

REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

FIRST DIVISION

**PHILIPPINE AEROSPACE
DEVELOPMENT CORPORATION,**
Petitioner,

- versus -

**COMMISSIONER OF INTERNAL
REVENUE,**
Respondent.

CTA CASE NO. 7830
Members:

Acosta, Chairperson
Uy, and
Fabon-Victorino, JJ.

Promulgated:

DEC 11 2012 ; 2:40 p.m.

X ----- X

D E C I S I O N

UY, J.:

The instant Petition for Review was filed on September 8, 2008 by petitioner, Philippine Aerospace Development Corporation, seeking for the cancellation of all deficiency tax assessments stated in the Final Decision on Disputed Assessment issued by respondent against it, finding petitioner liable for deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT), and withholding tax on compensation for taxable year 2003 in the total amount of ₱55,982,426.19.

THE FACTS

Culled from the records of this case, the factual antecedents are as follows:

Petitioner Philippine Aerospace Development Corporation is a government owned and controlled corporation (GOCC) created and existing under the laws of the Philippines, specifically, Presidential Decree No. 286, as amended. Its principal business address is at 7th Floor, Fujitsu House, Arnaiz Avenue, Makati City, Metro Manila.¹

Respondent, on the other hand, is the Commissioner of Internal Revenue (CIR) and is empowered to perform the duties of her office, including, among others, the power to decide, cancel and abate tax liabilities pursuant to Section 204(B) of the National Internal Revenue Code (NIRC) of 1997, as amended.²

On March 1, 2005, respondent, through Bureau of Internal Revenue (BIR) Revenue Region No. 8, issued Letter of Authority No. 45299, authorizing revenue officers of Revenue District Office (RDO) No. 51, Pasay City, to examine the books of account and other accounting records of petitioner for all its internal revenue taxes for the period covering January 2003 to December 2003.³

On December 27, 2006, petitioner received a Preliminary Assessment Notice (PAN) dated December 22, 2006 for taxable year 2003, assessing petitioner for the following deficiency taxes:⁴



¹ Par. 1, Joint Stipulation of Facts (JSF), Docket, p. 196.

² Par. 2, JSF, Docket, pp. 196-197.

³ Par. 3, JSF, Docket, p. 197.

⁴ Par. 4, JSF, Docket, p. 197, Exhibit "C".

TAX	AMOUNT
Income Tax	₱26,923,253.31
Value-added Tax	₱13,806,086.05

On January 12, 2007, petitioner received a Formal Assessment Notice (FAN) dated January 12, 2007, assessing petitioner for deficiency income tax and VAT for taxable year 2003, detailed as follows:⁵

TAX	AMOUNT
Income Tax	₱27,206,784.07
Value-added Tax	₱13,948,613.42

On February 16, 2007, petitioner filed its protest to the Formal Assessment Notice through a letter dated February 15, 2007. In said protest letter, petitioner stated its bases for contesting the various assessments enumerated in the FAN dated January 12, 2007.⁶

On March 15, 2007, petitioner filed another letter dated March 14, 2007 as a supplement to its protest; submitting supporting documents and expounding on the grounds mentioned in its protest.⁷

On September 11, 2007, petitioner received a letter dated September 5, 2007 from the Regional Director of BIR Revenue Region No. 8, denying petitioner's protest.⁸ Consequently, petitioner sent a letter dated October 10,

⁵ Par. 5, JSF, Docket, p. 197, Exhibit "D".

⁶ Par. 6, JSF, Docket, p. 197, Exhibit "E".

⁷ Par. 7, JSF, Docket, p. 198, Exhibit "F".

⁸ Par. 8, JSF, Docket, p. 198, Exhibit "G".



2007, and moved for the reconsideration of the BIR's decision contained in the letter dated September 5, 2007.⁹

In a letter dated November 5, 2007, BIR Revenue Region No. 8 stated that the docket of the case would be forwarded to Revenue District Office No. 51, Pasay City, for further verification, evaluation and appropriate action.¹⁰

On August 8, 2008, petitioner received a Final Decision on Disputed Assessment (FDDA) dated August 1, 2008, denying its protest on the ground that petitioner failed to submit supporting documents to substantiate its protest. BIR Revenue Region No. 8 assessed petitioner of the following deficiency taxes:¹¹

TAX	AMOUNT
Income Tax	₱ 32,650,996.77
Value-added Tax	16,661,370.88
Expanded Withholding Tax	728,503.90
Withholding Tax on Compensation	5,941,554.64
TOTAL	₱55,982,426.19

Hence, on September 8, 2008, petitioner timely filed the instant Petition for Review before this Court assailing the FDDA issued by respondent on August 1, 2008.



⁹ Par. 9, JSF, Docket, p. 198, Exhibit "H".

¹⁰ Par. 10, JSF, Docket, p. 198, Exhibit "I".

¹¹ Par. 11, JSF, Docket, p. 198; Exhibit "J".

On December 24, 2008, respondent filed her Answer¹² praying for the dismissal of the Petition for Review for lack of merit, and interposed the following Special and Affirmative Defenses:

"3. He reiterates and re-pleads the preceding paragraphs of this answer as part of his Special and Affirmative Defenses;

4. Deficiency income tax was assessed on the ground that there were purchases made during the year which were not supported by official receipts and invoices or other adequate records hence disallowed pursuant to Section 34 (A)(1)(b) of the National Internal Revenue Code (NIRC), as amended; the Requisition/Delivery Issue Slips (RDIS) were not billed as of December 31, 2003 despite the items were already delivered and the corresponding revenue already earned during the taxable year thus subjected to the 32% income tax rate pursuant to Section 27 of the NIRC; significant amount of expenses made, whose sources were not clearly accounted in petitioner's Financial Statements, hence, considered undeclared income pursuant to Section 32 of the NIRC; expenses were not subjected to withholding, hence, disallowed pursuant to Section 34 (K) in relation to Sections 57 and 58, all of the NIRC; net operating loss incurred in the subsequent year was carried over to the taxable year which should have been taken into consideration in computing the correct income tax liability for the current year; disallowance of the minimum corporate income tax; tax credit to be carried over to succeeding year disallowed in the current year considering that the tax benefits of the said amount were already forwarded to succeeding periods.

5. Deficiency value-added tax was assessed due to revenue not subjected to VAT, transactions deemed sales, properties disposed not yet dropped from the books, undeclared income from understated accounts receivable and undeclared income from unaccounted expenses were all not subjected to VAT, as well as, the input tax, input tax carried over from

¹² Docket, pp. 62-65.

previous period and creditable VAT withheld, were all unsupported.

6. Deficiency expanded withholding tax was assessed due to petitioner's failure to pay the expanded withholding tax on certain income payments.

7. Deficiency withholding tax on compensation was assessed due to certain salaries and wages that were not subjected to withholding tax.

8. Assessments are presumed correct and official functions are regularly done.

9. The burden of proving that the assessments are not correct rests on the petitioner."

Upon the filing of the parties' Joint Stipulation of Facts (JSF) on August 26, 2010¹³, the Court, in the Resolution dated September 14, 2010¹⁴, approved the same, and ordered the parties to proceed with the trial on the merits presenting only evidence not covered by the said JSF.

Petitioner presented its sole witness, Nancy C. Pagharion, in her capacity as Officer-In-Charge, Controller, of petitioner. Thereafter, petitioner's formally offered exhibits were admitted in a Resolution dated September 12, 2011¹⁵.



¹³ Docket, pp. 196-203.

¹⁴ Docket, p. 205.

¹⁵ Docket, pp. 518-519.

On her part, respondent manifested in open court during the hearing dated January 31, 2012 that she will no longer present any witnesses. Hence, the parties were directed to file their respective Memorandum.¹⁶

Petitioner filed its Memorandum on April 2, 2012. Thereafter, this case was submitted for decision on April 13, 2012¹⁷, for failure of respondent to file memorandum within the given period despite notice, as per Records Verification dated April 3, 2012.¹⁸

Hence, this Decision.

THE ISSUE

Based on the pleadings submitted by both parties, the sole issue presented before this Court is whether or not the deficiency tax assessments contained in the Final Decision on Disputed Assessment dated August 1, 2008 issued by respondent against petitioner have factual and legal bases.

THIS COURT'S RULING

The Court finds the instant petition partly meritorious.

Petitioner maintains that there is no basis for respondent's deficiency tax assessments. On the other hand, respondent asserts that petitioner is liable to pay deficiency income tax, value-added tax, expanded withholding tax, and withholding tax on compensation. Thus, this Court will determine the

¹⁶ Resolution dated January 31, 2012, Docket, p. 526.

¹⁷ Resolution dated April 13, 2012, Docket, p. 556.

¹⁸ Docket, p. 553.



legality of the alleged tax liability of petitioner, based on the parties' respective arguments, and addressing the items of the subject assessments *in seriatim*.

I. DEFICIENCY INCOME TAX

Respondent's examiner computed the deficiency income tax assessment for taxable year 2003 in the amount of ₱32,650,996.77 as follows:¹⁹

Net Income/(Loss) per ITR:			₱ (4,555,067.00)
Add: Adjustments/Disallowances			
Unsupported Purchases (Schedule 1)		₱ 18,493,926.37	
Undeclared Income from Understated Accounts Receivable (Schedule 2)		1,093,100.00	
Undeclared Income from Unaccounted Expenses (Schedule 3)		2,174,850.75	
Disallowed Expenses due to Non-Withholding (Schedule 4)		32,590,929.64	54,352,806.76
Taxable Income per Investigation			₱ 49,797,739.76
Add: Net Operating Loss Carry-Over (NOLCO)			4,555,067.00
Adjusted Taxable Income due per Investigation			₱ 54,352,806.76
Income Tax Due Thereon (32%)			₱ 17,392,898.16
Less: Payments per Return			
Prior Year's Excess Credit		₱ 779,126.51	
Tax Payments for the First Three Quarters		323,268.15	
Creditable Withholding Tax		391,779.63	
Total		₱ 1,494,174.29	
Less: Minimum Corporate Income Tax	₱ 453,178.88		
Unsupported Tax Payments for the 1st 3Qtrs	323,268.15		
Amount Carried Over to Succeeding Year	717,727.26	1,494,174.29	-
Deficiency Tax Due			₱ 17,392,898.16
Add: 20% Interest (4.16.04 to 09.03.08)			15,258,098.61
Total Amount Due			₱32,650,996.77

The determination as to whether or not the 2003 deficiency income tax assessment of ₱32,650,996.77 is correct basically hinges on the propriety of the income imputed as well as the expense deductions and tax credits disallowed by respondent, namely:

¹⁹ Exhibit "J", Docket, p. 289.

1.	Unsupported Purchases	₱ 18,493,926.37
2.	Undeclared Income from Understated Accounts Receivable	1,093,100.00
3.	Undeclared Income from Unaccounted Expenses	2,174,850.75
4.	Disallowed Expenses due to Non-Withholding	32,590,929.64
5.	Net Operating Loss Carry-Over (NOLCO)	4,555,067.00
6.	Minimum Corporate Income Tax	453,178.88
7.	Unsupported Tax Payments for the first three quarters	323,268.15
8.	Amount Carried Over to Succeeding Year	717,727.26

The above-enumerated items shall be discussed one by one.

1. Unsupported purchases

It is undisputed that respondent assessed petitioner for deficiency income tax on unsupported purchases due to the finding that there was a discrepancy in the value of purchases declared in petitioner's VAT Return compared to that in petitioner's Audited Financial Statements for 2003. As such, respondent concluded that there are purchases not supported by official receipts and invoices.²⁰

Respondent's examiner found a discrepancy in petitioner's purchases per VAT Returns and per Financial Statements amounting to ₱18,493,926.37 and disallowed the same for being unsupported by official receipts and invoices or other adequate records pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended, which provides:

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

²⁰ Par. 13, JSF, Docket, p. 199.



(A) *Expenses.* –

(1) *Ordinary and Necessary Trade, Business or Professional Expenses.* –

(a) *In General.* – xxx

xxx

xxx

xxx

(b) ***Substantiation Requirements.*** – **No deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records:** (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer." (*Emphasis supplied*)

Below is the computation of the alleged ₱18,493,926.37 unsupported purchases:²¹

Purchases per Value Added Tax Return		₱ 20,344,198.63
Less: Accounts per Financial Statement subject to Withholding Taxes:		
Repairs and Maintenance	₱ 3,260,294.00	
Rent Expenses – Land	1,637,728.00	
Security/Janitorial Services	1,184,175.00	
Telephone, Postage, Telegrams	630,080.00	
Advertising/Promotions	610,392.00	
Office Supplies	261,812.00	
Representation and Entertainment	45,319.00	
Medical Supplies	10,766.00	7,640,566.00
Difference - Purchases of Service Parts		₱ 12,703,632.63
Less: Purchases of Service Parts:		
Service Parts Used	₱ 40,328,811.00	
Add: Inventory, Ending	87,389,889.00	
Total	127,718,700.00	
Less: Inventory, Beginning	96,521,141.00	31,197,559.00
Unsupported Purchases		₱(18,493,926.37)

²¹ Exhibit "J", Docket, p. 291.

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On the other hand, petitioner argues that respondent's examiner failed to consider its purchases which are substantiated by receipts but are not subject to VAT and consequently not included in the VAT Returns.²² In support thereof, petitioner submitted documents to prove its purchase from Rolls-Royce Engine Services Limitada, Inc. (Rolls-Royce), which is registered as a Clark Special Economic Zone (CSEZ) Enterprise and enjoys exemption from all local and national taxes, including VAT.²³

Further, petitioner alleges that the huge difference between the beginning and ending inventory resulted not from its purchases but from inventories turned-over by its subsidiaries that have already closed down. Petitioner explains that after its creation in 1973, it established several subsidiaries, namely, National Aero Manufacturing, Inc.; Phil. Aero Systems, Inc.; Rotorcraft, Inc.; and Phil. Helicopter Services, Inc., with each maintaining its own books of accounts. However, when these subsidiaries eventually closed down, their inventory of spare parts were turned-over to petitioner's warehouse and thus, formed part of petitioner's annual ending inventory.²⁴ Petitioner clarifies that the inventories from its subsidiaries, although included in its year-end inventory, should not be considered as unsupported purchases for the reason that they are not purchases at all.



²² Exhibit "A", par. 14, Docket, p. 256.

²³ Exhibits "K", "K-1", "K-2", "K-3", and "K-4", Docket, pp. 294-302.

²⁴ Exhibit "E", Docket, pp. 268-270.

This Court finds petitioner's arguments unmeritorious.

Perusal of the records reveals that the purchase from Rolls-Royce amounting to ₱27,030,000.00 does not tally with the discrepancy found by respondent's examiner in the amount of ₱18,493,926.37. Further, petitioner failed to substantiate the amount of inventories allegedly turned-over by its former subsidiaries.

Thus, considering petitioner's failure to reconcile the discrepancy of ₱18,493,926.37, respondent's disallowance of the said amount shall be upheld in line with the principle that tax assessments by tax examiners are presumed correct and made in good faith, and all presumptions are in favor of the correctness of a tax assessment unless proven otherwise.²⁵ Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.²⁶

2. Undeclared Income from Accounts Receivable

Respondent based its assessment of undeclared income from Accounts Receivable on the finding that there were Requisition and Delivery Issue Slips (RDIS) which were issued in 2003, but not billed as of December 31, 2003. Respondent considered such items as delivered and the income from said sale deemed as having been earned by year-end 2003. Hence, the Accounts

²⁵ *Commissioner of Internal Revenue vs. Hon. Raul M. Gonzales, et al.*, G.R. No. 177279, October 13, 2010.

²⁶ *Marcos II vs. Court of Appeals, et al.*, G.R. No. 120880, June 5, 1997.



Receivable of ₱1,093,100.00, net of VAT, as computed below, was subjected to a thirty-two percent (32%) tax rate pursuant to Section 27 in relation to Section 32 of the NIRC of 1997, as amended:²⁷

Total Amount per Summary of Unbilled Requisition Delivery Issue Slips	₱ 1,202,410.00
Less: Output Tax	109,310.00
Accounts Receivable	₱1,093,100.00

Petitioner argues that it recognizes sales only when sales invoices are issued despite delivery of the items. This is due to its alleged peculiar arrangement with its clients, such as the different branches of the military and police. Moreover, military and police regulations require payment only when all work orders have been completed. Thus, deliveries in the year 2003 were not paid until 2004 and thereafter.²⁸

The Court agrees with respondent.

In its letter ²⁹ to the BIR dated October 10, 2007, requesting reconsideration of respondent's decision on the subject assessments, petitioner stated that it recognizes its income at the exact instance it is earned and reports the same to the concerned government agencies, like the Commission on Audit, the Department of Transportation, and the BIR. Likewise, petitioner declared that there were Consultants' fees which were supposed to be paid to the Office of the Government Corporate Counsel for

²⁷ Par. 14, JSF, Docket, p. 199.

²⁸ Exhibit "A", par. 18, Docket, p. 256.

²⁹ Exhibit "H", under Income Tax, item no. 3, par. 2, Docket, p. 282.

legal services rendered to petitioner, which were not yet paid in 2003 but taken-up in petitioner's books on accrual basis.³⁰

The foregoing arguments of petitioner reveal that it adopts the accrual method in reporting its income and expenses for income tax purposes. The employment of such accounting method, or any method for that matter, as long as it clearly reflects income, is recognized in Section 43 of the NIRC of 1997, as amended, which provides:

"SEC. 43. *General Rule.* - The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) **in accordance with the method of accounting regularly employed in keeping the books of such taxpayer**, but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. If the taxpayer's annual accounting period is other than a fiscal year, as defined in Section 22(Q), or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the taxable income shall be computed on the basis of the calendar year." (*Emphasis supplied*)

Under the accrual method, income is recognized in the period it is earned regardless of whether it has been received or not. In the same manner, expenses are accounted for in the period they are incurred and not in the period they are paid.

For purposes of determining when an income or expense is to be accrued, the taxpayer must apply the all-events test which requires: (1) fixing

³⁰ Exhibit "H", under Income Tax, item no. 4, par. 3, Docket, p. 283.

of a right to income or liability to pay; and (2) the availability of the reasonable accurate determination of such income or liability, as held by the Supreme Court in the case of ***Commissioner of Internal Revenue vs. Isabela Cultural Corporation***³¹, viz:

"The accrual method relies upon the taxpayer's right to receive amounts or its obligation to pay them, in opposition to actual receipt or payment, which characterizes the cash method of accounting. Amounts of income accrue where the right to receive them become fixed, where there is created an enforceable liability. Similarly, liabilities are accrued when fixed and determinable in amount, without regard to indeterminacy merely of time of payment.

For a taxpayer using the accrual method, the determinative question is, when do the facts present themselves in such a manner that the taxpayer must recognize income or expense? **The accrual of income and expense is permitted when the all-events test has been met. This test requires: (1) fixing of a right to income or liability to pay; and (2) the availability of the reasonable accurate determination of such income or liability.** (Emphasis supplied)

In the case of ***Filipinas Synthetic Fiber Corporation vs. Court of Appeals, Court of Tax Appeals and Commissioner of Internal Revenue***³², the Highest Tribunal emphasized that in accrual method of accounting, it is the right to receive income and not the actual receipt that determines when to include the amount in gross income, to wit:

"On the other hand, 'under the accrual basis method of accounting, income is reportable when all the events have

³¹ G.R. No. 172231, February 12, 2007.

³² G.R. Nos. 118498 and 124377, October 12, 1999.

occurred that fix the taxpayer's right to receive the income, and the amount can be determined with reasonable accuracy. Thus, *it is the right to receive income, and not the actual receipt, that determines when to include the amount in gross income.* Gleanable from this notion are the following requisites of accrual method of accounting, to wit: '(1) that the right to receive the amount must be valid, unconditional and enforceable, *i.e.*, not contingent upon future time; (2) the amount must be reasonably susceptible of accurate estimate; and (3) there must be a reasonable expectation that the amount will be paid in due course." (*Emphasis supplied*)

Applying the foregoing pronouncements to the instant case, the Accounts Receivable of petitioner as of December 31, 2003 amounting to ₱1,093,100.00, though unbilled and unpaid, should have been recognized as income by petitioner in 2003 inasmuch as the items have been delivered per the Requisition and Delivery Issue Slips. The income accrues to petitioner since there was already an unconditional right to the receipt of a sum certain, even though actual payment thereof has been deferred. Consequently, respondent's assessment on the amount of ₱1,093,100.00 shall be upheld.

3. Undeclared Income from Unaccounted Expenses

Respondent found a significant amount of expenses in petitioner's Financial Statements which were not clearly accounted for. Respondent inferred that since there were sources of funds not accounted for in petitioner's tax returns, petitioner had not reported part of its income.³³

³³ Par. 15, JSF, Docket, p. 199.

Respondent's examiner compared expense items per petitioner's ITR/Financial Statements with similar items per alphalist and found a difference of ₱2,174,850.75, computed as follows:³⁴

INCOME PAYMENTS	PER ITR/FS	PER ALPHALIST	UNACCOUNTED
Rent	₱ 2,751,697.00	₱ 3,668,165.24	₱ (916,468.24)
Professional Fee		1,236,326.77	(1,236,326.77)
Brokerage		22,055.74	(22,055.74)
Grand Total	₱2,751,697.00	₱4,926,547.75	₱(2,174,850.75)

Since the amounts per alphalist were higher than those reflected in the ITR/Financial Statements, respondent inferred that petitioner had undeclared income. However, petitioner asserts that the discrepancy was due to the difference in the way the expenses were booked in the ITR/Financial Statements and in the alphalist. Petitioner amortized rent, professional fees, and brokerage as part of cost of performing services and the same were not treated as ordinary operating expenses. An example would be rent for a specific hangar where all repair works are performed. Petitioner submitted supporting documents showing the details of its treatment of the said expenses.³⁵

The Court agrees with petitioner.

It is noteworthy that the imputation of alleged undeclared income is based on a mere presumption that since there were undeclared expenses,

³⁴ Exhibit "J", Docket, p. 291.

³⁵ Exhibits "L", and "L-1" to "L-12", Docket, pp. 303-321.

there were likewise undeclared incomes corresponding to these expenses. Even if these alleged unaccounted expenses are to be considered as income, the same may be offset by recording the equivalent payments as expenses. Hence, no taxable income will result from the said transactions.

While it is axiomatic that all presumptions are in favor of the correctness of tax assessments, the assessment itself should not be based on presumptions no matter how logical the presumption might be. In order to stand the test of judicial scrutiny, the assessment must be based on actual facts.³⁶ For lack of factual basis, the deficiency income tax assessment corresponding to the alleged undeclared income from unaccounted expenses of ₱2,174,850.75 should be cancelled.

4. Disallowed Expenses due to Non-withholding

Petitioner claims that it paid the reported withholding tax on the disallowed expenses, which is supported by the pertinent BIR forms. However, petitioner explained that there were other expenses which were not actually paid but were designated as an "accrual entry only". Likewise, petitioner states that there were other expenses that were actually not subjected to withholding tax since the same were not subject to withholding.

Respondent arrived at this assessment after comparing the expenses subject to withholding tax with the expenses in the alphalist. Respondent

³⁶ *Collector of Internal Revenue vs. Benipayo*, G.R. No. L-13656, January 31, 1962.



concluded that petitioner failed to withhold and remit the corresponding withholding taxes on certain expenses in violation of Sections 57 and 58 of the NIRC of 1997, as amended. As such respondent disallowed the same as deductions pursuant to Section 34 of the NIRC of 1997, as amended.³⁷

Per comparison of petitioner's expense items as recorded in its Financial Statements with those shown in its alphalist, respondent found a difference of ₱32,590,929.64 that was supposedly not subjected to withholding tax and therefore disallowed as expense pursuant to Sections 57 and 58 of the NIRC of 1997, as amended. The subject expense items are detailed hereunder:³⁸

INCOME PAYMENTS	PER ITR/FS	PER ALPHALIST	NOT SUBJECTED TO EWT
Expanded Withholding Tax			
Director's Fee	₱ 379,000.00		₱ 379,000.00
Consultants	₱ 300,000.00		₱ 300,000.00
Top 10000 Corp./Top 5000 Corp. Purchase Service Parts	₱ 31,197,559.00	₱ 14,084,619.07	₱ 17,112,939.93
Prime Contractor:			
Repairs and Maintenance – Labor	₱ 3,260,294.00		
Security	1,184,175.00		
Advertising	610,392.00		
Sub-Total	₱ 5,054,861.00		₱ 5,054,861.00
Total	₱ 36,931,420.00	₱ 14,084,619.07	₱ 22,846,800.93
Withholding Tax on Compensation			
Per Financial Statement/ITR:			
Labor and Overhead – COS	₱ 10,983,598.00		
Salaries and Wages – OE	7,015,798.00		
Indirect Labor – OE	2,982,022.00		
13th Month – OE	1,085,275.00		
Overtime Pay	93,019.00		
Total	₱ 22,159,712.00		
Per Alphalist			
13th Mo. Pay - Non-Taxable		₱ 1,345,994.00	
SSS, Pag-ibig, PHIC		1,047,281.39	

³⁷ Par. 16, JSF, Docket, p. 200.

³⁸ Exhibit "J", Docket, p. 291.

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Salaries - Non-Taxable		-	
13th Mo. Pay – Taxable		22,365.00	
Salaries – Taxable		9,999,942.90	
Total	P 22,159,712.00	P 12,415,583.29	P 9,744,128.71
Grand Total	P59,091,132.00	P26,500,202.36	P32,590,929.64

The findings of this Court on the above-enumerated expense items are as follows:

4(a). Expanded Withholding Tax

Director's Fees

Petitioner contends that taxes on Director's fees have been duly withheld and remitted per BIR forms marked as Exhibits "T" to "T-12", "T-12-a", and "T-12-b".³⁹

A review of the records reveals that the BIR forms referred to by petitioner pertain to its Monthly Remittance Returns of Income Taxes Withheld on Compensation (BIR Forms No. 1601-C), Annual Information Return of Income Taxes Withheld on Compensation and Final Withholding Taxes (BIR Form No. 1604-CF) with the attached alphalist of employees from whom taxes were withheld for the year 2003. The returns reflected the following remittances of withholding taxes on compensation:

2003	Exhibit	Total Amount Remitted
January	"T"	P 39,494.58
February	"T-1"	119,713.70
March	"T-2"	110,705.61
April	"T-3"	100,237.52

³⁹ Exhibits "T" and "T-1" to "T-12", Docket, pp. 486-515.

May	"T-4"	109,736.58
June	"T-5"	109,510.94
July	"T-6"	110,257.53
August	"T-7"	109,505.15
September	"T-8"	108,945.05
October	"T-9"	41,767.99
November	"T-10"	35,131.18
December	"T-11"	41,924.16
TOTAL	"T-12"	P 1,036,929.99

However, the aforesaid documents do not show whether the subject Director's fees formed part of the employees' compensation income subjected to withholding tax.

Likewise, petitioner's Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) [BIR Forms No. 1601-E] for the year 2003 reflected only the remittance of EWT on income payments pertaining to rentals (real property), income payments made by top 5,000 corporations to their local supplier of goods, and professional fees. In fact, petitioner did not remit any EWT on Director's fees since as reflected in the Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded), the portion corresponding to "EWT-fees of directors who are not employees of the company" was left blank.

Thus, for petitioner's failure to withhold EWT on the Director's fees in the amount of ₱379,000.00, the same should be disallowed from petitioner's claimed deductions from gross income pursuant to Section 34(K) of the NIRC of 1997, as amended, which states:



"(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."

Consultants' Fees

Petitioner alleges that the Consultants' fees amounting to ₱300,000.00 were supposed to be paid to the Office of the Government Corporate Counsel for the legal services it rendered. However, since the said fees were not paid in 2003, but were merely accrued, the same were not subjected to EWT.

Section 2.57.4 of Revenue Regulations (RR) No. 2-98, as amended by RR No. 12-01, provides when the obligation to withhold arises. Said Section reads:

*"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 **payment** is paid or payable, **or the income payment is accrued or recorded as an expense or asset, whichever is applicable, in the payor's books**, whichever comes first. The term 'payable' refers to the date the obligation becomes due, demandable or legally enforceable.*

Provided, however, that where income is not yet paid or payable but the same has been recorded as an expense or asset, whichever is applicable, in the payor's books, the obligation to withhold shall arise in the last month of the return period in which the same is claimed as an expense or amortized for tax purposes."
(Emphasis supplied)



Based on the foregoing, the obligation of petitioner to withhold arises at the time the Consultants' fees are paid, payable or accrued/recorded as expense in petitioner's books, whichever comes first. Applying this to the instant case, petitioner is mandated to withhold and remit the corresponding ten percent (10%) EWT in the amount of ₱30,000.00 in the month following the accrual. Hence, for petitioner's failure to do so, the disallowance of the amount of ₱300,000.00 shall be sustained pursuant to Section 34(K) of the NIRC of 1997, as amended.

Purchase of service parts

Respondent arrived at this assessment after finding that there exists a difference of ₱17,112,939.93 that was not subjected to one percent (1%) EWT after comparing petitioner's purchases of service parts for the year 2003 amounting to ₱31,197,559.00 with the amount that was subjected to 1% EWT per alphalist amounting to ₱14,084,619.07.

Petitioner however argues that the alleged purchases of service parts are not actually its purchases but turn-over of inventories by its former subsidiaries that already closed down and that respondent failed to consider its VAT- exempt purchases in the amount of ₱27,030,000.00 from Rolls-Royce Engine Services Limitada, Inc., a CSEZ Enterprise.

As stated earlier, this Court agrees with respondent for failure of petitioner to account for the discrepancy found by respondent on its purchases of services parts; thus, respondent's assessment on the amount of



₱17,112,939.93 shall stand pursuant to Section 34(K) of the NIRC of 1997, as amended.

Repairs and Maintenance-Labor, Security and Advertising

Anent the disallowed expenses attributable to repairs and maintenance, security and advertising due to non-withholding, petitioner submitted schedules of its repairs and maintenance and security and advertising expenses allegedly subjected to EWT for the year 2003⁴⁰, as follows:

Repairs and Maintenance			
Exhibit	Description	Amount	EWT
L-3	Bldg	₱ 199,938.06	₱ 1,774.75
L-4	Others	294,165.52	4,870.75
L-5	Others	1,913,916.45	1,019.19
L-6	Aircraft	9,788.87	195.78
L-7	MV-Labor	148,947.72	2,060.30
L-8	MV-Spares	314,250.74	6,271.41
	Total	₱2,881,007.36	₱ 16,192.18

Security			
Exhibit	Description	Amount	EWT
L-9	Security/Janitorial	₱ 747,266.60	₱ 32,359.04
L-10	Security/Janitorial	370,138.18	9,286.36
	Total	₱1,117,404.78	₱ 41,645.40

Advertising			
Exhibit	Description	Amount	EWT
L-11	Advertising Expenses	₱ 184,364.40	₱ 885.09
L-12	Advertising Expenses	426,027.47	1,074.37
	Total	₱610,391.87	₱1,959.46

⁴⁰ Exhibits "L-3" to "L-12", Docket, pp. 312-321.

Based on a review of petitioner's Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) [BIR Forms No. 1601-E] for the year 2003, it shows that there was no EWT remittance pertaining to these expenses since the portion of each returns corresponding to "EWT-prime contractors/sub-contractors" was left blank. Therefore, the Court finds that the said expenses cannot be deducted from petitioner's gross income pursuant to Section 34(K) of the NIRC of 1997, as amended.

4(b). Withholding Tax on Compensation

For petitioner's failure to refute respondent's finding that there were employees' salaries and wages per its Financial Statements/ITR that were not subjected to withholding tax in the amount of ₱9,744,128.71, the same shall be disallowed from petitioner's claimed deductions from gross income pursuant to Section 34(K) of the NIRC of 1997, as amended.

In other words, respondent's disallowance of petitioner's expenses in the amount of ₱32,590,929.64 due to non-withholding of taxes is upheld.

5. Net Operating Loss Carry-Over (NOLCO)

Petitioner contends that there is no basis for this assessment since it was at a loss position for 2003. In fact, it did not enjoy any tax benefit for the succeeding years since it continued to be in a loss position.⁴¹ On the other hand, respondent treated the NOLCO of ₱4,555,067.00 as addition to



⁴¹ Exhibit "A", par. 27, Docket, p. 257.

petitioner's taxable income for the year 2003 to recapture the tax benefit purportedly realized by petitioner in carrying this amount to the succeeding taxable year of 2004.⁴²

The Court agrees with petitioner.

Based on the records, respondent failed to present evidence to prove that petitioner used its 2003 net loss as NOLCO in the succeeding year. Granting, for the sake of argument, that petitioner actually deducted its 2003 net loss as NOLCO in the succeeding year 2004 and the said deduction was not proper as petitioner did not incur net loss, the same can only be the subject of assessment, when it was claimed as deduction in the year 2004 and not in the year 2003, for such is beyond the scope of the present assessment. Hence, adding back the net loss amount of ₱4,555,067.00 to petitioner's taxable income for the year 2003 is erroneous.

6. Minimum Corporate Income Tax

Respondent did not allow the Minimum Corporate Income Tax (MCIT) in the amount of ₱453,178.88 as tax credit against the computed deficiency income tax on the ground that the said amount would be carried over and credited against the normal income tax for the next three (3) years in accordance with Section 27 of the NIRC of 1997, as amended. Meanwhile,

⁴² Exhibit "J", Details of Discrepancies, item no. 5, Docket, p. 292.

petitioner maintains that it is entitled to utilize the MCIT as a credit for 2003 considering that respondent's assessments have no basis.

As correctly pointed out by respondent, the amount of ₱453,178.88 represents petitioner's MCIT for the year 2003. Thus, any tax benefit derived therefrom redounds to the succeeding year 2004. Since the tax benefit will be experienced in the succeeding years, at most, petitioner may only be assessed in the succeeding years.

7. Unsupported Tax Payments for the First Three Quarters

Respondent averred that petitioner was unable to support its tax payments for the first three (3) quarters in the amount of ₱323,268.15 in violation of Section 2.58.3(c) of Revenue Regulations No. 2-98, as amended. Petitioner countered that its tax payments for the first three quarters of the year 2003 are well-supported.

In order to disprove respondent's finding, petitioner submitted its Quarterly Income Tax Returns for the first, second, and third quarters of taxable year 2003.⁴³ A perusal of these returns shows that petitioner did not make any tax payment for the first three quarters. The amount of ₱323,268.15⁴⁴ represents petitioner's income tax due for the third quarter of 2003, which was never paid by petitioner. Be that as it may, the amount of ₱323,268.15 was not included in the "Total Tax Credits/Payments" of

⁴³ Exhibits "O", "O-1", and "O-2", Docket, pp. 326-331.

⁴⁴ Line 25C, Exhibit "O-2", Docket, p. 331.



₱1,170,906.14⁴⁵ reflected in petitioner's Annual Income Tax Return⁴⁶ for taxable year 2003 due to mathematical error made by petitioner in summing up all the figures representing its "Prior Year's Excess Credits" of ₱779,126.51, "Tax Payments for the First Three Quarters" of ₱323,268.15 and "Creditable Tax Withheld for the First Three Quarters" of ₱391,779.63. Instead of the correct summation of ₱1,494,174.29, petitioner indicated the amount of ₱1,170,906.14 as "Total Tax Credits/Payments", as illustrated below:

Prior Year's Excess Credits	₱ 779,126.51
Tax Payments for the First Three Quarters	323,268.15
Creditable Tax Withheld for the First Three Quarters	391,779.63
Total Tax Credits/Payments	₱ 1,170,906.14

Evidently, petitioner did not derive any tax benefit from the amount of ₱323,268.15 because it was not claimed as tax credit in 2003. It was erroneous on the part of respondent to disallow a tax credit which was not claimed at all by petitioner. However, since the amount of ₱323,268.15 was included by respondent as part of the ₱1,494,174.29 total tax payments per return, the subsequent disallowance or deduction of the amount of ₱323,268.14 had no effect on petitioner's income tax due.

8. Amount Carried Over to Succeeding Year



⁴⁵ Exhibit "N", line 27G, Docket, p. 322.

⁴⁶ Exhibit "N", Docket, p. 322.

Respondent disallowed the excess tax credits of ₱717,727.26 reflected in petitioner's 2003 Annual Income Tax Return in order to recapture the tax benefit realized by petitioner in carrying the amount of ₱717,727.26 to the succeeding year.

To this, We find that it was improper for respondent to disallow the 2003 excess tax credits of ₱717,727.26 because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2004. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year.

To recapitulate, after determining all the valid disallowances from petitioner's claimed deductions, this Court finds that petitioner is liable to pay a basic **DEFICIENCY INCOME TAX** in the reduced amount of **₱14,068,418.34**, computed as follows:

Net Income/(Loss) per ITR:		₱ (4,555,067.00)
Add: Adjustments/Disallowances		
Unsupported Purchases	₱ 18,493,926.37	
Undeclared Income from Understated Accounts Receivable	1,093,100.00	
Disallowed Expenses due to Non-Withholding	32,590,929.64	₱ 52,177,956.01
Taxable Income per Investigation		₱ 47,622,889.01
Income Tax Due Thereon (32%)		₱ 15,239,324.48
Less: Payments per Return		
Prior Year's Excess Credit	₱ 779,126.51	
Creditable Withholding Tax	391,779.63	1,170,906.14
Deficiency Income Tax Due		₱14,068,418.34

II. VALUE-ADDED TAX

Respondent's detailed computation of the deficiency value-added tax assessment for taxable year 2003 in the amount of ₱16,661,370.88 is reproduced herein below:⁴⁷

Revenue Subjected to VAT per returns			₱ 80,837,356.05
Add: Revenue not Subjected to VAT (Schedule 5)		₱ 402,034.95	
Disposal of Tools and Equipment		307,555.00	
Disposal of Properties Thru Bidding		5,672,000.00	
Undeclared Income from Understated Accounts Receivable (Schedule 2)		1,093,100.00	
Undeclared Income from Unaccounted Expenses (Schedule 3)		2,174,850.75	9,649,540.70
Total Receipts Subject to VAT			₱ 90,486,896.75
Output Tax Due Thereon (10%)			₱ 9,048,689.68
Less: Input Tax Carried Over From Previous Period		₱ 1,424,340.33	
Input Tax Claimed per Return		2,034,419.86	
Total		₱ 3,458,760.19	
Less: Unsupported Input Tax	₱ 1,849,392.64		
Unsupported Input Tax Carried Over From Previous Period	1,424,340.33	3,273,732.97	185,027.22
VAT Due			₱ 8,863,662.46
Less: Payments per Return		₱ 193,288.39	
Creditable VAT Withheld		4,289,892.96	
Total		₱ 4,483,181.35	
Less: Unsupported Creditable VAT Withheld		4,289,892.96	193,288.39
VAT Still Due			₱ 8,670,374.07
Add: 20% Interest (01.26.04 to 09.03.08)			7,990,996.81
Total Amount Due			₱16,661,370.88

As can be gleaned from the above computation, the deficiency VAT assessment arose from the following items:

1.	Revenue not Subjected to VAT	₱ 402,034.95
2.	Disposal of Tools and Equipment	307,555.00
3.	Disposal of Properties Through Bidding	5,672,000.00
4.	Undeclared Income from Understated Accounts Receivable	1,093,100.00
5.	Undeclared Income from Unaccounted Expenses	2,174,850.75
6.	Unsupported Input Tax	1,849,392.64

⁴⁷ Exhibit "J", Docket, pp. 289-290.

7.	Unsupported Input Tax Carried Over From Previous Period	1,424,340.33
8.	Unsupported Creditable VAT Withheld	4,289,892.96

The Court shall discuss the validity of the said assessment by looking into the propriety of each item.

1. Revenue not subjected to VAT

Invoking Sections 106 and 108, in relation to Section 105, of the NIRC of 1997, as amended, respondent imposed 10% VAT on the amount of ₱402,034.95, representing the discrepancy between petitioner's revenues per Financial Statements/ITR and the sales subjected to VAT per petitioner's VAT Returns, as shown below:⁴⁸

Revenue per Financial Statement	₱ 60,054,708.00
Rental Income	19,161,333.00
Hangarage Fees	1,615,297.00
Other Income	408,053.00
Total Revenue subject to VAT	₱ 81,239,391.00
Less: Sales subjected to VAT	80,837,356.05
Revenue not subjected to VAT	₱ 402,034.95

Petitioner counters that the amount alleged to be subject to VAT by respondent represents reimbursements for shared expenses such as share in electricity and water consumption and are not subject to VAT.⁴⁹ In support of its allegation, petitioner presented in evidence, various sales invoices and official receipts.⁵⁰

⁴⁸ Exhibit "J", Docket, p. 292.

⁴⁹ Exhibit "A", Docket, p. 258.

⁵⁰ Exhibits "P-1" to "P-62", Docket, pp. 334-394.

A careful scrutiny of the aforesaid documents indicates that these pertain to amounts billed and/or received by petitioner for import clearance, electricity charges, bid documents, photocopy, and dividends on preferred stock. However, the amounts shown on these documents do not tally with the discrepancy in revenues amounting to ₱402,034.95.

In addition, based solely on said documents, the Court cannot ascertain whether the amounts indicated therein are mere reimbursements of cost and that no amount of profit was added or charged by petitioner. Likewise, it cannot be determined with certainty whether or not petitioner claimed the entire input tax related to the shared expenses. Such fact is relevant herein, considering that if petitioner claimed the entire input tax on the shared expenses, then the amounts billed by petitioner for reimbursements must be subject to output tax.

Be that as it may, petitioner issued VAT invoices and official receipts for the alleged shared expenses. Based on Sections 106(D) and 108(C) of the NIRC of 1997, as amended, the amounts indicated in the VAT invoice and official receipt included the 10% VAT imposed under Sections 106(A) and 108(A) of the same Code.

Following the said provisions, the VAT invoices and official receipts issued by petitioner for the shared expenses included the 10% VAT. Such 10% VAT became petitioner's output VAT, which in turn became the input tax



of the entities to whom the VAT invoices and official receipts were issued. Clearly, petitioner is liable to pay 10% VAT on the amount of ₱402,034.95.

2. Disposal of Tools and Equipment

It was respondent's finding that petitioner's sale/disposal of tools and equipment was not subjected to VAT in violation of Section 106 of the NIRC of 1997, as amended. On the other hand, petitioner points out that the disposition of tools and equipment amounting to P307,555.00⁵¹ corresponds to its sale of unserviceable scrap material; and that the said sale, not being in the ordinary course of trade or business of petitioner, is not subject to VAT.

The Court finds the assessment in order.

Section 105 of the NIRC of 1997, as amended, provides that:

"SEC. 105. *Persons Liable.* — Any person who, in the course of trade or business, sells, barter, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to value-added tax (VAT) imposed in Sections 106 to 108 of this Code.

XXX

XXX

XXX

The phrase ***'in the ordinary course of trade or business'*** means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity." (*Emphasis supplied*)

⁵¹ Exhibit "Q", Docket, p. 395.

Based on the foregoing, the VAT is imposed on a sale or transaction entered into by a person in the course of any trade or business. A transaction will be characterized as having been entered into by a person in the course of trade or business if it is: (1) regularly conducted; and (2) undertaken in pursuit of a commercial or economic activity. Likewise, transactions that are made incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business. "Incidental" means something else as primary; something necessary, appertaining to, or depending upon another, which is termed the principal. Hence, an isolated transaction is not necessarily disqualified from being made incidentally in the course of trade or business.⁵²

Once an activity has been identified as a business, any supply (sale) made while carrying it on is likely to be made in the course or furtherance of business. No distinction is made between capital and revenue items. Thus, a supply (sale) in the course or furtherance of business includes: (1) *the disposition of the assets and liabilities of a business*; (2) the disposition of a business as going concern; and (3) anything done in connection with the termination or intended termination of a business.⁵³

Absence of proof to the contrary, the tools and equipment subject of the assessment shall be considered to have been used by petitioner in the

⁵² *CS Garments, Inc. vs. Commissioner of Internal Revenue*, C.T.A. EB Case No. 287, January 14, 2008.

⁵³ *Ibid.*



conduct of its business. Prior to the sale, the tools and equipment formed part of petitioner's assets being used in its business operations. Therefore, petitioner's sale of tools and equipment is an incidental transaction because the said tools and equipment were used in furtherance of petitioner's business. Consequently, the proceeds from the sale in the amount of ₱307,555.00 shall be subject to the 10% VAT imposed under Section 106(A) of the NIRC of 1997, as amended, as correctly determined by respondent.

3. Disposal of Properties through Bidding

Respondent discovered that petitioner sold various unserviceable properties consisting of three motor vehicles, aircraft carcasses, fuselages, jigs, ramps and other tools and equipment through public bidding, but the same were not dropped from the books and not subjected to VAT in violation of Section 106(B) of the NIRC of 1997, as amended.⁵⁴

On the other hand, petitioner counters that the amount of ₱5,672,000.00 allegedly realized from the sale of properties was actually not realized and that the said sum was stated as book value of the unserviceable equipment that was merely offered for sale through public bidding.⁵⁵

Since petitioner failed to offer any documentary proof to support its allegation and convince this Court that the assessment was erroneous, petitioner should be held liable to pay deficiency VAT on the amount of

⁵⁴ Exhibit "J", Docket, p. 293.

⁵⁵ Exhibit "A", Docket, p. 259.



₱5,672,000.00 pursuant to Section 106(A) of the NIRC of 1997, as amended, being consistent with the presumption that the BIR officials performed their official tasks/functions with regularity.

4. Undeclared Income from Understated Accounts Receivable

Respondent's assessment was based on the finding that petitioner had undeclared income from understated Accounts Receivable, particularly, that petitioner had delivered certain items in 2003, per the Requisition and Delivery Issue Slips, and earned income in the amount of ₱1,093,100.00 for taxable year 2003. The aforesaid income, as respondent claimed, should have been subjected to VAT.

We agree with respondent. Inasmuch as the Court has earlier stated that petitioner should have accrued the income of ₱1,093,100.00 when the deliveries were made in 2003, petitioner shall be held liable to pay deficiency VAT thereon pursuant to Section 106(A) of the NIRC of 1997, as amended.

5. Undeclared Income from Unaccounted Expenses

This assessment was based on the finding that petitioner had significant amounts of expenses, the sources of which were not accounted for in its Financial Statement. Respondent therefore concluded that petitioner had earned income which it failed to declare.



The Court finds respondent's position without merit. As discussed earlier, even if the expenses per alphalist were to be considered as income subject to output VAT, the same shall be offset by treating the equivalent payments as purchases for which input tax credits may be claimed. *Ergo*, no VATable income will result from the said transactions.

6. Unsupported Input Tax

This assessment arose from the difference between the purchases declared in the VAT Return and the Financial Statements with the amount declared in the VAT Return being less. However, petitioner explains that it did not claim any input tax on such purchases since the amount per Financial Statement is allegedly greater.

Pursuant to Section 110(B) of the NIRC of 1997, as amended, respondent disallowed the input tax of ₱1,849,392.64 corresponding to the unsupported purchases of service parts in the amount ₱18,493,926.37.⁵⁶

As We have stated earlier, petitioner was unable to substantiate its purchases of service parts in the amount of ₱18,493,926.37. Hence, the related input tax of ₱1,849,392.64 shall be disallowed in accordance with Sections 110(A)(1)(a) and (2)(a), in relation to Section 113(A)(1), of the NIRC of 1997, as amended, requiring that input tax on purchases of goods must be supported by VAT invoices, to wit:



⁵⁶ Exhibit "J", Docket, p. 293.

"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.

(2) The **input tax on domestic purchase of goods** or properties **shall be creditable:**

(a) To the **purchaser upon consummation of sale** and on importation of goods or properties; and

(b) To the importer upon payment of the value-added tax prior to the release of the goods from the custody of the Bureau of Customs.

However, in the case of purchase of services, lease or use of properties, the input tax shall be creditable to the purchaser, lessee or licensee upon payment of the compensation, rental, royalty or fee." (*Emphasis supplied*)

"SEC. 113. *Invoicing and Accounting Requirements for VAT-Registered Persons.* -

(A) *Invoicing Requirements.* – A VAT-registered person shall, for **every sale, issue an invoice** or receipt. In addition to the information required under Section 237, the following information shall be indicated in the invoice or receipt:

(1) A statement that the seller is a VAT-registered person, followed by his taxpayer's identification number (TIN); and



(2) The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax." (*Emphasis supplied*)

7. Unsupported Input Tax Carried Over from Previous Period

Citing Section 110(B) of the NIRC of 1997, as amended, respondent disallowed petitioner's input tax carried over from previous period in the amount of ₱1,424,340.33 for being unsupported by any documents.

We note that Section 110(B) of the NIRC of 1997, as amended, allows the carry-over of excess input VAT of a certain quarter to the succeeding quarter(s), such input VAT, to be creditable against the output VAT, must be duly substantiated by VAT invoices (in case of purchases of goods) or VAT official receipts (in case of purchases of services) as prescribed under Section 110(A) in relation to Section 113(A) of the NIRC of 1997, as amended. However, since petitioner did not present VAT invoices or official receipts, this Court sustains the disallowance of the input tax of ₱1,424,340.33.

8. Unsupported Creditable VAT Withheld

Pursuant to Section 114(C) of the NIRC of 1997, as amended, respondent denied petitioner's creditable VAT withheld amounting to ₱4,289,892.96 for petitioner's failure to substantiate.



To refute respondent's findings, petitioner submitted Certificates of Creditable Tax Withheld at Source (BIR Form No. 2307)⁵⁷. However, a scrutiny of these documents revealed that only a total of ₱1,009,093.98 was properly supported by BIR Form No. 2307, to wit:

Exhibit	Withholding Agent/Payor	Period Covered	Income Payments	VAT Withheld
R	Development Bank of the Philippines	03/12/03	₱ 22,407.50	₱ 1,344.45
R-1	Philippine Coast Guard	11/03/03	126,547.33	7,592.84
R-2	Philippine Coast Guard	11/03/03	126,983.50	7,619.01
R-3	Philippine National Police	01/01/03	98,082.00	7,668.23
R-4	National Transmission Corp.	10/01/03 to 10/31/03	2,138,132.39	64,143.96
R-4	National Transmission Corp.	10/01/03 to 10/31/03	753,089.09	45,185.34
R-6	Philippine National Police	01/--/03	10,000,000.00	781,818.18
R-7	Philippine National Police	02/--/03	667,127.00	23,078.65
R-7	Philippine National Police	02/--/03	866,925.91	59,887.69
R-9	Development Bank of the Philippines	09/02/03	67,222.50	4,033.35
R-11	Development Bank of the Philippines	04/23/03	44,815.00	2,688.90
R-12	Development Bank of the Philippines	05/22/03	22,407.50	1,344.45
R-13	Development Bank of the Philippines	03/18/03	22,407.50	1,344.48
R-14	Development Bank of the Philippines	11/21/03	22,407.50	1,344.45
VALID CREDITABLE VAT WITHHELD		Total	₱ 14,978,554.72	₱ 1,009,093.98

Therefore, the remaining amount of ₱3,280,798.98⁵⁸, which was not duly supported by BIR Form No. 2307, shall be disallowed as a tax credit for petitioner.

In sum, the Court finds petitioner liable to pay a basic **DEFICIENCY VAT** in the reduced amount of ₱7,443,795.01, computed as follows:

⁵⁷ Exhibits "R" and "R-1" to "R-26" (except Exhibits "R-10" and "R-15" which were denied admission by this Court), Docket, pp. 396-448.

⁵⁸ ₱4,289,892.96 less ₱1,009,093.98

Revenue Subjected to VAT per returns			₱ 80,837,356.05
Add: Revenue not Subjected to VAT		₱ 402,034.95	
Disposal of Tools and Equipment		307,555.00	
Disposal of Properties Thru Bidding		5,672,000.00	
Undeclared Income from Understated Accounts Receivable		1,093,100.00	7,474,689.95
Total Receipts Subject to VAT			₱ 88,312,046.00
Output Tax Due Thereon (10%)			₱ 8,831,204.60
Less: Input Tax Carried Over From Previous Period		₱ 1,424,340.33	
Input Tax Claimed per Return		2,034,419.86	
Total		₱ 3,458,760.19	
Less: Unsupported Input Tax	₱ 1,849,392.64		
Unsupported Input Tax Carried Over From Previous Period	1,424,340.33	3,273,732.97	185,027.22
VAT Due			₱ 8,646,177.38
Less: Payments per Return		₱ 193,288.39	
Creditable VAT Withheld		4,289,892.96	
Total		₱ 4,483,181.35	
Less: Unsupported Creditable VAT Withheld		3,280,798.98	1,202,382.37
Deficiency VAT Due			₱ 7,443,795.01

III. EXPANDED WITHHOLDING TAX

Upon investigation, it was found by respondent that petitioner failed to withhold and remit the EWT on certain income payments made, in violation of Section 2.57.2 of Revenue Regulations No. 2-98, as amended. Consequently, respondent assessed petitioner for deficiency EWT in the amount of ₱728,503.90, inclusive of interest, computed as follows:

Basic Deficiency Tax Due (Schedule 4)	₱ 378,026.62
Add: 20% Interest (01.16.04 to 09.03.08)	350,477.28
Total Amount Due	₱ 728,503.90

As We have discussed and determined earlier, petitioner failed to withhold and remit the EWT corresponding to its income payments for

Director's fee of ₱379,000.00, Consultants' fees of ₱300,000.00, purchases of service parts of ₱17,112,939.93, repairs and maintenance-labor of ₱3,260,294.00, security services of ₱1,184,175.00, and advertising expenses of ₱610,392.00. Therefore, petitioner is liable to pay basic deficiency EWT in the amount of ₱378,026.62, broken down as follows:

INCOME PAYMENTS	INCOME PAYMENT NOT SUBJECTED TO EWT	TAX RATE	EWT STILL DUE
Director's Fee	₱ 379,000.00	20%	₱ 75,800.00
Consultants	300,000.00	10%	30,000.00
Top 10000 Corp./Top 5000 Corp. Purchase Service Parts	17,112,939.93	1%	171,129.40
Prime Contractor:			
Repairs and Maintenance – Labor	₱ 3,260,294.00		
Security	1,184,175.00		
Advertising	610,392.00		
Sub-Total	₱ 5,054,861.00	2%	101,097.22
Total	₱ 27,901,661.93		₱ 378,026.62

IV. WITHHOLDING TAX ON COMPENSATION

Respondent assessed petitioner for deficiency withholding tax on compensation in the amount of ₱5,941,554.64, inclusive of interest, computed as follows:

Basic Deficiency Tax Due (Schedule 5)	₱ 3,083,121.19
Add: 20% Interest (01.16.04 to 09.03.08)	2,858,433.45
Total Amount Due	₱ 5,941,554.64

Respondent arrived at the computation of said deficiency withholding tax on compensation by using the prescribed Withholding Tax Tables pursuant to Section 24(A) of the NIRC of 1997, as amended, to wit:



Salaries and Wages not Subjected to Withholding Tax (Schedule 4)	₱ 9,774,128.71 ⁵⁹
Basic Deficiency Withholding Tax on Compensation per Audit	₱ 3,083,121.19

Petitioner argues that contrary to respondent's findings, it withheld and paid the pertinent withholding taxes on the salaries and wages. It explained that the difference in the amounts in its Financial Statements and the alphalist may be explained by a reconciliation of the entries.

We adhere to respondent's position.

Again, since petitioner failed to prove that the taxes related to the employees' compensation of ₱9,744,128.71 were withheld and remitted, the Court is constrained to rule that petitioner is liable to pay basic deficiency withholding tax in the amount of ₱3,083,121.19.

By way of resume, We find that the subject assessment issued by respondent against petitioner covering deficiency income tax, value-added tax, expanded withholding tax, and withholding tax on compensation for taxable year 2003 are proper and with legal and factual bases, subject to some modifications as discussed earlier.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. Accordingly, the Final Decision on Disputed Assessment issued by respondent against petitioner covering deficiency income tax, value-added tax, expanded withholding tax, and withholding tax

⁵⁹ Amount indicated per Schedule 4 is P9,744,128.71.



on compensation for taxable year 2003 is hereby **AFFIRMED with MODIFICATIONS**; and consequently, petitioner is **ORDERED TO PAY** the subject taxes in the reduced aggregate amount of **THIRTY ONE MILLION TWO HUNDRED SIXTEEN THOUSAND SEVEN HUNDRED ONE PESOS & 45/100 (P31,216,701.45)**, inclusive of the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

	Basic	25% Surcharge	Total
Income Tax	₱ 14,068,418.34	₱ 3,517,104.59	₱ 17,585,522.93
Value-added Tax	7,443,795.01	1,860,948.75	9,304,743.76
Expanded Withholding Tax	378,026.62	94,506.65	472,533.27
Withholding Tax on Compensation	3,083,121.19	770,780.30	3,853,901.49
Total	₱24,973,361.16	₱6,243,340.29	₱31,216,701.45

In addition, petitioner is likewise **ORDERED TO PAY** (a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of ₱14,068,418.34 computed from April 15, 2004, on expanded withholding tax of ₱378,026.62 and on withholding tax on compensation of ₱3,083,121.19 computed from January 15, 2004, and on value-added tax of ₱7,443,795.01 computed from January 25, 2004, 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 ₱31,216,701.45 and on the 20% deficiency interest which have accrued as afore-stated, computed from September 3, 2008 until full

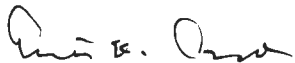


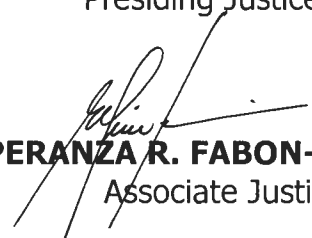
payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.


ERLINDA B. UY
Associate Justice

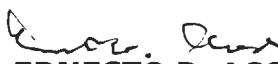
WE CONCUR:


(With Concurring and Dissenting Opinion)
ERNESTO D. ACOSTA
Presiding Justice


ESPERANZA R. FABON-VICTORINO
Associate Justice

CERTIFICATION

I hereby certify that the 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

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

FIRST DIVISION

**PHILIPPINE AEROSPACE,
DEVELOPMENT CORPORATION,**
Petitioner,

CTA CASE NO. 7830

Members:

-versus-

**ACOSTA, *Chairman*
UY, *and*
FABON-VICTORINO, JJ.**

**COMMISSIONER OF INTERNAL
REVENUE,**
Respondent.

Promulgated:

DEC 11 2012 ; 2:40 p.m.

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CONCURRING AND DISSENTING OPINION

ACOSTA, *PJ*:

With all due respect to my esteemed colleagues, although I concur with the final disposition of the case, which is to partially grant the Petition for Review and reduce the deficient tax due to THIRTY ONE MILLION TWO HUNDRED SIXTEEN THOUSAND SEVEN HUNDRED ONE PESOS AND 45/100 (P31,216,701.45), I disagree with the view to impose simultaneously a *deficiency rate* of twenty percent (20%) per annum and a *delinquency interest*, also at the rate of twenty percent (20%) per annum, on the unpaid balance of tax deficiency after 03 September 2008.

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The majority Decision ordered petitioner to pay, in addition to the tax due and the 25% surcharge, the following:

1. Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of P14,068,418.34 computed from 15 April 2004, on expanded withholding tax of P378,026.62 and on withholding tax on compensation of P3,083,121.19 computed from 15 January 2004, and on value-added tax of P7,443,795.01 computed from 25 January 2004, until full payment thereof pursuant to Section 249 (B) of the National Internal Revenue Code of 1997, as amended; and
2. Delinquency interest at the rate of twenty percent (20%) per annum on the total amount of P31,216,701.45 plus the imposed 20% deficiency interest which would have accrued, computed from 03 September 2008 until full payment thereof pursuant to Section 249 (C) of the National Internal Revenue Code of 1997, as amended.

Essentially, from 03 September 2008 up to the date the assessment shall have been fully paid, the Decision has imposed at least 40% interest per annum on the deficiency withholding tax due from petitioner.

The subject provision from the 1997 National Internal Revenue Code is Section 249 (A), (B) and (C), which provides:

SEC. 249. Interest. -

(A) In General. - There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as



may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.

(B) Deficiency Interest. - Any deficiency in the tax due, as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

(C) Delinquency Interest. - In case of failure to pay:

(1) The amount of the tax due on any return to be filed, or

(2) The amount of the tax due for which no return is required, or

(3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax.

Although a reading of the same would allow the interpretation of a simultaneous imposition of the deficiency interest and delinquency interest, I submit my humble opinion that it is not the intent of the law to impose such an undue amount of interest on any unpaid tax due to the Government. Clearly, the imposition of at least 40% per annum interest on any unpaid tax is grossly excessive and unjust.

In the old case of **Jamora, et al. vs. Meer, etc., et al.** [74 Phil. 22 (1942)], the Supreme Court stressed that the imposition of penalties for unpaid taxes such as interest is mandatory and cannot be condoned lightly:

xxx Tax laws imposing penalties for delinquencies are clearly intended to hasten tax payments or to punish evasions or neglect of duty in respect thereof. If delays in tax payments are to be condoned for light reasons, the law imposing penalties for delinquencies would be rendered nugatory, and the maintenance of the government and its multifarious activities would be as precarious as tax payers are willing or unwilling to pay their obligations to the state in time. The imperatives of public welfare will not approve of this result.



However, despite its mandatory imposition, the Supreme Court ruled that penalties for unpaid taxes due are not penal in character but are actually compensatory and laid down the rationale in imposing the same,¹ viz:

As regards interest, the reason is —

The imposition of 1% monthly is but a just compensation to the State for the delay in paying the tax and for the concomitant use by the taxpayer of funds that rightfully should be in the government's hands. (U.S. vs. Goldstein, 189 F (2d) 752; Ross vs. U.S. 148 Fed. Supp. 330; U.S. vs. Joffray 97 Fed. (2d) 488.) The fact that the interest charged is made proportionate to the period of delay constitutes the best evidence that such interest is not penal but compensatory (Castro vs. Collector of Internal Revenue, G.R. L-12174, Dec. 28, 1962, Resolution on Motion for Reconsideration.) (Emphasis ours.)

The imposition of deficiency interest and delinquency interest simultaneously for a given period of time, which will translate to at least 40% per annum interest on any unpaid tax may partake the nature of an imposition that is penal, rather than compensatory. Hence, an interpretation that calls for the simultaneous imposition must not be condoned for being not only grossly excessive and unconscionable but, likewise, counter to the wisdom of the pronouncements of the Supreme Court.

More importantly, jurisprudence is replete with decided cases that provide for only one imposition of the 20% interest per annum on the deficiency tax due. The Supreme Court in the case of **Philippine Refining Company vs. Court of Appeals**² held that:

As correctly pointed out by the Solicitor General, the deficiency tax assessment in this case, which was the subject of the demand letter of respondent Commissioner dated April 11, 1989, should have been paid within thirty (30) days from receipt thereof. By reason of petitioner's default thereon, the delinquency penalties of 25% surcharge and interest of 20% accrued from April 11, 1989. The fact that petitioner appealed the assessment to the CTA and that the same was modified

¹ Aguinaldo Industries Corporation vs. Commissioner of Internal Revenue, G.R. No. L-29790 February 25, 1982.

² G.R. No. 118794, May 8, 1996.



does not relieve petitioner of the penalties incident to delinquency. The reduced amount of P237,381.25 is but a part of the original assessment of P1,892,584.00.

Also, in the case of **Dr. Felisa L. Vda de San Agustin vs. Commissioner of Internal Revenue**³, the Supreme Court ruled in the following manner:

The delay in the payment of the deficiency tax within the time prescribed for its payment in the notice of assessment justifies the imposition of a 25% surcharge in consonance with Section 248A(3) of the Tax Code. The basic deficiency tax in this case being P538,509.50, the twenty-five percent thereof comes to P134,627.37. Section 249 of the Tax Code states that any deficiency in the tax due would be subject to interest at the rate of twenty percent (20%) per annum, which interest shall be assessed and collected from the date prescribed for its payment until full payment is made. The computation of interest by the Court of Tax Appeals -

$$\begin{array}{rcl} \text{Deficiency estate tax} & \times & \text{Interest Rate} & \times & \text{Terms} \\ \text{P538,509.50} & & 20\% \text{ per annum} & & 11/2 \text{ mo./12 mos} \\ & & & & (11/04/91 \text{ to } 12/19/91) \\ \hline & = & \text{P13,462.74} & & \end{array}$$

conforms with the law, i.e., computed on the deficiency tax from the date prescribed for its payment until it is paid.

Moreover, Revenue Regulation No. (RR) 12-99, which implements the provisions of the National Internal Revenue Code (NIRC), inclusive of Section 249, on assessment of national internal revenue taxes, fees and charges, provides in its Sections 5.4 and 5.5 the following:

SECTION 5. Mode of Procedures in Computing for the Tax and/or Applicable Surcharge. — Shown hereunder are illustrative cases for the computation and assessment of the tax, inclusive of surcharge (if applicable) and interest:

xxx

5.4 Penalty or penalties for deficiency tax. — As a rule, no surcharge is imposed on deficiency tax and on the basic tax. However, if the amount due inclusive of penalties is not paid on or before the due date stated on the demand letter, the corresponding surcharge shall be imposed.

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³ G.R. No. 138485, September 10, 2001.

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Illustration No. 3: XYZ CORPORATION filed its income tax return for calendar year 1997 with a net taxable income of P500,000.00. At the applicable income tax rate of 35% for the year 1997, its income tax amounted to P175,000.00. However, upon investigation, it was disclosed that its income tax return was false or fraudulent because it did not report a taxable income amounting to another P500,000.00. On its net income of P1,000,000.00, per investigation, the income tax due is P350,000.00. Deducting its payment per return filed, the deficiency, excluding penalties, amounted to P175,000.00. It was duly informed of this finding through a Preliminary Assessment Notice. Failing to protest on time against the preliminary assessment notice, a formal letter of demand and assessment notice was issued on May 31, 1999 calling for payment of the deficiency income tax on or before June 30, 1999.

In this case, said corporation is liable for the civil penalties of 50% surcharge for having filed a false or fraudulent return, plus 20% interest per annum on the deficiency, computed as follows:

Calendar Year 1997	
Income tax due per investigation	P350,000.00
Less: Income tax paid per return	<u>P175,000.00</u>
Deficiency income tax	P175,000.00
Add: 50% surcharge for filing a fraudulent or false return (P175,000.00 times 50%)	87,500.00
20% int. p.a. from 4-15-98 to 6-30-99 (P175,000.00 times .2415524)	42,271.67
	<u>P129,771.67</u>
Total amount due	P304,771.67

5.5 Late payment of a deficiency tax assessed. — In general, the deficiency tax assessed shall be paid by the taxpayer within the time prescribed in the notice and demand, otherwise, such taxpayer shall be liable for the civil penalties incident to late payment.

Illustration: Based on the above Illustration No. 3, Scenario 4, assuming that the calendar year 1997 deficiency income tax assessment against XYZ CORPORATION, in the amount of P304,771.67, is not paid by June 30, 1999, the deadline for payment of the assessment, and assuming further that this assessment has already become final and collectible. In this case, such corporation shall be considered late in payment of the said assessment. Assuming, further, that the corporation pays its tax assessment only by July 31, 1999, the civil penalties for late payment shall be computed as follows:

Calendar Year 1997	
Total deficiency income tax assessed on May 31, 1999	P304,771.67
Add: 25% surcharge for late payment (P304,771.67 times 25%)	76,192.92
20% interest p.a. from 7-1-99 to 7-31-99 (P304,771.67 times .0166667)	5,079.54
	<u>81,272.46</u>
Total amount due (excluding suggested compromise penalty for late payment)	P386,044.13

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Clearly, the computation in the two aforementioned illustrated cases separated the deficiency interest from the delinquency interest. In Illustration 3 under 5.4, the 20% interest is the *deficiency interest* which was imposed on the deficiency tax of the taxpayer from the time it was supposed to be paid until the date stated in the formal letter of demand. The illustration in Section 5.5, which is a case when the taxpayer failed to settle the deficiency on the date stated in the formal letter of demand, the computation no longer imposed the said deficiency interest but merely the 20% *delinquency interest* on the deficiency tax, inclusive of the deficiency interest that accrued. This RR 12-99 was issued by the Secretary of Finance to all internal revenue officers for their guidance when implementing the relevant provisions of the NIRC. A computation of surcharges and interest on delinquent deficient taxes should properly comply with such prescribed form.

It is with the foregoing that I cannot subscribe to the view of an imposition of a deficiency interest together with the delinquency interest after the deficiency tax assessment becomes due or becomes delinquent.


ERNESTO D. ACOSTA
Presiding Justice