REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

KEPCO PHILIPPINES CORPORATION, *Petitioner,*	**CTA CASE NO. 8319**
	Members:
-versus-	Del Rosario, *Chairperson* Uy, *and* Mindaro-Grulla, *JJ.*
THE COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Promulgated: NOV 07 2013 ; 1:00 p.m.

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DECISION

DEL ROSARIO, P.J.:

This is a Petition for Review filed by Kepco Philippines Corporation praying for the reversal and setting aside of the Final Decision on Disputed Assessment (FDDA) issued by the Commissioner of Internal Revenue (CIR) assessing petitioner for deficiency value-added tax (VAT) in the amount of ₱75,901,681.19, inclusive of interest and compromise penalty, for taxable year 2007.

THE FACTS

Petitioner Kepco Philippines Corporation is a domestic corporation duly organized and existing under the laws of the Republic of Philippines, with principal place of business at the 18th Floor Citibank Tower, 8741 Paseo de Roxas, Salcedo Village, Makati City.[1] The primary purpose of its incorporation is to "rehabilitate, operate, maintain and manage the Malaya Power Complex in Pililia, Rizal, Philippines and other power generating plants and related facilities for the conversion into electricity of fuel: provided, that, in no event shall the corporation itself engage in the general supply or distribution of electricity in retail trade or in the business of a public utility, or furnish electricity to end-users or consumers, or provide a

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[1] Par. 1, Facts Admitted, Joint Stipulation of Facts and Issue, CTA Docket, p. 141.

public service, or engage in industries or activities reserved by the Constitution or by law to corporations wholly or partially-owned by Filipino citizen."[2]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR), empowered to perform the duties of her office, including, among others, the power to decide disputed assessments, and such other matters vested in her in the National Internal Revenue Code (NIRC) and other special laws. She holds office at the BIR National Office Building, BIR Road, Diliman, Quezon City.

Petitioner extended financial assistance to its affiliates Kepco Ilijan Corporation (KEILCO) and Kepco Philippines Holdings, Inc. (KPHI) through loans with interest.[3]

KPHI is a corporation duly organized and existing under the laws of the Republic of the Philippines. Its primary purpose is to "invest in, purchase, or otherwise acquire and own, hold, use, sell, assign, transfer, mortgage, pledge, exchange, or otherwise dispose of real or personal property of every kind and description, including shares of stocks, bonds, debentures, notes, evidence of indebtedness, and other securities or obligations of any corporation or corporations, association or associations, domestic or foreign, for whatever lawful purpose or purposes the same may have been organized and to pay thereof in money or by exchanging thereof stocks, bonds or other evidence of indebtedness or securities of this or any other corporation, and while the owner or holder of any such real or personal property, stocks, bonds, debentures, contracts, or obligations, to receive, collect and dispose of the interest, dividends, and income arising from such property; and to possess and exercise in respect thereof all rights, powers and privileges ownership to the full extent permitted by law, including all voting powers of any stock so owned."[4]

KEILCO is likewise a corporation duly organized and existing under the laws of the Republic of the Philippines.[5] Its primary purpose is to "build, operate, maintain and manage the 1251 MW combined-cycle power plant in Ilijan, Batangas, Philippines."[6]

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[2] Exhibit "M-1", CTA Docket, p. 443.
[3] Exhibits "C", "C-1", and G", CTA Docket, pp. 372 and 406.
[4] Exhibit "E", CTA Docket, pp. 395-402.
[5] Exhibit "J", CTA Docket, pp. 410-422.
[6] Exhibit "J-1", CTA Docket, p. 411.

On April 15, 2008, petitioner filed its Annual Income Tax Return[7] for taxable year 2007.

Respondent issued Letter of Authority No. 2007-00017814 for the examination of petitioner's books of accounts and other accounting records for all internal revenue taxes for the period covering January 1, 2007 to December 31, 2007.[8] Consequently, the revenue officers issued a letter[9] to petitioner requesting the latter to submit its books of accounts and related records pertaining to the above-mentioned taxable period. Upon failure of petitioner to comply with the said letter,[10] a Second Request for Presentation of Records[11] dated October 16, 2008 was issued to petitioner on October 17, 2008. Subsequently, a Final Notice[12] dated May 18, 2009 was issued by respondent for failure of petitioner to submit the documents requested by the former despite of the two request letters.

