Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

FIRST DIVISION

KEPCO PHILIPPINES CORPORATION,
Petitioner,

-versus-

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8761
For: Assessment

Members:

DEL ROSARIO, P.J., *Chairperson*
UY, and
MINDARO-GRULLA, JJ.

Promulgated:

MAR 0 6 2017 ; 2:09 p.m.

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DECISION

MINDARO-GRULLA, J.:

The case involves the Petition for Review filed on January 29, 2014 by KEPCO Philippines Corporation (KEPHILCO) as petitioner, against the Commissioner of Internal Revenue as respondent, before the Court in Division, pursuant to Section 7(a)(1)[1] of Republic Act (RA) No. 1125[2], as amended, as well as Section 3(a)(1)[3] of Rule 4 and Section 4(a)[4] of Rule 8 of the Revised Rules of the Court of Tax Appeals, as amended.

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[1] Sec. 7. *Jurisdiction.* - The CTA shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue; xxx.

[2] Act Creating the Court of Tax Appeals.

[3] Sec. 3. *Cases within the jurisdiction of the Court in Division.* – The Court in Division shall exercise:
(a) Exclusive original over or appellate jurisdiction to review by appeal the following:
(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue.

[4] Sec. 4. *Where to appeal; mode of appeal.* –
(a) An appeal from a decision or ruling or the inaction of the Commissioner of Internal Revenue on disputed assessments or claim for refund of internal revenue taxes erroneously or illegally

Petitioner prays for the cancellation or withdrawal of the Final Decision on Disputed Assessment (FDDA) dated December 11, 2013, assessing it for alleged deficiency value-added tax (VAT), final withholding tax (FWT), and final withholding value-added tax for taxable year (TY) 2009 in the amount of ₱244,267,689.35.[5]

Petitioner KEPCO Philippines Corporation is a domestic corporation duly organized and existing under the laws of the Republic of Philippines.[6] Its primary purpose is to "rehabilitate, operate, maintain and manage the Malaya Power Complex in Pililia, Rizal, Philippines and other power generating plants and related facilities for the conversion into electricity of fuel: provided, that, in no event shall the corporation itself engage in the general supply or distribution of electricity in retail trade or in the business of a public utility, or furnish electricity to end-users or consumers, or provide a public service, or engage in industries or activities reserved by the Constitution or by law to corporations wholly or partially-owned by Filipino citizen."[7]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR), who is vested with the authority to carry out all the functions, duties and responsibilities of the said Office, including, *inter alia*, the power to decide, approve, and grant tax protests. He holds office at the 5th Floor, BIR National Office Building, BIR Road, Diliman, Quezon City.

Korean Electric Power Corporation (KEPCO) is a resident corporation of the Republic of Korea,[8] and is not registered to do business in the Philippines.[9]

On September 3, 1996, petitioner and KEPCO entered into a Technical Services Agreement.[10]

Petitioner extended financial assistance through loans with interest to its affiliates Kepco Ilijan Corporation (KEILCO) on November

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collected, the decision or ruling of the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade & Industry, the Secretary of Agriculture, and the Regional Trial Court in the exercise of their original jurisdiction, shall be taken to the Court by filing before it a petition for review as provided in Rule 42 of the Rules of Court. The Court in Division shall act on the appeal.

[5] Par. I, Pre-Trial Order, Docket, vol. II, p. 823

[6] Exhibit "P-10", Docket, vol. II, p, 967

[7] Exhibit "P-11", Docket, vol. II, p. 968

[8] Exhibit "P-15", Docket, vol. II, pp. 1013 to 1015

[9] Exhibit "P-17", Docket, vol. II, p. 1018

[10] Exhibit "P-18", Docket, vol. II, pp. 1019 to 1033

10, 2000,[11] and Kepco Philippines Holdings, Inc. (KPHI) on February 10, 2006.[12]

On April 14, 2010, petitioner filed its Annual Income Tax Return for TY 2009.[13] Thereafter, petitioner filed an Application for Relief from Double Taxation on April 28, 2010.[14]

Respondent issued a Letter of Authority No. LOA-121-2010-00000081[15] on September 24, 2010, authorizing revenue officers to examine petitioner's books of account and other accounting records for all internal revenue taxes from January 1, 2009 to December 31, 2009. As such, respondent asked petitioner to present its records and documents enumerated in the Checklist of Requirements and First Request for Presentation of Records[16] dated September 28, 2010.

Thereafter, petitioner received a Notice for Informal Conference[17] with Details of Discrepancies[18] and a Matrix of Computation[19] on April 30, 2012, informing petitioner that after the investigation, deficiency taxes were found.

As a consequence, a Preliminary Assessment Notice[20] (PAN) dated September 18, 2012 and an Audit Result/Assessment Notices[21] with Details of Discrepancies[22] were issued and received by petitioner on September 21, 2012, assessing it for alleged deficiency VAT, withholding VAT, final tax and expanded withholding tax (EWT) in the aggregate amount of ₱241,035,307.49. Petitioner disputed the said PAN on October 4, 2012.[23]

Respondent issued a Formal Letter of Demand[24] (FLD) with Details of Discrepancies[25], and an Audit Result/Assessment Notices[26] for VAT, withholding VAT, and final tax on December 4, 2012, which

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[11] Exhibits "P-5" and "P-6", Docket, vol. II, pp. 933 to 947
[12] Exhibit "P-7", Docket, vol. II, pp. 956 to 960
[13] Exhibit "P-8", Docket, vol. II, pp. 962 to 964
[14] Exhibit "P-20", Docket, vol. II, p. 1049
[15] Exhibit "R-1", BIR records, p. 31
[16] Exhibit "R-2", BIR records, pp. 29 to 30
[17] Exhibit "R-5", BIR records, p. 691
[18] Exhibit "R-5-a", BIR records, pp. 669 to 673
[19] Exhibit "R-5-b", BIR records, pp. 666 to 668
[20] Exhibit "R-8", BIR records, pp. 895 to 897
[21] Exhibits "R-8-a" to "R-8-d", BIR records, pp. 891 to 894
[22] Exhibit "R-8-e", BIR records, pp. 888 to 890
[23] BIR records, pp. 904 to 910
[24] Exhibit "R-10", BIR records, pp. 951 to 952
[25] Exhibit "R-10-d", BIR records, pp. 946 to 947
[26] Exhibits "R-10-a" to "R-10-c", BIR records, pp. 948 to 950

petitioner received on December 12, 2012. Petitioner filed its Protest Letter[27] on January 8, 2013.

On February 21, 2013, respondent issued BIR Ruling No. ITAD 033-13 that imposed thirty percent (30%) income tax on the business profits paid to KEPCO.[28] Petitioner then appealed the said ruling before the Department of Finance (DOF) on April 1, 2013.[29]

Respondent, through OIC-Assistant Commissioner Alfredo V. Misajon, issued a Final Decision on Disputed Assessment[30] on April 25, 2013, which was received by petitioner on May 29, 2013. In the said FDDA, respondent attached the Audit Result/Assessment Notices[31] for VAT, withholding VAT, and final tax, all dated December 4, 2012. Petitioner appealed the said FDDA with respondent on June 25, 2013.[32]

Respondent rendered a decision on petitioner's appeal on December 11, 2013, which the latter received on January 2, 2014, specifically stating that it constitutes the final decision on the matter.[33] Respondent issued a new Audit Result/Assessment Notices[34] for VAT, withholding VAT, and final tax, all dated December 20, 2013; which were all received by petitioner on January 2, 2014.

On January 29, 2014, petitioner filed this Petition for Review.

In the Answer[35] filed through registered mail on April 14, 2014 and received by this Court on April 23, 2014, respondent interposed the following special and affirmative defenses:

> "4. Respondent hereby repleads the above admissions and denials as part of her special and affirmative defenses.
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> **ARGUMENTS AND DISCUSSIONS**

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[27] BIR records, pp. 953 to 960
[28] Exhibit "P-22", Docket, vol. II, pp. 1051 to 1058
[29] Exhibit "P-23", Docket, vol. II, pp. 1059 to 1069
[30] Exhibit "P-1", Docket, vol. II, pp. 911 to 913; Exhibit "R-13", BIR records, pp. 977 to 979
[31] Exhibits "R-13-a" to "R-13-c", BIR records, pp. 974 to 976
[32] Exhibit "P-3", Docket, vol. II, p. 917; Exhibit "P-2", Docket, vol. II, pp. 917 to 922
[33] Par. 2, JSFI, Docket, vol. II, p. 630; Exhibit "P-4", Docket, vol. II, pp. 923 to 929; Exhibit "R-15", BIR records, pp. 1116 to 1122
[34] Exhibits "R-15-a" to "R-15-c", BIR records, pp. 1111 to 1115
[35] Docket, vol. I, pp. 156 to 170

Management and Technical Service Fees paid to Korea Electric Power Corporation (KEPCO) is subject to Final Withholding Tax and Withholding Value-Added Tax.

5. Upon verification, records bear out that the Management and Technical Service Fees paid by petitioner to Korea Electric Power Corporation (KEPCO), a non-resident foreign corporation domiciled in Korea, pertaining to the Technical Service Agreement (TSA) between petitioner and KEPCO in the total amount of Php231,413,322.24 was not subjected to Final Withholding Tax.

6. Petitioner, on the other hand, contends that it is not liable to pay Final Withholding Tax and Withholding VAT because it is covered by an existing tax treaty agreement.

