REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

Special Second Division

WESTCOAST AUTOMOTIVE CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 10561

Members:
RINGPIS-LIBAN, *PJ, Chairperson,*
MODESTO-SAN PEDRO, *and*
FERRER-FLORES, *JJ.*

Promulgated:
FEB 14 2023
1:40 p.m.

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DECISION

MODESTO-SAN PEDRO, J.:

The Case

Before the Court is a Petition for Review, filed on June 25, 2021, seeking the cancellation and withdrawal of respondent's assessment against petitioner for alleged deficiency income tax ("IT"), value-added tax ("VAT"), and administrative penalties covering the period from July 1, 2016 to June 30, 2017 ("subject period").

The Parties[1]

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines. Its principal office is located at Lot C-2, Subic Bay Gateway Park, Phase 1, Commercial Area, Subic Bay Freeport Zone, Philippines. It is registered with the Subic Bay Metropolitan Authority ("SBMA") and the Bureau of Internal Revenue ("BIR").

Respondent is the duly appointed Commissioner of Internal Revenue who is tasked to assess and collect all national internal revenue taxes, fees, and charges and enforce all forfeitures, penalties, and fines connected therewith.

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[1] Joint Stipulation of Facts and Issues, pp. 1-2, *Rollo* Vol. 1, pp. 558-559.

The Facts

On April 25, 2019, petitioner received Letter of Authority No. 124-2019-00000137 with Serial no. eLA201600096849, dated March 19, 2019, for the examination of its books of accounts and other accounting records for all internal revenue taxes for the subject period.[2]

Over a year later, petitioner received a Preliminary Assessment Notice ("PAN") on August 19, 2020, assessing it for alleged deficiency IT, VAT, expanded withholding tax ("EWT"), documentary stamp tax ("DST"), and miscellaneous tax. Petitioner filed a Reply Letter to the PAN on September 3, 2020, arguing that the assessment lacked factual and legal basis.[3]

Petitioner then received a Formal Letter of Demand ("FLD"), dated October 9, 2020, on October 20, 2020.[4] Aggrieved, petitioner filed a Protest Letter to the FLD on November 18, 2020, followed by a Letter with additional documents on January 14, 2021.[5]

On May 24, 2021, petitioner paid a portion of the assessed EWT, including interest and compromise penalty.[6]

However, on May 26, 2021, petitioner received respondent's Final Decision on Disputed Assessment ("FDDA").[7]

While petitioner paid the remaining portion of the assessed EWT and a portion of the assessed IT, including interest, on June 18, 2021, it was evidently not satisfied with the FDDA, as it filed the instant Petition on June 25, 2021. Respondent filed his Answer[8] on October 27, 2021.

The Court then conducted a full-blown trial, with petitioner presenting witness Allan S. Laxina[9] and Independent Certified Public Accountant ("ICPA") Atty. Edward M. Menor[10] and respondent presenting Revenue Officer Joann Serquiña.[11] The Court admitted all exhibits offered by both petitioner[12] and respondent.[13]

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[2] Petition for Review, pp. 2-3, *id.* at 7-8.
[3] Petition for Review, p. 3, *id.* at 8.
[4] *Id.*
[5] Petition for Review, p. 5, *id.* at 10.
[6] Petition for Review, p. 6, *id.* at 11.
[7] *Id.*
[8] *Id.* at 357-374.
[9] *See* Minutes of the Hearing, held on November 8, 2022, *id.* at 603.
[10] *See* Minutes of the Hearing, held on September 7, 2023, *Rollo* Vol. 2, p. 802.
[11] *See* Minutes of the Hearing, held on August 1, 2024, *Rollo* Vol. 3, p. 1129.
[12] Resolution, dated June 7, 2024, p. 2, *id.* at 1127.
[13] Resolution, dated December 6, 2024, p. 1, *id.* at 1151.

Petitioner[14] and respondent[15] filed their respective Memoranda on the same day: February 3, 2025. Thus, on February 10, 2025, the Court submitted this case for decision, via a Minute Resolution.[16]

Hence, this Decision.

The Issue

The sole issue raised before this Court is whether petitioner is liable for the assessed deficiency IT, VAT, and administrative penalties for the subject period.