After investigation, respondent found deficiency taxes due from petitioner;[13] thus, the former sent a letter to the latter requesting an informal conference.[14]

On December 6, 2010, respondent issued the Preliminary Assessment Notice[15] and Details of Discrepancies[16] against petitioner, wherein she assessed petitioner for alleged deficiency income tax, deficiency value-added tax, deficiency withholding tax on compensation, deficiency expanded withholding tax, deficiency final withholding tax, deficiency fringe benefits tax, and compromise penalty for non-filing of BIR Form No. 1707 and non-filing of return on withholding VAT on Technical Service Fees (TSF). Likewise, respondent issued a Formal Letter of Demand[17] on December 22, 2010 with attached details of discrepancy[18] and assessment notices,[19] which were received by petitioner on that same day.[20]

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[7] Exhibit "K", CTA Docket, pp. 423-425.
[8] Exhibit "1", BIR Records, p. 53.
[9] Exhibit "2", BIR Records, p. 55.
[10] Question and Answer No. 13, Exhibit "27", CTA Docket, p. 514.
[11] Exhibit "3", BIR Records, p. 56.
[12] Exhibit "4", BIR Records, p. 58.
[13] Exhibit "6". BIR Records, p. 5.
[14] Exhibit "5", BIR Records, p. 6.
[15] Exhibit "7", BIR Records, p. 30.
[16] Exhibit "8", BIR Records, p. 27.
[17] Exhibit "9", BIR Records, p. 36.
[18] Exhibit "10", BIR Records, p. 48.
[19] Exhibits "11" to "18", BIR Records, p. 38-45; Exhibit "A", CTA Docket, pp. 348-350.
[20] Exhibit "A-1", CTA Docket, p. 348.

On January 21, 2011, petitioner filed its Letter of Protest[21] against the Formal Letter of Demand.

Acting on the protest letter of petitioner, respondent conducted a reinvestigation of the case.[22] After the reinvestigation, a Final Decision on Disputed Assessment,[23] with attached Details of Discrepancies[24] and Audit Result/Assessment Notice,[25] was issued on July 13, 2011.[26]

On August 11, 2011, petitioner filed this Petition for Review.

Respondent interposed in her Answer[27] the following special and affirmative defenses:

> "10. xxx xxx xxx.
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> 11. Petitioner Kepco Philippines Corporation, is liable to pay its deficiency value added tax in the amount of Seventy Five Million Nine Hundred One Thousand Six Hundred Eighty One Pesos and 19/100 (P75,901,681.19) on the interest income earned on loans extended to its affiliates for taxable year 2007 for the following reasons:
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> 11.1 Petitioner is liable for value added tax when in the course of trade or business, it sells, barters, exchanges, leases goods or properties and renders services. This is within the purview of Section 105 of the National Internal Revenue Code of 1997 (NIRC of 1997), as amended, which is quoted below:
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> xxx xxx xxx
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> 11.2 Section 105 of the NIRC of 1997 must be read in conjunction with Sections 108, which is hereunder quoted for ready reference:
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> xxx xxx xxx
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> 11.3 The provisions of Section 105 of the NIRC of 1997, as amended clearly provides that any person who in the course of its trade or business, sells, barters, exchanges, leases goods or

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[21] Exhibits "B" and "B-1", CTA Docket, pp. 362-371.
[22] Exhibit "19", BIR Records, p. 120.
[23] Exhibit "25", BIR Records, p. 140.
[24] Exhibit "26", BIR Records, p. 136.
[25] Exhibit "24", BIR Records, p. 138.
[26] Exhibit "27"; CTA Docket, p. 513-520, 519.
[27] CTA Docket, pp. 111-119.

properties and renders services shall be subject to value added tax imposed in Section 106 or 108 of the NIRC of 1997, as amended.

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 non-stock, non-profit private organization or government entity.

11.4 Loan assistance extended by petitioner to its affiliates, being incidental to its business, is deemed a transaction 'in the course of trade and business'. The term 'incidental' means depending upon or appertaining to something else primary; something necessary appertaining to, or depending upon another, which is termed the principal; something incidental to the main purpose. Moreover, if the income from the main business activity is subject to value added tax, the incidental income shall also be subject to value added tax. Thus, the interest income earned by petitioner from the loans extended to its affiliates is subject to value added tax.

11.5 Furthermore, Section 108 of the NIRC of 1997, as amended defines the phrase sale of service as the performance of all kinds of services for others for a fee, remuneration or consideration. Hence, when petitioner extended interest bearing loans to its affiliates, it provided financial assistance for a fee or remuneration or consideration, regardless, whether petitioner has realized profit or not, such financial assistance is considered as sale of service that is subject to value-added tax.

12. It is a well-settled rule in taxation that the burden of proof is on the taxpayer to present evidence to show the incorrectness of the assessment.

13. The assessment in the amount of P75,901,681.19 was issued in accordance with law and regulations.

14. Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner, and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments *(Sy Po vs. Court of tax Appeals, 164 SCRA 524)*. Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notices."

Respondent's Pre-trial Brief[28] and petitioner's Pre-trial Brief[29] were filed on October 19, 2011 and November 4, 2011, respectively.

The parties filed their Joint Stipulation of Facts and Issue[30] on November 23, 2011. In the Resolution[31] dated November 25, 2011, this Court approved the same and terminated the pre-trial.

During trial, petitioner presented its witnesses, namely: Jennylin Layson and Marvin Chan. On the other hand, respondent presented her sole witness Ofelia P. Gratuito. Both parties submitted their respective documentary evidence.

Upon consideration of the respective Memoranda[32] of petitioner and respondent which were filed on July 2, 2013 and June 28, 2013, respectively, the case was submitted for decision on July 10, 2013.[33]

THE ISSUE

The issue raised for this Court's resolution is whether or not petitioner is liable to pay the assessed VAT on the interest income on the loans it extended to its affiliates, KEPCO Ilijan Corporation (KEILCO) and KEPCO SPC Power Corporation (KSCP), during the taxable year 2007.[34]

Records show, however, that the loans were extended to KEILCO and KPHI (and not to KSCP).[35] Thus, this Court shall rule on the issue of whether or not petitioner is liable to pay the assessed VAT on the interest income on the loans it extended to its affiliates, KEILCO and KPHI, during the taxable year 2007.

THE COURT'S RULING

The petition for review has no merit.

[28] CTA Docket, pp. 123-128.
[29] CTA Docket, pp. 130-134.
[30] CTA Docket, pp. 141-142.
[31] CTA Docket, p. 140.
[32] CTA Docket, pp. 590-606 and 581-588.
[33] Resolution, CTA Docket, p. 608.
[34] CTA Docket, p. 142.
[35] CTA Docket, pp. 9, 21,430 to 437, 482 to 487 and 592 to 594.

In arguing that it is not liable to pay the assessed VAT on the interest income on the loans it extended to its affiliates during the taxable year 2007, petitioner posits that its sole purpose is only to rehabilitate, operate, manage and sell electricity it generates from the Malaya Thermal Power Plant to the National Power Corporation, and the loans it extended to its affiliates were mere financial assistance. It explains that the loan extended to KEILCO on November 10, 2000 was to allow the latter to pursue the construction of its 1200 MW Ilijan Power Plant from 1999 to 2002; while the loan, which was given to KPHI on February 10, 2006, was for KPHI to purchase shares of stocks in Salcon Power Corporation, a publicly listed power generation company operating in the Province of Cebu.

Petitioner likewise argues that the interest income earned from the said loans was duly reported and the corresponding income tax thereon was paid. It points out that its basis for not imposing any VAT on the loans extended to the affiliates is BIR VAT Ruling No. 015-04 dated May 18, 2004. Further, it states that under Revenue Memorandum Circular (RMC) No. 42-2003 dated July 15, 2003, the BIR clarified that the only time that VAT is imposable on interest income on loans is when the taxpayer qualifies as a lending investor, dealer of securities, financial institution as the term is defined under Revenue Regulations (RR) No. 12-2003.

Petitioner also suggests that the decision of the Court of Tax Appeals (CTA) in the *Lapanday case*[36] has been relied upon by respondent in making the assessment of deficiency VAT on interest income. Yet, in the *Lapanday case*, the very nature of the business of Lapanday is to extend loans and other types of assistance to other corporations. Thus, when Lapanday extended or granted the loan to its affiliate, it was merely in the furtherance of its main purpose. It further cites the cases of *Waterfront Philippines Inc. vs. Commissioner of Internal Revenue*[37] and *Ongtenco vs. Commissioner of Internal Revenue,*[38] wherein the CTA held the non-VAT liability of interest income arising from loans extended merely for purposes of helping another company or entity to address certain financial needs or conditions.

On the other hand, respondent posits that the provision of Section 105 of the NIRC of 1997, as amended, clearly provides that any person who in the course of its trade or business, sells, barters, exchanges, leases goods or properties and renders services shall be subject to VAT imposed in Section 106 or 108 of the NIRC of 1997, as amended. 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

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[36] *Lapanday Foods Corporation vs. Commissioner of Internal Revenue*, CTA EB No. 367, January 29, 2009.
[37] CTA Case No. 8024, November 13, 2012.
[38] CTA Case No. 8190, December 12, 2012.

person regardless of whether or not the person engaged therein is a non-stock, non-profit private organization or government entity. Respondent asserts that interest income on loan assistance extended by petitioner to its affiliates, being incidental to its business, is deemed a transaction in the course of trade and business. The term "incidental" means depending upon or appertaining to something else primary; something necessary appertaining to, or depending upon another, which is termed the principal; something incidental to the main purpose.

Respondent further contends that if the income from the main business activity is subject to VAT, the incidental income shall also be subject to VAT. Thus, the interest income earned by petitioner from the loans extended to its affiliates is subject to VAT. According to respondent, Section 108 of the NIRC of 1997, as amended, defines the phrase "sale of service" as the performance of all kinds of services for others for a fee, remuneration or consideration. Hence, when petitioner extended interest bearing loans to its affiliates, it provided financial assistance for a fee or remuneration or consideration, regardless of whether petitioner has realized profit or not. Such financial assistance is considered as sale of service that is subject to value-added tax. Respondent insists that in the absence of proof to the contrary, petitioner is liable for deficiency VAT for taxable year 2007 because the presumption under the law is in favor of the correctness of tax assessments.

Section 105 of the NIRC of 1997 states that:

> "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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> The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.
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> 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.
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> The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by nonresident foreign

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> persons shall be considered as being rendered in the course of trade or business." *(Emphasis supplied)*

Pertinent thereto, Section 108 of the NIRC of 1997, as amended, provides:

> "SEC. 108. *Valued-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 the 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:
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> 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**. xxx" *(Emphasis supplied)*

Based on the foregoing provisions, any person who performs any kind of services for a fee, remuneration or consideration including those specifically mentioned above and similar services in the course of trade or business is subject to value-added tax.

Moreover, in *Renato V. Diaz and Aurora Ma. F. Timbol vs. The Secretary of Finance and The Commissioner of Internal Revenue,*[39] the Supreme Court held:

> "It is plain from the above that the law imposes VAT on 'all kinds of services' rendered in the Philippines for a fee, including those specified in the list. The enumeration of affected services is not exclusive. By qualifying 'services' with the words 'all kinds,' Congress has given the term 'services' an all-encompassing meaning. The listing of specific services are intended to illustrate how pervasive and broad is the VAT's reach rather than establish concrete limits to its application. Thus, every activity that can be imagined as a form of 'service' rendered for a fee should be deemed included unless some provision of law especially excludes it." (Citation omitted)

In the present case, petitioner extended financial assistance through loans with interest to its affiliates. It falls under similar services as that of a lending investor. This act is clearly a performance of service for a fee, remuneration or consideration within the context of Sec. 108, *supra*.

Furthermore, the provision of Section 105 of the NIRC of 1997 is clear and categorical in stating that a person shall be liable to VAT when the sale of services is done in the ordinary course of trade or business. The phrase "in the course of trade or business" connotes regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto.[40]

A transaction will be characterized as having been entered into by a person in the course of trade or business, if it is regularly conducted and undertaken in pursuit of a commercial or economic activity.[41] Transactions that are undertaken incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business. "Incidental" means something else as primary; something necessary, appertaining to, or depending upon another, which is termed principal.[42]

There is no denying that petitioner is a power generating company. Its primary purpose is to rehabilitate, operate, maintain and manage the Malaya Power Complex in Pililia, Rizal, Philippines and other power generating plants and related facilities for the conversion into electricity of fuel.[43]

[39] G.R. No. 193007, July 19, 2011.
[40] Value Added Tax 2007 Edition, Victorino C. Mamalateo, p. 82.
[41] CS Garments, Inc. vs. Commissioner of Internal Revenue, CTA EB No. 287, January 14, 2008.
[42] *Ibid.*
[43] Exhibit "M-1", CTA Docket, p. 443.

Petitioner's purpose of extending loan to its affiliate KEILCO in 2000 was to give financial assistance in order for the latter to design, construct, furnish, install, test, commission, own, operate and maintain a 1251 MW natural gas fired combined cycle generating plant with diesel fuel firing capability to be located at Ilijan, Batangas City.[44] On the other hand, the purpose of the loan given to petitioner's affiliate KPHI on February 10, 2006 was for KPHI to purchase shares of stocks in Salcon Power Corporation (SPC), a publicly listed power generation company operating in the Province of Cebu.[45]

Petitioner assisted its affiliate KEILCO in operating and maintaining other power generating plant located at Ilijan, Batangas. Petitioner also extended financial assistance to KPHI in order for the latter to acquire shares of stock in other generating plant (Salcon Power Corporation). In a sense, petitioner acts through its affiliates in pursuing its primary purpose of rehabilitating, operating, maintaining and managing other power generating plants and related facilities for the conversion into electricity of fuel.

Further, upon careful examination of the records, this Court finds that one of the secondary purposes of petitioner is to "aid in any manner any corporation, association, or trust, estate, domestic or foreign, or any firm or individual xxx."[46] In extending loans with interest to its affiliates, petitioner performed services which are incidental to its business. The financial assistance given by petitioner, being incidental to its business, is deemed a transaction in the course of its trade or business.

The CTA *En Banc,* in the case of *Lapanday Foods Corporation vs. Commissioner of Internal Revenue,*[47] made a similar ruling, to wit:

> "Petitioner argues that the First Division erred in finding that the interest income on loans extended by petitioner to its affiliates is subject to VAT; it is not a lending investor nor a dealer in securities or a financing company; it does not lend money to clients or customers in the ordinary course of trade or business and does not even habitually extend loans to its affiliates.
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> Petitioner's contention has also no merit.

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[44] Exhibit "C", CTA Docket, p. 372.
[45] Judicial Affidavit of Ms. Jennylin Layson marked as Exhibit. "L", CTA Docket, p. 433.
[46] Exhibit "M", CTA Docket, p. 444.
[47] CTA EB No. 367 (CTA Case No. 7097), January 29, 2009.

> Section 105 of the NIRC of 1997, as amended, provides:
>
> 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.
>
> The rule of regularity, to the contrary, notwithstanding, services as defined in this Code rendered in the Philippines by nonresident foreign persons shall be considered as being rendered in the course of trade or business.'

Pursuant to the above provision, any person who, in the course of his trade or business, sells, barters, exchanges or leases goods or properties, or renders services shall be liable to VAT imposed in Section 106 or Section 108 of the NIRC of 1997, as amended.

In the case at bench, petitioner is a domestic corporation engaged in managing, promoting, administering or assisting in any business or activity of corporations, partnerships, associations, individual or firm *(Exhibit 'F-1')*. When petitioner extended loans to its affiliates, it provided assistance to corporations, and thus performed services incidental to its business.

Furthermore, the loan assistance provided by petitioner to its affiliates, being incidental to its business, is deemed a transaction 'in the course of trade and business'. The phrase 'in the course of trade and business' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto *(Value Added Tax, Mamalateo, p. 82 [2007])*. 'Incidental' means depending upon or appertaining to something else primary; something necessary appertaining to, or depending upon another, which is termed the principal; something incidental to the main purpose *(Black's Law Dictionary, 6th ed. p. 762)*.

Considering the foregoing, We hold that the income generated by petitioner from the loans granted to its affiliates is subject to VAT, pursuant to Section 105, in relation to Section 108 of the NIRC of 1997, as amended.

In addition, if the income from the main business activity is subject to VAT, the incidental income shall also be subject to VAT, provided that there is no particular provision applicable to the specific transaction *(Value Added Tax, Mamalateo, p. 83 [2007])*. Considering that petitioner's income from its management services is subject to VAT, it necessarily follows then, that the interests from loan which is an incidental income, is also subject to VAT.

Petitioner further contends that it does not profit from lending to its affiliates, as the interest charged by the bank which funded the loans was the interest passed on to the affiliates; the loans were just an accommodation and the only reason why petitioner charged interest on the loans was to comply with Revenue Memorandum Order No. 63-99 dated July 19, 1999; and Revenue Memorandum Circular 43-2003 dated July 15, 2003 expressly provides that interest income on loans is subject to VAT only if the lender qualifies as a lending investor, dealer in securities, financial institution.

Again, this contention of the petitioner has no merit.

In the case of *Commissioner of Internal Revenue vs. Court of Appeals and Commonwealth Management and Services Corporation, 329 SCRA 237, 245*, the Supreme Court ruled:

> 'Section 108 of the National Internal Revenue Code of 1997 defines the phrase 'sale of service' as the 'performance of all kinds of services for others for a fee, remuneration or consideration'. It includes 'the supply of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking or project'.
>
> On February 5, 1998, the Commissioner of Internal Revenue issued BIR Ruling No. 010-98 emphasizing that a domestic corporation that provided technical, research, management and technical assistance to its affiliated companies and received payments on a reimbursement-of-cost basis, without any intention of realizing profit, was subject to VAT on services rendered. In fact, even if such corporation was organized without any intention of realizing profit, any income or profit generated by the entity in the conduct of its activities was subject to income tax.
>
> Hence, it is immaterial whether the primary purpose of a corporation indicates that it receives payments for services rendered to its affiliates on a reimbursement-on-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. As long as the entity provides service for a fee, remuneration or consideration, then the service rendered is subject to VAT.'

> Pursuant to the above ruling of the Supreme Court, petitioner's income from loans extended to its affiliates is subject to VAT. Whether petitioner has realized profit or not is insignificant, as long as the petitioner has provided financial assistance or services for a fee, remuneration or consideration, such service rendered is subject to VAT."

Based on the foregoing, this Court holds that petitioner is liable to pay the amount of ₱45,630,560.78 representing the basic deficiency VAT imposed on the ₱380,254,673.15 interest income that petitioner derived from the loans it extended to its affiliates for taxable year 2007.

The compromise penalty imposed by respondent in the amount of ₱50,000.00 cannot, however, be sustained. Under Revenue Memorandum Order No. 01-90, compromise penalties are only amounts suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same. Thus, compromise penalties imply mutual agreement between the taxpayer, on one hand, and the Commissioner of Internal Revenue, on the other. Absence of any showing that petitioner consented to the compromise penalty, the same should not be imposed.

WHEREFORE, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the compromise penalty imposed by respondent for taxable year 2007 in the amount of ₱50,000.00 is hereby **CANCELLED AND WITHDRAWN**. The deficiency VAT assessment for taxable year 2007 is however **AFFIRMED** with **MODIFICATIONS**. Petitioner is hereby **ORDERED TO PAY** respondent the amount of **FIFTY-SEVEN MILLION THIRTY-EIGHT THOUSAND TWO HUNDRED PESOS and 98/100 (₱57,038,200.98)**, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Basic Deficiency VAT	₱ 45,630,560.78
25% Surcharge	11,407,640.20
Total	**₱57,038,200.98**

In addition, petitioner is likewise **ORDERED TO PAY**:

(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT of ₱45,630,560.78 computed from January 25, 2008 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) delinquency interest at the rate of 20% per annum on the total amount of ₱57,038,200.98 and on the 20% deficiency interest which have accrued as afore-stated, computed from July 13, 2011 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

ROMAN G. DEL ROSARIO
Presiding Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

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

ROMAN G. DEL ROSARIO
Presiding Justice