



Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

EL PASO PHILIPPINES ENERGY
COMPANY, INC.,

Petitioner,

CTA CASE No. 8013

Members:

-versus-

CASTAÑEDA, JR., *Chairperson*,
CASANOVA, and
COTANGCO-MANALASTAS, JJ.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

FEB 23 2015

X-----X
10:45 a.m.

DECISION

CASTAÑEDA, JR., J:

This Petition for Review filed by El Paso Philippines Energy Company, Inc. (petitioner) seeks the cancellation of the assessment issued by the Commissioner of Internal Revenue (respondent) against petitioner for the following alleged deficiency internal revenue taxes covering taxable year 2004 in the aggregate amount of ₱78,196,263.27, inclusive of increments, broken down as follows:

Income Tax	₱ 28,134,150.84
Value-added Tax	13,089,608.45
Expanded Withholding Tax	186,695.72
Final Withholding Tax	1,607,754.27
Improperly Accumulated Earnings Tax	35,153,053.99
Compromise Penalty	25,000.00
TOTAL	₱78,196,263.27

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The Facts

Petitioner is a corporation duly organized and existing under the laws of the Philippines, with principal place of business at Ground Floor PFDA Building, Navotas Fish Port Complex, Navotas City. On the other hand, respondent is the Commissioner of the Bureau of Internal Revenue (BIR), the government agency tasked, among others, to collect national internal revenue taxes. She holds office at BIR National Office Building, Agham Road, Quezon City.¹

On August 23, 2005, petitioner received Letter of Authority (LOA) No. 00009462² dated August 18, 2005 from the BIR Revenue District Office (RDO) No. 43-Pasig City, for the examination of petitioner's books of accounts and other related accounting records for calendar year 2004, with the attached letter of even date, requesting submission of its books of accounts, financial statements, and other related accounting records and supporting documents.³

Petitioner complied with the said request through a letter⁴ dated September 5, 2005, forwarding to respondent copies of its books of account, financial statements, and other pertinent accounting records and supporting documents, which was received by the latter through BIR RDO No. 43-Pasig City on the same date. Petitioner also transmitted through a letter⁵ dated November 22, 2006 additional documents to BIR RDO No. 43-Pasig City, as requested.

In January 2007, BIR RDO No. 43-Pasig City issued a Notice⁶ dated January 23, 2007, informing petitioner of the findings as to its alleged tax liabilities and requiring petitioner to appear before BIR RDO No. 43-Pasig City for an informal conference. Subsequently, a Post Reporting Notice⁷ was issued on February 7, 2007.

On the other hand, Revenue Officer Alicia M. Camongol recommended to the Regional Director of RDO No. 43-Pasig City, through a Memorandum⁸, that petitioner's case be forwarded to the Assessment Division for the preparation of Preliminary Assessment Notice, for failure of petitioner to present complete and relevant documents.

Petitioner received a Revised Post Reporting Notice⁹ dated October 30, 2007. 

¹ Pars. 9 and 10, The Parties, Petition for Review, docket, p. 5.

² Exhibit "A-1", docket, p. 903; Exhibits "3" and "3-A", BIR Records, p. 31.

³ Par. 1, Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI), docket, pp. 475-476.

⁴ Exhibits "A" and "A-2", docket, p. 902.

⁵ Exhibits "B" and "B-1", docket, p. 904.

⁶ Exhibit "C", docket, p. 905; Exhibit "4", BIR Records, p. 254.

⁷ Exhibit "5", BIR Records, p. 258.

⁸ Exhibit "6", BIR Records, pp. 260-261.

⁹ Exhibit "D", docket, pp. 908-912; Exhibit "7", BIR Records, p. 278.L.

On November 26, 2007, petitioner filed a reply letter,¹⁰ contesting the deficiency taxes stated in the Revised Post Reporting Notice.

On January 8, 2008,¹¹ petitioner received a Preliminary Assessment Notice (PAN)¹² dated December 28, 2007, assessing it for alleged deficiency income tax of ₱27,652,132.17, deficiency value-added tax (VAT) of ₱12,871,522.50, deficiency expanded withholding tax (EWT) of ₱183,594.67, deficiency final withholding tax (FWT) of ₱1,581,049.20, and deficiency improperly accumulated earnings tax of ₱34,612,604.78, inclusive of interests, for calendar year 2004, as follows:

I. DEFICIENCY INCOME TAX			
Taxable income per return			
Add: Disallowances/Adjustments per investigation:			
Unaccounted income		₱48,641,323.00	
Unaccounted prime contractors		1,044,141.23	
Professional fees not subjected to EWT		1,154,982.00	
Interest expense not subjected to final tax		4,973,138.20	
Disallowed interest expense		288,715.93	₱56,102,300.36
Taxable income per investigation			56,102,300.36
Income tax due thereon			17,952,736.11
Less: Payments/tax credits			
Prior years excess tax credits claimed		₱10,715,585.00	
Creditable withholding tax claimed		15,517,047.00	
Total		26,232,632.00	
Less: Excess tax credits to be carried forward	₱22,203,593.00		
Deferred MCIT	4,029,039.00	26,232,632.00	-
Deficiency income tax			₱17,952,736.11
Add: 20% Interest p.a. from 04.16.05 to 12.28.07			9,699,396.06
TOTAL AMOUNT DUE			27,652,132.17
II. DEFICIENCY VALUE ADDED TAX			
Taxable receipts per return			₱72,705,617.83
Add: Adjustments/discrepancies per investigation:			
Unaccounted income	₱48,641,323.00		
Gross receipts not subjected to VAT	32,584,572.81		81,225,895.81
Taxable receipts per investigation			153,931,513.64
Value-added tax due thereon			15,393,151.36
Less: Allowable input tax/payments:			
Payments	₱6,194,285.89		
Input tax during the year	1,076,276.07		7,270,561.96

¹⁰ Exhibits "E" and "E-1", docket, pp. 913-914.

¹¹ Par. 7, Stipulated Facts, JSFI, docket, p. 477.

¹² Exhibit "F", docket, pp. 915-918; Exhibit "8", BIR Records, pp. 284.L-287.L.

Deficiency value-added tax			8,122,589.40
Add: 20% Interest p.a. from 01.25.05 to 12.28.07			4,748,933.09
TOTAL AMOUNT DUE			₱12,871,522.50
III. DEFICIENCY EXPANDED WITHHOLDING TAX			
Expanded withholding tax due thereon			₱ 115,498.20
Add: 20% Interest p.a. from 01.16.05 to 12.28.07			68,096.47
TOTAL AMOUNT DUE			183,594.67
IV. DEFICIENCY FINAL WITHHOLDING TAX ON INTEREST EXPENSE			
Interest expense not subjected to final withholding tax			₱ 4,973,138.20
Final withholding tax rate			20%
Final withholding tax on interest expense due thereon			994,627.64
Add: 20% Interest p.a. from 01.16.05 to 12.28.07			586,421.56
TOTAL AMOUNT DUE			1,581,049.20
V. DEFICIENCY IMPROPERLY ACCUMULATED EARNINGS TAX			
Taxable income			(435,096,750.00)
Add: Interest income subjected to final tax	607,823.00		
Equity in net earnings of subsidiary	171,352,773.00		
Losses	485,906,173.00		657,866,769.00
Balance			222,770,019.00
Less: Income tax payable			4,029,039.00
Balance			218,740,980.00
Less: Capital stock			8,140,000.00
Improperly accumulated earnings			210,600,980.00
Improperly accumulated earnings rate			10%
Improperly accumulated earnings tax			21,060,098.00
Less: 25% Surcharge	₱5,265,024.50		
20% interest p.a. from 01.11.06 to 12.28.07	8,262,482.28		
Compromise penalty	25,000.00		13,552,506.78
TOTAL AMOUNT DUE			₱ 34,612,604.78

On January 22, 2008, petitioner likewise received a Formal Letter of Demand (FLD) No. 431130¹³ dated January 15, 2008 with attached assessment notices¹⁴, *h*

¹³ Exhibit "G", docket, pp. 919-929; Exhibit "9-A", BIR Records, pp. 288.L-291.L.

¹⁴ Exhibit "9", BIR Records, pp. 291.L-298.L.

demanding payment of the following deficiency tax assessments (inclusive of interests as of February 15, 2008) for calendar year 2004.¹⁵

1. income tax - ₱28,134,150.84;
2. VAT - ₱13,089,608.45;
3. EWT - ₱186,695.72;
4. FWT - ₱1,607,754.27;
5. improperly accumulated earnings tax - ₱35,153,053.99; and
6. compromise penalty - ₱25,000.00.

The above-enumerated assessments can be broken down as follows:

I. DEFICIENCY INCOME TAX			
Taxable income per return			-
Add: Disallowances/Adjustments per investigation:			
Unaccounted income		₱48,641,323.00	
Unaccounted prime contractors		1,044,141.23	
Professional fees not subjected to EWT		1,154,982.00	
Interest expense not subjected to final tax		4,973,138.20	
Disallowed interest expense		288,715.93	₱56,102,300.36
Taxable income per investigation			56,102,300.36
Income tax due thereon			17,952,736.11
Less: Payments/tax credits			
Prior years excess tax credits claimed		10,715,585.00	
Creditable withholding tax claimed		15,517,047.00	
Total		26,232,632.00	
Less: Excess tax credits to be carried forward	₱22,203,593.00		
Deferred MCIT	4,029,039.00	26,232,632.00	-
Deficiency income tax			17,952,736.11
Add: 20% Interest p.a. from 04.16.05 to 2.15.08			10,181,414.73
TOTAL AMOUNT DUE			28,134,150.84
II. DEFICIENCY VALUE ADDED TAX			
Taxable receipts per return			72,705,617.83
Add: Adjustments/discrepancies per investigation:			
Unaccounted income	48,641,323.00		
Gross receipts not subjected to VAT	32,584,572.81		81,225,895.81
Taxable receipts per investigation			153,931,513.64
Value-added tax due thereon			15,393,151.36
Less: Allowable input tax/payments:			
Payments	6,194,285.89		

¹⁵ Par. 8, Stipulated Facts, JSFI, docket, pp. 477-478.

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Input tax during the year	1,076,276.07		7,270,561.96
Deficiency value-added tax			8,122,589.40
Add: 20% Interest p.a. from 01.25.05 to 2.15.08			4,967,019.05
TOTAL AMOUNT DUE			13,089,608.45
III. DEFICIENCY EXPANDED WITHHOLDING TAX			
Expanded withholding tax due thereon			115,498.20
Add: 20% Interest p.a. from 01.16.05 to 2.15.08			71,197.52
TOTAL AMOUNT DUE			186,695.72
IV. DEFICIENCY FINAL WITHHOLDING TAX ON INTEREST EXPENSE			
Interest expense not subjected to final withholding tax			4,973,138.20
Final withholding tax rate			20%
Final withholding tax on interest expense due thereon			994,627.64
Add: 20% Interest p.a. from 01.16.05 to 2.15.08			613,126.63
TOTAL AMOUNT DUE			1,607,754.27
V. DEFICIENCY IMPROPERLY ACCUMULATED EARNINGS TAX			
Taxable income			(435,096,750.00)
Add: Interest income subject to final tax		607,823.00	
Equity in net earnings of subsidiary		171,352,773.00	
Losses		485,906,173.00	657,866,769.00
Balance			222,770,019.00
Less: Income tax payable			4,029,039.00
Balance			218,740,980.00
Less: Capital stock			8,140,000.00
Improperly accumulated earnings			210,600,980.00
Improperly accumulated earnings rate			10%
Improperly accumulated earnings tax			21,060,098.00
Less: 25% Surcharge		5,265,024.50	
20% interest p.a. from 01.11.06 to 2.15.08		8,827,931.49	14,092,955.99
			₱35,153,053.99

Petitioner protested the aforesaid FLD and assessment notices on January 25, 2008,¹⁶ disputing the tax assessments and praying for reconsideration thereof. *Je*

¹⁶ Exhibits "H" and "H-1", docket, pp. 930 to 934; Exhibit "10", BIR Records, pp. 462-466.L.

Respondent then sent a Letter¹⁷ dated February 15, 2008, informing petitioner that its protest against the assessment for internal revenue tax liabilities for calendar year 2004 will be forwarded to BIR RDO No. 43-Pasig City.

On April 30, 2008, a Tax Verification Notice¹⁸ dated April 1, 2008 was received by petitioner, stating that Revenue Officer Marjonie Ando is authorized to verify supporting documents relative to "Re-investigation (AIRT)" covering the taxable period 2004. Also, a letter¹⁹ dated April 18, 2008 was attached therein, requesting petitioner to submit documents supporting its protest within ten (10) days from receipt thereof.

Respondent issued a Referral Note dated May 19, 2009²⁰ to Revenue Officer Rodrigo Peralta, directing him to continue the audit of petitioner's tax liabilities. On September 11, 2009, Revenue Officer Peralta made a Report of Investigation²¹, recommending to the Revenue District Officer of RDO No. 43A-East, Pasig City the denial of petitioner's request for reinvestigation for failure to substantiate its claim for cancellation of assessment.

Subsequently, on November 27, 2009, petitioner received a Preliminary Collection Notice²² dated October 23, 2009 from BIR Revenue Region No. 7, Quezon City, Regional Task Force, through its Regional Director, demanding payment from petitioner of the alleged tax assessments in the aggregate amount of ₱78,196,263.26.²³

As a result, petitioner filed this Petition for Review on December 28, 2009.

In her Answer²⁴ filed on February 5, 2010, respondent interposed the following special and affirmative defenses:

"8. This instant Petition was filed over the 30-day period within which to file the same as required by Section 228 of the Tax Code, as amended, therefore rendering the protested deficiency tax assessment for the taxable year 2004 final and demandable. *gr*

¹⁷ Exhibit "I", docket, p. 935.

¹⁸ Exhibit "J", docket, p. 936; Exhibit "11", BIR Records, p. 655.L.

¹⁹ Exhibit "J-1", docket, p. 937; Exhibits "12" and "12-A", BIR Records, p. 656.L.

²⁰ Exhibit "11-a", BIR Records, p. 660.L.

²¹ Exhibit "14", BIR Records, p. 667.L.

²² Exhibit "K", docket, p. 938; Exhibits "16", "16-A", and "16-B", BIR Records, pp. 673.L-674.L.

²³ Par. 12, Stipulated Facts, JSFI, docket, p. 479.

²⁴ Docket, pp. 236-239.

9. Due to said violation above, this Honorable Court has no jurisdiction to hear and resolve this instant petition, therefore, the same should be dismissed;

10. The assessments for deficiency Income, VAT, EWT's and Improperly Accumulated Earnings Taxes are valid and in accordance with law;

11. Assessments are prima facie presumed correct and made in good faith; the above assessments were determined from the deficiency computed from the records of the petitioner;

12. The burden of proof is upon the petitioner to prove that the assessment issued by the respondent is indeed null and void.

13. The power of taxation is a high prerogative of sovereignty. Its relinquishment is never presumed and any reduction or diminution thereof with respect to its mode or its rate must be strictly construed and the same must be couched in clear and unmistakable terms in order that it may be applied. (Floro Cement Corporation vs. Gorospe, G.R. No. 46787, Aug. 2, 1991).

14. In Statutory construction, in cases of ambiguities, the principle that the contemporaneous construction of a statute given by executive officers of the government whose duty is to execute it is entitled to great respect and should ordinarily control the construction, is so firmly embedded in our jurisprudence that no authorities need be cited to support it. (Phil Assoc. of Free Labor Unions vs. BLR). Executive Officials are presumed to have familiarized themselves with all the consideration pertinent to the meaning and purpose of the law and to have formed an independent, conscientious and competent expert opinion thereon (Richard vs. Drewry-Hughes Co. 94 S.E. 989)"

Respondent filed her Pre-Trial Brief²⁵ on May 13, 2010; while petitioner submitted its Pre-Trial Brief²⁶ on May 18, 2010.

During the hearing on May 21, 2010, counsel for respondent moved that the issue on prescription be resolved by the Court before proceeding with the trial of the case.²⁷ As such, the Memorandum (on Respondent's Preliminary Hearing on the *gr*

²⁵ Docket, pp. 247-249.

²⁶ Docket, pp. 250-266.

²⁷ TSN dated May 21, 2010, docket, p. 379.

Issue on Prescription)²⁸ was submitted on June 2, 2010. On the other hand, petitioner's Memorandum²⁹ and Reply Memorandum³⁰ were filed on June 21, 2010 and June 22, 2010, respectively.

On November 2, 2010 and February 9, 2011, the Court respectively denied respondent's affirmative defense of prescription and the Motion for Reconsideration of the same.³¹ The Court held that the instant Petition was timely filed.

The parties submitted their Joint Stipulation of Facts and Issues³² on August 1, 2011. Accordingly, the Court issued the Pre-Trial Order³³ on August 18, 2011, adopting the stipulated facts and issues made by the parties, and terminating the pre-trial.

On December 12, 2011, Romeo A. De Jesus, Jr. was commissioned by the Court as the Independent Certified Public Accountant (CPA) for the case.³⁴

Petitioner presented Amy P. Molin, Jaime B. Robles, Jr., and Romeo A. De Jesus, Jr. as its witnesses. On the other hand, respondent presented Revenue Officers Alicia Camongol, Alona Marie B. Alegre, Rodorico D. Peralta, and Arsenio L. Tomeldan.

Both parties formally offered their respective documentary and testimonial evidence.

The instant Petition for Review was submitted for decision on March 21, 2014, considering respondent's Memorandum³⁵ filed on February 18, 2014 and petitioner's Memorandum³⁶ filed on March 17, 2014.³⁷

The Issues

The parties submitted the following issues³⁸ to be resolved by the Court: 

²⁸ Docket, pp. 380-383.

²⁹ Docket, pp. 384-405.

³⁰ Docket, pp. 406-416.

³¹ Resolution dated November 2, 2010, docket, pp. 421-435; Resolution dated February 9, 2011, docket, pp. 458-461.

³² Docket, pp. 475-482.

³³ Docket, pp. 618-626.

³⁴ Resolution, docket, p. 767.

³⁵ Docket, pp. 1626-1632.

³⁶ Docket, pp. 1641-1676.

³⁷ Resolution, docket, p. 1677.

³⁸ Stipulated Issues, JSFI, docket, p. 480.

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1. Whether or not petitioner is liable to pay respondent the following subject assessments (inclusive of interests as of February 15, 2008) in the alleged sums of:

- a. deficiency income tax - ₱28,134,150.84;
- b. deficiency VAT - ₱13,089,608.45;
- c. deficiency EWT - ₱186,695.72;
- d. deficiency FWT on interest expense - ₱1,607,754.27;
- e. deficiency improperly accumulated earnings tax - ₱35,153,053.99; and

(2) Whether or not petitioner is liable to pay compromise penalty in the sum of ₱25,000.00.

The Court's Ruling

As earlier stated, the instant Petition has been timely filed, thus, the Court will now proceed to address the main issues presented by the parties.

I. DEFICIENCY INCOME TAX – ₱28,134,150.84

Respondent computed the deficiency income tax assessment for taxable year 2004 in the amount of ₱28,134,150.84 as follows:³⁹

Taxable income per return		₱ -
Add: Disallowances/Adjustments per investigation:		
Unaccounted income	₱48,641,323.00	
Unaccounted prime contractors	1,044,141.23	
Professional fees not subjected to EWT	1,154,982.00	
Interest expense not subjected to final tax	4,973,138.20	
Disallowed interest expense	288,715.93	56,102,300.36
Taxable income per investigation		₱ 56,102,300.36
Income tax due thereon		₱ 17,952,736.11
Less: Payments/tax credits		
Prior years excess tax credits claimed	₱10,715,585.00	
Creditable withholding tax claimed	15,517,047.00	
Total	₱26,232,632.00	
Less: Excess tax credits to be carried forward	₱22,203,593.00	
Deferred MCIT	4,029,039.00	26,232,632.00
Deficiency Income Tax		₱ 17,952,736.11
Add: 20% Interest p.a. from 04.16.05 to 2.15.08		10,181,414.73

³⁹ Exhibit "G", docket, p. 920.

TOTAL AMOUNT DUE	₱28,134,150.84
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Petitioner contends that the assessed deficiency income tax in the amount of ₱28,134,150.84 is baseless since it is based on the application of the "net worth" method.

On the other hand, respondent insists that due to some discrepancies on petitioner's income tax return and creditable withholding tax and alphalist/1601-E, petitioner has unaccounted source of income.

The Court will now determine the validity of the said assessment by looking into the propriety of the income imputed, as well as the expense deductions and tax credits disallowed by respondent, namely:

Unaccounted income	₱48,641,323.00
Unaccounted prime contractors	1,044,141.23
Professional fees not subjected to EWT	1,154,982.00
Interest expense not subjected to final tax	4,973,138.20
Disallowed interest expense	288,715.93
Excess tax credits to be carried forward	22,203,593.00
Deferred MCIT	4,029,039.00

**a. Unaccounted income –
₱48,641,323.00**

Invoking Section 32 of the National Internal Revenue Code (NIRC) of 1997, as amended, respondent assessed petitioner of deficiency income tax on the alleged unaccounted income of ₱48,641,323.00, representing the discrepancy between petitioner's receipts as reflected in its financial statements/income tax return (FS/ITR) and as computed by respondent based on the creditable income taxes withheld from petitioner:⁴⁰

Receipts per investigation:		
Creditable withholding tax	₱15,517,047.00	
Divided by the rate	10%	₱ 155,170,470.00
Receipts per FS/ITR		106,529,147.00
Difference		₱48,641,323.00

Petitioner asserted that respondent erred in using ten percent (10%) as the withholding tax rate in computing its gross receipts since the withholding tax rates applicable to its management fees vary from 10% to fifteen percent (15%). In *per*

⁴⁰ Exhibit "G", docket, p. 922.

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support of its claim, petitioner presented the Certificates of Creditable Tax Withheld at Source (BIR Form No. 2307) issued by its clients for taxable year 2004 that reflected the following income payments and creditable taxes withheld therefrom:

EXHIBIT	PAYOR	INCOME PAYMENT	TAX RATE	CWT
M	Duracom Mobile Power Corp.	₱ 9,184,999.70	10%	₱ 918,499.97
N	East Asia Utilities Corp.	50,735,294.10	10%	5,073,529.41
PPP	Cebu Private Power Corp.	35,294,117.67	15%	5,294,117.65
O	East Asia Power Resources Corp.	28,221,498.76	15%	4,233,224.81
TOTAL		₱123,435,910.23		₱15,519,371.84

For management fees from East Asia Utilities Corporation, the Court-commissioned Independent CPA found that the tax withheld was 15% (not 10%) per sales invoices examined and that income payments received amounted to ₱33,823,529.41 (not ₱50,735,294.10):⁴¹

EXHIBIT	INVOICE NO.	INVOICE DATE	TAX RATE	AMOUNT	EWT
NNN-7	N530N531-001	8/18/2004	15%	₱ 16,176,470.59	₱ 2,426,470.59
NNN-8	N530N531-002	8/18/2004	15%	17,647,058.82	2,647,058.82
TOTAL				₱33,823,529.41	₱5,073,529.41

The Independent CPA likewise observed that the net amount of ₱28,750,000.00 (₱33,823,529.41 less ₱5,073,529.41) received by petitioner from East Asia Utilities Corporation is supported by a corporate check dated September 22, 2004.⁴²

As a result, petitioner's adjusted total gross receipts for taxable year 2004 amounted to ₱106,524,145.54, detailed as follows:

EXHIBIT	PAYOR	INCOME PAYMENT
M	Duracom Mobile Power Corp.	₱ 9,184,999.70
NNN-7 and NNN-8	East Asia Utilities Corp.	33,823,529.41
PPP	Cebu Private Power Corp.	35,294,117.67
O	East Asia Power Resources Corp.	28,221,498.76
TOTAL		₱106,524,145.54

However, when the adjusted total gross receipts per withholding tax certificates and invoices are compared with that reported in petitioner's financial statements and income tax return, there remains a discrepancy of ₱5,001.46, computed as follows: *gr*

⁴¹ Exhibit "YYY", pp. 3-4, docket, pp. 1460-1461.

⁴² Exhibit "YYY", p. 4, docket, p. 1461; Exhibit "NNN-4", docket, p. 1404.

Gross receipts per FS/ITR	₱106,529,147.00
Adjusted gross receipts per withholding tax certificates	106,524,145.54
Difference	₱ 5,001.46

In its Reconciliation of Unaccounted Income⁴³, petitioner noted of the foregoing difference, in this wise:

“Note: The management fees billed to DMPC and EAPRC were in United States Dollars. As such, there are differences in foreign exchange rates used by the companies and upon payment/collection.”

On the other hand, the Independent CPA did not verify further the source of the difference because of the minimal amount involved.⁴⁴

In sum, petitioner has sufficiently explained the alleged unaccounted income found by respondent, except for the amount of ₱5,001.46. Consequently, petitioner shall be liable to pay deficiency income tax on the unaccounted difference of ₱5,001.46 in line with the rule that tax assessments by tax examiners are presumed correct and made in good faith, with the taxpayer having the burden of proving otherwise. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.⁴⁵

b. Unaccounted payments to prime contractors – ₱1,044,141.23

Respondent’s examiner compared petitioner’s income payments to prime contractors as reported in its FS/ITR with those reflected in petitioner’s alphalist/BIR Form No. 1601-E, and construed the difference as unaccounted source of income amounting to ₱1,044,141.23, broken down as follows:⁴⁶

Payments to prime contractors:	
Per FS/ITR	₱ 18,697.37
Per alphalist/BIR Forms No. 1601-E	1,062,838.60
Difference	₱ 1,044,141.23



⁴³ Exhibit “L”, docket, p. 939.
⁴⁴ Exhibit “YYY”, p. 4, docket, p. 1461.
⁴⁵ *Marcos II v. Court of Appeals, et al.*, G.R. No. 120880, June 5, 1997.
⁴⁶ Exhibit “G”, docket, p. 922.

Petitioner explained that the difference pertains to travel expenses by company officers and several payments made by petitioner on behalf of El Paso Bangladesh, its affiliated company. Those payments were purportedly made to a travel agency and were recorded as either Travel and Transportation Expenses or Accounts Receivable and were reported in petitioner's financial statements as such.⁴⁷

The Court finds for petitioner.

A scrutiny of petitioner's Alphalist of Payees Subject to Expanded Withholding Tax as of December 31, 2004⁴⁸ shows the following:

PAYEE	ATC	INCOME PAYMENT	RATE	EWT
Travel Counsellors Inc.	WC120	₱ 1,044,141.53	2%	₱ 20,882.83
DHL Worldwide Express	WC120	10,551.07	2%	211.02
Santiago, Jay Daniel R.	WI010	55,000.00	10%	5,500.00
Adfa Graph Enterprises	WC120	8,146.00	2%	162.92
TOTAL		₱1,117,838.60		₱ 26,756.77

Based on the listing of Alphanumeric Tax Codes (ATC) under Revenue Memorandum Order (RMO) No. 29-98, all of the foregoing with ATC WC120 represent payments to prime contractors/sub-contractors subject to 2% creditable withholding tax; while the payment to Santiago, Jay Daniel R. with ATC WI010 represents professional fees paid to an individual, such as lawyer, CPA, engineer, etc., subject to 10% creditable withholding tax. The latter was not included in the computation; thus, respondent's examiner arrived at the amount of ₱1,062,838.60 income payments per alphalist, as shown below:

PAYEE	INCOME PAYMENT	EWT
Travel Counsellors Inc.	₱ 1,044,141.53	₱ 20,882.83
DHL Worldwide Express	10,551.07	211.02
Adfa Graph Enterprises	8,146.00	162.92
TOTAL	₱1,062,838.60	₱21,256.77

As regards petitioner's income payments to DHL Worldwide Express and Adfa Graph Enterprises in the respective amounts of ₱10,551.07 and ₱8,146.00, totalling ₱18,697.07, respondent's examiner correctly found that these were reported in petitioner's FS/ITR for taxable year 2004. *Je*

⁴⁷ Exhibit "H", docket, p. 930.
⁴⁸ Attached to Exhibit "III", docket, p. 1164.

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Petitioner's general ledger for taxable year 2004 disclosed that the amount of ₱10,551.07, representing courier charges paid to DHL Worldwide Express, and the amount of ₱8,146.00, representing cost of printing invoices and official receipts paid to Adfa Graph Enterprises, were recorded under the "Communications"⁴⁹ and "Miscellaneous"⁵⁰ expense accounts, respectively. However, in its FS and ITR for taxable year 2004, both amounts were reported under "Others"⁵¹ and "Miscellaneous"⁵² expense accounts, respectively.

With reference to the income payments to Travel Counsellors, Inc. totaling ₱1,044,141.23, the same were reported in petitioner's FS/ITR for taxable year 2004 contrary to respondent's allegation.

As aptly found by the Independent CPA, the income payments of ₱1,044,141.23 were recorded as either "Transportation and Travel" expense or "Accounts Receivable-EPEIC" in petitioner's general ledger for taxable year 2004. Petitioner's Notes to its Audited Financial Statements as of December 31, 2004 and 2003, indicate that EPEIC stands for El Paso Energy International Company – foreign affiliate of petitioner.⁵³ Below is the breakdown of the amount of ₱1,044,141.23:

NAME OF PAYEE	OR NO.	OR DATE	AMOUNT	EWT	REFERENCE	DEBITED TO ACCOUNT TITLE AS FOLLOWS	EXH.	BIR RECORDS (EXHIBIT "1")
Travel Counsellors, Inc.	38675	25-Aug-04	₱ 147,440.00	₱ 2,948.80	JV#080407	Transportation and Travel	"P", "P-1" to "P-4"	Page 229
Travel Counsellors, Inc.	38858	17-Sep-04	187,841.82	3,756.84	JV#090405	Transportation and Travel	"Q", "Q-1" to "Q-6"	Page 229
Travel Counsellors, Inc.	39057	13-Oct-04	394,462.73	7,889.25	JV#100411	Accounts Receivable-EPEIC	"R", "R-1" to "R-6"	Page 239
Travel Counsellors, Inc.	39409	26-Nov-04	210,739.09	4,214.78	JV#110410	Accounts Receivable- EPEIC	"S", "S-1" to "S-5"	Page 239
Travel Counsellors, Inc.	39579	22-Dec-04	103,658.18	2,073.16	JV#120410	Accounts Receivable-EPEIC	"T", "T-2" to "T-6"	Page 239
			₱1,044,141.82	₱20,882.84				

⁴⁹ The sum of ₱1,224.91 and ₱9,326.46; Exhibit "1", BIR Records, p. 229.

⁵⁰ Exhibit "1", BIR Records, p. 228.

⁵¹ Exhibit "UUU", petitioner's Statement of Income for the year ended December 31, 2004, part of ₱969,722.00 [the sum of ₱54,490.05 Communications (Exhibit "1", BIR Records, p. 229) ₱8,403.05 Representation and Entertainment (Exhibit "1", BIR Records, p. 229), ₱845,528.12 Transportation and Travel (Exhibit "1", BIR Records, p. 229), ₱52,829.67 Bank Charges (Exhibit "1", BIR Records, p. 228) and ₱8,471.00 Miscellaneous (Exhibit "1", BIR Records, p. 228) expenses], docket, p. 1430.

⁵² Exhibit "TTT", Section D, line 107, part of ₱115,790.00 [the sum of ₱54,490.05 Communications (Exhibit "1", BIR Records, p. 229), ₱52,829.67 Bank Charges (Exhibit "1", BIR Records, p. 228) and ₱8,471.00 Miscellaneous (Exhibit "1", BIR Records, p. 228) expenses], docket, p. 1424.

⁵³ Exhibit "YYY", docket, p. 1463; Exhibit "UUU", Notes to Financial Statements, Note 7(e), docket, p. 1448.

The above income payments of ₱147,440.00 and ₱187,841.82 formed part of petitioner's claimed deduction for "Transportation and Travel" in the amount of ₱845,528.00 in its ITR for the year 2004.⁵⁴

In its Statement of Income for the year ended December 31, 2004, petitioner reflected as part of its Expenses the amount of ₱969,722.00 representing "Others", which composed of the ₱8,403.00 Representation and Entertainment⁵⁵, ₱845,528.00 Transportation and Travel⁵⁶, and ₱115,790.00 Miscellaneous⁵⁷ expenses.

On the other hand, the income payments in the amounts of ₱394,462.73, ₱210,739.09, and ₱103,658.18 formed part of the Accounts Receivable-EPEIC ending balance as of December 31, 2004 in the amount of ₱1,261,700.02.⁵⁸ The latter amount was included in the Receivable of ₱30,273,203.00, reflected in petitioner's Balance Sheet as of December 31, 2004.

As indicated in Note 3⁵⁹ of petitioner's Notes to Financial Statements, the Receivables in the amount of ₱30,273,203.00 is composed of the following:

Related Parties	₱ 8,038,169.00
Creditable withholding tax and others	22,235,034.00
	₱30,273,203.00

The Receivables from Related Parties of ₱8,038,169.00 consisted of the balances of the following Accounts Receivables as of December 31, 2004:

Accounts Receivable - EPEAC	₱6,776,468.99 ⁶⁰
Accounts Receivable - EPEIC	1,261,700.02 ⁶¹
	₱8,038,169.01

Based on the foregoing, petitioner duly reported the income payments of ₱1,044,141.82 in its FS/ITR for taxable year 2004. *jr*

⁵⁴ Exhibit "TTT", Section D, line 96, docket, p. 1424; Exhibit "1", BIR Records, p. 229.

⁵⁵ Exhibit "TTT", Section D, line 95, docket, p. 1424.

⁵⁶ Exhibit "TTT", Section D, line 96, docket, p. 1424.

⁵⁷ Exhibit "TTT", Section D, line 107, docket, p. 1424.

⁵⁸ Exhibit "1", BIR Records, p. 239.

⁵⁹ Exhibit "UUU", docket, p. 1439.

⁶⁰ Exhibit "1", BIR Records, p. 239.

⁶¹ Exhibit "1", BIR Records, p. 239.

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Respondent's allegation that petitioner had undeclared income arising from the alleged unreported income payments of ₱1,044,141.82 is without factual basis. By comparing petitioner's income payments to prime contractors/subcontractors per alphalist with those allegedly shown in petitioner's FS/ITR, respondent concluded that the difference pertains to petitioner's undeclared income. By doing so, respondent merely relied on assumptions without obtaining any evidence corroborating such findings. This is contrary to the doctrine laid down by the Supreme Court in *Collector of Internal Revenue v. Benipayo*⁶², wherein it was held that:

"xxx An assessment fixes and determines the tax liability of a taxpayer. As soon as it is served, an obligation arises on the part of the taxpayer concerned to pay the amount assessed and demanded. Hence, assessments should not be based on mere presumptions no matter how reasonable or logical said presumptions may be xxx.

In order to stand the test of judicial scrutiny, the assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption xxx."

Even if these alleged unaccounted income payments are to be treated as income, the same shall be offset by reporting the equivalent payments as expenses. Hence, no taxable income will result from the said transactions.

For lack of factual basis, the deficiency income tax assessment pertaining to the alleged undeclared income from unaccounted income payments of ₱1,044,141.23 should be cancelled.

**c. Professional fees not subjected to EWT –
₱1,154,982.00**

Pursuant to Section 34(K) of the NIRC of 1997, as amended, respondent disallowed petitioner's claimed deduction for professional fees in the amount of ₱1,154,982.00, as computed below, for its alleged failure to subject the same to EWT:

Professional fees:	
Per FS/ITR	₱ 1,209,982.00
Per alphalist	55,000.00
Difference	₱1,154,982.00

je

⁶² G.R. No. L-13656, January 31, 1962.

X-----X

Petitioner argued that the difference represents payments made to general professional partnerships, which are exempt from withholding tax pursuant to Section 2.57.5(B)(4) of Revenue Regulations (RR) No. 2-98, as amended by RR No. 14-02.⁶³ Petitioner submitted various documents to support its position, to wit:

EXHIBIT	PAYEE	AMOUNT
X-2 and Y	SGV & Co.	₱ 74,122.00
Z and Z-2	SGV & Co.	72,770.00
AA and AA-3	SGV & Co.	62,000.00
BB, BB-2 to BB-11	Puno & Puno Law Offices	221,938.17
DD and DD-3	Puno & Puno Law Offices	438,549.26
EE to EE-4	Puno & Puno Law Offices	40.36
FF-3 and FF-4	Siguion Reyna Montecillo & Ongsiako Law Offices	400.00
GG and GG-4	Puno & Puno Law Offices	732.93
HH-4	SGV & Co.	65,000.00
II, II-9 and II-10	Atty. Editha P. Talaboc	80.00
JJ-3	SyCip Salazar Law Offices	206,420.00
KK-3	SyCip Salazar Law Offices	12,929.62
TOTAL		₱1,154,982.34

The Court agrees with petitioner. Payments amounting to ₱1,154,982.34 were made to general professional partnerships, such as law offices and accounting/auditing firms. Section 22(B) of the NIRC of 1997, as amended, defines general professional partnerships as partnerships formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business. Corollary thereto, Section 26 of the same Code provides that a general professional partnership shall not be subject to income tax. Its partners are the ones liable in their individual capacity for the payment of income tax.

The Supreme Court, in the case of *Rufino R. Tan v. Ramon R. Del Rosario, Jr., et al.*⁶⁴, had the occasion to rule that the income tax is imposed not on the professional partnership, which is tax-exempt, but on the partners themselves in their individual capacity computed on their distributive shares of partnership profits. Considering that general professional partnerships are exempt from income tax, payments made to these partnerships are not subject to withholding tax pursuant to Section 2.57.5 of RR No. 2-98, as amended by RR No. 14-02, which states:

Sec. 2.57.5. *Exemption from Withholding.* – The withholding of creditable withholding tax prescribed in these Regulations shall not apply to income payments made to the following: *gc*

⁶³ Memorandum for Petitioner, docket, pp. 1660-1661.

⁶⁴ G.R. Nos. 109289 and 109446, October 3, 1994.

(A) National government agencies and its instrumentalities including provincial, city, municipal governments and barangays except government-owned and controlled corporations.

(B) Persons enjoying exemption from payment of income taxes pursuant to the provisions of any law, general or special, such as but not limited to the following:

- (1) xxx
- (2) Corporations duly registered with the Board of Investments, Philippine Export Processing Zones and Subic Bay Metropolitan Authority enjoying exemption from income tax pursuant to E.O. 226, as amended, R.A. 7916, the Omnibus Investment Code of 1997 and R.A. 7227, as amended, respectively;
- (3) xxx
- (4) **General professional partnerships**
- (5) Joint ventures or consortium formed for the purpose of undertaking construction projects or engaging in petroleum, coal, geothermal & other energy operations pursuant to an operating or consortium agreement under a service contract with the government.
(Emphasis supplied)

This means that respondent's disallowance of petitioner's claimed deduction for professional fees in the amount of ₱1,154,982.00 has no legal or factual basis. Consequently, the deficiency income tax assessment arising from the disallowed professional fees should be cancelled.

**d. Interest expense not subjected to FWT –
₱4,973,138.20**

Finding that part of petitioner's interest expense in the amount of ₱4,973,138.20 was not subjected to final withholding tax, respondent disallowed the same as deduction from petitioner's gross income, pursuant to Section 34(K) of the NIRC of 1997, as amended. Below is the computation of the disallowed interest expense of ₱4,973,138.20:⁶⁵

Interest expense:	
Per FS	₱133,047,207.00
Per alphalist	128,074,068.80
Difference	₱ 4,973,138.20

jr

⁶⁵ Exhibit "G", docket, p. 922.

Petitioner disagreed stating that all of its income payments amounting to ₱133,047,207.00 were subjected to the corresponding final tax and were remitted to the BIR as evidenced by its BIR Form Nos. 1601-F and 1604-CF. Further, respondent's computation is erroneous because it failed to consider petitioner's payments of interest expense in the succeeding taxable year 2005 for interest incurred in 2004; thus, explaining why the interest expense was reported in 2004 but not subjected to FWT in the same year.⁶⁶

To account for the difference of ₱4,973,138.20 found by respondent, petitioner submitted a Reconciliation of Interest Expense Per books and Per BIR Form No. 1701-F⁶⁷ and the related documents⁶⁸.

Examination of the foregoing shows that out of the ₱14,188,231.91 FWT remitted by petitioner to the BIR for the year 2004, only the FWT of ₱9,880,327.69 pertains to its interest expense for the said year, as computed below:

FWT per Annual Information Return of income Taxes Withheld on Compensation and Final Withholding Taxes (BIR Form No. 1604-CF)		₱14,188,231.91 ⁶⁹
Less: 1. FWT on Interest Expense for taxable year 2003		
Paid in January 2004	₱2,881,783.85 ⁷⁰	
Paid in March 2004	33,483.84 ⁷¹	
2. Forex loss pertaining to FWT on Interest Expense for taxable year 2003 (see computation below)	11,811.55	
3. FWT on Management Fee Expense for 2004	1,380,824.98	4,307,904.22
FWT per BIR Form No. 1604-CF pertaining to Interest Expense for taxable year 2004		₱ 9,880,327.69

Forex gain (loss) per schedule [Exhs. "ZZ" and "ZZ-1"]				
January			₱(17,131.47)	
March			75.10	
April			23,234.34	
June			(2,857.43)	
October			2,983.54	₱ 6,304.08
Less: Forex loss pertaining to 2003 interest expense				
Included in the month of Jan. 2004 per schedule [Exhibit	US\$ Amount	FX Rate	Php Amount	

⁶⁶ Memorandum for Petitioner, docket, pp. 1661-1662.
⁶⁷ Exhibits "ZZ" and "ZZ-1", docket, pp. 1102-1103.
⁶⁸ Exhibits "LL" to "YY" and "KKK-1.a" to "KKK-14.d", docket, pp. 1064-1101 and 1272-1344.
⁶⁹ Exhibit "YY", docket, p. 1101.
⁷⁰ Exhibit "ZZ", docket, p. 1102.
⁷¹ Exhibit "ZZ", *Ibid*.

X-----X

*ZZ]				
Accrued Interest thru Dec. 31, 2003 (US\$52.4M Loan) [Exhibit "KKK-1.b"]	519,240.33	55.50	28,817,838.32	
Interest for Jan. 1 - 23, 2004	173,080.11	55.43	9,593,172.79	
Interest paid on Jan. 23, 2004	692,320.44		38,411,011.11	
FWT rate used	10%		10%	
FWT due	69,232.04		3,841,101.11	
FWT remittance [Exhibit "ZZ"]	69,232.04	55.72900	3,858,232.58	
Forex gain (loss)			(17,131.47)	
Forex gain (loss) pertaining to Accrued Interest thru Dec. 31, 2003	51,924.03	(0.229) ⁷²	(11,890.60)	(11,890.60)
Included in the month of March 2004 per schedule [Exhibit "ZZ"]				
Accrued Interest, Dec. 10, 2003 - Feb. 29, 2004 (US\$2M Loan) [Exhibit "KKK-5.a"]	23,270.63	56.3350	1,310,950.66	
Accrued Interest March 1-10, 2004	2,872.92	55.3861	159,119.56	
Interest Paid on March 10, 2004	26,143.55		1,470,070.22	
FWT rate used	10%		10%	
FWT due	2,614.36		147,007.02	
FWT remittance [Exhibit "ZZ"]	2,614.36	56.2020	146,931.92	
Forex gain (loss) [Exhibit "ZZ"]			75.10	
Accounted for as follows:				
Jan. 1-31, 2004 [Exhibit "KKK-2.a"]	890.13	0.1330 ⁷³	118.39	
Feb. 1-29 [Exhibit "KKK-3.a"]	842.56	0.1330	112.06	
March 1-10, 2004 [Exhibit "KKK-5.a"]	287.29	(0.8159) ⁷⁴	(234.40)	
Dec. 10-31, 2003 [Exhibit "KKK-2.a"]	594.37	0.1330	79.05	79.05
	2,614.35		75.10	
Forex loss pertaining to FWT on interest expense for 2003				(11,811.55)
Forex gain pertaining to FWT on interest expense for 2004				₱ 18,115.63

Documents submitted by petitioner further show that petitioner's interest expense for taxable year 2004 amounting to ₱133,047,207.00 pertains to the remaining balance of drawdowns made on a loan facility from a foreign bank, Hollandsche Bank-Unie N.V. of Netherlands, totaling US\$54.4 million as of December 31, 2003. The first drawdown was made on January 28, 1999 and petitioner made partial payments to the foreign bank upon availability of funds. The US\$2 million loan was paid on June 20, 2004, while the US\$52.4 million loan was prepaid in full on June 30, 2004 by petitioner's parent company, EPEC Nederland Holdings B.V. of Netherlands. In effect, the latter was subrogated to the rights of the foreign bank under the loan facility agreement.⁷⁵ By virtue of subrogation⁷⁶, the *pc*

⁷² Difference between ₱55.50 and ₱55.729.

⁷³ Difference between ₱56.3350 and ₱56.202.

⁷⁴ Difference between ₱55.3861 and ₱56.202.

⁷⁵ Exhibit "UUU", Notes to Financial Statements, Nos. 6 and 7, docket, pp. 1446-1447; Exhibits "KKK-1" to "KKK-14.d", docket, pp. 1272-1344.

⁷⁶ Article 1303 of the Civil Code of the Philippines states that "**Subrogation transfers to the person subrogated the credit with all the rights thereto appertaining**, either against the debtor or against third persons, be they guarantors or possessors of mortgages, subject to stipulation in a conventional subrogation."

US\$52.4 million loan originally owed by petitioner to Hollandsche Bank-Unie N.V. of Netherland became payable to EPEC Netherland Holdings B.V. of Netherlands.

Considering that the US\$54.4 million loan was obtained by petitioner from a **non-resident foreign bank** (Hollandsche Bank-Unie N.V), and that US\$52.4 million thereof was subrogated to a **non-resident foreign corporation** (EPEC Netherland Holdings B.V), the imposable tax on the interest derived from said loan is 20% pursuant to Section 28(B)(5)(a) of the NIRC of 1997, as amended, which states:

SEC. 28. Rates of Income Tax on Foreign Corporations. –

XXX

XXX

XXX

(B) *Tax on Nonresident Foreign Corporation.* –

XXX

XXX

XXX

(5) *Tax on Certain Incomes Received by Nonresident Foreign Corporation.* –

(a) Interest on Foreign Loans. – A final withholding tax at the rate of twenty percent (20%) is hereby imposed on the amount of interest on foreign loans contracted on or after August 1, 1986.

However, paragraphs 2(a)(ii) and 2(b) of Article 11 of the Philippines-Netherlands Tax Treaty provide for the following preferential tax rates on interest:

ARTICLE 11

Interest

1. Interest arising in one of the States and paid to a resident of the other State may be taxed in that other State.

2. However, such interest may also be taxed in the State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed:

a) 10 per cent of the gross amount if such interest is paid: *je*

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- (i) in connection with the sale on credit of any industrial, commercial or scientific equipment, or
- (ii) on any loan of whatever kind granted by a bank, or any other financial institution,
- (iii) in respect of public issues of bonds, debentures or similar obligations.

b) 15 per cent of the gross amount of the interest in all other cases.

It is clear from the foregoing, prior to the subrogation of the US\$52.4 million loan to EPEC Netherland Holdings B.V., the applicable rate on the subject interest payments is the lower rate of ten percent (10%), pursuant to paragraph 2(a)(ii) of Article 11 of the Philippines-Netherlands Tax Treaty.

On the other hand, upon subrogation of the US\$52.4 million loan to EPEC Netherland Holdings B.V. on June 30, 2004, the applicable rate on the subject interest payments is fifteen percent (15%), pursuant to paragraph 2(b) of Article 11 of the Philippines-Netherlands Tax Treaty.

Therefore, the FWT due on the ₱133,047,207.00 interest expense claimed by petitioner for taxable year 2004 amounted to ₱16,318,128.04, as computed below:

EXH.	JV NO.	DATE	PARTICULARS	2004	FINAL WITHHOLDING TAX	
					RATE	AMOUNT DUE
KKK-1	010411	1/23/2004	Jan 1-23, \$52.4M loan	₱ 10,552,489.87	10%	₱ 1,055,248.99
KKK-2	010413	1/31/2004	Jan 1-31, \$2M loan	551,601.72	10%	55,160.17
KKK-2	010413	1/31/2004	Jan 24-31, \$52.4M loan	3,671,252.99	10%	367,125.30
KKK-3	020406	2/29/2004	Feb 1-29, \$2M loan	522,121.72	10%	52,212.17
KKK-3	020406	2/29/2004	Feb 1-29, \$52.4M loan	13,415,968.74	10%	1,341,596.87
KKK-4	030405	3/10/2004	Mar 1-10, \$2M loan	175,031.51	10%	17,503.15
KKK-5	030408	3/31/2004	Mar 1-31, \$52.4M loan	14,207,619.56	10%	1,420,761.96
KKK-5	030408	3/31/2004	Mar 10-31, \$2M loan	368,156.76	10%	36,815.68
KKK-6	040407	4/23/2004	Apr 1-23, \$52.4M loan	10,547,423.33	10%	1,054,742.33
KKK-7	040416	4/30/2004	Mar 31-Apr30, \$2M loan	524,823.40	10%	52,482.34
KKK-7	040416	4/30/2004	Apr 24-30, \$52.4M loan	3,248,146.39	10%	324,814.64
KKK-8	050404	5/31/2004	May 1-31, \$2M loan	534,725.73	10%	53,472.57
KKK-8	050404	5/31/2004	May 1-31, \$52.4M loan	14,285,587.66	10%	1,428,558.77
KKK-9	060402	6/10/2004	June 1-10, \$2M loan	174,111.86	10%	17,411.19
Subtotal				₱ 72,779,061.24		₱ 7,277,906.13
KKK-10	060405	6/30/2004	June 1-30, \$52.4M loan	₱ 14,254,490.72	15%	₱ 2,138,173.61

[Signature]

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KKK-11	070409	7/31/2004	Jul 1-31, \$52.4M loan	7,197,333.59	15%	1,079,600.04
KKK-12	080411	8/31/2004	Aug 1-31, \$52.4M loan	6,856,461.75	15%	1,028,469.26
KKK-13	090418	9/30/2004	Sep 1-25, \$52.4M loan	5,661,894.69	15%	849,284.20
KKK-14	090418	9/30/2004	Sep 26-30, \$52.4M loan	1,424,892.94	15%	213,733.94
	100417	10/20/2004	Add'l Accrual of on interest for Jul 1-Sep 25	1,986,302.16	15%	297,945.32
	100421	10/31/2004	Oct 1-31, \$52.4M loan	7,852,003.81	15%	1,177,800.57
	110411	11/30/2004	Nov 1-30, \$52.4M loan	7,542,540.90	15%	1,131,381.14
	120414	12/31/2004	Dec 1-25, \$52.4M loan	5,790,893.15	15%	868,633.97
	120414	12/31/2004	Dec 26-31, \$52.4M loan	1,701,332.38	15%	255,199.86
Subtotal				₱ 60,268,146.09	15%	₱ 9,040,221.91
Total				₱133,047,207.33		₱16,318,128.04

After comparing the FWT due of ₱16,318,128.04 against the FWT remittances of ₱9,880,327.64, the Court finds petitioner liable for deficiency FWT of ₱6,437,800.40 on its interest expense of ₱45,003,324.53, computed as follows:

EXHIBIT	JV NO.	DATE	FWT DUE	FWT REMITTED	FWT STILL DUE	DISALLOWED INTEREST (FWT STILL DUE DIVIDED BY APPLICABLE RATE)
KKK-1	010411	1/23/2004	₱ 1,055,248.99	₱ 959,317.26	₱ 95,931.73	
KKK-2	010413	1/31/2004	55,160.17	50,145.61	5,014.56	
KKK-2	010413	1/31/2004	367,125.30	333,750.27	33,375.03	
KKK-3	020406	2/29/2004	52,212.17	47,465.61	4,746.56	
KKK-3	020406	2/29/2004	1,341,596.87	1,219,633.52	121,963.35	
KKK-4	030405	3/10/2004	17,503.15	15,911.96	1,591.19	
KKK-5	030408	3/31/2004	1,420,761.96	1,291,601.78	129,160.18	
KKK-5	030408	3/31/2004	36,815.68	33,468.80	3,346.88	
KKK-6	040407	4/23/2004	1,054,742.33	958,856.67	95,885.66	
KKK-7	040416	4/30/2004	52,482.34	47,711.22	4,771.12	
KKK-7	040416	4/30/2004	324,814.64	295,286.04	29,528.60	
KKK-8	050404	5/31/2004	53,472.57	48,611.43	4,861.14	
KKK-8	050404	5/31/2004	1,428,558.77	1,298,689.79	129,868.98	
KKK-9	060402	6/10/2004	17,411.19	15,828.35	1,582.84	
Subtotal			₱ 7,277,906.13	₱ 6,616,278.31	₱ 661,627.82	₱ 6,616,278.20
KKK-10	060405	6/30/2004	₱ 2,138,173.61	₱ 1,295,862.79	₱ 842,310.82	
KKK-11	070409	7/31/2004	1,079,600.04	719,733.36	359,866.68	
KKK-12	080411	8/31/2004	1,028,469.26	685,646.18	342,823.08	
KKK-13	090418	9/30/2004	849,284.20	566,189.47	283,094.73	
KKK-14	090418	9/30/2004	213,733.94		213,733.94	
	100417	10/20/2004	297,945.32	14,733.16	283,212.16	
	100421	10/31/2004	1,177,800.57		1,177,800.57	
	110411	11/30/2004	1,131,381.14		1,131,381.14	
	120414	12/31/2004	868,633.97		868,633.97	
	120414	12/31/2004	255,199.86		255,199.86	

2

Subtotal	₱ 9,040,221.91	₱ 3,282,164.96	₱5,758,056.95	38,387,046.33
Total	₱16,318,128.04	₱ 9,898,443.27	₱6,419,684.77	₱45,003,324.53
Forex gain pertaining to FWT on interest expense for 2004		(18,115.63)	18,115.63	
Net Amount	₱16,318,128.04	₱9,880,327.64*	₱6,437,800.40	₱45,003,324.53

* The ₱.05 difference between the ₱9,880,327.69 FWT computed earlier and as computed above is due to rounding-off.

For failure to withhold and remit the corresponding FWT of ₱6,437,800.40, petitioner cannot claim the interest expense of ₱45,003,324.53 as deduction from its gross income for taxable year 2004, pursuant to Section 34(K) of the NIRC of 1997, as amended, which states that:

(K) *Additional Requirements for Deductibility of Certain Payments.* – Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section, Sections 58 and 81 of this Code.

e. Disallowed interest expense – ₱288,715.93

Petitioner's ITR for taxable year 2004 showed interest income subjected to final tax in the amount of ₱607,823.00.⁷⁷ Pursuant to Section 34(B) of the NIRC of 1997, as amended, respondent applied the limitation of deductibility of interest expense and disallowed the amount of ₱288,715.93, computed as follows:⁷⁸

Interest income subjected to final tax	₱ 607,823.00
Disallowed interest expense (₱607,823.00/80% x 38%)	₱288,715.93

It can be inferred from the foregoing that respondent assumed that the final tax rate on petitioner's interest income is 20%. Petitioner argued that the foregoing computation is erroneous because the applicable final tax rates on its interest income for the year 2004 are 7.5% (for US dollar accounts) and 20% (for Philippine peso accounts). Petitioner alleged that it had computed the interest expense limitation based on the amounts of interest income earned from its peso and US dollar accounts.⁷⁹ *jr*

⁷⁷ Exhibit "TTT", Section E, line 116, docket, p. 1424.

⁷⁸ Exhibit "G", docket, p. 922.

⁷⁹ Exhibit "H", docket, p. 931.

The Court agrees with petitioner.

Section 34 of the NIRC of 1997, as amended, prior to its amendment under Republic Act No. 9337, provides that the amount of interest that a taxpayer can deduct from his taxable gross income should be reduced by an amount equal to 38% of his interest income subjected to final tax, thus:

SEC. 34. *Deductions from Gross Income.* – xxx

(B) *Interest.* –

(1) *In General.* – The amount of interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business shall be allowed as deduction from gross income: *Provided, however,* That the taxpayer's otherwise allowable deduction for interest expense shall be reduced by an amount equal to the following percentages of the interest income subjected to final tax:

Forty-one percent (41%) beginning January 1, 1998;

Thirty-nine percent (39%) beginning January 1, 1999; and

Thirty-eight percent (38%) beginning January 1, 2000.
(*Emphasis supplied*)

For taxable year 2004, petitioner earned interest income in the amount of ₱607,823.34 (net of withholding tax) on its US dollar and Philippine peso savings accounts as evidenced by the various journal vouchers, entries in petitioner's Security Bank US dollar and peso savings accounts passbooks, Security Bank's Confirmations of Purchase, as well as Confirmations of Sale Without Recourse of Fixed Rate Treasury Notes (FXTN), and petitioner's Temporary Investment Advice and letters to Security Bank Corporation.⁸⁰

Under Section 27(D)(1) of the NIRC of 1997, as amended, the interest income derived by a domestic corporation from a depository bank under the expanded foreign currency deposit system is subject to a final tax at the rate of either seven and a half percent (7.5%) for US dollar accounts and twenty percent (20%) for Philippine peso accounts. Consequently, petitioner's non-deductible interest expense for taxable year 2004 amounted to ₱274,557.00, as correctly computed by petitioner, detailed as follows:

⁸⁰ Exhibits "LLL-1" to "LLL-13.c", docket, pp. 1345-1393.

EXHIBIT	DATE EARNED	AMOUNT OF INTEREST (NET OF FWT)	DIVISOR	LIMITATION RATE	NON-DEDUCTIBLE INTEREST EXPENSE
On US Dollar Accounts					
LLL-1 and LLL-1.b	3/31/2004	2,544.67	92.5% ⁸¹	38%	1,045.38
LLL-2 and LLL-2.b	6/30/2004	9,731.40	92.5%	38%	3,997.76
LLL-6 and LLL-6.a	9/20/2004	20,861.90	92.5%	38%	8,570.29
LLL-7 and LLL-7.c	9/30/2004	4,934.71	92.5%	38%	2,027.23
LLL-9 and LLL-9.a	10/19/2004	67,650.07	92.5%	38%	27,791.38
LLL-11 and LLL-11.a	11/18/2004	67,092.27	92.5%	38%	27,562.23
LLL-12 and LLL-12.a	12/20/2004	38,498.40	92.5%	38%	15,815.56
LLL-13 and LLL-13.c	12/29/2004	9,266.19	92.5%	38%	3,806.65
	Subtotal	220,579.61			90,616.49
On Peso Accounts					
LLL-1 and LLL-1.a	3/31/2004	10,391.83	80% ⁸²	38%	4,936.12
LLL-2, LLL-2.a, LLL-3.a	6/30/2004	7,696.26	80%	38%	3,655.72
LLL-3 and LLL-3.a	7/9/2004	38,666.67	80%	38%	18,366.67
LLL-3.d and LLL-4	7/19/2004	16,237.93	80%	38%	7,713.02
LLL-5 to LLL-5.c	8/19/2004	58,518.42	80%	38%	27,796.25
LLL-7 to LLL-7.b	9/30/2004	7,557.81	80%	38%	3,589.96
LLL-8 and LLL-8.a	10/8/2004	79,632.35	80%	38%	37,825.37
LLL-10 to LLL-10.d, LLL-11.a	11/10/2004	159,442.23	80%	38%	75,735.06
LLL-13 to LLL-13.b	12/29/2004	9,100.23	80%	38%	4,322.61
	Subtotal	387,243.73			183,940.77
	Total	607,823.34			274,557.26

Examination of petitioner's ITR for taxable year 2004 shows that petitioner's claimed deduction for interest expense amounted to ₱132,772,650.00⁸³, an amount lower by ₱274,557.00 when compared with the interest expense of ₱133,047,207.00⁸⁴ reflected in its audited FS for the same year. Clearly, petitioner did not claim all of its reported interest expense by applying the limitation, as provided by the NIRC of 1997, as amended. As a result, the disallowance of petitioner's interest expense in the amount of ₱288,715.93 should be cancelled.

f. Excess Tax Carried Over to
Succeeding Year -
₱22,203,593.00 *je*

⁸¹ 100% less 7.5% FWT.
⁸² 100% less 20% FWT.
⁸³ Exhibit "TTT", Section D, line 92, docket, p. 1424.
⁸⁴ Exhibit "UUU", docket, p. 1430.

Respondent disallowed petitioner's excess tax credits for taxable year 2004, but gave no explanation in the Details of Assessment/Discrepancies.⁸⁵ The Court could only surmise that the excess tax credits carried over to the succeeding year was disallowed in order to recapture the tax benefit realized by petitioner in carrying the said amount to the succeeding year.

However, it was improper for respondent to disallow the said excess tax credits because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2005. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year.

**g. Minimum Corporate Income Tax
(MCIT) – ₱4,029,039.00**

Respondent likewise disallowed petitioner's MCIT payment in the amount of ₱4,029,039.00 without further explanation.⁸⁶ Considering that the MCIT will be credited against the normal income tax for the three (3) immediately succeeding taxable years, pursuant to Section 27(E)(2) of the NIRC of 1997, as amended, its benefit will redound on the succeeding years. Thus, it is inappropriate to disallow the same for such is beyond the scope of the present assessment.

In fine, notwithstanding the ₱45,008,325.99 adjustments on petitioner's taxable income, representing the sum of petitioner's unaccounted income in the amount of ₱5,001.46 and disallowed interest expense in the amount of ₱45,003,324.53, petitioner still incurred a net loss in the amount of ₱390,088,424.04. Thus, petitioner's income tax liability was at the MCIT rate of two percent (2%) based on its gross income for taxable year 2004. However, petitioner's MCIT liability of ₱4,029,039.00 per its 2004 ITR shall be adjusted to ₱4,029,139.21 to reflect the unaccounted income of ₱5,001.46. Since petitioner's income tax credits were more than sufficient to cover its MCIT liability of ₱4,029,139.21, petitioner is not liable to pay any deficiency MCIT for taxable year 2004, as shown below:

Sales/Revenues/Receipts/Fees		₱ 106,529,147.00
Less: Cost of Sales/Services		9,205,500.00
Gross Income from Operation		₱ 97,323,647.00
Add: Non-operating and Other Income		104,128,312.00
Total Gross Income		₱ 201,451,959.00
Add: Unaccounted income		5,001.46
Adjusted Total Gross Income		₱ 201,456,960.46
Less: Deductions	₱636,548,709.00	

⁸⁵ Exhibit "G", docket, pp. 922-923.

⁸⁶ Exhibit "G", *Ibid*.

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Less: Disallowed Interest Expense	45,003,324.53	591,545,384.47
Adjusted Net Loss		₱(390,088,424.01)
Minimum Corporate Income Tax Due		₱ 4,029,139.21
Less: Tax Credits		
Prior Year's Excess Credits	₱ 10,715,585.00	
Creditable Tax Withheld for the First Three Quarters	11,286,147.00	
Creditable Tax Withheld for the Fourth Quarter	4,230,900.00	26,232,632.00
Excess Tax Credits		₱(22,203,492.79)

II. Deficiency VAT – ₱13,089,608.45

Respondent computed the deficiency VAT assessment in the amount of ₱13,089,608.45 by adding adjustments to petitioner's taxable receipts per VAT returns for the year 2004, consisting of (a) unaccounted income amounting to ₱48,641,323.00, and (b) gross receipts not subjected to VAT amounting to ₱32,584,572.81, as shown below:

Taxable receipts per return		₱ 72,705,617.83
Add: Adjustments/discrepancies per investigation:		
Unaccounted income	₱48,641,323.00	
Gross receipts not subjected to VAT	32,584,572.81	81,225,895.81
Taxable receipts per investigation		₱ 153,931,513.64
Value-added tax due thereon		₱ 15,393,151.36
Less: Allowable input tax/payments		
Payments	₱6,194,285.89	
Input tax during the year	1,076,276.07	7,270,561.96
Deficiency value-added tax		₱ 8,122,589.40
Add: 20% interest p.a. from 01.25.05 to 2.15.08		4,967,019.05
TOTAL AMOUNT DUE		₱13,089,608.45

The Court shall determine the propriety of each of the said adjustments.

a. Unaccounted income – ₱48,641,323.00

This assessment was based on the same finding under the deficiency income tax assessment (see discussion in item I.a) that the discrepancy between petitioner's receipts as reflected in its FS/ITR and as computed by respondent based on the creditable income taxes withheld from petitioner constitutes petitioner's unaccounted income in the amount of ₱48,641,323.00. *fr*

As stated earlier, petitioner was able to account for and substantiate the alleged unaccounted income of ₱48,641,323.00, except for the amount of ₱5,001.46. Therefore, petitioner shall be liable to pay deficiency VAT only on the unaccounted discrepancy of ₱5,001.46.

**b. Gross receipts not subjected to VAT
– ₱32,584,572.81**

Respondent's verification allegedly disclosed that petitioner's gross receipts amounting to ₱32,584,572.81, as computed below, was not subjected to VAT, hence, assessed pursuant to Section 108 of the NIRC of 1997, as amended:⁸⁷

Revenues per F/S	₱ 106,529,147.00
Add: A/R-related parties, beg. (net of VAT)	6,068,470.00
Total	₱ 112,597,617.00
Less: A/R-related parties, end (net of VAT)	(7,307,426.36)
Gross receipts per F/S	₱ 105,290,190.64
Less: Gross receipts per VAT returns	72,705,617.83
Gross Receipts not subjected to VAT	₱32,584,572.81

Petitioner's audited financial statements reflected that petitioner's Accounts Receivable-Related Parties beginning and ending balances amounted to ₱6,675,317.00 and ₱8,038,169.00, respectively. The amounts used in the computations are net of the VAT portion, as shown below:

	GROSS	VAT	NET
Accounts receivable-related parties, beg.	₱ 6,675,317.00	₱ 606,847.00	₱ 6,068,470.00
Accounts receivable-related parties, end.	8,038,169.00	730,742.64	7,307,426.36
Increase in accounts receivable	(₱1,362,852.00)	(₱123,895.64)	(₱1,238,956.36)

Petitioner explained that the ₱32,584,572.81 discrepancy comprised of the management fees paid by East Asia Utilities Corporation (EAUC) in the amount of ₱33,823,529.41⁸⁸ less the foregoing net increase in receivables of ₱1,238,956.36. It is represented that EAUC is a Philippine Economic Zone Authority (PEZA)-registered entity, and as such, it enjoys certain tax exemptions, including VAT. Hence, sales to it are effectively zero-rated, pursuant to Section 108(B) of the NIRC of 1997, as amended.

After examination of EAUC's Certificate of Registration with the PEZA⁸⁹ and its accompanying PEZA Board Resolution,⁹⁰ the Court finds that the same are not 

⁸⁷ Exhibit "G", docket, p. 923.

⁸⁸ Exhibits "NNN-7" and "NNN-8", docket, pp. 1408 and 1409, respectively.

⁸⁹ Exhibit "BBB", docket, p. 1105.

sufficient to prove that EAUC was PEZA-registered in taxable year 2004. Since the registration is subject to the provisions and rules and regulations of Republic Act No. 7916, as well as the terms and conditions of the Registration Agreement, the PEZA registration may be revoked if an entity is in violation of any of the afore-mentioned requirements. It is imperative therefore that petitioner must prove that EAUC is registered with PEZA in the year 2004, when the subject management fees were billed to and collected from EAUC, to justify the imposition of VAT at zero percent (0%). Absent the required PEZA certification, the Court is constrained to uphold the deficiency VAT assessment.

In sum, petitioner is liable to pay basic deficiency VAT for taxable year 2004 in the amount of ₱3,258,957.25, computed as follows:

Taxable receipts per return		₱ 72,705,617.83
Add: Adjustments/discrepancies per investigation		
Unaccounted income	₱ 5,001.46	
Gross receipts not subjected to VAT	32,584,572.81	32,589,574.27
Taxable receipts per investigation		₱105,295,192.10
Value-added tax due thereon		₱ 10,529,519.21
Less: Allowable input tax/payments		
Payments	₱6,194,285.89	
Input tax during the year	1,076,276.07	7,270,561.96
Deficiency value-added tax		₱ 3,258,957.25

III. DEFICIENCY EWT – ₱186,395.72

Upon investigation, it was found by respondent that petitioner failed to withhold and remit the EWT on professional fees paid. Thus, pursuant to Revenue Regulations No. 2-98, respondent assessed petitioner for deficiency EWT in the amount of ₱186,695.72, inclusive of interest, computed as follows:⁹¹

Professional fees per FS/ITR	₱1,209,982.00
Professional fees per AL/1601-E	55,000.00
Professional fees not subjected to EWT	₱1,154,982.00
EWT rate	10%
EWT due thereon	₱ 115,498.20
Add: 20% interest p.a. from 01.16.05 to 2.15.08	71,197.52
TOTAL AMOUNT DUE	₱ 186,695.72

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⁹⁰ Exhibit "CCC", docket, p. 1106.
⁹¹ Exhibit "G", docket, pp. 920 and 923.

As discussed and determined earlier (see discussion under deficiency income tax assessment, item I.c), the subject income payments amounting to ₱1,154,982.00 were made to general professional partnerships, which are exempt from income tax, pursuant to Section 26 in relation to Section 22(B) of the NIRC of 1997, as amended, and consequently, to withholding tax, as provided for under Section 2.57.5 of RR No. 2-98, as amended by RR No. 14-02. Therefore, respondent's deficiency EWT assessment on the said income payments shall be cancelled.

IV. DEFICIENCY FWT – ₱1,607,754.27

Respondent assessed petitioner for deficiency FWT in the amount of ₱1,607,754.24, inclusive of interest, computed as follows:

Interest expense not subjected to final withholding tax	₱ 4,973,138.20
Final withholding tax rate	20%
Final withholding tax on interest expense due thereon	₱ 994,627.64
Add: 20% Interest p.a. from 01.16.05 to 02.15.08	613,126.63
TOTAL AMOUNT DUE	₱1,607,754.27

As discussed earlier (see discussion under the deficiency income tax assessment, item I.d), petitioner failed to withhold and remit the FWT due of ₱6,437,800.40 on its interest expense of ₱45,003,324.53 for taxable year 2004. Consequently, petitioner is liable to pay basic deficiency FWT in the amount of ₱6,437,800.40 for taxable year 2004.

**V. DEFICIENCY IMPROPERLY
ACCUMULATED EARNINGS TAX –
₱35,153,053.99**

Respondent noted that petitioner failed to subject its earnings in excess of 100% of its capital stock to improperly accumulated earnings tax, hence, assessed pursuant to RR No. 02-99.⁹²

A reading of the afore-mentioned RR No. 02-99 reveals that it establishes the policies and procedures for the availment of immunity from audit and investigation of income tax, VAT and percentage tax filed under the Economic Recovery Assistance Payment (ERAP) Program.

Nevertheless, Section 29(C) of the NIRC of 1997, as amended, provides: *ju*

⁹² Exhibit "G", docket, p. 923.

SEC. 29. *Imposition of Improperly Accumulated Earnings Tax.*

—

(A) *In General.* — In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof, an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.

(B) *Tax on Corporations Subject to Improperly Accumulated Earnings Tax.* —

(1) *In General.* — The improperly accumulated earnings tax imposed in the preceding Section shall apply to every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(2) *Exceptions.* — The improperly accumulated earnings tax as provided for under this Section shall not apply to:

- (a) Publicly-held corporations;
- (b) Banks and other nonbank financial intermediaries; and
- (c) Insurance companies.

(C) *Evidence of Purpose to Avoid Income Tax.* —

(1) *Prima Facie Evidence.* — The fact that any corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members.

(2) *Evidence Determinative of Purpose.* — The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by the clear preponderance of evidence, shall prove to the contrary.

(D) *Improperly Accumulated Taxable Income.* — For purposes of this Section, the term 'improperly accumulated taxable income' means taxable income' adjusted by: 

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- (1) Income exempt from tax;
- (2) Income excluded from gross income;
- (3) Income subject to final tax; and
- (4) The amount of net operating loss carry-over deducted;

And reduced by the sum of:

- (1) Dividends actually or constructively paid; and
- (2) Income tax paid for the taxable year.

Provided, however, That for corporations using the calendar year basis, the accumulated earnings tax shall not apply on improperly accumulated income as of December 31, 1997. In the case of corporations adopting the fiscal year accounting period, the improperly accumulated income not subject to this tax, shall be reckoned, as of the end of the month comprising the twelve (12)-month period of fiscal year 1997-1998.

(E) *Reasonable Needs of the Business.* – For purposes of this Section, the term '*reasonable needs of the business*' includes the reasonably anticipated needs of the business.

The foregoing is implemented by RR No. 02-01, Sections 5 and 7 thereof provide:

SECTION 5. *Tax Base of Improperly Accumulated Earnings Tax.* – For corporations found subject to the tax, the "*Improperly Accumulated Taxable Income*" for a particular year is first determined by adding to that year's taxable income the following:

- (a) income exempt from tax;
- (b) income excluded from gross income;
- (c) income subject to final tax; and
- (d) the amount of net operating loss carry-over (NOLCO) deducted.

The taxable income as thus determined shall be reduced by the sum of:

- (a) income tax paid/payable for the taxable year;
- (b) dividends actually or constructively paid/issued from the applicable year's taxable income; *je*

X-----X

- (c) amount reserved for the reasonable needs of the business as defined in these Regulations emanating from the covered year's taxable income.

The resulting "*Improperly Accumulated Taxable Income*" is thereby multiplied by 10% to get the Improperly Accumulated Earnings Tax (IAET).

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SECTION 7. *Determination of Purpose to Avoid Income Tax.* – The fact that a corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. Likewise, the fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members. In both instances, the corporation may, by clear preponderance of evidence in its favor, prove the contrary.

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The following are *prima facie* instances of accumulation of profits beyond the reasonable needs of a business and indicative of purpose to avoid income tax upon shareholders:

- (a) Investment of substantial earnings and profits of the corporation in unrelated business or in stock or securities of unrelated business;
- (b) Investment in bonds and other long-term securities;
- (c) Accumulation of earnings in excess of 100% of paid-up capital, not otherwise intended for the reasonable needs of the business as defined in these Regulations.

Per VAT Returns⁹³ and Income Tax Returns⁹⁴ submitted, petitioner is a holding company. Pursuant to the provisions quoted above, it is *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. However, there should likewise be additional evidence to determine such purpose, as the instances enumerated in Section 7 of RR No. 02-01. 

⁹³ Exhibits "JJJ-1" to "JJJ-12", docket, pp. 1233-1271.

⁹⁴ Exhibits "QQQ" to "TTT", docket, pp. 1415-1425.

Petitioner was assessed of improperly accumulated earnings tax in the total amount of ₱21,060,098.00, computed thus:

Taxable income		(₱435,096,750.00)
Add: Interest income subject to final tax	₱ 607,823.00	
Equity in net earnings of subsidiary	171,352,773.00	
Losses	485,906,173.00	657,866,769.00
Balance		₱ 222,770,019.00
Less: Income tax payable		4,029,039.00
Balance		₱ 218,740,980.00
Less: Capital stock		8,140,000.00
Improperly accumulated earnings		₱ 210,600,980.00
Improperly accumulated earnings rate		10%
Improperly accumulated earnings tax		₱ 21,060,098.00

As correctly pointed out by petitioner, it cannot possibly have any improperly accumulated earnings, because it has a deficit of ₱3,707,998,535.00;⁹⁵ thus, no earnings to speak of, much more accumulation thereof.⁹⁶ Petitioner's Statements of Changes in Stockholders' Equity (Capital Deficiency) show that it has sustained a capital deficiency from the year 2002 until 2004.⁹⁷ Therefore, respondent's assessment against petitioner for deficiency improperly accumulated earnings tax of ₱35,153,053.99 is devoid of factual basis and should be cancelled.

VI. COMPROMISE PENALTY – ₱25,000.00

For alleged non/late/filing/payment of improperly accumulated earnings tax, respondent imposed compromise penalty against petitioner for taxable year 2004 in the amount of ₱25,000.00.

Pursuant to RMO No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Thus, compromise penalty implies mutual agreement between the taxpayer, on one hand, and the BIR, on the other. Absent any showing that petitioner consented to the compromise penalties, the same should not be imposed. Accordingly, respondent's imposition of compromise penalties, without the consent of petitioner, cannot be sustained.

WHEREFORE, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessments issued by respondent 

⁹⁵ Exhibit "DDD", docket, p. 1107.
⁹⁶ Memorandum for Petitioner, docket, p. 1672.
⁹⁷ Exhibit "UUU", docket, p. 1431.

against petitioner for taxable year 2004 covering deficiency income tax in the amount of ₱28,134,150.84, deficiency expanded withholding tax in the amount of ₱186,395.72, deficiency improperly accumulated earnings tax in the amount of ₱35,153,053.99 and compromise penalty in the amount of ₱25,000.00 are hereby **CANCELLED** and **WITHDRAWN**. However, respondent's assessments covering deficiency value-added tax and final withholding tax for taxable year 2004 are hereby **AFFIRMED**, and petitioner is held liable to pay the modified amount of ₱12,120,947.06, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, computed as follows:

	BASIC TAX	SURCHARGE	TOTAL
Value-added Tax	₱ 3,258,957.25	₱ 814,739.31	₱ 4,073,696.56
Final Withholding Tax	6,437,800.40	1,609,450.10	8,047,250.50
Total	₱9,696,757.65	₱2,424,189.41	₱12,120,947.06

In addition, petitioner is held liable to pay:

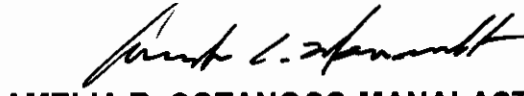
- (a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT in the amount of ₱3,258,957.25 and basic FWT in the amount of ₱6,437,800.40 computed from January 25, 2005 and January 15, 2005, respectively, until full payment thereof, pursuant to Section 249(B) of the NIRC of 1997, as amended; and
- (b) Delinquency interest at the rate of 20% per annum on the total amount of ₱12,120,947.06 and on the deficiency interest which have accrued as afore-stated in (a) computed from December 2, 2009⁹⁸ until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.


JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:


CAESAR A. CASANOVA
Associate Justice


AMELIA R. COTANGCO-MANALASTAS
Associate Justice

⁹⁸ Exhibit "K", docket, p. 938; Par. 12, Stipulated Facts, JSFI, docket, p. 479.

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.


JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

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


ROMAN G. DEL ROSARIO
Presiding Justice