REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	CTA EB NO. 1412 (CTA Case No. 8607)
- versus -	
ICONIC BEVERAGES, INC., Respondent.	
x-------------------------------------x	CTA EB NO. 1417 (CTA Case No. 8607)
ICONIC BEVERAGES, INC., Petitioner,	Present:
- versus -	DEL ROSARIO, *PJ* CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN, and MANAHAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: JAN 30 2018 2:15 p.m.

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DECISION

Fabon-Victorino, J.:

Both aggrieved, the Commissioner of Internal Revenue (CIR) and Iconic Beverages, Inc. (IBI) elevated to the Court

En Banc the Decision[1] dated August 14, 2015, as well as the subsequent Resolution[2] dated January 6, 2016, rendered by the Court in Division in CTA Case No. 8607, via separate *Petitions for Review* which were subsequently consolidated for review and determination in a *Minute Resolution*[3] dated February 24, 2016, pursuant to Section 1, Rule 31 of the Revised Rules of Court.

The CIR filed his *Petition for Review*[4] on February 9, 2016, assailing the Decision[5] dated August 14, 2015, and the Resolution[6] dated January 6, 2016 issued by the Court in Division, granting albeit partially IBI's Petition for Review which impugned the deficiency income tax assessment issued against it for taxable year (TY) 2009 in the amount of ₱131,312,747.39.

On the other hand, the *Petition for Review*[7] filed by IBI on January 22, 2016 prays to reverse and set aside the same Decision[8] and the Resolution[9] and in lieu thereof another decision be rendered: (1) declaring that its royalty income for TY 2009 is passive income subject to 20% final withholding tax; (2) declaring that it is not liable for assessed deficiency income tax for TY 2009 as well as deficiency interest and delinquency interest; and (3) ordering the cancellation of the deficiency income tax assessment for TY 2009 issued against it by the CIR.

THE FACTS AND THE PROCEEDINGS

The facts, as culled from the record, are as follows:

The CIR is the head of the Bureau of Internal Revenue (BIR) with the power to assess and collect all internal revenue taxes, fees and other charges, and to enforce all forfeitures, penalties, and fines connected therewith, with

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[1] CTA EB No. 1412 Docket, pp. 21-41.
[2] CTA EB No. 1412 Docket, pp. 42-53.
[3] CTA EB No. 1412 Docket, p. 58.
[4] CTA EB No. 1412 Docket, pp. 8-17.
[5] CTA EB No. 1412 Docket, pp. 21-41.
[6] CTA EB No. 1412 Docket, pp. 42-53.
[7] CTA EB No. 1417 Docket, pp. 1-27.
[8] See *Note* 2.
[9] See *Note* 3.

office at BIR National Office Building, BIR Road, Diliman, Quezon City.

IBI, on the other hand, is a domestic corporation, with principal place of business at the SMC Head Office Complex located at No. 40 San Miguel Avenue, Mandaluyong City.

IBI received from the BIR a Letter of Authority (LOA) No. 121-2010-00000012 [10] dated May 14, 2010 for the examination of its books of accounts and other financial records pertinent to its internal revenue taxes for TY 2009. This was followed by a Notice of Informal Conference (NIC) indicating that its alleged deficiency internal revenue taxes have been submitted for evaluation.

The BIR subsequently issued a Preliminary Assessment Notice[11] (PAN) dated October 19, 2011, finding IBI liable for deficiency income tax (IT), documentary stamp tax (DST), and administrative penalties for TY 2009 in the aggregate amount of ₱111,382,989.41, inclusive of interest and compromise penalty.

IBI protested the PAN through a letter [12] dated November 4, 2011, which the BIR received on even date.

On April 17, 2012, IBI received a Formal Letter of Demand [13] (FLD) with attached Final Assessment Notices (FAN) dated March 30, 2012, assessing it for alleged deficiency IT and DST in the sum of ₱119,944,634.43, inclusive of interest, compromise and other administrative penalties, computed as follows:

Income Tax		
Taxable Net (Loss) Per ITR (NOLCO)		₱50,009,617.40
Add: Royalty income subject to regular income tax	₱856,063,257.00	
Unrecorded sales to SMC	25,000.00	
Unrecorded purchases from SMC	5,684.96	856,093,941.96
Adjusted Taxable Net Income		₱856,093,941.96
Tax Due		₱256,828,182.59
Less: Final tax of 20%		171,212,651.40
Deficiency Income Tax		85,615,531.19

[10] Exhibit P-5, *Rollo*, pp. 364.
[11] Exhibit P-7, *Rollo*, pp. 366-367
[12] Exhibit P-8, *Rollo*, pp. 373-375.
[13] Exhibit P-9, *Rollo*, pp. 376-377.

Add: Interest (4/16/2010 to 4/15/2012)	₱34,246,212.48	
Compromise	50,000.00	34,296,212.48
Total Deficiency Income Tax		**₱119,911,743.66**
Documentary Stamp Tax		
Taxable Basis Per Return		₱10,000,183,750.00
Tax Due		50,000,919.00
Less: Tax Paid Per Return		50,000,000.00
Basic Deficiency Tax		919.00
Add: Interest (3/5/2009 to 4/15/2012)	₱571.76	
Compromise Penalty	400.00	971.76
Total Deficiency Documentary Stamp Tax		**₱1,890.76**
Administrative Penalties		
Non-filing of BIR Form 2550M for the month of Jan. 2009		₱1,000.00
Non-filing of Summary List of Sales/Purchases		13,000.00
(SLS-Jan.-Feb. 2009/SLP – Jan.-July 2009, Sept.-Dec. 2009)		
Non-filing of BIR 1601 (Jan., June, July, and Oct. 2009)		4,000.00
Non-filing of BIR Form 1604-E		1,000.00
Non-filing of Alphalist of Payees (MAP)		12,000.00
Total		**₱31,000.00**

IBI likewise protested[14] the FAN on May 16, 2012, for lack of factual and legal bases. It also claimed that its royalties were properly declared as passive income subject to Final Withholding Tax (FWT) of twenty percent (20%) on the gross amount.

The CIR denied IBI's protest in the Final Decision on Disputed Assessment[15] (FDDA) dated January 7, 2013. In the said FDDA, the CIR cancelled the DST assessment, the Administrative Penalties, and the deficiency IT arising from the "unrecorded purchases from San Miguel Corporation", on the ground that IBI voluntarily settled the said deficiencies. The CIR also cancelled the "unrecorded sales to San Miguel Corporation" upon finding that it was not a taxable sale. The CIR however upheld the deficiency IT on IBI's revenues derived from San Miguel Brewery, Inc. (SMBI) and My Philippines Lifestyles, Inc. (MPLI), which IBI treated as royalty income subject to 20% Final Tax (FT). The CIR found IBI still liable for deficiency IT in the total amount of ₱131,312,747.39, as shown below:

TAX TYPE	BASIC	INTEREST	PENALTY	TOTAL
Income Tax	₱85,606,325.70	₱45,656,421.69	₱50,000.00	₱131,312,747.39

[14] Exhibit P-10, *Rollo*, pp. 381-383.
[15] Exhibit P-11, *Rollo*, pp. 384-385.

On February 7, 2013, IBI assailed the adverse ruling via a Petition for Review[16] filed with the Court in Division.

In his *Answer*[17], the CIR maintained that the royalty fees received by IBI from SMBI and MPLI were in the nature of active income arising from the active pursuit of its business and must be subject to the regular corporate IT of 30% under Section 27 of the National Internal Revenue Code (NIRC) of 1997, as amended. He explained that royalties and other income arising from the active pursuit of business in accordance with the primary purpose of the licensor are in the nature of ordinary business income subject to 30% corporate IT.

After trial, the Court in Division promulgated the assailed Decision of August 14, 2015, granting, *albeit* partially, IBI's Petition for Review. The Court cancelled the assessment for compromise penalty but affirmed with modification the assessment for deficiency IT for TY 2009 on the ground that IBI failed to support its defense that the royalties received in 2009 were not earned in active pursuit or performance of its primary purpose. The Court in Division also emphasized the principle that tax assessments by tax examiners are presumed correct and made in good faith. Since IBI failed to present substantial evidence to overturn this presumption, the assessment thereon must be sustained. The decretal portion of the assailed Decision reads as follows:

> **WHEREFORE**, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. The compromise penalty assessed by respondent against petitioner in the amount of ₱50,000.00 is hereby **CANCELLED**. On the other hand, the remaining amount in the assessment covering deficiency income tax for the taxable year 2009 is hereby **AFFIRMED** with some modifications. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **₱88,254,300.60** representing basic deficiency income tax for

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[16] *Rollo*, pp. 6-17.
[17] *Rollo*, pp. 79-85.

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the taxable year 2009 inclusive of the twenty-five percent (25%) surcharge imposed under Section 248 (A) (3) of the NIRC of 1997, computed as follows:

Taxable Income	₱(50,009,617.40)
Add: Royalty income subject to regular income tax	856,063,257.00
Adjusted Taxable Net Income	₱806,053,639.60
Tax Rate	30%
Tax Due	₱241,816,091.88
Less: Final Tax of 20% (856,063,257.00 x 20%)	171,212,651.40
Deficiency Income Tax	₱70,603,440.48
Add: 25% Surcharge	17,650,860.12
Total Amount Due	₱88,254,300.60

Likewise, petitioner is **ORDERED TO PAY** the following:

(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of ₱70,603,440.48 computed from April 15, 2010 until full payment thereof pursuant to Section 249 (B) of the NIRC of 1997; and

(b) delinquency interest at the rate of 20% per annum on the total amount of ₱88,254,300.60 and on the 20% deficiency interest which have accrued as afore-stated in (a) computed from January 9, 2013 until full payment thereof pursuant to Section 249 (C) of the NIRC of 1997.

SO ORDERED.

Both IBI's and the CIR's *Motions for Reconsideration* were denied for lack of merit, in the equally assailed Resolution of January 6, 2016.

Hence, the present consolidated *Petitions for Review.*

Significantly, on April 18, 2016, IBI filed a *Motion (To Be Allowed to Pay Judgment Award Without Prejudice to the Pending Appeal)*[18], which the Court *En Banc* granted per

[18] CTA EB No. 1412 Docket, pp. 76-86.

Resolution[19] dated August 3, 2016. Accordingly, IBI was directed (1) To pay the CIR the judgment award strictly in accord with the assailed Decision of August 14, 2015, within fifteen (15) days from notice; and (2) To show proof of payment to the Court within five (5) days from such payment.

IBI complied[20] with the directive which the Court *En Banc* NOTED in the Resolution[21] dated September 21, 2016.

This consolidated Petitions for Review was deemed submitted for decision on January 30, 2017[22], after the parties filed their respective memoranda[23].

THE ISSUES

The CIR submits that -

> THE ₱50,009,617.40 REPRESENTING IBI's EXPENSES, SHOULD HAVE BEEN JUSTIFIED BY EVIDENCE.

The IBI, on the other hand, raises the following issues for resolution:

I. WHETHER ITS ROYALTY INCOME IS SUBJECT TO 20% FINAL WITHHOLDING TAX.

II. WHETHER IT IS LIABLE FOR THE AMOUNT OF ₱70,603,440.48 AS DEFICIENCY INCOME TAX FOR CALENDAR YEAR ENDING 2009 PLUS 25% SURCHARGES AS WELL AS 20% DEFICIENCY AND DELINQUENCY INTEREST FOR LATE PAYMENT UNTIL FULLY PAID.

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[19] CTA EB No. 1412 Docket, pp. 95-98.
[20] CTA EB No. 1412 Docket, pp. 99-101.
[21] CTA EB No. 1412 Docket, pp. 109-110.
[22] Resolution, CTA EB No. 1412 Docket, pp. 173-174.
[23] Resolution, CTA EB No. 1412 Docket, pp. 113-115.

In his *petition*, the CIR claims that IBI failed to establish the factual and legal bases of the tax deduction because it was not able to present any documentary evidence to justify deduction of expenses in the amount of ₱50,009,617.40. Hence, the said deduction from IBI's taxable income should not have been allowed. Corollary to the foregoing is the legal presumption that his assessment is correct and made in good faith and that IBI must prove the contrary.

In its *Comment*[24], IBI prays to deny CIR's *Petition for Review* saying that: (1) the CIR's arguments are a mere rehash of his *Motion for Partial Reconsideration (Re: Decision dated 14 August 2015)* dated September 1, 2015, which the Court in Division categorically rejected; (2) the CIR never questioned, in fact, even recognized and admitted the said ₱50,009,617.40 IBI's expenses for TY 2009; and (3) the said judicial admissions by the CIR are conclusive, hence, do not require further evidence to prove them.

In its own Petition for Review, IBI posits that the Court in Division misappreciated the evidence it presented *vis-a-vis* its claim that the royalty income it earned during the TY 2009 were passive income.

IBI defines passive income as one arising from mere ownership of the asset. It does not require any action or active participation from the owner. Precisely it deemed the royalties it earned from its trademarks or intellectual property rights as passive income as they arose from mere ownership of its trademarks or intellectual property rights without any action or active participation on its part. The finding of the Court in Division that it did not incur any operating expenses to generate the said royalties best supports its position.

Further, the fact that it did not engage in the business of manufacturing, buying, selling, or dealing in alcoholic and non-alcoholic beverages during the TY 2009, hence, did not incur any operating expense therefor, will convert the subject royalties earned from its own trademarks or intellectual property rights to ordinary income. Its primary

[24] CTA EB No. 1412 Docket, pp. 62-74.

purpose does not even hint that it should engage and carry on the business of distributing, marketing and promoting its trademarks and other intellectual property rights by licensing them out.

IBI also claims that the licensing out of its intellectual property rights under the License Agreement was not in line or within its primary purpose, rendering the License Agreement with SMBI a mere incidental and one-time transaction. Also, the fact that the said transaction yielded a huge royalty income for TY 2009, will not render the said royalty income ordinary or active income.

For IBI, the word license in its Amended Article of Incorporation refers to its acquisition of licenses to use intellectual property rights of other entity, to aid in the achievement of its primary business of manufacturing, buying, selling and dealing in alcoholic and non-alcoholic beverages.

IBI further believes that the presumption in favor of the correctness of CIR's assessment is not applicable in its case on account that it was able to present substantial evidence and sound legal basis to back-up its claim that the royalties earned are passive income.

Lastly, IBI finds the computation of deficiency interest and delinquency interest made by the Court in Division incorrect. According to IBI, although deficiency interest and delinquency interest are different in nature, they may not be imposed simultaneously. The 20% interest under Section 249(A) of the NIRC of 1997, as amended, can either be Deficiency Interest under Section 249(B) or Delinquency Interest under Section 249(C) of the same Code. In any event, only one kind of interest is applicable for each period, *i.e.*, from the date prescribed by law for the payment of the tax until the last day to pay the deficiency assessment under the FAN, and, from the day after the last day to pay the deficiency assessment under the FAN until full payment.

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RULING OF THE COURT EN BANC

Both *Petitions for Review* are bereft of merit, hence, should be denied.

Indeed, the arguments advanced by the CIR in his *Petition for Review* are mere restatement of his arguments truncated from his previous pleadings which the Court in Division had laid to rest in the assailed Resolution of January 6, 2016. Each and every issue raised by the parties had been amply discussed and determined in the assailed Decision and Resolution, thus the Court *En Banc* sees no compelling reason to modify, much more deviate from the ruling of the Court in Division in favor of IBI given that the claimed deduction in its 2009 Annual Income Tax Return amounting to ₱50,009,617.40 was neither put in issue nor questioned in the pleadings filed by the CIR with the Court in Division. By so doing, the CIR concurred with the said deduction and can no longer at this point impugn to resurrect a dead cause. Thus, the Court *En Banc* agrees with the Court in Division in disposing the issue in the following fashion:

> As correctly argued by [IBI], there is nothing in the pleadings filed by [CIR], in the subject Formal Letter of Demand or in the Final Decision on Disputed Assessment which would show that [CIR] questioned the deduction claimed by [CIR] in the amount of ₱50,009,617.40 as per its 2009 Annual ITR.
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> Likewise, the issue on the said deduction was not among the issues stipulated by the parties pursuant to their Joint Stipulations of Facts and Issue filed on September 5, 2013.
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> Accordingly, the Court correctly computed [IBI's] tax liability based on the unquestioned items in [IBI's] 2009 Annual ITR, including its declared deduction in the amount of ₱50,009,617.40.[25]

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[25] Assailed Resolution, See Note 3.

Note that during the examination of books of account and other accounting records of IBI, its ₱50,009,617.40 expenses for TY 2009 were not disallowed nor even questioned by the CIR. In computing IBI's deficiency income tax (*i.e.*, PAN and FAN), the CIR himself allowed and recognized the said expenses amounting to ₱50,009,617.40. Thus, the CIR cannot now turn 180 degrees and question the computation of the Court in Division and gloss over his admissions in the documents he himself issued and in the various pleadings he filed before the Court in Division.

Evidently, the same is true with IBI's Petition for Review. It is a replica of its *Memorandum* dated July 7, 2014 and its *Motion for Reconsideration (of the Decision dated August 14, 2015)* dated September 1, 2015. No reason nor rhyme exists for the Court *En Banc* to alter, modify, much more reverse the observation and conclusion of the Court in Division that (1) IBI generated its royalty income in the active pursuit and performance of its primary purpose, thus, the subject royalty income is not passive but active income; and (2) that the simultaneous imposition of deficiency and delinquency interests, is not prohibited.

As ruled by the Court in Division, IBI failed to establish that the assessment for deficiency IT issued against it by the CIR was incorrect. A reevaluation of the evidence presented by IBI, particularly its Audited Financial Statements for TY ended December 31, 2009[26] showed that royalties earned under the License Agreements it executed with SMBI and MPLI were its main source of income for TY 2009. The said business transactions were certainly in line, if not in accord, with IBI's primary purpose as stated in its Articles of Incorporation[27] which included owning, purchasing, licensing and/or acquiring such trademarks and other intellectual property rights in furtherance of its business.

IBI therefore cannot insist without transgression that the royalties it earned from its trademarks or intellectual property rights are passive income as they were not derived from the active pursuit of its main trade or business of manufacturing, buying, selling and dealing in alcoholic and

[26] Exhibit P-13, Docket pp. 391-411.
[27] Exhibit P, Docket pp. 348-355.

non-alcoholic beverages, hence, the royalties it received from SMBI and MPLI should be subject to the general rate of 20% Final Withholding Tax and not to 30% regular corporate tax.

IBI cannot also claim that the act of licensing out of its trademarks and intellectual property rights which yielded in its favor royalties were incidental and one-time transactions, therefor the revenues derived therefrom were passive income subject to a final tax of 20%. But the IBI's Audited Financial Statements for the year ended December 31, 2009 belied this contention for it showed that the licensing out of its trademarks and intellectual property rights were the only business activities of IBI and its lone lifeblood for the TY 2009. IBI did not engage in any business activity beyond licensing out of its trademarks and intellectual property rights, precisely because such was its primary purpose.

The Court in Division correctly computed the deficiency income tax and interest.

Finally, on the issue of alleged incorrect computation of deficiency IT and interest thereon. IBI agrees with the Court in Division that deficiency and delinquency interest are different in nature, but claims that they may be imposed simultaneously. Allegedly, the 20% interest under Section 249(A) of the NIRC of 1997, as amended, can either be deficiency interest under Section 249(B) or delinquency interest under Section 249(C) of the same Code. Per IBI, only one kind of interest is applicable for each period, *i.e.*, **deficiency interest** shall be assessed <u>from the date prescribed by law for the payment of the deficiency tax until the last day to pay the same under the FAN</u>; and **delinquency interest** shall be assessed <u>from the day after the last day to pay the deficiency tax under the FAN until full payment thereof</u>.

The Court *En Banc* is not persuaded.

A comparison of Section 249(B) and 249(C)(3) of the NIRC of 1997, as amended, reveals that the deficiency interest on any deficiency tax is assessed "from the date prescribed for its payment until the full payment thereof"; while the delinquency interest, which is imposed for failure to pay a deficiency tax or any surcharge or interest thereon, is assessed commencing "on the due date appearing in the notice and demand of the Commissioner... until the amount is fully paid".

Thus, the Court *En Banc* is one with the Court in Division when it ruled, as follows:

> It is clear from the above provisions that deficiency interest is imposed upon any tax that is still due and unpaid to the government, while delinquency interest is the interest imposed on failure to pay (i) the amount of tax due on any return required to be filed, or (ii) the amount of tax due for which no return is required, or (iii) deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner.
>
> Also, Section 249 (B) and (C) (3) of the NIRC of 1997, as amended, clearly states that the deficiency interest on any deficiency tax shall be assessed "from the date prescribed for its payment until the full payment thereof"; while the assessment of the delinquency interest that is imposed upon failure to pay a deficiency tax, or any surcharge or interest thereon, shall be reckoned from "the due date appearing in the notice and demand of the Commissioner until the amount is fully paid".
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> In sum, these two (2) interests are different in nature. Also, there was no indication from the said provisions of law that these sets of interest cannot be imposed simultaneously.[28]

[28] Assailed Resolution, *See* Note 3.

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WHEREFORE, the *Petitions for Review* filed on February 9, 2016 and January 22, 2016 by the Commissioner of Internal Revenue and Iconic Beverages, Inc., respectively, are hereby **DENIED** for lack of merit.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

ROMAN G. DEL ROSARIO
Presiding Justice

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

Ma. Belen
MA. BELEN RINGPIS-LIBAN
Associate Justice

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII 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.

ROMAN G. DEL ROSARIO
Presiding Justice