Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

FIRST DIVISION

ICONIC BEVERAGES, INC., Petitioner,	**CTA Case No. 8607** For: Assessment
-versus-	Members: DEL ROSARIO, P.J., *Chairperson* UY, and MINDARO-GRULLA, JJ.
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: AUG 14 2015 ; 2:13 p.m.

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D E C I S I O N

MINDARO-GRULLA, J.:

This resolves the Petition for Review filed on February 7, 2013 by Iconic Beverages, Inc. as petitioner, against the Commissioner of Internal Revenue (CIR), as respondent, for the Court in Division, pursuant to Section 7 (a) (1) of Republic Act (RA) No. 1125, An Act Creating the Court of Tax Appeals, as amended[1], as well as Rule 4, Section 3 (a) (1), in relation to Rule 8, Section 4(a), of the Revised Rules of the Court of Tax Appeals (RRCTA)[2].

1 Sec. 7. *Jurisdiction.* –The CTA shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
x x x x x x
(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;
x x x x x x

2 Rule 4. Sec. 3. *Cases within the jurisdiction of the Court in Division.* – The Court in Division shall exercise:
(a) Exclusive original over or appellate jurisdiction to review by appeal the following:

x x x x x x

Petitioner seeks the cancellation of the assessment issued against it for alleged deficiency income tax for calendar year 2009 in the amount of ₱131,312,747.39, inclusive of interest and penalties.

Petitioner Iconic Beverages, Inc. is a corporation organized and existing under the laws of the Philippines, with principal place of business at the SMC Head Office Complex, 40 San Miguel Ave., Mandaluyong City.[3]

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

Petitioner received from the BIR Letter of Authority No. 121-2010-00000012 dated May 14, 2010, authorizing the examination of petitioner's books of accounts and other financial records for all internal revenue taxes for the taxable year 2009.[4] ∠

> (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;
> x x x x x x

Rule 8. Sec. 4. *Where to appeal; mode of appeal.* –

(a) An Appeal from a decision or ruling or the inaction of the Commissioner of Internal Revenue on disputed assessments or claim for refund of internal revenue taxes erroneously or illegally collected; the decision or ruling of the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade & Industry, the Secretary of Agriculture, and the Regional Trial Court in the exercise of their original jurisdiction, shall be taken to the Court by filing before it a petition for review as provided in Rule 42 of the Rules of Court. The Court in Division shall act on the appeal.

[3] Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Issue (JSFI), Docket, p. 267.
[4] Par. 4, Stipulation of Facts, JSFI, Docket, pp. 267-268.

Thereafter, the Large Taxpayers Service of the BIR issued to petitioner a Notice of Informal Conference dated March 4, 2011, stating that "there have been found deficiency internal revenue taxes due from you which are now submitted to this Office for final evaluation".[5]

Petitioner received from respondent a Preliminary Assessment Notice (PAN) dated October 19, 2011, which found petitioner liable for deficiency income tax, documentary stamp tax (DST), and administrative penalties for the taxable year 2009 in the aggregate amount of ₱111,382,989.41, inclusive of interest and compromise penalty.[6]

Subsequently, respondent issued a Formal Letter of Demand (FLD) with attached Final Assessment Notices (FAN) dated March 30, 2012, assessing petitioner for purported deficiency income tax and DST in the aggregate amount of ₱119,944,634.43, inclusive of interest, compromise and other administrative penalties, computed as follows:[7]

Income Tax			
Taxable Net (Loss) Per ITR (NOLCO)			₱ 50,009,617.40
Add:	Royalty income subj. to reg. income tax	₱856,063,257.00	
	Unrecorded sales to SMC	25,000.00	
	Unrecorded purchases from SMC	5,684.96	856,093,941.96
Adjusted Taxable Net Income			856,093,941.96
	Tax Due		256,828,182.59
Less:	Final Tax of 20%		- 171,212,651.40
Deficiency Income Tax			85,615,531.19
Add:	Interest (4/16/2010 to 4/15/2012)	₱ 34,246,212.48	
Compromise Penalty		50,000.00	34,296,212.48
Total Deficiency Income Tax			₱ 119,911,743.66
Documentary Stamp Tax			
Taxable Basis Per Return			₱10,000,183,750.00
Tax Due			50,000,919.00
Less:	Tax Paid Per Return		-50,000,919.00
Basic Deficiency Tax			919.00
Add:	Interest (3/5/2009 to 4/15/2012)	₱ 571.76	
Compromise Penalty		400.00	971.76
Total Deficiency Documentary Stamp Tax			₱ 1,890.76

[5] Par. 5, Stipulation of Facts, JSFI, Docket, p. 268.
[6] Par. 6, Stipulation of Facts, JSFI, Docket, p. 268.
[7] Par. 7, Stipulation of Facts, JSFI, Docket, pp. 268-269.

Administrative Penalties		
Non-filing of BIR Form 2550 M for the month of Jan. 2009		₱ 1,000.00
Non-filing of Summary List of Sales/Purchases		13,000.00
(SLS-Jan.-Feb. 2009/SLP-Jan.-July, 2009, Sept.-Dec. 2009)		
Non-filing of BIR Form 1601 (Jan., June, July, Oct. 2009)		4,000.00
Non-filing of BIR Form 1604-E		1,000.00
Non-filing of Alphalist of Payees (MAP)		12,000.00
Total		₱ 31,000.00

On May 16, 2012, petitioner filed its protest to the FLD and FAN, arguing that it properly declared its royalties as passive income subject to the final withholding tax of twenty percent (20%) on the gross amount and that the FLD and FAN are without factual and legal bases.[8]

However, respondent issued a Final Decision on Disputed Assessment (FDDA) dated January 7, 2013, wherein she denied in part the protest. In the FDDA, respondent upheld the alleged income tax deficiencies of petitioner relating to income derived from San Miguel Brewery, Inc. (SMBI) and from My Philippines Lifestyles, Inc. (MPLI); which petitioner treated as royalty income and subjected to 20% final tax.[9]

On the other hand, respondent cancelled the DST assessment, the administrative penalties and the income tax deficiency arising from the supposed "unrecorded purchases from San Miguel Corporation" after petitioner voluntarily settled these alleged deficiencies. Respondent also cancelled the income tax audit adjustment relating to the alleged "unrecorded sales to San Miguel Corporation" after petitioner submitted supporting documents establishing that the ₱25,000.00 amount received by petitioner from San Miguel Corporation was not a taxable sale, the details of which are as follows:[10]

TAX TYPE	BASIC	INTEREST	PENALTY	TOTAL
Income Tax	₱85,606,325.70	₱45,656,421.69	₱50,000.00	₱131,312,747.39

[8] Exhibit "P-10", Docket, pp. 381-383.
[9] Par. 8, Stipulation of Facts, JSFI, Docket, p. 269; Exhibit "P-11", Docket, pp. 384-386.
[10] Par. 9, Stipulation of Facts, JSFI, Docket, p. 269.

Thus, on February 7, 2013, petitioner filed the present Petition for Review before this Court.[11]

In her Answer[12] filed on April 19, 2013, respondent interposed the following special and affirmative defenses:

> "**The payments received by petitioner from the active conduct of trade or business is considered ordinary business income subject to the 30% regular corporate income tax**
>
> 5. Clearly, Iconic Beverages, Inc. **('IBI')** is primarily engaged in the business of manufacturing, buying, selling (on wholesale) and dealing in alcoholic and non-alcoholic beverages and to own, purchase, license and/or acquire such trademarks and other intellectual property rights <u>necessary for the furtherance of its business</u>.
>
> 6. It may help to know the following factual backdrop:
>
> 6a. In exchange for a 100% ownership of IBI's shares of stocks, San Miguel Corporation **('SMC')** <u>transferred</u> its trademark and other intellectual property rights to IBI on 27 February 2009.
>
> 6b. Eventually, on 29 April 2009, all of SMC's shares of stocks in IBI were sold to San Miguel Brewery, Inc. **('SMBI')**. However, IBI retains ownership of the Intellectual Property Rights in connection with the preparation, manufacturing, packaging, and marketing of the beer and malt-based products and in

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[11] Docket, pp. 6-16.
[12] Docket, pp. 79-86.

connection with the distribution and sale of the products within the Philippines.

6c. IBI has no other income but that from SMBI and MPLI.

7. Now, in petitioner's obvious attempt to escape from the burden of corporate income tax, it argues that the term 'license' in its primary purpose should mean as acquisition of trademarks and other intellectual property rights.

8. However, records disclosed that IBI granted SMBI the license to use its IP rights in connection with the preparation, manufacturing, packaging and marketing of the licensee's beer and malt-based beverage products and in connection with the distribution and sale of the same.

9. For ease of reference, certain provisions of the License Agreement, pertinently reads:

'I – xxx

1. The Licensor (IBI) hereby grants the Licensee (SMBI), subject to the terms and conditions contained herein, an exclusive license to research and develop products using the IP rights, make, have made, sell and offer to sell the products using the IP Rights, and otherwise to use and exploit the IP rights in and throughout the Philippines. xxx

The License granted under this Agreement includes the right for the Licensee to sub-license the IP Rights to any of its subsidiaries, at the Licensee's discretion, provided that the sub-license agreements impose on the sub-licensee or sub-licensees the same conditions as are imposed on the License in this Agreement xxx' (words in brackets supplied)

10. Further, another License Agreement was entered into by and between IBI and My Philippines Lifestyle, Inc. **('MPLI')** for the use of IBI's Licensed Marks in connection with the manufacture, advertising, marketing, sale and distribution of t-shirts under MPLI's brand of 'My Philippines' t-shirts.

11. Just as obvious, petitioner had licensed out its trademarks and intellectual property rights in furtherance of its business.

12. Verily, the transactions of petitioner with SMBI and MPLI cannot insulate it from scrutiny that it is in actual pursuit of its primary purpose.

13. Being so, the royalty fees received by petitioner from SMBI and MPLI are in the nature of <u>active income</u> arising from the active pursuit of its business and must be subject to the regular corporate income tax under Section 27 of the NIRC, as amended.

14. Hence, the royalties received by petitioner from SMBI and MPLI must be reported as petitioner's Gross Income under Section 32 of the NIRC, as amended.

15. Respondent maintains that, royalties and other income arising from the active pursuit of business, where such activities are in accordance with the primary purpose of the licensor, are in the nature of ordinary business income subject to 30% corporate income tax.

16. Another fine point is to be subject to the 20% final withholding tax, the royalties must be in the nature of passive income. Section 27(D)(1) of the NIRC, as amended, provides:

xxx xxx xxx

17. In its Annual Income Tax Return for taxable year 2009 IBI reported royalty income in the total amount of ₱856,063,257.00 as non-taxable income.

18. Per verification it was disclosed that 855,902,703.30 represents royalty income derived from SMBI's use of certain Domestic Intellectual Property Rights for IBI and 160,553.70 represents royalty income derived from 'My Philippines' t-shirts which are in accordance with the primary purpose of petitioner. Hence, must be assessed pursuant to Section 27(A) of the NIRC, as amended.

19. Hence, IBI is liable for income tax for calendar year ending 2009 in the aggregate amount of **₱131,312,747.39**.

The Assessment issued against petitioner is valid and lawful

20. Respondent posits that, assessment are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimates is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously. **(Marcos II vs. Court of Appeals G.R. No. 120880 June 5, 1997)**

21. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise, the presumption of correctness of tax assessment stands **(Commissioner of Internal Revenue vs. Hantex Trading Co. Inc., G.R. No. 136975, March 31, 2005).** The presumption in favor of the correctness of tax assessment stands where evidence to the contrary is wanting. Hence, the assessment issued against petitioner is imbued with factual and legal bases.

> 22. All presumption are in favor of the correctness of tax assessments *(Sy Po vs. Court of Tax Appeals, 164 SCRA 524)*. Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice.
>
> 23. Well settled in the field of taxation – the burden of proof is on the taxpayer to present evidence to show the incorrectness of the assessment.
>
> 24. Here, it can hardly be denied that they royalty fees received by petitioner from SMBI and MPLI are in the nature of active income arising from the active pursuit of its business. Thus, must be subject to 30% corporate income tax."

The case was then set for pre-trial conference on June 7, 2013.[13] Petitioner filed its Pre-Trial Brief[14] on May 31, 2013; while respondent's Pre-Trial Brief[15] was filed on June 6, 2013.

Thereafter, the parties filed their Joint Stipulation of Facts and Issue[16] on August 5, 2013, which was later approved as per the Court's Resolution[17] dated August 22, 2013. Accordingly, this Court issued the Pre-Trial Order[18] dated October 7, 2013.

After petitioner's completion of the presentation and formal offer of evidence, this Court admitted as evidence for petitioner Exhibits "P" to "P-16-a" as per Resolution[19] dated February 27, 2014.

Petitioner formally offered the following exhibits:

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[13] Notice of Pre-Trial Conference dated April 23, 2013, Docket, p. 87.
[14] Docket, pp. 88-98.
[15] Docket, pp. 189-194.
[16] Docket, pp. 267-276.
[17] Docket, p. 278.
[18] Docket, pp. 303-313.
[19] Docket, pp. 463-464.

Exhibit	Description
P	Amended Articles of Incorporation
P-1	BIR Certificate of Registration
P-2	1st Quarterly Income Tax Return
P-2-a	2nd Quarterly Income Tax Return
P-3-a	3rd Quarterly Income Tax Return
P-4-a	Annual Income Tax Return
P-5	BIR Letter of Authority No. 121-2010-00000012 dated May 14, 2010
P-6	Notice of Informal Conference
P-7	Preliminary Assessment Notice (PAN)
P-8	Reply to PAN dated November 4, 2011
P-9	Formal Letter of Demand with attached Final Assessment Notice (FAN)
P-10	Protest to FAN dated May 16, 2012
P-11	Final Decision on Disputed Assessment (FDDA)
P-12	BIR Form 2306 for the period April to June 2009
P-12-a	BIR Form 2306 for the period July to September 2009
P-12-b	BIR Form 2306 for the period October to December 2009
P-13	Audited Financial Statements for 2009
P-14	License Agreement between petitioner and San Miguel Brewery, Inc.
P-15	Judicial Affidavit of Atty. P. Clinton Laudencia dated May 31, 2013
P-15-a	Signature of Atty. P. Clinton Laudencia
P-16	Judicial Affidavit of Noemi Ronquillo
P-16-a	Signature of Noemi Ronquillo

Respondent, on the other hand, presented and formally offered Exhibits "R-1" to "R-7-1"[20], which were admitted in the Resolutions dated May 30, 2014[21] and August 12, 2014[22].

Respondent's documentary exhibits are as follows:

Exhibit	Description
R-1	Letter of Authority No. 121-2010-00000012 dated May 14, 2010
R-2	Articles of Incorporation of Iconic Beverages, Inc. dated December 11, 2008

[20] Docket, pp. 480-484.
[21] Docket, pp. 491-492.
[22] Docket, pp. 522-523.

R-3	Trademark License Agreement executed by and between Iconic Beverages, Inc. and My Philippines Lifestyle, Inc.
R-4	License Agreement by and between Iconic Beverages, Inc. and San Miguel Brewery, Inc.
R-5	Memorandum for the Commissioner of Internal Revenue thru channels dated December 11, 2012
R-6	Print out of Annual Income Tax Return BIR Form 1702 of Iconic Beverages, Inc. for taxable year 2011
R-7	Judicial Affidavit of Ms. Criscela M. Lacsamana
R-7-1	Signature of Ms. Lacsamana

The case was submitted for decision on October 14, 2014[23], considering petitioner's Memorandum[24] filed on July 7, 2014 and respondent's failure to file her memorandum as per Records Verification dated October 14, 2014.

The parties submitted the following issues[25] for this Court's disposition:

1. Whether petitioner's royalty income is subject to 20% final withholding tax; and

2. Whether petitioner is liable for the amount of ₱131,312,747.39 as deficiency income tax for calendar year 2009 plus 25% surcharge as well as 20% deficiency and delinquency interests for late payment until fully paid.

Since the foregoing issues are interrelated, the Court shall resolve them together.

In the FDDA appeal before this Court, respondent found petitioner liable for deficiency income tax for the taxable year 2009, broken down as follows:

Tax Type	Basic Tax	Interest (Until Dec. 15, 2012)	Compromise Penalty	Total
Income Tax	₱85,606,325.70	₱45,656,421.69	₱50,000.00	₱131,312,747.39

[23] Resolution dated October 14, 2014.
[24] Docket, pp. 500-518.
[25] Stipulation of Issue, JSFI, Docket, p. 270.

According to respondent's findings in the FDDA, petitioner reported royalty income in the total amount of ₱856,063,257.00 in its Annual Income Tax Return (ITR) for the taxable year 2009 as non-taxable income. Verification of the said royalties allegedly disclosed that ₱855,902,703.30 represents royalty income derived from SMBI's use of certain Domestic IP Rights of petitioner, and ₱160,553.70 represents royalty income derived from MPLI's use of petitioner's Licensed Marks under the brand name "My Philippines" t-shirts which are in accordance with the primary purpose of petitioner; and that the royalty income was subjected to 20% final withholding tax by the payor and subjected to twelve percent (12%) value-added tax (VAT) by petitioner.

As stated in the FDDA and based on the BIR ruling cited therein, respondent asserts that "to be subject to the 20% final withholding tax, the royalties must be in the nature of passive income." Respondent points out that "the payment received by" petitioner "from the active conduct of trade or business is considered ordinary business income subject to the 30% regular corporate income tax pursuant to Section 27 (A) of the Tax Code".

Petitioner counters that its royalty income is passive income since it was not derived from the active conduct of trade or business.

At the outset, it must be emphasized that when assessments are assailed, the burden of proof is upon the complaining party. It is incumbent upon the complaining party to clearly show that the assessment was erroneous, in order to relieve himself from it.[26]

Also, as cases filed before this Court are litigated *de novo*, party-litigants must prove every minute aspect of their cases.[27]

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[26] *Commissioner of Internal Revenue vs. Construction Resources of Asia, et. al.*, G.R. No. L-68230, November 25, 1986, citing *Collector of Internal Revenue vs. Bohol Land Transportation Co.*, G.R. Nos. L-13099 and L-13462, April 29, 1960.
[27] *Dizon vs. Court of Tax Appeals, et. al.*, G.R. No. 140944, April 30, 2008.

Bearing these in mind, the Court shall determine whether petitioner presented sufficient evidence to prove that the subject assessment for deficiency income tax against petitioner for the taxable year 2009 was erroneously made.

Pertinent to the resolution of this matter is Section 57 of the National Internal Revenue Code (NIRC) of 1997, quoted hereunder for ready reference:

> 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.
>
> (B) *Withholding of Creditable Tax at Source.* – The Secretary of Finance may, upon the recommendation of the Commissioner, require the withholding of a tax on the items of income payable to natural or juridical persons, residing in the Philippines, by payor-corporation/persons as provided for by law, at the rate of not less than one percent (1%) but not more than thirty-two percent (32%) thereof, which shall be credited against the income tax liability of the taxpayer for the taxable year. *(Emphasis supplied)*

Section 57(A) expressly states that final tax can be imposed on certain kinds of income and enumerates these as passive income. Some of these passive incomes are mentioned in Section 24(B)(1) of the NIRC of 1997, as amended, including royalty income. The significant portion of Section 24(B)(1) provides:

> SEC. 24. *Income Tax Rates.* –
>
> xxx xxx xxx
>
> (B) *Rate of Tax on Certain Passive Income.* –
>
> (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 competitions, which shall be imposed a final tax of ten percent (10%); xxx

However, to be subject to the 20% final withholding tax, the royalties must be in the nature of a passive income.

In the case of *Chamber of Real Estate and Builders Associations, Inc. vs. The Hon. Executive Secretary Alberto Romulo, et al.*[28], the Supreme Court explained that the BIR defines passive income by stating what it is not:

> xxx if the income is generated in the **active pursuit and performance of the corporation's primary purposes**, the same is not passive income xxx[29] *(Emphasis supplied)*

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[28] G.R. No. 160756, March 9, 2010.
[29] BIR Ruling No. DA-501-2004, September 24, 2004.

In other words, passive income 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".[30]

On the other hand, taxable income means the pertinent items of gross income specified in the Tax Code, less the deductions and/or personal and additional exemptions, if any, authorized for these types of income. Under Section 32 of the Tax Code, gross income means income derived from whatever source, including compensation for services; the conduct of trade or business or the exercise of a profession; dealings in property; interests; rents; royalties; dividends; annuities; prizes and winnings; pensions; and a partner's distributive share in the net income of a general professional partnership. Section 34 enumerates the allowable deductions; Section 35, personal and additional exemptions.[31]

The definition of gross income is broad enough to include all passive incomes subject to specific rates or final taxes.[32] Thus, if the income is not part of the passive income subject to specific rates or final taxes, the same will still be part of the taxpayer's gross income subject to normal corporate income tax as provided in Section 27(A) of the NIRC of 1997, as amended.

To support its claim that the royalty income earned during the taxable year 2009 is passive income, petitioner presented its Amended Articles of Incorporation[33], Quarterly Income Tax Returns for taxable year 2009[34], Annual Income Tax Return for taxable year 2009[35], BIR Form No. 2306 for the period covering April to December 2009[36], Audited Financial Statements for the taxable year 2009[37], License

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[30] *Chamber of Real Estate and Builders Associations, Inc. vs. The Hon. Executive Secretary Alberto Romulo, et. al., supra. note 26*

[31] *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.* G.R. No. 160528, October 9, 2006.

[32] *Ibid.*

[33] Exhibit "P", Docket, pp. 348-355.

[34] Exhibits "P-2", "P-2-a", and "P-3-a", Docket, pp. 357-359.

[35] Exhibit "P-4-a", Docket, pp. 360-363.

[36] Exhibits "P-12", "P-12-a" and "P-12-b", Docket, pp. 387-389.

[37] Exhibit "P-13", Docket, pp. 391-411.

Agreement between petitioner and SMBI[38], and Judicial Affidavits of Atty. P. Clinton Laudencia, Jr.[39] and Noemi Ronquillo[40].

While an examination of the foregoing evidence shows that petitioner's income subject of the assessment is generated from its grant of license to use its IP rights to SMBI[41], and to MPLI[42], which are considered part of its assets, the Audited Financial Statements of petitioner for the taxable year ended December 31, 2009[43] indicate that the said income from royalties in the amount of ₱856,063,257.00 is the main source of income of petitioner for the taxable year 2009. This appears to be in line with petitioner's primary purpose, part of which is the owning, purchasing, licensing and/or acquiring such trademarks and other intellectual property rights necessary for the furtherance of its business as stated in petitioner's Articles of Incorporation[44]. Accordingly, there is factual basis to conclude that petitioner generated its royalty income in active pursuit and performance of its primary purpose.

Petitioner, on the other hand, alleges that while it may "own, purchase, license and/or acquire such trademarks and other intellectual property rights," these activities are merely incidental to and in furtherance of petitioner's main trade or business of "manufacturing, buying, selling (on wholesale) and dealing in alcoholic and non-alcoholic beverages".

Petitioner contends that engaging in a trade or business presupposes that the business activities are regular, continuous and considerable. Therefore, isolated or sporadic transactions do not constitute as the conduct of a trade or business. A casual business activity does not amount to engaging in trade or business in the Philippines for income tax purposes. Transactions which are occasional, incidental and casual do not constitute the doing or engaging in business contemplated by law.

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[38] Exhibit "P-14", Docket, pp. 412-422.
[39] Exhibit "P-15", Docket, pp. 100-109.
[40] Exhibit "P-16", Docket, pp. 292-301.
[41] Exhibit "P-14", Docket, pp. 412-422.
[42] Exhibit "R-3", Docket, pp. 220-224.
[43] Exhibit "P-13", Docket, pp. 391-411.
[44] Exhibit "P", Docket, pp. 348-355.

From the above definition given by petitioner, it cannot be said that the act of licensing out petitioner's IP rights is an incidental transaction considering that its Audited Financial Statements for the taxable year 2009 clearly show that the main source of petitioner's income is the royalty payments made by SMBI and MPLI.

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

On this matter, let it be noted that the rates of tax provided under Section 27(D) of the NIRC of 1997, as amended, pertains to **certain passive income**. As previously mentioned, if the income is generated in the **active pursuit and performance of the corporation's primary purposes**, the same is not passive income. In view of the Supreme Court's pronouncement as regards the definition of passive income, the determination as to whether the royalty income is passive income is necessary before the tax rates provided in Section 27(D) of the NIRC of 1997, as amended, may apply to the said royalty income. Thus, the Court finds petitioner's argument bereft of merit.

All the foregoing only leads the Court to conclude that petitioner's income from licensing out its IP rights is income generated in active pursuit and performance of petitioner's primary purpose and thus, is not passive income.

Also, while petitioner's tax manager, Atty. P. Clinton Laudencia, Jr.,[45] and the Manager of SMBI's Accounting and Financial Services Department[46] 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", petitioner's financial

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[45] Exhibit "P-15", Docket, pp. 100-109.
[46] Exhibit "P-16", Docket, pp. 292-301.

statements, however, show that 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. The said financial statements also indicate no source of income other than petitioner's royalty income and interest income.

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 for the taxable year 2009.[47] In addition, the Annual Income Tax Return[48] of petitioner for the taxable year 2011 showed no cost of sales/services for such taxable year, thus giving this 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.

Considering the above discussion, petitioner's evidence failed to support its claim that the royalties in the taxable year 2009 were not earned in active pursuit or performance of its primary purpose. Hence, petitioner failed to discharge its burden to prove that the assessment was erroneously made.

At this juncture, it must be emphasized that tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment. It is to be presumed, however, that such assessment was based on sufficient evidence. Upon the introduction of the assessment in evidence, a *prima facie* case of liability on the part of the taxpayer is made. If a taxpayer files a Petition for Review before this Court and assails the assessment, the *prima facie* presumption is that the assessment made by the BIR is correct, and that in preparing the same, the BIR personnel regularly performed their duties. This rule for tax initiated suits is premised on several factors other than the normal evidentiary rule imposing proof obligation on petitioner-taxpayer: the presumption of administrative regularity; the

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[47] Docket, p. 399.
[48] Docket, p. 399.

likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the Tax Code. However, the *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious.[49]

Since petitioner failed to present substantial evidence to overturn the presumption of correctness of respondent's assessment, the assessment against petitioner for deficiency income tax on its royalty income for the taxable year 2009 is upheld, except for the compromise penalty.

It must be stressed that a compromise penalty is imposed to avoid prosecution for violation of the provisions of the Tax Code.[50] Pursuant to Revenue Memorandum Order (RMO) No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on a taxpayer in the event that a taxpayer refuses to pay the same. Clearly, the compromise penalty implies a mutual agreement between the parties in respect to the thing or subject matter which is so compromised. The imposition of the compromise penalty without the conformity of the taxpayer is illegal and unauthorized.[51]

In this case, there is nothing in the records which would show that petitioner consented to the compromise penalty. Consequently, the compromise penalty should not be imposed and must be cancelled.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. The compromise penalty assessed by respondent against petitioner in the amount of ₱50,000.00 is hereby **CANCELLED**. On the other hand, the remaining amount in the assessment covering deficiency income tax for the

[49] *Commission of Internal Revenue vs. Hantex Trading Corp., Inc.* G.R. No. 136975, March 31, 2005.
[50] *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et. al.,* G.R. Nos. L-12928 and L-12932, March 31, 1962.
[51] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc. et. al.*, G.R. No. L-35266, January 21, 1991.

taxable year 2009 is hereby **AFFIRMED** with some modifications. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **₱88,254,300.60** representing basic deficiency income tax for the taxable year 2009 inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, computed as follows:

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

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

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

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

SO ORDERED.

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

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

ERLINDA P. UY
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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
Chairperson, 1st Division