sales
Polymer Products (Phils.) Inc.	₱ 5,431,071.43
RI Chemical Corporation	486,160.71
Polymer Products (Phils.) Inc.	1,855,053.57
Polymer Products (Phils.) Inc.	6,191,026.79
Polymer Products (Phils.) Inc.	691,607.14
Polymer Products (Phils.) Inc.	3,901,637.50
RI Chemical Corporation	486,160.71
Polymer Products (Phils.) Inc.	1,127,892.86
Polymer Products (Phils.) Inc.	1,647,250.00
Polymer Products (Phils.) Inc.	8,751,125.72
Polymer Products (Phils.) Inc.	3,139,312.50
Polymer Products (Phils.) Inc.	1,500,000.00
Total	**₱35,208,298.93**

Clearly, out of the ₱35,208,298.93 total sales, only 3% in the amount of ₱972,321.42[49] pertains to RI Chemical Corporation; while the remaining 97% in the amount of ₱34,235,977.51 pertains to Polymer Products (Phils.) Inc., petitioner's affiliate company.

As correctly pointed out by respondent, there is no reason for petitioner to employ agents to sell to a "customer" which happens to be its affiliate and which even shares the same office with petitioner.

Correspondingly, the mere fact that petitioner does not have any ending or beginning inventory[50] proves that it has the capacity to sell all of its imports within the year it was bought, and thus, not in the danger of having excessive stocks due to a scant sales volume requiring the employ of agents or brokers.

Furthermore, other than the vouchers and a journal entry[51], petitioner did not provide any information as to which sales these commissions and professional fees pertain. It also did not specify in those vouchers what percentage was used in computing these commissions.

Inasmuch as the records do not show that the commissions in the amount of ₱3,805,872.73 and professional fees in the amount of ₱544,313.20 totaling ₱4,350,185.93 were appropriate and helpful in the realization of petitioner's income for calendar year 2007, the said expenses **cannot** be deemed "ordinary" and "necessary" in carrying on of petitioner's trade or business as contemplated under Section 34(A)(1)(a)(i) of the NIRC of 1997, as amended.

[49] The sum of 486,160.71 and 486,160.71.
[50] Petitioner's claimed purchases in the amount of ₱28,896,877.07 was also reflected as cost of sales in its 2007 ITR, Exhibit "4", line 16C., BIR Records, p. 15.
[51] Exhibits "R-71" to "R-89", docket, vol. I, pp. 531-548.

Moreover, this Court cannot sustain petitioner's application of the decision in the *Rightfield Property case*[52] to the instant case. In the said case, there was a finding that the commissions and management fees paid are ordinary and necessary expense. Thus the Court stated:

> 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 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. *(Emphasis supplied)*

Unlike in the *Rightfield Property case*, herein petitioner was not able to establish that its commissions and professional fees were ordinary and necessary in the carrying on of its trade or business, making the present case incomparable with the aforesaid case. Therefore, a ruling similar to the case invoked by petitioner may not be adopted by this Court in the resolution of issues in the present case.

Accordingly, petitioner's claimed commissions and professional fees in the total amount of ₱4,350,185.93 shall be disallowed as deductions from its gross income for calendar year 2007 and petitioner shall be liable for deficiency income tax thereon.

B. Overstatement of Purchases – ₱2,693,487.55

This amount was arrived at by respondent by computing the difference between the purchases as indicated in petitioner's ITR and the purchases as stated in respondent's audit, as shown below:[53]

Purchases per ITR	₱28,896,877.07[54]
Purchases per Audit	26,203,389.52
Overstatement of Purchases	**₱ 2,693,487.55**

Respondent considered this as an overstatement on the ground that petitioner failed to substantiate the claimed purchases with proper supporting

[52] *Supra.*
[53] Exhibit "A", docket, vol. I, pp. 441-443.
[54] The same amount was reflected as petitioner's cost of sales, Exhibit "4", line 16C, BIR Records, p. 15.

documents as mandated under Section 34(A)(1)(b) of the NIRC of 1997, as amended.[55]

In response, petitioner formally offered the following as supporting evidence of its purchases for calendar year 2007 in the total amount of ₱28,896,877.07:[56]

1. Schedule (Imports Transaction Reconciliation of Listing for Enforcement) which summarizes and shows the breakdown of the costs of petitioner's purchases for calendar year 2007;[57]
2. Official receipts evidencing petitioner's payment of insurance, broker's and surveyor's fees for calendar year 2007;[58]
3. Commercial invoices issued by petitioner's suppliers evidencing petitioner's payments for raw materials imported in calendar year 2007;[59] and
4. Import Entry and Internal Revenue Declarations (IERDs) showing petitioner's payment of customs duties and import processing fees for calendar year 2007.[60]

However, some of the aforesaid exhibits were denied by the Court due to the following reasons:

1. failure to present the original copies as evidence or even just for comparison;[61]
2. failure to establish to the satisfaction of the Court the loss, destruction, or unavailability of the original documents;[62] and
3. lack of effort on the part of petitioner to secure even certified true copies of the denied exhibits.[63]

Thus, based on the exhibits admitted by the Court, petitioner was able to substantiate its claimed purchases for calendar year 2007 only in the amount of ₱17,196,796.17, detailed as follows:

Exhibit	Particulars	Amount of Purchases	
		Per Official Receipt/ Debit Advice	Net of VAT, if there is any
S-3	insurance premium	₱ 7,534.62	₱ ₱6,727.34

[55] Respondent's Memorandum, vol. II, docket, p. 961.
[56] Petitioner's Memorandum, vol. II, docket, p. 988.
[57] Exhibit "S", docket, vol. I, p. 549.
[58] Exhibits "S-3" to "S-69", docket, vol. I, pp. 550-608.
[59] Exhibits "S-70" to "S-93", docket, vol. I, pp. 609-650.
[60] Exhibits "S-94" to "S-118", docket, vol. I, pp. 651-689.
[61] Resolution, November, 9, 2012, docket, vol. II, p. 757.
[62] Resolution, March 19, 2013, docket, vol. II, p. 842.
[63] Resolution, March 19, 2013, docket, vol. II, p. 842.

S-4	brokerage fees	6,218.82	5,552.52
S-5	brokerage fees	9,390.00	9,390.00
S-6	survey fees	2,967.00	2,649.11
S-8	insurance premium	7,295.80	6,514.11
S-9	brokerage fees	66,275.90	59,174.91
S-10	survey fees	989.00	883.04
S-11	survey fees	989.00	883.04
S-12	brokerage fees	26,280.00	26,280.00
S-13	brokerage fees	11,876.72	10,604.21
S-15	insurance premium	3,956.37	3,532.47
S-16	brokerage fees	6,793.48	6,065.61
S-17	brokerage fees	42,090.00	42,090.00
S-19	survey fees	989.00	883.04
S-21	brokerage fees	6,254.49	5,584.37
S-22	brokerage fees	9,390.00	8,383.93
S-25	brokerage fees	27,590.00	24,633.93
S-26	brokerage fees	6,207.36	5,542.29
S-28	survey fees	989.00	883.04
S-30	insurance premium	3,956.11	3,532.24
S-31	insurance premium	1,736.36	1,550.32
S-32	brokerage fees	34,299.65	34,299.65
S-33	brokerage fees	34,590.00	34,590.00
S-34	brokerage fees	7,087.28	6,327.93
S-35	survey fees	989.00	883.04
S-36	survey fees	989.00	883.04
S-37	insurance premium	4,678.33	4,177.08
S-38	survey fees	989.00	883.04
S-39	brokerage fees	6,240.59	5,571.96
S-40	brokerage fees	27,590.00	27,590.00
S-41	survey fees	989.00	883.04
S-42	insurance premium	1,363.15	1,217.10
S-43	brokerage fees	6,294.20	5,619.82
S-44	brokerage fees	27,590.00	27,590.00
S-45	insurance premium	2,031.53	1,813.87
S-46	survey fees	989.00	883.04
S-47	brokerage fees	5,589.80	4,990.89
S-48	brokerage fees	16,890.00	16,890.00
S-49	insurance premium	465.45	415.58
S-50	survey fees	989.00	883.04
S-51	survey fees	989.00	883.04
S-52	survey fees	989.00	883.04
S-53	survey fees	989.00	883.04
S-54	survey fees	989.00	883.04
S-55	brokerage fees	31,336.62	31,336.62
S-56	brokerage fees	6,161.97	5,501.76
S-57	brokerage fees	28,590.00	28,590.00
S-58	brokerage fees	6,295.81	5,621.26

S-59	brokerage fees	9,390.00	9,390.00
S-60	insurance premium	12,240.65	10,929.15
S-61	brokerage fees	11,390.00	11,390.00
S-62	brokerage fees	6,267.83	5,596.28
S-63	survey fees	989.00	883.04
S-64	survey fees	989.00	883.04
S-65	brokerage fees	30,117.04	30,117.04
S-66	survey fees	989.00	883.04
S-67	survey fees	989.00	883.04
S-68	insurance premium	4,120.76	3,679.25
S-69	brokerage fees	30,298.37	30,298.37
S-70-a	importation of goods	745,362.00	745,362.00
S-70-a	bank charges	4,050.10	4,050.10
S-71-a	importation of goods	2,889,954.72	2,889,954.72
S-71-a	bank charges	9,438.44	9,438.44
S-72-a	importation of goods	736,383.60	736,383.60
S-72-a	bank charges	4,022.08	4,022.08
S-73-a	importation of goods	714,711.60	714,711.60
S-73-a	bank charges	3,463.19	3,463.19
S-75-a	importation of goods	3,464,294.40	3,464,294.40
S-75-a	bank charges	10,544.37	10,544.37
S-76-a	importation of goods	833,429.82	833,429.82
S-76-a	bank charges	4,292.79	4,292.79
S-79-a	importation of goods	860,808.00	860,808.00
S-79-a	bank charges	3,865.11	3,865.11
S-83-a	importation of goods	839,710.08	839,710.08
S-83-a	bank charges	43,520.92	43,520.92
S-84-a	importation of goods	883,685.38	883,685.38
S-84-a	bank charges	3,932.11	3,932.11
S-85-a	importation of goods	339,066.11	339,066.11
S-85-a	bank charges	3,010.00	3,010.00
S-86-a	importation of goods	355,589.76	355,589.76
S-86-a	bank charges	3,251.60	3,251.60
S-87-a	importation of goods	767,379.20	767,379.20
S-87-a	bank charges	4,107.32	4,107.32
S-88-a	importation of goods	749,088.00	749,088.00
S-88-a	bank charges	4,066.76	4,066.76
S-89-a	importation of goods	878,136.75	878,136.75
S-89-a	bank charges	3,414.67	3,414.67
S-91-a	importation of goods	701,883.00	701,883.00
S-91-a	bank charges	3,930.35	3,930.35
S-92-a	importation of goods	737,130.24	737,130.24
S-92-a	bank charges	4,028.11	4,028.11
TOTAL		**₱ 17,224,084.64**	**₱ 17,196,796.17**

Since petitioner failed to fully substantiate its claimed purchases for calendar year 2007 in the amount of ₱28,896,877.07, the overstatement of purchases as found by respondent in the amount of ₱2,693,487.55 shall be upheld and disallowed as deduction from petitioner's calendar gross income for the same year pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended, which states:

> SEC. 34. *Deductions from Gross Income.* - xxx
>
> (A) *Expenses.* -
>
> (1) *Ordinary and Necessary Trade, Business or Professional Expenses.* -
>
> xxx xxx xxx
>
> (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.

