REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
Quezon City

Third Division

FLUOR DANIEL, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 9267

Members:

UY, *Chairperson*
RINGPIS-LIBAN, *and*
MODESTO-SAN PEDRO, *JJ.*

Promulgated:
MAY 28 2021
10:00 a.m.

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DECISION

RINGPIS-LIBAN, J.:

The Case

The *Petition for Review* prays that the Court render judgment ordering the cancellation and withdrawal of Respondent's assessments for deficiency value-added tax ("VAT") for the period from January 01, 2012 to June 30, 2012, and compromise penalty, in the aggregate amount of Php15,413,306.33.[1]

The Facts

Petitioner Fluor Daniel, Inc. – Philippines is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal place of business at 3F Asian Star Building, ASEAN Drive, Filinvest Corporation, Alabang, Muntinlupa City.[2] It is a registered

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1 Docket, Pre-Trial Order dated February 15, 2017, Summary of the Case, p. 379.
2 *Id.*, Joint Stipulation of Facts and Issue (JSFI), Admitted Facts, Par. 1, p. 338.

taxpayer of the Bureau of Internal Revenue ("BIR"), with Taxpayer's Identification No. (TIN) 000-159-649-000.[3]

Respondent is the duly appointed Commissioner of Internal Revenue vested under appropriate laws with the authority to carry out the functions, duties, and responsibilities of said office, including, inter alia, the power to decide disputed assessments and to cancel and abate tax liabilities, pursuant to the provisions of the National Internal Revenue Code ("NIRC") of 1997, as amended, and other tax laws, rules and regulations, with office address at the BIR National Office Building, BIR Road, Diliman, Quezon City.[4]

On November 28, 2012, Petitioner received the *Letter of Authority* ("LOA") No. LOA-V1-2012-00000056 dated November 19, 2012, authorizing the Revenue Officers ("ROs") of Large Taxpayers Regular VAT Audit Group 1 to examine Petitioner's books of accounts and other accounting records for VAT for the 1st and 2nd quarters of calendar year ("CY") 2012.[5] The said ROs are composed of Messrs. Eric Sandoval and Michael Aldrin Bumanglag, with Group Supervisor ("GS") Glorializa Samoy.[6]

Subsequently, OIC-Assistant Commissioner Nestor S. Valeroso of the BIR – Large Taxpayers Service ("LTS") issued the *Memorandum of Assignment* MOA dated August 01, 2014, with No. LT-VATAG-2014-0003,[7] authorizing RO Junelyn Ivanhoe S. Fernandez and GS Lydia A. Vito to continue the audit or investigation of the previously assigned ROs.

On March 30, 2015, Petitioner, through its President, Mr. Angus Alexander George Murray, executed a *Waiver of the Defense of Prescription under the Statute of Limitations of the National Internal Revenue Code*, which was accepted by OIC-Assistant Commissioner Alfredo V. Misajon on April 07, 2015, in connection with the investigation of its VAT liabilities, for the period ending June 30, 2012. This extended the period of assessment until June 30, 2015.[8]

On June 11, 2015, Petitioner received Respondent's *Preliminary Assessment Notice* ("PAN"), with attached *Details of Discrepancies*, in which Respondent informed Petitioner of the proposed assessment for deficiency VAT for the 1st

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3 *Id.*, JSFI, Admitted Facts, Par. 2, p. 338; Exhibit "P-29", pp. 2266 to 2267.
4 *Id.*, Petition for Review, Par. 1, vis-à-vis Answer, Par. 1, pp. 11 and 77, respectively.
5 *Id.*, JSFI, Admitted Facts, Par. 3, pp. 338 to 339.
6 Docket, Exhibit "P-1", p. 2162; BIR Records (Folder 1), p. 79.
7 Docket,Exhibit "R-3", BIR Records (Folder 1), p. 88.
8 Docket,Exhibit "R-5", BIR Records (Folder 1), p. 186.

and 2nd quarters of CY 2012, in the aggregate amount of Php15,313,306.33, and compromise penalty in the amount of Php100,000.00.[9]

Petitioner then filed with the BIR – LTS, a *request for reconsideration* of the PAN, on June 25, 2015.[10]

Thereafter, on June 29, 2015, Petitioner received a *Formal Letter of Demand* ("FLD"), with attached *Final Assessment Notice* ("FAN") dated June 29, 2015 and *Details of Discrepancies,* issued by Respondent through OIC-Assistant Commissioner of the BIR – LTS.[11] In the FLD/FAN, Respondent requested Petitioner to pay its alleged deficiency VAT for the 1st and 2nd quarters of CY 2012 in the total amount of Php15,313,306.33, and compromise penalty in the amount of Php100,000.00, computed as follows: [12]

I. VALUE-ADDED TAX

Vatable Receipts per VAT Return			Php 401,953.93
Add: Sales Still Subject to VAT			80,473,347.32
Adjusted Vatable Receipts			Php 80,875,301.25
Output Tax Due			Php 9,705,036.15
Less:	Input Tax		
	Claimed per Returns	Php 21,606,635.70	
	Less: Input Tax Carry Over	21,558,401.23	48,234.47
VAT Due			Php 9,656,801.68
Less: Tax Payment			-
Deficiency Value Added Tax			Php 9,656,801.68
Add: 20% Interest *(7/26/2012 to 6/30/2015)*			5,656,504.65
TOTAL AMOUNT DUE			Php 15,313,306.33

II. COMPROMISE PENALTY

Sec. 255 of the NIRC - for the Basic Tax Due of Php9,656,801.68	Php 50,000.00
Sec. 113 of the NIRC - Non Compliance to Invoicing Requirements	50,000.00
TOTAL AMOUNT DUE	Php 100,000.00[13]

Based on the *Details and Discrepancies* attached to the FAN, the assessments for deficiency VAT and compromise penalties were based on the following: (1)

9 Docket, Admitted Facts, Par. 4, p. 339; Exhibit "P-2", pp. 2164 to 2166; BIR Records (Folder 1), Exhibit "R-7", pp. 228 to 230.
10 Docket, JSFI, Admitted Facts, Par. 5, p. 339.
11 *Id.,* Par. 6, p. 339.
12 *Id.,* Exhibit "P-4", pp. 2172 to 2176; BIR Records (Folder 1), Exhibit "R-9", pp. 237 to 241.
13 *Id.,* JSFI, Admitted Facts, Pars. 6 and 7, p. 339.

sales still subject to VAT of Php80,473,347.32, and (2) compromise penalty of Php100,000.00.[14]

On July 28, 2015, Petitioner filed with the BIR – LTS, a request for reconsideration of the FLD/FAN, wherein Petitioner prayed for the cancellation and withdrawal of Respondent's assessments for deficiency VAT for the 1st and 2nd quarters of CY 2012, and the corresponding compromise penalty.[15]

Petitioner filed the instant *Petition for Review* on February 23, 2016.[16]

On April 22, 2016, Respondent filed his *Answer*,[17] raising the following special and affirmative defenses, to wit:

"SPECIAL AND AFFIRMATIVE DEFENSES

4. Respondent reiterates and re-pleads the preceding paragraphs of this Answer as part of her Special and Affirmative Defense.

Petitioner is liable for deficiency Value Added Tax.

5. Petitioner posits that its sales amounting to Eighty Million Four Hundred Seventy Three Thousand Three Hundred Forty Seven Pesos and 32/100 (P80,473,347.32) are exempt from Value Added Tax (VAT) pursuant to Section 109 (K) of the National Internal Revenue Code (Tax Code) in relation to Presidential Decree No. 1354 (PD 1354).

6. Petitioner is mistaken.

7. Section 1 of PD 1354 is clear. Only subcontractors are subject to the preferential rate of eight percent (8%) in lieu of all taxes. Specifically:

> **Section 1. Tax on subcontractors. Every subcontractor,** whether domestic or foreign, **entering into a contract with a service contractor engaged in petroleum operations in the Philippines shall be liable to a final income tax equivalent to eight**

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[14] *Id.,* Par. 8, Admitted Facts, JSFI, Docket – Vol. 1, p. 340.

[15] *Id.,* Par. 9, Admitted Facts, JSFI, Docket – Vol. 1, p. 340; Exhibit "P-5", Docket – Vol. 5, pp. 2177 to 2181.

[16] *Id.,* pp. 10 to 31.

[17] *Id.,* pp. 77 to 88.

> **percent (8%) of its gross income derived from such contract, such tax to be in lieu of any and all taxes,** whether national or local: Provided, however, that any income received from all other sources within and without the Philippines in the case of domestic subcontractors and within the Philippines in the case of foreign subcontractors shall be subject to the regular income tax under the National Internal Revenue Code. The term 'gross income' means all income earned or received as a result of the contract entered into by the subcontractor with a service contractor engaged in petroleum operations in the Philippines under Presidential Decree No. 87.
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> **(Emphasis supplied).**

8. It is clear export of the above quoted provisions, to be entitled to the preferential rate of eight percent (8%) the following conditions must concur:

    a. That there be a service contractor engaged in petroleum operations in the Philippines;
    b. That the service contractor subcontracted some of its obligations in the service contract; and
    c. That the subcontractors entered into a contract with the service contractor engaged in petroleum operations in the Philippines.

9. In the case at hand, Petitioner is not a subcontractor who entered into a contract with a service contractor engaged in petroleum operations.

10. Assuming but without admitting the representations made by Petitioner, Shell Philippines Exploration BV (SPEX), a service contractor entered into a contract with Flour Daniel Pacific Inc. (FDPI) for the provision of project consultation services in connection with the petroleum operations for the exploration and development of the Malampaya natural gas field.

11. FDPI then subcontracted the same to Petitioner.

12. Thus, Petitioner is a subcontractor of the subcontractor, FDPI and not a subcontractor of a petroleum service contractor, SPEX.

13. Therefore, the preferential rate of eight percent (8%) under PD 1354 in relation to Section 109(K) of the Tax Code is not available to it.

14. It must be stressed that the burden of proof is on the taxpayer who claims the exemption and he must justify his claim by the clearest grant under the Constitutional or statutory law and cannot be permitted by vague implications.

15. As here, the law is clear, no grant whatsoever under PD 1354 was given to subcontractors of subcontractors of service contractors engaged in petroleum operations.

16. Petitioner as a subcontractor of FDPI has a distinct and separate juridical personality from its alleged affiliate. Thus, FDPI's privilege of availing of the preferential rate of eight (8%) percent cannot be claimed by Petitioner.

17. Moreover, assuming but definitely not conceding that Petitioner's sales amounting to Eighty Million Four Hundred Seventy Three Thousand Three Hundred Forty Seven and 32/100 (P80,473,347.32) was indeed rendered to a service contractor engaged in petroleum operation, Petitioner has not provided Respondent an iota of evidence that said sales were rendered in relation to the petroleum operations of SPEX.

18. Thus, Petitioner, for relying on a non-existent exemption and failure to adduce evidence in support of its claim, is indeed liable for deficiency VAT in the aggregate amount of Fifteen Million Three Four Hundred Thirteen Thousand Three Hundred Six Pesos and 33/100 (P15,413,306.33).

The Input Tax Carry Over was properly deducted by Respondent in the computation of Petitioner's deficiency VAT assessment.

19. Petitioner claimed that Respondent erred in deducting Petitioner's input tax credits.

20. Again, Petitioner is mistaken.

21. Sections 110 and 112 of the Tax Code state:

Section 110. Tax Credits. —

(A) Creditable Input Tax. —

(1) Any input tax evidenced by a VAT invoice or official receipt issued in accordance with Section 113 hereof on the following transactions shall be creditable against the output tax:

a. Purchase or importation of goods:

i. For sale; or
ii. For conversion into or intended to form part of a finished product for sale including packaging materials; or
iii. For use as supplies in the course of business; or
iv. For use as materials supplied in the sale of service; or
v. For use in trade or business for which deduction for depreciation or amortization is allowed under this Code, except automobiles, aircraft and yachts.

b. Purchase of services on which a value-added tax has been actually paid.

(2) The input tax on domestic purchase of goods or properties shall be creditable.

a. To the purchaser upon consummation of sale and on importation of goods or properties; and
b. (b) To the importer upon payment of the value-added tax prior to the release of the goods from the custody of the Bureau of Customs.

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(3) A VAT-registered person who is also engaged in transactions not subject to the value-added tax shall be allowed tax credit as follows:

a. Total input tax which can be directly attributed to transactions subject to value-added tax; and
b. A ratable portion of any input tax which cannot be directly attributed to either activity.

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The term 'input tax' means the value-added tax due from or paid by a VAT-registered person in the course of his trade or business on importation of goods or local purchase of goods or services, including lease or use of property, from a VAT-registered person. It shall also include the transitional input tax determined in accordance with Section 111 of this Code.

The term 'output tax' means the value-added tax due on the sale or lease of taxable goods or properties or services by any person registered or required to register under Section 236 of this Code.

(B) Excess Output or Input Tax. — If at the end of any taxable quarter the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person. If the input tax exceeds the output tax, **the excess shall be carried over to the succeeding quarter or quarters. Any input tax** attributable to the purchase of capital goods or to zero-rated sales by a VAT-registered person **may at his option be refunded or credited against other internal revenue taxes, subject to the provisions of Section 112.**

(C) Determination of Creditable Input Tax. — The sum of the excess input tax carried over from the preceding month or quarter and the input tax creditable to a VAT-registered person during the taxable month or quarter shall be reduced by the amount of claim for refund or tax credit for value-added tax and other adjustments, such as purchase returns or allowances and input tax attributable to exempt sale.

The claim for tax credit referred to in the foregoing paragraph shall include not only those filed with the Bureau of Internal Revenue but also those filed with other government agencies, such as the Board of Investments and the Bureau of Customs.

(Emphasis supplied).

22. Clearly, there is no question that a taxpayer, may choose either to refund its excess or unutilized input taxes or carry it over and credit the same for its internal tax liabilities.

23. However, this is possible only if Petitioner has exercised such option and has informed the Bureau of Internal Revenue of its decision to exercise the same.

24. In the case bar, Petitioner has not exercised its option to credit the same for its VAT liabilities. In fact, it carried it over for succeeding taxable periods.

25. In fact, Petitioner's alleged Input Tax Credits may have already been used up in other taxable periods.

26. Hence, Respondent properly disallowed Petitioner claim for Input Tax Credits.

Petitioner is liable for deficiency interest in relation to it deficiency VAT Assessment.

27. Section 249 of the Tax Code is clear. It states:

> **SEC. 249. Interest.** —
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> (A) **In General.** — There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.
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> (B) **Deficiency Interest.** — Any deficiency in the tax due, as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.
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> (C) **Delinquency Interest.** — In case of failure to pay:
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> 1. The amount of the tax due on any return to be filed, or
> 2. The amount of the tax due for which no return is required, or
> 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.

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28. From the clear import of Section 249, any deficiency in any unpaid amount of tax is subject to the twenty percent (20%) deficiency interest. It made no qualification whatsoever in the type of tax involved.

29. Thus, Petitioner is liable for deficiency interest due on all its unpaid taxes.

The compromise penalty was included as a suggestion for Petitioner to avoid criminal prosecution.

30. Lastly, Petitioner submitted that compromise penalties cannot be imposed without the consent of the taxpayer.

31. Respondent agrees with Petitioner that the essence of compromise penalties are mutuality and it cannot be imposed without the agreement of conformity of the taxpayer.

32. The Honorable Supreme Court in the case of Philippines International v. CIR held that:

> However, with respect to the compromise penalty in the total sum of Php13,200.00, we have repeatedly held **that this Court has no jurisdiction to compel a taxpayer to pay the same because by its very nature it implies a mutual agreement between the parties in respect to the thing or subject matter which is so compromised and the choice of paying or not paying it distinctly belongs to the taxpayer.**
>
> **(Emphasis supplied)**.

33. In fact, Respondent only included such portion as a suggestion to Petitioner to pay it in lieu of criminal prosecution pursuant to Revenue Memorandum Circular No. 17-1990, specifically:

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III. Guidelines and Instructions:

1. The internal revenue officers concerned shall apply the Revised Schedule of Compromise Penalties embodied in Annex 'A' to ensure uniformity of action.

2. In no case shall the compromise penalty differ in amount from those specified in the aforementioned Schedule, except when duly approved by the Commissioner or, in a proper case, by the Regional Directors.

3. **Although all amounts of compromise penalties incident to violations shall be itemized in the assessment notice and/or demand letter along with the other administrative penalties like surcharge and interest, the same should not form part of the total amount assessed/demanded but should appear separately as a suggestion to the taxpayer to pay lieu of criminal prosecution. If paid, the compromise penalties shall be collected and accounted for under the usual procedures, as internal revenue**.

4. Since compromise penalties are only amounts suggested in settlement of criminal liability, and may not therefore be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the suggested compromise penalty, the violation shall be referred for criminal action as heretofore mentioned.

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(Emphasis supplied).

34. Thus, it is well within the prerogative of Petitioner to decide whether to heed Respondent's suggestion to pay the compromise penalty to avoid criminal prosecution."

On April 27, 2016, the Pre-Trial Conference was initially set on August 02, 2016.[18] However, due to Petitioner's *Urgent Motion to Reset Pre-Trial Conference* filed on July 28, 2016,[19] the Pre-Trial Conference was reset to, and held on,

[18] *Id.,* Notice of Pre-Trial Conference dated April 27, 2016, pp. 89 to 90.
[19] *Id.,* pp. 112 to 115.

November 08, 2016.[20] Prior thereto, *Respondent's Pre-Trial Brief* was submitted on July 29, 2016;[21] while *Petitioner's Pre-trial Brief* and *Petitioner's Amended Pre-Trial Brief* were respectively filed on July 28, 2016[22] and November 03, 2016.[23]

In the meantime, on July 22, 2016, the *BIR Records* for the instant case was submitted by Respondent.[24]

The parties filed their *Joint Stipulation of Facts and Issue* ("JSFI") on December 16, 2016.[25] In the Resolution dated February 03, 2017,[26] the said JSFI was noted and admitted as part of the record of the case. The Court issued the Pre-Trial Order dated February 15, 2017,[27] and deeming the termination of the Pre-Trial Conference.

The trial of the case then ensued.

During trial, Petitioner presented documentary and testimonial evidence. It offered the testimonies of the following individuals, namely: (1) Mr. Ramon M. Villaflores,[28] Senior Manager, Finance – General Accounting of Petitioner; and (2) Ms. Yvette Luna Agustin,[29] Director for Project Business Services of Petitioner.

During the hearing held on July 31, 2017, Petitioner moved for the recall of Ms. Yvette Luna. However, Petitioner's motion was denied in open court.[30]

Petitioner then filed its *Motion for Reconsideration (Re: Resolution dated July 31, 2017) (with Motion to Defer Submission of Formal Offer of Evidence)* on August 15, 2017,[31] praying for the Court to: (1) reconsider its Resolution dated July 31, 2017; (2) allow Petitioner to recall Ms. Yvette Luna Agustin for the presentation of OEP Contract as part of the Prime Contract; and (3) defer the submission of Petitioner's *Formal Offer of Evidence* until the instant motion is resolve, or until the

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20 *Id.,* Order dated July 28, 2016, p. 132; Minutes of the hearing held on, and Order dated, November 8, 2016, pp. 324 and 326 to 327, respectively.
21 *Id.,* pp. 133 to 136.
22 *Id.,* 116 to 131.
23 *Id.,* pp. 146 to 161.
24 *Id.,* Manifestation (Re: Submission of BIR Records) dated July 22, 2016, pp. 104 to 105.
25 *Id.,* pp. 338 to 351.
26 *Id.,* pp. 376 to 377.
27 *Id.,* pp. 379 to 386.
28 *Id.,* Exhibit "P-34", pp. 166 to 183, Minutes of the hearing held on February 28, 2017, p. 388.
29 *Id.,* Exhibit "P-35", Docket – Vol. 1, pp. 392 to 402; Minutes of the hearing held on, and Order dated, March 28, 2017, pp. 435 to 437; Exhibit "P-36", pp. 449 to 453; Minutes of the hearing held on, and Order dated, July 31, 2017, Docket – Vol. 2, pp. 917 to 919.
30 *Id.,* Minutes of the hearing held on, and Order dated, July 31, 2017, pp. 917 to 919.
31 *Id.,* pp. 923 to 930.

Petitioner has presented the testimony of Ms. Agustin. No comment was filed thereon by Respondent.[32] However, the said *Motion for Reconsideration* was denied for lack of merit in the Resolution dated November 20, 2017.[33]

On December 27, 2017, Petitioner filed a *Motion to Admit Formal Offer of Evidence,* [34] with attached *Formal Offer of Evidence.* [35] Petitioner also filed a *Manifestation and Submission* on January 08, 2018,[36] claiming that it inadvertently attached photocopies of Exhibits "P-1" to "P-32", inclusive of submarkings; and thus, it prays for the Court to admit the attached original marked exhibits for the purposes stated in its *Formal Offer of Evidence.* Respondent filed his *Comment/Opposition (Re: Petitioner's Motion to Admit Formal Offer of Evidence)* on February 09, 2018.[37] Thus, in the Resolution dated February 09, 2018,[38] the Court noted Petitioner's *Manifestation and Submission*, and admitted the originally marked exhibits as part of the *Motion to Admit Formal Offer of Evidence.*

In the Resolution dated July 30, 2018,[39] the Court: (1) granted Petitioner's *Motion to Admit Formal Offer of Evidence*; (2) admitted the attached *Formal Offer of Evidence*; and (3) gave Respondent a period of ten (10) days from notice to file his comment or opposition on Petitioner's *Formal Offer of Evidence.* In compliance, Respondent filed his *Comment (Re: Formal Offer of Evidence)* on August 13, 2018.[40]

In the Resolution dated October 09, 2018, [41] the Court admitted Petitioner's exhibits, *except* for the following:

1) Exhibits "P-21", "P-28", "P-30", "P-32", and "P-32-a", for failure to present the originals for comparison;

2) Exhibit "P-23", for not being found in the records of the case; and

3) Exhibits "P-32-b" and "P-32-c", for failure to identify the same.

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32 *Id.,* Records Verification dated October 23, 2017 issued by the Judicial Records Division of this Court, p. 939.
33 *Id.,* pp. 941 to 942.
34 *Id.,* pp. 943 to 947.
35 *Id.,* pp. 948 to 959.
36 *Id.,* pp. 2159 to 2161.
37 *Id.,* pp. 3365 to 3368.
38 *Id.,* p. 3364.
39 *Id.,* pp. 3371 to 3372.
40 *Id.,* pp. 3373 to 3374.
41 *Id.,* Resolution dated October 9, 2018, pp. 3377 to 3378.

Consequently, on October 30, 2018, Petitioner filed an *Omnibus Motion (a) For Partial Reconsideration (Re: Resolution dated October 9, 2018); and (b) To Set Commissioner's Hearing,*[42] praying for the Court: (1) to set one (1) commissioner's hearing for the comparison and marking of Petitioner's Exhibits "P-21", "P-23", "P-28", "P-30", "P-32" and "P-32-a"; (2) to allow Petitioner a period of ten (10) days from the commissioner's hearing to file a *Supplemental Formal Offer of Evidence*; (3) to reconsider its Resolution dated October 09, 2018; and (4) to issue a Resolution admitting the previously mentioned exhibits. Respondent filed his *Opposition (Re: Omnibus Motion dated 30 October 2018)* on January 04, 2019.[43]

In the Resolution dated March 26, 2019,[44] the Court: (1) granted Petitioner's *Motion to Set Commissioner's Hearing*; (2) set a Commissioner's Hearing for the marking of Exhibits "P-21", "P-23", "P-28", "P-30", "P-32" and "P-32-a" after a comparison with the originals on April 30, 2019; (3) gave Petitioner a period of ten (10) days from the date of Commissioner's Hearing within which to submit its *Supplemental Formal Offer of Evidence*; and (4) reset the initial presentation of evidence for the Respondent to July 04, 2019.

On May 10, 2019, Petitioner filed a *Supplemental Formal Offer of Evidence (with Motion to Set Commissioner's Hearing),*[45] praying for the Court: (1) to set the case for Commissioner's Hearing for the comparison and marking of Petitioner's documentary exhibits; (2) to defer the resolution on Petitioner's *Supplemental Formal Offer of Evidence* until after the Commissioner's Hearing; and (3) to admit Exhibits "P-21", "P-23", "P-28", "P-30", "P-32" and "P-32-a", as part of Petitioner's evidence.

In the Resolution dated May 17, 2019,[46] the Court: (1) noted Petitioner's *Supplemental Formal Offer of Evidence*; (2) granted Petitioner's *Motion to Set Commissioner's Hearing*; and (3) set the Commissioner's Hearing on June 13, 2019, for the marking of Petitioner's documentary exhibits.

Thereafter, Petitioner filed an *Urgent Motion to Reset Commissioner's Hearing* on June 11, 2019.[47] In the Resolution dated June 14, 2019,[48] the Court: (1) granted Petitioner's *Urgent Motion to Reset Commissioner's Hearing*; (2) canceled and reset the previously scheduled Commissioner's Hearing on June 13, 2019 to July 16, 2019 for the marking of Petitioner's exhibits; and (3) canceled and reset the

[42] *Id.,* pp. 3381 to 3387.
[43] *Id.,* pp. 3400 to 3402.
[44] *Id.,* pp. 3420 to 3422.
[45] *Id.,* pp. 3426 to 3430.
[46] *Id.,* p. 3943.
[47] *Id.,* pp. 3944 to 3946.
[48] *Id.,* p. 3951.

previously scheduled initial presentation of evidence for Respondent on July 4, 2019 to September 12, 2019.

On July 18, 2019, Petitioner submitted the exhibits which were marked as certified true copies during the above-stated Commissioner's Hearing.[49] The same was noted and admitted by the Court in its Resolution dated July 25, 2019.[50]

In the Resolution dated September 11, 2019,[51] the Court: (1) partially granted Petitioner's *Motion for Reconsideration (Re: Resolution dated October 9, 2018)*; (2) admitted Exhibits "P-21", "P-28", "P-30", "P-32" and "P-32-a"; (3) denied Exhibit "P-23", for failure of the exhibit formally offered to correspond with the duly marked document.

On September 27, 2019, Petitioner filed an *Omnibus Motion: (a) for Partial Reconsideration (Re: Resolution dated September 11, 2019); and (b) to Admit Amended Supplemental Formal Offer of Evidence,*[52] with attached *Amended Supplemental Formal Offer of Evidence,*[53] praying for the Court to reconsider its Resolution dated September 11, 2019 and to issue a Resolution admitting the said *Amended Supplemental Formal Offer of Evidence* and Exhibit "P-23" as part of Petitioner's documentary evidence. However, no comment was filed thereon by Respondent.[54]

In the meantime, Respondent likewise presented his documentary and testimonial evidence. As for his testimonial evidence, Respondent offered the testimony of his sole witness, Mr. Junely Ivanhoe S. Fernandez,[55] a Revenue Officer III of the BIR.

On October 08, 2019, Respondent filed through registered mail a *Motion to Admit Attached Formal Offer* of Evidence,[56] with attached *Respondent's Formal Offer of Evidence.*[57] Petitioner filed its *Comment/Opposition to Respondent's Motion to Admit Attached Formal Offer of Evidence* on November 15, 2019.[58]

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49 *Id.,* Submission dated July 18, 2019, pp. 3952 to 3954.
50 *Id.,* p. 4423.
51 *Id.,* 4425 to 4427.
52 *Id.,* pp. 4436 to 4441.
53 *Id.,* pp. 4442 to 4445.
54 *Id.,* Records Verification Report dated October 15, 2019 issued by the Judicial Records Division of this Court, p. 4459.
55 *Id.,* Exhibit "R-12", pp. 3408 to 3415; Minutes of the hearing held on, and Order dated, September 12, 2019, pp. 4428 and 4431 to 4432, respectively.
56 *Id.,* pp. 4447 to 4451.
57 *Id.,* pp. 4453 to 4456.
58 *Id.,* pp. 4463 to 4469.

In the Resolution dated December 13, 2019,[59] the Court: (1) granted Petitioner's *Omnibus Motion: (a) for Partial Reconsideration (Re: Resolution dated September 11, 2019) and (b) To Admit Amended Supplemental Formal Offer of Evidence*; (2) admitted Petitioner's *Amended Supplemental Formal Offer of Evidence*; (3) admitted Exhibit "P-23" as part of Petitioner's documentary evidence; (4) granted Respondent's *Motion to Admit Attached Formal Offer of Evidence*; (5) admitted the attached Respondent's *Formal Offer of Evidence*; and (6) ordered Petitioner to comment on Respondent's *Formal Offer of Evidence* within ten (10) days from notice.

Petitioner then filed its *Comment (Re: Respondent's Formal Offer of Evidence dated October 7, 2019)* on January 20, 2020.[60] Thus, in the Resolution dated February 13, 2020,[61] the Court admitted Respondent's Exhibits, and gave both parties a period of thirty (30) days to submit their respective memorandum.

Respondent filed his *Memorandum* on June 15, 2020,[62] while Petitioner filed its *Memorandum* on June 26, 2020.[63]

The instant case was deemed submitted for decision on July 07, 2020.[64]

The Issue

The parties raised this sole issue for this Court's resolution, to wit:

> "WHETHER OR NOT RESPONDENT'S ASSESSMENTS AGAINST PETITIONER FOR ALLEGED DEFICIENCY VAT FOR THE PERIOD JANUARY 1, 2012 TO JUNE 30, 2012 AND COMPROMISE PENALTY IN THE AGGREGATE AMOUNT OF Php15,413,306.33 IS VALID."[65]

Petitioner's Arguments

Petitioner argues that the assessment for deficiency VAT for the period of January 01, 2012 to June 30, 2012 is void for having been issued in violation of Petitioner's right to due process. According to Petitioner, the assessment for

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[59] *Id.,* pp. 4473 to 4476.
[60] *Id.,* pp. 4477 to 4482.
[61] *Id.,* pp. 4484 to 4485.
[62] *Id.,* pp. 4486 to 4494.
[63] *Id.,* pp. 4496 to 4526.
[64] *Id.,* Resolution dated July 7, 2020, p. 4528.
[65] *Id.,* JSFI, Issue, p. 340.

deficiency VAT on Petitioner's sales to Flour Daniel Pacific Inc. ("FDPI") on July 25, 2012, covered by Official Receipt No. 9577,[66] amounting to Php19,548,758.97, is invalid on the ground that the revenue officers did not have authority under the LOA to examine Petitioner's books of accounts for the 3rd quarter of CY 2012. Thus, Petitioner insists that the assessment for deficiency VAT on Petitioner's sales amounting to Php80,473,347.32 is invalid.

Petitioner also questions the validity of the assessment on the ground that revenue officers failed to revalidate the LOA within the one hundred twenty (120)-day period provided under Revenue Memorandum Circular ("RMC") No. 40-2006 and Revenue Memorandum Order ("RMO") No. 38-88. For Petitioner, such failure renders the subject assessment void as the same stemmed from a lapsed LOA.

Further, Petitioner claims that the revenue officers failed to conduct quality audit when they merely presumed that the "Intercompany-Staff Labor and Mark-up", in the amount of Php80,473,347.32, pertains to sales subject to VAT. As such, it is Petitioner's position that the subject FLD lacks factual and legal bases as the same was merely based on presumed facts. Petitioner also insists that proof of inward remittance is not required for the exemption from VAT to apply. Likewise, Petitioner claims that the said amount should be considered by Respondent as exempt sale under Presidential Decree ("PD") No. 1354 which provides that a subcontractor of a service contractor engaged in petroleum operations in the Philippines under PD No. 87 shall not be subject to any tax, except for a final income tax equivalent to eight percent (8%) of its gross income derived from its contract.

Furthermore, Petitioner argues that the deduction from Petitioner's input tax credits of the "input tax carry over" in the amount of Php21,558,401.23 and the unilateral imposition of compromise penalty have no factual and legal bases.

Respondent's Counter-arguments

Respondent counters that Petitioner is a subcontractor of the subcontractor, FDPI, and not a subcontractor of a petroleum service contractor, Shell Philippines Exploration BV ("SPEX"). Thus, FDPI's privilege of availing of the preferential rate of eight percent (8%) under PD No. 1354, in relation to Section 109(K) of the NIRC of 1997, as amended, cannot be claimed by Petitioner. Respondent also insists that Petitioner has not provided an iota of evidence that said sales were rendered in relation to the petroleum operations of SPEX. Thus, Petitioner should be held liable for deficiency VAT in the aggregate amount of Php15,413,306.33.

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[66] Exhibit "P-20".

In addition, Respondent claims that the input tax carry over was properly deducted by Respondent in the computation of Petitioner's deficiency VAT assessment, as Petitioner has not exercised its option to credit the same for its VAT liabilities and, in fact, carried it over for succeeding taxable periods.

Respondent also insists that Petitioner is liable for deficiency interest in relation to its deficiency VAT assessment, as well as for the corresponding interest and compromise penalties.

Discussion/Ruling

The Court has jurisdiction over the present case.

The Court shall first determine the timeliness of the filing of the present Petition for Review in accordance with Section 228 of the NIRC of 1997, as amended, which provides as follows:

> "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:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as

> may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> **If the protest** is denied in whole or in part, or **is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the 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."[67]

Pursuant to Section 228 of the NIRC of 1997, as amended, Petitioner has thirty (30) days from receipt of the FAN/FLD within which to file its administrative protest and another thirty (30) days from receipt of Respondent's decision or from the lapse of the 180-day period within which to file its Petition for Review with the court.

Petitioner received the FAN/FLD, dated June 29, 2015 on the same day.[68] Petitioner had thirty (30) days from June 29, 2015 or until July 29, 2015 within which to file its administrative protest. Petitioner timely filed its *Request for Reconsideration* of the FAN/FLD on July 28, 2015.[69]

Counting one hundred eighty (180) days therefrom, Respondent had until January 24, 2016 within which to act upon the protest of Petitioner. Since Respondent failed to do so, Petitioner opted to file a *Petition for Review* with this court on February 23, 2016[70], which was well within thirty (30) days after the expiration of the 180-day period.

The Court shall now proceed to discuss the merits of the case.

The subject LOA need not be revalidated.

Petitioner claims that the LOA was not revalidated, although the ROs' audit was completed beyond one hundred twenty (120) days from the said

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67 *Emphasis supplied.*
68 Docket, Exhibit "P-4", pp. 2172 to 2176; BIR Records (Folder 1), Exhibit "R-9", pp. 237 to 241.
69 Docket, JSFI, Admitted Facts, Par. 9, p. 340; Exhibit "P-5", pp. 2177 to 2181.
70 *Id.,* pp. 10 to 31.

LOA's issuance, and hence, the deficiency VAT assessments arose from an invalid audit examination of its books of accounts.

We disagree with Petitioner.

RMC No. 23-2009[71] dated April 16, 2009 categorically states that failure on the part of the revenue officer to request for revalidation of an LOA or upon the expiration of the "revalidation period" does not nullify the LOA, nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued. The said issuance states, in part, as follows:

> "I. Revalidation of LAs
>
> The revalidation of LA[72] shall give rise to the extension of the period within which the Revenue Officer (RO) assigned to the case shall submit the report of investigation to higher authorities for review and approval, without the imposition of applicable administrative sanctions. Depending on the classification of the pending tax case, said extension period shall be equivalent to the original prescribed number of days within which to report the case under existing revenue issuances. **Failure on the part of the RO to request for the revalidation of LA or the expiration of the 'revalidation period' does not nullify the LA nor will it affect or modify the rules on the reglementary period within which an assessment may be validly issued.** However, this shall be considered as a ground for the imposition of disciplinary action and demerit in the performance rating of the concerned RO, including the reassignment of the case to another RO if the Regional Director, upon the recommendation of the Revenue District Officer, deems it necessary."[73]

Thus, considering that LOA No. LOA-V1-2012-00000056 was issued on November 19, 2012,[74] the above-quoted provisions of RMC No. 23-2009 must already govern the instant case, as the same was already in full effect at the time of the issuance of the said LOA. Correspondingly, the lack of revalidation of the subject LOA, despite the lapse of the 120-day period, does not nullify the same.

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[71] SUBJECT: Reiteration of Policies and Procedures Relative to Revalidation of Letters of Authority, Issuance of Subpoena Duces Tecum, and Review of Cases by the Assessment Division.

[72] That is, an LOA or a Letter of Authority.

[73] *Emphasis added.*

[74] Docket, Exhibit "P-1", p. 2162; BIR Records (Folder 1), p. 79.

The subject assessment is void, as a consequence of the violation of Petitioner's right to administrative due process for Respondent's failure to consider the explanations of Petitioner as embodied in its request for reconsideration of the PAN.

The issuance of the FLD/FAN, without consideration and evaluation of the defenses contained in the *request for reconsideration* of the PAN, violated Petitioner's right to due process.

To recall, Petitioner received the PAN on June 11, 2015 assessing it for deficiency income VAT, for the 1st and 2nd quarters of CY 2012[75], in the aggregate amount of Php15,313,306.33.

Based on the *Details of Discrepancies* of the PAN, the following items comprise the various tax assessments: (1) sales still subject to VAT amounting to Php80,473,347.32 and (2) compromise penalty amounting to Php100,000.00.

On June 25, 2015, Petitioner filed its *request for reconsideration* of the PAN, Petitioner addressing the findings in the PAN. [76] Petitioner provided an explanation for every line item/finding of the BIR, and endeavoured to refute the alleged deficiency assessments as being devoid of any legal or factual bases.

On June 29, 2015 however, just four (4) days from the filing of Petitioner's *request for reconsideration* of the PAN, Respondent issued the subject FLD/FAN.[77] The FLD/FAN contained the very same issues and the same amount of deficiency taxes stated in the PAN. Moreover, in issuing the FLD/FAN dated June 29, 2015, the BIR never addressed or even cited the arguments raised by Petitioner in its *request for reconsideration* of the PAN.

Section 3 of Revenue Regulation ("RR") No. 12-99, as amended by RR No. 18-2013[78] expressly provides that "[i]f the taxpayer, within fifteen (15) days from date of receipt of the PAN, responds that he/it disagrees with the findings

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[75] Docket, Par. 4, Admitted Facts, JSFI, p. 339; Exhibit "P-2", pp. 2164 to 2166; BIR Records (Folder 1), Exhibit "R-7", pp. 228 to 230.

[76] Docket, Exhibit "P-3", pp. 2167 to 2171.

[77] *Id.,* JSFI, Admitted Facts, Par. 6, p. 339.

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

of deficiency tax or taxes, an FLD/FAN shall be issued within fifteen (15) days from filing/submission of the taxpayer's response."

Based on the foregoing provision, part of the due process requirement in the issuance of a deficiency tax assessment is the issuance and service of a PAN. Moreover, Petitioner is given fifteen (15) days from receipt of the PAN within which to respond thereto, before the issuance of the FAN by the BIR.

Relative thereto, in *Commissioner of Internal Revenue v. Avon Products Manufacturing, Inc., Et. Al.* ("*Avon* case"),[79] the Supreme Court pronounced:

> "**Tax assessments issued in violation of the due process rights of a taxpayer are null and void.** **While the government has an interest in the swift collection of taxes, the Bureau of Internal Revenue and its officers and agents cannot be overreaching in their efforts, but must perform their duties in accordance with law, with their own rules of procedure, and always with regard to the basic tenets of due process.**
>
> **The 1997 National Internal Revenue Code, also known as the Tax Code, and revenue regulations allow a taxpayer to file a reply or otherwise submit comments or arguments with supporting documents at each stage in the assessment process. Due process requires the Bureau of Internal Revenue to consider the defenses and evidence submitted by the taxpayer and to render a decision based on these submissions. Failure to adhere to these requirements constitutes a denial of due process and taints the administrative proceedings with invalidity.**
>
> xxx xxx xxx
>
> Under the Bureau of Internal Revenue's own procedures, the taxpayer is required to respond to the Notice of Informal Conference and to the Preliminary Assessment Notice within 15 days from receipt. Despite Avon's timely submission of a Reply to the Notice of Informal Conference and protest to the Preliminary Assessment Notice, together with supporting documents, the Commissioner and her agents violated their own procedures by refusing to answer or even acknowledge the submitted Reply and protest. N

[79] G.R. Nos. 201398-99 and 201418-19, October 03, 2018.

The Notice of Informal Conference and the Preliminary Assessment Notice are a part of due process. They give both the taxpayer and the Commissioner the opportunity to settle the case at the earliest possible time without the need for the issuance of a Final Assessment Notice. However, <u>this purpose is not served in this case because of the Bureau of Internal Revenue's inaction or failure to consider Avon's explanations</u>.

xxx xxx xxx

It is true that the Commissioner is not obliged to accept the taxpayer's explanations, as explained by the Court of Tax Appeals. **However, when he or she rejects these explanations, he or she must give some reason for doing so. He or she must give the particular facts upon which his or her conclusions are based, and those facts must appear in the record.**

Indeed, the Commissioner's inaction and omission to give due consideration to the arguments and evidence submitted before her by Avon are deplorable transgressions of Avon's right to due process. **<u>The right to be heard, which includes the right to present evidence, is meaningless if the Commissioner can simply ignore the evidence without reason.</u>**

xxx xxx xxx

Compliance with strict procedural requirements must be followed in the collection of taxes as emphasized in *Commissioner of Internal Revenue v. Algue, Inc.*:

> Taxes are the lifeblood of the government and so should be collected without unnecessary hindrance. On the other hand, **such collection should be made in accordance with law as any arbitrariness will negate the very reason for government itself.** It is therefore necessary to reconcile the apparently conflicting interests of the authorities and the taxpayers so that the real purpose of taxation, which is the promotion of the common good, may be achieved.

xxx xxx xxx

But even as we concede the inevitability and indispensability of taxation, it is a requirement in all democratic regimes that it be exercised reasonably and in accordance with the prescribed procedure. If it is not, then the taxpayer has a right to complain and the courts will then come to his succor. For all the awesome power of the tax collector, he may still be stopped in his tracks if the taxpayer can demonstrate...that the law has not been observed. (Emphasis supplied)

xxx. ***[The Commissioner of Internal Revenue's]* disregard of the standards and rules renders the deficiency tax assessments null and void**. xxx."[80]

The foregoing doctrinal pronouncement affirms that the issuance of a PAN is a part of due process; that the issuance thereof gives both the taxpayer and Respondent opportunity to settle the case at the earliest possible time without the need for the issuance of a FAN or to reduce the assessment at the earliest opportunity; that this purpose is not served in case Respondent or the BIR fails to consider the taxpayer's explanations or arguments before the FAN is issued; that the failure by Respondent or the BIR to give due consideration to the said explanations or arguments is a deplorable transgression of the taxpayer's right to due process; and that the disregard by respondent or the BIR of the standards and rules renders the deficiency tax assessments null and void.

In this respect, the Court finds that in issuing the FLD/FAN, the BIR never addressed or delved into the arguments raised by Petitioner in its *request for reconsideration* of the PAN. This is clear when Respondent issued a FAN which as a complete replica of the PAN, without even stating and explaining the demerits of Petitioner's contentions.

The right of taxpayer to answer the PAN carries with it the correlative duty on the part of the BIR to consider the response thereto; and that the issuance of the FAN without even hearing the side of the taxpayer is anathema to the cardinal principles of due process. Right to due process is the opportunity to be heard. However, such opportunity would be wasted if the reply or protest

80 *Emphasis and underscoring supplied.*

to assessments submitted to the BIR is not taken into consideration. It is an empty and meaningless exercise if the same is not even considered by the BIR.

As part of the due process requirement in the issuance of tax assessments, Respondent must give the reason/s for rejecting Petitioner's explanations, and must give the particular facts upon which his conclusions are based, and those facts must appear on record. Respondent has obviously not observed such requirement in the issuance of the subject FLD/FAN. Thus, the inevitable conclusion is that Petitioner's right to due process, as recognized under Section 228 of the NIRC of 1997, as amended, and Sections 3.1.2 and 3.1.4 of RR No. 12-99, was violated by Respondent. As a consequence of such violation, the said deficiency tax assessment is rendered void and cannot be enforced against Petitioner.

Assuming without conceding that there was no violation of due process, the assessment issued by Respondent against Petitioner should still be cancelled and/or withdrawn for lack of legal and factual basis.

To reiterate, the deficiency VAT assessment arose from the following items:

A. Sales Still Subject to VAT	Php 80,473,347.32
B. Disallowed Input Tax Carry-Over	21,558,401.23

A. Sales Still Subject to VAT

Respondent imposed twelve percent (12%) VAT on Petitioner's sales amounting to Php80,473,347.32 based on the following finding as stated in the Details of Discrepancy attached to the FLD:[81]

> **<u>Sales Still Subject to VAT, P80,473,347.32</u>** – Verification disclosed that you had sales still subject to Value Added Tax (VAT). The said amount pertained to the revenues intercompany – staff labor and mark up. This was the result of the contract between you and Flour Daniel Pacific Inc. which is a domestic corporation. Further verification disclosed that this amount was not included in the inward remittances received by your company. Therefore, no

[81] BIR Records, Exhibit "R-9", p. 239.

proof that would qualify to the interference that the said amount would be part of the exempt sales. Hence, this should be subjected to VAT pursuant to Section 108 of the 1997 Tax Code, as implemented by Revenue Regulations (RR) No. 16-2005.

Petitioner counter argues that the assessed sales of Php80,473,347.32 pertain to its gross receipts from services rendered to its affiliate, FDPI, which are exempt from VAT pursuant to Section 109(K) of the NIRC of 1997, as amended, in relation to PD No. 1354.

In the case at bar, Ms. Yvette Luna Agustin, testified that SPEX, is a petroleum service contractor of the Philippine Government under the Oil Exploration and Development Act of 1972 (*i.e.,* PD No. 87, as amended) and under Service Contract No. 38 (SC 38). SPEX undertook to perform petroleum operations for the development of the Malampaya natural gas field located in offshore Palawan, and in doing so, it engaged a number of subcontractors and one of them is Petitioner's affiliate, FDPI. She testified that FDPI is required to provide feasibility studies, engineering, and project consultation services pursuant to the below enumerated contracts entered into with SPEX:

a. Basic Design and Engineering Package Contract dated June 27, 2011; and

b. Offshore Engineering, Procurement Contract dated July 17, 2012.[82]

Ms. Agustin also mentioned that Section 9.2 of the agreement between SPEX and FDPI allows the latter to subcontract part of its works to its affiliates, *viz:*

"**9.2 SUBCONTACTING**

The CONTRACTOR [FDPI] shall not subcontract the whole of WORK. The CONTRACTOR shall not subcontract any part of the WORK without prior written approval of the COMPANY [SPEX]. The CONTRACTOR shall ensure that the rights of the COMPANY and the requirements in the CONTRACT regarding SUBCONTRACTORS are effectively provided for in any SUBCONTRACT. Notwithstanding the foregoing, CONTRACTOR may have parts of the work performed by its AFFILIATES or their employees, in which case the CONTRACTOR shall be responsible for such WORK, and the COMPANY will look solely to the

[82] Docket, Exhibit "P-35", Q-22&A to Q-10&A, pp. 397 to 398.

CONTRACTOR as if the WORK were performed by CONTRACTOR.

Consequently, FDPI subcontracted parts of the works under the Prime Contract to Petitioner, which is one of FDPI's affiliates in Philippines.[83]

Thus, it is Petitioner's position that being a subcontractor of FDPI, its gross receipts from the below enumerated sales of services to FDPI should be subjected to eight (8%) final income tax, **in lieu of all other taxes**, under PD No. 1354, thus:

Official Receipt No.	Date	Gross Receipts (in PHP)
9538[84]	03/21/2012	14,959,643.84
9548[85]	04/25/2012	15,947,780.78
9567[86]	06/20/2012	30,017,162.73
9577[87]	07/25/2012	19,548,758.97
Total		**80,473,346.32**[88]

The Court is not convinced.

Under Section 1 of PD No. 1354,[89] domestic or foreign subcontractor entering into a contract with a service contractor engaged in petroleum operations in the Philippines shall be liable to a preferential tax rate eight percent (8%), to wit:

> "SECTION 1. *Tax on subcontractors.* — **Every subcontractor, whether domestic or foreign, entering into a contract with a service contractor engaged in petroleum operations in the Philippines shall be liable to a final income tax equivalent to eight percent (8%) of its gross income derived from such contract, such tax to be in lieu of any and all taxes, whether national or local:** Provided, however, that any income received from all other sources within and without the Philippines in the case of domestic subcontractors and within the Philippines in the case of foreign subcontractors shall be subject to the regular income tax imposed under the National Internal

83 *Id.,* Exhibit "P-35", Q-26&A, pp. 398 to 399.
84 Exhibit "P-17".
85 Exhibit "P-18"
86 Exhibit "P-19"
87 Exhibit "P-20"
88 Docket, Petitioner's Memorandum, Pars. 66 to 68, pp. 4518.
89 IMPOSING FINAL INCOME TAX ON SUBCONTRACTORS AND ALIEN EMPLOYEES OF SERVICE CONTRACTORS AND SUBCONTRACTORS ENGAGED IN PETROLEUM OPERATIONS IN THE PHILIPPINES UNDER PRESIDENTIAL DECREE NO. 87 dated April 21, 1978.

> Revenue Code. The term "gross income" means all income earned or received as a result of the contract entered into by the subcontractor with a service contractor engaged in petroleum operations in the Philippines under Presidential Decree No. 87."[90]

In order for the above-stated law to apply, the following conditions must be met:

1. that there must be a service contractor engaged in petroleum operations in the Philippines;

2. that the service contractor subcontracted some of its obligations in the service contact; and

3. that a foreign or domestic subcontractor undertook the above-stated obligations through a contract entered into with the service contractor.

In other words, PD No. 1354 will only apply when there is a contract entered into between the service contractor engaged in petroleum operations in the Philippines and the domestic/foreign subcontractor. Settled is the rule that where the language of the law is clear and unequivocal, it must be given its literal application and applied without interpretation. The general rule of requiring adherence to the letter in construing statutes applies with particular strictness to tax laws and provisions of a taxing act are not to be extended by implication.[91]

Moreover, a contractor, in general, is one who contracts to do work for another. It is strictly applicable to any person who enters into a contract, but is commonly reserved to designate one who, for a fixed price, undertakes to procure the performance of works or services on a large scale, or the furnishing of goods in large quantities whether for the public or a company or individual. Such are generally classified as general contractor (responsible for the entire job) and subcontractors (responsible for only portion of a job).[92]

Based on the above-stated facts, the Court agrees with Respondent's position that Petitioner is a subcontractor of the subcontractor, and not a subcontractor engaged by a service contractor as contemplated under Section 1 of PD No. 1354. In fact, SPEX was not even a party to the Master Workshare Service Agreement (MWSA)[93] that was executed between FDPI and Petitioner on January 02, 2012, in which FDPI authorized Petitioner to perform the

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90 *Emphasis supplied.*
91 Commissioner of Internal Revenue v. Julieta Ariete, G.R. No. 164152, January 21, 2010.
92 Black's Law Dictionary with Pronunciations, Sixth Edition, p. 326.
93 Docket, Exhibit "P-30", pp. 2257 to 2266.

services within the general scope provided in the Prime Contract entered into by SPEX and FDPI.

More so, Section 3 of PD No. 1354 explicitly states that it is the service contractor that should deduct, withhold, and pay the tax imposed in the afore-quoted Section 1 of the said law, to wit:

> "SECTION 3. *Manner of collecting the tax.* — (a) Every service contractor shall deduct, withhold, and pay the tax imposed in Section 1 of this Decree from the amounts paid by the service contractor to the subcontractor under the contract entered into by and between them in the same manner and subject to the same conditions as provided in Section 54 of the National Internal Revenue Code."

In this case, it is not the service contractor, SPEX, who deducted, withheld and paid the tax imposed on subcontractors under Section 1 of the said law, but the FDPI as testified by Petitioner's witness, Mr. Ramon M. Villaflores in this wise:

Q36.	You mentioned that the appropriate withholding tax was duly withheld by the FDPI on its income payments to Petitioner. How much tax did FDPI withhold on its income payments to the Company?
A:	**FDPI withheld an 8% final tax on its income payments to Petitioner, which was equivalent to Php6,437,867.71.** The summary shows the correlation between the income payments made by FDPI to Petitioner and the tax withheld.
Q37.	You mentioned that FDPI withheld 8% final tax on its income payments to Petitioner. What proof do you have, if any, that FDPI withheld such amount from its income payments to Petitioner?
A:	FPIS issued a Certificate of Final Tax Withheld at Source (BIR Form 2306) to the Company showing that it withheld Php10,020,794.77 on its income payments to the Company. The schedule of the final taxes withheld attached to the BIR Form 2306 shows that the amount of Php10,020,794.71 includes the Php6,437,867.71 final tax withheld on the Company's income from FDPI in the amount of USD1,875,351.60 (equivalent to Php80,473,346.32)."[94]

[94] *Id.,* Exhibit "P-34", Q-36&A, p. 175 to 176.

Thus, Petitioner is not entitled to avail of the eight percent (8%) final income tax rate being given to subcontractors of service contractors engaged in petroleum operations under PD No. 1354.

Petitioner may not likewise rely on BIR Ruling Nos. 031-02[95] and 122-15[96] in availing the said preferential tax rate of eight percent (8%) final income tax. For one, said rulings are mere response of the BIR to queries forwarded by a particular taxpayer. Thus, the same cannot be considered as general interpretative rules issued by the CIR pursuant to its power under Section 4 of the NIRC that can be considered applicable to all taxpayers.[97]

For another, the CIR is not bound by the ruling of his predecessors, but, to the contrary, the overruling of decisions is inherent in the interpretation of laws.[98]

More so, jurisprudence provides that, upon filing of Respondent's Answer in this case on April 22, 2016, contesting Petitioner's claim of exemption from VAT, the same should be considered as "deemed a revocation"[99] of BIR Ruling Nos. 031-02 and 122-15.

Accordingly, the subject gross receipts of Php80,473,347.32, broken down below, are subject to 12% VAT.

Exhibit	Customer Name	OR No.	OR Date	OR Amount	PHP Conversion
"P-17"	FDPI (0302)	9538	3/21/2012	$ 471,720.02	Php14,959,643.84
"P-18"	Fluor Daniel Pacific, Inc-Phil (0302)	9548	4/25/2012	469,744.11	15,947,780.78
"P-19"	FDPI (0302)	9567	6/20/2012	833,344.57	18,401,377.80
					1,989,362.93
					9,626,422.00
"P-20"	FDPI (0302)	9577	7/25/2012	628,612.65	3,481,415.87
					2,943,163.11
					4,553,327.48
					1,739,712.63
					6,831,139.88
Total				**$ 2,403,421.35**	**Php 80,473,346.32**

95 August 12, 2002.
96 April 17, 2015.
97 San Roque Power Corp. v. Commissioner of Internal Revenue, G.R. No. 203249, July 23, 2018.
98 Misamis Oriental Association of Coco Traders, Inc. v. Department of Finance, et al., G.R. No. 108524, November 10, 1994.
99 Commissioner of Internal Revenue vs. Burmeister and Wain Scandinavian Contractor Mindanao. Inc., G.R. No. 153205, January 22, 2007.

However, as correctly pointed out by Petitioner, the amount of Php19,548,758.97 which was covered by OR No. 9577[100] dated July 25, 2012, is not within the scope of the present assessment as the LOA in the instant case covers only the 1st and 2nd quarters of 2012.

It must be emphasized that pursuant to Section 108 in relation to Section 113 of the NIRC of 1997, as amended, the 12% VAT on sales of services is based on gross receipts as evidenced by VAT official receipts, thus:

> "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: Provided, That the President, upon the recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of value-added tax to twelve percent (12%), after any of the following conditions has been satisfied:
>
> xxx xxx xxx
>
> 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." (Underscoring supplied)
>
> "SEC. 113. *Invoicing and Accounting Requirements for VAT-registered Persons.* —
>
> (A) Invoicing Requirements. — A VAT-registered person shall issue:
>
> xxx xxx xxx
>
> (2) A VAT official receipt for every lease of goods or properties, and for every sale, barter or exchange of services. (Underscoring supplied)

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[100] Docket, Exhibit "P-20", p. 411.

Thus, the collection of Php19,548,758.97 falls under the 3rd quarter of 2012 and should not be included and reported under the 1st and 2nd quarters of 2012.

Considering the above, Petitioner's adjusted vatable receipts for the 1st and 2nd quarters of 2012 will be Php61,326,541.28 with the corresponding output tax due of Php7,359,184.95, computed as follows:

Vatable Receipts per VAT Returns	Php 401,953.93
Add: Sales Still Subject to VAT *(Php80,473,347.32 less Php19,548,758.97)*	60,924,587.35
Adjusted Vatable Receipts	Php 61,326,541.28
Output Tax Due	Php 7,359,184.95

B. Disallowed Input Tax Carry-Over

Respondent disallowed Petitioner's excess input tax credit carried-over to the succeeding period amounting to Php21,558,401.23. However, no legal and factual bases were provided in the Details of Discrepancy[101] to justify the disallowance of such amount.

> "**SEC. 228.** ***Protesting of Assessment.* —**
>
> 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."

The aforequoted Section 228 of the NIRC of 1997, as amended, in part provides that the taxpayers shall be informed in writing of the law and the facts on which the assessment is made otherwise the assessment is void. This was further implemented by Section 3.1.4 of RR No. 12-99 in this way:

> "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 the payment of taxpayer's deficiency tax or

[101] *Id.,* Exhibit "P-4", p. 2174.

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."

Based on the above provisions of the law and regulations, a taxpayer has the right to be fully informed of the law and the facts upon which an assessment is based, the purpose being that the taxpayer should be given the opportunity to refute the findings of the examiners and give its own version or explanation with respect to the alleged findings of deficiencies or discrepancies. This stems from the basic constitutional principle that no person shall be deprived of his property without due process of law.

In sum, while Petitioner is liable for output VAT for the assessed gross receipts of Php60,924,587.35, nevertheless it has no deficiency VAT liability for the 1st and 2nd quarters of 2012 as its input tax credits far exceeded its output VAT liability for the same period, as computed below:

Vatable Receipts per VAT Returns		Php 401,953.93
Add: Sales Still Subject to VAT		60,924,587.35
Adjusted Vatable Receipts		61,326,541.28
Output Tax Due		Php 7,359,184.95
Less: Input Tax		
Claimed per Returns	Php21,606,635.70	
Less: Input Tax carry Over	0.00	21,606,635.70
VAT Due		Php (14,247,450.75)
Less: Tax Payment		0.00
Excess Input Tax		**Php(14,247,450.75)**

Petitioner is not liable to pay the subject compromise penalty.

Lastly, notwithstanding the foregoing disquisitions, it is well to point out that Respondent erred in imposing the subject compromise penalty. RMO No. 19-2007[102] provides that the penalties therein are only amounts suggested in the 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 means that it is imposed only to avoid prosecution for violation of the provisions of the Tax

[102] SUBJECT: The Consolidated Revised Schedule of Compromise Penalties for Violations of the National Internal Revenue Code.

Code.[103] Thus, the imposition of the compromise penalty without the conformity of the taxpayer is illegal and unauthorized.[104] Considering that Respondent had not shown that Petitioner conformed to the imposition of the compromise penalty, with more reason that the compromise penalty must not be imposed.

WHEREFORE, in light of the foregoing considerations, the instant *Petition for Review* is **GRANTED**. Accordingly, the FLD and FAN dated June 29, 2015, holding Petitioner liable for deficiency VAT and compromise penalty in the respective amounts of Php15,313,306.33 and Php100,000.00, for January 01, 2012 to June 30, 2012, are **CANCELLED** and **SET ASIDE**. Consequently, Respondent is **ENJOINED** and **PROHIBITED** from collecting the said amount against Petitioner.

SO ORDERED.

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice

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[103] The Philippine International Fair, Inc. v. Collector of Internal Revenue, G.R. Nos. L-12928 and L-12932, March 31, 1962.

[104] Refer to Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc., Et Al., G.R. No. 35266, January 21, 1991.

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.

ERLINDA P. UY
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