REPUBLIC OF THE PHILIPPINES
Court Of Tax Appeals
QUEZON CITY

THIRD DIVISION

KEPCO ILIJAN CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 8091

Members:

BAUTISTA, Chairperson,
PALANCA-ENRIQUEZ, and
COTANGCO-MANALASTAS, JJ.

Promulgated:
OCT 23 2012
Fernando 11:36 a.m.

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D E C I S I O N

PALANCA-ENRIQUEZ, J.:

THE CASE

This is a Petition for Review filed by Kepco Ilijan Corporation (hereafter "petitioner") praying for the withdrawal of the Formal Letter of Demand (FLD), dated August 20, 2009 issued by respondent Commissioner of Internal Revenue for the assessment of deficiency value-added tax (VAT) and final withholding tax (FWT) for taxable year 2006, in the total amount of P93,557,711.63.

THE PARTIES

Petitioner is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines, with principal place of business at 18th Floor Citibank Tower, 8741 Paseo de Roxas, Salcedo Village, Makati City.

Respondent, on the other hand, is the duly appointed Commissioner of Internal Revenue, vested under appropriate laws, with authority to carry out all functions, duties and responsibilities of said office, including inter alia, the power to decide, approve and grant tax protests, and holds office at the 5th Floor, BIR National Office Building, BIR Road, Diliman, Quezon City.

THE FACTS

The facts, as culled from the records, are, as follows:

On August 25, 2009, petitioner received a Formal Letter of Demand, issued by respondent, for deficiency VAT and FWT for taxable year 2006 in the total amount of P93,557,711.63, inclusive of penalties and surcharges.

On September 23, 2009, petitioner filed its letter-protest disputing the assessment.

Alleging inaction, on April 21, 2010, petitioner filed the instant Petition for Review.

On May 31, 2010, respondent filed her Answer and alleged by way of special and affirmative defenses that: audit and investigation disclosed that petitioner declared in its 4th quarter VAT return zero-rated sales amounting to P242,947,485.67 which it failed to explain the nature of such receipts, hence, subject to 12% VAT; petitioner failed to treat receipts amounting to P700,188.39 subject to VAT, as it is a miscellaneous income, incidental to its business, from penalties imposed to suppliers for late deliveries of goods as stated in the contract and collection from accommodation of visitors on its dormitory; petitioner is liable for deficiency VAT in the amount of P29,237,720.89, pursuant to Section 108 of the NIRC of 1997, as amended; petitioner is liable for underwithholding of final tax on various payments to non-resident corporations amounting to P101,851,105.07; thus, it is liable for deficiency FWT in the amount of P32,592,353.62; the documents presented by petitioner were not sufficient to cancel the assessment; and tax assessments are entitled to the presumption of correctness and made in good faith; thus, the taxpayer has the duty to prove otherwise.

Petitioner presented Jane Pagkalinawan and Godofredo Saises, as witnesses, and documentary evidence, marked as *Exhibits "A" to "K"*, inclusive of their submarkings, which were admitted by the Court in its Resolutions dated April 1, 2011 and July 13, 2011.

On the other hand, respondent presented Theresa Carillo and Teresita Villamor, as witnesses, and documentary evidence, marked as *Exhibits "1" to*

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"17", inclusive of their submarkings, which were admitted by the Court in a Resolution dated February 3, 2012.

Thereafter, both parties were ordered to file their simultaneous memoranda, within thirty (30) days from notice; afterwhich, the case shall be deemed submitted for decision.

Considering petitioner "Memorandum" filed on April 10, 2012 and respondent's "Memorandum (for Respondent)" filed on April 3, 2012, this case was deemed submitted for decision on April 13, 2012.

THE ISSUES

As stipulated upon by the parties, the following are the issues for this Court's consideration:

I

WHETHER OR NOT PETITIONER IS LIABLE TO PAY THE ASSESSED VAT WITH RESPECT TO THE SALES ADJUSTMENT RELATED TO THE SALE OF ITS ELECTRICITY (from December 25, 2003 to October 31, 2005) TO THE NATIONAL POWER CORPORATION (NPC) REFLECTED IN ITS 4^{TH} QUARTER RETURN FOR THE TAXABLE YEAR 2006 IN THE AMOUNT OF P44,170,922.37.

II

WHETHER PETITIONER, PENDING THE APPROVAL OF ITS TAX TREATY EXEMPT RULING APPLICATION, IS LIABLE TO PAY THE ASSESSED FINAL TAX WITH RESPECT TO (A) THE PAYMENTS IT MADE TO KEPCO FOR THE LATTER'S EXPENSES INCURRED IN SECURING THE

PERFORMANCE SECURITY BOND AND (B) PAYMENTS UNDER THE MTSA WHICH ARE WITHIN THE PURVIEW OF THE R.P.-KOREA TAX TREATY IN THE AMOUNT OF P49,386,789.26.

Principal Issue

The foregoing issues raised by both parties boil down to the principal issue of whether or not petitioner may be held liable to pay the assessed deficiency VAT and FWT in the total amount of P93,557,711.63, all for taxable year 2006.

THE COURT'S RULING

The petition has no merit.

Respondent assessed petitioner for deficiency VAT and FWT in the aggregate amount of P93,557,711.63, broken down, as follows:

	Basic	Interest	Compromise	Total
VAT	₱ 29,237,720.89	₱14,883,201.48	₱ 50,000.00	**₱ 44,170,922.37**
FWT	32,592,353.62	16,769,435.64	25,000.00	**49,386,789.26**
Total	**₱ 61,830,074.51**	**₱31,652,637.12**	**₱ 75,000.00**	**₱93,557,711.63**

Assessment for Deficiency VAT

The assessment for deficiency VAT was computed, as follows:

Gross Taxable Sales per VAT Returns		₱6,587,091,396.01
Add: Adjustments		
Zero-rated sales per 4th Qtr returns	₱242,947,485.67	
Miscellaneous Income	700,188.39	243,647,674.06
Adjusted Taxable Base		₱6,830,739,070.07
Multiply by VAT Rate (see Computation)		12%

Output Tax per Audit		₱ 806,045,806.62
Less: Input Tax		
Deferred Input Tax, Beg.	₱ 395,629.20	
Current Input Tax	79,488,587.68	
Total Available Input Tax	79,884,216.88	
Less: Deferred Input Tax End	(25,203,127.20)	
Excess of standard input & actual input tax	419,252,959.87	
Total Available Input Tax		473,934,049.55
VAT Payable per Audit		₱ 332,111,757.07
Less: Creditable Taxes Withheld		302,874,036.18
Basic Tax Due		₱ 29,237,720.89
Add: 20% Interest (1-26-07 to 8-15-2009)	₱14,883,201.48	
Compromise Penalty	50,000.00	14,933,201.48
Total Deficiency VAT		**₱ 44,170,922.37**

(Exhibit "A")

As regards the assessment for 12% VAT on petitioner's zero rated sales amounting to P242,947,485.67, respondent claims that petitioner declared said amount in its 4th quarter VAT return, but failed to explain the nature of such receipts, hence, are subject to 12% VAT on the assumption that these payments were related to billed, but uncollected sale of electricity to NPC, and as such, are subject to the transitory provisions of *RA 9337*, particularly the need to provide an inventory and submission of any report to the BIR regarding any pending "billed but uncollected sale of service".

Petitioner, on the other hand, maintains that the amount of P242,947,485.67, declared in its 4th quarter VAT return, is related to tariff revenue adjustments paid by NPC from December 25, 2003 until October 31,

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2005, which has been billed and collected prior to the effectivity of *RA 9337,* hence, there is no reason for the applicability of the transitory provisions provided under said law, or its implementing Revenue Regulation related to it. Further, these adjustments pertain to the United States Producers Price Index and Philippine Consumer Price Index adjustment factors allowed under the Energy Conversion Agreement (ECA) between petitioner and NPC. Under the 8th Schedule of ECA, petitioner (therein referred to as the "Generator") shall bill and NPC shall pay the following fees:

1) Availability Fees composed of the Capital Recovery Fees and Fixed Operating and Maintenance FEE (FOMF); and
2) Energy Fees (EF).

Pursuant to the Energy Commission Agreement, the aforesaid fees are subject to adjustments, to wit:

> "If any such value (the price indices) is adjusted and later published as so adjusted, any amounts paid or payable under this Agreement (the ECA) by reference to such value shall be recalculated and any resultant over or under payment shall be repaid or paid as appropriate, with interest at the Agreed Interest Rate."

Records show that on December 14, 2006, petitioner billed NPC for the adjustment of the sale of electricity covering the period of December 25, 2003 until October 31, 2005 *(Exhibit "D").* At the outset, such sales adjustments may be considered as zero-rated sales, as they are clearly covered by *Revenue*

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Memorandum Circular (RMC) No. 61-05, dated October 27, 2005 *(Exhibit "G-1"),* and *ERC Resolution No. 20 Series of 2005 (Exhibit "F-1"),* which provides:

> "Generation rate and foreign exchange rate adjustments to electricity sold on or before October 31, 2005, although billed and collected thereafter shall be considered as VAT zero-rated."

However, the above provisions must be read in conjunction with the provisions of *RR 16-2005*, which prescribe the conditions on the treatment of sales made before or after the effectivity of *RA 9337*, to wit:

> **"TRANSITORY AND OTHER PROVISIONS**
>
> (c) *Billed but uncollected sale of services.* – Amounts due on sale of services becoming liable to VAT under RA No. 9337 rendered before the effectivity of RA No. 9337, payments of which are received on or after the effectivity of RA No. 9337, shall be considered as accrued as of the day immediately preceding the effectivity of RA No. 9337 for the purpose of VAT exemption and payment of any applicable percentage tax, if any, or VAT exemption as the case may be, subject to the following conditions:
>
> (i) Information return to be filed on or before sixty (60) days from the effectivity of RA No. 9337 showing the name(s) of the contractor(s), client(s), customer(s) and the amount(s) of the contract price outstanding as of the day immediately preceding the effectivity of RA No. 9337, and containing a declaration of the obligation to pay the applicable percentage tax due if any;
>
> (ii) The seller billed the amount before the effectivity of RA No. 9337, and a copy of such billing is attached to the information return required in (1) hereof;
>
> (iii) The seller has recorded in his books of accounts as of the day immediately preceding the effectivity of RA No. 9337 the amount receivable; and
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> (iv) The seller files on or before the 20th day after each month, the regular percentage tax return for the payment of the

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> percentage tax on payments received after the effectivity of RA No. 9337.
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> In the case of sale of electricity, if a billing period covers power consumption for the period before and after the effectivity of RA No. 9337, 10% shall be applied only to electricity consumption for the period on or after the effectivity of RA No. 9337. The electricity consumption before the effectivity of RA No. 9337 shall not be subject to 10% VAT but to the applicable franchise/percentage tax.
>
> **Failure to comply with the above-stated conditions shall automatically subject the gross receipts to the VAT**." *(Emphasis supplied)*

Basic is the rule that an assessment is presumed valid and the taxpayer has the burden to overcome this presumption. A perusal of the evidence adduced by petitioner shows that petitioner failed to show compliance with the aforesaid conditions. For failure of petitioner to comply with the conditions prescribed under *RR 16-2005*, we find respondent's assessment for 12%VAT on petitioner's gross receipts amounting to P242,947,485.67 valid.

As to the alleged miscellaneous income, respondent maintains that petitioner failed to treat the receipts amounting to P700,188.39, consisting of miscellaneous income from penalties imposed to suppliers for late deliveries of goods and collection from accommodation of visitors on its dormitory, as subject to VAT considering that it is income incidental to its business.

Petitioner, on the other hand, claims that a) the P100,450.00 are payments made by visitors of the Ilijan dormitory for purposes of maintenance and not for the purpose of generating income; and b) the payment for penalties imposed by petitioner to its supplier or contractors for late delivery of goods is not subject to VAT as it is not an income arising from services or even related to its business, but mere indemnification arising out of a breach of contract by supplier when it incurs a delay in the delivery of the goods within the agreed timeframe provided under the relevant agreements. Likewise, such payment amounting to only P140,500.00, not having exceeded the amount of P550,000.00, is VAT exempt, pursuant to *Section 109(z) of the NIRC of 1997*, which provides:

> "SEC. 109. *Exempt Transactions.* – The following shall be exempt from the value-added tax:
>
> xxx xxx
>
> (z) Sale or lease of goods or properties or the performance of services other that the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of Five hundred fifty thousand pesos (P550,000.00): xxx"

Corollary thereto, *Section 105 of the NIRC of 1997, as amended*, provides:

> "SEC. 105. *Persons Liable.* - Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to value-added tax (VAT) imposed in Sections 106 to 108 of this Code.
>
> xxx xxx
>
> The phrase 'in the ordinary course of trade or business' means the regular conduct or pursuit of a commercial or an economic activity, **including transactions incidental thereto**, by any person regardless of whether or not the person engaged therein is a non-stock, non-profit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity." *(Emphasis supplied)*

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Pursuant to the above provisions, the VAT is imposed on a sale or transaction entered into by a person in the course of any trade or business. A transaction is in the course of trade or business when: (1) regularly conducted; and (2) undertaken in pursuit of a commercial or economic activity. Likewise, transactions that are made incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business. "Incidental" means something else as primary; something necessary, appertaining to, or depending upon another, which is termed the principal *(Deoferio, Jr. And Mamalateo, The Value Added Tax In The Philippines, First Edition, pp. 81-82)*. Hence, an isolated transaction is not necessarily disqualified from being made incidentally in the course of trade or business.

In this case, by petitioner's own admission, the amount of P700,188.39 was acquired in connection with its business transactions, though the same may not be directly connected with its sale of electricity. Clearly, the same are incidental transactions in the pursuit of petitioner's business. Accordingly, petitioner's miscellaneous income, being incident to the pursuit of its commercial or economic activity, should be subjected to VAT.

In sum, petitioner is still liable for deficiency VAT of P29,237,720.89 computed, as follows:

Gross Taxable Sales per VAT Returns		₱6,587,091,396.01
Add: Adjustments		
Zero-rated sales per 4th Qtr returns	₱242,947,485.67	
Miscellaneous Income	700,188.39	243,647,674.06
Adjusted Taxable Base		₱6,830,739,070.07
Multiply by VAT Rate		12%
Output Tax per Audit		₱ 806,045,806.62
Less: Input Tax		
Deferred Input Tax, Beg.	₱ 395,629.20	
Current Input Tax	79,488,587.68	
Total Available Input Tax	79,884,216.88	
Less: Deferred Input Tax End	(25,203,127.20)	
Excess of standard input & actual input tax	419,252,959.87	
Total Available Input Tax		473,934,049.55
VAT Payable per Audit		₱ 332,111,757.07
Less: Creditable Taxes Withheld		302,874,036.18
Basic Deficiency Tax Due		**₱ 29,237,720.89**

Assessment for Deficiency FWT

Respondent assessed petitioner for deficiency final withholding tax amounting to P49,386,789.26, inclusive of interests and penalty, for under-withholding of final tax on various income payments to a non-resident corporation computed, as follows:

Final withholding Tax Due Per Audit		₱33,224,779.63
Final withholding Tax Paid		632,426.01
Deficiency Final Withholding Tax		32,592,353.62
Add: Interest (1-11-2007 to 8-15-2009)	₱16,769,435.64	
Compromise Penalty	25,000.00	16,794,435.64
Total Deficiency Final Tax		**₱ 49,386,789.26**

(Exhibit "A")

Petitioner, on the other hand, maintains that the assessed amount of P49,386,789.26 was imposed on the a) reimbursement made by petitioner to Korea Electric Power Corporation (hereafter "KEPCO") with respect to the expenses incurred by KEPCO in posting the necessary performance security in favor of NPC amounting to P36,472,139.14; and b) payments made to KEPCO, pursuant to the Management and Technical Services Agreement executed in November 2000 in the total amount of P65,378,965.93.

As regards the posting of performance security, petitioner contends that it was KEPCO which procured the necessary performance security from the Korea Exchange Bank in view of its financial and credit standing. Necessarily, KEPCO incurred certain charges for the posting of performance security equivalent to 1% of the performance security. These charges incurred by KEPCO must be reimbursed by petitioner. As reimbursement, they do not constitute as income on the part of KEPCO, which will be subjected to any final or withholding tax.

Petitioner's contention is bereft of factual basis.

The evidence adduced by petitioner *(Exhibits "H", "I", "I-1", "J")* failed to establish the fact that the amount of P36,472,139.14 represents a reimbursable amount and not profit or income remittance or allocation to KEPCO. The alleged Agreement pertaining to the reimbursement mechanism

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mentioned by petitioner is insufficient to grant its claim considering that the same was not formally offered as evidence before this Court. Hence, mere allegations without evidence to prove the same cannot be a basis to strike out a presumptively valid assessment.

As to the second component which consists of the payments made to KEPCO in relation to the Management and Technical Service Agreement, petitioner claims that it merely adopted BIR Ruling No. DA-ITAD 83-05, dated August 22, 2005, and BIR Ruling No. DA-ITAD 149-06, dated December 8, 2006, issued in its favor in a similar transaction covering the years 2002 until 2005 *(Exhibits "I" and "I-1")* declaring said payments as exempt from any final or withholding tax, pursuant to the provisions of the R.P.-Korea Tax Treaty.

A perusal of both BIR Ruling No. DA-ITAD 83-05 and BIR Ruling No. DA-ITAD 149-06 shows that they were issued upon finding of petitioner's compliance with the requirements provided under the R.P.-Korea Tax Treaty. Clearly, the relief provided under R.P.-Korea Tax Treaty is not automatic, thus, petitioner has the burden of proving that it complied with the requirements of the aforesaid agreement.

In this regard, records show that petitioner's request for a tax treaty relief ruling for taxable year 2006 is still pending with the BIR *(Exhibit "H")*.

Therefore, petitioner's compliance with the R.P.-Korea Tax Treaty is still pending determination by the BIR. Moreover, petitioner merely presented its letter-request to show that it has a pending application with the BIR, but failed to present supporting evidence; thus, this Court cannot rule on petitioner's compliance with the R.P.-Korea Tax Treaty.

Consequently, this Court finds petitioner liable to pay basic deficiency tax due amounting to P32,592,353.62, computed, as follows:

Guarantee Fees	₱ 36,472,139.14
Technical & Advisory Services	65,378,965.93
Total	₱ 101,851,105.07
Final Tax Rate	32%
Basic Deficiency Tax Due	**₱ 32,592,353.62**

As regards the compromise penalty of P75,000.00, the same is hereby cancelled there being no mutual agreement between the parties. Settled is the rule that the imposition of the same without the conformity of the taxpayer is illegal and unauthorized *(Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., 193 SCRA 92)*. *RMO 1-90* expressly provides that "compromise penalties are only amounts suggested in settlement of criminal liability, and may not therefore be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the suggested compromise penalty". Considering that petitioner did not pay the compromise penalty imposed by the respondent, it clearly did not agree to settle the same.

WHEREFORE, premises considered, the instant Petition for Review is hereby **DENIED,** and accordingly **DISMISSED** for lack of merit. Accordingly, petitioner Kepco Ilijan Corporation is hereby **ORDERED TO PAY** respondent Commissioner of Internal Revenue the aggregate amount of **SEVENTY SEVEN MILLION TWO HUNDRED EIGHTY SEVEN THOUSAND FIVE HUNDRED NINETY THREE and 14/100 PESOS (P77,287,593.14)**, representing deficiency VAT and Final Withholding Taxes for the taxable year 2006, inclusive of the 25% surcharge imposed under *Section 248(A)(3) of the NIRC of 1997, as amended*, computed, as follows:

	Basic	**25% Surcharge**	**Total**
VAT	₱29,237,720.89	₱ 7,309,430.22	₱36,547,151.11
FWT	32,592,353.62	8,148,088.41	40,740,442.03
Total	₱61,830,074.51	₱15,457,518.63	**₱77,287,593.14**

In addition, petitioner is ordered to pay:

(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT of P29,237,720.89 computed from January 25, 2007 and on the basic deficiency FWT of P32,592,353.62 computed from January 15, 2007, until full payment thereof, pursuant to *Section 249(B) of the NIRC of 1997, as amended*; and

(b) delinquency interest at the rate of twenty percent (20%) per annum on the total deficiency taxes of P77,287,593.14 and on the 20% deficiency interest which has accrued, as aforestated in paragraph (a) hereof, computed from August 15, 2009 until full payment thereof, pursuant to *Section 249(C) of the NIRC of 1997, as amended.*

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

(On Leave)
AMELIA R. COTANGCO-MANALASTAS
Associate Justice

A T T E S T A T I O N

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 Article VIII, Section 13 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.

ERNESTO D. ACOSTA
Presiding Justice