In sum, petitioner is liable to pay basic deficiency income tax for calendar year 2007 in the amount of ₱2,465,285.73, computed as follows:

Taxable income per ITR		₱ 1,316,760.03
Add: Adjustments per investigation		
Non-deductible expense	₱4,350,185.93	
Overstatement of purchases	2,693,487.55	7,043,673.48
Taxable income per investigation		₱ 8,360,433.51
Income Tax due thereon		₱ 2,926,151.73
Less: Allowable payments/tax credit		
Payments	₱ 118,506.24	
Creditable Tax withheld per ITR	342,359.76	460,866.00
Deficiency Income Tax		**₱ 2,465,285.73**

II. DEFICIENCY EXPANDED WITHHOLDING TAX

Finding that petitioner failed to withhold and remit the EWT on its income payments for commissions amounting to ₱3,341,091.33 as required under Revenue Regulations No. 2-98, as amended, respondent assessed petitioner of deficiency EWT for calendar year 2007 in the amount of ₱503,269.04, inclusive of interest, computed as follows:[64]

	Per FS/ Audit	Per Return	Difference
Commissions	₱3,805,872.73	₱464,781.40	₱3,341,091.33
Tax Rate			10%
Deficiency Expanded Withholding Tax			**₱ 334,109.13**
Add: 20% Interest p.a. (01.16.08 to 07.28.10)			169,159.91
Total Amount Due			**₱ 503,269.04**

Petitioner stated in its Memorandum[65] that it withheld and remitted EWT in the amount of ₱352,082.99 for its commission payments totaling ₱3,520,829.90 as seen in its BIR Form No. 1601-E filed on June 10, 2008. It further stated that the difference between the commission payments for calendar year 2007 as per its vouchers (₱3,805,872.73) and the commission payments of ₱3,520,829.90 as per its BIR Form No. 1601-E filed on June 10, 2008 is only due to timing difference. A portion of petitioner's commission payments for calendar year 2007 as per its vouchers pertains to commissions earned during calendar year 2006 but remitted only in calendar year 2007.

However, given the fact that the **only Monthly Remittance of Creditable Income Taxes Withheld (Expanded) (BIR Form No. 1601-E)**[66] provided as evidence was dated June 10, 2008 with a description "For the Month 05 2008" and that petitioner did not provide any proof that this truly represents commissions for calendar year 2007, the Court affirms respondent's findings as guided by the Supreme Court's ruling in the case of *Commissioner of Internal Revenue vs. Gonzalez, et al.*[67], to wit:

> Tax assessments by tax examiners are presumed correct and made in good faith, and all presumptions are in favor of the correctness of a tax assessment unless proven otherwise.

Accordingly, respondent's assessment against petitioner for basic deficiency EWT for calendar year 2007 in the amount of ₱334,109.13 shall be upheld:

	Per FS/ Audit	Per Return	Difference
Commissions	₱3,805,872.73	₱464,781.40	₱3,341,091.33
Tax Rate			10%
Deficiency Expanded Withholding Tax			**₱334,109.13**

[64] Exhibit "A", docket, vol. I, pp. 441-443.
[65] Petitioner's Memorandum, docket, vol. II, p. 1000.
[66] Exhibit "T", docket, vol. I, p. 691.
[67] G.R. No. 177279, October 13, 2010.

WHEREFORE, the instant Petition for Review is hereby **DENIED** for lack of merit. The assessments issued by respondent against petitioner covering deficiency income tax and EWT for calendar year 2007 are hereby **AFFIRMED**. Accordingly, petitioner is **ORDERED** to **PAY** respondent the amount of ₱3,499,243.57, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Deficiency Tax	Basic	Surcharge	Total
Income Tax	₱ 2,465,285.73	₱ 616,321.43	₱ 3,081,607.16
Expanded Withholding Tax	334,109.13	83,527.28	417,636.41
Total	**₱2,799,394.86**	**₱699,848.71**	**₱3,499,243.57**

In addition, petitioner is **ORDERED** to **PAY** the following:

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of ₱2,465,285.73 computed from April 15, 2008 and on the basic deficiency EWT of ₱334,109.13 computed from January 15, 2008 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) Delinquency interest at the rate of 20% per annum on the total deficiency taxes of ₱3,499,243.57 and on the 20% deficiency interest which have accrued as afore-mentioned in (a), computed from July 28, 2010[68] until full payment thereof pursuant to Section 249(C)(3) of the NIRC of 1997, as amended.

SO ORDERED.

Ma. Belen

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

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[68] Due Date per FLD/Assessment Notices, Exhibit "A", docket, vol. I, pp. 441-443.

ATTESTATION

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

LOVELL R. BAUTISTA
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice