REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

Third Division

ICONIC BEVERAGES, INC.,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8813

Members:

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

Promulgated:

AUG 09 2016
11:15 a.m.

x -- x

DECISION

BAUTISTA, J:

The Case

This is a Petition for Review[1] pursuant to *Section 3(a)(1)*[2], *Rule 4 of the Revised Rules of the Court of Tax Appeals ("RRCTA")*, in relation to *Section 228*[3] *of the National Internal Revenue Code of 1997* (*"1997 NIRC"*)

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[1] *Records, CTA Case No. 8813, Vol. 1, Petition for Review,* pp. 15-84, with annexes.

[2] "SECTION 3. Cases Within the Jurisdiction of the Court in Divisions. — The Court in Divisions shall exercise:

(a) Exclusive original or appellate jurisdiction to review by appeal the following:

(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue; xxx"

[3] "SECTION 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: xxx

The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) to appeal the denial of respondent Commissioner of Internal Revenue ("CIR") of petitioner Iconic Beverages, Inc. ("IBI")'s letter-protest dated November 29, 2013 disputing the assessments issued by the former against the latter in the aggregate amount of One Hundred Seven Sixty Million Nine Hundred Forty-Seven Thousand Twenty-Four Pesos and Sixty Centavos (Php176,947,024.60), inclusive of interest and penalties, representing alleged deficiency Income Tax, Value-Added Tax ("VAT") and administrative penalties for taxable year 2010.[4]

The Parties

IBI is a corporation organized and existing under the laws of the Philippines,[5] with principal place of business at the 40 San Miguel Ave., Mandaluyong City, Philippines.[6]

Respondent is the duly appointed CIR who is tasked to assess and collect all national internal revenue taxes, fees and charges, and enforce all forfeitures, penalties, and fines connected therewith.[7] She holds office at the Bureau of Internal Revenue ("BIR") National Office Building, Agham Road, Diliman, Quezon City.[8]

The Facts

Petitioner received from the BIR Letter of Authority No. 116-2011-00000013 dated July 5, 2011, authorizing the examination of petitioner's books of accounts and other financial records for VAT for the taxable year 2010.[9]

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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 the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable."

[4] *Records, Vol. 1, Petition for Review,* p. 16.

[5] *Id., Vol. 2, Exhibit "P-1," Certificate of Filing of Amended Articles of Incorporation ("AAOI"),* pp. 739-740.

[6] *Id., Exhibit "P-1," AAOI,* p. 740.

[7] *Id., Vol. 1, Joint Stipulation of Facts and Issue ("JSFI"),* p. 553.

[8] *Id.*

[9] *Id., Vol. 2, Exhibit "P-2," VAT Letter of Authority ("LOA"),* p. 747.

Thereafter, petitioner received a Notice for Informal Conference[10] ("NIC") dated August 2, 2013[11] issued by the Large Taxpayers Service of the BIR.[12] The NIC proposed to assess petitioner for deficiency income tax, VAT and administrative penalties in the aggregate amount of Php162,202,504.03.[13]

On September 19, 2011, Letter of Authority No. 116-2011-00000043 was issued by the BIR covering all internal revenue taxes, except for VAT, for the taxable year 2010.[14]

Petitioner received from respondent a Preliminary Assessment Notice[15] ("PAN") dated October 19, 2011[16]. The PAN informed petitioner "that there has been found deficiency Income Tax and [VAT], inclusive of legal increments, for calendar year 2010" in the aggregate amount of Php165,018,629.73, inclusive of interest and compromise penalty.[17] The breakdown of the computation is as follows:[18]

TAX TYPE		BASIC		INTEREST		PENALTY		TOTAL
Income Tax	Php	110,485,702.32	Php	54,425,559.66	Php	50,000.00	Php	164,961,261.98
VAT		18,463.32		9,904.43		4,000.00		32,367.75
Administrative Penalties		-		-		25,000.00		25,000.00
TOTAL	**Php**	**110,504,165.64**	**Php**	**54,435,464.09**	**Php**	**79,000.00**	**Php**	**165,018,629.73**

In a letter[19] dated September 30, 2013, which respondent received on even date, petitioner replied to the PAN.[20]

Thereafter, petitioner received a Formal Letter of Demand[21] ("FLD") dated November 7, 2013, with attached Final Assessment Notices[22] ("FAN"), assessing petitioner for purported deficiency Income Tax and VAT in the aggregate amount of Php168,712,193.64,

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[10] *Records, Vol. 2, Exhibit "P-3," Notice for Informal Conference ("NIC")*, pp. 749-751.
[11] Actual exhibit states August 2, 2013 but JSFI states August 6, 2013.
[12] *Records, Vol. 1, JSFI*, p. 554.
[13] *Id.*
[14] *Id., Vol. 2, Exhibit "P-2.1," Other Taxes LOA*, p. 748.
[15] *Id., Exhibit "P-4," Preliminary Assessment Notice ("PAN")*, pp. 752-756.
[16] Date was not provided in the actual exhibit but JSFI states this date.
[17] *Records, Vol. 2, Exhibit "P-4," PAN*, p. 752.
[18] *Id.*
[19] *Id., Vol. 2, Exhibit "P-5," Reply to the PAN*, pp. 757-764, with annexes.
[20] *Id., Vol. 1, JSFI*, p. 554.
[21] *Id., Vol. 2, Exhibit "P-6," Formal Letter of Demand ("FLD")*, pp. 765-769.
[22] *Id., Final Assessment Notices ("FAN")*, pp. 770-772.

inclusive of interest, compromise and other administrative penalties,[23] computed as follows:

Assessment No. IT-116-LOA-000013-010-13-175
INCOME TAX:

	Taxable Income *per* ITR					Php	(2,788,986.00)
	Add: Adjustments						
1	Royalty Income *per* FS						1,112,710,572.00
2	Unreported income:						
2.a	Variance - royalty reported by San Miguel Brewery (SMB)						
	Per SMB	Php	1,112,565,652.17				
	Per [IBI]		1,112,483,107.97				
		Php	82,544.20				
2.b	Variance - royalty reported by My Philippines Lifestyles, Inc. (MPLI)						
	Per MPLI	Php	271,656.05				
	Per IBI		200,339.28				
		Php	71,316.77	Php	153,860.97		
3	Unallowable deduction - unsubstantiated expense						
	Per Return	Php	2,858,986.00				
	Per Audit		2,757,219.75	Php	101,766.25		255,627.22
	Taxable Income *per* Audit					Php	1,110,177,213.22
	Tax rate						30.00%
	Income tax due						333,053,163.97
	Less: Final Withholding Tax Remitted						
	Per SMB			Php	222,513,130.43		
	Per MPLI				54,331.21		222,567,461.64
	Deficiency Income Tax - Basic					Php	110,485,702.32
	Add: Interest 20%pa. (4/16/2011 - 11/30/2013 = 960 days)			Php	58,118,506.43		
	Compromise Penalty				50,000.00		58,168,506.43
	Total deficiency income tax					**Php**	**168,654,208.75**

Assessment No. VT-116-LOA-000013-010-13-175
VALUE ADDED TAX:

	Royalty *per* return			Php	1,112,710,572.27
1	Add: Unreported income				
1.a	Variance - royalty reported by San Miguel Brewery (SMB)				
	Per SMB	Php	1,112,565,652.17		
	Per IBI		1,112,483,107.97		82,544.20
1.b	Variance - royalty reported by My Philippines Lifestyles, Inc. (MPLI)				
	Per MPLI	Php	271,656.05		
	Per IBI		200,339.28		71,316.77
	Royalty *per* audit			Php	1,112,864,433.24
	Tax rate				12%
	Output tax			Php	133,543,731.99
	Less: Allowable input tax				18,595.02
	VAT due *per* audit				133,525,136.97
	Less: VAT paid				133,506,673.65
	Deficiency VAT - Basic			Php	18,463.32
	Add: Interest 20%pa (11/26/2011 - 11/30/2013 = 1,040 days)	Php	10,521.56		
	Compromise Penalty		4,000.00		14,521.56
	Total deficiency Value Added Tax			**Php**	**32,984.88**

Assessment No. MC-116-LOA-000013-010-13-177
ADMINISTRATIVE PENALTIES:

[23] *Records, Vol. 1, JSFI,* p. 554.

1	Non filing of BIR Form No. 1702Q (1st and 2nd Qtr. 2010)	Php 25,000.00
2	Non filing of BIR Form No. 1601-E (May, July and August 2010)	
3	Non filing of Summary List of Sales	

On December 2, 2013, petitioner filed its protest[24] to the FLD and FAN, arguing that it properly declared its royalties as passive income subject to the final withholding tax rate of twenty percent (20%) on the gross amount, and that the FLD and FAN are without factual and legal basis.

However, respondent issued a Final Decision on Disputed Assessment[25] ("FDDA") on April 3, 2014, wherein she denied the protest, and found due from petitioner deficiency Income Tax, VAT and administrative penalties.[26] This was received by petitioner on April 4, 2014.[27] The details are as follows:[28]

TAX TYPE		BASIC		INTEREST		PENALTY		TOTAL
Income Tax	Php	110,485,702.32	Php	66,351,961.50	Php	50,000.00	Php	176,887,663.82
VAT		18,463.32		11,897.46		4,000.00		34,360.78
Administrative Penalties		-		-		25,000.00		25,000.00
TOTAL	**Php**	**110,504,165.64**	**Php**	**66,363,858.96**	**Php**	**79,000.00**	**Php**	**176,947,024.60**

By reason of the denial by respondent of the petitioner's protest, the latter filed the instant Petition for Review[29] on May 5, 2014, citing as legal basis *Section 3(a)(1), Rule 4 of the RRCTA,* in relation to *Section 228 of the 1997 NIRC.*

On August 20, 2014, respondent filed her Answer[30] interposing the following Special and Affirmative Defenses, in sum:[31] *(1)* That petitioner is liable for deficiency Income Tax, VAT and compromise penalty in the amount of Php176,947,024.60; *(2)* That petitioner was not denied due process; and *(3)* That the assessment against petitioner is valid and lawful.

The case was then set for pre-trial conference on November 20, 2014,[32] which was later rescheduled to February 5, 2015.[33] Petitioner

[24] *Records, Vol. 2, Exhibit "P-7," Protest to the FAN,* pp. 773-780, with annexes.
[25] *Id., Exhibit "P-8,"* pp. 781-787, with annexes.
[26] *Id., Vol. 1, JSFI,* p. 554.
[27] *Id., Vol. 2, Exhibit "P-8,"* p. 781.
[28] *Id.* at 781-782.
[29] *Id., Vol. 1, Petition for Review,* pp. 15-84, with annexes.
[30] *Id., Answer,* pp. 105-111.
[31] *Id.* at 106-111; emphases retained.
[32] *Id.* at 126.
[33] *Id.* at 128.

filed its Pre-Trial Brief[34] on November 17, 2014; while respondent's Pre-Trial Brief[35] was filed by registered mail on November 18, 2014.

Thereafter, the parties filed their Joint Stipulation of Facts and Issue ("JSFI")[36] on February 10, 2015, which was later approved *per* Pre-Trial Order[37] dated February 23, 2015.

After petitioner's completion of the presentation and Formal Offer of Evidence ("FOE")[38], the Court admitted as evidence most of petitioner's exhibits except *Exhibit* "P-22.8" for being a mere photocopy, *per* Resolution[39] dated July 8, 2015.

Respondent, on the other hand, manifested[40] in open Court, on August 24, 2015, that she has no evidence to present.

In the Resolution[41] dated August 27, 2015, the Court ordered the parties to simultaneously file their respective memoranda within thirty (30) days.

The case was submitted for decision on October 20, 2015[42] , considering petitioner's and respondent's Memorandum filed on September 23, 2015[43] and October 3, 2015[44], respectively; hence, this Decision.

The Issue[45]

The sole issue for consideration of the Court is:

WHETHER OR NOT PETITIONER IS LIABLE FOR ALLEGED DEFICIENCY INCOME TAX AND VAT AND ADMINISTRATIVE PENALTIES IN THE

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[34] *Records, Vol. 1,* pp. 129-143.
[35] *Id.* at 433-438.
[36] *Id., JSFI,* pp. 553-565.
[37] *Id., Vol. 2, Pre-Trial Order ("PTO"),* pp. 568-575.
[38] *Id., Formal Offer of Evidence ("FOE"),* pp. 715-738.
[39] *Id.* at 943-944.
[40] *Records, Vol. 2,* p. 953.
[41] *Id.* at 955.
[42] *Id.* at 1000.
[43] *Id., Petitioner's Memorandum,* pp. 956-980.
[44] *Id., Respondent's Memorandum,* pp. 987-997, filed by registered mail.
[45] *Id.* at 571.

AGGREGATE AMOUNT OF PHP716,947,024.60, INCLUSIVE OF INTEREST AND COMPROMISE PENALTIES FOR TAXABLE YEAR 2010.

Petitioner's Arguments

Petitioner contends that items, *i.e.*, Income Tax, VAT, administrative penalties, in the deficiency assessment issued by respondent should be considered withdrawn and cancelled based on the grounds discussed below.

1. *Income Tax*

For the item Variance Royalty - as reported by SMBI and MPLI, petitioner argues that its royalty income is passive income because it was not derived from the active conduct of trade or business.

It is alleged by petitioner that it employed no resource to promote the use of its trademarks and other intellectual property rights held as intangible assets, as shown by petitioner's Audited Financial Statements ("AFS"). Moreover, petitioner claims that no marketing and/or promotional activities were undertaken by it in order to entice potential licensees to enter into a licensing agreement, as testified to by the Tax Manager of IBI and Manager for Accounting and Financial Services of SMBI, Atty. Andrei Josef Y. Kasilag[46] and Ms. Noemi L. Ronquillo[47], respectively.

Likewise, petitioner contends that even assuming that its royalty income was derived in connection with the active conduct of trade or business, *Section 27(D)(1) of the 1997 NIRC* does not distinguish between royalty earned in pursuit of the corporation's primary purpose and one that is not.[48]

Petitioner, further alleges that while its primary purpose may "own, purchase, license and/or acquire such trademarks and other intellectual property rights," these activities are merely incidental to and in furtherance of its main trade or business of "manufacturing,

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[46] *Records, Vol. 2, Exhibit "P-18,"* pp. 860-871.
[47] *Id., Exhibit "P-19,"* pp. 872-882.
[48] *Id.* at 964-965.

buying, selling (on wholesale) and dealing in alcoholic and non-alcoholic beverages."[49]

Petitioner avers that supposing it is liable to pay the 30% tax rate as prescribed under *Section 27(A) of the 1997 NIRC* and not the final tax rate of 20% for passive income under *Section 27(D)(1) of the 1997 NIRC,* the provisions of *Section 34(L) of the 1997 NIRC* on optional standard deduction should apply. Thus, assuming its royalty income for taxable year 2010 in the amount of Php1,112,720,572.00 is treated as regular income and applying the optional standard deduction of 40%, the result would show that it is not liable for any deficiency income tax.[50]

For the item *Unsubstantiated Expense*, petitioner submits that the aforementioned item must be cancelled for failure to state the actual bases for the disallowance, and consequently, depriving petitioner of its right to due process.[51] Furthermore, petitioner claims that its deductions are properly substantiated, in full compliance with the requirements of the *1997 NIRC*.[52]

2. *VAT*

For the item Variance Royalty – as reported by SMBI and MPLI, petitioner reiterates its position that it has no unreported Income Tax which can form as a basis for deficiency Income Tax, and consequently of deficiency VAT.[53]

Likewise, petitioner emphasizes that for the imposition of VAT to be proper, it must be shown that petitioner received money or its equivalent from its sale, barter, or exchange of goods or properties or from sale or exchange of services, which petitioner alleges to be absent in the instant case.[54]

Petitioner finally avers that under the assumption that it is liable for VAT, respondent is barred by prescription to assess it for the 1st to 3rd quarters of taxable year 2010, pursuant to *Section 203 of the 1997*

[49] *Records, Vol. 2,* pp. 966-967.
[50] *Id.* at 968-969.
[51] *Id.* at 971.
[52] *Id.*
[53] *Id.* at 974.
[54] *Id.*

NIRC and the Supreme Court case entitled *HPCO Agridev Corp. v. CIR.*[55]

3. *Other Penalties*

For the item Compromise Penalties under deficiency Income Tax and VAT, petitioner submits that the imposition lacks factual and legal basis.[56]

For the item Administrative Penalties for the alleged failure to file the returns, *i.e.*, Quarterly Income Tax Return for the 1st and 2nd quarters, Monthly Remittance Return of Creditable Income Taxes Withheld for the months of May, July and August, and Summary List of Sales and Purchases, petitioner maintains that it filed the aforementioned returns in accordance with the requirements of the *1997 NIRC.*[57]

In view of the foregoing, petitioner prays that the Court *(a)* declare the royalty income for taxable year 2010 as passive income subject to 20% Final Withholding Tax ("FWT"); *(b)* declare that petitioner is not liable for alleged deficiency Income Tax, VAT and administrative penalties for taxable year 2010 in the aggregate amount of Php176,947,024.60, inclusive of interest and penalties; and *(c)* order the FLD and FAN withdrawn and cancelled.[58]

Respondent's Counter-Arguments

Respondent opposes the foregoing allegations and states: *(1)* 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 reported as Gross Income under *Section 32 of the 1997 NIRC,* and thus, subject to the regular corporate income tax under *Section 27(A) of the 1997 NIRC;*[59] *(2)* that the assessment issued against petitioner for VAT and administrative penalties has become final, executory and demandable, for failure to file a protest thereto in accordance with *RR No. 12-99;*[60] and *(3)* that all presumptions are in favor of the correctness

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[55] *Records, Vol. 2,* p. 976.
[56] *Id.* at 978.
[57] *Id., Vol. 1,* pp. 33-34.
[58] *Id.* at 32-33.
[59] *Id., Vol. 2,* pp. 990-992.
[60] *Id.* at 992-994.

of tax assessment, for tax assessments by tax examiners are presumed correct and made in good faith, as ruled by the Supreme Court in the case *CIR v. Construction Resources of Asia, Inc.*[61]

The Ruling of the Court

Respondent's right to assess petitioner for deficiency Income Tax and VAT for taxable year 2010 have partially prescribed.

Section 203 of the 1997 NIRC mandates that internal revenue taxes must be assessed within three (3) years reckoned from the period fixed by law for the filing of the tax return or the actual date of filing, whichever is later. It states:[62]

> 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 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.

Pursuant to the above provision, respondent has three (3) years from the filing of the returns to assess petitioner of any internal revenue tax. Consequently, the Court addresses the application of *Section 203 of the 1997 NIRC* to each of petitioner's alleged deficiency tax type below.

