REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

VISAYAS GEOTHERMAL POWER COMPANY, Petitioner,	**CTA EB No. 1291** **(CTA Case No. 8425)**
-versus-	**Present:** Del Rosario, *P.J.*, Castañeda, Jr., Bautista, Uy, Casanova, Fabon-Victorino, Mindaro-Grulla, and Ringpis-Liban, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: SEP 21 2016 3:06 p.m.

x---x

DECISION

CASTAÑEDA, JR., *J.* :

Before this Court is a Petition for Review filed on April 27, 2015 by petitioner Visayas Geothermal Power Company (petitioner, for brevity) assailing the November 17, 2014 Decision[1] and the March 16, 2015 Resolution[2] promulgated by the First Division of the Court of Tax Appeals (CTA 1st Division) in the case entitled, *"Visayas Geothermal Power Company v. Commissioner of Internal Revenue,"* docketed as CTA Case No. 8425.

Petitioner prays that this Court, after due notice and hearing, render judgment: (1) giving due course to the instant Petition; (2) declaring as null and void the Assessment Notices No. 014-089-WT-2002-079-06 dated 20 June 2006, as well as the Preliminary Collection Letter dated 06 January

[1] *Rollo*, pp. 47-89, penned by Associate Justice Cielito N. Mindaro-Grulla and concurred in by Presiding Justice Roman G. Del Rosario, and Associate Justice Erlinda P. Uy.
[2] *Id.*, pp. 90-97; with Concurring Opinion penned by Presiding Justice Roman G. Del Rosario, *Rollo*, pp. 98-102.

2012, issued by respondent; (3) directing respondent to cancel and withdraw the assessments for alleged deficiency final withholding tax and value-added tax for taxable year ended 2002 with an aggregate amount of Pesos: Twenty-Six Million Two Hundred Thirty-Six Thousand Three Hundred Fifty-Four & 41/100 (₱26,236,354.41), inclusive of interests and compromise penalties; and (4) prohibiting and enjoining respondent from taking any action intended to enforce, or make any collection on the basis of, the said assessments. Petitioner likewise prays for other just and equitable reliefs.

The dispositive portion of the assailed Decision[3] states:

> **WHEREFORE,** premises considered, the instant Petition for Review is hereby **DENIED** for lack of merit.
>
> **SO ORDERED.**

The dispositive portion of the assailed Resolution[4] reads:

> **WHEREFORE**, in view of the foregoing, petitioner's "Motion for Reconsideration (Re: Decision dated 17 November 2014)" is hereby **DENIED** for lack of merit.
>
> **SO ORDERED.**

THE FACTS

The facts[5] of this case as found by the CTA 1st Division are as follows:

> Petitioner Visayas Geothermal Power Company is a general partnership registered with the Securities and Exchange Commission, xxx xxx xxx
>
> xxx xxx xxx
>
> On June 1, 1996, petitioner executed a Service Agreement with CalEnergy Company, Inc. whereby the latter shall provide corporate management, financial planning support, and technical and administrative support services for

[3] *Rollo*, p. 88.
[4] *Id.*, p. 96.
[5] *Id.*, pp. 48-52; Assailed Decision, pp. 2-6(Citations Omitted).

the operation of the Malitbog Geothermal Power Plant in the Philippines.

Petitioner filed its Monthly Remittance Returns of Final Income Taxes Withheld and Monthly Remittance Returns of Value-added Tax and Other Percentage Taxes Withheld on the following dates:

FINAL WITHHOLDING TAX - 2002	
MONTH	**DATE FILED**
January	February 11, 2002
February	March 11, 2002
March	April 9, 2002
April	May 10, 2002
May	June 7, 2002
June	July 9, 2002
July	August 8, 2002
August	September 6, 2002
September	October 9, 2002
October	November 7, 2002
November	December 9, 2002
December	January 10, 2003

WITHHOLDING VALUE-ADDED TAX - 2002	
MONTH	**DATE FILED**
January	February 8, 2002
February	March 8, 2002
March	April 29, 2002
April	May 10, 2002
May	June 7, 2002
June	July 9, 2002
July	August 8, 2002
August	September 6, 2002
September	October 10, 2002
October	November 8, 2002
November	December 10, 2002
December	January 10, 2003

On July 4, 2005, petitioner received a Letter of Authority authorizing Revenue Officer Elizabeth Olaguer of Revenue District Office (RDO) No. 89-Ormoc City to examine its books of accounts and other accounting records for income taxes covering the period January 1, 2002 to December 31, 2002.

Petitioner received a letter from respondent's representative on January 13, 2006, informing it that the Audit Report on its internal revenue taxes due for the period January 1, 2002 to December 31, 2002 was already submitted. The said letter also invited petitioner to an informal conference in case it did not agree with the findings.

On February 9, 2006, petitioner received a second letter from respondent's representative stating therein that she has made an amended report and gave petitioner a period of five (5) days from receipt of the letter to present in writing its side of the case as well as to submit supporting documents.

On May 5, 2006, petitioner received from respondent a Preliminary Assessment Notice (PAN) dated April 20, 2006. According to the PAN, petitioner is liable for final withholding tax on gross amount of income derived from all sources within the Philippines by non-resident foreign corporation and final withholding of VAT in the amount of ₱25,923,652.90 due to its alleged failure to withhold final income taxes and final VAT on Management Service Fees it paid to MidAmerican Energy Holdings Company (formerly CalEnergy Company, Inc.) for taxable year 2002; citing as basis paragraphs 1 and 2 (b) (ii) of Article 13 of the RP-US Tax Treaty, Section 7 of Revenue Regulations (RR) No. 14-2002, and Sections 108 and 106 of the National Internal Revenue Code (NIRC) of 1997.

On May 19, 2006, petitioner, through Isla Lipana & Co., filed its protest to the PAN dated April 20, 2006 before the BIR. Petitioner argued that Management Service Fees are not royalty payments nor involve a grant of a license for the use of proprietary rights; the services of MidAmerican Energy Holdings Company were performed outside of the Philippines; and the right of respondent to assess petitioner already prescribed. Thus, petitioner prayed that the PAN issued against it be cancelled and withdrawn.

On June 23, 2006, petitioner received two (2) Assessment Notices, both numbered 014-089-WT-2002-079-06 and issued on June 20, 2006. The said Assessment Notices stated that petitioner is liable for deficiency FWT and final withholding tax on VAT (WVAT) amounting to ₱26,236,354.41, inclusive of surcharges, interest, and penalties.

Petitioner filed its protest dated July 13, 2006 with the BIR on July 19, 2006.

Petitioner received a letter dated August 15, 2006 on August 22, 2006, signed by Regional Director Atty. Estrella V. Martinez, denying its protest dated July 13, 2006. The Regional Director explained that Section 42 (4) (f) expanded the meaning of royalties; the RP-US Treaty does not limit permanent establishment as a "fixed base of business" but also includes furnishing of consultancy services by a resident of one of the Contracting States; and that the submission of petitioner's FWT and VAT returns does not hold probative value for the said returns pertain to entities other than MidAmerican Energy Holdings Company.

On September 20, 2006, petitioner filed with then BIR Commissioner Jose Mario C. Buñag a request for reconsideration of the decision of Regional Director Martinez denying its protest dated July 13, 2006.

In a decision issued on June 2, 2010, the BIR Commissioner denied petitioner's request for reconsideration.

Consequently, petitioner filed with the BIR Commissioner letters dated June 22, 2010 and March 28, 2011, which were received on June 23, 2010 and March 28, 2011, respectively. The June 22, 2010 letter requested an urgent review and reconsideration of the BIR Commissioner's decision based on factual and legal grounds; while the March 28, 2011 letter reiterated petitioner's position that it is not liable for deficiency FWT and WVAT.

On January 9, 2012, petitioner received a Preliminary Collection Letter from respondent stating therein that the constructive receipt of the decision of the BIR Commissioner dated June 2, 2010 by petitioner rendered the said decision final and that the request for reconsideration does not affect the finality of the decision considering that it is not an available remedy. Respondent requested petitioner to pay

₱26,236,354.41, representing petitioner's purported deficiency FWT and WVAT for the taxable year 2002.

On February 3, 2012, petitioner filed the instant Petition for Review before this Court.

The CTA 1st Division denied petitioner's Petition for Review and its Motion for Reconsideration on November 17, 2014 and March 16, 2015, respectively, for lack of merit.

Petitioner filed its appeal with the CTA *En Banc* on April 27, 2015. On June 29, 2015, respondent filed a Manifestation and Motion, stating among others, that the factual findings and conclusions of the CTA 1st Division under the assailed Decision and Resolution with Concurring Opinion dated March 16, 2015 of Hon. Justice Roman G. Del Rosario in CTA Case No. 8425, were adopted as part of the Comment to the Petition for Review.

Thereafter, this Court ordered the parties to file their respective Memorandum. Petitioner filed its Memorandum. Respondent filed a "Manifestation & Motion" stating that the factual findings and conclusions of the CTA 1st Division under the assailed Decision and Resolution with Concurring Opinion dated March 16, 2015 of Hon. Justice Roman G. Del Rosario in CTA Case No. 8425, as well as, the respondent's comments on the Petition for Review contained in the "Manifestation and Motion" dated June 29, 2015, were adopted as Memorandum. On October 14, 2015, this case was submitted for decision.

Hence, this Decision.

ISSUES

Petitioner's Assignment of Errors on the part of CTA 1st Division – in holding that it is liable for deficiency FWT and WVAT are as follows:[6]

a. The Honorable CTA – 1st Division erred in sustaining the BIR's erroneous finding that the Management/service fees paid by Petitioner to MEHC amounted to P50,870,007.59, rather than P11,045,589.13 as reflected in the records;

[6] *Rollo*, p. 17.

b. The Honorable CTA – 1st Division erred in applying the 10-year prescriptive period under Sections 203 and 222 of the Tax Code for failure of the Respondent to prove the existence of any fraud or falsity; hence, the Assessments have already prescribed.

c. Even assuming for the sake of argument that the assessment has not prescribed, the Honorable CTA – 1st Division erred in finding that Petitioner is liable for the alleged deficiency taxes for failure to even consider the following factual circumstances:

c.1. That the Management/Service Fees paid to MEHC are service fees rather than royalty payments;
c.2. That the Management/Service Fees paid to MEHC are rendered offshore and thus, not considered to have a Philippine-source under the "source rule" principle of taxation;
c.3. That MEHC is a non-resident foreign corporation, and thus, taxed only on Philippine-source income; and
c.4. That even assuming for the sake of argument that the payments have a Philippine source, there is no Philippine Permanent Establishment ("PE") against which the income of MEHC could be attributed, hence, the same is not subject to Philippine taxes.

THIS COURT'S RULING

The petition is partly meritorious.

We agree with the CTA 1st Division that, "[t]ax assessments by tax examiners are presumed correct and made in good faith, and all presumptions are in favor of the correctness of a tax assessment unless proven otherwise." [7]

In this case, petitioner was assessed as a withholding agent for deficiency Final Withholding Tax on Gross Amount of Income Derived from all Sources within the Philippines by Non-resident Foreign Corporation and the Final Withholding of Value-added Tax.

"[Withholding agent] is considered a 'taxpayer' under the NIRC as he is personally liable for the withholding tax as well as for deficiency assessments, surcharges, and penalties, should the amount of the tax

[7] *Rollo*, p. 85; Assailed Decision, p. 39, citing *Commissioner of Internal Revenue v. Hantex Trading Co., Inc.*, G.R. No. 136975, March 31, 2005.

withheld be finally found to be less than the amount that should have been withheld under [the] law."[8]

Annex "A"[9] of the Preliminary Assessment Notice states that:

DETAILS OF DISCREPANCIES

1. **On Final Withholding Tax on Gross Amount of Income Derived from all Sources within the Philippines by Non-resident Foreign Corporation.** Verification and reconciliation of all information/documents gathered by this office disclosed that VGPC failed to withhold a final income taxes on Management Service Fees paid to MidAmerican Energy Holdings (CalEnergy Company, Inc.) for taxable year 2002 totaling P50,870,007.59. ***Under Article 13 par. 1 and 2b(ii) of the RP-US Tax Treaty*** provides royalties derived by a resident of one of the Contracting States from sources within the other contracting state may be taxed by both Contracting States. However, the tax imposed by that contracting State shall not exceed x x x x x x x x x in the case of the Philippine, the least of x x x x x x x x x x x x 15 percent of the gross amount of the royalties, where the royalties are paid by a corporation registered with the Philippine Board of Investments and engaged in preferred areas of activities. In view of the foregoing, VGPC is bound to withhold 15% of all payments made to MidAmerican Energy Holdings for the services the latter rendered.

2. ***On Final Withholding of Value-added Tax.*** Verification and reconciliation of all information/documents gathered by this office disclosed that VGPC failed to withhold a final Value-added tax on Management Service Fees paid to MidAmerican Energy Holdings (CalEnergy Company, Inc.) for taxable year 2002 totaling P50,870,007.59. ***Revenue Regulation No. 14-2002, sec. 7*** provides "In general, value-added tax due on the sale of goods and services are not subject to withholding since the tax is not determinable at the time of sale. However, gross payments to non-residents by both government and private entities for services rendered in the Philippines shall be subject to final withholding tax at the rate of 10% to be filed and paid using BIR Form No. 1600 xxxxxxx. In view hereof, VGPC is obligated to withhold 10% of all payments made to MidAmerican Energy Holdings for the services the latter rendered considering that Management Service Fees is subject to Value-Added Tax as provided by law. ***Under Sections 108 and 108 par. 6 of the National Internal Revenue Code of 1997,*** as amended, provides that "There shall be levied, assessed and collected, a value-added tax

---

[8] *Commissioner of Internal Revenue v. Smart Communication, Inc.*, G.R. Nos. 179045-46, August 25, 2010.
[9] Division Docket, Vol. II, p. 600.

equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties. The phrase sale or exchange of services means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors, x x x x x x x x x x x x x x x x x x. The phrase "sale or exchange of services shall likewise include: x x x x x x x x x x x x x x x x x x x x (6) The supply of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme."

The Assessment Notices No. 014-089-WT-2002-079-06 dated 20 June 2006,[10] state the computation of the disputed taxes for taxable year 2002 in the amount of P26,236,354.41, inclusive of interests and compromise penalties, as follows:

a.) For deficiency FWT

TAX TYPE WT BASED ON/REASON Audit findings, review & evaluation DUE DATE July 15, 2006	Basic Tax Add: 25% surcharge Interest fr. 2.11.02 to 7.15.06 compromise penalty TOTAL AMOUNT STILL DUE & COLLECTIBLE	Amount P 7, 630,501.14 1, 907,625.28 5, 928,723.27 229,000.00 P 15,695,849.69

b) For deficiency WVAT

TAX TYPE WT BASED ON/REASON Audit findings, review & evaluation DUE DATE July 15, 2006	Basic Tax Add: 25% surcharge interest fr. 2.11.02 to 7.15.06 compromise penalty TOTAL AMOUNT STILL DUE & COLLECTIBLE	Amount P 5, 087,000.77 1, 271,750.19 3, 952,753.76 229,000.00 P 10,540,504.73

In this case, petitioner assails that the Assessments are erroneous.

"Where the taxpayer is appealing to the tax court on the ground that the Collector's assessment is erroneous, it is incumbent upon him to prove there what is the correct and just liability by a full and fair disclosure of all

[10] Exhibits "F", "F-1", "F-2", "G","G-1" & "G-2", Division Docket, Vol. II, pp. 613-614.

pertinent data in his possession. Otherwise, if the taxpayer confines himself to proving that the tax assessment is wrong, the tax court proceedings would settle nothing, and the way would be left open for subsequent assessments and appeals in interminable succession."[11]

Based on the foregoing, the taxpayer assailing the assessments has the burden of proving that the tax assessments are wrong **and** also what is the correct and just liability.

Petitioner failed to prove that services were performed abroad

Petitioner alleges that even assuming for the sake of argument that the assessment has not yet prescribed, it is not liable for the alleged deficiency taxes because the Management/Service Fees paid to MEHC are service fees and not royalty payments; the service fees paid by VGPC to MEHC are not Philippine-sourced income under the "source rule" principle of taxation; MEHC is a non-resident foreign corporation, and thus, taxed only on Philippine-sourced income; and that even assuming for the sake of argument that the payments have a Philippine source, there is no Philippine Permanent Establishment ("PE") against which the income of MEHC could be attributed, hence, the same is not subject to Philippine taxes.

Petitioner argues that respondent failed to adduce any evidence which would prove that the services provided by MEHC to petitioner are rendered within the Philippines. Petitioner alleges that it has proven through documentation and other relevant proof that the services provided by MEHC are performed outside the Philippines, particularly the US. Since the services are rendered outside the Philippines, these would not have a Philippine source.

Petitioner states that the management fees paid by petitioner to MEHC for the Services may not fall under the definition of royalty payments pursuant to the Philippine-US Treaty. Article 13 (3)[12] of the treaty provides that the term "royalties" refer to the use or the right to use proprietary rights on copyright, patent, trademark, design or model plan, secret formula or process or other like right of property and information concerning industrial, commercial or scientific experience.

---

[11] *Sy Po v. Court of Tax Appeals , et al.*, G.R. No. L-81446, August 18, 1988 citing the case of *Collector of Internal Revenue v. Reyes*, 104 Phil 1061 (1958) Unrep., Nos. L-11534 and L-11558, November 25, 1958.

[12] "3. The term 'royalties' as used in this article means payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. The term 'royalties' also includes gains derived from the sale, exchange or other disposition of any such right or property which are contingent on the productivity, use, or disposition thereof."

Petitioner argues that considering that MEHC is a non-resident foreign corporation, it is only subject to Philippine-sourced income as provided under Section 23 (f) of the Tax Code, which provides:

> "(F) A foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines."

Petitioner alleges that considering that the services rendered by MEHC are rendered offshore, and therefore, not sourced within the Philippines, it necessarily follows that the income from such services are not taxable in the Philippines, and that in like manner, the payments are neither subject to Philippine VAT.

Petitioner submits that MEHC can render the contemplated services outside the Philippines. With modern technology such as telecommunications, fax, email, internet, and videophone, personnel from MEHC do not have to be physically present in the Philippines to perform these services as alleged by petitioner. Even assuming for the sake of argument that there is income sourced from the Philippines, the same shall only be taxed if MEHC has a permanent establishment (PE)[13] in the Philippines under the Treaty. Petitioner alleges that MEHC has no PE in the Philippines. Petitioner explains that Article 8(1)[14] of the Philippine - US Treaty provides that US residents are taxable in the Philippines only on business profits[15] attributable to the PE. gr

---

[13] Article 5
Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which a resident of one of the Contracting States engages in a trade or business.

2. The term "fixed place of business" includes but is not limited to:
(a) A seat of management;
(b) A branch;
(c) An office;
(d) A store or other sales outlet;
(e) A factory;
(f) A workshop;
(g) A warehouse;
(h) A mine, quarry, or other place of extraction of natural resources;
(i) A building site or construction or assembly project or supervisory activities in connection therewith, provided such site, project or activity continues for a period of more than 183 days; and
(j) The furnishing of services, including consultancy services, by a resident of one of the Contracting States through employees or other personnel, provided activities of that nature continue (for the same or a connected project) within the other Contracting State for a period or periods aggregating more than 183 days.

[14] **ARTICLE 8**
BUSINESS PROFITS

(1) Business profits of a resident of one of the Contracting States shall be taxable only in that State unless the resident has a permanent establishment in the other Contracting State. If the resident has a permanent establishment in that other Contracting State, tax may be imposed by that other Contracting State on the business profits of the resident but only on so much of them as are attributable to the permanent establishment.

[15] (6) The term "business profits" means income derived from any trade or business whether carried on by an individual, corporation or any other person, or group of persons, including the rental of tangible (movable) property.

Petitioner's contentions are unmeritorious.

Pertinent portions of the Service Agreement[16] made and entered into on June 1, 1996 between CalEnergy Company, Inc. [now MEHC] and Petitioner, state:

> WHEREAS, VGPC requires corporate management, financial planning support, technical and administrative support services (the "Services") for the operation of the Malitbog Geothermal Power Plant in the Philippines;
>
> WHEREAS, the Services to be provided by CE to VGPC will neither involve the grant of a license for the use of its proprietary rights nor will CE gain any proprietary right for methods, processes or information developed or acquired in the course of rendering services to VGPC;
>
> xxx xxx xxx
>
> NOW, THEREFORE , the parties agree as follows:
>
> xxx xxx xxx
>
> 9. Delegation of Duties/**Performance of Services within the Philippines.** CE may perform any of the Services required herein either directly or through any of its affiliates or subsidiaries or authorized third parties. In the event that any of the Services shall be required to be performed within the Philippines, the presence of any CE personnel or the personnel of any of its affiliates or subsidiaries or authorized third parties performing such Services in the Philippines shall not exceed a period or periods aggregating more than 183 days.

"In our jurisprudence, the test of taxability is the 'source', and the source of an income is 'that activity . . . which produced the income' *(Howden & Co., Ltd. vs. Collector of Internal Revenue, 13 SCRA 601, reiterated in Commissioner of Internal Revenue vs. Japan Air Lines, Inc., 202 SCRA 450).* It is not the presence of any property from which one derives rentals and royalties that is controlling, but rather as expressed under the **expanded meaning of 'royalties', it includes 'royalties for the supply of scientific, technical, industrial, or commercial knowledge or informations; and the technical advice, assistance or services rendered**

[16] Exhibit "R-14", Division Docket, Vol. II, pp. 587-591.

in connection with the technical management and administration of any scientific, industrial or commercial undertaking, venture, project or scheme', and others (Section 37 (a)(7)[17] as amended by P.D. 1457)."[18] *(Emphasis Supplied)*

Section 9 of P.D. 1457[19] reads:

> SECTION 9. Subparagraph (4) of paragraph (a) of Section 37 of the National Internal Revenue Code is hereby amended to read as follows:
>
> **"(4) Rentals and royalties.** — Rentals and royalties from property located in the Philippines or from any interest in such property, including rentals or royalties for —
> "(A) the use of, or the right or privilege to use in the Philippines any copyright, patent, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;
> "(B) the use of, or the right to use in the Philippines any industrial, commercial or scientific equipment;
> "(C) the supply of scientific, technical, industrial or commercial knowledge or information;
> "(D) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property, or right as is mentioned in paragraph (a) any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c); or
> "(E) the supply of services by a nonresident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any brand, machinery or other apparatus purchased from such nonresident person;
> **"(F) any other amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;** and
> "(G) the use of or the right to use —
> "(i) motion picture films;
> "(ii) films or video tapes for use in connection with television; or

[17] Should be Section 37 (a) (4) of the 1977 NIRC as amended.
[18] *Philippine American Life Insurance Company, Inc. et al v. Hon. Court of Tax Appeals, and The Commissioner of Internal Revenue*, CA-G.R. SP No. 31283, April 25, 1995 (CTA Case No. 3504, 3943), with Entry of Judgment, October 11, 1995.
[19] Amending Certain Sections of the National Internal Revenue Code of 1977, as amended, and for other Purposes, June 11, 1978.

"(iii) tapes for use in connection with radio broadcasting." *(Emphasis Supplied).*

It is noteworthy to mention that Section 37 (a)(4) of the National Internal Revenue Code (NIRC) of 1977 as amended by P.D. 1457 is now Section 42 (A)(4) of the 1997 NIRC which reads as follows:

SECTION 42. *Income from Sources Within the Philippines.* —

(A) Gross Income From Sources Within the Philippines.— x x x

(4) Rentals and Royalties. — Rentals and royalties from property located in the Philippines or from any interest in such property, including rentals or royalties for —

"(a) The use of or the right or privilege to use in the Philippines any copyright, patent, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;

"(b) The use of, or the right to use in the Philippines any industrial, commercial or scientific equipment;

"(c) The supply of scientific, technical, industrial or commercial knowledge or information;

"(d) The supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a), any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c);

"(e) The supply of services by a nonresident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any brand, machinery or other apparatus purchased from such nonresident person;

"(f) Technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; and

"(g) The use of or the right to use:

"(i) Motion picture films;

"(ii) Films or video tapes for use in connection with television; and

"(iii) Tapes for use in connection with radio broadcasting. *(Emphasis Supplied).*

A plain reading of the said provisions shows that the services rendered by MEHC such as the corporate management, financial planning support, technical and administrative support services (the "Services") for the operation of the Malitbog Geothermal Power Plant in the Philippines are covered by the expanded meaning of royalties.

The CTA First Division discussed that:

> "In general, a non-resident foreign corporation is liable for gross income tax on income derived from all sources within the Philippines. Section 28 (B)(1)[20] of the NIRC of 1997, as amended, provides:
>
> SEC. 28. *Rates of Income Tax on Foreign Corporations.* —
>
> xxx xxx xxx
>
> (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 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 or 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 shall be thirty percent (30%).
>
> On the other hand, to be liable for VAT, a non-resident foreign corporation should render service in the Philippines. Sections 105 and 108 (A) of the NIRC of 1997, as amended, state:

---

[20] Should be read as follows (Prior to the amendment by RA 9337 which was enforced on November 1, 2005):
"SECTION 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 or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs 5(c) and (d): Provided, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and, effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).

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.

xxx xxx xxx

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

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

(A) *Rate and Base of Tax.* — . . .

xxx xxx xxx

The phrase *'sale or exchange of services'* means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, xxx

xxx xxx xxx

Based on [the] above–mentioned provisions of the NIRC, in order for petitioner not to be subject to FWT, it must prove that MidAmerican Energy Holdings Company is (1) a foreign corporation not engaged in business in the Philippines; and (2) its source of income came from outside of the Philippines. On the other hand, in order for petitioner not to be subject to WVAT, it must prove that MidAmerican Energy Holdings Company is (1) a non-resident foreign corporation; and (b) it rendered services outside of the Philippines."[21]

In *Commissioner of Internal Revenue v. Juliane Baier-Nickel, as represented by Marina Q. Guzman (Attorney-in-fact)*,[22] "the [Supreme] Court reiterates the rule that 'source of income' relates to the property, activity or service that produced the income. With respect to rendition of

[21] *Rollo*, pp. 84-85.
[22] *Commissioner of Internal Revenue v. Juliane Baier-Nickel, as represented by Marina Q. Guzman (Attorney-in-fact)*, G.R. No. 153793, August 29, 2006.

labor or personal service, as in the instant case, it is the place where the labor or service was performed that determines the source of the income."

Applying the *Baier-Nickel* case *(supra)*, the CTA 1st Division states that "[i]n petitioner's case, the source of income of MidAmerican Energy Holdings Company is its corporate management, financial planning support, and technical and administrative support services it provides to petitioner."[23]

In this case, it is important to prove where such services were performed.

In the instant case, there is no proof that the services were rendered in its Head Office in the United States. It is noteworthy to mention that the written correspondences (Exhibits "RR," "SS," "TT," "UU," "VV," and "WW," with all sub-markings), which were received through facsimile allegedly showing proof of the services rendered by MEHC on behalf of petitioner in its Head Office,[24] were denied admission[25] by the CTA 1st Division.

We also reiterate with approval the findings of the CTA 1st Division, as follows:

> "Petitioner, in an attempt to prove that MidAmerican Energy Holdings Company's services are performed abroad, presented, among others, the Judicial Affidavit of its witness. The Court finds the testimony of petitioner's witness in the Judicial Affidavit insufficient to establish its allegation. Similarly, the Service Agreement between petitioner and MidAmerican Energy Holdings Company (CalEnergy Company, Inc.) merely stipulates the kinds of services that MidAmerican Energy Holdings Company will perform but not the manner and the place where the said services will be performed. **What it merely proves is that MidAmerican Energy Holdings Company is a foreign corporation not engaged in business in the Philippines as shown by its Proof of Residency for taxable years 2002 to 2012 and Certification of Non-Registration of Company issued by the SEC. Consequently, petitioner is liable for FWT and WVAT.**"[26] (Emphasis supplied) *Jr*

---

[23] *Rollo*, p.86.
[24] Division Docket, Vol. I, p. 434.
[25] Division Docket, Vol. II, p. 980.
[26] *Rollo*, p. 86.

Based on the foregoing discussions, this Court agrees that petitioner is liable for the said taxes for its failure to prove that MEHC performed the services outside the Philippines.

The ten (10)-year prescriptive period is applicable in this case

Petitioner alleges that in applying the 10-year prescriptive period, as an exception to the general rule, respondent must prove by clear and convincing evidence that the returns are false. Otherwise, the applicable prescriptive period shall be three (3) years. Petitioner alleges that such burden cannot be conveniently shifted to the petitioner on the basis of the presumption that the assessment is presumed correct. Petitioner also alleges that the cases of *Aznar v. Court of Tax Appeals*[27] *("Aznar case")* and *Commissioner of Internal Revenue v. The Estate of Benigno Toda, Jr.*[28] *("Benigno Toda case")* are not applicable to this case. Petitioner argues that since respondent failed to prove any fraud or falsity on the part of the petitioner, the regular three (3) year prescriptive period should apply, and that the assessments have already prescribed for being issued beyond the said period.

Petitioner's arguments are untenable.

As a general rule, internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return or from the day the return was filed, whichever is later.[29]

The exceptions to the 3-year period of assessment are provided in Section 222(a) of the NIRC of 1997, as amended, which states:

> "SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* –
>
> (a) In the case of a <u>false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or</u>

[27] No. L-20569, August 23, 1974.
[28] G.R. No. 147188, September 14, 2004.
[29] Section 203 of the National Internal Revenue Code of 1997, as amended, states:

"SEC. 203. *Period of Limitation Upon Assessment and Collection.*— Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

omission: *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof." (Underscoring Supplied)

In this case, the CTA 1st Division ruled that the ten-year prescriptive period is applicable because the returns are false and We agree, thus, pertinent portions of the assailed Decision[30] are quoted:

"A false return implies deviation from the truth whether intentional or not. **Since petitioner failed to prove that MidAmerican Energy Holdings Company's source income is derived from sources outside the Philippines and that it rendered services outside of the Philippines, the returns filed are considered false, justifying the application of the ten-year prescriptive period under Section 222 of the NIRC of 1997.**

The various returns of petitioner for FWT and WVAT were filed in 2002 and 2003. Counting ten years from those years, respondent had until 2012 and 2013 to assess petitioner for deficiency FWT and WVAT. Since the PAN, the FAN, and the Preliminary Collection Letter were received by petitioner on May 5, 2006, June 23, 2006, and January 9, 2012, respectively, respondent's right to assess and/or collect from petitioner deficiency FWT and WVAT has not yet prescribed." *(Emphasis Supplied)*

Pertinent portions of the assailed Resolution[31] is also reiterated with approval:

"In the case of *Aznar vs. Court of Tax Appeals,* the Supreme Court held that a return is considered false when there is deviation from the truth whether intentional or not, to wit:

'We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1)

[30] Division Docket, Vol. II, p. 1196; *Rollo*, p. 88.
[31] Division Docket, Vol. II, pp. 1227 to 1228; *Rollo*, pp. 94 to 95.

> falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely "falsity", "fraud" and "omission". That there is a difference between **"false return"** and "fraudulent return" cannot be denied. While the first merely **implies deviation from the truth, whether intentional or not,** the second implies intentional or deceitful entry with intent to evade the taxes due.' *(Emphasis supplied)"*

Furthermore, in the case of *Commissioner of Internal Revenue vs. The Estate of Benigno P. Toda, Jr., et al.,* the Supreme Court ruled that even if the return merely failed to reflect the true or actual amount without fraud on the part of the taxpayer, the prescriptive period to assess the correct taxes is ten years from the discovery of the falsity.

> 'And even assuming *arguendo* that there was no fraud, we find that the income tax return filed by CIC for the year 1989 was false. It did not reflect the true or actual amount gained from the sale of the Cibeles property.'

The *'nil'* returns filed by petitioner are considered false since petitioner is liable for FWT and WVAT when it failed to prove that the income payments made to MEHC were exempt from FWT and WVAT. Moreover, petitioner's allegation that there was no evidence presented to prove its intention to deviate from the truth when it filed the corresponding FWT and WVAT returns is of no moment. A false return implies deviation from the truth whether intentional or not."

Based on the foregoing, the ten-year prescriptive period is applicable in this case.

Management/Service Fees paid to MEHC for taxable year 2002 amounted to ₱11,045,589.13

Petitioner alleges that the total service fees paid to MEHC for the taxable year 2002 amounted to only ₱11,045,589.13 and not ₱50,870,005.59

as alleged in the assailed Assessment Notices. To support its claim, Petitioner even attached to the Petition for Review a copy of its Audited Financial Statements as of 31 December 2002 (specifically, Note 8) admitted as Exhibit "LL", and that a perusal of the management fees paid to MEHC for 2002 per invoice (Exhibits "XX" to "III") would reveal that the fees totaled only P11,045,589.13. Petitioner compared the actual amount of management fees paid to MEHC for 2002 per invoice (₱11,045,589.13) versus the amount lifted by respondent (₱50,870,007.59) which resulted to a discrepancy of ₱39,824,418.46.

After a careful perusal of the records, this Court finds that petitioner's contention is meritorious.

Petitioner's Notes to Audited Financial Statements for the years ended December 31, 2002 and 2001 (Amounts in thousands, unless indicated otherwise), specifically Notes 8 and 10, report management service fees and cost allocation of ₱61,916,000,[32] of which only ₱11,046,000 pertain to management fees paid to MidAmerican (formerly CalEnergy Company, Inc.).[33] The pertinent portions of the Audited Financial Statements, read:

<u>Note 8- Related party transactions; payable to affiliates</u>

In the normal course of business, the Partnership transacts with companies which are considered related parties under SFAS 24/IAS 24, "Related Party Disclosures". These transactions mainly involve the following:

xxx xxx xxx

b) Management fees amounting to P11,046 for the year ended December 31, 2002 (2001 – P11,994) to MidAmerican (formerly CalEnergy Company, Inc.). Under the terms of the service agreement, the Partnership shall pay a fee equivalent to 10% of the Partnership's operating expenses in consideration for support services rendered by MidAmerican (Note 10).

c) Cost allocations amounting to P34,915 for the year ended December 31, 2002 (2001 – P46,261) from CalEnergy International Services, Inc. (CEISI). Under the provisions of the agreement, the Partnership shall reimburse actual expenses incurred to facilitate the promotion and development of the business relationship between the Partnership and its customer (Note 10).

d) Service fees amounting to P15,955 for the period October 1 to December 31, 2002 to the Regional Operating Headquarters of

[32] Exhibit "LL", Division Docket Vol. II, p. 739.
[33] *Id.*, p. 737.

CalEnergy International Services, Inc. (CEISI- ROHQ). On October 1, 2002, CEISI-ROHQ has commenced operations for the primary purpose of performing qualifying services for MidAmerican's affiliates, subsidiaries or branches located in the Asia Pacific Region. CEISI-ROHQ shall bill the Partnership based on actual services rendered (Note 10).

xxx xxx xxx

Note 10 – Plant Operations

Details of the plant operation expenses for the years ended December 31 consist of:

	2002	2001
xxx xxx xxx	P xxx	xxx
Management Service fees and cost allocations (Note 8)	61,916	58,255
xxx xxx xxx		

As correctly pointed out by petitioner, respondent's examiner erroneously took up the amounts of cost allocations from CalEnergy International Services, Inc. (CEISI) and service fees paid to the Regional Operating Headquarters of CalEnergy International Services, Inc. (CEISI-ROHQ) as management fees paid by petitioner to MidAmerican (formerly CalEnergy Company, Inc.),[34] as shown hereafter:

Cost allocations from CEISI	₱ 34,915,000.00
Service fees to CEISI-ROHQ	15,955,000.00
Total	**₱50,870,000.00**

Petitioner also submitted to the Court the invoices issued by MEHC for the year 2002[35] pertaining to the subject management fees, summarized as follows:

Month	Exhibit	USD	PHP[36]
January	"XX"	16,455.90	842,871.20
February	"YY"	26,223.70	1,345,669.17
March	"ZZ"	16,277.40	832,507.62
April	"AAA"	15,574.60	791,547.90
May	"BBB"	19,954.70	999,131.83
June	"CCC"	19,279.60	972,077.43
July	"DDD"	12,837.20	656,622.78
August	"EEE"	15,543.40	805,769.86

[34] Exhibit "NN", Q&A No. 33, Division Docket, Vol. II, p. 764; see also TSN (September 6, 2012 Hearing), pp. 31-34.
[35] Division Docket, Vol. II, pp. 922-933.
[36] Exhibit "J", pp. 5-6, Division Docket, Vol. II, pp. 646-647.

September	"FFF"	18,138.20	951,529.97
October	"GGG"	17,314.10	920,071.27
November	"HHH"	16,423.30	879,139.25
December	"III"	19,674.50	1,048,650.85
TOTAL		**213,696.60**	**11,045,589.13**

Based on the foregoing discussion, the Court is convinced that the total amount of management fees for the year 2002, which should be the basis of the subject assessment, is ₱11,045,589.13.

We do not agree, however, with petitioner's contention that the BIR's findings must be stricken down because the basis used by the BIR to calculate the alleged deficiency FWT and WVAT was erroneous. "[A]ny error made by a tax official in the assessment or computation of taxes does not have the effect of relieving the taxpayer from the full amount of liability as fixed by law. Errors of tax officers or officials of the Government do not bind the Government or prejudice its right to the taxes or dues collectible by it from its citizens. (*Canlubang Sugar Estate v. Standard Alcohol Co. [Phil.], Inc., G. R. No. L-10887, April 16, 1958; Philippine American Drug Co. v. Collector of Internal Revenue, et al.,* G.R. No. L-13032, August 31, 1959; *Teodoro Lewin v. Emilio Galang,* G.R. No. L-15253, Oct. 31, 1960.)"[37]

With respect to the compromise penalties in the amount of ₱229,000.00 each for the assessment in deficiency FWT and in FWVAT, respectively, this Court finds the imposition of compromise penalties to be without legal basis. Compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on the taxpayer in the event that a taxpayer refuses to pay the same.[38] Thus, compromise penalties imply mutual agreement between the taxpayer, on one hand, and the CIR, on the other. Considering that there is no mutual agreement in this case, the compromise penalties should not be imposed.

In sum, the Court *En Banc* agrees with the findings and conclusions rendered by the First Division of this Court except for the amount of the management/service fees paid and the imposition of compromise penalties.

WHEREFORE, premises considered, the Petition for Review *En Banc* is **PARTLY GRANTED.** Accordingly, the assailed Decision and the Resolution promulgated on November 17, 2014 and on March 16, 2015, respectively, by the CTA First Division are **AFFIRMED with**

[37] *Collector of Internal Revenue v. McGrath*, G.R. No. L-12710, February 28, 1961, & *McGrath v. Collector of Internal Revenue*, G.R. No. L- 12721, February 28, 1961.
[38] Revenue Memorandum Order (RMO) NO. 01-90.

MODIFICATIONS. The Compromise Penalties are **CANCELLED.** Management/Service fees amount to only ₱ 11,045,589.13.

Accordingly, petitioner (Visayas Geothermal Power Company) is ordered to pay respondent the total deficiency tax liability amounting to ₱3,451,746.60, inclusive of the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, computed as follows:

	Final Withholding Tax	**Final Withholding of VAT**	**Total**
Management fees	₱ 11,045,589.13	₱ 11,045,589.13	
Tax rate	15%	10%	
Deficiency tax	₱ 1,656,838.37	₱ 1,104,558.91	₱ 2,761,397.28
Surcharge (25%)	414,209.59	276,139.73	690,349.32
Total	**₱ 2,071,047.96**	**₱ 1,380,698.64**	**₱ 3,451,746.60**

In addition, petitioner is likewise held liable to pay:

a) Deficiency interest at the rate of 20% per annum pursuant to Section 249(B) of the NIRC of 1997, as amended, on the basic deficiency final withholding tax and final withholding on value-added tax, computed from February 10, 2002, March 10, 2002, April 10, 2002, May 10, 2002, June 10, 2002, July 10, 2002, August 10, 2002, September 10, 2002, October 10, 2002, November 10, 2002, December 10, 2002 and January 15, 2003, until full payment thereof; and

b) Delinquency interest at the rate of 20% per annum on the total amounts due of ₱2,071,047.96 and ₱1,380,698.64 representing deficiency final withholding tax and final withholding on value-added tax, inclusive of the 25% surcharge thereon, respectively, and on the deficiency interest which have accrued as aforestated in (a), computed from July 15, 2006[39] until full payment thereof, pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

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

[39] Exhibits "F" and "G", Division Docket, Vol. II, pp. 613-614.

WE CONCUR:

(With Concurring and Dissenting Opinion)
ROMAN G. DEL ROSARIO
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

(With due respect, I join PJ's Concurring and Dissenting Opinion.)
ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

VISAYAS GEOTHERMAL POWER COMPANY, *Petitioner,*	**CTA EB NO. 1291** (CTA Case No. 8425)
-versus-	Present: **DEL ROSARIO**, *PJ*, **CASTAÑEDA, JR.**, **BAUTISTA**, **UY**, **CASANOVA**, **FABON-VICTORINO**, **MINDARO-GRULLA**, *and* **RINGPIS-LIBAN**, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, *Respondents.*	Promulgated: SEP 21 2016 3:06 p.m.

x- -x

CONCURRING AND DISSENTING OPINION

DEL ROSARIO, PJ.:

I concur with the conclusions reached by the *ponencia* which partially granted the petition filed by Visayas Geothermal Power Company (VGPC) except for the imposition of deficiency interest on the assessed deficiency final withholding tax (FWT) and final withholding on value-added tax (FWVAT).

I reiterate my consistent position that deficiency interest may only be imposed on tax specifically covered and defined by the relevant provisions of the National Internal Revenue Code (NIRC), *i.e.*, income tax, donor's tax and estate tax. Consequently, the imposition of deficiency interest on the assessed deficiency FWT and FWVAT in the present case must be cancelled.

In this regard, I quote below the position I have taken in the consolidated cases of *Commissioner of Internal Revenue vs.*

Philippine Tobacco Flue-Curing & Redrying Corporation[1] on the imposition of deficiency interest:

> "xxx I am not unaware of *Paper Industries Corporation of the Philippines vs. Court of Appeals, Commissioner of Internal Revenue, and Court of Tax Appeals (PICOP)*,[2] which somehow made mention of deficiency interest under the NIRC of 1977. **I must stress, however, that *PICOP* cannot be relied upon to justify the imposition of deficiency interest on petitioner's excise tax liability. *PICOP* did not state nor resolve the issue whether or not the deficiency interest provided for in Section 249 (B) of the NIRC of 1997, as amended, may be imposed on tax other than donor's, estate, and income taxes.** Thus, not having been resolved therein, *PICOP* cannot be considered as a doctrine on the matter. The case of *Office of the Ombudsman vs. Honorable Court of Appeals and Former Deputy Ombudsman for the Visayas Arturo C. Mojica*,[3] is instructive:
>
>> 'The legal maxim "*stare decisis et non quieta movere*" (follow past precedents and do not disturb what has been settled) states that where the same questions relating to the same event have been put forward by parties similarly situated as in a previous case litigated and decided by a competent court, the rule of *stare decisis* is a bar to any attempt relitigate the same issues.
>>
>> xxx xxx xxx
>>
>> **Thus, where the issue involved was not raised nor presented to the court and not passed upon by the court in the previous case, the decision in the previous case is not *stare decisis* of the question presented.'**

---

[1] CTA EB Nos. 1218 and 1220, April 11, 2016. This is consistent with my earlier opinion in *Avon Products Manufacturing, Inc. vs. Commissioner of Internal Revenue, CTA EB No. 1062, January 15, 2016; CIR vs. Staedtler (Philippines), Inc., CTA EB No. 1310, January 28, 2016; Medicard Philippines, Inc. vs. CIR, CTA EB No. 1224, January 29, 2016; Lourdes College vs. CIR, CTA EB No. 1164, February 2, 2016; Philippine Aerospace Development Corporation vs. CIR, CTA EB No. 1035, February 9, 2016; CIR vs. BPI-Philam Life Assurance Corporation, CTA EB No. 1240, February 11, 2016; CIR vs. OfficeMetro Philippines, Inc. (formerly Regus Centres, Inc.), and OfficeMetro Philippines, Inc. vs. CIR, CTA EB Nos. 1210 & 1213, March 7, 2016; CIR vs. ESS Manufacturing Company, Inc., ESS Manufacturing Company, Inc. vs. CIR, CTA EB Nos. 1169 & 1175, March 30, 2016; and Lourdes College vs. Commissioner of Internal Revenue, CTA EB No. 1164, July 28, 2016.*

[2] G.R. Nos. 106949-50, December 1, 1995.

[3] G.R. No. 146486, March 4, 2005.

If *PICOP* has any relevance to the present controversy, it is the doctrinal precedent that **deficiency interest may be imposed only on tax specifically covered by the relevant provision of the NIRC of 1977**. Thus, the Court in *PICOP*, while recognizing that transaction tax is in the nature of income tax and that deficiency interest is imposable on income tax, nonetheless declined to impose such deficiency interest on transaction tax after noting the significant provisions of the NIRC of 1977: ***first*, it is Section 51 (c)(1), (e)(1), and (3) which impose deficiency interest; *second*, Section 51(c)(1) confines such deficiency interest on taxes covered by TITLE II; and, *third*, that transaction tax does not fall within TITLE II.** Thus:

> **'It will be seen that Section 51 (c) (1) and (e) (1) and (3), of the 1977 Tax Code, authorize the imposition of surcharge and interest only in respect of a *"tax imposed by this Title,"* that is to say, Title II on "Income Tax."** It will also be seen that Section 72 of the 1977 Tax Code imposes a surcharge only in case of failure to file a return or list *"required by this Title,"* that is, *Title II on "Income Tax."* **The thirty-five percent (35%) transaction tax is, however, imposed in the 1977 Tax Code by *Section 210 (b) thereof which Section is embraced in Title V on "Taxes on Business"* of that Code.** Thus, while the thirty-five percent (35%) transaction tax is in truth *a tax imposed on* interest *income* earned by lenders or creditors purchasing commercial paper on the money market, the relevant provisions, *i.e.,* Section 210 (b), were *not* inserted in Title II of the 1977 Tax Code. The end result is that the thirty-five percent (35%) transaction tax is *not* one of the taxes in respect of which Section 51 (e) authorized the imposition of surcharge and interest and Section 72 the imposition of a fraud surcharge.'

True, the Supreme Court in *PICOP* declared that the present provision of the NIRC mentions that **additions** on tax applies to all taxes. While such pronouncement may not be construed beyond the context in which it was made, *PICOP* simply confirmed that *in general*, certain penalties and charges are applicable to all types of tax or deficiency tax; **PICOP, however, did not categorically construe the provision of Section 249 (B) that deals with "deficiency interest" on the type of tax "as defined in [the] Code."** Note that the present NIRC is

wm

> explicit with respect to the type of tax on which deficiency interest may be imposed, viz:
>
> > 'Section 249.Interest-
> >
> > (B) Deficiency Interest. – Any deficiency in the tax due, **as the term is defined in this Code**, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.' (Emphasis supplied)
>
> **Section 249 (B) cannot be any clearer: the deficiency interest must refer only to 'deficiency in the tax due, as the term is defined in [the] Code.'**
>
> Verily, as the law stands, only donor's, estate, and income taxes carry a provision on deficiency tax; they are the types of taxes on which such deficiency interest may be imposed.
>
> Finally, Sections 247 (a) and 249 (A) are **general provisions** that impose "additions" to the tax and "interest" thereon. Both sections may not be read in isolation from the relevant and **specific provision** of Section 249 (B) with respect to the imposition of "deficiency" interest, more so as all these provisions fall within the same Chapter I of Title X of the NIRC of 1997, as amended.
>
> Otherwise stated, Sections 247 (a) and 249 (A) must reasonably be read and construed subject to the provision of Section 249 (B) - - all these provisions being covered by the **same** Chapter I of Title X of the NIRC of 1997, as amended."

In sum, deficiency interest may be imposed only on tax specifically covered and defined by the relevant provisions of the NIRC, *i.e., income tax, donor's tax and estate tax*; **conversely, deficiency interest may not properly be imposed on FWT and FWVAT assessed against petitioner.**

Also apt is my discussion in my Concurring and Dissenting Opinion in *Philippine Aerospace Development Corporation vs. Commissioner of Internal Revenue*[4] which I quote below:

[4] CTA EB No. 1035, February 9, 2016.

> 'Settled is the rule that laws imposing tax is construed strictly against the government and liberally in favor of the taxpayer. **Unless clearly imposed by pertinent provision of law, deficiency interest as an additional tax burden should not simply be presumed. Thus, the obligation to pay deficiency interest may not be applied to taxes other than income tax, donor's tax and estate tax, irrespective of whether an assessment is issued or not. After all, the deficiency tax assessed is still subject to the delinquency interest rate of 20% per annum until fully paid. Truth be told, the delinquency interest rate of 20% is way more than the legal interest of 12% per annum.**'

The power of taxation is sometimes called also the power to destroy. It should, therefore, be exercised with caution to minimize injury to the proprietary rights of a taxpayer. **It must be exercised fairly, equally and uniformly, lest the tax collector kills the hen that lays the golden egg.[5] Indeed, the imposition of 20% deficiency interest per annum on a <u>tax not clearly within the context of the law</u>, in addition to 20% delinquency interest per annum and a surcharge of 25% on the amount due under Section 248 of the NIRC, is too burdensome for a taxpayer to survive and continue with its business affairs.**

At this point, I would also like to re-state my *obiter dictum* in my Concurring Opinion on the Resolution dated March 16, 2015,[6] relative to the application of the ten (10) year prescriptive period to assess in case of false returns, *viz.*:

> In *Aznar vs. Court of Tax Appeals*, the Supreme Court held that to be considered false returns, mere deviation from the truth, whether intentional or not, is sufficient, *viz.*:
>
> > **'We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and**

---
[5] Roxas vs. Court of Tax Appeals, G.R. No. L-25043, April 26, 1968.
[6] Rollo, pp.99-102.

> **failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely "falsity", "fraud" and "omission". That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.'**

Pursuant to the *Aznar Case*, the ten (10) year prescriptive period to assess would apply for all false returns, whether done intentionally or not. In other words, as long as the returns indicate any false entry, the BIR can assess the taxpayer within ten (10) years from the discovery of the said falsification.

Unless and until modified by the Supreme Court *En Banc*, the pronouncement of the Supreme Court in the *Aznar case* stands. It need not be emphasized that in our judicial hierarchy, the Supreme Court reigns supreme. All courts, tribunals and administrative bodies exercising quasi-judicial functions are obliged to conform to its pronouncements. It has the last word on what the law is; it is the final arbiter of any justiciable controversy. In other words, there is only one Supreme Court from whose decisions all other courts should take their bearings.

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

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

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

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

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

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

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

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

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

attempted and falsity has not knowingly been indulged in to evade the tax; and,

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

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

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

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

(citations omitted)

All told, I vote to PARTIALLY GRANT the Petition for Review filed by VGPC. Accordingly, the assailed Decision and Resolution promulgated on November 17, 2014 and on March 16, 2015, respectively, should be AFFIRMED with MODIFICATIONS. The Compromise Penalties should be CANCELLED. The Management/ Service Fees should amount only to ₱11,045,589.13. Thus, VGCP should be ORDERED to pay respondent the total deficiency tax liability amounting to ₱3,451,746.60, inclusive of the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

	Final Withholding Tax	Final Withholding of VAT	TOTAL
Management Fees	₱ 11,045,589.13	₱ 11,045,589.13	
Tax Rate	15%	10%	
Deficiency Tax	₱ 1,656,838.37	₱ 1,104,558.91	₱ 2,761,397.28
Surcharge (25%)	414,209.59	276,139.73	690,349.32
Total	**₱ 2,071,047.96**	**₱ 1,380,698.64**	**₱ 3,451,746.60**

In addition, petitioner should likewise be held liable to pay delinquency interest at the rate of 20% per annum on the total amounts due of ₱2,071,047.96 and ₱1,380,698.64 representing deficiency FWT and FWVAT, inclusive of 25% surcharge thereon, respectively, computed from July 15, 2006 until full payment thereof, pursuant to Section 249(C)(3) of the NIRC of 1997, as amended.

ROMAN G. DEL ROSARIO
Presiding Justice