REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SIME DARBY PILIPINAS INC., (FORMERLY SIME DARBY INTERNATIONAL TIRE CO., INC.)
Petitioner,

- versus -

C.T.A. CASE NO. 4448

THE COMMISSIONER OF INTERNAL REVENUE
Respondent.
x - - - - - - - - - - - - - - x

8/8/94

DECISION

The instant petition seeks for the cancellation of various tax assessments served by the respondent covering the fiscal years ending June 30, 1986 and June 30, 1987.

Petitioner is a domestic corporation primarily engaged in the manufacture and recapping of tires. On April 14, 1989, the petitioner received from the respondent a pre-assessment notice assessing it liable for the following deficiency taxes for the fiscal years ending June 30, 1986 and June 30, 1987, inclusive of interests and surcharge:

A. Income Tax

FY 6-30-86	P 4,032,937.66
FY 6-30-87	3,328,323.21

B.	Sales Tax	
	FY 6-30-86	9,475,151.03
	FY 6-30-87	14,623,220.58
C.	Penalty for late filing & Payment of Royalty Tax Fourth Quarter Ending June 30, 1987	185,437.72
D.	Contractor's Tax	1,190.49
	Total	P31,646,260.69

On May 2, 1989, the petitioner filed with the respondent's office its protest assailing the propriety of the deficiency tax assessments made. However, on April 14, 1989, the respondent issued a formal assessment reiterating its liability for the abovementioned deficiency taxes. Consequently, on June 1, 1989, petitioner filed another protest seeking for a reinvestigation of the assessments and at the same time admitting its liability for the assessed deficiency contractor's tax amounting to P1,190.49 which it paid on the same date, as evidenced by BIR Payment Order No. C-5589703 and CB Confirmation Receipt No. B-16571211.

On February 20, 1990, the respondent finally issued her decision on the disputed assessments acknowledging the petitioner's payment of the deficiency contractor's tax and demanding for the payment of the balance of

P31,645,070.00 representing the total sum of the assessed income, sales and withholding tax deficiencies.

Thus, the instant petition.

The issues to be resolved in this case are whether or not the petitioner is liable for the payment of deficiency income and sales tax for the FY 1986 and 1987 and penalty for late filing and payment of final withholding tax on royalty for the fourth quarter of FY 1987.

One of the basis of the respondent in assessing the petitioner for deficiency income taxes for the FY's 1986 and 1987 is her disallowance of the costs of petitioner's long distance phone calls amounting to P48,436.79 (FY 1985-1986) and P107,306.22 (FY 1986-1987) and as valid deductions from its gross revenues for the fiscal years ending June 30, 1986 and June 30, 1987, respectively. The respondent contends that such expenses should have been deducted in the corresponding fiscal years that the calls were made. Thus, calls which were billed in July or during the initial months of fiscal years 1986 and 1987 were only allowed by the respondent as valid deductions in the previous fiscal year when the calls were actually made.

The petitioner, on the other hand, claims that it was not possible to accrue the costs of long distance calls made during the latter months of a fiscal year since the bills corresponding thereto were only received during the start of the succeeding fiscal year. In other words, the petitioner contends that the business expenses covering the costs of said long distance calls accrued from the time that it was actually billed by the telephone company.

We sustain the contention of the petitioner.

The petitioner's witness testified that it generally adopts the accrual method in determining its income and liabilities. And if the taxpayer is on the accrual basis, for the purposes of determining deductions, it is necessary that there be a definite fixed liability (Law of Federal Income Taxation, Mertens, vol. 4A, par. 25.10).

It has also been held that in order to be accruable in the taxable year, a valid obligation upon which the profit (or loss in the case of a deduction) is to be determined must have existed in the year in which the obligation became binding or enforceable. (Utah Idaho Sugar Co. vs. Staye Tax Commission, 73 P 2d 974).

Therefore, it cannot be said that the petitioner accrued its long distance calls at the time that they were actually made. It would be impractical for the petitioner to claim as deductible expense the mere estimate of the costs of the long distance calls it had made. Hence, the obligation on the part of the petitioner to pay or expend money which constitutes a deductible loss did not occur until it received from the telephone company the demand to pay a definite fixed amount representing the costs of long distance phone calls made.

