REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

ISHIDA PHILIPPINES TUBE CO., INC., Petitioner,	**CTA CASE NO. 9729**
- versus -	Members: **CASTAÑEDA, JR.,** *Chairperson, and* **BACORRO-VILLENA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: OCT 08 2020 8:45 a.m.

x - x

DECISION

BACORRO-VILLENA, J.:

At bar is a Petition for Review[1] seeking to nullify the Final Decision on Disputed Assessment (**FDDA**) issued against Ishida Philippines Tube Co., Inc. (**petitioner/Ishida**), finding it liable for deficiency Income Tax (**IT**), Value-Added Tax (**VAT**), Expanded Withholding Tax (**EWT**), Final Withholding Tax (**FWT**), including

[1] Pursuant to 2005 *Revised Rules of the CTA, as amended.*
Rule 4. Jurisdiction of the Court.
...
Sec. 3. *Cases within the jurisdiction of the Court in Division.-* The Division shall exercise:
(a) Exclusive original over or appellate jurisdiction to review by appeal the following:
(1) Decisions of 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
...

penalties and interests, in the total amount of Eight Million Eight Hundred Seventy-Eight Thousand Six Hundred Twenty-Nine Pesos and 89/100 (₱8,878,629.89), covering taxable year (**TY**) ended 31 December 2012.

FACTS OF THE CASE

Petitioner Ishida is a domestic corporation duly organized and existing under Philippine laws and registered with the Securities and Exchange Commission[2] (**SEC**) and with the Bureau of Internal Revenue (**BIR**), with Taxpayer Identification No. (**TIN**) 202-935-083. It is primarily engaged in the manufacturing, importing, exporting, buying, selling or otherwise dealing in (at wholesale) such goods as stainless steel pipes and tubings, ordinary steel pipes and tubings, structural steel, and other metallic goods of similar nature. Likewise, in equipment, materials, supplies used or employed in or related to the manufacture of such finished products. Petitioner is categorized as one of the Top 10,000 corporations.[3]

Respondent Commissioner of Internal Revenue (**respondent/CIR**), on the other hand, is vested with the authority to assess and collect all internal revenue taxes, fees, charges and the enforcement of all forfeitures, penalties and fines connected therewith, including the execution of judgments in all cases decided in its favor.

On 24 April 2014, petitioner received a Letter of Authority (**LOA**) No. SN-eLA201100033485/LOA-54A-2014-00000040[4] from the BIR to examine the books of accounts and other accounting records for all internal revenue taxes for the calendar year 01 January 2012 to 31 December 2012 (**CY 2012**).

On 03 November 2015, petitioner received the Preliminary Assessment Notice[5] (**PAN**) and filed its reply[6] thereto on 18 November 2015.

[2] Exhibit "P-1", Division Docket, Volume I, p. 435.
[3] Exhibit "P-2", id., p. 446.
[4] Exhibit "R-1", BIR Records, p. 305.
[5] Exhibit "P-3", Division Docket, Volume I, pp. 447-449.
[6] Exhibit "P-4", id., pp. 450-452.

On 26 January 2016, petitioner received the Formal Letter of Demand[7] (**FLD**) dated 08 December 2015, assessing it for deficiency taxes amounting to ₱8,878,629.89. On 24 February 2016, petitioner filed its protest[8] to the FLD, attaching thereto the copy of its Service Agreement[9] with Ishida Ironworks Co., Ltd. (**IICL**).

On 06 November 2017, petitioner received the FDDA[10] that denied its protest and reiterated the assessment against it for deficiency taxes as detailed below:

Tax Type	Deficiency Tax	Interest	Surcharge	Compromise	Total
Income tax	1,928,384.33	1,013,326.34	-	25,000.00	2,966,710.67
VAT	1,797,341.71	1,023,253.71	-	25,000.00	2,845,595.42
EWT	193,002.71	110,936.90	-	16,000.00	319,939.61
FWT	1,505,037.50	865,087.31	376,259.38	-	2,746,384.19
Total	**5,423,766.25**	**3,012,604.26**	**376,259.38**	**66,000.00**	**8,878,629.89**

Aggrieved, on 06 December 2017, petitioner filed a Petition for Review before this Court appealing respondent's FDDA. After thrice moving for extension of time, respondent filed his Answer[11] on 12 March 2018.

PROCEEDINGS BEFORE THE COURT

The Pre-Trial Conference[12] proceeded after both parties filed their respective Pre-Trial Briefs.

During the Pre-Trial Conference[13], the parties were given time to file their Joint Stipulation of Facts and Issues[14] (**JSFI**), which the Court thereafter approved and adopted in its Pre-Trial Order.[15] The pre-trial was then terminated accordingly.

7 Exhibit "P-5", id., pp. 453-455.
8 Exhibit "P-6", id., pp. 456-458.
9 Exhibits "P-11" to "P-11.4", id., pp. 500-504.
10 Exhibit "P-7", id., pp. 459-461.
11 Id., pp. 92-109.
12 Id., pp. 131-132.
13 Minutes of the Hearing, held on 21 June 2018, id., p. 177.
14 The parties filed their JSFI on 11 July 2018, id., pp. 183-189.
15 Issued on 26 July 2018, id., pp. 191-194.

When trial ensued subsequently, petitioner presented two witnesses, namely: (1) its accountant, Ms. Annielee Tapawan[16] (**Tapawan**); and, (2) the Court-Commissioned Independent Certified Public Accountant, Mr. Sonny S. Bonilla[17] (**ICPA Bonilla**), who both executed their Judicial Affidavits, in lieu of their direct testimony.

On the witness stand, Tapawan identified documents relating to petitioner's registration with the SEC and the BIR, as well as the receipt of the assessment notices and the protest to the PAN and FLD filed.

On cross-examination, Tapawan confirmed that petitioner submitted additional documents in support of its protest to the FLD. However, she failed to recall if they were submitted after the filing of petitioner's protest.[18]

ICPA Bonilla, on the other hand, testified as to his ICPA Report. Likewise, as to the procedures he observed in evaluating the documents contained in his report. He was not subjected to cross-examination.[19]

After the presentation of its last witness, petitioner filed its Formal Offer of Evidence[20] (**FOE**) and the Court admitted all of its offered exhibits.[21]

For his part, respondent presented his lone witness, Revenue Officer Romanito Guiuan (**RO Guiuan**), who likewise testified by way of Judicial Affidavit[22] in lieu of his direct testimony.

On the witness stand, RO Guiuan declared that he was among the ROs that conducted the audit investigation of petitioner's books of accounts. As a result of his investigation, he recommended the issuance of the PAN and Final Assessment Notice (**FAN**) for

16 Judicial Affidavit, id., pp. 165-173.
17 Corrected Judicial Affidavit, id., pp. 388-422.
18 TSN dated 30 July 2018.
19 TSN dated 23 January 2019.
20 Dated 11 February 2019, Division Docket, Volume I, pp. 423-434.
21 Resolution dated 02 April 2019, id., Volume II, pp. 508-511.
22 Judicial Affidavit, id., 524-531.

petitioner's tax deficiency on IT, VAT, EWT and FWT. He also identified the documents pertaining to the audit investigation of petitioner.

On cross-examination, RO Guiuan was asked whether he was able to check if the contract contained an automatic renewal clause. When shown with the original copy of the contract, while he stated that the said contract was executed in September 2008, he confirmed that the clause therein was not an automatic renewal clause.[23]

On the same cross-examination, RO Guiuan also testified that the basis for his findings of discrepancy on petitioner's VAT and EWT liability were mainly petitioner's audited financial statements and other documents.[24] When asked which provision in the RP-Japan Treaty he used for his FWT assessment on the management fees, he retorted that he could no longer recall which provision was actually used as basis.

Thereafter, respondent filed an FOE[25] and the Court admitted all of his exhibits in its 06 August 2019 Resolution.[26] The Court then ordered the parties to file their respective memoranda.

Later, respondent filed a Manifestation[27] stating that he was adopting his arguments in his Answer as his Memorandum, while petitioner filed its Memorandum[28] on 07 October 2019. With the filing of the parties' memoranda, the Court submitted the case for decision in a Resolution dated 15 October 2019.[29]

ISSUES

As the parties so stipulated in their JSFI[30], the issues for this Court's resolution are:

[23] TSN dated 10 June 2019.
[24] Which he claimed he had vouched for randomly yet did not specify what those documents were.
[25] Filed on 16 June 2019, Division Docket, Volume II, pp. 539-544.
[26] Id., pp. 547-549.
[27] Id., pp. 550-552.
[28] Id., pp. 562-596.
[29] Id., p. 597.
[30] Stipulation of Issues, JSFI, Division Docket, Volume I, p. 185.

I.
WHETHER THE COURT HAS JURISDICTION OVER THE CASE.

II.
WHETHER PETITIONER IS LIABLE TO PAY THE DEFICIENCY TAXES AMOUNTING TO P8,878,629.89, REPRESENTING THE ALLEGED DEFICIENCY TAXES FOR INCOME TAX, VALUE-ADDED TAX, EXPANDED WITHHOLDING TAX, FINAL WITHHOLDING TAX, PLUS PENALTIES AND INTEREST.

ARGUMENTS

As to jurisdiction, petitioner is firm on its stand that this Court has jurisdiction over its petition as it timely filed the appeal within thirty (30) days from receipt of respondent's FDDA.

With respect to its alleged failure to submit relevant supporting documents before the BIR within sixty (60) days from the filing of the protest, petitioner maintains that the "relevant supporting documents" that must be submitted within sixty (60) days is for it to determine and decide on. According to it, the BIR can only inform the taxpayer to submit additional documents but it is without choice as to what specific documents should be submitted.

In opposing the assessment issued against it, which it insists has not attained finality, petitioner forwards the following specific justifications below for every item assessed (against it).

As to deficiency IT, it appears from Details of Discrepancies attached to the FLD that respondent disallowed the deduction of the management fee amounting to ₱6,020,150.00, pursuant to Section 34(A)[31] of the National Internal Revenue Code (**NIRC**) of 1997, as amended, as it arose from a service agreement with IICL that was outdated and should thus not apply to its 2012 operations.

Petitioner explains that the Service Agreement providing for the payment of management fee contains an automatic renewal clause for the successive periods beyond the initial one-year contract period. The

[31] **Sec. 34.** *Deductions from Gross Income. - ...*
(A) *Expenses. -*

payments made qualify as an allowable deduction for IT purposes as it originated from a valid contract, and were incurred during the TY and were directly attributable in the conduct of its business.

Additionally, as for the tax credit of ₱122,339.70 that was disallowed (for being unsupported with BIR Form No. 2307), petitioner concedes to the ICPA's findings that there was an unsubstantiated portion but only to the extent of ₱66,528.11 and not ₱122,339.70 as respondent had so found.

As regards the assessed VAT deficiency, the respondent's findings of VAT deficiency resulted from two items: (1) scrap sales amounting to ₱1,945,156.00; and, (2) interest income from loan receivable totaling to ₱2,520,000. Both items were apparently not included in the VAT returns, thus, were considered as undeclared sales.

In refutation, petitioner contends that the scrap sales were included in the VAT returns and were accordingly subjected to VAT. Moreover, the interest income from loan receivable is not subject to VAT as it cannot be considered as incidental to its business. It argues that it is not engaged in the business of lending, dealing in securities, or financing services for it to qualify under Revenue Regulations (**RR**) No. 12-2003[32] or performing similar functions.

With respect to the EWT, petitioner again yields to the ICPA's findings that there is deficiency EWT but only to the extent of ₱87,016.53, exclusive of interest and surcharge.

According to petitioner, as regards the EWT, the right of respondent to assess the same has already prescribed for the most part of 2012 as the FLD was issued only on 08 December 2015 or beyond the three-year prescriptive period pursuant to Section 203[33] of the NIRC of

32 *Amending Certain Provisions of Revenue Regulation No. 18-99 Implementing Section 5 of Republic Act No. 8424, otherwise known as the Tax Reform Act of 1997, and other pertinent provisions of the National Internal Revenue Code of 1997 imposing VAT on services of banks, non-bank financial intermediaries and finance companies, beginning January 1, 2003 pursuant to Section 1 of Republic Act No. 9010.*

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

1997, as amended. Under Section 2.58(A)(2) of RR 2-98[34], as amended, the monthly remittance of EWT and FWT shall be made within ten (10) days after the end of each month, except for taxes withheld in December (which shall be filed on or before 15 January of the following year). However, for taxpayers enrolled in the BIR's Electronic Filing and Payment System (**eFPS**), the filing of the withholding tax shall be five (5) days later than the deadline set in RR 2-98.

Anent the FWT, petitioner also contends that this assessed item is unsupported either in the RR 2-98 or under the RP-Japan Tax Treaty. The IICL's scope of provided services pertains primarily to management and sales support, and not to payment of royalties. In relation thereto, it distinquishes royalties from business profits, pointing out that its services should be considered business profits considering that there was no transfer of "know-how". As the services are considered business profits, the management fee should be exempt from FWT absent any showing that IICL has a permanent establishment in the Philippines. The absence of permanent establishment was supported by the Certificate of Non-Registration issued by the SEC, Certificate of Tax Residency and IICL's Articles of Incorporation. Further, the Service Agreement provides that the services are to be rendered outside the Philippines.

Lastly, as to the Compromise Penalty, petitioner insists on its cancellation as there was no mutual agreement or compromise with respondent.

Respondent, for his part, counters that the Court has no jurisdiction over the case mainly because the assessment has already become final, executory and unappealable for petitioner's failure to submit the relevant supporting documents within sixty (60) days from filing of protest.

---

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-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.

34 *Implementing Republic Act No. 8424, "An Act Amending the National Internal Revenue Code, as Amended" Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes.*

Anent the issue of prescription, respondent contends that the period to assess EWT has not yet prescribed. The three-year prescriptive period allegedly extends only to internal revenue taxes and does not apply to penalties imposed on withholding agents for failure to remit the taxes withheld. The amount sought to be collected from a withholding agent is a form of penalty and not a tax imposition.

Moreover, respondent argues that the assessment issued against petitioner has factual and legal bases, and presumption of the correctness of assessment remains on his side. It is up to petitioner to discharge its burden to provide contrary evidence (in contesting the validity or correctness of the assessment) and prove that he erred.

RULING OF THE COURT

After a careful examination of the parties' contrasting arguments, the Court finds partial merit in petitioner's claims.

Before the Court proceeds to tackle the items of assessment assailed, it deems propitious to first settle respondent's attack on its jurisdiction over the case.

As the records show, respondent assails the jurisdiction of the Court on the basis that the assessment has attained finality for petitioner's failure to submit relevant documents within sixty (60) days from the filing of the protest. Respondent considered petitioner's protest as one for reinvestigation and advised taxpayer to submit relevant supporting documents within sixty (60) days pursuant to Section 228[35] of the NIRC of 1997, as amended, and as implemented by RR 12-99[36] and subsequently RR 18-2013.[37] Thus, respondent is of the

---

35 **Sec. 228.** *Protesting of Assessment.* – ...

...

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.

...

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

view that the assessment against petitioner has attained finality and no longer open for appeal.

We disagree.

Petitioner's protest actually had its Service Agreement with IICL appended to it. If respondent had deemed the same as not compliant, jurisprudence has settled that it is the taxpayer that decides what documents it will submit to support its protest. Although, admittedly, petitioner did not submit *additional* documents within the sixty (60) days, this does not affect the validity of the protest.

In *Commissioner of Internal Revenue v. First Express Pawnshop Company, Inc.*[38], the Supreme Court already rejected the argument that an assessment attains finality and becomes unappealable by a taxpayer's mere failure to submit supporting documents, thus:

> ...
> **We reject petitioner's view that the assessment has become final and unappealable. It cannot be said that respondent failed to submit relevant supporting documents that would render the assessment final because when respondent submitted its protest, respondent attached the GIS and Balance Sheet**. Further, petitioner cannot insist on the submission of proof of DST payment because such document does not exist as respondent claims that it is not liable to pay, and has not paid, the DST on the deposit on subscription.
>
> **The term "relevant supporting documents" should be understood as those documents necessary to support the legal basis in disputing a tax assessment as determined by the taxpayer. The BIR can only inform the taxpayer to submit additional documents. The BIR cannot demand what type of supporting documents should be submitted. Otherwise, a taxpayer will be at the mercy of the BIR, which may require the production of documents that a taxpayer cannot submit.**
> ...

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

38 G.R. Nos. 172045-46, 16 June 2009; Emphasis supplied.

Considering further that the instant Petition for Review has been filed within thirty (30) days from petitioner's receipt of the FDDA, the Court has jurisdiction over the case.

Proceeding to the merits of the assessment, the Court shall discuss the assessment for each tax item, in *seriatim*.

I. <u>INCOME TAX</u>

The deficiency assessment for IT resulted from the: (1) disallowance of management fee as expense; and, (2) disallowance of tax credits, detailed as follows:

...

Taxable income (loss) per ITR					₱	11,578,293.00
Add:	Disallowed Expenses – Management Fee					6,020,150.00
Total Taxable Income					₱	17,598,443.00
Tax Due (30%)					₱	5,279,532.90
Less:	Payments		₱	1,271,358.45		
	Creditable Withholding Tax			2,202,129.82		
	Total			3,473,488.27		
	Less:	Unsupported Creditable Withholding Tax		122,339.70		3,351,148.57
Basic Deficiency Tax					**₱**	**1,928,384.33**
Add:	Interest (4.16.13 to 12.01.15)					1,013,326.34
Total Amount Due					**₱**	**2,941,710.67**

...

A. DISALLOWED MANAGEMENT FEE - ₱6,020,150.00

Respondent's verification disclosed that the management fee amounting to ₱6,020,150.00 arose from a Service Agreement between petitioner and IICL (petitioner's parent company) that was outdated and could not apply to petitioner's 2012 operations. On that basis, respondent disallowed the said expense pursuant to Section 34(A)[39] of the NIRC of 1997, as amended.

---

[39] **Sec. 34.** *Deductions from Gross Income.* – ...

...

A perusal of the contract, however, shows that the Service Agreement contains an automatic renewal clause, to wit:

> ...
> Article 8. Term
>
> This Agreement shall be effective for a period of twelve (12) months commencing from the date it is signed by the parties, **subject to an automatic renewal for successive periods of one (1) year each**, unless either party provides to the Other Party a written notice to the contrary not later than one (1) month prior to expiration of the term, and the same shall apply to any successive extension.[40]
>
> ...

From the above, it is clear that the Service Agreement can still be applied to 2012 operation absent any evidence to the contrary.

A business expense to be deductible, must comply with the following requisites:

> ...
> The expense must be ordinary and necessary.[41]
> 1. It must be paid or incurred within the taxable year.[42]
> 2. It is connected with the trade or business.[43]
> 3. The tax required to be deducted and withheld therefrom has been paid.[44]

(A) *Expenses.* -
(1) *Ordinary and Necessary Trade, Business or Professional Expenses.* -
(a) *In General.* - There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession, including:
...
(iv) A reasonable allowance for entertainment, amusement and recreation expenses during the taxable year, that are directly connected to the development, <u>management and operation of the trade, business or profession of the taxpayer, or that are directly related to or in furtherance of the conduct of his or its trade</u>, business or exercise of a profession not to exceed such ceilings as the Secretary of Finance may, by rules and regulations prescribe, upon recommendation of the Commissioner, <u>taking into account the needs as well as the special circumstances, nature and character of the industry, trade, business, or profession of the taxpayer</u>: *Provided*, That any expense incurred for entertainment, amusement or recreation that is contrary to law, morals public policy or public order shall in no case be allowed as a deduction. (Underscoring supplied)

40 Emphasis supplied.
41 Section 34(A)(1)(a), NIRC of 1997, as amended.
42 Id.
43 Id.
44 Sections 57 and 58, id.; in relation to Section 2.58.5 of Revenue Regulations No. 2-98.

4. It must be substantiated by invoices, official receipts (ORs) or other adequate records.[45]
5. It must not be contrary to law, morals, public policy or public order.[46]

...

The <u>first</u>, <u>third</u>, and <u>sixth</u> requisites refer to the "ordinary and necessary expense" of the trade or business.

RR 9-83[47] defines *"ordinary"* as an expense that is normal, usual, or customary (in size and character) for the taxpayer's trade or business. On the other hand, *"necessary"* means an expense that is appropriate, and helps develop and maintain the taxpayer's business. It must be reasonable to expect business benefits to result from the expense.

In *Atlas Consolidated Mining & Development Corporation v. Commissioner of Internal Revenue*[48], the Supreme Court held that the determination of whether an expense is "ordinary and necessary" depends on the nature of the expenditure itself, as follows:

> ...
> While it is true that there is a number of decisions in the United States delving on the interpretation of the terms "ordinary and necessary" as used in the federal tax laws, no adequate or satisfactory definition of those terms is possible. Similarly, this Court has never attempted to define with precision the terms "ordinary and necessary." There are however, certain guiding principles worthy of serious consideration in the proper adjudication of conflicting claims. **Ordinarily, an expense will be considered "necessary" where the expenditure is appropriate and helpful in the development of the taxpayer's business. It is "ordinary" when it connotes a payment which is normal in relation to the business of the taxpayer and the surrounding circumstances. The term "ordinary" does not require that the payments be habitual or normal in the sense that the same taxpayer will have to make them often; the payment may be unique or non-recurring to the particular taxpayer affected.**

---

[45] Section 34(A)(1)(b), id.
[46] Section 34(A)(1)(c), id.
[47] *Supplemental Regulations to Revenue Regulations No. 6-82.*
[48] G.R. No. L-26911, 27 January 1981, 102 SCRA 246.

> There is thus no hard and fast rule on the matter. The right to a deduction depends in each case on the particular facts and the relation of the payment to the type of business in which the taxpayer is engaged. The intention of the taxpayer often may be the controlling fact in making the determination. **Assuming that the expenditure is ordinary and necessary in the operation of the taxpayer's business, the answer to the question as to whether the expenditure is an allowable deduction as a business expense must be determined from the nature of the expenditure itself, which in turn depends on the extent and permanency of the work accomplished by the expenditure.**[49]
>
> ...

This Court is convinced that the management fees that petitioner paid, as supported by the RCBC telegraphic transfers[50] to IICL, are ordinary and necessary expenses normally incurred by entities providing goods and services to PEZA-registered and export-oriented enterprises. Likewise, as provided in the Service Agreement between petitioner and IICL[51], the subject management fees are payments for the advertisement and promotion of petitioner's products manufactured in the Philippines (to potential clients in Japan and other countries outside the Philippines) and assistance in the procurement of raw materials and supplies from Japan, among others. In fact, petitioner is included in IICL's company brochure.[52] In addition, petitioner's products are also advertised in the building façade of IICL in Japan.[53]

As regards the <u>fourth</u> requisite, respondent claims that the payments it made to IICL are subject to FWT in accordance with RP-Japan Tax Treaty and pursuant to Section 57(A)[54] of the NIRC of 1997, as amended.

---

49 Emphasis supplied.

50 Exhibits "ICPA TL-1" to "ICPA TL-4".

51 Article 1 on Scope of Services. Exhibits "P-11" to "P-11.4".

52 Exhibits "ICPA BRO-1" to "ICPA BRO-5".

53 Exhibits "ICPA BIL-1".

54 **Sec. 57**. *Withholding of Tax at Source*. –
(A) *Withholding of Final Tax on Certain Incomes*. - Subject to rules and regulations the Secretary of Finance may promulgate, upon the recommendation of the Commissioner, requiring the filing of income tax return by certain income payees, the tax imposed or prescribed by Sections 24(B)(1), 24(B)(2), 24(C), 24(D)(1); 25(A)(2), 25(A)(3), 25(B), 25(C), 25(D), 25(E), 27(D)(1), 27(D)(2), 27(D)(3), 27(D)(5), 28(A)(4), 28(A)(5), 28(A)(7)(a), 28(A)(7)(b), 28(A)(7)(c), 28(B)(1), 28(B)(2), 28(B)(3), 28(B)(4), 28(B)(5)(a), 28(B)(5)(b), 28(B)(5)(c); 33; and 282 of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 58 of this Code.

On the contrary, petitioner claims that the management fees paid to IICL are not subject to FWT as they do not constitute royalty payments (there being no undivulged technical information involved or anything capable of being patented or not) and the services do not involve transfer of "know-how". Rather, the payments are in the nature of business profits rendered outside of the Philippines. Even assuming that the fees are Philippine-sourced, it is exempt pursuant to the RP-Japan Tax Treaty since IICL has no "permanent establishment" in the Philippines.

We agree with petitioner.

While generally, income of non-resident foreign corporations in the Philippines are subject to a 30% FWT[55], Section 32(B)(5) of the NIRC of 1997, as amended, recognizes the treaty obligations to which the Philippines is a signatory, *viz*:

> ...
>
> **Sec. 32.** *Gross Income.* -
>
> ...
>
> (B) *Exclusions from Gross Income.* – The following items shall not be included in gross income and shall be exempt from taxation under this Title:
>
> ...
>
> > (5) *Income Exempt under Treaty.* – **Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.**[56]
>
> ...

[55] **Sec. 28.** *Rates of Income Tax on Foreign Corporations.* -

...

(B) *Tax on Nonresident Foreign Corporation.* -

(1) *In General.* - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraph 5(c): *Provided*, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%). (Underscoring supplied)

...

[56] Emphasis supplied.

One of the treaties is the RP-Japan Tax Treaty that provides the types of income that the contracting states may earn with corresponding preferential rate or exemption, as the case may be; primarily to avoid double taxation on both taxing jurisdictions. The RP-Japan Tax Treaty is applicable where the parties are residents of the contracting states. Article 4 of the Tax Treaty provides:

> ...
>
> *Article 4*
>
> 1) For the purposes of this Convention, the term "resident of a Contracting State" means any person who, **under the laws of that Contracting State, is liable to tax therein by reason of his domicile, residence, place of head or main office, place of incorporation or any other criterion of a similar nature**. But this term does not include any person who is liable to tax in that Contracting State in respect only of income from sources therein.[57]
>
> ...

It is beyond question that petitioner is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines.[58] Clearly, it is a national of the Philippines by the definition found in Article 3(1)(h)(i) of the said RP-Japan Tax Treaty. It reads:

> ...
>
> Article 3
>
> 1. For the purposes of this Convention, unless the context otherwise requires:
>
> ...
>
> h) the term "nationals" means:
>
> (i) in relation to the Philippines, all individuals possessing the citizenship of the Philippines **and all juridical persons created or organized under the laws of the Philippines** and all organizations without juridical personality treated for the purposes of Philippine tax as juridical persons created or organized under the laws of the Philippines[.][59]
>
> ...

57 Emphasis supplied.
58 JSFI, Division Docket, Volume I, p. 184.
59 Emphasis supplied.

As to IICL, records disclose that it is indeed a resident of Japan within the contemplation of Article 3(1) of the same treaty, through the following documents:

> ...
>
> 1. Duly consularized Certificate of Tax Residency of Ishida Ironwork Co., Ltd. by the office of Philippine Embassy in Japan on 14 August 2013;[60]
> 2. Articles of Incorporation of Ishida Ironwork Co., Ltd.;[61] and,
> 3. Certification of Non-Registration of Company issued by the Philippine Securities and Exchange Commission ("SEC") on 03 June 2013, which certifies that its records do not show the registration of "Ishida Ironworks Co., Ltd." as a corporation or as a partnership.
>
> ...

In the determination of whether IICL's income should have been subjected to FWT, the said income must be properly classified based on the nature of the services rendered. Article 1 of the Service Agreement which enumerates the scope of services to be performed by IICL is reproduced below:

> ...
>
> Article 1. Scope of Services
>
> The Service Provider shall provide the Customer with the following services all of which shall be performed in Japan and/or other areas outside the Philippines, to wit:
>
> 1. Advertisement and promotion of the products manufactured by the Customer in the Philippines to potential clients in Japan and other countries outside the Philippines;
> 2. Assist in the procurement of raw materials and supplies in Japan with regard to quality and specifications;
> 3. Provide information regarding the status of the steel industry in Japan and other countries outside the Philippines;
> 4. Review the financial and other aspects of operation; and[,]
> 5. Formulate marketing and business strategy for the Customer.
>
> (Hereinafter collectively referred to as the "Services")

60 Exhibits "ICPA RES-1.10" to "ICPA RES-1.19".
61 Exhibits "ICPA RES-1.1" to "ICPA RES-1.9".

> **The above-enumerated offshore services shall in no case involve the transfer of any of the Service Provider's technology, know-how or other intellectual property rights.**
>
> The employees and personnel of the Service Provider shall exclusively perform the services for the Customer in Japan or in other countries outside the Philippines. Should it be necessary for the Service Provider to send its employees to the Philippines, the stay of these individuals shall not in any case exceed the period of six (6) months.[62]
>
> ...

For the services, petitioner is bound to pay IICL a monthly fee of Nine Hundred Fifty Thousand Japanese Yen (¥950,000.00). The management fee shall be paid every 25th day of succeeding quarter through bank telegraphic transfer.[63]

It is noteworthy that the FLD, FDDA and respondent's Answer are unclear as to the basis of the FWT assessment. From the amount of deficiency FWT, it appears that respondent imposed a 25% rate[64], thus suggesting that the services were considered as royalties.

The relevant provisions of the RP-Japan Tax Treaty, as amended, read:

> ...
>
> *Article 12*
>
> 1) **Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other Contracting State.**
>
> 2) *However, such royalties may also be taxed in the Contracting State in which they arise, and according to the laws of that Contracting State, but if the recipient is the beneficial owner of the* ***royalties the tax so charged shall not exceed:***

---

62 Emphasis supplied.
63 Article 2. Service Fees of the Service Agreement.
64 *Convention between the Republic of the Philippines and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income,* effective beginning 01 January 1981.

a) 15 per cent of the gross amount of the royalties if the royalties are paid in respect of the use of or the right to use cinematograph films and films or tapes for radio or television broadcasting;

b) 10 per cent of the gross amount of the royalties in all other cases.[65]

...

4) **The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work** including cinematograph films and films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.[66]

5) The provisions of **paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein**, or performs in that other Contracting State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of **Article 7 or Article 14, as the case may be, shall apply.**[67]

...

Article 7

1. **The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on a business in the other Contracting State through a permanent establishment situated therein.** If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in that other Contracting State but only so much of them as is attributable to that permanent establishment.[68]

...

---

65 Paragraph 2 of Article 12 was amended in *Protocol Amending the Convention Between the Republic of the Philippines and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income,* effective 01 January 2009. (Emphasis supplied and italics in the original text)

66 Emphasis supplied.

67 Emphasis supplied.

68 Emphasis supplied.

As gleaned from the provisions on royalties and business profits, the former is more restrictive in the sense that it requires a transfer of know-how, whereas the latter is more encompassing. Notably, the Service Agreement stipulates that the offshore services shall in no case involve the transfer of any "technology, know-how or other intellectual property rights".

The *Commentaries on the 2010 Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital* provides a useful guide in distinguishing royalties from business profits, thus:

> ...
>
> 11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 is referring to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how. The words "**payments ... for information concerning industrial, commercial or scientific experience" are used in the context of the transfer of certain information that has not been patented and does not generally fall within other categories of intellectual property rights**. It generally corresponds to **undivulged information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived**. Since the definition relates to information concerning previous experience, the Article does not apply to payments for new information obtained as a result of performing services at the request of the payer.
>
> 11.1 In the know-how contract, **one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public**. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.
>
> 11.2 This type of contract thus differs from contracts for the provision of services, **in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party**. Payments made under the latter contracts generally fall under Article 7.

> 11.3 The need to distinguish these two types of payments, i.e. payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:
>
> - Contracts for the supply of **know-how concern information of the kind described in paragraph 11 that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.**
>
> - In the case of contracts for the provision of services, the supplier **undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.**
>
> - In most cases involving the **supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material.** On the other hand, **a contract for the performance of services would, in the majority of cases, involve a very much greater level of expenditure by the supplier in order to perform his contractual obligations.** For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.[69]
>
> ...

From the foregoing comparison, read parallel with the scope of the services in the Service Agreement, the Court is inclined to rule that the services performed by IICL is in the nature of business profits.

Under the RP-Japan Tax Treaty, the payments for business profits are exempt, unless IICL maintains a "permanent establishment" in the Philippines. A permanent establishment under Article 5 of the RP-Japan Tax Treaty is:

---

[69] OECD Model Tax Convention on Income and Capital, Condensed Version, July 2010, pp. 225-226.

...

Article 5

1) For the purposes of this Convention, the term "**permanent establishment" means a fixed place of business** through which the business of an enterprise is wholly or partly carried on.
2) The term "permanent establishment" includes especially:
   a) a store or other sales outlet;
   b) a branch;
   c) an office;
   d) a factory;
   e) a workshop;
   f) a warehouse;
   g) a mine, an oil or gas well, a quarry or other place of extraction of natural resources.[70]

...

The case records are bereft of evidence showing that IICL has a "permanent establishment" here in the Philippines. Moreover, it can be deduced from the Service Agreement itself that there is no intention to keep any "permanent establishment". To assume otherwise would mean that the parties breached their agreement. Likewise, it bears stressing that respondent did not even mention that IICL has a "permanent establishment", hence subject to FWT.

In sum, We find that the management fees paid to IICL are not subject to FWT as the services rendered offshore are in the nature of business profits.

With respect to the <u>second</u> and <u>fifth</u> requisites, the payment of management fees to IICL amounting to ₱6,020,150.00 was supported with RCBC telegraphic transfers and invoices issued by IICL[71], to wit:

Invoice Date	Exhibit No.	Amount in JPY	Telegraphic Transfer Date	Exhibit No.
April 10, 2012	ICPA JINV-1	2,850,000	April 30, 2012	ICPA TL-1
July 10, 2012	ICPA JINV-2	2,850,000	July 31, 2012	ICPA TL-2
October 10, 2012	ICPA JINV-3	2,850,000	October 28, 2011	ICPA TL-3

70 Emphasis supplied.
71 Supra at note 50.

January 10, 2013	ICPA JINV-4	2,850,000	January 30, 2013	ICPA TL-4
TOTAL		**11,400,000**		

The above documents, including the Service Agreement, are indicative of the actual payments made to IICL amounting to JPY11,400,000 – JPY2,850,000 paid in 2011; JPY5,700,000 paid in 2012; and JPY2,850,000 paid in 2013 for the expenses that were accrued in 2012.

Anent the above, Section 11(2)(f) of RR 6-2006[72] provides that:

> ...
> **For foreign currency income and expense items recognized in the reporting period, for each period presented (i.e., including comparatives), translation should be based on exchange rates at the dates of the transactions.** For practical reasons, a rate that approximates the actual exchange rates at the dates of the transactions, for example, an average rate for the period may be used to translate foreign currency income and expense items[.][73]
> ...

Per this Court's own verification, it finds that petitioner was able to substantiate the amount of ₱4,397,550.00 in accordance with Section 34(A)(1)(b) of the NIRC of 1997[74], as amended, computed as follows:

Exhibit No.	Telegraphic Transfer Date	Amount in JPY	Monthly BSP end-of-period (EOP) exchange rate[75]	Amount in PHP
ICPA TL-1	April 30, 2012	2,850,000	0.5282	1,505,370
ICPA TL-2	July 31, 2012	2,850,000	0.5361	1,527,885

---

72 *Regulating the Use of Functional Currency Other than the Philippine Peso in Financial Statements that will be Submitted and in the Books of Accounts that will be Maintained for Internal Revenue Tax Purposes.*

73 Emphasis supplied.

74 Supra at note 39.
(b) Substantiation Requirements. – No deduction from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer.

75 http://www.bsp.gov.ph/statistics/excel/pesocross.xls. per data accessed on 17 August 2020.

ICPA TL-4	January 30, 2013	2,850,000	0.4787[76]	1,364,295
		8,550,000		**4,397,550**

As regards the payment made for the Billing Invoice dated 10 October 2012[77] (relative to the management fees for the third quarter of 2012), the Court cannot verify the actual payment of the said expense. Petitioner's telegraphic transfer pertains to the third quarter of TY 2011 dated 28 October 2011.[78] There is a discrepancy between the handwritten date showing "10/28/12" and the machine validation date of "10/28/2011". Moreover, at the bottom portion of the form, the purpose stated was *"Payments for management fee for 3rd Quarter 2011"*.[79] Hence, only the unsubstantiated management fees in the amount of ₱1,622,600.00 (₱6,020,150.00 less ₱4,397,550.00) should be disallowed as deductions from gross income.

B. UNSUPPORTED CREDITABLE WITHHOLDING TAX - ₱122,339.70

Per respondent's verification, tax credits amounting to ₱122,339.70 were not fully substantiated with BIR Form No. 2307 hence were disallowed in violation of the provision of Section 2.58.3(B)[80] of RR 2-98.[81]

On the other hand, based on the ICPA's examination, out of the total creditable withholding tax (**CWT**) at source claimed in TY 2012 amounting to ₱2,202,129.00, only ₱2,135,601.71 were supposedly substantiated by individual CWT certificates.[82]

76 *Using the exchange rate on the last business day of the year it was accrued – 2012.* The Audited Financial Statements of petitioner did not disclose the exchange rate used in converting the management fees paid to peso.
77 Exhibit No. "ICPA JINV-3".
78 Exhibit No. "ICPA TL-3".
79 Id.
80 **SEC. 2.58.3**. *Claim for Tax Credit or Refund.* –
...
(B) Claims for tax credit or refund of any creditable income tax which was deducted and withheld on income payments shall be given due course only when it is shown that the income payment has been declared as part of the gross income and the fact of withholding is established by a copy of the withholding tax statement duly issued by the payor to the payee showing the amount paid and the amount of tax withheld therefrom.
...
81 Supra at note 34.
82 Annex A, ICPA Report, Exhibits "P-9" to "P-9.34".

Upon further scrutiny of the submitted CWT certificates, together with the ICPA's report, the Court finds that no valid CWT certificates supported the amounts below:

Payor's Name	CWT	ICPA Exhibit
Certificates issued were not signed by the payor/payor's authorized representative		
CLC Marketing Ventures Corporation	10,135.31	"ICPA CWTQ1-6"
Far Eastern Hardware & Furniture Enterprises, Inc.	1,044.65	"ICPA CWTQ1-15"
Greyhound Marketing Corporation	898.10	"ICPA CWTQ1-24"
Greyhound Marketing Corporation	522.72	"ICPA CWTQ3-17"
Subtotal	**12,600.78**	
No payee's TIN is indicated in the certificate		
Fabricator Phils Inc.	867.00	"ICPA CWTQ2-46"
Fabricator Phils Inc.	2,192.38	"ICPA CWTQ2-70"
Fabricator Phils Inc.	2,402.71	"ICPA CWTQ3-35"
Fabricator Phils Inc.	1,306.70	"ICPA CWTQ4-10"
Fabricator Phils Inc.	895.66	"ICPA CWTQ4-44"
Fabricator Phils Inc.	879.24	"ICPA CWTQ4-60"
Subtotal	**8,543.69**	
Payee's TIN indicated in the certificate is not that of the petitioner		
Fabricator Phils Inc.	278.48	"ICPA CWTQ1-13"
Fabricator Phils Inc.	2,478.33	"ICPA CWTQ1-82"
Fabricator Phils Inc.	308.30	"ICPA CWTQ2-12"
Valerie Products Mfg. Inc.	158.00	"ICPA CWTQ3-27"
Subtotal	**3,223.11**	
TOTAL	**24,367.58**	

The rule is that "the fact of withholding is established by a copy of the withholding tax statement duly issued by the payor to the payee".[83] Thus, insofar as the CWT certificates that were not signed by the payor or payor's authorized representative/s are concerned, they should be denied for they were not issued in accordance with the said rule.

With respect to the CWT certificates where the payee's TIN was not petitioner's or that no payee's TIN was indicated therein, denial should be expected in the light of this Court's consistent pronouncements in *Zuellig Pharma Corporation v. Commissioner of Internal Revenue*[84], citing *Commissioner of Internal Revenue v. Philippine Bank of Communications*[85], where We held:

> ...
>
> **This Court has previously discussed why CWT certificates without the claimant's TIN are properly disallowed.** In the case of *Commissioner of Internal Revenue vs. Philippine Bank of Communication,* the Court *en banc* declared:
>
> > "x x x [A] claim for tax refund or credit, like a claim for tax exemption, is construed strictly against the taxpayer. **It must be kept in mind that the TIN serves as identification of taxpayers in relation to their payment with the BIR. Absent this, even with the taxpayer's name, it cannot be verified if indeed the taxpayer paid the correct amount to the government.** Well entrenched in our jurisprudence is that tax refunds are in the nature of tax exemptions. As such, they are regarded as in derogation of sovereign authority and to be construed strictissimi juris against the person or entity claiming the exemption. Accordingly, the claimant has the burden of proof to establish the factual basis of his or her claim for tax credit or refund.
> >
> > **Thus, the certificates with corrections not properly countersigned and with incomplete details, such as absence of PBCom's TIN, are properly disallowed.**"

[83] Section 2.58.3(B) of RR 2-98, as amended, supra at note 34.
[84] CTA EB Nos. 1793 and 1794, 01 October 2019.
[85] CTA EB Nos. 1421 and 1423, 23 May 2017.

> Thus, *We* uphold the Court in Division's ruling to disallow petitioner's CWT in the amount of ₱10,144,896.40 for being supported by CWT certificates with incorrect TIN.[86]
>
> ...

Since petitioner was only able to support with duly accomplished CWT certificates the amount of ₱2,111,234.13 (₱2,135,601.71 less ₱24,367.58) of its CWT for TY 2012, it is to this extent that it may validly claim a tax credit against its IT liability. Consequently, a total of ₱90,895.69 (₱2,202,129.82 less ₱2,111,234.13) tax credits must be disallowed for IT purposes.

In conclusion, petitioner should be held liable for basic deficiency IT in the amount of <u>₱577,675.32</u>, computed as follows:

Taxable income (loss) per ITR					₱	11,578,293.00
Add:	Disallowed Expenses - Management Fee					1,622,600.00
Total Taxable Income					₱	13,200,893.00
Tax Due (30%)					₱	3,960,267.90
Less:	Payments		₱	1,271,358.45		
	Creditable Withholding Tax			2,202,129.82		
	Total			3,473,488.27		
	Less:	Unsupported Creditable Withholding Tax		90,895.69		3,382,592.58
Basic Deficiency Tax					₱	577,675.32

II. <u>VALUE-ADDED TAX</u>

Based on the records, petitioner was assessed of deficiency VAT in the amount of ₱2,820,595.43, with ₱1,797,341.71 as basic deficiency VAT and ₱1,023,253.72 as interest, respectively, computed as follows:[87]

[86] Citation omitted, emphasis supplied and emphasis in the original text.

[87] Exhibit "P-5", Division Docket, Volume I, p. 453.

Taxable Sales per VAT Returns filed				₱	166,087,393.00
Add:	Undeclared Sales - Scrap Sales	₱	1,945,156.00		
	Interest Income from Loan Receivable		2,520,000.00		4,465,156.00
Total Revenues subject to VAT				₱	170,552,549.00
Output Tax (12%)				₱	20,466,305.88
Less:	Input Tax Claimed per VAT Returns filed	₱	98,708,795.97		
	Less: Excess input tax carried over to the succeeding quarter		79,908,098.44		
	Input tax on capital assets		131,733.36		18,668,964.17
Basic Deficiency Tax				₱	1,797,341.71
Add:	Interest (1.26.13 to 12.01.15)				1,023,253.72
Total Amount Due				**₱**	**2,820,595.43**

Respondent assessed petitioner of deficiency VAT based essentially on these items, to wit:

Item	Amount
Undeclared scrap sales	₱1,945,156.00
Undeclared interest income from Loan Receivable	2,520,000.00

A. UNDECLARED SCRAP SALES
– ₱1,945,156.00

Respondent's verification showed that scrap sales amounting to ₱1,945,156.00 were not declared in petitioner's VAT returns for TY 2012. Petitioner, on the other hand, contends that the scrap sales were subjected to VAT and were reported in its monthly/quarterly VAT returns.

We uphold respondent's assessment.

Sections 106 and 108 of the NIRC of 1997, as amended, provide:

...
Sec. 106. *Value-Added Tax on Sale of Goods or Properties.* -

(A) *Rate and Base of Tax.* - There shall be levied, assessed and collected on **every sale, barter or exchange of goods or properties, value-added tax equivalent to ten percent (10%) (now 12%) of the gross selling price** or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor...

...

> **The term "*gross selling price*" means the total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax.** The excise tax, if any, on such goods or properties shall form part of the gross selling price.[88]
>
> ...
>
> **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%) (now 12%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties...
>
> ...
>
> **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.**[89]
>
> ...

Clearly from the foregoing, the VAT on the sale of goods or properties accrues upon the consummation of sale regardless of whether the consideration thereof was actually received. On the other hand, the VAT on the sale of services, use or lease of properties accrues upon actual or constructive receipt of the consideration irrespective of whether the service has been rendered pursuant to Section 108 of the NIRC of 1997, as amended, as quoted above.

In other words, for VAT purposes, the accrual method of accounting (i.e., the income is reported in the period it is earned without regard to whether it has been received or not) must be employed in the case of sale of goods or properties while the cash method accounting (i.e., the income is reported based on gross receipts/collection) must be adopted for sale of services, lease or use of properties.[90]

---

[88] Emphasis supplied.
[89] Emphasis supplied.
[90] *Deutsche Knowledge Services Pte. Ltd. v. Commissioner of Internal* Revenue, CTA E.B. Case No. 1145, 09 June 2015.

In the instant case, it is undeniable that petitioner is engaged in the sale of goods such as stainless steel pipes and tubings, ordinary steel pipes and tubings, structural steel and other metallic goods of similar nature, and any and all equipment, materials, supplies used or employed in or related to the manufacture of such finished products.[91]

Petitioner's Audited Financial Statements (**AFS**) likewise states that its revenue recognition for sale of goods is on accrual basis, such as when the risks and rewards of ownership of the goods have passed to the buyer, i.e., generally when the customer has acknowledged delivery of the goods.[92] A careful examination of petitioner's pieces of evidence would reveal the following differences:

	Per AFS[93]	**Per Amended VAT Returns[94]**	**Difference**
Taxable Sales			
Sale of goods	₱166,087,393.00	₱165,808,174.54	₱279,218.46
Scrap Sales	1,945,156.00	-	1,945,156.00
Zero-rated Sales	66,806,233.00	69,032,040.62	(2,225,807.62)
Total	**₱234,838,782.00**	**₱234,840,215.16**	**₱(1,433.16)**

Petitioner claims further that the total amount of taxable sales *per* Amended VAT Returns of ₱165,808,174.54 includes the subject scrap sales of ₱1,945,156.00. However, its pieces of evidence such as the Scrap Sales Receipt[95], Scrap Sales schedule[96], Schedule of 2011[97], 2012[98] and 2013[99] VATable Sales Invoices, and Credit Memos[100] are insufficient to prove that the corresponding output VAT on the said scrap sales were indeed declared and remitted in 2012. Petitioner should have presented the Amended Summary Lists of Sales that would tally with the total amount of sales subject to VAT.

91 Exhibits "ICPA CER-1" to "CER-1.13".
92 Exhibit "ICPA AFS-13".
93 Exhibit "ICPA AFS-31".
94 Exhibit "R-16", pp. 348-375.
95 Exhibits "ICPA SSR-1" to "ICPA SSR-40.1".
96 Annex AI, ICPA Report.
97 Exhibits "ICPA S2011" to "ICPA S2011-1".
98 Exhibits "ICPA VSQ1-1" to "VSQ4-253".
99 Exhibits "ICPA S2013" to "ICPA S2013-1".
100 Exhibits "ICPA CMVS-1" to "ICPA CMVS-71".

It is noteworthy that despite petitioner's voluminous documents, there remains an unaccounted variance of ₱1,433.86 as shown below[101]:

	Vatables Sales	Zero Rated	TOTAL
Regular Sale of Goods	163,861,584.88	69,032,040.62	232,893,625.51
Scrap Sales	1,945,155.80	-	1,945,155.80
Unaccounted variance	1,433.86	-	1,433.86
TOTAL	**165,808,174.54**	**69,032,040.62**	**234,840,215.17**

Moreover, the Supplementary Information Requirements under RR 15-2010 Disclosure in the AFS (Note 19.1)[102] clearly provides the following:

> ...
>
> *(b) Input VAT*
>
> The movement of input VAT in 2012 is summarized below:
>
> | | | |
> |---|---|---|
> | Balance at beginning of year | ₱ | 78,270,263 |
> | Goods for resale/manufacture or further processing | | 17,456,851 |
> | Goods other than for resale or manufacture | | 1,370,742 |
> | Capital goods not subject to amortization | | 759,483 |
> | Services lodged under cost of goods sold | | 823,960 |
> | Services lodged under other accounts | | 1,522,439 |
> | **Applied against output VAT** | | **(20,163,906)**[103] |
> | Balance at end of the year | ₱ | 80,039,832 |
>
> ...

Petitioner should have reconciled and substantiated the difference between the amount of Taxable Sales and Zero-Rated Sales as disclosed in its AFS and the amounts reported in the Amended VAT Returns.

With the above and with the burden of proof imposed upon the complaining party to show clearly that the assessment is erroneous,

101 Annex AH, ICPA Report.
102 Exhibit "ICPA AFS-31".
103

	Sales	12% VAT
Regular Sale of Goods	₱ 166,087,393.00	₱ 19,930,487.16
Scrap Sales	1,945,156.00	233,418.72
Total	**₱ 168,032,549.00**	**₱ 20,163,905.88**

failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.[104] Accordingly, respondent's assessment finding the amount of ₱1,945,156.00 subject to VAT shall be sustained.

B. UNDECLARED INTEREST INCOME FROM LOAN RECEIVABLE – ₱2,520,000.00

As to the deficiency VAT on assessed on petitioner's interest income from loans extended to Ishida Realty Company, Inc. (**IRCI**), it insists that no legal or factual basis support the same. According to it, it is not incidental to the primary purpose of the company and it is not, in any way, engaged in lending, dealing in securities or financing services or performing similar functions, for it to qualify under RR 12-2003.[105]

The Court remains unconvinced.

Section 105[106] of the NIRC of 1997, as amended, provides that any person who in the course of trade or business, sell, barter, exchange, lease goods or properties, render services, and any person who import goods is liable to VAT. *'In the course of trade* or *business'* refers to regular conduct or pursuit of a commercial or an economic activity, including transactions *incidental* thereto.[107] Thus, transactions undertaken incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business.[108] *'Incidental'* means subordinate to something of greater importance.[109]

---

104 *Marcos II v. Court of Appeals, et al.*, G.R. No. 120880, 05 June 1997.

105 Supra at note 32.

106 **Sec. 105.** *Persons Liable.* – Any person who, in the course of trade or business, sells[,] barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.

...

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

...

107 *Commissioner of Internal Revenue v. Court of Appeals and Commonwealth Management and Services Corporation*, G.R. No. 125355, 30 March 2000, 329 SCRA 237. (Italics supplied)

108 Eufrocina M. Sacdalan-Casasola, National Internal Revenue Code (Annotated), 2013 Edition, p. 761.

109 Black's Law Dictionary, 8th ed., p. 2226.

In *Mindanao II Geothermal Partnership v. Commissioner of Internal Revenue*[110], the Supreme Court explained the meaning of an "incidental" transaction, to wit:

> ...
>
> Mindanao II asserts that the sale of a fully depreciated Nissan Patrol is not an incidental transaction in the course of its business; hence, it is an isolated transaction that should not have been subject to 10% VAT.
>
> ...
>
> Mindanao II relies on *Commissioner of Internal Revenue v. Magsaysay Lines, Inc. (Magsaysay)* and *Imperial v. Collector of Internal Revenue (Imperial)* to justify its position. *Magsaysay*, decided under the NIRC of 1986, involved the sale of vessels of the National Development Company (NDC) to Magsaysay Lines, Inc. We ruled that the sale of vessels was not in the course of NDC's trade or business as it was involuntary and made pursuant to the Government's policy for privatization. *Magsaysay*, in quoting from the CTA's decision, imputed upon *Imperial* the definition of "carrying on business." *Imperial*, however, is an unreported case that merely stated that "'to engage' is to embark in a business or to employ oneself therein."
>
> Mindanao II's sale of the Nissan Patrol is said to be an isolated transaction. However, it does not follow that an isolated transaction cannot be an incidental transaction for purposes of VAT liability. **Indeed, a reading of Section 105 of the 1997 Tax Code would show that a transaction "in the course of trade or business" includes "transactions incidental thereto." Mindanao II's business is to convert the steam supplied to it by PNOC-EDC into electricity and to deliver the electricity to NPC. In the course of its business, Mindanao II bought and eventually sold a Nissan Patrol. Prior to the sale, the Nissan Patrol was part of Mindanao II's property, plant, and equipment. Therefore, the sale of the Nissan Patrol is an incidental transaction made in the course of Mindanao II's business which should be liable for VAT.**
>
> ...

Applying the foregoing jurisprudence, this Court, in the case of *CS Garments, Inc. v. Commissioner of Internal Revenue*[111] (**CS Garments**) held that, although the primary business of CS Garments is

---

[110] 706 Phil. 48 (2013); Citations omitted and emphasis supplied.
[111] CTA EB Case No. 287, 14 January 2008.

the manufacturing of garments for sale abroad, the sale of motor vehicle to its general manager is considered an incidental transaction subject to VAT for it was purchased and used in carrying out petitioner's business, thus:

> ...
>
> Here, petitioner's primary business is the manufacturing of garments for sale abroad. In carrying-out its business, petitioner acquired and eventually sold a Mercedes Benz to its General Manager Mr. Sudhoff. Prior to the sale, the motor vehicle formed part of petitioner's capital assets, specifically under the account, "Property, Plant and Equipment". The Rules on International Accounting Standards (IAS) defines Property, Plant and Equipment as follows:
>
> > "6. Definitions
> > Property, plant and equipment are tangible assets that:
> >
> > (a) are held by an enterprise **for use in the production or supply of goods or services, for rental to others, or for administrative purposes**; and
> >
> > (b) are expected to be used during more than one period."
>
> **Therefore, the sale of the motor vehicle is an incidental transaction because the said vehicle was purchased and used in furtherance of petitioner's business.**
>
> Once an activity has been identified as a business, any supply[sale] made while carrying it on is likely to be made in the course or furtherance of business. No distinction is made between capital and revenue items. Thus, a supply[sale] in the course or furtherance of business includes: (1) *the disposition of the assets and liabilities of a business*, (2) the disposition of a business as going concern; and (3) anything done in connection with the termination or intended termination of a business.[112]
>
> ...

[112] Citation omitted, emphasis supplied and italics in the original text.

Moreover, citing this Court's ruling in *CS Garments*, the BIR issued Revenue Memorandum Circular (**RMC**) No. 15-2011[113], revoking the prior ruling for Interadent Zahntechnik Phils. Incorporated (**IZPI**), exempting the sale of its company car from VAT inasmuch as its regular line of business is the manufacturing and export of custom-made dental products (it follows that it may only be subjected to 12% VAT on sales related to this kind of business activity). Further, that there is nothing to indicate that IZPI's sale of its company cars is made on regular basis or even incidental to the manufacturing and/or export of dental products.

In the instant case, petitioner's AFS[114] shows that the subject interest income arose from the unsecured loan to IRCI, to wit:

> ...
>
> **16. RELATED PARTY TRANSACTIONS**
>
> *16.2 Lease Agreement*
>
> Since 2003, the Company leases land from Ishida Realty Company, Inc. (IRCI), a related party under common control. The lease term is **for a period of 15 years** up to July 31, 2018, renewable thereafter upon mutual agreement by both parties. The agreed monthly rental is P230,000 for the first three years which is subject to review and renegotiation thereafter. In 2012 and 2011, monthly rental did not change at P230,000. **Rental expenses charged to operations amounted to P2,760,000 both in 2012 and 2011 and are shown as part of Cost of Goods Sold and Other Operating Expenses** in the statements of income (see Notes 11 and 12). There were no outstanding liabilities from this transaction as of December 31, 2012 and 2011.
>
> *16.3 Loan Receivable*
>
> On September 4, 2003, the Company granted a P21,000,000 unsecured loan to IRCI, **which was used by the latter to purchase a parcel of land being leased to the Company.** The loan, **payable in 15 years**, bears fixed interest of 12% per annum. The loan remained outstanding as December 31, 2012 and 2011 and is presented as Loan Receivable in the statements of financial position. Total interest income earned from this loan, included as part of the Finance Income account in the statements of income amounted to

---

113 Revocation of BIR Ruling DA-563-2006 dated September 19, 2006 pursuant to CTA E.B. Case No. 287 dated January 14, 2008.

114 Exhibit "ICPA AFS-29".

> P2,520,000 in 2012 and 2011 (see Note 13). The outstanding interest receivable amounted to P210,000 as December 31, 2012 and 2011 and are presented as part of Others under Trade and Other Receivables account in the statements of financial position (see Note 5).[115]
>
> ...

A scrutiny of petitioner's AFS yields that it has no Land and/or Building Account under Non-Current Assets. This implies that petitioner's principal place of business and registered office is situated at the leased land from IRCI. The same is reinforced by the fact that rental payments to IRCI were charged as manufacturing overhead, which is part of the Cost of Goods Sold.[116] Interestingly too, the original lease term and the loan term coincide at fifteen (15) years. These circumstances would indicate that the loan extended to IRCI is incidental to petitioner's business, thus subject to VAT.

Even *assuming arguendo* that the loan is not incidental to its business, the payments received are still subject to VAT. An examination of the documents supporting the interest payments from IRCI reveals that petitioner have receipted them with VAT official receipts (**ORs**).[117]

In accordance with Section 113[118] of the NIRC of 1997, as amended, if a VAT-registered person issues a VAT invoice or VAT OR for a VAT-exempt transaction, but fails to display prominently on the invoice or receipt the words "*VAT-exempt sale*", or issue a non-VAT

---

115 Emphasis supplied.

116 Exhibit "ICPA AFS-23".

117 Exhibits "ICPA OR-1" to "ICPA OR-13".

118 **Sec. 113**. *Invoicing and Accounting Requirements for VAT-Registered Persons.* –

...

(B) *Information Contained in the VAT Invoice or VAT Official Receipt.* – The following information shall be indicated in the VAT invoice or VAT official receipt:

...

> (2) The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax: *Provided*, That:
>
> ...
>
> > (b) If the sale is exempt from value-added tax, the term **'VAT-exempt sale'** shall be written or printed prominently on the invoice or receipt;

...

(D) *Consequence of Issuing Erroneous VAT Invoice or VAT Official Receipt.* –

> ...
>
> (2) If a VAT-registered person Issues a VAT invoice or VAT official receipt for a VAT-exempt transaction, but fails to display prominently on the invoice or receipt the term 'VAT-exempt sale', **the issuer shall be liable to account for the tax imposed in Section 106 or 108 as if Section 109 did not apply.**

acknowledgement receipt in the case of reimbursable expenses[119], the transaction shall become taxable and the issuer shall be liable to pay VAT thereon.

As found by the ICPA, the total amount of interest payments receipted with VAT ORs and which petitioner received in TY 2012 is ₱2,730,000.00.[120] Hence, We sustain the assessment for VAT arising from income from loan receivable.

Relative to the aforementioned, the Court is, however, constrained to revise the other amounts i.e., Taxable Sales *per* VAT Returns filed and Input Tax Claimed *per* VAT Returns filed, to reflect the updated amounts *per* Amended VAT Returns that were filed on 14 February 2014[121], to wit:

Taxable Sales per VAT Returns filed					₱	165,808,174.54
Add:	Undeclared Sales - Scrap Sales		₱	1,945,156.00		
	Interest Income from Loan Receivable			2,730,000.00		4,675,156.00
Total Revenues subject to VAT					₱	170,483,330.54
Output Tax (12%)					₱	20,457,999.66
Less:	Input Tax Claimed per VAT Returns filed		₱	99,936,812.74		
	Less:	Excess input tax carried over to the succeeding quarter		79,908,098.44		
		Input tax on capital assets		131,733.36		19,896,980.94
Basic Deficiency Tax					₱	**561,018.72**

III. EXPANDED WITHHOLDING TAX

Petitioner argues that the period to assess for EWT for the most part of 2012 has already prescribed as the FLD was only issued on 08 December 2015 or more than three (3) years from the filing of the monthly EWT returns.

Respondent counters that the assessment for EWT is not covered by the three-year prescriptive period under Section 203[122] of the NIRC,

---

119 RMC No. 9-2006: Clarifying the Amount Subject to VAT and Expanded Withholding Tax (Income Tax) of Brokers and Others Similarly Situated and the Other Parties with Whom They Transact Business.

120 Annex "INT", ICPA Report.

121 Exhibit "ICPA AFS-23".

122 Supra at note 33.

of 1997, as amended. Allegedly, the assessment for deficiency EWT from petitioner as withholding agent is in the nature of a penalty rather than a tax.

We find respondent's contention specious.

In *Commissioner of Internal Revenue v. La Flor Dela Isabela, Inc.*[123], the Supreme Court discussed exhaustively the withholding tax system and the classification of withholding taxes, whether as tax or penalty, and the corresponding prescriptive period for assessment:

> ...
>
> *Withholding taxes are internal revenue taxes covered by Section 203 of the NIRC.*
>
> ...
>
> The CIR, however, forwards a novel theory that Section 203 is inapplicable in the present assessment of EWT and WTC deficiency against La Flor. It argues that withholding taxes are not contemplated under the said provision considering that they are not internal revenue taxes but are penalties imposed on the withholding agent should it fail to remit the proper amount of tax withheld.
>
> ...
>
> Under the existing withholding tax system, the withholding agent retains a portion of the amount received by the income earner. In turn, the said amount is credited to the total income tax payable in transactions covered by the EWT. On the other hand, in cases of income payments subject to WTC and Final Withholding Tax, the amount withheld is already the entire tax to be paid for the particular source of income. Thus, it can readily be seen that the payee is the taxpayer, the person on whom the tax is imposed, while the payor, a separate entity, acts as the government's agent for the collection of the tax in order to ensure its payment.
>
> As a consequence of the withholding tax system, two distinct liabilities arise – one for the income earner/payee and another for the withholding agent.
>
> ...

123 G.R. No. 211289, 14 January 2019.

It is true that withholding tax is a method of collecting tax in advance and that a withholding tax on income necessarily implies that the amount of tax withheld comes from the income earned by the taxpayer/payee. Nonetheless, the Court does not agree with the CIR that withholding tax assessments are merely an imposition of a penalty on the withholding agent, and thus, outside the coverage of Section 203 of the NIRC.

...

A careful analysis of the above-quoted decision, however, reveals that the Court did not equate withholding tax assessments to the imposition of civil penalties imposed on tax deficiencies. The word "penalty" was used to underscore the dynamics in the withholding tax system that is the income of the payee being subjected to tax and not of the withholding agent. <u>It was never meant to mean that withholding taxes do not fall within the definition of internal revenue taxes, especially considering that income taxes are the ones withheld by the withholding agent. Withholding taxes do not cease to become income taxes just because it is collected and paid by the withholding agent.</u>

The liability of the withholding agent is distinct and separate from the tax liability of the income earner. It is premised on its duty to withhold the taxes paid to the payee. Should the withholding agent fail to deduct the required amount from its payment to the payee, it is liable for deficiency taxes and applicable penalties. In *Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing Corporation*, the Court explained:

> It thus becomes important to note that under Section 53 (c) of the NIRC, the withholding agent who is "required to deduct and withhold any tax" is made *"personally liable for such tax"* and indeed is indemnified against any claims and demands which the stockholder might wish to make in questioning the amount of payments effected by the withholding agent in accordance with the provisions of the NIRC. **The withholding agent, P&G-Phil., is directly and independently liable for the correct amount of the tax that should be withheld from the dividend remittances. The withholding agent is, moreover, subject to and liable for deficiency assessments, surcharges and penalties should the amount of the tax withheld be finally found to be less than the amount that should have been withheld under the law.**

A "person liable for the tax" has been held to be a "person subject to tax" and properly considered a "taxpayer". The terms "liable for tax" and "subject to tax" both connote legal obligation or duty to pay a tax. It is very difficult, indeed conceptually impossible, to consider a person who is statutorily made "liable for tax" as *not* "subject to tax." By any reasonable standard, such a person should be regarded as a party in interest, or as a person having sufficient legal interest to bring a suit for refund of taxes he believes were illegally collected from him.

Thus, withholding tax assessments such as EWT and WTC clearly contemplate deficiency internal revenue taxes. Their aim is to collect unpaid income taxes and not merely to impose a penalty on the withholding agent for its failure to comply with its statutory duty. Further, a holistic reading of the Tax Code reveals that the CIR's interpretation of Section 203 is erroneous. Provisions of the NIRC itself recognize that the tax assessment for withholding tax deficiency is different and independent from possible penalties that may be imposed for the failure of withholding agents to withhold and remit taxes. For one, Title X, Chapter I of the NIRC provides for additions to the tax or deficiency tax and is applicable to all taxes, fees and charges under the tax code.

In addition, Section 247(b) of the NIRC provides:

SEC. 247. *General Provisions.* –

x x x x

(b) If the withholding agent is the Government or any of its agencies, political subdivisions or instrumentalities, or a government-owned or controlled corporation[,] the employee thereof responsible for the withholding and remittance of the tax shall be personally liable for the additions to the tax prescribed herein.

On the other hand, Section 251 of the Tax Code reads:

SEC. 251. *Failure of a Withholding Agent to Collect and Remit Tax.* – Any person required to withhold, account for and remit any tax imposed by this Code or who willfully fails to withhold such tax, or account for and remit such tax, or aids or abets in any manner to evade any such tax or the payment thereof, shall, in addition to other penalties provided for under this Chapter, be liable upon conviction to a penalty equal to the total amount of the tax not withheld, or not accounted for and remitted.

Based on the above-cited provisions, it is clear to see that the "penalties" are amounts collected on top of the deficiency tax assessments including deficiency withholding tax assessments. Thus, it was wrong for the CIR to restrict the EWT and WTC assessments against La Flor as only for the purpose of imposing penalties and not for the collection of internal revenue taxes.[124]

...

From the foregoing, it is clear that the assessment for EWT for CY 2012 is subject to the three-year prescriptive period.

Section 2.58(A)(2)(a)[125] of RR 2-98[126], as amended by RR No. 17-2003[127], requires that the manual filing of the EWT and FWT returns be filed within ten (10) days after the end of each month for the months of January to November and on or before January 15 of the following year for the month of December. Additionally, pursuant to RR 26-2002[128], for the purpose of filing returns under the eFPS, taxpayers classified under group B, such as herein petitioner, are required to file the monthly withholding tax returns within thirteen (13) days following the end of the month.

124 Citation omitted, emphasis and italics in the original text, and underscoring supplied.

125 **Sec. 2.58. RETURNS AND PAYMENT OF TAXES WITHHELD AT SOURCE.** —
(A) *Monthly return and payment of taxes withheld at source.* —
...
(2) **WHEN TO FILE** —
(a) For both large and non-large taxpayers, the withholding tax return, whether creditable or final (including final withholding taxes on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements) shall be filed and payments should be made within ten (10) days after the end of each month, except for taxes withheld for the month of December each year, which shall be filed on or before January 15 of the following year...
...

126 Supra at note 34.

127 *Amending Further Pertinent Provisions of Revenue Regulations No. 2-98, as Amended, Providing for Additional Transactions Subject to Creditable Withholding Tax; Re-Establishing the Policy that the Capital Gains Tax on the Sale, Exchange or Other Disposition of Real Property Classified as Capital Assets Shall be Collected as Final Withholding Tax, Thereby Further Amending Revenue Regulations Nos. 8-98 and 13-99, as Amended by Revenue Regulations No. 14-2000; and for Other Purposes.*

128 *Amending Further Revenue Regulations No. 9-2001, as Amended by Revenue Regulations No. 2-2002 and Revenue Regulations No. 9-2002, Providing for the Staggered Filing of Returns of Taxpayers Enrolled in the Electronic Filing and Payment System (EFPS) Based on Industry Classification.*

Applying the foregoing provisions of law and regulations, the period of limitation on respondent's right to assess EWT is shown below:

Period covered	**Date of actual filing**	**Last day prescribed by law to file the return**	**Last day to assess under Section 203 of the NIRC of 1997**
January 2012	February 09, 2012[129]	February 14, 2012	February 14, 2015
February 2012	March 14, 2012[130]	March 14, 2012	March 14, 2015
March 2012	April 12, 2012[131]	April 14, 2012	April 14, 2015
April 2012	May 11, 2012[132]	May 14, 2012	May 14, 2015
May 2012	June 14, 2012[133]	June 14, 2012	June 14, 2015
June 2012	July 09, 2012[134]	July 14, 2012	July 14, 2015
July 2012	August 10, 2012[135]	August 14, 2012	August 14, 2015
August 2012	September 14, 2012[136]	September 14, 2012	September 14, 2015
September 2012	October 12, 2012[137]	October 14, 2012	October 14, 2015
October 2012	November 12, 2012[138]	November 14, 2012	November 14, 2015
November 2012	December 11, 2012[139]	December 14, 2012	December 14, 2015
Amended December 2012	February 13, 2013[140]	January 15, 2013	February 13, 2016

As shown, when the FLD was issued on <u>08 December 2015</u>[141], respondent's right to assess petitioner for deficiency EWT for the months of January to October 2012 had already prescribed. Accordingly, only the assessment for deficiency EWT for the months of November and December 2012 was issued within the three-year prescriptive period allowed by law.

---

129 Exhibit "R-16", p. 469.
130 Exhibit "R-16", p. 466.
131 Exhibit "R-16", p. 464.
132 Exhibit "R-16", p. 462.
133 Exhibit "R-16", p. 460.
134 Exhibit "R-16", p. 458.
135 Exhibit "R-16", p. 456.
136 Exhibit "R-16", p. 454.
137 Exhibit "R-16", p. 452.
138 Exhibit "R-16", p. 450.
139 Exhibit "R-16", p. 448.
140 Exhibit "R-16", p. 446.
141 Exhibit "R-5", BIR Records, pp. 722-728.

Notably, however, while this Court finds that respondent's right to assess petitioner for deficiency EWT for the months of January to October 2012 had prescribed, an examination of the pieces of evidence would show that petitioner failed to establish clearly which portion of said deficiency taxes pertain to the prescribed periods. In the absence of proof to the contrary, this Court is thus constrained to impute the entire deficiency EWT assessment to the unprescribed portion for the TY 2012.

The records show that petitioner was assessed for alleged deficiency EWT for CY 2012 amounting to ₱303,939.61, inclusive of interest, computed as follows:[142]

Expenses subject to withholding - Annex A	₱	185,006,235.72
Total tax due		2,437,464.28
Less: Tax Paid		2,244,461.57
Basic Deficiency Tax		193,002.71
Add: Interest (1.16.13 to 12.01.15)		110,936.90
Total Amount Due	**₱**	**303,939.61**

Annex A

	Amount	**Tax Due**
Rentals (5%)	4,058,378.94	202,918.95
Professional Fees (0%)	750,028.42	-
Professional Fees (10%)	66,456.00	6,645.60
Professional Fees (15%)	1,312,471.83	196,870.77
Purchase of Materials (1%)	154,534,905.11	1,545,349.05
Purchase of Services (2%)	24,283,995.42	485,679.91
	185,006,235.72	**2,437,464.28**

Petitioner claims that, for EWT on rentals, only the amount of ₱3,478,211.04 should be subjected to 5% EWT as compared to respondent's findings of ₱4,058,378.94. Moreover, that for EWT on purchase of materials, the amount that should be subjected to 1% EWT is ₱147,043,005.54, as opposed to respondent's findings of ₱154,534,905.11. Lastly, petitioner claims that for EWT on purchase of services, only the amount of ₱24,118,556.13 should be subjected to 2% EWT as compared to respondent's findings of ₱24,283,995.42. It is noted that petitioner did not dispute the remaining deficiency EWT of ₱87,016.53.

[142] Exhibit "P-5", Division Docket, Volume I, p. 453.

From the foregoing, the disputed items, in relation to respondent's EWT assessment, are the following:

Item	Per FLD[143]		Per petitioner's claim	
	Tax Base	Amount	Tax Base	Amount
Rentals (5%)	₱4,058,378.94	₱202,918.95	₱3,478,211.04	₱173,910.55
Purchase of materials (1%)	154,534,905.11	1,545,349.05	147,043,005.54	1,470,430.06
Purchase of services (2%)	24,283,995.42	485,679.91	24,118,556.13	482,371.12

Per independent verification of petitioner's Monthly Remittance Returns of Creditable Income Taxes Withheld (Expanded) or BIR Form No. 1601-E[144], for the TY 2012, the Court finds that petitioner paid a total amount of ₱2,244,461.57 withholding taxes, broken down as follows:

	Income Payments	EWT remitted
Rentals (5%)	₱3,478,213.20	₱173,910.66
Professional Fees (10%)	66,456.00	6,645.60
Professional Fees (15%)	1,312,471.83	196,870.77
Purchase of Materials (1%)	143,107,420.00	1,431,074.20
Purchase of Services (2%)	21,798,017.00	435,960.34
Total	₱169,762,578.03	₱2,244,461.57

A. RENTALS SUBJECT TO 5%
- ₱580,166.80

Allegedly, the following rental payments were not subjected to 5% EWT:

Rentals[145]	₱4,058,380.00
Less: Income payments subjected to 5% EWT	3,478,213.20
DISCREPANCY	₱580,166.80

The discrepancy is accounted as follows:[146]

[143] Id.
[144] Exhibit "R-16", pp. 446-469.
[145] Exhibit "ICPA AFS-24".
[146] Division Docket, Volume I, p. 350.

Particulars	Amount
Payment for driver services subjected to 2% EWT	₱432,560.76
Driver's 13th month not subject to EWT	11,000.00
Amortization of prepaid expenses not subjected to EWT	25,000.00
Amortization of prepaid expenses previously subjected to EWT in 2011	111,607.14
Total	₱580,167.90

A.1 PAYMENT FOR DRIVER SERVICES SUBJECT TO 2% EWT

As the ICPA aptly found, the Statement of Accounts, Trip Tickets, Bank Vouchers, and ORs[147] sufficiently prove that the nature of the transaction is a supply of services by Triple A Car Rental Services ('Triple A Car'). Triple A Car provides a driver to petitioner and the latter pays for the services rendered by Triple A Car's driver based on the number of hours rendered as reflected on the trip tickets.

Relative to the withholding of EWT on purchase of services, Section 2.57.2(M) of RR 2-98, as amended by RR 6-2009[148], provides:

> ...
>
> **Sec. 2.57.2.** *Income Payment Subject to Creditable Withholding Tax and Rates Prescribed Thereon.* - Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines:
>
> ...
>
> (M) *Income payments made by the top twenty thousand (20,000) private corporations to their local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax.* — Income payments made by any of the top 20,000 private corporations, as determined by the Commissioner, to their local/resident supplier of goods and local/resident supplier of services, including non-resident aliens engaged in trade or business in the Philippines. *Provided*, however, that for purchases involving agricultural products in their original state, the tax required to be

[147] Exhibits "ICPA DRI-8.1", "ICPA DRI-9.1", "ICPA DRI-11.1" and "ICPA DRI-13.1".

[148] *Amending Further Pertinent Provisions of Revenue Regulations (RR) No. 2-98, as Amended, Providing for an Additional Criteria in the Determination of Top 20,000 Private Corporations, Including the Threshold on their Purchases of Agricultural Products, and Additional Transactions Subject to Creditable Withholding Tax on Income Payments Made by the Top Five Thousand (5,000) Individual Taxpayers Engaged in Trade/Business or Practice of Profession.*

> withheld under, this sub-section shall only apply to purchases in excess of the cumulative amount of Three Hundred Thousand Pesos (P300,000) within the same taxable year. For this purpose, an agricultural product in their original state as used in these Regulations, shall only include corn, coconut, copra, palay, rice, cassava, coffee, fruit, vegetable, marine food product, poultry and livestock.
>
> Supplier of goods – One percent (1%)
> Supplier of services – Two percent (2%)[149]
>
> ...

Undeniably, petitioner is categorized as one of the Top 10,000 Corporations[150] obligated to withhold 2% from income payments it made to Triple A Car.

A thorough examination of petitioner's documents, including the "Alphabetical List of Payees From Whom Taxes Were Withheld" (MAP)[151], reveals that petitioner properly subjected the income payments for the services rendered by Triple A Car amounting to ₱432,560.76 to 2% EWT, in accordance with the aforecited provision and such should not be included as income payments subject to 5% EWT.

A.2 DRIVER'S 13TH MONTH NOT SUBJECT TO EWT

Clearly from the afore-mentioned Section 2.57.2(M) of RR 2-98, a top corporation's income payments for a supply of services shall be subjected to 2% EWT. Having established that income payments made to Triple A Car are purchases of services, petitioner is also required to withhold 2% from the income payment made to Triple A Car, representing 13th month pay of the latter's employee.

149 Emphasis supplied.
150 Joint Stipulation of Facts and Issues, Division Docket, Volume I, p. 185.
151 Exhibits "ICPA MAP-1" to "ICPA MAP-12".

A.3 AMORTIZATION OF PREPAID EXPENSES NOT SUBJECTED TO EWT

As the ICPA explained, the subject amount of ₱25,000.00 represented the one-month amortization of the prepaid rent totalling to ₱150,000.00 paid on 30 October 2012, as evidenced by OR No. 1514.[152] Petitioner did not submit any evidence to support its argument that the same is not subject to 5% EWT. However, a scrutiny of petitioner's documents yields the following discrepancy:

Supplier	Per Official Receipt			Per MAP		Difference
	OR No.	Date	Amount	Month	Amount	
Jurie E. Entac	1458[153]	5/11/12	₱142,500	May 2012[154]	₱150,000	₱7,500[155]
Jurie E. Entac	1514[156]	10/30/12	142,500	-	-	142,500

From the above, petitioner did not remit the amount it withheld on 30 October 2012 on its income payment to Jurie E. Entac, (proprietor of Entac Transport Service) as evidenced by OR No. 1514 in the amount of ₱7,500.00.

Per the ICPA's examination of petitioner's documents, the ICPA also found out the non-payment of petitioner of its 5% EWT due on OR No. 1514, to wit:[157]

> ...
> 6. The aforementioned amortization of prepaid rental expense amounting to P25,000.00 represents one month amortization of the paid prepaid rents in the amount of P150,000.00 under Official Receipts No. 1514 shown as **Exhibit No. ICPA AMOR-2** that was paid on October 30, 2012. The Petitioner failed to pay the corresponding 5% expanded withholding tax of the said prepaid rent.[158]
> ...

---

152 Exhibit "ICPA AMOR-2".
153 Exhibit "ICPA AMOR-1".
154 Exhibit "ICPA MAP-5".
155 Amount withheld by petitioner computed as follows: *P150,000 – (P150,000 x 5% EWT)*.
156 Exhibit "ICPA AMOR-1".
157 Supra at note 146.
158 Emphasis in the original text.

Section 2.57.4 of RR No. 2-98, as amended by RR 12-2001[159], provides:

> ...
> **Sec. 2.57.4.** *Time of Withholding.* - The obligation of the payor to deduct and withhold the tax under Section 2.57 of these [R]egulations arises at the time an **income payment is <u>paid</u> or payable**, or the income payment is accrued or **recorded as an expense or asset**, whichever is applicable, in the payor's books, **whichever comes first**. The term "payable" refers to the date the obligation becomes due, demandable or legally enforceable.[160]
> ...

In the instant case, petitioner only claimed the one-month amortization of ₱25,000.00 as expense and recorded the difference of ₱125,000.00 as prepaid expense asset. However, since petitioner had already paid the entire amount of ₱150,000.00 and in fact, properly withheld the amount of ₱7,500.00; it should have remitted said amount in 2012. As the same is an assessment covering the October 2012 EWT Return, which had already prescribed, its cancellation will be in order.

<u>A.4 AMORTIZATION OF PREPAID EXPENSES PREVIOUSLY SUBJECTED TO EWT IN 2011</u>

Petitioner failed to offer any evidence to substantiate its claim that the prepaid expenses amounting to ₱111,607.14 were already subjected to EWT in 2011. Hence, respondent's assessment of this particular item must likewise be sustained.

To summarize, the Court affirms the 5% EWT deficiency on the following item:

---

159 *Amendment to the Pertinent Provisions of Revenue Regulations No. 1-98, as Amended, Revenue Regulations No. 2-98 as Amended, and Revenue Regulations No. 6-2001, Relative to the Revision of Withholding Tax Rates on Certain Income Payments Subject to Withholding Tax, the Deferment of the New Deadline Dates For Filing Selected Tax Returns, the Reporting Requirements for Receipts of Talent Fees, and for Other Purposes.*

160 Emphasis and underscoring supplied.

Description	Amount
Amortization of prepaid expenses previously subjected to EWT in 2011	₱111,607.14

PURCHASE OF MATERIALS SUBJECT TO 1% - ₱11,427,485.11

Petitioner also alleges that the following purchases of materials were not subjected to 1% EWT:[161]

...

Purchase of Materials:	
Building	₱502,023.91
Machinery	3,209,457.53
Furniture and fixture	292,613.55
Land improvements	1,673,244.25
Construction in Progress	651,987.19
Purchases	137,940,975.30
Welfare FOH	5,048,929.67
Retirement benefit expenses	410,651.63
Factory Supplies	11,422,851.02
Others and donations	577,496.31
Welfare	2,032,318.27
Entertainment	759,947.96
Travel expense	245,881.52
Subtotal	*₱164,768,378.11*
Less: Importations not subject to 1% EWT	10,233,473.00
Total	154,534,905.11
Less: Income payments subjected to 1% EWT	143,107,420.00
DISCREPANCY	₱11,427,485.11

...

Petitioner likewise claims that the following should not be included in the above computation because by its nature, these items are not subject to 1% EWT:

Description	Amount
Welfare FOH	₱5,048,929.67
Retirement benefit expenses	410,651.63
Welfare	2,032,318.27
Total	₱7,491,899.57

[161] Division Docket, Volume I, p. 352.

Despite its insistence, petitioner did not present supporting documents and it was only able to show that the above items were presented as part of the Salaries and Employee Benefits account in the AFS.

In the determination of a taxpayer's EWT liability, proof of payment/incurrence of the expense, such as invoices and ORs, is necessary for the Court to ascertain the actual nature of the income payment (and rule on the taxability of the same). Unfortunately for petitioner, it did not even present its "Chart of Accounts" that would have shown the nature and description of the assets, the liability elements, the equity structure, the sources of revenue, the expenses (Cost of Sales, Cost of Manufacturing inclusive of Selling and Administrative Expenses) and the summary accounts of an organization.[162] With this, the Court is thus constrained to uphold *in toto* the respondent's deficiency EWT assessment as regards expenses that should be subject to 1% EWT.

B. PURCHASE OF SERVICES SUBJECT TO 2% - ₱2,485,978.42

As regards the purchase of services subject to 2%, the following purchases of services were allegedly not subjected to EWT[163]:

...	
Purchase of Services:	
Light and water	₱6,866,332.46
Maintenance	85,315.21
Carriage in	1,929,133.30
Up-keep vehicle	2,255,240.41
Association Dues	413,939.12
Light and water	762,925.82
Communication	919,188.37
Carriage out	6,555,098.52
Security	960,000.00
Up-keep office	228,719.62
Advertising Expenses	17,922.00
Interest expense	3,290,180.59
Total	₱24,283,995.42

162 Hedish, Norman D. "Account Classification and Principle Codification." *The Accounting Review*, Vol. 34, No. 4, 1959, pp. 660–662.

163 Division Docket, Volume I, p. 354.

Less: Income payments subjected to 2% EWT	21,798,017.00
DISCREPANCY	₱2,485,978.42

...

Petitioner maintains that the following should not be included in the above computation because these are not subject to 2% EWT:

Description	Amount
Maintenance	₱85,315.21
Up-keep vehicle	2,255,240.41
Security	598,000.00
Total	₱2,938,555.62

In support of petitioner's claims above, it argues that expense account for both "Maintenance" and "Up-keep Vehicle" include its purchases of parts and services. Yet, it failed to forward evidence to show such expenses therefore, the assessment must stand.

As regards, the "Security" expense account, petitioner also posits that it should include only the security guards' salaries that have been reimbursed to the agency, hence should not be subject to 2% EWT.

Sections IV and V of RMC 39-07[164], dated 22 January 2007, clarify the tax treatment of the security guards' salaries forming part of the contract price of the security agency's service, to wit:

> ...
>
> **IV. MANNER OF ISSUING RECEIPT FOR THE ENTIRE CONTRACT PRICE.** -
>
> ...
>
> With respect to the security guards' salaries which are mandated by law to be paid by the Client through the Security Agency, the amount so paid representing salaries must be covered by a Non-VAT Acknowledgement Receipt. This document, coupled with the notarized certification of the expanded withholding taxes prescribed in Paragraph V hereunder, shall be a sufficient

164 SUBJECT: Clarifying the Income Tax and VAT Treatment of Agency Fees/Gross Receipts of Security Agencies Including the Withholding of Taxes Due thereon.

> substantiation for the expense that will be claimed as a deduction from gross income by the Client.
>
> **V. WITHHOLDING TAX COMPLIANCE.** -
>
> ...
>
> Insofar as the Agency Fee is concerned, the Client is constituted as the withholding agent of the EWT following the rule above-mentioned. However, with respect to the portion of the Contract Price representing the amount segregated and earmarked as salaries of the security guards, the Security Agency shall be the one responsible for the withholding of the tax on compensation income. This is so because while it is the Client who claims the payment as an expense, it is the Security Agency who physically controls the payment to the salaries of the Security Guards. However, in order to comply with the requirement for deductibility under Section 34(K), in relation to Section 58 and 81, all of the National Internal Revenue Code, as amended, the Security Agency must furnish its Client, on or before January 31 of the year following the year of withholding, a **Notarized Certification** (see Annex "A") indicating the names of the guards employed by the Client, their respective TINs, the amount of their salaries and the amount of tax withheld from each. This certification together with the covering Non-VAT acknowledgment Receipt must be kept on file by the Client as substantiation for the claim of the expense.[165]
>
> ...

In the instant case, petitioner's security agency, JDL Security and Investigation, Inc., only issued VAT Service Invoices and VAT ORs[166] for the entire amount – agency fee and salaries of the security guards. Aside from the VAT ORs breakdown for each, petitioner failed to present a notarized certification from the security agency (certifying that the said agency withheld the proper withholding tax on compensation on the security guards' salaries). Such is not in compliance with the documentation requirements under RMC 39-07. Thus, the EWT assessment on the security guards' salaries amounting to ₱598,000.00 should likewise be sustained.

Below is the revised computation of petitioner's 2% EWT deficiency, as follows:

---

165 Emphasis in the original text and underscoring supplied.
166 Exhibits "ICPA SEC-2" to "ICPA SEC-23".

...

Purchase of Services:	
Light and water	₱6,866,332.46
Maintenance	85,315.21
Carriage in	1,929,133.30
Up-keep vehicle	2,255,240.41
Association Dues	413,939.12
Light and water	762,925.82
Communication	919,188.37
Carriage out	6,555,098.52
Security	960,000.00
Up-keep office	228,719.62
Advertising Expenses	17,922.00
Interest expense	3,290,180.59
Subtotal	*₱24,283,995.42*
Add adjustments:	
Payment for driver services subjected to 2% EWT (A.1)	432,560.76
Driver's 13th month not subject to EWT (A.2)	11,000.00
Total income payments subject to 2% EWT	₱24,727,556.18
Less: Income payments subjected to 2% EWT	21,798,017.00
Income payments not subjected to 2% EWT	₱2,929,539.18

...

In sum, petitioner should be held liable for basic deficiency EWT in the amount of ₱178,445.99, computed as follows:

...

	Income payments	**EWT due**
Rental payments not subjected to 5% EWT	₱111,607.14	₱5,580.36
Purchase of materials not subjected to 1% EWT	11,427,485.11	114,274.85
Purchase of services not subjected to 2% EWT	2,929,539.18	58,590.78
Basic deficiency EWT		₱178,445.99

...

IV. FINAL WITHHOLDING TAX

As previously discussed, assessment for withholding taxes are within the purview of the regular three-year assessment period under

Section 203[167] of the NIRC of 1997, as amended. A summary of the filing of FWT returns are as follows:

Period covered	**Date of actual filing**	**Last day prescribed by law to file the return**	**Last day to assess under Section 203 of the NIRC of 1997**
January 2012	February 09, 2012[168]	February 14, 2012	February 14, 2015
February 2012	March 08, 2012[169]	March 14, 2012	March 14, 2015
March 2012	April 11, 2012[170]	April 14, 2012	April 14, 2015
April 2012	May 11, 2012[171]	May 14, 2012	May 14, 2015
May 2012	June 06, 2012[172]	June 14, 2012	June 14, 2015
June 2012	July 05, 2012[173]	July 14, 2012	July 14, 2015
July 2012	August 15, 2012[174]	August 14, 2012	August 15, 2015
August 2012	September 05, 2012[175]	September 14, 2012	September 14, 2015
September 2012	October 01, 2012[176]	October 14, 2012	October 14, 2015
October 2012	November 09, 2012[177]	November 14, 2012	November 14, 2015
November 2012	December 11, 2012[178]	December 14, 2012	December 14, 2015
December 2012	January 14, 2013[179]	January 15, 2013	January 15, 2016

Notably, since the FLD was issued only on 08 December 2015 or more than three years from the filing of the returns for the months of January to October 2012, the assessment for the said months had prescribed. With this, only the assessment for November and December 2012 will be considered.

Respondent also assessed petitioner for alleged deficiency FWT for CY 2012 amounting to ₱2,746,384.19, inclusive of interest, computed as follows:

---

167 Supra at note 33.
168 Exhibit "R-16", p. 444.
169 Exhibit "R-16", p. 442.
170 Exhibit "R-16", p. 440.
171 Exhibit "R-16", p. 438.
172 Exhibit "R-16", p. 436.
173 Exhibit "R-16", p. 433.
174 Exhibit "R-16", p. 431.
175 Exhibit "R-16", p. 429.
176 Exhibit "R-16", p. 427.
177 Exhibit "R-16", p. 425.
178 Exhibit "R-16", p. 423.
179 Exhibit "R-16", p. 421.

...

Income payments subject to withholding - Annex A		₱6,020,150.00
Total tax due		1,505,037.50
Less: Tax Paid		-
Basic Deficiency Tax		**1,505,037.50**
Add:	25% Surcharge	376,259.38
	Interest (1.16.13 to 12.01.15)	865,087.31
Total Amount Due		**₱2,746,384.19**

Annex A

IV. FINAL WITHHOLDING TAX

Management fee as stated above, was subjected to final tax in accordance to Revenue Regulation 2-98 and RP-Japan tax treaty and assessed pursuant to the provisions of Section 57(A) of the NIRC.

...

It is noteworthy that the FLD failed to provide for the tax rate that respondent used in arriving at the tax due. It is only by working back the equation (tax due divided by the income payment subject to withholding tax) that the rate of 25% as used in the assessment can be arrived at.

Based on the Details of Discrepancies (Annex A)[180], the FWT assessment was a result of the management fees paid to IICL and the basis used was the RP-Japan Tax Treaty. A logical assumption is that respondent treated the management fees as royalties. However, the rate of 25% relied upon was prior to the amendment of the RP-Japan Tax Treaty which became effective in 2009.

On cross-examination, RO Guiuan also failed to specify the classification of the payments, whether royalties or business profits. He simply mentioned that management fee is one of the fees that is subject to FWT.[181]

It is a basic tenet that the FLD should state the facts, law, rules and regulations, or jurisprudence on which it is based, otherwise the

180 Exhibit "P-5", id., pp. 453-455.
181 Supra at note 22.

assessment is void.[182] Due process dictates that taxpayers should be properly informed of the assessment against it to effectively refute the same and present evidence justifying its claim.

Insofar as the assessment for FWT is concerned, the legal basis on which the assessment was based is wanting. Petitioner was left to assume the classification of the income and the corresponding rate.

Moreover, as earlier discussed, IICL's rendered services are in the nature of business profits as the same did not include a transfer of "know-how". From the reading of the RP-Japan Tax Treaty, business profits are not subject to tax, unless there is a "permanent establishment" in the Philippines.

The Service Agreement is likewise more than clear that the services were to be performed offshore and the parties did not intend to establish a "permanent establishment" in this jurisdiction. Absent any indication that services were actually performed here in the Philippines or that IICL maintained a fixed place of business within the country, the general rule stands that payments for business profits are exempt from tax. The assessment then for FWT for CY 2012 should be cancelled.

V. COMPROMISE PENALTY

Pursuant to Section 255 of the NIRC of 1997, as amended, respondent assessed petitioner of compromise penalties amounting to ₱66,000.00, broken down as follows:[183]

Nature of Violation	Compromise Penalty
Late payment of Income Tax	₱25,000.00
Late payment of Value Added Tax	25,000.00
Late payment of Expanded Withholding Tax	16,000.00
Total Compromise Penalties	₱66,000.00

---

182 Section 3.1.4 of RR No. 12-99 or the *Implementing the Provisions of the National Internal Revenue Code of 1997 Governing the Rules of Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extra-Judicial Settlement of a Taxpayer's Criminal Violation of the Code Through Payment of a Suggested Compromise Penalty.*

183 Exhibit "P-5", Division Docket, Volume I, p. 453.

Under Revenue Memorandum Order (**RMO**) No. 01-90[184], compromise penalties are only amounts suggested in settlement of criminal liability and the same may not be imposed on or exacted from the taxpayer in the event that a taxpayer refuses to pay the same.

It is a well-settled rule that the Court has no jurisdiction to compel a taxpayer to pay the compromise penalty because by its very nature, it implies a mutual agreement between the parties in respect to the thing or subject matter that is so compromised, and the choice of paying or not paying it distinctly belongs to the taxpayer.[185] Absent any showing that herein petitioner consented to the compromise penalty, its imposition should be deleted. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[186] Necessarily, the total compromise penalties of ₱66,000.00 should be similarly cancelled.

WHEREFORE, premises considered, petitioner Ishida Philippines Tube Co., Inc.'s Petition for Review is **PARTIALLY GRANTED**. The assessments for Final Withholding Tax (FWT) and Compromise Penalty amounting to ₱2,746,384.19 and ₱66,000.00, respectively, are **CANCELLED** while the assessments for Income Tax (IT), Value-Added Tax (VAT) and Expanded Withholding Tax (EWT) are hereby **AFFIRMED WITH MODIFICATION.**

Accordingly, petitioner is **ORDERED** to pay respondent Commissioner of Internal Revenue the amount of **₱1,304,504.26, ₱1,292,224.14,** and **₱412,031.35**, representing basic IT, VAT and EWT, respectively, inclusive of the 25% surcharge, 20% deficiency interest and 20% delinquency interest imposed thereon under Sections 248(A)(3)[187], 249(B) and (C)[188] of the NIRC of 1997, as amended, respectively, computed until 31 December 2017, as determined below:

---

184 Amendments to the Provisions of a "Revised Schedule of Compromise Penalties" for internal revenue violations as prescribed in RMO 26-86.

185 *The Philippines International Fair, Inc. v. The Collector of Internal Revenue, et. al.*, 114 Phil. 710 (1962).

186 *Commissioner of Internal Revenue v. Lianga Bay Logging Co., Inc., et. al.*, 271 Phil. 82 (1991).

187 **Sec. 248.** *Civil Penalties.* –

(A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:

...

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

188 **Sec 249.** *Interest.* –

	IT	VAT	EWT	TOTAL
Basic	577,675.32	561,018.72	178,445.99	1,317,140.03
Surcharge (25%)	144,418.83	140,254.68	44,611.50	329,285.01
Deficiency Interest (20%) until November 06, 2017				
IT - 4/16/13 to 11/6/17 (P577,675.32 x 20% x 1,666 days/ 365 days)	527,346.35			527,346.35
VAT - 1/26/13 to 11/6/17 (P561,018.72 x 20% x 1,746 days/ 365 days)		536,733.53		536,733.53
EWT - 1/16/13 to 11/6/17 (P178,445.99 x 20% x 1,756 days/ 365 days)			171,699.26	171,699.26
Total Amount Due as of November 6, 2017	**1,249,440.50**	**1,238,006.93**	**394,756.75**	**2,882,204.18**
Deficiency Interest (20%) from November 7, 2017 to December 31, 2017				
IT - 11/7/17 to 12/31/17 (P577,675.32 x 20% x 55 days/ 365 days)	17,409.39			17,409.39
VAT - 11/7/17 to 12/31/17 (P561,018.72 x 20% x 55 days/ 365 days)		16,907.41		16,907.41
EWT - 11/7/17 to 12/31/17 (P178,445.99 x 20% x 55 days/ 365 days)			5,377.82	5,377.82
Delinquency Interest (20%) from November 7, 2017 to December 31, 2017				
IT - 11/7/17 to 12/31/17 (P1,249,440.50 x 20% x 55 days/ 365 days)	37,654.37			37,654.37
VAT - 11/7/17 to 12/31/17 (P1,238,006.93 x 20% x 55 days/ 365 days)		37,309.80		37,309.80
EWT - 11/7/17 to 12/31/17 (P394,756.75 x 20% x 55 days/ 365 days)			11,896.78	11,896.78
Total Amount Due as of December 31, 2017	**1,304,504.26**	**1,292,224.14**	**412,031.35**	**3,008,759.75**

(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.
(B) *Deficiency Interest.* – A 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.
(C) *Delinquency Interest.* – In case of failure to pay:
(1) The amount of the tax due on any return required to be filed, or
(2) The amount of 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.

In addition, petitioner is **ORDERED** to pay delinquency interest at the rate of 12% computed from 01 January 2018 until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended by Republic Act No. 10963, also known as Tax Reform for Acceleration and Inclusion (TRAIN) and as implemented by RR No. 21-2018[189], on said deficiency taxes based the following principal amounts:

Income Tax	₱1,249,440.50
Value Added Tax	1,238,006.93
Expanded Withholding Tax	394,756.75

SO ORDERED.

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

I CONCUR:

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

[189] *Regulations Implementing Section 249 (Interest) of the National Internal Revenue Code (NIRC) of 1997, as amended under Section 75 of the Republic Act (RA) No. 10963 or the "Tax Reform for Acceleration and Inclusion (TRAIN Law".*

ATTESTATION

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

JUANITO C. CASTAÑEDA, JR.
Associate Justice
2nd Division Chairperson

CERTIFICATION

Pursuant to Section 13, 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