REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL SECOND DIVISION

METRO RAIL TRANSIT CORPORATION,	**CTA Case No. 9016**
Petitioner,	Members:
-versus-	**CASTAÑEDA, JR.**, *Chairperson* *and* **MANAHAN**, *JJ.*
COMMISSIONER OF INTERNAL REVENUE,	Promulgated: JAN 08 2019
Respondent.	11:N a.m.

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DECISION

MANAHAN, *J.*:

The case involves the Petition for Review[1] filed by Metro Rail Transit Corporation (MRTC) on March 25, 2015, praying for the reversal and setting aside of the Decision of the Commissioner of Internal Revenue dated February 5, 2015 that found it liable for deficiency taxes for taxable year 2007 in the aggregate amount of ₱1,631,807,856.98.

THE PARTIES

Petitioner MRTC is a corporation duly organized and existing under Philippine laws. Its office address is located at 15th Floor, The Belvedere Tower, San Miguel Avenue, Ortigas Center, Pasig City.[2]

On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof

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[1] Docket, CTA Case No. 9016, Vol. I, pp. 10-66.
[2] *Id.*, Vol. IV, Exhibit "P-1", p. 2258.

administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

THE FACTS

Petitioner's primary purpose is to build, lease, maintain and transfer a railway transit system in Metro Manila known as Phase I of the Light Rail Transit System (LRT) Line 3 built pursuant to the Agreement dated August 8, 1997 between Metro Rail Transit Corp. Limited and the Department of Transportation and Communications, now the Department of Transportation (DOTr), as may be amended from time to time.[3]

The BIR sent a Notice of Informal Conference[4] to petitioner to inform petitioner of the results of investigations regarding its tax liabilities for taxable year 2007 and to enable petitioner to present its side of the case and submit whatever evidence it may have in its favor.

On July 15, 2010, petitioner received an undated Preliminary Assessment Notice (PAN)[5] with Details of Discrepancies from the BIR's Large Taxpayers Regular Audit Division III.[6]

On August 20, 2010, petitioner received[7] the Formal Letter of Demand (FLD) with Final Assessment Notices (FAN) and Details of Discrepancies[8] dated August 2, 2010, assessing it for deficiency income tax (IT), value-added tax (VAT), final withholding tax (FWT), expanded withholding tax (EWT), fringe benefits tax (FBT), and documentary stamp tax (DST).[9]

Petitioner filed its protest[10] dated September 9, 2010 with the BIR on September 15, 2010.[11]

Subsequently, petitioner received an undated Final Decision on Disputed Assessment (FDDA)[12] with Details of

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[3] Docket, Vol. IV, Exhibit "P-1", pp. 2259-2260.
[4] BIR Records, Vol. I, Exhibit "P-7", p. 1017.
[5] *Id.*, Vol. I, Exhibits "P-8" and "R-7", pp. 1041-1047.
[6] Docket, Vol. II, Par. 2, Joint Stipulation of Facts and Issues (JSFI), p. 1147.
[7] *Id.*, Vol. II, Par. 4, JSFI, p. 1147.
[8] BIR Records, Vol. I, Exhibit "P-9", pp. 1056-1069.
[9] Docket, Vol. II, Par. 3, JSFI, p. 1147.
[10] Exhibit "P-14", Folder No. 1, Judicial Affidavit of Carmen F. Cintura.
[11] Docket, Vol. II, Par. 5, JSFI, p. 1148.
[12] Exhibit "P-22", Folder No. 1, Judicial Affidavit of Carmen F. Cintura.

Discrepancies on September 23, 2014, demanding the payment of ₱1,590,724,214.41, allegedly representing deficiency IT, VAT, FWT, EWT and FBT, inclusive of increments for taxable year 2007.[13] On October 23, 2014, petitioner filed its Request for Reconsideration[14] dated October 22, 2014.

On February 24, 2015, petitioner received respondent's Decision dated February 5, 2015, denying its request for reconsideration, demanding payment of ₱1,631,807,856.98 from petitioner, allegedly representing deficiency IT, VAT, FWT, EWT, FBT and increments for late payment of income tax for taxable year 2007.[15]

Meanwhile, on March 19, 2015, petitioner paid the deficiency EWT[16] and FBT[17] assessments, including the interests thereon through the Electronic Filing and Payment System (EFPS) of the BIR in the amount of ₱7,574,619.54 and ₱4,671,888.83, respectively.[18]

Petitioner filed the present Petition for Review on March 25, 2015. Thereafter, respondent filed his Answer[19], through registered mail on June 26, 2015 and received by the Court on July 2, 2015, interposing the following Special and Affirmative Defenses:

> "**SPECIAL AND AFFIRMATIVE DEFENSES**
>
> On the basis of the foregoing allegations and in further support of the Specific Denials herein set forth, respondent respectfully alleges as her defense that:
>
> Basic as a hornbook principle is that, taxes are the lifeblood of the government and should be collected without unnecessary hindrance. It is upon taxation that the Government chiefly relies to obtain the means to carry on its operations and it is of the utmost importance that the means adopted to enforce the collection of taxes levied should be summary and interfered with as little as possible.

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[13] Docket, Vol. II, Par. 6, JSFI, p. 1148.
[14] Exhibit "P-23", Folder No. 1, Judicial Affidavit of Carmen F. Cintura.
[15] Docket, Vol. II, Par. 7, JSFI, p. 1148.
[16] *Id.*, Vol. IV, Exhibit "P-25", p. 2846.
[17] *Id.*, Vol. IV, Exhibit "P-26", p. 2854.
[18] *Id.*, Vol. II, Pars. 8 and 9, JSFI, p. 1148.
[19] *Id.*, Vol. I, pp. 752-764.

Petitioner is liable to pay its deficiency income tax in the amount of P1,391,806,794.98.

Additional financing income:

In the process of verifying petitioner's taxable income, there were audit adjustments that resulted to additional income that were not fully subjected to income tax pursuant to Section 27 and in relation to Section 32 (A) of the Tax Code of 1997 which provides:

xxx xxx xxx

The revenue of petitioner is comprised of (1) Lease financing income from the equity rental for the use of the rail system and (2) interest income on debt rental service. Both were credited to Lease Financing Income account. After considering the adjustment due to error in pick-up (accruals per various journal voucher) of interest income of debt rental service of Php533,661,783.66, the actual interest income earned for the period January and July 2007 per JV# 07008 and 070093 was reduced to P322,008,741.78.

xxx xxx xxx

Upon further investigation, new evidence i.e. SARO was introduced substantiating the 5% final withholding VAT of petitioner's liabilities. The 5% final withholding VAT on equity rental and interest on debt rental represent the net VAT payable of petitioner and the remaining 7% effectively accounts for the standard input VAT for sale of services to government in lieu of the actual input VAT directly attributable to such sales. The actual input tax of petitioner for the year 2007 amounts to P824,661.13 only. Since the actual input VAT attributable to sale of services is less than7% of gross payment, the difference is closed to expense as cost.

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The above computation is in accordance with Section 4.114-2 of Revenue Regulations 16-2005 which states that:

xxx xxx xxx

Unexplained source of income (Discrepancy in the alpha list of income payees subject to withholding tax on compensation against book balance):

The figures used in itemizing the balance of general and administrative expenses were derived from the interim and unaudited summary of administrative expenses since this was the only data available during audit. In compliance with the provision of Section 6, (A) of the Tax Code of 1997, data reflected in the unfiled Audited Financial Statement (AFS) *cn* cannot be used because the Letter of Authority had already been issued prior to the availability of the AFS.

Unexplained disbursement:

Careful perusal on the various journal vouchers, canvass sheets, bank statements and debit/ credit memos submitted in support of their protest, disclosed that the transaction (dollar conversion) under investigation were indeed converted to pesos and ultimately credited to petitioner's peso account with the exception on Journal Voucher No. 70103 dated August 31, 2007 and Journal Voucher No. 070159 dated December 31, 2007 which were incurred for various owner's administrative expenses. These were disallowed for failure to present supporting documents in violation of Section 34 (A) (1) (b) of the Tax Code of 1997, as amended.

Petitioner is liable to pay the amount of P4,195,329.65 for late payment of the 5% withholding VAT.

Petitioner is a VAT-registered taxpayer. Verification of the VAT returns disclosed that petitioner merely filed the returns without declaring any amount of gross receipts subject to value added tax. The total gross receipts per FLD/FAN subject to VAT is P3,021,451,907.80 pursuant to Section 108 of the Tax Code of 1997, as amended. On the other hand, input tax credits claimed amounting to P3,702,457.34 (inclusive of current input tax for the year 2007 in the amount of P824,661.13) was part of disallowance since everything was carried over to the succeeding taxable year 2008.

Further as explained earlier, the 5% final withholding VAT on equity rental and interest on debt rental represent the net VAT payable of petitioner and the remaining 7% effectively accounts for the standard input VAT for sale of services to government in lieu of the actual input VAT directly attributable to such sales. The actual input tax of petitioner for the year 2007 amounts to P824,661.13 only. Since the actual input VAT attributable to sale of services is less than 7% of gross payment, the difference is closed to expense as cost. Thus, the assessment for basic deficiency value added tax was cancelled. However, the total amount due represent the increments due to late payment of 5% withholding VAT paid by DOTC through SARO.

Income payments/interest paid to credit facilities namely FCDU and non-resident foreign corporation were not subjected to final withholding tax, thus

petitioner is liable to pay the amount of P122,985,384.04 final withholding tax.

Petitioner is liable to pay its deficiency final withholding tax for its failure to subject certain income payments like interest paid to credit facilities like FCDU and non-resident foreign corporation to final withholding tax.

Petitioner alleged that the loans under the Omnibus Agreement, both principal and interest is the responsibility of the Philippine Government through DOF. Petitioner further alleged that the payments were processed by the DOTC which handled the withholding and the DOF made the payment, net of withholding tax.

Audit and investigation revealed that it was petitioner who claimed the interest and recorded the same as expense in its books of accounts. Petitioner thru DBP submitted documents in the form of Special Allotment Order (SARO) to support its withholding of 10% final tax on interest paid to FCDU but only in the amount of P11,538,959.00.

With regard to the interest paid the other two (2) lenders, Czech and Jexim, petitioner invoked DOJ Ruling No. 12 which states that 'Payments to be made by any ROP obligor to the lenders and the agents pursuant to any Philippine Documents or any document to be furnished by any ROP obligor will be free and clear of withholding taxes and all other taxes imposed by the Republic'. Respondent humbly disagrees. The opinion of the DOJ cannot be given weight, since it is a mere interpretation that does not bind respondent. On the contrary, Section 4 of the Tax Code provides that original jurisdiction to interpret tax laws resides with herein respondent.

Petitioner is liable for increments for late payment of income tax for its failure to pay within the prescribed period.

Petitioner is also subjected to pay increments incidental to its failure to pay quarterly and annual income tax due in full within the prescribed period.

A review of petitioner's quarterly and annual income tax returns for taxable year 2007 disclosed that petitioner failed to pay in full the income tax due amounting to P1,617,544,194.18 within the prescribed due dates. The 25% surcharge and 20% interest per annum have been imposed pursuant to Section 248 (A) (4) and Section 249 (A) of the 1997 Tax Code.

> Petitioner alleged that under the BLT Agreement, the DOTC is the one responsible for payment of its deficiency taxes, interest and penalties assessed with respect to its corporate income taxes on the profit arising from its rail operations. Respondent reiterates its position that the BLT Agreement is an agreement between MRTC and DOTC, therefore any assessment arising from this transaction is assessable to petitioner and not DOTC.
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> The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong, but also that the taxpayer is right. The presumption in favor of the correctness of tax assessment stands where evidence to the contrary is wanting.
>
> 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."

The pre-trial conference was set on November 12, 2015.[20] Accordingly, petitioner's Pre-Trial Brief[21] was filed on October 12, 2015; while respondent's Pre-Trial Brief[22] was filed on October 9, 2015.

The parties filed their Joint Stipulation of Facts and Issues[23] on November 27, 2015, which was approved by the Court in its Pre-Trial Order[24] issued on January 22, 2016.

Petitioner presented Atty. Alberto B. Reyno[25], Ms. Carmen F. Cintura, and Atty. Jude Z. Lee as its witnesses.[26]

Petitioner filed its Formal Offer of Evidence[27] through registered mail on March 15, 2016 and received by the Court on

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[20] Docket, Vol. II, Notice of Resetting dated October 13, 2015, p. 1121.
[21] *Id.*, Vol. II, pp. 799-809.
[22] *Id.*, Vol. II, pp. 873-877.
[23] *Id.*, Vol. II, pp. 1147-1152.
[24] *Id.*, Vol. II, pp. 1199-1216.
[25] *Id.*, Vol. II, Minutes of the hearing dated February 3, 2016, p. 1222.
[26] *Id.*, Vol. II, Minutes of the hearing dated February 29, 2016, p. 1232.
[27] *Id.*, Vol. IV, pp. 2195-2256.

March 28, 2016, offering Exhibits "P-1" to "P-77-A", inclusive of submarkings.

On May 19, 2016, petitioner filed a Manifestation and Supplemental Offer of Evidence[28], offering Exhibits "P-30", "P-30-A", "P-31", "P-31-A", "P-32", "P-32-A", "P-32-B", "P-35", "P-35-A", "P-35-B", and "P-35-C". Respondent filed his Comment (Re: Petitioner's Original and Supplemental Formal Offer of Evidence)[29] on June 13, 2016.

In the Resolution[30] dated July 20, 2016, the Court admitted all of petitioner's formally offered exhibits, but denied the admission of Exhibits "P-40", "P-49" "P-51", and "P-52".

Petitioner filed its Motion for Partial Reconsideration (of the Resolution dated July 20, 2016) and Tender of Excluded Evidence[31] on August 9, 2016.

In the Resolution[32] dated October 6, 2016, the Court denied petitioner's Motion for Partial Reconsideration (of the Resolution dated July 20, 2016), but noted its Tender of Excluded Evidence.

Respondent presented Revenue Officer Elizabeth U. Cadiz as his only witness.[33]

On October 13, 2016, respondent filed his Formal Offer of Documentary Evidence[34], offering Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-8", "R-9", "R-10", "R-11", "R-12", "R-13", "R-14", "R-15", and "R-15-a". Petitioner filed its Comment [on Respondent's Formal Offer of Documentary Evidence dated October 13, 2016][35] on November 9, 2016.

In the Resolution[36] dated January 19, 2017, the Court admitted all the exhibits formally offered by respondent.

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[28] Docket, Vol. V, pp. 3027-3035.
[29] *Id.*, Vol. V, pp. 3045-3047.
[30] *Id.*, Vol. V, pp. 3063-3067.
[31] *Id.*, Vol. V, pp. 3075-3092.
[32] *Id.*, Vol. V, pp. 3169-3174.
[33] *Id.*, Vol. V, Minutes of the hearing dated October 10, 2016, p. 3175.
[34] *Id.*, Vol. V, pp. 3182-3188.
[35] *Id.*, Vol. V, pp. 3212-3214.
[36] *Id.*, Vol. V, pp. 3226-3228. *on*

For rebuttal evidence, petitioner presented Ms. Rhodora V. Reyes[37] and Senior State Solicitor Omar Diaz.[38]

On April 27, 2017, petitioner filed its Supplemental Offer of Evidence[39], offering Exhibits "P-40", "P-51", "P-51-A", "P-52", and "P-52-A", as additional documentary evidence. Respondent filed his Comment Re: Supplemental Formal Offer of Evidence[40] on May 5, 2017.

The Court admitted Exhibits "P-40", "P-51", "P-51-A", "P-52", and "P-52-A" in the Resolution[41] dated October 6, 2017.

The Court declared the case submitted for decision on January 8, 2018,[42] considering petitioner's Memorandum[43] filed on December 8, 2017 and respondent's Memorandum[44] filed on December 21, 2017.

ISSUES

The parties submitted the following issues for the Court's resolution:[45]

1. Whether or not the alleged deficiency tax assessments issued by the BIR against MRTC is improper.

2. Whether MRTC is liable to pay the deficiency IT, VAT, FWT and increments for late payment all for taxable year 2007 as stated in Respondent's Decision, excluding the EWT and FBT payments made by petitioner, plus 25% surcharge and 20% deficiency and delinquency interest for late payment until fully paid pursuant to Sections 248 and 249 of the National Internal Revenue Code.

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[37] Docket, vol. V, Minutes of the hearing dated March 22, 2017, p. 3242.
[38] *Id.*, vol. V, Minutes of the hearing dated April 24, 2017, p. 3244.
[39] *Id.*, Vol. V, pp. 3247-3251.
[40] *Id.*, Vol. V, pp. 3266-3268.
[41] *Id.*, Vol. V, pp. 3272-3273.
[42] *Id.*, Vol. V, Resolution dated January 8, 2018, p. 3427.
[43] *Id.*, Vol. V, pp. 3288-3409.
[44] *Id.*, Vol. V, pp. 3416-3426.
[45] *Id.*, Vol. II, JSFI, p. 1148.

Petitioner's Arguments[46]

As to the alleged IT deficiency, petitioner argues that it had correctly declared its revenue for IT purposes and respondent erroneously disregarded its explanation that the portion of Lease Financing Income not subjected to IT was due to the variance between MRTC's Lease Financing Income as per its amended 2007 income tax return (ITR) vis-à-vis its adjustments where such variance was the result of the difference between the application of Generally Accepted Accounting Principle (GAAP) and tax treatment of leases.

It also argues that the difference between the salary-related expenses per books versus income payments subject to withholding tax on compensation (WTC) per Alpha List cannot be considered as undeclared source of income subject to IT and the amount of Php35,264,589.61, representing income payments which it allegedly did not subject to EWT, should be deducted from its income in light of its payment of the deficiency EWT assessment. Petitioner argues that respondent is precluded from using as basis the "Receipts from Equity Rental per Reinvestigation" in the amount Php2,794,430,733.52 because this is much higher than and is inconsistent with the amount reflected in both the PAN and FLD.

Petitioner further argues that respondent failed to consider that a portion of the alleged "unexplained disbursement not duly supported by documentary evidence" actually pertained to payments made by MRTC to MRT Development Corporation (MRTDC) for advances it made for general and administrative expenses, which were substantiated with check vouchers and receipts. Petitioner asserts that it is the DOTr which should be liable to pay any deficiency IT assessment under Section 9.3 of the Build-Lease-Transfer (BLT) Agreement.

As to the alleged VAT deficiency, petitioner argues that the imposition of deficiency interest and compromise penalty on VAT is void for lack of legal basis and that it cannot be held liable for the acts and omissions of DOTr which is the withholding agent.

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[46] *Supra.*, Note 43.

As to the alleged FWT deficiency, respondent deducted the incorrect amount of FWT on the Foreign Currency Deposit Unit (FCDU) income payments. The DOTr had the receipt, custody, control, and disposal over the payments to the foreign lenders, hence, the former should be liable for any deficiency FWT.

Petitioner also asserts that it is not liable for any deficiency FWT on the payments made to JEXIM and CZECH because the Government expressly undertook to deduct, withhold, and pay any taxes due on payments made to them as confirmed in the DOJ Opinion which expressly declared that payments made by the Government to JEXIM and CZECH will be free and clear of withholding taxes, and that JEXIM is a financial institution wholly-owned by the Government of Japan.

As to the increments on late payment of IT, petitioner argues that it is not liable for such because it cannot be held liable for DOTr's acts and omissions as the Government agreed that it would pay MRTC's corporate IT.

Petitioner also argues that the imposition of compromise penalty is without its consent, hence, such imposition is improper and said increments should be collected from the DOTr.

Respondent's Counter-Arguments[47]

Respondent, on the other hand, argues that petitioner is liable to pay the assessed deficiency IT in the amount of Php1,391,806,794.98 on the additional income that were not fully subjected to IT and there is an unexplained source of income as shown by the discrepancy in the alpha list of income payees subject to WTC against book balance.

Respondent also argues that petitioner is liable to pay the amount of Php4,195,329.65 for late payment of the 5% withholding VAT and that income payments/interest paid to credit facilities namely FCDU and non-resident foreign corporation were not subjected to FWT, thus, petitioner is liable to pay the amount of Php122,985,384.04.

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[47] *Supra.*, Note 44. con

Respondent further argues that petitioner is liable for increments for late payment of IT for its failure to pay within the prescribed period.

RULING OF THE COURT

The Court shall first determine the timeliness of the filing of the present case. Pertinent to the resolution of this matter is Section 228 of the NIRC of 1997, as amended, which states:

> 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 preassessment notice shall not be required in the following cases:
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> 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.
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> 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 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.

Pursuant to Section 228 of the NIRC of 1997, petitioner has thirty (30) days from receipt of the FLD/FAN within which to file its administrative protest and another thirty (30) days from receipt of respondent's decision, or from the lapse of one hundred eighty (180)-day period within which to file its Petition for Review with the Court of Tax Appeals. *cm*

Petitioner received the FLD/FAN and Details of Discrepancies dated August 2, 2010, assessing it for deficiency IT, VAT, FWT, EWT, FBT, and DST for the taxable year 2007 on August 20, 2010. Petitioner had 30 days from August 20, 2010 or until September 20, 2010[48] to file its administrative protest. Petitioner filed with the BIR its protest dated September 9, 2010 on September 15, 2010.

Thereafter, petitioner received an undated FDDA with Details of Discrepancies demanding the payment of ₱1,590,724,214.41, inclusive of interests, surcharges and compromise penalties on September 23, 2014. On October 23, 2014, petitioner filed its request for reconsideration dated October 22, 2014.

On February 24, 2015, petitioner received respondent's Decision dated February 5, 2015 denying its request for reconsideration and demanding payment from petitioner of ₱1,631,807,856.98 as deficiency taxes for taxable year 2007. Counting 30 days from February 24, 2015, petitioner had until March 26, 2015 within which to file its Petition for Review with the Court. Hence, the Petition for Review filed by petitioner on March 25, 2015 was clearly within the 30-day prescriptive period.

The Court shall now determine the merits of the case.

Petitioner contends[49] that it is the DOTr, which is liable to pay any deficiency income tax assessment, pursuant to Section 9.3 of the Build, Lease and Transfer (BLT) Agreement[50] entered into by and between petitioner and DOTr on August 8, 1997, which provides:

> 9.3. <u>Taxes: Exemption</u>. xxx
>
> **DOTC shall reimburse Metro Rail for payments of its Philippine corporate income taxes on the profits arising from its rail operations.** xxx Any amounts paid by Metro Rail in respect of such taxes shall bear interest at the rate of 15% per annum from the date of payment to the date of reimbursement by DOTC, which shall be payable at the same time as such reimbursement. For purposes of this paragraph, "Philippine corporate income taxes on the profits arising from its rail operations" includes deficiency taxes, interest and

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[48] September 19, 2010 fell on a Sunday.
[49] Docket, Vol. I, Petition for Review, pp. 39-40.
[50] *Id.*, Vol. III, Exhibit "P-3", pp. 1400-1401.

> penalties assessed in respect thereof, except to the extent caused by the gross negligence, fraud or willful misconduct of Metro Rail. Except as set forth above, DOTC shall have no right to examine any form or return relating to Metro Rail's income taxes nor Metro Rail's books nor to question any item shown on any such form or return.

The Court does not agree.

Income tax is a national tax imposed on the net or the gross income realized in a taxable year.[51] Income tax, it should be stressed, is imposed on an individual or entity as a form of excise tax or a tax on the privilege of earning income. In exchange for the protection extended by the State to the taxpayer, the government collects taxes as a source of revenue to finance its activities. Income tax should be borne by the taxpayer alone as it constitutes payment made in exchange for benefits received by the taxpayer from the State.[52] Thus, the payment of income tax remains the liability of petitioner which earned its profits arising from its rail operations.

The Court shall now discuss the subject tax assessments against petitioner for deficiency basic taxes, surcharges, interest, and compromise penalties for taxable year 2007.

I. Compromise Penalties – ₱320,000.00

Respondent imposed compromise penalties on the following deficiency taxes in the total amount of ₱320,000.00:[53]

Deficiency income tax	₱ 50,000.00
Deficiency VAT	70,000.00
Deficiency FWT	50,000.00
Deficiency EWT	25,000.00
Deficiency FBT	25,000.00
Increments for late payment of income tax[54]	100,000.00
Total	**₱320,000.00**

It must be stressed that a compromise penalty is imposed to avoid prosecution for violation of the provisions of the Tax

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[51] *Commissioner of Internal Revenue vs. Solidbank Corporation,* G.R. No. 148191, November 25, 2003.

[52] *Republic of the Philippines, represented by Energy Regulatory Board vs. Manila Electric Company,* G.R. Nos. 141314 and 141369, November 15, 2002.

[53] Exhibit "P-22".

[54] BIR Records, Folder 1, FLD, Exhibit "P-9", p. 1066.

Code. Under Revenue Memorandum Order (RMO) 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. It is well-settled that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[55] Absent a showing that petitioner consented to the compromise penalty, its imposition should be deleted. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[56]

In the present case, there is nothing in the records which would show that petitioner consented to the imposition of compromise penalty. Thus, the imposition of the same on the deficiency taxes in the total amount of ₱320,000.00 cannot be sustained.

II. Deficiency Income Tax – ₱1,058,290,558.63

An examination of the FDDA shows that respondent adjusted certain assessment items from the FLD. The following shows the final deficiency income tax assessment in the FDDA:

	FLD[57]	FDDA[58]	
		Adjustments	**Final Assessed Amount**
Taxable income per Return	₱ 4,621,554,841.00		₱ 4,621,554,841.00
Add: Adjustments			
Lease financing income not subjected to income tax	1,316,541,837.61	₱(304,081,762.29)	1,012,460,075.32
Unexplained source of income:			
Excess income payment subject to WTC, resulting from recon per Alphalist vs book balances	1,106,014.81	116.04	1,106,130.85
Unexplained disbursement on the purchase of $ for owner's (Sps. Robert John L. Soprepena &/or Melissa Louise L. Soprepena) admin expenses. Both are not stockholders of MRTC, being the latter a wholly owned subsidiary of MRTH II, a domestic corporation	38,491,352.95	(24,214,075.00)	14,277,277.95

[55] *The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et al.*, G.R. Nos. L-12928 and L-12932, March 31, 1962.
[56] *Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc., et al.*, G.R. No. L-35266, January 21, 1999.
[57] BIR Records, Folder 1, Exhibit "P-9", p. 1069.
[58] Exhibit "P-22".

Income payments not subjected to EWT	35,264,589.61		35,264,589.61
Disallowed expenses:			
BIR penalty charged to Taxes and Licenses	3,000.00		3,000.00
Donation to the OSG-MRT Taskforce to various real property tax related cases	400,000.00		400,000.00
Difference between the 7% VAT that effectively accounts for the standard input tax and the actual input tax		218,145,769.06	218,145,769.06
ADJUSTED TAXABLE INCOME	**₱6,013,361,635.98**		**₱5,903,211,683.79**
Tax rate	35%		35%
Aggregate income tax	**₱2,104,676,572.59**		**₱2,066,124,089.33**
Less: Tax payments/credits	1,620,510,563.83		1,620,510,563.83
Tax payable	**₱ 484,166,008.76**		**₱ 445,613,525.50**
Add: Interest (April 15, 2008 to Sept. 15, 2010) at 48.35%	234,094,265.24		
Interest (April 16, 2008 to Sept. 30, 2014) 2358 days			575,757,092.12
Compromise penalty			50,000.00
TOTAL DEFICIENCY INCOME TAX	**₱ 718,260,274.00**		**₱1,021,420,617.62**

Based on the foregoing, the following items comprise the deficiency IT assessment of petitioner:

A. Lease financing income not subject to income tax	₱1,012,460,075.32
B. Unexplained source of income:	
B1. Excess income payment subject to WTC, resulting from recon per Alphalist vs book balances	1,106,130.85
B2. Unexplained disbursement on the purchase of $ for owner's (Sps. Robert John L. Soprepena and/or Melissa Louise L. Soprepena) admin expenses. Both are not stockholders of MRTC, being the latter a wholly owned subsidiary of MRTH II, a domestic corporation	14,277,277.95
C. Income payments not subjected to EWT	35,264,589.61
D. Disallowed expenses:	
D1. BIR penalty charged to Taxes and Licenses	3,000.00
D2. Donation to the OSG-MRT Taskforce to various real property tax related cases	400,000.00
E. Difference between the 7% VAT that effectively accounts for the standard input tax and the actual input tax	218,145,769.06

A. Lease financing income not subject to income tax – ₱1,012,460,075.32

In the process of verifying petitioner's taxable income, respondent found that there are audit adjustments that resulted in additional income that were not fully subjected to income tax pursuant to Section 27 and in relation to Section 32(A) of the NIRC of 1997.[59]

Considering both the computation of the assessment in the FLD and the adjustments made in the FDDA, the following shows the computation of the alleged lease financing income not subject to income tax amounting to ₱1,012,460,075.32:

	FLD	FDDA
Lease financing income from equity rental	₱ 4,275,514,912.95	₱ 4,275,514,912.95
Interest income on debt rental	533,661,783.00	229,580,021.37
Total financing income per reinvestigation	**₱4,809,176,695.95**	**₱4,505,094,934.32**
Sales/Revenues/Receipts/Fees per ITR	3,492,634,859.00	3,492,634,859.00
Lease financing income not subject to income tax	**₱1,316,541,836.95**	**₱1,012,460,075.32**

Based on the above computation, there are two (2) components of financing income which should be subjected to income tax:

	FLD	FDDA
Lease financing income from equity rental	₱ 4,275,514,912.95	₱ 4,275,514,912.95
Interest income on debt rental	533,661,783.00	229,580,021.37
Total financing income subject to income tax	**₱4,809,176,695.95**	**₱4,505,094,934.32**

A.1. Interest income on debt rental

It can be noted that the interest income on debt rental amounting to ₱533,661,783.00 in the FLD is related to the interest payments to foreign lenders which were subjected to deficiency FWT, detailed as follows:

Interest on loans:	
FCDU - Local	₱ 144,616,217.59
Czech	166,623,303.91
JEXIM	222,422,262.16
Total Interest Income	**₱533,661,783.66***

**with difference of ₱0.66.*

After re-investigation and payment by the DOTC, through the Special Allotment Request Order (SARO), of the corresponding withholding tax on the FCDU credit facility, the said interest income of ₱533,661,783.00 was adjusted in the

[59] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", p. 1064.

FDDA to ₱229,580,021.37, which pertains to the following income payments:

Income payments to Czech	₱ 98,827,948.11
Income payments to JEXIM	130,752,073.26
Total	**₱ 229,580,021.37**

Upon examination of the records, the Court found that the amount of ₱533,661,783.00 pertains to actual interests earned and accruals of interest on FCDU, Czech and JEXIM credit facilities as indicated in petitioner's journal vouchers (JVs)[60], as shown below:[61]

		IN US $			
Period	**Number**	**FCDU**	**Czech**	**JEXIM**	**Total**
January	JV# 070008	1,149,564.20	1,129,659.51	1,492,588.16	3,771,811.87
February	JV# 070028	151,757.10	162,257.00	214,114.73	528,128.83
March	JV# 070039	151,757.10	162,257.00	214,114.73	528,128.83
April	JV# 070051	151,757.10	162,257.00	216,694.43	530,708.53
May	JV# 070069	148,475.87	158,748.74	209,485.22	516,709.83
June	JV# 070081	148,475.87	158,748.74	206,961.31	514,185.92
July	JV# 070093	792,144.67	952,492.41	1,272,054.86	3,016,691.94
August	JV# 070106	74,709.87	134,483.28	175,326.32	384,519.47
September	JV# 070119	74,709.87	134,483.28	186,016.95	395,210.10
October	JV# 070127	74,709.87	134,483.28	183,878.82	393,071.97
November	JV# 070142	74,709.87	134,483.28	192,431.33	401,624.48
December	JV# 070155	74,709.87	134,483.28	190,293.20	399,486.35
Total					**11,380,278.12**

		IN PHP			
Period	**Number**	**FCDU**	**Czech**	**JEXIM**	**Total**
January	JV# 070008	56,229,783.28	55,256,165.27	73,008,457.31	184,494,405.86
February	JV# 070028	7,342,160.17	7,850,155.76	10,359,084.92	25,551,400.85
March	JV# 070039	7,362,799.14	7,872,222.71	10,388,204.52	25,623,226.37
April	JV# 070051	7,257,327.96	7,759,454.09	10,362,760.98	25,379,543.03
May	JV# 070069	6,950,749.14	7,431,663.28	9,806,841.30	24,189,253.72
June	JV# 070081	6,853,645.93	7,327,841.61	9,553,333.89	23,734,821.43
July	JV# 070093	36,130,510.54	43,444,131.31	58,019,694.07	137,594,335.92
August	JV# 070106	3,442,182.70	6,196,182.57	8,077,984.92	17,716,350.19
September	JV# 070119	3,383,909.00	6,091,285.61	8,425,451.75	17,900,646.36
October	JV# 070127	3,315,624.18	5,968,367.89	8,160,542.23	17,444,534.30
November	JV# 070142	3,228,811.31	5,812,098.32	8,316,497.13	17,357,406.76
December	JV# 070155	3,118,614.24	5,613,735.49	7,943,409.14	16,675,758.87
Total					**533,661,683.66**

[60] BIR Records, Folder 1, pp. 250, 310, 327, 340, 370, 392, 429, 469, 480, 501, 550, and 569.
[61] *Id.*, Folder 1, Exhibit A to Notice of Informal Conference, Exhibit "P-7", p. 1011.

An examination of petitioner's JV entries shows that for a particular loan, petitioner recognizes interest income and interest expense at the same time with the same amount. The following shows the pro-forma entries in the said JVs:

Lease receivables – interest *or* AR - DOTC - interest	xxx	
Interest expense – lender (credit facility)	xxx	
Interest payable – lender (credit facility)		xxx
Lease financing income – lender (credit facility)		xxx

Based on the foregoing entry, petitioner records the interest expense on loans since it is the borrower in accordance with the respective Credit Facility Agreements with the three (3) lenders: (1) FCDU; (2) Investicni A Postovni Banka, A.S. (Czech); and (3) The Exim-Import Bank of Japan (JEXIM).[62] On the other hand, it is the Republic of the Philippines, through the DOTr, which undertook to pay the loans and interest directly to the foreign lenders. Hence, petitioner records a receivable from the DOTr to account for the supposed payment of the interest arising from the loans and credits interest income to account for such receivable.

Further examination of the JVs shows that in July 2007, in JV No. 070093, the actual interest income earned for the period covering February to July 2007 in the total amount of ₱137,594,335.92 was recognized by petitioner, while reversing the accruals for the months of February to June 2007 previously made under JV Nos. 070028, 070039, 070051, 070069, and 070081, in the aggregate amount of ₱124,478,246.74, as can be summarized below:

JV No. 070093 ***(To take up interest on various credit facilities)***	
FCDU	₱ 36,130,510.54
Czech	43,444,131.31
JEXIM	58,019,694.07
Total actual interest income	**₱ 137,594,335.92**

JV No. 070093 ***(Reversal of accrued interest on various credit facilities)***					
Period (2007)	**JV No.**	**Lender**			
		FCDU	**Czech**	**JEXIM**	**Total**
February	070028	₱ 7,342,160.17	₱ 7,850,155.76	₱ 10,359,084.92	₱ 25,551,400.85
March	070039	7,362,799.14	7,872,222.71	10,388,204.52	25,623,226.37
April	070051	7,257,327.96	7,759,454.09	10,362,760.98	25,379,543.03
May	070069	6,950,749.14	7,431,663.28	9,806,841.30	24,189,253.72
June	070081	6,853,645.93	7,327,841.61	9,553,333.89	23,734,821.43

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[62] Docket, Vol. IV, Exhibits "P-11" to "P-13", pp. 2647 to 2749.

Discrepancy (over reversal)		0.71	0.94	(0.31)	1.34
Total		**₱35,766,683.05**	**₱38,241,338.39**	**₱50,470,225.30**	**₱124,478,246.74**

On the other hand, the accrued interest income per JV Nos. 070106, 070119, 070127, 070142, and 070155 aggregating ₱87,094,696.48, as summarized below, pertains to accruals for January 2008, thus were removed by respondent in the FDDA:

Period	**JV No.**	**Lender**			**Total**
		FCDU	**Czech**	**JEXIM**	
August	070106	₱ 3,442,182.70	₱ 6,196,182.57	₱ 8,077,984.92	₱ 17,716,350.19
September	070119	3,383,909.00	6,091,285.61	8,425,451.75	17,900,646.36
October	070127	3,315,624.18	5,968,367.89	8,160,542.23	17,444,534.30
November	070142	3,228,811.31	5,812,098.32	8,316,497.13	17,357,406.76
December	070155	3,118,614.24	5,613,735.49	7,943,409.14	16,675,758.87
	Total	**₱16,489,141.43**	**₱29,681,669.88**	**₱40,923,885.17**	**₱87,094,696.48**

It was also noted that reversals aggregating ₱710,371,710.63 were recorded in JV No. 070008 but the entries did not indicate the applicable period of accruals of interest that they reversed. These entries were disregarded by respondent in computing the assessment.

As a result, only the actual interest income recorded in January and July 2007 aggregating ₱322,088,741.78 through JV Nos. 070008 and 070093 remain, which served as respondent's source in computing the assessment:

Period	**JV No.**	**Lender**			**Total**
		FCDU	**Czech**	**JEXIM**	
January	70008	₱ 56,229,783.28	₱ 55,256,165.27	₱ 73,008,457.31	₱ 184,494,405.86
July	70093	36,130,510.54	43,444,131.31	58,019,694.07	137,594,335.92
	Total	**₱92,360,293.82**	**₱98,700,296.58**	**₱131,028,151.38**	**₱322,088,741.78**

Period	**JV No.**	**FCDU**	**Czech**	**JEXIM**	**Total**
January	70008	US$ 1,149,564.20	US$ 1,129,659.51	US$ 1,492,588.16	US$3,771,811.87
July	70093	792,144.67	952,492.41	1,272,054.86	3,016,691.94
	Total	**US$ 1,941,708.87**	**US$ 2,082,151.92**	**US$ 2,764,643.02**	**US$6,788,503.81**

Comparing the above accruals amounting to ₱322,088,741.78 and respondent's final finding of interest income on debt rentals amounting to ₱333,718,269.16 shows a difference of ₱11,269,527.38, as computed below:

Lender	per JVs	per Respondent	Difference
FCDU	₱ 92,360,293.82	₱ 104,138,247.80	**₱11,777,953.98**
Czech	98,700,296.58	98,827,948.11	**127,651.53**
JEXIM	131,028,151.38	130,752,073.26	**(276,078.12)**
Total	**₱322,088,741.78**	**₱333,718,269.16**	**₱11,629,527.38**

The differences may be accounted as follows:

1. The interest on FCDU loan was grossed up by respondent as it was found that the amount in petitioner's JVs are already net of the 10% withholding tax on FCDU and 5% withholding tax on offshore bank.

2. The additional interest for overdue payment on FCDU loan amounting to US$2,519.46 (net of tax is US$2,240.28) with equivalent peso amount of ₱122,690.14, which respondent derived from the supporting computation and documents of Statement of Allotment and Release Order No. A-07-06146[63], was not recorded by petitioner in its books.

3. Different exchange rates used by respondent and petitioner. Respondent adopted the rates used in the computation of taxes withheld supporting the SAROs issued by DOTr as payment of the loan to the lenders.[64]

4. The interest on JEXIM loan per JV No. 070093 amounting to JP¥151,435,102.00 was erroneously picked up by respondent at JP¥151,535,102.00.

The following table demonstrates the computation of the above differences:

Lender	Interest, Net of Tax	Grossed-up Interest in FDDA	Exchange Rate used in FDDA	Php Amount in FDDA	Exchange Rate used in JV	Php Amount per JV	Difference in Php
JV No. 070008:							
FCDU	US$ 1,149,564.20	US$ 1,292,813.38	49.027	₱ 63,382,761.58	48.914	₱ 56,229,783.28	₱ 7,152,978.30
Additional FCDU Interest	US$ 2,240.28	US$ 2,519.46	48.697	122,690.14	-	-	122,690.14
Czech	US$ 1,129,659.51	US$ 1,129,659.51	49.027	55,383,816.80	48.914	55,256,165.27	127,651.52
JEXIM	JP¥179,602,601.00	JP¥179,602,601.00	0.404865	72,714,800.95	0.4065	73,008,457.31	(293,656.36)
JV No. 070093:							
FCDU	US$ 792,144.67	US$ 890,855.19	45.611	40,632,796.07	45.611	36,130,510.54	4,502,285.53
Czech	US$ 952,492.41	US$ 952,492.41	45.611	43,444,131.31	45.611	43,444,131.31	-

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[63] BIR Records, Folder 2, pp. 209 and 216.
[64] BIR Records, Folder 2, p. 216.

JEXIM	JP¥151,435,102.00	JP¥151,535,102.00	0.382995567	58,037,272.31	0.38313	58,019,694.07	17,578.24
Total				**₱333,718,269.16**		**₱322,088,741.78**	**₱11,629,527.37**
Recap:							
FCDU		US$2,186,188.03		₱ 104,138,247.80			₱ 11,777,953.97
Czech		US$2,082,151.92		98,827,948.11			127,651.52
JEXIM		JP¥331,137,703.00		130,752,073.26			(276,078.12)
TOTAL				**₱333,718,269.16**		**₱322,088,741.79**	**₱11,629,527.38**

Considering the error in the amount picked up by respondent, the assessed amount of interest income on debt rental should be at ₱333,679,969.60:

Lender	Interest	Rate used in FDDA[65]	Should be Assessed Amount
JV70008:			
FCDU	US$ 1,292,813.38	49.027	₱ 63,382,761.58
Additional FCDU Interest	US$ 2,519.46	48.697	122,690.14
Czech	US$ 1,129,659.51	49.027	55,383,816.80
JEXIM	JP¥ 179,602,601.00	0.404865	72,714,800.95
JV70093:			
FCDU	US$ 890,855.19	45.611	₱ 40,632,796.07
Czech	US$ 952,492.41	45.611	43,444,131.31
JEXIM	JP¥ 151,435,102.00	0.382995567	57,998,972.75
Total			**₱333,679,969.61**
Recap:			
FCDU	US$ 2,186,188.03		₱ 104,138,247.79
Czech	US$ 2,082,151.92		98,827,948.11
JEXIM	JP¥ 331,037,703.00		130,713,773.70
TOTAL			**₱333,679,969.60**

Meanwhile, an analysis of petitioner's computation of revenues[66] shows that its claimed interest income on debt rental services amounting to ₱269,190,814.10 was not declared in its Amended Annual Income Tax Return (AAITR) for 2007.

It may be observed that instead of reconciling the discrepancy as found by respondent as against its declared income per AAITR of ₱3,492,634,859.00[67], petitioner made a straightforward comparison between its income per books totaling US$98,700,613.56 or ₱4,545,008,727.28[68] against its income per AITR of ₱3,492,634,858.84,[69] resulting in a

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[65] Using BSP rate.
[66] Annex A-1-d, Letter dated October 25, 2010, Exhibit "P-15".
[67] Docket, Vol. IV, Line 15, 2007 AITR, Exhibit "P-20", p. 2844.
[68] *Id.*, Vol. IV, Annex A-1-b, Letter dated October 25, 2010, Exhibit "P-15"; Line 15, 2007 AITR, Exhibit "P-20", p. 2844.
[69] *Id.*, Vol. IV, Line 15, 2007 AITR, Exhibit "P-20", p. 2844 (not yet rounded off).

reconciling item of non-taxable income amounting to ₱1,052,373,027.45.[70] This reconciling item was explained by petitioner to be the difference in the accounting treatment of finance lease and operating lease.

The Court finds this straightforward comparison erroneous. The Court believes that in reconciling the difference between the accounting treatment of finance lease and operating lease, only the Lease Financing Income amounting to US$92,923,839.01 or ₱4,275,514,913.18[71] should have been considered. Petitioner should not have included the Interest on Debt Rental in the reconciliation since it arose from a different nature of transaction and did not really arise from the lease of the LRTA facilities to the DOTr.

And as claimed by petitioner, the revenues declared in the AAITR for 2007 amounting to ₱3,492,634,859.00[72] only pertain to the lease income in accordance with the accounting policies on operating lease. In other words, the interest income on debt rental was indeed not declared and subjected to income tax.

The Court believes, however, that the gross amount of interest income from debt rental amounting to ₱333,679,969.60, as found by respondent and corrected by the Court, should be declared as taxable for income tax purposes. It should not be reduced by the amount of ₱104,138,247.79 corresponding to the interest expense on FCDU loan which was accordingly subjected to final income tax. The taxability of interest income on debt rental is not dependent as to whether or not the related interest expense was subjected to FWT.

Section 31 of the NIRC of 1997 provides that "taxable income" means the pertinent items of gross income specified in the Tax Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the Tax Code or other special laws.

And as provided in Section 32(A) of the NIRC of 1997, taxable gross income means all income derived from whatever source, except if it can be classified as one of the exclusions from gross income under Section 32(B) of the same Code.

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[70] Annex A-1-d, Letter dated October 25, 2010, Exhibit "P-15".
[71] Annex A-1-b, Letter dated October 25, 2010, Exhibit "P-15".
[72] Docket, Vol. IV, Line 15, 2007 AITR, Exhibit "P-20", p. 2844.

In this case, the interest income on debt rental amounting to ₱333,679,969.61 is amongst "all income from whatever source" as defined in Section 32(A) of the NIRC of 1997, and does not qualify as one of the exclusions under Section 32(B) of the same Code. As such, it shall be declared in full amount before being reduced by any deductions as provided in Section 31.

However, it can be noted that the interest on debt rental declared in the 2007 AFS only amounted to US$5,769,485.03 or ₱269,157,167.42.[73] There arises a difference between the amount declared in the AFS and the interest income on debt rental as found by this Court amounting to ₱64,522,802.18 (₱333,679,969.60- ₱269,157,167.42).

Since petitioner did not account as to how it arrived at the amount of interest income on debt rental declared in the Audited Financial Statements (AFS), we shall stick to the amount found by the Court.

The Court moves forward to the next component of this assessment item.

A.2. Lease financing income from equity rental

Proceeding from the findings in subsection A.1, the Court finds that the lease financing income which should have been assessed for failure to subject to income tax should only be in the amount of ₱782,880,054.18, as computed below:

Lease financing income per books	₱4,275,514,913.18
Revenues per ITR	3,492,634,859.00
Lease financing income not subject to income tax	**₱782,880,054.18**

Petitioner explained that the portion of Lease Financing Income not subjected to income tax was due to the variance between MRTC's Lease Financing Income as per its Amended 2007 Income Tax Return (ITR) vis-à-vis its books as a result of accounting adjustments and the application of GAAP and the tax treatment of leases.

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[73] ₱254,457,435.10+₱14,699,732.32, Annex A-1-b, Letter dated October 25, 2010, Exhibit "P-15".

According to petitioner, for accounting purposes, it is required to comply with the Philippine Accounting Standards 17 on Leases ("PAS 17") which enumerates the requisites for a lease to be classified either as an operating lease or a finance lease. As reflected in petitioner's 2007 AFS, its Lease Financing Income is accounted for under the finance lease method (*i.e.*, depreciation expense over the leased property is not allowed as a deduction from the accounting books of the lessor, petitioner). For accounting purposes, it is the lessee who is allowed to claim the depreciation expense in a finance lease.

Petitioner further explains that for tax purposes, however, the distinction between an operating and finance lease is irrelevant as far as it is concerned because petitioner is not a financing company. The distinction is relevant only for finance companies. This is allegedly very clear from Sections 2.8 and 2.9 of Revenue Regulations (RR) No. 9-2004[74], which explicitly provide:

> 2.8. *Financial Leasing* – shall refer to the mode of extending credit through a non-cancellable lease contract under which the lessor purchases or acquires, at the instance of the lessee, machinery, equipment, motor vehicles, appliances, business and office machines, and other movable or immovable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least seventy percent (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract (R.A. No. 5980 as amended by R.A. No. 8556). A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.
>
> 2.9. *Operating Lease* – shall refer to a lease other than a finance lease of a finance company.

Petitioner posits that it is unmistakable from the phrase "of a finance company" that any lease by a "non-finance

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[74] Implementing Certain Provisions of Republic Act No. 9238, Re-Imposing the Gross Receipts Tax on Banks and Non-Bank Financial Intermediaries Performing Quasi-Banking Functions and Other Non-Bank Financial Intermediaries Beginning January 1, 2004.

company" is automatically characterized as an operating lease. Without that phrase, Section 2.9 might have opened the door for interpretation that an operating lease is a "lease other than a finance lease [as defined in Section 2.8]" and the type of business or industry the lessor is engaged might have been irrelevant - but that is not the case.[75]

Moreover, petitioner claims that, in any event, the BLT Agreement between petitioner and the Government is not a finance lease under the law and established jurisprudence.[76]

In this instance, petitioner finds the Supreme Court ruling in the case of *PCI Leasing and Finance, Inc. vs. Trojan Metal Industries, Incorporated, et al.*[77] relevant, where the High Court discussed the nature of finance lease as follows:

> Thus, in a true financial leasing, whether under RA 5980 or RA 8556, a finance company purchases on behalf of a cash-strapped lessee the equipment the latter wants to buy but, due to financial limitations, is incapable of doing so. The finance company then leases the equipment to the lessee in exchange for the latter's periodic payment of a fixed amount of rental.

Petitioner also finds support in the case of *Beltran, et al. vs. PAIC Finance Corporation, et al.*[78], where the Supreme Court elaborated on the nature of finance lease, to wit:

> xxx But a financial lease must be preceded by a purchase and sale contract covering the equipment which becomes the subject matter of the financial lease. The financial lessor takes the role of the buyer of the equipment leased. And so the formal or documentary tie between the seller and the real buyer of the equipment, *i.e.*, the financial lessee, is apparently severed. In economic reality, however, that relationship remains. The sale of the equipment by the supplier thereof to the financial lessor and the latter's legal ownership thereof are intended to secure the repayment over time of the purchase price of the equipment, plus financing charges, through the payment of lease rentals; that legal title is the upfront security held by the financial lessor, a security probably superior in some instances to a chattel mortgagee's lien.

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[75] Docket, Vol. V, Pars. 96 to 98, Petitioner's Memorandum, pp. 3343 to 3345.
[76] Par. 101, Petitioner's Memorandum, docket, vol. V, p. 3346.
[77] G.R. No. 176381, December 15, 2010.
[78] G.R. Nos. 83113 and 83258, May 19, 1992.

The BLT Agreement entered into between petitioner and the Government (although considered as a financial lease under accounting standards) does not fall within the statutory definition of a finance lease. The nature of a statutory financial leasing agreement does not contemplate the underlying transaction covered by the BLT Agreement for several reasons, including the following:

> (a) First, a statutory finance lease involves a finance company that purchases property on behalf of a lessee. Petitioner is not a finance company as defined by Republic Act No. 8556, or the Financing Company Act, because it is not primarily organized for the purpose of extending credit facilities.[79]
>
> (b) Second, a statutory finance lease contemplates a sale or acquisition of machinery, equipment, and other movable or immovable property. As the Supreme Court held, a financial lease is "preceded by a purchase and sale contract covering the [property]." In petitioner's case, the subject of the BLT Agreement is the construction of the LRTS Phase I. Petitioner, as the supposed "financial lessor", did not purchase the LRTS Phase I; on the contrary, petitioner built it.
>
> (c) Third, the rationale behind a financial leasing transaction is that the lessee is financially incapable of purchasing the equipment on its own. It cannot be said that the Government is financially incapable of constructing the LRTS Phase I on its own.
>
> (d) Fourth, the financing contemplated under the Financing Company Act is to extend credit facilities to "consumers and industrial, commercial,

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[79] Section 3(a) of RA No. 8556 defines "financing companies" as corporations, except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organized or operating under other special laws, which are primarily organized for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or factoring commercial papers or accounts receivable, or by buying and selling contracts, leases, chattel mortgages, or other evidences of indebtedness, or by financial leasing of movable as well as immovable property. On the other hand, MRTC's primary purpose as stated in its amended Articles of Incorporation is "To build, lease, maintain and transfer a railway transit system in Manila known as Phase 1 of the Light Rail Transit System (LRT) Line 3 built pursuant to the Agreement dated August 8, 1997 between Metro Rail Transit Corp. Limited and the Department of Transportation and Communications, as may be amended from time to time." *cu*

> or agricultural enterprise". The Government is clearly not a "consumer" or an "industrial, commercial, or agricultural enterprise".
>
> (e) Fifth, to qualify as a "financial leasing" under the Financing Company Act, there should be no obligation on the part of the lessee to purchase the leased property from the owner-lessor at the end of the lease contract. The BLT Agreement requires the Government to purchase LRTS Phase I "at the end of the Revenue Period".

Petitioner contends that since the BLT Agreement is (a) an operating lease under RR No. 9-2004 and (b) does not qualify as a statutory finance lease, there is no other way to treat it but as an operating lease.

This means that petitioner is entitled to claim depreciation not only under Section 34(F) of the Tax Code, but also under RR No. 19-86, which allows lessors to claim deductions for all ordinary and necessary expenses paid or incurred during the taxable year which are attributable to the earning of rental income, to wit:

> SECTION 2. *Reporting of Income and Deductions by a Lessor or a Vendor.* –
>
> 2.01 *Lessor if contract is a lease* – The amount paid for the use of property under an agreement which is determined under these regulations to be a lease shall be considered as rental (and therefor includible in gross income) of the lessor. Such lessor may deduct all ordinary and necessary expenses paid or incurred during the taxable year which are attributable to the earning of the income. In addition, the lessor, with respect to properties subject to an "operating lease" as defined in subparagraph 2.01/1 of this Section, will be allowed a deduction for depreciation determined pursuant to Section 30 (f) of the National Internal Revenue Code (NIRC) and the Regulations thereunder: *Provided*, however, that tangible personal properties listed in Annex "A" of these Regulations which are subject to "finance lease" (as defined in subparagraph 2.01/2 of this Section) may be depreciated during the primary lease period but such period shall not be less than 60% of the depreciable life of the property as indicated in Annex "A". If, under the agreement, the lessee pays to the lessor a stipulated rental, and in addition pays certain other expenses which are properly payable by the lessor, the lessor is deemed to have received as rental income not only the stipulated rental but also the amount of such

> other expenses paid by the lessee to, or for the account of, the lessor.

This allegedly explains the difference in the accounting treatment vis-a-vis tax treatment (*i.e.*, allowing the deduction of ordinary and necessary expenses such as depreciation expense from the lessor's income) which resulted in a justifiable reduction of MRTC's income for income tax purposes. This is because:

> (a) in accordance with Section 34(F) of the Tax Code and Section 2 of RR 19-86, petitioner deducted depreciation as an allowable expense for income tax purposes;
>
> (b) but such depreciation expense was not deducted in petitioner's accounting records or 2007 AFS since it is not an allowable deduction on the lessor's part under PAS 17.[80]

Petitioner's arguments must be rejected.

The Court finds that petitioner is mistaken in relying on RR No. 09-04 dated June 21, 2004.

It should be noted that RR No. 09-04 was issued for the purpose of imposing gross receipts tax (GRT) on banks and non-bank financial intermediaries performing quasi-banking functions and other non-bank financial intermediaries beginning January 1, 2004 pursuant to RA No. 9238. And the definition of terms under Section 2 therein was enumerated for purposes of implementing the revenue regulation.

It is thus clear that the definitions of "financial leasing" and "operating lease" in Sections 2.8 and 2.9 of RR No. 09-04, which were relied upon by petitioner, were only for the purpose of implementing the imposition of GRT as described above, but not for income tax purposes.

RR No. 09-04 is very specific as to its purpose – imposition of GRT. Petitioner thus cannot extend the coverage of the RR

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[80] Docket, Vol. V, Pars. 96 to 98 and 101 to 107, Petitioner's Memorandum pp. 3343 to 3350.

and interpret it in a way as to also apply the guidelines therein on the income taxation of its lease financing income.

Petitioner likewise mentioned the application of RR No. 19-86 dated January 1, 1987, as amended by RR No. 22-86, in this case. At first, one would suppose that this RR is applicable in petitioner's case since it laid down the guidelines of taxability of leases in general. However, it is clear from Section 2 of this RR that it was issued to prescribe the rules to govern the tax treatment of lease agreements and provide guidelines for determining whether certain transactions purporting to be leases of **tangible personal property** are in reality conditional sales contracts.

Pursuant to the BLT Agreement executed by petitioner and DOTr, "[petitioner] shall be responsible for the design, construction, equipping, completion, testing and commissioning of Light Railway Transit System (LRTS) Phase 1"[81] and that "since [petitioner] is not franchised to operate a public utility, the parties therein agree that upon each Partial Opening Date and Completion Date, **this Agreement will constitute a lease of the completed portion of LRTS Phase 1 or the entire LRTS Phase 1, as the case may be, by [petitioner] to DOTC** (now DOTr) from such date until the end of the Revenue Period, such lease and DOTC's right of possession thereunder being **subject to payment by DOTC of the Rental Fees** due pursuant to Paragraph 9 and all adjustments thereto and other amounts due pursuant to this Agreement." Further, "following each Partial Opening Date and throughout the Revenue Period, [petitioner] will provide Technical Maintenance of LRTS Phase 1 in accordance with Annex F, subject to payment by DOTC of the Rental Fees due pursuant to Paragraph 9 and all adjustments thereto and other amounts due pursuant to this Agreement."[82]

The property – LRTS Phase 1 – being leased out by petitioner to DOTr is an immovable property under Article 415 of the New Civil Code, specifically as "contracts for public works, and servitudes and other real rights over immovable property."

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[81] Docket, Vol. IV, LRTS Phase 1 means the rail transport system comprising about 16.9 line kilometers extending from Taft Avenue, Pasay City to North Avenue, Quezon City, occupying a strip in the center of EDSA xxx (Par. 1 Definitions, BLT Agreement, Exhibit "P-3", p. 2272).

[82] *Id.*, Vol. IV, Pars. 3.1, 3.2, and 3.3, BLT Agreement, Exhibit "P-3", p. 2276.

As such, petitioner cannot likewise apply RR No. 19-86 which only applies to leases of tangible personal property.

It is clear in the BLT Agreement that petitioner shall receive Rental Fees in exchange for its undertaking to construct the LRTS Phase 1 and provide for its subsequent technical maintenance.

Pursuant to Section 32(A) of the NIRC of 1997, such rental fees received by petitioner constitute gross income, to wit:

> SEC. 32. *Gross Income.* –
>
> (A) *General Definition.* – Except when otherwise provided in this Title, gross income means all income derived from whatever source, including (but not limited to) the following items:
>
> (1) Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items;
> (2) Gross income derived from the conduct of trade or business or the exercise of a profession;
> (3) Gains derived from dealings in property;
> (4) Interests;
> (5) **Rents**;
> (6) Royalties;
> (7) Dividends;
> (8) Annuities;
> (9) Prizes and winnings;
> (10) Pensions; and
> (11) Partner's distributive share from the net income of the general professional partnership. (*Emphasis supplied*)

Under Section 43 of the NIRC of 1997, **the taxable income shall be computed** upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) **in accordance with the method of accounting regularly employed** in keeping the books of such taxpayer.

Hence, when there are no other tax rules or regulations which apply to a particular transaction, the Tax Code allows that the taxpayer's accounting method employed in determining its income and in keeping its books be also employed in determining its taxable income for tax purposes.

In this case, since there is no specific tax rules and regulations which can squarely apply to the taxation of petitioner's lease financing income, it is but proper to adopt the accounting method employed by petitioner in keeping its books. Thus, in accordance with Section 32(A), in relation to Section 43 of the NIRC of 1997, petitioner should have employed only one accounting method for both bookkeeping and tax purposes in determining its income. In other words, for tax purposes, petitioner's lease financing income (contemplating the Rental Fees stipulated in the BLT Agreement), should be accounted for in the same way it accounted its lease financing income in its books. Consequently, the whole amount of lease financing income of US$92,923,839.01 or ₱4,275,514,913.18[83] as declared in petitioner's 2007 AFS shall be subjected to income tax.

Considering the foregoing, the Court finds that petitioner's additional taxable lease financing income amounts to ₱1,116,560,023.78, as computed below:

Lease financing income from equity rental	₱ 4,275,514,913.18
Interest income on debt rental	333,679,969.60
Total taxable income per Court's findings	**₱4,609,194,882.78**
Less: Sales/Revenues/Receipts/Fees per ITR	3,492,634,859.00
Taxable income not subject to income tax	**₱1,116,560,023.78**

However, the Court shall uphold only to the extent assessed by respondent in the FDDA amounting to ₱1,012,460,075.32 since the amount to be collected from petitioner should not go beyond what is stated in the assessment. In excess of such stated therein, petitioner was not informed in writing of the facts and law on which the amount is made, thus, the taxpayer has no opportunity to dispute the said amount, in violation of due process.[84]

B. Unexplained source of income

B.1. Excess income payment subject to WTC, resulting from recon per Alphalist vs book balances – ₱1,106,130.85

In the process of verifying petitioner's taxable income, respondent found that there are audit adjustments that resulted in additional income that were not fully subjected to

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[83] Annex A-1-b, Letter dated October 25, 2010, Exhibit "P-15".
[84] *Commissioner of Internal Revenue vs. Transnational Plans, Inc.*, CTA EB Nos. 1337 and 1339 (CTA Case No. 8291), March 27, 2017.

income tax pursuant to Section 27 and in relation to Section 32(A) of the NIRC of 1997, as amended.[85]

In respondent's letter to petitioner received by the latter on August 9, 2010 showing the former's results of investigation of the latter's internal revenue tax liabilities for the period from January 1, 2007 to December 31, 2007, the assessed amount resulted from a higher compensation declared in the Alphalist as compared to the compensation declared in petitioner's books/AFS:[86]

Income payment subject to WTC per Alphalist	₱ 20,659,145.66
Income payment subject to WTC per Books/FS	19,553,130.85
Unexplained source of income	**₱1,106,014.81**

After respondent's re-investigation, the amount was increased to ₱1,106,130.85.[87]

Petitioner asserts that respondent's treatment of the alleged difference as taxable income is erroneous and has no factual and legal bases. Petitioner added that all that the difference proves is that petitioner paid higher withholding taxes on its salary-related expenses, and no additional income can be validly attributed to petitioner as a consequence.

Petitioner insists that the presumption that the alleged difference is an additional income lacks legal and factual bases. Respondent did not make any conclusive or positive finding that the alleged difference resulted in a flow of income on the part of petitioner. The supposed additional income is merely based on the presumption that any difference arising from the reconciliation of balances should either be treated as additional income or disallowed as an expense. This is an incorrect dichotomy.

Petitioner points out that the Supreme Court has ruled that for income to be taxable, the following requisites must be present: (a) there must be gain or profit; (b) that the gain or

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[85] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", p. 1064.
[86] *Id.*, Folder 1, Notice of Informal Conference, Exhibit "P-7", p. 1012.
[87] Details of Discrepancy, FDDA, Exhibit "P-22", p. 7.

profit is realized or received, actually or constructively; and (c) it is not exempted by law or treaty from income tax.[88]

Moreover, the difference between the salary-related expenses per books versus income payments subject to WTC per Alphalist does not meet the foregoing requisites, because petitioner had no gain or profit in the first place when it paid higher withholding taxes on its salary-related expenses.[89]

The Court finds merit in petitioner's arguments.

It is worthy to note that the imputation of undeclared income is based on a mere presumption that since there were alleged undeclared salaries and wages in petitioner's FS, there was likewise undeclared income which corresponds to it. Even if these alleged undeclared salaries and wages are to be considered as income, the same will be offset by recording the equivalent payment as expense. Hence, no taxable income will result from the said transaction.

Furthermore, it must be emphasized that, for income tax purposes, a taxpayer is free to deduct from its gross income a lesser amount or not claim any deduction at all. What is prohibited by the income tax law is to claim a deduction beyond the amount authorized.[90] Hence, even granting that there is an undeclared expense, the same is not prohibited by law.

Bearing in mind that an undeclared expense is not prohibited by law, it goes without saying that petitioner can exercise its discretion on whether it will declare a lesser amount of deduction or none at all.[91]

While axiomatic is the fact that all presumptions are in favor of the correctness of tax assessments, the assessment itself should not be based on presumptions no matter how logical the presumption might be. In order to stand the test of judicial scrutiny, the assessment must be based on actual facts.

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[88] *Commissioner of Internal Revenue vs. The Court of Appeals, et al.*, G.R. No. 108576, January 20, 1999.

[89] Docket, Vol. V, Pars. 120 to 122 and 124 to 125, Petitioner's Memorandum, pp. 3357 to 3359.

[90] *Commissioner of Internal Revenue vs. Phoenix Assurance Co. Ltd.*, G.R. No. L-19727, May 20, 1965.

[91] *Modern Imaging Solutions. Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 8987, March 21, 2017. um

The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption.[92]

For lack of factual basis, the deficiency income tax assessment pertaining to the alleged undeclared income from discrepancy in salaries and wages amounting to ₱1,106,130.85 should be cancelled.

B2. Unexplained disbursement on the purchase of $ for owner's (Sps. Robert John L. Sobrepena and/or Melissa Louise L. Sobrepena) admin expenses. Both are not stockholders of MRTC, being the latter a wholly owned subsidiary of MRTH II, a domestic corporation - ₱14,277,277.95

In the process of verifying petitioner's taxable income, respondent found that there are audit adjustments that resulted in additional income that were not fully subjected to income tax amounting to ₱38,491,352.95 pursuant to Section 27 and in relation to Section 32(A) of the NIRC of 1997.[93]

As stated in the Details of Discrepancies attached to the FDDA, respondent's perusal of various journal vouchers particularly JV No. 70103 dated August 31, 2007 and JV No. 70159 dated December 31, 2007 disclosed that these were incurred for various owner's administrative expenses. Upon reinvestigation, it was also disclosed that the expenditures amounting to ₱24,214,075.00 are now fully explained and duly substantiated, hence, deducted from the taxable income per FLD/FAN pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended.[94] As a result, the assessment was reduced to ₱14,277,277.95.

According to petitioner, the remaining portion of the alleged unexplained disbursement on the purchase of US$ in the amount of ₱14,277,277.95 pertained to: (a) advances to Mr. Paul Daza, who was a member of petitioner's Board of Directors in 2007, and (b) general and administrative expenses advanced by and shared with MRT Development Corporation (MRTDC).[95]

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[92] *Collector of Internal Revenue vs. Benipayo*, G.R. No. L-13656, January 31, 1962.
[93] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", p. 1064.
[94] Details of Discrepancy, FDDA, Exhibit "P-22", p. 7.
[95] Docket, Vol. V, Par. 141, Petitioner's Memorandum, p. 3364.

Petitioner added that respondent failed to consider that a portion of the remaining ₱14,277,277.95 refers to payments made by petitioner to MRTDC for advances the latter made for general and administrative expenses and that these expenses were adequately substantiated with check vouchers and receipts, to wit:

Payee	Description/Particulars	Check Voucher No./Date[96]	Amount Advanced to MRTC (in ₱)	Official Receipt No./Date[97]
Rental for MRT office				
Dominion Development & Investment Inc.	Rental of MRT officer [sic] for the period December 7, 2006 - January 6, 2007	5774/January 8, 2007	₱ 133,011.25	0536A/January 30, 2007
	Payment for the rental of MRT office covering the period March 7, 2006 - April 6, 2007	6008/April 11, 2007	133,011.25	0566A/April 20, 2007
Payment of legal services rendered to MRTC				
Suarez & Narvasa Law Firm	Payment for legal services rendered for MRTC covering the period Feb. 16-28, 2007	6091/May 25, 2007	169,500.00	6002/May 29, 2007
	Payment for legal services rendered for MRTC covering the period Mar. 1-31, 2007	6092/May 25, 2007	473,450.00	5990/May 29, 2007
	Payment for legal services rendered for MRTC covering the period Apr. 1-30, 2007 re: Various matters (see attached)	6116/June 4, 2007	314,835.00	6045/June 8, 2007
Donation to the Office of the Solicitor General				
Office of the Solicitor General	Payment for the donation to the OSG-MRT3 Taskforce to various Real Property Tax related cases	5971/March 30, 2007	120,000.00	3267000E/ April 3, 2007
Electrical charges for MRTC office				
Manila Electric Company	Payment for electrical charges of Unit B of MRT office covering the period January 14,2007 to February 13, 2007	5962/March 27, 2007	19,898.95	0000352597/ March 2007
	Payment for electrical charges of Unit A of MRT office covering the period February 13, 2007 - March 14, 2007	5967/March 27, 2007	22,780.39	0000352598/ March 2007
Purchase of tires and repairs and maintenance of MRTC's vehicles				
Carland Marketing	Payment for purchase of 4 tires for MB 100 Vans service vehicle	6016/April 11, 2007	8,125.00	2252/May 2, 2007
Total			**₱1,386,486.84**	

Petitioner claims that as shown in the foregoing table, it was able to prove that out of the remaining ₱14,277,277.95, the payments amounting to ₱1,386,486.84 were supported by documentary evidence (*i.e.*, check vouchers and receipts). Consequently, respondent should have deducted the amount of

[96] Exhibits "P-69", "P-69-C", "P-70", "P-70-C", "P-70-F", "P-71", "P-72", "P-72-C", "P-73".
[97] Exhibits "P-69-B", "P-69-E", "P-70-B", "P-70-E", "P-70-H", "P-71-B", "P-72-B", "P-72-E", and "P-73-B".

₱1,386,486.84 in arriving at petitioner's alleged deficiency income tax.[98]

It is to be noted that petitioner's summation in the above table of substantiated expenses is incorrect. The payment for purchase of 4 tires for MB 100 Vans service vehicle amounting to ₱8,125.00 was not included in the total amount of ₱1,386,486.84. Adding the amount of ₱8,125.00, the total should be ₱1,394,611.84.

Based on respondent's records, the remaining assessed amount of ₱14,277,277.95 was lifted from petitioner's Journal Voucher (JV) Nos. 070103 and 070159, the summary of entries therein were as follows:[99]

	Account	**JV No. 070103**	**JV No. 070159**
Dr.	Advances to O/E Paul Daza	₱ 2,000,000.00	₱ -
Dr.	General & Admin Expenses	9,968,380.87	2,308,897.08
Cr.	Accounts Payable MRTDC	(11,968,380.87)	(2,308,897.08)

From the above JV entries, respondent picked up the following amounts which comprised the alleged unexplained disbursements of ₱14,277,277.95:

Account	**JV No.**	**Amount**
Advances to Officers/Employees - Paul Daza	070103	₱ 2,000,000.00
General & admin expenses	070103	9,968,380.87
General & admin expenses	070159	2,308,897.08
Total		**₱14,277,277.95**

As shown in petitioner's AFS for 2007,[100] MRT Development Corporation (MRTDC) is an affiliate of petitioner.

The check vouchers (CV) of MRTDC as presented by petitioner to support expenses amounting to ₱1,394,611.84 show that these amounts were entered in MRTDC's books as "Advances to MRTC", which show that said expenses were not claimed by MRTDC and instead treated the same as receivables from petitioner.

Among the JVs which served as basis of respondent for the assessed amount, only JV No. 070159 was found in the records

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[98] Docket, Vol. V, Pars. 142 to 143, Petitioner's Memorandum, pp. 3364 to 3369.
[99] BIR Records, Folder 2, Schedules, Exhibit "R-10", p. 481.
[100] Notes 2 and 8, 2007 AFS, Exhibit "P-16", pp. 1 and 18.

showing the following journal entry, which accounted for General and Admin. Expenses amounting to ₱2,308,897.08:[101]

Insurance - Office space	665,056.25	
Management & other professional fees	1,514,029.00	
Power, light, water & other utilities	129,811.83	
Advances from affiliates – MRTDC		2,308,897.08
Take up various owner's admin expenses advanced by MRTDC		

JV No. 070159 clearly shows that the expenses booked and claimed by petitioner was treated as payable to MRTDC as shown by the credit entry to "Advances from affiliates – MRTDC" account.

However, based on the attached schedule showing the breakdown of the amounts in JV No. 070159,[102] only the Rental of MRT office for the period December 7, 2006 - January 6, 2007 amounting to ₱133,011.25 coincides with the check voucher and receipt submitted by petitioner,[103] which was paid by MRTDC.

As for the remaining expenses petitioner claimed to be substantiated with check vouchers and receipts amounting to ₱1,261,600.59 (₱1,394,611.84 less ₱133,011.25), the Court cannot verify whether the same indeed pertain to general administrative expenses in petitioner's book and were treated as payables to MRTDC due to lack of documents. Neither can the Court assume that the same pertains to the alleged general and administrative expenses referred to in JV No. 07103.

Even if the expenses amounting to ₱1,261,600.59 were already substantiated, the Court cannot readily accept the CVs and official receipts presented by petitioner, considering that these documents belong to a different entity – MRTDC. It is incumbent upon petitioner to show through corroborating evidence that these amounts were indeed booked and claimed as expenses of petitioner even if the same were paid by another entity. Hence, the Court is constrained to uphold the assessments over said amount.

As for the alleged Advances to Officers/Employees - Paul Daza amounting to ₱2,000,000.00, petitioner did not submit

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[101] Annex C-17, Letter dated October 25, 2010, Exhibit "P-15".
[102] Annex C-17-a, Letter dated October 25, 2010, Exhibit "P-15".
[103] Exhibits "P-69-A" and "P-69-B".

any supporting documents for the Court to adequately verify its nature. As such, we shall maintain respondent's assessment over the same.

In view of the foregoing, the assessment on the total unexplained disbursement of ₱14,144,266.70 (₱14,277,277.95 less ₱133,011.25) shall be sustained.

C. Income payments not subjected to EWT – ₱35,264,589.61

As stated in the Details of Discrepancies attached to the FLD, a comparison of the balance per Books/FS against the Alphalist reveals that certain income payments were either not subjected to the correct tax rates or none at all, a requirement under Section 57(B) of the NIRC of 1997, as implemented by RR Nos. 2-98, 6-2001, 12-2001, 14-2002 and 17-2003.

Accordingly, income payments amounting to ₱35,264,589.62 were disallowed by respondent since they did not meet the requisites of deductibility pursuant to Section 34(K) of the NIRC of 1997 and as further implemented by Section 2.58.4 of RR No. 2-98 dated April 17, 1998.[104]

As earlier mentioned, after receiving respondent's Decision, petitioner paid the deficiency EWT assessment, including interest, related to the subject income payments of ₱35,264,589.61 on March 19, 2015.

Petitioner posits that in light of its payment of the corresponding deficiency EWT assessment, the related income payments of ₱35,264,589.61 should be deducted from petitioner's gross income.

In this regard, petitioner invokes Section 2.58.5 of RR No. 2-98, as amended, which provides in part:

> SECTION 2.58.5. *Requirements for Deductibility.* – Any income payment which is otherwise deductible under the Code shall be allowed as a deduction from the payor's gross income only if it is shown that the income tax required to be withheld has been paid to the Bureau in accordance with Secs. 57 and 58 of the Code.

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[104] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", p. 1064.

> A deduction will also be allowed in the following cases where no withholding of tax was made:
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> (A) The payee reported the income and pays the tax due thereon and the withholding agent pays the tax including the interest incident to the failure to withhold the tax, and surcharges, if applicable, at the time of the audit investigation or reinvestigation/reconsideration.
>
> (B) The recipient/payee failed to report the income on the due date thereof, but the withholding agent/taxpayer pays the tax, including the interest incident to the failure to withhold the tax, and surcharges, if applicable, at the time of the audit/investigation or reinvestigation/reconsideration.
>
> (C) The withholding agent erroneously underwithheld the tax but pays the difference between the correct amount and the amount of tax withheld, including the interest, incident to such error, and surcharges, if applicable, at the time of the audit/investigation or reinvestigation/ reconsideration.

The Court disagrees with petitioner.

Section 2.58.5 of RR No. 2-98, as amended by RR No. 14-2002, reads:

> SECTION 2.58.5. *Requirements for Deductibility* – Any income payment which is otherwise deductible under the Code shall be allowed as a deduction from the payor's gross income only if it is shown that the income tax required to be withheld has been paid to the Bureau in accordance with Secs. 57 and 58 of the Code.
>
> A deduction will also be allowed in the following cases where no withholding of tax was made:
>
> xxx xxx xxx
>
> (C) The withholding agent erroneously underwithheld the tax but pays the difference between the correct amount and the amount of tax withheld, including the interest, incident to such error, and surcharges, if applicable, **at the time of the audit/investigation or reinvestigation/reconsideration**. *(Emphasis supplied)*

Pursuant to the foregoing revenue regulations, it is clear that a deduction is allowed even when no tax was withheld **only** when the corresponding deficiency withholding taxes were paid at the time of the audit/investigation or reinvestigation/ reconsideration. can

In the instant case, petitioner received the Final Decision on Disputed Assessment on September 23, 2014. On October 23, 2014, it filed a request for reconsideration with the CIR. The CIR issued a decision on February 5, 2015, which was received by petitioner on February 24, 2015. Thus, petitioner's payment on March 19, 2015 cannot be considered as paid at the time of the audit investigation or reinvestigation/reconsideration.

Without payment of the subject withholding taxes at the time prescribed by the rules and regulations, the Court finds no basis to cancel the disallowance of the corresponding expenses.

D. Disallowed expenses

D1. BIR penalty charged to Taxes and Licenses – ₱3,000.00; and

D2. Donation to the OSG-MRT Taskforce to various real property tax related cases – ₱400,000.00

These expenses were disallowed by respondent since they did not meet the requisites of deductibility pursuant to Section 34(A) of the NIRC of 1997.[105]

These items were not refuted by petitioner hence, must not be disturbed.

E. Difference between the 7% VAT that effectively accounts for the standard input tax and the actual input tax – ₱218,145,769.06

As stated in the Details of Discrepancies attached to the FDDA, this represents the difference between the 7% VAT that effectively accounts for standard input tax and the actual input tax. Since the actual input VAT attributable to sale of services is less than the 7% standard VAT, the difference is closed to expense or cost pursuant to Section 4.112-2 of Revenue Regulations No. 16-05 dated September 1, 2005, as amended,[106] to wit:

Receipts from equity rental per reinvestigation	₱2,794,430,733.52
Interest income on debt rental service per reinvestigation	333,718,269.16
Total receipts subject to VAT	₱3,128,149,002.68

[105] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", p. 1064.
[106] Exhibit "P-22", p. 7.

Standard input tax (7%)	₱ 218,970,430.19
Less: Actual input tax	(824,661.13)
Difference - closed to expense or cost (revenue)	**₱218,145,769.06**

Petitioner argues that, as can be seen above, the FDDA indicated that the Receipts from Equity Rental supposedly "per Reinvestigation" is in the amount of ₱2,794,430,733.52. The amount is evidently higher than the amount of petitioner's Receipts from Equity Rental as reflected in both the PAN[107] and the FLD[108] (*i.e.*, ₱2,487,790,124.14).

Moreover, respondent did not provide any basis for increasing the amount of Receipts from Equity Rental from ₱2,487,790,124.14 to ₱2,794,430,733.52. The FDDA also did not bother to explain the factual and legal bases for deviating from the Receipts from Equity Rental stated in the PAN and the FLD.

Petitioner further posits that it is imperative that the taxpayer be informed of the nature of the assessment so it can properly refute that assessment. Section 228 of the Tax Code is clear that failure to comply with the same shall render the assessment void.

Accordingly, the assessment on the alleged additional income is void inasmuch as respondent's own documents (including the FLD and FDDA) failed to inform petitioner of the factual and legal bases of the purported increase in the amount of Receipts from Equity Rental in the sum of ₱306,640,609.38.[109]

The Court finds for petitioner.

It bears stressing that the assessment pertaining to the difference between the 7% VAT that effectively accounts for the standard input tax and the actual input tax of ₱218,145,769.06 is related to the VAT assessment which was cancelled by respondent upon its reinvestigation.

Based on the FDDA, the assessment arose after respondent allegedly took into consideration all relevant documents submitted in support of petitioner's protest to the

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[107] BIR Records, Folder 1, Exhibit "P-8", p. 1046.
[108] BIR Records, Folder 1, Exhibit "P-9", p. 1068.
[109] Docket, Vol. V, Pars. 132 to 135, Petitioner's Memorandum, pp. 3361 to 3364.

FLD. Respondent categorically stated in the FDDA that its reinvestigation disclosed that additional receipts of ₱106,697,094.88 [Gross receipts per FAN of ₱3,021,451,907.80 less Receipts per reinvestigation of ₱3,128,149,002.68] is subject to VAT pursuant to Section 108 of the NIRC of 1997, as amended. Further, the 5% final withholding VAT on equity rental and interest on debt rental services which were withheld by DOTC through SARO shall represent petitioner's net VAT payable and the remaining 7% effectively accounts for the standard input VAT in lieu of the actual input VAT that amounts to ₱824,661.13 only. Since the actual input VAT attributable to sale of services is less than the 7% that effectively accounts for petitioner's standard input VAT in lieu of the actual input VAT, the difference is closed to expense or cost, which forms part of adjustment to deficiency income tax. This is consistent with the provisions under Section 4.114-2 of RR No. 16-05, to wit:

> SECTION 4.114-2. *Withholding of VAT on Government Money Payments and Payments to Non-Residents.* –
>
> (a) The government or any of its political subdivisions, instrumentalities or agencies, including government-owned or controlled corporations (GOCCs) shall, before making payment on account of each purchase of goods and/or of services taxed at 10% [now at 12%] VAT pursuant to Secs. 106 and 108 of the Tax Code, deduct and withhold a final VAT due at the rate of five percent (5%) of the gross payment thereof.
>
> The five percent (5%) final VAT withholding rate shall represent the net VAT payable of the seller. The remaining five percent (5%) [now 7%] effectively accounts for the standard input VAT for sales of goods or services to government or any of its political subdivisions, instrumentalities or agencies including GOCCs, in lieu of the actual input VAT directly attributable or ratably apportion to such sales. Should actual input VAT exceed the five percent (5%) [now 7%] of gross payments, the excess may form part of the seller's expense or cost. On the other hand, if actual input VAT is less than 5% [now 7%] of gross payment, the difference must be closed to expense or cost.

In the FDDA, however, respondent did not adequately inform petitioner of how he arrived at the revised amount of receipts of ₱3,128,149,002.68 and what brought such increase of ₱106,697,094.88. While it is true that the legal provisions were indicated in the said FDDA, respondent nonetheless failed to show the basis for the amounts indicated therein. This renders the assessment null and void which cannot give rise to an obligation upon petitioner to pay deficiency taxes, and it divests the taxing authority of the right to collect them.

Moreover, it was observed that this particular item of assessment was not included in the FLD in computing petitioner's deficiency income tax. It only arose upon issuance of the FDDA.

Sections 3.1.4 to 3.1.6 of RR No. 12-99[110] laid down the due process requirement in the issuance of a deficiency tax assessment through the FLD, the petitioner's protest against the aforesaid FLD and the eventual issuance of a decision over such disputed assessment, to wit:

> SECTION 3. *Due Process Requirement in the Issuance of a Deficiency Tax Assessment.* –
>
> 3.1 Mode of procedures in the issuance of a deficiency tax assessment:
>
> xxx xxx xxx
>
> 3.1.4 *Formal Letter of Demand and Assessment Notice.* – **The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative.** The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void (see illustration in ANNEX B hereof). The same shall be sent to the taxpayer only by registered mail or by personal delivery. If sent by personal delivery, the taxpayer or his duly authorized representative shall acknowledge receipt thereof in the duplicate copy of the letter of demand, showing the following: (a) His name; (b) signature; (c) designation and authority to act for and in behalf of the taxpayer, if acknowledged received by a person other than the taxpayer himself; and (d) date of receipt thereof.
>
> 3.1.5 *Disputed Assessment.* – The taxpayer or his duly authorized representative **may protest administratively against the aforesaid formal letter of demand and assessment notice** within thirty (30) days from date of receipt thereof. If there are several issues involved in the formal letter of demand and assessment notice but the taxpayer only disputes or protests against the validity of some of the issues raised, the taxpayer shall be required to pay the

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[110] *Implementing the Provisions of the National Internal Revenue Code of 1997 Governing the Rules on Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extra-Judicial Settlement of a Taxpayer's Criminal Violation of the Code Through Payment of a Suggested Compromise Penalty.*

deficiency tax or taxes attributable to the undisputed issues, in which case, a collection letter shall be issued to the taxpayer calling for payment of the said deficiency tax, inclusive of the applicable surcharge and/or interest. No action shall be taken on the taxpayer's disputed issues until the taxpayer has paid the deficiency tax or taxes attributable to the said undisputed issues. The prescriptive period for assessment or collection of the tax or taxes attributable to the disputed issues shall be suspended.

The taxpayer shall state the facts, the applicable law, rules and regulations, or jurisprudence on which his protest is based, otherwise, his protest shall be considered void and without force and effect. If there are several issues involved in the disputed assessment and the taxpayer fails to state the facts, the applicable law, rules and regulations, or jurisprudence in support of his protest against some of the several issues on which the assessment is based, the same shall be considered undisputed issue or issues, in which case, the taxpayer shall be required to pay the corresponding deficiency tax or taxes attributable thereto.

The taxpayer shall submit the required documents in support of his protest within sixty (60) days from date of filing of his letter of protest, otherwise, the assessment shall become final, executory and demandable. The phrase "submit the required documents" includes submission or presentation of the pertinent documents for scrutiny and evaluation by the Revenue Officer conducting the audit. The said Revenue Officer shall state this fact in his report of investigation.

If the taxpayer fails to file a valid protest against the formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof, the assessment shall become final, executory and demandable.

If the protest is denied, in whole or in part, by the Commissioner, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from date of receipt of the said decision, otherwise, the assessment shall become final, executory and demandable.

In general, if the protest is denied, in whole or in part, by the Commissioner or his duly authorized representative, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from date of receipt of the said decision, otherwise, the assessment shall become final, executory and demandable: Provided, however, that if the taxpayer elevates his protest to the Commissioner within thirty (30) days from date of receipt of the final decision of the Commissioner's duly authorized representative, the latter's decision shall not be considered final, executory and demandable, in which case, the protest shall be decided by the Commissioner. *cn*

> If the Commissioner or his duly authorized representative fails to act on the taxpayer's protest within one hundred eighty (180) days from date of submission, by the taxpayer, of the required documents in support of his protest, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from the lapse of the said 180-day period, otherwise, the assessment shall become final, executory and demandable.
>
> 3.1.6 *Administrative Decision on a Disputed Assessment.* – The decision of the Commissioner or his duly authorized representative shall (a) state the facts, the applicable law, rules and regulations, or jurisprudence on which such decision is based, otherwise, the decision shall be void (see illustration in ANNEX C hereof), in which case, the same shall not be considered a decision on a disputed assessment; and (b) that the same is his final decision. (*Emphasis supplied*)

In RR No. 18-2013[111] dated November 28, 2013, the above provisions were amended and required a taxpayer protesting the assessment to file a written request for reconsideration or reinvestigation, to wit:

> 3.1.4 *Disputed Assessment.* – The taxpayer or its authorized representative or tax agent may protest administratively against the aforesaid FLD/FAN within thirty (30) days from date of receipt thereof. The taxpayer protesting an assessment may file a written request for reconsideration or reinvestigation defined as follows:
>
> (i) ***Request for reconsideration*** – refers to a plea of re-evaluation of an assessment on the basis of existing records without need of additional evidence. It may involve both a question of fact or of law or both.
>
> (ii) ***Request for reinvestigation*** – refers to a plea of re-evaluation of an assessment **on the basis of newly discovered or additional evidence that a taxpayer intends to present in the reinvestigation.** It may also involve a question of fact or of law or both.
>
> The taxpayer shall state in his protest (i) the nature of protest whether reconsideration or reinvestigation, specifying newly discovered or additional evidence he intends to present if it is a request for reinvestigation, (ii) date of the assessment notice, and (iii) the applicable law, rules and regulations, or jurisprudence on which his protest is based, otherwise, his protest shall be considered void and without force and effect.
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> xxx xxx xxx

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[111] *Amending Certain Sections of Revenue Regulations No. 12-99 Relative to the Due Process Requirement in the Issuance of a Deficiency Tax Assessment.*

> For requests for reinvestigation, the taxpayer shall submit all relevant supporting documents in support of his protest within sixty (60) days from date of filing of his letter of protest, otherwise, the assessment shall become final. The term "relevant supporting documents" refer to those documents necessary to support the legal and factual bases in disputing a tax assessment as determined by the taxpayer. The sixty (60)-day period for the submission of all relevant supporting documents shall not apply to requests for reconsideration. Furthermore, the term "the assessment shall become final" shall mean the taxpayer is barred from disputing the correctness of the issued assessment by introduction of newly discovered or additional evidence, and the FDDA shall consequently be denied.
>
> xxx xxx xxx
>
> If the **protest is denied, in whole or in part, by the Commissioner's duly authorized representative,** the taxpayer may either: (i) appeal to the Court of Tax Appeals (CTA) within thirty (30) days from date of receipt of the said decision; or **(ii) elevate his protest through request for reconsideration to the Commissioner within thirty (30) days from date of receipt of the said decision. No request for reinvestigation shall be allowed in administrative appeal and only issues raised in the decision of the Commissioner's duly authorized representative shall be entertained by the Commissioner.**
>
> xxx xxx xxx
>
> 3.1.5 *Final Decision on a Disputed Assessment (FDDA).* – The decision of the Commissioner or his duly authorized representative shall state the (i) facts, the applicable law, rules and regulations, or jurisprudence on which such decision is based, otherwise, the decision shall be void (see illustration in ANNEX "C" hereof), and (ii) that the same is his final decision. (*Emphasis supplied*)

Clarifying the above-cited paragraph, Revenue Memorandum Circular (RMC) No. 11-2014 dated February 18, 2014 was issued by respondent, stating in paragraph 5 therein the following:

> (5) RR 12-99, as amended by RR 18-2013, provides that "[f]or requests for reinvestigation, the taxpayer shall submit all relevant supporting documents in support of his protest within sixty (60) days from date of filing of his letter of protest, otherwise, the assessment shall become final." The term "the assessment shall become final" means that the failure of the taxpayer who requested for a reinvestigation to submit all relevant supporting documents within the sixty (60)- day period shall render the FLD/FAN "final" by operation of law. He/it shall be barred from disputing the correctness of the

> FLD/FAN by the introduction of newly discovered or additional evidence because he/it is deemed to have lost his/its chance to present these evidence. **The BIR shall then deny the request for reinvestigation through the issuance of an FDDA.** (*Emphasis supplied*)

Based on the foregoing provisions, after respondent or his duly authorized representative issued the FLD and Final Assessment Notice (FAN) and is duly received by the taxpayer, the latter may protest the same by filing a protest letter, either through a request for reconsideration or reinvestigation, containing the facts, the applicable law, rules and regulations, or jurisprudence on which the protest is based. Upon due filing of the protest letter and the supporting documents by the taxpayer in accordance with Section 3.1.5 of RR No. 12-99 (now Section 3.1.4), the FLD/FAN becomes a "disputed assessment", where the protested items of assessment are classified as disputed items.

Respondent or his duly authorized representative shall then render a decision over the taxpayer's protest in accordance with Section 3.1.6 of RR No. 12-99 (now Section 3.1.5) through the issuance of a FDDA. If the FDDA was issued by respondent's duly authorized representative, the taxpayer may, as one of its option, elevate the FDDA to respondent but only for a request for reconsideration and only the issues raised in the FDDA of respondent's duly authorized representative shall be entertained by respondent.

From this, it can only be understood that the FDDA of respondent or his duly authorized representative shall only delve on the disputed items in the FLD/FAN. Respondent is precluded from incorporating a new assessment in the FDDA which was not part of the disputed items in the protest letter of the taxpayer, nor in the FLD/FAN. Taking from the name of the document itself – Final Decision on Disputed Assessment – the FDDA shall only refer to respondent's decision over the disputed assessment, which is the FLD/FAN, and nothing more.

Such is the case herein where the difference between the 7% VAT that effectively accounts for the standard input tax and the actual input tax amounting to ₱218,145,769.06 was not previously assessed in the FLD. Its nature was based on a new ground or legal basis which would require a new set of facts, the applicable law, rules and regulations, or jurisprudence for petitioner to effectively protest or dispute the same. Since said assessment only arose in the FDDA, petitioner can no longer fully avail of the remedies to effectively dispute it since requests for reinvestigation is no longer allowed at this stage pursuant to Section 3.1.4 of RR No. 18-2013. As a consequence, petitioner can no longer submit newly discovered or additional evidence to refute the new assessment even if it is still capable or willing to do so.

To allow respondent to incorporate new assessments in the FDDA would deprive the taxpayer of its right to due process and would put the latter at the mercy of the former.

Hence, this particular assessment item should be cancelled for being issued contrary to the guidelines of RR No. 12-99, as amended by RR No. 18-2013.

Furthermore, as the said new assessment item was not indicated in the FLD, it should be considered as not having been assessed by the CIR within the prescriptive period.[112]

In fine, the Court finds petitioner liable to pay the basic deficiency income tax of ₱368,828,806.59, computed as follows:

Taxable income per Return	₱ 4,621,554,841.00
Add: Adjustments	
Lease financing income not subject to income tax	1,012,460,075.32
Unexplained disbursement on the purchase of $ for owner's (Sps. Robert John L. Soprepena &/or Melissa Louise L. Soprepena) admin expenses. Both are not stockholders of MRTC, being the latter a wholly owned subsidiary of MRTH II, a domestic corporation	14,144,266.70
Income payments not subjected to WE	35,264,589.61
Disallowed expenses:	
BIR penalty charged to Taxes and Licenses	3,000.00
Donation to the OSG-MRT Taskforce to various real property tax related cases	400,000.00
ADJUSTED TAXABLE INCOME	**₱5,683,826,772.63**
Tax rate	35%
Income Tax Due	**₱1,989,339,370.42**
Less: Tax payments/credits	1,620,510,563.83
Basic Deficiency Income Tax	**₱ 368,828,806.59**

[112] *Commissioner of Internal Revenue vs. Transnational Plans, Inc.*, CTA EB Nos. 1337 and 1339 (CTA Case No. 8291), March 27, 2017.

III. Deficiency Value-added Tax - ₱4,195,329.65

In the FDDA, respondent imposed against petitioner VAT penalties in the total amount of ₱4,195,329.65, determined as follows:[113]

Basic value added tax		₱ -
Add:	Interest, computed based on various dates	4,125,329.65
	Compromise penalty	70,000.00
TOTAL AMOUNT DUE		**₱4,195,329.65**

In the FDDA, respondent already cancelled the basic deficiency VAT previously assessed per FLD/FAN. However, respondent still imposed upon petitioner the total amount of ₱4,195,329.65 supposedly representing the increments due to the late payment of the 5% final withholding VAT paid by DOTr through SARO.[114]

Petitioner claims that the imposition of deficiency interest and compromise penalty is void for lack of legal basis. Petitioner argues that it is indisputable that petitioner is not liable for the 12% VAT because the DOTr, the sole purchaser of petitioner's services, is a government agency. As such, the DOTr is required by law to deduct and withhold a 5% final withholding VAT on all its purchases of goods and services.

Petitioner posits that the DOTr is the statutory withholding agent of its income payments to its supplier of goods and services. As such, it is responsible for filing the VAT returns and remittance of withholding taxes to the BIR. This was clarified in RMC No. 23-07:

> The person in-charge of withholding in each government agency (Government offices, bureaus, agencies or instrumentalities, local government units, GOCCs) shall prepare the following forms, file the tax returns to the appropriate BIR collecting agents and pay the corresponding withholding taxes due thereon xxx

Petitioner further maintains that since it is the DOTr which is responsible for the remittances of the final VAT withheld, the interest and compromise penalty on its late

[113] FDDA, Exhibit "P-22", p. 3.
[114] Details of Discrepancy, FDDA, Exhibit "P-22", p. 8.

remittances of the 5% final withholding VAT should be imposed against it. There is no logic, let alone any legal basis, for shifting the responsibility to MRTC, which is not the taxpayer contemplated by law or regulations.

According to petitioner, it cannot be held liable for the acts or omissions of another person (*i.e.,* DOTr) who is constituted by the Tax Code and RR No. 16-2005 as the withholding agent responsible for withholding such taxes.[115]

The Court agrees with petitioner.

Section 114(C) of the NIRC of 1997 and Section 4.114-2 of RR No. 16-2005 provide:

> SEC. 114. *Return and Payment of Value-added Tax.* –
>
> xxx xxx xxx
>
> (C) *Withholding of Value-added Tax.* – The Government or any of its political subdivisions, instrumentalities or agencies, including government-owned or -controlled corporations (GOCCs) shall, before making payment on account of each purchase of goods and services which are subject to the value-added tax imposed in Sections 106 and 108 of this Code, deduct and withhold a final value-added tax at the rate of five percent (5%) of the gross payment thereof: *Provided,* That the payment for lease or use of properties or property rights to nonresident owners shall be subject to ten percent (10%) withholding tax at the time of payment. For purposes of this Section, the payor or person in control of the payment shall be considered as the withholding agent. xxx
>
> SECTION 4.114-2. *Withholding of VAT on Government Money Payments and Payments to Non-Residents.* –
>
> (a) The government or any of its political subdivisions, instrumentalities or agencies, including government-owned or controlled corporations (GOCCs) shall, before making payment on account of each purchase of goods and/or of services taxed at 10% VAT pursuant to Secs. 106 and 108 of the Tax Code, deduct and withhold a final VAT due at the rate of five percent (5%) of the gross payment thereof.

Based on the foregoing, the Government, the DOTr in this case, **shall deduct and withhold** a final VAT due at the rate of 5% on gross payment on purchases of goods and services which are subject to VAT imposed in Sections 106 and 108 of the NIRC of 1997. The VAT withheld under this Section shall be remitted

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[115] Docket, Vol. V, Pars. 150 to 153, Petitioner's Memorandum, pp. 3373 to 3375.

within ten (10) days following the end of the month the withholding was made.

In the present case, it is undisputed that the DOTr is the payor or person in control of the payment on the equity rental and interest on debt rental services provided by petitioner to the former. Needless to say, the DOTr is the withholding agent of the 5% VAT due on the VATable purchase of services it made from petitioner, which is required to be deducted from the gross purchases before making payments to petitioner. Also, the DOTr, as the withholding agent, is required to remit to the BIR the said VAT withheld on the 10th day following the end of the month when the withholding was made. This makes the DOTr liable for the tax it is duty bound to withhold. Accordingly, petitioner cannot be faulted for the lapses of the DOTr in remitting on time the VAT it withheld from petitioner.

Thus, the deficiency VAT assessment pertaining to the increments due to late payment of the 5% withholding VAT is void and shall be cancelled.

IV. Deficiency Final Withholding Tax - ₱122,985,384.04

Respondent's verification disclosed that petitioner failed to subject the income payments/interest paid to the Credit Facilities namely FCDU, and non-resident foreign corporations (JEXIM and Czech) to final withholding tax of 10% and 20%, respectively, pursuant to Section 57(A) of the NIRC of 1997 as implemented by Section 2.57.1 of RR No. 2-98 dated April 17, 1998, as amended. While it is true that petitioner does not have control on the remittance of the withholding tax on its income payments (being shifted to DOTr as per BLT Agreement), the time of withholding as provided for in Section 2.57.4 of RR No. 2-98, as amended and RMC No. 9-2006 was not correctly applied.[116]

	TAX BASE	RATE	TAX REQUIRED
Interest on loans:			
FCDU - Local	₱ 144,616,217.59	10%	₱ 14,461,621.76
CZECH	166,623,303.91	20%	33,324,660.78
JEXIM	222,422,262.16	20%	44,484,452.43
Amount of tax required to be withheld	**₱533,661,783.66**		**92,270,734.97**
Less: Payment made per BIR Form 1601-F			-
Deficiency final income tax			₱ 92,270,734.97

[116] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", p. 1063.

Add: 50% surcharge	₱ 46,135,367.49		
Interest (January 10, 2008 to Sept. 15, 2010) at 53.61%	49,466,341.02		95,601,708.50
Total Deficiency Final Income Tax on Interest on Loans			**₱187,872,443.47**

Upon re-investigation, petitioner's payment to FCDU Credit Facility through SARO issued by DOTC amounting to ₱10,413,799.80 was considered by respondent. Hence, the assessment is partially reduced by this amount which represents the 10% final withholding tax on petitioner's income payments to FCDU. Computation below:[117]

	TAX BASE	**FINAL W/TAX**
Final withholding tax per FLD/FAN	₱ 533,661,783.66	₱ 92,270,734.97
Less: Adjustments per reinvestigation	(199,943,514.50)	(35,940,930.90)
Adjusted amount per reinvestigation	333,718,269.16	56,329,804.07
Less: Withheld by DOTC thru SARO on FCDU only	(104,138,247.79)	(10,413,799.80)
Net	**₱229,580,021.37**	**₱45,916,004.27**
As accounted for:		
Income payment to Czech	₱ 98,827,948.11	₱ 19,765,589.62
Income payments to JEXIM	130,752,073.26	26,150,414.65
	₱229,580,021.37	**₱45,916,004.27**

As shown above, the income payments and the corresponding FWT related to FCDU credit facility was already removed from the assessment. As such, only the income payments to Czech and JEXIM amounting to ₱98,827.948.11 and ₱130,752,073.26, respectively, remain to be assessed with deficiency FWT.

However, as corrected by the Court (discussed under Income on debt rental), the assessment should only be in the amount of ₱229,541,721.81 (excluding the interest payments to FCDU), as computed below:

Lender	**Interest**	**Rate used in FDDA[118]**	**Should be Assessed Amount**
JV70008:			
Czech	US$ 1,129,659.51	49.027	₱ 55,383,816.80
JEXIM	JP¥ 179,602,601.00	0.404865	72,714,800.95
JV70093:			
Czech	US$ 952,492.41	45.611	43,444,131.31
JEXIM	JP¥ 151,435,102.00	0.382995567	57,998,972.75
Total			**₱ 229,541,721.81**

[117] Details of Discrepancy, FDDA, Exhibit "P-22", p. 9.
[118] Using BSP rate.

Recap:			
Czech	US$ 2,082,151.92		98,827,948.11
JEXIM	JP¥ 331,037,703.00		130,713,773.70
TOTAL			**₱ 229,541,721.81**

Petitioner argues that the alleged deficiency FWT has no legal basis.

In its Memorandum, petitioner asserts the following:[119]

> 164. The FDDA stated that MRTC failed to subject the income payments to the Credit Facilities, particularly CZECH and JEXIM (collectively, the "Foreign Lenders") to FWT. According to the FLD and FDDA, the alleged deficiency FWT assessment is the sum of ₱45,916,004.27, representing the basic tax due notwithstanding the BIR's admission in the FLD that MRTC does not have control over the remittance of the withholding tax:
>
> > While it is true that you [i.e., MRTC] do not have the control on the remittance of the withholding tax on your income payments (being shifted to DOTC as per BLT Agreement), the time of withholding as provided for in Section 2.57.4 of RR 2-98 as amended and RMC # 9-2006 was not correctly applied.
>
> 165. MRTC is not liable for deficiency FWT because it had no receipt, custody, control, or disposal over the income payment to the Foreign Lenders and any withholding taxes which may have been due thereon. DOTr made the income payments to the Foreign Lenders and had receipt, custody, control and disposal over the income payments. Hence, if at all, it is the DOTr which should be made liable for any alleged deficiency FWT.
>
> 166. MRTC cannot be held liable for the acts or omissions of another person (*i.e.*, DOTr) who is the entity responsible for withholding such taxes following the principle of *res inter alios acta*, which provides that the rights of a party cannot be prejudiced by an act, declaration, or omission of another.
>
> 167. The FLD and FDDA incorrectly assumed that MRTC had the burden to withhold the taxes even though the BIR had expressly admitted in the FLD that MRTC did not have control over the remittance of FWT.
>
> 168. Under Section 57 of the Tax Code, the "payor-corporation and/or person" is required to withhold the final taxes on certain items of income including Section 28 (B) on the payment of interest income to non-resident foreign

[119] Docket, Vol. V, Pars. 164 to 168, 170 to 178, 181 to 183, and 189, Petitioner's Memorandum, pp. 3379 to 3394.

corporations. In turn, Section 59 states that the tax "shall be paid by the owners of such gains, profits and income, **or the proper person having the receipt, custody, control or disposal of the same**".

xxx xxx xxx

170. This is also consistent with Section 2.57.3 of RR 2-98 which provides that the obligation to withhold taxes is imposed on the person having control over the payment, to wit:

xxx xxx xxx

171. As clearly expressed in Section 59 of the Tax code xxx and the BIR itself in RR 2-98, the burden of withholding the tax is imposed on the person having "receipt, custody, control, or disposal" over the income payment. The rationale is self-evident. How can a person who does not have the money to be used for payment be expected to deduct from something he does not have? Therefore, MRTC could not be considered as the withholding agent because it was DOTr which had receipt, custody, control and disposal over the payments to the Foreign Lenders.

172. The reason why the Government, through DOTr, paid the interest directly to the Foreign Lenders is because of Sections 9.1(a) and (d) of the BLT Agreement, which provide:

> 9.1. (a) Payment of Rental Fee. Rental Fees shall be comprised of (A) the amounts specified in tables 1 and 2 of Annex A-1 hereto, as increased or decreased pursuant to this Agreement, (B) the amounts determined pursuant to Paragraph 9.2, (C) if applicable, the amounts determined pursuant to Paragraph 7.9, (D) the amounts in respect of maintenance hereinafter specified, (E) commencing the first Month, amounts in respect of Metro Rail's staffing and administration costs equal to U.S. $41,667 per Month (as such amount shall be adjusted at the same times and in the same manner as set forth in Attachment 1 to Annex 1 to the Maintenance Agreement) and (F) reimbursement of Metro Rail for all payments made by it other than staffing and administration costs and Metro Rail's one-quarter share of the cost of the Expert where Metro Rail has exercised its right to use the Expert. DOTC shall pay the Rental Fees specified in table 2 of Annex A-1 to or to the order of Metro Rail in United States dollars to such account or accounts and in such manner as Metro Rail shall from time to time specify. The Rental Fees specified in table 1 of Annex A-1 shall be paid on the respective due dates and in the respective currencies of the corresponding payments owed by Metro Rail (or its assignee) to the **Lenders**. The Rental Fees specified in table 2 of Annex A-1 shall be paid monthly, the first such monthly payment becoming due on the last day of the first Month; it being understood such Rental Fees falling due between the Completion Deadline and the Completion Date, if any,

> shall not be paid by DOTC, but shall be deemed paid and discharged. Any Rental Fees determined pursuant to Paragraph 7. 9 shall be due as agreed pursuant thereto. Rental Fees in respect of maintenance shall be equal to the maintenance fees (as more fully set forth in the DOTC's concurrence to the Maintenance Agreement) payable under the Maintenance Agreement (without taking into account any adjustments therein corresponding to any adjustments under Paragraph 9.2 or resulting from setoff rights of Metro Rail under the Maintenance Agreement), and shall be payable on the same dates and in the same manner as such fees are payable by Metro Rail under the Maintenance Agreement. Rental Fees in respect of reimbursements pursuant to clause (F) above shall be payable upon presentation of verified invoices for the payments for which reimbursement is sought. Rental Fees set forth in table 2 of Annex A-1 hereto shall be appropriately increased or decreased to preserve Metro Rail's Net Economic Return whenever Project Cost changes to reflect such change and whenever required by the provisions of this Agreement.
>
> * * *
>
> (d) Metro Rail has agreed to assign absolutely, irrevocably, and unconditionally to the Lenders all of its rights, title and interests in and to the Rental Fees referred to in table 1 of Annex A-1 (as adjusted hereunder) and all other amounts payable under Paragraph 9.1 (c) pursuant to the Deed of Assignment. **DOTC has agreed to evidence its acknowledgement and consent to such assignment and its acceptance of its obligations thereunder, including the obligation to make payments of the Rental Fees** referred to in table 1 of Annex A-1 and such other amounts directly to the Intercreditor Agent, pursuant to the Consent (as defined in the Common Agreement). (*Emphasis supplied*)

173. In fact, the amounts paid by DOTr to the Lenders pursuant to the Omnibus Agreement did not enter MRTC's bank accounts at all. Inasmuch as MRTC did not have receipt, custody, control, or disposal over these income payments, MRTC is not the proper party to bear the burden of the alleged deficiency FWT assessment.

174. Stated otherwise, any deficiency FWT assessment cannot be imposed on a taxpayer who, like MRTC, is not the person liable to withhold the tax.

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175. MRTC cannot be held liable for the deficiency FWT because the Government itself confirmed that the payments to the Foreign Lenders shall be paid in full without "set-off, deduction, or withholding" Furthermore, in the event that the Government is required to withhold any taxes from the payments, the Government already made an express

undertaking that it will be in charge of deducting or withholding and paying any taxes due on the payments to the Foreign Lenders, including the remittance of the full amount of such taxes to the proper government agency. This confirmation and undertaking is embodied in Section 2 of Consent of the Republic, which was executed by the Government through DOTr and DOF, to wit:

> Section 2. Consent to Assignment
>
> **The Republic hereby acknowledges, approves and consents** to the assignment, conveyance, setting over and transfer of the Assigned Property contemplated by the terms of the Assignment and confirms to the Intercreditor Agent, the other Agents and the Lenders **that all amounts payable in respect of the Assigned Property**[120] **shall be paid directly to the Intercreditor Agent (to such account or accounts as may be designated by the Intercreditor Agent) for the benefit of the Lenders and the other Agents strictly in accordance with the terms of the BLT Agreement and <u>without set-off, deduction or withholding</u> and free of any defense or counterclaim.** Notwithstanding the foregoing, **if at any time the Republic or the Intercreditor Agent is required to deduct or withhold any taxes from any payment by it under or in respect of the Assigned Property** (including without limitation, remittance of the Assigned Property by the Intercreditor Agent to the Other Agents and the Lenders), **the Republic will pay the full amount of such taxes to the proper relevant Government Authority**, together with such additional amounts to the Intercreditor Agent, each other Agent and each Lender as may be necessary so that each such payment to the Intercreditor Agent, each other Agent and each Lender, after deduction or withholding for or on account of such taxes, will not be less than the amount provided for in the immediately preceding sentence (and the Republic will indemnify the Intercreditor Agent, the other Agents and the Lenders from any failure of the Republic to do so). The Republic covenants with the Intercreditor Agent, the other Agents and the Lenders that if any future legislation or regulation imposing any new requirements for obtaining any Government Approval from the Republic or any other Government Authority is proposed or implemented and is likely to have a Material Adverse Effect, the Republic shall consult and cooperative with and assist the Intercreditor Agent, the other Agents and the Lenders in their efforts to eliminate or mitigate such Material Adverse Effect.[121] (*Emphasis and underscoring supplied*)

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[120] Docket, Vol. IV, Exhibit "P-39", All of the right, title, and interest of the Company in and to the Assigned Contract Rights and the Assigned Revenues. (Section 2.01, Deed of Assignment between MRTC and Tokyo-Mitsubishi International (HK), Ltd., p. 2871.)

[121] Docket, Vol. V, Exhibit "P-40", pp. 3252 to 3253.

176. It is readily apparent that the Government undertook to remit the full amount of the payments to the Foreign Lenders without any deductions.

177. Even assuming that the payments should be subject to taxes, the Government not only undertook to "deduct or withhold" any taxes from any payments made by it in respect of the Assigned Property --including, among others, the payments to the Foreign Lenders-- but also undertook to pay the full amount of such taxes. As such, the Government should pay the full amount of such taxes to the BIR, which is the proper relevant Government Authority referred to above.

178. Consequently, with respect to the alleged FWT on the payments made to JEXIM (assuming without conceding that the payments to it are subject to FWT), it was the Government who undertook to <u>deduct or withhold, and remit the FWT</u> to Respondent. This express undertaking must be recognized and respected by Respondent since the *Consent of the Republic of the Philippines* was signed not only by the DOTr Secretary, but also by the DOF Secretary who exercises supervision and control over the BIR.

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XI. Assuming without conceding that MRTC is a withholding agent, MRTC is still not liable for the FWT on the income payments to JEXIM because it is a financial institution wholly-owned by the Government of Japan.

181. Under Section 32 of the Tax Code, income exempt under a treaty is excluded from gross income, to wit:

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182. The *Convention between the Republic of the Philippines and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* ***("Philippines-Japan Tax Treaty")*** signed on February 13, 1980, as amended by *the Protocol Amending the Convention between the Republic of the Philippines and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* ***("Amending Protocol")***, signed on December 9, 2006, provides for a tax exemption in favor of a financial institution wholly-owned by a contracting party.

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183. In the JEXIM Credit Facility Agreement entered into between JEXIM and MRTC, JEXIM expressly represented that it was a government financial institution of Japan. In fact, the reference to JEXIM as a financial institution wholly-owned by the Japanese Government also appears in the Philippines-Japan Tax Treaty.

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189. Inasmuch as the JEXIM Credit Facility was signed in 1997 when the Philippines-Japan Tax Treaty was in force, the payments to JEXIM are exempt under the treaty.

It is to be noted that respondent did not dispute the existence of the Consent of the Republic (Consent) being invoked by petitioner to support its claim that it cannot be made liable for any FWT which may arise on the interest payments to the lenders.

Petitioner submitted the SAROs[122] supporting the payment of withholding tax on the interest payments to FCDU. Attached to these SAROs are the Request for Issuance of SARO by the DOTC addressed to the DBM, DOTC's Computation of Tax Withheld for FCDU Payment, Bank Debit Advice issued by *Banko Sentral ng Pilipinas* addressed to the Treasurer of the Republic of the Philippines re: charging the latter's foreign currency deposit account for the payment of the principal and interest arising from the JEXIM, Czech, FCDU Credit Facility, and Request for Payment by The Bank of Tokyo-Mitsubishi UFJ, Ltd. (as the Intercreditor Agent[123] of the lenders as stipulated in the Common Agreement[124]).

It can be gleaned from the SAROs and its supporting documents that petitioner had no direct participation or intervention in the payment process of the loans and any tax arising from the payment of interest.

These same SAROs were submitted by petitioner to respondent to support the former's request for reinvestigation[125] and were even considered by the latter in reducing the deficiency FWT assessment. It is therefore presumed that respondent acknowledges the payment process, which is

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[122] Docket, Vol. V, SARO Nos. A-07-06146 and A-07-06852, Exhibits "P-30" and "P-31", pp. 2977 to 2998.

[123] Docket, Vol. IV, Exhibit "P-10", **All payments (whether of principal, interest, commitment or other fees or any other amount) due to each Lender** with respect to its Loans or to any Agent under any Financing Document **shall be made to the account of the Intercreditor Agent for distribution to each Lender** or such Agent pursuant to the terms of this Agreement and the respective Principal Credit Agreement (or, as to any Agents, other Financing Document) to which such Lender or Agent is a party xxx. (*Emphasis supplied*) (Sec. 2.02 Payment, Common Agreement, p. 2424.

[124] Docket, Vol. IV, Exhibit "P-10", p. 2420.

[125] BIR Records, Folder 2, pp. 201 to 224.

consistent with the Republic's undertaking to pay the lenders as manifested in its Consent.

Verily, as admitted by respondent in the FLD and as it is found from the payment process of the loans, petitioner had no control over the payment of the interest on loans extended by the lenders. Neither did petitioner have any custody over the funds to be disbursed to pay the obligations arising from the Credit Facility Agreement evidencing the loans granted to petitioner.

Based on the above premises, under Section 2.57(A) of RR No. 2-98,[126] petitioner, as the borrower in the Credit Facility Agreement, is primarily considered as the payor who has the duty to withhold and remit the final tax on interest expense due to the lenders.

This does not mean, however, that only the payor-borrower can be constituted as withholding agent. Under Section 59 of the NIRC of 1997, any person who has control, receipt, custody, or disposal of the income may be constituted as withholding agent:

> SEC. 59. *Tax on Profits Collectible from Owner or Other Persons.* – The tax imposed under this Title upon gains, profits, and income not falling under the foregoing and not returned and paid by virtue of the foregoing or as otherwise provided by law shall be assessed by personal return under rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner. The intent and purpose of the Title is that all gains, profits and income of a taxable class, as defined in this Title, shall be charged and assessed with the corresponding tax prescribed by this Title, and **said tax shall be paid by** the owners of such gains, profits and income, **or the proper person having the receipt, custody, control or disposal of the same.** For purposes of this Title, ownership of such gains, profits and income or liability to pay the tax shall be determined as of the year for which a return is required to be rendered. (*Emphasis supplied*)

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126 SECTION 2.57. *Withholding of Tax at Source.* -
(A) *Final Withholding Tax.* - Under the final withholding tax system the amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income tax due from the payee on the said income. **The liability for payment of the tax rests primarily on the payor as a withholding agent.** Thus, in case of his failure to withhold the tax or in case of under withholding, the deficiency tax shall be collected from the payor/withholding agent. The payee is not required to file an income tax return for the particular income. (*Emphasis supplied*)

The intent and purpose of the NIRC provisions on withholding taxes is also explicitly stated, *i.e.*, that all gains, profits, and income "are charged and assessed with the corresponding tax" and said tax paid by "the owners of such gains, profits and income, or the proper person having the receipt, custody, control or disposal of the same.[127]

In this case, while petitioner is the borrower in the Credit Facility Agreement, it, however, does not have the custody, control, or disposal of the interest income of the lenders being subjected to final tax. As established earlier, it is the DOTr which pays the interest earned by the lenders from the loan granted to petitioner.

Thus, applying the provisions of Section 59 of the NIRC of 1997, petitioner, not being the proper person having the receipt, custody, control or disposal of the interest payments, cannot be considered as the payor who is required to withhold the final income tax on the interest payments to the lenders. Accordingly, the instant FWT assessment shall be cancelled and withdrawn.

V. Deficiency Expanded Withholding Tax – ₱7,548,669.19
VI. Deficiency Fringe Benefits Tax – ₱4,665,463.57

In the FDDA, respondent assessed petitioner of deficiency EWT in the total amount of ₱7,292,219.06, as computed below:[128]

Basic expanded withholding tax	₱ 3,099,479.97
Add: Interest (January 11, 2008 to Sept. 30, 2014) 2454 days	4,167,739.09
Compromise penalty	25,000.00
TOTAL AMOUNT DUE	**₱7,292,219.06**

As stated in the Details of Discrepancies attached to the FDDA, respondent verified if the prescribed withholding tax rates for each kind of income payments were properly applied and the reinvestigation disclosed that petitioner's income payments to regular suppliers of goods were either not subjected to correct tax rates or not subjected at all. Respondent reiterates his assessment per FAN and the details are presented under Schedule 4 showing basic deficiency EWT which was computed pursuant to Section 57(B) of the NIRC as

[127] *Banco De Oro, et al. vs. Republic of the Philippines, et al.*, G.R. No. 198756, August 16, 2016.
[128] FDDA, Exhibit "P-22", p. 3.

implemented by Revenue Regulations Nos. 2-98, 6-2001, 12-2001, 14-2002, 17-2003, as amended,[129] to wit:

Schedule 4			
Income Payments/ATC	**Tax Base**	**Rate**	**Tax Required to be Withheld**
Purchases – Goods	₱ 2,183,131.02	1%	₱ 21,831.31
Purchases - Services	13,712,739.48	2%	274,254.79
Rental	1,488,362.52	5%	74,418.13
Professional fees	18,818,089.82	15%	2,822,713.47
Professional fees	(937,733.22)	10%	(93,773.32)
Basic expanded withholding tax	**₱35,264,589.62**		**₱3,099,444.38**

Also, petitioner was assessed by respondent of deficiency FBT in the total amount of ₱4,507,289.76, computed as follows:[130]

Basic fringe benefits tax	**₱1,911,703.39**
Add: Interest (January 11, 2008 to Sept. 30, 2014) 2454 days	2,570,586.37
Compromise penalty	25,000.00
TOTAL AMOUNT DUE	**₱4,507,289.76**

Respondent's reinvestigation disclosed that petitioner provided benefits to its managerial and supervisory employees in various forms namely, car plans and related expenses such as fuel and lubricant, repairs and maintenance, insurance, and other similar employee benefits that constitute fringe benefits. The total monetary value of fringe benefits amounted to ₱4,062,369.71 whereas the total grossed-up monetary value of fringe benefits amounted to ₱5,974,073.10. Applying statutory FBT rate of 32%, the resultant deficiency FBT is One Million Nine Hundred Eleven Thousand Seven Hundred Three and 39/100 (₱1,911,703.39) pursuant to Section 33 of the NIRC as implemented by Revenue Regulations No. 3-98 dated May 21, 1998, as amended.[131]

As mentioned earlier, petitioner already paid both the basic deficiency EWT and FBT, as well as the deficiency interest penalties imposed thereon on March 19, 2015 as evidenced by BIR Forms No. 0605.

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[129] Details of Discrepancy, FDDA, Exhibit "P-22", p. 8.
[130] FDDA, Exhibit "P-22", p. 4.
[131] Details of Discrepancy, FDDA, Exhibit "P-22", p. 9.

With these payments, petitioner now asserts that the deficiency EWT and FBT assessments must be cancelled.

Indeed, the basic deficiency EWT and FBT assessments must already be cancelled in view of the settlement made by petitioner. However, petitioner is not totally relieved from its total tax liabilities as it is required to pay the increments thereon, such as the 25% surcharge and the 20% delinquency interest imposed under Sections 248(A)(3) and 249(C)(3) of the NIRC of 1997, which provide:

> SEC. 248. *Civil Penalties.* –
>
> (A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:
>
> xxx xxx xxx
>
> (3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; xxx
>
> SEC. 249. *Interest.* –
>
> xxx xxx xxx
>
> (C) *Delinquency Interest.* – In case of failure to pay:
>
> xxx xxx xxx
>
> (3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax.

The law is very clear. The imposition of surcharge is mandatory. This is justified because the intention of the law is precisely to discourage delay in the payment of taxes due to the State. The delay in the payment of the deficiency tax within the time prescribed for its payment in the notice of assessment justifies the imposition of a 25% surcharge, pursuant to Section 248(A)(3) of the Tax Code.

On the other hand, the imposition of delinquency interest is also proper. Section 249(C)(3) of the NIRC of 1997 mandates the imposition of such interest in the event that the taxpayer is held liable for deficiency taxes. Based on established doctrine, these charges incident to delinquency are compensatory in nature and are imposed for the taxpayer's use of the funds at the time when the State should have control of said funds. Collecting such charges is mandatory.[132]

VII. Increments for Late Payment of Income Tax – ₱434,122,451.90

Respondent's review of petitioner's Quarterly and Annual Income Tax Returns for taxable year 2007 disclosed that petitioner failed to pay in full the income tax due amounting to ₱1,617,544,194.18 within the prescribed due dates. The 25% surcharge and 20% interest per annum have been imposed pursuant to the provisions of Section 248(A)(4) and Section 249(A) of the Tax Code of 1997. The compromise penalty, on the other hand, was imposed pursuant to RMO No. 1-90, as amended.[133] The total increments for late payment of income tax in the amount of ₱434,122,451.91 was computed as follows:

	Income Tax Per Return	Date Filed	Due Date	Date of SARO	Amount Paid	No. of Days Late	Interest
Q1	₱ 135,568,272.09	5/31/2007	5/30/2007	11/13/2007[134]	₱ 135,568,272.09	167	₱ 12,405,425.45
Q2	7,382,847.31	8/28/2007	8/29/2007	11/13/2007[135]	7,382,847.31	76	307,450.08
Q3	491,242,698.43	11/26/2007	11/29/2007	12/29/2007[136]	491,242,698.43	30	8,075,222.44
Final	983,350,376.35	7/10/2009	4/15/2008	4/30/2008[137]	986,316,746.00	15	8,106,712.98
	₱1,617,544,194.18				₱1,620,510,563.83		
Total Interest							₱ 28,894,810.95
Add:	Surcharge (25% of P1,620,510,563.83)						405,127,640.96
	Compromise penalty						100,000.00
TOTAL AMOUNT DUE							**₱434,122,451.91**

Petitioner contends that it is not liable for late payment of income tax in the amount of ₱434,122,451.90347 because it cannot be held liable for DOTr's acts and omissions. The government, the DOTr in this case, allegedly agreed that it would pay petitioner's corporate income taxes. Thus, petitioner cannot be prejudiced by any delay caused by the DOTr.

The Court finds for petitioner.

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[132] *Bank of the Philippine Islands vs. Commissioner of Internal Revenue*, G.R. No. 137002, July 27, 2006.
[133] BIR Records, Folder 1, Details of Discrepancy, FLD, Exhibit "P-9", BIR Records, Folder 1, p. 1063.
[134] Docket, Vol. V, Exhibit" P-32", p. 2969.
[135] *Id.*
[136] *Id.*, Vol. IV, Exhibit "P-33", p. 2861.
[137] *Id.*, Vol. IV, Exhibit "P-34", p. 2862.

It is to be noted that on March 8, 2006, the BIR, the DOTr, and petitioner met to resolve the issue on how the BIR can collect the internal revenue tax liabilities on the EDSA-MRT III project without any cash outlay from petitioner. The parties agreed on the following terms:

> 1. For All *(sic)* internal revenue taxes for which DOTC is ultimately liable under the BLT Agreement, MRTC shall prepare the appropriate tax returns and furnish a copy thereof to DOTC for its review and comments at least fifteen (15) days before the subject tax return is due for filing with the BIR.
>
> 2. Within five (5) days from the receipt of tax returns, DOTC shall provide MRTC with its comments thereon or any suggested comments. Should no comment be received by MRTC from DOTC within the time given, the tax return shall be deemed at correct.
>
> 3. MRTC shall file the appropriate tax returns with the BIR on or before the due date.
>
> 4. Upon receipt of the tax return, the BIR shall evaluate and certify the validity of the internal revenue taxes ascertained by MRTC. Thereafter, the BIR shall issue an assessment based on its review and furnish copies of the same to MRTC and DOTC.
>
> 5. Within seven (7) days from receipt by DOTC of the assessment, DOTC shall immediately request the Department of Budget and Management ("DBM") for a Special Allotment Release Order ("SARO"), covering the amount of the assessment determined by the BIR at the tax due.
>
> 6. DOTC shall coordinate with DBM for the issuance of the SARO to DOTC.
>
> 7. Based on the SARO issued, DOTC will prepare the TRA for remittance to the BIR.
>
> 8. The foregoing procedure shall be the mechanism on the payment of taxes under the BLT Agreement for as long as the relevant General Appropriations Act includes a provision(s) essentially similar to that provided in Section 13 of the GAA of 2003 (the "Provision").[138]

Clearly, from the foregoing, the DOTr undertook the responsibility of settling petitioner's tax liabilities. As such, petitioner should not be made to pay the increments for the late payment by the DOTr of the income tax due, especially that the

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[138] Docket, Vol. V, Exhibit "P-42", Minutes of the BIR-DOTC-MRTC Meeting, pp. 3038 to 3039. *un*

BIR agreed to collect any such taxes from the DOTr as reflected in the Minutes of the March 8, 2006 meeting. Any delay in the payments caused by the Government itself cannot be attributed to petitioner. That would be plainly unjust and inequitable. Consequently, the increments for late payment of income tax should be cancelled and withdrawn.

As to the deficiency DST included in the FLD and FAN, this Court will not anymore discuss its validity considering that such was not anymore provided in the FDDA as well as not raised as an issue in the petition for review.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. The assessments issued by respondent against petitioner for taxable year 2007 covering deficiency VAT (penalties only), FWT, and increments for late payment of IT are **CANCELLED** and **SET ASIDE**. On the other hand, the deficiency IT, EWT and FBT assessments are **AFFIRMED but with MODIFICATION**. Accordingly, petitioner is **ORDERED TO PAY** respondent the amount of **₱1,731,830,990.47**, representing basic deficiency income tax and the 25% surcharge, 20% deficiency interest and 20% delinquency interest imposed on the deficiency IT, EWT and FBT under Sections 248(A)(3) and 249(B) and (C) of the NIRC of 1997, as amended, respectively, computed until December 31, 2017, as determined below:

	IT	EWT	FBT	TOTAL
Basic	₱ 368,828,806.59	₱ 3,099,479.97	₱ 1,911,703.39	₱ 373,839,989.95
Surcharge (25%)	92,207,201.65	774,869.99	477,925.85	93,459,997.49
Deficiency Interest (20%) until February 24, 2015				
IT - 4/16/08 to 2/24/2015 (₱368,828,806.59 x 20% x 2,506 days/ 365 days)	506,457,528.39			506,457,528.39
EWT - 1/16/08 to 2/24/2015 (₱3,099,444.38 x 20% x 2,597 days/ 365 days)		4,410,602.46		4,410,602.46
FBT - 1/11/08 to 2/24/2015 (₱1,911,703.39 x 20% x 2,602 days/ 365 days)			2,725,617.66	2,725,617.66
Total Amount Due, February 24, 2015	**₱ 967,493,536.63**	**₱8,284,952.42**	**₱5,115,246.90**	**₱ 980,893,735.95**
Deficiency Interest (20%) from February 25, 2015 until December 31, 2017/March 19, 2015				
IT - 2/25/2015 to 12/31/17 (₱368,828,806.59 x 20% x 1,041 days/ 365 days)	210,383,993.24			210,383,993.24
EWT - 2/25/15 to 3/19/2015 (₱3,099,444.38 x 20% x 23 days/ 365 days)		39,061.94		39,061.94
FBT - 2/25/15 to 3/19/2015 (₱1,911,703.39 x 20% x 23 days/ 365 days)			24,092.70	24,092.70
Delinquency Interest (20%) from February 24, 2015 until December 31, 2017/March 19, 2015				

IT - 2/25/15 to 12/31/17 (₱967,493,536.63 x 20% x 1,041 days/ 365 days)	551,868,915.96			551,868,915.96
EWT - 2/25/15 to 3/19/15 (₱8,284,952.42 x 20% x 23 days/ 365 days)		104,413.10		104,413.10
FBT - 2/24/15 to 3/19/15 (₱5,115,246.89 x 20% x 23 days/ 365 days)			64,466.13	64,466.13
Delinquency Interest (20%) on Surcharge from March 19, 2015 until December 31, 2017				-
EWT - 3/19/15 to 12/31/17 (₱774,869.99 x 20% x 1,018 days/ 365 days)		432,228.85		432,228.85
FBT - 3/19/15 to 12/31/17 (₱477,925.85 x 20% x 1,018 days/ 365 days)			266,590.97	266,590.97
Total	**₱1,729,746,445.83**	**₱8,860,656.31**	**₱5,470,396.70**	**₱1,744,077,498.84**
Less: Payment on March 19, 2015				
Basic Tax		(3,099,479.97)	(1,911,703.39)	(5,011,183.36)
Interest		(4,475,139.57)	(2,760,185.44)	(7,235,325.01)
Total	**₱1,729,746,445.83**	**₱1,286,036.77**	**₱ 798,507.87**	**₱1,731,830,990.47**

In addition, petitioner is **ORDERED to PAY** delinquency interest at the rate of 12% computed from January 1, 2018 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended by Republic Act No. 10963, also known as Tax Reform for Acceleration and Inclusion (TRAIN) and as implemented by RR No. 21-2018, on the following amounts:

Income Tax	₱967,493,536.63
EWT	₱ 774,869.99
FBT	₱ 477,925.85

SO ORDERED.

CATHERINE T. MANAHAN
Associate Justice

I CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

ATTESTATION

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

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

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice