REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

MCDONALD'S PHILIPPINES REALTY CORPORATION, *Petitioner,*	CTA EB No. 1638 (CTA CASE NO.8766)
	Present: DEL ROSARIO, P.J.,
-versus-	CASTAÑEDA, JR., UY, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN, and
COMMISSIONER OF INTERNAL REVENUE,	MANAHAN, *JJ.*
Respondent.	Promulgated: OCT 11 2018 4:26 p.m.

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D E C I S I O N

MINDARO-GRULLA, J.:

Submitted for decision of this Court *En Banc* is a Petition for Review filed by McDonald's Philippines Realty Corporation (MPRC), under *Section 3(b), Rule 8 of the 2005 Revised Rules of the Court of Tax Appeals*[1]*, as amended*, seeking the reversal of the Decision dated December 15, 2016 [2] and the Resolution dated March 30, 2017[3] rendered by the Third Division of this Court in the case entitled *"McDonald's Philippines Realty Corporation vs. Commissioner*

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[1] RULE 8, Sec 3. *Who may appeal; period to file petition.-*

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(b) A party adversely affected by a decision or resolution of a Division of the Court on a motion for reconsideration or new trial may appeal to the Court by filing before it a petition for review within fifteen days from receipt of a copy of the questioned decision or resolution. Upon proper motion and the payment of the full amount of the docket and other lawful fees and deposit for costs before the expiration of the reglementary period herein fixed, the Court may grant an additional period not exceeding fifteen days from the expiration of the original period within which to file the petition for review. (Rules of Court, Rule 42, sec. 1a)

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[2] Penned by Associate Esperanza R. Fabon-Victorino, concurred in by Associate Justice Ma. Belen M. Ringpis-Liban, En Banc Docket, pp. 53-84, Associate Justice Lovell R. Bautista was on leave.

[3] Penned by Associate Esperanza R. Fabon-Victorino, concurred in by Associate Justice Lovell R. Bautista and Associate Justice Ma. Belen M. Ringpis-Liban, En Banc Docket, pp. 86-91.

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of Internal Revenue", docketed as CTA Case No. 8766, the dispositive portions of which, respectively, read as follows:

Decision dated December 15, 2016:

"**WHEREFORE,** the Petition for Review filed by McDonald's Philippines Realty Corporation is **PARTIALLY GRANTED**. The Final Decision on Disputed Assessment issued by respondent against petitioner covering deficiency VAT for CY 2007 is partly upheld. Accordingly, petitioner is hereby **ORDERED** to pay respondent the amount of P2,224,211.02 representing the sum of the basic deficiency VAT for taxable CY 2007 in the amount of P1,779,368.82 and the 25% surcharge imposed under Section 248 (A)(3) of the NIRC of 1997, in the amount of P444,842.20 as shown below:

Basic Deficiency VAT	P1,779,368.82
Add: 25% Surcharge	444,842.20
Total	P2,224,211.02

In addition, petitioner is liable to pay:

a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency VAT of P1,779,368.82 computed from January 2008, until full payment thereof pursuant to Section 249(B) of the 1997 NIRC, as amended; and

b) Delinquency interest at the rate of twenty percent (20%) per annum on the 20% deficiency interest which have accrued as aforestated in (a) and on the total amount of P2,224,211.02, computed from January 17, 2014 until full payment thereof pursuant to Section 249 (C) of the 1997 NIRC, as amended.

SO ORDERED."

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Resolution dated March 30, 2017:

"**WHEREFORE**, petitioner's *Motion for Partial Reconsideration* dated January 12, 2017 is DENIED, for lack of merit. The Decision dated December 15, 2016 is **AFFIRMED**, *in toto.*

SO ORDERED."

The following facts of the case as recited by the Court in Division in its Decision[4] and as established by evidence on record, read as follows:

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

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

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

On December 10, 2010, petitioner received a copy of the Preliminary Assessment Notice (PAN) dated September 15, 2010 for deficiency Income Tax (IT), VAT, and Documentary Stamp Tax (DST) in the aggregate amount of P33,432,243.06,

[4] Supra note 2.

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

On February 23, 2011, petitioner protested the PAN.

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

On March 30, 2012, petitioner received a copy of respondent's Formal Letter of Demand (FLO) with attached Details of Discrepancies dated March 15, 2012, and Audit/Assessment Notice No. LTD0-122-VT-2007-00015 dated March 1, 2012 (FAN), which it protested on April 26, 2012.

On January 17, 2014, petitioner received a copy of respondent's Final Decision on Disputed Assessment (FDDA) with attached Details of Discrepancies dated January 16, 2014, finding it liable for deficiency VAT for CY 2007 in the total amount of P3,595,275.39.

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

In his Answer, respondent counters that the assessment for deficiency VAT for CY 2007 was issued in accordance with law, rules and jurisprudence. The assessment was issued within the 3-year prescriptive period mandated in Section 222(b) of the NIRC of 1997, as amended, on account of the two (2) Waivers of the Defense of Prescription duly executed by petitioner. Even assuming that the assessment was issued beyond the three (3) year prescriptive period, petitioner's case will fall within the 10- year prescriptive period for having filed a false or fraudulent VAT returns for CY 2007, pursuant to Section 222(a) of the NIRC of 1997, as amended. Finally, petitioner is liable to pay deficiency VAT assessment arising from rental/interest income in the amount of P3,595,275.39.

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

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

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

She further declared that on July 15, 2008, petitioner received a copy of LOA No. 00006884 dated July 1, 2008. This was followed by a copy of the PAN dated September 15, 2010 which petitioner received on December 10, 2010, for alleged deficiency IT, VAT, and DST in the aggregate amount of P33,432,243.06.

On December 15, 2010, petitioner, through its resident agent Romeo Bachoco, executed a Waiver

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

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

On March 30, 2012, petitioner received a copy of the FLD/FAN cancelling the assessments for deficiency IT and DST but reiterating the demand for payment of petitioner's deficiency VAT in the total amount of P3,104,836.70, inclusive of interest and surcharge.

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

On January 17, 2014, petitioner received a copy of the Final Decision on Disputed Assessment (FDDA) dated January 16, 2014, finding petitioner liable for deficiency VAT for CY 2007 in the total amount of P3,595,275.39, inclusive of interest and surcharge. The deficiency VAT assessment for CY 2007 allegedly arose from rental/interest income in the amount of P11,080,687.70 not subjected to VAT. In addition, the BIR imposed a fifty percent (50%) surcharge on the said amount. Witness Nuguit opined that the deficiency VAT assessment for CY 2007 has no legal and factual bases on the following grounds, to wit: (1) the deficiency VAT assessment for CY 2007 has prescribed; (2) the Waiver did not validly extend the prescriptive period for issuance of the BIR's deficiency VAT assessment for CY 2007; (3) even assuming for the sake of argument that the assessment has not yet prescribed, the BIR's deficiency VAT assessment on rental income is invalid; (4) petitioner's interest income is not subject to VAT; and (5) petitioner may not be held liable for the 50% surcharge.

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

The present case involves petitioner's judicial protest against the BIR's deficiency VAT assessment for CY 2007. GADC is involve in the case since the BIR assessed petitioner for deficiency VAT on the interest income that it received from GADC in CY 2007. The BIR imposed VAT on petitioner's interest income from GADC invoking the ruling in the case of Lapanday Foods Corporation vs. CIR *(Lapanday case*), saying that petitioner and GADC are affiliates, hence, the interest on loans extended to affiliates is subject to VAT. Such conclusion, according to Atty. Alvarez Mouliac, has no basis since neither is a stockholder of the other.

ICPA **Katherine O. Constantino** stated in her Judicial Affidavit that pursuant to the Court's directive, she conducted verification procedures on the documents supporting petitioner's protest against respondent's assessment for alleged deficiency VAT for CY 2007. The said verification revealed that petitioner did not under-declare its rental income in its quarterly VAT Returns for CY 2007. In fact, petitioner overpaid its output VAT for CY 2007 in the total amount of P2,212,420.45.

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

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

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

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

By way of a Judicial Affidavit, **Ricardo B. Calma** testified that he was among the ROs authorized to audit all internal revenue taxes of petitioner. The audit was conducted at petitioner's place of business. Thereafter, a Letter for an Informal Conference with Details of Discrepancies was sent to petitioner. Per their recommendation, a PAN with Details of Discrepancies was later issued assessing petitioner of deficiency IT, VAT and DST, which the latter protested. After review and evaluation of petitioner's protest, they still found it liable for deficiency VAT. Thus, the issuance of a FAN with Details of Discrepancies against petitioner.

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

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

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

In the assailed Decision, the Court in Division partly upheld the BIR's FDDA against petitioner and ruled that it is liable for deficiency VAT for CY 2007, but reduced the surcharge imposed upon petitioner to twenty five percent (25%) pursuant to Section 248 (A)(3)[5] of the NIRC of 1997, as amended.

Aggrieved, petitioner filed a Motion for Partial Reconsideration which was denied for lack of merit in the assailed Resolution. Hence, this Petition for Review was filed.

In the instant petition, petitioner contends that respondent's right to assess petitioner's deficiency VAT liability for the first, second, third and fourth quarters of calendar year 2007 has already prescribed. Further, petitioner insists that the interest income it derived from the unpaid rentals and loans it granted to GADC is not subject to VAT considering that these were not incurred in the course of trade or business.

We rule to DENY the Petition for Review.

The assessment period of internal revenue taxes is specified in Section 203 of the 1997 NIRC, which provides as follows:

> "Sec. 203. Period of Limitation Upon Assessment and Collection. - Except as provided in Section 222, ***internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return,*** and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period; Provided,

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[5] 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:

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(3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or

That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing of thereof shall be considered filed on such last day."

In sum, internal revenue taxes are assessed within three years from the time prescribed by law for filing the return or the actual date of the filing of the return, whichever is later.[6]

In cases of VAT returns, Section 114 of the NIRC of 1997, as amended, mandates that it should be filed every quarter, specifically, within twenty-five (25) days following the close of each taxable quarter, to wit:

"SEC. 114. *Return and Payment of Value-Added Tax.* -

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

Any person, whose registration has been cancelled in accordance with Section 236, shall file a return and pay the tax due thereon within twenty-five (25) days from the date of cancellation of registration: *Provided,* that only one consolidated return shall be filed by the taxpayer for his principal place of business or head office and all branches."

As correctly illustrated by the Court in Division[7], in applying Section 114(A) in relation to Section 203 of the 1997 NIRC of 1997, as amended, respondent had until the following dates within which to assess petitioner of

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[6] Commissioner of Internal Revenue v. Next Mobile, Inc. (Formerly Nextel Communications Philippines, Inc., CTA EB Case No. 1001, May 28, 201 4; and Commissioner of Internal Revenue vs. First Sumiden Realty, Inc., CTA EB Case No. 975, January 7, 2014.
[7] En Banc Docket, p. 62.

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deficiency VAT for the four (4) quarters of calendar year 2007:

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

Records, however, reveal that since the FAN was only received by the petitioner on March 30, 2012, there is no doubt that the assessments made for petitioner's alleged deficiency VAT for the first, second, third and fourth quarters of CY 2007 were issued beyond the 3-year prescriptive period provided under Section 203 of the NIRC, as amended.

While there is no dispute that the assessment notices were issued beyond the three (3) year prescriptive period, respondent, nonetheless, alleged that petitioner's filing of a false or fraudulent return warrants extension of the prescriptive period to ten (10) years.

The failure of petitioner to report its rental/interest income undeclared receipts to the total declared VAT receipts corresponds to more than thirty percent (30%). Hence, invoking Section 248(B) of the NIRC of 1997, as amended, respondent avers that such under declaration rendered petitioner's VAT returns for the CY 2007 as false or fraudulent.

Notably, Section 222(a) of the NIRC, as amended, provides for an exception to Section 203, which reads:

> "SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* - (a) In the case of a false or fraudulent return with intent to evade tax or failure to file a return, ***the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission***: *Provided,* That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof."

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There are therefore, three instances when the three-year prescriptive period does not apply, namely: ***(1) filing a false return, (2) filing a fraudulent return with intent to evade tax, and (3) failure to file a return***. In all these instances, the period within which to assess deficiency taxes is ten (10) years from discovery of the fraud, falsification or omission.[8]

On these bases, it is necessary first to determine whether or not petitioner's VAT returns for the CY 2007 are false or fraudulent.

First, on the rental income, petitioner's deficiency VAT was computed imposing a 12% VAT on its gross receipts from rental income and interest for taxable year 2007. This is based on Section 108(A) of the NIRC of 1997 as amended, which states that:

> "SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties. –*
>
> (A) *Rate and Base of Tax.* -There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of the gross receipts, derived from the sale or exchange of services, including the use or lease of properties.
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> xxx xxx xxx
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> The term **'gross receipts'** means the **total amount of money or its equivalent representing** the contract price, compensation, service fee, **rental** or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments **actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax."** *(Emphasis supplied)*

In the case at bar, the issue however is whether or not respondent correctly computed petitioner's vatable gross receipts for CY 2007.

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[8] Commissioner of Internal Revenue vs. Arturo Tulia, G.R. No. 139858, October 25, 2005.

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The assailed Decision has exhaustively explained in detail and extensively used the exhibits as reference to address this issue[9].

Consequently, after considering all the evidence on record and the findings of the ICPA[10], the Court in Division correctly concluded that respondent's use of the 1.12 divisor instead of 1.07, on petitioner's Rental Receivables, is misplaced. The use of 1.07 as a divisor is borne by the fact that petitioner records its receivables with the 5% expanded withholding tax already deducted.

In this regard, record even shows that there is an overpayment of VAT on its rental income in the amount of P1,680,056.96. Clearly, petitioner has sufficiently proven that it paid the VAT on all of its gross receipts on rental income.

Second, on the interest income from loans for CY 2007, petitioner's assertion that its interest-bearing loans are only incidental to its primary business activity of leasing real properties cannot be given scant consideration by this Court.

Persons or entities liable to VAT are specified in Sections 105 & 108 of the 1997 NIRC, to reiterate:

> "SEC. 105. Persons Liable. - Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value added tax (VAT) imposed in Sections 106 to 108 of this Code.
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> The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.
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> The phrase **"in the course of trade or business" means the regular conduct or**

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[9] Supra note 2, pp.71-79.
[10] Division Docket, Findings and Observations, Exhibit "P-35".

pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.

The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by nonresident foreign persons shall be considered as being rendered in the course of trade or business."

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"SEC 108. Value-added Tax on Sale of Services and Use or Lease of Properties. –

(A) Rate and Base of Tax. - There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties.

The phrase 'sale or exchange of services' means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, resthouses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by

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land relative to their transport of goods or cargoes; common carriers by air and sea relative to their transport of passengers, goods or cargoes from one place in the Philippines to another place in the Philippines, sales of electricity by generation companies, transmission, and distribution companies, services of franchise grantees of electric utilities, telephone and telegraph, radio and television broadcasting and all franchise grantees except those under Section 119 of this Code and nonlife insurance companies (except their crop insurances), including surety, fidelity, indemnity and bonding companies; ***and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties***. xxx" (Emphasis supplied.)

Accordingly, in *Mindanao II Geothermal Partnership vs. Commissioner of Internal Revenue*[11], the Supreme Court interpreted the meaning of an "incidental" transaction, thus:

"Mindanao II asserts that the sale of a fully depreciated Nissan Patrol is not an incidental transaction in the course of its business; hence, it is an isolated transaction that should not have been subject to 10% VAT.

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Mindanao II relies on *Commissioner of Internal Revenue vs. Magsaysay Lines, Inc. (Magsaysay)* and *Imperial vs. Collector of Internal Revenue (Imperial)* to justify its position. *Magsaysay,* decided under the NIRC of 1986, involved the sale of vessels of the National Development Company (NDC) to Magsaysay Lines, Inc. We ruled that the sale of vessels was not in the course of NDC's trade or business as it was involuntary and made pursuant to the Government's policy for privatization. *Magsaysay,* in quoting from the CTA's decision, imputed upon *Imperial* the definition of "carrying on business". *Imperial,* however, is an

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[11] Mindanao II Geothermal Partnership vs. Commissioner of Internal Revenue, G.R. Nos. 193301 & 194637, March 11, 2013.

> unreported case that merely stated that 'to engage' is to embark in a business or to employ oneself therein.
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> Mindanao II's sale of the Nissan Patrol is said to be an isolated transaction. However, it does not follow that an isolated transaction cannot be an incidental transaction for purposes of VAT liability. ***Indeed, a reading of Section 105 of the 1997 Tax Code would show that a transaction "in the course of trade or business" includes "transactions incidental thereto." Mindanao II's business is to convert the steam supplied to it by PNOC-EDC into electricity and to deliver the electricity to NPC. In the course of its business, Mindanao II bought and eventually sold a Nissan Patrol. Prior to the sale, the Nissan Patrol was part of Mindanao II's property, plant, and equipment. Therefore, the sale of the Nissan Patrol is an incidental transaction made in the course of Mindanao II's business which should be liable for VAT.***"

Hence, we agree with the Court in Division in ruling that petitioner's interest bearing loans from GADC's unpaid rentals is a transaction made in the course of its lease business, for emphasis, we quote:

> "In the case of CS *Garments, Inc. vs. CIR,* this Court held that although the primary business of CS *Garments* is the manufacturing of garments for sale abroad, the sale of motor vehicle to its general manager is considered an incidental transaction subject to VAT for it was purchased and used in carrying out petitioner's business, thus:
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> > 'Here, petitioner's primary business is the manufacturing of garments for sale abroad. In carrying-out its business, petitioner acquired and eventually sold a Mercedes Benz to its General Manager Mr. Sudhoff. Prior to the sale, the motor vehicle formed part of petitioner's capital assets, specifically under the account, "Property, Plant and Equipment". The Rules on

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International Accounting Standards (IAS) defines Property, Plant and Equipment as follows:

6. Definitions Property, plant and equipment are tangible assets that:

(a) are held by an enterprise ***for use in the production or supply of goods or services, for rental to others, or for administrative purposes***; and

(b) are expected to be used during more than one period.

Therefore, the sale of the motor vehicle is an incidental transaction because the said vehicle was purchased and used in furtherance of petitioner's business.

Once an activity has been identified as a business, any supply[sale] made while carrying it on is likely to be made in the course or furtherance of business. No distinction is made between capital and revenue items. Thus, a supply[sale] in the course or furtherance of business includes: (1) the disposition of the assets and liabilities of a business, (2) the disposition of a business as going concern; and (3) anything done in connection with the termination or intended termination of a business.'*(Boldfacing supplied)*

Similarly, in the case of *Lapanday Foods Corporation vs. CIR,* this Court ruled that if the income from the main business activity is subject to VAT, the incidental income shall also be subject to VAT, provided that there is no particular provision applicable to the specific transaction.

In the instant case, petitioner's audited financial statements for the years ended December

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31, 2006 and 2007 disclose that the subject interest income arose from the following two (2) loan/debt agreements with its lone client, GADC, allocated for the acquisition of real properties and unpaid rentals, to wit:

'1. Related Party Transactions

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b. On March 17, 2005, the Branch entered into a loan agreement with GADC covering interest-bearing, long term advances granted to GADC in prior years **for land and equipment purchased for various restaurants and warehouse** amounting to P57,431,435. The loan is payable in full on March 17, 2009. Interest on the loan shall accrue at 8.4375% from March 1, 2005 to March 17, 2006; thereafter, interest shall accrue at six-month PHIBOR rate plus 2%, which the Branch will reset on March 18 of each year.

On the same date, the Branch and GADC signed an Acknowledgement of Debt Agreement, whereby GADC acknowledged that it has **unpaid rentals** and interest due to the Branch amounting to P366, 712,722 ("receivable"). In accordance with the terms of the said agreement, GADC executed a Promissory Note in favor of the Branch for P366,712,722, which is payable in full on March 17, 2009. Interest on the receivable shall accrue at 8.4375% from March 1, 2005 to March 17, 2006; thereafter, the interest shall accrue at six-month PHIBOR rate plus 2%, which the Branch will reset on March 18 of each year.' *(Boldfacing supplied)*

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Relative to the loan amount of P57,431,435.38, the utilization of the proceeds thereof was clearly set forth in the Loan Agreement of March 17, 2005 between petitioner and GADC, as follows:

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

Considering that petitioner established its branch office in the Philippines for the purpose of purchasing and leasing back two (2) existing McDonald's Restaurants to GADC and developing new McDonald's Restaurant sites which will then be leased to McGeorge Foods, Inc. as stated in its License to Transact Business in the Philippines issued by the SEC on November 12, 1984, it can be safely concluded that the loan it granted to GADC in the amount of P57,431,435.38 was in the pursuit of its leasing business with GADC. Consequently, the interest income it derived from the said loan, being incidental to its leasing business, is deemed a transaction *"in the course of trade or business"* which is subject to VAT pursuant to Section 105, in relation to Section 108(A) of the NIRC of 1997, as amended.

The same holds true with regard to GADC's debt to petitioner in the amount of P366, 712,722.00. The Acknowledgement of Debt executed by petitioner and GADC on March 17, 2005 states, thus:

> 'WHEREAS, MPRC owns the leasehold improvements and the equipment, seating, signage and design of McDonald's Restaurants owned and operated by GADC which restaurants are listed in Annex "A, attached thereto;
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> WHEREAS, MPRC also owns the leasehold improvements and equipment in the distribution and supply warehouse located at Marikina City, Philippines;
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> WHEREAS, MPRC leased the above leasehold improvements and the equipment seating, signage and design to GADC in return for payment of lease/rental fees; and
>
> WHEREAS, to date, GADC has unpaid rentals due MPRC.
>
> NOW, in consideration of the mutual covenants and premises herein provided, the parties hereto hereby agree as follows:
>
> <u>Article I - Amount of the Receivables</u>
>
> Upon and subject to the terms and conditions of this Agreement, GADC hereby acknowledges that it has unpaid rentals and unpaid interest due to MPRC in the amount

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of THREE HUNDRED SIXTY-SIX MILLION SEVEN HUNDRED TWELVE THOUSAND SEVEN HUNDRED TWENTY-ONE PHILIPPINE PESOS AND SEVENTY-NINE PHILIPPINE CENTAVOS (Php366,712,721.79), (the "Receivables")

xxx xxx xxx

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

Given the circumstances at bar, there is nothing in the Court in Division's Decision which would cause this Court to deviate from its ruling. As already stated, Section 222 mandatorily provides that a false or fraudulent return with intent to evade tax or failure to file a return, the tax may be assessed at any time within ten years after the discovery of the falsity, fraud or omission.

The case of *Aznar vs. Court of Tax Appeals* is pivotal in this case wherein the Supreme Court ruled in this wise:

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

b

> ***denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.***"

Applying the doctrine in the afore-quoted case, it is evident that **petitioner committed falsity in its 2007 Quarterly VAT Returns as it did not declare substantial receipts from its interest income in the amount of P25,522,729.00**. While the under-declaration in petitioner's gross receipts did not arise from a deliberate attempt to evade tax, nonetheless, its deviation from the truth warrants the application of the ten (10)-year prescriptive period for assessment.

Lastly, on the imposition of interest, this Court finds no reason nor rhyme to discuss them anew as the law itself provides that imposition of deficiency and delinquency interest on taxes due from petitioner. There is no double imposition of interests as the law clearly differentiates deficiency interest from delinquency interest. *Deficiency* is defined as the amount still due and collectible from a taxpayer upon audit or investigation; whereas *delinquency* is defined as the failure of the taxpayer to pay the tax due on the date fixed by law or indicated in the assessment notice or letter of demand.

Given the circumstances at bar, it was clearly established that petitioner's deficiency VAT and surcharge covering CY 2007 remain unpaid.

However, in view of the effectivity of Republic Act (RA) No. 10963 or otherwise known as the "Tax Reform for Acceleration and Inclusion" Law (TRAIN) on January 1, 2018, this Court shall apply the pertinent provisions thereof on the imposition of deficiency and delinquency interests in determining the amount to be ultimately paid by petitioner.

WHEREFORE, premises considered, the instant petition is **PARTIALLY GRANTED**. Accordingly, the Final Decision of Disputed Assessment issued by respondent against petitioner covering deficiency VAT for the taxable year 2007 is partly **UPHELD WITH MODIFICATIONS.** Petitioner is **ORDERED TO PAY NINE MILLION TWO HUNDRED SIX**

THOUSAND TWO HUNDRED THIRTEEN AND 6/100 PESOS (P9,206,213.06) representing basic deficiency VAT, the 25% surcharge and deficiency and delinquency interests imposed under Sections 248(A)(3) and 249(B) and (C) of the NIRC of 1997, as amended, respectively computed until December 31, 2017:[12]

Basic Deficiency VAT	P1,779,368.82
Add: 25% Surcharge	P444,842.20
Deficiency Interest computed from January 26, 2008[13] through January 17, 2014.	P1,779,368.82 20% * 5.9836 years
Subtotal	**P2,129,392.60**
Total Amount Due as of January 17, 2014 *(Deficiency VAT with surcharge plus Deficiency Interest)*	**P4,353,603.63**
Deficiency Interest computed from January 18, 2014[14] through December 31, 2017.	P1,779,368.82 20% * 3.9562 years
Subtotal	**P1,407,895.11**
Delinquency interest computed from January 18, 2014 through December 31, 2017.	P4,353,603.63 20% * 3.9562 years
Subtotal	**P3,444,714.32**
TOTAL AMOUNT DUE- December 31, 2017 *(Deficiency VAT with Deficiency interest plus Delinquency Interest)*	**P9,206,213.06**

Accordingly, in applying the provisions on the TRAIN law, petitioner should be held liable to pay delinquency interest at the rate of 12%[15] on the total unpaid basic deficiency tax, surcharge, deficiency interest as of January 17, 2014 amounting to P4,353,603.63, computed from January 1, 2018 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended by the TRAIN Law.

[12] Section 6 of Revenue Regulations No. 21-2018 dated September 14, 2018.
[13] Section 114(A) of the NIRC of 1997, as amended, and Section 4.114-1(A) of Revenue Regulations No. 16-2005.
[14] Section 114(A) of the NIRC of 1997, as amended, and Section 4.114-1(A) of Revenue Regulations No. 16-2005.
[15] Section 2 of Revenue Regulations 21-2018 dated September 14, 2018.

SO ORDERED.

CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

(with Dissenting Opinion)
ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

ERLINDA P. UY
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court En Banc.

ROMAN G. DEL ROSARIO
Presiding Justice

REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

MCDONALD'S PHILIPPINES REALTY CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA EB No. 1638
(CTA Case No. 8766)

Present:

DEL ROSARIO, *P.J.*,
CASTAÑEDA, JR.,
UY,
FABON-VICTORINO,
MINDARO-GRULLA,
RINGPIS-LIBAN, *and*
MANAHAN, *JJ.*

Promulgated:

OCT 11 2018
4:26 p.m.

x- x

DISSENTING OPINION

***DEL ROSARIO, P.J.*:**

With utmost respect, I am constrained to withhold my assent to the *ponencia* of my esteemed colleague, the Honorable Associate Cielito N. Mindaro-Grulla, denying the Petition for Review filed by petitioner McDonald's Philippines Realty Corporation, and thereby affirming the assailed Decision of the Court in Division which partially upheld the tax assessments of the respondent.

The *ponencia* found that petitioner's Quarterly VAT Returns for CY 2007 were false thus warranting the application of the ten (10) year prescriptive period to assess as provided under Section 222(a) of the

National Internal Revenue Code ("NIRC") of 1997, as amended. I submit, however, that the three (3) year prescriptive period should be applied due to lack of evidence of intent to evade tax on the part of petitioner.

In ***Commissioner of Internal Revenue vs. Philippine Daily Inquirer***,[1] the Supreme Court clarified that entry of wrong information in tax returns due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return, viz.:

> "Thus, while the filing of a fraudulent return necessarily implies that the act of the taxpayer was intentional and done with intent to evade the taxes due, **the filing of a false return can be intentional or due to honest mistake**. In *CIR v. B.F. Goodrich Phi/s., Inc.*, the Court stated that **the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return.** In this case, we do not find enough evidence to prove fraud or intentional falsity on the part of POI." (Boldfacing supplied; citation omitted)

It is my humble opinion that unless and until modified by the Supreme Court *En Banc*, the pronouncement in *Philippine Daily Inquirer* should be applied in determining whether the ten-year prescriptive period shall be applied in cases involving false returns. Indeed, the Supreme Court, by tradition and in our system of judicial administration, has the last word on what the law is; it is the final arbiter of any justiceable controversy. There is only one Supreme Court from whose decisions all other courts should take their bearings.[2]

In ***Visayas Geothermal Company vs. Commissioner of Internal Revenue***,[3] I have expressed, by way of obiter, my position that the three (3)-year prescriptive period under Section 203 of the NIRC of 1997, as amended should apply in cases of false returns filed without intent to evade tax but due only to plain oversight, negligence or mistake, *viz.*:

> "By way of obiter, however, I wish to state my humble view that in cases of false returns with no intent to evade tax, **but due only to plain oversight, negligence or mistake**, the three (3)-year prescriptive period under Section 203 of the NIRC of 1997, as amended, should apply.

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[1] G.R. No. 213943, March 22, 2017.

[2] Development Bank of the Philippines v. NLRC, March 1, 1995, 242 SCRA 59; Albert v. Court of First Instance of Manila (Branch VI), L-26364, May 29, 1968, 23 SCRA 948 cited in the Concurring Opinion of Sandoval-Gutierrez, J., Raul L. Lambino v. The Commission on Elections, G.R. No. 174153, October 25, 2003.

[3] CTA Case No. 8425, Concurring Opinion in the Resolution dated March 16, 2015.

In this regard, I respectfully submit that the doctrine laid down in the *Aznar* case must be revisited in order to come up with a proper interpretation and application of the said provision, specifically, on the applicability of the ten-year prescriptive period in cases where the taxpayer's return is found to be false. It must be stressed that a careful application of Section 222 of the NIRC of 1997, as amended, is important to safeguard the rights of the taxpayers against the limitless taxing power of the government.

Section 222 of the NIRC of 1997, as amended, originated from Section 332 (a) of the NIRC of 1939, which was lifted from Section 276 (a) of the Internal Revenue Code of 1939 of the United States of America. When Presidential Decree No. 1158 was enacted into law, Section 332 (a) of the NIRC of 1939 was adopted as Section 223 (a) of the NIRC of 1977, as follows:

> 'Sec. 223. Exceptions as to period of limitation of assessment and collection of taxes. - (a) In the case of false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within the ten years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of the civil or criminal action for the collection thereof.'

With the enactment of Republic Act No. 8424, otherwise known as National Internal Revenue Code of 1997, Section 222 (a) restated Section 223 (a) of the NIRC of 1977, as follows:

> 'Sec. 222. Exceptions as to period of limitation of assessment and collection of taxes.- (a) In the case of false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within the ten years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.'

After a careful reading of the afore-cited Section 222 of the NIRC of 1997, as amended, I am of the opinion that the phrase 'with intent to evade tax' does not only apply to cases of fraudulent returns, but also to cases of false returns. This is evident by the fact that **no comma** was placed between the words *'[i]n the case of false'* and the words *'or fraudulent return with intent to evade tax'*. This clearly shows that the phrase *'with intent to evade tax'* modifies not only the words *'fraudulent return'* but also the word *'false'*.

Moreover, American jurisprudence on the matter, although merely persuasive as sizeable portion of the Philippine Tax Code is lifted from the United States Internal Revenue Code, is instructive:

1) It is not sufficient that the return filed be false if, in fact, there exists no intent to evade any tax. Thus, the mere fact that the inadequacy of the taxpayer's bookkeeping system causes a false return to be filed does not prevent the running of the statute where no concealment of any kind has been attempted and falsity has not knowingly been indulged in to evade the tax; and,

2) It has been held [that] where the taxpayer made no disclosure of a transaction on which he made a profit, his return was false with intent to evade the tax and that such tax could be assessed after the expiration of the usual period of limitation.

Indubitably, the filing of a false return must be coupled with intent to evade tax in order for the usual period of limitation not to apply. Applying this to Section 222 of the NIRC of 1997, as amended, a false return must have been made with intent to evade tax in order for the ten (10) year prescriptive period to apply.

The application of the ten-year prescriptive period to assess even to situations involving false tax returns, <u>without intent to evade tax</u> on the part of the taxpayer, would render lifeless the three-year prescriptive period to assess under Section 203 of the NIRC of 1997, as amended, for practically all deficiency tax assessments involve entries in the return that are necessarily false. It will result in an absurd situation wherein the ten-year prescriptive period will be the usual period of limitation instead of the three-year prescriptive period. Such application will run counter to the Supreme Court's categorical pronouncement in **Republic of the Philippines v. Ablaza**, *viz.*:

> 'The law on prescription being a remedial measure should be **interpreted in a way conducive to bringing about the beneficent purpose of affording protection to the taxpayer** within the contemplation of the Commission which recommend[ed] the approval of the law.' (Emphasis supplied)" (Citations omitted)

I reiterated my aforestated view in the consolidated cases of ***Commissioner of Internal Revenue vs. Hoya Glass Disk Philippines and Hoya Glass Disk Philippines, Inc. vs. Commissioner of Internal Revenue***,[4] ***McDonald's Philippines Realty Corporation vs. Commissioner of Internal Revenue and Commissioner of Internal Revenue vs. McDonald's Philippines Realty Corporation***[5] as well as in ***Commissioner of Internal Revenue vs. Newspaper Paraphernalia, Inc.***[6]

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[4] CTA EB Nos. 1524 and 1529, August 16, 2017.
[5] CTA EB Nos. 1283 & 1284, February 9, 2017.
[6] CTA EB No. 1425, April 21, 2017.

In this case, the *ponencia* affirmed the findings of the Court in Division that petitioner's income from unpaid rentals and loan extended to another entity should have been indicated in its gross receipts for VAT purposes.

Petitioner's mistake in not reporting in its VAT Returns the said interest income as part of its gross receipts did not *ipso facto* make its 2007 Quarterly VAT Returns false that would warrant the application of the ten (10) year period to assess. There is no evidence to prove that petitioner intended to file a false Quarterly VAT Return. Truth to tell, petitioner clarified that the reason for not reporting the said interest income as part of its gross receipts in its VAT Returns was its honest belief that such interest income did not form part of its VAT-able gross receipts pursuant to Section 105 of the NIRC of 1997, as amended and Revenue Memorandum Circular (RMC) No. 42-2003. Petitioner cannot be said to have fraudulently concealed its interest income since the interest income was reflected in its 2007 Income Tax Return and Audited Financial Statements.[7]

Moreover, no less than the Court in Division recognized in the assailed Decision that "the under-declaration in petitioner's gross receipts and interest income for CY 2007 did not arise from a deliberate attempt on its part to evade tax but due on the honest belief that it is not subject to VAT."[8]

In the absence of evidence showing that petitioner filed a false return with intent to evade tax, the three (3) year prescriptive period should be applied.

The following are the dates of filing of petitioner's Quarterly VAT Returns and the corresponding deadlines for assessment:

Period Covered		**Date Filed**	**Last Day to File Return**	**Last Day to Assess**
1st Qtr	January 1 – March 31, 2007	April 20, 2007	April 25, 2007	**April 25, 2010**
2nd Qtr	April 1 – June 30, 2007	June 24, 2007	July 25, 2007	**July 25, 2010**
3rd Qtr	July 1 – September 30, 2007	October 19, 2007	October 25, 2007	**October 25, 2010**
4th Qtr	October 1 – December 31, 2007	March 26, 2008	January 25, 2008	**March 26, 2011**

After the expiration of the three (3)-year prescriptive period to assess petitioner for deficiency VAT for the 1st, 2nd and 3rd quarters of CY 2007, petitioner's Resident Agent Romeo B. Bachoco

[7] Exhibits "P-21" and "P-41", CTA Division Docket, pp. 745-747, and 852-874, 856.
[8] p. 29. of the Assailed Decision (CTA Case No. 8766, December 15, 2016).

executed on December 29, 2010 a Waiver of the Defense of Prescription under the Statute of Limitations until **December 31, 2011**, to submit the documents pertaining to the investigation of income tax, VAT and withholding tax liabilities for CY 2007.[9]

On December 27, 2011, before the lapse of the first waiver, Bachoco executed another Waiver of the Defense of Prescription extending respondent's right to assess until **March 31, 2012**.[10]

Considering that the First Waiver was executed by petitioner after the expiration of the three (3)-year prescriptive period to assess it for deficiency VAT for the 1st, 2nd and 3rd quarters of CY 2007, and in view of the fact that the FAN was received by petitioner on March 30, 2012, respondent's assessment for the 1st, 2nd and 3rd quarters of CY 2007, having clearly prescribed, is void. The assessment for the 4th quarter of CY 2007, having been made within the extended period as provided in the Second Waiver, is, however, valid.

All told, I VOTE to:

a) **PARTIALLY GRANT** the Petition for Review;

b) **CANCEL** and **WITHDRAW** on the ground of prescription the Formal Letter of Demand dated March 15, 2012, Audit Result/Assessment Notice No. LTDO-122-VT-2007-00015 dated March 1, 2012 and Final Decision on Disputed Assessment dated January 16, 2014 insofar as they found petitioner liable for deficiency VAT for the 1st, 2nd and 3rd quarter of CY 2007; and

c) **REMAND** the case to the Court in Division for the determination of the amount of petitioner's deficiency VAT liability for the 4th quarter of CY 2007, plus 25% surcharge and 12% deficiency and delinquency interests.

ROMAN G. DEL ROSARIO
Presiding Justice

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[9] Exhibit "P-4", CTA Division Docket, p. 595.
[10] BIR Records, p. 442.