REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

THIRD DIVISION

POWER SECTOR ASSET AND LIABILITIES CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8475
Re: Assessment

Members:

Bautista, Chairperson,
Fabon-Victorino, and
Ringpis-Liban *JJ.*

Promulgated:

DEC 02 2014
2:00 p.m.

x--x

DECISION

RINGPIS-LIBAN, J.:

This is a Petition for Review [1] pursuant to Section 228 [2] of the National Internal Revenue Code of 1997 (Tax Code), as amended, filed by petitioner Power Sector Assets and Liabilities Corporation (PSALM) on April 18, 2012 seeking for the cancellation and withdrawal of Assessment No. VT-08-00072 [3] for deficiency Value-Added Tax (VAT) issued against it by respondent Commissioner of Internal Revenue in the total amount of **TEN BILLION ONE HUNDRED THREE MILLION ONE HUNDRED FIFTY EIGHT THOUSAND SEVEN HUNDRED FIFTEEN and 06/100 PESOS (₱10,103,158,715.06),** inclusive of penalties and interest, for the taxable year-ending December 31, 2008.

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[1] Docket, pp. 6 to 59, including Annexes.
[2] Section 228. Protesting an Assessment. - xxx xxx xxx
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 (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, executor and demandable.
[3] Exhibit "R-11".

THE FACTS

Petitioner is a Philippine government-owned entity created under Section 49 of Republic Act (R.A.) No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA) which took ownership of all existing National Power Corporation (NPC) generation assets, liabilities, Independent Power Producer (IPP) contracts, real estate and all other disposable assets. Furthermore, it was mandated to manage the orderly sale, disposition, and privatization of NPC generation assets, real estate and other disposable assets, and IPP contracts with the objective of liquidating all NPC financial obligations and stranded contract costs in an optional manner [4].

Respondent is the duly appointed Commissioner of Internal Revenue (CIR), vested with authority to carry out all the functions, duties and responsibilities of the Bureau of Internal Revenue (BIR), including *inter alia*, the power to decide, approve and grant claims for refund or tax credit of internal revenue taxes. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City where she may be served with notices and other processes of this Honorable Court.

On June 9, 2011, respondent issued a Final Assessment Notice (FAN) [5] covered by Assessment VT-08-00072, alleging that for the taxable year-ending December 31, 2008, petitioner has an alleged deficiency VAT of ₱10,103,158,715.06, inclusive of penalties and interest, computed and broken down as follows [6]:

Taxable Sales per return		-
Add: Adjustments		
Proceeds from sales of generating assets	₱53,859,322,483.00	
Proceeds from lease of Naga Complex	172,096,188.00	
Collection of Income	9,183,364.00	
Collection of Receivables	1,148,257.00	₱54,041,750,292.00
Total Proceeds to be subject to VAT		54,041,750,292.00
Output Tax		6,485,010,035.04
Less: Creditable Input Tax		
Input tax carried over from previous quarter	30,364,192.07	
Input tax claimed per VAT return	14,932,013.06	
Total Input tax per VAT return	45,296,205.13	
Less: Excess Input Tax Carried Over to Succeeding Period	45,296,205.13	-
Value Added Tax Due		6,485,010,035.04

[4] Paragraph 1, Joint Stipulation of Facts and Issues (JSFI); Docket, pp. 143-149.
[5] Exhibit "R-9".
[6] Paragraphs 6 and 8, JSFI; Docket, pp. 143-149.

Less: VAT payments		-
Deficiency Value Added Tax		6,485,010,035.04
Add: Increments		
Interest	3,618,098,680.02	
Penalty	50,000.00	3,618,148,680.02
TOTAL DEFICIENCY VAT		**₱ 10,103,158,715.06**

On July 7, 2011, petitioner filed its administrative protest against the FAN with the Large Taxpayers Service (LTS) of the LT Audit and Investigation Division II (LTAID) of the BIR. On September 5, 2011, petitioner filed its supplemental protest reiterating its substantive defenses.

On March 19, 2012, respondent issued the Final Decision on the Disputed Assessment (FDDA) denying petitioner's protest for lack of factual and legal basis [7].

Aggrieved thereby, petitioner filed herein Petition for Review [8].

In her Answer [9], respondent interposed the following special and affirmative defenses: ***(1)*** petitioner PSALM is liable to pay deficiency VAT for failure to declare gross receipts [10] subject to VAT in its VAT returns for the year-ending December 31, 2008; ***(2)*** Section 105 of the Tax Code, as amended, provides that any person who in the course of trade or business, sells, barters, exchanges, leases goods or properties and renders services shall be subject to VAT imposed in Section 106 and 108 of the same code; and, ***(3)*** Revenue Regulation (RR) No. 04-2007, amending relevant provisions of RR No. 16-2005, subjected to VAT the sale of real properties not primarily held for sale or for lease but used in business.

On August 3, 2012, respondent filed her Pre-Trial Brief [11]. Petitioner, on the other hand, filed its Pre-Trial Brief [12] on August 14, 2012.

Thereafter, both parties submitted their Joint Stipulation of Facts and Issues [13] (JSFI) on September 26, 2012. However, this Court in a Resolution [14] dated October 2, 2012, directed both parties to submit a Supplemental Joint

7 Paragraph 13, JSFI, *Docket*, pp. 143 - 149.
8 ***Ibid.***
9 Docket, pp. 91-103.
10 Petitioner's Statement of Cash Flows for the year-ending December 31, 2008; Docket, p. 759 marked as Exhibit "O"
11 Docket, pp. 110-118.
12 Docket, pp. 119-125.
13 Docket, pp. 143-149.
14 Docket, p. 151.

Stipulation of Facts and Issues since their initial JSFI failed to indicate the list of documents and witnesses for presentation as well as the hearing dates agreed upon.

In compliance, both parties submitted their Supplemental Joint Stipulation of Facts and Issues [15] on November 5, 2012. Still feeling the need to include additional documents, the parties further submitted a Second Supplemental Joint Stipulation of Facts and Issues [16] on January 30, 2013. This Court approved the same in our Resolution [17] dated February 20, 2013. Accordingly, this Court issued a Pre-Trial Order [18] on March 1, 2013, declaring the pre-trial terminated and ordering petitioner to proceed with the initial presentation of its evidence.

On April 3, 2013, this Court issued an Order [19] transferring the case to this Court's Third Division, chaired by Hon. Lovell R. Bautista, pursuant to CTA Administrative Circular No. 01-2013 [20].

On June 24, 2013, petitioner filed its Formal Offer of Evidence [21], offering Exhibits "A" to "AAAAA", inclusive of sub-markings. In response, respondent filed her Comment (Re: Petitioner's Formal Offer of Evidence [22]) on July 9, 2013, stating she has no objection to the admission of petitioner's enumerated exhibits, without however, necessarily admitting the materiality, relevancy, and probative value as well as the validity of the purpose for which the said exhibits were offered in evidence.

In a Resolution [23] dated July 15, 2013, this Court admitted all exhibits formally offered by petitioner and deemed the latter to have rested its case. Then, on September 24, 2013, respondent filed her Formal Offer of Evidence [24], offering Exhibits "R-1" to "R-18", inclusive of sub-markings. In its Comment [25], petitioner objected to the admission of respondent's formal offer of evidence for being baseless and self-serving. In the October 17, 2013 Resolution [26], this Court admitted all of respondent's exhibits and further

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15 *Docket*, pp. 182-190.
16 *Docket*, pp. 642-645.
17 *Docket*, p. 651.
18 *Docket*, pp. 653-661.
19 *Docket*, p. 662.
20 "Reorganizing the Three (3) Divisions of the Court of Tax Appeals" dated March 26, 2013.
21 *Docket*, pp. 674-1302.
22 *Docket*, pp. 1309-1312.
23 *Docket*, pp. 446-447.
24 *Docket*, pp. 1336-1383.
25 Filed on October 8, 2013, Docket pp. 1384-1385.
26 *Docket*, pp. 1387-1388.

ordered both parties to submit their respective memoranda within thirty (30) days thereafter.

On December 6, 2013, petitioner submitted its Memorandum [27], while respondent submitted her Memorandum [28] on December 20, 2013.

Thus, this Court, in a Resolution [29] dated January 2, 2014, deemed the case submitted for decision.

STATEMENT OF ISSUES

The issues raised [30] by the parties for this Court's determination are as follows:

I.

Whether or not the BIR's 13 May 2002 Ruling No. 20-2002 regarding petitioner's exemption from VAT relative to NPC's sale of its asset pursuant to R.A. 9136 has been repealed by R.A. 9337;

II.

Whether or not petitioner is liable for VAT deficiency, corresponding surcharges, interest and penalties of ₱10,103,158,715.06 for the fiscal year-ending on December 31, 2008;

III.

Whether or not the respondent's disallowance of input tax credits of ₱45,296,205.13 for taxable year 2008 is valid and legal; and,

IV.

Whether or not petitioner is liable to pay Compromise Penalty.

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27 *Docket*, pp. 1417-1442.
28 *Docket*, pp. 1443-1456
29 *Docket*, p. 1458.
30 Issues, JSFI, *Docket*, pp. 147-148.

THE COURT'S RULING

Prior to this Court's determination of the present Petition for Review on its merits, this Court shall pass upon the timeliness of the filing the same. Section 228 of the Tax Code, as amended, provides for the prescriptive periods to be observed in the case of assessment for deficiency VAT, as follows:

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

In the instant case, petitioner received the FAN issued by respondent on June 10, 2011 holding it liable for deficiency VAT in the total amount of ₱10,103,158,715.06, inclusive of penalties and interest, for taxable year-ending 2008.

On July 7, 2011, or within the thirty-day period prescribed under the afore-quoted provision of the Tax Code, petitioner filed its administrative protest against the FAN with the BIR LTAID. Thereafter, on September 5, 2011, within the sixty-day period likewise prescribed under the same Tax Code, petitioner filed its supplemental protest reiterating its substantive defenses and submitted therewith all relevant documents it deemed sufficient to support its protest.

On March 19, 2012, respondent issued the FDDA denying petitioner's protest for lack of factual and legal basis. Pursuant to Section 228 of the Tax Code, as amended, if the protest is denied in whole or in part, the taxpayer may appeal the denial to this Court within thirty (30) days from receipt of the decision. Thus, counting thirty (30) days therefrom, petitioner had until April 18, 2012 within which to file its appeal with this Court.

Petitioner filed the instant Petition for Review on April 18, 2012. Since the petition was filed on time, this Court has jurisdiction to take cognizance of the same pursuant to Section 7(a)(2) of R.A. No. 1125, as amended by Section 7 of R.A. No. 9282[31].

The Court shall now proceed to resolve this case on the merits.

BIR Ruling No. 20-2002 Has Been Superseded by the Enactment of R.A. No. 9337 Making Petitioner Liable for Deficiency VAT

Based on the assessment sought to be cancelled by petitioner, respondent subjected the following proceeds[32] to VAT to arrive at the alleged deficiency VAT assessment:

Sale of Generating Assets	P 53,859,322,483.00
Lease of the Naga Complex	172,096,188.00
Collection of Income	9,183,364.00
Collection of Receivables	1,148,257.00
TOTAL	**54,041,750,292.00**

[31] **Section 7. Jurisdiction.** - The CTA shall exercise:

a. Exclusive appellate jurisdiction to review by appeal, as herein provided:

xxx xxx xxx

2. Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relations thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period of action, in which case the inaction shall be deemed a denial; *x x x.*

[32] Par. 9, JSFI, *Docket*, pp. 143-149

Petitioner argues that the proceeds from the privatization of NPC's assets totalling an aggregate amount of ₱54,041,750,292.00 is not subject to VAT, hence, making petitioner not liable for the assessed deficiency VAT for the year-ending December 31, 2008. In the sale of generating assets, lease of Naga Complex and collection of Income and Receivables, petitioner maintains that the repeal of NPC's VAT-exemption does not affect its VAT-exemption since it does not base its exemption on R.A. 6395 [33] but rather on R.A. 9136 or the EPIRA.

Petitioner is a government-owned and controlled corporation created pursuant to Section 49[34] of the EPIRA, the principal purpose of which is to manage the orderly sale, disposition and privatization of NPC generation assets, real estate and other disposable assets, and IPP contracts with the objective of liquidating all NPC financial obligations, stranded contract costs, and stranded debts in an optimal manner.[35]

In the performance of its functions and for the attainment of its objectives, petitioner shall have the power to, among others, "formulate and implement a program for the sale and privatization of the NPC assets and IPP contracts"[36] and "to sell or dispose of the same at such price and under such terms and conditions as it may deem necessary or proper, subject to applicable laws, rules and regulations."[37] Thus, the subsequent repeal of NPC's charter by R.A. 9337 or the Expanded Value-Added Tax Law[38], effectively subjecting NPC's sale of electricity to VAT, has no impact whatsoever on either petitioner's privatization activities or its exemption from VAT.

In support of the foregoing arguments, petitioner offered BIR Ruling No. 20-2002 dated May 13, 2002 where the BIR opined that, based on the enactment of EPIRA creating PSALM and granting it specific powers and

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33 An Act Revising the Charter of the National Power Corporation.

34 "**SECTION 49.** ***Creation of Power Sector Assets and Liabilities Management Corporation.*** - There is hereby created a government-owned and -controlled corporation to be known as the "Power Sector Assets and Liabilities Management Corporation", hereinafter referred to as the "PSALM Corp.", which shall take ownership of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets. All outstanding obligations of the NPC arising from loans, issuances of bonds, securities and other instruments of indebtedness shall be transferred to and assumed by the PSALM Corp. within one hundred eighty (180) days from the approval of this Act."

35 "**SECTION 50.** ***Purpose and Objective, Domicile and Term of Existence.*** - The principal purpose of the PSALM Corp. is to manage the orderly sale, disposition, and privatization of NPC generation assets, real estate and other disposable assets, and IPP contracts with the objective of liquidating all NPC financial obligations and stranded contract costs in an optimal manner."

36 Section 51 (a), EPIRA.

37 Section 51 (b), EPIRA.

38 An Act Amending Sections 27, 28, 34, 106, 107, 108, 109, 110, 111, 112, 113, 114, 116, 117, 119, 121, 148, 151, 236, 237 and 288 of the National Internal Revenue Code of 1997, as amended, and for other purposes.

functions, petitioner's privatization activities are not made in the course of trade or business, and should not therefore be subjected to VAT. The pertinent portion of the ruling reads as follows:

> "**C. *Privatization of Assets.***
>
> xxx xxx xxx
>
> **2. Privatization of assets by PSALM is not subject to VAT –**
>
> Pursuant to Section 105 in relation to Section 106, both of the Tax Code of 1997, a value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods, is collected from any person, who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, which tax shall be paid by the seller or transferor.
>
> The phrase 'in the course of trade or business' means the regular conduct or pursuit of a commercial activity, including transactions incidental thereto.
>
> <u>Since the disposition or sale of the assets is a consequence of PSALM's mandate to ensure the orderly sale or disposition of the property and thereafter to liquidate the outstanding loans and obligations of NPC, utilizing the proceeds from sales and other property contributed to it, including the proceeds from the Universal Charge, and not conducted in pursuit of any commercial or profitable activity, including transactions incidental thereto, **the same will be considered an isolated transaction, which will therefore not be subject to VAT**</u>. (BIR Ruling No. 113-98 dated July 23, 1998)" *(Underscoring ours)*

Based thereon, petitioner posits that the sale of NPC's generating assets, lease of the Naga complex, collection of income, and collection of receivables were neither made in petitioner's ordinary course of trade or business nor were they incidental thereto because they were not carried out in pursuit of a commercial or an economic activity, but are to be considered as isolated transactions, hence, the not subject to VAT in accordance with Section 105 of the Tax Code, as amended.

Contrary to petitioner's position, respondent contends that upon the enactment of R.A. 9337 on July 1, 2005, the electric power system was subjected to the VAT system. Since BIR Ruling No. 020-2002 was issued based on the law existing at that time, the EPIRA, a subsequent enactment, effectively supersedes said BIR Ruling.

Part "V" of the said BIR Ruling states that:

> "V. ***Requested Ruling***
>
> In reply, please be informed that the transactions arising from or relating to the privatization of NPC will be taxed in the manner described below. In this connection, it is to be noted that this ruling shall apply only to the facts as represented, in connection with the applicable provisions of the EPIRA, the IRR, the Tax Code of 1997 and related laws existing as of the date of the ruling." *(Underscoring ours)*

Thus, respondent claims that petitioner cannot postulate that BIR Ruling N. 20-2002 is still in consonance with the amendments of R.A. 9337 since Sections 106 and 108 of the Tax Code have been amended.

We find petitioner's arguments bereft of merit.

Section 105 of the Tax Code provides that any person who, in the course of its trade or business, sells, barters, exchanges, leases goods or properties and renders services shall be subject to VAT imposed in section 106 or 108, as follows:

> "**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."

Based on the records of the case, it is undisputed that the enactment of R.A. 9337 on July 1, 2005 placed the Electric Power Industry under the VAT system. Particularly, the amended provisions therein mandated that the sale of electricity by generation companies, transmission and distributions companies shall be subject to VAT on the basis of Sections 106 and 108 of the Tax Code, as amended.

Sections 106 and 108, as amended, now reads as follows:

> **"SEC. 106. *Value-Added Tax on Sale of Goods or Properties. -***
>
> (A) *Rate and Base of Tax.* - There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor.
>
> (1) The term **'goods or properties'** shall mean all tangible and intangible objects which are capable of pecuniary estimation and shall include:
>
> (a) Real properties held primarily for sale to customers or held for lease in the ordinary course of trade or business;
>
> (b) The right or the privilege to use patent, copyright, design or model, plan secret formula or process, goodwill, trademark, trade brand or other like property or right;
>
> (c) The right or the privilege to use in the Philippines of any industrial, commercial or scientific equipment;
>
> (d) The right or the privilege to use motion picture films, films, tapes and discs; and
>
> (e) Radio, television, satellite transmission and cable television time.
>
> The term **'gross selling price'** means the total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax. The excise tax, if any, on such goods or properties shall form part of the gross selling price.

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.

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 xxx lessors of property, whether personal or real xxx sales of electricity by generation companies, transmission, and distribution companies; xxx"

Section 106 imposes VAT on "all kinds of goods and properties" sold in the Philippines. The term "goods and properties" have been given an all-encompassing meaning to include the sale of the generation assets of petitioner. Therefore, the sale of the Masinloc Plant, Ambuklao/Binga and the collection from the Pantabangan sales fall under that umbrella and should be deemed subject to VAT unless some provision of law expressly exempts it.

Likewise, Section 108 imposes VAT on gross receipts of lessors of property and to those arising from the sale of electricity by generation companies, transmission and distribution companies.

With the enactment of R.A. No. 9337, the electric power industry's main business activities were made subject to VAT. Therefore, by classifying petitioner's income from its main business activity as subject to VAT, it follows that its incidental income shall likewise be subject to VAT.

Accordingly, RR No. 16-2005 was amended by RR No. 4-2007 to be in harmony with the amendments of RA No. 9337 and subjected the sale of real properties not primarily held for sale or for lease but used in business to VAT, to wit:

"SEC.4.109-1 ***VAT-Exempt Transactions –***

xxx xxx xxx

> (B) *Exempt Transactions* – Subject to the provisions of Sec.4.109-2 hereof, the following transactions shall be exempt from VAT:
>
> xxx xxx xxx
>
> (p) The following sales of real properties are exempt from VAT, namely:
>
> (1) Sale of real properties not primarily held for sale to customers or held for lease in the ordinary course of trade or business.
>
> <u>However, even if the real property is not primarily held for sale to customers or held for lease in the ordinary course of trade or business but the same is used in the trade or business of the seller, the sale thereof shall be subject to VAT being transactions incidental to the taxpayer's main business</u>." *(Underscoring ours)*

Based on the foregoing, if petitioner's property is one used in trade or business, the sale thereof shall be subject to VAT being a transaction incidental to its main business. The term "incidental" shall mean 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.[39] Hence, even if petitioner's property is classified as being not primarily held for sale or lease in the ordinary course of trade or business, the provision of exemption is negated by the fact that it is incidental to its main business and not merely an isolated transaction.

Clearly, the sale by petitioner of its generating assets regarded as real properties used in trade or business and the lease of its Naga Complex shall be subject to VAT under Sections 106 and 108 of the Tax Code, as amended by R.A. No. 9337. There is no provision under the Tax Code that exempts the said transactions from VAT nor subjects it as zero-rated.

Further, on the basis of R.R. No. 04-2007, the proceeds of petitioner from the collection of income and collection of receivables, being incidental to its business of privatization of National Power Corporation assets, is deemed a transaction subject to VAT.

In summary, it is clear from the provisions of R.A. No. 9337 amending Sections 106 and 108 of the Tax Code, and also the provisions of R.R. No. 04-2007 amending R.R. No. 16-2005 that petitioner is an entity subject to VAT.

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[39] *Magsaysay Lines, Inc. et al. vs. Commissioner of Internal Revenue,* CTA Case No. 4353, April 27, 1992.

Hence, the proceeds from sale of generating assets, lease of Naga complex and the collection of income and receivables stated in its Statement of Cash Flows for the year-ending December 31, 2008 were correctly assessed by respondent to be subject to VAT and therefore making petitioner liable to pay deficiency VAT inclusive of interest as provided by the Tax Code.

The Proceeds arising from privatization activities of petitioner remains to be the same computed as follows:

Taxable Sales per return		-
Add: Adjustments		
Proceeds from sales of generating assets	P53,859,322,483.00	
Proceeds from lease of Naga Complex	172,096,188.00	
Collection of Income	9,183,364.00	
Collection of Receivables	1,148,257.00	P54,041,750,292.00
Total Proceeds to be subject to VAT		**54,041,750,292.00**

Petitioner is Entitled to Claim Input Tax Credits Amounting to ₱45,296,205.13 Representing Excess Input Tax Carried Over to Succeeding Period in the Books of Petitioner.

Petitioner also disputes respondent's disallowance of input tax credits of ₱45,296,205.13 for taxable year-ending 2008. Petitioner primarily argues that the assessment has no factual or legal basis for the disallowance of the said tax credits.

In the Details of Discrepancies attached to the FAN, respondent expounded on why the proceeds arising from petitioner's privatization activities was subject to the imposition of VAT. However, no details were included as to why the assessment did not consider the previous year's input tax carry-over and the current year's input tax payments as allowable credits towards the assessed VAT liability against petitioner.

In her memorandum filed December 20, 2013, respondent likewise failed to support her position in disallowing the said input tax credits. Respondent rested her case by arguing that determination [of taxes] and assessments are presumed correct and made in good faith[40] and that all presumptions are in favor of the correctness of tax assessments.[41]

In support of sustaining input tax credits, petitioner maintains that since the income derived from the 2008 privatization of NPC's assets cannot be subjected to VAT, petitioner did not have any vatable sale transactions in the said taxable year against which it could apply its input VAT. Therefore, they opted to carry-forward and accumulate the input VAT credits. In other words, petitioner did not use any input tax credits in taxable year 2008 since it had no output tax to declare, as shown in its VAT Returns.[42]

We find for petitioner.

Section 110(B) of the Tax Code provides for the rule regarding excess input tax, as follows:

> "**(B)** ***Excess Output or Input Tax.*** – If at the end of any taxable quarter the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person. <u>If the input tax exceeds output tax, the excess shall be carried over to the succeeding quarter or quarters</u>. Provided, however, that any input tax attributable to zero-rated sales by a VAT-registered person may at his option be refunded or credited against other internal revenue taxes, subject to the provisions of Section 112." *(Underscoring ours)*

As clearly indicated in the FAN, respondent disallowed input tax credits equivalent to an aggregate amount of ₱45,296,205.13 representing: (1) input tax carried over from previous quarter; and (2) input tax claimed per VAT returns.

Petitioner relied on BIR Ruling No. 20-2002 and the EPIRA -- on which the former was based -- when it posited that the transactions of petitioner arising from privatization activities were not subject to VAT. In its Annual Audit Report for the year-ending December 31, 2008, the Commission on Audit (COA) verified petitioner's representation that its sales income arose solely from privatization activities. Hence, as earlier stated, petitioner did not have any output VAT adjunct to its sales transactions to which existing tax credits for the year 2008 may be credited and it therefore opted to carry it forward.

[40] *Commissioner of Internal Revenue vs. Raul M. Gonzales et al.*, G.R. No. 177279, October 13, 2010.
[41] *Sy Po vs. Court of Tax Appeals*, G.R. No. L-81446, August 18, 1988.
[42] Exhibits "A" to "N".

To prove that input tax credits carried over to the year 2009 were intact and remained unused, petitioner submitted to this Court its quarterly VAT returns for the year 2007[43], its monthly VAT declarations and Quarterly VAT returns for the year 2008[44] and its quarterly VAT return for the first quarter of 2009[45].

This Court earlier ruled that proceeds arising from the privatization activities of petitioner are properly subject to VAT. We find that input tax credits should be allowed in finally determining the VAT liability of petitioner, inclusive of allowable penalties. Had petitioner allowed output tax to be imposed on its gross receipts during 2008 as the transactions took place, all available tax credits incurred and accumulated within the same year could have been used against the determined VAT liability arising from any proceeds from income generating activities.

Output Tax		P 6,485,010,035.04
Less: Creditable Input Tax		
Input tax carried over from previous quarter	30,364,192.07	
Input tax claimed per VAT return	14,932,013.06	45,296,205.13
Value Added Tax Due		6,439,713,829.91
Less: VAT payments		-
DEFICIENCY VALUE-ADDED TAX		**P 6,439,713,829.91**

Petitioner is Not Liable for the Imposition of Compromise Penalty Amounting to ₱50,0000.00, There Being No Compromise Agreement Between the Parties.

Respondent argues that the twenty percent (20%) interest and compromise penalty were imposed pursuant to Section 249 of the Tax Reform Act of 1997, as amended and Revenue Memorandum Order (RMO) No 01-1990, as amended by RMO 119-2007.[46]

As regards the imposition of interest, we partially agree with petitioner. The Court finds no basis for respondent's imposition of compromise penalty in light of the long-standing rule that compromise penalties are amounts

43 Exhibit A.
44 Exhibits "B" to "M".
45 Exhibit "N".
46 Respondent's Memorandum dated December 19, 2013, *Docket*, p. 1453.

suggested in settlement of criminal liability, and may not therefore, be imposed or exacted on the taxpayer.[47]

Paragraphs 4 and 5 of Part III (Guidelines and Instructions) of the RMO No. 01-1990 (Amendments to the provisions of a "Revised Schedule of Compromise Penalties" for internal revenue violators as prescribed by RMO 02-1986", dated November 28, 1989) provides, as follows:

> "x x x 4. Although all amounts of compromise penalties incident to violations shall be itemized in the assessment notice and/or demand letter along with the other administrative penalties like surcharge and interest, the same should not form part of the total amount assessed/demanded but should appear separately as a suggestion to the taxpayer to pay in lieu of criminal prosecution. If paid, the compromise penalties shall be collected and accounted for under the usual procedures, as internal revenue.
>
> 5. Since 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, the violation shall be referred from criminal action as heretofore mentioned. x x x" *(Underscoring ours)*

The Court has no jurisdiction to compel a taxpayer to pay the [assessed] compromise penalty. By its very nature, a compromise penalty implies mutual agreement between the parties with respect to the thing or subject matter which is so compromised, and the choice of paying it or not paying it distinctly belongs to the taxpayer. Absent any showing that petitioner consented to the compromise penalty, the same should not be imposed, otherwise, its imposition is illegal and unauthorized. Considering that petitioner did not indicate its conformity to the imposition of the compromise penalty, the compromise penalty is cancelled.[48]

As regards the penalty interest, records show that respondent failed to indicate in the FAN the factual basis for the determination of the period in which the imposed penalty interest is computed. In Revenue Memorandum

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47 *Filpride Resources Incorporated vs. Commissioner of Internal Revenue,* CTA Case No. 8233, November 12, 2013; *Kepco Ilijan Corporation vs. Commissioner of Internal Revenue,* CTA Case No. 8091, October 23, 2012; *Platinum Plans Phil., Inc. vs. Commissioner of Internal Revenue,* CTA Case No. 7878, September 7, 2011.

48 *Saranggani Resources Corporation vs. Commissioner of Internal Revenue,* CTA Case No. 8105, November 5, 2013 *citing The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et al.,* G.R. Nos. L-12928 and L-12932, March 31, 1962 and *Commissioner of Internal Revenue vs. Lianga Bay Logging Co.,* G.R. No. 35266, January 21, 1999.

Circular (RMC) No. 46-1999, the BIR illustrated the computation of the penalty interest incident to deficiency or delinquency taxes which commences from the last day prescribed by law for filing a return.

Accordingly, petitioner's VAT liability is modified, computed as follows:

Deficiency Value Added Tax		₱ 6,439,713,829.91
Add: Increments		
Interest (01-25-2009 [49] to 06-30-2011 [50])	P 3,126,348,741.53	
Compromise Penalty	-	3,126,348,741.53
Total Deficiency VAT		**₱ 9,566,062,571.44**

WHEREFORE, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessments issued by respondent against petitioner covering taxable year 2008 for deficiency value-added tax are **UPHELD** but in the **MODIFIED AMOUNT** of **NINE BILLION FIVE HUNDRED SIXTY SIX MILLION SIXTY TWO THOUSAND FIVE HUNDRED SEVENTY ONE and 44/100 PESOS (₱9,566,062,571.44)**, inclusive of twenty percent (20%) interest imposed upon Section 249(A) of the Tax Code, as amended.

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

a) Deficiency interest at the rate of 20% per annum on the basic deficiency VAT of ₱6,439,713,829.91 computed from June 30, 2011 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997;

b) Delinquency interest at the rate of 20% per annum on the basic deficiency VAT of ₱6,439,713,829.91 June 30, 2011[51] until full payment thereof pursuant to Section 249(C)(3) of the NIRC of 1997, as amended; and

c) Delinquency interest at the rate of 20% per annum on the deficiency interest which have accrued as afore-stated in (a) computed from June

49 Last day prescribed by law for filing VAT return for the fourth quarter for the year 2008 pursuant to Section 114 of the Tax Code.
50 End-date stated in the FAN dated June 9, 2011.
51 "xxx it must be emphasized that the imposition of said delinquency interest shall commence from the lapse of the period indicated in the assessment notice within which the assessed basic tax due and corresponding increments must be paid because it is only then that the taxpayer shall be considered to have failed to pay the deficiency tax the surcharge and the interest thereon, and shall continue to run "until the amount is fully paid". (*Takenaka Corporation Philippine Branch vs. Commissioner of Internal Revenue*, CTA Case No. 7701, March 8, 2011)

30, 2011 until full payment thereof pursuant to Section 249(C)(3) of the NIRC of 1997, as amended.

SO ORDERED.

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

ATTESTATION

I attest that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

LOVELL R. BAUTISTA
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13 of Article VIII of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the above Decision has been reached in consultation with the members of the Court in Division before the case was assigned to the writer of the opinion of this Court.

ROMAN G. DEL ROSARIO
Presiding Justice