Another basis of the respondent in assessing the petitioner for deficiency income tax is her allocation of a proportional amount of business expenses incurred in the making of tires to the petitioner's earnings from interests and money market placements by using the following formula:

$$\frac{\text{Nontaxable revenues (income which is tax-exempt, tax-free, or otherwise not subject to the 35\% corporate income tax)}}{\text{Total revenues (taxable and non-taxable revenues)}} = \text{Ratio}$$

As testified to by petitioner's witness, the respondent claims that since the petitioner also earned income from interests and money market placements, it should allocate a certain part of its operating cost to the generation of such passive income, thus in effect, disallowing a proportionate amount of deductible expenses from the petitioner's income in the manufacture and recapping of tires.

However, the undisputed claim of the petitioner is that no expenses were incurred in the production of its passive income such as income earned from the interests in bank deposits. Moreover, these income had already been subjected to a final withholding tax of 20%. By the very nature of a final tax, the income is taxed based on its gross amount, without consideration of any deductions or costs that may have actually been incurred in their production.

We therefore cannot find any valid reason for the respondent's allocation of deductible expenses to the petitioner's income that has been subject to a final tax. Neither can we find any legal basis for adopting the abovementioned formula in view of the unrefuted testimony of the petitioner's witness that during the examination on its accounting records, all the pertinent journals, ledgers and documents covering both taxable and non-taxable revenues were duly presented to the respondent.

As to the second issue, the deficiency sales tax assessed against the petitioner resulted from the respondent's disallowance of alleged overpayment of advanced sales tax on imported nylon and fabric which the petitioner has been paying at the rate of 30% of their gross value, and which were then credited against its 20% sales tax liability on the sale of tires. The respondent alleged that the petitioner is liable for advanced sales tax on its importation at the rate of 20% and not 30%. She submits that since the petitioner should have only paid a tax rate of 20% on its importation of nylon and fabric, the excess payment of 10% cannot be applied as a tax credit on its sales of tires.

However, a mere perusal of the pertinent provisions of law reveals otherwise. Section 163 of the 1986 Tax Code as amended by P.D. 2031 and E.O. 36 provides:

> "Sec. 163. ***Percentage tax on original sales of articles.*** - There shall be levied, assessed and collected, once only on every original sale, barter, exchange, or similar transaction for nominal or valuable consideration intended to transfer ownership of, or title to, the articles hereinbelow enumerated, a tax based on gross selling price or gross value in money of the articles so sold, bartered, exchanged, or transferred, such tax to be paid by the manufacturer, producer or importer:
>
> (1) Thirty per cent (30%), on the following non-essential articles:

xxx xxx xxx

(1) Textiles wholly or in chief value of silk, wool, or linen; nylon or other synthetic and/or chemical fabrics not intended for clothing; wool and silk hats; and furs and manufactures thereof. (Underscoring ours.)

xxx xxx xxx."

It is undisputed that the nylon and fabrics that are being imported by the petitioner are not intended for clothing and are being used exclusively for the manufacture of tires. It is therefore clear from the above-quoted provision that the subject importations are classified as non-essential articles taxable at the rate of 30% and not 20% as alleged by the respondent.

In fact, the succeeding provisions specifically enumerated those articles, classified as essential, whose advanced sales tax shall be equal to the sales tax of the finished product. Section 163 of the same Tax Code, as amended, provides:

" x x x x x x x x x.

(2) Ten per cent (10%), on the following essential articles:

(a) Processed meat, fruits, vegetables, fish and other sea foods and processed food products for human consumption;

(b) Processed milk, creamers, dairy products, butter and its substitutes like margarine;

(c) Bread and bakery products;

(d) Lard, shortening and cooking oil;

(e) Beverages and concentrates thereof, whether in liquid, powder or granulated form, intended for consumption as a drink, including but not limited to, processed coffee, cocoa, tea or ginger;

(f) Wheat flour;

(g) Clothes and textiles intended for clothing;

(h) Medicines and articles primarily intended for the administration thereof.

(i) Soaps, detergents, toothbrushes and toothpastes.

(j) Writing pads, notebook, ordinary lead pencils and disposable ballpens.

(k) Cement, hollow blocks, logs, lumber, plywood, plyboard, fiber-board glass, roofing materials, steel bars, nails, sand and gravel, woven bamboo splits (sawali), *nipa* shingles, bamboo, basic sanitary and plumbing fixtures and fittings.

