REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

ITW TEXWIPE PHILIPPINES,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE No. 7357

Members:

Acosta, *Chairperson.*
Bautista, *and*
Casanova, *JJ.*

Promulgated:

JUN 17 2009 ; 9:49am

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DECISION

ACOSTA, *PJ:*

This Petition for Review seeks the cancellation of respondent's Formal Letter of Demand and Assessment Notice No. 57-2000 dated May 31, 2005, assessing petitioner for deficiency final withholding taxes on royalty expenses; general administrative expenses; sales commission expenses; and, final withholding taxes on value-added tax (VAT) for calendar year 2000 in the aggregate amount of ₱25, 104, 368.59, inclusive of surcharge, interest and compromise penalties.

THE FACTS

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

Petitioner ITW Texwipe Philippines, Inc. is corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, registered with the Securities and Exchange Commission (SEC) through Certificate of Incorporation No. A-1997-23343 dated January 21, 1998. It is likewise registered with the Philippine Economic Zone Authority (PEZA) through Certificate of Registration No. 98-011 as an Ecozone Export Enterprise and operating at No. 4 Circuit Street, Bo. Diezmo, Light Industry Science Park (LISP) Cabuyao, Laguna.[1]

Respondent Commissioner of Internal Revenue is the official duly authorized under Section 4 of the National Internal Revenue Code (NIRC) to assess and collect internal revenue taxes, with the power to decide disputed assessments, among others, subject to the exclusive jurisdiction of this Honorable Court.[2]

Respondent, in its Formal Letter of Demand and Assessment Notice (FAN) No. 57-2000 dated May 31, 2005 and signed by the Respondent through Acting Regional Director Merlinda I. Ordoyo, assessed petitioner for deficiency Final Withholding Tax (FWT) on: a) royalty expenses; b) general administrative expenses; c) commission expenses; and value added tax (VAT) on gross payments to Texwipe International LLC (Texwipe USA) for calendar year 2000 in the aggregate amount of ₱25,104,368.59, inclusive of surcharge, interest and compromise penalties, to wit:[3]

I. FINAL WITHHOLDING TAX				
A. TECHNOLOGY LICENSE AGREEMENT				
Royalty Expense - Texwipe, U.S.A.	Php	10,700,000.00	Php	1,605,000.00
tax rate		x 15%		
B. GENERAL AND ADMINISTRATIVE AGREEMENT				
Gen. & Admin Exp. -Texwipe U.S.A.	Php	3,863,130.00		
		X 32%		1,236,201.60
C. SALES COMMISSION AGREEMENT				
Commission Expense - Texwipe U.S.A.	Php	17,911,462.00		
		X 32%	Php	5,731,667.84
			Php	8,572,869.44
DEFICIENCY TAX				

[1] Par. 1.01, , Joint Stipulation of Facts and Issues (JSFI), Rollo, p. 148.
[2] Par. 1.03, *Ibid*, p. 149.
[3] Rollo, p. 29.

ADD:	25% surcharge	Php	2,143,217.36		
	86.96% interest (01/26/2001 to 05/31/05)		7,454,967.27		
	Compromise		25,000.00		9,623,184.63
	TOTAL AMOUNT DUE			**Php**	**18,196,054.07**

II. FINAL WITHHOLDING OF VALUE ADDED TAX

Gross payments to Texwipe U.S.A.		Php	32,474,592.00
tax rate			10%
		Php	3,247,459.20

DEFICIENCY TAX					
ADD:	25% surcharge	Php	811,864.80		
	86.96% interest (01/26/2001 to 05/31/05)		2,823,990.52		
	Compromise		25,000.00		3,660,855.32
	TOTAL AMOUNT DUE			**Php**	**6,908,314.52**

The assessed deficiencies were due to alleged violations or non-compliance with Section 57(A) of the NIRC, Revenue Regulation No. 2-98, Articles 4 & 13 of the RP-US Tax Treaty and Revenue Regulation No. 7-95,[4]

On June 10, 2005, petitioner received a copy of the FAN.[5]

On June 17, 2005, petitioner filed its reply to the FAN, protesting the respondent's assessments and raising the following arguments with respect to each item of assessment:

> a. Royalties – The Corporation withheld and remitted the amount of ₱4,216,258.64 as evidenced by BIR Form No. 1601-F with the BIR on August 27, 2001. No royalty payments were actually made in 2000 and payments of royalty started only in 2001, thus the filing of the appropriate return in said year. Considering that the return for withholding tax on royalties was filed on August 27, 2001, the assessment for said taxes has prescribed pursuant to Section 203 of the NIRC.
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> b. General and Administrative Expenses – This pertains to services rendered outside the Philippines. Income derived by a non-resident foreign corporation from sources outside the Philippines is not subject to tax.
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> c. Commission Expenses – This pertains to services rendered outside the Philippines. Income derived by a non-resident foreign corporation from outside the Philippines is not subject to tax.
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> d. VAT – Royalty expense for 2000 was only on accrual and no payment was actually made. Thus, no FWT is due.

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[4] Par. 1.05, *Id*, p. 149.
[5] Par. 1.06, *Id*, p. 150.

> Further, these pertained to services rendered outside the Philippines which are not subject to VAT.[6]

Curiously enough, petitioner received a letter from respondent through Revenue District Office (RDO) No. 57 on July 21, 2005 replying to the petitioner's protest letter stating merely that the right of the government to assess the petitioner has not yet prescribed. No resolution was issued on whether the petitioner's protest has been denied in whole or in part and instead, the latter referred the issues on the assessments of deficiency withholding tax on sales commissions and general and administrative expenses to the Assessment Division for proper disposition. It then advised petitioner that the whole docket of the case will be forwarded to the Regional Office of San Pablo City for appropriate action.[7]

Petitioner did not receive any letter from the Assessment Division or from the Regional Office in reply to the petitioner's protest letter pursuant to the referral made by the RDO in its letter dated July 21, 2005.[8]

On October 3, 2005, petitioner received the Preliminary Collection Letter dated September 19, 2005 issued again by RDO No. 57, collecting from the petitioner the alleged deficiency FWT and FWT-VAT for calendar year 2000 in the total amount of ₱ 25, 104,368.59, inclusive of surcharge, interest and compromise penalties.[9]

Thus, on October 28, 2005, petitioner filed this instant Petition for Review[10] praying that judgment be rendered canceling FAN No. 57-2000 dated May 31, 2005 and the Preliminary Collection Letter dated September 29, 2005 which assessed petitioner for alleged deficiency final withholding tax on royalty expense; general and administrative expense; and, sales commission expense and final withholding on VAT taxes for calendar year 2000 in the total amount of ₱25,104,368.50; and, declaring the same to be null and void and without legal force and effect.

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[6] Par. 1.07, *Id*, p. 150.
[7] Par. 1.08, *Id*, p. 151.
[8] Par. 1.09, *Id*, p. 151.
[9] Par. 1.10, *Id*, p. 151.
[10] Rollo, p. 4-99.

On December 18, 2005, respondent filed a Motion for Leave to Admit Attached Answer[11] which was granted in the Resolution[12] of this Court on February 2, 2006.

In his Answer, respondent raised the following special and affirmative defenses:[13]

> 10. This Honorable Court is wont of jurisdiction to entertain the instant Petition for Review. Section 228 of the NIRC of 1997 categorically states that "...within sixty (60) days from the filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final" (Emphasis supplied). As borne by the records of the case, petitioner did not just fail to submit the documents after it filed its protest, it obstinately refused to submit documents requested by the respondent's examiners despite several requests made during the investigation stage and even during the protest. In fact, petitioner even wrote a letter dated July 18, 2005, in response to a request for submission of documents by the respondent's examiners stating that "no amount of documents could prove the same [petitioner's protest] except the proper interpretation and application of the law."
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> 11. It bears mentioning that all of petitioner's defenses against the assessment are based not only on provisions of law, but, on interpretation of the scope and limitation of the agreements between petitioner and its alleged foreign contracting partners. Petitioner desperately seeks to defeat the assessment by anchoring its protest on exemptory provisions of a treaty agreement between the Republic of the Philippines and U.S. It is indubitable that the contentions of petitioner cannot be resolved merely by its postulations on the nature and scope of contracts it entered with its U.S.-based payees without producing the alleged contracts and proving the exempt nature of services alluded to in said contracts, and strict compliance with its provisions. Thus, petitioner's obstinate refusal to submit documents within sixty (60) days from the filing of its protest, despite repeated demands to do so, is clearly unjustifiable.
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> 12. Being that the assessment is final after the lapse of sixty (60) day period from petitioner's protest, petitioner should have filed its petition for review with this Court after the lapse of said period. To reiterate, the assessment had already become final due to petitioner's failure/refusal to submit documents within sixty (60) days from filing of its protest. The protest was filed by the taxpayer on June 17, 2005. Petitioner had until August 16, 2005 to submit documents relevant to its protest. Until this

[11] Rollo, p. 102-112.
[12] Rollo, p. 117.
[13] Answer, Rollo, p. 107-110.

> date, no documents was ever submitted to the respondent's regional offices

On March 9, 2006, respondent filed his Motion to Dismiss[14] on the ground of the Court's lack of jurisdiction arising from the failure of petitioner to file the supporting documents to the protest. The petitioner submitted its Opposition[15] to the said Motion to Dismiss[16] on April 3, 2006.

On March 10, 2006, however, the Joint Stipulation of Facts and Issues (JSFI)[17] were filed by the parties. A corresponding Resolution[18] dated March 14, 2006 approved said JSFI and thereafter terminated the pre-trial.

A Resolution[19] dated July 6, 2006 was promulgated by the Court denying respondent's Motion to Dismiss for lack of merit.

During trial, both petitioner and respondent presented testimonial and documentary evidence in support of their respective positions.

On January 26, 2009, the case was submitted for decision after petitioner and respondent submitted their Memoranda[20] on January 23, 2009 and January 9, 2009, respectively.

THE ISSUES

By agreement of the parties, the issues to be tried and resolved in this case are the following:

I

Whether or not this Honorable Court has jurisdiction on the ground that the Petition for Review is allegedly filed out of time.

II

Whether the assessment for alleged deficiency final withholding taxes on royalties for the year 2000 is erroneous and should be nullified.

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[14] Rollo, p. 140-145.
[15] Rollo, p. 157-168.
[16] Rollo, p. 157-179.
[17] Rollo, p. 148-153.
[18] Rollo, p. 154.
[19] Rollo, p. 186-189.
[20] Rollo, p. 660-695.

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III

Whether the assessment for alleged deficiency final withholding taxes on general and administrative expenses for the year 2000 is erroneous and should be nullified.

IV

Whether the assessment for alleged deficiency final withholding taxes on sales commission for the year 2000 is erroneous and should be nullified.

V

Whether the assessment for alleged deficiency final withholding taxes on value added tax (VAT) for the year 2000 is erroneous and should be nullified.

VI

Whether the assailed Formal Letter of Demand and Assessment No. 57-2000 for alleged deficiency final withholding taxes for the year 2000 has prescribed and should be nullified and set aside.

VII

Whether or not petitioner is liable for deficiency final withholding tax and final withholding tax-VAT in the amount of ₱18,196,054.07 and ₱6,908,314.52, respectively, for the year 2000.

THE ARGUMENTS OF THE PARTIES

Petitioner's Arguments

As to the deficiency final withholding tax on petitioner's royalty expenses, petitioner argues that it already paid and remitted the final withholding tax equivalent to ₱1,605,000.00 on its royalty payments amounting to ₱10,700,000.00 for taxable year 2000 when it filed on August 27, 2001 its BIR Form No. 1601-F and correspondingly paid ₱4,216,258.64 as withholding tax. It further alleges that the BIR Form No. 1601-F, though is only a Monthly Remittance Return of Final Income Taxes Withheld, contains a schedule setting forth the aggregate amount of ₱28,108,390.93, presumably containing all royalty expenses for 1998, 1999 and 2000. Since it avers that the withholding taxes on royalty were actually paid and remitted on August 27, 2001, petitioner argues that the assessment for deficiency withholding taxes on the same has already prescribed.

As to the deficiency final withholding tax on general and administrative expenses and final withholding tax on service commission, petitioner avers that the services from such expenses were rendered to a non-resident foreign

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corporation, particularly Texwipe USA, and were performed outside the Philippines and thus, not subject to income or withholding tax.

As to the final withholding tax on VAT, petitioner alleges that it is not liable for withholding VAT allegedly on payments to Texwipe USA since it is a PEZA-registered Economic Zone Enterprise and is exempt from all direct and indirect taxes.

Lastly, petitioner reiterates that the Formal Assessment for final withholding tax for the year 2000 has already prescribed and should be nullified and set aside since it submitted its Annual Income Tax Return (BIR Form No. 1702) for calendar year ending December 31, 2000 on April 16, 2001 and respondent only has until April 16, 2004 within which to assess petitioner. Petitioner argues that the assessment which was received by petitioner on June 10, 2005 was made beyond the reglementary period.

Respondent's Arguments

Respondent, on the other hand, reiterates that upon verification, it found petitioner to have failed to remit any final withholding tax due on the income payments made to Texwipe USA. Respondent reiterates the duty of petitioner to withhold the final tax when it recognized royalty expense, general/administrative expense and sales commission expense as business expenses in its books for taxable year 2000 and already took advantage of the benefit as provided by law for the allowance of deduction from gross income.

Since Texwipe USA received remuneration and derived service income from sources within the Philippines, respondent argues that the entire gross receipts derived should be subjected to VAT.

Lastly, respondent argues that the statute of limitations on prescription under Section 203 of the 1997 NIRC will not apply since petitioner failed to file the return as required by law. It emphasizes that the provision applicable is Section 222 of the 1997 NIRC which provides a ten (10) year period for assessment of taxes wherein no return was filed.

THE DECISION OF THE COURT

We find the petition partly meritorious. Allow us to discuss the issues *in seriatim*.

The Petition for Review Was Filed on Time, Thus, the Court Has Jurisdiction.

The parties have agreed to set forth as issue petitioner's failure to submit supporting documents within sixty (60) days after it filed its protest with respondent[21]. Respondent, thus, alleges that the filing of the instant petition for review is premature.

The issue on the timely filing of the instant petition for review has already been the subject of respondent's Motion to Dismiss[22] dated March 9, 2006 to which the Court already resolved in Its Resolution[23] dated July 6, 2006, to wit:

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> It has been held that non-submission of supporting documents within sixty (60) days from the filing of the protest does not make the necessary notice issued final and executory. The requirement under Section 228 of the National Internal Revenue Code of 1997 merely requires the taxpayer to submit all the documents in support of its protest without, however, compelling it to submit in cases where it feels that no such documents are necessary, To force a taxpayer in submitting the documents, which it feels are not important to its case, would in effect place the taxpayer at the mercy of examiners of the Bureau of Internal Revenue, who may abuse such authority and prevent the early resolution of the taxpayer's protest. In putting the phrase "the assessment shall become final" is interpreted as no longer giving the taxpayer the opportunity to present or defend its protest after the lapse of the sixty 956)) day period considering that after the same, the respondent is obligated to resolve the protest within one hundred eighty (180) days.
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> As regards the argument of respondent that the instant petition for review is premature for there is yet no final decision rendered by the Commissioner on the protest of petitioner, this Court disagrees.
>
> The requisite for the validity of an administrative decision of the respondent on a disputed assessment which may be appealable to this Court are as follows:
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> 1. statement of the facts, the applicable law, rules and regulations or jurisprudence on which such decision is based, otherwise, the decision shall be void; and
> 2. that the same is his final decision on the protest.

[21] JSFI.
[22] Rollo, p. 660-695.
[23] Rollo, p. 186-189.

> Verily, the final decision which is appealable to this Court must be one which has been decided by the Commissioner or his duly authorized representative. Only a final decision or inaction of the respondent on a disputed assessment may be the subject of an appeal to this Court.
>
> Based on the above, a perusal of the Preliminary Collection Letter dated September 5, 2005 issued by the Revenue District Officer of the Revenue District Office No. 57 shows that it was issued as a consequence of the protest letter admittedly filed by the Acting Revenue Regional Director Merlinda I. Ordoyan of Revenue Region No. 9. Thus, the issuance of the preliminary collection letter is tantamount to an outright denial of the protest filed by the intention of the respondent to resort to the summary remedies of collection as provided for by law in case of non-settlement of the taxes due within (10) days from the receipt of the said collection letter. In effect, the preliminary collection letter is the final decision of the respondent, through Acting Revenue Regional Director, on the protest of the petitioner, which is appealable to this Court.
>
> WHEREFORE, in view of the foregoing, respondent's Motion to Dismiss is hereby DENIED for lack of merit."

Hence, the Court already ruled that it has jurisdiction to decide over the instant petition for review.

The Petitioner is Not Liable for Final Withholding Taxes on the Royalty Expenses.

Petitioner argues that the alleged deficiency final withholding tax on royalty expenses for the year 2000 arising from its Technology License Agreement with Texwipe USA was already paid and remitted on August 27, 2001 after it filed its BIR Form No. 1601-F on the same date. Petitioner, however, admitted that it accrued the royalty expenses on said Technology License Agreement in 1998, 1999 and 2000, respectively, however, only paid the corresponding final withholding taxes on August 27, 2001.[24]

Respondent, on the other hand, argues that the obligation to withhold said tax on petitioner's royalty expenses accrues at the time the royalties are recorded in its books and when petitioner actually benefited by allowing it as a deduction, pursuant to Section 57(A) of the 1997 NIRC as implemented by RR No. 2-98., as well as Article 4 of the RP-US Tax Treaty.[25]

Since the application of the RP-US Tax Treaty has never been the contention of both parties, the Court shall not dwell on the tax rate applicable

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[24] 4.04 Memorandum of Petitioner, Rollo, p.678.
[25] Memorandum of Respondent, Rollo, p. 664.

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in the instant case. Instead, the Court shall focus on the proper time of withholding the tax on royalties.

At the outset, Section 58 of the 1997 NIRC provides the period for the filing of the return and the payment and remittance of final tax withheld under Section 57 of the Same Code, to wit:

> **Section 57.** *Withholding of Tax at Source.* -
>
> (A) *Withholding of Final Tax on Certain Incomes.* - Subject to rules and regulations the Secretary of Finance may promulgate, upon the recommendation of the Commissioner, requiring the filing of income tax return by certain income payees, XXX of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 58 of this Code.
>
> **Section 58.** *Returns and Payment of Taxes Withheld at Source.* -
>
> (A) *Quarterly Returns and Payments of Taxes Withheld.* - Taxes deducted and withheld under Section 57 by withholding agents shall be covered by a return and paid to, except in cases where the Commissioner otherwise permits, an authorized Treasurer of the city or municipality where the withholding agent has his legal residence or principal place of business, or where the withholding agent is a corporation, where the principal office is located.
>
> The taxes deducted and withheld by the withholding agent shall be held as a special fund in trust for the government until paid to the collecting officers.
>
> **The return for final withholding tax shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter**, while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which withholding was made: Provided, That the Commissioner, with the approval of the Secretary of Finance, may require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the government. (Emphasis provided)

The above provisions were implemented by Revenue Regulations (RR) No. 2-98, as amended by RR No. 12-01. Section 2.57.4 thereof, provides when the obligation to withhold arises, thus:

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> "Sec. 2.57.4. Time of withholding. — The **obligation of the payor to deduct and withhold the tax under Section 2.57 of these Regulations arises at the time an income payment is paid or payable, or the income payment is accrued or recorded as an expense or asset, whichever is applicable, in the payor's books, <u>whichever comes first</u>.** The term "payable" refers to the date the obligation becomes due, demandable or legally enforceable.
> Provided, however, that where income is not yet paid or payable but the same has been recorded as an expense or asset, whichever is applicable, in the payor's books, the obligation to withhold shall arise in the last month of the return period in which the same is claimed as an expense or amortized for tax purposes. (Emphasis Ours)

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In other words, the above-provision requires the petitioner to withhold the royalty payments when it is paid, becomes payable, or were accrued or recorded as expense in petitioner's books, <u>whichever comes first</u>. Moreover, if petitioner recorded the royalty payments as expense, although they were not yet paid or payable, the obligation to withhold shall be within the last month of the return period in which the royalty payments were claimed as expense for tax purposes.

Applying the above provisions in the case at bar, the Court deems it proper to evaluate the evidence presented by the parties based on the date when petitioner's obligation to withhold arose.

First, as to when payments were made, the Court observes that there is no evidence on record which indicates when the royalty payments were made to Texwipe USA for calendar year 2000. It follows then that the date of royalty payments cannot be made as basis to oblige petitioner to withhold the tax on the royalties.

Second, as to when the royalties became due and demandable, the Court did not find any evidence on record which point out the date when payments to Texwipe USA were to be made. The Technology License Agreement was never presented on trial, thus, it was impossible for respondent and the Court to determine when the obligation became payable.

Third, as to when the payments were accrued, the Court, after a closer examination of the evidence presented observed that petitioner recorded in its books the royalty payments in a yearly basis. Petitioner also claimed as expense in its Annual Income Tax Return[26] for the year 2000 the royalty payments to Texwipe USA in the amount of ₱10,700,000.00.

Based on the foregoing, therefore, lacking any evidence to conclude when the royalty payments became due and payable for failure of the partiest to present as evidence the Technology License Agreement, the Court has no choice but to apply the third option which is when the payments were recorded and accrued, as provided in the second paragraph of Section 2.57.4 of RR 2-92. Thus, petitioner's obligation to pay the final withholding tax on the royalty payments arose at the time such expense was recorded and accrued by petitioner.

However, records strongly indicate that petitioner withheld and paid the final withholding tax on such royalties on August 27, 2001, when petitioner filed BIR Form No. 1601-F. Considering that the petitioner filed the return and correspondingly paid the final withholding tax royalties on August 27, 2001, respondent has three (3) years from aforesaid date or on or before August 27, 2004 to assess petitioner, pursuant to Section 203 of the 1997 NIRC, to wit:

> **Section 203.** *Period of Limitation Upon Assessment and Collection.* - Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed 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 a 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 purposes 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.

Unfortunately, respondent issued the assessment over the final withholding tax on royalties only on May 31, 2005, thus, the assessment on the final withholding tax on royalty expense has already prescribed. Accordingly, petitioner cannot be made liable to pay said tax.

[26] Exhibit "M", Rollo, p. 432-433.

The Petitioner is Liable For the Final Withholding Taxes on General and Administrative Expenses.

Petitioner alleges that it should not be held liable for the final withholding tax on its general and administrative expense in the amount of ₱1,236,201.60 for the year 2000 since the services rendered by Texwipe USA, a non-resident foreign corporation, were performed outside the Philippines. Petitioner presented its Audited Financial Statement for the year 2000, as well as, various Corporate Processes Procedure data to prove that the general and administrative services provided by Texwipe USA were all rendered in the USA.

After a thorough analysis of the evidence presented by petitioner, the Court is not convinced that the services performed by Texwipe USA were all rendered abroad. The Court has no way of determining what exactly are the services provided by Texwipe USA and where they were rendered since petitioner failed to present the General and Administrative Agreement it allegedly entered into with Texwipe USA. The administration of justice is not a matter of guess work. While pleadings should be liberally construed with a view to substantial justice between the parties, courts should not be left to conjectures in the determination of issues submitted by the parties or their attorneys.[27]

Moreover, the Court cannot countenance petitioner's argument that the income generated by Texwipe USA from the general and administrative services it rendered to petitioner are not subject to income or withholding tax because Texwipe USA is a non-resident corporation which has no permanent establishment in the Philippines nor has furnished services, including consultancy services, within the Philippines for a period aggregating more than 183 days. The petitioner did not present an iota of evidence that will prove said allegations. Mere allegations without supporting proofs are not evidence in themselves.

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[27] *Go Occo & Co. vs De La Costa*, GR. No. 45116, September 17, 1936.

Therefore, petitioner is liable for the final withholding taxes on its general and administrative expense paid to Texwipe USA in the amount of ₱1,236,201.60, including surcharges and interest.

The compromise penalty, however, cannot be imposed there being no compromise agreement between the parties.

The Petitioner is Not Liable for the Final Withholding Tax on Sales Commission Expenses.

Petitioner once more alleges that the services rendered by Texwipe USA, arising from its Sales Commission Agreement[28] were performed outside the Philippines, thus the income of Texwipe USA arising thereto should not be subjected to final tax in the Philippines.

It is important to note that only labor and personal services performed in the Philippines are considered Philippine-sourced income and are subject to tax. Accordingly, Section 42(A)(3) of the 1997 NIRC provides that:

> **Section 42.** *Income from Sources Within the Philippines.-*
>
> (A) *Gross Income From Sources Within the Philippines.* - The following items of gross income shall be treated as gross income from sources within the Philippines:
>
> (3) *Services.* - Compensation for labor or personal services performed in the Philippines;

The Court observed that petitioner submitted its Sales Commission Agreement with Texwipe USA, which stated that:

> NOW, THEREFORE, for and in consideration of the foregoing premises, the parties hereto hereby covenant, under the following terms and conditions:
>
> 1. Texwipe USA shall undertake the sale of the goods and/or products manufactured thereby to the European Common and Asian Markets, as the designated sales agent of TPI.
> 2. The proceeds of such sales shall be remitted directly to TPI, and shall be considered a sale made by TPI.

The agreement itself furnishes the best means of its exposition. The Sales Commission Agreement clearly stipulates that the sales services are to be

[28] Exhibit "O".

rendered in European Common and Asian Markets. Moreover, records indicate that Texwipe USA facilitated the sales by emailing customers who are outside the Philippines and reporting the sales by emails, thus, the Court is convinced that the sales services rendered by Texwipe USA were performed outside the Philippines.

Since the sales services were performed by Texwipe USA outside the Philippines, it then follows that the services are not taxable in the Philippines.

The Petitioner is Not Liable For the Final Withholding Value Added Tax On Its Payments to Texwipe USA

Petitioner alleges that it is not required to withhold and remit the ten percent (10%) VAT on its gross payments to Texwipe USA since it is a PEZA-registered Economic Zone Export Enterprise and is exempt from all direct and indirect taxes pursuant to Section 24 of RA No. 7916, otherwise known as "Special Economic Zone Act of 1993".

At the outset, the lease or use of certain 'know how' formulations and technical standards, and the supply of technical advice and services in connection with technical management and administration by non-resident persons or his employees are subject to ten percent (10%) value added tax pursuant to Section 108 of the 1997 NIRC, to wit:

> **Section 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. xxx
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> (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;
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> xxx xxx xxx
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> (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;

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Consequently, the royalties, general and administrative services and sales services rendered by Texwipe USA to petitioner are subject to VAT. As a result, petitioner is required to withhold the VAT on the payments for said services and treat the same as "passed on" VAT, pursuant to Section 4.110-3(b) of RR. No. 7-95 (now Section 4.114-2(b) of RR. No 16-05).

However, in *Commissioner of Internal Revenue vs. Seagate Technology (Philippines)*[29], the Supreme Court held that no VAT shall be imposed directly upon business establishments operating within the ecozone under RA 7916, which also means that no VAT may be passed on and imposed indirectly to said enterprises. As thoroughly explained in said case, viz:

> Special laws may certainly exempt transactions from the VAT. However, the Tax Code provides that those falling under PD 66 are not. PD 66 is the precursor of RA 7916 -- the special law under which respondent was registered. The purchase *transactions* it entered into are, therefore, not VAT-exempt. These are subject to the VAT; respondent is required to register.
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> Since the purchases of respondent are not exempt from the VAT, the rate to be applied is zero. Its exemption under both PD 66 and RA 7916 effectively subjects such transactions to a zero rate, because the ecozone within which it is registered is managed and operated by the PEZA as a *separate customs territory*. This means that in such zone is created the legal fiction of foreign territory. Under the *cross-border principle*of the VAT system being enforced by the Bureau of Internal Revenue (BIR), no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority. If exports of goods and services from the Philippines to a foreign country are free of the VAT, then the same rule holds for such exports from the national territory -- except specifically declared areas -- to an ecozone.
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> Sales made by a VAT-registered person in the customs territory to a PEZA-registered entity are considered exports to a foreign country; conversely, sales by a PEZA-registered entity to a VAT-registered person in the customs territory are deemed imports from a foreign country. An ecozone -- indubitably a geographical territory of the Philippines -- is, however, regarded in law as foreign soil. This legal fiction is necessary to give meaningful effect to the policies of the special law creating the zone. If respondent is located in an export processing zone within that ecozone, sales to the export processing zone, even without being actually exported, shall in fact be viewed as *constructively exported* under EO 226. Considered as export sales, such purchase transactions by respondent would indeed be subject to a zero rate.
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[29] GR No. 153866, February 11, 2005.

> Applying the special laws we have earlier discussed, respondent as an entity is exempt from internal revenue laws and regulations.
>
> **This exemption covers *both* direct and indirect taxes, stemming from the very nature of the VAT as a tax on consumption, for which the direct *liability* is imposed on one person but the indirect *burden* is passed on to another. Respondent, as an exempt entity, can neither be directly charged for the VAT on its sales nor indirectly made to bear, as added cost to such sales, the equivalent VAT on its purchases. *Ubi lex non distinguit, nec nos distinguere debemus.* Where the law does not distinguish, we ought not to distinguish.**
>
> Moreover, the exemption is both express and pervasive for the following reasons:
>
> *First*, RA 7916 states that "no taxes, local and national, shall be imposed on business establishments operating within the ecozone." Since this law does not exclude the VAT from the prohibition, it is deemed included. *Exceptio firmat regulam in casibus non exceptis.* An exception confirms the rule in cases not excepted; that is, a thing not being excepted must be regarded as coming within the purview of the general rule.
>
> Moreover, even though the VAT is not imposed on the entity but on the transaction, it may still be passed on and, therefore, indirectly imposed on the same entity -- a patent circumvention of the law. That no VAT shall be imposed directly upon business establishments operating within the ecozone under RA 7916 also means that no VAT may be passed on and imposed indirectly. *Quando aliquid prohibetur ex directo prohibetur et per obliquum.* When anything is prohibited directly, it is also prohibited indirectly. (Emphasis Ours)
>
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Applying the foregoing on the case at bar, the petitioner which has sufficiently established that it is a PEZA registered enterprise is not liable directly or indirectly for VAT, thus, it cannot be held liable for the final withholding tax on VAT for its gross payments to Texwipe USA.

The Final Withholding Tax on General and Administrative Expenses Has Not Yet Prescribed

Considering that the final withholding tax on royalties has already prescribed as discussed previously, the Court shall consider the final withholding tax on general and administrative expense; sales commission; and VAT since no returns relative thereto was filed by petitioner.

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In view of petitioner's failure to present any final withholding tax returns for the its final withholding tax on its payments to Texwipe USA for the general and administrative services for the year 2000, respondent has ten (10) years from the discovery of the omission and falsity to assess petitioner.

Respondent's issuance of FAN No. 57-2000 on May 31, 2005, insofar as to the final withholding tax on the general and administrative expense was proper considering that he may assess petitioner the said tax within the ten (10) year prescriptive period as provided in Section 222 of the 1997 NIRC, viz:

> **Section 222.** *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.*
>
> (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a preceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

In closing, the Court is mindful of the well-entrenched principle that assessments are presumed to be correct unless the contrary is shown. The burden of proof rest upon the taxpayer to overcome such presumption. [30]

WHEREFORE, the Petition for Review is hereby **PARTIALLY GRANTED.** Accordingly, respondent is **ORDERED TO CANCEL/WITHDRAW** the assessment for taxable year 2000 insofar as to the final withholding tax on royalty expense and sales commission expense in the amount of ₱15,575,801.16 and final withholding tax on VAT in the amount of ₱6,908,314.52. However, petitioner is **ORDERED** to **PAY** respondent the assessment in the reduced amount of **₱2,620,252.91** representing petitioner's deficiency final withholding tax on general and administrative expenses for taxable year 2000, with applicable interest and surcharges, computed as follows:

[30] *Tan Guan vs. The Court of Tax Appeals and the Commissioner of Bureau of Internal Revenue*, GR No. L-23676, April 27, 1967.

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General and Administrative Expenses - Texwipe U.S.A.	P 3,863,130.00
Multiply by: Final Withholding Tax Rate	32%
Final Withholding Tax Due	P 1,236,201.60
Add: 25% Surcharge	309,050.40
20% Interest (01/26/2001 to 05/31/2005)	1,075,000.91
Total Amount Due	**P 2,620,252.91**

In addition, petitioner is hereby **ORDERED** to **PAY** twenty percent (20%) delinquency interest on the total amount of **₱2,620,252.91** from October 13, 2005 until full payment thereof, pursuant to Section 249(c)(3) of the 1997 Tax Code, as amended.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

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.

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division