REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

MCDONALD'S PHILIPPINES REALTY CORPORATION, Petitioner,	CTA Case No. 8766
	Members:
- versus -	BAUTISTA, *Chairperson* FABON-VICTORINO, and RINGPIS-LIBAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: DEC 15 2016 4:16 p.m.

x- -x

DECISION

***Fabon-Victorino, J.*:**

The instant Petition for Review[1] prays for the cancellation and withdrawal of the assessment issued by respondent Commissioner of Internal Revenue (CIR) against petitioner McDonald's Philippines Realty Corporation for alleged deficiency Value-Added Tax (VAT) of ₱3,595,275.39, inclusive of interest and surcharge, for calendar year (CY) 2007.

Petitioner is a foreign corporation organized and existing under the laws of Delaware, United States of America (USA). It is licensed to do business in the Philippines through its Philippine branch, located at the 17th Floor, Citibank Center Building, Paseo de Roxas, Salcedo Village, Makati City.[2] It is registered with the Bureau of Internal Revenue (BIR), Large Taxpayers District Office (LTDO), with Tax Identification No. (TIN) 000-130-921-000.[3]

---

[1] Docket, pp. 7-36.
[2] Par. 1, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), docket, p. 461.
[3] Par. 2, Admitted Facts, JSFI, docket, pp. 461-462.

Respondent, on the other hand, is the Commissioner of the BIR, empowered to decide disputed assessments and cancel and abate tax liabilities in accordance with National Internal Revenue Code (NIRC) of 1997, as amended. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Petitioner avers that on July 15, 2008, the BIR issued Letter of Authority (LOA) No. 00006884 dated July 1, 2008, authorizing Revenue Officers (RO) Elsie Galvez, Amelita Tugade, Ma. Theresa Espino, and Ricardo Calma to examine its books of accounts and other accounting records relative to its internal revenue taxes for CY 2007.[4]

On December 10, 2010, petitioner received a copy of the Preliminary Assessment Notice (PAN) dated September 15, 2010 for deficiency Income Tax (IT), VAT, and Documentary Stamp Tax (DST) in the aggregate amount of ₱33,432,243.06, inclusive of compromise penalty and interest, for CY 2007.[5]

On December 29, 2010, petitioner's Resident Agent Romeo B. Bachoco executed a Waiver of the Defense of Prescription under the Statute of Limitations of the NIRC, as amended,[6] until December 31, 2011 to submit the documents pertaining to the investigation/reinvestigation of IT, VAT and Withholding Tax (WT) liabilities for CY 2007.

On February 23, 2011, petitioner protested the PAN.[7]

On December 27, 2011, Romeo Bachoco executed another Waiver of the Defense of Prescription extending respondent's right to assess until March 31, 2012.[8]

On March 30, 2012, petitioner received a copy of respondent's Formal Letter of Demand[9] (FLD) with attached Details of Discrepancies dated March 15, 2012, and

---

[4] Par. 4, Admitted Facts, JSFI, docket, p. 462.
[5] Par. 5, Admitted Facts, JSFI, docket, p. 462.
[6] Exhibit P-4.
[7] Exhibit P-5.
[8] BIR Records, p. 442.
[9] Par. 6, Admitted Facts, JSFI, docket, p. 462.

Audit/Assessment Notice No. LTDO-122-VT-2007-00015 dated March 1, 2012 (FAN), which it protested[10] on April 26, 2012.

On January 17, 2014, petitioner received a copy of respondent's Final Decision on Disputed Assessment (FDDA) with attached Details of Discrepancies dated January 16, 2014, finding it liable for deficiency VAT for CY 2007 in the total amount of ₱3,595,275.39.[11]

Hence, this Petition for Review filed on February 17, 2014.

In his Answer[12], respondent counters that the assessment for deficiency VAT for CY 2007 was issued in accordance with law, rules and jurisprudence. The assessment was issued within the 3-year prescriptive period mandated in Section 222(b) of the NIRC of 1997, as amended, on account of the two (2) Waivers of the Defense of Prescription duly executed by petitioner. Even assuming that the assessment was issued beyond the three (3) year prescriptive period, petitioner's case will fall within the 10-year prescriptive period for having filed a false or fraudulent VAT returns for CY 2007, pursuant to Section 222(a) of the NIRC of 1997, as amended. Finally, petitioner is liable to pay deficiency VAT assessment arising from rental/interest income in the amount of ₱3,595,275.39.

After the pre-trial conference, the parties filed their Joint Stipulation of Facts and Issues[13], thereafter a Pre-Trial Order[14] was issued on September 8, 2014.

To prove its case, petitioner presented (1) the director for Accounting of Golden Arches Development Corporation (GADC), Cornelia M. Naguit; (2) the Corporate Legal Counsel and Corporate Secretary of GADC, Atty. Kristina S. Alvarez-Mouliac; and (3) the Independent Certified Public Accountant (ICPA) Katherine O. Constantino.

---

[10] Exhibit P-7.
[11] Pars. 7 and 8, Admitted Facts, JSFI, docket, pp. 462-463.
[12] Docket, pp. 176-192.
[13] Docket, pp. 461-470.
[14] Docket, pp. 512-520.

In her Judicial Affidavit[15], **Cornelia M. Naguit** declared that as Director for Accounting of Golden Arches Development Corporation (GADC), she (1) attends to GADC's entire accounting operations including its tax compliance; (2) provides accounting services to petitioner in accordance with the terms and conditions in the Lease Agreement entered into between GADC and petitioner; (3) oversees the preparation of petitioner's tax returns and reviews them before filing with the BIR; and (4) assists the Revenue Officers in their examination of the books of accounts of GADC and petitioner and safekeeps the letters and notices issued in relation thereto.

She further declared that on July 15, 2008, petitioner received a copy of LOA No. 00006884 dated July 1, 2008. This was followed by a copy of the PAN dated September 15, 2010 which petitioner received on December 10, 2010, for alleged deficiency IT, VAT, and DST in the aggregate amount of ₱33,432,243.06.

