REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

EL PASO PHILIPPINES ENERGY COMPANY, INC., Petitioner,	**CTA CASE NO. 8013**
	Members:
- versus -	**CASTAÑEDA, JR.,** *Chairperson,* **CASANOVA,** *and* **COTANGCO-MANALASTAS,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: MAY 1 8 2015 3:53 pm

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RESOLUTION

CASTAÑEDA, JR., *J.*:

For resolution are:

(1) Respondent's **Motion for Partial Reconsideration** filed on March 5, 2015, with petitioner's **Comment (Re: Motion for Partial Reconsideration dated 4 March 2015)** filed on March 27, 2015; and

(2) Petitioner's **Motion for Partial Reconsideration** filed on March 11, 2015, without respondent's comment despite notice.

Both petitioner and respondent seek partial reconsideration of the Court's Decision dated February 23, 2015, the dispositive portion of which reads as follows:

WHEREFORE, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessments issued by respondent against petitioner for taxable year 2004 covering deficiency income tax in the amount of ₱28,134,150.84, deficiency expanded withholding tax in the amount of ₱186,395.72, deficiency improperly accumulated earnings tax in the amount of ₱35,153,053.99 and compromise penalty in the amount of ₱25,000 are hereby **CANCELLED** and **WITHDRAWN**. However, respondent's assessments covering deficiency value-added tax and final withholding tax for taxable year 2004 are hereby **AFFIRMED**, and petitioner is held liable to pay the modified amount of ₱12,120,947.06, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, computed as follows:

	BASIC TAX	**SURCHARGE**	**TOTAL**
Value-added Tax	₱ 3,258,957.25	₱ 814,739.31	₱ 4,073,696.56
Final Withholding Tax	6,437,800.40	1,609,450.10	8,047,250.50
Total	**₱9,696,757.65**	**₱2,424,189.41**	**₱ 12,120,947.06**

In addition, petitioner is held liable to pay:

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT in the amount of ₱3,258,957.25 and basic FWT in the amount of ₱6,437,800.40 computed from January 25, 2005 and January 15, 2005, respectively, until full payment thereof, pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) Delinquency interest at the rate of 20% per annum on the total amount of ₱12,120,947.06 and on the deficiency interest which have accrued as afore-stated in (a) computed from December 2, 2009 until full payment thereof, pursuant to Section 249 (C) of the NIRC of 1997, as amended.

SO ORDERED.

Respondent's Motion for Partial Reconsideration

In assailing the aforesaid decision, respondent claims that the Court erred in cancelling the assessment on deficiency Income Tax (IT) in the amount of ₱28,134,150.84, deficiency Expanded Withholding Tax (EWT) in the amount of ₱186,395.72, deficiency Improperly Accumulated Earnings Tax (IAET) in the amount of ₱35,153,053.99 and Compromise Penalty in the amount of ₱25,000 for taxable year 2004.

We deny respondent's Motion for Partial Reconsideration.

After a thorough evaluation of the respondent's arguments, the Court finds the same, *except* as regards the argument on Minimum Corporate Income Tax (MCIT), as mere rehash of what has been extensively passed upon in the assailed Decision.

Respondent invokes for the first time the application of paragraph E(3) of Section 27 of the 1997 National Internal Revenue Code (NIRC),[1] contending that petitioner failed to account whether the latter's losses arose from prolong labor dispute, force majeure and legitimate business reverses.

This argument is misplaced. Section 27(E)(3) of the 1997 NIRC is inapplicable here as it pertains to the conditions wherein the application of MCIT may be suspended. Petitioner never invoked exemption from MCIT. In fact, petitioner recognized its MCIT liability of ₱4,029,039.00 which was later on adjusted by the Court to ₱4,029,139.21.

We reiterate our ruling on the MCIT, as follows:

> xxx Considering that the MCIT will be credited against the normal income tax for the three (3) immediately succeeding taxable years, pursuant to Section 27(E)(2) of the NIRC of 1997, as amended, its benefit will redound on the succeeding years. Thus, it is inappropriate to disallow the same for such is beyond the scope of the present assessment.
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> In fine, notwithstanding the ₱45,008,325.99 adjustments on petitioner's taxable income, representing the sum of petitioner's unaccounted income in the amount of ₱5,001.46 and disallowed interest expense in the amount of ₱45,003,324.53, petitioner still incurred a

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[1] SEC. 27. *Rates of Income Tax on Domestic Corporations.* –

xxx xxx xxx

(E) Minimum Corporate Income Tax on Domestic Corporations. –

xxx xxx xxx

(3) *Relief from the Minimum Corporate Income Tax Under Certain Conditions.* – The Secretary of Finance is hereby authorized to suspend the imposition of the minimum corporate income tax on any corporation which suffers losses on account of prolonged labor dispute, or because of force majeure, or because of legitimate business reverses.

net loss in the amount of ₱390,088,424.04. Thus, petitioner's income tax liability was at the MCIT rate of two percent (2%) based on its gross income for taxable year 2004. However, petitioner's MCIT liability of ₱4,029,039.00 per its 2004 ITR shall be adjusted to ₱4,029,139.21 to reflect the unaccounted income of ₱5,001.46. Since petitioner's income tax credits were more than sufficient to cover its MCIT liability of ₱4,029,139.21, petitioner is not liable to pay any deficiency MCIT for taxable year 2004, as shown below:

Sales/Revenues/Receipts/Fees			₱ 106,529,147.00
Less:	Cost of Sales/Services		9,205,500.00
Gross Income from Operation			₱ 97,323,647.00
Add:	Non-operating and Other Income		104,128,312.00
Total Gross Income			₱ 201,451,959.00
Add:	Unaccounted income		5,001.46
Adjusted Total Gross Income			₱ 201,456,960.46
Less:	Deductions	₱636,548,709.00	
	Less: Disallowed Interest Expense	45,003,324.53	591,545,384.47
Adjusted Net Loss			₱(390,088,424.01)
Minimum Corporate Income Tax Due			₱ 4,029,139.21
Less:	Tax Credits		
	Prior Year's Excess Credits	₱ 10,715,585.00	
	Creditable Tax Withheld for the First Three Quarters	11,286,147.00	
	Creditable Tax Withheld for the Fourth Quarter	4,230,900.00	26,232,632.00
Excess Tax Credits			**₱(22,203,492.79)**

Considering the foregoing, there is no cogent reason to disturb the assailed Decision.

<u>Petitioner's Motion for Partial Reconsideration</u>

Petitioner anchors its Motion for Partial Reconsideration on the following grounds:

A. The Court gravely erred in partially upholding the Value-Added Tax (VAT) assessment against petitioner in the amount of ₱3,258,957.25 when it was clearly established by undisputed Exhibits "BBB" and "CCC", which are public documents issued by the Philippine

Economic Zone Authority (PEZA) that East Asia Utilities Services Corporation (EAUC) is a VAT-exempt entity since 2000 up to the present. Thus, petitioner cannot be assessed for deficiency VAT for services rendered to EAUC; and

B. The Court gravely erred in holding petitioner liable for deficiency Final Withholding Tax (FWT) in the amount of ₱6,437,800.40 as the matter of subrogation was never raised as an issue in the answer of the BIR nor was it specified as an issue during pre-trial such that there is a denial of due process upon petitioner, rendering such declaration null and void.

Deficiency VAT Assessment

Petitioner insists that it presented the Certificate of Registration No. 98-01-U (Exhibit "BBB") and Certificate of Board Resolution, which were both issued by PEZA (Exhibit "CCC"), and the same sufficiently established EAUC as a PEZA-registered enterprise and a VAT-exempt entity. Based on the aforesaid certificates, petitioner asserts that EAUC is exempt from national taxes, including VAT, beginning January 2000 and such exemptions continue as long as petitioner remains in good standing and commits no violation of any of the provisions of Republic Act No. 7916, as amended, the Rules and Regulations implementing the same, and the terms and conditions of the Registration Agreement.

Petitioner further argues that respondent failed to raise in any of the latter's pleading that EAUC violated any of the provisions of the aforementioned law, rules and regulations, and that of the agreement. According to petitioner, respondent neither adduced any testimonial and documentary evidence to prove any violation of the same to revoke the incentives granted, nor raised it as issue during the trial. Petitioner points out that it is a well-settled rule that defenses not raised in the answer are deemed waived. Petitioner assumes that having established EAUC as a PEZA-registered enterprise entitled to incentives, the burden of proving the contrary rests with the respondent and not with the petitioner.

Petitioner's arguments lack merit.

On the argument that EAUC's PEZA registration was never raised as an issue during the entire course of the trial, it bears stressing that paragraph 2 of Section 1, Rule 14 of the Revised Rules of the Court of Tax Appeals (RRCTA) states that "[i]n deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case".

Moreover, a perusal of the records shows that in the Answer[2], respondent specifically denied the allegation that EAUC is a PEZA-registered entity and is exempt from national and local taxes including VAT. Since respondent denied the abovementioned material facts even before the trial has begun, petitioner has to present evidence to clearly establish that EAUC was still PEZA registered enterprise and VAT-exempt entity during taxable year 2004.

The submission of EAUC's Certificate of Registration No. 98-01-U[3] and the Certificate of Board Resolution[4], which were both given by the PEZA respectively on April 27, 1998 and January 28, 2000, failed to convince the court that EAUC was PEZA registered enterprise and VAT-exempt entity during taxable year 2004.

This has already been passed upon by the Court in its Decision, *viz*:

> After examination of EAUC's Certificate of Registration with the PEZA and its accompanying PEZA Board Resolution, the Court finds that the same are not sufficient to prove that EAUC was PEZA-registered in taxable year 2004. Since the registration is subject to the provisions and rules and regulations of Republic Act No. 7916, as well as the terms and conditions of the Registration Agreement, the PEZA registration may be revoked if an entity is in violation of any of the afore-mentioned requirements. **It is imperative therefore that petitioner must prove that EAUC is registered with PEZA in the year 2004,** when the subject management fees were billed to and collected from EAUC, to justify the imposition of VAT at zero percent (0%). Absent the required PEZA certification, the Court is

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[2] Par. 7 of the Answer, docket, p. 237.
[3] Exhibit "BBB", docket, p. 1105.
[4] Exhibit "CCC", docket, p. 1106.

constrained to uphold the deficiency VAT assessment. (Emphasis supplied)

"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."[5]

Deficiency FWT Assessment

Petitioner posits that the Court's basis in awarding FWT in favor of respondent devolves upon the issue of subrogation, which is a matter that was never raised in any of the pleadings in the entire course of the trial nor was it raised as an issue during pre-trial. It is allegedly violative of fair play as petitioner was deprived of the opportunity to meet this issue head on, and a denial of due process. Thus, the award should be declared allegedly as null and void.

Petitioner points out that the award of deficiency FWT in the amount of ₱6,437,800.40 is excessive as the amount sought in the Formal Letter of Demand (FLD) and prayed for in the Answer by respondent was merely ₱1,607,754.27. It is petitioner's stands that the court cannot grant a relief not prayed for in the pleadings or in excess of what is being sought by the party. Petitioner explains that in the FLD, the deficiency FWT was not based on the subrogation between EPEC Netherland Holding B.V and Hollandsche Bank-Unie N.V., but based on the mere comparison of interest expense per Financial Statement (FS) and per alphalist.

Petitioner's arguments lack merit.

We reiterate that "in deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case"[6].

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[5] *Commissioner of Internal Revenue v. Bank of the Philippine Islands,* G.R. No. 134062, April 17, 2007, 521 SCRA 373.
[6] Section 1, Rule 14 of RRCTA.

Under Section 7(a)(1) of Republic Act No. 1125, as amended, the CTA exercises exclusive appellate jurisdiction to review by appeal 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 NIRC or other laws administered by the Bureau of Internal Revenue (BIR).

Based on the foregoing, it is within the Court's jurisdiction to determine the correctness of the assessment which necessarily includes the determination of the correct tax liability of petitioner.

Respondent assessed petitioner on deficiency FWT only in the amount of ₱1,607,754.27. However, upon examination of the evidence presented by petitioner, the Court found a deficiency FWT amounting to ₱6,437,800.40.

Initially, the deficiency FWT is based on the discrepancy on the interest expense per Financial Statement (FS) and per alphalist, computed as follows:

Interest expense:	
Per FS	₱ 133,047,207.00
Per alphalist	128,074,068.80
Difference	**₱ 4,973,138.20**

Petitioner presented documents, such as Reconciliation of Interest Expense Per books and Per BIR Form No. 1701-F[7] and the related documents[8], to account the difference of ₱4,973,138.20.

Based on petitioner's evidence, the interest expense in the amount of ₱133,047,207.00 pertains to the remaining balance of drawdowns made on a loan facility totalling US$54.4 million as of December 31, 2003 from Hollandsche Bank-Unie N.V. of Netherlands, a foreign bank. Further scrutiny of the evidence shows that petitioner's parent company, EPEC Netherland Holdings B.V. of Netherlands, paid the foreign bank on June 30, 2004 in the amount of US$52.4 million out of the US$54.4 million loan. There was

[7] Exhibits "ZZ" and "ZZ-1", docket, pp. 1102-1103.
[8] Exhibits "LL" to "YY" and "KKK-1" to "KKK-14.d", docket, pp. 1064-1101; 1272-1344, respectively.

subrogation when petitioner's parent company paid the loan for and in behalf of petitioner.

Accordingly, the Court correctly applied the 15% tax rate, instead of 10%, after the subrogation on June 30, 2004, pursuant to paragraph 2(b) of Article 11 of the Philippines-Netherlands Tax Treaty. The FWT due on the interest expense claimed by petitioner for taxable year 2004 in the amount of ₱133,047,207.00, is ₱16,318,128.04. After comparing the FWT due of ₱16,318,128.04 against the FWT remittances of ₱9,880,327.64, the Court finds petitioner liable for deficiency FWT of ₱6,437,800.40.

It is worthy to emphasize that the assessment on deficiency FWT was upheld, notwithstanding the incorrect rate previously applied in the assessment, and the amount thereof was modified based mainly on the evidence presented by petitioner. In the case of *Commissioner of Internal Revenue v. Court of Appeals, Citytrust Banking Corporation and Court of Tax Appeals*[9], it has been ruled that the government is not bound by the errors committed by its agents, *viz*:

> It is a long and firmly settled rule of law that the Government is not bound by the errors committed by its agents. In the performance of its governmental functions, the State cannot be estopped by the neglect of its agent and officers. Although the Government may generally be estopped through the affirmative acts of public officers acting within their authority, their neglect or omission of public duties as exemplified in this case will not and should not produce that effect.
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> Nowhere is the aforestated rule more true than in the field of taxation. It is axiomatic that the Government cannot and must not be estopped particularly in matters involving taxes. Taxes are the lifeblood of the nation through which the government agencies continue to operate and with which the State effects its functions for the welfare of its constituents. The errors of certain administrative officers should never be allowed to jeopardize the Government's financial position, especially in the case at bar where the amount involves millions of

[9] G.R. No. 106611, July 21, 1994, 234 SCRA 348.

> pesos the collection whereof, if justified, stands to be prejudiced just because of bureaucratic lethargy.
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> xxx xxx xxx
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> In fact, as the Court of Tax Appeals itself has heretofore conceded, it would be only just and fair that the taxpayer and the Government alike be given equal opportunities to avail of remedies under the law to defeat each other's claim and to determine all matters of dispute between them in one single case. It is important to note that in determining whether or not petitioner is entitled to the refund of the amount paid, it would necessary to determine how much the Government is entitled to collect as taxes. This would necessarily include the determination of the correct liability of the taxpayer and, certainly, a determination of this case would constitute res judicata on both parties as to all the matters subject thereof or necessarily involved therein.

Meanwhile, the Court finds no legal and factual basis on petitioner's alleged violation of due process. One of the most basic and fundamental precepts of law enshrined in the Constitution is that no person shall be deprived of his property without due process of law (Section 1, Article III of the 1987 Constitution).

Here, the Assessment Notice was duly issued and received by petitioner, thus it was informed of the tax assessment against it. The Court examined carefully the evidence presented in order to award the correct tax liability of petitioner due the government. It is unfortunate that respondent's agent made mistake in the application of the appropriate tax rate.

"Along with police power and eminent domain, taxation is one of the three basic and necessary attributes of sovereignty. Taxes are the lifeblood of the government and their prompt and certain availability is an imperious need. It is through taxes that government agencies are able to operate and with which the State executes its functions for the welfare of its constituents. It is for this reason that we cannot let petitioner's oversight bar the government's rightful claim."[10] Accordingly, the Court deems it just and fair to apply the correct tax rate in this case, resulting to an increase in petitioner's tax liability.

WHEREFORE, in view thereof, both respondent's and petitioner's **Motions for Partial Reconsideration** are **DENIED** for lack of merit.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

CAESAR A. CASANOVA
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

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[10] *Commissioner of Internal Revenue v. Manila Bankers' Life Insurance Corporation*, G.R. No. 169103, March 16, 2011, 645 SCRA 500,519.