649 Phil. 519

SECOND DIVISION

[G.R. No. 178697, November 17, 2010]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. SONY PHILIPPINES, INC., RESPONDENT.

D E C I S I O N

MENDOZA, J.:

This petition for review on *certiorari* seeks to set aside the May 17, 2007 Decision and the July 5, 2007 Resolution of the Court of Tax Appeals - En Banc[1] *(CTA-EB),* in C.T.A. EB No. 90, affirming the October 26, 2004 Decision of the CTA-First Division[2] which, in turn, partially granted the petition for review of respondent Sony Philippines, Inc. *(Sony)*. The CTA-First Division decision cancelled the deficiency assessment issued by petitioner Commissioner of Internal Revenue *(CIR)* against Sony for Value Added Tax *(VAT)* but upheld the deficiency assessment for expanded withholding tax *(EWT)* in the amount of P1,035,879.70 and the penalties for late remittance of internal revenue taxes in the amount of P1,269, 593.90.[3]

THE FACTS:

On November 24, 1998, the CIR issued Letter of Authority No. 000019734 *(LOA 19734)* authorizing certain revenue officers to examine Sony's books of accounts and other accounting records regarding revenue taxes for **"the period 1997 and unverified prior years."** On December 6, 1999, a preliminary assessment for 1997 deficiency taxes and penalties was issued by the CIR which Sony protested. Thereafter, acting on the protest, the CIR issued final assessment notices, the formal letter of demand and the details of discrepancies.[4] Said details of the deficiency taxes and penalties for late remittance of internal revenue taxes are as follows:

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

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

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

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

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

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

LATE REMITTANCE OF FINAL WITHHOLDING TAX (Assessment No. ST-LR2-97-0127-2000)

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

LATE REMITTANCE OF INCOME PAYMENTS (Assessment No. ST-LR3-97-0128-2000)

Basic Tax Due	P	
Add: Penalties		
25 % Surcharge	P 8,865.34	
Interest up to 3-31-2000	58.29	
Compromise	2,000.00	10,923.60
Penalties Due	P	10,923.60

GRAND TOTAL **P15,895,632.65**[5]

Sony sought re-evaluation of the aforementioned assessment by filing a protest on February 2, 2000. Sony submitted relevant documents in support of its protest on the 16th of that same month.[6]

On October 24, 2000, within 30 days after the lapse of 180 days from submission of the said supporting documents to the CIR, Sony filed a petition for review before the CTA.[7]

After trial, the CTA-First Division disallowed the deficiency VAT assessment because the subsidized advertising expense paid by Sony which was duly covered by a VAT invoice resulted in an input VAT credit. As regards the EWT, the CTA-First Division maintained the deficiency EWT assessment on Sony's motor vehicles and on professional fees paid to general professional partnerships. It also assessed the amounts paid to sales agents as commissions with five percent (5%) EWT pursuant to Section 1(g) of Revenue Regulations No. 6-85. The CTA-First Division, however, disallowed the EWT assessment on rental expense since it found that the total rental deposit of P10,523,821.99 was incurred from January to March 1998 which was again beyond the coverage of LOA 19734. Except for the compromise penalties, the CTA-First Division also upheld the penalties for the late payment of VAT on royalties, for late remittance of final withholding tax on royalty as of December 1997 and for the late remittance of EWT by some of Sony's branches.[8] In sum, the CTA-First Division partly granted Sony's petition by cancelling the deficiency VAT assessment but upheld a modified deficiency EWT assessment as well as the penalties. Thus, the dispositive portion reads:

> WHEREFORE, the petition for review is hereby PARTIALLY GRANTED. Respondent is ORDERED to CANCEL and WITHDRAW the deficiency assessment for value-added tax for 1997 for lack of merit. However, the deficiency assessments for expanded withholding tax and penalties for late remittance of internal revenue taxes are UPHELD.
>
> Accordingly, petitioner is DIRECTED to PAY the respondent the deficiency expanded withholding tax in the amount of P1,035,879.70 and the following penalties for late remittance of internal revenue taxes in the sum of P1,269,593.90:
>
> 1. VAT on Royalty P 429,242.07
> 2. Withholding Tax on Royalty 831,428.20
> 3. EWT of Petitioner's Branches 8,923.63
>
> Total P 1,269,593.90

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

SO ORDERED.[9]

The CIR sought a reconsideration of the above decision and submitted the following grounds in support thereof:

A. The Honorable Court committed reversible error in holding that petitioner is not liable for the deficiency VAT in the amount of P11,141,014.41;

B. The Honorable court committed reversible error in holding that the commission expense in the amount of P2,894,797.00 should be subjected to 5% withholding tax instead of the 10% tax rate;

C. The Honorable Court committed a reversible error in holding that the withholding tax assessment with respect to the 5% withholding tax on rental deposit in the amount of P10,523,821.99 should be cancelled; and

D. The Honorable Court committed reversible error in holding that the remittance of final withholding tax on royalties covering the period January to March 1998 was filed on time.[10]

On April 28, 2005, the CTA-First Division denied the motion for reconsideration. Unfazed, the CIR filed a petition for review with the CTA-EB raising identical issues:

1. Whether or not respondent (Sony) is liable for the deficiency VAT in the amount of P11,141,014.41;

2. Whether or not the commission expense in the amount of P2,894,797.00 should be subjected to 10% withholding tax instead of the 5% tax rate;

3. Whether or not the withholding assessment with respect to the 5% withholding tax on rental deposit in the amount of P10,523,821.99 is proper; and

4. Whether or not the remittance of final withholding tax on royalties covering the period January to March 1998 was filed outside of time.[11]

Finding no cogent reason to reverse the decision of the CTA-First Division, the CTA-EB dismissed CIR's petition on May 17, 2007. CIR's motion for reconsideration was denied by the CTA-EB on July 5, 2007.

The CIR is now before this Court via this petition for review relying on the very same grounds it raised before the CTA-First Division and the CTA-EB. The said grounds are reproduced below:

GROUNDS FOR THE ALLOWANCE OF THE PETITION

I

THE CTA EN BANC ERRED IN RULING THAT RESPONDENT IS NOT LIABLE FOR DEFICIENCY VAT IN THE AMOUNT OF PHP11,141,014.41.

II

AS TO RESPONDENT'S DEFICIENCY EXPANDED WITHHOLDING TAX IN THE AMOUNT OF PHP1,992,462.72:

A. THE CTA EN BANC ERRED IN RULING THAT THE COMMISSION EXPENSE IN THE AMOUNT OF PHP2,894,797.00 SHOULD BE SUBJECTED TO A WITHHOLDING TAX OF 5% INSTEAD OF THE 10% TAX RATE.

B. THE CTA EN BANC ERRED IN RULING THAT THE ASSESSMENT WITH RESPECT TO THE 5% WITHHOLDING TAX ON RENTAL DEPOSIT IN THE AMOUNT OF PHP10,523,821.99 IS NOT PROPER.

III

THE CTA EN BANC ERRED IN RULING THAT THE FINAL WITHHOLDING TAX ON ROYALTIES COVERING THE PERIOD JANUARY TO MARCH 1998 WAS FILED ON TIME.[12]

Upon filing of Sony's comment, the Court ordered the CIR to file its reply thereto. The CIR subsequently filed a manifestation informing the Court that it would no longer file a reply. Thus, on December 3, 2008, the Court resolved to give due course to the petition and to decide the case on the basis of the pleadings filed.[13]

The Court finds no merit in the petition.

The CIR insists that LOA 19734, although it states "the period 1997 and unverified prior years," should be understood to mean the fiscal year ending in March 31, 1998. [14] The Court cannot agree.

Based on Section 13 of the Tax Code, a Letter of Authority or LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. It empowers or enables said revenue officer to examine the books of account and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax.[15] The very provision of the Tax Code that the CIR relies on is unequivocal with regard to its power to grant authority to examine and assess a taxpayer.

