REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

FIRST DIVISION

WATERFRONT PHILIPPINES, INC.
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8024

Members:

ACOSTA, *PJ*,
UY, *and*,
FABON-VICTORINO, *JJ*.

Promulgated:
NOV 13 2012 ; 3:00 p.m.

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DECISION

ACOSTA, *PJ*:

This Petition for Review seeks the cancellation and withdrawal of deficiency assessment on the value added tax, amended expanded withholding tax and compromise penalty for taxable year 2006 in the total amount P3,260,960.73, inclusive of increments.

THE FACTS

As stipulated by the parties in the Joint Stipulation of Facts and Issues and as borne by the records of this case, the following are the undisputed facts:

Petitioner is a domestic corporation duly organized and existing under the laws of the Philippines with principal office at IPT Building, Pre-Departure Area, MCIA, Cebu City.

Respondent is the duly appointed Commissioner of Internal revenue, vested with authority to act as such, including among others, the power to authorize the examination of taxpayer's book of accounts, to issue and decide deficiency assessment of internal revenue taxes.

On November 8, 2007, the Bureau of Internal revenue issued Letter of Authority No. LOA 2007 00015191 for the investigation of petitioner's business operations and books of accounts for calendar year 2006.

On January 14, 2009, the Formal Letter of Demand issued by BIR Revenue Region No. 13 - Cebu City was received by the petitioner. In turn, petitioner filed its formal written protest with the BIR on February 10, 2009.

In its letters dated February 18 and April 24, 2009, the BIR informed petitioner that in response to its formal written protest of February 9, 2009, the docket of the case was referred back to BIR Revenue District Office No. 80 - Mandaue City for reinvestigation, and submission of supporting documents within 60 days from the filing of the formal written protest.

The BIR issued Tax Verification Notice No. TVN-2003-00110949 dated July 7, 2009 for reinvestigation of petitioner's 2006 internal revenue taxes; and in response, petitioner submitted additional supporting documents in its letter dated July 23, 2009 that was filed with BIR on July 24, 2009. Thereafter, the BIR released its Post Reporting Notice that was received by the petitioner on September 25, 2009.

Respondent issued its Final Decision on Disputed Assessment (FDDA) on December 8, 2009 directing petitioner to pay the assessment or to appeal final decision to the Court of Tax Appeals within 30 days of the receipt of the decision. The respondent seeks to collect deficiency assessments as follows:

1. Value-Added Tax
(old Assessment No. 80-vat-13-2006-2008-12-223):

Interest Income		11,907,902.00
Output tax due:		
((P11,907,902.00/12)*10%)	9,232.52	
((P11,907,902.00*11/12)*12%)	1,309,869.22	1,409,101.74
Add: 25% Surcharge		352,275.44
20% Interest (01/25/07-01/10/09)		551,115.33
Compromise Penalty		25,000.00
Total deficiency tax		**P2,337,492.51**

The CIR made no adjustment on the deficiency value-added taxes due on interest income derived from loans granted to Metro Alliance Holdings and Equities Corporation (MAHEC) and Wellex Group, Inc (TWGI) as per assessment No. 80-vat-13-2006-2008-12-223 since no BIR ruling exempting said income from VAT was specifically issued in favor of the petitioner. The respondent stated that pursuant to Revenue Regulation 16-2005, any person, who in the course of trade or business, sells or barters, exchanges or leases goods or properties, or renders services, and any person who imports goods, shall be liable to value-added tax imposed in Section 106-108 of the Tax Code.

2. Expanded Withholding Tax
(Assessment No. 80-we-13-2006-2008-12-222/amended):

Management Fee	4,060,000.00
Multiply by withholding tax rate	15%
Expanded withholding tax due	609,000.00
Less: Remittances	58,000.00
Basic Deficiency tax	551,000.00
Add: 20% Interest (01/11/07-12/15/09)	322,448.22
Compromise Penalty for non-submission of Alphalist of payees	25,000.00
Total deficiency tax	**P 898,448.22**

Reinvestigation of the case revealed that management fee of P4,060,000.00 was recorded in the books as part of Trade and Other Payables, however, only P58,000.00 was withheld and remitted to the BIR. On the other hand, no alphalist of payees whose income are subject to expanding withholding tax was submitted, hence, a compromise penalty was imposed pursuant to Revenue Memorandum Order No. 19-2007 which resulted to a deficiency expanded withholding tax of P898,448.22.

3. Compromise Penalty
(Assessment No. 80-it-13-2006-2008-12-222)
(for unauthorized use of computerized accounting system)

Compromise Penalty	**P 25,000.00**

Petitioner received the BIR Final Decision on Disputed Assessment dated December 8, 2009 on December 18, 2009. Petitioner, however, is protesting the compromise penalty assessment, deficiency value added tax and amended expanded withholding tax assessments. It has decided to appeal the final decision of the BIR to the Court of Tax Appeals on the grounds of lack of legal and factual bases in the issuance of the assessments that was exhaustively discussed in its formal protest letter of February 9, 2009.

The Petitioner filed the Petition for Review on January 15, 2010 in compliance with Section 228 of R.A. No. 8424 which mandates that if the protest is denied in whole or in part, the taxpayer adversely affected by the decision may appeal to the Court of Tax Appeals within 30 days from the receipt of the decision; otherwise, the decision shall become final, executory and demandable.

The respondent in its answer states that:

XXX XXX XXX

3. The petitioner is liable for deficiency value-added tax (VAT). A substantial portion of the petitioner's income was from interest income on loans granted to Metro Alliance Holdings and Equities Corporation (MAHEC) and to Wellex Group, Inc. (WGI) which are related parties to petitioner. In the ordinary course of its operations, petitioner extends and obtains cash advances and loans to/from related parties for working capital purposes as well as to finance the construction and operation of its hotel projects in furtherance of its primary purpose as stated in its Articles of Incorporation. Hence, the interest income is revenue realized from the services rendered by petitioner to its related

parties as part of its ordinary course of trade or business. Pursuant to Revenue Regulations No. 16-2005, any person who, in the course of trade or business sells, barters, exchanges or leases goods and properties, or renders service, and any person who imports goods, shall be liable to VAT imposed in Sections 106 to 108 of the National Internal Revenue Code of 1997 (NIRC of 1997). Moreover, Section 4.105-3 of the Revenue Regulations No. 16-2005 provides that the term "in the course of trade or business" shall mean the regular conduct or pursuit of a commercial or economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is non-stock, non-profit private organization or government entity.

4. Petitioner is likewise liable for deficiency Expanded Withholding Tax (EWT). Pursuant to Section 2.57.2 of Revenue Regulations No. 2-1998, as amended by Revenue Regulation No. 7-2000, there shall be withheld creditable income tax at the rates specified for each class of payee from the enumerated list of items of income payments to persons residing in the Philippines including director's fees. Withholding should be done upon payment of expense or upon recognition in the books. Per verification, a management fee of P4,060,000 was recorded in the petitioner's books as part of trade and other payables, however , only P58,000.00 was withheld and remitted. No alphalist of payees whose income are subjected to expanded withholding tax has been

submitted, hence, a compromise penalty was imposed pursuant to Revenue Memorandum Order No. 19-2007 which resulted to a total deficiency expanded withholding tax of P898,448.22.

5. A compromise penalty of P25,000.00 was imposed due to unauthorized use of computerized accounting system.
6. All presumptions are in favor of the correctness of tax assessments. The good faith of tax assessors and the validity of their actions are presumed. They will be presumed to have taken into consideration all the facts to which their attention was called (CIR vs. Construction Resources of Asia, Inc. 145 SCRA 671). It is incumbent upon the taxpayer to prove the contrary (Mindanao Bus Company vs. CIR 1 SCRA 538; CIR vs. Tuazon, Inc. 173 SCRA 397) and failure to do so shall vest legality on respondent's actions and assessments.
7. Failure to present proof of error in the assessment will justify judicial affirmation of said assessment (Delta Motors Co. vs. Commissioner, CTA Case No. 3782, 21 May 1986; Commissioner of Internal Revenue vs. Court of Appeals, et al., G.R. Nos. 104151 and 105563, 10 March 1995).

Due execution, authenticity and veracity of the contents of the following documents were also included in the Joint Stipulation of Facts and Issues[1]:

a) BIR Preliminary Assessment Notice and Details of Discrepancy.

b) BIR Formal Letter of Demand and the Details of Discrepancy.

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[1] Rollo pp 000135-000138.

c) BIR Final Decision on Disputed Assessment dated October 30, 2009.

d) BIR Memorandum Report dated 27 November 2006.

e) Petitioner's formal protest letter filed by Manabat San Agustin & Co. dated February 9, 2009 and submitted to BIR Revenue Region No. 18, Cebu City on February 10, 2009.

On August 28, 2012, with the submission of respondent's Memorandum on May 23, 2012 and in the absence of the petitioner's Memorandum despite the opportunity granted, this instant petition was deemed submitted for decision by this Honorable Court.

THE ISSUES

By agreement of the parties, the issues to be tried and resolved in this case as enumerated in the Joint stipulation of Facts and Issues are the following:

I. *Whether or not Metro Alliance Holdings and Equities Corporation (MAHEC) and Wellex Group, Inc (TWGI) are related parties to petitioner.*

II. *Whether or not petitioner is liable for deficiency Value Added Tax (VAT) in the amount of P2,337,494 for taxable year 2006.*

III. *Whether or not petitioner is liable for deficiency Expanded Withholding Tax (EWT) in the amount of P898,448.22 for taxable year 2006.*

IV. Whether or not petitioner is liable for deficiency compromise penalty in the amount of P25,000.00.

THE DECISION OF THE COURT

The Court shall discuss the issues in *seriatim*.

Related Parties to Petitioner.

On the first issue, the controversy basically lies on whether or not Metro Alliance Holdings and Equities Corporation (MAHEC) and Wellex Group, Inc (TWGI) are related parties to petitioner.

The purpose of determining whether or not the parties abovementioned are related parties is to determine whether or not the transaction of the petitioner on lending funds to MAHEC and TWGI be subjected to Value-Added Tax as lending investor.

The petitioner submitted the following documents to prove its contention that they are related parties :

1. Notes to the Parent Company Financial Statements: Note No. 1: Reporting entity: Corporate Information [2] and Note No. 5: Related Party Transactions [3] were presented to establish the Petitioner's corporate information on its incorporation, holdings and business operations. This document shows that it is an affiliate company of the Wellex Group, Inc. and established that Metro Alliance Holdings &

[2] Exhibit K-2
[3] Exhibit K-3

Equities Corp. and the Wellex Group, Inc. to whom loans were granted are related parties to Petitioner, respectively.

Under the Implementing rules and regulation of RA 8799 or the Securities Regulation Code (Rule 68) it is stated that related parties and their transactions should be disclosed in their financial statements, to wit:

> (21) Material Related Party Transactions which Affect the Financial Statements –
> A. The financial statements filed shall disclose material related party transactions other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. Disclosure of transactions that are eliminated in the preparation of consolidated or combined financial statements is not required in those statements. This disclosure should include the following:
> 1. The nature of the relationship(s).
> 2. A description of the transactions (summarized when appropriate) for the periods for which an income statement is presented, including amounts, if any, and such other information as is deemed necessary to an understanding of the effects on the financial statements.
> 3. The pesos volume of transactions for each of the periods for which income statements are presented, and the effects of any change in the method of establishing the terms from that used in the preceding period.
> 4. Amounts due to or from related parties as of the date of each balance sheet presented, and if not otherwise apparent, the terms and manner of settlement.
> B. In some cases, aggregation of similar transactions by type or related party may be appropriate. Sometimes, the effect of the relationship between or among the related parties may be so pervasive that disclosure of such relationship alone is sufficient.
> XXX XXX XXX
> C. Transactions involving related parties cannot be presumed to be carried out on an arm's length basis, as the requisite conditions of competitive free-market dealings may not exist. Representations about transactions with the related parties, if made shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's length transactions unless such representations can be substantiated.

Applying the above provision, the disclosure of the petitioner of its affiliates to its financial statement is a strong indication that the parties are indeed related parties.

2. The General Information Sheet for CY 2006[4] listed the name of The Wellex Group Inc. as stockholder of petitioner. This proved that Wellex Group Inc. owns 63% equity in petitioner and that the petitioner is an affiliated party of the Wellex Group Inc. An "Affiliate" means a corporation that directly or indirectly, through one or more intermediaries, is controlled by, or is under the common control of, another corporation, which thereby becomes its parent corporation.
3. BDO Stockholder's Ledger for the Wellex group, Inc.[5] and BDO Stockholder's Ledger for Metro Alliance Holdings & Equities Corp.[6] showed that Wellex Group Inc. has 14,370,000 shares of stocks investment in petitioner as of November 19, 2008 and that Metro Alliance Holdings & Equities Corp. has 1,143,466,800 shares investment in petitioner as of November 14, 2001, respectively.
4. Original copy of the certification[7] executed by Mr. Arthur R. Ponsaran as Corporate Secretary of petitioner notarized on January 11, 2011 consisting of 2 pages shows that the Wellex group Inc. owns 63% equity in petitioner and that petitioner is an affiliated party of the Wellex group Inc.

After the comprehensive study and scrutiny of the documents presented by the petitioner and in the absence of any arguments and documents submitted by the respondent disproving that Metro Alliance Holdings and

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[4] Exhibit M-1
[5] Exhibit R-1.
[6] Exhibit R-2.
[7] Exhibit V.

Equities Corporation (MAHEC) and Wellex Group, Inc (TWGI) are related parties to the petitioner, the documentary evidence proved sufficient and cast no doubt that they are indeed related parties. Thus, this Court cannot subject the petitioner to Value Added Tax as lending investors, the lender and the borrower, being related parties.

Deficiency Value Added Tax (VAT)

After judicial determination that the petitioner and MAHEC and TWGI are related parties, consequently, the Court finds the contention of the respondent as stated on the Final Decision on Disputed Assessment[8] without merit.

VAT is imposed on sale or exchange of services for others for a fee, remuneration or consideration including those performed or rendered by lending investors (Section 108 of the Tax Code). A lending investor is defined under Section 4.108-3 of Revenue Regulation 16-2005 as follows:

> "Lending investor includes all persons other than banks, non-bank financial intermediaries, finance companies and other financial intermediaries, finance companies and other financial intermediaries not performing quasi-banking functions who make a practice of lending money for themselves or others at interest."

In addition, BIR Ruling dated March 31, 1997 provided for the requisites to be considered in determining who are lending investors. The requisites are as follows:

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[8] Rollo pp. 667-672.

"1. One must be engaged in the business of lending money for themselves or others at interest; and

2. The lending of money must be carried on with a view to profit or livelihood."

This was applied by the BIR in VAT Ruling No. 015-04 dated May 18, 2004 wherein it was held that:

> "It is clear from the foregoing facts that TDK is not engaged in the practice of lending money. It is organized as a manufacturer of electronic materials and components rather than to engage in lending activities. The lending of money for an interest which is not pursued as a business activity but merely to assist someone in need, will not make the lender a lending investor within the contemplation of Section 108 of the Tax Code. Accordingly, the interest income earned or received by TDK from its loan to PTPI is exempt from the value-added tax."

Before applying the pronouncement, it is imperative that we know WPI's primary purpose as stated in its Amended Articles of Incorporation and to quote:

> To carry on the business of an investment holding company and for that purpose either in the name of the said corporation or in the name of any other corporation in which it shall have an equity interest, to receive, purchase or otherwise acquire an interest in, hold, own, pledge, mortgage, assign, dispose and generally deal in all kinds of securities including but not limited to shares of stock of corporation which shall include but shall not be limited to financial services institutions such as banking, insurance, stockbrokering,

> leasing, hire, purchase, and other forms of financial services as are found in modern financial market; to acquire and hold real property (except land) and personal property of all kinds; to purchase, acquire, convey, lease, mortgage, contract for, manage, administer and/or operate alone or jointly with others any interest in real or personal property which includes but not limited to hotels, inns, restaurants, cafes, bars, stores and offices, barbershops, and beauty lounges, sports facilities, places of amusement and entertainment of all kinds; to enter into any lawful arrangement for sharing profits with any corporation, association, partnership, person or entity, domestic and foreign, in carrying on or of any business which the corporation is authorized to carry on; or to grant concessions, rights, licenses to others to operate, manage or deal with the same; and to do any and all things necessary, suitable, convenient, proper or incidental to the accomplishment of the above purposes.

Clearly, there is no indication that the advances provided to its affiliates are activities within WPI's ordinary course of business. The purpose of the cash advance granted by WPI is merely to provide financial support to its affiliates and not to generate income. Based on the definition and requisites above stated, WPI shall not be considered as a lending investor since it does not habitually engage itself in lending transactions and it does not extend cash advances to its affiliates with a view to profit or livelihood. The reason for imputing interest on the cash advance is to make the transaction at arm's length.

As to who is considered lending investor, BIR defined the term as "as one who makes practice of lending money for themselves or others at interest". (BIR Ruling No. 452-88 dated September 15, 1988)

Moreover, in Piso Bank vs. Commissioner of Internal Revenue, CTA Case No. 4117 dated June 6, 1989, the case of Molo vs. Yatco, 71 Phil. 468, was cited to read as follows:

> "Where it appears that on **six** occasions a person accepted mortgages to guarantee loans to be made to different persons at an interest of 12% and such person does not prove that such transactions were made accidentally or because of certain peculiar circumstances, it should be presumed that he in reality made a practice of lending money at interest, thus becoming a lending investor under the law. (Emphasis supplied)"

Based on the above-quoted case, a person who has engaged in lending activities for six times or more shall be presumed as habitually engaged in the practice of lending money to others and done in pursuit of a business activity. In the case at hand, the cash advances was done only once which negates habituality of lending money at interest.

In addition, the grant of cash advance to MAHEC and TWGI by WPI was not made with intention to practice lending of money to others but exclusively with its affiliate, thus, WPI cannot be considered as a lending investor. Any interest derived by WPI from the cash advance transaction shall not be subject to VAT on lending investors.

Deficiency Expanded Withholding Tax (EWT)

A letter[9] from BIR Revenue Region No. 13- Cebu City was received by the petitioner, signed by Jose N. Tan, Regional Director dated February 18, 2009 was received by the petitioner informing him that the docket relative to the protest letter dated February 9, 2009 has been returned to Revenue District No. 80, Mandaue City for reinvestigation.

On September 25, 2009, a Post Reporting Notice[10] was sent to the petitioner. It was stated in the Schedule of Computation that an additional tax liability which pertains to director's fees shall be assessed, computed as follows:

Expanded Withholding Tax

Management fee- accounts payable credit entries	P4,060,000.00
Tax due	609,000.00
Less: remittance	58,000.00
WE tax payable	551,000.00
Interest	292,030.00
Total WE payable	P 843,030.00

After further study and analysis of the records of the case, the petitioner was not able to substantiate its protest on the assessment of expanded withholding tax on Director's fees. It is worth noting that the petitioner did not present any witness nor submit any document to contradict the amended assessment of the respondent on expanded withholding tax. The petitioner even filed a Motion for Issuance of Order allowing BIR Cebu RDO No. 80 to Accept Tax Payment on May 18, 2011. In a resolution

[9] Rollo 000045, Annex F.
[10] Rollo 000055, Annex J.

promulgated May 26, 2011, this Court denied the abovementioned Motion, the same being the incorrect remedy under the circumstances.

To end, it is worthy to note that assessment are prima facie presumed correct and made in good faith. It is the taxpayer and not the BIR who has the duty of proving otherwise. In the absence of proof of any irregularity in the performance of official duties, an assessment will not be disturbed. Failure to present proof of error in the assessment will justify judicial affirmance of said assessment.[11]

Compromise Penalty

In the judicial affidavit of Ann Roussel O. Salarda[12], General Accountant of the petitioner, it was admitted that the accounting department of the petitioner, despite repeated search, could not locate the document that may have been submitted to the BIR relative to the use of computerized accounting system. It was also admitted that the management of petitioner has paid the P25,000.00 Compromise Penalty Assessment on March 23, 2011 through the BIR's eFPS system as evidenced payment confirmation from the BIR[13]. Thus, the respondent alleges that petitioner is liable to pay P25,000.00 compromise penalty for the unauthorized use computerized accounting system.

[11] CIR vs. CA, 242 SCRA 313-314
[12] Rollo 000402 A4.
[13] Rollo 000389.

In addition, the Final Decision on Disputed Assessment (Schedule 1) also indicated therein that the petitioner is liable to pay compromise penalty for non-submission of alpha list of payees amounting to P25,000.00.

However, in both assessments, no compromise agreement between the parties was reached. There is no document presented in this Court that would indicate that both parties agreed to enter into a compromise agreement. Accordingly, the imposition of a compromise penalty has no basis. As discussed earlier, "the imposition of the same without the conformity of the taxpayer is illegal and unauthorized" (Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc.,). Thus, petitioner should not be subject to compromise penalties.

WHEREFORE, premises considered, the petitioner's prayer for the cancellation of the assessment covering deficiency amended expanded withholding tax for taxable year 2006 are hereby **DENIED**.

Accordingly, petitioner is hereby **ORDERED** to pay respondent deficiency amended expanded withholding tax for the taxable year 2006 in the amount of P873,448.22, inclusive of 25% surcharge and 20% deficiency interest imposed pursuant to Section 248 A(3) and 249(B) of the NIRC of 1997.

Likewise, petitioner is **ORDERED** to pay delinquency interest at the rate of 20% per annum on the total deficiency taxes of P873,448.22 from December 15, 2009 until full payment thereof pursuant to Section 249(C)(3) of the 1997 NIRC.

FINALLY, as to the petitioner's prayer for the cancellation of the assessment on the deficiency value added tax for taxable year 2006 and the compromise penalty for the unauthorized use of computerized accounting system and for non-submission of alpha list of payees, this Court finds it meritorious to cancel the same. Consequently, respondent is hereby **ORDERED** to **CANCEL** the assessment on the deficiency value added tax for taxable year 2006 and the assessment on the compromise penalty for the unauthorized use of computerized accounting system and for non-submission of alpha list of payees.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Justice