REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

ACES PHILIPPINES CELLULAR SATELLITE CORPORATION, *Petitioner,*	**CTA CASE NO. 8567**
	Members: **CASTAÑEDA, JR.,** *Chairperson* **CASANOVA,** and **COTANGCO-MANALASTAS,** *JJ.*
-versus-	
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	**Promulgated:** JUL 23 2014 2:10 p.m.

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DECISION

COTANGCO-MANALASTAS, *J.*:

STATEMENT OF THE CASE

Before this Court is the Petition for Review filed on November 5, 2012 by Aces Philippines Cellular Satellite Corporation (petitioner) to appeal the Final Decision on Disputed Assessment (FDDA) issued by the Commissioner of Internal Revenue (respondent), which denied petitioner's protest of Final Assessment Notice (FAN) No. 019-E-0704006650 and Revised Report of Investigation dated June 13, 2012 that found petitioner liable for deficiency final withholding tax for taxable year 2006.

STATEMENT OF FACTS

Petitioner Aces Philippines Cellular Satellite Corporation is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office address at Group V Naval Magazine, Subic Bay Freeport Zone. It is registered with the Subic Bay Metropolitan Authority as a Subic Bay Freeport Enterprise for the purpose of engaging in the business of providing communication services via satellite, having been issued a

Certificate of Registration and Tax Exemption No. 99-0010 dated November 12, 2006.[1]

On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) vested with authority to exercise the functions of said office, including, *inter alia,* the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto, or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. She holds office at the BIR National Office Building, Diliman, Quezon City.

In 1995, petitioner was incorporated in the Philippines to operate telecommunications gateways and equipment involving the processing, storage, monitoring and retrieval of data, image, voice, audio and tone.[2]

On March 12, 1997, petitioner, through its parent company Philippine Long Distance Telephone Company (PLDT), entered into an Air Time Purchase Agreement with P.T. Asia Cellular Satellite (PTACS), a company duly established and organized in Indonesia. The said agreement was subsequently assigned by PLDT to petitioner, while PTACS assigned the same agreement to Aces International Limited (AIL) in 1998.[3] AIL is a foreign corporation duly established and organized in Bermuda. Its principal business objective is to provide and develop a mobile satellite telecommunication network in the Asia-Pacific region and to engage in any other business required to achieve the said objective.[4]

The agreement granted petitioner the right to purchase satellite communications time from AIL which petitioner sells and furnishes to its subscribers, the consideration for which is the payment of satellite airtime fees by petitioner to AIL.[5]

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[1] Pars. 1.02 and 1.03, Stipulation of Facts, Joint Stipulation of Facts (JSF), docket, pp. 1407-1408
[2] Par. 1.04, Stipulation of Facts, JSF, docket, p. 1408
[3] Par. 1.05, Stipulation of Facts, JSF, docket, p. 1408
[4] Par. 1.07, Stipulation of Facts, JSF, docket, p. 1408
[5] Par. 1.06, Stipulation of Facts, JSF, docket, p. 1408

Petitioner received a copy of the BIR Letter of Authority (LOA) No. 00051992 dated August 21, 2007 on September 5, 2007, designating Revenue Officer Leilani Arellano under the supervision of OIC-Assistant Revenue District Officer Esperanza Castro of Revenue District Office (RDO) No. 19, Revenue Region No. 4, to examine petitioner's books of accounts and other accounting records for all internal revenue taxes for taxable year 2006.[6]

Subsequently, petitioner received the First Notice for Presentation of Records (BIR First Notice) from the BIR dated August 28, 2007, enumerating the list of audit requirements pursuant to BIR LOA No. 00051992. Petitioner likewise received a Second Notice for Presentation of Records dated September 20, 2007, reiterating BIR's request for the presentation of petitioner's books of accounts and accounting records for taxable year 2006 pursuant to BIR LOA No. 00051992.[7]

Thereafter, petitioner transmitted the documents requested in the BIR's First and Second Notices in a letter dated October 4, 2007, which was received by BIR RDO No. 19 on October 10, 2007. Petitioner, in the same letter, requested to be allowed to complete the rest of the requirements until the end of October 2007.[8]

On December 8, 2009, petitioner executed a Waiver of the Defense of Prescription under Statute of Limitation of the National Internal Revenue Code to extend the period for the assessment of taxes up to December 31, 2010. This waiver was received by the BIR on December 9, 2009.[9]

Petitioner then submitted to the BIR additional documents relative to the BIR audit through a transmittal memo dated June 1, 2010, which was received on June 3, 2010.[10]

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[6] Pars. 1.09 and 1.10, Stipulation of Facts, JSF, docket, p. 1409
[7] Pars. 1.11 and 1.12, Stipulation of Facts, JSF, docket, p. 1409
[8] Par. 1.13, Stipulation of Facts, JSF, docket, p. 1409
[9] Par. 1.14, Stipulation of Facts, JSF, docket, p. 1409
[10] Par. 1.15, Stipulation of Facts, JSF, docket, p. 1409

On June 10, 2010, petitioner received a Notice of Informal Conference[11] dated May 27, 2010 from respondent, through then OIC-Revenue District Officer Rey Roberto Manalili of RDO No. 19, relative to petitioner's alleged deficiency income tax, expanded withholding tax (EWT), final withholding tax (FWT), and documentary stamp tax (DST), inclusive of penalties, the total of which amounted to P176,688,087.39. The said Notice further advised petitioner to attend the informal conference within fifteen (15) days from receipt, otherwise, an assessment will be issued for approval by higher authorities.

Petitioner attended the informal conference on June 28, 2010, wherein petitioner and respondent discussed the details of the initial findings in the Notice and petitioner informed respondent that it will submit a position paper to address the said findings.[12]

On July 1, 2010, petitioner wrote OIC-Revenue District Officer Rey Roberto Manalili, requesting an extension of fifteen days from date of informal conference to submit the position paper. This letter was received on July 6, 2010.[13]

On July 2, 2010, petitioner executed another Waiver of the Defense of Prescription under Statute of Limitation of the National Internal Revenue Code to extend the period for the assessment of taxes up to March 31, 2011.[14]

Petitioner submitted its position paper on the findings of deficiency taxes enumerated in the Notice of Informal Conference on July 12, 2010.[15]

On August 2, 2010, petitioner received a letter from RDO No. 19 dated July 23, 2010, containing revised findings of deficiency taxes after taking into consideration the position paper filed by petitioner. The letter stated that there is still

[11] Pars. 1.16 and 1.17, Stipulation of Facts, JSF, docket, p. 1410
[12] Par. 1.18, Stipulation of Facts, JSF, docket, p. 1410
[13] Par. 1.19, Stipulation of Facts, JSF, docket, p. 1410
[14] Par. 1.20, Stipulation of Facts, JSF, docket, p. 1410
[15] Par. 1.21, Stipulation of Facts, JSF, docket, p. 1410

found due from petitioner deficiency EWT and FWT, inclusive of penalties, amounting to P136,458,794.53.[16]

Thereafter, petitioner filed a supplemental position paper dated August 12, 2010, addressing the issues raised in the revised findings, which was received by the office of Atty. Romulo Aguila, Jr., Regional Director of Revenue Region No. 4, on August 18, 2010.[17]

On January 21, 2011, respondent, as represented by the Regional Director of Revenue Region No. 4, issued a Preliminary Assessment Notice (PAN) to inform petitioner of its final withholding tax, value-added tax, and expanded withholding tax liabilities, inclusive of penalties, amounting to P147,755,274.69. Petitioner received the PAN on March 2, 2011.[18]

Petitioner filed a position paper against the PAN dated March 22, 2011, which was received by respondent through the Office of the Regional Director of Revenue Region No. 4 on March 28, 2011.[19]

Petitioner received a Formal Letter of Demand and FAN No. 019-E-0704006650 with the corresponding details of discrepancies dated February 14, 2011 from respondent as represented by the Regional Director of BIR Revenue Region No. 4, reiterating the demand for payment of deficiency FWT, VAT, and EWT, inclusive of penalties, amounting to P152,759,792.12. Petitioner received the FAN on March 22, 2011.[20]

On April 14, 2011, petitioner filed its protest letter to the FAN dated April 8, 2011, pursuant to Section 228 of the NIRC of 1997, as amended, which allows a taxpayer thirty (30) days from receipt of the assessment to protest the FAN.[21]

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[16] Par. 1.22, Stipulation of Facts, JSF, docket, pp. 1410-1411
[17] Par. 1.23, Stipulation of Facts, JSF, docket, p. 1411
[18] Pars. 1.24 and 1.25, Stipulation of Facts, JSF, docket, p. 1411
[19] Par. 1.26, Stipulation of Facts, JSF, docket, p. 1411
[20] Pars. 1.27 and 1.28, Stipulation of Facts, JSF, docket, p. 1411
[21] Par. 1.29, Stipulation of Facts, JSF, docket, p. 1412

On May 23, 2011, petitioner received a facsimile copy of a letter from respondent, stating the following matters: (1) referral of the BIR audit of petitioner for taxable year 2006 to another BIR revenue officer, Ms. Gracita Agaton; (2) re-investigation of the alleged deficiency taxes indicated in the FAN; and (3) request for detailed schedule of gross receipts and audit transaction trail of interconnection fee.[22]

On June 13, 2011, petitioner transmitted the requested documents in a letter dated June 9, 2011 to respondent through Atty. Maglangit S. Decampong, the OIC-Assistant Revenue District Officer of RDO No. 19.[23]

Petitioner received a facsimile copy of an Amended Notice of Informal Conference dated August 10, 2011 from respondent through the OIC-Assistant Revenue District Officer of RDO No. 19, informing petitioner of the revised findings of alleged deficiency taxes after the results of re-investigation. The Amended Notice showed deficiency expanded withholding taxes and final withholding taxes, inclusive of penalties, amounting to P147,762,520.41.[24]

On August 23, 2011, petitioner paid the deficiency expanded withholding taxes, inclusive of penalties, as indicated in the Amended Notice amounting to P80,421.88 through the BIR e-filing and e-payment system.[25]

In a letter dated August 24, 2011, petitioner protested the deficiency final withholding tax assessment in the Amended Notice, which was received by the Revenue District Officer of RDO No. 19 on September 7, 2011.[26]

On October 12, 2011, petitioner received a facsimile copy of a letter dated October 11, 2011 from respondent, requiring petitioner to submit additional documents in order to clarify issues raised by the Assessment Division of Revenue Region No. 4.[27]

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[22] Par. 1.30, Stipulation of Facts, JSF, docket, p. 1412
[23] Par. 1.31, Stipulation of Facts, JSF, docket, p. 1412
[24] Par. 1.32, Stipulation of Facts, JSF, docket, p. 1412
[25] Par. 1.34, Stipulation of Facts, JSF, docket, p. 1412
[26] Par. 1.35, Stipulation of Facts, JSF, docket, p. 1413
[27] Par. 1.36, Stipulation of Facts, JSF, docket, p. 1413

Petitioner submitted the requested documents to respondent, through the office of the Revenue District Officer of RDO No. 19, in a letter dated October 25, 2011. The said letter and the requested documents were received on November 2, 2011 by Ms. Gracita Agaton, Revenue Officer of the Assessment Division.[28]

On December 15, 2011, petitioner received a facsimile copy of another Amended Notice of Informal Conference (Second Amended Notice) from respondent through Mr. Rey Roberto Manalili, the Revenue District Officer of RDO No. 19, informing petitioner of the revised findings involving the alleged deficiency final withholding taxes.[29] Petitioner in a letter dated December 20, 2011 filed a position paper to the Second Amended Notice which was received on December 22, 2011.[30]

On February 28, 2012, petitioner received a facsimile copy of a letter dated on the same date from the office of Atty. Maglangit S. Decampong, the OIC-Assistant Revenue District Officer of RDO No. 19, informing petitioner that the Legal Division of Revenue Region No. 4 has issued a memorandum bearing the final resolution on the issue of the deficiency final withholding taxes. The letter likewise mentioned the endorsement of the case to Revenue Region No. 4 for the issuance of the final decision on disputed assessment.[31]

On March 7, 2012, petitioner submitted to respondent, through the office of Ms. Araceli Francisco, the Regional Director of Revenue Region No. 4, a copy of the financial statements of the non-resident payee subject of the alleged deficiency final withholding taxes in order to bolster petitioner's stance that the purported deficiency final withholding taxes should be withdrawn and cancelled.[32]

Petitioner received a copy of the Revised Report of Investigation dated June 13, 2012 from the office of Atty. Maglangit S. Decampong, the OIC-Assistant Revenue District Officer, on June 19, 2012, stating the remaining findings of

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[28] Par. 1.37, Stipulation of Facts, JSF, docket, p. 1413
[29] Par. 1.38, Stipulation of Facts, JSF, docket, p. 1413
[30] Par. 1.39, Stipulation of Facts, JSF, docket, p. 1413
[31] Par. 1.40, Stipulation of Facts, JSF, docket, pp. 1413 1414
[32] Par. 1.41, Stipulation of Facts, JSF, docket, p. 1414

alleged deficiency final withholding taxes, inclusive of penalties, amounting to P163,377,931.84, and inviting petitioner to an informal conference within ten (10) days from receipt of said Revised Report.[33]

Respondent finally issued on August 23, 2012 a Final Decision on Disputed Assessment through Ms. Araceli Francisco, which was received by petitioner on October 3, 2012.[34]

As a result, petitioner filed the instant Petition for Review on November 5, 2012, assailing the FDDA issued on August 23, 2012.

Respondent interposed the following special and affirmative defenses in her Answer[35] filed on January 14, 2013:

> "5. The tax deficiency assessment on the petitioner is based on facts, law, rules and jurisprudence. Petitioner was assessed for tax deficiency on the ground that its satellite airtime fees are subject to final withholding tax.
>
> 5.1. Petitioner is liable for a total tax deficiency in the amount of P170,935,184.92 covering tax deficiency for the year 2006 inclusive of surcharges and interest penalty computed up to August 31, 2012. After verification and evaluation of the documents submitted by petitioner in protest to the final assessment notice, the documents failed to refute and cancel the assessments.
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> 5.2 A portion of the Final Decision on Disputed Assessment (FDDA) dated August 23, 2012 contains the results of the re-investigation by the respondent as to the tax liability of the petitioner. Pertinent portion of the FDDA reads as follows:

[33] Par. 1.42, Stipulation of Facts, JSF, docket, p. 1414
[34] Pars. 1.43 and 1.44, Stipulation of Facts, JSF, docket, pp. 1414 and 1416
[35] Docket, pp. 714-725

FINAL DECISION ON DISPUTED ASSESSMENT

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I. Final withholding tax

Income payment to non-resident foreign corporation which was subjected to 35% final tax was not cancelled by the investigating office. Satellite Airtime fee to Aces International Limited (AIL) a non-resident foreign corporation a satellite service provider was subjected to 35% final tax. This was confirmed when the Legal Division sustained the position of the district office that 'the situs of tax for service is the place where the service is rendered. Under the Philippine source of income rules for income tax purposes, service income will be considered Philippine source only if the service are rendered in the Philippines.' As such final tax on income payments (satellite airtime fee to AIL) is collectible considering that AIL is non-resident foreign corporation.

Computation:	
Satellite Airtime Fee	199,312,169.00
Tax Due	69,759,259.15
Add: 24% Surcharge	17,439,814.79
Interest (7-30-06 to 8-31-12)	83,711,110.98
Compromise penalty	25,000.00
Total Amount Payable	**170,935,184.92**

II. VALUE ADDED TAX

Total vatable receipts from collections of receivable for the 2nd quarter of 2006 which were assessed at 12% rate was found taxable at 10% at such additional 2% assessment was cancelled. It was found that collections were billed prior to February 1, 2006 and provisions of RMC 8-2006 were complied.

III. Expanded Withholding Tax

Per re-investigation interconnection fees taxed at 15% was found as a contra revenue account which does not constitute an expense, thus assessment was cancelled by the district office.

Considering that these are already the results of the re-investigation submitted by Revenue District Office No. 19, Subic Bay Freeport Zone, this office is constrained to enforce the collection of your deficiency tax as recommended.

It is requested that your aforesaid deficiency final withholding tax inclusive of penalties incident to delinquency be paid immediately upon receipt hereof.

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6. Clearly, the deficiency assessments issued against petitioner have factual and legal bases.

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7. The primary issue of the instant case is whether the Air Time fees paid by petitioner to AIL, a non-resident foreign corporation, are income from services rendered within the Philippines, hence, subject to 35% Final Withholding Tax.

8. Substantial to the foregoing, the assessment made by respondent against the petitioner is based on factual and legal basis.

8.1 Section 28 (B) (1) of the National Internal Revenue Code of 1997 (NIRC), provides as follows:

(B) *Tax on Nonresident Foreign Corporations.* -

(1) *In General.* - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraph 5 (c) and (d): *Provided,* That effective January 1, 2009, the rate of income tax shall be thirty percent (30%).

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8.3 More importantly, Section 42 (A) (3) of the NIRC provides as follows:

Sec. 42. Income from Sources Within the Philippines. -

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(A) Gross Income From Sources Within the Philippines. - The following items of gross income shall be treated as gross income from sources within the Philippines:

(3) Services. - Compensation for labor or personal services performed in the Philippines;

8.4 Similarly, worthy of note is Section 57 (A) which reads as follows:

> 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); 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.

8.5 In the case of *Commissioner of Internal Revenue vs. Air India, et al.* citing the case of *Commissioner of Internal Revenue vs. Overseas British Airways Corporation,* the Supreme Court had an occasion to rule that:

> 'The Tax Code defines 'gross income' thus:
>
> "Gross Income' includes gains, profits, and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from profession, vocations, trades, business, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits,

and income derived from any source whatever...

'The definition is broad and comprehensive to include proceeds from sales of transport documents.' The words income from any source whatever' disclose a legislative policy to include all income not expressly exempted within the class of taxable income under our laws.'

Income means 'cash received or its equivalent'; it is the amount of money coming to a person within a specific time...; it means something distinct from principal or capital. For, while capital is a fund, income is a flow. As used in our income tax law, 'income' refers to the flow of wealth.

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'**The source of an income is the property, activity or service that produced the income. For the source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from activity within the Philippines.** In BOAC's case, the sale of tickets in the Philippines is the activity that produces the income. The tickets exchanged hands here and payments for fares were also made here in Philippine currency. The situs of the source of payments is the Philippines. **The flow of wealth proceeded from, and occurred within, Philippine territory, enjoying the protection accorded by the Philippine government. In consideration of such protection, the flow of wealth should share the burden of supporting the government.**

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> 'BOAC, however, would impress upon this Court that income derived from transportation is income for services, with the result that the place where the services are rendered determines the source and since BOAC's service of transportation is performed outside the Philippines, the income derived is from sources without the Philippines and, therefore, not taxable under income tax laws,...
>
> 'The absence of flight operations to and from the Philippines is not determinative of the source of income or the situs of income taxation. Admittedly, BOAC was an off-line international airline at the time pertinent to this case. The test of taxability is the 'source'; and the source of an income is that activity... which produced the income. Unquestionably, the passage documentations in these cases were sold in the Philippines and the revenue therefrom was derived from a business activity regularly pursued within the Philippines. And even if the BOAC tickets sold covered the 'transport of passengers and cargo to and from foreign cities', it cannot alter the fact that income from the sale of tickets was derived from the Philippines. The word 'source' conveys one essential idea, that of origin, and the origin of the income herein is the Philippines.' (Emphasis Supplied)

9. The tax deficiency against the petitioner is proper and valid. The records show that petitioner has an Air Time Purchase Agreement with AIL, a non-resident foreign corporation and not engaged in trade or business in the Philippines. In the said agreement, it was stipulated that petitioner has the right to satellite communications time to serve its subscribers and for which it paid airtime fees to AIL.

10. Based on the foregoing, it is clear that the airtime fees paid by petitioner to AIL are income derived from sources within the Philippines. Those fees are the income from services rendered in the

Philippines. It can be noted that the communication time rendered by AIL, through petitioner, was made available within the Philippines, subscribed and patronized by Filipinos and, consequently, they paid their subscription fees for such services. All of these transactions and activities occurred within the Philippines.

11. Non-residents foreign corporations are liable to pay taxes for income derived from sources within the Philippines. The source or origin of income is determined by the situs where the activity or service was performed. As claimed by the petitioner, it cannot be said that the situs of the activity, in this case, took place outside the Philippines because the nature of the business of AIL speaks otherwise. The activity in which the AIL is engaged in providing a satellite communication time. As such, there can only be an income-producing activity when such communication time is subscribed into. Petitioner, on its part, entered into an Airtime Purchase Agreement with AIL to make this satellite communication time available in the Philippines. With that, the services, which is making the satellite communication time available in the Philippines, is actually offered in the Philippines, and subscribed within the Philippines. There is, indeed, no doubt that the fact that the exchange of service and money, as payment for such service, occurred within the Philippines.

12. xxx. Contrary to such claim, the absence of such ground station in the Philippines is not determinative of the situs of the income-producing activity. On the contrary, what determines situs is place where the income generating activity took place. Based on the factual findings of the respondent, the income derived by AIL are sourced within the Philippines.

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> 14. Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner, and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments *(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 notices."

The case was set for pre-trial conference on February 14, 2013.[36] Petitioner's Pre-Trial Brief[37] was filed on February 11, 2013; while respondent's Pre-Trial Brief [38] was filed on February 12, 2013. Subsequently, the parties filed with this Court their Joint Stipulation of Facts[39] on March 5, 2013.

During the hearing held on April 25, 2013, respondent manifested that the case involved only legal issues and that she will not present any witness. On the other hand, petitioner manifested that out of its five intended witnesses who already submitted their judicial affidavits, petitioner will only present one witness, in the person of Felimon R. Llavore.[40] During the same hearing, the Court declared the pre-trial terminated and ordered petitioner to present its lone witness and to file its Formal Offer of Evidence within fifteen (15) days after the completion of the testimony of petitioner's witness.

Meanwhile, the Court issued a Pre-Trial Order[41] on May 7, 2013 which, among others, approved the Joint Stipulation of Facts.

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[36] Notice of Pre-Trial Conference issued on January 16, 2013, docket, p. 727
[37] Docket, pp. 743-765
[38] Docket, pp. 1388-1394
[39] Docket, pp. 1407-1417
[40] Docket, p. 1475
[41] Docket, pp. 1477 1481

On May 10, 2013, petitioner formally offered Exhibits "A" to "EE-1"[42], which were admitted as part of its documentary evidence as per this Court's Resolutions dated June 6, 2013[43] and July 19, 2013[44].

The case was submitted for decision on November 5, 2013, considering the Memorandum (For Petitioner Aces Philippines Cellular Satellite Corporation)[45] filed on August 23, 2013 and respondent's Memorandum [46] filed through registered mail on October 21, 2013 and received by the Court on October 31, 2013.[47]

STATEMENT OF ISSUES

The parties submitted the following issues [48] for this Court's resolution:

> "a. Whether or not the satellite airtime services subject of the satellite airtime fees is considered performed in the Philippines so as to be deemed income from within the Philippines, hence subject to Philippines income tax and consequently, to final withholding tax.
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> b. Even assuming for the sake of argument that the payment for such satellite airtime services is considered as income arising from within the Philippines, whether or not Respondent used the correct income tax or final withholding tax rate of 35%."

RULING OF THE COURT

The assailed FDDA[49] imposed Philippine income tax at the rate of thirty-five percent (35%) and consequently, final

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[42] Docket, pp. 1482-1489
[43] Docket, pp. 2092-2093
[44] Docket, pp. 2113-2114
[45] Docket, pp. 2115-2148
[46] Docket, pp. 2182-2196
[47] Docket, p. 2198
[48] Par. II, Stipulation of Issues, JSF, docket, p. 1416

withholding tax on the fees received by the non-resident foreign payee for payments made by petitioner for satellite airtime since the income was derived within the Philippines. The assailed assessment for final withholding tax with interest and penalties as stated in the FDDA is computed as follows:

Satellite Airtime Fee	P199,312,169.00
Tax Due	P 69,759,259.15
Add: 25% Surcharge	17,439,814.79
Interest (7-30-06 to 8-31-12)	83,711,110.89
Compromise penalty	25,000.00
TOTAL AMOUNT PAYABLE	P170,935,184.92

Petitioner opposed the assessment for final withholding tax, alleging that the services required in providing satellite airtime to petitioner were performed outside the Philippines and as such, the airtime fees derived from the services should be considered as income from sources outside the Philippines which should not be subjected to Philippine income tax.

According to petitioner, the satellite airtime provider AIL owns a satellite system which is comprised of the following: (a) Garuda 1 satellite, a geosynchronous communications satellite situated at 123° East, at a distance of 22,000 miles from earth, equipped with 88 transponders equivalent to 88 cell sites, which has the capacity to receive, amplify and transmit radio signals to and from user terminals and earth station or gateway. A gateway is interconnected with fixed line telephone systems and cellular telephone systems for the termination of calls; and (b) Satellite Network Control Center which monitors and controls the satellite and route calls to the proper earth station or gateway. It is located and manned at AIL's facility in Batam Island, Indonesia. This satellite system is designed to allow it to sell communication time to providers of satellite communication services such as petitioner.

Petitioner alleged that when a subscriber of petitioner makes a call using the satellite user terminal, AIL's Garuda 1 Satellite, located in outer space, receives the call and beams the signal back to AIL's Network Control Center, located in Indonesia; which would determine as to where to route the call

[49] Exhibit "BB"

which, in this case, is the gateway facilities owned by petitioner. AIL's service to petitioner is allegedly terminated or finished when its Network Control Center provides information to the Garuda Satellite to which gateway the call shall be routed. After which, it is petitioner's gateway which will receive the call and route said call to its switch. The switch will then process the call for routing and termination.[50]

AIL purportedly bills petitioner for the use of satellite communications time also commonly called satellite airtime fees, which pertain to each six-second interval of satellite utilization time for the transmission of a voice or data to or from a terminal and gateways. The billing of AIL for petitioner's purchase of satellite airtime fees covers the utilization of satellite airtime from the time when AIL's Garuda 1 Satellite located in outer space receives the call and beams the signal back to AIL's Network Control Center located in Indonesia up to the point when said Network Control Center provides information to the Garuda Satellite to which gateway the call will be routed.[51] The participation of petitioner is to perform the functions of receiving the call and routing of said call (to Philippine telecommunication companies, either to a SMART, PLDT, Globe or Sun subscriber), and petitioner is then billed by the corresponding telecommunication company which terminated the call to its subscriber.[52]

Since the Network Control Center of AIL that performs the services required in providing satellite airtime to petitioner is located outside the Philippines, petitioner concluded that the income derived from the payment of satellite airtime fees by petitioner to AIL is considered to be income from sources outside the Philippines.

To support its claim, petitioner cited Section 164 of Revenue Regulations No. 2, implementing Section 37 now Section 42 of the Tax Code, and BIR Ruling No. ITAD-214-02 dated December 4, 2002.

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[50] Exhibit "EE", A9
[51] Exhibit "EE", A14
[52] Exhibit "EE", A15

Petitioner further alleged that assuming for the sake of argument that payment for such satellite airtime services is considered as income arising from within the Philippines, the proper applicable income tax or final withholding tax is 7.5% as provided under Section 28(B) of the NIRC of 1997, as amended, which imposes 7.5% tax on rentals, charters and other fees derived by a non-resident lessor of aircraft, machineries and other equipment.

Respondent countered that the airtime fees are income from services rendered in the Philippines. Respondent noted that the communication time rendered by AIL, through petitioner, was made available within the Philippines, subscribed, patronized and paid by Filipinos through the subscription fees for such services. All of these transactions and activities occurred within the Philippines.

Respondent explained that the activity in which AIL is engaged in is in providing satellite communication time. As such, there can only be an income-producing activity when such communication time is subscribed into. Respondent pointed out that petitioner entered into an Airtime Purchase Agreement with AIL to make this satellite communication time available in the Philippines. With that, the service, which is the making of the satellite communication time available in the Philippines, is actually offered and subscribed within the Philippines. Clearly, the exchange of service and money, as payment for such service, occurred within the Philippines.

There is no dispute that the appealed portion of the FDDA concerns the deficiency final withholding tax assessment on the payment made by petitioner, a domestic corporation[53], of satellite airtime fee, which is considered as service fee[54], to AIL, a non-resident foreign corporation.[55] The transaction involved in the assailed assessment is deemed to be sale of services by a non-resident foreign corporation to a domestic corporation.

The Court found instructive Section 28(B) of the NIRC of 1997, as amended, which provides:

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[53] Par. 1.02, Stipulation of Facts, JSF, docket, p. 1407
[54] Par. 5.13, Petitioner's Memorandum, docket, p. 2134
[55] Par. 1.07, Stipulation of Facts, JSF, docket, p. 1408

> "SEC. 28. *Rates of Income Tax on Foreign Corporations.* -
>
> xxx xxx xxx
>
> (B) *Tax on Nonresident Foreign Corporation.* -
>
> (1) *In General.* - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year **from all sources within the Philippines** xxx" *(Emphasis supplied)*

Simply put, the income of the non-resident foreign corporation, AIL in this case, is taxable in the Philippines if the income is received from **all sources within the Philippines**. In relation thereto, Section 57 of the NIRC of 1997, as amended, requires the payor-corporation, such as petitioner, to withhold the tax imposed under Section 28(B)(1) of the NIRC of 1997, as amended.

Significantly, in order for the services fees to be treated as gross income from sources within the Philippines, the income or compensation for labor or personal services should be performed in the Philippines as provided under Section 42(A)(3) of the NIRC of 1997, as amended.

In the case of *Commissioner of Internal Revenue vs. Juliane Baier-Nickel, as represented by Marina Q. Guzman, (Attorney-in-fact)* [56], the Supreme Court held that the important factor which determines the **source of income** of personal services is not the residence of the payor, or the place where the contract for service is entered into, or the place of payment, **but the place where the services were actually rendered**.

[56] G.R. No. 153793, August 29, 2006

In the same case, the High Court cited the case of *Alexander Howden and Co., Ltd. vs. Collector of Internal Revenue*[57], wherein the Supreme Court addressed the issue on the applicable source rule relating to reinsurance premiums paid by a local insurance company to a foreign insurance company in respect of risks located in the Philippines. It was held therein that **the undertaking of the foreign insurance company to indemnify the local insurance company is the activity that produced the income**. **Since the activity took place in the Philippines, the income derived therefrom is taxable in our jurisdiction**. Citing *Mertens, The Law of Federal Income Taxation*, the Supreme Court emphasized that the technical meaning of **source of income is the property, activity or service that produced the same**.

Clearly, the "source of income" is the place where the service was performed or the place where the activity that produced the income took place.

Accordingly, the Court shall determine whether the evidence presented by petitioner is sufficient to prove that the services rendered by the non-resident foreign corporation were not performed in the Philippines in order for the income to be exempt from tax in the Philippines.

In the Founder NSP Air Time Purchase Agreement dated March 12, 1997 between PT Asia Cellular Satellite (PTACS) and Philippine Long Distance Telephone Company (PLDT), PTACS agreed to sell satellite communications time for the ACES System to PLDT, and PLDT agreed to purchase satellite communications time for the ACES System from PTACS and be the sole supplier of ACES Services to subscribers residing in the Philippines. ACES Services is defined in the agreement as the services utilizing the ACES System. [58]

It is further provided in the agreement that PLDT will, throughout the term of the contract, **purchase from PTACS such Billable Units of satellite communications time as**

[57] G.R. No. L 19392, April 14, 1965
[58] Exhibit "DD", pages 1 and 14

PLDT requires to provide the ACES Services in the Philippines and as PTACS is able to deliver.[59]

Also, as to the term of payment, it was stipulated that PTACS will invoice PLDT, and PLDT will pay, **for all satellite communications time, measured in Billable Units, used by PLDT during each Billing Month in a Billing Period.**[60]

Billable Unit is defined in the agreement as each six-second interval (fractions thereof to be rounded up to the next six-second interval) of **satellite utilization time for a voice or data call to or from a terminal**, **excluding satellite utilization time for call set-up, unanswered calls and incomplete calls**.[61]

It must be noted that the said agreement was subsequently assigned by PLDT to petitioner while PTACS assigned the same agreement to AIL in 1998.[62]

After consideration of the relevant portions of the agreement and its subsequent assignment to petitioner and AIL, the Court finds that petitioner pays AIL airtime fees only when the satellite airtime is delivered to petitioner and to its subscribers and is subsequently utilized by them in the Philippines for a voice or data call, excluding satellite utilization time for call set-up, unanswered calls and incomplete calls.

In other words, the activity that produces income is the undertaking of providing satellite communication time to be delivered by AIL and utilized by petitioner and its subscribers in the Philippines. Therefore, the activity which produced the income took place in the Philippines. Accordingly, respondent is correct in imposing final withholding tax on the service fees paid to AIL which are considered income from sources within the Philippines. /

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[59] Exhibit "DD", page 3
[60] Exhibit "DD", page 4
[61] Exhibit "DD", Definitions, Annex Z
[62] Par. 1.05, Stipulation of Facts, JSF, docket, p. 1408

The evidence presented by petitioner is insufficient to support its claim that the service fee received by AIL should be considered as income from sources outside the Philippines. Aside from the self-serving affidavit executed by petitioner's witness, Mr. Felimon R. Llavore[63], and the agreement between PLDT and PTACS which was subsequently assigned to petitioner and AIL, there is nothing in the evidence presented by petitioner that would lead the Court to deduce that the services rendered by the non-resident foreign corporation were performed outside the Philippines. The agreement presented by petitioner only showed that PTACS agreed to provide satellite communications time in the Philippines. Thus, it is reasonable to conclude that the activity which produced the income took place in the Philippines.

As to the proper tax rate, the Court finds unmeritorious petitioner's allegation that the applicable income tax or final withholding tax is 7.5% as provided under Section 28(B) of the NIRC of 1997, as amended, which imposes 7.5% tax on rentals, charters and other fees derived by a non-resident lessor of aircraft, machineries and other equipment.

Again, petitioner failed to present evidence to prove that the fee paid to AIL is for the use of AIL's equipment. The agreement presented by petitioner did not stipulate that the payment of satellite airtime fees is for the rental or use of the satellite equipment of AIL. What was mentioned in the agreement is that the payment of fees is for the utilization by petitioner and its subscribers of the airtime services of AIL. Aside from the agreement and the affidavit executed by petitioner's witness, there is no documentary evidence presented by petitioner which would prove that the airtime fee was paid for the use of AIL's equipment. Hence, petitioner's allegation that the proper rate of tax applicable is 7.5% cannot be sustained.

At this juncture, it must be emphasized that tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior

[63] Exhibit "EE"

officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments.[64]

In this case, petitioner failed to discharge the burden of proving that AIL's income was from sources outside the Philippines and that it should be exempt from the application of the Philippine income tax law. Thus, respondent's findings that petitioner is liable to pay the basic final withholding tax in the amount of P69,759,259.15 on the satellite airtime fees as per the assailed FDDA dated August 23,2012 shall not be disturbed.

On the other hand, as to the compromise penalty imposed by respondent, it must be stressed that a compromise penalty is imposed to avoid prosecution for violation of the provisions of the Tax Code.[65] 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 the 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.[66] And there is nothing in the records which would show that petitioner consented to the compromise penalty. Therefore, the compromise penalty should not be imposed and must be cancelled.

WHEREFORE, premises considered, the assessment issued by respondent against petitioner covering deficiency final withholding tax for taxable year 2006 as per the assailed Final Decision on Disputed Assessment dated August 23, 2012 is hereby **AFFIRMED** with some modifications. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **P87,199,073.94**, representing deficiency final withholding tax for taxable year 2006, inclusive of the twenty-

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[64] *Sy Po vs. Honorable Court of Tax Appeals, et al.*, G.R. No. 81446, August 18, 1988

[65] *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et al.*, G.R. Nos. L 12928 and L 12932, March 31, 1962

[66] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.*, G.R. No. L-35266, January 21, 1991

five percent (25%) surcharge imposed under Section 248(3) of the NIRC of 1997, computed as follows:

Basic Final Withholding Tax Due	P 69,759,259.15
Add: 25% Surcharge	17,439,814.79
TOTAL AMOUNT DUE	**P87,199,073.94**

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

(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency final withholding tax of P69,759,259.15 computed from January 10, 2007 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 P87,199,073.94 and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from October 3, 2012 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997.

SO ORDERED.

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

WE CONCUR:

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ATTESTATION

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

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13, 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.

ROMAN G. DEL ROSARIO
Presiding Justice