

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

FIRST DIVISION

SONY PHILIPPINES, INC.,

Petitioner,

- versus -

C.T.A. CASE NO. 6185

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

OCT 26 2004

[Signature]

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DECISION

Appealed before us for review are the assessments for the deficiency value-added tax and expanded withholding tax and penalties for late remittance of withholding taxes on royalty, value-added tax on royalty and withholding taxes of some of petitioner's branches in the total amount of P15,895,632.65 for the year 1997.

Petitioner is a corporation duly organized and existing under the laws of the Republic of the Philippines with principal office located at 26th Floor, The Enterprise Center Tower I, Ayala Avenue corner Paseo de Roxas, Makati City.

On November 24, 1998, petitioner received Letter of Authority No. 000019734 issued by then BIR Commissioner Beethoven Rualo authorizing Revenue Officers A. Aluquin, M.A. Perez, G.L. Samoy, T. Villamor, S. Villarin & A. See to be supervised by Group Head G. Urot of Special Team created pursuant to RSO 673-98, to examine its books of accounts and other accounting records for all internal revenue taxes for the period 1997 and unverified prior years (*Exhibit 1*).

On December 6, 1999 petitioner received a preliminary assessment notice for the proposed assessments for 1997 deficiency taxes and penalties in the gross amount of P15,462,527.51 (*Exhibit 3*). Petitioner protested the aforesaid proposed assessments on December 21, 1999 (*Exhibit 4*).

After taking into account petitioner's protest on the preliminary assessment notice (*Exhibit 5*), respondent issued the final assessment notices, formal letter of demand and details discrepancies on January 1, 1999 holding petitioner liable for the following deficiency taxes and penalties for late remittance of internal revenue taxes, to wit: (*1154 to 1161, BIR records*)

DEFICIENCY VALUE-ADDED TAX
(Assessment No. ST-VAT-97-0124-2000)

Basic Tax Due		P 7,958,700.00
Add: Penalties		
Interest up to 3-31-2000	P3,157,314.41	
Compromise	<u>25,000.00</u>	<u>3,182,314.41</u>
Deficiency Value-Added Tax Due		<u><u>P 11,141,014.41</u></u>

DEFICIENCY EXPANDED WITHHOLDING TAX
(Assessment No. ST-EWT-97-0125-2000)

Basic Tax Due		P 1,416,976.90
Add: Penalties		
Interest up to 3-31-2000	P 550,485.82	
Compromise	<u>25,000.00</u>	<u>575,485.82</u>
Deficiency EWT Due		<u><u>P 1,992,462.72</u></u>

LATE REMITTANCE OF VAT ON ROYALTY PAYMENTS
(Assessment No. ST-LR1-97-0126-2000)

Basic Tax Due		P -
Add: Penalties		
Surcharge	P 359,177.80	
Interest up to 3-31-2000	87,580.34	
Compromise	<u>16,000.00</u>	<u>462,758.14</u>
Penalties Due		<u><u>P 462,758.14</u></u>

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LATE REMITTANCE OF FINAL WITHHOLDING TAX

(Assessment No. ST-LR2-97-0127-2000)

Basic Tax Due		P	-
Add: Penalties			
Surcharge	P1,729,690.71		
Interest up to 3-31-2000	508,783.07		
Compromise	50,000.00		2,288,473.78
Penalties Due		P	<u>2,288,473.78</u>

LATE REMITTANCE OF INCOME PAYMENTS

(Assessment No. ST-LR3-97-0128-2000)

Basic Tax Due		P	-
Add: Penalties			
25% Surcharge	P 8,865.31		
Interest up to 3-31-2000	58.29		
Compromise	2,000.00		10,923.60
Penalties Due		P	<u>10,923.60</u>

GRAND TOTAL

P15,895,632.65

On February 2, 2000, petitioner filed its protest requesting the cancellation and/or reconsideration of the aforementioned final assessments (*pages 1222 to 1229, BIR records*). On February 16, 2000, petitioner submitted relevant documents to support its protest (*pages 1230 to 1246, BIR records*).

On October 24, 2000, within thirty (30) days after the lapse of one hundred eighty (180) days from submission of supporting documents with the respondent, petitioner filed the present Petition for Review.

The issues as jointly stipulated by the parties are as follows:

7. The issue that has to be resolved is whether the petitioner is liable for the deficiency taxes as assessed by the respondent, more particularly described below:

7.1. Deficiency VAT assessment, inclusive of surcharge, interest and compromise penalty, of Eleven Million One Hundred Forty One Thousand Fourteen and 41/100 (P11,141,014.41);

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- 7.1.1. Whether petitioner is entitled to input tax on advertising agency fees it paid even if it receives subsidy from its parent company for its expenses.
- 7.1.2. Assuming, for the sake of argument, that the input VAT is to be disallowed, whether petitioner has unused input VAT for the fiscal year ending March 31, 1998.
- 7.2. Deficiency EWT assessment, inclusive of surcharge, interest and compromise penalty, of One Million Nine Hundred Ninety Eight [should be Two] Thousand Four Hundred Sixty Two and 72/100 Pesos (P1,992,462.72);
- 7.2.1. Whether the following income payments enumerated in 3.2 above are subject to withholding taxes, and if so, whether petitioner withheld taxes therefrom:
- a. Sale of motor vehicles;
 - b. Income payments to general professional partnerships;
 - c. Commission expense; and
 - d. Rental deposits.
- 7.3. Surcharge, interest and compromise penalty of Four Hundred Sixty Two Thousand Seven Hundred Fifty Eight and 14/100 Pesos (P462,758.14) for late remittance of VAT on royalty;
- Whether petitioner belatedly paid the VAT due on its royalty payments within the date prescribed by law.
- 7.4. Surcharge, interest and compromise penalty of Two Million Eight [should be Two] Hundred Eighty Eight Thousand Four Hundred Seventy Three and 68/100 Pesos (P2,288,473.78) for late remittance of withholding tax on royalty;
- Whether the petitioner belatedly paid withholding taxes in two (2) royalty payments it made to Sony-Japan within the date prescribed by law.
- 7.5. Surcharge, interest and compromise penalty of Ten Thousand Nine Hundred Twenty Three and 60/100 Pesos (P10,923.60) for late remittance of other withholding taxes;

Whether petitioner belatedly remitted the withholding taxes to the revenue district offices (“RDOs”) where its provincial branches are located within the date prescribed by law.

We will discuss the above issues *in seriatim*.

DEFICIENCY VALUE-ADDED TAX P11,141,014.41

The deficiency value-added tax arose from the respondent’s disallowance of input VAT credits derived on advertising expense of petitioner in the amount of P7,877,700.00 (basic).

Respondent is of the opinion that the said expense does not result to input VAT credits because the expense was actually paid by Sony International Singapore as an advertising support for petitioner. The expense was evidenced by Journal Voucher No. 98-03-51 and unnumbered Journal Voucher dated March 31, 1998 in the respective amounts of P37,400,000.00 and P41,377,000.00. Respondent further cites as legal basis for the disallowance Section 110 of the Tax Code which provides:

SEC. 110. Tax Credits –

A. Creditable Input Tax. -

(1) **Any input tax** evidenced by a VAT invoice or official receipt issued in accordance with Section 113 hereof on the following transactions shall be creditable against the output tax:

(a) Purchase or importation of goods:

xxx xxx xxx

(b) **Purchase of services on which a value-added tax has been actually paid.**

xxx xxx xxx

The term ‘input tax’ means the value-added tax due from or paid by a VAT-registered person in the course of his trade or business

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on importation of goods or local purchase of goods or services, including lease or use of property, from a VAT-registered person. It shall also include the transitional input tax determined in accordance with Section 111 of this Code.

The term ‘**output tax**’ means the value-added tax due on the sale or lease of taxable goods or properties or services by any person registered or required to register under Section 236 of this Code.

(B) *Excess Output or Input Tax.* – if at the end of any taxable quarter the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person. If the input tax exceeds the output tax, the excess shall be carried over to the succeeding quarter or quarters. Any input tax attributable to the purchase of capital goods or to zero-rated sales by a VAT-registered person may at his option be refunded or credited against other internal revenue taxes, subject to the provisions of Section 112. *(Emphasis supplied).*

Likewise, respondent avers that even assuming that petitioner is entitled to input VAT on its advertising expense, the reimbursed expense constitutes income and therefore subject to output VAT.

Petitioner, on the other hand, opines that the deficiency value-added tax assessment is void pursuant to Section 228 of the National Internal Revenue Code of 1997, to quote:

SEC. 228. *Protesting of Assessment.* — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however,* That a pre-assessment notice shall not be required in the following cases:

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The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

While petitioner was made aware that the assessment was based on respondent’s finding that Sony International Singapore paid the advertising expense and that Section

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110 of the Tax was his legal basis, it nevertheless sought the cancellation thereof on the ground that respondent departed from his original factual basis. Petitioner refers to the following testimony of respondent's witness: (*TSN, pages 33-34, February 27, 2003*)

ATTY. SAMADAN:

Q. Mr. Witness, it (sic) regards again to the deficiency VAT assessment. A taxpayer argued that the disallowances of these input taxes on an advertising expenses (sic) would be improper, what do you say to that, Mr. Witness?

MR. ALOQUIN:

A. Basically to incur advertising expenses is ordinary and valid expense of the company. What is not ordinary refers to the reimbursement of these expenses coming from a foreign branch or affiliated company which can be regarded as indirect adjustments to excessive inter-company billings or transfer pricing adjustments among controlled taxpayers or in certain case a window dressing adjustments (sic). (Underlining supplied).
(*See also TSN, pages 44-46, May 19, 2003*)

Petitioner posits in its memorandum that the deliberate non-inclusion of the said presumptions and allegations of fact in the Formal Assessment Notice renders the deficiency assessment void pursuant to Section 3.1.4. of Revenue Regulations No. 12-99.

We do not agree.

The fact that petitioner knew (and even admitted) of the previous factual and legal bases appearing in the Assessment Notice and Formal Letter of Demand is sufficient compliance with Section 228. Whatever other reasons raised (or might be raised) during trial will be considered as a defense in support of the deficiency assessment.



It bears stressing that the purpose of Section 228 of the National Internal Revenue Code of 1997 in requiring that "(t)he taxpayer be informed of the law and facts on which assessment is made" is to give the taxpayer the opportunity to refute the findings of the examiner and give a more accurate and detailed explanation regarding the assessment(s) (*ING Bank N.V. Manila Branch vs. Commissioner of Internal Revenue, CTA Case No. 6187, August 9, 2004 citing Belle Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5930, April 4, 2002*). The purpose of the said law having been served in the instant case, Section 228 of the National Internal Revenue Code of 1997 is deemed to have been complied with. Therefore, the assessment is not null and void.

Records reveal that petitioner already recognized that the deficiency VAT came from the disallowance of input taxes on advertising expense based on Section 110 of the Tax Code. The same provision became also the basis of respondent's alternative finding as regards petitioner's liability to output VAT (still embraced under deficiency VAT assessment). Therefore, it is now incumbent upon petitioner to rebut the said findings of the respondent.

Indeed advertising expense is a legitimate business expense. Hence, once incurred and VAT invoice is issued, the purchaser or buyer is entitled to input VAT credits pursuant to Section 110 of the 1997 Tax Code.

There is no argument that petitioner paid and incurred advertising expense. This was admitted by respondent (*see pages 1384, BIR records*) and was evident in the following testimony of respondent's witness, Mr. Aloquin, to wit: (*TSN, pages 55-58, February 27, 2003*)

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ATTY. MANESES:

Q. Definitely these advertising expenses, Mr. Witness, invoices were issued by advertising companies, is that correct?

MR. ALOQUIN:

A. That's correct.

ATTY. MANESES:

Q. And to whose name were these invoices issued, Mr. Witness?

MR. ALOQUIN:

A. In the name of Sony Philippines, Incorporated, of course.

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ATTY. MANESES:

Q. And who paid for these advertising expenses?

MR. ALOQUIN:

A. The taxpayer, the petitioner which is the Sony Philippines, Incorporated.

In as much as petitioner incurred advertising expenses and paid the same, it is entitled to input VAT credits. What the court would like to address at this point, however, is the focal controversy of whether or not the subsidized advertising expense is an income on the part of petitioner subject to output VAT.

Section 106 of the Tax Code provides:

SEC. 106. *Value-Added Tax on Sale of Goods or Properties.* –

(A) *Rate and Base of Tax.* – There shall be levied, assessed and collected on **every sale, barter or exchange of goods or properties**, value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or

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exchanged, such tax to be paid by the seller or transferor. (*Emphasis supplied*).

It is clear from the above law that in order for a VAT registered person to be liable for 10% value-added tax, there must be (either) a sale, a barter or an exchange of goods or properties. This element is not present in the case at bar.

The fact that the advertising expense is subsidized or reimbursed by Sony International Singapore does not render the same automatically subject to output VAT. There was no sale, barter or exchange of goods or properties from the questioned transaction. Neither was there an exchange of service. The reason for the assistance was the adverse economic condition experienced by petitioner during that time (*see page 1227, BIR records*). Thus, we find no plausible reason for the imposition of output VAT. ✓

The respondent's reliance on the Supreme Court's decision in the case of *Commissioner of Internal Revenue vs. Court of Appeals and Commonwealth and Services Corporation (COMASERCO for brevity), G.R. No. 125355, March 30, 2000*, is misplaced. Pertinent portion of the said pronouncement reads as follows:

It is immaterial whether the primary purpose of a corporation indicates that it receives payments for **services rendered** to its affiliates on a reimbursement-on-cost basis only, without realizing profit, for purposes of determining liability for VAT on **services rendered**. As long as the entity provides service for a fee, remuneration or consideration, then the **service rendered** is subject to VAT. (*Emphasis supplied*).

It is clear from the above ruling that there was a sale. COMASERCO rendered services to its affiliates. What were being taxed were these services rendered to its affiliates. Thus, the Supreme Court ruled that COMASERCO was liable to output VAT.



It must be clarified that the payment on a “reimbursement-on-cost basis only, without realizing profit” was a manner of billing by COMASERCO to its affiliates. Such mode of pricing is not equivalent to the ‘reimbursement’ of advertising expense in the case at bar. Considering that there was no sale, barter or exchange of goods or properties in the instant case, the imposition of output VAT on subsidized advertising expense has no leg to stand on.

Even assuming that petitioner is liable to output VAT, still the deficiency assessment will not prosper. The court noted that the revenue examiners went beyond the authority conferred to them by LOA No. 19734. Pursuant to RAMO 2-95, a Letter of Authority authorizes or empowers a designated Revenue Officer to examine, verify and scrutinize a taxpayer's books and records in relation to his internal revenue tax liabilities for a *particular period*. In the present case, the letter of authority, the examiners were authorized to examine petitioner's books of accounts and other accounting records for the period “1997 & unverified prior years”. However, the respondent's basis for the deficiency value-added tax for year 1997 was the year 1998.

Records disclose that petitioner is adopting a fiscal year ending March 31. The period specified in the letter of authority was for the year 1997 and prior years. If we harmonized the two, it follows that the examination should have been limited to the fiscal year ended March 31, 1997 and prior years. But since petitioner commenced its business operations only on October 1, 1997¹, it would render the letter of authority invalid because there was no business operation yet. Neither could we construe that the period

¹ See Note 1 of Notes to Financial Statements for the fiscal year ended March 31, 1998 (page 1054, BIR records).

referred in the letter of authority covered the fiscal year ended March 31, 1998 and prior years. As discussed, the period covered by the subject letter of authority was 1997 and prior years which was legibly typed-written thereon. At most, the revenue examiners were authorized to examine transactions of petitioner for the period October 1997 to December 1997. Clearly then, the revenue examiners acted without authority in arriving at the deficiency VAT assessment. Thus, the same should be considered without force and effect. A deficiency assessment issued without a valid authority is a nullity.

Anent the deficiency tax assessments which we can not verify the source based on the available evidence and records, we will assume that the same were issued within the scope of the Letter of Authority No. 19734. This is in consonance with the subsequent act of petitioner in offering a tender of payment relative to the findings by the respondent of its tax liability (*pages 117-118, CTA records*). In fact, there was an admission on the part of petitioner with respect to some of the deficiency taxes and penalties assessed as manifested in its protest letter.

Moreover, 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 tax assessments (*Bonifacia Sy Po vs. Court of Tax Appeals and Hon. Commissioner of Internal Revenue, 164 SCRA 524*). Failure to present proof of error in the assessment will justify judicial affirmance of said assessment (*Delta Motors Co. vs. Commissioner, CTA Case No. 3782, May 21, 1986*).

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DEFICIENCY EXPANDED WITHHOLDING TAX P1,992,462.72

Respondent assessed petitioner of deficiency expanded withholding tax (EWT) arising from the alleged ‘under’ withholding of tax on certain income payments made by petitioner, detailed as follows: *(page 1065, BIR records and Exhibit A)*

	Amount	Rate	EWT Due
Transportation Equipment	P 1,337,100.00	1%	P 13,371.00
Transportation Equipment	30,497,862.00	2%	609,957.24
Distribution	52,995,813.33	1%	529,958.13
Advertising & Promo	22,413,955.00	1%	224,139.55
Rental	4,467,951.00	5%	223,397.55
Professional Fee	3,614,121.00	5%	180,706.05
Utilities	812,652.00	1%	8,126.52
Freight & Handling	809,323.00	1%	8,093.23
Repairs & Maintenance	722,857.00	1%	7,228.57
Security	321,324.00	1%	3,213.24
Commission	2,904,997.00	10%	290,499.70
Rental Deposit	10,523,821.99	5%	526,191.10
Total EWT Due			P 2,624,881.88
Less: EWT Remitted			1,207,904.98
Basic Deficiency EWT			P 1,416,976.90
Add: 20% Interest			550,485.82
Compromise Penalty			25,000.00
Total Deficiency EWT Due			<u>P 1,992,462.72</u>

From the above listed deficiency EWT, petitioner questions, by way of the instant petition for review, the validity of the assessment on: (a) transportation equipment or motor vehicles; (b) professional fee; (c) commission expense; and (d) rental deposit.

We will tackle the above items individually.

a. Motor Vehicles - P623,328.24

We sustain the respondent’s assessment on this particular item primarily because petitioner did not assail the validity of the said deficiency in its protest. In the case of **3M Philippines, Inc. vs. Commissioner of Internal Revenue, C.T.A. Case No. 3856, August 14, 1987**, the court ruled:

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Since petitioner did not protest or dispute administratively the disallowance of this pre-operational expense as capital expenditure, petitioner cannot raise this issue for the first time on appeal in this Court. This cannot be permitted, for the same reason that underlies the requirement of prior exhaustion of administrative remedies to give administrative authorities the prior opportunity to decide controversies within their competence, and in much the same way that, on the judicial level issues not raised in the lower court cannot be raised for the first time on appeal. To sanction such a procedure whereby the court — which is supposed to review administrative determinations — would not review, but determine and decide for the first time, a question not raised at the administrative forum. (*Aguinaldo Industries Corporation vs. Commissioner of Internal Revenue and the Court of Tax Appeals, L-29790, February 25, 1982, 112 SCRA 136.*)

Therefore, petitioner is liable for the deficiency EWT assessment on motor vehicles which it failed to seek reconsideration in its protest.

b. Professional Fee - P180,706.05

Out of the total professional fee of P3,614,121.00 subjected by respondent to deficiency EWT of P180,706.05, only the amount of P577,196.30 paid to general professional partnership was claimed by petitioner as not subject to expanded withholding tax (*page 1226, BIR records*). Petitioner cites in its memorandum Section 22(B) of the Tax Code, the Supreme Court's decision in the case of *Tan vs. Del Rosario, G.R. No. 109289 [1994]*, and Revenue Rulings No. DA-057-2-96 dated December 5, 1995 and Revenue Ruling No. UN-424-12-4-95 as its bases.

We agree with the petitioner that the income payments made to general professional partnership as a juridical person is exempt from income tax *vis-à-vis* the expanded withholding tax. Its partners are the ones liable in their individual capacity for the payment of income tax pursuant to Section 23 of the Tax Code. This was elucidated by Supreme Court in the case of *Rufino R. Tan, et al. vs. Ramon R. Del Rosario Jr, as*



Secretary of Finance & Jose U Ong, as Commissioner of Internal Revenue, G.R. Nos. 109289 and 109446, dated October 3, 1994 in this wise:

"Exempt partnerships," upon the other hand, are not similarly identified as corporations nor even considered as independent taxable entities for income tax purposes. A general *professional* partnership is such an example. Here, the partners themselves, not the partnership (although it is still obligated to file an income tax return [mainly for administration and data]), are liable for the payment of income tax in their *individual* capacity computed on their respective and distributive shares of profits. In the determination of the tax liability, a partner does so as an *individual*, and there is no choice on the matter. In fine, under the Tax Code on income taxation, the general professional partnership is deemed to be no more than a mere mechanism or a flow-through entity in the generation of income by, and the ultimate distribution of such income to, respectively, each of the individual partners.

However, as correctly held by the respondent in his memorandum, petitioner failed to present relevant documents to support the claimed payment of professional fee to general professional partnership. What we have found on the records of the case were Billing Statements from Joaquin Cunanan & Co. and Quisumbing Torres & Evangelista which we considered invalid proofs of payment of professional fees (*pages 1236 to 1242, BIR records*). The primary evidence of payment of service is an official receipt issued by the said general professional partnerships to petitioner as required under Section 238 of the Tax Code.

Therefore, petitioner is liable for the subject deficiency expanded withholding tax on professional fee allegedly paid to the general professional partnerships.

c. Commission Expense - P290,499.70

Petitioner, through counsel, objects to the imposition of 10% expanded withholding tax on its commission expense in the amount of P2,904,997.00. It expounds that: (*page 1226, BIR records*)

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2. The commission expense as per our client's records show an amount of P10,200 only (and not P2,904,997); furthermore, the 10% withholding tax rate applied on commission payments to sales agents or broker is erroneous since the rate applicable to broker is only 5% pursuant to Section 2.7.2(G) of Revenue Regulations No. 2-98.

From the above explanation, it can be deduced that petitioner is questioning only the rate applied by respondent to the sum of P2,894,797.00 (P2,904,997.00 less P10,200.00) in arriving at the deficiency EWT as it conceded that the commission expense in the amount of P10,200.00 was subject to 10% EWT. In view thereof, we are limiting our review on the correctness of the applicable rate under the category of sales agents and brokers.

Section 1(g) of Revenue Regulations No. 6-85 provides:

(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%).

Based on the above regulation, the correct withholding tax on commission paid to brokers and agents is 5%. Applying this rate to the instant case will result to a total deficiency withholding tax of P145,759.85, computed as follows:

	Amount	Rate	Withholding Tax
1. Commission Expense	P 10,200.00	10%	P 1,020.00
2. Broker, Dealer	2,894,797.00	5%	144,739.85
Total	<u>P 2,904,997.00</u>		<u>P 145,759.85</u>

d. *Rental Deposit - P526,191.10*

Petitioner denied that it is responsible for the withholding of 5% tax on its rental deposits relying upon BIR Ruling No. 48-80. On the other hand, respondent opines that petitioner is liable for the 5% tax on its rental deposits by citing also the same BIR ruling.

For easy reference, the said ruling is hereby quoted:

[I]f the advance payment made pursuant to a Lease Contract is in the nature of a security deposit for the faithful performance of certain obligations of the lessee, the lessor realizes no taxable income in the year the advance payment is received. But, if the advance payment is a security deposit and the conditions which make the security deposit the property of the lessor occur, then the lessor realizes a taxable income to the extent of the security deposit and the lessee is entitled to a deduction of the same extent (*Estate of George E. Baker*, 13 BTA 562 cited in BIR Ruling No. 011-69 dated October 3, 1969).

In view thereof, and considering that the said two months cash deposit to be made by your tenants does not actually form part of the rental payment per Contract of Lease, this Office is of the opinion as it hereby holds that it is not subject to the 5% withholding tax xxx, provided however, that if any part of the deposit is subsequently applied as rental, such payment is income to the lessor and therefore shall be subject to the withholding tax.

In the absence of the lease contracts between petitioner and its lessors from which the ruling was based, we will no longer discuss the applicability of BIR Ruling No. 48-80 to the case of petitioner. Instead, we will resolve the issue based on the available evidence on record.

Earlier we have discussed that the revenue examiners were only authorized to examine petitioner's accounting records for the year 1997 and prior years. Records show that the total rental deposit of P10,523,821.99 was incurred by petitioner during the period January 1998 to March 1998 (*see page 1221, BIR records*). This period was not covered by the letter of authority. Therefore, the assessment for deficiency expanded withholding tax on rental expense is invalid.

Based on the foregoing discussions, petitioner's deficiency expanded withholding tax is recomputed as follows:

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	Amount	Rate	EWT Due
Transportation Equipment	P 1,337,100.00	1%	P 13,371.00
Transportation Equipment	30,497,862.00	2%	609,957.24
Distributio	52,995,813.33	1%	529,958.13
Advertising & Promo	22,413,955.00	1%	224,139.55
Rental	4,467,951.00	5%	223,397.55
Professional Fee	3,614,121.00	5%	180,706.05
Utilities	812,652.00	1%	8,126.52
Freight & Handling	809,323.00	1%	8,093.23
Repairs & Maintenance	722,857.00	1%	7,228.57
Security	321,324.00	1%	3,213.24
Commission/Dealer/Salesman	2,904,997.00	5%;10%	145,759.85
Total EWT Due			P 1,953,950.93
Less: EWT Remitted			1,207,904.98
Basic Deficiency EWT			P 746,045.95
Add: 20% Interest			289,833.74
Total Deficiency EWT Due			P 1,035,879.70

REMITTANCE OF VAT ON ROYALTY **P462,758.14**

Respondent finds petitioner liable for penalties due to late payment of VAT on royalties. He is of the opinion that payment of VAT should be made within twenty-five (25) days following the close of each taxable quarter pursuant to Section 114 of the Tax Code. The penalties are broken down as follows: *(page 1066, BIR records)*

	Date Filed	Amount	VAT Due
Royalty Payment	03-31-98	P 14,367,112.11	P 1,436,711.21
Surcharge and Penalties			
25% Surcharge			359,177.80
20% Interest			87,580.34
Compromise			16,000.00
VAT Due on March Remittance			P 1,899,469.35
Royalty Payment	7/8/1998	16,929,239.12	1,692,923.91
Total		P 31,296,351.23	P 3,592,393.26
Less: VAT Payment	7/8/1998		3,129,635.12
Deficiency VAT Surcharge and Penalties			P 462,758.14

In its protest, petitioner assails the validity of the computation of the interest and the imposition of compromise penalty. Petitioner insists that the interest for the VAT on royalty for March 1998 should be for the period of April 11 to July 8, 1998 only. While the compromise penalty should be deleted for lack of consent of petitioner. It rationalizes that compromise penalty is consensual in character and may not be imposed on the taxpayer without its consent pursuant to Revenue Regulations No. 12-99.

In view of the admission of petitioner, this court holds petitioner liable for the penalties for the late payment of VAT on royalties except compromise penalty in the amount of P429,242.07 computed as follows:

	Date Filed	Amount	VAT Due
Royalty Payment	03-31-98	P 14,367,112.11	P 1,436,711.21
Surcharge and Penalties			
25% Surcharge			359,177.80
20% Interest			70,064.27
VAT Due on March Remittance			P 1,865,953.28
Royalty Payment	7/8/1998	16,929,239.12	1,692,923.91
Total		P 31,296,351.23	P 3,558,877.19
Less: VAT Payment	7/8/1998		3,129,635.12
Deficiency VAT Surcharge and Penalties			<u>P 429,242.07</u>

**LATE REMITTANCE OF FINAL
WITHHOLDING TAX ON ROYALTIES**

P2,288,473.78

Likewise, respondent maintains that petitioner belatedly remitted its final withholding tax on royalties as of December 1997 and for the period January to March 1998, to wit:
(page 1062, BIR records)

	<u>Amount</u>	<u>Rate</u>	<u>Final Tax Due</u>
Accrued Royalty Expense as of December 31, 1997	<u>P 14,367,112.11</u>	25%	P 3,591,778.03
Add : 25% Surcharge			897,944.51
20% Interest 1-10-98 to 7-8-98			440,361.82
Compromise			25,000.00
Total Amount Due for Dec. accruals			<u>P 4,955,084.36</u>
Royalty Expense for Jan. to March	<u>P 16,929,238.71</u>	25%	P 4,232,309.68
Add : 25% Surcharge			1,058,077.42
20% Interest 4-10-98 to 7-8-98			260,895.80
Compromise			25,000.00
Total Amount Due for March accruals			<u>P 5,576,282.90</u>
Total Final Tax Due on Royalty Expense			<u>P 10,531,367.26</u>
Less: Final Tax Remittance dated 7-8-98	P 7,824,087.81		
Surcharge per Return	226,331.22		
Interest per Return	<u>192,474.55</u>		8,242,893.58
Deficiency Final Tax			<u><u>P 2,288,473.68</u></u>

Respondent cites as legal bases Sections 50 and 51 of the (then) Tax Code and Revenue Regulations No. 5-82.

In its protest, petitioner refutes respondent's findings and clarifies the terms of payment of its royalty to Sony Japan as follows:

We believe that your examiner's computation has no legal basis considering that under Section 2.57.54 of RR 2-98, it was stated that withholding tax returns shall be filed and remitted within 10 days following the month an income is paid or becomes payable, whichever comes first. The terms "payable", as defined in the regulations, refers to the date the obligation becomes due, demandable or legally enforceable (and not the date of accrual).

In this case, the Manufacturing Licensing Agreement entered into between Sony Philippines and Sony Japan (which gave rise to the royalties) provides that royalties shall be payable after two months following each semi-annual period ending on June 30 and December 31. As such, we believe that royalty payments covering the first half and latter half of the year are legally demandable only on August 31 and February 28, respectively.

Applying the foregoing, royalties for the period January to March 1998 are payable on August 1998. Since our client paid the royalty at an earlier date (i.e. June 1998), we believe that our client properly remitted the withheld tax on July 10, 1999 (or 10 days following the end of the month of such payment).

On the other hand the royalties applicable for the quarter ending December 1997 should be payable on February 28, 1998. In such case, the tax due thereon should have been remitted on or before March 10, 1998. (*page 1224, BIR records*)

After a careful scrutiny of the Manufacturing License Agreement (*Exhibit H*), we find the above asseverations of petitioner tenable.

Revenue Regulations Nos. 5-82 and 2-98 provide the manner of withholding, remittance, and payment of final tax on royalty in this order:

Revenue Regulations No. 5-82.

Section. 3. Time of Withholding. – The obligations of the payor to deduct and withhold under these regulations arises at time income which subject to withholding under Section 1 hereof is payable or paid.

Revenue Regulations No. 2-98.

Section 2.57.4. Time of Withholding. – The obligation of the payor to deduct and withhold the tax under Section 2.57 of these regulations arises at the time an income is paid or payable, whichever comes first. The term “payable” refers to the date the obligation become due, demandable or legally enforceable.

Section 2.58. RETURNS AND PAYMENT OF TAXES WITHHELD AT SOURCE. -

(A) *Monthly return and payment of taxes withheld at source*

xxx

xxx

xxx

(2) WHEN TO FILE –

(a) The withholding tax return, whether creditable or final, shall be filed and payments should be made within 10 days after the end of each

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month except for taxes withheld for December which shall be filed or before January 25 of the following year.

From the foregoing regulations, the obligation of petitioner to deduct and withhold final taxes on royalty payments arises only when the royalty is paid or payable.

In Article X(5) of the Manufacturing License Agreement between petitioner and Sony Japan (*Exhibit H-1*), the following terms of royalty payments were agreed upon:

(5) Within two (2) months following each semi-annual period ending June 30 and December 31, the LICENSEE shall furnish to the LICENSOR a statement, certified by an officer of the LICENSEE, showing quantities of the MODELS sold, leased or otherwise disposed of by the LICENSEE during such respective semi-annual period and amount of royalty due pursuant this ARTICLE X therefor, and the LICENSEE shall pay the royalty hereunder to the LICENSOR concurrently with the furnishing of the above statement.

Prescinding from the above, the obligation of petitioner to pay royalty to Sony-Japan arises within two months following each semi-annual period ending June 30 and December. 31. Hence, royalty is payable (at the latest) at the end of August and February. Since there was accrual of royalty as of December 1997 and June 1998, the corresponding final withholding taxes should be paid and remitted on the January 10, 1998 and July 10, 1998.

Records reflect that petitioner paid its final tax on royalty as of December 1997 on July 8, 1998. The payment of final tax for the accrued royalty as of December 1997 should have been made on January 10, 1998. Undoubtedly, petitioner belatedly paid its royalty as of December 31, 1997.

With respect to royalty for January to March 1998, this court confirms that the same was seasonably remitted. It should be noted that January to March 1998 was covered by the first semi-annual period (June 30). Royalty for this period is payable until



August 1998. But petitioner accrued the same as of June 30, 1998, therefore, the remittance of final tax should be made on July 10, 1998. Since it was paid on July 8, 1998, then there was no late remittance.

Below is the recomputation of penalties for the late remittance of final tax on royalty as of December 1997 which petitioner is liable for, to wit:

	<u>Amount</u>	<u>Rate</u>	<u>Final Tax Due</u>
Accrued Royalty Expense as of December 31, 1997	<u>P 14,367,112.11</u>	25%	P 3,591,778.03
Add : 25% Surcharge			897,944.51
20% Interest 1-10-98 to 7-8-98			<u>352,289.46</u>
Total Amount Due for Dec. accruals			P 4,842,012.00
Less: Final Tax Remittance dated 7-8-98	P 3,591,778.03		
Surcharge per Return	226,331.22		
Interest per Return	<u>192,474.55</u>		<u>4,010,583.80</u>
Deficiency Final Tax			<u><u>P 831,428.20</u></u>

**LATE REMITTANCE OF EXPANDED
WITHHOLDING TAX**

P10,923.60

Lastly, penalties for the late remittance of expanded withholding tax were assessed against petitioner for failure of some of its branches to remit the withholding tax within the prescribed period, detailed as follows: (*page 1067, BIR records*)

Branch	Month	Due Date	Date Filed	Amount
Cagayan	March	4/10/98	4/13/98	P 15,750.09
Iloilo City	March	4/10/98	4/13/98	11,928.19
Zamboanga	March	4/10/98	4/13/98	<u>7,783.06</u>
Total				<u><u>P 35,461.34</u></u>
Penalties				
25% Surcharge				P 8,865.34
Interest				58.29
Compromise				<u>2,000.00</u>
Total Penalties Due				<u><u>P 10,923.63</u></u>

Petitioner acknowledges the penalties for the late remittance of expanded withholding tax of the above branches except that the computation for interest is to be adjusted to conform with the standard computation contained in Revenue Memorandum Circular No. 46-99 and that the compromise penalty should be cancelled in the absence of petitioner's consent pursuant to Revenue Regulations No. 12-99 (*page 1223, BIR records*).

After verification, we find that the respondent's computation of interest is in order and was based on RMO 46-99. However, we agree with petitioner that the compromise penalty should not be imposed for lack of mutual agreement between petitioner and respondent (*Industrial Inspection (Int'l.) Incorporated vs. Liwayway Vinzons Chato in her capacity as The Commissioner of Bureau of Internal Revenue, CTA Case No. 5152, May 19, 1997 citing Collector of Internal Revenue vs. UST, G.R. L-11274 & L-11280, November 28, 1958*).

Hence, petitioner is still obliged to pay the amount of P8,923.63 (P10,923.63 less P2,000.00) as penalties for the late remittance of withholding taxes of some of its branches.

WHEREFORE, the petition for review is hereby **PARTIALLY GRANTED**. Respondent is **ORDERED** to **CANCEL** and **WITHDRAW** the deficiency assessment for value-added tax for 1997 for lack of merit. However, the deficiency assessments for expanded withholding tax and penalties for late remittance of internal revenue taxes are **UPHELD**.

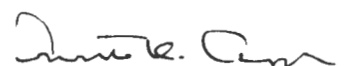


Accordingly, petitioner is **DIRECTED** to **PAY** the respondent the deficiency expanded withholding tax in the amount of P1,035,879.70 and the following penalties for late remittance of internal revenue taxes in the sum of P1,269,593.90:

1. VAT on Royalty	P 429,242.07
2. Withholding Tax on Royalty	831,428.20
3. EWT of Petitioner's Branches	<u>8,923.63</u>
Total	<u>P1,269,593.90</u>

plus 20% delinquency interest from January 17, 2000 until fully paid pursuant to Section 249(C)(3) of the 1997 Tax Code.

SO ORDERED.


ERNESTO D. ACOSTA
Presiding Justice

I CONCUR:


LOVELL R. BAUTISTA
Associate Justice

CERTIFICATION

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


ERNESTO D. ACOSTA
Presiding Justice
Chairman, First Division

