REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

ICONIC BEVERAGES, INC.,
Petitioner,

-versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8607
For: Assessment

Members:

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

Promulgated:

JAN 06 2016; 11:10 a.m.

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RESOLUTION

MINDARO-GRULLA, *J.*:

For this Court's resolution are:

1. petitioner's **Motion for Reconsideration [of the Decision dated August 14, 2015]**, filed on September 1, 2015, with respondent's **Opposition to Motion for Reconsideration**, filed on October 1, 2015; and

2. respondent's **Motion for Partial Reconsideration (Re: Decision dated 14 August 2015)**, filed through registered mail on September 1, 2015 and received by the Court on September 10, 2015, with petitioner's **Comment/Opposition [To Respondent's Motion for Partial Reconsideration**

(Re: Decision dated 14 August 2015) dated September 1, 2015], filed on September 30, 2015.

The parties move for the reconsideration of the Decision[1] promulgated on August 14, 2015, the dispositive portion of which reads:

"**WHEREFORE**, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. The compromise penalty assessed by respondent against petitioner in the amount of ₱50,000.00 is hereby **CANCELLED**. On the other hand, the remaining amount in the assessment covering deficiency income tax for the taxable year 2009 is hereby **AFFIRMED** with some modifications. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **₱88,254,300.60** representing basic deficiency income tax for the taxable year 2009 inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, computed as follows:

Taxable Income	₱ (50,009,617.40)
Add: Royalty income subject to regular income tax	856,063,257.00
Adjusted Taxable Net Income	₱ 806,053,639.60
Tax Rate	30%
Tax Due	₱ 241,816,091.88
Less: Final Tax of 20% (₱856,063,257 x 20%)	171,212,651.40
Deficiency Income Tax	₱ 70,603,440.48
Add: 25% Surcharge	17,650,860.12
Total Amount Due	**₱88,254,300.60**

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

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

[1] Docket, pp. 534-554.

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

SO ORDERED."

Petitioner anchors its motion on the following grounds:

1. Passive income is income generated by the taxpayer's assets. Royalty income is by nature passive income;

2. In any case, the royalty income is not within the primary purpose of petitioner and the same was derived not in the active pursuit of its trade or business;

3. Assuming *arguendo* that petitioner's royalty income is ordinary income, applying section 34(L) of the 1997 NIRC, which allows a 40% optional standard deduction from the gross income, petitioner is not liable for any deficiency income tax; and

4. Assuming *arguendo* that the royalty income is ordinary income and assuming further that petitioner will not be allowed to avail of the optional standard deduction, this Court incorrectly computed the deficiency income tax and interest.

In the assailed Decision, the Court found that petitioner's income from royalty is its main source of income for the taxable year 2009 which appears to be in line with its primary purpose, i.e., owning, purchasing, licensing and/or acquiring such trademarks and other intellectual property rights necessary for the furtherance of its business as stated in petitioner's Articles of Incorporation[2]. The Court held that there is factual basis to conclude that petitioner generated its royalty income in the active pursuit and performance of its primary purpose, and therefore, is not a passive income.

[2] Exhibit P, docket, pp. 348-355.

Accordingly, the Court upheld the findings of the respondent that the said royalty income is subject to ordinary income tax, and not to final tax.

Petitioner's allegation that the royalty income is in the nature of passive income, that it is not within the primary purpose of petitioner, and that it was derived not in the active pursuit of trade or business were already addressed in the assailed Decision.

Petitioner maintains that Section 27 (D)(1) of the National Internal Revenue Code (NIRC) of 1997, as amended, does not distinguish between royalty earned in the active pursuit of the corporation's primary purpose and one that is earned not in the active pursuit of its primary purpose specifically because royalty income is in the nature of a passive income. Petitioner adds that the mere fact that royalty income was the only income derived by petitioner for taxable year 2009 does not and should not transform the royalty income, which is by nature a passive income, to ordinary income.

Also, petitioner claims that the absence of cost of sales/services for 2011 is not relevant since the subject of this case is petitioner's income and activities in 2009. Petitioner further alleges that even assuming *arguendo* that the absence of cost of sales/services for 2011 can be considered, the mere fact that petitioner did not actively pursue a business of manufacturing, buying, selling, or dealing in alcoholic and non-alcoholic beverages, thereby, leading to the absence of cost of sales/services for 2011, does not transform the royalty income earned by petitioner from its intellectual property rights into ordinary income since said royalty income arose from petitioner's mere ownership of the intellectual property rights.

Allegedly, no resource was employed by petitioner to promote the use of its trademarks and other intellectual property rights held as intangible assets as shown by petitioner's Audited Financial

Statements. Petitioner claims that no marketing and/or promotional activities were undertaken by petitioner in order to entice potential licensees to enter into a licensing agreement with petitioner.

Respondent opposes the foregoing allegations and states that the royalty fees received by petitioner are in the nature of active income arising from the active pursuit of its business and must be subject to the regular corporate income tax under Section 27 of the NIRC, as amended. Respondent adds that despite petitioner's insistence claiming that the income derived from San Miguel Brewery, Inc. and My Philippines Lifestyles, Inc. are passive income, documents speak otherwise and that mere allegation is not evidence and is not equivalent to proof.

A perusal of the foregoing shows that they are the same arguments raised by petitioner in its Memorandum[3] which have been sufficiently resolved and passed upon by the Court in the assailed Decision.

To reiterate the Court's ruling, petitioner's evidence failed to support its claim that the royalties in the taxable year 2009 were passive income, and not earned in the active pursuit or performance of its primary purpose.

It must again be pointed out that the tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment. It is to be presumed, however, that such assessment was based on sufficient evidence. Upon the introduction of the assessment in evidence, **a *prima facie* case of liability on the part of the taxpayer is made.** If a taxpayer files a petition for review in the CTA and assails the assessment, the *prima facie* presumption is that the assessment made by the BIR is correct, and that in preparing the same, the BIR personnel regularly performed their duties. This rule for tax initiated suits is premised on several factors other than the normal evidentiary rule imposing proof obligation on the petitioner-taxpayer: the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the NIRC.[4] ℒ

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[3] Docket, pp. 500-518.

[4] *Commissioner of Internal Revenue vs. Hantex Trading Co., Inc.*, G.R. No. 136975, March 31, 2005.

The *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious.[5]

When assessments are assailed, the burden of proof is upon the complaining party (petitioner). It is incumbent upon the latter to clearly show that the assessment was erroneous, in order to relieve himself from it.[6]

Also, as cases filed before this Court are litigated *de novo*, party-litigants must prove every minute aspect of their cases.[7]

In the case of *Republic Cement Corporation vs. Commissioner of Internal Revenue*[8], this Court sitting *En Banc* ruled that unlike tax assessments that enjoy the presumption of regularity, taxpayers' claims of no liability against deficiency taxes should be sufficiently established x x x.

The evidence presented by petitioner failed to support its claim that the tax assessment against it is arbitrary and capricious. Instead, petitioner's evidence supported the basis of the tax assessment issued by respondent. Thus, the Court correctly upheld the assessment against petitioner for deficiency income tax on its royalty income for the taxable year 2009.

The optional standard deduction under Section 34 (L) of the NIRC of 1997, as amended, should not be applied in the computation of petitioner's tax liability.

Petitioner avers that assuming it is liable to pay the 30% tax rate as prescribed under Section 27(A) and not the final tax rate of 20% for passive income under Section 27(D)(1), petitioner submits

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[5] *Ibid.*

[6] *Interprovincial Autobus Co., Inc. vs. Collector of Internal Revenue*, G.R. No. L-6741, January 31, 1956; *Collector of Internal Revenue vs. Bohol Land Transportation Co.*, G.R. Nos. L-13099 and L-13462, April 29, 1960; *Commissioner of Internal Revenue vs. Construction Resources of Asia, Inc., et al.*, G.R. No. L-68230, November 25, 1986.

[7] *Rafael Arsenio S. Dizon, in his capacity as the Judicial Administrator of the Estate of the deceased Jose P. Fernandez vs. Court of Tax Appeals, et al.*, G.R. No. 140944, April 30, 2008.

[8] CTA EB Case No. 821, July 18, 2012.

that the Court should apply the provisions of Section 34(L) on optional standard deduction.

Petitioner argues that assuming its royalty income for taxable year 2009 in the amount of ₱856,063,257.00 is treated as regular income and applying the (40%) optional standard deduction, the result would show that it is not liable for any deficiency income.

Section 34 (L) of the NIRC of 1997, as amended, provides:

> "SEC. 34. **Deductions from Gross Income. –** xxx
>
> xxx xxx xxx
>
> (L) *Optional Standard Deduction*. - In lieu of the deductions allowed under the preceding Subsections, an individual subject to tax under Section 24, other than a nonresident alien, may elect a standard deduction in an amount not exceeding forty percent (40%) of his gross sales or gross receipts, as the case may be. In the case of a corporation subject to tax under section 27(A) and 28(A)(1), it may elect a standard deduction in an amount not exceeding forty percent (40%) of it gross income as defined in Section 32 of this Code. **Unless the taxpayer signifies in his return his intention to elect the optional standard deduction, he shall be considered as having availed himself of the deductions allowed in the preceding Subsections.** Such election when made in the return shall be irrevocable for the taxable year for which the return is made: *Provided*, That an individual who is entitled to and claimed for the optional standard shall not be required to submit with his tax return such financial statements otherwise required under this Code: *Provided, further*, That except when the Commissioner otherwise permits, the said individual shall keep such records pertaining to his gross sales or gross receipts, or the said corporation shall keep such records pertaining to his gross income as defined in Section 32 of this Code during the taxable year, as may be required by the rules and regulations promulgated by the Secretary of Finance, upon recommendation of the Commissioner." (*Emphasis supplied*)

The foregoing provision dictates that the taxpayer should signify in its return the intention to elect the optional standard deduction. Otherwise, it shall be considered to have availed of the other deductions allowed in Section 34 of the NIRC of 1997, as amended.

A perusal of petitioner's 2009 Annual Income Tax Return (ITR)[9] shows that it declared itemized deductions in the total amount of ₱50,009,617.40 which resulted to a net loss in the same amount. There was nothing in petitioner's ITR which would show that it opted to avail of the optional standard deduction. Thus, the optional standard deduction under Section 34 (L) should not be applied in the computation of petitioner's tax liability.

The Court correctly computed the deficiency income tax and interest.

In its attempt to apply Section 249 of the NIRC of 1997, as amended, on the basis of its own interpretation, petitioner alleges that considering its failure to pay the tax on April 15, 2010, the date when the tax should have been timely paid, it became liable for deficiency interest starting April 16, 2010 up to April 15, 2012, the alleged date when full payment of the deficiency tax and deficiency interest should be made as per BIR'S Formal Letter of Demand dated March 30, 2012.

Furthermore, petitioner mentions that it was required to immediately pay the alleged deficiency tax as per respondent's Final Decision on Disputed Assessment dated January 7, 2013 upon receipt thereof including the 20% deficiency interest computed as of December 15, 2012.

Since petitioner failed to pay within the period set by the respondent, it allegedly became delinquent. As such, petitioner insists that the interest to be imposed is no longer deficiency interest, but instead, the delinquency interest should be imposed under Section 249 (C)(3) of the NIRC of 1997, as amended.

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[9] Exhibit P-4-a, docket, pp. 360-362.

Petitioner contends that there is no legal basis for the simultaneous imposition of the deficiency and delinquency interest under Section 249 of the NIRC of 1997 and that imposition of the two sets of interests would be oppressive and confiscatory.

Likewise, petitioner mentions that the imposition of interest under Section 249 of the NIRC of 1997, as amended, is compensatory in nature and not punitive.

On this matter, let it be stressed that the Court computed the interest on petitioner's tax liability based on the following provisions of law:

> "SEC. 247. **General Provisions.-**
>
> (a) The additions to the tax or deficiency tax prescribed in this Chapter shall apply to all taxes, fees and charges imposed in this Code. The amount so added to the tax shall be collected at the same time, in the same manner and as part of the tax."
>
> "SEC. 249. **Interest.-**
>
> (A) *In General.* - There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.
>
> (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.
>
> (C) *Delinquency Interest.* -In case of failure to pay:
>
> (1) The amount of the tax due on any return to be filed, or
> (2) The amount of the tax due for which no return is required, or

> (3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax."

Contrary to petitioner's allegation, the foregoing provisions show that deficiency interest is different from delinquency interest and as such, the simultaneous imposition of both types of interest is not precluded.

It is clear from the above provisions that deficiency interest is imposed upon any tax that is still due and unpaid to the government, while delinquency interest is the interest imposed on failure to pay (i) the amount of tax due on any return required to be filed, or (ii) the amount of tax due for which no return is required, or (iii) <u>deficiency tax</u>, or any <u>surcharge</u> or <u>interest</u> thereon on the due date appearing in the notice and demand of the Commissioner.

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

In sum, these two (2) interests are different in nature. Also, there was no indication from the said provisions of law that these sets of interest cannot be imposed simultaneously.

As clearly stated in the above provisions, both deficiency and delinquency interests shall be assessed until full payment thereof. At this juncture, it bears stressing that the first and fundamental duty of the Court is to apply the law. When the law is clear and free from any doubt or ambiguity, there is no room for construction or interpretation. Where the law speaks in clear and categorical language, there is no occasion for interpretation; there is only room for application.[10]

Considering that the Court only applied the abovementioned provisions and imposed the deficiency and delinquency interest as mandated therein, petitioner's allegation that it is not liable to pay deficiency interest, but only the delinquency interest, has no leg to stand on.

In view of the foregoing, the Court finds petitioner's Motion for Reconsideration bereft of merit.

Moving on to respondent's **Motion for Partial Reconsideration (Re: Decision dated 14 August 2015)**, respondent contends that the deduction as claimed by petitioner should have been justified by evidence. Considering the alleged failure of petitioner to prove by sufficient evidence its claim for deduction in the amount of ₱50,009,617.40, the same should not be deducted from its taxable income.

On the contrary, petitioner avers that even prior to the filing of the Petition for Review, respondent's own documents would show that she never questioned petitioner's expenses for taxable year 2009 in the amount of ₱50,009,617.40. Also, petitioner claims that respondent's judicial admissions in the proceedings before the Court are conclusive and do not require further evidence to prove them.

The Court disagrees with the respondent.

As correctly argued by petitioner, there is nothing in the pleadings filed by respondent, in the subject Formal Letter of Demand[11] or in the Final Decision on Disputed Assessment[12] which would show that respondent questioned the deduction claimed by petitioner in the amount of ₱50,009,617.40 as per its 2009 Annual ITR.

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[10] *Nippon Express (Philippines) Corporation vs. Commissioner of Internal Revenue,* G.R. No. 196907, March 13, 2013, citing the case of *Rizal Commercial Banking Corporation vs. Intermediate Appellate Court and BF Homes, Inc.,* G.R. No. 74851, December 9, 1999.
[11] Exhibit P-9, docket, pp. 376-377.
[12] Exhibit P-11, docket, pp. 384-385.

Likewise, the issue on the said deduction was not among the issues stipulated by the parties pursuant to their Joint Stipulations of Facts and Issue filed on September 5, 2013[13].

Accordingly, the Court correctly computed petitioner's tax liability based on the unquestioned items in petitioner's 2009 Annual ITR, including its declared deduction in the amount of ₱50,009,617.40.

WHEREFORE, finding no cogent reason to reverse the Court's ruling in the assailed Decision, petitioner's **Motion for Reconsideration (of the Decision dated August 14, 2015)**, and respondent's **Motion for Partial Reconsideration (Re: Decision dated 14 August 2015)** are **DENIED** for lack of merit.

SO ORDERED.

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

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

ERLINDA P. UY
Associate Justice

[13] Docket, pp. 267-276.