On December 15, 2010, petitioner, through its resident agent Romeo Bachoco, executed a Waiver which extended the period to assess petitioner's internal revenue taxes for CY 2007 until December 31, 2011. It was accepted by the BIR on January 6, 2011 through its OIC-Assistant Commissioner, BIR-LTS for Excise and LTDOs Zenaida G. Garcia.

On February 23, 2011, petitioner filed its protest to the PAN.

On March 30, 2012, petitioner received a copy of the FLD/FAN cancelling the assessments for deficiency IT and DST but reiterating the demand for payment of petitioner's deficiency VAT in the total amount of ₱3,104,836.70, inclusive of interest and surcharge.

On April 26, 2012, petitioner protested the FAN reiterating its request to cancel the deficiency VAT for CY 2007.

---

[15] Exhibit P-28.

On January 17, 2014, petitioner received a copy of the Final Decision on Disputed Assessment (FDDA) dated January 16, 2014, finding petitioner liable for deficiency VAT for CY 2007 in the total amount of ₱3,595,275.39, inclusive of interest and surcharge. The deficiency VAT assessment for CY 2007 allegedly arose from rental/interest income in the amount of ₱11,080,687.70 not subjected to VAT. In addition, the BIR imposed a fifty percent (50%) surcharge on the said amount. Witness Nuguit opined that the deficiency VAT assessment for CY 2007 has no legal and factual bases on the following grounds, to wit: (1) the deficiency VAT assessment for CY 2007 has prescribed; (2) the Waiver did not validly extend the prescriptive period for issuance of the BIR's deficiency VAT assessment for CY 2007; (3) even assuming for the sake of argument that the assessment has not yet prescribed, the BIR's deficiency VAT assessment on rental income is invalid; (4) petitioner's interest income is not subject to VAT; and (5) petitioner may not be held liable for the 50% surcharge.

In her Judicial Affidavit[16], **Atty. Kristina S. Alvarez-Mouliac** stated that she is GADC's corporate legal counsel and corporate secretary since 2006. As legal counsel, she manages GADC's legal affairs and provides legal advice to its various departments, including negotiation and drafting of agreements for and on behalf of the company. As Corporate Secretary, she keeps the company's corporate records. She also prepares and files the company's reportorial requirement with the Securities and Exchange Commission (SEC), including the company's General Information Sheet (GIS).

The present case involves petitioner's judicial protest against the BIR's deficiency VAT assessment for CY 2007. GADC is involve in the case since the BIR assessed petitioner for deficiency VAT on the interest income that it received from GADC in CY 2007. The BIR imposed VAT on petitioner's interest income from GADC invoking the ruling in the case of Lapanday Foods Corporation vs. CIR (*Lapanday* case),[17] saying that petitioner and GADC are affiliates, hence, the interest on loans extended to affiliates is subject to VAT. Such

---

[16] Exhibit P-29.
[17] CTA Case No. 7097, October 18, 2007.

conclusion, according to Atty. Alvarez-Mouliac, has no basis since neither is a stockholder of the other.

ICPA **Katherine O. Constantino** stated in her Judicial Affidavit[18] that pursuant to the Court's directive, she conducted verification procedures on the documents supporting petitioner's protest against respondent's assessment for alleged deficiency VAT for CY 2007. The said verification revealed that petitioner did not under-declare its rental income in its quarterly VAT Returns for CY 2007. In fact, petitioner overpaid its output VAT for CY 2007 in the total amount of ₱2,212,420.45.

On petitioner's interest income, she declared that respondent's computation thereon matches the company's general ledger on interest income for CY 2007, as well as its audited financial statements for CY 2007 and annual Income Tax Returns (ITR) for the same CY.

Further, all the documents supporting petitioner's judicial protest against respondent's deficiency VAT assessment for CY 2007, which were used as basis for the schedules and summaries used in her Report, were faithful reproductions of their originals, except the certified true copy of its License to Transact Business in the Philippines issued by the SEC.

Petitioner rested its case *via* its *Formal Offer of Evidence*[19] filed on March 5, 2015 per Resolution[20] dated March 20, 2015.

For his part, respondent presented Revenue Officer (1) Ricardo B. Calma and (2) Belinda D. Balagtas, as his witnesses.

By way of a Judicial Affidavit[21], **Ricardo B. Calma** testified that he was among the ROs authorized to audit all internal revenue taxes of petitioner. The audit was conducted

[18] Exhibit P-30.
[19] Docket, pp. 562-584.
[20] Docket, pp. 1031-1032.
[21] Exhibit R-15.

at petitioner's place of business. Thereafter, a Letter for an Informal Conference with Details of Discrepancies was sent to petitioner. Per their recommendation, a PAN with Details of Discrepancies was later issued assessing petitioner of deficiency IT, VAT and DST, which the latter protested. After review and evaluation of petitioner's protest, they still found it liable for deficiency VAT. Thus, the issuance of a FAN with Details of Discrepancies against petitioner.

RO **Belinda D. Balagtas**, also executed a Judicial Affidavit[22], in which she declared pursuant to Memorandum of Assignment No. 122-REA-13-03-00302 dated March 7, 2013, she evaluated petitioner's protest to the FAN. Subsequently, she submitted a Memorandum recommending the issuance of an FDDA which she personally served to petitioner on January 17, 2014.

On September 4, 2015, respondent rested his case upon the admission of all his documentary exhibits.[23]

On December 18, 2015, the instant case was deemed submitted for decision with petitioner's Memorandum[24] filed on October 28, 2015. Despite directive, respondent failed to file any.[25]

STATEMENT OF ISSUES

The main issue[26] submitted by the parties for resolution is as follows:

> WHETHER OR NOT PETITIONER IS LIABLE FOR THE ALLEGED DEFICIENCY VAT FOR CY 2007 IN THE TOTAL AMOUNT OF ₱3,595,275.39.

---

[22] Exhibit R-16.
[23] Resolution dated September 4, 2015, docket, pp. 1075-1076.
[24] Docket, pp. 1086-1140.
[25] Resolution dated December 18, 2015, docket, p. 1143.
[26] Issues, JSFI, docket, pp. 463-464.

They subdivided the foregoing into the following sub-issues, to wit:

1. Whether or not respondent's right to assess petitioner's alleged deficiency VAT for CY 2007 has prescribed;

2. Whether or not the Waiver signed by petitioner on December 15, 2010 extended the period for the issuance of respondent's deficiency assessment for CY 2007;

3. Whether or not petitioner underdeclared its rental income for CY 2007 for VAT purposes;

4. Whether or not petitioner's interest income for CY 2007 is subject to VAT; and

5. Whether or not the imposition of a 50% surcharge on petitioner's alleged deficiency VAT for CY 2007 is valid.

THE COURT'S RULING

Just like in any assessment cases, the timeliness of the filing of the Petition for Review must first be ascertained.

Section 228[27] of the National Internal Revenue Code (NIRC) of 1997, as amended, provides that a taxpayer

[27] SEC. 228. *Protesting of Assessment.* — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: Provided, however, That a pre-assessment notice shall not be required in the following cases: xxx xxx xxx

The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

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

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, **the taxpayer adversely affected by the** adversely affected by the decision of the respondent may appeal to the Court of Tax Appeals (CTA) within thirty (30) days from receipt of the adverse decision; otherwise, it shall become final, executory and demandable.

It is undisputed that on January 17, 2014, petitioner received respondent's FDDA. Thus, petitioner had thirty (30) days from January 17, 2014 or until February 16, 2014 within which to appeal respondent's adverse decision. Evidently, the instant Petition for Review was seasonably filed on February 17, 2014, as February 16, 2014 was a Sunday.

On whether or not respondent's right to assess petitioner's deficiency VAT has prescribed:

Under Section 203 of the NIRC of 1997, as amended, respondent is authorized to assess internal revenue taxes within three (3) years from the last day prescribed by law for the filing of the tax return, or the actual date of filing of such return, whichever comes later. Thus, an assessment notice issued after the three-year prescriptive period is considered invalid and ineffective.[28]

Corollarily, Section 114 (A)[29] of the NIRC of 1997, as amended, and Section 4.114-1 (A) of RR No. 16-2005 provide that Quarterly VAT Returns shall be filed within twenty-five (25) days following the close of each taxable quarter. Summarized below are the dates of filing of petitioner's

---

decision or inaction **may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision**, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable. (*Emphasis supplied*)

[28] SEC. 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."

[29] SEC. 114. *Return and Payment of Value-added Tax.* —

(A) In General. — Every person liable to pay the value-added tax imposed under this Title shall file a quarterly return of the amount of his gross sales or receipts within twenty-five (25) days following the close of each taxable quarter prescribed for each taxpayer: Provided, however, That VAT-registered persons shall pay the value-added tax on a monthly basis.

Quarterly VAT Returns and the corresponding dates within which respondent should assess petitioner for deficiency VAT for CY 2007:

Period Covered		Date Filed	Last Day to File Return	Last Day to Assess
1st Qtr	Jan. 1-Mar. 31, 2007	April 20, 2007	April 25, 2007	April 25, 2010
2nd Qtr	April 1-June 30, 2007	July 24, 2007	July 25, 2007	July 25, 2010
3rd Qtr	July 1-Sept. 30, 2007	October 19, 2007	October 25, 2007	October 25, 2010
4th Qtr	Oct. 1-Dec. 31, 2007	March 26, 2008[30]	January 25, 2008	March 26, 2011

From the foregoing, respondent had until April 25, 2010, July 25, 2010, October 25, 2010 and March 26, 2011 within which to assess petitioner for deficiency VAT for the first, second, third and fourth quarter of CY 2007, respectively. Evidence however show that petitioner received the FAN only on March 30, 2012, or beyond the last day prescribed by law to assess petitioner for deficiency VAT for CY 2007.

There was no denying on the part of respondent that the assessment notices were issued beyond the three-year prescriptive period to assess under Section 203 of the NIRC of 1997, as amended. He however claims that the 10-year period to assess must apply since petitioner filed a false or fraudulent VAT return when it failed to report its rental/interest income for VAT purposes. Per respondent, assessment may be made at any time within 10 years from the discovery of the falsity, fraud or omission as in the present case. In addition, for seasonably executing two waivers, petitioner is now estopped from questioning the validity of such waivers.[31]

Petitioner, on the other hand, states that it did not fraudulently conceal its interest income for CY 2007 as it was clearly reflected in Lines 18 and 60 of its ITR for CY 2007, and was made subject to IT and the applicable EWT. The only reason for not reporting the said interest income as part of the gross receipts in its VAT Returns was its belief that such interest income did not form part of its VATable gross receipts

---

[30] Amended Return.
[31] Answer, docket, pp. 177-185.

pursuant to Section 105 of the NIRC of 1997, as amended, and Revenue Memorandum Circular (RMC) No. 42-2003.[32]

Verily, under extraordinary cases of filing false, fraudulent returns or failure to file returns, the tax may be assessed within ten (10) years from discovery of the falsity, fraud or omission in accordance with Section 222(a) of the 1997 NIRC.[33]

Based on the said provision, the three-year prescriptive period under Section 203 of the NIRC of 1997, as amended, does not apply in the following instances, namely: (1) filing a false return, (2) filing a fraudulent return with intent to evade tax, and (3) failure to file a return. In these three (3) instances, the period within which to assess deficiency taxes is ten (10) years from discovery of the fraud, falsification or omission.[34]

Thus, to know if respondent's right to assess petitioner for deficiency VAT for CY 2007 has prescribed, it is paramount to determine whether petitioner's VAT returns for the CY 2007 are false or fraudulent.

Petitioner claims that no legal or factual basis exists for respondent to impose VAT on its interest income because it was not incurred in the ordinary course of trade or business. Petitioner is not a lending investor within the contemplation of Section 108 of the NIRC of 1997, Section 4.108-3(g) of Revenue Regulations No. 16-2005, and BIR Ruling No. DA-320-07 as it is licensed by the SEC to engage in the business of leasing real properties only.

---

[32] Memorandum, docket, p. 1103.

[33] SEC. 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 proceeding 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.
>
> xxx xxx xxx

[34] *Commissioner of Internal Revenue v. Arturo Tulio*, G.R. No. 139858, October 25, 2005, 474 SCRA 147.

Further, its interest income in CY 2007 was derived from its (i) Loan Agreement with GADC dated March 17, 2005 covering the interest-bearing, long term advances granted to GADC in prior years for land and equipment purchased by GADC for its various restaurants and warehouse; and (ii) Acknowledgment of Debt Agreement executed between petitioner and GADC, whereby the latter acknowledged that it had unpaid rentals and interest due to petitioner amounting to ₱366,712,722.00. Other than these two (2) isolated transactions, petitioner did not enter into any other loan agreement with any party for the purpose of making a profit out of lending. Petitioner cannot be therefore be deemed a lending investor as it is not habitually engaged in the business of lending money for profit.

The Court is not convinced.

Section 105[35] of the NIRC of 1997, as amended, provides that any person who in the course of trade or business, sell, barter, exchange, lease goods or properties, render services, and any person who import goods is liable to VAT. '*In the course of trade or business*' refers to regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto.[36] Thus, transactions undertaken incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business.[37] '*Incidental*' means depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another, which is termed the principal; something incidental to the main purpose.[38]

---

[35] 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.

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.

[36] *Commissioner of Internal Revenue v. Court of Appeals and Commonwealth Management and Services Corporation*, G.R. No. 125355, March 30, 2000, 329 SCRA 237.

[37] Victor A. Deoferio, Jr. and Victorino Mamalateo, The Value Added Tax in the Philippines, 2000 Edition, p. 82.

[38] Black's Law Dictionary, 6th ed., p. 762.

In the case of *CS Garments, Inc. vs. CIR*,[39] this Court held that although the primary business of *CS Garments* is the manufacturing of garments for sale abroad, the sale of motor vehicle to its general manager is considered an incidental transaction subject to VAT for it was purchased and used in carrying out petitioner's business, thus:

> Here, petitioner's primary business is the manufacturing of garments for sale abroad. In carrying-out its business, petitioner acquired and eventually sold a Mercedes Benz to its General Manager Mr. Sudhoff. Prior to the sale, the motor vehicle formed part of petitioner's capital assets, specifically under the account, "Property, Plant and Equipment". The Rules on International Accounting Standards (IAS) defines Property, Plant and Equipment as follows:
>
> > 6. Definitions
> >
> > Property, plant and equipment are tangible assets that:
> >
> > (a) are held by an enterprise **for use in the production or supply of goods or services, for rental to others, or for administrative purposes**; and
> >
> > (b) are expected to be used during more than one period.
>
> **Therefore, the sale of the motor vehicle is an incidental transaction because the said vehicle was purchased and used in furtherance of petitioner's business**.
>
> Once an activity has been identified as a business, any supply[sale] made while carrying it on is likely to be made in the course or furtherance of business. No distinction is made between capital and revenue items. Thus, a supply[sale] in the course or furtherance of business includes: (1) the disposition of the

---

[39] CTA EB Case No. 287, January 14, 2008.

> assets and liabilities of a business, (2) the disposition of a business as going concern; and (3) anything done in connection with the termination or intended termination of a business. (*Boldfacing supplied*)

Similarly, in the case of *Lapanday Foods Corporation v. CIR*,[40] this Court ruled that 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.

In the instant case, petitioner's audited financial statements[41] for the years ended December 31, 2007 and 2006 disclose that the subject interest income arose from the following two (2) loan/debt agreements with its lone client, GADC, allocated for the acquisition of real properties and unpaid rentals, to wit:

> 1. Related Party Transactions
>
> a. xxx
>
> b. On March 17, 2005, the Branch entered into a loan agreement with GADC covering interest-bearing, long term advances granted to GADC in prior years **for land and equipment purchased for various restaurants and warehouse** amounting to P57,431,435. The loan is payable in full on March 17, 2009. Interest on the loan shall accrue at 8.4375% from March 1, 2005 to March 17, 2006; thereafter, interest shall accrue at six-month PHIBOR rate plus 2%, which the Branch will reset on March 18 of each year.
>
> On the same date, the Branch and GADC signed an Acknowledgement of Debt Agreement, whereby GADC acknowledged that it has **unpaid rentals** and interest due to the Branch

---

[40] CTA EB Case No. 367, January 29, 2009.
[41] Exhibit P-41.

> amounting to P366,712,722 ("receivable"). In accordance with the terms of the said agreement, GADC executed a Promissory Note in favor of the Branch for P366,712,722, which is payable in full on March 17, 2009. Interest on the receivable shall accrue at 8.4375% from March 1, 2005 to March 17, 2006; thereafter, the interest shall accrue at six-month PHIBOR rate plus 2%, which the Branch will reset on March 18 of each year. (*Boldfacing supplied*)

Relative to the loan amount of ₱57,431,435.38, the utilization of the proceeds thereof was clearly set forth in the Loan Agreement[42] of March 17, 2005 between petitioner and GADC, as follows:

> WHEREAS, **MPRC loaned GADC an amount of money for the period 16 July 1985 to 14 June 1991 to assist GADC in its purchase of real properties in the Philippines**;
>
> WHEREAS, GADC acknowledges the existence of the loan and receipt thereof from MPRC and the use of the proceeds thereof to purchase real properties located in the Philippines and more specifically described in Annex "A" of this Agreement;
>
> WHEREAS, **GADC has since developed some of the real properties as sites for McDonald's Restaurants, while one property was used to establish a distribution and supply warehouse**; and
>
> WHEREAS, while the real properties described in Annex "A" were sold by GADC in 2002 to another corporation, Golden Arches Realty Corporation, **the McDonald's Restaurants, as well as the distribution and supply warehouse located therein,**

w/

[42] Exhibit P-18.

> **remain the properties of GADC.** (*Boldfacing Supplied*)

Considering that petitioner established its branch office in the Philippines for the purpose of purchasing and leasing back two (2) existing McDonald's Restaurants to GADC and developing new McDonald's Restaurant sites which will then be leased to McGeorge Foods, Inc. as stated in its License to Transact Business[43] in the Philippines issued by the SEC on November 12, 1984, it can be safely concluded that the loan it granted to GADC in the amount of ₱57,431,435.38 was in the pursuit of its leasing business with GADC. Consequently, the interest income it derived from the said loan, being incidental to its leasing business, is deemed a transaction "*in the course of trade or business*" which is subject to VAT pursuant to Section 105, in relation to Section 108 (A) [44] of the NIRC of 1997, as amended.

The same holds true with regard to GADC's debt to petitioner in the amount of ₱366,712,722.00. The Acknowledgement of Debt[45] executed by petitioner and GADC on March 17, 2005 states, thus:

> WHEREAS, MPRC owns the leasehold improvements and the equipment, seating, signage and design of McDonald's Restaurants

[43] Exhibit P-16.

[44] SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* —
(A) Rate and Base of Tax. — There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties. 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 franchise grantees except those under Section 119 of this Code and nonlife 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

[45] Exhibit P-19.

owned and operated by GADC which restaurants are listed in Annex "A" attached thereto;

WHEREAS, MPRC also owns the leasehold improvements and equipment in the distribution and supply warehouse located at Marikina City, Philippines;

WHEREAS, MPRC leased the above leasehold improvements and the equipment seating, signage and design to GADC in return for payment of lease/rental fees; and

WHEREAS, to date, GADC has unpaid rentals due MPRC.

NOW, in consideration of the mutual covenants and premises herein provided, the parties hereto hereby agree as follows:

Article I — Amount of the Receivables

Upon and subject to the terms and conditions of this Agreement, GADC hereby acknowledges that it has unpaid rentals and unpaid interest due to MPRC in the amount of THREE HUNDRED SIXTY-SIX MILLION SEVEN HUNDRED TWELVE THOUSAND SEVEN HUNDRED TWENTY-ONE PHILIPPINE PESOS AND SEVENTY-NINE PHILIPPINE CENTAVOS (Php366,712,721.79), (the "Receivables")

xxx xxx xxx

Evidently, the interest income derived by petitioner from GADC's unpaid rentals, is considered a transaction made in the course of petitioner's lease business, and is subject to VAT pursuant to Section 105 in relation to Section 108 (A) of the NIRC of 1997, as amended.

As earlier stated, there are three exceptions to the three-year prescriptive period to assess internal revenue taxes, viz., (1) filing of false return, (2) filing of fraudulent return with intent to evade tax, and (3) failure to file a return. The tax may be assessed or a proceeding in court for the collection of such tax may be initiated without assessment at any time within ten years after the discovery of the falsity, fraud or omission.

In the case of *Aznar vs. CTA*[46], the Supreme Court distinguished between "false" and "fraudulent" returns in the following fashion:

> . . . We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely "falsity", "fraud" and "omission". **That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due**.

Following the doctrine laid down in the *Aznar case*, it is evident that petitioner committed falsity in its 2007 Quarterly VAT Returns as it did not declare its VATable interest income for CY 2007 amounting to ₱25,522,729.00. Since there is a deviation from the truth, the ten (10)-year assessment period applies.

Thus, petitioner's receipt of the FLD/FAN on March 30, 2012, assessing it of deficiency VAT for CY 2007, was within the prescriptive period to issue assessment.

---

[46] G.R. No. L-20569, August 23, 1974, 58 SCRA 519.

The foregoing observation renders a discussion on the validity of the two (2) Waivers executed by petitioner unwarranted.

On whether or not petitioner is liable for the alleged deficiency VAT for CY 2007.

In the FDDA, respondent finds petitioner liable for alleged deficiency VAT for CY 2007 in the amount of ₱3,595,275.39, computed as follows:

Rental and interest receivable, beginning (₱25,076,586,00 / 1.12)		₱ 22,389,808.93
Add: Income during the year		
Rental income	₱ 41,121,288.00	
Interest income	25,522,729.00	₱ 66,644,017.00
Total amount available for collection		₱ 89,033,825.93
Less: Rental and interest receivable, end (₱38,866,011.00 / 1.12)		34,701,795.54
Gross receipts to be subjected to VAT		₱ 54,332,030.39
Multiply by VAT rate		12%
Total Output VAT per audit		₱ 6,519,843.65
Less: Output VAT per returns		5,190,149.13
Basic Deficiency VAT		₱ 1,329,694.52
Add: 50% Surcharge	₱ 664,847.26	
Interest (01/26/08 to 01/31/14)	1,600,733.62	₱ 2,265,580.88
TOTAL DEFICIENCY VAT		**₱ 3,595,275.40**

Clear from the above computation that the assessment arose from respondent's imposition of 12% VAT on petitioner's gross receipts from rental income and interest income for taxable year 2007. Thus, to determine whether the assessment is correct, the propriety of these two assessment items must be looked into.

ON THE RENTAL INCOME:

The Court agrees with petitioner that the alleged underpayment of VAT on its rental income is attributable to the erroneous manner of computation employed by respondent. It appears that respondent computed the beginning and ending balances of petitioner's receivables by dividing the amount of said receivables by 1.12, instead of 1.07 (*i.e.*, net of 5% expanded withholding tax component).

As illustrated by the ICPA[47], petitioner's pro-forma Journal Entry (JE) to record rent accrual is:

Account Code	Particulars	Debit	Credit
214.010	Income tax payable (5% withholding tax)	xxx	
233.010004	Other amounts due from GADC (Receivables)	xxx	
411.030001	Minimum Rent to MPRC (Sales)		xxx
411.030002	% Rent in Exc of Minimum (Sales)		xxx
213.020001	Deferred Output VAT (Liability)		xxx

By way of example, the ICPA used JE No. 2372 for rent accrual in January 2007, to wit:[48]

Account Code	Particulars	Debit	Credit
214.010	Income Tax Payable (5% EWT)	122,378.22	
233.010004	Other amounts due from GADC (Receivables)	2,618,893.94	
411.030001	Minimum Rent to MPRC (Sales)		1,166,666.67
411.030002	% Rent in Exc of Minimum (Sales)		161,098.77
411.030002	% Rent in Exc of Minimum (Sales)		95,029.88
411.030002	% Rent in Exc of Minimum (Sales)		502,636.77
411.030002	% Rent in Exc of Minimum (Sales)		416,902.83
411.030002	% Rent in Exc of Minimum (Sales)		105,229.51
213.020001	Deferred Output VAT (Liability)		293,707.73

The total sales per the above JE amount to ₱2,447,564.43 (consolidated totals of Account Codes 411.030001 - Minimum Rent to MPRC and 411.030002 - % Rent in Exc of Minimum). With the said amount, the VAT payable is ₱293,707.73 (₱2,447,564.43 x 12%), while the EWT is ₱122,378.22 (₱2,477,564.43 x 5%). Note that the 5% EWT is required to be withheld on rentals pursuant to Section 2.57.2 in relation to Section 2.57.4 of Revenue

[47] Constantino Guadalquiver & Co. through its Partner, Ms. Katherine O. Constantino.
[48] Exhibit P-45-a.

Regulations (RR) No. 02-98, as amended by RR Nos. 12-01 and 17-03.

It must be noted that the receivables booked under Account Code 233.010004 - Other Amounts Due from GADC amounting to ₱2,618,893.94 already includes the VAT portion of the said sales, less the five percent (5%) EWT, as shown below:

Total Sales	₱	2,447,564.43
Add: Deferred Output VAT		293,707.73
Less: Expanded Withholding Tax		(122,378.22)
Other amounts due from GADC (Receivables)	**₱**	**2,618,893.94**

Upon collection of the rental income/receivables, petitioner's pro-forma entry is:

Cash	xxx	
Deferred output VAT	xxx	
Other amounts due from GADC		xxx
Output VAT		xxx

The above ICPA findings correspond with the details shown in the Official Receipt (OR) No. 0088 supporting petitioner's collection for January 2007 rental, to wit:

Exhibit	O.R. No.	Date	Amount Received
"P-43-c"	0088	19-Apr-07	2,447,564.43

As correctly observed by the ICPA, the amount stated as received in the VAT ORs pertained to the net receivable amount (rental inclusive of VAT and less expanded withholding tax). Except for OR No. 0092, the ORs[49] showed a breakdown of amount received with "P" for rental income amount "V" for VAT and "T" for expanded withholding tax. Thus, the amount written in the "sum of Pesos" pertained to the net receivable amount, that is, rental plus 12% VAT and less 5% EWT.

[49] Exhibits P-43-a to P-43-k.

Clearly, petitioner's Rent Receivable as of December 31, 2006 and December 31, 2007 should be divided by 1.07 to arrive at the amount of rental income (net of VAT).

The ICPA also provided a breakdown of the Rental and Interest Receivables as of December 31, 2006 and 2007 which were reflected in Note 9 of petitioner's Audited Financial Statements for the year 2007 in the respective amounts of ₱25,076,586.00 and ₱38,866,011.00, as follows[50]:

	Rental (a)	Interest (b)	Other Advances (c)	Total (a + b + c)	Per Note 9 of the Audited Financial Statements for the CY 2007[51]	Difference
Dec. 31, 2006	₱2,279,051.46	₱22,369,373.74	₱428,160.80	₱25,076,586.00	₱25,076,586.00	-
Dec. 31, 2007	19,727,415.56	19,129,671.34	8,924.03	38,866,010.93	38,866,011.00	(0.07)

Adopting respondent's method in computing the alleged deficiency VAT on rental income but dividing the Rental Receivables as of December 31, 2006 and 2007 in the respective amounts of ₱2,279,051.46 and ₱19,727,415.56 by 1.07 instead of the 1.12 factor erroneously used by respondent, the result would be an overpayment of VAT in the amount of ₱2,212,420.45, as shown below:

Rent Receivable, beginning	(₱2,279,051.46 ÷ 1.07)	₱	2,129,954.64
Add: Rental Income during the year			41,121,288.00
Total Amount Available for Collection		₱	43,251,242.64
Less: Rent Receivable, end	(₱19,727,415.56 ÷ 1.07)		18,436,837.00
Gross Receipts on Rentals for the year 2007		₱	24,814,405.64
Output VAT Due		₱	2,977,728.68
Less: Creditable Input Tax			-
VAT Due/Payable Per Audit		₱	2,977,728.68
Less: VAT payments			5,190,149.13
VAT Overpayment		₱	(2,212,420.45)

The ICPA validated the aforesaid VAT overpayment of ₱2,212,420.45 through comparison of the collections of rental income as substantiated by official receipts issued by petitioner during the year 2007 *vis-à-vis* the VATable rent

[50] Exhibit P-35, Findings and Observations no. 5.
[51] Exhibit P-41.

income declared per petitioner's Quarterly VAT Returns for the said year, as follows:[52]

	1st Qtr 2007 (January to March)	2nd Qtr 2007 (April to June)	3rd Qtr 2007 (Jul. to Sept.)	4th Qtr 2007 (Oct. to Dec.)	Total
Per Quarterly collection based on Official Receipts	₱4,573,910.60	₱ 8,404,975.20	₱6,507,750.05	₱ 4,398,293.98	₱ 23,884,929.83
Per Line 15 "Vatable Sales/Receipt - Private" Quarterly VAT Returns for the CY 2007	4,612,816.92	9,295,544.67	6,507,750.11	22,835,131.00	43,251,242.70
Total	**₱(38,906.32)**	**₱(890,569.47)**	**₱ (0.06)**	**₱(18,436,837.02)**	**₱(19,366,312.87)**

As found by the ICPA, the discrepancies for the first and second quarters of CY 2007 pertain to pass through real property taxes.[53]

The difference for the fourth quarter of CY 2007 pertains to the following:[54]

Particulars	Journal Listing No.	Exhibit Reference	Rent Income	Rent Receivable
Rent rebuild for 2006 and 2007 for the period of December 2007 where collections were received on July 2008	2629	P-45-r	₱ 14,000,474.67	₱ 14,980,507.86
Rent for November 2007 where collections were received on January 2008	2580	P-45-p	2,089,223.59	2,235,469.25
Rent for December 2007 were collections were received on January 2008	2596	P-45-q	2,347,138.73	2,511,438.45
Total			**₱ 18,436,836.99***	**₱19,727,415.56**

* *rounding off difference*

Petitioner's collection of the ₱18,436,836.99 in 2008 is documented as follows:[55]

[52] Exhibit P-35, Findings and Observations no. 10.
[53] *Ibid.*
[54] *Id.*
[55] *Id.*

Particulars	O.R. No.	O.R. Date	Exhibit Reference	Rent Income	Rent Receivable
Rent rebuild for 2006 and 2007 for the period of December 2007 where collections were received 2008	0106	7/25/2008	P-57	₱ 14,000,474.67	₱ 14,980,507.86
Rent for November 2007 where collections were received on January 2008	0097	1/11/2008	P-58	2,089,223.59	2,235,469.25
Rent for December 2007 were collections received on January 2008	0098	1/25/2008	P-59	2,347,138.73	2,511,438.45
Total				**₱ 18,436,836.99**	**₱ 19,727,415.56**

Notice that in the above table, the amount of Rent Receivable was also reflected showing that these items, which were collected only in 2008, were considered Rent Receivable-ending for CY 2007. The ICPA then showed her findings upon verification of the ending balance of Rent Receivable as of December 31, 2007, thus:[56]

Particulars	Rent income (a)	Rent Receivable, ending per Findings no. 6 (b)	Rental income per Findings no. 6 (c = (b)/1.07))	Difference (a-c)
Rent rebuild for 2006 and 2007 for the period of December 2007 where collections were received 2008	₱ 14,000,474.67	₱ 14,980,507.86	₱ 14,000,474.64	₱ 0.03
Rent for November 2007 where collections were received on January 2008	2,089,223.59	2,235,469.25	2,089,223.60	(0.01)
Rent for December 2007 were collections received on January 2008	2,347,138.73	2,511,438.45	2,347,138.74	(0.01)
Total	**₱ 18,436,836.99**	**₱ 19,727,415.56**	**₱ 18,436,836.97**	**₱ 0.02**

The 12% output VAT due on the Rent Receivable as of December 31, 2007 amounted to ₱2,212,420.44, broken down as follows:

Particulars	Journal Listing No.	Exhibit Reference	Rent Income	VAT Output (Rent Income x 12%)
Rent rebuild for 2006 and 2007 for the period of December 2007 where	2629	P-45-r	₱ 14,000,474.67	₱ 1,680,056.96

[56] Exhibit P-35, Findings and Observations no. 10.

collections were received on July 2008				
Rent for November 2007 where collections were received on January 2008	2580	P-45-p	2,089,223.59	250,706.83
Rent for December 2007 were collections were received on January 2008	2596	P-45-q	2,347,138.73	281,656.65
Total			**₱ 18,436,836.99***	**₱2,212,420.44**

While the rental amount of ₱18,436,836.99 had not been collected by petitioner as of December 31, 2007, the related output VAT of ₱2,212,420.44 was paid by petitioner in advance upon its filing of amended Quarterly VAT Return for the fourth quarter of CY 2007. This can be seen from the ICPA's comparison of the original 4th Quarterly VAT Return and amended 4th Quarterly VAT Return filed by petitioner for CY 2007, to wit:[57]

	Original 4th Quarter 2007 VAT Return)	**Amended 4th Quarter VAT Return**	**Difference**
	Exhibit "P-55"[58]	**Exhibit "P-56"[59]**	
Sales	₱ 4,389,294.00	₱ 22,835,131.00	₱ (18,445,837.00)
VAT Output	527,795.28	2,740,215.72	(2,212,420.44)
Net VAT Payable	527,795.28	2,740,215.72	(2,212,420.44)
Less:			-
Monthly VAT payments - previous two months	527,795.28	527,795.28	-
Others - VAT for November and December 2007 rent collected in January 2008	-	532,363.48	(532,363.48)
Total Tax Credits	527,795.28	1,060,158.76	(532,363.48)
Total Amount Payable (Overpayment)	**₱ 0.00**	**₱ 1,680,056.96**	**₱ (1,680,056.96)**

In fine, petitioner had actually overpaid its output VAT for CY 2007.

[57] Exhibit P-35, Findings and Observations no. 10.
[58] Docket, pp.982-983.
[59] Docket, pp.984-985.

ON THE INTEREST INCOME:

The record shows that petitioner subjected its interest income to 2% EWT upon recording of the interest accrual as follows[60]:

Account Code	Account Name	Debit	Credit
233.010004	Other amounts due from GADC (Receivable)	xxx	
439.010010/ 439.010012	Interest Inc - Debt Acknowledg/ Interest on Loan		xxx
214.010	Income tax payable	xxx	
233.010004	Other amounts due from GADC		xxx

Petitioner's pro-forma entry for the collection of interest income is:

Cash	xxx	
Other amounts due from GADC		Xxx

Thus, respondent should have divided the Interest Receivables as of December 31, 2006 and 2007 in the respective amounts of ₱22,369,373.74 and ₱19,129,671.34 by .98 (*i.e.* net of the 2% EWT) instead of 1.12 in order to arrive at the interest income, net of EWT.

As computed below, petitioner's undeclared gross receipts on interest income for CY 2007 amounted to ₱28,828,548.20 and is therefore liable to pay the corresponding deficiency VAT of ₱3,459,425.78, excluding interest and surcharge, computed as follows:

Interest Receivable, beginning	(₱ 22,369,373.74 ÷0.98)	₱ 22,825,891.57
Add: Interest Income during the year		25,522,729.42
Total Amount Available for Collection		₱ 48,348,620.99
Less: Interest Receivable, ending	(₱19,129,671.34 ÷0.98)	19,520,072.80
Gross Receipts on Interest Income		₱ 28,828,548.20
Multiply by VAT Rate		12%
Basic Deficiency VAT		**₱ 3,459,425.78**

[60] Exhibit P-35, Findings and Observations no. 4.

With an overpayment of VAT on rental income amounting to ₱1,680,056.96 and a basic deficiency VAT on interest income amounting to ₱3,459,425.78, petitioner's basic deficiency VAT for CY 2007 should only be ₱1,779,368.82.

On whether or not the imposition of a 50% surcharge on petitioner's alleged deficiency VAT for CY 2007 is valid.

In the *Aznar case*, the Supreme Court declared that there is no basis for the imposition of the fifty percent (50%) fraud penalty in the absence of a willful fraudulent act on the part of the taxpayer, thus:

> The second issue which appears to be of vital importance in this case centers on the lower court's imposition of the fraud penalty (surcharge of 50% authorized in Section 72 of the Tax Code).
>
> xxx xxx xxx
>
> From the above exposition of facts, we cannot but emphatically reiterate the well-established doctrine that fraud cannot be presumed but must be proven. As a corollary thereto, we can also state that fraudulent intent could not be deduced from mistakes however frequent they may be, especially if such mistakes emanate from erroneous entries or erroneous classification of items in accounting methods utilized for determination of tax liabilities. The predecessor of the petitioner undoubtedly filed his income tax returns for the years 1946 to 1951 and those tax returns were prepared for him by his accountant and employees. It also appears that petitioner in his lifetime and during the investigation of his tax liabilities cooperated readily with the B.I.R. and there is no indication in the record of any act of bad faith committed by him.

> The lower court's conclusion regarding the existence of fraudulent intent to evade payment of taxes was based merely on a presumption and not on evidence establishing a willful filing of false and fraudulent returns so as to warrant the imposition of the fraud penalty. **The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some legal right. Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by the law. It must amount to intentional wrong-doing with the sole object of avoiding the tax**. It necessarily follows that a mere mistake cannot be considered as fraudulent intent, and if both petitioner and respondent Commissioner of Internal Revenue committed mistakes in making entries in the returns and in the assessment, respectively, under the inventory method of determining tax liability, it would be unfair to treat the mistakes of the petitioner as tainted with fraud and those of the respondent as made in good faith.
>
> **We conclude that the 50% surcharge as fraud penalty authorized under Section 72 of the Tax Code should not be imposed, but eliminated from the income tax deficiency for each year from 1946 to 1951, inclusive**. (*Emphasis supplied*)

The 50% surcharge cited in the *Aznar case* is lifted from Section 72 of the then Tax Code, which reads as follows:

> SEC. 72. *Surcharges for failure to render returns and for rendering false and fraudulent returns*. — In case of willful neglect to file the return or list required under this Title within the time prescribed by law, or **in the case a false or fraudulent return or list is willfully made**, the Commissioner of Internal Revenue shall add to the tax or to the deficiency tax, **in case any payment has been made on the basis of such return before the**

> **discovery of the falsity or fraud, a surcharge of fifty per centum of the amount of such tax or deficiency tax...** *xxx*

Presently, Section 248 (B) of the NIRC of 1997, as amended, applies and mirrors a portion of the provision in Section 72 of the former Tax Code on the imposition of 50% surcharge as follows:

> "SEC. 248. *Civil Penalties.* —
>
> "(B) **In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud**: Provided, That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein. (*Emphasis supplied*)

In the instant case, the under-declaration in petitioner's gross receipts on interest income for CY 2007 did not arise from a deliberate attempt on its part to evade tax but due on the honest belief that it is not subject to VAT. This is supported by the fact that the interest income amounting to ₱25,522,729.00 was indeed reported in petitioner's annual Income Tax Return[61] for CY 2007.

---

[61] Exhibit P-21.

Applying the rationale laid down by the Supreme Court in the *Aznar case*, the 50% surcharge imposed by the respondent in the present case is improper, thus, must be cancelled and withdrawn. However, the Court imposes surcharge of 25% pursuant to Section 248 (A) (3) of the 1997 NIRC, as amended, for "*failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment*".

WHEREFORE, the Petition for Review filed by McDonald's Philippines Realty Corporation is **PARTIALLY GRANTED**. The Final Decision on Disputed Assessment issued by respondent against petitioner covering deficiency VAT for CY 2007 is partly upheld. Accordingly, petitioner is hereby **ORDERED** to pay respondent the amount of ₱2,224,211.02 representing the sum of the basic deficiency VAT for taxable CY 2007 in the amount of ₱1,779,368.82 and the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, in the amount of ₱444,842.20, as shown below:

Basic Deficiency VAT	₱ 1,779,368.82
Add: 25% Surcharge	444,842.20
Total	**₱ 2,224,211.02**

In addition, petitioner is liable to pay:

a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT of ₱1,779,368.82 computed from January 25, 2008, until full payment thereof pursuant to Section 249(B) of the 1997 NIRC, as amended; and

b) Delinquency interest at the rate of twenty percent (20%) per annum on the 20% deficiency interest which have accrued as aforestated in (a) and on the total amount of ₱2,224,211.02, computed from January 17, 2014 until full payment thereof pursuant to Section 249(C) of the 1997 NIRC, as amended.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We concur:

ON LEAVE
LOVELL R. BAUTISTA
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
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.

ESPERANZA R. FABON-VICTORINO
Associate Justice
Acting Chairperson

CERTIFICATION

Pursuant to Section 13 of Article VIII 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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice