

## 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<sup>[1]</sup> (CTA-EB), in C.T.A. EB No. 90, affirming the October 26, 2004 Decision of the CTA-First Division<sup>[2]</sup> 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.<sup>[3]</sup>

#### 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.<sup>[4]</sup> 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	<u>25,000.00</u>	<u>3,182,314.41</u>
Deficiency VAT Due	P	<u>11,141,014.41</u>

#### **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		<u>25,000.00</u>
Deficiency EWT Due	P	<u>1,992,462.72</u>

**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		<u>16,000.00</u>
Penalties Due	P	<u>462,758.14</u>

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

Basic Tax Due	P	
Add: Penalties		
Surcharge	P	1,729,690.71
Interest up to 3-31-2000		508,783.07
Compromise		<u>50,000.00</u>
Penalties Due	P	<u>2,288,473.78</u>

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

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

**GRAND TOTAL** **P15,895,632.65**<sup>[5]</sup>

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 16<sup>th</sup> of that same month.<sup>[6]</sup>

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.<sup>[7]</sup>

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.<sup>[8]</sup> 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.<sup>[9]</sup>

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.<sup>[10]</sup>

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.<sup>[11]</sup>

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:

### **GROUND 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.**<sup>[12]</sup>

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.<sup>[13]</sup>

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.<sup>[14]</sup> 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.<sup>[15]</sup> 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