1. *Prescription as to deficiency Income Tax*

Petitioner was assessed for deficiency Income Tax for taxable year 2010 on three (3) grounds, to wit:[63] *(a)* the royalty fees received by petitioner are in the nature of active income arising from the active

[61] *Records, Vol. 2,* p. 994.
[62] Underscoring ours.
[63] *Records, Vol. 2, Exhibit "P-6,"* pp. 765-772.

pursuit of its business and must be reported as Gross Income under *Section 32 of the 1997 NIRC,* and thus, subject to the regular corporate income tax under *Section 27(A) of the 1997 NIRC; (b)* the total variance obtained by comparing the income payments subjected to withholding tax by petitioner's withholding agents, as reported by petitioner and as reported by the withholding agents; and *(c)* the unallowable deductions claimed by petitioner without proper substantiation pursuant to *Section 34(A)(b) of the 1997 NIRC.*

Section 77 of the 1997 NIRC provides the due date for the filing of the final adjustment Income Tax Return ("ITR"), as follows:[64]

> SECTION 77. *Place and Time of Filing and Payment of Quarterly Corporate Income Tax.* —
>
> xxx xxx xxx
>
> (B) *Time of Filing the Income Tax Return.* — The corporate quarterly declaration shall be filed within sixty (60) days following the close of each of the first three (3) quarters of the taxable year. <u>The final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be.</u>

Records show that the ITR for taxable year 2010 was filed on April 15, 2011[65], hence, respondent had until April 15, 2014 to issue an assessment against petitioner. Petitioner received the FLD with the attached FAN on November 7, 2013. Clearly, the respondent's right to assess petitioner for Income Tax deficiency is within the prescriptive period under *Section 203 of the 1997 NIRC.*

2. *Prescription as to deficiency VAT*

Respondent assessed petitioner of deficiency VAT in the total amount of Php18,463.32, as prescribed by *Section 108 of the 1997 NIRC.*

The relevant provision is *Section 114(A) of the 1997 NIRC,* to wit:[66]

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[64] Underscoring ours.
[65] *Records, Vol. 2, Exhibit "P-9,"* p. 789.
[66] Underscoring ours.

SECTION 114. *Return and Payment of Value-added Tax.-*

(A) In General. - Every person liable to pay the value-added tax imposed under this Title shall file a quarterly return of the amount of [his/her] gross sales or receipts within twenty-five (25) days following the close of each taxable quarter prescribed for each taxpayer: Provided, however, That VAT-registered persons shall pay the value-added tax on a monthly basis.

The quarterly VAT returns were filed on the following dates, with the corresponding dates of prescription:[67]

Period	Date Filed	Statutory Due Date	Exhibit	Date of Prescription
First Quarter	April 20, 2010	**April 25, 2010**	P-12[68]	April 25, 2013
Second Quarter	July 20, 2010	**July 25, 2010**	P-12.1[69]	July 25, 2013
Third Quarter	October 20, 2010	**October 25, 2010**	P-12.2[70]	October 25, 2013
Fourth Quarter	January 20, 2011	**January 25, 2011**	P-12.3[71]	January 27, 2014[72]

Considering that petitioner received the FLD with the attached FAN on November 7, 2013[73], respondent's right to assess petitioner for the first to the third quarters of taxable year 2010 has prescribed, pursuant to *Section 203* in relation to *Section 114 of the 1997 NIRC.* Hence, only the assessment relating to the fourth quarter of taxable year 2010 remains.

Petitioner is liable to pay Income Tax, VAT and administrative penalty at reduced amounts.

The Court shall proceed now to the sole issue of whether or not petitioner is liable for deficiency Income Tax, VAT, inclusive of surcharge, interest and compromise penalties, in the total amount of Php176,947,024.60 for taxable year 2010.

1. *Income Tax*

[67] In bold are the dates from which the counting of the three (3)-year period commence.
[68] *Records, Vol. 2,* p. 825.
[69] *Id.* at 826.
[70] *Id.* at 827.
[71] *Id.* at 828.
[72] January 25, 2014 fell on a Saturday.
[73] *Records, Vol. 2, Exhibit "P-6,"* p. 765.

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The alleged Income Tax deficiency for taxable year 2010 is composed of three (3) items, namely:

1)	Royalty Income *Per* AFS	Php	1,112,710,572.00
2)	Unreported Income		153,860.97
3)	Unallowable Deductions- unsubstantiated expenses		101,766.25

a. Royalty Income

With respect to royalty income, pertinent to the resolution of this matter is *Section 57 of the 1997 NIRC*:

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

Section 57(A) of the 1997 NIRC expressly states that final tax can be imposed on certain kinds of income and enumerates these as passive income. Among the enumerated passive incomes is royalty income as prescribed in *Section 24(B)(1) of the 1997 NIRC*, which provides:[74]

> SEC. 24. *Income Tax Rates.* –
>
> xxx xxx xxx
>
> (B) <u>*Rate of Tax on Certain Passive Income.*</u> –

[74] Underscoring ours.

> (1) *Interests, Royalties, Prizes, and Other Winnings.* — A final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements; royalties, except on books, as well as other literary works and musical compositions, which shall be imposed a final tax of ten percent (10%); prizes (except prizes amounting to Ten thousand pesos (P10,000) or less which shall be subject to tax under Subsection (A) of Section 24; and other winnings (except Philippine Charity Sweepstakes and Lotto winnings), derived from sources within the Philippines: xxx

From above-quoted Section, only royalties in the nature of a passive income is subject to the general rate of 20% FWT.

In the case of *Chamber of Real Estate and Builders Associations, Inc. v. The Hon. Executive Secretary Alberto Romulo, et al.*,[75] the Supreme Court had the occasion to explain that the BIR defines passive income by stating what it is not:

> Section 57 (A) expressly states that final tax can be imposed on certain kinds of income and enumerates these as passive income. The BIR defines passive income by stating what it is not:
>
>> "... if the income is generated in the active pursuit and performance of the corporation's primary purposes, the same is not passive income..."
>
> It is income generated by the taxpayer's assets. These assets can be in the form of real properties that return rental income, shares of stock in a corporation that earn dividends or interest income received from savings.

It is apparent from the Supreme Court's pronouncement that before the tax rates provided in *Section 24(B)(1) of the 1997 NIRC* may apply to royalty income, it is necessary to determine whether the royalty income is indeed passive income. Furthermore, the determination of whether or not the royalty income is passive income is directly related to whether the income is generated in the active pursuit and performance of the corporation's primary purpose.

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[75] G.R. No. 160756, March 9, 2010, 614 SCRA 605.

An examination of the evidence presented shows that petitioner's income subject of the assessment arose from a License Agreement with SMBI for the latter's use of certain Domestic IP Rights[76] of petitioner,[77] as contained in a License Agreement[78]. Said IP Rights are likewise included in petitioner's AFS as part of its assets in the amount of Php10,000,000,000.00.[79] The AFS of petitioner for the taxable years ended December 31, 2010 and December 31, 2009 likewise indicate that the said income from royalties in the amounts of Php1,112,710,572.00 and Php856,063,257.00, respectively, is the main source of income of petitioner for both taxable years 2010 and 2009.[80]

Clearly, petitioner's AFS for taxable years 2010 and 2009 is in consonance with petitioner's primary purpose in its Amended Articles of Incorporation[81], part of which is "to own, purchase, license and/or acquire such trademarks and other intellectual property rights necessary for the furtherance of its business." Accordingly, there is factual basis to conclude that petitioner generated its royalty income in active pursuit and performance of its primary purpose.

While it is true that petitioner's tax manager, Atty. Andrei Kasilag[82] and the Manager of SMBI's Accounting and Financial Services Department, Ms. Noemi L. Ronquillo[83] testified by way of Judicial Affidavits that petitioner's main line of business is "the manufacturing, buying, selling, and otherwise dealing in alcoholic and non-alcoholic beverages" and that the acquisition of trademarks and other intellectual property rights is merely incidental thereto; petitioner's financial statements reveal otherwise since it has no operating expenses for its alleged main trade or business of manufacturing, buying, selling (on wholesale) and dealing in alcoholic and non-alcoholic beverages. In fact, the financial statements indicate no source of income for both 2009 and 2010 other than petitioner's royalty income and a minimal amount of interest income.[84]

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[76] Philippine beer and malt-based beverage brands including related trademarks, copyrights, patents and other intellectual property rights and know-how (Domestic IP Rights).
[77] *Records, Vol. 2, Exhibit "P-10," AFS, Notes to the Financial Statements, Note 8 Related Party Transactions*, p. 809.
[78] *Id., Exhibit "P-11," License Agreement with SMBI*, pp. 812-822; *Exhibit "P-11.1," Amendment to License Agreement*, pp. 823-824.
[79] *Id., Exhibit "P-10," AFS*, p. 796; see *Notes to the Financial Statements, Note 5 Intangibles*, p. 808.
[80] *Id., Exhibit "P-10," AFS*, p. 797.
[81] *Id., Exhibit "P-1," AAOI*, p. 740.
[82] *Id., Exhibit "P-18," Judicial Affidavit ("JA") of Atty. Andrei Kasilag*, pp. 860-870.
[83] *Records, Vol. 1, Exhibit "P-19," JA of Ms. Noemi L. Ronquillo*, pp. 154-164.
[84] *Id., Vol. 2, Exhibit "P-10," AFS*, p. 797.

The Court further observes that the amount of cash flows from petitioner's operating activities consists only of income from its royalty and interest income as presented in its Statement of Cash Flows[85] for both taxable years 2010 and 2009. Likewise, the ITR[86] of petitioner for the taxable year 2010 showed no cost of sales/services for such taxable year, thus, giving the Court sufficient reason to doubt whether petitioner's main line of business actually involves the manufacturing, buying, selling, and otherwise dealing in alcoholic and non-alcoholic beverages, as what petitioner claims it to be.

In view of the foregoing, the Court concludes that petitioner's income from licensing out its intellectual property rights is income generated in the active pursuit and performance of its primary purpose, thus, is not passive income. Clearly, petitioner's evidence failed to support its claim that the royalties in taxable year 2010 were not earned in active pursuit or performance of its primary purpose. Thus, the Court upholds the basic deficiency Income Tax assessment as to royalty income in the amount of Php1,112,710,572.00.

b. Unreported Income

The item Unreported Income represents the total variance obtained by comparing income payments subjected to withholding tax by petitioner's withholding agents, SMBI and MPLI, computed as follows:

Unreported Income				
Variance- Royalty reported by SMBI				
Per SMBI	Php	1,112,565,652.17		
Per IBI		1,112,483,107.97	Php	82,544.20
Variance- Royalty reported MPLI				
Per MPLI	Php	271,656.05		
Per IBI		200,339.28	Php	71,316.77
Total			**Php**	**153,860.97**

For the royalty variance reported by SMBI in the amount of Php82,544.20, petitioner alleges that this represents royalty expense adjustment paid by SMBI to San Miguel Corporation ("SMC") for the

[85] *Records, Vol. 2, Exhibit "P-10," AFS*, p. 799.
[86] *Id., Exhibit "P-9," Income Tax Return ("ITR")*, p. 789.

year 2008[87] as evidenced by SMC Official Receipt No. 115388[88], Document Overview - Display[89], SMC Payment Request Memorandum[90] and SMC Miscellaneous Sales Invoice[91]. However, these documents do not pertain to royalty expense adjustment for the year 2008 in the amount of Php82,544.20, instead, they represent additional royalty income for the taxable year 2008 in the amount of Php75,940.63.

Further, petitioner submitted Schedule of Discrepancies[92], Royalty Schedule for 2008[93] and a Certificate of Creditable Tax Withheld at Source[94] amounting to Php82,544.16 with SMC as the payee. However, petitioner merely attached the last two (2) aforementioned documents in the Judicial Affidavit of Ms. Noemi Ronquillo executed on November 14, 2014 and did not offer the same in its FOE. Accordingly, the Court maintains the assessment on royalty variance reported by SMBI in the amount of Php82,544.20.

For the royalty variance reported by MPLI in the amount of Php71,316.77, petitioner alleges that it "is at a loss as to how the amounts of Php271,656.05 reported by MPLI and Php200,339.28 reported by IBI were arrived at by the BIR." Petitioner maintains that its royalty income from MPLI for taxable year 2010 is in the amount of Php227,464.29.[95]

From the BIR Records, it appears that respondent extracted the 20% final tax remittances for the taxable year 2010 of MPLI from the database of Revenue District Office ("RDO") 38-North, Quezon City[96], and worked back to get the total tax base of Php271,656.05, computed as follows:

Period		**Tax Paid (A)**	**Tax Rate (B)**		**Tax Base (A/B)**
May-10	Php	14,160.71	20%	Php	70,803.55

[87] *Records, Vol. 1, Exhibit "P-19," JA of Ms. Noemi L. Ronquillo, A55*, p. 300.
[88] *Id., Vol. 2, Exhibit "P-14,"* p. 842.
[89] *Id., Exhibit "P-14.1,"* p. 843.
[90] *Id., Exhibit "P-14.2,"* p. 844.
[91] *Id., Exhibit "P-14.3,"* p. 845.
[92] *Id., Vol. 1, Exhibit "P-19," JA of Ms. Noemi Ronquillo, A55-56*, p. 300; see *Vol. 2, Exhibit "P-14,"* p. 842.
[93] *Records, Vol. 1, Exhibit "P-19," JA of Ms. Noemi Ronquillo, A55-56*, p. 300; see *Vol. 2, Exhibit "P-14.6,"* p. 400, not included in the FOE.
[94] *Id., Exhibit "P-19," JA of Ms. Noemi Ronquillo, A55-56*, p. 300; see *Exhibit "P-14.7,"* p. 401, not included in the FOE.
[95] *Id., JA of Ms. Noemi Ronquillo, A55*, p. 300.
[96] *BIR Records*, p. 317.

Aug-10	12,567.86	20%		62,839.30
Sep-10	11,914.36	20%		59,571.80
Oct-10	2,178.57	20%		10,892.85
Dec-10	13,509.71	20%		67,548.55
Total			**Php**	**271,656.05**

On the other hand, respondent summarized the Official Receipts ("OR") issued by the petitioner to MPLI to come up with the total amount of Php200,339.28. However, examination reveals that the total amount is only Php194,675.00 because OR Nos. 11 and 13 did not match with the summary provided by respondent, broken down as follows:

OR Date	OR No.	Customer		VAT		VAT Sale[97]		*Per* OR	Reference
5/17/2010	**11**	**My Phils. Lifestyle Inc.**	**Php**	**8,274.78**	**Php**	**68,956.51**	**Php**	**63,440.00**	***BIR Records*, p. 171**
6/3/2010	**13**	**My Phils. Lifestyle Inc.**		**221.65**		**1,847.05**		**1,699.29**	***BIR Records*, p. 169**
7/7/2010	15	My Phils. Lifestyle Inc.		3,261.43		27,178.57		27,178.57	*BIR Records*, p. 167
7/19/2010	17	My Phils. Lifestyle Inc.		2,702.14		22,517.86		22,517.86	*BIR Records*, p. 165
9/8/2010	20	My Phils. Lifestyle Inc.		1,540.71		12,839.29		12,839.29	*BIR Records*, p. 162
9/8/2010	21	My Phils. Lifestyle Inc.		1,887.86		15,732.14		15,732.14	*BIR Records*, p. 161
12/16/2010	25	My Phils. Lifestyle Inc.		3,630.00		30,250.00		30,250.00	*BIR Records*, p. 157
12/16/2010	26	My Phils. Lifestyle Inc.		1,215.00		10,125.00		10,125.00	*BIR Records*, p. 156
12/16/2010	27	My Phils. Lifestyle Inc.		1,307.14		10,892.86		10,892.85	*BIR Records*, p. 153
	Total				**Php**	**200,339.28**	**Php**	**194,675.00**	

Upon scrutiny of the evidence presented and since the Court cannot ascertain whether the remittances made by MPLI, as extracted by respondent from the database of RDO 38-North, Quezon City, were all earnings from petitioner, the variance on royalty income reported by MPLI amounting to Php71,316.77 is hereby cancelled.

c. Unsubstantiated Expenses

The item unallowable deductions is composed of the following:

		***Per* ITR/FS**		***Per* Audit**		**Variance**
Taxes and Licenses	Php	2,318,610.00	Php	2,246,345.98	Php	72,264.02
Professional Fee		525,427.00		422,852.38		102,574.62
Transportation and Travel		14,949.00		4,252.50		10,696.50
Others		-		83,768.89		(83,768.89)
Total	**Php**	**2,858,986.00**	**Php**	**2,757,219.75**	**Php**	**101,766.25**

Petitioner argues that this item lacks factual and legal basis, thus, deprived petitioner of its right to due process. It submits that respondent failed to provide petitioner with a breakdown of the alleged unsupported expenses.

[97] *BIR Records*, p. 381.

The Court partially agrees with petitioner's argument.

In the case *Commissioner of Internal Revenue v. Enron Subic Power Corporation*[98], the Highest Tribunal elucidated the importance of informing the taxpayer of the factual and legal bases of the assessment. The Supreme Court ruled:

> The law requires that the legal and factual bases of the assessment be stated in the formal letter of demand and assessment notice. Thus, such cannot be presumed. Otherwise, the express provisions of *Article 228 of the [1997] NIRC and RR No. 12-99* would be rendered nugatory. The alleged factual bases in the advice, preliminary letter and audit working papers did not suffice. There was no going around the mandate of the law that the legal and factual bases of the assessment be stated in writing in the formal letter of demand accompanying the assessment notice.
>
> We note that the old law merely required that the taxpayer be notified of the assessment made by the CIR. This was changed in 1998 and the taxpayer must now be informed not only of the law but also of the facts on which the assessment is made. Such amendment is in keeping with the constitutional principle that no person shall be deprived of property without due process. In view of the absence of a fair opportunity for Enron to be informed of the legal and factual bases of the assessment against it, the assessment in question was void. We reiterate our ruling in *Reyes v. Almanzor, et al.*:
>
> > "Verily, taxes are the lifeblood of the Government and so should be collected without unnecessary hindrance. However, such collection should be made in accordance with law as any arbitrariness will negate the very reason for the Government itself."

In the same vein, the Highest Tribunal held in *Commissioner of Internal Revenue v. Hantex Trading Co., Inc.*[99] that:

> The rule is that in the absence of the accounting records of a taxpayer, his tax liability may be determined by estimation.

[98] G.R. No. 166387, January 19, 2009, 576 SCRA 212.
[99] G.R. No. 136975, March 31, 2005, 454 SCRA 301.

> The petitioner is not required to compute such tax liabilities with mathematical exactness. Approximation in the calculation of the taxes due is justified. To hold otherwise would be tantamount to holding that skillful concealment is an invincible barrier to proof. However, the rule does not apply where the estimation is arrived at arbitrarily and capriciously.

After an examination of the FLD[100], FAN[101], and BIR Records, the Court notes two (2) matters for the item Unsubstantiated Expenses. *First*, there is no breakdown of the "*Per* Audit" amounts for the items "Professional Fee," "Transportation and Travel" and "Others" in any of the aforementioned documents. As argued by petitioner, these items lack factual and legal basis. Clearly, the "*Per* Audit" amounts, and the resulting variance amounts were arrived at arbitrarily and capriciously. Consequently, this particular assessment item is cancelled. *Second*, based on the BIR Records, the item "Taxes and Licenses" has a "*Per* Audit" breakdown, as shown below:

Kind of Fee/Tax		**Amount**	**OR Number**	**Reference**
Manufacturer	Php	562,873.57	0698607	*BIR Records*, p. 229
Business License		560,686.57	0793776	*BIR Records*, p. 227
Manufacturer		1,120,873.14	0996886	*BIR Records*, p. 226
Garbage Charges		500.00	0996886	*BIR Records*, p. 226
Fire		312.70	0698607	*BIR Records*, p. 229
Sanitary		100.00	0698607	*BIR Records*, p. 229
Mayor's Permit		1,000.00	0698607	*BIR Records*, p. 229
Total *Per* Audit	Php	2,246,345.98		
Per ITR/FS		2,318,610.00		
Variance	**Php**	**72,264.02**		

From the above table, it is evident that there was factual basis in arriving at the variance of "Taxes and Licenses." Thus, this particular assessment item remains.

d. Optional Standard Deduction

Petitioner avers that assuming it is liable to pay the thirty percent (30%) tax rate prescribed under *Section 27(A) of the 1997 NIRC* and not the FWT rate of twenty percent (20%) for passive income under *Section 27(D)(1) of the 1997 NIRC*, the Court should apply the provisions of *Section 34(L) of the 1997 NIRC* on optional standard deduction.[102]

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[100] *Records, Vol. 2, Exhibit "P-6,"* pp. 765-769.
[101] *Id.* at 770-772.
[102] *Id., Petitioner's Memorandum*, pp. 968-969.

Section 34 (L) of the 1997 NIRC states:[103]

> SEC. 34. *Deductions from Gross Income.* -
>
> 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)(l), 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. <u>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</u>: 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.

The above-quoted Section provides that a taxpayer should signify in its return the intention to elect the optional standard deduction. Otherwise, the taxpayer shall be considered to have availed of the other deductions allowed in *Section 34 of the 1997 NIRC.*

A perusal of petitioner's 2010 ITR[104] shows that it declared itemized deductions in the total amount of Php2,858,986.00 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

[103] Underscoring ours.
[104] *Records, Vol. 2, Exhibit "P-9,"* pp. 789-791.

Section 34 (L) of the 1997 NIRC should not be applied in the computation of petitioner's tax liability.

In sum, only the amount of Php110,434,456.63 basic deficiency Income Tax is upheld, computed as follows:

Taxable Income *Per* ITR			Php	(2,858,986.00)[105]
Add: Adjustments				
1. Royalty Income *Per* FS				1,112,710,572.00
2. Variance- Royalty reported by SMBI				
Per SMBI	Php	1,112,565,652.17		
Per IBI		1,112,483,107.97	Php	82,544.20
3. Unallowable Deductions- Taxes and Licenses				
Per audit	Php	2,246,345.98		
Per return		2,318,610.00	Php	72,264.02
Taxable Income *Per* Audit			Php	1,110,006,394.22
Tax Rate				30%
Income Tax Due			Php	333,001,918.27
Less: Final Withholding Tax Remitted				
Per SMBI	Php	222,513,130.43		
Per MPLI		54,331.21	Php	222,567,461.64
Deficiency Income Tax - Basic			**Php**	**110,434,456.63**

2. *VAT*

In the discussion as to prescription, the Court has ruled that respondent's right to assess petitioner for deficiency VAT for the first to the third quarters of taxable year 2010 has prescribed, pursuant to *Section 203* in relation to *Section 110 of the 1997 NIRC* and *Section 2 of RR No. 5-93.*

However, the Court notes that petitioner's Reply to the PAN[106] dated September 30, 2013 addressed respondent's assessment on the deficiency Income Tax and failed to do the same on the deficiency VAT. Likewise, in petitioner's Protest to the FLD and FAN[107] dated November 29, 2013, petitioner once again addressed respondent's assessment on the deficiency Income Tax and failed to do the same on the deficiency VAT and administrative penalties.

Section 228 of the 1997 NIRC reads:[108]

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[105] *Records, Vol. 2, Exhibit "P-9,"* pp. 789-791.
[106] *Id., Vol. 1, Exhibit "P-5," Reply to the PAN,* pp. 757-764, with annexes.
[107] *Id., Vol. 2, Exhibit "P-7," Protest to the FAN,* pp. 773-780, with annexes.
[108] Underscoring ours.

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

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

<u>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.</u>

xxx xxx xxx

To implement the provisions of *Section 228 of the 1997 NIRC, RR No. 12-99*[109] was issued. *Section 3.1.2 of RR No. 12-99* is explicit:[110]

3.1.2 *Preliminary Assessment Notice (PAN).* — If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, the said Office shall issue to the taxpayer, at least by registered mail, a [PAN] for the proposed assessment, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based. <u>If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall be considered in default, in which case, a formal letter of demand and assessment notice shall be caused to be issued by the said Office, calling for payment of the taxpayers deficiency tax liability, inclusive of the applicable penalties.</u>

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[109] September 6, 1999.
[110] Underscoring ours.

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Moreover, *Section 3.1.5 of RR No. 12-99* provides:[111]

> 3.1.5 *Disputed Assessment.* – The taxpayer or his duly authorized representative may protest administratively against the aforesaid formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof. If there are several issues involved in the formal letter of demand and assessment notice but the taxpayer only disputes or protests against the validity of some of the issues raised, the taxpayer shall be required to pay the deficiency tax or taxes attributable to the undisputed issues, in which case, a collection letter shall be issued to the taxpayer calling for payment of the said deficiency tax, inclusive of the applicable surcharge and/or interest. No action shall be taken on the taxpayer's disputed issues until the taxpayer has paid the deficiency tax or taxes attributable to the said undisputed issues. The prescriptive period for assessment or collection of the tax or taxes attributable to the disputed issues shall be suspended.
>
> The taxpayer shall state the facts, the applicable law, rules and regulations, or jurisprudence on which his protest is based, otherwise, his protest shall be considered void and without force and effect. If there are several issues involved in the disputed assessment and the taxpayer fails to state the facts, the applicable law, rules and regulations, or jurisprudence in support of his protest against some of the several issues on which the assessment is based, the same shall be considered undisputed issue or issues, in which case, the taxpayer shall be required to pay the corresponding deficiency tax or taxes attributable thereto.
>
> The taxpayer shall submit the required documents in support of his protest within sixty (60) days from date of filing of his letter of protest, otherwise, the assessment shall become final, executory and demandable. The phrase "submit the required documents" includes submission or presentation of the pertinent documents for scrutiny and evaluation by the Revenue Officer conducting the audit. The said Revenue Officer shall state this fact in his report of investigation.
>
> If the taxpayer fails to file a valid protest against the formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof, the assessment shall become final, executory and demandable.

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[111] Underscoring ours.

xxx xxx xxx

In the instant case, petitioner merely stated in its Reply to the PAN[112]:

> With regard to the other findings of deficiency [VAT], we request for additional time of fifteen (15) days to submit our position and other documents.
>
> In consideration of the above, we request that the [PAN] (Part I) finding for deficiency income taxes related to royalties received by [IBI], be set aside.

Petitioner reiterated the aforementioned in its Protest to the FLD and FAN[113]. The Court quotes:

> With regard to the other findings of deficiency [VAT] and other penalties, we request for additional time of fifteen (15) days to submit our position and other documents.
>
> In consideration of the above, we request that the [FLD] findings of deficiency income taxes related to royalties received by [IBI], be set aside.

Undoubtedly, petitioner only protested the assessment for Income Tax. It likewise failed to submit its position and documents to justify its claim on the assessment for VAT, which shall be considered an undisputed issue, in which case, the taxpayer shall be required to pay the corresponding deficiency tax attributable thereto.

Considering petitioner's failure to validly protest the deficiency VAT for the fourth quarter of taxable year 2010, the same remains. Thus, petitioner is liable for basic deficiency VAT for the 4th quarter of 2010 for royalty variance reported by MLPI amounting to Php3,260.83, computed as follows:

Royalty *Per* Return			Php	1,112,710,572.27
Add: Unreported Income				
2b. Variance- Royalty reported by [MPLI]				
Per MPLI				
Remittance of MPLI on Oct. 2010[114]	Php	10,892.85		

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[112] *Records, Vol. 2, Exhibit "P-5," Reply to the PAN,* p. 759.
[113] *Id., Exhibit "P-7," Protest to the FAN,* p. 775.
[114] *BIR Records,* p. 315.

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Remittance of MPLI on Dec. 2010[115]		67,548.55	Php	78,441.40		
Per IBI						
Per OR#25 dated 12/16/2010[116]	Php	30,250.00				
Per OR#26 dated 12/16/2010[117]		10,125.00				
Per OR#27 dated 12/16/2010[118]		10,892.86	Php	51,267.86	Php	27,173.54
Royalty *per* Audit					Php	1,112,737,745.81
Tax Rate						12%
Output Tax					Php	33,528,529.50
Less: Allowable Input Tax						18,595.02
VAT Due *per* Audit					Php	133,509,934.48
VAT Paid						133,506,673.65
Deficiency VAT - Basic					**Php**	**3,260.83**

3. *Compromise Penalty*

Respondent imposed compromise penalties on the deficiency Income Tax and VAT in the amounts of Php50,000.00 and Php4,000.00, respectively.

In the case *Felisa L. Vda. De San Agustin v. Commissioner of Internal Revenue*[119], the Supreme Court stated that a compromise, by its nature, is mutual in essence. Thus, the imposition of a compromise penalty without the conformity of the taxpayer is illegal and unauthorized.[120]

In the case at bench, no document was presented in Court that would indicate that both parties agreed to enter into a compromise agreement. Accordingly, the imposition of a compromise penalty has no basis and is illegal and unauthorized.[121] Thus, petitioner should not be subjected to compromise penalties.

4. *Administrative Penalty*

Under the FDDA[122], respondent imposed administrative penalties in the amount of Php25,0000.00 pursuant to *Section 250 of the 1997 NIRC*, for the following:

1. Non filing of BIR Form No. 1702Q (1st and 2nd Qtrs: 2010);

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115 *BIR Records*, p. 315.
116 *Id.* at 156.
117 *Id.* at 155.
118 *Id.* at 154.
119 G.R. No. 138485, September 10, 2001, 364 SCRA 802.
120 *Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc. and the Court of Tax Appeals*, G.R. No. L-35266, January 21, 1991, 193 SCRA 86.
121 *Id.*
122 *Records, Vol. 2, Exhibit "P-8,"* p. 782.

2. Non filing of BIR Form No. 1601-E (May, June and August 2010); and

3. Non filing of Summary List of Sales

Section 250 of the 1997 NIRC reads as follows:[123]

> SECTION 250. *Failure to File Certain Information Returns.* —In the case of each failure to file an information return, statement or list, or keep any record, or supply any information required by this Code or by the Commissioner on the date prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall, upon notice and demand by the Commissioner, be paid by the person failing to file, keep or supply the same, One thousand pesos (P1,000) for each such failure: Provided, however, That the aggregate amount to be imposed for all such failures during a calendar year shall not exceed Twenty-five thousand pesos (P25,000).

A perusal of the records show that petitioner violated *Section 250 of the 1997 NIRC,* for non-filing of BIR Form No. 1601-E for the months of May, June and August 2010, as well as non-filing of the Summary List of Sales for 2010, in the aggregate and reduced amount of Php4,000.00 (Php1,000.00 for each failure). Administrative penalties for non-filing of BIR Form No. 1702Q for the first[124] and second[125] quarters of 2010 are hereby cancelled since petitioner was able to provide the same to the Court.

WHEREFORE, in view of the foregoing, the present Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, petitioner is hereby **ORDERED TO PAY** deficiency Income Tax, Value-Added Tax and administrative penalties for the taxable year ended 2010, in the reduced amount of **One Hundred Thirty-Eight Million Fifty-One Thousand One Hundred Forty-Six and 82/100 Pesos (Php138,051,146.82)**, inclusive of the twenty-five percent (25%) surcharge imposed under *Section 248(A)(3) of the 1997 NIRC,* computed as follows:

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[123] Underscoring ours.
[124] *Records, Vol. 2, Exhibit "P-17,"* p. 857.
[125] *Id., Exhibit "P-17.1,"* p. 858.

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

ROMAN G. DEL ROSARIO
Presiding Justice

Tax Type		Basic Tax		25% Surcharge		Total
Income Tax	Php	110,434,456.63	Php	27,608,614.16	Php	138,043,070.78
Value-Added Tax		3,260.83		815.21		4,076.04
Administrative Penalties						4,000.00
Total	**Php**	**110,437,717.46**	**Php**	**27,609,429.36**	**Php**	**138,051,146.82**

In addition, petitioner is liable to pay:

1. Deficiency interest at the rate of twenty percent (20%) *per annum* pursuant to *Section 249(B) of the 1997 NIRC* on the basic deficiency Income Tax of Php110,434,456.63 and Value-Added Tax of Php3,260.83 computed from April 16, 2011 and January 26, 2011, respectively, until full payment thereof; and

2. Delinquency interest at the rate of twenty percent (20%) *per annum* on the amount of Php138,047,146.82 (Net of administrative penalties of Php4,000.00 but inclusive of 25% surcharge); and on the twenty percent (20%) deficiency interest which have accrued as aforestated in Item 1, computed from April 3, 2014 until full payment thereof pursuant to *Section 249(C) of the 1997 NIRC*, as amended.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice