REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

EAST ASIA UTILITIES CORPORATION,
Petitioner,

- versus-

COMMISSIONER OF INTERNAL, REVENUE,
Respondent.

CTA CASE NO. 8179

Members:

Castañeda, *Chairperson*
Casanova, and
Cotangco-Manalastas, *JJ.*

Promulgated:

MAY 2 1 2014

4:25 p.m.

x- x

DECISION

COTANGCO-MANALASTAS, *J.:*

This is a Petition for Review filed on October 15, 2010 by East Asia Utilities Corporation to appeal the Final Decision on Disputed Assessment (FDDA)[1] of the Commissioner of Internal Revenue that demanded the payment of ₱2,791,894.70, representing alleged deficiency income tax and penalties covering taxable year 2006.

FACTS

Petitioner East Asia Utilities Corporation is a corporation organized and existing under and by virtue of the laws of the Philippines, with principal office located at Barangay Ibo, Mactan Export Processing Zone (MEPZ), Lapu-Lapu City, Cebu.[2] It is registered with the Philippine Economic Zone Authority (PEZA) as an ECOZONE Utilities Enterprise at the Mactan Economic Zone and West Cebu Industrial Park-Special Economic Zone, as evidenced by Certificate of Registration No. 98-01-U[3] dated April 27, 1998 and by Amended Certificate of Registration No. 98-01-U[4] dated April 23, 2009. Petitioner operates a 50.164 megawatt power plant within the Mactan

[1] Exhibit "P".
[2] Par. 1, Stipulation of Facts, Joint Stipulation of Facts, docket, p. 244; Exhibit "A".

Export Processing Zone.[5] The said power plant was duly accredited and certified as a Private Sector Generation Facility by the Department of Energy (DOE) as evidenced by its DOE Certificate of Accreditation No. 98-05-40[6] issued on May 28, 1998.

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR), empowered to perform the duties of her office, including, among others, the power to assess and collect all national internal revenue taxes, fees and charges, and to enforce all forfeitures, penalties, and fines connected therewith. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

A PEZA Certificate of Board Resolution was issued on January 28, 2000, which provides that effective January 2000, petitioner shall be entitled to the incentives under Sections 24 and 42 of Republic Act (R.A.) No. 7916, as amended, including: (a) exemption from national and local taxes, and in lieu thereof, payment of five percent (5%) tax on gross income; and (b) additional deduction for training expenses (1/2 of value), subject to the guidelines to be issued by PEZA in coordination with the Department of Labor and Employment and Department of Finance.[7]

On July 17, 2009, petitioner received a Preliminary Assessment Notice (PAN) from respondent through the BIR's Large Taxpayer's District Office-Cebu, District Office No. 123, which assessed petitioner for alleged tax deficiency in the amount of ₱5,892,780.71, consisting of (a) income tax in the amount of ₱5,884,985.91 and (b) expanded withholding tax in the amount of ₱7,794.80, for calendar year ending December 2006, plus interest to be computed upon payment.[8]

On August 3, 2009, petitioner filed a reply dated July 29, 2009 to the PAN addressed to the BIR's Large Taxpayer's District Office-Cebu, District Office No. 123.[9]

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[5] Exhibit "X".
[6] Exhibit "C".
[7] Exhibit "B-1".

On September 29, 2009, petitioner received a Formal Letter of Demand (FLD)[10] together with Audit Result/Assessment Notice Nos. 123-IT-20-2006-2009-08-063 and 123-WE-20-2006-2009-08-062 dated August 25, 2009[11]. In the said FLD, respondent requested petitioner to pay the aggregate amount of ₱6,095,971.08, representing income tax of ₱6,087,916.46 and expanded withholding tax of ₱8,054.62 for the year 2006.

On October 10, 2009, petitioner paid the expanded withholding tax in the amount of ₱8,054.62 through the BIR's Electronic Filing and Payment System (eFPS).[12]

On October 29, 2009, petitioner filed a letter of protest dated October 20, 2009 with attached supporting documents to respondent Commissioner and Zenaida G. Garcia, OIC-Assistant Commissioner- Large Taxpayers Service, informing them that it paid the expanded withholding tax; disputing the deficiency income tax assessment; and requesting that the deficiency income tax assessment be cancelled and withdrawn.[13]

Petitioner received the Final Decision on Disputed Assessment[14] on September 17, 2010, assessing petitioner for deficiency income tax in the reduced amount of ₱2,791,894.70, inclusive of increments for taxable year 2006. The contents of the FDDA are quoted below:

> "SEP 17 2010
>
> **East Asia Utilities Corporation**
> Brgy. Ibo, MEPZ, Lapu-lapu City
> TIN: 004-760-842-000
>
> **FINAL DECISION ON DISPUTED ASSESSMENT**
>
> Gentlemen:
>
> Referring to your letter dated October 20, 2009, please be informed that your protest against the taxable year ending 2006 assessed deficiency taxes in

[10] Exhibits "H"; Exhibit "9".
[11] Exhibits "9-A" and "9-B".
[12] Exhibits "K", "K-1", and "K-2".

the total adjusted amount of P2,791,894.70 inclusive of increments, subject matter of our covering formal letter of demand (final assessment notice) undated, is hereby denied for lack of factual and legal basis. The aforesaid assessment is premised on the following:

Deficiency Income Tax (P2,791,894.70) - The findings were based on RR 1-95; RR 16-99; RA 7916; RR 2-2005; RR 11-2005 that direct costs shall be limited in computing the 5% preferential tax rate from gross sales/revenues derived from business activity within the ECOZONE as mandated by the rules and regulations.

The taxpayer's justification and legal basis for claiming in full the cost of sales was in(*sic*) pursuant to the PEZA Law and as interpreted in BIR Ruling DA-608-2006 issued to Samsung Electro-Mechanics Phils., Corp. (SAMPHIL) dated February 8, 2007, and BIR Ruling No. DA-476-03-Eighty Eight Floor Gifts, Inc. dated March 3, 2008, both are PEZA registered manufacturing companies enjoying the 5% special tax rate based on gross income. Please take note that although EAUC is a PEZA registered company it is engaged in sale of services, unlike the two mentioned companies which are both engaged in the sale of goods, hence, the rulings issued to SAMPHIL and Eighty-Eight Floor cannot be applied to EAUC.

The records of this case disclosed that you have not introduced any evidence to overthrow the validity of our said findings.

It is requested that your aforesaid deficiency taxes be paid immediately upon receipt hereof, inclusive of penalties incident to delinquency. This is our final decision. If you disagree, you may appeal this final decision with Court of Tax Appeals within thirty (30) days from date of receipt hereof, otherwise our said deficiency taxes shall become final, executory and demandable.

ZENAIDA G. GARCIA
Assistant Commissioner
LTS (Excise & LTDO's)"

Consequently, petitioner filed the instant Petition for Review on October 15, 2010, praying that the Final Decision on Disputed Assessment dated September 17, 2010 be dated August 25, 2009 which assessed petitioner for deficiency income tax in the aggregate amount of ₱2,791,894.70, inclusive of surcharges, penalties and interest, for taxable year 2006 be cancelled.

In her Answer[15] filed on November 24, 2010, respondent interposed the following Special and Affirmative Defenses:

> "7. Respondent reiterates and re-pleads the preceeding paragraphs of this Answer as part of her Special and Affirmative Defenses.
>
> 8. Petitioner East Asia Utilities Corp., is liable to pay its deficiency income tax for calendar year 2006 in the total amount of Six Million Eighty-Seven Thousand Nine Hundred Sixteen Pesos and 46/100 (Php6,087,916.46) including penalties, surcharges and interest as contained in the Final Assessment Notice against petitioner for the following reasons:
>
> 8.1 The instant petition should not be given due course by this Honorable Court for being filed out of time.
>
> 8.1.1 The assessment already attained its finality due to failure on the part of petitioner to submit the pertinent documents in support of its protest within sixty (60) days from date of filing of the same. Thus, the pertinent portion of the Memorandum Report submitted by the examiner who conducted the investigation of petitioner's case is provided hereunder:
>
> > 'The assessed amount was based on the unresolved issues, the taxpayer's representative promised to submit additional documents, which as of this date, they failed to do so, hence this assessment.'
>
> 8.1.2 Section 3.1.5 of Revenue Regulations 12-99, implementing the provisions of Section 228 of the NIRC provides, to wit:
>
> > '3.1.5 Disputed Assessment. –
> >
> > xxx xxx xxx
> >
> > The taxpayer shall submit the **__required documents__** in support of his protest within sixty (60) days from date of filing of his letter of

> protest, otherwise, the assessment shall become final, executory and demandable. **The phrase 'submit the required documents' includes submission or presentation of the <u>pertinent documents</u> for scrutiny and evaluation by the Revenue Officer conducting the audit**. The said Revenue Officer shall state this fact in his report of investigation. *(Emphasis and underlining supplied)*
>
> xxx xxx xxx'

Indubitably, petitioner did not submit the pertinent documents within 60 days from date of filing of its letter-protest dated October 29, 2009 which would have been necessary for the scrutiny and thorough evaluation of its case and which would have been sufficient to overthrow the validity of the findings against it.

8.1.3 It is a well-settled rule in taxation that the burden of proof is on the taxpayer to present evidence to show the incorrectness of the assessment. Despite petitioner's promise to submit additional documents, it failed to submit all pertinent papers, records and documents which could evidently prove the incorrectness of the assessment made by respondent.

8.1.4 In case of disputed assessments, the burden of proof is on the taxpayer to establish the fact that it is indeed not liable for any deficiency taxes subject of the assessment. The failure to show documents that would substantiate a claim that no deficiency taxes are due, would result to upholding the validity of the assessment for deficiency income taxes (***Camara Steel Industries, Inc. vs. Commissioner of Internal Revenue***).

8.1.5 Prescinding from and anent the foregoing considerations, it can categorically be stated that a discussion on the reversal of the assailed Final Decision on Disputed Assessment dated September 17, 2010, as what the instant petition is pressing on the Honorable Court, is moot and academic. An issue or a case becomes moot and academic when it ceases to present a justiciable controversy so that a determination thereof would be without practical use and value (***James L. King, et al., vs. Court of Appeals, et al., G.R. No. 158195 December 16, 2005***). In such cases, there is no actual substantial relief to which the petitioner would be entitled to and which would be negated by the dismissal of the petition (***Vda. De Davao vs. Court of Appeals, 426 SCRA 91 [2004]***). Thus, in ***Gancho-on vs. Secretary of Labor and Employment, G.R. No. 108033,***

> 'It is a rule of universal application, almost, that courts of justice constituted to pass upon substantial rights will not consider questions in which no actual interests are involved; they decline jurisdiction of moot cases. And where the issue has become moot and academic, there is no justiciable controversy, so that a declaration thereon would be of no practical use or value. There is no actual substantial relief to which petitioners would be entitled and which would be negated by the dismissal of the petition.'

Since the assessment issued against petitioner had long become final, unappealable and demandable, petitioner's prayer of reversing and setting aside the Final Decision on Disputed Assessment dated September 17, 2010 has become moot and academic. Hence, there is no necessity for discussion of the same for it ceased to present a justiceable controversy. Consequently, the determination of the said issue would be of no practical use or value.

8.2 Assuming arguendo that petitioner has complied with the requirement of the law with respect to the submission of pertinent documents thereby making the Final Assessment Notice appealable, still, respondent respectfully avers that the assessment for taxable year 2006 in the amount of Php2,791,894.70 as contained in the Final Decision on Disputed Assessment was issued in accordance with law and regulations.

The approach of investigation as per Memorandum Report of the examiner who conducted the investigation is quoted hereunder, *to wit*:

> 'Initial steps taken in the audit were guided by firsthand interview with management and discussion with accounting personnel concerned on systems flow of transactions and process flow of documents as well as familiarization with business organization, accounting methods, bookkeeping system, books of accounts and degree of internal control. The audit included, on a test basis, verification of supporting documents to check proper cut-off of revenues and purchases and validity of expenses claimed.
>
> Figures in different BIR returns and alpha listings were also reconciled with the books and corresponding BIR forms were verified if filed and taxes due were paid on time.'

8.3 Comprehensive study of petitioner's books of accounts and pertinent accounting records disclosed that it is liable to pay the total deficiency income tax assessment.

8.4 The alleged expenses were disallowed due to the unreconciled figures from the CD file submitted by petitioner and the failure to submit additional documents. The findings were based on Revenue Regulations 1-95, as amended by Revenue Regulations 16-99; Republic Act 7916; Revenue Regulations 2-2005; and Revenue Regulations 11-2005 that direct costs shall be limited in computing the 5% preferential tax rate from gross sales/revenues derived from business activity within the ECOZONE as mandated by the rules and regulations.

Revenue Regulations 1-95, as amended by Revenue Regulations 16-99, provides that:

'REVENUE REGULATION NO 1-95

SUBJECT: Rules and Regulations to implement the tax incentives provisions under paragraphs (b) and (c) of Section 12, Republic Act No. 7227 otherwise known as the Bases Conversion and Development Act of 1992.

xxx xxx xxx

SEC. 3. DEFINITION. - For purposes of these Regulations, the terms used herein shall be construed to have the following meanings:

xxx xxx xxx

o. Gross income earned – refers to gross sales or gross revenues derived from the business activity within the zone, net of sales discounts and sales returns and allowances and minus costs of sales or direct costs but before any deduction for administrative expenses or incidental losses during a given taxable period. For financial enterprises, gross income shall include interest income, gains from sales, and other income, net of allowable deductions. The following deductions shall be allowable for the calculation of gross income earned for specific types of enterprises:

1) Trading and manufacturing enterprises

xxx xxx xxx

2) Service enterprises
Direct salaries, wages or labor expense
Service supervision salaries
Direct Materials, supplies used or resold to another SBMA registered enterprise
Depreciation of machineries, equipment and buildings owned and/or constructed
Financing Charges associated with fixed assets
Rent and utility charges for buildings and capital equipment

xxx xxx xxx'

8.5 Petitioner's reliance on BIR Rulings issued to a PEZA-registered company engaged in the sale of goods is bereft of merit. It bears stressing that although petitioner is a PEZA registered company, it is engaged in the sale of services. Since petitioner is engaged in a different field, it is humbly submitted that the BIR Rulings relied upon by petitioner cannot be applied to it.

8.5 Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner, and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments (***Sy Po vs. Court of Tax Appeals***). Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notices."

On March 31, 2011, this Court appointed Luis A. Cañete as Independent Certified Public Accountant (CPA).[16]

During trial, petitioner presented the following as witnesses: Macario P. Balali, its Human Resources and Logistics Manager;[17] Luis A. Cañete, the duly commissioned Independent CPA;[18] Noel T. Fernandez, Manager of petitioner's 50.164 MW power plant;[19] Agnes Kim Eng T. Chu, its General Accountant, Finance and Accounting Group;[20] and Maria

[16] Docket, p. 294.
[17] Minutes of Hearing dated March 7, 2011, docket, p. 282.
[18] Minutes of Hearing dated September 5, 2011 and October 3, 2012, docket, pp. 385 and 2187.

Gracita M. Bacalla, its Comptroller or Head, Finance and Accounting Group.[21] On April 20, 2012, petitioner filed its Offer of Documentary Evidence[22], submitting Exhibits "A" to "CC", inclusive of sub-markings; which this Court admitted via Resolution[23] dated June 15, 2012. On October 18, 2012, petitioner filed its Supplemental Offer of Documentary Evidence with Motion to Admit[24], which this Court resolved in the Resolution[25] dated November 20, 2012.

On the other hand, respondent presented Emeteria M. Ang as her sole witness.[26] Thereafter, respondent filed her Formal Offer of Documentary Evidence[27], submitting Exhibits "1" to "12", inclusive of sub-markings; which this Court admitted in the Resolutions dated March 1, 2013[28] and April 17, 2013[29].

The case was submitted for decision on June 11, 2013, considering petitioner's Memorandum filed on June 3, 2013 and the report of the Court's Records Division that respondent failed to file a Memorandum.[30]

ISSUE

Basically, the issue is whether or not the FDDA dated September 17, 2010 should be reversed and set aside and the Final Assessment Notice dated August 25, 2009 which assessed petitioner of income tax in the amount of ₱2,791,894.70, inclusive of penalties and interest, for taxable year 2006, should be cancelled.

DISCUSSION/RULING

This Court shall resolve first the issue on the timeliness of filing of the instant Petition for Review and petitioner's submission of the required documents in support of its protest.

[21] Minutes of Hearing dated March 21, 2012, docket, p. 992.
[22] Docket, pp. 996-1029.
[23] Docket, pp. 1036-1053.
[24] Docket, pp. 2190-2197.
[25] Docket, pp. 2205-2207.
[26] Minutes of Hearing dated January 16, 2013, docket, p. 2216.
[27] Docket, pp. 2217-2224.
[28] Docket, pp. 2239-2240.

Respondent argues that the instant petition should not be given due course by this Court for being filed out of time. Respondent avers that under Section 3.1.5 of Revenue Regulations No. 12-99, implementing Section 228 of the National Internal Revenue Code (NIRC) of 1997, petitioner as taxpayer must submit the required documents in support of its protest within sixty (60) days from date of filing of the protest letter, otherwise, the assessment shall become final, executory and demandable. As alleged by respondent, petitioner did not submit the pertinent documents within 60 days from date of filing of its protest, rendering the assessment final, executory and demandable.

Petitioner counters that the instant petition was filed on time and that it complied with all the requirements prescribed by law and applicable regulations in assailing the issued assessments. Petitioner alleges that the FLD/FAN has been superseded by the FDDA, hence, it is the assessment of deficiency taxes stated in the FDDA that is subject of this case and not the assessment reflected in the FLD/FAN. In addition, the protest also informed respondent that petitioner already settled and paid the EWT deficiency assessment of ₱8,054.62 stated in the FAN through the eFPS.

Petitioner asserts that it submitted documents to support its claim together with the protest. It also points out that the FAN has not become final, unappealable and demandable since respondent never informed or advised petitioner that the documents in support of its protest were insufficient; and even if it failed to submit the said documents with its protest, this will not bar petitioner from presenting applicable documents in the proceedings before the Court.

This Court finds for petitioner.

Section 228 of the NIRC of 1997, as amended, provides:

> "SEC. 228. *Protesting of Assessment.* –
>
> xxx xxx xxx
>
> **If the protest is denied in whole or in part**, or is not acted upon within one hundred eighty days from submission of documents, **the taxpayer adversely affected by the**

> **Appeals within thirty (30) days from receipt of the said decision**, or from the lapse of the one hundred eighty (180)-day period; otherwise the decision shall become final, executory and demandable." *(Emphasis supplied)*

On the other hand, Section 3(a) of Rule 8 of the Revised Rules of the Court of Tax Appeals states:

> "SEC. 3. *Who may Appeal; period to file petition.* -(a) **A party adversely affected by a decision**, ruling or the inaction **of the Commissioner of Internal Revenue on disputed assessments** or claims for refund of internal revenue taxes, or by a decision or ruling of the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade and Industry, the Secretary of Agriculture, or a Regional Trial Court in the exercise of its original jurisdiction **may appeal to the Court by petition for review filed within thirty days after receipt of a copy of such decision or ruling**, or expiration of the period fixed by law for the Commissioner of Internal Revenue to act on the disputed assessments. In case of inaction of the Commissioner of Internal Revenue on claims for refund of internal revenue taxes erroneously or illegally collected, the taxpayer must file a petition for review within the two-year period prescribed by law from payment or collection of the taxes." *(Emphasis supplied)*

From the aforesaid provisions, a party adversely affected by a decision or ruling of the Commissioner of Internal Revenue on disputed assessments may appeal to this Court by filing a petition for review within thirty days after receipt of a copy of such adverse decision or ruling.

In the instant case, petitioner received the FDDA on September 17, 2010. Counting from September 17, 2010, petitioner had until October 17, 2010 to file a Petition for Review. On October 15, 2010, petitioner filed its Petition for Review, or two days before the thirty (30)-day period would have expired. Clearly, petitioner filed the instant Petition for Review within the prescriptive period.

Moreover, contrary to respondent's allegations that petitioner failed to submit documents in support of its protest, petitioner filed its letter of protest dated October 20, 2009 together with the supporting documents before respondent Commissioner and Zenaida G. Garcia, OIC-Assistant petitioner informed respondent that it paid the expanded withholding tax on October 10, 2009.[31] Hence, petitioner has complied with the legal requirement with respect to the submission of supporting documents.

The Court shall now determine the issue pertaining to the purported liability of petitioner for deficiency income tax in the total amount of ₱2,791,894.70, including penalties and interest.

A perusal of pertinent exhibits showed that petitioner is a duly registered enterprise with the Philippine Economic Zone Authority as an ECOZONE Utilities Enterprise[32] entitled to the five percent (5%) preferential tax rate[33] on gross income under Section 24 of R.A. No. 7916, otherwise known as "The Special Economic Zone Act of 1995" (PEZA Law), as amended, which provides:

> "SECTION 24. *Exemption from National and Local Taxes.* - Except for real property taxes on land owned by developers, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu thereof, five percent (5%) of the **gross income** earned by all business enterprises within the ECOZONE shall be paid and remitted as follows:
>
> (a) Three percent (3%) to the National Government;
>
> (b) Two percent (2%) which shall be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located." *(Emphasis supplied)*

Gross Income is defined in Section 2(nn) of Rule I of the Rules and Regulations to Implement R.A. No. 7916 (PEZA Rules), as follows:

> "nn. *'Gross Income'* for purposes of computing the special tax due under Section 24 of the Act refers to gross sales or gross revenues derived from business activity within the ECOZONE, net of sales discounts, sales returns and allowances and minus costs of sales or direct costs but before any deduction is made for administrative expenses or incidental losses during a given taxable period. The allowable

[31] Exhibit "I".

deductions from 'gross income' are specifically enumerated under Section 2, Rule XX of these Rules."

In this regard, Section 4 of Rule XX of the PEZA Rules enumerates the specific deductions for ECOZONE Utilities Enterprises, to wit:

"SECTION 4. *Gross Income Earned; Allowable Deductions* - For purposes of these Rules, Gross Income earned shall be defined in Section 2 (nn) of Rule I of these Rules, subject to the following allowable deductions for specific types of enterprises:

xxx xxx xxx

2. For ECOZONE Developer/Operator, Facilities, Utilities and Tourism Enterprises.

- Direct salaries, wages or labor expenses
- Service supervision salaries
- Direct materials, supplies used or resold to another ECOZONE Enterprise
- Depreciation of machinery, equipment and buildings owned and/or constructed
- Financing charges associated with fixed assets
- Rent and utility charges for buildings and capital equipment"

In its Annual Income Tax Return[34] for taxable year 2006 filed with the BIR on April 16, 2007, petitioner reported a gross income in the amount of ₱116,760,958.00 with the corresponding 5% tax in the amount of ₱5,838,047.90.

However, based on an examination of petitioner's books of accounts and accounting records for taxable year 2006, respondent found petitioner liable for deficiency income tax in the amount of ₱2,791,894.70, the detailed computation of which as contained in her Final Decision on Disputed Assessment is reproduced hereunder:[35]

PARTICULARS	SPECIAL	DISCREPANCY	PER AUDIT
Sales/revenues	₱1,513,125,250.00		₱1,513,125,250.00
Less: Cost of sales/services	1,396,364,292.00	₱34,467,835.76	1,361,896,456.24
Gross Income	116,760,958.00		151,228,793.76

Add: Other non-operating and taxable income	-		-
Total gross income	116,760,958.00		151,228,793.76
Deductions	-		-
Total taxable income	116,760,958.00		151,228,793.76
Tax due (5%)	5,838,047.90		7,561,439.69
Less: Tax payments/credits			
3 quarters payments	2,677,506.15		
CWT	60,645.37		
Per return	764,677.20		
Total	₱ 3,502,828.72		3,502,828.72
Add: 2% LGU payment			2,335,219.18
Total payment			5,838,047.90
Deficiency-basic tax			1,723,391.79
Add: Interest (4.16.07 to 05.16.10)			1,068,502.91
Total tax due and payable			**₱ 2,791,894.70**

The deficiency income tax assessment arose from respondent's disallowance of petitioner's claimed cost of sales/services in the amount of ₱34,467,835.76, broken down as follows:[36]

PARTICULARS	AMOUNT
SSS-employer cost	₱ 306,882.12
Pag-ibig employer cost	24,950.78
Medical/health insurance	465,621.03
Accident/Life insurance	70,410.55
Uniform/working gears	319,257.02
Employee Activities	20,486.59
Training and Development-non-technical	31,495.87
Training and Development-technical	125,838.74
Insurance and freight	1,707,489.68
Hauling and trucking services	23,952.75
Brokerage fees	261,829.61
Other inventory incidental cost	536,977.10
Safety programs and services	1,695,767.23
Other professional fees	182,939.12
DOE Electrification Fund	7,338,411.98
Insurance-power plant	19,473,119.22
Insurance-other assets	152,531.85

General Office-expense	1,057,080.11
Business expense	636,604.54
Taxes and licenses	36,189.87
TOTAL	**₱ 34,467,835.76**

Respondent cites the following law and regulations as legal bases of the aforesaid disallowances:

1. R.A. No. 7916 or the PEZA Law;
2. Revenue Regulations (RR) No. 01-95 (Rules and Regulations to Implement the Tax Incentives Provisions under Paragraphs (b) and (c) of Section 12, R.A. No. 7227 Otherwise known as the Bases Conversion and Development Act of 1992);
3. RR No. 16-99 (Amending RR No. 1-95, as Amended, and Other Related Rules and Regulations to Implement the Provisions of Paragraphs (b) and (c) of Section 12 of R.A. No. 7227, Otherwise Known as the "Bases Conversion and Development Act of 1992" Relative to the Tax Incentives Granted to Enteprises Registered in the Subic Special Economic and Freeport Zone);
4. RR No. 02-05 (Consolidated Revenue Regulations Implementing Relevant Provisions of R.A. No. 7227 Otherwise Known as "Bases Conversion and Development Act of 1992", RA No. 7916 as Amended Otherwise Known as "Special Economic Zone Act of 1995" and R.A. No. 7922 Otherwise Known as "Cagayan Special Economic Zone Act of 1995" Thereby Amending RR No. 1-95 as Amended by RR No. 16-99); and
5. RR No. 11-05 (Regulations Defining "Gross Income Earned" to Implement the Tax Incentive Provision in Section 24 of Republic Act No. 7916, otherwise known as "The Special Economic Zone Act of 1995" Revoking Section 7 of RR No. 02-05, and Suspending the Effectivity of Certain Provisions of RR No. 02-05).

Applicable to the present case is RR No. 11-05, revoking Section 7 of RR No. 02-05. The significant portions of RR No. 11-05 and RR No. 02-05 are quoted hereunder for clarity:

RR No. 02-05

"For purposes of computing the total five percent (5%) tax rate imposed by Republic Act No. 7227, Republic Act No. 7903, Republic Act No. 7922 and Republic Act No. 7916, the cost of sales or direct cost shall **consist only** of the following cost or expense items which shall be computed in accordance with Generally Accepted Accounting Principles (GAAP):

xxx xxx xxx

For ECOZONES under R.A. No. 7916 –

xxx xxx xxx

2. *ECOZONE Developer/Operator, Facilities, Utilities and Tourism Enterprises:*

- Direct salaries, wages or labor expense
- Service supervision salaries
- Direct materials, supplies used
- Depreciation of machinery and equipment used in registered activities
- Financing charges associated with fixed assets used in registered activities the amount of which were not capitalized
- Rent and utility charges for buildings and capital equipment used in undertaking registered activities" *(Emphasis supplied)*

RR No. 11-05

"For purposes of computing the total five percent (5%) tax rate imposed, **the following direct costs are included in the allowable deductions** to arrive at gross income earned for specific types of enterprises:

2. ECOZONE Developer/Operator, Facilities, Utilities and Tourism Enterprises:

- Direct salaries, wages or labor expense
- Service supervision salaries
- Direct materials, supplies used

- Depreciation of machineries and equipment used in the rendition of registered services, and of that portion of the building owned or constructed that is used exclusively in the rendition of registered service
- Rent and utility charges for buildings and capital equipment used in the rendition of registered services
- Financing charges associated with fixed assets used in the registered service business the amount of which were not previously capitalized." *(Emphasis supplied)*

Petitioner argues that the enumeration of direct costs under RR No. 11-05 is not an exclusive or closed list of expenses that may be deducted by PEZA-registered enterprises from their gross sales for the purpose of computing the 5% gross income tax (GIT). Instead, the enumeration of direct costs is intended as a guide in determining the items that may be considered direct costs or costs of sales. It noted that RR No. 11-05 amended Section 7 of RR No. 02-05 by deleting the words "consist only" and restating the pertinent phrase to "the following direct costs are included in the allowable deductions xxx."[37]

The Court agrees with petitioner.

It is clear from the amendment made under RR No. 11-05 that the list is not meant to be all-inclusive but merely enumerates the expenses that can be considered as direct costs. PEZA-registered enterprises may be allowed to deduct expenses which are in the nature of direct costs even though the same are not included in the list.

The criteria in determining whether the item of cost or expense should be part of direct cost is the direct relation of such item in the rendition of the PEZA-registered services. If the item of cost or expense can be directly attributed in providing the PEZA-registered services, then it should be treated as direct cost.

It is important to note that Section 27(E)(4) of the NIRC of 1997, as amended, defines cost of services as "xxx direct costs and expenses necessarily incurred to provide the services required by the customers and clients including (A) salaries and employee benefits of personnel, consultants and specialists directly rendering the service and (B) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies: xxx."

Thus, the rest of the costs can be classified as operating expenses which are defined as "primary recurring costs associated with central operations, other than cost of goods sold, which are incurred to generate sales. Operating expenses are normally classified into the following two categories:

a. Distribution costs (or selling expenses)
b. General and administrative expenses

Distribution costs are those expenses related directly to the company's efforts to generate sales (*e.g.*, sales salaries, commissions, advertising, delivery expenses, depreciation of store furniture and equipment, and store supplies). General and administrative expenses are expenses related to the general administration of the company's operations (*e.g.*, officers and office salaries, office supplies, depreciation of office furniture and fixtures, telephone, postage, accounting and legal services, and business licenses and fees)."[38]

The Court will now determine whether the disallowed expenses are direct cost or cost of sales which can be considered as valid deductions from petitioner's gross income.

With regard to the subject disallowed expenses, petitioner has to prove that they were directly used or related in its power generation services, not just for the continued efficient and effective operations of the corporation.

SSS Employer Cost - ₱306,882.12
Pag-ibig Employer Cost - ₱24,950.78
Medical/Health Insurance - ₱465,621.03
Accident/Life Insurance - ₱70,410.55
Uniform/Working Gears - ₱319,257.02

Petitioner avers that the expenses related to SSS Employer Cost, Pag-ibig Employer Cost, Medical/Health

Insurance, Accident/Life Insurance, and Uniform/Working Gears were incurred for its plant operations personnel and as such should be considered as part of the personnel's compensation and consequently allowed as deductions as "direct salaries, wages, or labor expenses" pursuant to RR No. 11-2005.[39]

A certification from petitioner's Human Resource and Logistics Department shows that the following employees were assigned to the Operations and Maintenance Department in the year 2006:[40]

NAME	POSITION/TASK
1. Albarico, Cezar V.	Shift Superintendent
2. Anuta, Abelardo M.	Control Room Operator
3. Archival, Eduardo A.	Electrical Maintenance Service
4. Arenas, Joselito Z.	Shift Superintendent
5. Atillo, Wendell S.	Control Room Operator
6. Avenido, Erwin E.	Shift Superintendent
7. Bacula, Regel C.	Planning Engineer
8. Baguio, Reynaldo A.	Mechanic
9. Balili, Florante O.	Shift Superintendent
10. Buanghug, Bernardo A.	Electrical and Instrumentation Technician
11. Cabili, Romeo M.	Mechanic
12. Cajes, Enerio P.	Mechanic
13. Conjurado, Sherwin P.	Mechanical Technician
14. Dingal, Nelson T.	Mechanical Specialist
15. Gamalo, Juan D.	Engine Room Engineer
16. Javier, Floriano B.	Electrical and Instrumentation Technician
17. Juntilla, Vicente C.	Complex Electrical Operations and Maintenance
18. Manlangit, Isidro Sr. R.	Engine Room Engineer
19. Nisnisan, Abe P.	Control Room Operator
20. Piape, Samuel Jr. G.	Control Room Operator
21. Pontino, Robenson Q.	Electrical and Instrumentation Technician
22. Tangarorang, Jose Q.	Engine Room Engineer

Further, Mr. Macario P. Balali, petitioner's Human Resource and Logistics Department Manager, stated the following in his judicial affidavit:[41]

[39] Par. 75, Memorandum for the Petitioner, docket, p. 2329.

"Q33: What is the nature of the work of EAUC employees assigned to its Operations and Maintenance Departments?

A33: EAUC employees assigned to its Operations and Maintenance Departments perform work that are directly connected with plant operations or EAUC's power production activities. Employees assigned to the Operations and Maintenance Departments are therefore the plant operations personnel of EAUC."

To support the SSS and Pag-ibig Employer Costs, petitioner submitted schedules of the subject costs,[42] lists of operations and maintenance department employees whose employer's share of SSS, PhilHealth and Pag-Ibig contributions were taken up as part of direct costs along with the respective remittance lists, payment returns and receipts.[43]

It should be noted that the SSS employer cost of ₱306,882.12 consists of the following:

MONTH	SSS	PHILHEALTH	TOTAL
January	₱ 18,363.77	₱ 6,150.37	₱ 24,514.14
February	18,363.77	6,225.22	24,588.99
March	18,363.77	6,200.27	24,564.04
April	18,363.77	6,187.79	24,551.56
May	18,363.77	6,237.70	24,601.47
June	18,363.77	6,175.32	24,539.09
July	18,363.77	6,212.74	24,576.51
August	20,200.15	6,749.19	26,949.34
September	20,200.15	6,786.61	26,986.76
October	20,200.15	6,799.09	26,999.24
November	20,200.15	6,861.46	27,061.61
December	20,200.15	6,749.19	26,949.34
TOTAL	**₱229,547.14**	**₱77,334.95**	**₱306,882.09***

**rounding-off difference*

Examination of the submitted documentary evidence reveals that the subject expenses were incurred for petitioner's personnel assigned in the Operations and Maintenance Departments in the year 2006. /

Anent the Medical/Health and Accident/Life insurance and Uniform/Working Gears expenses, petitioner submitted schedules of medical/health insurance, accident/life insurance and uniform/working gears[44] with supporting documents such as statements of accounts, requests for payments and official receipts, requisition and issuance slips, and suppliers' invoices.[45] Scrutiny of the foregoing shows that the said expenses include premiums for petitioner's on-the-job student-trainees likewise assigned to the same departments for its apprenticeship program in the amount of ₱19,864.86, to wit:

EXHIBIT	PARTICULARS	AMOUNT
S-3-A-1-A to C, E to H	Insurance coverage for OJTs	₱ 9,832.10
S-3-A-2-A to C, E to H	Insurance coverage for OJTs	10,032.76
	TOTAL	**₱19,864.86**

Petitioner's on-the-job trainees for the year 2006 are as follows:[46]

Apprenticeship program April 1, 2006	**Apprenticeship program June 28, 2006**
1. Jose Jonna T. Chavez	1. Roy Angelu E. Batula
2. Mahaliel Jared C. Leong	2. Jade Brix T. De Asis
3. Andre A. Cabrera	3. Edward F. Francisco
4. Jason N. Reuyan	4. Rowell V. Garcia
5. Jovelon A. Oracoy	5. Giovani F. Paculanang

Further, the Court found that the following supplies and working gears amounting to ₱84,709.84 were issued to on-the-job-trainees or personnel not assigned in the Operations and Maintenance Department:

EXHIBIT	ITEM	ISSUED TO	QTY	COST	TOTAL
S-4-A-72-A to S-4-B-72	Safety shoes	Densing, R.A. Medina, N.B. Balali, M.P. Lim, R.Q. Añasco, C.T. Cabana, L.O.	11	₱1,314.66	₱ 14,461.26

44 Exhibits "S-2", "S-3", and "S-4".

		Camus, E.M.			
		Pun-an, V.P.			
		Cuyos, F.J.			
		Fernandez, N.T.			
		Barredo, O.Y.			
S-4-A-398-A to S-4-B-398	Safety shoes	De Asis, Jade Brix T., Francisco, Edward F. & Batula, Roy Angelu E.	3	1,322.88	3,968.64
	Spectacles (Goggles)		3	284.20	852.60
S-4-A-419-A to S-4-B-419	Cap,Bump White	Rowell V. Garcia and Giovani F. Paculanang	2	566.74	1,133.48
	Ear plug		5	115.00	575.00
	Spectacles (Goggles)		2	284.20	568.40
	Safety shoes		2	1,322.88	2,645.76
S-4-A-585-A to S-4-B-585	Ear muffs	For guardhouse use	20	1,227.74	24,554.80
		For Admin use	10	1,227.74	12,277.40
	Cap,Bump White	For guardhouse use	20	567.14	11,342.80
		For Admin use	3	567.14	1,701.42
S-4-A-656-A to S-4-A-656-B	Ear muffs	Bacus, Kristine	1	1,227.74	1,227.74
	Cap,Bump White		1	567.14	567.14
S-4-A-747-A to S-4-A-747-B	Safety shoes	Legaspi, Vincent V., Tabanao, Michael, Debulosan, Niño, Duyag, Romeo, Curiba, Realiza	5	1,366.86	6,834.30
	Spectacles (Goggles)		5	115.00	575.00
	Ear plug		5	284.82	1424.10
	TOTAL				**₱ 84,709.84**

Furthermore, the following were included in petitioner's uniform/working gear expense but should be disallowed as cost of sales/services for the year 2006:

EXHIBIT	PARTICULARS		AMOUNT
S-4-A-822	Intercompany Charges-Uniform for:		
	R.Q. Lim	R.A. Densing	₱ 3,753.54
	M.P. Balali	L.O. Cabana	
	F.J. Cuyos	N.B. Medina	
S-4-A-883 to S-4-A-883-D	Intercompany Charges-Pants for:		1,422.76
	Fernandez, N.	Dela Cerna	
	Hatulan	Barredo	
not found on file	Shirt jack with logo		609.76
not found on file	Gloves, High voltage 30KV w/ inner gloves		1.00
not found on file	Shield, Safe face protection for glasses		3.00
	TOTAL		**₱ 5,790.06**

Accident/Life insurance premiums paid and working gears for petitioner's on-the-job trainees should not form part of its direct salaries, wages and labor expense. Petitioner can still carry on its power generation activities without having to incur cost for its apprenticeship program. Moreover, the very nature of the OJT or apprenticeship program is under the human resource or administrative function of a company. In other words, costs pertaining to it should be classified as operating expenses.

Thus, petitioner has sufficiently proven that its SSS and Pag-ibig Employer Costs, Medical/Health and Accident/Life Insurances and Uniform/Working Gears expenses should be included in its cost of services for the year 2006 except for accident/life insurance and uniform/working gear in the amount of ₱110,147.46, computed as follows:

	Amount (a)	Allocation for the 5% preferential rate (b) = (a) x 99.8031%[47]
Accident/Life insurance	₱ 19,864.86	₱ 19,825.75
Working gears	84,709.84	84,543.05
Uniform	5,790.06	5,778.66
Disallowed Accident/Life Insurance and Uniform/Working Gear expense	**₱110,364.76**	**₱ 110,147.46**

Employee Activities - ₱20,486.59

Examination of the supporting documents submitted reveals that the expense account of "Employee Activities" pertains to the following:[48]

PARTICULARS	AMOUNT
Holy mass for St. Nino Feast	₱ 1,523.99
Pingpong tournament expenses	6,986.22
Treadmill for physical fitness club	11,976.37
TOTAL	**₱20,486.59**

[47] Total PEZA sales ₱1,513,125,250 = 99.8031% (Exhibit "T", p. 8).

While the said expense may promote the "physical health as well as the spiritual and moral well-being of its (petitioner's) plant operations personnel",[49] the same is not directly related or essential to the rendition of its registered service. This means that respondent correctly disallowed "Employee Activities" amounting to ₱20,486.59 from petitioner's cost of sales.

Training and Development-Non-Technical - ₱31,495.87
Training and Development-Technical - ₱125,838.74

Per petitioner's Plant Manager, "Training and Development-Non-Technical" refers to the development of management skills, behavioral skills and personality development, whereas "Training and Development-Technical" focuses on the development of special skills or practical knowledge especially in mechanical, industrial arts, scientific field or practical science of a particular position or job function.[50]

From petitioner's explanation, non-technical training expenses are clearly general and administrative costs, while technical training may be considered as direct cost of service. Considering so, the following technical training expenses should be disallowed for being incurred not for petitioner's Operations and Maintenance personnel:

Exhibit	OR No.	Payee	Petitioner's Personnel	Amount
S-7-A-7-A to S-7-A-7-F	0731	CESEEPS International Association Inc.	E. Camus	₱ 3,600.00
S-7-A-10-A to S-7-A-10-F	0758	CESEEPS International Association Inc.	E. Camus	3,600.00
S-7-A-12-A to S-7-A-12-F	0781	CESEEPS International Association Inc.	E. Camus	3,600.00
S-7-A-17-A to S-7-A-17-F	0797	CESEEPS International Association Inc.	E. Camus	3,600.00
S-7-A-18-A to S-7-A-18-G	-	Institute of Integrated Electrical Engrs.	N. Fernandez	14,478.06

TOTAL	**₱28,878.06**
Allocation for the 5% preferential rate	99.8031%
Disallowed Uniform/Working Gear expense	**₱28,821.21**

Consequently, out of the ₱125,838.74 technical training and development expenses, only ₱97,017.53 (₱125,838.74 less ₱28,821.21) should be allowed to be included in petitioner's cost of services for the purpose of computing the 5% GIT.

Hauling and Trucking Services - ₱23,952.75

Petitioner's hauling and trucking services expense is comprised of the following:[51]

Rental of crane to relocate concrete pole	₱ 11,976.37
Rental of motorized pumpboat for cleaning of berthing dolphin platform	11,976.37
TOTAL	**₱ 23,952.74**

Engr. Noel T. Fernandez, petitioner's plant manager, explained that (1) the rented crane was used to relocate concrete poles utilized in connection with petitioner's transmission facilities, and (2) the motorized pump boat was used for maintaining petitioner's berthing dolphin or fuel platform (*i.e.*, the facility where barges carrying bunker fuel necessary for the plant's operations dock and where said bunker fuel is unloaded into pipelines that carry or transport the same to the plant). The concrete poles and dolphin/fuel platform are essential plant facilities that must be regularly repaired and maintained for petitioner's continued and efficient operation.[52]

The Court finds the foregoing to be in order. Hence, the subject expenses should become part of petitioner's cost of services.

Insurance and Freight - ₱1,707,489.68
Brokerage Fees - ₱261,829.61
Other Inventory Incidental Cost - ₱536,977.10

Petitioner avers that insurance and freight, brokerage fees and other inventory costs are costs to maintain and repair the plant's machinery and equipment to ensure that it operates efficiently and with the least possible disruptions. Moreover, it imported spare parts (which were not available locally) necessary to repair and maintain in good order the machinery and equipment and the subject costs were incurred in connection thereto.[53]

Upon examination of the supporting documents, the Court finds that the said expenses should be included in the deductions for the computation of gross income except for the following findings amounting to ₱507,336.25, which should be disallowed for the reasons stated:

INSURANCE AND FREIGHT				
EXHIBIT	**DATE**	**REFERENCE NO.**	**GROSS AMOUNT**	**ALLOCATION FOR THE 5% PREFERENTIAL RATE (GROSS AMOUNT X 99.8031%)**
1. *Contents of shipment not specified in invoice*				
S-8-A-8-F	2/15/2006	D00601235	₱ 1,800.00	
S-8-A-20-F	3/9/2006	CEBAC017985	7,974.00	
S-8-A-21-F (1/4)	3/20/2006	CEBI26823	9,120.46	
S-8-A-21-F (4/4)	3/13/2006	CEB391506	10,723.13	
S-8-A-31-F (1/2) &(2/2)	4/7/2006	CEBI29329/ EAS577658	7,036.54	
S-8-A-39-F	5/19/06 & 5/22/06	CEBI34851/ CEB413635	13,514.24	
S-8-A-74-F	7/31/2006	CEBAC020381	8,455.00	
S-8-A-85-F (1/6) to (6/6)	various	various	49,127.38	
S-8-A-102-F (1/3) to (3/3)	various	various	24,814.80	
S-8-A-108-F (1/2) to (2/2)	10/6/06 & 11/6/06	52E001917/ 52E001915	77,523.34	
Subtotal			*₱210,088.89*	
2. *No invoice, cannot be ascertained whether shipment of spare parts or not*				
S-8-A-15-A	2/22/2006	10245	₱ 5,646.61	
S-8-A-16-A	2/24/2006	10265	49,532.33	
Subtotal			*₱ 55,178.94*	
3. *No supporting documents*				
-	2/28/2006	89373/10237	₱ 36,735.78	
-	3/21/2006	JV200603020	1,012.92	
-	7/20/2006	10633/10810	992.56	

-	8/31/2006	11116	7,723.50	
-	12/31/2006	JV200612191	1,918.01	
-	12/31/2006	JV200612192	9,488.62	
Subtotal			*₱ 57,871.40*	
TOTAL DISALLOWED INSURANCE AND FREIGHT			**₱323,139.23**	**₱ 322,503.04**
BROKERAGE FEES				
1. No invoice, cannot be ascertained whether shipment of spare parts or not				
S-10-A-8-B(1/5)	4/5/2006	183301	₱ 8,981.44	
S-10-A-8-B(2/5)	4/5/2006	183304	50.00	
TOTAL DISALLOWED BROKERAGE FEES			**₱ 9,031.44**	**₱ 9,013.66**
OTHER INVENTORY INCIDENTAL COST				
1. No invoice, cannot be ascertained whether shipment of spare parts or not				
S-11-A-2-B	1/30/2006	4016	₱ 8,495.00	
S-11-A-13-B	4/10/2006	0449	8,302.50	
S-11-A-18-G	5/17/2006	APV300-17897	68,880.99	
S-11-A-21-B	6/13/2006	DN/2006/26	20,136.41	
S-11-A-28-B	9/5/2006	DN/2006/30	51,499.46	
S-11-A-34-B	10/25/2006	DN/2006/36	18,852.02	
TOTAL DISALLOWED OTHER INVENTORY INCIDENTAL COST			**₱176,166.38**	**₱175,819.55**
GRAND TOTAL OF DISALLOWED EXPENSES			**₱508,337.05**	**₱507,336.25**

Insurance-Other Assets - ₱152,531.85
Insurance-Power Plant - ₱19,473,119.22

Petitioner's insurance expense account for its Power Plant involves the following:[54]

Industrial all-risk insurance from 11/28/05 to 11/28/06	₱ 17,709,057.53
Fronting fee re: insurance	305,784.97
Public utility insurance	550,870.40
General liability insurance	77,439.79
Industrial all-risk insurance from 11/28/06 to 11/28/07	829,966.54
TOTAL	**₱19,473,119.22**

On the other hand, its insurance expense account for Other Assets in the amount of ₱152,531.85 includes (a) premiums paid on a surety bond obtained in connection with petitioner's importation of spare parts for the machinery and equipment used in the plant and (b) premiums for a comprehensive car insurance for petitioner's truck.[55]

The Court finds petitioner's insurance premium payments for its Other Assets and Power Plant in the respective amounts of ₱152,531.85 and ₱19,473,119.22 to be in order. Consequently, it is proper to include said expenses in its cost of services.

DOE Electrification Fund - ₱7,338,411.98

Pursuant to Section 4 of Rule 29(A) of the Implementing Rules and Regulations of Republic Act No. 9136, also known as "Electric Power Industry Reform Act of 2001" (EPIRA), generation companies shall set aside ₱0.01 per kilowatt hour of total electricity sales as financial benefit of host communities, thus:

> "SECTION 4. *Nature of Benefits Provided under E.R. 1-94.*
>
> (a) The Generation Company and/or energy resource developer shall set aside one centavo per kilowatt-hour (₱0.01/kWh) of the total electricity sales as financial benefit of the host communities of such Generation Facility, where applicable."

In relation thereto, Section 10 of Energy Regulation No. 1-94 provides:

> "SEC. 10. *Implementation and Enforcement Measures.* The DOE shall take all necessary reasonable measures to ensure the proper enforcement of these rules and regulations, which measures shall not be limited to those specified under this Section.
>
> **In the event of violation or non-compliance with these rules and regulations, the DOE may, upon prior notice and hearing to the power producer or the energy resource developer, (a) issue an order to the power producer or the energy resource developer to cease and desist operations; and/or (b) withdraw, suspend, revoke, cancel, or annul the geophysical survey or service contract of the energy resource developer of the accreditation status granted to the power producer.** However, in the case of wilful violation of or wilful

failure to comply with these rules and regulation, the DOE may, without prior notice and hearing, but after proper investigation or verification, *muto propio*, or upon verified complaint by any aggrieved party, proceed with the enforcement measures enumerated in this paragraph." *(Emphasis supplied)*

Likewise, PEZA Board Resolution No. 07-393[56] dated August 21, 2007, provides in pertinent part:

"Section 4. Procedure for Applying as a Registered Ecozone Power Generation Enteprises

xxx xxx xxx

4. Obligation and Responsibilities

xxx xxx xxx

f) A one centavo per kilowatt hour (P0.01/kWh) sales shall be set aside to communities hosting the power generation facility following the rules and regulations and applicable orders and circulars to implement Section 5(i) of Republic Act No. 7638.

xxx xxx xxx

Section 8. Penalties

xxx xxx xxx

3. Any violation or default in the performance of the covenants and obligations set forth in this Registration Guidelines by the Registrant shall constitute a ground for the revocation of the registration if no corrective or remedial measures satisfactory to PEZA are instituted within thirty (30) days from written notice of such violation or default. PEZA, however, shall be compensated for all the damages that it may have suffered by reason of such violation or default."

Contributions to the DOE Electrification Fund are required by law to "devise ways and means of giving direct benefits to the province, city, or municipality, especially the community and people affected, and equitable and preferential benefit to the region that hosts the energy resource and/or the energy-generating facility."[57] Said contributions should be made because petitioner is a generation company, not in order to generate electricity. PEZA made it a requisite in applying for registration, just as payment of business licenses and fees is requisite to be able to conduct and operate a business. As such, the mandatory contribution is in the nature of an operating expense, specifically a general and administrative expense.

Moreover, it is noteworthy that out of the claimed DOE Electrification Fund of ₱7,352,888.21, only the amount of ₱2,338,403.35 refers to taxable year 2006 as found by the Court-commissioned Independent CPA, to wit:[58]

> "While we found the amount of ₱7,352,888.21 to be actually incurred, properly supported and actually paid, we found it to be an overstated charge for 2006. DOE audited electrification fees for 2006 is only ₱2,338,403.35. The difference of ₱5,014,484.86 could pertain to periods prior to 2006. Therefore, the amount of ₱7,338,411.98 claimed is overstated by ₱5,004,611.34, the allocated amount corresponding to ₱5,014,484.86."

Be that as it may, the entire claimed DOE Electrification Fund in the amount of ₱7,338,411.98 shall be disallowed as part of petitioner's cost of services for purposes of computing the 5% GIT.

Safety Programs and Services - ₱1,695,767.23
Other Professional Fees - ₱182,939.12

Petitioner avers that the following expenses recorded in its Safety Programs and Services and Other Professional Fees accounts should be considered as costs under "direct materials" or "supplies used" and "rent and utility charges for buildings and capital equipment used in the rendition of registered services" as provided in RR No. 11-05:

Safety Programs and Services *(Exhibit "S-12")*	**Amount**
Fire Hose	₱ 27,785.19
Oil Spill Kit	85,910.73

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[57] Section 5(i) of Republic Act No. 7638, An Act Creating the Department of Energy Rationalizing the

Fire Hose Boxes	117,483.74
Medical Supplies for Clinic	7.98
Life Jacket/Ring	4,307.50
Complete Rehab of Fire Water Loop	1,460,272.08
TOTAL	**₱1,695,767.22**

Other Professional Fees *(Exhibit "S-13")*	**Amount**
Sampling/Analysis of air quality-for baseline data	₱ 41,917.31
PCHEM Consultancy	5,289.57
Programming works on fuel oil system flow	55,889.75
Air Monitoring Services	47,905.50
Air Quality Testing	31,937.00
TOTAL	**₱ 182,939.13**

Engr. Fernandez, petitioner's Plant Manager, further states:[59]

"Q25: What do you know of the deduction claimed as 'safety programs and services', if any?

A25: This deduction represents the costs incurred by EAUC in procuring safety equipment and environmental protection gears which are necessary for the safe and proper conduct of Plant operations. These include fire hoses, oil spill kits, fire hose, fire hose boxes, life jacket/ring and rehabilitation of fire water loop that we use in case of accidents or any other mishap in the Plant.

Q26: What do you know of the deduction claimed as 'other professional fees', if any?

A26: This deduction represents the professional fees paid by EAUC in connection with monitoring the Plant's stack emissions and ambient air quality in accordance with the requirements of Republic Act No. 8749, otherwise known as the Clean Air Act (the ***'Clean Air Act'***). These are fees paid to companies or businesses that specialize in sampling analysis of air quality and air quality testing. This deduction also includes programming works for fuel oil system flow of fuel oil booster module for efficient operations and monitoring control."

Except for the Other Professional Fees in the allocated amount of ₱31,937.00[60], which were incurred not in the year 2006 but in 2007, the subject costs should be included in the computation of petitioner's gross income.

General Office Expense - ₱1,057,080.11
Business Expense - ₱636,604.54
Taxes and Licenses - ₱36,189.87

Examination of the supporting documents submitted shows that the foregoing expenses comprised of the following:[61]

GENERAL OFFICE EXPENSES	**AMOUNT**
Office supplies	₱ 420,281.21
Publications and subscription	4,523.08
Telephone and other communications	93,747.47
Postage and other courier services	1,599.13
Vehicle Repairs and Maintenance	86,973.34
Gas and oil	226,669.27
Water expense	199,303.67
Hardware and software repairs and maintenance	15,818.79
Mimeographing and photocopying	8,164.16
TOTAL	**₱1,057,080.12**

BUSINESS EXPENSES	**AMOUNT**
Representation	₱ 1,670.70
Transportation Expenses	107,487.79
Out of Town Travel	72,751.33
Meals, Board and Lodging	454,694.72
TOTAL	**₱ 636,604.54**

TAXES AND LICENSES	**AMOUNT**
Registration Renewal for Isuzu Elf	₱ 2,978.52
NTC License Renewal for Radio Subscription	6,634.91
Renewal of Permit to Operate, Discharge	2,320.42
Waste Water Discharge Permit Fee	6,487.20
Input Tax expense	17,768.81
TOTAL	**₱ 36,189.86**

As earlier discussed, operating expenses are primary recurring costs associated with central operations, which are incurred to generate sales. General and administrative expenses are related to the general administration of the company's operations (*e.g.*, officers and office salaries, office supplies, depreciation of office furniture and fixtures, telephone, postage, accounting and legal services, and business licenses and fees).

Clearly, petitioner's general office expense, business expense and taxes and licenses appropriately fall under operating expenses, specifically general and administrative expenses.

In fine, petitioner's disallowed cost of services for taxable year 2006 is reduced to ₱9,798,510.88, summarized as follows:

PARTICULARS	AMOUNT
Accident/Life insurance	₱ 19,825.75
Working gears	84,543.05
Uniform	5,778.66
Employee Activities	20,486.59
Training and Development-non-technical	31,495.87
Training and Development-technical	28,821.21
Insurance and freight	322,503.04
Brokerage fees	9,013.66
Other inventory incidental cost	175,819.55
Other professional fees	31,937.00
DOE Electrification Fund	7,338,411.98
General Office-expense	1,057,080.11
Business expense	636,604.54
Taxes and licenses	36,189.87
TOTAL	**₱ 9,798,510.88**

Consequently, petitioner is liable to pay deficiency 5% GIT in the amount ₱489,925.55 on the disallowed expenses of ₱9,798,510.88. However, it must be emphasized that only the amount of ₱293,955.33 representing 3% deficiency GIT on the disallowed expenses of ₱9,798,510.88 shall be remitted to the national government. The remaining 2% deficiency GIT in the amount of ₱195,970.22 shall be remitted directly to the Office of the Treasurer, City of Lapu-Lapu, where petitioner is located.

WHEREFORE, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessment for deficiency income tax is **UPHELD** with modifications. Petitioner is hereby **ORDERED TO PAY** respondent for deficiency 5% GIT for the year 2006 in the amount of ₱612,406.94, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

	NATIONAL GOVERNMENT	**TREASURER'S OFFICE, LAPU-LAPU CITY**	**TOTAL**
Basic Tax Due	₱ 293,955.33	₱ 195,970.22	₱ 489,925.55
Surcharge	73,488.83	48,992.56	122,481.39
TOTAL	**₱367,444.16**	**₱ 244,962.78**	**₱ 612,406.94**

In addition, petitioner is hereby **ORDERED TO PAY** the following:

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of ₱293,955.33 (due to the National Government) and ₱195,970.22 (due to the Treasurer's Office, Lapu-Lapu City) or in the sum of ₱489,925.55 computed from April 15, 2007 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended:

	NATIONAL GOVERNMENT	**TREASURER'S OFFICE, LAPU-LAPU CITY**	**TOTAL**
Basic Tax Due	₱ 293,955.33	₱ 195,970.22	₱ 489,925.55
20% Deficiency Interest	Computed from April 15, 2007 until full payment	Computed from April 15, 2007 until full payment	

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ATTESTATION

I attest 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's Division.

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

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution and the Division Chairperson's Attestation, 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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice

(b) Delinquency interest at the rate of 20% per annum on the total amount due of ₱367,444.16 (due to the National Government) and ₱244,962.78 (due to the Treasurer's Office, Lapu-Lapu City) or in the sum of ₱612,406.94 and on the deficiency interest which have accrued as aforestated in (a) computed from September 17, 2010 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended:

	NATIONAL GOVERNMENT	**TREASURER'S OFFICE, LAPU-LAPU CITY**	**TOTAL**
Basic Tax Due	₱ 293,955.33	₱ 195,970.22	₱ 489,925.55
25% Surcharge	73,488.83	48,992.56	122,481.39
TOTAL	**₱ 367,444.16**	**₱ 244,962.78**	**₱ 612,406.94**
20% Delinquency Interest	Computed from September 17, 2010 until full payment	Computed from September 17, 2010 until full payment	

SO ORDERED.

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

CAESAR A. CASANOVA
Associate Justice