(l) Fish, poultry, swine and cattle feeds.

(m) Fertilizers, pesticides and technical materials for use in the formulation of pesticides.

(n) Spare parts and accessories of motor vehicles, <u>except tires</u>." (Underscoring ours)

It is worthy to stress that the above-quoted provision clearly excludes tires from those enumerated essential articles whose raw materials shall be fixed at the same rate as the finished product. Therefore, there is no legal basis for the respondent in imposing an advanced sales tax on nylon and fabric which is equal to the rate imposed on tires. Consequently, the entire 30% advanced sales tax paid by the petitioner on the imported raw material should be allowed to be credited against the 20% sales tax imposed on tires under Section 163(4) of the same Tax Code.

Finally, with regard to the last issue, the respondent contends that the petitioner was late in the filing and payment of the final withholding tax on royalty under Section 25(b) of the 1987 Tax Code due to Uniroyal Goodrich of U.S.A. for the fourth quarter of the fiscal year ended June 30, 1987. The respondent alleged that the filing and payment of the said withholding tax should have been made within a period of twenty five (25) days from the close of the fourth quarter, specifically on or before July 25, 1987 in accordance with Section 52(a) in conjunction with Section 51 of the Tax Code.

Section 52(a) provides:

> "SEC. 52. *Returns and payment of taxes withheld at source.* - (a) **Quarterly returns and payment of taxes withheld.** - Taxes deducted and withheld under Section 51 shall be covered by a return and paid to the Revenue District Officer, Collection Agent, or duly authorized Treasurer of the city, or municipality where the withholding agent has his legal residence. or principal place of business, or where the withholding agent is a corporation, where the principal office is located. The taxes deducted and withheld by the withholding agent

shall be held as a special fund in trust for the Government until paid to the collecting officers. The Commissioner of Internal Revenue may, with the approval of the Minister of Finance, require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the Government. <u>The return for final withholding tax shall be filed and the payment made within 25 days from the close of each calendar quarter</u>, while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which withholding was made." (Underscoring supplied.)

The respondent alleged that since the filing and payment of the withholding tax on royalty was belatedly made on August 10, 1987, the petitioner is liable for penalty.

In refutation of respondent's claim, the petitioner contends that the respondent failed to consider its Technical Service Agreement with Uniroyal Goodrich U.S.A. under Article V, paragraph 5.3 of which states:

> "Fee Accrual and Payment - The Technical Fee provided in paragraph 5.1 shall accrue as company sales subject to such fee are made, and the accrued fee shall be paid to B.F. Goodrich within thirty (30) days next following the end of each calendar quarter year in which such sales are made."

It is further alleged that since the quarterly royalty fee becomes demandable as a matter of right by Uniroyal Goodrich of U.S.A. only on the 30th day following the end of each calendar quarter, the last day for the filing and payment of the final withholding tax is on October 25, 1987.

From this conclusion, it would therefore seem that the petitioner is of the impression that the income from royalties on sales accrued only on the quarter when the royalties became demandable by Uniroyal Goodrich U.S.A..

However, as earlier discussed, for purposes of determining income and liabilities under the accrual method, it is necessary that the taxpayer incur a definite fixed liability.

Section 5.1 of the Technical Service Agreement provides that the technical fee or royalty payment shall be computed at 3% of the petitioner's net realized sales. Therefore, the petitioner's liability to pay royalties to Uniroyal Goodrich U.S.A. became fixed and determinable from the time the sales were made. The deferment of the actual payment does not alter the fact that the income of Uniroyal Goodrich U.S.A. from royalties accrued from the time of sale since it is from that time that the right of the petitioner to a fixed sum became determinable. It is of no moment that the Agreement provides for a deferred payment of the royalties due to Uniroyal Goodrich U.S.A.. What is important is the fact that the income on royalties have already been earned and accrued in favor of Uniroyal Goodrich U.S.A..

WHEREFORE, judgment is hereby rendered cancelling the deficiency income and sales tax assessments for the fiscal years ending June 30, 1986 and June 30, 1987 issued by respondent against petitioner. However, petitioner is hereby ordered to pay in favor of respondent the sum of P185,437.72 as penalty for late filing and payment of royalty tax for the fourth quarter ending June 30, 1987. No pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, August 8, 1994.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals