REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

CLARK WATER CORPORATION, Petitioner,	**CTA CASE NOS. 9519**
-versus-	Members: **Castañeda, Jr.,** *Chairperson,* **Mindaro-Grulla,** and, **Bacorro-Villena,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: JUN 17 2020 9:00 a.m.

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DECISION

CASTAÑEDA, JR., *J.*:

THE CASE

This *Petition for Review* filed by petitioner Clark Water Corporation on January 16, 2017, prays for the cancellation and withdrawal of the assessment issued by respondent against petitioner for its alleged deficiency value-added tax (VAT) for calendar year (CY) 2014 in the total amount of ₱4,366,648.49, inclusive of interests and penalties.[1]

THE PARTIES

Petitioner is a domestic corporation duly organized and existing under Philippine laws, with registered principal office at Depot 1901, Bicentennial Hill, Clark Freeport Zone, Clark Field, Pampanga.[2]

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[1] Refer to the Pre-Trial Order dated June 27, 2017, Docket — Vol. I, p. 223.
[2] Par. 1, Stipulated Facts, *Joint Stipulation of Facts and Issues* (JSFI), Docket — Vol. I, p. 214.

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue (CIR) vested under appropriate laws with the authority to carry out the functions, duties and responsibilities of his Office including *inter alia*, the power to decide disputed assessments, cancel and abate tax liabilities pursuant to the provisions of the National Internal Revenue Code of 1997 (NIRC), as amended, and other laws, rules and regulations.[3] His principal office is located at the BIR National Office Building, Agham Road, Diliman, Quezon City.[4]

ANTECEDENTS (ADMINISTRATIVE LEVEL)

On August 3, 2015, petitioner received the *Letter of Authority* (LOA) No. 21A-2015-00000162/eLA201100064214 from BIR-RDO No. 21A - North Pampanga, authorizing Revenue Officer (RO) Amor Canlas and Group Supervisor Jose Gil Reyes to examine petitioner's books of accounts and other accounting records for all internal revenue taxes including Documentary Stamp Tax, other taxes (miscellaneous tax) for the period from January 1, 2014 to December 31, 2014.[5]

Subsequently, petitioner received a copy of the *Preliminary Assessment Notice (PAN)* dated July 7, 2016,[6] assessing it of deficiency Income Tax (IT), VAT, and Expanded Withholding Tax (EWT) for CY 2014 in the aggregate amount of ₱3,827,590.31, inclusive of interest, penalties and surcharge.

On July 27, 2016, petitioner filed its *protest letter to the PAN*, disputing only the findings on deficiency VAT.[7] Atty. Jethro M. Sabariaga acknowledged the receipt of the proof of payment on the deficiency IT and EWT in the respective amounts of ₱299,905.90 and ₱40,031.33 in his letter dated August 15, 2016.[8]

On October 5, 2016, petitioner received respondent's *Formal Letter of Demand* (FLD) and *Final Assessment Notice* (FAN) dated September 19, 2016, assessing petitioner of deficiency VAT for CY 2014 in the total amount of ₱4,406,648.49.[9]

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[3] Par. 3, Stipulated Facts, JSFI, *Id.*
[4] Par. 2, The Parties, *Petition for Review*, Docket — Vol. I, p. 11
[5] Exhibit "P-4", Docket — Vol. I, pp. 303 to 304.
[6] Exhibit "P-5", Docket — Vol. I, pp. 305 to 307.
[7] Exhibit "P-6", Docket — Vol. I, pp. 308 to 310.
[8] Exhibit "P-7", Docket — Vol. I, p. 311.
[9] Exhibit "P-8", Docket — Vol. I, pp. 312 to 316.

Petitioner filed its *protest letter* to the FLD and FAN on November 4, 2016.[10]

On December 16, 2016, petitioner received the respondent's *Final Decision on Disputed Assessment (FDDA)* dated December 6, 2016, denying its protest to the FLD and FAN.[11]

PROCEEDINGS BEFORE THIS COURT

Petitioner filed the instant *Petition for Review* on January 16, 2017.[12]

Respondent filed his *Answer* on April 7, 2017,[13] interposing the following defenses, to wit:

> "5.1 Income generated by petitioner from its sales in customs territory is subject to VAT.
>
> 5.2 The Formal Letter of Demand dated September 19, 2016 informed petitioner of its liability for deficiency value-added tax (VAT) for taxable year 2014. The Details of Discrepancies expressly provides:
>
> > 'Verification of your records disclosed that your receipts amounting to ₱22,984,353.84 are sales in the customs territory or outside the zone, thus, subjected to 12% VAT pursuant to Revenue Memorandum Circular No. 50-2007.'
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> 5.3 Respondent holds that petitioner is liable for deficiency VAT on its sales transactions within the customs territory (or outside Ecozone or Freeport) for taxable year 2014.
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> 5.4 It was clearly explained in the Letter dated December 6, 2016 issued by Revenue Region No. 4 — San Fernando, Pampanga that:
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> > 'Section 5 of Department Order No. 3-08 provides that for purposes of implementing the special 5% tax on Gross Income Earned, in lieu of national and local taxes, granted to Ecozone Enterprises and Freeport Enterprises in SSEZ, SFZ, CFZ, PPFZ, and MSEZ, gross income earned shall refer to gross sales or gross revenue derived from **business activities**

[10] Exhibit "P-9", Docket — Vol. I, pp. 317 to 321.
[11] Exhibit "P-10", Docket — Vol. I, pp. 322 to 325.
[12] Docket — Vol. I, pp. 10 to 24.
[13] Docket — Vol. I, pp. 74 to 80.

> **<u>within the subject Ecozone and Freeport</u>**, net of sales discounts, sales returns and allowances minus cost of sales or direct costs but before any deduction for administrative, marketing, selling, and/or operating expenses or incidental losses during a given taxable year. Thus, the 5% preferential tax rate is only applicable to the income earned by registered enterprises within the zone. Logically, any income earned from sources within the customs territory shall be subject to the internal revenue taxes and rates imposed for enterprises in the customs territory, including VAT.

5.5 Further, the Philippine VAT System adheres to the Cross Border Doctrine, according to which, no VAT shall be imposed to form part of the cost of the goods destined for consumption outside of the territorial border of the taxing authority. Hence, actual export of goods and services from the Philippines to a foreign country must be free of VAT; while **<u>those destined for use or consumption within the Philippines shall be imposed with [twelve percent (12%) VAT</u>**. (*CIR vs. Toshiba Information Equipment, G.R. No. 150154, August 9, 2005.*)

5.6 Revenue Memorandum Circular (RMC) No. 50-2007 specifically provides that:

> 'Freeport Zone-registered enterprises may generate income from sources within the Customs Territory of up to thirty (30%) of its total income from all sources; provided, that should a Freeport Zone-registered enterprise's income from sources within the Customs Territory exceed thirty percent (30%) of its total income from all sources, then it shall be subject to income tax laws of the Customs Territory; provided further, <u>that in any case, customs duties and taxes must be paid with respect to transactions, receipts, income and sales of articles to the Customs Territory and in the Customs Territory</u>.' (Emphasis supplied)

5.7 Clearly, petitioner's receipts amounting to ₱22,984,353.84 are sales in the customs territory or outside the zone, thus, subjected to 12% VAT pursuant to Revenue Memorandum Circular No. 50-2007.

5.8 Section 2 of RMC No. 50-2007 clarifies tax treatment of sales transactions within [the] customs territory, viz:

> Generally, products manufactured or produced within the SFZ, CFZ, and PPFZ are destined for export to foreign countries. While such products under certain conditions, may also be sold to buyers in the customs territory, such sales are technically

> considered as importations by such buyers from the customs territory. Since these Freeport Zones, as defined by law, are considered as separate customs territories, the buyer from the customs territory is treated as an importer and is subject to the corresponding customs duties and import taxes on his purchase of products from within these Freeport Zones.'

5.9 Furthermore, petitioner cannot contend that it is not liable for VAT on its sales of services for being classified as a non-VAT entity. Needless to state, even assuming that petitioner is registered as non-VAT entity, its gross annual receipts far exceed the threshold provided under Section 109 of the Tax Code.

5.10 Hence, considering that verification showed that petitioner's gross receipts exceeded the ₱1,919,500 threshold, it cannot escape the fact that it is mandatorily subject to VAT.

6. x x x

6.1 The imposition of interest and surcharge on the deficiency assessment is pursuant to Sections 248 and 249 of the Tax Code.

6.2 It can be gleaned that for failure of petitioner to pay the VAT due within the period prescribed by law for paying the same, it is thus liable to pay interest and surcharge in accordance with the above provisions of the Tax Code.

6.3 Contrary to petitioner's allegation, there is no need to prove fraud/intentional violation before civil penalties are imposed as the law was enacted to ensure prompt payment of taxes."

The pre-trial conference was initially set on April 27, 2017.[14] However, upon the filing of petitioner's *Urgent Motion to Defer Pre-Trial Conference* on April 21, 2017[15] and respondent's *Motion to Reset Pre-Trial Conference* on April 24, 2017,[16] the Pre-Trial Conference was reset to,[17] and held on, May 25, 2017.[18]

Respondent's Pre-Trial Brief was filed on May 18, 2017,[19] while *Petitioner's Pre-Trial Brief* was filed on May 19, 2017.[20]

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[14] Notice of Pre-Trial Conference dated April 11, 2017, Docket – Vol. I, pp. 81 to 82.
[15] Docket – Vol. I, pp. 88 to 90.
[16] Docket – Vol. I, pp. 94 to 98.
[17] Order dated April 26, 2017, Docket – Vol. I, p. 99.
[18] Minutes of the hearing held on, and Order dated, May 25, 2017, Docket – Vol. I, pp. 199 to 200.
[19] Docket — Vol. I, pp. 115 to 120.
[20] Docket — Vol. I, pp. 187 to 196.

The *BIR Records* for the instant case was filed on May 18, 2017.[21]

The parties filed their *Joint Stipulation of Facts and Issues* on June 19, 2017,[22] which was approved and adopted in the Pre-Trial Order dated June 27, 2017.[23] The Court also deemed the Pre-Trial terminated.

During trial, petitioner presented its documentary and testimonial evidence. Petitioner offered the testimonies of the following individuals: Ms. Daisy A. Lacap,[24] petitioner's Accounting Manager; and Ms. Arlyn S. Villanueva,[25] the Court-commissioned Independent Certified Public Accountant (ICPA).

On October 12, 2017, petitioner filed its *Formal Offer of Evidence*.[26] Respondent filed his *Opposition Re: Petitioner's Formal Offer of Evidence* on October 23, 2017.[27]

In the Resolution dated February 15, 2018,[28] the Court admitted petitioner's Exhibits, except for the following: **Exhibits "P-15-1-823", "P-15-2-912", "P-15-2-1202", "P-15-2-1689", "P-15-2-1751", "P-15-2-1803", "P-15-2-1804", "P-15-2-1866", "P-15-2-1886", "P-15-3-136", "P-15-3-146", "P-15-3-166", "P-15-3-339", "P-15-3-432", "P-15-3-433", "P-15-3-458", "P-15-3-473", "P-15-3-537", "P-15-3-549", "P-15-3-635", "P-15-3-638", "P-15-3-1297", "P-15-3-1299", "P-15-3-1321", "P-15-3-1323", "P-15-3-1334", "P-15-3-1407", "P-15-3-1413", "P-15-3-1506", "P-15-3-1567", "P-15-3-1612", "P-15-3-1683", "P-15-3-1746", "P-15-3-1783" to "P-15-3-1784", "P-15-3-1824", "P-15-3-1891", "P-15-3-1907", "P-15-3-1933", "P-15-3-1949", "P-15-4-31", "P-15-4-325", "P-15-4-494", "P-15-4-553", "P-15-4-597", "P-15-4-608", "P-15-4-648", "P-15-4-678", "P-15-4-721", "P-15-4-723", "P-15-4-1085", "P-15-4-1922", "P-15-4-1947", "P-15-4-2000", "P-15-4-2010", "P-15-**

[21] Docket — Vol. I, pp. 121 to 123.
[22] Docket — Vol. I, pp. 214 to 221.
[23] Docket — Vol. I, pp. 223 to 226.
[24] Exhibit "P-13", Docket — Vol. I, pp. 127 to 138; Minutes of the hearing held on, and Order dated, July 3, 2017, Docket — Vol. I, pp. 227 to 228.
[25] *Oath of Commission* dated July 18, 2017, Docket — Vol. I, p. 247; Minutes of the hearing held on, and Order dated, July 20, 2017, Docket — Vol. I, pp. 248 to 249; Exhibit "P-16", Docket — Vol. I, pp. 260 to 265; Minutes of the hearing held on, and Order dated, October 2, 2017, Docket — Vol. I, pp. 266 to 267.
[26] Docket — Vol. I, pp. 268 to 282.
[27] Docket — Vol. I, pp. 342 to 345.
[28] Docket — Vol. I, pp. 348 to 354.

4-2013", "P-15-4-2062", "P-15-4-2154", "P-15-6-54", "P-15-6-175", "P-15-6-224", "P-15-6-306", "P-15-6-388", "P-15-6-415", "P-15-6-715", "P-15-6-1446" to "P-15-6-1530", "P-15-6-1561", "P-15-7-19", "P-15-7-1279", "P-15-7-1472", "P-15-8-23", "P-15-8-491", "P-15-8-540", "P-15-8-703", "P-15-8-797", "P-15-8-803", "P-15-8-808", "P-15-8-821", "P-15-8-826", "P-15-8-837", "P-15-8-854, "P-15-8-876", "P-15-8-895" to "P-15-8-896", "P-15-8-902", "P-15-8-907", "P-15-8-922", "P-15-8-927", "P-15-8-937", "P-15-8-947", "P-15-8-994", "P-15-8-1000", "P-15-8-1045", "P-15-8-1092" to "P-15-8-1094", "P-15-8-1099", "P-15-8-1114", "P-15-8-1132" to "P-15-8-1134", "P-15-8-1145" to "P-15-8-1146", "P-15-8-1176", "P-15-8-1187" to "P-15-8-1188", "P-15-8-1194" to "P-15-8-1196", "P-15-8-1201", "P-15-8-1214" to "P-15-8-1216", "P-15-8-1222", "P-15-8-1232" to "P-15-8-1234", "P-15-8-1240", "P-15-8-1247", "P-15-8-1262", "P-15-8-1263", "P-15-8-1268", "P-15-8-1274", "P-15-8-1280" to "P-15-8-1282", "P-15-8-1323", "P-15-8-1331" to "P-15-8-1332", "P-15-8-1361" to "P-15-8-1362", "P-15-8-1369", "P-15-8-1412", "P-15-8-1424", "P-15-8-1425", "P-15-8-1436", "P-15-8-1444" to "P-15-8-1446", "P-15-8-1474", "P-15-8-1516", "P-15-8-1617", "P-15-8-1648", "P-15-8-1657" to "P-15-8-1659", "P-15-8-1669", "P-15-8-1695", "P-15-8-1698", "P-15-8-1720", "P-15-8-1722, "P-15-8-1731", "P-15-8-1750, "P-15-8-1754" to "P-15-8-1756", "P-15-8-1761", "P-15-8-1769" to "P-15-8-1770", "P-15-8-1775", "P-15-8-1781", "P-15-8-1789", "P-15-8-1794", "P-15-8-1802", "P-15-8-1807", "P-15-8-1843" to "P-15-8-1845", "P-15-8-1847", "P-15-8-1849" to "P-15-8-1852", "P-15-8-1888" to "P-15-8-1889", "P-15-8-1896", "P-15-8-1902", "P-15-8-1915" to "P-15-8-1921", "P-15-8-1926", "P-15-8-1950" to "P-15-8-1951", "P-15-8-1964", "P-15-8-1967", "P-15-9-405", "P-15-9-615", "P-15-9-617", "P-15-9-687", "P-15-9-996", "P-15-9-1088", "P-15-9-1194", "P-15-9-1310", "P-15-9-1314", "P-15-9-1335", "P-15-11-67", "P-15-11-74", "P-15-11-80" to "P-15-11-82", "P-15-11-147" to "P-15-11-149", "P-15-11-171" to "P-15-11-174", "P-15-11-178" to "P-15-11-183", "P-15-11-187" to "P-15-11-190", "P-15-11-194" to "P-15-11-200", "P-15-11-203", "P-15-11-205", "P-15-11-209" to "P-15-11-211", "P-15-11-216" to "P-15-11-218", "P-15-11-237", "P-15-11-250", "P-15-11-266" to "P-15-11-268", "P-15-11-274" to "P-15-11-275", "P-15-11-280", "P-15-11-325" to "P-15-11-328", "P-15-11-345" to "P-15-11-349", "P-15-11-351", "P-15-11-353", "P-15-11-367" to "P-15-11-370", "P-15-11-375" to "P-15-11-376", "P-15-11-381", "P-15-11-392" to "P-15-11-394", "P-15-11-407", "P-15-11-

411", "P-15-11-415" to "P-15-11-417", "P-15-11-598" to "P-15-11-605", "P-15-11-608" to "P-15-11-609", "P-15-11-614" to "P-15-11-615", "P-15-11-622" to "P-15-11-626", "P-15-11-628", to "P-15-11-630", "P-15-11-635" to "P-15-11-636", "P-15-11-640", "P-15-11-657", "P-15-11-663" to "P-15-11-664", "P-15-11-668", "P-15-11-682", "P-15-11-700", "P-15-11-713" to "P-15-11-714", "P-15-11-799" to "P-15-11-800", "P-15-11-808" to "P-15-11-810", "P-15-11-812" to "P-15-11-815", "P-15-11-818" to "P-15-11-822", "P-15-11-826" to "P-15-11-827", "P-15-11-829" to "P-15-11-831", "P-15-11-834" to "P-15-11-835", "P-15-11-848", "P-15-11-864", "P-15-11-870" to "P-15-11-871", "P-15-11-873", "P-15-11-884" to "P-15-11-885", "P-15-11-919", "P-15-11-979" to "P-15-11-981", "P-15-11-997" to "P-15-11-1000", "P-15-11-1204", "P-15-11-1210", "P-15-11-1316", "P-15-13-5", "P-15-13-8", "P-15-13-12", "P-15-13-14" to "P-15-13-16", "P-15-13-18", "P-15-13-24", "P-15-13-27" to "P-15-13-28", "P-15-13-30", "P-15-13-32" to "P-15-13-34", "P-15-13-36" to "P-15-13-39", "P-15-13-46", "P-15-13-48" to "P-15-13-56", "P-15-13-58", "P-15-13-64", "P-15-13-67" to "P-15-13-69", "P-15-13-83" to "P-15-13-87", "P-15-13-89", "P-15-13-93" to "P-15-13-95", "P-15-13-101" to "P-15-13-102", "P-15-13-104" to "P-15-13-105", "P-15-13-116" to "P-15-13-119", "P-15-13-122" to "P-15-13-126", "P-15-13-128" to "P-15-13-131", "P-15-13-133" to "P-15-13-134", "P-15-13-140" to "P-15-13-142", "P-15-13-144" to "P-15-13-149", "P-15-13-155", "P-15-13-157" to "P-15-13-162", "P-15-13-164", "P-15-13-167" to "P-15-13-182", "P-15-13-185", "P-15-13-188" to "P-15-13-190", "P-15-13-193" to "P-15-13-194", "P-15-13-196", "P-15-13-198", "P-15-13-201", "P-15-13-203" to "P-15-13-204", "P-15-13-206" to "P-15-13-212", "P-15-13-214", "P-15-13-221", "P-15-14-27" (Unmetered ORs August 2014), P-15-14-7" (Unmetered ORs September 2014), and **"P-15-14-11" (Unmetered ORs December 2014)**, for not being found in the records of the case.

Thus, petitioner filed, *via* registered mail, its *Motion for Partial Reconsideration (Re: Resolution dated February 15, 2018)* on March 8, 2018.[29] Respondent, however, failed to file his comment thereon.[30]

[29] Docket — Vol. I, pp. 355 to 363.

[30] Records Verification dated April 18, 2018 issued by the Judicial Records Division of this Court, Docket – Vol. I, p. 367.

In the Resolution dated May 21, 2018,[31] the Court partially granted the above-stated Motion for Partial Reconsideration and admitted certain Exhibits, except for the following: **Exhibits "P-15-2-1689", "P-15-6-1447" to "P-15-6-1529", "P-15-8-23", "P-15-13-178" to "P-15-13-181", and "P-15-14-7" (Unmetered ORs September 2014)**, for not being found in the records of the case.

Undeterred, petitioner filed a *Submission with Motion for Reconsideration* on June 13, 2018, praying, among others, for the admission of Exhibits "P-15-14-7", "P-15-2-1689", "P-15-6-1447" to "P-15-6-1529", "P-15-8-23", and "P-15-13-178" to "P-15-13-181" as part of petitioner's evidence.[32] Respondent, however, failed to file his comment thereon.[33]

In the Resolution dated August 7, 2018,[34] the Court granted petitioner's Motion for Reconsideration and admitted the above-stated denied Exhibits.

On the other hand, respondent presented documentary as well as testimonial evidence. With respect to testimonial evidence, respondent offered the testimony of Mr. Jose Gil L. Reyes,[35] Revenue Officer IV of the BIR.

Thereafter, respondent filed his *Formal Offer of Evidence* on October 19, 2018.[36] Petitioner filed its *Comment (To Respondent's Formal Offer of Evidence)* on November 14, 2018.[37] The Court admitted all Exhibits offered by respondent in its Resolution dated January 22, 2019.[38]

In view of the filing of respondent's *Memorandum* on March 26, 2019,[39] and petitioner's *Memorandum* on April 10, 2019,[40] the case was deemed submitted for decision on April 22, 2019.[41]

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[31] Docket — Vol. II, pp. 369 to 372.
[32] Docket — Vol. II, pp. 382 to 389.
[33] Records Verification dated July 16, 2018 issued by the Judicial Records Division of this Court, Docket – Vol. II, p. 392.
[34] Docket — Vol. II, pp. 394 to 396.
[35] Exhibit "R-9", Docket – Vol. I, pp. 105 to 114; Minutes of the hearing held on, and Order dated, October 15, 2018, Docket – Vol. II, pp. 402 to 403.
[36] Docket — Vol. II, pp. 404 to 410.
[37] Docket — Vol. II, pp. 417 to 420.
[38] Docket — Vol. II, pp. 422 to 423.
[39] Docket — Vol. II, pp. 433 to 443.
[40] Docket — Vol. II, pp. 448 to 467.
[41] Resolution dated April 22, 2019, Docket — Vol. II, p.468.

THE ISSUES

The parties submitted the following issues[42] for the consideration of the Court:

"**For Petitioner:**

A. WHETHER OR NOT THE ALLEGED DEFICIENCY VAT FOR CY 2014 SHOULD BE CANCELLED AND WITHDRAWN FOR LACK OF ANY LEGAL AND/OR FACTUAL BASIS;

B. WHETHER OR NOT PETITIONER IS LIABLE FOR INTEREST AND SURCHARGE;

For Respondent:

C. WHETHER PETITIONER HAS NO LEGAL AND FACTUAL BASES IN PROTESTING THE VALIDITY OF THE ASSESSMENT FOR DEFICIENCY VALUE-ADDED TAX FOR TAXABLE YEAR 2014."

Petitioner's arguments:

Petitioner mainly argues that as a registered Clark Special Economic Zone (CSEZ) enterprise, pursuant to Section 15 of Republic Act (RA) No. 7227,[43] as amended by RA No. 9400,[44] it enjoys the preferential tax rate of 5% on its gross income, in lieu of all national and local taxes, unless it breaches the 30% threshold on its sales within the customs territory as mentioned in Section 8 of Department of Finance (DOF) No. 30-08.

Petitioner claims that the ICPA was able to ascertain that its revenues from enterprises located outside of the CSEZ territory constituted only 8.86% of petitioner's total revenue for CY 2014. On such basis, petitioner claims that its sales within the customs territory should not be subject to VAT. *je*

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[42] Par. 3, Issues, JSFI, Docket — Vol. I, p. 215.

[43] AN ACT ACCELERATING THE CONVERSION OF MILITARY RESERVATIONS INTO OTHER PRODUCTIVE USES, CREATING THE BASES CONVERSION AND DEVELOPMENT AUTHORITY FOR THIS PURPOSE, PROVIDING FUNDS THEREFOR AND FOR OTHER PURPOSES, March 13, 1992.

[44] AN ACT AMENDING REPUBLIC ACT NO. 7227, AS AMENDED, OTHERWISE KNOWN AS THE BASES CONVERSION AND DEVELOPMENT ACT OF 1992, AND FOR OTHER PURPOSES, March 20, 2007.

Respondent's counter-arguments:

Respondent, on the other hand, argues that petitioner's sale of services outside the Ecozone are subject to VAT based on the existing law, jurisprudence and implementing rules; that the alleged 5% preferential tax is not applicable to petitioner's sales transactions outside the Ecozone; and, that the subject interest and surcharge are correctly imposed.

THE COURT'S RULING

Notwithstanding the issues raised by the parties, this Court resolves to raise, and rule on, the following related issue, which it deems as necessary to achieve an orderly disposition of the instant case, before looking into the issues raised by the parties, if still warranted, to wit:

"**Whether or not the subject FLD is a valid assessment.**"

It must be stressed that the instant Petition for Review seeks the cancellation and withdrawal of respondent's assessment against petitioner for alleged deficiency VAT for CY 2014 in the total amount of ₱4,366,648.49, inclusive of interest and penalties. Thus, it is proper to primarily resolve the issue raised by this Court.

Moreover, there is legal basis that concedes authority for the Court to resolve the same issue.

Legal basis to resolve the foregoing issue.

Section 1, Rule 14 of the 2005 Revised Rules of the Court of Tax Appeals reads as follows:

> "RULE 14
> JUDGMENT, ITS ENTRY AND EXECUTION
>
> SECTION 1. – Rendition of judgment – xxx
>
> **In deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case.**" *(Emphasis supplied)*

Based on the foregoing provision, this Court is not bound by the issues specifically raised by the parties, but may also rule upon related issues necessary to achieve an orderly disposition of the case. Such power of this Court is confirmed and recognized by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Lancaster Philippines, Inc.*,[45] *viz*:

> "**On whether the CTA can resolve an issue which was not raised by the parties, <u>we rule in the affirmative</u>.**
>
> **Under Section 1, Rule 14 of A.M. No. 05-11-07-CTA, or the Revised Rules of the Court of Tax Appeals, the CTA is not bound by the issues specifically raised by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case.** The text of the provision reads:
>
> > **SECTION 1. *Rendition of judgment.* – xxx**
> >
> > **In deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case.**
>
> **The above section is clearly worded.** On the basis thereof, the CTA Division was, therefore, well within its authority to consider in its decision the question on the scope of authority of the revenue officers who were named in the LOA even though the parties had not raised the same in their pleadings or memoranda. The CTA En Banc was likewise correct in sustaining the CTA Division's view concerning such matter." *(Emphases ours)*

Furthermore, in *Commissioner of Internal Revenue vs. Eastern Telecommunications Philippines, Inc.*,[46] the Supreme Court held:

> "The general rule is that appeals can only raise questions of law or fact that (a) were raised in the court below, and (b) are within the issues framed by the parties therein. An issue which was neither averred in the pleadings nor raised during trial in the court below cannot be raised for the first time on appeal. The rule was made for the benefit of the adverse party and the trial court as well. Raising new issues at the appeal level is offensive to the basic rules of fair play and justice and is violative of a party's constitutional right to due process of law. Moreover, the trial court should be

[45] G.R. No. 183408, July 12, 2017.
[46] G.R. No. 163835, July 7, 2010.

> given a meaningful opportunity to consider and pass upon all the issues, and to avoid or correct any alleged errors before those issues or errors become the basis for an appeal.
>
> xxx xxx xxx
>
> **The rule against raising new issues on appeal is not without exceptions; it is a procedural rule that the Court may relax <u>when compelling reasons so warrant or when justice requires it</u>. What constitutes good and sufficient cause that would merit suspension of the rules is <u>discretionary upon the courts</u>.** Former Senator Vicente Francisco, a noted authority in procedural law, cites an instance when the appellate court may take up an issue for the first time:
>
> > **<u>The appellate court may, in the interest of justice, properly take into consideration in deciding the case *matters of record* having some bearing on the issue submitted which the parties failed to raise or the lower court ignore, although they have not been specifically raised as issues by the pleadings</u>.** This is in consonance with the liberal spirit that pervades the Rules of Court, and the modern trend of procedure which accord the courts broad discretionary power, consistent with the orderly administration of justice, in the decision of cases brought before them. [Emphasis supplied.]
>
> xxx xxx xxx
>
> **<u>Another exemption from the rule against raising new issues on appeal is when the question involves matters of public importance</u>**." (*Emphases and underscoring ours)*

On the basis of the foregoing doctrinal pronouncements, it is clear that while it is a general rule that appeals can only raise questions of law or fact that (a) were raised in the court below, and (b) are within the issues framed by the parties therein, the same admits of certain exceptions, namely, (i) in the interest of justice, matters of record having some bearing on the issue submitted which the parties failed to raise or the lower court ignore, and (ii) questions involving matters of public importance.

In this case, whether or not the subject tax assessment is valid is a matter of record, and of *public importance*. The said issue is a *matter of record* because the parties submitted their respective evidence to establish what transpired in the proceedings *a quo*, and thus, could be resolved by simply referring to the same evidence. Moreover, the issue raised by this Court has some bearing on the issues submitted by the parties. Furthermore, the same issue can be deemed as *matter of public importance*, simply because a void assessment bears no valid fruit.[47] Taxpayers, including petitioner, must not be held liable under an invalid tax assessment.

Correspondingly, We see no legal obstacle to resolve the above-stated issue raised by this Court.

The subject VAT assessment is void since petitioner's tax liability remains indefinite.

In *Commissioner of Internal Revenue vs. Fitness By Design, Inc.*,[48] the Supreme Court ruled:

> "The issuance of a valid formal assessment is a substantive prerequisite for collection of taxes. Neither the National Internal Revenue Code nor the revenue regulations provide for a 'specific definition or form of an assessment.' However, the National Internal Revenue Code defines its explicit functions and effects. An assessment does not only include a computation of tax liabilities; it also includes a demand for payment within a period prescribed. Its main purpose is to determine the amount that a taxpayer is liable to pay.
>
> xxx xxx xxx
>
> A final assessment is a notice 'to the effect that the amount therein stated is due as tax and a demand for payment thereof.' This demand for payment signals the time 'when the penalties and interests begin to accrue against the taxpayer and enabling the latter to determine his remedies[.]' Thus, it must be 'sent to and received by the taxpayer, and must demand payment of the taxes described therein within a specific period.'
>
> The disputed Final Assessment Notice is not a valid assessment.
>
> First, it lacks the definite amount of tax liability for which respondent is accountable. It does not purport to be a demand for payment of tax due, which a final assessment notice should supposedly be. An assessment, in the context of the National Internal Revenue Code, is a 'written notice and demand made by the [Bureau of Internal Revenue] on the taxpayer for the settlement of a due tax liability that is there definitely set and fixed.' Although the disputed notice provides for the computation of respondent's tax liability, the amount remains indefinite. It only provides that the tax

[47] *Samar-I Electric Cooperative vs. Commissioner of Internal Revenue*, G.R. No. 193100, December 10, 2014.
[48] G.R. No. 215957, November 9, 2016.

> due is still subject to modification, depending on the date of payment. Thus:
>
> > The complete details covering the aforementioned discrepancies established during the investigation of this case are shown in the accompanying Annex 1 of this Notice. The 50% surcharge and 20% interest have been imposed pursuant to Sections 248 and 249 (B) of the [National Internal Revenue Code], as amended. Please note, *however, that the interest and the total amount due will have to be adjusted if prior or beyond April 15, 2004*." (*Underscoring supplied and citations omitted*)

In *Fitness By Design*, the Supreme Court concluded that the disputed Final Assessment Notice was *not* a valid assessment because it did "not purport to be a *demand for payment* of tax due, which a final assessment notice should supposedly be."

To demand means to "require (a person) to do"[49] and is also defined as "the assertion of a legal right", "an imperative xxx by one person to another under a claim of right, requiring the latter to do or yield something or to abstain from some act."[50] A demand is "a claim, a legal obligation xxx a thing or amount claimed to be due"[51]

In this case, an examination of the tenor of the FLD dated September 19, 2016[52] would reveal that there is *no* demand or requirement for the taxpayer to pay the taxes due. The phrase "you are *requested* to pay your deficiency value-added" negates the imperative nature of the requirement to pay as it gives the taxpayer the option *not* to pay if it is not amenable to the assessment:

> "**FORMAL LETTER OF DEMAND**
>
> **CLARK WATER CORPORATION**
> Depot 1901 Bicentennial Hill, CSEZ
> Clarkfield, Pampanga
> TIN: 205-334-965
>
> Gentlemen:
>
> Please be informed that after investigation, there have been found due from you deficiency value added tax for the taxable year 2014, as shown hereunder:

[49] Shorter Oxford English Dictionary (6th Edition), Vol. I, p. 639.
[50] Black's Law Dictionary (Abridged 5th Edition), pp. 223-224.
[51] Words and Phrases Permanent Edition, Vol. 12, p. 18.
[52] Exhibit "P-8", Docket — Vol. I, pp. 312 to 313.

Assessment No: 21AR1504041909

xxx xxx xxx

Please note that the interest and total amount due will have to be adjusted if paid beyond October 31, 2016.

The complete details covering the aforementioned discrepancies established during the investigation of this case are shown in the accompanying ANNEX A.

The 25% surcharge was imposed following the provision of Section 248(A) of the National Internal Revenue Code.

The 20% interest per annum was imposed following the provisions of Section 249(B) of the NIRC.

Compromise penalties were imposed pursuant to RMO 7-2015.

In view thereof, you are requested to pay your deficiency value-added tax through the duly authorized agent bank in which you are enrolled within the time shown in the enclosed assessment notice.

We hope that you will give this matter your preferential attention."

Very truly yours,

(SIGNED)
ATTY. JETHRO M. SABARIAGA
OIC-Regional Director"

(Underscoring supplied)

Secondly, the FLD lacks the definite amount of tax liability for which petitioner is accountable. Specifically, the FLD states that the interest will still *"the interest and total amount due will have to be adjusted if paid beyond October 31, 2016."* Similar to the facts in *Fitness By Design*, although the disputed notice provides for a computation of petitioner's VAT liability, the amount thereof remains indefinite, since the said tax assessment is still subject to modification or adjustment, depending on the date of payment by petitioner.

Accordingly, the FLD is deficient according to the standards set in *Fitness by Design.* Such being the case, the subject VAT assessment is void, and thus, bears no valid fruit.[53]

[53] Refer to *Commissioner of Internal Revenue vs. Reyes*, G.R. Nos. 159694 and 163581, January 27, 2006.

Petitioner is not liable to pay the subject compromise penalty.

Since the subject VAT assessment is void, petitioner cannot likewise be held liable to the compromise penalty in the amount of ₱40,000.00.

It must be stressed that a compromise is, by its nature, mutual in essence.[54] It implies agreement. One party cannot impose it upon the other.[55] Compromise penalties are only amounts suggested in settlement of criminal liability and may not be imposed or exacted on the taxpayer in the event of refusal to pay the suggested amount.[56] Considering that there is no indication that petitioner consented to the subject compromise penalty, the said amount cannot be sustained.

In view of the finding that the subject assessment is invalid and the subject compromise penalty may not be imposed in this case, it becomes unnecessary to address the other issues and arguments raised by the parties.

WHEREFORE, in light of the foregoing considerations, the assailed subject assessment and FDDA holding petitioner liable for deficiency VAT in the amount of ₱4,366,648.49, inclusive of surcharge, interests and compromise penalty for CY 2014 is **CANCELLED** and **SET ASIDE**.

SO ORDERED.

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

WE CONCUR:

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

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[54] Refer to *Vda. De San Agustin vs. Commissioner of Internal Revenue*, G.R. No. 138485, September 10, 2001.
[55] *Commissioner of Internal Revenue vs. Abad, et al.*, G.R. No. L-19627, June 27, 1968.
[56] Refer to Part III.4, Revenue Memorandum Order No. 7-2015.

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

ATTESTATION

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

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice