REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

SPLASH CORPORATION,
Petitioner,

- *versus* -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8483

Members:

Del Rosario, Chairperson,
Uy, and
Mindaro-Grulla, *JJ.*

Promulgated:
APR 06 2017 8:46 a.m.

x--x

DECISION

DEL ROSARIO, P.J.:

This is a Petition for Review with Application for Issuance of Preliminary Injunction/Temporary Restraining Order filed by Splash Corporation seeking the cancellation of the Final Assessment Notice issued by the Bureau of Internal Revenue (BIR) demanding payment for the alleged deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT) and compromise penalty in the aggregate amount of Two Hundred Fifty-Six Million Nine Hundred Forty-Six Thousand Fifty-Eight Pesos and 68/100 (₱256,946,058.68) for taxable year 2008.

THE PARTIES

Petitioner is a corporation duly organized and existing under Philippine laws with offices at the 5th Floor, W Office Building, 11th Avenue corner 28th Street, Bonifacio Global City, Taguig.[1]

Respondent is the Commissioner of the Bureau of Internal Revenue (CIR), vested by law with authority to make assessments of internal revenue taxes and to decide disputed assessments.[2] He holds

[1] Par. II(A)(2) Admitted Facts, Pre-Trial Order (PTO), Docket Vol. II, p.1130.
[2] Sec. 4 and 6, National Internal Revenue Code (NIRC) of 1997, as amended.

office at the BIR National Office Building, Agham Road, Diliman, Quezon City.[3]

THE FACTS

The Bureau of Internal Revenue (BIR) issued Letter of Authority (LOA) No. 2008 0007401 dated June 4, 2009[4] to petitioner authorizing Revenue Officers (ROs) Larah Vito, Rosario Arriola, Ma. Catalina Benedicto and Jesus Reyes of the Large Taxpayers Audit and Investigation Division II (LTAID II) to examine its books of accounts and other accounting records for all internal revenue taxes for the period from January 1, 2008 to December 31, 2008.

To extend the prescriptive period for respondent to assess petitioner of tax liabilities for taxable year 2008, it issued three (3) Waivers:

Waiver[5]	**Extended Period to Asses**
First Waiver[6]	Not later than December 31, 2010
Second Waiver[7]	Not later than June 30, 2011
Third Waiver[8]	Not later than December 31, 2011

On June 9, 2011, petitioner received a copy of a Preliminary Assessment Notice (PAN) dated May 16, 2011[9] finding petitioner liable for deficiency taxes amounting to ₱248,747,613.70.

On June 27, 2011, petitioner filed a reply-letter to the PAN advancing reasons against the findings of the BIR.[10]

On September 7, 2011, petitioner received a copy of the Final Assessment Notice (FAN) dated August 18, 2011 with attached Details of Discrepancies/Findings to the FAN[11] assessing petitioner for

[3] Par. II(A)(3), Admitted Facts, PTO, Docket Vol. II, p. 1131.
[4] Exhibit "1", BIR Records, p. 1093.
[5] Documents denominated as "WAIVER OF THE DEFENSE OF PRESCRIPTION UNDER THE STATUTE OF LIMITATIONS OF THE NATIONAL INTERNAL REVENUE CODE"; Exhibits "WW" to "WW-2", Docket Vol. IV, pp. 2496-2507.
[6] Exhibit "WW-1", Docket Vol. IV, pp. 2500-2501.
[7] Exhibit "WW-2", Docket Vol. IV, pp. 2506-2507.
[8] Exhibit "WW", Docket Vol. IV, pp. 2496-2497.
[9] Exhibit "12", BIR Records, pp. 944-947.
[10] Exhibit "13", BIR Records, pp. 954-968.
[11] Exhibit "B" to "B-7", Docket Vol. I, pp.114-121; Par. II(A)(1), Admitted Facts, PTO, Docket Vol. III, p. 1130.

gm

deficiency income tax, VAT, EWT and compromise penalty, detailed as follows: [12]

Tax Type		Basic Tax	Increments		Total
I. Income Tax	₱	152,413,477.00	77,551,209.13	₱	229,964,686.13
II. Value Added Tax		14,662,504.45	8,148,523.01		22,811,027.46
III. Expanded Withholding Tax		2,611,947.89	1,483,397.20		4,095,345.09
IV. Compromise Penalty			75,000.00		75,000.00
Total	₱	**169,687,929.34**	**87,258,129.34**	₱	**256,946,058.68**

On October 7, 2011, petitioner filed a request for reconsideration of the FAN.[13]

Citing inaction of respondent on its request for reconsideration, petitioner filed this Petition for Review with Application for Issuance of Preliminary Injunction/Temporary Restraining Order on May 4, 2012.[14]

On May 30, 2012, petitioner filed a Formal Offer of Exhibits[15] in support of its application for the issuance of preliminary injunction/temporary restraining order.

Treating the application for issuance of preliminary injunction/temporary restraining order as a motion for the suspension of the collection of the tax liability, on July 12, 2012, the Court granted the same and ordered the BIR to hold in abeyance the collection of the alleged deficiency tax assessments subject to the posting of a bond.[16]

In the Resolution dated August 16, 2012,[17] the Court admitted respondent's Amended Answer.[18] Respondent interposed the following special and affirmative defenses, summarized as follows:

1. Petitioner is liable for income tax in the total amount of ₱229,964,686.13, inclusive of increments for taxable year 2008.[19]

2. The person who may claim the exemption under Republic Act No. 7459 (RA 7459) is Dr. Rolando B. Hortaleza (Dr. Hortaleza)

---

[12] Exhibit "B", Docket Vol. I, p. 114.
[13] Exhibit "KK", Docket Vol. IV, pp. 1845-1857.
[14] Par. 17, Petition for Review, Docket Vol. I, p.6.
[15] Docket Vol. I, pp. 105-110.
[16] Docket Vol. I, pp. 262-265.
[17] Docket Vol. I, p. 359.
[18] Docket Vol. I, pp. 307-328.
[19] Par. 6.1, Amended Answer, Docket Vol. I, p. 308.

and not petitioner, hence, the net income from transactions which petitioner treated as tax exempt in its tax returns shall be subject to income tax pursuant to Sections 27 and 31 of the Tax Code; [20]

3. The tax exemption applies only to the sale of inventions by the inventor, Dr. Hortaleza.[21]

4. Under RA 7459, the term "Inventors" as certified by the Filipino Inventors Society and duly confirmed by the Screening Committee shall qualify for tax exemption during the first ten (10) years from the date of the first sale of the "invented property". Said exemption privilege shall be extended to the legal heir or assignee upon the death of the inventor. Based on the foregoing, it is Dr. Hortaleza, the inventor, who was endorsed by the Filipino Inventors Society (FIS) and the Department of Science and Technology (DOST), who may avail of the tax exemption privilege, not petitioner. The registered owner of the intellectual properties per Bureau of Patents was Dr. Hortaleza and not Splash. Sometimes the name of the inventor and the corporation are endorsed by FIS. This occurs when the inventor has prepared the invention in behalf of the corporation which did not happen in the instant case; [22]

4. In the conduct of the investigation, the Revenue Officers found that Dr. Hortaleza has not assigned his intellectual properties to Splash for the year under review. It was in year 2010 that "Dr. Hortaleza has decided to cash out ten of his "utility models", apparently skin care formulations currently used by the listed cosmetic company that he co-founded with his wife, with petitioner agreeing to pay Dr. Hortaleza, ₱3,000,000.00;[23]

5. Petitioner is the owner of the goods sold, not Dr. Hortaleza. Dr. Hortaleza is merely a stockholder of petitioner. For Dr. Hortaleza, to be the owner, he should have engaged the services of petitioner to manufacture and sell his invention. It is a well settled principle that a stockholder has a separate and distinct personality with the corporation.[24]

---

[20] Par. 6.2, Amended Answer, Docket Vol. I, p. 308.
[21] Par. 6.2, Amended Answer, Docket Vol. I, p. 309.
[22] Par. 6.2.1, Amended Answer, Docket Vol. I, pp. 309-310.
[23] Par. 6.2.2, Amended Answer, Docket Vol. I, p. 310.
[24] Par. 6.2.3, Amended Answer, Docket Vol. I, pp. 310-11.

6. BIR Rulings DA 280-98 and DA 281-98 affirmed that the exemption privileges under RA 7459 are exclusive to the inventor and shall not extend to a party to a joint venture agreement or to any entity that the inventor may deal or contact with, and that the exemption privileges shall be extended to the legal heir or assignee upon the death of the inventor. [25]

7. BIR Ruling No. 101-98 also held that the inventor shall be the one entitled to exemption privileges and that the corporation selling his invention shall not be entitled to the tax incentives previously granted to the individual inventor under RA 7459; [26]

8. BIR Ruling Nos. 041-95 and 042-95, 181-95, 158-99 and 139-99 cited by petitioner, stating that a corporation established by an inventor who is a majority stockholder to said corporation may avail of the tax exemption privileges under RA 7459, are not applicable to the instant case.[27]

9. Petitioner cannot claim the incentives granted to Dr. Hortaleza. Petitioner was incorporated in 1991. The first of Dr. Hortaleza's inventions that qualified under RA 7459 was made a decade after. Thus, Dr. Hortaleza cannot claim that he founded Petitioner for the purpose of commercializing his inventions and availing the tax incentives because Splash already existed when he made the inventions.[28]

10. Unlike the other corporations in the BIR Rulings cited by petitioner, petitioner is a public corporation. It offered its shares to the public in an initial public offering in 2007. Per 2008 General Information Sheet (GIS), Dr. Hortaleza owns only one share.[29]

11. Ownership of the right (patents) to manufacture and market the inventions has always remained with Dr. Hortaleza. He only allowed petitioner to use his rights. He sold some of these rights to petitioner for ₱300,000,00.00 in 2010. If petitioner and Dr. Hortaleza are one and the same, then Dr. Hortaleza should have assigned his rights to petitioner without any consideration; [30]

---

[25] Par. 6.2.3, Amended Answer, Docket Vol. I, pp. 310-311.
[26] Par. 6.2.3, Amended Answer, Docket Vol. I, p. 311.
[27] Par. 6.2.4, Amended Answer, Docket Vol. I, pp. 311.
[28] Par. 6.2.4, Amended Answer, Docket Vol. I, pp. 311-312.
[29] Id.
[30] Par. 6.2.4, Amended Answer, Docket Vol. I, p. 312.

m

12. The proviso in Section 6 of RA 7459 that "this tax exemption privilege pertaining to invention shall be extended to the legal heir/assignee upon the death of the inventor", clearly suggests that the tax privilege is for the benefit of the inventor and not for the benefit of the company commercializing the invention; [31]

13. Petitioner cannot use all BIR rulings issued prior to January 1, 1998 as basis to support its position against any assessments pursuant to Revenue Memorandum Circular (RMC) No. 22-2012 dated March 22, 2012. Further, all of the BIR Rulings (except BIR Ruling DA 285-2004), allegedly supporting the claims for tax exemptions by petitioner, specifically stated that it is Dr. Hortaleza (not petitioner) who is the inventor qualified for the said tax exemption; [32]

14. Petitioner presented or rather misrepresented to the Court that petitioner was the inventor/owner of various skin care composition products and was the one who applied for the patent registration with the Bureau of Patents and the Intellectual Property Office;[33]

15. Various customers have submitted Summary Lists of Purchases in support of their VAT returns wherein the respective amount of total purchases from petitioner is higher that the respective amount of sales indicated in the Summary List of Sales submitted by petitioner. The discrepancies between the purchase data of the customers and the sales data by petitioner were considered as understated sales subject to tax under Sections 27 and 32 of the Tax Code;[34]

16. Petitioner did not deduct the normal income tax on its taxable income per tax return from available tax credits. Accordingly, the next taxable income should be taxed pursuant to Section 27 of the Tax Code;[35]

17. Petitioner is liable for VAT in the amount of ₱22,811,027.46, inclusive of increments for taxable year 2008 for the following reasons:[36]

---

[31] Par. 6.2.4, Amended Answer, Docket Vol. I, p. 313.
[32] Par. 6.2.5, Amended Answer, Docket Vol. I, p. 314.
[33] Par. 6.2.6, Amended Answer, Docket Vol. I, p. 314.
[34] Par. 6.3, Amended Answer, Docket Vol. I, p. 315.
[35] Par. 6.4, Amended Answer, Docket Vol. I, p. 315.
[36] Par. 6.5, Amended Answer, Docket Vol. I, p. 315.

17.1 The understated sales should be taxed pursuant to Section 106 of the Tax Code, amounting to ₱6,790,482.54, representing 12% of the discrepancy in sales (12% of ₱56,587,354.52) per tax relief data as against the sales per summary list of sales (SLS) ;[37]

17.2 The sale of motor vehicles should be taxed pursuant to Section 106 of the Tax Code, amounting to ₱258,734.20, representing the output tax due thereon (12% of ₱2,158,119.00);[38]

17.3 The output tax balance and input tax balance in the financial statements of petitioner as of December 31, 2008 are ₱20,957,560.00 and ₱788,060.23. The VAT payment for the 4th quarter of CY 2008 should be ₱20,169,499.77 (₱20,957,560.00-Php788,060.23). Since the VAT payment made per the 4th quarter VAT return was only ₱12,843,202.23, petitioner was still deficient in the amount of ₱7,326,297.54 (₱20,169,499.77- ₱12,843,202.23). The logical explanation for this discrepancy is the 4th quarter VAT return is prepared earlier (on or before January 20) than the financial statements (on or before April 15). More often than not, the books of accounts are still open (accounting term) after the preparation of the 4th quarter VAT return. Transactions that were then recorded in the books only after the 4th quarter VAT return was filed were not considered in the VAT return but were included in the financial statements;[39]

18. Petitioner is liable for EWT in the total amount of ₱4,095,345.09, inclusive of increments, for the taxable year 2008 based on the following reasons:[40]

18.1 Supervalue, Inc. is a supermarket and that the income it received from petitioner is for the use of its display cases, thus, petitioner should have withheld 5% expanded withholding tax on the lease payments (display cases) to various supermarkets pursuant to Section 57 of the Tax Code. Considering that petitioner withheld only 2% from its payments to Supervalue, Inc., it is liable for the difference amounting to ₱2,611,947.20. Assuming for the sake of argument that said payments to Supervalue, Inc. are for

---

[37] Par. 6.5.1, Amended Answer, Docket Vol. I, p. 316.
[38] Par. 6.5.2, Amended Answer, Docket Vol. I, p. 316.
[39] Par. 6.5.3, Amended Answer, Docket Vol. I, pp. 316-318.
[40] Par. 6.6, Amended Answer, Docket Vol. I, p.318.

services rendered which is subject to (2%) withholding tax, there will still remain a portion of the proposed deficiency tax assessment;[41]

19. Petitioner is liable for compromise penalties in the total amount of ₱75,000.00 considering that petitioner did not contest in its protest the suggested penalties for non-filing of various information returns, hence, petitioner cannot raise this issue for the first time on appeal;[42]

20. Tax exemptions, as a rule, shall always be construed strictly against the person claiming the exemption;[43]

21. The Waivers are valid and binding between respondent and petitioner. The three Waivers signed and executed by petitioner are valid and binding since the same were all signed by the Commissioner of Internal Revenue, through his duly authorized official in the name of Zenaida G. Garcia, Assistant Commissioner, Large Taxpayers Service, pursuant to Revenue Delegation Authority Order No. 04-07 in compliance with the requirement of Revenue Memorandum Order No. 20-90 (RMO 20-90). It bears a definite expiration and acceptance date of the respondent. Petitioner was furnished a copy of said Waivers as reflected by petitioner's representative's signature on the face of the instruments;[44]

22. Petitioner is estopped from raising the issue of prescription for the first time on appeal based on the invalidity of the three Waivers it executed. Perusal of petitioner's protest letter filed with respondent revealed that issues on the invalidity of the Waivers as well as the prescription of respondent's right to assess petitioner were not raised therein. It is well settled that under the same underlying principle of prior exhaustion of administrative remedies, on the judicial level, issues not raised in the lower court cannot be raised for the first time on appeal; [45]

---

[41] Par. 5.6.1 (sic), Amended Answer, Docket Vol. I, p. 318.
[42] Par. 6.7, Amended Answer, Docket Vol. I, p. 319.
[43] Par. 6.2.7, Amended Answer, Docket Vol. I, p. 315.
[44] Par. 7, Amended Answer, Docket Vol. I, p. 319.
[45] Par. 8, Amended Answer, Docket Vol. I, pp. 322-323.

On August 14, 2012, petitioner filed its Pre-Trial Brief.[46] On September 5, 2012, respondent filed his Pre-Trial Brief.[47] On September 10, 2012, petitioner filed its Amended Pre-Trial Brief.[48]

In a Resolution dated September 6, 2012, the Court denied petitioner's Amended Motion to Reduce Bond and granted petitioner's motion for additional period of fifteen (15) days within which to post the required surety bond and submit documentary requirements mentioned in the July 12, 2012 Resolution.[49]

On September 18, 2012, petitioner filed a Motion to Withdraw Motion for Suspension of Collection of Tax[50] which the Court granted on September 21, 2012.[51]

In a Resolution dated October 10, 2012,[52] this Court granted the Motion to Admit Stipulation of Facts and Issues (JSFI) and approved the parties' belatedly filed JSFI.[53]

On June 11, 2013, the Court issued a Pre-Trial Order and terminated the Pre-Trial. [54]

During trial, petitioner presented testimonial and documentary evidence. Petitioner presented four (4) witnesses, namely: Jasmin U. Tan,[55] Jose Enrique D. Santos,[56] Christina Buenafe[57] and Raphael C. Miguel.[58] Respondent also presented testimonial and documentary evidence with Nicasio H. Lumagui Jr. as his lone witness.[59]

With the filing of petitioner's Memorandum[60] on June 20, 2016 and posting of respondent's Memorandum[61] on June 28, 2016, the case was deemed submitted for decision on July 14, 2016.[62]

---

[46] Docket Vol. I, pp. 336-346.
[47] Docket Vol. I, pp. 372-379.
[48] Docket Vol. I, pp. 386-394.
[49] Docket Vol. I, pp. 380-384.
[50] Docket Vol. I, pp. 402-405.
[51] Resolution, Docket Vol. I, p. 407.
[52] Resolution, Docket Vol. I, p. 427.
[53] Docket Vol. I, pp. 422-426.
[54] Docket Vol. III, pp. 1130-1140.
[55] Docket Vol. I, p. 443; Docket Vol. III, p. 1639.
[56] Docket Vol. III, pp. 1094, 1111 and 1802.
[57] Docket Vol. III, pp. 1429 and 1511.
[58] Docket Vol. III, pp. 1159.
[59] Docket Vol. V, pp. 2975.
[60] Docket Vol. V, pp. 3060-3116.
[61] Docket Vol. V, pp. 3125-3142.
[62] Resolution, Docket Vol. V, p. 3145.

m

ISSUES

The issues[63] submitted by the parties for the Court's resolution are:

1. Whether petitioner has a separate and distinct personality from Dr. Hortaleza;

2. Whether Dr. Hortaleza is the beneficial owner of petitioner;

3. Whether petitioner is eligible to claim income tax exemption privilege under RA 7459;

4. Whether petitioner is the owner of the tax exempt products invented by Dr. Hortaleza;

5. Whether petitioner is liable for deficiency income tax, VAT, EWT and compromise penalty, for taxable year 2008;

6. Whether respondent can subject to income tax petitioner's sales of allegedly tax exempt products in disregard of the provisions of RA 7459, the rulings of the BIR, and the final and executory judgment rendered by the Court of Tax Appeals and the Supreme Court;

7. Whether the tax exemption under Section 6 of RA 7459 attaches to petitioner's income derived from the commercial sale of Dr. Hortaleza's invention;

8. Whether petitioner is entitled to the claimed tax exemption albeit the commercial production/sale of Dr. Hortaleza's invention is done through alleged petitioner corporation;

9. Whether the August 18, 2011 FAN issued by the CIR in disregard of the May 29, 2007 judgment of the Court of Tax Appeals and the August 4, 2008 Resolution of the Supreme Court are valid;

---

[63] Stipulated Issues, PTO, Docket Vol. III, pp. 1131-1133.

om

10. Whether the alleged discrepancy between sales per tax relief data versus summary list of petitioner exists;

11. Whether the alleged discrepancy between sales per tax relief data and petitioner's summary list of sales constitute sufficient legal and factual basis to hold petitioner liable for alleged deficiency income tax;

12. Whether the alleged discrepancy between sales per tax relief data and petitioner's summary list of sales constitute sufficient legal and factual basis to hold petitioner liable for alleged deficiency VAT;

13. Whether the normal income tax on net taxable income of petitioner per return was not deducted from available tax credits;

14. Whether sales of old motor vehicles to employees are subject to VAT although the seller is not engaged in the business of selling motor vehicles;

15. Whether petitioner understated its VAT payments for the fourth quarter of 2008;

16. Whether petitioner has lease payments that were not subjected to EWT;

17. Whether petitioner was informed of the law and the facts from which the assessment for income tax, VAT and EWT for the year 2008 was based, pursuant to Section 228 of the Tax Code of 1997;

18. Whether respondent's right to assess petitioner for EWT and VAT for the year 2008 had already prescribed; and

19. Whether petitioner is liable for the alleged deficiency EWT, VAT and income tax for taxable year 2008.

In addition, in its Memorandum, petitioner raised the invalidity of the assessments issued on the ground that there was no valid issuance or revalidation of the LOA.

Essentially, the main issues to be resolved are 1) whether respondent's right to assess petitioner of deficiency taxes has prescribed; 2) whether it is petitioner or Dr. Hortaleza who is entitled to claim the income tax exemption under Section 6 of RA 7459; and, 3) whether petitioner is liable to pay the assessed deficiency income tax, EWT and VAT for taxable year 2008.

RULING OF THE COURT

The assessment for deficiency income tax, EWT and VAT for taxable year 2008 has not yet prescribed

Section 203[64] of the National Internal Revenue Code (NIRC) of 1997, as amended mandates the BIR to assess internal revenue taxes within three years from the last day prescribed by law for the filing of the tax return or the actual date of filing of such return, whichever comes later. An assessment notice issued after the three (3)-year prescriptive period is not valid and effective. Exceptions to this rule are provided under Section 222[65] of the NIRC of 1997, as amended.[66]

Pursuant to Section 77 of the NIRC of 1997, as amended, a corporate taxpayer (on a calendar year basis of reporting) must file its Annual Income Tax Return (ITR) on or before April 15 of the following year.

On the other hand, Section 114(A) of the NIRC of 1997, as amended, and Section 4.114-1(A) of Revenue Regulations (RR) No. 16- 05 provide that Quarterly VAT Returns shall be filed within twenty-five (25) days following the close of each taxable quarter.

---

[64] SEC. 203. Period of Limitation Upon Assessment and Collection. – Except as provided in Section 222, internal revenue taxes shall be assessed within 3 years after the last day by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided,* That in case where a return is filed beyond the period prescribed by law, the three (3) year period shall be counted from the day the return was filed. For purposed of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. (Boldfacing supplied)
[65] Sec. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes.—
xxx
(b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon. (Boldfacing supplied)
[66] G.R. No. 212825, December 7, 2015.

om

With respect to the EWT, Section 2.58(A)(2)(b) of RR No. 17-03, in relation to Section 7 of RR No. 09-01, as last amended by RR No. 26-02, provides that the electronic filing of EWT Returns of taxpayers engaged in manufacturing such as herein petitioner must be made within fourteen (14) days following the end of the month.

Summarized below are the dates of filing of petitioner's Annual ITR, Quarterly VAT Returns, Monthly EWT Returns and the corresponding dates within which respondent should assess petitioner for deficiency income tax, VAT and EWT for taxable year 2008:

Annual Income Tax Return				
Period Covered	Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
2008	"NN"[67]	April 15, 2009	April 15, 2009	April 15, 2012
	"NN"[68]	May 22, 2009	-	May 22, 2012

Quarterly VAT Returns					
Period Covered		Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
1st Quarter	January 1 to March 31- 2008	"EE"[69]	April 24, 2008	April 25, 2008	April 25, 2011
2nd Quarter	April 1 to June 30, 2008	"FF"[70]	July 23, 2008	July 25, 2008	July 25, 2011
4th Quarter	October 1 to December 31, 2008	"HH"[71]	January 23, 2009	January 25, 2009	January 25, 2012
		"E6"[72] (Amended Return)	April 30, 2008	-	

Monthly EWT Returns				
Month Covered	Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
January 2008	Q[73]	February 14, 2008	February 14, 2008	February 14, 2011
February 2008	R[74]	March 14, 2008	March 14, 2008	March 14, 2011
March 2008	S[75]	April 14, 2008	April 14, 2008	April 14, 2011
April 2008	T[76]	May 14, 2008	May 14, 2008	May 19, 2011
	U[77]	May, 19, 2008 (amended return)		
May 2008	V[78]	June 12, 22008	June 14, 2008	July 14, 2011
June 2008	W[79]	July 14, 2008	July 14, 2008	July 30, 2011

[67] Exhibit "NN", Docket Vol. IV, pp. 2085-2087.
[68] Exhibit "NN", Docket Vol. IV, pp. 2088-2089.
[69] Docket Vol. IV, pp. 2036-2037.
[70] Docket Vol. IV, pp. 2038-2039.
[71] Docket Vol. IV, pp. 2040-2041
[72] Docket Vol. IV, pp. 2751-2752.
[73] Docket Vol. IV, pp. 2016-2017.
[74] Docket Vol. IV, pp. 2018-2019.
[75] Docket Vol. IV, pp. 2020-2021.
[76] Docket Vol. IV, pp. 2022-2023.
[77] Docket Vol. IV, pp. 2024-2025.
[78] Docket Vol. IV, pp. 2026-2027.
[79] Docket Vol. IV, pp. 2028-2029.

	X[80]	July 30, 2008 (amended return)		
July 2008	Y[81]	August 14, 2008	August 14, 2008	August 14, 2011
December 2008	DD[82]	January 15, 2009	January 14, 2009	January 14, 2012

A scrutiny of the records show that petitioner failed to present in evidence its Quarterly VAT Return for the 3rd quarter of 2008 and its Monthly EWT Returns for the months of August 2008 to November 2008. Thus, this Court could not determine the dates when petitioner filed said returns which dates are relevant for purposes of establishing whether the right of respondent to assess petitioner for VAT and EWT during those period has prescribed.

Based on the table above, and considering petitioner's failure to present its Quarterly VAT Return for the 3rd quarter of 2008 and its Monthly EWT Returns for the months of August 2008 to November 2008, the Court finds that when petitioner received the FAN on September 7, 2011 for deficiency taxes for 2008, respondent's right to assess has not yet prescribed with respect to income tax, 3rd and 4th quarters VAT and August to December EWT.

Records, however, show that petitioner issued three (3) Waivers to extend the prescriptive period for assessing its tax liabilities for taxable year 2008. Details of the Waivers are as follow:

Waiver[83]	**Exhibit**	**Date of Execution of Waiver**	**Date of Acceptance of BIR**	**Date of Extension of Investigation**	**Date of Notarization**	**Date of Receipt of Splash of the Accepted Waiver**
First Waiver	WW-1[84]	[undated]	September 30, 2010	Not later than December 31, 2010	September 29, 2010	October 8, 2010
Second Waiver	WW-2[85]	[undated]	December 8, 2010	June 30, 2011	December 6, 2010	January 31, 2011
Third Waiver	WW[86]	May 13, 2011	December 31, 2011	Not later than December 31, 2011	May 18, 2011	June 9, 2011

While not disowning the Waivers, petitioner contends that the same are invalid as: (1) they do not bear the date of acceptance by the

---

[80] Docket Vol. IV, pp. 2030-2031.
[81] Docket Vol. IV, pp. 2032-2033.
[82] Docket Vol. IV, pp. 2035-2036.
[83] Documents denominated as "WAIVER OF THE DEFENSE OF PRESCRIPTION UNDER THE STATUTE OF LIMITATIONS OF THE NATIONAL INTERNAL REVENUE CODE"; Exhibits "WW" to "WW-2", Docket Vol. IV, pp. 2496-2507.
[84] Docket Vol. IV, p. 2500.
[85] Docket Vol. IV, p. 2506.
[86] Docket Vol. IV, p. 2496.

BIR such that it cannot be ascertained whether the Waivers were executed prior to the expiration of the 3-year period to assess petitioner[87]; (2) the Waivers were not signed by the CIR considering that the amount involved is more than Php1 million[88]; and (3) the Waivers were not properly notarized.[89]

For his part, the CIR asserts that the waivers are valid and binding between respondent and petitioner; the requirements set forth in Revenue Memorandum Order (RMO) No. 20-90 have been substantially complied with; and, petitioner is estopped from raising the issue of prescription for the first time on appeal based on the invalidity of the Waivers.[90]

A detailed evaluation of the Waivers *vis-a-vis* the requirements set by RMO No. 20-90 shows that the Waivers indeed failed to strictly conform to the prescribed format as: 1) the date of execution of the first and second waivers were not indicated on their face; and 2) the proof of identity, *i.e.* Community Tax Certificate, indicated in the Acknowledgment of the third Waiver is not a competent evidence of identity.[91]

While it may be true that the Waivers issued by petitioner failed to comply with the requirements specified in RMO No. 20-90, petitioner's positive acts prior to and subsequent to the issuance of the FAN precludes it from claiming that the Waivers are invalid and that the deficiency tax assessments issued against it for the year 2008 were issued beyond the prescriptive period. Having itself caused such infirmities in the Waivers, petitioner is estopped from questioning the same, consistent with the pronouncement in *Commissioner of Internal Revenue vs. Next Mobile Inc.,*[92] to wit:

> "**Both parties knew the infirmities of the Waivers yet they continued dealing with each other on the strength of these documents without bothering to rectify these infirmities.** In fact,

---

[87] Par. 16, Petition, Docket Vol. I, p. 5
[88] Id.; Pars. 136-139 Memorandum, Docket Vol. V, pp. 3110-3111.
[89] Par. 135, Memorandum, Docket Vol. V, p. 3110.
[90] Amended Answer, Docket Vol. I, pp. 319-323; Memorandum, Docket Vol. V, pp.3136-3139
[91] *Baylon v. Alamo*, A.C. No. 6962, June 25, 2008; 2004 RULES ON NOTARIAL PRACTICE, Rule II, Sec. 12. *Competent Evidence of Identity*. - The phrase competent evidence of identity refers to the identification of an individual based on:
(a) at least one current identification document issued by an official agency bearing the photograph and signature of the individual; or
(b) the oath or affirmation of one credible witness not privy to the instrument, document or transaction who is personally known to the notary public and who personally knows the individual, or of two credible witnesses neither of whom is privy to the instrument, document or transaction who each personally knows the individual and shows to the notary public documentary identification.
[92] G.R. No. 212825, December 7, 2015.

in its Letter Protest to the BIR, respondent did not even question the validity of the Waivers or call attention to their alleged defects.

xxx xxx xxx

The general rule is that when a waiver does not comply with the requisites for its validity specified under RMO No. 20-90 and RDAO 01-05, it is invalid and ineffective to extend the prescriptive period to assess taxes. However, due to its peculiar circumstances, We shall treat this case as an exception to this rule and find the Waivers valid for the reasons discussed below.

First, the parties in this case are *in pari delicto* or 'in equal fault.' *In pari delicto* connotes that the two parties to a controversy are equally culpable or guilty and they shall have no action against each other. However, although the parties are *in pari delicto*, the Court may interfere and grant relief at the suit of one of them, where public policy requires its intervention, even though the result may be that a benefit will be derived by one party who is in equal guilt with the other.

Here, to uphold the validity of the Waivers would be consistent with the public policy embodied in the principle that taxes are the lifeblood of the government, and their prompt and certain availability is an imperious need. Taxes are the nation's lifeblood through which government agencies continue to operate and which the State discharges its functions for the welfare of its constituents. As between the parties, it would be more equitable if petitioner's lapses were allowed to pass and consequently uphold the Waivers in order to support this principle and public policy.

Second, the Court has repeatedly pronounced that parties must come to court with clean hands. Parties who do not come to court with clean hands cannot be allowed to benefit from their own wrongdoing. Following the foregoing principle, respondent should not be allowed to benefit from the flaws in its own Waivers and successfully insist on their invalidity in order to evade its responsibility to pay taxes.

Third, respondent is estopped from questioning the validity of its Waivers. While it is true that the Court has repeatedly held that the doctrine of estoppel must be sparingly applied as an exception to the statute of limitations for assessment of taxes, the Court finds that the application of the doctrine is justified in this case. Verily, the application of estoppel in this case would promote the administration of the law, prevent injustice and avert the accomplishment of a wrong and undue advantage. **Respondent executed five Waivers and delivered them to petitioner, one after the other. It allowed petitioner to rely on them and did not raise any objection against their validity until petitioner assessed taxes and penalties against it. Moreover, the application of estoppel is necessary to prevent the undue injury that the government would suffer because of the cancellation of petitioner's assessment of respondent's tax liabilities.**

> **Finally, the Court cannot tolerate this highly suspicious situation. In this case, the taxpayer, on the one hand, after voluntarily executing waivers, insisted on their invalidity by raising the very same defects it caused. On the other hand, the BIR miserably failed to exact from respondent compliance with its rules. The BIR's negligence in the performance of its duties was so gross that it amounted to malice and bad faith. Moreover, the BIR was so lax such that it seemed that it consented to the mistakes in the Waivers. Such a situation is dangerous and open to abuse by unscrupulous taxpayers who intend to escape their responsibility to pay taxes by mere expedient of hiding behind technicalities.** (Boldfacing supplied)

A judicious review of the records reveals that petitioner performed acts that induced respondent to defer the issuance of the FAN. As afore-stated, to extend the prescriptive period to assess petitioner for deficiency taxes for the year 2008, petitioner freely, voluntarily and consciously executed the Waivers fully aware of their nature and legal significance. As a necessary consequence of the Waivers, respondent in turn delayed the issuance of the FAN. The FAN dated August 18, 2011, assessing petitioner for deficiency taxes for the year 2008, was received by petitioner on September 7, 2011, within the extended period as provided for in the questioned Waivers. On October 7, 2011, when petitioner filed a request for reconsideration of the FAN and sought the withdrawal and cancellation of the deficiency tax assessments allegedly for lack of legal and factual bases, petitioner did not even raise as an issue the invalidity of the Waivers and the prescription of respondent's right to assess petitioner for deficiency taxes for the year 2008.

Otherwise stated, petitioner's positive acts depict an admission that the Waivers are valid. Thus, consistent with *Next Mobile*, petitioner is estopped from questioning the validity of the Waivers and the issuance of the corresponding FAN within the extended period. By the principle of estoppel, to allow petitioner to impugn the validity of the Waivers after benefiting therefrom and after inducing respondent to rely on the same is simply too abhorrent, to say the least. Guided by the foregoing, the Court is convinced that the CIR's right to assess petitioner for deficiency VAT and EWT for the year 2008 was validly extended by the Waivers.

The issue of lack of authority of the revenue officers to examine petitioner may not be raised belatedly as it is violative of the right to due process

The Court notes that the issue on the validity of the issuance or re-validation of the LOA was only raised by petitioner in its Memorandum, after trial. Neither its Petition nor protest to the assessment questioned the validity of the LOA.

Petitioner submits that the assessment issued against it is void since the examination of its books of accounts was not authorized under the law as Revenue Officer (RO) Nicasio H. Lumagui, Jr. who allegedly examined its books of account was not duly armed with a valid LOA, in blatant violation of the Tax Code and jurisprudence.[93] Although an LOA was issued, petitioner avers that the name of RO Nicasio H. Lumagui, Jr. was not indicated therein and that notwithstanding the LOA's revalidation, it remained defective.[94] Thus, the examination of petitioner's books of accounts was unauthorized and the corresponding assessment, issued as a consequence thereof, is void. Being void, the same cannot give rise to a valid source of obligation for a void assessment bears no valid fruit.[95]

Records bear that a Revalidation Notice dated February 11, 2010[96] and Final Notice dated June 10, 2010[97] were sent to petitioner and received by Eric D. Santos on March 25, 2010 and June 10, 2010, respectively, to inform it of the authority of ROs Miriam N. Jalandoni, Francisco Ramos and Ali Hassan M. Lucman Jr. under Group Supervisor Nicasio H. Lumagui Jr. to continue the examination of petitioner. **Despite receipt of these notices then, petitioner did not question the authority of the ROs conducting the examination of its books of accounts.**

Furthermore, if petitioner sincerely believes that RO Nicasio H. Lumagui, Jr. had no authority to conduct the audit and examination of its books, thus rendering void the assessment which was consequently issued after the audit and examination, petitioner should have raised the same at the earliest opportunity, *i.e.*, when petitioner filed its protest against the assessment before the BIR or, at the very least, in its Petition for Review and Pre-Trial Brief before this Court.

---

[93] Par. 13, Memorandum, Docket Vol. V, p. 3064.
[94] Par. 14, Memorandum, Docket Vol. V, p. 3065.
[95] Par. 15, Memorandum, Docket Vol. V, p. 3065.
[96] BIR Records, p. 80.
[97] Exhibit "6"; BIR Records, p. 391.

Rules of fair play dictate that petitioner should be barred from raising the issue at this stage of the proceedings as to do so would deprive respondent of the opportunity to present evidence in support of his position.

On this point, the teachings of *Henry L. Mon v. Court of Appeals, et al.*[98] is most enlightening:

> Courts of justice have no jurisdiction or power to decide a question not in issue. **A judgment that goes outside the issues and purports to adjudicate something on which the court did not hear the parties, is not only irregular but also extra-judicial and invalid. The rule rests on the fundamental tenets of fair play.**" (Boldfacing supplied)

The tax exemption granted under RA 7459 is available only to the inventor himself

Pivotal to the issue of whether petitioner is liable to the assessed deficiency income tax is the construction of Section 6 of RA 7459 otherwise known as the Inventors and Invention Incentives Act of the Philippines.

RA 7459 declares the national policy to give priority to invention and its utilization on the country's productive systems and national life; and to this end provide incentives to inventors and protect their exclusive right to their invention, particularly when the invention is beneficial to the people and contributes to national development and progress. Pursuant to the national policy, the Government shall provide a program to set up a climate conducive to invention and innovation, give encouragement and support to inventors who are creative and resourceful, as well as imbued with a deep sense of nationalism, and maximize the capability and productivity of inventors through incentives and other forms of assistance and support.[99]

Pertinent Sections of RA 7459 read:

> "ARTICLE I TITLE, POLICY PROGRAM AND DEFINITION OF TERMS
>
> SECTION 2. Declaration of National Policy and Program. — It is hereby declared to be the national policy to give priority to invention and its utilization on the country's productive systems and

[98] G.R. No.118292, April14, 2004.
[99] Section 2, RA 7459.

national life; and to **this end provide incentives to investors and protect their exclusive right to their invention**, particularly when the invention is beneficial to the people and contributes to national development and progress.

Pursuant to the national policy, the Government shall provide a program to set up a climate conducive to invention and innovation, give encouragement and support to inventors who are creative and resourceful, as well as imbued with a deep sense of nationalism, and maximize the capability and productivity and inventors through incentives and other forms of assistance and support.

ARTICLE III TAX INCENTIVES AND TAX EXEMPTIONS

SECTION 5. Tax Incentives. — **Inventors, as certified by the Filipino Inventors Society and duly confirmed by the Screening Committee**, shall be exempt from payment of license fees, permit fees and other business taxes in the development of their particular inventions. This is an exception to the taxing power of the local government units. The certification shall state that the manufacture of the invention is made on a commercial scale.

Inventors shall be exempt from paying any fees involved in their application for registration of their inventions.

SEC. 6. Tax Exemption.- To promote, encourage, develop and accelerate commercialization of technologies developed by local researchers or adapted locally from foreign sources including inventions, any income derived from these technologies shall be exempted from all kinds of taxes during the first ten (10) years from the date of the first sale, subject to the rules and regulations of the Department of Finance: ***Provided,* That this tax exemption privilege pertaining to invention shall be extended to the legal heir or assignee upon the death of the inventor.**

The technologies, their manufacture or sale, shall also be exempt from payment of license, permit fees, customs duties and charges on imports." (Boldfacing supplied)

The present controversy particularly relates to the identification of the person who is entitled to the tax exemption privilege under the afore-quoted Section 6 of RA 7459, specifically – as between petitioner and Dr. Hortaleza, who is entitled to the tax exemption granted?

Expectedly, the parties espouse opposing views. To be sure, there is no dispute that the inventor of the products sold which generated the income being taxed is Dr. Hortaleza.[100]

[100] Pars. 8, 9 and 10, Petition for Review, Docket Vol. V, pp. 2-3; Pars. 6.2.1. to 6.2.6, Amended Answer, pp.309-315.

Petitioner theorizes that its sales of the products invented by Dr. Hortaleza are exempt from income tax under Section 6 of RA 7459. Citing BIR Rulings, petitioner adds that if the commercial production and sale of an invention is done by the inventor through his majority-owned corporation, the corporation is entitled to the tax exemption, as it is in that way that the inventor himself is able to avail of the tax incentive.[101]

Petitioner argues that the exemption granted by RA 7459 attaches to the income derived from the sale of invention and other technologies covered by the law, regardless of the seller.[102] The term "inventor" under RA 7459 should be construed to include a business conduit established by the actual inventor for the purpose of selling technologies and inventions.

Petitioner explains that to further commercialization of the inventions of Dr. Hortaleza, Dr. Hortaleza established Ang-Hortaleza Corporation (AHC), which serves as a holding company, of which in 2008, he together with his wife, Dr. Rosalinda A. Hortaleza, owns 99.9999994% of its shares of stock. He is also the Chairman and President of AHC. AHC, in turn, owns 70% of the shares of stock of petitioner, another corporation established by Dr. Hortaleza for the purpose of commercializing his inventions.[103] Petitioner adds that Dr. Hortaleza exercises a large amount of control of the business enterprise of petitioner as he is also its Chairman and CEO. Being a member of the Board of Directors and one of the officers of both corporations, Dr. Hortaleza becomes one of their managers as the Board is the business manager of the corporation.[104]

Contrarily, respondent submits that petitioner is not eligible to claim the income tax exemption privilege under RA 7459 as it applies only to the sale of inventions by the inventor. Respondent asserts that under RA 7459, it is the "inventor" certified by the Filipino Inventors Society (FIS) and duly confirmed by the DOST who is qualified to the exemption; in this case, it is Dr. Hortaleza. Respondent, however, concedes that sometimes the names of the inventor and the corporation are endorsed by the FIS in cases where the inventors have prepared the invention in behalf of the corporation but clarifies that such is not the case with Dr. Hortaleza and petitioner.[105]

---

[101] Petition for Review, Docket Vol. V, p.9.
[102] Pars. 64 to 75, Memorandum, Docket Vol. V, pp. 3084-3087.
[103] Par. 56, Memorandum, Docket Vol. V, p. 3081.
[104] Par. 57, Memorandum, Docket Vol. V, p. 3081.
[105] Amended Answer, Docket Vol. I, pp. 309-310.

While the Court recognizes that the interpretation of the CIR who is in charge of executing [tax laws], is an authoritative construction of great weight, nevertheless, the principle is not absolute. If through a misapprehension of law an officer has issued an erroneous interpretation, the error must be corrected when the true construction is ascertained.[106]

A circumspect reading of Section 6 vis-à-vis Sections 2 and 5 of RA 7459 reveals an uncertainty in identifying the party who may claim the income tax exemption provided therein. Thus, the Court must ascertain the true intent of the law.

It is a hornbook doctrine in statutory construction that it is the duty of the court in construing a law to determine legislative intention from its language.[107] However, when the intent of the law is not apparent as worded, or when the application of the law would lead to absurdity or injustice, legislative history is all important. In such cases, courts may take judicial notice of the origin and history of the law, the deliberations during the enactment, as well as prior laws on the same subject matter to ascertain the true intent or spirit of the law.[108] After all, tax exemptions are never presumed and are strictly construed against the taxpayer and liberally in favor of the taxing authority. They can only be given force when the grant is clear and categorical. The surrender of the power to tax, when claimed, must be clearly shown by a language that will admit of no reasonable construction consistent with the reservation of the power. If the intention of the legislature is open to doubt, then the intention of the legislature must be resolved in favor of the State.[109]

Congressional records[110] disclose that when Representative Mario S. Ty was asked during deliberation with respect to the tax incentives provision of House Bill No. 24801, which later became RA 7459, he was clear and categorical in saying that the tax incentives pertain exclusively to the original inventor, *viz.*:

> MR. DOMINGO. xxx
> May I go to page 2, on line 11, with respect to "Tax Incentives." **It is stated here that inventors are given tax incentives. Suppose an inventor transfers his rights to other persons, would that transferee be entitled to tax incentives?**

---

[106] *Banco De Oro, et al., vs. Republic of the Philippines*, et al., G.R. No. 198756, January 13, 2015.
[107] *People v. Degamo*, G.R. No. 121211, April 30, 2003.
[108] *Commissioner of Internal Revenue v. SM Prime Holdings, Inc. and First Asia Realty Development Corporation*, G.R. No. 183505, February 26, 2010.
[109] *Smart Communications, Inc. v. City of Davao, et al.*, G.R. No. 155491, September 16, 2008.
[110] There was no discussion in the Senate on Section 6 of RA 7459 on tax exemption.

Mr. TY. **No. And under the contemplation of this bill, this will refer to the original inventor.** Because if he sells his invention to somebody, then that is going to be commercialized already. That is not... The one who is purchasing the invention is no longer the original inventor. **What we are contemplating here is giving the tax incentives to the original inventors**.

xxx xxx xxx

MR. DOMINGO. xxx

I asked that question because, I really wanted to know whether transferees or those who buy rights on invention are entitled to incentives and loan assistance. Because there are inventors who really could not commercially appropriate their inventions.

But, Mr. Speaker, Your Honor, suppose the inventor would surreptitiously or secretly sell his invention to some other persons and the transferees would be the one to secure the patent for the invention, would that transferee or buyer of the invention be entitled to cash rewards and dividends?

MR. TY. Well, your Honor, in that particular example that you just made, without knowing that he is not the original inventor, he may pass on as – you know – the original, inventor. Just like a person, a businessman for example, who wants to avoid paying taxes, buys a winning sweepstakes ticket from somebody, and the Sweepstakes Office does not know that he was the one who is the original owner of that, then that is passed on as a winning ticket with taxable deductions. So that in like manner also, if the transferee is not known as that he is not the original inventor, then he can pass on for – you know – as the original inventor.

MR. DOMINGO. **Can we not, you Honor, Mr. Speaker, provide for a mechanism to avoid this possibility of a transferee or buyer of an invention be prohibited from doing it**?

MR. TY. Yes, Mr. Speaker, your Honor. Thank you for bringing this to light because it is really possible that not original inventors will be the ones to claim the rewards and then the tax exemptions and other benefits like loan assistance. So I am happy that your Honor has brought this up, and I would welcome, the committee would welcome any amendment to this effect **in order to safeguard that only the original inventors will be the ones to avail of the benefits as provided for in this bill**.

MR. DOMINGO. So, your Honor, when the time or period of amendments would come, may we suggest some amendments in order to correct this possible loophole that would arise when this law would be approved.

MR. TY. Well, thank you, Mr. Speaker, your Honor. We welcome the proposed amendment because I know it will strengthen the bill and do away with false claims as regards the invention, just to avail of the benefits as provided for under this bill. So that the amendments that you will propose, I hope that you will do it at the proper time, and the committee will not hesitate to take them in.

xxx xxx xxx[111]

As currently worded, Section 6 of RA 7459 provides that *"any income derived from these technologies shall be exempted from all kinds of taxes during the first ten (10) years from the date of the first sale, subject to the rules and regulations of the Department of Finance."* Section 6 also contains a proviso which states that *"the tax exemption privilege pertaining to invention shall be extended to the legal heir or assignee upon the death of the inventor."*

Consistent with the intent of its framers to provide incentives to the original inventors, Section 6 of RA 7459 must be interpreted to mean that the tax exemptions refers to the <u>income derived by the inventor</u> from the technologies. The first part of Section 6 of RA 7459 must be read in relation to its proviso. The phrase exempting from taxes any income derived from the technologies necessarily pertains to the income derived by the inventor which tax exemption shall be transferable to the inventor's legal heir or assignee **only upon his death**.

Stated differently, while the first part of Section 6 does not indicate the words **"by the inventor"** between the phrases *"any income derived"* and *"from these technologies shall be exempted from all kinds of taxes"*, it is obvious from the proviso contained in Section 6 - - **this tax exemption privilege pertaining to invention shall be extended to the legal heir or assignee upon the death of the <u>inventor</u>** - - that the tax exemption necessarily refers to **<u>the income derived by the inventor</u> from the technologies**.

This is the logical and rational understanding of Section 6 of RA 7459 which is consistent with the legislative intent as well as the National Policy and Program declared in Section 2 of RA 7459 to **provide incentives to investors, protect their exclusive right to their invention, and give encouragement and support to creative and resourceful inventors**.

It is a fundamental rule in statutory construction that the clauses, phrases, sections and provisions of a law be read as a

[111] During the continuation of the consideration of Committee Report No. 00676 on House Bill No. 24801 on August 2, 1990.

on

whole; never as disjointed or truncated parts,[112] for a law is enacted as a single entity and not by installment of paragraphs here and subsections there. Moreover, a law should not be so construed as to produce an absurd result.[113] Statutes should receive a sensible construction, such as will give effect to the legislative intention and so as to avoid an unjust or an absurd conclusion.[114]

Applying basic and fundamental rules on statutory construction, the ineluctable conclusion is that the purpose of Section 6 of RA 7459 is to exempt the income derived by the inventor from the technologies or inventions. To say that the tax exemption attaches to the income from the technologies or inventions, irrespective of the person or entity deriving the same, would render senseless the proviso extending the tax exemption to the legal heir or assignee of the inventor upon his death. **Had the framers of RA 7459 intended the tax exemption to apply to anyone who derives income from the technologies or inventions, the proviso in the last part of Section 6 of RA 7459 would not have been incorporated therein. For in the absence of such proviso, an inventor's assignee or "presumptive heirs" would be entitled to tax exemption, even during the inventor's lifetime, as long as income is derived from the inventor's technology.**

Truth to tell, the inventor, Dr. Hortaleza, appears to be mindful that he alone is entitled to claim tax exemption on income derived from his inventions, thus, he saw the need to assign the invention to petitioner to extend the tax exemption to petitioner as his assignee. On this point, the argument of respondent in his Memorandum is noteworthy:

> "Xxx xxx xxx. First as discussed in the preceding paragraphs, Dr. Hortaleza and Splash are separate and distinct from each other. Second, Dr. Hortaleza did not even assign the rights to his inventions to Splash during the year under review (2008). **Finally, it defies ordinary senses as to how Dr. Hortaleza can sell his rights to Splash for P300,000,000.00 in 2010 and transfer his exemption privilege if the invention and exemption privilege already belong to both transferor (Dr. Hortaleza) and transferee (Splash) prior to 2010, using simple logic. It is absolutely**

---

[112] *Samar II Electric Cooperative, Inc. vs. Estrella Quijano*, G.R. No. 144474, April 27, 2007, citing *Civil Service Commission v. Joson, Jr.*, G.R. No. 154674, May 27, 2004, 429 SCRA 773, 786.
[113] *Ang Giok Chip vs. Springfield*, G.R. No. L-33637, December 31, 1931.
[114] *Condrado Cosico, Jr. vs. National Labor Relations Commission*, G.R. No. 118432 May 23, 1997, citing *Commissioner of Internal Revenue v. TMX Sales, Inc.*, G.R. No. 83736 January 15, 1992.

illogical for Splash to buy rights and claim exemption privilege when in the first place it already owns it. How much more it can stand the test of judicial scrutiny."[115] (Boldfacing supplied)

The noble objective of RA 7459 to assist inventors - - obviously aware of the financial inadequacies of quite a number of Filipino inventors to commercially produce their inventions - - is further highlighted in its related provisions. For instance, in Sections 7 and 10 of RA 7459, the government provides support to inventors by assisting them in the initial experiments and prototype development and other inventor-development related activities as well as loan assistance. The law certainly does not contemplate extending the foregoing assistance and tax exemption to each and every person or entity that produce, manufacture, commercially distribute or market the technologies or inventions.

As the patentee, the inventor's invention is protected. But even as the inventor has the exclusive right to make use, and vend the thing patented, and consequently to preclude others from exercising like privileges, he may give his consent and allow third parties to copy and profit from his patented invention. The tax exemption privilege, however, remains exclusive to him. To reiterate, the exemption on income derived from the invention by the inventor, being personal to him, may only be extended to his legal heirs or assignees upon his death.

Relatedly, to implement RA 7459, DOST issued implementing rules and regulations, Section 4.3 of which provides that: "[t]ax and duty exemptions shall be principally governed by orders, revenue regulations and/or administrative issuances from the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC). xxx xxx xxx." Thus, the then Acting Secretary of Finance, upon recommendation of the CIR, issued RR No.19-93[116] prescribing guidelines and procedures for the availment by Filipino Inventors of tax incentives and tax exemptions provided under Sections 5 and 6 of Article III of RA 7459.

RR No. 19-93 provides:

"SECTION 3. Tax Incentives and Tax Exemptions. —

A. As an exemption to the taxing power of the local government units, **Filipino inventors** shall, in the development of

---

[115] Respondent's Memorandum, Docket Vol. V, p. 3132.

[116] Subject: Republic Act No. 7459, Otherwise Known as the "Investors and Invention Incentives Act of the Philippines", Providing Tax Incentives and Tax Exception Privileges to Filipino Inventors.

their particular inventions, be **exempt** from the payment of the following to the local government units concerned:

(a) License fees;

(b) Permit fees;

(c) Other business taxes; and

(d) Fees involved in their application for registration of their inventions.

B. To promote, encourage, develop and accelerate commercialization of technologies developed by local researches or adopted locally from foreign sources including inventions, any income derived from these technologies shall be exempted from all kinds of taxes during the first ten (10) years from the date of the first sale on a commercial scale, provided that this exemption privilege pertaining to the invention **shall be extended to the legal heir or assignee upon death of the inventor**.

C. The inventor shall be exempt from the following taxes for which otherwise **he shall have been directly liable**:

(a) Income tax on the net income derived from the sale of invention products resulting from newly discovered/developed technologies by local researches or new technology adopted from foreign sources whether it be patented machine, product, process including implements or tools and other related gadgets of invention, utility, model and industrial design patents;

xxx xxx xxx;

D. xxx xxx xxx.

SECTION 4. Conditions for Availment of Tax Incentives and Tax Exemptions. —

A. **Filipino inventor** and/or owner of technology, shall submit **his application for tax exemption** in a form prescribed thereafter, in triplicate, to the Commissioner of Internal Revenue, Attn: Legislative, Ruling and Research Division (LRRD), together with the following documents:

a. Certification issued by the FIS that the invention is new or original, and the technology is newly developed by local researches or adopted locally from foreign sources;

b. Confirmation by the Screening Committee;

c. Certification from the BIR that the manufacture and/or sale of the invention products from technology developed is made on a commercial scale;

om

> d. Taxpayer Identification Card (TIN) and registration as non—VAT taxpayer;
>
> e. Initial capitalization required to fund the invention /technology; and
>
> f. Volume/capacity/amount required in the manufacture and fabrication of the invention/technology to attain the status of commercial scale.
>
> xxx xxx xxx.
>
> SECTION 6. Taxability as Withholding Agent. —
>
> An inventor shall be constituted as a withholding agent and shall be required to withhold and remit to the BIR withholding **tax on his payment as an employer of compensation income to his employees or on his payments to persons subject to expanded withholding tax**.
>
> SECTION 7. Bookkeeping and Reportorial Requirements. —
>
> **An inventor qualified as tax exempt** under this provisions of the Act shall keep regular and accurate records of **his transactions** and **shall maintain separate books of accounts of his transaction involving the sale of invention products and technologies** in accordance with existing law and the Bookkeeping Regulations. **He shall file** an annual information return on or before the 15th day of the fourth month following the end of **his taxable period** which shall be subject to examination by the BIR to determine if the conditions under which **he was granted tax exemption are complied with and the taxes due**, if any." (Boldfacing supplied)

It is settled that rules and regulations - - as those promulgated by the Secretary of Finance for the effective enforcement of the tax provisions of RA 7459 - - are given weight and respect by the courts in view of the rule-making authority given to those who formulate them and their specific expertise in their respective fields.[117] Hence, absent any showing that RR No. 19-93 is inconsistent with the provisions of RA 7459, its provisions should be respected and applied accordingly.

As afore-discussed extensively, and given the various yet complementing provisions of RR No. 19-93, there is no denying that the tax incentive/exemption under RA 7459 is vested on the Filipino inventor whose privilege may be transferred to his legal heir/s or assignee/s only upon his death and not to any third-party company or entity who may derive income from the inventor's invention.

---

[117] *Eastern Telecommunications Philippines, Inc. vs. Commissioner of Internal Revenue*, G.R. No. 183531, March 25, 2015, citing *Chamber of Real Estate and Builders' Associations, Inc. v. Hon. Executive Secretary Alberto Romulo, et al.*, 628 Phil. 508, 535 (2010).

Dr. Hortaleza and Splash Corporation are two separate and distinct personalities

Considering that the tax exemption under Section 6 of RA 7459 pertains only to the inventor and Dr. Hortaleza has allegedly considerable interest and control in petitioner, may petitioner and Dr. Hortaleza be considered one and the same?

The Court answers in the negative.

It is an elementary and fundamental principle of Corporation Law that a corporation is an entity separate and distinct from its stockholders and from other corporations to which it may be connected. [118] Thus, in *Aboitiz Equity Ventures, Inc. vs. Victor S. Chiongbian*,[119] the Supreme Court elucidates:

> "It is basic that a corporation has a personality separate and distinct from that of its individual stockholders. Thus, a stockholder does not automatically assume the liabilities of the corporation of which he is a stockholder. As explained in *Philippine National Bank v. Hydro Resources Contractors Corporation*:
>
> > 'A corporation is an artificial entity created by operation of law. It possesses the right of succession and such powers, attributes, and properties expressly authorized by law or incident to its existence. It has a personality separate and distinct from that of its stockholders and from that of other corporations to which it may be connected. xxx xxx xxx.'
>
> **In fact, even the ownership by a single stockholder of all or nearly all the capital stock of a corporation is not, in and of itself, a ground for disregarding a corporation's separate personality.** As explained in *Secosa v. Heirs of Francisco*:
>
> > 'It is a settled precept in this jurisdiction that a corporation is invested by law with a personality separate from that of its stockholders or members. It has a personality separate and distinct from those of the persons composing it as well as from that of any other entity to which it may be related. *Mere ownership by a single stockholder or by another corporation of all or nearly all of the capital stock of a corporation is not in itself sufficient ground for disregarding the separate corporate personality.* A corporation's authority to act and its liability for its actions are separate and apart from the individuals who own it.'

---

[118] *Pacific Rehouse Corporation vs. Court of Appeals and Export Industry Bank, Inc.*, G.R. Nos. 199687 and 201537, March 24, 2014.
[119] G.R. No.197530, July 9, 2014.

xxx xxx xxx." (Boldfacing supplied)

Petitioner nonetheless justifies the disregard of the corporate personality of petitioner and Dr. Hortaleza, its alleged owner and controlling shareholder, on the premise that it is in line with the public policy to "promote, encourage, develop, and accelerate commercialization of technologies developed by local researchers or adapted locally from foreign sources including inventions" laid down in RA 7459 and to do otherwise would be inequitable as it would prevent local inventors from availing of the tax exemption.[120]

The proposition is erroneously premised. For one, there is nothing in the law that precludes local inventors from availing of the tax exemption. In fact, and as afore-discussed, the noble objective of the law is to provide incentives to local inventors - - and only to "inventors" - - excluding third parties.

Had the "inventor" opted to convert itself to a corporate entity which, in turn, obtained the corresponding accreditation from the FIS, the corporate entity would then be entitled to the tax exemption as, in essence, the corporation becomes the "inventor". In the case at bar, however, it is Dr. Hortaleza who remains the "inventor" while petitioner undeniably stands as a party separate and distinct from the inventor. Mere invocation of the vague concept of "commercialization of invention" does not *per se* justify a blind disregard of settled principles regarding the nature of a juridical entity as possessing a personality separate from its corporate officers and stockholders.

For another, and for emphasis, petitioner itself disclosed in Note 15 (i) of its 2008 Audited Financial Statements (AFS) that *"there are certain patents owned by Dr. Hortaleza, Chairman and Chief Executive Officer, which the Company uses free of charge."*[121] Thus, as pointed out by respondent in his Memorandum, Dr. Hortaleza appears to have unequivocably recognized that he is the "inventor" and that it was indispensable for him to sell or assign his rights over some of his inventions to petitioner in 2010 for the latter to avail of the privileges of a local inventor.

Moreover, records of the case are peppered with documents confirming that it is Dr. Hortaleza who is the "inventor" and thus, the person who is entitled to the privileges provided for in RA 7459. The

---

[120] Par. 61, Memorandum, Docket Vol. V, p. 3083.
[121] Exhibit I, Docket Vol. IV, p. 1962.

ml

Applications, dated March 5, 2007,[122] September 17, 2007,[123] December 5, 2007,[124] May 12, 2008,[125] September 28, 2008,[126] October 8, 2008,[127]for BIR Rulings filed by FIS for and on behalf of Dr. Hortaleza, with attached Certifications of Membership and Endorsement for Tax Exemption and Dr. Hortaleza's Letters-Requests to FIS, are most revealing as they all explicitly state that Dr. Hortaleza, as the inventor, fully deserves to avail of the tax incentives and privileges provided for by law. As said Applications and attached Certifications and Letters-Requests are similarly worded, the Court quotes the March 5, 2007 Application and its attached Certification and Letter-Request,[128] *viz.*:

"**FILIPINO INVENTORS SOCIETY**
25 Gil Puyat Ave., cor. Bautista St., Brgy. Palanan, Makati City M.M. Philippines
TELS: 729-2271 / 729 – 2278

05 March 2007

HON. MARIO C. BUÑAG
Commissioner
Bureau of Internal Revenue
BIR National Office, Agham Road
Diliman, Quezon City

Dear Sir:

Greetings!

As per advisement and instruction of Technology Application and Promotion Institute (TAPI), Department of Science and Technology (DOST), citing the provisions of **2005 IRR for RA 7459 Sec. 4.3** which specifically states that "xxx xxx xxx", inventors wanting to avail of tax incentives are directed forthright to BIR and/or DOF (ref.: precedent recently approved applications of Inventors Rolando B. Hortaleza and Marcelo C. Tomas in December 2006).

In concurrence, **we are hereby respectfully endorsing DR. ROLANDO B. HORTALEZA, M.D., inventor, patentee, entrepreneur and bona fide member of the Filipino Inventors Society**, and FOUR (4) of his duly patented Utility Model Inventions on SKIN CARE, **for availing of tax exemption privileges provided for under Republic Act No. 7459**, otherwise known as the "Inventors and Invention Incentives Act of the Philippines".

---

[122] Exhibit "VV", Docket Vol. IV, pp. 2206 – 2209.
[123] Exhibit "VV", Docket Vol. IV, pp. 2308 – 2311.
[124] Exhibit "VV", Docket Vol. IV, pp. 2349 – 2352.
[125] Exhibit "VV", Docket Vol. IV, pp. 2386 – 2388.
[126] Exhibit "VV", Docket Vol. IV, pp. 2405 – 2406.
[127] Exhibit "VV", Docket Vol. IV, pp. 2446 – 2449.
[128] Exhibit "VV", Docket Vol. IV, pp. 2206 – 2209.

mf

Said inventions, are being produced, manufactured and marketed on full commercial scale, exclusively by Splash Corporation, under registered and popular brandnames.

The Filipino Inventors Society expresses its sincere opinion that the above-named inventor fully deserves to avail of the tax incentives and privileges provided for by law, in view of the extensive economic and social contributions that his industry have (sic) thus far made for our people. Said inventor's tax savings will be used for furthering industrial research and development as well as for continued support of civic and social welfare organizations.

Herewith submitted is the pertinent documentary portfolio of the said inventor, with the official FIS Certificate of Membership & Endorsement for Tax Exemption.

Trusting this letter merits your kind preferential attention.

Very respectfully yours,

(sgd.)
TEODORICO E. CASTAÑEDA
National Secretary, FIS"[129]

(boldfacing supplied)

xxx xxx xxx

""FILIPINO INVENTORS SOCIETY
25 Gil Puyat Ave., cor. Bautista St., Brgy. Palanan, Makati City M.M. Philippines
TELS: 729-2271 / 729 – 2278

CERTIFICATION
OF MEMBERSHIP AND ENDORSEMENT FOR
TAX EXEMPTION

This is to certify that **INV. ROLANDO B. HORTALEZA** is a bona fide member of the Filipino Inventors Society and is a holder of a Utility Model Patent Certificate of Registration issued by the Intellectual Property Office of the Republic of the Philippines, as follows:

xxx xxx xxx

This is to certify further that the above patented inventions are commercially produced and marketed under their respective brandnames and trademarks xxx xxx xxx exclusively produced, manufactured and distributed by SPLASH CORPORATION with business address at xxx xxx xxx.

[129] Exhibit "VV", Docket Vol. IV, p. 2206.

This certification is issued to the above-named inventor in order for him to avail of the tax exemption privileges under RA 7459, otherwise known as the Inventors and Invention Incentives Act of the Philippines pursuant to the Implementing Rules and Regulations of the Bureau of Internal Revenue and Memorandum Circular No. 94-169 of the Department of Interior and Local Government adopted by City Ordinance No. SP 406-S96 of the Local Government of Quezon City.

Issued this 1st day of March, 2007 in Quezon City, Metro Manila, Republic of the Philippines.

FILIPINO INVENTORS SOCIETY

(sgd.)
TEODORICO E. CASTAÑEDA
National Secretary"[130]

(boldfacing supplied)

xxx xxx xxx

"16 February 2006

THE NATIONAL SECRETARY
Filipino Inventors Society
62-A Holy Spirit Drive
Don Antonio Heights
Quezon City, Metro Manila

Dear Sir/Madam :

As a bona fide member of the Filipino Inventors Society (FIS), I would like to benefit from the incentives and privileges available to me as an inventor, as provided for under Republic Act 7459 otherwise known as the Inventors Incentives Act of the Philippines. May I request therefore, to be endorsed by the FIS to the RA 7459 Screening Committee of the Technology Application and Promotion Institute (TAPI), Department of Science and Technology (DOST), so that my duly patented and commercialized invention with details below,

xxx xxx xxx

be applied for tax exemption, to which I, as the undersigned inventor and patentee, am legally entitled to under the said Act.

My above-stated invention / innovation product is already in commercial state of development is manufactured, distributed and marketed exclusively by Splash Corporation with business address

[130] Docket Vol. IV, p. 2207.

at HBC Corporate Center, 548 Mindanao Avenue, Quezon City under the brand names Extraderm and Maxipeel Exfoliant products.

Herewith attached are photocopies of the required documents for your consideration.

Very truly yours,

(sgd.)
ROLANDO B. HORTALEZA, M.D.
Inventor Member"[131] *(boldfacing supplied)*

Indubitably, both the FIS and Dr. Hortaleza recognize that, Dr. Hortaleza, as the inventor, is the person entitled to the tax incentives/exemption granted under RA 7459. While the quoted documents specify that petitioner produces, distributes and markets Dr. Hortaleza's invention/innovation product, there is nothing in said documents which state that the tax exemption privilege being applied for by the inventor should also be extended to petitioner.

Having ascertained that the tax exemption granted under Section 6 of RA 7459 pertains only to the inventor, the Court is not inclined to sustain petitioner's position, as to exempt petitioner from income taxation would certainly amount to judicial legislation.

In fine, the Court finds no reason to treat Dr. Hortaleza and petitioner one and the same.

Commissioner of Internal Revenue vs. Splash Corporation*, CTA EB No. 330, May 5, 2008 and *The Commissioner of Internal Revenue vs. Splash Corporation*, G.R. No. 183160, August 4, 2008, are not *stare decisis

In *Commissioner of Internal Revenue vs. Splash Corporation*,[132] the CTA *En Banc* dismissed the CIR's petition and affirmed the assailed May 29, 2007 Decision and October 30, 2007 Resolution of the Court in Division in CTA Case No. 7917 which granted the claim for refund of excess payment of income tax of petitioner for taxable year 2002.

---

[131] Docket Vol. IV, p. 2209.
[132] CTA EB No. 330, May 5, 2008.

In the August 4, 2008 Resolution[133] in *The Commissioner of Internal Revenue v. Splash Corporation*, G.R. No. 183160, the Supreme Court denied the CIR's petition for failure to sufficiently show any reversible error in the assailed decision to warrant the exercise of the discretionary appellate jurisdiction of the Supreme Court. The August 4, 2008 Resolution became final and executory on October 2, 2008.[134]

In the present case, petitioner claims that the issuance of the FAN is a mere subterfuge to disturb and re-litigate the findings of this Court in sheer violation of the doctrine of immutability of judgment considering that the afore-cited CTA *En Banc* decision and Supreme Court resolution are final and executory and can no longer be altered or modified.[135]

A perusal of the May 29, 2007 Decision and October 30, 2007 Resolution of the Court in Division in CTA Case No. 7197, reveals that they refer to the **refund claim** of petitioner pursuant to BIR Ruling No. DA-506-2004 which was issued to petitioner based on its representation that it is the "registered inventor". Thus, the caveat in the last paragraph thereof which states that "This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void." Notably, the issues of who is eligible to claim the income tax exemption under Section 6 of RA 7459 and whether petitioner and Dr. Hortaleza are one and the same, were never raised, litigated or resolved in CTA Case No. 7197 or in CTA EB No. 330. Specifically, in the CTA *En Banc* decision, the issue disposed of pertains to the implication of Section 4 (B) of RR No. 19-93 on petitioner's claim for refund. On the other hand, in the May 29, 2007 Decision of the Court in Division the issue centered on whether certain utility models qualify as inventions under RA 7459 justifying the application of Section 6 of RA 7459. **In both cases, the issue on whether it is petitioner or it is Dr. Hortaleza who is the registered inventor of the subject invention is not at all involved albeit the same is the pivotal legal question in the present case.**

On this point, *the Office of the Ombudsman vs. Honorable Court of Appeals and Former Deputy Ombudsman for the Visayas Arturo C. Mojica*,[136] is instructive:

---

[133] Docket Vol. IV, p. 1867.
[134] Docket Vol. IV, p. 1866.
[135] Pars. 29 to 32, Petition for Review, Docket Vol. I, pp. 12-14.
[136] G.R. No. 146486, March 4, 2005.

> The legal maxim "*stare decisis et non quieta movere*" (follow past precedents and do not disturb what has been settled) states that where the same questions relating to the same event have been put forward by parties similarly situated as in a previous case litigated and decided by a competent court, the rule of *stare decisis* is a bar to any attempt relitigate the same issues.
>
> xxx xxx xxx
>
> **Thus, where the issue involved was not raised nor presented to the court and not passed upon by the court in the previous case, the decision in the previous case is not *stare decisis* of the question presented.**

Indeed, the CTA *En Banc* Decision and Supreme Court Resolution should not, in any way, emasculate the government from discharging its functions as prescribed for in the NIRC, particularly the power and authority of the CIR to assess taxpayers whenever circumstances so warrant. Otherwise stated, the issuance of the FAN can hardly be considered a subterfuge of the Court in Division's May 29, 2007 Decision or Supreme Court's August 4, 2008 Resolution as the present controversy is separate and distinct from the final and executory decision of the Court in Division in CTA Case No. 7197.

In light of the foregoing discussion and given that the cited decision and resolution did not pass upon the issues involved in the present petition, they are not decisive of the same.

The Court will now determine the amount of tax liability of petitioner.

I. DEFICIENCY INCOME TAX – ₱229,964,686.13

Respondent computed the deficiency income tax assessment for taxable year 2008 in the amount of ₱229,964,686.13, inclusive of interest and penalty, as follows:[137]

Taxable Income per return		₱ 193,550.00
Add: Adjustments:		
Net income from transactions allegedly Exempt under RA 7459		378,686,173.00
Discrepancy in sales per tax relief data (AITEID) as against sales per SLS		56,587,354.52
Net Income per investigation		₱ 435,467,077.52

[137] Exhibit "JJ", Docket Vol. IV, p. 2043.

Income tax due thereon (35%)		₱ 152,413,477.00
Less: Income tax paid / credit per return:		
Prior year's excess credit	₱ 10,952,092.00	
Creditable Withholding Taxes (2008)	16,075,206.04	
Minimum Corporate Income Tax (2008)	(5,535,408.16)	
Carried over to succeeding year	(21,491,889.88)	-
Deficiency Income Tax		₱ 152,413,477.00
Add: Interest from 04.16.09 to 10.31.11	₱ 77,501,209.13	
Suggested penalty for late payment	50,000.00	77,551,209.13
Total amount due and collectible		**₱ 229,964,686.13**

The deficiency income tax assessment is hinged on the following:

a.) Net income from transactions allegedly Exempt under RA 7459	₱ 378,686,173.00
b.) Discrepancy in sales per tax relief data (AITEID) as against sales per SLS	56,587,354.52
c.) Net Taxable Income per Return	193,550.00
d.) Minimum Corporate Income Tax (2008)	5,535,408.16
e.) Carried over to succeeding year	21,491,889.88

a. Net income from transactions allegedly exempt under RA 7459 - ₱378,686,173.00

Respondent's verification disclosed that petitioner declared the amount of ₱378,686,173.00 as exempt from income tax under RA 7459.

Petitioner, however, argues that in the FAN, as well as in the Details of Discrepancies attached to the FAN,[138] there is no explanation as to how the amount of ₱378,686,173.00 was obtained. Petitioner further claims that its Financial Statements and Annual Income Tax Return will show that the amount of ₱378,686,173.00 does not exist. Considering that there is no clear reference and explanation as to how the amount assessed was arrived at, the assessment therefore lacks factual basis.[139]

Petitioner also contends that a perusal of its Annual ITR for the year 2008[140] shows that the net income from operations claimed as tax exempt amounted only to ₱368,932,498.00, computed as follows:[141]

[138] Exhibit "JJ", Docket Vol. IV, pp. 2043-2046.
[139] Pars. 47 and 48, Memorandum, Docket Vol. V, p. 3078.
[140] Exhibit "NN", Docket Vol. IV, p. 2085.
[141] Par. 49, Memorandum, Docket Vol. V, p. 3078

Sales/Revenues	₱ 2,439,244,819.00
Less: Cost of Sales	1,012,349,970.00
Gross Income from Operation	₱ 1,426,894,849.00
Less: Deductions	1,057,962,351.00
	₱ 368,932,498.00

Contrary to petitioner's allegation that the amount of ₱378,686,173.00 does not exist, the Reconciliation of Net Income per Books against Taxable Income attached to petitioner's Annual ITR ended December 31, 2008 offered by petitioner clearly reflected the amount of ₱378,686,173.00[142] as exempt Taxable Income. Albeit the amount of ₱368,932,498.00 was the figure reported in the Annual ITR as exempt, petitioner failed to explain why the amount of exempt taxable income against its reconciliation is not the same.

Thus, considering that petitioner is not exempt under RA 7459, the net income from transactions previously considered by petitioner as tax exempt in the amount of ₱378,686,173.00 shall be subject to tax.

b. Discrepancy in sales per tax relief data as against sales per SLS - ₱56,587,354.52

From the matching of third party information/data, respondent's examiner found that various customers have submitted Summary Lists of Purchases in support of their VAT returns wherein the respective amount of total purchases from petitioner is higher than the respective amount of sales indicated in petitioner's Summary List of Sales. The discrepancies between the purchase data of the customers and the sales data by petitioner was treated as understated sales subject to tax under Sections 27 and 32 of the NIRC of 1997, as amended.

Based on the schedule of understated sales prepared by respondent, the findings for the alleged under-declaration of sales in the amount of ₱56,587,354.52 was arrived at, as follows:[143]

Customer's Name	Sales per AITEID	Sales per SLS	Discrepancy
H&B Perfection Marketing	₱135,658,752.62	₱ 94,436,894.85	₱41,221,857.77
International Pharmaceuticals	2,393,973.17	-	2,393,973.17
Super Shopping Mart, Inc.	52,419,186.46	44,094,908.88	8,324,277.58

[142] Exhibit "NN", Docket Vol. IV, p. 2093.
[143] Annex C of Exhibit "KK", Docket Vol. IV, p.1869.

Super Value Inc.	155,423,622.65	150,776,376.65	4,647,246.00
Total	**₱345,895,534.90**	**₱289,308,180.38**	**₱56,587,354.52**

Petitioner submits that the above assessment is without basis.

Of the alleged sales discrepancies, petitioner noted that the sales to H&B Perfection Marketing in the amount of ₱135,658,752.62 is incorrect, there being no clear factual basis. Petitioner's verification of H&B Perfection Marketing's Audited Financial Statements allegedly shows that its purchases from petitioner for taxable year 2008 amounted only to ₱70,630,439.42[144].

Likewise, petitioner claims that the amount of purchases by International Pharmaceuticals were inaccurate because said taxpayer is its supplier, not a customer. It asserts that International Pharmaceuticals never made purchases from petitioner.

As to the amount of sales made to Super Shopping Mart, Inc., petitioner states that it was actually ₱50,485,154.55[145] per its Summary List of Sales instead of ₱44,094,908.88 per respondent's schedule.

Petitioner also points out that respondent failed to consider the fact that the recording practice of its customers, which it has no control of, may vary such that the timing by which its customers recognize their purchases do not coincide with the timing by which petitioner recognizes its sales.[146]

Moreover, petitioner claims that the remaining alleged discrepancies can also be attributed to several other reasons such as: 1) incorrect pick up of amount of purchases reported by customers per Tax RELIEF Data/AITED; and 2) inaccurate reporting of purchases by customers (e.g. only gross purchases were reported, without considering purchase returns/discounts). [147]

Considering that petitioner was able to present supporting documents to prove that it has no understated sales,[148] and in the absence of any controverting evidence offered by respondent to refute the same, the scale of preponderance of evidence shall tilt in

---

[144] Exhibit "LL", Docket Vol. IV, p. 2053.
[145] Exhibit "MM", Docket Vol. IV, pp. 2055-2084.
[146] Exhibit "KK", Docket Vol. IV, p. 1852.
[147] Exhibit "KK", Docket Vol. IV, p. 1852.
[148] Exhibit "LL", Docket Vol. IV, p. 2053; Exhibit "MM", Docket Vol. IV, pp. 2055-2084; Exhibit "KK", Docket Vol. IV, p. 1852.

petitioner's favor. Thus, the Court finds no sufficient basis to sustain the income tax assessment against petitioner on its alleged under-declaration of sales in the amount of ₱56,587,354.52.

c. Net Taxable Income per Return - ₱193,550.00

Petitioner did not deduct the normal income tax on its taxable income per tax return from the available tax credits. Accordingly, respondent taxed the net taxable income pursuant to Section 27 of the NIRC of 1997, as amended.

The Court notes that when petitioner filed its Annual Income Tax Return for taxable year 2008, petitioner paid a minimum corporate income tax (MCIT) of ₱5,535,408.16[149] (using its available tax credits) as it was higher than the regular corporate income tax of ₱67,742.50[150].

In view, however, of the Court's finding that petitioner is not entitled to income tax exemption on income derived from the sale of Dr. Hortaleza's inventions, petitioner's regular corporate income tax would consequently be greater than the MCIT. Hence, in lieu of MCIT, petitioner is liable to pay the regular corporate income tax of 35% based on its adjusted net taxable income.

d. Minimum Corporate Income Tax (2008) – ₱5,535,408.16

Respondent deducted the amount of ₱5,535,408.16 representing the MCIT paid for taxable year 2008.

As afore-discussed, petitioner is liable to pay the regular corporate income tax of 35% based on its adjusted net taxable income. Petitioner will be taxed twice if both MCIT and regular corporate income tax will be deducted against its available tax credits. Thus, only the regular corporate income tax should be deducted from its available tax credits for 2008.

e. Carried over to succeeding year – ₱21,491,889.88

Respondent disallowed the amount of ₱21,491,889.88 representing the excess income tax credits carried over to the

---

[149] Exhibit "NN", Line 27, Docket Vol. IV, p. 2088.
[150] Exhibit "NN", Line 25B, Docket Vol. IV, p. 2088; Exhibit "NN", Line 29, Docket Vol. IV, p. 2088.

succeeding year 2009. However, no legal and factual bases were provided in the Details of Discrepancies[151] to justify the disallowance of such amount despite the clear mandate of Section 228 of the NIRC of 1997, as amended, which provides that the taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Further, any tax benefit derived by petitioner from the carry-over of the excess tax credits redounds to the succeeding year of 2009. Since the tax benefit will be in the succeeding year, at most, petitioner may only be assessed in the said succeeding year.

In sum, petitioner is liable for basic deficiency income tax for taxable year 2008 in the amount of ₱105,580,605.01, computed taking into consideration the excess tax credits that were carried over to the succeeding year 2009, as follows:

Taxable Income per return		₱ 193,550.00
Add: Net income from transactions allegedly Exempt under RA 7459		378,686,173.00
Taxable Income per investigation		₱ 378,879,723.00
Income tax due thereon (35%)		₱ 132,607,903.05
Less: Income tax paid / credit per return:		
Prior year's excess credit	₱ 10,952,092.00	
Creditable Withholding Taxes (2008)	16,075,206.04	27,027,298.04
Basic Deficiency Income Tax		**₱ 105,580,605.01**

II. DEFICIENCY VALUE-ADDED TAX - ₱22,811,027.46

Respondent computed the deficiency VAT assessment for taxable year 2008 in the amount of ₱22,811,027.46, inclusive of interest and penalty, as follows:[152]

[151] Exhibit "JJ", Details of Discrepancies, Docket Vol. IV, p. 2046.
[152] Exhibit "JJ", Docket Vol. IV, p. 2044.

12% Vatable Sales per return		₱3,104,523,727.33
Output tax per return		₱ 372,542,847.28
Add: Adjustments:		
Output Tax on RELIEF		6,790,482.54
Output tax on the Sale of Motor Vehicle		258,734.28
Unpaid Output Tax balance of the 4th Quarter Vat return:		
Output Payable per F/S Less: Input Tax balance	₱ 20,957,560.00 788,060.23	
Vat payable for 4th quarter return	₱ 20,169,499.77	
Less: Vat paid per 4th quarter return	12,843,202.23	7,326,297.54
Total Output Tax per investigation		₱ 386,918,361.64
Less: Allowable Input Tax:		
Input Tax per return	₱272,282,964.10	
Less: Unsupported Vat payment on importations	286,990.00	
Total Allowable Input Tax	₱271,995,974.10	271,995,974.10
Value Added Tax payable		₱ 114,922,387.54
Less: Tax paid per return		100,259,883.09
Deficiency Value Added Tax		₱ 14,662,504.45
Add: Increments:		
Interest from 01.26.09 to 10.30.11	₱ 8,098,523.01	
Suggested penalty for late payment	50,000.00	8,148,523.01
Total amount due and collectible		**₱ 22,811,027.46**

The deficiency VAT assessment arose from the following items:

a.) Output Tax on RELIEF	₱ 6,790,482.54
b.) Output tax on the Sale of Motor Vehicle	258,734.28
c.) Unpaid Output Tax balance of the 4th Quarter Vat return	7,326,297.54
d.) Unsupported Vat payment on importations	286,990.00

a. Output Tax on understated sales per Tax Relief Data - ₱6,790,482.54

Respondent computed the output tax deficiency based on the alleged under-declared sales of petitioner in the amount of ₱56,587,354.52. The amount of ₱6,790,482.54[153] represents 12% of the discrepancy in sales per tax relief data as against the sales per summary list of sales. Respondent posits that the understated sales should be taxed pursuant to Section 106 of the Tax Code.

As elucidated earlier, petitioner presented supporting documents to prove that it has no understated or undeclared sales for the taxable

[153] ₱56,587,354.52 x 12%.

year 2008 and respondent failed to refute the same. Thus, absent under-declaration of sales by petitioner, the income tax assessment was cancelled. The output tax deficiency, based on the alleged understated sales, should likewise be cancelled for lack of basis.

b. Output Tax on Sale of Motor Vehicles - ₱258,734.28

Pursuant to Section 106 of the NIRC of 1997, as amended, respondent assessed petitioner of output VAT deficiency amounting to ₱258,734.28[154] representing 12% of petitioner's sale of motor vehicles in the amount of ₱2,156,119.00[155].

Petitioner contends that proceeds from the sale of motor vehicles to its employees in the amount of ₱2,158,119.00 cannot be subject to VAT pursuant to Section 105 of the NIRC of 1997, as amended, which applies to transactions made in the ordinary course of business of a taxpayer. It claims that the sale of motor vehicles to its employees was not made in the ordinary conduct of its trade or business because it is primarily engaged "to manufacture, bottle, pack, and market cosmetics and other beauty products in the Philippines and abroad."[156] The sale of the motor vehicle to its employees was an isolated transaction and not normally done in the "regular conduct of trade or business".

The Court disagrees.

Section 105 of the NIRC of 1997, as amended, states:

> "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 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

[154] ₱2,156,119.00 x 12%.
[155] ₱2,158,119.00 per Details of Discrepancies (Exhibit "JJ", CTA Docket Vol. IV, p.2046); actual proceeds from sale of property and equipment per FS is ₱2,156,119.00 (Exhibit "I", CTA Docket Vol. IV, p. 1932).
[156] Exhibit "O", Docket Vol. IV, p. 2001.

of its net income and whether or not it sells exclusively to members or their guests), or government entity. *(Emphasis supplied)*

Based on the foregoing, VAT is imposed on a sale or transaction entered into by a person in the course of any trade or business. A transaction will be characterized as having been entered into by a person in the course of trade or business if it is: (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.[157] Hence, an isolated transaction is not necessarily disqualified from being made incidentally in the course of trade or business.

While petitioner's primary business is the manufacturing, bottling, packing, and marketing cosmetics and other beauty products in the Philippines and abroad, it appears that proceeds from sale of property and equipment in the amount of ₱2,156,119.00 is reported in its Statements of Cash Flows from Investing Activities[158].

Once an activity has been identified as a business, any supply (sales) made in pursuit thereof is likely to be made in the course of business. No distinction is made between capital and revenue items. A supply (sales) in the course or furtherance of business includes: (1) *the disposition of the* assets *and liabilities of* a *business;* (2) the disposition of a business as going concern; and (3) anything done in connection with the termination or intended termination of a business.[159]

The sale of the motor vehicle, which is an incidental transaction made in furtherance of business, shall accordingly be subjected to VAT.

c. Unpaid Output Tax Balance of the 4th Quarter VAT Return - ₱7,326,297.54

Respondent's investigation revealed that the VAT payable for the fourth quarter as per petitioner's financial statements as of December 31, 2008 was ₱20,169,499.77, but what was actually paid per

[157] Deoferio, Jr. and Mamalateo, The Value Added Tax In The Philippines, First Edition, pp. 81-82.
[158] Exhibit "I", Docket Vol. IV, p. 1932.
[159] Deoferio, Jr. and Mamalateo, The Value Added Tax In The Philippines, First Edition, p. 83.

petitioner's 4th Quarter VAT Return was only for ₱12,843,202.23[160]. Hence, the unpaid VAT of ₱7,326,297.54, was computed as follows:

Output payable per F/S	₱20,957,560.00
Less: Input Tax balance	788,060.23
VAT payable for 4th quarter return	₱20,169,499.77
Less: VAT paid per 4th quarter return	12,843,202.23
Unpaid Output tax balance of the 4th quarter return	**₱ 7,326,297.54**

Petitioner contends that the alleged output tax deficiency was presumed by respondent simply by comparing the VAT paid per 4th quarter VAT return with the output tax balance per financial statements.[161]

To support its argument, petitioner presented its Computation of VAT Payable for the 4th Quarter of 2008[162], 4th Quarter VAT Return for 2008[163], Summary List of Sales[164] and Summary List of Purchases and Importations[165]. The court-appointed ICPA, Mr. Raphael C. Miguel testified that the amount of sales declared per 4th quarter VAT return are based on sales recorded per general ledger and supported by summary list of sales for the 4th quarter. On the other hand, the amount of purchases and importations declared per 4th quarter VAT return matched with recorded purchases per books and with summary list of purchases and importations.[166]

Petitioner also alleges that VAT payable per petitioner's financial statements for the year 2008 included other items that do not form part of output VAT liability for that particular year. Hence, the balance of VAT payable per financial statement in the amount of ₱20,957,560.00 is overstated.[167]

Petitioner notes that the balance of VAT payable, as reported in its Financial Statement for taxable year 2008 in the amount of ₱20,957,560.00, was arrived at after considering erroneous adjusting entries made in both years 2007 and 2008 affecting the balance of VAT payable account. Petitioner reconciled the discrepancy as follows:[168]

---

160 Exhibit "HH", Line 29, Docket Vol. IV pp. 2040-2041.
161 Memorandum, Docket Vol. V, p. 3134.
162 Exhibit "NNN", p. 11, Docket Vol. IV, p. 2543.
163 Exhibit "KKK-1" or Exhibit "HH", Docket Vol. IV pp. 2040-2041.
164 Exhibit "HHH-1" or Exhibit "MM", Docket Vol. IV pp. 2055-2084.
165 Exhibit "JJJ-1".
166 Exhibit "NNN", No. 3.4, p. 11, Docket Vol. IV, p. 2543.
167 Exhibit "G6", Q&A No. 9, Docket Vol. V, pp. 2756-2757.
168 Exhibit "G6", Q&A No. 10, Docket Vol. V, pp. 2757-2758.

VAT Payable per F/S	₱ 20,957,560.78
Less: Input Tax	788,060.23
Net VAT Payable per BIR	₱ 20,169,499.55
Reconciling Items:	
1. Adjusting entries to deduct SNC transactions & balances	₱(10,513,544.68)
2. Reversal of entries previously booked pertaining to SNC balances	7,107,030.35
3. Erroneous set up of withholding tax salaries	(4,965,201.89)
4. Erroneous entry made on VAT payable account	(180,286.90)
5. Erroneous entry made on VAT payable account	360,573.80
6. Erroneous entry made on VAT payable account	87,434.39
VAT payable as corrected	₱ 12,065,504.62
VAT paid in 4th quarter VAT return	12,843,202.23
Excess of VAT Payment over VAT payable, as adjusted	₱ (777,697.61)

The Court is not persuaded.

It is evident from the above reconciliation that the audited and adjusted amount of VAT payable is ₱20,169,499.55, and therefore, it is the amount that should have been reported for tax purposes after considering all adjustments affecting taxable year 2008.

It should be noted that the audited financial statements were dated April 14, 2009[169] which is later than the date when petitioner filed its 4th Quarterly VAT Return on January 23, 2009[170]. It cannot be said that the amount of **₱12,843,202.23**, which was earlier reported, is the adjusted amount.

In the absence of documentary proof that the adjustments made by the external auditor are indeed erroneous, the Court finds that respondent's assessment should be upheld.

d. Unsupported VAT payments on importations – ₱286,990.00

Respondent disallowed petitioner's input VAT on importations for taxable year 2008 in the amount of ₱286,990.00 for allegedly being unsupported. Petitioner, however, submitted Bureau of Customs (BOC) Import Entry and Internal Revenue Declaration (IEIRD) bearing reference number BSI-001/08[171], showing it had incurred input VAT on its importations in the amount of ₱104,346.00.

[169] Exhibit "I", Docket Vol. IV, pp. 1927-1981.
[170] Exhibit "HH", Docket Vol. IV, pp. 2040-2041.
[171] Exhibit "OO", Docket Vol. IV, p. 2149.

It should be noted that the amount of ₱104,346.00 per BOC IEIRD is less than and not equal to the disallowed amount of ₱286,990.00 unsupported VAT payments on importation. The Court cannot ascertain whether the said document forms part of the unsupported input VAT on importations or whether it already formed part of the supported input VAT not in question. For petitioner's failure to present evidence whereby the Court can verify that the document it submitted is included in the amount of unsupported input VAT payments on importations, the disallowance should not be disturbed.

In sum, petitioner is liable for basic deficiency VAT for taxable year 2008 in the amount of ₱7,872,021.91, computed as follows:

12% Vatable Sales per return		₱3,104,523,727.33
Output tax per return		₱ 372,542,847.28
Add: Adjustments:		
Output tax on the Sale of Motor Vehicle		258,734.28
Unpaid Output Tax balance of the 4th Quarter Vat return		7,326,297.54
Total Output Tax per investigation		₱ 380,127,879.10
Less: Allowable Input Tax:		
Input Tax per return	₱272,282,964.10	
Less: Unsupported Vat payment on importations	286,990.00	
Total Allowable Input Tax	₱271,995,974.10	271,995,974.10
Value Added Tax payable		₱108,131,905.00
Less: Tax paid per return		100,259,883.09
Basic Deficiency Value Added Tax		**₱ 7,872,021.91**

III. DEFICIENCY EXPANDED WITHHOLDING TAX – ₱4,095,345.09

Respondent assessed petitioner for the corresponding deficiency EWT in the amount of ₱4,095,345.09, inclusive of interest, computed as follows:[172]

Rent & lease (Part of other overhead expense & operating expense)		₱ 21,237,345.81
Display allowance – fixed		113,269,933.67
Display allowance – variable		3,583,539.63
Total		₱138,090,819.11
Less: Service fees to SVI subjected to 2% EWT		32,327,293.00
Total Rent Expense		₱105,763,526.11

[172] Exhibit "JJ", Docket Vol. IV, p. 2044.

5% Expanded Withholding Tax due		₱ 5,288,176.31
Less: Tax paid		2,676,228.42
Deficiency Expanded Withholding Tax		₱ 2,611,947.89
Add: Increments:		
Interest from 01.16.08 to 10.31.11	₱1,458,397.20	
Suggested penalty for late payment	25,000.00	1,483,397.20
Total amount due and collectible		**₱ 4,095,345.09**

Respondent assessed petitioner with deficiency expanded withholding tax arising from the alleged lease payments (display cases) to various supermarkets (less the ₱32,327,293 service fees paid to Supervalue, Inc. subjected to the 2% EWT) that were not subjected to 5% expanded withholding tax pursuant to Section 57 of the NIRC of 1997, as amended.

Petitioner asserts that the assessment was premised on the presumption that all transactions recorded/lodged under "Display Allowances" constitute lease payments to supermarkets for display cases, subject to 5% expanded withholding tax.[173]

It claims that the account "Display Allowances" does not entirely represent rental expenses to which the 5% creditable withholding tax applies. "Display Allowances" consists of the following:[174]

Nature	Payee	Amount	EWT
Rental	Various Customers	₱ 53,524,068.40	5%
Service Fee	Super Value, Inc.	32,327,293.00	2%
Service Fee	Super Shopping Mart, Inc.	8,279,500.05	2%
Conditional Discounts	Various Customers	43,959,957.66	Not Applicable
Total		**₱138,090,819.11**	

For the alleged rental payments in the amount of ₱8,279,500.05 paid to Super Shopping Mart, Inc., petitioner explained that this is for service fees subject only to 2% EWT which is included in the amount of ₱20,173,728.50[175] shown in the Alpha List of Payees supporting expanded withholding tax returns.[176] The Court, however, cannot ascertain whether the rental payment of ₱8,279,500.05 actually formed part of the ₱20,173,728.50. Thus, the deficiency EWT on this item shall not be disturbed.

---

[173] Exhibit "XX", Q&A No. 52, Docket Vol. IV, p. 2526.
[174] Exhibit "XX", Q&A No. 52, Docket Vol. IV, p. 2527.
[175] Exhibit "SS", Docket Vol. IV, p. 2168.
[176] Exhibit "XX", Q&A No. 52, Docket Vol. IV, p. 2527.

As to the alleged rental payments not subjected to EWT in the amount of ₱43,959,957.66, petitioner points out that this represents total payments to distributors representing conditional discounts given to distributors for promotional expenses which include display allowances incurred by the distributor to promote petitioner's products which were recorded in General Ledger and supported by credit memos[177] with supporting official receipt and other documents issued by the supermarket/department stores to the distributors.[178] A perusal of the supporting documents prove that such are indeed display allowances and are not lease payments. Therefore, the display allowances in the amount of ₱43,959,957.66 must be cancelled in the assessment.

In fine, petitioner's liability to pay basic deficiency EWT for taxable year 2008 should only be in the amount of ₱413,950.00, computed as follows:

Rent & lease (Part of other overhead expense & operating expense)	₱ 21,237,345.81
Display allowance – fixed	113,269,933.67
Display allowance – variable	3,583,539.63
Total	₱ 138,090,819.11
Less: Service fees to SVI subjected to 2% EWT	32,327,293.00
Conditional Discounts	43,959,957.66
Total Rent Expense	₱ 61,803,568.45
5% Expanded Withholding Tax due	₱ 3,090,178.42
Less: Tax paid	2,676,228.42
Basic Deficiency Expanded Withholding Tax	**₱ 413,950.00**

IV. COMPROMISE PENALTIES – ₱75,000.00 and ₱125,000.00

The CIR imposed compromise penalties for petitioner's failure to file the following returns in the total amount of ₱75,000[179]:

On failure to file the following:	**Amount**
Summary List of Sales and Purchases for the 1st and 2nd quarters and Summary List of Importations	₱ 25,000.00
Monthly Summary List of Withholding Tax Withheld	25,000.00
Monthly Summary List of Alpha List of Payees	25,000.00
Total	**₱ 75,000.00**

[177] Exhibits "DDD-1" to "DDD-679".
[178] Exhibit "NNN", No. 2.1, p.10; Docket Vol. IV, p. 2542.
[179] Exhibit "JJ", Docket Vol. IV, p. 2045.

In addition to the compromise penalties above, the CIR imposed a "suggested penalty for late payment" which were included in the deficiency income tax, EWT and VAT:

	Suggested Penalty
IT	₱ 50,000.00
VAT	50,000.00
EWT	25,000.00
Total	**₱ 125,000.00**

Such impositions, however, cannot be sustained. Under RMO No. 01-90, as amended by RMO No. 19-07, compromise penalties are amounts 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. It is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[180]

The compromise penalty totaling ₱200,000.00 should not be imposed on petitioner. The protest by petitioner could only signify that there was no agreement that had effectively been reached between the parties.[181]

The CIR claims that petitioner cannot raise this issue for the first time on appeal since petitioner did not protest the compromise penalties totaling ₱200,000.00. But since there is likewise nothing in the records to show that petitioner consented to the imposition of the same. In the absence of factual or legal basis, compromise penalties must be cancelled.

WHEREFORE, premises considered, the Petition for Review is **PARTIALLY GRANTED**. The Final Assessment Notice dated August 18, 2011, assessing petitioner for deficiency income tax, value-added tax, expanded withholding tax and compromise penalty, is MODIFIED so as to reflect the basic deficiency income tax assessment amounting to ₱105,580,605.01, basic value-added tax assessment amounting to

---

[180] *The Philippines International Fair, Inc. v. The Collector of Internal Revenue, et al.,* G.R. Nos. L-12928 and L-12932, March 31, 1962.
[181] *Dr. Felisa. L. Vda. De San Agustin, in substitution of Jose Y. Feria, in his capacity as Executor of the Estate of Jose San Agustin v. Commissioner of Internal Revenue,* G.R. No. 138485, September 10, 2001.

₱7,872,021.91 and basic deficiency expanded withholding tax amounting to ₱413,950.00

Accordingly, petitioner is hereby ORDERED to pay respondent the REDUCED AMOUNT of ONE HUNDRED FORTY-TWO MILLION THREE HUNDRED THIRTY-THREE THOUSAND TWO HUNDRED TWENTY-ONE PESOS AND 15/100 (₱142,333,221.15), inclusive of 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Tax Type	**Basic Tax**	**25% Surcharge**	**Total**
Income Tax	₱105,580,605.01	₱26,395,151.25	₱131,975,756.26
Value Added Tax	7,872,021.91	1,968,005.48	9,840,027.39
Expanded Withholding Tax	413,950.00	103,487.50	517,437.50
Total	₱113,866,576.92	₱28,466,644.23	₱142,333,221.15

In addition, petitioner is ORDERED to pay:

a. Deficiency interest at the rate of 20% per annum on the basic deficiency income tax of ₱105,580,605.01 computed from April 15, 2009 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended;

b. Delinquency interest at the rate of 20% per annum on the total amount due of ₱142,333,221.15 representing deficiency income tax, deficiency VAT and deficiency EWT, inclusive of the 25% surcharge, computed from October 31, 2011 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended; and,

c. Delinquency interest at the rate of 20% per annum on the 20% deficiency interest which have accrued as afore-stated in (a) computed from October 31, 2011 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

ROMAN G. DEL ROSARIO
Presiding Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice