REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

Third Division

CLARK WATER CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8865

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

Promulgated:
NOV 23 2016
2:35 p.m.

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DECISION

BAUTISTA, J:

The Case

This is a Petition for Review[1] filed on August 11, 2014, pursuant to *Section 7(a)(2)*[2] of *Republic Act ("RA") No. 1125*[3], as amended by *RA No. 9282*[4] and *RA No. 9503*[5], and *Section 3(a)(2)*[6], *Rule IV of the Revised*

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[1] *Records, CTA Case No. 8865, Vol. 1, Petition for Review,* pp. 17-150, with annexes.
[2] "Sec. 7. *Jurisdiction.* - The Court of Tax Appeals shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided.
xxx xxx xxx
(2) Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relations thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period of action, in which case the inaction shall be deemed a denial; xxx"
[3] *"An Act Creating the Court of Tax Appeals."*
[4] *"An Act Expanding the Jurisdiction of the Court of Tax Appeals (CTA), Elevating its Rank to the Level of a Collegiate Court with Special Jurisdiction and Enlarging its Membership, Amending for the Purpose Certain Sections of Republic Act No. 1125, as amended, Otherwise Known as the Law Creating the Court of Tax Appeals, and for Other Purposes."*
[5] *"An Act Enlarging the Organizational Structure of the Court of Tax Appeals, Amending for the Purpose Certain Sections of the Law Creating the Court of Tax Appeals, and for Other Purposes."*
[6] "SECTION 3. *Cases Within the Jurisdiction of the Court in Divisions.* — The Court in Divisions shall exercise:
(a) Exclusive original or appellate jurisdiction to review by appeal the following:
xxx xxx xxx

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Rules of the Court of Tax Appeals ("RRCTA"), seeks for the Court to render judgment ordering the cancellation and withdrawal of respondent Commissioner of Internal Revenue ("CIR")'s assessment against petitioner for alleged deficiency income tax and value-added tax ("VAT") for calendar year ("CY") 2010 in the total amount of Five Million Four Hundred Ninety-Five Thousand Three Hundred Fourteen and 9/100 Pesos (Php5,495,314.09).[7]

The Parties[8]

Petitioner Clark Water Corporation ("CWC"), formerly "Clark Vivendi Water Corporation,"[9] is a domestic corporation duly organized and existing under Philippine laws,[10] with registered principal office address at Depot 1901, Bicentennial Hill, Clark Freeport Zone, Clark Field, Pampanga.[11] It is authorized by the Securities and Exchange Commission ("SEC") to transact business in the Philippines under SEC Registration No. A199915674[12] dated October 1, 1999; is registered with the Bureau of Internal Revenue ("BIR") - Revenue District Office ("RDO") No. 21A, with Tax Identification No. 205-334-965-000;[13] and is registered as a Clark Special Economic Zone ("CSEZ") enterprise, engaged in the operation and maintenance of water and sewerage system within the CSEZ.[14]

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(2) Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code or other applicable law provides a specific period for action: Provided, that in case of disputed assessments, the inaction of the Commissioner of Internal Revenue within the one hundred eighty day-period under Section 228 of the National Internal Revenue Code shall be deemed a denial for purposes of allowing the taxpayer to appeal his case to the Court and does not necessarily constitute a formal decision of the Commissioner of Internal Revenue on the tax case; Provided, further, that should the taxpayer opt to await the final decision of the Commissioner of Internal Revenue on the disputed assessments beyond the one hundred eighty day-period abovementioned, the taxpayer may appeal such final decision to the Court under Section 3(a), Rule 8 of these Rules; and Provided, still further, that in the case of claims for refund of taxes erroneously or illegally collected, the taxpayer must file a petition for review with the Court prior to the expiration of the two-year period under Section 229 of the National Internal Revenue Code; xxx"

[7] *Records, Vol. 1, Petition for Review,* p. 27.

[8] *Id., Joint Stipulation of Facts and Issues ("JSFI"),* pp. 350-351.

[9] *Id., Exhibit "P-1," Certificate of Filing of Amended Articles of Incorporation ("AOI"),* p. 399.

[10] *Id.*

[11] *Id.* at 403.

[12] *Id.* at 399.

[13] *Records, Vol. 1, Exhibit "P-3," BIR Certificate of Registration,* p. 409.

[14] *Id., Exhibits "P-15" and "P-15.1," CSEZ Certificate of Registration and Tax Exemption, Permit To Operate,* pp. 457-459.

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Respondent is the duly appointed CIR vested under the appropriate laws with authority to carry out the functions, duties and responsibilities of his Office, including *inter alia,* the power to decide disputed assessments, cancel and abate tax liabilities pursuant to the provisions of the *1997 National Internal Revenue Code, as amended ("1997 NIRC"),* and other tax laws, rules and regulations.

The Facts

On April 12, 2011, petitioner filed its Annual Income Tax Return ("ITR") for CY 2010.[15]

On September 14, 2011, petitioner received[16] Letter of Authority ("LOA") No. 21A-2011-00000199/eLA201000057633 from the BIR-RDO No. 21A, authorizing Revenue Officer ("RO") Rachael Liwanag and Group Supervisor ("GS") Noel Miranda to examine petitioner's books of accounts and other accounting records of all internal revenue taxes for the period January 1, 2010 to December 31, 2010.[17] Attached to the LOA is a list of business records and documents to be submitted to facilitate the early termination of the case.[18]

On July 23, 2012, petitioner received a letter from the BIR-RDO No. 21A, requesting the reproduction of petitioner's master and transaction files in electronic form.[19]

On May 29, 2013, petitioner received a copy of respondent's Notice for Informal Conference ("NIC"),[20] with the following computation of deficiency taxes:[21]

Income Tax	Php	121,020.84
VAT		4,033,763.88
EWT		16,906.41
Administrative Penalties		38,000.00
TOTAL	**PHP**	**4,209,691.13**

[15] *Records, Vol. 1, Exhibit "P-17," 2010 Income Tax Return ("ITR"),* pp. 502-504; *BIR Records, Exhibit "R-2," 2010 ITR,* pp. 506-510.
[16] Through Daisy Lacad.
[17] *Records, Vol. 1, JSFI,* p. 351; see *Exhibit "P-4," Letter of Authority ("LOA"),* p. 410.
[18] *Id., Exhibit "P-4," Attachment to LOA,* p. 411.
[19] *Id., Exhibit "P-5," Letter Request for Electronic Files,* p. 412.
[20] *Id., Exhibit "P-6," Notice for Informal Conference ("NIC"),* p. 413.
[21] *Id.* at 414.

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Petitioner replied to the NIC on June 11, 2013, stating that it deems reasonable to settle only the amount of Php175,927.84, broken down as follows:[22]

Income Tax	Php	121,020.84
EWT		16,906.41
Administrative Penalties		38,000.00
TOTAL	**PHP**	**175,927.84**[23]

Hence, it questioned only the alleged deficiency VAT, claiming that the assessment lacked legal and factual basis.[24]

Consequently, on June 18, 2013, petitioner filed Payment Forms or BIR Form No. 0605, and paid[25] the following deficiency taxes:[26]

KIND OF TAX	BASIC		INTEREST		SURCHARGE		COMPROMISE		TOTAL	
Income Tax	Php	75,186.78	Php	33,834.06	Php	-	Php	12,000.00	Php	121,020.84
EWT		11,823.67		7,094.20		-		3,000.00		21,917.87
Administrative Penalties		-		-		-		38,000.00		38,000.00
TOTAL	**PHP**	**87,010.45**	**PHP**	**40,928.26**	**PHP**	**-**	**PHP**	**53,000.00**	**PHP**	**180,938.71**

On September 17, 2013, petitioner received a copy of respondent's Amended NIC[27], stating that the computation as to deficiency income tax was adjusted, as follows:[28]

KIND OF TAX	BASIC		INTEREST		SURCHARGE		COMPROMISE		TOTAL	
Amendment *per* Review	Php	1,019,893.44	Php	514,059.95	Php	-	Php	25,000.00	Php	1,558,953.39
Income Tax - Paid on June 19, 2013		75,186.78		33,834.06		-		12,000.00		121,020.84
INCOME TAX - ADJUSTED NIC	**PHP**	**944,706.66**	**PHP**	**480,225.89**	**PHP**	**-**	**PHP**	**13,000.00**	**PHP**	**1,437,932.55**

On September 27, 2013, petitioner filed its reply to the Amended NIC.[29]

On November 22, 2013, petitioner received a copy of the Preliminary Assessment Notice ("PAN") assessing it for deficiency income tax and VAT for CY 2010 in the total amount of Php5,479,568.98, inclusive of interest, penalties and surcharge:[30]

[22] *Records, Vol. 1, JSFI,* p. 351.
[23] Correct total amount is Php175,927.25, hence, the difference of Php0.59.
[24] *Records, Vol. 1, Exhibit "P-7," Reply to the NIC,* pp. 417-418.
[25] *Id., Exhibits "P-8.2," "P-8.5," and "P-8.8,"* pp. 421, 424 and 427; payment date is June 19, 2013.
[26] *Id., Exhibits "P-8" to "P-8.8," BIR Form No. 0605,* pp. 419-427.
[27] *Id., Exhibits "P-9" and "P-9.1," Amended NIC,* pp. 428-430.
[28] *Id., JSFI,* p. 351; see *Exhibit "P-9.1," Amended NIC,* p. 429.
[29] *Id., JSFI,* p. 351; see *Exhibit "P-10," Reply to Amended NIC,* pp. 431-434.
[30] *Records, Vol. 1, JSFI,* p. 351; see *Exhibit "P-11," Preliminary Assessment Notice ("PAN"),* pp. 435-437.

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KIND OF TAX		BASIC		INTEREST		SURCHARGE		COMPROMISE		TOTAL
Income Tax	Php	944,706.66	Php	488,098.44	Php	-	Php	13,000.00	Php	1,445,805.10
VAT		2,166,899.39		1,300,139.64		541,724.85		25,000.00		4,033,763.88
TOTAL	**PHP**	**3,111,606.05**	**PHP**	**1,788,238.08**	**PHP**	**541,724.85**	**PHP**	**38,000.00**	**PHP**	**5,479,568.98**

On December 6, 2013, petitioner filed its protest to the PAN.[31]

On December 27, 2013, petitioner received a copy of the Formal Letter of Demand ("FLD")[32] and Final Assessment Notices ("FAN")[33] for alleged deficiency income tax and VAT in the total amount of Php5,495,314.09, broken down as follows:

KIND OF TAX		BASIC		SURCHARGE		COMPROMISE		TOTAL
Income Tax	Php	944,706.66	Php	-	Php	13,000.00	Php	957,706.66
VAT		2,166,899.39		541,724.85		25,000.00		2,733,624.24
TOTAL	**PHP**	**3,111,606.05**	**PHP**	**541,724.85**	**PHP**	**38,000.00**	**PHP**	**3,691,330.90**

On January 13, 2014, petitioner filed its Protest to the FAN.[34]

Due to the inaction of respondent on its Protest, petitioner was left with no recourse but to seek redress from the Court on August 11, 2014, through the present Petition for Review.[35]

On September 12, 2014, respondent filed a Motion for Extension to File Answer[36], which was granted by the Court in its Order[37] dated September 16, 2014.

On October 13, 2014, respondent filed her Answer[38], interposing the following Special and Affirmative Defenses, as summarized: *(1)* that the sales of petitioner to enterprises within customs territory are considered technical importations, hence, subject to the twelve percent (12%) VAT; *(2)* that petitioner is liable for deficiency income tax for failure to pay customs duties and taxes due on sales made within customs territory; *(3)* that petitioner is liable for surcharge and interest imposed on the deficiency income tax and VAT; and *(4)* that

[31] *Records, Vol. 1, JSFI,* p. 352; see *Exhibit "P-12," Protest to the PAN,* pp. 438-442.
[32] *Id., JSFI,* p. 352; see *Exhibit "P-13," Formal Letter of Demand ("FLD"),* pp. 443-447.
[33] *Id., JSFI,* p. 352; see *Exhibit "P-13," Final Assessment Notices ("FAN"),* pp. 448-450.
[34] *Id., JSFI,* p. 352; see *Exhibit "P-14," Protest to the FAN,* pp. 451-456.
[35] *Id., Petition for Review,* pp. 17-150, with annexes.
[36] *Id* at 153-156.
[37] *Records, Vol. 1,* p. 157.
[38] *Id., Answer,* pp. 158-170.

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compromise penalty was included only as a suggestion so that petitioner may avoid criminal prosecution.[39]

Respondent and petitioner filed their respective Pre-trial Briefs on November 14, 2014[40] and November 24, 2014[41].

On December 19, 2014, the parties filed their Joint Stipulation of Facts and Issues ("JSFI")[42], thus, a Pre-Trial Order[43] was issued on January 14, 2015.

On March 6, 2015, petitioner filed its Formal Offer of Evidence ("FOE")[44] offering *Exhibits* "P-1" to "P-17" and "P-19," with sub-markings; which was resolved by the Court in its Resolution[45] dated March 31, 2015, admitting *Exhibits* "P-1," "P-2," "P-3," "P-4," "P-5," "P-6," "P-7," "P-8," "P-8.1," "P-8.2," "P-8.3," "P-8.4," "P-8.5," "P-8.6," "P-8.7," "P-8.8," "P-9," "P-9.1," "P-10," "P-11," "P-12," "P-13," "P-14," "P-15," "P-15.1," "P-16," "P-17," "P-19," and "P-19.1," and denying *Exhibit* "P-6-1," for not being marked.

On May 29, 2015, respondent filed her FOE[46], offering *Exhibits* "R-1" to "R-9" and "R-9-a," which was resolved by the Court in its June 23, 2015[47] Resolution admitting *Exhibits* "R-1" to "R-8," and denying *Exhibits* "R-19" and "R-19-a" for not being marked.

In compliance to the October 12, 2015 Resolution[48] of the Court granting the parties a period of thirty (30) days from notice to file their respective memoranda, petitioner and respondent then filed their Memoranda on November 14, 2015[49] and November 16, 2015[50], respectively.

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[39] *Records, Vol. 1, Answer,* pp. 158-157.
[40] *Id., Respondent's Pre-Trial Brief,* pp. 173-179.
[41] *Id.* at 320-332.
[42] *Id., JSFI,* pp. 350-359.
[43] *Id., Pre-Trial Order ("PTO"),* pp. 362-369.
[44] *Id., Formal Offer of Evidence ("FOE"),* pp. 388-398.
[45] *Records, Vol. 1,* p. 509.
[46] *Id., Respondent's FOE,* pp. 516-522.
[47] *Records, Vol. 2,* pp. 527-528; as confirmed in the Court's August 13, 2015 and October 12, 2015 Resolutions, pp. 553-554 and 577-579.
[48] *Id.* at 579.
[49] *Id., Petitioner's Memorandum,* pp. 599-615.
[50] *Id., Respondent's Memorandum,* pp. 584-596.

On January 6, 2016, the Court promulgated a Resolution[51] submitting the case for Decision; hence, this Decision.

The Issue[52]

WHETHER OR NOT PETITIONER IS LIABLE FOR THE AMOUNT OF PHP5,495,314.09 REPRESENTING DEFICIENCY INCOME TAX AND VAT, INCLUSIVE OF INTEREST, PENALTIES AND SURCHARGE FOR CY 2010.

Petitioner's Arguments[53]

Petitioner avers that it is subject to a preferential tax rate of five percent (5%) on its gross income in *lieu* of all national and local taxes under *Republic Act No. 7227* and applicable regulations; and that it is not liable for interest, surcharge and compromise penalty.

Respondent's Counter-Arguments[54]

Respondent counters that the sales of petitioner within the customs territory are technical importations subject to 12% VAT; that petitioner is liable for deficiency income tax for its failure to pay customs duties and taxes due on its sale of services within customs territory; and that petitioner is liable for interest, surcharges and penalties attributable to the deficiency taxes.

The Ruling of the Court

The three (3)- and ten (10)-year periods to assess income tax and VAT have not yet prescribed.

Sections 203 and 222(a) of the 1997 NIRC mandates that respondent should issue an assessment for deficiency taxes within 3 years from the last day prescribed by law to file the tax return or the actual date of filing of such return, whichever comes later; and any

[51] *Records, Vol. 2,* p. 618.
[52] *Records, Vol. 1, PTO,* p. 364.
[53] *Records, Vol. 2, Petitioner's Memorandum,* pp. 615-612.
[54] *Id., Respondent's Memorandum,* pp. 587-593.

assessment notice issued beyond this 3-year prescriptive period shall not be valid; save in cases wherein no return was filed, hence, assessment may be made within 10 years from discovery of the omission, to wit:

> SECTION 203. *Period of Limitation Upon Assessment and Collection.* — Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.
>
> xxx xxx xxx
>
> SECTION 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* —
>
> (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.[55]

Since the instant case involves deficiency income tax and VAT, the prescribed due dates for the filing of the returns, to be used as bases for the prescriptive periods, vary accordingly.

1. *Income Tax*

Section 77(B) of the 1997 NIRC provides that the filing of the Income Tax Return ("ITR") shall be on or before the fifteenth (15th) day of April, or the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be, to wit:

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[55] Underscoring ours.

SEC. 77. *Place and Time of Filing and Payment of Quarterly Corporate Income Tax.* -

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(B) *Time of Filing the Income Tax Return.* – The corporate quarterly declaration shall be filed within sixty (60) days following the close of each of the first three (3) quarters of the taxable year. <u>The final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be.</u>[56]

2. *Value-Added Tax*

The filing of the Quarterly VAT Returns must be made within twenty-five (25) days after the close of each taxable quarter. *Section 114(A) of the 1997 NIRC* provides, as follows:

SEC. 114. *Return and Payment of Value-added Tax.*-

(A) *In General.* - <u>Every person liable to pay the value-added tax</u> imposed under this Title <u>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</u>: Provided, however, That VAT-registered persons shall pay the value-added tax on a monthly basis.[57]

Based on the records, petitioner's ITR was actually filed on April 12, 2011. As to VAT, petitioner did not file any but records reveal that discovery was made on or around May 29, 2013, when petitioner received a copy of the NIC[58] with the finding of deficiency VAT. The table below will shed light into the reckoning dates of the 3- and 10-year periods to assess:[59]

TAX RETURNS	ACTUAL DATE OF FILING	LAST DATE TO FILE RETURN	LAST DAY TO ASSESS
Income Tax – Annual filing			

[56] Underscoring ours.
[57] *Id.*
[58] *Records, Vol. 1, Exhibit "P-6," Notice for Informal Conference ("NIC"),* p. 413.
[59] In bold are the bases for the running of the prescriptive period; underscored are the last dates to assess.

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Annual Income Tax Return	April 12, 2011[60]	**April 15, 2011**	<u>April 15, 2014</u>

TAX RETURNS	DATE OF DISCOVERY	LAST DAY TO ASSESS
VAT – Quarterly filing		
1st Quarter VAT Return	**May 29, 2013**	<u>May 29, 2023</u>
2nd Quarter VAT Return	**May 29, 2013**	<u>May 29, 2023</u>
3rd Quarter VAT Return	**May 29, 2013**	<u>May 29, 2023</u>
4th Quarter VAT Return	**May 29, 2013**	<u>May 29, 2023</u>

The FLD[61] and the FAN[62] issued by respondent on December 13, 2013, were received by petitioner on **December 27, 2013**. Since assessment is deemed made when notice to this effect is released, mailed or sent to the taxpayer,[63] the periods within which to assess petitioner shall be based on December 27, 2013. Looking into the last dates to assess on the table above, respondent properly assessed petitioner within the periods provided by law.

Petitioner is liable to pay both deficiency income tax and VAT assessments.

Accordingly, the Court shall determine whether petitioner can overturn the presumption of correctness of respondent's assessment and prove that the same is without foundation and merit. Such determination shall likewise address the issue on whether petitioner is liable for deficiency tax liabilities representing income tax and VAT, with increments, for CY 2010.

1. *Income Tax - Php944,706.66*

The detailed deficiency income tax assessment was computed by respondent in the following manner:

DETAILS	PER RETURN		ADJUSTMENTS		PER AUDIT		SPECIAL RATE (5%) 92.35%		REGULAR RATE (30%) 7.65%	
Revenues							Php	217,867,923.21	Php	18,057,494.94
Cost of Services:										
Fuel, Oil, Lubricants and Chemical	Php	31,866,225.38	Php	-	Php	31,866,225.38	Php	29,428,459.14		
Rents		5,591,112.00		(15,079.37)		5,576,032.63		5,149,466.13		
Salaries, Wages and Employee Benefits		12,500,984.19		(249,329.70)		12,251,654.49		11,314,402.92		
Depreciation/Amort. - Operating Asset		38,473,994.97		-		38,473,994.97		35,530,734.35		
Other Costs		12,914,694.51		(303,587.84)		12,611,106.67		11,646,357.01		
Total Cost of Services					Php	100,779,014.14	Php	93,069,419.56	Php	8,316,729.24

[60] *Records, Vol. 1, Exhibit "P-17," 2010 ITR,* pp. 502-504; *BIR Records, Exhibit "R-2," 2010 ITR,* pp. 506-510.
[61] *Id., JSFI,* p. 352; see *Exhibit "P-13," FLD,* pp. 443-447.
[62] *Id, JSFI,* p. 352; see *Exhibit "P-13," FAN,* pp. 448-450.
[63] *Basilan Estates, Inc. v. Commissioner of Internal Revenue, et. al.,* G.R. No. L-22492, September 5, 1967, 21 SCRA 17.

Gross Profit					Php	124,798,503.65	Php	9,740,765.70
Less:								
Gen. Admin Expenses						-	Php	4,648,677.97
Selling Expenses						-		218,415.49
Taxable Income Per Audit					Php	124,798,503.65	Php	4,873,672.24
Tax Due					Php	6,239,925.18	Php	1,462,101.67
Total Tax Due							Php	7,702,026.85
Less: Tax Due to LGU								2,691,568.00
Tax Due							Php	5,010,458.85
Less: Tax paid/withheld per return & paid per investigation	Php	4,112,538.93[64]	Php	(46,786.74)			Php	4,065,752.19
Tax Still Due							Php	944,706.66
Add: Interest								503,843.55
Compromise Penalty								13,000.00
TOTAL DEFICIENCY INCOME TAX							**PHP**	**1,461,550.21**

The entire assessment flows from respondent's finding that a portion of petitioner's revenue in the amount of Php18,057,494.94[65] is subject to a regular tax rate of 30%.

Petitioner maintains that as a registered CSEZ enterprise, hence, it enjoys the preferential tax rate of 5% in *lieu* of all local and national taxes under *Republic Act No. 7227* and applicable regulations, unless the enterprise breaches the 30% threshold on its sales within customs territory; and that its sales of services within the customs territory amounted to Php18,057,494.94 or only 7.65% of the total sales.

According to respondent, he did not assess petitioner for breach of the 30% threshold of income within the customs territory but for failure to pay the corresponding customs duties and taxes for the sale of services made outside the CSEZ.

Respondent's argument is meritorious.

Petitioner did not provide any official receipt or invoice in relation to its sales amounting to Php18,057,494.94 to refute respondent's finding that these service transactions were made outside the CSEZ, so that it will not be subjected to customs duties and taxes. In fact, it was admitted by petitioner through its Memorandum[66] that its gross receipts from its sales to enterprises outside the CSEZ is in the total amount of Php18,057,494.94.

Likewise, petitioner did not refute the adjustments made by the respondent on the cost of services such as "Rents" in the amount of Php15,079.37, "Salaries, Wages and Employee Benefits" of

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[64] Php4,037,352.35 (see *Exhibit* "P-17," line 29) plus Php75,186.78 (see *Exhibit* "P-8.4," line 19).
[65] *BIR Records*, pp. 5-7.
[66] *Records, Vol. 1, Petitioner's Memorandum*, par. 4, p. 601.

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Php249,329.70 and Other Costs of Php303,587,.84. Neither did it submit any documentary evidence to disprove such assessment.

Additionally, an examination of the BIR Records reveal that the deduction made by respondent on the "Tax paid / Withheld *per* return and Paid *per* investigation" in the amount of Php46,786.74[67] is proper. This amount represents withholding tax payments (BIR Form No. 2307)[68] covering the taxable year 2009 which is outside CY 2010.

Clearly, petitioner failed to overcome, by sufficient evidence, the presumption of correctness of the deficiency income tax assessment. Thus, respondent's assessment on deficiency basic income tax in the amount of Php944,706.66 is upheld.

2. *Value-Added Tax - Php2,166,899.39*

The FLD[69] shows the assessment of deficiency VAT, including compromise penalty, in the amount of Php4,033,763.88 on petitioner's sales of services within the customs territory pursuant to the provisions of *Section 108 of the 1997 NIRC* and *Revenue Regulations No. 1-95* as clarified in *Q & A No. 7 of Revenue Memorandum Circular No. 50-2007* which provides, that in any case, customs duties and taxes must be paid with respect to transactions, receipts, income and sales to customs territory.

DETAILS		AMOUNT		
Sales subject to VAT			Php	18,057,494.94
Output Tax Due				2,166,899.39
Basic VAT Due				2,166,899.39
Add: 25% Surcharge	Php	541,724.85		
Interest		1,300,139.64		
Compromise Penalty		25,000.00	Php	1,866,864.49
TOTAL VAT DEFICIENCY			**PHP**	**4,033,763.88**

As discussed earlier, petitioner admitted that it generated sales of services within customs territory in the amount of Php18,057,494.94. If the services are performed or rendered outside the freeport zone or within the custom's territory, such sale of services are considered as technical importations, thus subject to 12 % VAT.

[67] Rounding off difference of Php0.18.
[68] *BIR Records*, pp. 382-395.
[69] *Records, Vol. 1, Exhibit "P-13," FLD*, pp. 443-447.

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It is undisputed that petitioner did not present any documentary evidence in support of its VAT transactions. Neither did it file any VAT return to overthrow respondent's assessment. What is only clear from the records[70] is that VAT was assessed on petitioner's sale of services to individuals/enterprises with an address different from the CSEZ wherein the petitioner's business address[71] is located.

Let it be stressed that in the determination of the tax liability of petitioner, the Court is guided by the rule that tax assessments are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularity in the performance of duties, an assessment duly made by the BIR examiner and approved by his superior officers will not be disturbed.[72]

Since petitioner failed to present and offer evidence to prove that it is not liable to pay the assessed deficiency VAT, the presumption of correctness of the subject tax assessment remains.

Petitioner is not liable to pay compromise penalty.

Respondent's imposition of compromise penalty amounting to Php38,000.00, with Php13,000.00 attributable to income tax and Php25,000.00 to VAT,[73] cannot be sustained. *Under RMO No. 01-90*, as amended by *RMO No. 19-07*, 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 the latter 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 with respect to the thing or subject matter that is so compromised, and the choice of paying or not paying the penalty distinctly belongs to the taxpayer.[74]

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[70] *BIR Records*, pp. 5-7.
[71] *Records, Vol. 1, JSFI, par. 1*, p. 341.
[72] *Commissioner of Internal Revenue v. Bank of the Philippine Islands*, G.R. No. 134062, April 17, 2007, 521 SCRA 373, citing *Sy Po vs. Court of Tax Appeals*, G.R. No. L-81446, August 18, 1988, 164 SCRA 524.
[73] *Records, Vol. 1, JSFI*, p. 352; see *Exhibit "P-13," FLD and FAN*, pp. 443-450.
[74] *The Philippines International Fair, Inc. v. Collector of Internal Revenue, et. al.*, G.R. Nos. L-12928 and L-12932, March 31, 1962, 4 SCRA 774.

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The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[75]

Absent any clear showing that petitioner consented to the compromise penalty, its imposition should be deleted.

<u>Petitioner is liable to pay surcharge on both deficiency income tax and VAT assessments.</u>

Section 248(A) of the 1997 NIRC imposes a twenty-five percent (25%) for certain cases, *viz.*:[76]

> SECTION 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:
>
> > (1) <u>Failure to file any return and pay the tax due thereon as required under the provisions of this Code or rules and regulations on the date prescribed</u>; or
> >
> > (2) Unless otherwise authorized by the Commissioner, filing a return with an internal revenue officer other than those with whom the return is required to be filed; or
> >
> > (3) <u>Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment</u>; or
> >
> > (4) Failure to pay the full or part of the amount of tax shown on any return required to be filed under the provisions of this Code or rules and regulations, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment.[77]

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[75] *Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc., et. al.,* G.R. No. L-35266, January 21, 1991, 193 SCRA 86.
[76] Underscoring ours.
[77] *Id.*

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Based on evidence gathered and the foregoing provisions, petitioner failed to pay both deficiency income tax and VAT within the time prescribed for its payment in the FAN, and to file any VAT return and pay the tax due thereon on the dates prescribed by law. Consequently, the 25% surcharge applies to both deficiency income tax and VAT of petitioner for CY 2010.

In view of the foregoing, the present Petition for Review is hereby **DENIED.** The assessment issued by respondent against petitioner for taxable year 2010 covering deficiency income tax and VAT is **UPHELD.** Accordingly, petitioner is hereby **ORDERED TO PAY** deficiency income tax and VAT in the total amount of **Three Million Eight Hundred Eighty Nine Thousand Five Hundred Seven and 56/100 Pesos (Php3,889,507.56),** inclusive of the 25% surcharge imposed under *Section 248(A)(1)(3) of the 1997 NIRC,* computed as follows:

TYPE OF TAX		BASIC		25% SURCHARGE		TOTAL
Income Tax	Php	944,706.66	Php	236,176.67	Php	1,180,883.33
Value Added Tax		2,166,899.39		541,724.85		2,708,624.24
TOTAL	**PHP**	**3,111,606.05**	**PHP**	**777,901.51**	**PHP**	**3,889,507.56**

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

1. Deficiency interest at the rate of twenty percent (20%) *per annum* on the basic deficiency income tax and VAT computed from the dates indicated below until full payment thereof pursuant to *Section 249(B) of the 1997 NIRC:*

TYPE OF TAX		BASIC TAX	DEFICIENCY INTEREST COMPUTED FROM
Income Tax	Php	944,706.66	April 16, 2011
Value Added Tax		2,166,899.39	January 26, 2011

2. Delinquency interest at the rate of twenty percent (20%) *per annum* on the amount of Php3,889,507.56, representing the basic deficiency income tax and VAT and the corresponding 25% surcharge; and on the twenty percent (20%) deficiency interest which have accrued as aforestated in Item (1), computed from December 13, 2013[78] until full payment thereof pursuant to *Section 249(C) of the 1997 NIRC.*

[78] *Records, Vol. 1, Exhibit "P-13," FLD,* pp. 443-447.

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SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

Ma. Belen 3

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

ATTESTATION

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

LOVELL R. BAUTISTA
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice

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