> SEC. 6. **Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. -**
>
> (A)Examination of Returns and Determination of tax Due. - After a return has been filed as required under the provisions of this Code, the Commissioner or his duly authorized representative **may authorize the examination of any taxpayer and the assessment of the correct amount of tax:** *Provided*, *however*, That failure to file a return shall not prevent the Commissioner from **authorizing the examination of any taxpayer.** x x x [Emphases supplied]

Clearly, there must be a grant of authority before any revenue officer can conduct an examination or assessment. Equally important is that the revenue officer so authorized must not go beyond the authority given. In the absence of such an authority, the assessment or examination is a nullity.

As earlier stated, LOA 19734 covered "the period 1997 and unverified prior years." For said reason, the CIR acting through its revenue officers went beyond the scope of their authority because the deficiency VAT assessment they arrived at was based on records from January to March 1998 or using the fiscal year which ended in March 31, 1998. As pointed out by the CTA-First Division in its April 28, 2005 Resolution, the CIR knew which period should be covered by the investigation. Thus, if CIR wanted or intended the investigation to include the year 1998, it should have done so by including it in the LOA or issuing another LOA.

Upon review, the CTA-EB even added that the coverage of LOA 19734, particularly the phrase "and unverified prior years," violated Section C of Revenue Memorandum Order No. 43-90 dated September 20, 1990, the pertinent portion of which reads:

> 3. A Letter of Authority should cover **a taxable period not exceeding one taxable year**. The practice of issuing L/As covering audit of "unverified

> prior years is hereby prohibited. If the audit of a taxpayer shall include more than one taxable period, the other periods or years shall be specifically indicated in the L/A.[16] [Emphasis supplied]

On this point alone, the deficiency VAT assessment should have been disallowed. Be that as it may, the CIR's argument, that Sony's advertising expense could not be considered as an input VAT credit because the same was eventually reimbursed by Sony International Singapore *(SIS),* is also erroneous.

The CIR contends that since Sony's advertising expense was reimbursed by SIS, the former never incurred any advertising expense. As a result, Sony is not entitled to a tax credit. At most, the CIR continues, the said advertising expense should be for the account of SIS, and not Sony.[17]

The Court is not persuaded. As aptly found by the CTA-First Division and later affirmed by the CTA-EB, Sony's deficiency VAT assessment stemmed from the CIR's disallowance of the input VAT credits that should have been realized from the advertising expense of the latter.[18] It is evident under Section 110[19] of the 1997 Tax Code that an advertising expense duly covered by a VAT invoice is a legitimate business expense. This is confirmed by no less than CIR's own witness, Revenue Officer Antonio Aluquin.[20] There is also no denying that Sony incurred advertising expense. Aluquin testified that advertising companies issued invoices in the name of Sony and the latter paid for the same.[21] Indubitably, Sony incurred and paid for advertising expense/ services. Where the money came from is another matter all together but will definitely not change said fact.

The CIR further argues that Sony itself admitted that the reimbursement from SIS was income and, thus, taxable. In support of this, the CIR cited a portion of Sony's protest filed before it:

> The fact that due to adverse economic conditions, Sony-Singapore has granted to our client a subsidy equivalent to the latter's advertising expenses will not affect the validity of the input taxes from such expenses. Thus, at the most, this is an additional income of our client subject to income tax. We submit further that our client is not subject to VAT on the subsidy income as this was not derived from the sale of goods or services. [22]

Insofar as the above-mentioned subsidy may be considered as income and, therefore, subject to income tax, the Court agrees. However, the Court does not agree that the same subsidy should be subject to the 10% VAT. To begin with, the said subsidy termed by the CIR as reimbursement was not even exclusively earmarked for Sony's

advertising expense for it was but an assistance or aid in view of Sony's dire or adverse economic conditions, and was only "equivalent to the latter's (Sony's) advertising expenses."

Section 106 of the Tax Code explains when VAT may be imposed or exacted. Thus:

> SEC. 106. **Value-added Tax on Sale of Goods or Properties. -**
>
> (A) Rate and Base of Tax. - There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor.

Thus, there must be a sale, barter or exchange of goods or properties before any VAT may be levied. Certainly, there was no such sale, barter or exchange in the subsidy given by SIS to Sony. It was but a dole out by SIS and not in payment for goods or properties sold, bartered or exchanged by Sony.

In the case of *CIR v. Court of Appeals (CA)*,[23] the Court had the occasion to rule that services rendered for a fee even on reimbursement-on-cost basis only and without realizing profit are also subject to VAT. The case, however, is not applicable to the present case. In that case, COMASERCO rendered service to its affiliates and, in turn, the affiliates paid the former reimbursement-on-cost which means that it was paid the cost or expense that it incurred although without profit. This is not true in the present case. Sony did not render any service to SIS at all. The services rendered by the advertising companies, paid for by Sony using SIS dole-out, were for Sony and not SIS. SIS just gave assistance to Sony in the amount equivalent to the latter's advertising expense but never received any goods, properties or service from Sony.

Regarding the deficiency EWT assessment, more particularly Sony's commission expense, the CIR insists that said deficiency EWT assessment is subject to the ten percent (10%) rate instead of the five percent (5%) citing Revenue Regulation No. 2-98 dated April 17, 1998.[24] The said revenue regulation provides that the 10% rate is applied when the recipient of the commission income is a natural person. According to the CIR, Sony's schedule of Selling, General and Administrative expenses shows the commission expense as "commission/dealer salesman incentive," emphasizing the word salesman.

On the other hand, the application of the five percent (5%) rate by the CTA-First Division is based on Section 1(g) of Revenue Regulations No. 6-85 which provides:

> (g) Amounts paid to certain Brokers and Agents. - On gross payments to

customs, insurance, real estate and commercial brokers and agents of professional entertainers - five per centum (5%).[25]

In denying the very same argument of the CIR in its motion for reconsideration, the CTA-First Division, held:

> x x x, commission expense is indeed subject to 10% withholding tax but payments made to broker is subject to 5% withholding tax pursuant to Section 1(g) of Revenue Regulations No. 6-85. While the commission expense in the schedule of Selling, General and Administrative expenses submitted by petitioner (SPI) to the BIR is captioned as "commission/dealer salesman incentive" the same does not justify the automatic imposition of flat 10% rate. As itemized by petitioner, such expense is composed of "Commission Expense" in the amount of P10,200.00 and `Broker Dealer' of P2,894,797.00.[26]

The Court agrees with the CTA-EB when it affirmed the CTA-First Division decision. Indeed, the applicable rule is Revenue Regulations No. 6-85, as amended by Revenue Regulations No. 12-94, which was the applicable rule during the subject period of examination and assessment as specified in the LOA. Revenue Regulations No. 2-98, cited by the CIR, was only adopted in April 1998 and, therefore, cannot be applied in the present case. Besides, the withholding tax on brokers and agents was only increased to 10% much later or by the end of July 2001 under Revenue Regulations No. 6-2001.[27] Until then, the rate was only 5%.

The Court also affirms the findings of both the CTA-First Division and the CTA-EB on the deficiency EWT assessment on the rental deposit. According to their findings, Sony incurred the subject rental deposit in the amount of P10,523,821.99 only from January to March 1998. As stated earlier, in the absence of the appropriate LOA specifying the coverage, the CIR's deficiency EWT assessment from January to March 1998, is not valid and must be disallowed.

Finally, the Court now proceeds to the third ground relied upon by the CIR.

The CIR initially assessed Sony to be liable for penalties for belated remittance of its FWT on royalties (i) as of December 1997; and (ii) for the period from January to March 1998. Again, the Court agrees with the CTA-First Division when it upheld the CIR with respect to the royalties for December 1997 but cancelled that from January to March 1998.

The CIR insists that under Section 3[28] of Revenue Regulations No. 5-82 and Sections 2.57.4 and 2.58(A)(2)(a)[29] of Revenue Regulations No. 2-98, Sony should also be

made liable for the FWT on royalties from January to March of 1998. At the same time, it downplays the relevance of the Manufacturing License Agreement (MLA) between Sony and Sony-Japan, particularly in the payment of royalties.

The above revenue regulations provide the manner of withholding remittance as well as the payment of final tax on royalty. Based on the same, Sony is required to deduct and withhold final taxes on royalty payments when the royalty is paid or is payable. After which, the corresponding return and remittance must be made within 10 days after the end of each month. The question now is when does the royalty become payable?

Under Article X(5) of the MLA between Sony and Sony-Japan, the following terms of royalty payments were agreed upon:

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

Withal, Sony was to pay Sony-Japan royalty within two (2) months after every semi-annual period which ends in June 30 and December 31. However, the CTA-First Division found that there was accrual of royalty by the end of December 1997 as well as by the end of June 1998. Given this, the FWTs should have been paid or remitted by Sony to the CIR on January 10, 1998 and July 10, 1998. Thus, it was correct for the CTA-First Division and the CTA-EB in ruling that the FWT for the royalty from January to March 1998 was seasonably filed. Although the royalty from January to March 1998 was well within the semi-annual period ending June 30, which meant that the royalty may be payable until August 1998 pursuant to the MLA, the FWT for said royalty had to be paid on or before July 10, 1998 or 10 days from its accrual at the end of June 1998. Thus, when Sony remitted the same on July 8, 1998, it was not yet late.

In view of the foregoing, the Court finds no reason to disturb the findings of the CTA-EB.

WHEREFORE, the petition is **DENIED.**

SO ORDERED.

Carpio, (Chairperson), Leonardo-De Castro,[*] *Peralta*, and *Abad, JJ*., concur.

* Designated as additional member in lieu of Justice Antonio Eduardo B. Nachura per raffle dated April 14, 2010.

[1] Penned by Associate Justice Lovell R. Bautista with Presiding Justice Ernesto D. Acosta and Associate Justices Juanito C. Castañeda, Erlinda P. Uy, Caesar A. Casanova and Olga Palanca-Enriquez, concurring.

[2] Penned by Presiding Justice Ernesto D. Acosta with Associate Lovell R. Bautista, concurring.

[3] *Rollo*, pp. 9-10.

[4] Id. at 60-61.

[5] Id.

[6] Id. at 62.

[7] Id.

[8] Id. at 42.

[9] Id. at 83-84.

[10] Id. at 86.

[11] Id. at 43.

[12] Id. at 16-17.

[13] Id. at 253.

[14] Id. at 17-18.

[15] National Internal Revenue Code;

SEC. 13. **Authority of a Revenue Officer. -** Subject to the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, a Revenue Officer assigned to perform assessment functions in any district may, **pursuant to a Letter of Authority** issued by the Revenue Regional Director, **examine taxpayers within the jurisdiction of the district in order to collect the correct amount of tax, or to recommend the assessment of any deficiency tax**

due in the same manner that the said acts could have been performed by the Revenue Regional Director himself. (emphasis supplied)

[16] Revenue Memorandum Order No. 43-90 dated September 20, 1990, amending Revenue Memorandum Order No. 37-90 prescribing revised guidelines for Examination of Returns and Issuance of Letters of Authority to Audit, *rollo*, p. 46.

[17] Id. at 21.

[18] Id. at 64.

[19] National Internal Revenue Code;

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:

x x x.

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

x x x.

The term `**input tax**' means **the value-added tax due from or paid by a VAT-registered person in the course of his trade or business on** importation of goods or local purchase of goods or **services**, including lease or use of property, from a VAT-registered person. It shall also include the transitional input tax determined in accordance with Section 111 of this Code.

x x x. (emphasis supplied)

[20] *Rollo*, p. 66; TSN, February 27, 2003, pp. 33-34 and 36.

[21] Id. at 68; TSN, February 27, 2003, pp. 55-58.

[22] Id. at 22.

[23] *CIR v. CA*, 385 Phil. 875 (2000).

[24] *Rollo*, p. 24.

[25] Id. at 75.

[26] Id. at 88.

[27] Id. at 52.

[28] Revenue Regulations No. 5-82

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

[29] Revenue Regulations No. 2-98

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

Section 2.58 Returns and Payment of Taxes Withheld at Source. -

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

x x x

(2) When to File -

[30] *Rollo*, p. 81.