7. The assessment was pursuant to Section 57(A) of the NIRC of 1997, as amended, the pertinent provision of which is quoted hereunder:

> '**Section 57. Withholding of Tax at Source. –**
>
> **Withholding of Final Tax on Certain Incomes.** – Subject to the rules and regulations, the secretary of Finance may promulgate, upon the recommendation of the Commissioner, requiring the filing of income tax return by certain income payees, the tax imposed or prescribed by sections 24(B)(1), 24(B)(2), 24(C), 24(D)(1), 25(A)(2), 25(B), 25(C), 25(D), 25(E), 27(D)(1), 27(D)(2), 27(D)(3), 27(D)(5), 28(A)(4), 28(A)(5), 28(A)((7)(A), 28 (A)(7)(b), 28(A)(7)(c), 28(B)(1), 28(B)(2), 28(B)(3), 28(B)(4), 28(B)(5)(a), 28(B)(5)(b), 28(B)(5)(c), 33, and 282 of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions provided in section 58 of this Code.'

8. In relation to Section 57(A), Section 28(B) of the NIRC provides that:

> B) Tax on Nonresident Foreign Corporation. –

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(1) In General. – Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) 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 or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs (C) and (d): Provided, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and, effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).

(2) Nonresident Cinematographic Film Owner, Lessor or Distributor. – A cinematographic film owner, lessor, or distributor shall pay a tax of twenty-five percent (25%) of its gross income from all sources within the Philippines.

(3) Nonresident Owner or Lessor of Vessels Chartered by Philippine Nationals. – A nonresident owner or lessor of vessels shall be subject to a tax of four and one-half percent (4 ½%) of gross rentals, lease or charter fees from leases or charters to Filipino citizens or corporations, as approved by the Maritime Industry Authority.

(4) Nonresident Owner or Lessor of Aircraft, Machineries and Other Equipment. – Rentals, charters and other fees derived by a nonresident lessor of aircraft, machineries and other equipment shall be subject to a tax of seven and one-half percent (7 ½%) of gross rentals or fees.

(5) Tax on Certain Incomes Received by a Nonresident Foreign Corporation. –

(a) Interest on Foreign Loans. – A final withholding tax at the rate of twenty percent (20%) is hereby imposed on the amount of interest on foreign loans contracted on or after August 1, 1986;

(b) Intercorporate Dividends. – A final withholding tax at the rate of fifteen percent (15%) is hereby imposed on the amount of cash and/or property dividends received from a domestic corporation, which

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shall be collected and paid as provided in Section 57 (A) of this Code, subject to the condition that the country in which the nonresident foreign corporation is domiciled, shall allow a credit against the tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines equivalent to twenty percent (20%) for 1997, nineteen percent (19%) for 1998, eighteen percent (18%) for 1999, and seventeen percent (17%) thereafter, which represents the difference between the regular income tax of thirty-five percent (35%) in 1997, thirty-four percent (34%) in 1998, and thirty-three percent (33%) in 1999, and thirty-two percent (32%) thereafter on corporations and the fifteen percent (15%) tax on dividends as provided in this subparagraph;

(c) Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange. – A final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation, except shares sold, or disposed of through the stock exchange:

No over ₱100,000 . . . . 5%
On any amount in excess of ₱100,000...10%'
(Emphasis supplied.)

9. Based on the foregoing and contrary to the allegation of petitioner, the payment made to KEPCO is subject to final withholding tax pursuant to Section 28 (B) (1), NIRC, which imposes income tax on a foreign corporation not engaged in trade or business in the Philippines at the rate of thirty percent (30%) of the gross income received during each taxable year from all sources within the Philippines.

10. Besides, Section 2.57 (I) (1) of Revenue Regulations 2-98, as amended, provides that income derived from all sources within the Philippines by a non-resident foreign corporation shall be subject to final withholding tax based on the gross amount of income at the rate of tax prescribed therefor on gross income such as interest, dividends, rents, royalties, salaries, premiums (except reinsurance premium), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income. Likewise, Section 2.75 (A), RR 2-98 provides that:

'Under the final withholding tax system, the amount of income tax withheld by the withholding agents is constituted as a full and final payment of the income tax due from the payee on said income. The liability for payment of the tax rests primarily on the payor as a withholding agent. Thus, in case of his failure to withhold the tax or in case of under withholding, the deficiency tax shall be collected from the payor/withholding agent. The payee is not required to file an income tax return for the particular income. The finality of the withholding tax is limited only to the payee's income tax liability on the particular income. It does not extend to the payee's other tax liability on said income, such as when the said income is further subject to percentage tax.'

11. Petitioner avows that since KEPCO is a resident of a tax treaty country, any income arising from services are treated as business profits. Thus, under the R.P.-Korea tax treaty, for the income to be taxable in the Philippines, the income-earner (KEPCO) must have permanent establishment as provided in Article 5 and Article 3(b) of the aforementioned treaty.

12. Upon examination of the records, it revealed that the Project Agreement between KEPCO and National Power Corporation was signed on **May 17, 1995**, therefore KEPCO has been in operation for fourteen (14) years counted from 1995 up to taxable year 2009. Pursuant to the said project agreement, petitioner and KEPCO entered into a Technical Service Agreement (TSA) on **03 September 1996**, details of which are given below:

- KEPCO and the National Power Corporation **(NPC)** entered into an agreement whereby KEPCO undertakes to rehabilitate, operate, maintain and manage the 650MW Thermal Power Plant Complex in Pililia, Rizal.
- Pursuant to the accession Agreement, KEPHILCO became a party to the project and agreed to perform and comply with all the obligation of KEPCO, which necessarily have to be performed in the Philippines.
- KEPCO is engaged in the business of, among others, power generation, and has skill, knowledge and experience in said field.
- In reliance upon such skill knowledge and experience, KEPHILCO requested KEPCO provided primary support in connection with the project.
- The Technical Service to be furnished by KEPCO to KEPHILCO includes the following:

  - Project management and advisory services to be provided by members of the Philippine Project

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Team and those of other department of KEPCO head office;
- Technical Services to be provided by KEPCO's experts for operation, maintenance and rehabilitation of the Malaya Power Plant, which includes: test, analysis and diagnosis of efficiency, on-the-job training of plant operators, progress control of rehabilitation, inspection/quality control and supply of technical data and information;
- Training services for KEPCO facilities, Supply of instruction materials, assignment of KEPCO instructors of KEPHILCO;
- Supply of rental of tools, equipment and materials;
- and other services required for the implementation of the Project Agreement.

13. Since the project agreement and technical service agreement has been existing for several years, thus services rendered by KEPCO to petitioner therefore exceeds the 183-day period provided for in the tax treaty.

14. To further bolster her position, respondent respectfully invites the attention of this Honorable Court to the case of *Collector of Internal Revenue vs. Burmeister and Wain Scandinavian Contractor Mindanao, Inc.*). The facts of the case are as follows: a Consortium of several non-resident foreign corporations entered into a contract with the National Power Corporation (NPC) for the operation and maintenance of NPC's two 100 MW power barges for a fifteen year term. The Consortium subcontracted to Burmeister and Wain Scandinavian Contractor Mindanao, Inc. (Burmeister) the actual operation and maintenance of the two barges, as well as the performance of other duties and acts which necessarily have to be done in the Philippines. NPC pays the Consortium, pursuant to its agreement with them. The Consurtium, on the other hand, pays Burmeister, as its subcontractor. In Burmeister's claim for refund the Supreme Court held: 'Considering the length of time, the Consortium's operation and maintenance of NAPOCOR's power barges cannot be classified as a single or isolated transaction.'

15. In the abovementioned case, the court took note of the existence of the **15-year contract to operate and maintain NAPOCOR's two 100-megawatt power barges in Mindanao**.

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16. Applying therefore, the ruling in the *Burmeister* case, it can be deduced that: Considering the length of time, KEPCO's operation-rehabilitation, operation, maintenance and management of the 650MW Thermal Power Plant Complex in Pililia, Rizal cannot be classified as a single or isolated transaction. Accordingly, Management and Technical Service Fees paid to KEPCO is taxable.

17. Seeing also that the management and technical services rendered by KEPCO constitute sale of services which is VATable under Section 108 (6) of the NIRC, the management fees paid by petitioner should also be subject to withholding VAT in accordance to Section 4.114 (A) (2) (b) of Revenue Regulations No. 2-98, as amended and Section 4.114-2 (b)(2) of Revenue Regulations No. 16-2005, as amended, which requires private corporations, whether large or non-large taxpayers, to withhold the VAT of twelve percent (12%) with respect to payments made to non-residents, for services rendered in the Philippines by said non-residents.

Petitioner is liable for the deficiency value added tax for taxable year 2009 on loans extended to its affiliates

18. Upon verification of petitioner's income accounts per Trial Balance/Audited Financial Statements for taxable year 2009 revealed that it earned Interest Income from financial assistance extended to its affiliates amounting to ₱291,967,526.00, which was not subjected to value-added tax.

19. The transaction under consideration is the interest income earned by petitioner from financial assistance extended to the following affiliates:

> (1) KEPCO Ilijan Corporation (KEILCO) in the amount of US$80,000,000.00 which was denominated as the 'KEPCO Replacement Loan,' the purpose of which was to allow KEILCO to pursue the construction of its 1200 MW Ilijan Power Plant; and
>
> (2) KEPCO Philippines Holdings, Inc (KPHI) in the amount of ₱1,073,500,000.00 which money was used for the purchased of share of stock of

Salcon Power Corporation, a publicly listed power generation company.

20. In both cases, petitioner claimed that the said affiliates did not have funds/access to funding, consequently, petitioner, being the more established company, had to provide financial assistance.

21. Petitioner avers that the interest income earned from activities which were not in the regular course of business and as such should not be subject to the 12% VAT under Section 105 of the 1997 Tax Code.

22. However, Section 105 of the National Internal Revenue Code of 1997, as amended, does not support petitioner's position:

> SEC. 105. Persons Liable. – Any person who, in the course of trade or business, sells barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.
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> The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services.
>
> This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.
>
> **<u>The phrase 'in the course of trade or business' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto</u>**, by any person regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.
>
> The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by nonresident foreign persons shall be considered as being rendered in the course of trade or business. (Emphasis and underscoring supplied)

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23. It is worth stressing that the act of extending financial assistance in the form of interest-bearing loan facilities made by petitioner to its affiliates is a means of aiding a corporation which is well within petitioner's secondary purpose as stated in its Articles of Incorporation (AOI). The funds utilized to extend the loan to petitioner's affiliates are necessarily connected to the petitioner's purpose as indicated in its AOI. Accordingly, the interest revenue which inevitably accrued upon the loan, certainly constitutes as income in relation to petitioner's trade or business.

24. In the case of *CS Garments, Inc. vs. Commissioner of Internal Revenue*, petitioner-CS Garments pointed out that the sale of its motor vehicle, a Mercedez Benz, to its General Manager, Mr. Claus Sudhoff amounting to ₱1,600,000, is not subject to VAT since it was not made in the ordinary course of its trade or business. Petitioner-CS Garments alleged that before a particular transaction may be subject to VAT, it is important to determine the taxpayer's role or link in the production chain of that particular product or service. Where the sale, barter or exchange of that particular product or service is not made in the course of trade or business, such transaction may not be made subject to VAT. It further alleged that since its primary business is to engage in the manufacture of garments for sale abroad, the sale of its used company car does not have a direct relevance to petitioner's primary business of manufacturing of garments. However, the Honorable Court of Tax Appeals *En Banc* ruled that such argument is bereft of any merit. Respondent quotes the Honorable Court's enlightening ratiocination:

> 'Based on the foregoing, the VAT is imposed on a sale or transaction entered into by a person in the course of any trade or business. A transaction will be characterized as having been entered into by a person in the course of trade or business if it is: (1) regularly conducted; and (2) undertaken in pursuit of a commercial or economic activity. **<u>Likewise, transactions that are made incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business.</u>** "Incidental" means something else as primary; something necessary, appertaining to, or depending upon another, which is termed the principal. **<u>Hence, an isolated transaction is not necessarily disqualified from being made incidentally in the course of trade or business.</u>**

Here, petitioner's primary business is the manufacturing of garments for sale abroad. In carrying-out its business, petitioner acquired and eventually sold a Mercedes Benz to its General Manager Mr. Sudhoff. Prior to the sale, the motor vehicle formed part of petitioner's capital assets, specifically under the account, "Property, Plant and Equipment".

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Therefore, the sale of the motor vehicle is an incidental transaction because the said vehicle was purchased and used in furtherance of petitioner's business.

Once an activity has been identified as a business, any supply [sale] made while carrying it on is likely to be made in the course or furtherance of business. No distinction is made between capital and revenue items.' (Emphases supplied)

25. Corollarily, in the case of *Lapanday Foods Corporation vs. Commissioner of Internal Revenue*, the Honorable Court of Tax Appeals *En Banc* held that interest on loans extended to its affiliates is subject to value added tax (VAT), even if the loans are for accommodation only and the taxpayer did not realize profit from the transactions. The court rejected Lapanday Foods Corporation's claim that since it does not lend money to clients or customers in the ordinary course of trade of business and does not habitually extend loans to affiliates, interest income on loans that it extended to affiliates are not subject to VAT. In interpreting Section 105 of the Tax Code of 1997, this Court held that the phrase 'in the course of trade or business means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, regardless of whether or not the person engaged therein is non-stock, non-profit private organization or government entity.'

26. Finally, the instant case is similarly close to *Philippine National Oil Company v. CIR*, wherein the Honorable Court of Tax Appeals ruled that:

'Petitioner submits that the issue whether or not the interest income on advances received by a parent from its subsidiaries/affiliates is subject to VAT, is a novel issue which has not been resolved. This Court disagrees. In the case of Lapanday Foods Corp. vs. Commissioner of Internal Revenue, we ruled:

> "Furthermore, the loan assistance provided by petitioner to its affiliates, being incidental to its business, is deemed a transaction 'in the course of trade and business'. The phrase 'in the course of trade and business' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto (Value Added Tax, Mamalateo, p. 82 [2007}). 'Incidental means depending upon or appertaining to something else primary; something necessary appertaining to, or depending upon another, which is termed the principal; something incidental to the main purpose (Black's Law Dictionary, 61h ed. P. 763).
>
> Considering the foregoing, we hold that the income generated by petitioner from the loans granted to its affiliates is subject to VAT, pursuant to Section 105, in relation to Section 108 of the NIRC of 1997, as amended.
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> Pursuant to the above ruling of the Supreme Court, petitioner's income from loans extended to its affiliates is subject to VAT. Whether petitioner has realized profit or not is insignificant, as long as the petitioner has provided financial assistance or services for a fee, remuneration or consideration, such service rendered is subject to VAT."

Clearly, interest income received by a parent company from loans or advances it has granted to its subsidiaries/affiliates is subject to VAT.' (Emphasis supplied.)

27. In sum, considering the foregoing categorical jurisprudential pronouncements, petitioner's act of extending interest bearing loans to its affiliates, to provide financial

assistance for a fee or remuneration or consideration, constitutes as sale of service that is subject to value added tax.

The presumption under the law is in favor of the correctness of tax assessments.

28. Respondent respectfully maintains that, as it stands, the deficiency tax liabilities assessed against petitioner is proper in all respects, and it is upon petitioner to establish that the assessment was incorrect or improper.

29. In this jurisdiction, the rule is settled that he who alleges must prove. This is especially true in tax assessment cases where the assessments are presumed correct. As held by the Highest Court:

> 'xxx xxx xxx
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> **Tax assessments by tax examiners are presumed correct 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.
>
> xxx xxx xxx' (Emphasis supplied)

30. Verily, in the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously.

31. It must be stressed that, the *onus probandi* is on the taxpayer. As provided in Section 1, Rule 131 of the Rules of Court, he must establish his claim by the amount of evidence required by law. He must discharge this burden before it may be shifted. Failing such, the consequence is dire for the taxpayer as the Highest Court has repeatedly held:

In the case of *Collector of Internal Revenue v. Bohol Land Trans.* Co. (107 Phil. 965, 974), this Court stated that:

Since no evidence was presented to substantiate the errors that are claimed to have been committed by the Collector in making the assessments for the years 1948, 1949 and 1950, the trial court had no other alternative than to resort to the legal truism that 'all presumptions are in favor of the correctness of tax assessments.' The burden of proof is on the taxpayer to show the contrary. This is what the company failed to do.

This action finds support in the following authorities:

All presumptions are in favor of the correctness of tax assessments. The good faith of tax assessors and the validity of their actions are presumed. They will be presumed to have taken into consideration all the facts to which their attention was called. No presumption can be indulged that all of the public officials of the state in the various counties who have to do with the assessment of property for taxation will knowingly violate the duties imposed upon them by law.

As a logical out-growth of the presumption in favor of the validity of assessments, when such assessments are assailed, the burden of proof is upon the complaining party. It is incumbent upon the property owner clearly to show that the assessment was erroneous, in order to relieve himself from it. (51 AM. Jur, pages 620-621).' (*Interprovincial Autobus Co., Inc. v. Collector of Internal Revenue*, 98 Phil., 290; 52 Off. Gaz., [2]791.). (Emphases supplied)

32. Without a doubt, it is upon petitioner to present evidence and establish the inaccuracy or outright invalidity of the assessment made against it. Corollary, its failure to do so further confirms the propriety and exactness of the assessment.

33. Viewed in the light of the foregoing considerations, respondent submits that petitioner utterly failed to discharge the burden. Accordingly, the validity of the assessments remain unsoiled."

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Respondent's Pre-Trial Brief[36] and petitioner's Pre-Trial Brief[37] were filed on August 28, 2014 and on September 2, 2014, respectively.

On September 10, 2014, the Court granted petitioner's Motion for Leave to Take Deposition Outside the Philippines.[38]

The parties submitted their Joint Stipulation of Facts and Issue[39] on September 26, 2014, which the Court approved on October 2, 2014.[40] On even date, the pre-trial was terminated. Consequently, the Court issued a Pre-Trial Order[41] on October 27, 2014.

To support its claim, petitioner presented Ms. Jennylin Layson as its witness. Petitioner likewise submitted the deposition through written interrogatories of Mr. Jung Woon Kwang. Further, petitioner formally offered its documentary exhibits which were all admitted in evidence by the Court.[42]

Petitioner's documentary exhibits are as follows:

Exhibit:	Description:
P-1	Formal Decision on Disputed Assessment issued by the respondent dated April 25, 2013 for the taxable year 2009 which was received by the petitioner on May 29, 2013
P-2	Letter protest filed by the petitioner dated June 25, 2013 addressed before the Large Tax Payer Services of the BIR
P-3	Date received of the protest filed (June 25, 2013)
P-4	Decision rendered by the CIR dated December 11, 2013
P-5	KEPCO Replacement Loan (KRL) dated November 10, 2000
P-6	Recital Paragraph of the KRL
P-7	Loan Agreement between KEPHILCO and KPHI dated February 10, 2006

[36] Docket, vol. I, pp. 238 to 245
[37] Docket, vol. I, pp. 266 to 271
[38] Resolution, Docket, vol. II, pp. 609 to 614
[39] Docket, vol. II, pp. 630 to 635
[40] Resolution, Docket, vol. II, p. 637
[41] Docket, vol. II, pp. 823 to 833
[42] Resolution dated March 3, 2015, Docket, vol. II, pp. 1129 to 1130 and Resolution dated September 28, 2015, Docket, vol. II, pp. 1185 to 1186

P-8	KEPHILCO's ITR for 2009
P-9	Payment of interest income for 2009
P-10	KEPHILCO's Articles of Incorporation
P-11	Primary Purpose under the AOI
P-12	BIR-ITAD Ruling dated March 8, 2007
P-13	BIR-ITAD Ruling dated April 11, 2011
P-14	TTRA application dated April 28, 2010
P-16	Consularized Special Power of Attorney issued by KEPCO to KEILCO
P-17	Certification from the Philippine SEC that KEPCO is not registered to do business in the Philippines
P-19	Certification as to the actual number of days KEPCO personnel rendered services in the Philippines and photocopies of KEPCO personnel's respective passport
P-20	Duly accomplished application form 0901 for relief of double taxation dated April 28, 2010
P-21	Compliance with BIR Revenue Regulation Bulletin No. 01-03
P-22	BIR-ITAD Ruling dated February 2013
P-23	Appeal to the DOF dated April 1, 2013
P-24	Judicial Affidavit of Ms. Jennylin Layson, as amended on October 22, 2014
P-24-1	Signature of Ms. Jennylin Layson in the Judicial Affidavit
P-25	Written Interrogatories of Mr. Jung Woon Kwang before the Philippine Embassy at the Republic of Korea dated October 23, 2014 copy of which was directly served before the Honorable Court by the Department of Foreign Affairs on December 4, 2014
P-26	Signature of Mr. Kwang in his Written Interrogatories

On the other hand, respondent presented the following witnesses to disprove petitioner's claim: Revenue Officers Criscela M. Lacsamana, and Rogelio P. Gonzales. Also, respondent's documentary evidence was formally offered and the Court admitted the same.[43]

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[43] Resolution dated March 16, 2016, Docket, vol. II, pp. 1220 to 1221

Respondent's documentary evidence are as follows:

Exhibit:	Description:
R-1	Letter of Authority No. 121-2010-00000081 dated September 24, 2010
R-2	Checklist of Requirements and First Request for Presentation of Records (Checklist) dated September 28, 2010
R-3	Waiver of the Statute of Limitations Under the NIRC (WAIVER) executed on February 17, 2012
R-4	Memorandum Report dated April 13, 2012
R-5	Notice for Informal Conference
R-5-a	Details of Discrepancies
R-5-b	Matrix of Computation
R-6	Waiver of the Statute of Limitations Under the NIRC executed on May 29, 2012
R-7	Memorandum Report dated September 5, 2012
R-8	Preliminary Assessment Notice dated September 18, 2012
R-8-a	Audit Result/Assessment Notice for VAT
R-8-b	Audit Result/Assessment Notice for Final Tax
R-8-c	Audit Result/Assessment Notice for Withholding VAT
R-8-d	Audit Result/Assessment Notice for Expanded Withholding Tax
R-8-e	Details of Discrepancies
R-9	Memorandum Report dated November 22, 2012
R-9-a	Details of Discrepancies
R-9-b	Matrix of Computation
R-10	Formal Letter of Demand dated December 04, 2012
R-10-a	Audit Result/Assessment Notice for VAT with Assessment No. ELTADI-VT-2009-00103
R-10-b	Audit Result/Assessment Notice for Withholding VAT with Assessment No. ELTADI-WV-2009-00079
R-10-c	Audit Result/Assessment Notice for Final Tax with Assessment No. ELTADI-FT-2009-00079
R-10-d	Details of Discrepancies

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R-11	Memorandum of Assignment dated March 06, 2013
R-12	Memorandum Report dated April 25, 2013
R-13	Final Decision on Disputed Assessment dated April 25, 2014
R-13-a	Audit Result/Assessment Notice for VAT with Assessment No. ELTADI-VT-2009-00103
R-13-b	Audit Result/Assessment Notice for Withholding VAT with Assessment Notice No. ELTADI-WV-2009-00079
R-13-c	Audit Result/Assessment Notice for Final Tax with Assessment No. ELTADI-FT-2009-00079
R-14	Memorandum Report dated December 12, 2013
R-15	Decision dated December 11, 2013
R-15-a	Audit Result/Assessment Notice for VAT with Assessment No. VT-2009-00103
R-15-b	Audit Result/Assessment Notice for Withholding VAT with Assessment Notice No. WV-2009-00079
R-15-c	Audit Result/Assessment Notice for Final Tax with Assessment No. VT-2009-00103
R-16	Judicial Affidavit of Revenue Officer Criscela M. Lacsamana
R-16-a	Signature of Affiant Criscela M. Lacsamana
R-17	Judicial Affidavit of Revenue Officer Rogelio M. Gonzales
R-17-a	Signature of Affiant Rogelio M. Gonzales

On April 21, 2016, the case was deemed submitted for decision after respondent manifested that he would adopt the Answer dated April 11, 2014 as his Memorandum[44] and after petitioner filed its Memorandum[45] on April 18, 2016.

The parties presented the following issues[46] to be resolved by this Court:

1. Whether petitioner is liable to pay FWT and VAT with respect to the technical service fee agreement it paid to Korea Electric Power Corporation (KEPCO), a non-

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[44] Manifestation filed on April 7, 2016, Docket, vol. II, pp. 1222 to 1224
[45] Docket, vol. II, pp. 1228 to 1250
[46] Par. II, JSFI, Docket, vol. II, p. 631

resident foreign corporation and a resident of a tax treaty country for taxable year 2009;

2. Whether petitioner is liable to pay the assessed Value Added Tax (VAT) with respect to the interest income on the loans it extended to its affiliates.

Initially, the Court shall determine the timeliness of the filing of the Petition for Review.

Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, provides:

> "SEC. 228. *Protesting of Assessment.* – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however,* That a preassessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty

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(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."

Based on the foregoing provision, petitioner had thirty (30) days from receipt of respondent's decision on January 2, 2014 or until February 1, 2014 within which to appeal.

Considering that this Petition for Review was filed on January 29, 2014, the same was timely filed.

The Court will now address the submitted issues.

In the FLD, petitioner was assessed for deficiency VAT, withholding VAT, and FWT, detailed as follows:[47]

FINAL WITHHOLDING TAX				
Payment of Technical and Advisory Services				₱ 231,413,322.24
Income Tax Rate				30%
Final Tax Due				₱ 69,423,996.67
Add: Surcharge			₱ 17,355,999.17	
Interest up to 11/30/2012			46,336,694.78	
Compromise Penalty			50,000.00	63,742,693.95
Total Deficiency Final Tax				**₱133,166,690.62**
WITHHOLDING VAT				
Payment of Technical and Advisory Services				₱ 231,413,322.24
VAT Rate				12%
Withholding VAT				₱ 27,769,598.67
Add: Surcharge			₱ 6,942,399.67	
Interest up to 11/30/2012			18,534,686.58	
Compromise Penalty			50,000.00	25,527,086.25
Total Deficiency Withholding VAT				**₱ 53,296,684.92**
VALUE-ADDED TAX				
Taxable Sales per VAT Return				₱3,390,184,266.11
Add: Income Not Subjected to VAT				
Interest Income from Advances to Affiliates				291,967,526.60
Total Income Subject to VAT				₱3,682,151,792.71
Output Tax Due Thereon				₱ 441,858,215.13
Less: Input Tax Credits				
Input Tax Carried Over from Previous Period			₱ 9,550,969.64	
Excess of Standard over Actual Input VAT			205,301,158.23	
VAT Withheld on Sales to Government			169,509,213.31	
Input Tax Claimed Per VAT Return		₱31,650,516.52		
Add: Deferred Input Tax, beginning	₱615,102.35			
Less: Deferred Input Tax, ending	253,878.48	361,223.87	32,011,740.39	416,373,081.57
				₱ 25,485,133.56
Less: Input Tax Carried Over to Succeeding Period				(9,550,969.64)
Deficiency VAT				₱ 35,036,103.20
Add: Interest up to 11/30/2012			₱ 22,718,210.61	

[47] Exhibits "R-10" to "R-10-d", BIR records, pp. 946 to 952

Compromise Penalty			50,000.00	22,768,210.61
Total Deficiency VAT				**₱ 57,804,313.81**

I. Deficiency Final Withholding Tax - ₱133,166,690.62

Respondent's verification disclosed that pursuant to the Technical Services Agreement (TSA) between petitioner and KEPCO, the management and technical service fees paid in the amount of ₱231,413,322.24 by petitioner to KEPCO, a non-resident foreign corporation, was not subjected to FWT, required under Section 57(A) in relation to Section 28(B)(1) of the NIRC of 1997, as amended; Section 2.57-1(I)(1) of Revenue Regulations (RR) No. 02-98, as amended; and as pronounced by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Burmeister and Wain Scandinavian Contractor Mindanao, Inc.*[48]

On the other hand, petitioner contends that since KEPCO is a resident of a tax treaty country, it is not liable to pay FWT and withholding VAT, relying on Article 7 of the RP-Korea Tax Treaty.

Respondent holds that the Project Agreement between KEPCO and National Power Corporation (NPC) was signed on **May 17, 1995**; therefore, KEPCO has been in operation for fourteen (14) years counted from 1995 up to 2009. Pursuant to the Project Agreement, petitioner and KEPCO entered into a TSA on **September 3, 1996**, details of which are given below:[49]

a. KEPCO and NPC entered into an agreement whereby KEPCO undertakes to rehabilitate, operate, maintain and manage the 650MW Thermal Power Plant Complex in Pililia, Rizal.

b. Pursuant to the Accession Agreement, petitioner became a party to the Project and agreed to perform and comply with all the obligations of KEPCO, **which necessarily have to be performed in the Philippines**.

c. KEPCO is engaged in the business of, among others, power generation, and has skill, knowledge and experience in said field.

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[48] G.R. No. 153205, January 22, 2007

[49] Exhibit "P-18", Docket, vol. II, pp. 1022 to 1032

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d. Relying upon such skill, knowledge and experience, petitioner requested KEPCO to provide primary support in connection with the Project.

e. The technical services to be furnished by KEPCO to petitioner include the following:

1. Project management and advisory services to be provided by the members of Philippines Project Team and those of other department of KEPCO head office;

2. Technical services to be provided by KEPCO's experts for operation, maintenance and rehabilitation of Malaya Power Plant, which include test, analysis and diagnosis of efficiency, on-the-job training of plant operators, progress control of rehabilitation, inspection/quality control and supply of technical data and information;

3. Training services for KEPCO facilities, supply of instruction materials, and assignment of KEPCO instructors;

4. Supply or rental of tools, equipment and materials; and

5. Other services required for the implementation of the Project Agreement.

Since the Project Agreement and TSA have existed for several years, respondent posits that the services rendered by KEPCO to petitioner exceeded the 183-day period provided in the tax treaty.

Respondent applied the ruling in the *Burmeister* case in petitioner's case, stating that KEPCO's operation – rehabilitation, operation, maintenance and management of the 650MW Thermal Power Plant Complex in Pililia, Rizal – cannot be classified as a single or isolated transaction. Accordingly, the management and technical service fees paid to KEPCO are allegedly taxable.

Respondent points out that even granting that the technical service fees paid by petitioner to KEPCO fell within the purview of the RP-Korea Tax Treaty, petitioner did not file a Tax Treaty Relief Application (TTRA) before the Office of the International Tax Affairs Division (ITAD) at least fifteen (15) days before the intended transaction or payment of technical service fees, as mandated by Revenue Memorandum Order (RMO) No. 1-2000 and BIR Ruling No. ITAD 053-12 dated February 15, 2012.

The Court finds for petitioner.

As cited in the BIR Ruling No. ITAD 134-11 dated April 25, 2011[50] and DA ITAD BIR Ruling No. 037-07[51], generally, business profits (or industrial and commercial profits) include payments for the supply of goods and services, and for the lease of personal properties. In this case, the compensation for project management and administrative advisory services, technical services, training services, compensation for the supply of tools, equipment and materials, and compensation for the rental of tools and materials (but not of equipment), being in the nature of *business profits*, are taxed under Article 7, in relation to Article 5 of the RP-Korea Tax Treaty, to wit:

"ARTICLE 7
Business profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."

"ARTICLE 5
Permanent Establishment

1. For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term 'permanent establishment' includes especially:

[50] Exhibit "P-13", Docket, vol. II, pp. 1000 to 1001
[51] Exhibit "P-12", Docket, vol. II, pp. 983 to 984

a) a place of management;
b) a branch;
c) an office;
d) a factory;
e) a workshop;
f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
g) premises used as a sales outlet; and
h) a warehouse, in relation to a person providing storage facilities for others.

3. a) a building site or construction, installation or assembly project or supervisory activities in connection therewith, constitute a permanent establishment only if such site, project or activity continues for a period of more than six months;

   b) the furnishing of services including consultancy services by an enterprise through an employee or other personnel constitutes a permanent establishment only if activities of that nature continue within a Contracting State for a period or periods exceeding in the aggregate 183 days within any twelve-month period; and

   c) a place of exploration of natural resources constitutes a permanent establishment only if it exists for more than six months."

Under Article 7, the compensation for project management and administrative advisory services, etc. is subject to Philippine income tax if it is attributable to a permanent establishment (PE) of KEPCO in the Philippines; otherwise, the compensation is exempt from Philippine income tax. Under Article 5, KEPCO is considered to have a PE if it has in the Philippines a fixed place of business through which it carries on its business (like a branch or an office), or if it furnishes services in the Philippines for more than 183 days within any twelve-month period.[52]

The Certification of Non-Registration of Company[53] issued by the Securities and Exchange Commission, certifying that KEPCO is not registered as a corporation or a partnership in the Philippines, establishes that it is unlikely for KEPCO to have a branch, an office or any other fixed place of business in the Philippines. Moreover, the

[52] DA ITAD BIR Ruling No. 037-07
[53] Exhibit "P-17", Docket, vol. II, p. 1018

Certification from KEPCO[54] signed by the Senior Manager of its Overseas Project Management Department, as supported by the breakdown of managerial and technical services rendered by KEPCO personnel and copies of their passports, shows that such services were rendered for an aggregate period not exceeding 183 days within a twelve-month period, *i.e.,* taxable year 2009, as broken down below:

Name of Dispatched Personnel	Position/ Designation	Service Rendered Itinerary	Travel		Duration	No. of Day	Service Area
			from	to			
Lim IckHun	General Manager	Calibration of over/under excitation limitation settings etc.	9-Apr-09	15-Apr-09	7	7	Malaya
Ryu Ho Sun	General Manager	Confirm the reliability and capability of K2 Generator AVR components etc.	3-May-09	6-May-09	4	4	Malaya
Kim, Byeong-Rae Lee YoungJun	General Manager General Manager	Close examination of Generator, Exciter, PT and Current Transformer etc.	23-Sep-09	30-Sep-09	8	8	Malaya
Bae Chun Hee Chang Jung Chel	General Manager General Manager	Visual inspection of Generator, Boiler WW, SH, RH Tube etc.	8-Oct-09	16-Oct-09	9	9	Malaya
Lim IckHun	General Manager	Close examination of Generator AVR K1 and K2	12-Oct-09	18-Oct-09	7	7	Malaya
						35	

Clearly, KEPCO, as properly contended by petitioner, does not have a PE in the Philippines for TY 2009. Hence, the profits derived by KEPCO from the rendition of services under the TSA shall not be subject to Philippine income tax pursuant to Article 7(1) in relation to Article 5 of the RP-Korea Tax Treaty.

With regard to the issue on procedural requirement, the Supreme Court, in the case of *Deutsche Bank AG Manila Branch vs. Commissioner of Internal Revenue*[55], explained that taxpayers cannot be deprived of their entitlement to the benefit of a treaty for failure to comply with an administrative issuance requiring the prior filing of an application for tax treaty relief. The obligation to comply with a tax treaty must take precedence over RMO No. 01-00. Below is the pertinent part of the Decision:

"***Tax Treaty vs. RMO No. 1-2000***

Our Constitution provides for adherence to the general principles of international law as part of the law of the land. The time-honored international principle of *pacta sunt servanda* demands the performance in good faith of treaty obligations on the part of the states that enter into the agreement. Every treaty in force is binding upon the parties, and obligations under the treaty must be performed by them in good faith. More

[54] Exhibit "P-19", Docket, vol. II, pp. 1034 to 1048
[55] G.R. No. 188550, August 19, 2013

importantly, treaties have the force and effect of law in this jurisdiction.

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'A state that has contracted valid international obligations is bound to make in its legislations those modifications that may be necessary to ensure the fulfillment of the obligations undertaken.' Thus, laws and issuances must ensure that the reliefs granted under tax treaties are accorded to the parties entitled thereto. The BIR must not impose additional requirements that would negate the availment of the reliefs provided for under international agreements. xxx

Likewise, it must be stressed that there is nothing in RMO No. 1-2000 which would indicate a deprivation of entitlement to a tax treaty relief for failure to comply with the 15-day period. We recognize the clear intention of the BIR in implementing RMO No. 1-2000, but the CTA's outright denial of a tax treaty relief for failure to strictly comply with the prescribed period is not in harmony with the objectives of the contracting state to ensure that the benefits granted under tax treaties are enjoyed by duly entitled persons or corporations.

Bearing in mind the rationale of tax treaties, the period of application for the availment of tax treaty relief as required by RMO No. 1-2000 should not operate to divest entitlement to the relief as it would constitute a violation of the duty required by good faith in complying with a tax treaty. The denial of the availment of tax relief for the failure of a taxpayer to apply within the prescribed period under the administrative issuance would impair the value of the tax treaty. At most, the application for a tax treaty relief from the BIR should merely operate to confirm the entitlement of the taxpayer to the relief.

The obligation to comply with a tax treaty must take precedence over the objective of RMO No. 1-2000. Logically, noncompliance with tax treaties has negative implications on international relations, and unduly discourages foreign investors. While the consequences sought to be prevented by RMO No. 1-2000 involve an administrative procedure, these may be remedied through other system management processes, e.g., the imposition of a fine or penalty. But we cannot totally deprive those who are entitled to the benefit of a treaty for failure to strictly comply with an administrative issuance requiring prior application for tax treaty relief."

In fine, the deficiency FWT assessment amounting to ₱133,166,690.62 is devoid of merit, hence, must be cancelled.

II. Deficiency Withholding VAT - ₱53,296,684.92

In addition to FWT, respondent assessed petitioner's payments to KEPCO as subject to VAT under Section 108(A)(6) of the NIRC of 1997, as amended, and as implemented by Section 4.114(A)(2)(b) of Revenue Regulations (RR) No. 02-98, as amended, Section 4.112-2(b)(2) of RR No. 16-05, as amended, and *Commissioner of Internal Revenue vs. Burmeister and Wain Scandinavian Contractor Mindanao, Inc.*[56]

The assessment is upheld.

Under Section 108(A) in relation to Section 105 of the NIRC of 1997, as amended, the management and technical services rendered in the Philippines by personnel of KEPCO, being a non-resident foreign corporation, are subject to VAT, to wit:

> "SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* –
>
> (A) *Rate and Base of Tax.* – There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties: *Provided*, that the President, upon the recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of **value-added tax to twelve percent (12%)** xxx
>
> xxx xxx xxx
>
> (6) The supply of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;"
>
> "SEC. 105. *Persons Liable.* – **Any person who, in the course of trade or business**, sells, barters, exchanges, leases goods or properties, **renders services**, and any person who

[56] G.R. No. 153205, January 22, 2007

imports goods **shall be subject to the value-added tax (VAT) imposed in Sections** 106 to **108 of this Code.**

The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.

The phrase '*in the course of trade or business*' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.

The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by nonresident foreign persons shall be considered as being rendered in the course of trade or business." (*Emphasis supplied*)

Relative thereto, petitioner is mandated to withhold the corresponding twelve percent (12%) VAT before remitting the said management and technical fees to KEPCO pursuant to Section 4.114-2(b)(2) of RR No. 16-05, as amended by RR No. 04-07, thus:

"SECTION 4.114-2. *Withholding of VAT on Government Money Payments and Payments to Non-Residents.* –

xxx xxx xxx

(b) The government or any of its political subdivisions, instrumentalities or agencies including GOCCs, as well as **private corporation**, individuals, estates and trusts, **whether large or non-large taxpayers, shall withhold twelve percent (12%) VAT, starting February 1, 2006, with respect to the following payments**:

(1) Lease or use of properties or property rights owned by non-residents; and

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(2) **Other services rendered in the Philippines by non-residents.**

In remitting VAT withheld, the withholding agent shall use BIR Form No. 1600 Remittance Return of VAT and Other Percentage Taxes Withheld.

VAT withheld and paid for the non-resident recipient (remitted using BIR Form No. 1600), which VAT is passed on to the resident withholding agent by the non-resident recipient of the income, may be claimed as input tax by said VAT-registered withholding agent upon filing his own VAT Return, subject to the rule on allocation of input tax among taxable sales, zero-rated sales and exempt sales. The duly filed BIR Form No. 1600 is the proof or documentary substantiation for the claimed input tax or input VAT.

xxx xxx xxx

VAT withheld under this Section shall be remitted within ten (10) days following the end of the month the withholding was made." *(Emphasis supplied)*

The Court finds no merit in petitioner's invocation of the RP-Korea Tax Treaty with regard to the subject assessment for deficiency withholding VAT. Article 2 of the RP-Korea Tax Treaty provides:

"ARTICLE 2
Taxes Covered

1. The taxes to which this Convention shall apply are:

a) In the case of the Philippines:

(i) the income taxes imposed by the Government of the Republic of the Philippines, (hereinafter referred to as 'Philippine Tax').

b) In the case of Korea:

(i) the income tax and

(ii) the corporate tax, (hereinafter referred to as 'Korean Tax').

2. The Convention shall apply also to any **identical or substantially similar taxes** which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any substantial changes which have been made in their respective taxation laws." *(Emphasis supplied)*

The phrase "identical or substantially similar taxes" under paragraph 2, in relation to "income taxes" under paragraph 1, does not contemplate the inclusion of VAT, for the simple reason that VAT is **not** a tax on income. In *Contex Corporation vs. Hon. Commissioner of Internal Revenue*[57], the Supreme Court ruled:

"At this juncture, it must be stressed that the **VAT is an indirect tax**. As such, the amount of tax paid on the goods, properties or services bought, transferred, or leased may be shifted or passed on by the seller, transferor, or lessor to the buyer, transferee or lessee. **Unlike a direct tax, such as the income tax, which primarily taxes an individual's ability to pay based on his income or net wealth, an indirect tax, such as the VAT, is a tax on consumption of goods, services, or certain transactions involving the same.** The VAT, thus, forms a substantial portion of consumer expenditures." *(Emphasis supplied)*

Thus, petitioner is liable to pay basic deficiency withholding VAT in the amount of ₱27,769,598.67, computed as follows:

Payment of technical and advisory services	₱231, 413,322.24
VAT rate	12%
Basic Deficiency Withholding VAT	**₱27,769,598.67**

III. Deficiency Value-added Tax - ₱57,804,313.81

Respondent's verification of petitioner's income accounts per Trial Balance/Audited Financial Statements for TY 2009 disclosed that the interest income from financial assistance extended to the following

[57] G.R. No. 151135, July 2, 2004

affiliates, totaling to ₱291,967,526.60, was not subjected to VAT, to wit:

(1) **KEPCO Ilijan Corporation (KEILCO)** in the amount of US$80,000,000.00, which was denominated as the 'KEPCO Replacement Loan', the purpose of which was to allow KEILCO to pursue the construction of its 1200 MW Ilijan Power Plant; and

(2) **KEPCO Philippines Holdings, Inc. (KPHI)** in the amount of ₱1,073,500,000.00, which was used for the purchase of shares of stock of Salcon Power Corporation, a publicly listed power generation company.

According to respondent, petitioner's act of extending financial assistance in the form of interest-bearing loan facilities to its affiliates is a means of aiding a corporation which is well within its secondary purpose, as stated in its Articles of Incorporation. The same is considered as having been done in the course of trade or business subject to 12% VAT pursuant to Section 108, in relation to Section 105, of the NIRC of 1997, as amended, and in accordance with the Court's Decision in the following cases: *Lapanday Foods Corporation vs. Commissioner of Internal Revenue*[58]; *Philippine National Oil Company vs. Commissioner Sixto S. Esquivias IV, et al.*[59]; and *Waterfront Philippines, Inc. vs. Commissioner of Internal Revenue*[60].

Petitioner primarily argues that its act of extending loans to its affiliates is not incidental to its primary purpose.

Petitioner states that several jurisprudence and BIR rulings have interpreted that, for VAT purposes, the word "incidental" contemplates an activity that necessarily follows the carrying out of the primary function. In other words, the term "incidental" means "depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another which is termed the principal; something incidental to the main purpose."

[58] CTA EB No. 367, January 29, 2009
[59] CTA EB No. 587, June 2, 2011
[60] CTA Case No. 8024, April 24, 2013

Petitioner points out that based on its Amended Articles of Incorporation[61], its primary purpose is "to rehabilitate, operate, maintain and manage the Malaya Power Complex in Pililia, Rizal, Philippines and other power generating plants and related facilities for the conversion into electricity of fuel." Thus, petitioner insists that it does not engage in the service of extending loans to any entity. The mere fact that the affiliate-borrower is also engaged in the power generation sector is allegedly of no moment. Extending two (2) loans is no way incidental to petitioner's main business as a power generation company. Petitioner, whether directly or indirectly, will not be able to manage, operate and maintain the power plants of the affiliates despite the loans extended to them.

Relying on Revenue Memorandum Circular (RMC) No. 42-03[62] and various BIR rulings, petitioner contends that the interest income earned by a non-lending investor is not subject to VAT.

Petitioner explains that as early as 1959, a lending investor has been defined as one who dedicates himself **habitually** to the business of lending money at interest. It presupposes a series of dealings with the general public. **There must be regularity of transactions as a part of the business operation.** After the effectivity of the NIRC of 1997, as amended, such definition has never changed. Under Section 4.108-3 of Revenue Regulations No. 16-2005, a lending investor is defined as follows:

> "'*Lending investor*' includes all persons other than banks, non-bank financial intermediaries, finance companies and other financial intermediaries not performing quasi-banking functions who make **a practice** of lending money for themselves or others at interest."

Allegedly, to be considered a lending investor, one must habitually practice or make it a practice to lend money for themselves or others.

Stressing that it extended only two loans to its affiliates – one in 2000 and the other in 2006, petitioner insists that the act of extending these two (2) loans – which are six (6) years apart – cannot be

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[61] Exhibit "P-11", Docket, vol. II, p. 968

[62] "Q-12: Is interest income on loan subject to VAT?
A-12: If the taxpayer qualifies as a lending investor, dealer in securities, financial institution as defined in Revenue Regulations No. 12-2003, or another entity performing similar financing activities, interest income is subject to VAT."

considered as one habitually engaged in the "practice of lending money" within the definition of a lending investor.

The Court sustains respondent's position.

The issue is not novel. In a similar case[63] involving the same parties, the Court of Tax Appeals *En Banc* ruled that the interest-bearing loan transactions extended to affiliates are incidental to petitioner's business, and are covered by VAT, to wit:

> "Persons or entities liable to VAT are specified in Sections 105 and 108 of the 1997 NIRC, as amended, reading:
>
> > 'SEC. 105. *Persons Liable.* – Any person who, in the course of trade or business, sells barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.
> >
> > The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.
> >
> > **The phrase 'in the course of trade or business' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person** regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.
> >
> > The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by nonresident foreign persons shall be considered as being rendered in

[63] CTA EB No. 1155 (CTA Case No. 8319), November 3, 2014

the course of trade or business.' (Emphasis supplied)

xxx xxx xxx

'SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* –

(A) Rate and Base of Tax. – There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties: xxx xxx xxx

The phrase 'sale or exchange of services' means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, rest houses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire another domestic common carriers by land relative to their transport of goods or cargoes; common carriers by air and sea relative to their transport of passengers, goods or cargoes from one place in the Philippines to another place in the Philippines; sales of electricity by generation companies, transmission, and distribution companies; services of franchise grantees of electric utilities, telephone and telegraph, radio and television broadcasting and all other franchise grantees except those under section 119 of this Code, and nonlife insurance companies (except their crop insurances), including surety, fidelity, indemnity, and bonding companies; **and similar**

> **services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties**. xxx' (Emphasis supplied.)

A transaction is characterized as having been entered into by a person in the course of trade or business if it is (1) regularly conducted and (2) undertaken in pursuit of a commercial or economic activity, regardless of whether or not the entity is profit-oriented. In the same manner, the law treats transactions undertaken incidental to the pursuit of a commercial or economic activity as entered in the course of trade or business. 'Incidental' means depending upon or appertaining to something else as primary; something necessary appertaining to, or depending upon another, which is termed the principal; something incidental to the main purpose.

The Supreme Court agreed with this Court in defining the phrase 'in the course of trade or business' in the case of *Commissioner of Internal Revenue v. Magsaysay Lines, Inc., et al.* where it was ruled that:

> That the sale of the vessels was not in the ordinary course of trade or business of NDC was appreciated by both the CTA and the Court of Appeals, the latter doing so even in its first decision which it eventually reconsidered, We cite with approval the CTA's explanation on this point:
>
> In *Imperial v. Collector of Internal Revenue*, xxx, the term **'carrying on business' does not mean the performance of a single disconnected act, but means conducting, prosecuting and continuing business by performing progressively all the acts normally <u>incident thereof</u>; while 'doing business' conveys the idea of business being done, not from time to time, but all the time.** xxx **'Course of business' is what is usually done in the management of trade or business**. xxx (Emphasis supplied.)

In the case of *Lapanday Foods Corporation v. Commissioner of Internal Revenue*, this Court treated interest bearing loan transactions extended by Lapanday to affiliates as financial assistance incidental to its business of managing, promoting, administering or assisting in any business or activity of corporations, partnerships, associations, individual or firm. These loan transactions were made in the course of Lapanday's trade or business subject to VAT. We explained that:

> In the case at bench, petitioner is a domestic corporation engaged in managing, promoting, administering or assisting in any business or activity of corporations, partnerships, associations, individual or firm (Exhibit 'F-1'). When petitioner extended loans to its affiliates, it provided assistance to corporations, and thus performed services incidental to its business.
>
> Furthermore, the loan assistance provided by petitioner to its affiliates, being incidental to its business, is deemed a transaction 'in the course of trade and business'. The phrase 'in the course of trade and business' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto xxx
>
> Considering the foregoing, We hold that the income generated by petitioner from the loans granted to its affiliates is subject to VAT, pursuant to Section 105, in relation to Section 108 of the NIRC of 1997, as amended.
>
> In addition, if the income from the main business activity is subject to VAT, the incidental income shall also be subject to VAT, provided that there is no particular provision applicable to the specific transaction xxx Considering that petitioner's income from its management services is subject to VAT, it necessarily follows then, that the interests from loan which is an incidental income, is also subject to VAT.

In the case at bar, the Court in Division correctly observed that the loans granted to its affiliates, KEILCO and KPHI are incidental to petitioner's primary business of power generation of its Malaya Power Complex in Rizal and other power generating plants justifying the imposition of VAT. Pertinent excerpts of the assailed Decision declared that:

There is no denying that petitioner is a power generating company. **Its primary purpose is to rehabilitate, operate, maintain and manage the Malaya Power Complex in Pililia, Rizal, Philippines and other generating plants and related facilities for the conversion into electricity of fuel.**

Petitioner's purpose of extending loan to its affiliate KEILCO in 2000 was to give financial assistance in order for the latter to design, construct, furnish, install, test, commission, own, operate and maintain a 1251 MW natural gas fired combined cycle generating plant with diesel fuel firing capability to be located at Ilijan, Batangas City. On the other hand, the purpose of the loan given to petitioner's affiliate KPHI on February 10, 2006 was for KPHI to purchase shares of stocks in Salcon Power Corporation (SPC), a publicly listed power generation company operating in the Province of Cebu.

Petitioner assisted its affiliate KEILCO in operating and maintaining other power generating plant located at Ilijan, Batangas. Petitioner also extended financial assistance to KPHI in order for the latter to acquire shares of stock in other generating plant (SALCON Power Corporation). **In a sense, petitioner acts through its affiliates in pursuing its primary purpose of rehabilitating, operating, maintaining and managing other power generating plants and related facilities for the conversion into electricity of fuel.**

Further, upon careful examination of the records, this Court finds that **one of the secondary purposes of petitioner is to 'aid in any manner any corporation, association, or trust, estate, domestic or foreign, or any firm or individual. In extending loans with interest to its affiliates, petitioner performed services which are incidental to its business. The financial assistance given by petitioner, being incidental to its business, is deemed a transaction in the**

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> **course of its trade or business.** (Emphasis supplied.)
>
> Here, the loans granted by petitioner to KEILCO and KPHI are intended to be allocated for the construction of the generating power plant to be located in Ilijan, Batangas and for the purchase of shares of stock in SPC, a publicly listed generation company in Cebu, respectively. Evidently, these loan transactions are in furtherance of petitioner's main line of business of rehabilitation, operation, maintenance, management not only of its power generating plants **but also 'other power generating plants and related facilities for the conversion into electricity of fuel' as shown in its amended articles of incorporation.**
>
> The Court *En Banc* finds no cogent reason to reverse the findings of the Court in Division in treating interest bearing loan transactions granted to KEILCO and KPHI being incidental to petitioner's primary business subject to VAT." *(Citations omitted)*

The present assessment pertains to the same loans extended by petitioner to its affiliates referred to in the afore-quoted case. As such, the interest income received therefrom by petitioner for the year 2009 in the amount of ₱291,967,526.60 is subject to VAT pursuant to Section 105 and Section 108(A) of the NIRC of 1997, as amended.

Also, the Court noticed from respondent's computation of deficiency VAT that the amount of ₱9,550,969.64[64] representing the excess input VAT for the year 2009 which shall be carried over to the subsequent quarters was disallowed. However, respondent has not indicated the basis for the said disallowance in the Details of Discrepancies[65] attached to the FLD or in the FDDA[66] dated April 25, 2013, or in the Decision[67] dated December 11, 2013.

Respondent's failure to provide the factual and legal bases for the assessment denied petitioner of due process for not having the opportunity to be clarified with the issues which, in its discretion, needs to be refuted. Thus, pursuant to Section 228 of the NIRC of 1997, as amended, this item of assessment shall be considered void.

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[64] BIR records, p. 354

[65] Exhibit "R-10-d", BIR records, p. 947

[66] Exhibit "R-13", BIR records, p. 979

[67] Exhibit "R-15", BIR records, pp. 1116 to 1118

Further, it is improper for respondent to disallow the amount of ₱9,550,969.64 because any tax benefit derived by petitioner from the carry-over of the said amount redounds to the succeeding year 2010. Since the tax benefit will be in the succeeding year, petitioner may only be assessed in the said succeeding year.

In sum, petitioner is liable for basic deficiency VAT in the amount of ₱25,485,133.56, computed as follows:

Taxable sales per VAT return				₱3,390,184,266.11
Add: Income not subjected to VAT				
Interest income from advances to affiliates				291,967,526.60
Total income subject to VAT				₱3,682,151,792.71
Output tax due thereon				₱ 441,858,215.13
Less: Input tax credits				
Input tax carried over from previous period			₱ 9,550,969.64	
Excess of standard over actual input VAT			205,301,158.23	
VAT withheld on sales to government			169,509,213.31	
Input tax claimed per VAT return		₱31,650,516.52		
Add: Deferred input tax, beginning	₱615,102.35			
Less: Deferred input tax, ending	253,878.48	361,223.87	32,011,740.39	416,373,081.57
Basic Deficiency VAT				**₱ 25,485,133.56**

IV. Compromise Penalties

The compromise penalties in the total amount of ₱150,000.00 are hereby cancelled, there being no mutual agreement between the parties. Settled is the rule that the imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[68] RMO No. 1-90 provides that compromise penalties are only amounts suggested in settlement of criminal liability, and may not therefore be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the suggested compromise penalty. Considering that petitioner did not pay the compromise penalty imposed by respondent, it clearly did not agree to settle the same.

After meticulously examining the records and having discussed the issues raised by the parties, the Court finds merit that the final withholding tax assessment in the amount of ₱133,166,690.62 should be cancelled; and affirms with modification, the assessments covering deficiency final withholding VAT and deficiency VAT in the amount of ₱66,586,415.29.

[68] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.*, G.R. No. L-35266, January 21, 1991

As to the imposition of deficiency interest and delinquency interest, although the *ponente* maintains the position that deficiency interest applies to all internal revenue taxes imposed by the Tax Code[69], however, this Court in majority finds that deficiency interest may be imposed only on tax specifically covered and defined by the relevant provisions of the NIRC, i.e., income tax, donor's tax and estate tax.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. The assessment issued by respondent against petitioner for the taxable year 2009 covering deficiency final withholding tax in the amount of ₱133,166,690.62 is **CANCELLED** and **SET ASIDE**. However, the assessments issued by respondent against petitioner for taxable year 2009 covering deficiency final withholding VAT and deficiency VAT are **AFFIRMED** with **MODIFICATIONS**.

Accordingly, petitioner is **ORDERED TO PAY** respondent the following:

a) Basic final withholding VAT in the amount of ₱27,769,598.67 plus 25% surcharge of ₱6,942,399.67;

b) Basic deficiency VAT in the amount of ₱25,485,133.56 plus 25% surcharge of ₱6,371,283.39; and

c) Delinquency interest at the rate of 20% per annum on ₱66,568,415.29, representing the total of the amounts stated under (a) and (b), computed from February 1, 2014 until full payment thereof, pursuant to section 249 (C) of the National Internal Revenue Code (NIRC) of 1997, as amended.

SO ORDERED.

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

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[69] In accordance with the Court's En banc Decision in the case of Takenaka Corporation Philippine Branch vs. Commissioner of Internal Revenue CTA EB Case No. 745, September 4, 2012.

WE CONCUR:

(See Concurring Opinion)
ROMAN G. DEL ROSARIO
Presiding Justice

ERLINDA P. UY
Associate Justice

C E R T I F I C A T I O N

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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice
Chairperson, 1st Division

REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

FIRST DIVISION

KEPCO PHILIPPINES CORPORATION,
Petitioner,

-*versus*-

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE No. 8761

Members:

Del Rosario, Chairperson,
Uy, *and*
Mindaro-Grulla, *JJ.*

Promulgated:
~~MAR 06 2017~~ ; 2:09 p.m.

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CONCURRING OPINION

DEL ROSARIO, P.J.:

I concur with the *ponencia* in partially granting the Petition for Review filed by Kepco Philippines Corporation thereby cancelling the final withholding tax assessment in the amount of ₱133,166,690.62; affirming, with modifications, the assessments covering deficiency final withholding VAT and deficiency VAT and ordering petitioner to pay respondent the total amount ₱66,568,415.29, representing deficiency final withholding VAT and deficiency VAT, inclusive of 25% surcharge, plus 20% delinquency interest per annum on the total amount of ₱66,568,415.29.

With regard to the non-imposition of 20% deficiency interest on the basic deficiency final withholding VAT and basic deficiency VAT, the *ponente* made the following statement in her *ponencia*:

> "As to the imposition of deficiency interest and delinquency interest, although the *ponente* maintains the position that deficiency interest applies to all internal revenue taxes imposed by the Tax

> Code, however, this Court in majority finds that deficiency interest may be imposed only on tax specifically covered and defined by the relevant provisions of the NIRC, i.e, income tax, donor's tax and estate tax."

The issue on afore-stated deficiency interest is no longer novel to this Court. Thus, I reiterate the position I have taken in the consolidated cases of *Commissioner of Internal Revenue vs. Philippine Tobacco Flue-Curing & Redrying Corporation*[1] [2] on the imposition of deficiency interest:

> "xxx I am not unaware of *Paper Industries Corporation of the Philippines vs. Court of Appeals, Commissioner of Internal Revenue, and Court of Tax Appeals (PICOP),*[3] which somehow made mention of deficiency interest under the NIRC of 1977. I must stress, however, that *PICOP* cannot be relied upon to justify the imposition of deficiency interest on petitioner's excise tax liability. *PICOP* did not state nor resolve the issue whether or not the deficiency interest provided for in Section 249 (B) of the NIRC of 1997, as amended, may be imposed on tax other than donor's, estate, and income taxes. Thus, not having been resolved therein, *PICOP* cannot be considered as a doctrine on the matter. The case of

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[1] CTA EB Nos. 1218 and 1220, April 11, 2016. This is consistent with my earlier opinion in *Avon Products Manufacturing, Inc. vs. Commissioner of Internal Revenue, CTA EB No. 1062, January 15, 2016; CIR vs. Staedtler (Philippines), Inc., CTA EB No. 1310, January 28, 2016; Medicard Philippines, Inc. vs. CIR, CTA EB No. 1224, January 29, 2016; Lourdes College vs. CIR, CTA EB No. 1164, February 2, 2016; Philippine Aerospace Development Corporation vs. CIR, CTA EB No. 1035, February 9, 2016; CIR vs. BPI-Philam Life Assurance Corporation, CTA EB No. 1240, February 11, 2016; CIR vs. OfficeMetro Philippines, Inc. (formerly Regus Centres, Inc.), and OfficeMetro Philippines, Inc. vs. CIR, CTA EB Nos. 1210 & 1213, March 7, 2016; and CIR vs. ESS Manufacturing Company, Inc., ESS Manufacturing Company, Inc. vs. CIR, CTA EB Nos. 1169 & 1175, March 30, 2016.*

[2] CTA EB Nos. 1218 and 1220, April 11, 2016. This is consistent with my earlier opinion in *Avon Products Manufacturing, Inc. vs. Commissioner of Internal Revenue, CTA EB No. 1062, January 15, 2016; CIR vs. Staedtler (Philippines), Inc., CTA EB No. 1310, January 28, 2016; Medicard Philippines, Inc. vs. CIR, CTA EB No. 1224, January 29, 2016; Lourdes College vs. CIR, CTA EB No. 1164, February 2, 2016; Philippine Aerospace Development Corporation vs. CIR, CTA EB No. 1035, February 9, 2016; CIR vs. BPI-Philam Life Assurance Corporation, CTA EB No. 1240, February 11, 2016; CIR vs. OfficeMetro Philippines, Inc. (formerly Regus Centres, Inc.), and OfficeMetro Philippines, Inc. vs. CIR, CTA EB Nos. 1210 & 1213, March 7, 2016; and CIR vs. ESS Manufacturing Company, Inc., ESS Manufacturing Company, Inc. vs. CIR, CTA EB Nos. 1169 & 1175, March 30, 2016.*

[3] G.R. Nos. 106949-50, December 1, 1995.

Office of the Ombudsman vs. Honorable Court of Appeals and Former Deputy Ombudsman for the Visayas Arturo C. Mojica,[4] is instructive:

> "The legal maxim "*stare decisis et non quieta movere*" (follow past precedents and do not disturb what has been settled) states that where the same questions relating to the same event have been put forward by parties similarly situated as in a previous case litigated and decided by a competent court, the rule of *stare decisis* is a bar to any attempt relitigate the same issues.
>
> xxx xxx xxx
>
> **Thus, where the issue involved was not raised nor presented to the court and not passed upon by the court in the previous case, the decision in the previous case is not *stare decisis* of the question presented."** (Emphasis supplied)

If *PICOP* has any relevance to the present controversy, it is the doctrinal precedent that **deficiency interest may be imposed only on tax specifically covered by the relevant provision of the NIRC of 1977**. Thus, the Court in *PICOP*, while recognizing that transaction tax is in the nature of income tax and that deficiency interest is imposable on income tax, nonetheless declined to impose such deficiency interest on transaction tax after noting the significant provisions of the NIRC of 1977: ***first,* it is Section 51 (c)(1), (e)(1), and (3) which impose deficiency interest; *second,* Section 51 (c) (1) confines such deficiency interest on taxes covered by TITLE II; and, *third,* that transaction tax does not fall within TITLE II.** Thus:

> **"It will be seen that Section 51 (c) (1) and (e) (1) and (3), of the 1977 Tax Code, authorize the imposition of surcharge and interest only in respect of a *"tax imposed by this Title,"* that is to say, Title II on "Income Tax."** It will also be seen that Section 72 of the 1977 Tax Code imposes a surcharge only in case of failure to file a return or list *"required by this Title,"* that is, *Title II on "Income Tax."* **The thirty-five percent (35%) transaction tax is, however, imposed in the 1977 Tax Code by**

[4] G.R. No. 146486, March 4, 2005.

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> ***Section 210 (b) thereof which Section is embraced in Title V on "Taxes on Business"*** **of that Code.** Thus, while the thirty-five percent (35%) transaction tax is in truth *a tax imposed on* interest *income* earned by lenders or creditors purchasing commercial paper on the money market, the relevant provisions, *i.e.,* Section 210 (b), were *not* inserted in Title II of the 1977 Tax Code. The end result is that the thirty-five percent (35%) transaction tax is *not* one of the taxes in respect of which Section 51 (e) authorized the imposition of surcharge and interest and Section 72 the imposition of a fraud surcharge." (Emphases supplied)

True, the Supreme Court in *PICOP* declared that the present provision of the NIRC mentions that **additions** on tax applies to all taxes. While such pronouncement may not be construed beyond the context in which it was made, *PICOP* simply confirmed that *in general*, certain penalties and charges are applicable to all types of tax or deficiency tax; **PICOP, however, did not categorically construe the provision of Section 249 (B) that deals with "deficiency interest" on the type of tax "as defined in [the] Code."** Note that the present NIRC is explicit with respect to the type of tax on which deficiency interest may be imposed, viz:

> 'Section 249.Interest-
>
> (B) Deficiency Interest. – Any deficiency in the tax due, **as the term is defined in this Code**, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.' (Emphasis supplied)

Section 249 (B) cannot be any clearer: the deficiency interest must refer only to 'deficiency in the tax due, <u>as the term is defined in [the] Code</u>.'

Verily, as the law stands, only donor's, estate, and income taxes carry a provision on deficiency tax; they are the types of taxes on which such deficiency interest may be imposed.

> Finally, Sections 247 (a) and 249 (A) are **general provisions** that impose "additions" to the tax and "interest" thereon. Both sections may not be read in isolation from the relevant and **specific provision** of Section 249 (B) with respect to the imposition of "deficiency" interest, more so as all these provisions fall within the same Chapter I of Title X of the NIRC of 1997, as amended.
>
> Otherwise stated, Sections 247 (a) and 249 (A) must reasonably be read and construed subject to the provision of Section 249 (B) - - all these provisions being covered by the **same** Chapter I of Title X of the NIRC of 1997, as amended."

In sum, deficiency interest may be imposed only on tax specifically covered and defined by the relevant provisions of the NIRC, *i.e., income tax, donor's tax and estate tax*; **conversely, deficiency interest may not properly be imposed on the VAT and EWT assessed against SPDC.**

Also apt is my discussion in my Concurring and Dissenting Opinion in *Philippine Aerospace Development Corporation vs. Commissioner of Internal Revenue*[5] which I quote below:

> Settled is the rule that laws imposing tax is construed strictly against the government and liberally in favor of the taxpayer. **Unless clearly imposed by pertinent provision of law, deficiency interest as an additional tax burden should not simply be presumed. Thus, the obligation to pay deficiency interest may not be applied to taxes other than income tax, donor's tax and estate tax, irrespective of whether an assessment is issued or not. After all, the deficiency tax assessed is still subject to the delinquency interest rate of 20% per annum until fully paid. Truth be told, the delinquency interest rate of 20% is way more than the legal interest of 12% per annum.**

The power of taxation is sometimes called also the power to destroy. Therefore, it should be exercised with caution to minimize injury to the proprietary rights of a taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kills

[5] CTA EB No. 1035, February 9, 2016.

the "hen that lays the golden egg."[6] Indeed, the imposition of 20% deficiency interest per annum on a tax not clearly within the context of the law, in addition to 20% delinquency interest per annum and a surcharge of 25% on the amount due under Section 248 of the NIRC of 1997, as amended, is too burdensome for a taxpayer to survive and continue its business affairs.

All told, I VOTE to PARTIALLY GRANT the Petition for Review filed by Kepco Philippines Corporation; CANCEL and SET ASIDE the final withholding tax assessment in the amount of ₱133,166,690.62; AFFIRM, with MODIFICATIONS, the assessments covering deficiency final withholding VAT and deficiency VAT; ORDER petitioner to pay respondent the following: (a) basic final withholding VAT in the amount of ₱27,769,598.67 plus 25% surcharge of ₱6,942,399.67; (b) basic deficiency VAT in the amount of ₱25,485,133.56 plus 25% surcharge of ₱6,371,283.39; and, (c) delinquency interest at the rate of 20% per annum on ₱66,568,415.29, representing the total of the amounts stated under (a) and (b), computed from February 1, 2014 until full payment thereof, pursuant to Section 249(C) of the National Internal Revenue Code (NIRC) of 1997, as amended.

ROMAN G. DEL ROSARIO
Presiding Justice

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6 *Commissioner of Internal Revenue vs. SM Prime Holdings, Inc.*, G.R. No. 183505, February 26, 2010, *citing Roxas vs. Court of Tax Appeals*, G.R. No. L-25043, April 26, 1968.