Arguments of the Parties

Petitioner's Arguments

Petitioner raises the following arguments in its Memorandum:

(1) As petitioner's sales of automotive goods and services were done within the Subic Special Economic and Freeport Zone ("SSEFZ"), the income derived therefrom is considered income from sources within the SSEFZ, regardless of whether its customers were not registered with the Subic Bay Metropolitan Authority ("SBMA") or not residents of the SSEFZ; as such, respondent erred in using these to consider petitioner as having breached the 30% threshold of income from sources within the Customs Territory (*i.e.*, within Philippine territory outside of the SSEFZ);

(2) Respondent also erred in considering petitioner to have breached the 30% threshold by using petitioner's income from activities other than those for which it is registered with the SBMA as such activities, such as providing assistance with obtaining car insurance policies or loans, are still integral and related to its "main" car dealership business;

(3) The assessment for undeclared revenue is erroneous as it is based on mere presumptions and unverified third-party matching, contrary to respondent's own *Revenue Memorandum Order* ("*RMO*") *Nos. 04-2003 and 46-2004*;

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14 *Id.* at 1182-1223.
15 *Id.* at 1154-1178.
16 *Id.* at 1227.

(4) The assessment for undeclared revenue from unaccounted purchases is also mistaken as the same is also based on unverified third-party information and as income tax should not be imposed based merely on alleged undeclared or underdeclared purchases;

(5) The assessment for income not subjected to income tax should be cancelled as petitioner already paid the tax on such after its receipt of the FDDA, albeit calculated using the preferential 5% gross income tax ("PGIT") rate rather than the higher 30% regular corporate income tax ("RCIT") as it did not breach the 30% threshold;

(6) As petitioner paid the deficiency EWT, including interest and compromise penalty, the cost of sales/revenues should be allowed as a deduction in the computation of the alleged deficiency IT;

(7) As with respondent's assessment of deficiency IT from undeclared revenue, his assessment of deficiency VAT from undeclared revenue should be similarly cancelled as it is also based on mere presumptions and unverified third-party matching;

(8) As with respondent's assessment of deficiency IT from unaccounted purchases, his assessment deficiency VAT from unaccounted purchases should also be cancelled, for similar reasons;

(9) Petitioner did not breach the 30% threshold, so its sales are exempt from 12% VAT; and

(10) Compromise penalties are only amounts suggested in settling criminal liabilities and cannot be imposed, so the assessment of such penalties against petitioner should be cancelled as well.

Respondent's Arguments

Meanwhile, in respondent's Memorandum, he counters the above as so:

(1) Considering that 83% of petitioner's sales during the subject period were to customers either not registered with the SBMA or not residing in the SSEFZ, it crossed the 30% threshold and is thus liable for the higher 30% RCIT;

(2) As petitioner failed to substantiate its claim, that its sources of other income are integral to its main business, at the administrative level, it cannot submit new documents to substantiate that claim here at the judicial level;

(3) Respondent properly used the Reconciliation of Listing for Enforcement ("RELIEF") system to match petitioner's undeclared sales and purchases with the actual purchases and sales of other taxpayers;

(4) Petitioner paid only a portion of the EWT due and did not provide respondent with a breakdown of said payment;

(5) As with his assessment of deficiency IT, respondent's use of the RELIEF system as a basis for his deficiency VAT assessment against petitioner is valid;

(6) As, to reiterate, petitioner exceeded the 30% threshold, it is still liable for 12% VAT; and

(7) The compromise penalty was imposed as petitioner failed to pay the taxes due within the time prescribed.

The Ruling of the Court

The petition is meritorious.

A taxpayer only qualifies for the PGIT if its income from sources within the Philippines does not exceed 30% of its total income

Respondent's assessment is based on the contention that petitioner is liable for RCIT and VAT, not the PGIT. He argues that petitioner crossed the 30% threshold provided by *Section 44 of the Implementing Rules and Regulations* ("*IRR*") *of Republic Act* ("*RA*") *No. 7227*. He argues so as he sees a number of petitioner's sources of income as being from within the Philippines. For petitioner, however, these sources are *not* from within the Philippines, so it qualifies for paying the PGIT in lieu of all national internal revenue taxes, such as RCIT and VAT. The crux of the current controversy, then, is what sources count as being within the Philippines.

Sections 12(b) & (c) of RA No. 7227 provide that businesses within the SSEFZ are allowed to pay only 3% of their gross income earned to the government of the Philippines in lieu of national internal revenue taxes:

> (b) The Subic Special Economic Zone shall be operated and managed as a separate customs territory ensuring free flow or movement of goods and capital within, into and exported out of the Subic Special Economic Zone, as well as provide incentives such as tax and duty-free importations of raw materials, capital and equipment. However, exportation or removal of goods from the territory of the Subic Special Economic Zone

> to the other parts of the Philippine territory shall be subject to customs duties and taxes under the Customs and Tariff Code and other relevant tax laws of the Philippines;
>
> (c) The provision of existing laws, rules and regulations to the contrary notwithstanding, *no taxes, local and national, shall be imposed within the Subic Special Economic Zone.* ***In lieu of paying taxes, three percent (3%) of the gross income earned by all businesses and enterprise within the Subic Special Economic Zone shall be remitted to the National Government***, one percent (1%) each to the local government units affected by the declaration of the zone in proportion to their population area, and other factors. In addition, there is hereby established a development fund of one percent (1%) of the gross income earned by all business and enterprise within the Subic Special Economic Zone to be utilized for the development of municipalities outside the City of Olongapo and the Municipality of Subic, and other municipalities contiguous to the base areas.
>
> In case of conflict between national and local laws with respect to tax exemption privileges in the Subic Special Economic Zone, the same shall be resolved in favor of the latter;
> (Emphasis and italics supplied.)

However, a taxpayer only qualifies for this PGIT if the income it gains from "sources within the Customs Territory"—which are sources within the Philippines—does not exceed 30% of its total income, as laid down in *Section 44 of the IRR of RA No. 7227*:

> Sec. 44. Percentage of Income Allowable from Sources Within the Customs Territory. *SBF Enterprises may generate income from sources within the Customs Territory of up to Thirty Percent (30%) of its total income from all sources*; provided, that ***should an SBF Enterprise's income from sources within the Custom[s] Territory exceed Thirty Percent (30%) of its total income from all sources, then it shall be subject to the income tax laws of the Customs Territory***; provided, further, that in any case, custom duties and taxes must be paid with the [sic] respect to income from sales of articles to the Customs Territory.
> (Emphasis and italics supplied.)

Section 3 of the IRR of RA No. 7227, which defines various terms, unfortunately lacks a definition of "sources within the Customs Territory", though *Sections 4(a) & (b)* of the same require that its rules be construed in favor of the SSEFZ and of tax exemption privileges within it.

The instant case thus arises from this ambiguity. Petitioner earned income from sales and services for various customers who were either not registered with the SBMA or were not residents of the SSEFZ. These customers came from the Philippines. For respondent, as these customers came from the Philippines, the income earned from such customers is income earned from sources within the Philippines. For petitioner, as the sales made to and services performed for such customers were all done within the SSEFZ, the income earned from such sales and services is *not* income from sources within the Philippines.

To put the question another way: what exactly are "sources" in the phrase "sources within the [Philippines]"? Are petitioner's *customers* its sources of income, as implied by respondent's arguments? Or are petitioner's *sales and services* its sources of income, as petitioner insists?

After a review of relevant laws and jurisprudence, the Court finds for petitioner.

The location of a source of income is the place where the income-generating activity was performed

In *Commissioner of Internal Revenue v. Baier-Nickel*[17] ("*Baier-Nickel*"), the Supreme Court explained the location of a source of income, in the context of the taxability of non-resident aliens, in this wise:

> Pursuant to [*Section 25(a)(1) & (b) of the National Internal Revenue Code of 1997, as amended* ("*NIRC*")], non-resident aliens, whether or not engaged in trade or business, are subject to Philippine income taxation on their income received from all sources within the Philippines. Thus, the keyword in determining the taxability of non-resident aliens is the income's "source." In construing the meaning of "source" in Section 25 of the NIRC, resort must be had on the origin of the provision.
>
> The first Philippine income tax law enacted by the Philippine Legislature was Act No. 2833, which took effect on January 1, 1920. Under Section 1 thereof, nonresident aliens are likewise subject to tax on income "from all sources within the Philippine Islands," thus —
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>> SECTION 1. (a) There shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the Philippine Islands, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the Philippine Islands by every individual, a nonresident alien, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise.
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> Act No. 2833 substantially reproduced the United States (U.S.) Revenue Law of 1916 as amended by U.S. Revenue Law of 1917. Being a law of American origin, the authoritative decisions of the official charged with enforcing it in the U.S. have peculiar persuasive force in the Philippines.

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17 G.R. No. 153793, August 29, 2006.

The Internal Revenue Code of the U.S. enumerates specific types of income to be treated as from sources within the U.S. and specifies when similar types of income are to be treated as from sources outside the U.S. Under the said Code, compensation for labor and personal services performed in the U.S., is generally treated as income from U.S. sources; while compensation for said services performed outside the U.S., is treated as income from sources outside the U.S. A similar provision is found in Section 42 of our NIRC, thus:

> SEC. 42. . . .
>
> (A) Gross Income From Sources Within the Philippines. . . .
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> . . . .
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> (3) Services. — Compensation for labor or personal services performed in the Philippines;
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> . . . .
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> (C) Gross Income From Sources Without the Philippines. . . .
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> . . . .
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> (3) Compensation for labor or personal services performed without the Philippines;

The following discussions on sourcing of income under the Internal Revenue Code of the U.S., are instructive:

> The Supreme Court has said, in a definition much quoted but often debated, that income may be derived from three possible sources only: (1) capital and/or (2) labor; and/or (3) the sale of capital assets. While the three elements of this attempt at definition need not be accepted as all-inclusive, they serve as useful guides in any inquiry into whether a particular item is from "sources within the United States" and suggest an investigation into the nature and location of the activities or property which produce the income.
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> If the income is from labor the place where the labor is done should be decisive; if it is done in this country, the income should be from "sources within the United States." If the income is from capital, the place where the capital is employed should be decisive; if it is employed in this country, the income should be from "sources within the United States." If the income is from the sale of capital assets, the place where the sale is made should be likewise decisive.
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> Much confusion will be avoided by regarding the term "source" in this fundamental light. It is not a place, it is an activity or property. As such, it has a situs or location, and if that situs or location is within the United States the

resulting income is taxable to nonresident aliens and foreign corporations.

The intention of Congress in the 1916 and subsequent statutes was to discard the 1909 and 1913 basis of taxing nonresident aliens and foreign corporations and to make the test of taxability the "source," or situs of the activities or property which produce the income. The result is that, on the one hand, nonresident aliens and nonresident foreign corporations are prevented from deriving income from the United States free from tax, and, on the other hand, there is no undue imposition of a tax when the activities do not take place in, and the property producing income is not employed in, this country. Thus, if income is to be taxed, the recipient thereof must be resident within the jurisdiction, or the property or activities out of which the income issues or is derived must be situated within the jurisdiction so that the source of the income may be said to have a situs in this country.

The underlying theory is that the consideration for taxation is protection of life and property and that the income rightly to be levied upon to defray the burdens of the United States Government is that income which is created by activities and property protected by this Government or obtained by persons enjoying that protection.

The important factor therefore which determines the source of income of personal services is *not the residence of the payor, or the place where the contract for service is entered into, or the place of payment, but* ***the place where the services were actually rendered.***

. . . .

The Court reiterates the rule that *"source of income" relates to* ***the property, activity or service that produced the income.*** With respect to rendition of labor or personal service, as in the instant case, *it is the place where the labor or service was performed that determines the source of the income.* ***There is therefore no merit in petitioner's interpretation which equates source of income in labor or personal service with the residence of the payor or the place of payment of the income.***
(Citations omitted; emphasis and italics supplied.)

The last two paragraphs quoted above are clear. In determining the location of a source of income, what is controlling is "the place where the services were actually rendered", *not* other related locations, such as the residence of the payor.

Another relevant case is that of *Aces Philippines Cellular Satellite Corporation v. The Commissioner of Internal Revenue*[18] ("*Aces*"). There, Aces Bermuda, a foreign company, operated telecommunications satellites. These satellites were located in outer space, which is outside of Philippine

[18] G.R. No. 226680, August 30, 2022.

jurisdiction. While they did not own the terrestrial gateways in the Philippines to which its satellites routed communications, the Supreme Court still deemed Aces Bermuda as taxable by the Philippines. This is because the income from such telecommunications operations was generated upon "receipt of the routed call by gateways located within the Philippines." That Aces Bermuda was a foreign company, that the satellites were outside Philippine jurisdiction, and that it did not legally own the terrestrial gateways were of not moment: the calls routed by Aces Bermuda's satellites were taken within the Philippines. The service thus occurred within the Philippines, so the income was generated within the Philippines. As such, the source of income was considered to have been from within the Philippines and taxable by the Philippine government.[19]

Baier-Nickel and *Aces* both refute respondent's treatment of "sources from within the [Philippines]" as sources of income that *originate* from the Philippines. In *Baier-Nickel*, the residence of the income payor or the place where the income was paid did not matter. In *Aces*, that Aces Bermuda was a foreign company which only legally owned equipment outside of Philippine territory was likewise deemed not controlling. What was decisive was *where the income-generating activity actually occurred.* Applied here, the non-registration or non-residency of petitioner's customers is of no moment: it is *where its sales and services were actually done* that is important.

Indeed, respondent's taking of a source of income's origin as its location is not even consistent with tax laws more general than *RA No. 7227.* A hypothetical situation based on *Section 28(b)(1) of the NIRC* illustrates this. Consider said provision:

> SEC. 28. Rates of Income Tax on Foreign Corporations. —
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> . . . .
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> (B) Tax on Nonresident Foreign Corporation. —
>
> (1) In General. — Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines, effective January 1, 2021, shall pay a tax equal to twenty-five percent (25%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed and determinable annual, periodic or casual gains, profits and incomes, and capital gains, except capital gains subject to tax under subparagraph 5(c).

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[19] Respondent cites *Aces* in defense of his position. However, he merely uses it condemn the "unfair practice of taxpayers" without substantially showing how petitioner is engaged in such an "unfair practice". After reading the Decision in question, the Court finds that the case actually *undermines* respondent's own arguments, as discussed above.

With the above provision in mind, suppose that ABC Corp. is a Malaysian corporation that manages an apartment in Bangkok. Its only office is in Bangkok, and the only apartment it manages is in said city, so it is a "foreign corporation not engaged in trade or business in the Philippines". Suppose further that a resident of the Philippines rents an apartment unit from ABC Corp. for a few years. Can respondent collect 25% of the income derived from said rent, treating the Philippine resident as a source of income from within the Philippines?

Clearly not. ABC Corp. is a foreign corporation with no business in the Philippines. The rented apartment unit is located outside of Philippine territory. That the one who rented the apartment is a resident of the Philippines is of no moment and cannot be considered the source of income. It is the Philippine resident's act of renting the apartment that is the source of income here. And as such act occurred outside of Philippine territory, the Philippines has no authority to tax said income.

Neither can we give credence to respondent's citation of *Revenue Memorandum Circular* ("*RMC*") *No. 50-2007*, which states that the sale of vehicles in the SSEFZ is subject to VAT zero-rating only if said vehicles "are used exclusively within the subject special Freeport Zone." Respondent used said *RMC* as one of his primary bases for claiming that petitioner exceeded the 30% threshold. However, said use was erroneous. First, the provision covers VAT zero-rating and is thus inapplicable to taxpayers who are fully exempted from VAT, such as those who qualify for payment of the PGIT in lieu of all other taxes, including VAT. In other words, the cited provision from *RMC No. 50-2007* covers qualification for *VAT zero-rating*, not *PGIT*. Second, applying this restriction to claim that customers who use the sold vehicles outside the SSEFZ count as "sources within the [Philippines]" would add a requirement not already present in *RA No. 7227* or its *IRR* and even contradict the jurisprudential precedent laid down by *Baier-Nickel* and *Aces*.

Following *Baier-Nickel*, *Aces*, and a logical reading of the *NIRC*, then, respondent was mistaken in considering the residency of petitioner's customers when determining its sources of income. He had insufficient legal basis for doing so. Instead, he should have instead looked to *where petitioner's sales and services actually occurred* when determining whether petitioner crossed the 30% threshold.

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Petitioner qualifies for the PGIT in lieu of all other taxes, so respondent's RCIT and VAT assessments have no legal basis

As found by the ICPA Menor, petitioner earned all of its income through sales and services that occurred within the SSEFZ. This is shown by how petitioner's vehicle sales invoices, debit memos, and cash receipts were all issued in its principal address, which is located within the SSEFZ.[20] Considering that the sources of its income were from within the SSEFEZ, then, petitioner qualifies for the preferential tax rate provided by *RA No. 7227* and should only be liable for the PGIT in lieu of all taxes.

Considering this, respondent's RCIT and VAT assessments, as issued through the assailed FLD and FDDA, have no legal basis. Petitioner is not liable for RCIT or VAT—it is liable for PGIT only. Hence, the disputed assessment is void, for imposing taxes which petitioner is not legally liable to pay.

It is unnecessary to discuss the other arguments and issues raised by respondent, as these are based on the erroneous assumption that petitioner is liable for RCIT and VAT.

ACCORDINGLY, the instant Petition for Review, filed on June 25, 2021, is hereby **GRANTED**. The assessment against petitioner for alleged deficiency income tax and value-added tax for the period from July 1, 2016 to June 30, 2017, as issued through the Formal Letter of Demand, dated October 9, 2020, and the undated Final Decision on Disputed Assessment is **CANCELLED** and **SET ASIDE**.

Respondent and his agents are **ENJOINED** and **PROHIBITED** from collecting the taxes sought by the void assessment.

SO ORDERED.

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice

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[20] ICPA Report, p. 23, Rollo Vol. 2, p. 708.

WE CONCUR:

MA. BELEN M. RINGPIS-LIBAN
Presiding Justice

ON OFFICIAL BUSINESS
CORAZON G. FERRER-FLORES
Associate Justice

CERTIFICATION

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

MA. BELEN M. RINGPIS-LIBAN
Presiding Justice