REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

Third Division

ICONIC BEVERAGES, INC.,
Petitioner,

CTA CASE NO. 8813

Members:

-versus-

Bautista, *Chairperson*
Fabon-Victorino, *and*
Ringpis-Liban, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
NOV 09 2016
2:09 p.m.

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RESOLUTION

BAUTISTA, J:

For resolution are:

1. Petitioner's Motion for Reconsideration [of the Decision dated August 9, 2016] ("petitioner's MR") filed on September 6, 2016; with respondent's Comment (Re: Petitioner's Motion for Reconsideration) ("respondent's Comment") filed on October 10, 2016;

2. Respondent's Motion for Partial Reconsideration (Re: Decision dated 10 August 2016) ("respondent's MR") filed by registered mail on September 13, 2016; with petitioner's Comment/Opposition [To Respondent's Motion for Partial Reconsideration] ("petitioner's Comment") filed on October 13, 2016; and

3. Respondent's Urgent Motion for Additional Time with Entry of Appearance filed on September 30, 2016.

On August 9, 2016, the Court promulgated its Decision, the dispositive portion thereof reads as follows:

WHEREFORE, in view of the foregoing, the present Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, petitioner is hereby **ORDERED TO PAY** deficiency Income Tax, Value-Added Tax and administrative penalties for the taxable year ended 2010, in the reduced amount of **One Hundred Thirty-Eight Million Fifty-One Thousand One Hundred Forty-Six and 82/100 Pesos (Php138,051,146.82)**, inclusive of the twenty-five percent (25%) surcharge imposed under *Section 248(A)(3) of the 1997 NIRC*, computed as follows:

Tax Type		Basic Tax		25% Surcharge		Total
Income Tax	Php	110,434,456.63	Php	27,608,614.16	Php	138,043,070.78
Value-Added Tax		3,260.83		815.21		4,076.04
Administrative Penalties						4,000.00
Total	**Php**	**110,437,717.46**	**Php**	**27,609,429.36**	**Php**	**138,051,146.82**

In addition, petitioner is liable to pay:

1. Deficiency interest at the rate of twenty percent (20%) *per annum* pursuant to *Section 249(B) of the 1997 NIRC* on the basic deficiency Income Tax of Php110,434,456.63 and Value-Added Tax of Php3,260.83 computed from April 16, 2011 and January 26, 2011, respectively, until full payment thereof; and

2. Delinquency interest at the rate of twenty percent (20%) *per annum* on the amount of Php138,047,146.82 (Net of administrative penalties of Php4,000.00 but inclusive of 25% surcharge); and on the twenty percent (20%) deficiency interest which have accrued as aforestated in Item 1, computed from April 3, 2014 until full payment thereof pursuant to *Section 249(C) of the 1997 NIRC*, as amended.

SO ORDERED.[1]

In the Decision, the Court settled the issue of prescription by ruling that respondent's right to assess petitioner for deficiency Value Added Tax ("VAT") has prescribed for the first to the third quarters of taxable year 2010, pursuant to *Section 203* in relation to *Section 114 of the 1997 National Internal Revenue Code, as amended ("1997 NIRC")*, hence, only the assessment relating to the fourth quarter remains; and petitioner is liable to pay Income Tax, VAT and administrative penalty at reduced amounts.

[1] Emphases retained.

The Court concluded, based on evidence presented, that petitioner's income from licensing out its intellectual property rights is income generated in the active pursuit and performance of its primary purpose, thus, is not passive income. Consequently, it upheld the basic deficiency Income Tax assessment as to royalty income.

As to Taxes and Licenses, the Court found there was factual basis in arriving at the said variance, and sustained the assessment relating thereto.

Petitioner avers that assuming it is liable to pay the thirty percent (30%) tax rate prescribed under *Section 27(A) of the 1997 NIRC*, the Court should apply the provisions of *Section 34(L) of the 1997 NIRC* on optional standard deduction ("OSD"). In turn, the Court stated that the taxpayer should signify in its return the intention to elect the OSD. However, a perusal of petitioner's 2010 ITR shows that it did not elect the same. In fact, it declared itemized deductions which resulted to a net loss in the same amount. Thus, the Court ruled that the OSD under *Section 34 (L) of the 1997 NIRC* should not be applied in the computation of petitioner's tax liability.

As to VAT, records reveal that petitioner only protested the assessment for Income Tax, and that it failed to submit its position and documents to justify its claim on the assessment for VAT. Considering petitioner's failure to validly protest the deficiency VAT for the fourth quarter of taxable year 2010, the Court upheld the assessment relating thereto.

Lastly, the Court imposed both deficiency interest at the rate of twenty percent (20%) *per annum* pursuant to *Section 249(B) of the 1997 NIRC;* and delinquency interest at the rate of twenty percent (20%) *per annum* pursuant to *Section 249(C) of the 1997 NIRC.*

1. Petitioner's MR

Petitioner avers that the royalty income it earned is in the nature of passive income; that assuming *arguendo* that the same is ordinary income, *Section 34(L) of the 1997 NIRC* allows a 40% OSD from Gross Income, which will result in petitioner not being liable for any deficiency Income Tax; that documents presented in support of the alleged unreported income establish that it is not income of petitioner; that respondent failed to indicate the factual and legal bases of the alleged unallowable deduction for taxes and licenses; that there is no legal and factual basis for the alleged deficiency VAT; and that the Court incorrectly computed interest.

On September 8, 2016, the Court ordered respondent to file his comment to petitioner's MR within ten (10) days from notice.

On September 30, 2016, respondent filed its Urgent Motion for Additional Time with Entry of Appearance, wherein it alleges that the handling counsel was transferred to another Revenue Region and the case was just recently reassigned to the present handling counsels, who need ample time to study the case in order to protect the interest of the Government. Hence, the handling counsels ask for another ten (10) days to file their comment, and their entry of appearance.

In the interest of substantial justice, respondent's Urgent Motion for Additional Time is hereby **GRANTED** and the Entry of Appearance is hereby **NOTED**. Henceforth, let all copies of pleadings, orders, and processes be served and furnished to Attys. Cornelio Chito M. dela Peña, Maria Haidee Lourdes C. Organo and Rowell B. Vicente at the Litigation Division, BIR, Room 703, BIR Building, Diliman, Quezon City.

On October 10, 2016, respondent filed his Comment arguing that the Court correctly ruled that petitioner is liable for deficiency Income Tax and VAT for the year 2010; that it was not denied due process; and that the assessment issued against petitioner is valid and lawful.

The Court finds petitioner's MR devoid of merit.

Petitioner's royalty income is in the active pursuit and performance of its primary purpose.

A perusal of the foregoing shows that they are the same arguments raised by petitioner in its Memorandum[2] which have been sufficiently resolved and passed upon by the Court in the assailed Decision.

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[2] *Records, CTA Case No. 8813, Vol. 2,* pp. 956-980.

Petitioner's evidence failed to support its claim that the royalties in the taxable year 2010 were passive income, and not earned in the active pursuit or performance of its primary purpose.

To reiterate, an examination of the evidence presented shows that petitioner's income subject of the assessment arose from a License Agreement[3] with San Miguel Brewery Inc. ("SMBI") for the latter's use of certain Domestic IP Rights[4] of petitioner[5]. Said IP Rights are likewise included in petitioner's AFS as part of its assets in the amount of Php10,000,000,000.00.[6] The AFS of petitioner for taxable years ended December 31, 2010 and December 31, 2009 likewise indicate that the said income from royalties in the amounts of Php1,112,710,572.00 and Php856,063,257.00, respectively, is the main source of income of petitioner for both taxable years 2010 and 2009.[7]

Clearly, petitioner's AFS for taxable years 2010 and 2009 is in consonance with petitioner's primary purpose in its Amended Articles of Incorporation[8], part of which is "to own, purchase, license and/or acquire such trademarks and other intellectual property rights necessary for the furtherance of its business." Accordingly, there is factual basis to conclude that petitioner generated its royalty income in the active pursuit and performance of its primary purpose.

40% Optional Standard Deduction

Petitioner asserts that assuming it is liable to pay the 30% tax rate as prescribed under *Section 27(A) of the 1997 NIRC* and not the final tax rate of 20% for passive income under *Section 27(D)(1) of the 1997 NIRC,* the Court should apply the provisions of *Section 34(L) of the same Code* on OSD.

Further, petitioner argues that assuming its royalty income for taxable year 2010 in the amount of Php1,112,710,572.26[9] is treated as regular income and applying the 40% OSD, the result would show that it is not liable for any deficiency income.

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[3] *Records, Vol. 2, Exhibit "P-11," License Agreement with SMBI,* pp. 812-822; *Exhibit "P-11.1," Amendment to License Agreement,* pp. 823-824.
[4] Philippine beer and malt-based beverage brands including related trademarks, copyrights, patents and other intellectual property rights and know-how (Domestic IP Rights).
[5] *Records, Vol. 2, Exhibit "P-10," Audited Financial Statements, ("AFS"), Notes to the Financial Statements, Note 8 Related Party Transactions,* p. 809.
[6] *Id., Exhibit "P-10," AFS,* p. 796; see *Notes to the Financial Statements, Note 5 Intangibles,* p. 808.
[7] *Id., Exhibit "P-10," AFS,* p. 797.
[8] *Id., Exhibit "P-1," Amended Articles of Incorporation ("AAOI"),* p. 740.
[9] *Id., Exhibit "P-9," Income Tax Return ("ITR"), line 123.*

Section 34 (L) of the 1997 NIRC provides:

> SEC. 34. *Deductions from Gross Income.* - xxx
>
> xxx xxx xxx
>
> (L) *Optional Standard Deduction.* - In lieu of the deductions allowed under the preceding Subsections, an individual subject to tax under Section 24, other than a nonresident alien, may elect a standard deduction in an amount not exceeding forty percent (40%) of his gross sales or gross receipts, as the case may be. In the case of a corporation subject to tax under section 27(A) and 28(A)(l), it may elect a standard deduction in an amount not exceeding forty percent (40%) of it gross income as defined in Section 32 of this Code. <u>Unless the taxpayer signifies in his return his intention to elect the optional standard deduction, he shall be considered as having availed himself of the deductions allowed in the preceding Subsections.</u> Such election when made in the return shall be irrevocable for the taxable year for which the return is made: Provided, That an individual who is entitled to and claimed for the optional standard shall not be required to submit with his tax return such financial statements otherwise required under this Code: Provided, further, That except when the Commissioner otherwise permits, the said individual shall keep such records pertaining to his gross sales or gross receipts, or the said corporation shall keep such records pertaining to his gross income as defined in Section 32 of this Code during the taxable year, as may be required by the rules and regulations promulgated by the Secretary of Finance, upon recommendation of the Commissioner.[10]

The foregoing provision dictates that the taxpayer should signify in its return the intention to elect the OSD. Otherwise, it shall be considered to have availed of the other deductions allowed in *Section 34 of the 1997 NIRC.*

A perusal of petitioner's 2010 Annual Income Tax Return ("ITR")[11] shows that it declared itemized deductions in the total amount of Php2,858,986.16[12], which resulted to a net loss in the same amount. There was nothing in petitioner's ITR which would indicate that it opted to avail of the OSD. Thus, the OSD under *Section 34(L) of*

[10] Underscoring ours.
[11] *Records, Vol. 2, Exhibit "P-9."*
[12] *Id., line 119.*

the 1997 NIRC should not be applied in the computation of petitioner's tax liability.

Unreported Income - Php82,544.20

Petitioner maintains that it was not involved in the transaction between SMB and SMC relative to the 2008 royalty adjustment, thus it has no unreported income in the amount of Php82,544.20.

To reiterate, petitioner submitted its Schedule of Discrepancies[13], Royalty Schedule for 2008[14] and Certificate of Creditable Tax Withheld at Source[15] amounting to Php82,544.16 with SMC as the payee. However, petitioner merely attached the last two (2) aforementioned documents in the Judicial Affidavit of Ms. Noemi Ronquillo executed on November 14,2014 and did not formally offer the same in its FOE. The Court finds these documents relevant in disputing the said assessment. However, this Court cannot give value to documents which were not formally offered as evidence. Accordingly, the Court upholds the assessment on royalty variance reported by SMBI in the amount of Php82,544.20.

Unsubstantiated Taxes and Licenses - Php72,264.02.

The Court affirms its position that petitioner failed to fully substantiate its "Taxes and Licenses" account. Respondent's audit result on the said account reveals that only Php2,246,345.98 was properly supported with official receipt,s compared to the Php2,318,610.00 reflected in the ITR/FS, thus, the difference of Php72,264.02 remains to be the proper subject of an assessment due to unsupported expenses, computed as follows:

KIND OF FEE/TAX	AMOUNT		OR NUMBER	REFERENCE
Manufacturer	Php	562,873.57	0698607	*BIR Records*, p. 228
Business License		560,686.57	0793776	*BIR Records*, p. 226
Manufacturer		1,120,873.14	0996886	*BIR Records*, p. 225
Garbage Charges		500.00	0996886	*BIR Records*, p. 225
Fire		312.70	0698607	*BIR Records*, p. 228
Sanitary		100.00	0698607	*BIR Records*, p. 228

[13] *Records, Vol. 1, Exhibit "P-19," JA of Ms. Noemi Ronquillo, A55-56*, p. 300; see *Vol. 2, Exhibit "P-14,"* p. 842.
[14] *Id., Vol. 1, Exhibit "P-19," JA of Ms. Noemi Ronquillo, A55-56*, p. 300; see *Vol. 2, Exhibit "P- 14.6,"* p. 400, not included in the FOE.
[15] *Id., Exhibit "P-19," JA of Ms. Noemi Ronquillo, A55-56*, p. 300; see *Exhibit "P-14.7,"* p. 401, not included in the FOE.

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Mayor's Permit		1,000.00	0698607	*BIR Records*, p. 228
Total Per Audit	Php	2,246,345.98		
Per ITR/FS		2,318,610.00		
VARIANCE	**PHP**	**72,264.02**		

Basic deficiency VAT - Php3,260.83

As pointed out and discussed by the Court is its Decision, petitioner's failure to validly protest the deficiency VAT for the fourth quarter of taxable year 2010 warrants that the assessment is in order. Thus, petitioner is liable for basic deficiency VAT for the 4th quarter of 2010 for royalty variance reported by My Philippines Lifestyles, Inc. ("MPLI") amounting to Php3,260.83.

The Court correctly computed the interest.

A comparison of *Section 249(B) and 249(C)(3) of the 1997 NIRC* reveals that the deficiency interest on any deficiency tax is assessed "from the date prescribed for its payment until the full payment thereof;" while the delinquency interest, which is imposed for failure to pay a deficiency tax or any surcharge or interest thereon, is assessed starting "on the due date appearing in the notice and demand of the Commissioner... until the amount is fully paid." Clearly, the law allows the imposition of these two kinds of interest simultaneously.

2. ***Respondent's MR***

Respondent avers that its right to assess petitioner for deficiency VAT has not prescribed; and that the assessment issued against petitioner is valid and lawful. Respondent contends its right to assess and collect from petitioner for deficiency taxes for taxable year 2010 runs for ten (10) years from the date of discovery of non-filing of VAT returns or upon discovery of the false return filed by petitioner.

On September 23, 2016, the Court ordered petitioner to file its comment to respondent's MR within ten (10) days from notice.

On October 13, 2016, petitioner filed its Comment arguing that respondent's right to assess petitioner for deficiency VAT has already prescribed, hence, the assessment is without legal force and effect.

The Court finds no merit in respondent's MR.

Respondent cannot use the argument of non-filing of VAT returns because petitioner was able to provide its quarterly VAT returns for the CY 2010 which were stamped "Received" by the respondent, as follows:

TAX RETURN	DATE OF FILING	EXHIBIT
VAT 1st Quarter	April 20, 2010	P-12
VAT 2nd Quarter	July 20, 2010	P-12.1
VAT 3rd Quarter	October 20, 2010	P-12.2
VAT 4th Quarter	January 20, 2011	P-12.3

On the argument of filing a false return, respondent did not indicate the basis of its claim that the information embodied in the VAT returns were falsely represented.

As stated in the Court's Decision, respondent's right to assess petitioner for deficiency VAT for the first to third quarters of CY 2010 has already prescribed.

WHEREFORE, there being no compelling reason to disturb the August 9, 2016 Decision of the Court, petitioner's Motion for Reconsideration [of the Decision dated August 9, 2016] and respondent's Motion for Partial Reconsideration (Re: Decision dated 10 August 2016) are hereby **DENIED** for lack of merit.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

(On Leave)
MA. BELEN M. RINGPIS-LIBAN
Associate Justice