REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

ITW TEXWIPE PHILIPPINES, INC.,
Respondent.

CTA EB NO. 534
(CTA Case No. 7357)

Present:

ACOSTA, *P.J.*,
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA,
PALANCA-ENRIQUEZ,
FABON-VICTORINO,
MINDARO-GRULLA, and
COTANGCO-MANALASTAS, *JJ.*

Promulgated:
NOV 0 9 2010

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DECISION

COTANGCO-MANALASTAS, *J.*:

Before the Court *En Banc* is a Petition for Review challenging the Court of Tax Appeals (CTA) First Division's Decision dated June 17, 2009 and the Resolution dated August 24, 2009, ordering the Commissioner of Internal Revenue to cancel or withdraw the assessment he issued against ITW Texwipe Philippines, Inc. for taxable year 2000, representing final withholding tax (FWT) on royalty expense and sales commission expense in the amount of P15,575,801.16 and final withholding tax on value-added tax (FWT-VAT) in the amount of P6,908,314.52.

Antecedent Facts

The facts as stipulated by the parties in their Joint Stipulation of Facts and Issues[1] and as borne by the records of the case are as follows:

Petitioner Commissioner of Internal Revenue is the official duly authorized under Section 4 of the National Internal Revenue Code (NIRC) to assess and collect internal revenue taxes, with the power to decide disputed assessments, among others.

Respondent ITW Texwipe Philippines, Inc. (Texwipe Philippines) is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, registered with the Securities and Exchange Commission through Certificate of Incorporation No. A-1997-23343 dated January 21, 1998. It is likewise registered with the Philippine Economic Zone Authority (PEZA) as an Ecozone Export Enterprise, as evidenced by its Certificate of Registration No. 98-011.

On May 31, 2005, herein petitioner, through Acting Regional Director Melinda I. Ordoyo, issued a Formal Letter of Demand and Assessment Notice (FAN) No. 57-2000.

In the said FAN, petitioner assessed respondent Texwipe Philippines for deficiency final withholding tax on: (a) royalty expenses; (b) general administrative expenses; (c) commission expenses; and (d) value-added tax on gross payments to Texwipe International LLC (hereinafter referred to as

[1] Records, pp. 148-153.

"Texwipe USA") for calendar year 2000 in the aggregate amount of P25,104,368.59, inclusive of surcharge, interest and compromise penalties.

The assessed deficiencies were due to alleged violations of or non-compliance with Section 57(A) of the NIRC, Revenue Regulations Nos. 2-98 and 7-95, and Articles 4 and 13 of the RP-US Tax Treaty.

On June 10, 2005, respondent Texwipe Philippines received a copy of the FAN.

On June 17, 2005, respondent filed its reply to the FAN, protesting petitioner's assessments and raising the following arguments with respect to each item of assessment:[2]

> "a. Royalties – The Corporation withheld and remitted the amount of P4,216,258.64 as evidenced by BIR Form No. 1601-F with the BIR on August 27, 2001. No royalty payments were actually made in 2000 and payments of royalty started only in 2001, thus the filing of the appropriate return in said year. Considering that the return for withholding tax on royalties was filed on August 27, 2001, the assessment for said taxes has prescribed pursuant to Section 203 of the NIRC.
>
> b. General and Administrative Expenses – This pertains to services rendered outside the Philippines. Income derived by a non-resident foreign corporation from sources outside the Philippines is not subject to tax.
>
> c. Commission Expenses – This pertains to services rendered outside the Philippines. Income derived by a non-resident foreign corporation from sources outside the Philippines is not subject to tax.
>
> d. VAT – Royalty expense for 2000 was only on accrual and no payment was actually made. Thus, no FWT is due. Further, these pertained to services rendered outside the Philippines which are not subject to VAT."

[2] *Rollo,* pp. 27-28.

Interestingly, on July 21, 2005, respondent Texwipe Philippines received a letter from petitioner, through Revenue District Office (RDO) No. 57, stating that the right of the government to assess respondent has not yet prescribed.

No resolution was however issued on whether herein respondent's protest has been denied in whole or in part. Instead, herein petitioner referred the issues on the assessments of deficiency withholding tax on sales commissions and general and administrative expenses to the Assessment Division for proper disposition. Meanwhile, respondent Texwipe Philippines did not receive any letter from the Assessment Division or from the Regional Office in reply to its protest letter pursuant to the referral made by the RDO of its letter dated July 21, 2005.

On October 3, 2005, respondent Texwipe Philippines received the Preliminary Collection Letter dated September 19, 2005, issued again by RDO No. 57, collecting from respondent the alleged deficiency FWT and FWT-VAT for calendar year 2000 in the total amount of P25,104,368.59, inclusive of surcharge, interest, and compromise penalties.

On October 28, 2005, respondent Texwipe Philippines filed a Petition for Review praying that judgment be rendered canceling FAN No. 57-2000 and the Preliminary Collection Letter, which assessed Texwipe Philippines for alleged deficiency FWT on royalty expense, general and administrative expense, sales commission expense, and FWT on VAT for calendar year 2000 in the total amount of P25,104,368.59. It also prayed that the same be declared null and void and without legal effect.

On December 18, 2005, herein petitioner filed a Motion for Leave to Admit Attached Answer[3], which was granted in a Resolution[4] dated February 2, 2006. In his Answer[5], petitioner raised the following Special and Affirmative Defenses:

> "10. This Honorable Court is wont of jurisdiction to entertain the instant Petition for Review. Section 228 of the NIRC of 1997 categorically states that '*...within sixty (60) days from the filing of the protest, all relevant supporting documents shall have been submitted; otherwise,* ***the assessment shall become final***' (Emphasis supplied). As borne by the records of the case, petitioner did not just fail to submit documents after it filed its protest, it obstinately refused to submit documents requested by the respondent's examiners despite several requests made during the investigation stage and even during the protest. In fact, petitioner even wrote a letter dated July 18, 2005, in response to a request for submission of documents by the respondent's examiners stating that '*no amount of documents could prove the same [petitioner's protest] except the proper interpretation and application of the law.*'
>
> 11. It bears mentioning that all of petitioner's defenses against the assessment are based not only on provisions of law, but, on interpretation of the scope and limitation of the agreements between petitioner and its alleged foreign contracting partners. Petitioner desperately seeks to defeat the assessment by anchoring its protest on exemptory provisions of a treaty agreement between the Republic of the Philippines and U.S. It is indubitable that the contentions of petitioner cannot be resolved merely by its postulations on the nature and scope of contracts it entered with its U.S.-based payees without producing the alleged contracts and proving the exempt nature of services alluded to in said contracts, and strict compliance with its provisions. Thus, petitioner's obstinate refusal to submit documents within sixty (60) days from the filing of its protest, despite repeated demands to do so, is clearly unjustifiable.

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[3] Record, p. 102-104.
[4] Record, p. 117.
[5] Record, pp. 105-112.

12. Being that the assessment is final after the lapse of sixty (60) day period from petitioner's protest, petitioner should have filed its petition for review with this Court after the lapse of said period. To reiterate, the assessment had already become final due to petitioner's failure/refusal to submit documents within sixty (60) days from filing of its protest. The protest was filed by the taxpayer on June 17, 2005. Petitioner had until August 16, 2005 to submit documents relevant to its protest. Until this date, no documents (*sic*) was ever submitted to the respondent's regional offices supporting the June 17, 2005 protest. Clearly, under the NIRC of 1997, the assessment has already become final even before the taxpayer filed the instant petition for review on October 28, 2005."

On March 9, 2006, herein petitioner filed his Motion to Dismiss[6] on the ground of the Court's lack of jurisdiction, arising from the alleged failure of Texwipe Philippines to file the supporting documents to the protest. Texwipe Philippines submitted its Opposition[7] to the said motion on April 3, 2006.

However, on March 10, 2006, a Joint Stipulation of Facts and Issues was entered into and filed by the parties. A corresponding Resolution[8] dated March 14, 2006 approved said stipulation of facts and issues and thereafter terminated the pre-trial. Meanwhile, a Resolution[9] dated July 6, 2006 was also issued by the Court denying the Motion to Dismiss for lack of merit.

The Ruling of the Court in Division

After hearing on the merits, the Court in Division rendered the Decision[10] dated June 17, 2009, the dispositive part of which reads:

[6] Record, pp. 140-145.
[7] Record, pp. 157-168.
[8] Record, p. 154.
[9] Record, pp. 186-189.
[10] *Rollo*, pp. 25-44.

"**WHEREFORE**, the Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, respondent is hereby **ORDERED TO CANCEL/WITHDRAW** the assessment for taxable year 2000 insofar as to the final withholding tax on royalty expense and sales commission expense in the amount of P15,575,801.16 and final withholding tax on VAT in the amount of P6,908,314.52. However, petitioner is **ORDERED** to **PAY** respondent the assessment in the reduced amount of **P2,620,252.91** representing petitioner's deficiency final withholding tax on general and administrative expenses for taxable year 2000, with applicable interest and surcharges, computed as follows:

General and Administrative Expenses – Texwipe USA	P 3,863,130.00
Multiply by: Final Withholding Tax Rate	32%
Final Withholding Tax Due	P 1,236,201.60
Add: 25% Surcharge	309,050.40
20% Interest (01/26/2001 to 05/31/2005)	1,075,000.91
Total Amount Due	**P2,620,252.91**

In addition, petitioner is hereby **ORDERED** to **PAY** twenty percent (20%) delinquency interest on the total amount of **P2,620,252.91** from October 13, 2005 until full payment thereof, pursuant to Section 249(c)(3) of the 1997 Tax Code, as amended.

SO ORDERED."

In its Decision, the Court in Division found that respondent Texwipe Philippines is not liable to pay the FWT on royalty expense, sales commission expense, and final withholding on VAT. It further held that it has jurisdiction to decide over the Petition for Review filed by Texwipe Philippines as the issuance of the preliminary collection letter is tantamount to an outright denial of its protest. However, the Court ruled that Texwipe Philippines is liable for FWT on general and administrative expenses as no evidence was presented to prove that the services performed by Texwipe USA were rendered outside the Philippines.

Not satisfied with the foregoing Decision, herein petitioner filed a Motion for Partial Reconsideration[11]. In a Resolution[12] dated August 24, 2009, the Court in Division denied the Motion for Partial Reconsideration for lack of merit.

Issues

Hence, petitioner filed the instant Petition for Review on September 24, 2009, raising the following issues[13]:

> "WHETHER OR NOT THE FIRST DIVISION ERRED IN DECLARING THAT RESPONDENT IS NOT LIABLE FOR FINAL WITHHOLDING TAXES ON ROYALTY EXPENSES.
>
> WHETHER OR NOT THE FIRST DIVISION ERRED IN HOLDING (SIC) THAT RESPONDENT IS NOT LIABLE FOR THE FINAL WITHHOLDING TAX ON SALES COMMISSION EXPENSE AS WELL AS THE FINAL WITHHOLDING VALUE ADDED TAX ON PETITIONER'S PAYMENTS TO TEXWIPE USA."

Petitioner argues that the period of prescription as provided in Section 203 of the NIRC of 1997 cannot be applied in the instant case considering that Texwipe Philippines failed to file a return as required by law. Instead, it is the ten (10)-year prescriptive period that should apply. She further asserts that as a withholding agent, Texwipe Philippines is not assessed for the collection of income tax but for the enforcement of the withholding tax provision; hence, it is liable for penalty equal to the total amount of tax not collected and remitted. Petitioner likewise alleges that Texwipe Philippines is liable on sales commission expense since Texwipe International LLC received remuneration and derived service income from sources within the Philippines.

[11] Records, pp. 720-731.
[12] *Rollo*, pp. 45-51.
[13] *Rollo*, p. 13.

1395

She also claims that Texwipe Philippines is liable for FWT-VAT on the payments it made to Texwipe USA.

Conversely, respondent Texwipe Philippines claims that its FWT on royalty payments for 2000 was withheld and remitted on August 27, 2001 when it filed BIR Form No. 1601-F[14], indicating income payments for technology and royalty expenses in the total amount of P28,108,390.93. It further contends that petitioner has failed to show proof that the service income was derived from sources within the Philippines. Lastly, respondent Texwipe Philippines maintains that the payments it made to Texwipe USA are not subject to VAT since Texwipe Philippines is a PEZA-registered Export enterprise; hence, exempt from all direct and indirect taxes.

The Ruling of the Court *En Banc*

The Court *En Banc* will address the issues presented by petitioner in *seriatim*.

Anent the question of prescription, the Court *En Banc* agrees with the ruling of the Court in Division that the prescriptive period under Section 203 of the NIRC of 1997 applies in the instant case.

Section 203 of the NIRC of 1997 explicitly provides for the period within which herein petitioner may issue an assessment, to wit:

> "SEC. 203. *Period of Limitation Upon Assessment and Collection.* – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond

[14] Records, pp. 49-50.

> the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

Based on the afore-quoted provision, the Bureau of Internal Revenue (BIR) has three (3) years counted from the date of actual filing of the return or from the last date prescribed by law for the filing of such return, whichever comes later, to assess a national internal revenue tax.[15]

The BIR had three years from the last day respondent Texwipe Philippines filed its return within which to send to the latter an assessment notice. As correctly found by the Court in Division, Texwipe Philippines withheld and paid the final withholding tax on such royalties on August 27, 2001, when Texwipe Philippines filed BIR Form No. 1601-F. Considering that Texwipe Philippines filed the return and correspondingly paid the final withholding tax on said royalties on August 27, 2001, the BIR had three years from said date or until August 27, 2004 to assess Texwipe Philippines.

Unfortunately, the BIR issued the deficiency FWT assessment on royalties only on May 31, 2005 or more than three years after the filing of the afore-mentioned return. Thus, the assessment on the final withholding tax on royalty expense has already prescribed. Accordingly, Texwipe Philippines cannot be made liable to pay said tax.

As to the allegation that the assessment of deficiency FWT on Texwipe Philippines is not an assessment for collection of a tax, but a penalty to the

[15] *Bank of the Philippine Islands vs. Commissioner of Internal Revenue*, G.R. No. 139736, October 17, 2005.

withholding agent who failed to collect and remit the tax, the Court finds the same to be untenable.

As correctly pointed out by the Court in Division, the penalty under Section 251 of the NIRC of 1997 falls under the provisions on statutory offenses and penalties imposed in addition to taxes. Being so, they shall be considered an additional part of the deficiency taxes being assessed. Likewise, they shall be collected at the same time, in the same manner, and as part of the tax.[16] Consequently, they are assessed and collected from the taxpayer at the time the primary taxes are assessed and collected, which is within the 3-year prescriptive period.[17] Inasmuch as the assessment of deficiency FWT on respondent Texwipe Philippines' royalty expenses was ruled to have prescribed, it follows that any assessment over the penalty imposed on said tax has also prescribed.

As to the allegation that Texwipe Philippines is liable for FWT on sales commission expense, the Court *En Banc* holds that the income of Texwipe USA arising from the services it rendered for Texwipe Philippines should not be subject to final tax in the Philippines.

Section 42(A)(3) of the NIRC of 1997 provides:

"SEC. 42. *Income from Sources Within the Philippines.* –

(A) *Gross Income From Sources Within the Philippines.* – The following items of gross income shall be treated as gross income from sources within the Philippines:

xxx xxx xxx

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[16] Section 247(a), Republic Act No. 8424 entitled "*An Act Amending the National Internal Revenue Code, as amended, and for Other Purposes.*"
[17] *Express Telecommunications Company, Inc. vs. CIR*, CTA Case No. 5687, April 12, 2000.

> (3) *Services.* – Compensation for labor or personal services performed in the Philippines;"

Clearly, only labor and personal services performed in the Philippines are considered Philippine-sourced income and hence, subject to tax. The important factor therefore which determines the source of income of personal services is not the residence of the payor, or the place where the contract for service is entered into, or the place of payment, but the **place where the services were actually rendered.**[18]

Here, it is evident that the sales services were performed outside the Philippines. The Sales Commission Agreement[19] entered into between Texwipe Philippines and Texwipe USA furnishes the best means to prove said allegation, the applicable parts of which state:

> "NOW, THEREFORE, for and in consideration of the foregoing premises, the parties hereto hereby covenant, under the following terms and conditions:
>
> 1. Texwipe USA shall undertake the sale of the goods and/or products manufactured thereby to the **European Common and Asian Markets**, as the designated sales agent of TPI.
>
> 2. The proceeds of such sales shall be remitted directly to TPI, and shall be considered a sale made by TPI." *(Emphasis supplied)*

Plainly, the Sales Commission Agreement reveals that the sales services are to be rendered in European Common and Asian Markets. Moreover, records indicate that Texwipe USA facilitated the sales by e-mailing

[18] *Commissioner of Internal Revenue vs. Baier-Nickel*, G.R. No. 153793, August 29 2006.
[19] Records, pp. 95-96.

customers who are outside the Philippines and reporting the sales by e-mails. Therefore, the services were rendered outside the Philippines.

Lastly, We sustain respondent's contention that it is not required to withhold and remit the FWT-VAT on its gross payments to Texwipe USA since it is a PEZA-registered Export Enterprise and is not liable directly or indirectly for VAT.

As a rule, the lease or use of certain "know how" formulations and technical standards, and the supply of technical advice and services in connection with technical management and administration by non-resident persons or his employees are subject to ten percent (10%) value-added tax pursuant to Section 108 of the NIRC of 1997. Consequently, the royalties and sales services rendered by Texwipe USA to Texwipe Philippines should be subject to VAT.

However, in *Commissioner of Internal Revenue vs. Toshiba Information Equipment (Phils.), Inc.*[20], the Supreme Court held that an Ecozone enterprise is a VAT-exempt entity. Sales of goods, properties and services to Ecozone enterprises shall be subject to VAT at zero percent (0%); thus, no VAT may be passed on and imposed indirectly to said enterprises.

Further, Section 24, Chapter III of Republic Act No. 7916[21] provides that *except for real property taxes on land owned by developers,* ***no taxes, local and national, shall be imposed on business establishments operating within the Ecozone****. In lieu thereof, five percent (5%) of the gross income earned by all business enterprises within the Ecozone shall be*

[20] G.R. No. 150154, August 9, 2005.
[21] "*Special Economic Zone Act of 1995, as amended.*"

paid. The 5% preferential tax rate imposed on the gross income of a PEZA-registered enterprise shall be in lieu of all national taxes including VAT. The rationale for this rule is that the Philippine VAT system adheres to the "Cross Border Doctrine," according to which, no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority.[22]

WHEREFORE, premises considered, the instant Petition for Review is hereby **DENIED**. Accordingly, the assailed Decision and Resolution dated June 17, 2009 and August 24, 2009, respectively, of the Court in Division in CTA Case No. 7357 are hereby **AFFIRMED IN TOTO**.

SO ORDERED.

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

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[22] *Toshiba Information Equipment (Phils.) Inc. vs. Commissioner of Internal Revenue*, G.R. No. 157594, March 9, 2010.

(On Leave)
OLGA PALANCA-ENRIQUEZ
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

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

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice