Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

THOMAS C. ONGTENCO,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8190

For: Cancellation of assessment for deficiency Value-Added Tax

Present:
CASTAÑEDA, JR., Chairperson
CASANOVA, and
MINDARO-GRULLA, JJ.

Promulgated:
DEC 12 2012
1:25 p.m.

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DECISION

MINDARO-GRULLA, J.:

This is a Petition for Review filed on November 18, 2010 by Thomas C. Ongtenco as petitioner, against the Commissioner of Internal Revenue (CIR) as respondent, for the Court in Division, pursuant to Section 7(a)(1) of Republic Act (RA) No. 1125, An Act Creating the Court of Tax Appeals, as amended[1], as well as Rule 4, Section 3 (a) (1), in relation to Rule 8, Section

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[1] Sec. 7. *Jurisdiction.* – The CTA shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
x x x x x x
(2) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds or internal revenue taxes, fees of other charges, penalties in relation thereto, or other matters arising under the

4(a), of the Revised Rules of the Court of Tax Appeals (RRCTA)[2]. Petitioner seeks the cancellation of the assessment for deficiency value-added tax (VAT) in the amount of ₱1,998,745.34, inclusive of interest and penalty for calendar year (CY) 2006.

Petitioner Thomas C. Ongtenco is a Filipino, of legal age and with registered address at Motortrade, Vinzons Avenue, Daet, Camarines Norte.[3] He is also registered with the BIR Revenue District Office (RDO) No. 64-Daet, Camarines Norte as an income tax and non-VAT taxpayer as evidenced by

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National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;

x x x x x x

[2] Rule 4. Sec. 3. *Cases within the jurisdiction of the Court in Division.* – The Court in Division shall exercise:

(a) Exclusive original over or appellate jurisdiction to review by appeal the following:

x x x x x x

(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code of other laws administered by the Bureau of Internal Revenue;

x x x x x x

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

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

[3] Par. 1, Petition for Review, Docket, p. 4.

his Certificate of Registration No. OCN2006064-000913, bearing Tax Identification No. (TIN) 114-097-367-000 N-VAT.[4]

Respondent is the Commissioner of the Bureau of Internal Revenue, who is duly appointed and empowered to perform the duties of her office, including, among others, the power to decide, cancel, and abate tax liabilities. She holds office at the 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City.

On November 14, 2008, Letter of Authority No. 00014179[5] was issued to investigate all internal revenue tax liabilities of petitioner for CY 2006.

As a result of the investigation, respondent found petitioner liable of income tax and value-added tax deficiencies. Thus, on August 19, 2009, respondent issued a Preliminary Assessment Notice (PAN)[6] with details of discrepancy against petitioner, which the latter received on August 24, 2009.[7]

Petitioner filed a protest letter[8] dated September 5, 2009 as a reply to the PAN, which was received by respondent on September 8, 2009.

Petitioner subsequently received from respondent a Formal Letter of Demand and Assessment Notice No. 064-06-114-097-367 dated March 16, c

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[4] Exhibit "C".
[5] Exhibit "1".
[6] Exhibit "4".
[7] Judicial Affidavit of Mr. Thomas Ongtenco, Exhibit "O", Docket, p. 293.
[8] Exhibit "F".

2010[9], covering calendar year 2006, assessing petitioner for alleged deficiency income tax amounting to ₱34,618.78 and deficiency VAT amounting to ₱2,109,268.71, inclusive of twenty-five percent (25%) surcharge and interest, as well as compromise penalty on VAT amounting to ₱50,000.00.

On April 16, 2010, petitioner filed a protest letter dated April 16, 2010[10], through registered mail[11], contesting the assessment and requesting its withdrawal and cancellation for lack of legal and factual bases.

On October 22, 2010, petitioner received from respondent a letter/decision dated August 27, 2010[12], cancelling the deficiency income tax assessment of ₱34,618.78 and reducing the deficiency VAT assessment from ₱2,109,268.71 to ₱1,998,745.34.

Considering respondent's decision as a denial, petitioner filed the instant Petition for Review on November 18, 2010.

On January 7, 2011, respondent filed her Motion to Admit Attached Answer[13], which was approved by this Court in a Resolution[14] dated January 13, 2011. In her Answer[15], respondent interposed the following Special and Affirmative Defenses:

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[9] Exhibit "12"; Par. 3(b), Facts Admitted, Joint Stipulation of Facts and Issue (JSFI), Docekt, p. 97.
[10] Exhibit "J".
[11] Exhibit "J-2".
[12] Exhibits "K" and "K-2".
[13] Docket, pp. 52-58.
[14] Docket, p. 71.
[15] Docket, pp. 61-69.

"4. Petitioner Thomas C. Ongtenco is liable to pay its deficiency value-added tax in the amount of One Million Nine Hundred ninety Eight Thousand Seven Hundred Forty Five and 34/100 (₱1,998,745.34).

5. In the case of Lapanday Foods Corporation vs. Commissioner of Internal Revenue *(CTA Case No. 7097, January 29, 2009)*, this Honorable Court held that interest on loans extended to affiliates is subject to value added tax (VAT), even if the loans are for accommodation only and the taxpayer did not realize profit from the transactions. The Court rejected petitioner's claim that since it does not lend money to clients or customers in the ordinary course of trade or business and does not habitually extend loans to affiliates, interest income on loans that it extended to affiliates are not subject to VAT. Interpreting Section 105 of the Tax Code of 1997, this Court held that phrase 'in the course of trade or business means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, regardless of whether or not the person engaged therein is non-stock, non profit private organization or government entity.'

Hence interest income generated from the loan assistance to its affiliates shall be subject to value-added tax (VAT). This is consistent with the rule that if the income from main business activity is subject to VAT, the incidental income shall also be subject to VAT. Considering that the company's income from management services is subject to VAT, the interest income, being incidental income, shall also be subject to VAT.

The VAT applies notwithstanding the fact that the company does not profit from lending to its affiliates because it only passes on to its affiliates the interest that is charged by the bank from which the funds are sourced. The Tax Code of 1997 defines 'sale of services' as the performance of all kinds of services for others for a fee, remuneration or consideration.

Consequently, interest income of petitioner from Intertrade Credit Corporation amounting to ₱8,610,000 is subject to VAT. While his gross sales amounting to ₱1,390,770 is also subject to VAT even if petitioner is registered as a non-VAT taxpayer since the total gross receipts from the income from ICC and from the receipts not subject to expanded withholding tax exceed the threshold of ₱1,500,000 pursuant to Section 4.109-1(B) (v) and Section 9.236-1 of Revenue Regulation No. 16-2005.

6. Petitioner's reliance on VAT Ruling No. 015-04, BIR Ruling DA-232-07, BIR Ruling DA 320-07 and BIR Ruling DA-118-08 is clearly misplaced.

   Petitioner's filing of his Answer before the CTA challenging respondent's claim for refund effectively serves as a revocation of previous BIR Ruling. (G.R. No. 153205 January 22, 2007 Commissioner of Internal Revenue vs. Burmeister and Wain Scandinavian Contractor Mindanao, Inc.)

   In addition, it must be stressed that the decision in the case of Lapanday Foods Inc. vs. Commissioner of Internal Revenue is controlling under the reasoning that the Honorable Court's interpretation or construction in this case establishes the contemporaneous legislative intent of the tax law; the latter as so interpreted and construed would thus constitute part of that law as of the date the statute is enacted.

7. Petitioner admitted the fact of non-submission of necessary documents in support of its protest. This omission is fatal to the administrative claim.

   7.1. Section 228 of the NIRC of 1997 is hereunder quoted for ready reference:

   > *Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.*

   7.2 Relative therewith, Revenue Regulations No. 12-99 implementing the provisions of the NIRC governing assessment of National Internal Revenue Taxes likewise provides:

   Section 3. Due Process Requirement in the Issuance of a Deficiency Tax Assessment.

   3.1.5. Disputed Assessment •

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> *The taxpayer shall submit the required documents in support of his protest within sixty (60) days from date of filing of his letter of protest, otherwise, the assessment shall become final, executory and demandable.*

7.3 The foregoing was promulgated pursuant to the power of the Commissioner of Internal Revenue to interpret tax laws as enunciated in Section 4 of the NIRC, to wit:

> *SEC. 4. Power of the Commissioner to Interpret Tax Laws and to Decide Tax Cases. – The power to interpret the provisions of this Code and other tax laws shall be under the exclusive and original jurisdiction of the Commissioner, subject to review by the Secretary of Finance.*

7.4 The mandatory character of Section 228 and Revenue Regulations No. 12-99 cannot be gainsaid. The word 'shall' connotes an imperative and indicates the mandatory character of a statute. The general rule of requiring adherence to the letter in construing statutes applies with particular strictness to tax laws and provisions of a taxing act are not to be extended by implication. (CIR v. Court of Appeals, 338 Phil. 322, 330 (1997). To rule otherwise would not just prevent the Commissioner from reconsidering the protested assessment but will practically render nugatory the intention of Congress.

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

9. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise the presumption of correctness of tax assessment stands (Commissioner of Internal Revenue vs. Hantex Trading Co. Inc., G.R. No. 136975, March 31, 2005)

10. Petitioner has not pointed out any provision or item in the assessment notice which bears a trace of falsity. The averments

> were based on conjectures, surmises and speculations. These cannot supply the basis for the charge of impropriety of the assessments made."

Thereafter, on February 7, 2011, notice was issued for a pre-trial conference which was set for March 17, 2011.

Petitioner filed his Pre-trial Brief on March 11, 2011; while respondent filed her Pre-trial Brief on February 15, 2011.

On March 30, 2011, the parties filed with this Court their Joint Stipulation of Facts and Issues, which was later approved in a Resolution dated April 1, 2011. In the same Resolution, the pre-trial conference was deemed terminated.

Trial proceeded, during which petitioner presented two (2) witnesses, namely: Thelma M. Idaba, and petitioner himself, Thomas C. Ongtenco.

On May 23, 2011, petitioner filed his Formal Offer of Evidence[16], offering Exhibits "A" to "Q-2", inclusive of submarkings; which this Court admitted in Resolutions[17] dated June 7, 2011 and July 22, 2011.

The documentary evidence formally offered by petitioner and admitted are as follows:

Exhibits	Description of Documents
A	Articles of Incorporation of Intertrade Credit Corporation (ICC).
B	Certification executed by Ms. Thelma Idaba,

[16] Docket, pp. 203-208.
[17] Docket, pp. 321-322 and 351.

	Accounting Supervisor of ICC.
B-1	Name and signature of Ms. Thelma Idaba appearing on the said Certification.
C	BIR Form No. 2303 or Certificate of Registration No. OCN 2006-064-00913 issued to Thomas C. Ongtenco, with Tax Identification No. 114-097-367-000 N-VAT issued by the Bureau of Internal Revenue, Revenue Region No. 010, Revenue District Office No. 064 on April 01, 2006.
D	BIR Form 2303 or Certificate of Registration No. OCN 4RC0000567353 issued to Thomas C. Ongtenco, with Tax Identification No. 114-097-367-001 issued by Bureau of Internal Revenue, Revenue Region No. 005, Revenue District Office No. 027 on December 19, 2006.
F	Protest Letter dated September 5, 2009 with attachments in response to the Pre-Assessment Notice (PAN) issued by the Bureau of Internal Revenue, with BIR stamp received dated September 8, 2009.
G	Letter dated November 23, 2009 of taxpayer addressed to the BIR submitting additional documents.
G-1	Post Office Registry Receipt No. 15020 with mailing date of November 24, 2009.
H	Two-page letter dated February 5, 2010 of the Bureau of Internal Revenue, Revenue Region No. 10, Legazpi City, signed by Atty. Diosdado R. Mendoza, OIC Regional Director, and addressed to Atty. Maria Rachel V. Riego de Dios in reply to the protest letter to the PAN issued against Mr. Thomas C. Ongtenco.
J	Petitioner's Protest Letter dated April 16, 2010.
J-2	Post Office Registry Receipt No. 10276 with mailing date of April 16, 2010.

K	One-page letter of the Bureau of Internal Revenue dated August 27, 2010 Revenue Region No. 10, Legazpi City, signed by Atty. Diosdado R. Mendoza, Regional Director, and addressed to Atty. Maria Rachel V. Riego de Dios in reply to the protest letter to the FLD/AN issued against Mr. Thomas C. Ongtenco.
K-1	Annex A to the Final Decision of the BIR.
K-2	Envelope showing Makati postal stamp dated October 18, 2010 and office receipt dated October 22, 2010.
N	Judicial Affidavit of Ms. Thelma M. Idaba.
N-1	Name and signature of Ms. Thelma M. Idaba appearing in page 5 of the Judicial Affidavit.
O	Judicial Affidavit of Mr. Thomas C. Ongtenco.
O-1	Name and signature of Mr. Thomas C. Ongtenco.
P	Certification issued by the Department of Trade and Industry (DTI) dated November 7, 2006 to Thomas Chua Ongtenco under the business name MTRADE MOTORCYCLE PARTS SUPPLY.
Q	BIR Form No. 1701 or Annual Income Tax Return of Petitioner, Thomas C. Ongtenco for CY 2006.
Q-1	BIR Form No. 2316 issued by Motortrade Nationwide Corp. for CY 2006 in the name of Petitioner, Thomas C. Ongtenco.
Q-2	BIR Form No. 2316 issued by Broadvue Traders Corp. for CY 2006 in the name of Petitioner, Thomas C. Ongtenco.

Respondent likewise, presented two (2) witnesses, namely: Mr. Manolito B. Gagalac and Ms. Lani M. Borja.

On December 9, 2011, respondent filed her Formal Offer of Documentary Evidence[18], offering Exhibits "1", "4" and "8 to "17-a", inclusive of submarkings; which this Court admitted in a Resolution[19] dated January 6, 2012.

The documentary evidence formally offered by respondent and admitted, are as follows:

Exhibits	Description of Documents
1	Letter Notice No. 00014179 dated November 14, 2008 duly signed by Regional Director Atty. Diosdado Mendoza
1-a	Date/Signature of taxpayer/authorized representative, Chiela B. Villaflores on November 19, 2009 evidencing receipt of the Letter Notice
4	Preliminary Assessment Notice (PAN) dated August 19, 2009 together with Details of Discrepancies duly signed by Maria Alfonso, Assistant Regional Director.
8	Memorandum dated July 24, 2009 signed by Manolito B. Gagalac.
9	Letter dated February 5, 2010 signed by Atty. Diosdado Mendoza, Regional Director.
10	Affidavit of Revenue Officer Manolito B. Gagalac.
10-a	Signature of Affiant, Manolito B. Gagalac.

[18] Docket, pp. 385-393.
[19] Docket, pp. 418-419.

11	2nd Indorsement signed by Atty. Edmond P. Lladoc returning the case docket to Assessment Division.
12	Formal Letter of Demand dated March 16, 2010 in the amount of ₱2,143,887.49 duly signed by Atty. Diosdado Mendoza, Regional Director.
13	Assessment Notice dated March 16, 2010 for income tax duly signed by Atty. Diosdado Mendoza, Regional Director.
14	Assessment Notice dated March 16, 2010 for VAT duly signed by Atty. Diosdado Mendoza Regional Director.
15	Letter dated August 27, 2010 duly signed by Atty. Diosdado Mendoza Regional Director.
16	Computation of Deficiency Taxes.
17	Affidavit of Revenue Officer Lani M. Borja.
17-a	Signature of Affiant, Lani M. Borja.

On February 23, 2012, the instant case was submitted for decision after submission of petitioner's Memorandum[20] on February 17, 2012 and respondent's Memorandum[21] on February 20, 2012.

The issue[22] is -

"WHETHER OR NOT PETITIONER IS LIABLE FOR THE DEFICIENCY VALUE-ADDED TAX IN THE AMOUNT OF ₱1,998,745.34, INCLUSIVE OF INTEREST AND PENALTY FOR THE CALENDAR YEAR 2006."

[20] Docket, pp. 420-435.
[21] Docket, pp. 436-450.
[22] Docket, p. 98.

Respondent contends that petitioner's gross receipt for 2006, consisting of petitioner's gross sales amounting to ₱1,390,770.00. and interest income from Intertrade Credit Corporation (ICC) amounting to ₱8,610,000.00, is subject to value-added tax.

On the other hand, petitioner avers that being a non-VAT taxpayer, he is not subject to VAT inasmuch as his gross sale of ₱1,390,770.00 does not exceed the threshold amount of ₱1,500,000.00 as provided under Section 4.109-1(B)(v) of Revenue Regulations No. 16-2005, as amended, and the interest income he received from ICC only arose from a single transaction and not in the ordinary course of his trade or business.

Both parties anchor their claim on Sections 105 and 108 of the National Internal Revenue Code (NIRC) of 1997, as amended, to wit:

> "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 the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.
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> xxx xxx xxx
>
> The phrase **'in the 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 nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity." *(Emphasis supplied)*
>
> "SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* –

(A) *Rate and Base of Tax.* — There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties: Provided, That the President, upon the recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of value-added tax to twelve percent (12%), after any of the following conditions has been satisfied:

xxx xxx xxx

The phrase *'sale or exchange of services'* means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, resthouses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by land relative to their transport of goods or cargoes; common carriers by air and sea relative to their transport of passengers, goods or cargoes from one place in the Philippines to another place in the Philippines; sales of electricity by generation companies, transmission, and distribution companies; services of franchise grantees of electric utilities, telephone and telegraph, radio and television broadcasting and all other franchise grantees except those under Section 119 of this Code and non-life insurance companies (except their crop insurances) including surety, fidelity, indemnity and bonding companies; and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties. The phrase 'sale or exchange of services' shall likewise include:

(1) The lease or the use of or the right or privilege to use any copyright, patent, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;

(2) The lease or the use of, or the right to use of any industrial, commercial or scientific equipment;

(3) The supply of scientific, technical, industrial or commercial knowledge or information;

(4) The supply of any assistance that is ancillary and subsidiary to and is furnished as a means of enabling the application or enjoyment of any such property, or right as is mentioned in subparagraph (2) or any such knowledge or information as is mentioned in subparagraph (3);

(5) The supply of services by a nonresident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any brand, machinery or other apparatus purchased from such nonresident person;

(6) The supply of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;

(7) The lease of motion picture films, films, tapes and discs; and

(8) The lease or the use of or the right to use radio, television, satellite transmission and cable television time." *(Emphasis supplied)*

Based on the afore-quoted provisions, respondent assessed petitioner for alleged deficiency VAT on the ground that the interest income he earned from lending money to ICC, in addition to his gross sales, is subject to VAT since as provided by the said provisions, the performance of all kinds of services for others for a fee, consideration or remuneration in the course of trade or business is subject to VAT.

Respondent reiterates the ruling of this Court *En Banc* in the case of *Lapanday Foods Corporation vs. Commissioner of Internal Revenue*[23], as follows:

> "The Court of Tax Appeals in ***Lapanday Foods Corporation vs. Commissioner of Internal Revenue*** *(CTA Case No. 7097, Jan. 29, 2009)* ruled that interest on loans extended to affiliates is subject to value-added tax (VAT), even if the loans are for accommodation only and the taxpayer did not realize profit from the transactions.
>
> The CTA rejected petitioner's claim that since it does not lend money to clients or customers in the ordinary course of trade or business and does not habitually extend loans to affiliates, interest income on loans that it extended to affiliates are not subject to VAT. Citing Section 105 of the Tax Code of 1997, the CTA held that 'the phrase 'in the course of trade or business' means the regular conduct or pursuit of a commercial or an economic activity, *including transactions incidental thereto*, regardless of whether or not the person engaged therein is a non stock, non profit private organization or government entity.'
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> Hence, interest income generated from the loan assistance to its affiliates shall be subject to value-added tax (VAT). This is also consistent with the rule that if the income from the main business activity is subject to VAT, the incidental income shall also be subject to VAT. Considering that the company's income from management services is subject to VAT, the interest income, being incidental income, shall also be subject to VAT.
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> The VAT applies notwithstanding the fact that the company does not profit from lending to its affiliates because it only passes on to the affiliates the interest that is charged by the bank from which the funds are sourced. The Tax Code of 1997 defines 'sale or service' as the performance of all kinds of services for others for a fee, remuneration or consideration.
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> In BIR Ruling No. 10-1998, the Bureau of Internal Revenue (BIR) emphasized that payments received for services rendered to affiliates on reimbursement-on-cost basis, without intention of realizing profits, is subject to VAT. Based from the above discussion, the income of Mr. Ongtenco from Intertrade Credit Corp. amounting to ₱8,610,000.00 is subject to VAT." [24]

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[23] CTA EB No. 367 (CTA Case No. 7097), January 29, 2009.

[24] Exhibit "9".

Respondent further explains that notwithstanding the fact that petitioner is a non-VAT taxpayer, considering that his gross receipts, consisting of gross sales of ₱1,390,770.00 and interest income from ICC of ₱8,610,000.00, exceed the ₱1,500,000.00 threshold, petitioner's gross receipts for CY 2006 is subject to VAT pursuant to Section 4.109-1(B)(v) and Section 9.236-1 of Revenue Regulations No. 16-2005.

Petitioner counter-argues that respondent's reliance on the ruling of this Court in the case of *Lapanday Foods Corporation vs. Commissioner of Internal Revenue*[25] (*Lapanday case*), with respect to his interest income, is misplaced and that the subject assessment lacks factual and legal bases.

This Court agrees with petitioner.

As can be clearly deduced from Sections 105 and 108 of the NIRC of 1997, as amended, in order for a person to be liable to VAT, he or she must sell, barter, exchange or lease goods or properties, render service, or import goods, in the ordinary course of business or trade. The term "in the course of trade or business", as provided by Section 105 of the NIRC of 1997, connotes "regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto."[26]

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[25] *Supra.*
[26] Value Added Tax, 2007 Edition, Victorino C. Mamalateo, p. 82.

In the instant case, petitioner's act of lending money to ICC, where he is a director and a stockholder cannot be considered as an act of lending in the course of his trade or business. Contrary to the scenario in the *Lapanday case*, where this Court *En Banc* held that "petitioner (Lapanday Foods Corporation) is a domestic corporation engaged in managing, promoting, administering or assisting in any business or activity of corporations, partnerships, associations, individual or firm", petitioner in the instant case is engaged in the business of selling motorcycle parts and accessories. Although petitioner is a stockholder and director of ICC at the time he lent or advanced money to the company, his act of lending money to ICC was not done in the course of his business or trade but merely an isolated transaction in order to help the company in its provincial expansion programs in 2004, considering that, at that time, ICC was just starting and it was having difficulties in getting and applying for loans from banks.[27]

Furthermore, in the *Lapanday case*, the loan assistance provided by Lapanday Foods Corporation to its affiliates, being "incidental" to its business, is deemed a transaction "in the course of trade or business". The term "incidental" means "depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another

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[27] Exhibits "N" and "O".

which is termed the principal; something incidental to the main purpose."[28] Thus, this Court held that the income generated by Lapanday Foods Corporation from the loans granted to its affiliates is subject to VAT.

As earlier stated, petitioner's act of lending money to ICC was a one-time assistance to the latter in his capacity as a stockholder of ICC. The said act cannot also be considered as incidental to the business of petitioner since he is registered as an Electrical Engineer and his business is trading motorcycle parts and accessories under the business name of MTRADE Motorcycle Parts Supply[29], which has no connection in any way to lending activities.

Apparently, the ruling of this Court in the *Lapanday case* cannot be applied to the present case. The interest income of petitioner from lending money to ICC is not a transaction made in the course of trade or business but an isolated transaction and therefore, not subject to VAT.

In the case of *Commissioner of Internal Revenue vs. Magsaysay Lines, Inc., et al.,*[30] the Supreme Court had the occasion to explain the concept of the phrase "in the course of trade or business" in connection to VAT, to wit:

> "Yet VAT is not a singular-minded tax on every transactional level. Its **assessment bears direct relevance to the taxpayer's role or link in the production chain**. Hence, as affirmed by Section 99 of the Tax Code and its subsequent incarnations,

[28] Black's Law Dictionary, 6th ed., p. 762.
[29] Exhibit "D".
[30] G.R. No. 146984, July 28, 2006.

the tax is levied only on the sale, barter or exchange of goods or services by persons who engage in such activities, in the course of trade or business. These transactions outside the course of trade or business may invariably contribute to the production chain, but they do so only as a matter of accident or incident. As the sales of goods or services do not occur within the course of trade or business, the providers of such goods or services would hardly, if at all, have the opportunity to appropriately credit any VAT liability as against their own accumulated VAT collections since the accumulation of output VAT arises in the first place only through the ordinary course of trade or business.

That the sale of the vessels was not in the ordinary course of trade or business of NDC was appreciated by both the CTA and the Court of Appeals, the latter doing so even in its first decision which it eventually reconsidered. We cite with approval the CTA's explanation on this point;

> In Imperial v. Collector of Internal Revenue, G.R. No. L-7924, September 30, 1955 (97 Phil. 992), the term *'carrying on business'* does not mean the performance of a single disconnected act, but means conducting, prosecuting and continuing business by performing progressively all the acts normally incident thereof; while 'doing business' conveys the idea of business being done, not from time to time, but all the time. xxx
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> What is clear therefore, based on the aforecited jurisprudence, is that 'course of business' or 'doing business' connotes regularity of activity. In the instant case, the sale was an isolated transaction. The sale which was involuntary and made pursuant to the declared policy of Government for privatization could no longer be repeated or carried on with regularity. It should be emphasized that the normal VAT-registered activity of NDC is leasing personal property.
>
> xxx xxx xxx
>
> The conclusion that the sale was not in the course of trade or business, which the CIR does not dispute before this Court, should have definitively settled the matter. Any sale, barter or exchange of goods or services not in the course of trade or business is not subject to VAT." *(Emphasis supplied)*

Considering the foregoing, this Court finds that the interest income received by petitioner from ICC, being an isolated act and not made in the ordinary course of petitioner's business or trade, is not subject to VAT. Consequently, petitioner's remaining gross receipts for CY 2006 consists only of his gross sales amounting to ₱1,390,770.00. Nevertheless, this Court likewise finds the same to be not subject to VAT since petitioner's gross sales for CY 2006 is below the VAT threshold as provided under Section 4.109-1(B)(v) of Revenue Regulations No. 16-2005, which states:

> "SEC. 4.109-1. *VAT-Exempt Transactions.* –
>
> (A) xxx
>
> (B) Exempt Transactions. –
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> xxx xxx xxx
>
> (v) Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, **the gross annual sales and/or receipts do not exceed the amount of One Million Five Hundred Thousand Pesos (₱1,500,000.00)**; Provided, That not later than January 31, 2009 and every three (3) years thereafter, the amount of ₱1,500,000.00 shall be adjusted to its present value using the Consumer Price Index, as published by the NSO.
>
> For purposes of the threshold of ₱1,500,000.00, the husband and the wife shall be considered separate taxpayers. However, the aggregation rule for each taxpayer shall apply. For instance, if a professional, aside from the practice of his profession, also derives revenue from other lines of business which are otherwise subject to VAT, the same shall be combined for purposes of

> determining whether the threshold has been exceeded. Thus, the VAT-exempt sales shall not be included in determining the threshold." *(Emphasis supplied)*

In fine, petitioner's interest income from Intertrade Credit Corporation is not subject to VAT because the transaction was not made by petitioner in the ordinary course of his trade or business, but an isolated act. Likewise, the gross sales of petitioner is not subject to VAT pursuant to Section 4.109-1(B)(v) of Revenue Regulations No. 16-2005. Hence, this Court finds respondent's assessment against petitioner for deficiency value-added tax in the amount of ₱1,998,745.34 to be without legal and factual bases.

WHEREFORE, premises considered, the Petition for Review is hereby GRANTED. Accordingly, respondent's deficiency VAT assessment against petitioner in the amount of ₱1,998,745.34 is hereby CANCELLED and SET ASIDE.

SO ORDERED.

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

WE CONCUR:

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

CAESAR A. CASANOVA
Associate Justice

C E R T I F I C A T I O N

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

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Acting Presiding Justice
Chairperson, 2nd Division