REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

THUNDERBIRD PILIPINAS HOTELS AND RESORTS, INC., Petitioner,	**CTA CASE NO. 7902**
	Members:
- versus -	**ACOSTA**, *PJ*, **UY**, *and*, **FABON-VICTORINO**, *JJ*.
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** JUL 18 2012; 2:00p.m.

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DECISION

ACOSTA, *PJ*:

This Petition for Review seeks the cancellation and withdrawal of the deficiency income and expanded withholding tax assessments issued by respondent against petitioner for taxable year 2006 in the amounts of P9,917,601.26 and P5,414,109.74, respectively, inclusive of increments.

THE FACTS

As stipulated by the parties in the Joint Stipulation of Facts and Issues[1] and as borne by the records of this case, the following are the undisputed facts:

Petitioner is a domestic corporation duly incorporated and existing under Philippines laws, with business address at VOA Pennsylvania Avenue, Poro Point, San Fernando City, La Union. It is engaged in the business of conducting and operating hotels, clubs, restaurants and all other businesses appurtenant and/or related thereto. It is also registered as a Poro Point Special Economic and Freeport Zone ("PPSEFZ")[2]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue ("BIR") with power, among others, to decide disputed assessments of deficiency internal revenue taxes and penalties imposed in relation thereto, with office address at the Fifth Floor, BIR National Office Building, BIR Road, Diliman, Quezon City where she may be served with summons and other legal processes.[3]

Petitioner filed its Annual Income Tax Return (ITR) for taxable year 2006 on April 16, 2007 with the BIR RDO No. 3. Revenue Region No. 1 in accordance with Section 77 of the 1997 NIRC.[4]

Petitioner's ITR for taxable year 2006 shows the amount of P14,201,733.00 as deferred rent under Line 115 thereof as a reconciling item on the company's net income per books against its taxable income.[5]

On November 19, 2008, Assessment Notice ("Assessment Notices") Nos. IT-03-06-241-973-218 and WE-03-06-241-973-218 for deficiency income tax and expanded withholding tax, respectively, together with a Formal Letter of Demand

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[1] *Rollo*, pp. 242-247.
[2] Joint Stipulation of Facts and Issues (JSFI), Par. 1, *Rollo*, p. 242.
[3] *Ibid*, Par. 2, p. 242.
[4] *Id*, Par. 8, p. 244.
[5] *Id*, Par. 10, p. 245.

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("FLD"), were issued against petitioner by the BIR through the Office of the Regional Director, Revenue Region No. 1 (Calasiao, Pangasinan), for the taxable year 2006, in connection with the investigation conducted pursuant to Letter of Authority No. 00072404 dated September 20, 2007. Petitioner received the Assessment Notices and FLD on November 26, 2008.[6]

Pursuant to the Assessment Notices, the BIR assessed petitioner for deficiency taxes in the aggregate amount of P15,331,711.00, inclusive of interest and penalties computed as follows:[7]

I. Income Tax		
Gross Taxable Income per Return		P 151,683,405.43
Add: Purchases Paid not in the name of Thunderbird		11,068,373.43
Taxable Income		P 162,751,778.43
Tax Due		P 8,137,588.92
Less: Basic Tax Paid		553,418.67
Basic Income Tax Deficiency		P 7,584,170.25
Interest (4.16.07 to 10.30.08)		2,333,431.01
Total Deficiency Income Tax		**P 9,917,601.26**
II. Expanded Withholding Tax		
Deficiency Withholding Tax on Outside Services		P 38,305.93
Deficiency Withholding Tax on Rent		1,134,402.22
Deficiency Withholding Tax on Legal and Professional Fees		759,895.33
Deficiency Withholding Tax on Marketing and Promotions		62,761.90
Deficiency Withholding Tax on Director's Fee		10,279.99
Deficiency Withholding Tax on Management Fee		1,979,199.86
Total Expanded Withholding Tax Deficiency		P 3,984,845.23
Add: Interest (1.16.07 to 10.30.08)	**P** 1,425,264.51	
Compromise Penalty (No January to March 1601-E and 1604-E with Alphabetical List of Payees	4,000.00	1,429,264.51
Total Deficiency Expanded Withholding Tax		**P 5,414,109.74**
Total Tax Deficiency		**P 15,331,711.00**

[6] *Id*, Par. 3, p. 243.
[7] *Id*, Par. 4, p. 243-244.

However, as indicated in the FLD, basic deficiency income tax in the amount of P533,418.67 arising from a disallowance of certain purchases that were allegedly not in the name of petitioner, was already paid by petitioner on May 8, 2008. The total amount paid was P761,557.01, including interest and surcharge.[8]

On December 23, 2008, petitioner filed with the Office of the Regional Director, BIR Revenue Region No. 1, a formal protest letter[9] against the deficiency tax assessments, citing both legal and factual grounds.

On February 19, 2009, petitioner filed with the Office of the Regional Director, BIR Revenue Region No. 1 a supplemental protest dated February 18, 2009 and submitted supporting documents.[10]

Through his letter dated February 24, 2009, BIR OIC Regional Director Tomas C. Rosales of Revenue Region No. 1 rendered a decision on petitioner's protest, denying the same with finality and sought to enforce collection of the alleged deficiency income tax and expanded withholding tax liability for taxable year 2006, in the aggregate amount of P15,331,711.00, inclusive of interest and penalties. Petitioner received the said letter on March 4, 2009.[11]

On March 30, 2009, petitioner received a collection letter from the Revenue District Officer ("RDO") of San Fernando City, La Union, requesting payment of the assessed tax within ten (10) days from receipt. Petitioner replied on April 1, 2009 that it will appeal the decision of the Regional Director to the Court of Tax Appeals on or before April 3, 2009, and consequently, requested the RDO to defer collecting the tax pending petitioner's exhaustion of its legal remedies under the law.[12]

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[8] *Id*, Par. 7, p. 244.
[9] Exhibit "P".
[10] Exhibit "Q".
[11] JSFI, Par. 5, p. 244.
[12] *Id*, Par. 6, p. 244.

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On April 3, 2009, petitioner filed the Petition for Review[13]. Thereafter, on August 24, 2009, it filed a Motion to Suspend Collection of Tax.[14]

On April 30, 2009, petitioner filed a Manifestation[15] submitting the correct document marked as Annex "A".

On May 8, 2009, respondent filed a First Motion for Extension of Time to File Answer.[16]

On May 15, 2009, the Court issued a Resolution[17] ordering the respondent to file a comment to petitioner's Motion to Suspend Collection of Tax within fifteen (15) days from notice and the petitioner to file a reply within five (5) days from receipt of the comment.

On June 10, 2009, respondent filed a Motion to Admit Attached Comment (Re: Comment on Petitioner's Motion to Suspend Collection of Taxes)[18].

On June 24, 2009, petitioner filed its Manifestation[19] attaching its advance copies of the Comment (to Respondent's Motion to Admit Comment) and Reply (to Respondent's Attached Comment) which it sent through registered mail on June 22, 2009.

On June 25, 2009, respondent filed a Motion to Admit Attached Answer[20].

In her Answer[21], respondent raised the following special and affirmative defenses:[22]

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[13] *Rollo*, pp. 4-51.
[14] *Rollo*, pp. 53-67.
[15] *Rollo*, pp. 71-73.
[16] *Rollo*, pp. 82-85.
[17] *Rollo*, pp. 87-88.
[18] *Rollo*, pp. 89-100.
[19] *Rollo*, pp. 101-110.
[20] *Rollo*, pp.111-127.
[21] *Rollo* 115-127.
[22] *supra.*

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4. Respondent adopts the abovementioned admission and denials defenses as part of his special and affirmative defenses.

5. Petitioner failed to submit all the required documents under the Notices sent by respondent.

5.1 On 21 September 2007, respondent sent a First Request for Presentation of Records that required petitioner to submit the following documents in relation to its 2006 Income Tax (IT), Value-Added Tax (VAT) and Withholding Taxes for examination:

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The First Request for Presentation of Records was signed by Revenue Officer Ernesto B. Penullar who was duly authorized to conduct examination on the books of accounts and records of petitioner for taxable year 2006 by virtue of Letter of Authority No. 00072404 dated 20 September 2007. The said First Request was received by a certain Maria Fe Ramos for petitioner.

5.2 On 23 October 2007, respondent, through Revenue Officer Penullar, sent a Second Request for Presentation of Records via registered mail. Respondent reiterated the need for petitioner to present the accounting records enumerated in the First Request. To emphasize this requirement, Section 20 of Revenue Regulations No. V-1 was quoted thereon as follows:

> "*Inspection of Books, Register and Records* – All books, register and other records and vouchers such as invoices required by regulations shall be kept at all times at the place of business of the taxpayer, subject to inspection by any Internal Revenue Office and upon demand, the same must be immediately be produced and submitted for inspection."

5.3 On 17 December 2007, respondent, through Revenue District Officer Imelda A. Bueno, sent a Final Notice Before Issuance of *Subpoena Duces Tecum*. In the Final Notice, the need for petitioner to present the documents required under the previous notices were reiterated with emphasis on the submission of all the required documents or face the consequence of having a *Subpoena Duces Tecum* served upon petitioner. The Final Notice was served by constructive notice on 17 December 2007. Still, however, petitioner refused to comply with the duty imposed upon it by law.

5.4 In a Memorandum for the Regional Director of Revenue District Office No. 3 dated 21 January 2008, revenue Officer Penullar reported that petitioner submitted photocopies of mandatory returns and made and oral request that it be given additional time to submit disbursements books and other source documents. Petitioner did not make good on its promise.

5.5 An audit under the auspices of LOA 00072404 conducted by Revenue Officer Penullar revealed the following material findings and discrepancies:

a. A total of P11,068,374.43 in trade purchases was paid for by another corporation (East Bay Resorts, Inc.) and hence disallowed in audit as taxpayer's paid purchases. Thus, petitioner was assessed P8,049,313.92 of gross income tax, excluding legal increments.

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b. Compromise penalties, civil penalties and 20% interest were imposed for late filing of 1601C and 1601E returns for the months of April to November in the amounts of P911,540.29 and P254,726.77 respectively, pursuant to Revenue Memorandum Circular No. 19-2007 and Sections 248 and 249 of the National Internal Revenue Code of 1997.

c. Petitioner failed to file its Monthly Alpha List of Payees and its year-end Inventory List, hence, petitioner was penalized P12,000.00 and P1,000.00 respectively, in accordance with RMC No. 19-2007.

d. Although petitioner has not been notified officially as one of the top 10,000 taxpayers, it has nevertheless started to deduct and remit EWT as per schedule.

e. 25% surcharge and 20% interest pursuant to Section 248 and 249 of the NIRC of 1997.

f. The result of the audit investigation is that petitioner is liable for the following internal revenue tax deficiencies: (i) income tax in the amount of P11,682,505.19; (ii) expanded withholding tax in the amount of P254,726.77; and (iii) withholding tax on compensation in the amount of P911,840.29.

Issuance of a Preliminary Assessment Notice to petitioner was therefore recommended.

6. The assessment is valid based on the best evidence obtainable.

6.1 Petitioner's obstinate failure to comply with the First Request for Presentation of Records, Second Request for Presentation of Records and Final Notice Before Issuance of *Subpoena Duces Tecum* did not in the least bit affect the validity of the assessment. Such lack of cooperation merely hampered the proceedings.

6.2 Section 6(B) of the NIRC of 1997 reads in part:

> "In case a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise files a false or fraudulent return or other document, the Commissioner shall make or amend the return form his own knowledge and from such information as he can obtain through testimony or otherwise which shall be *prima facie* correct and sufficient for all legal purposes."

By express provision of law, the photocopied documents sent by petitioner, although incomplete, are correct and sufficient for all legal purposes.

7. Petitioner's protest failed to sufficiently refute the respondent's assessment.

7.1 In a letter 11 November 2008, respondent denied petitioner's protest in this wise:

"A. Expanded Withholding Taxes

1. **Outside Services** – your contention that taxes due thereon has been withheld and remitted cannot be considered since no proof of remittance was submitted. As you stated in our previous reply letter, there is a balance of P38,305.93 after accounting the payments made. The computation is clearly shown in the Expanded Withholding Taxes Computation Sheet.

   Your allegation that you are not liable for some of the outside services because you are not a top ten thousand taxpayer is without merit since the items are subject to withholding tax by payees irrespective of whether they were notified as top ten thousand or not. This was provided under Revenue Regulations (RR) No. 30-2003 dated December12, 2003 which amended the pertinent provisions of RR No. 2-98, 17-2003 and 8-98. Moreover, your company subjected the outside to withholding tax as shown by the following data lifted from your records:

OUTSIDE SERVICES	AMOUNTS
Direct Cost	P 3,869,039.00
General & Administrative Expenses	15,794,666.00
Other Expenses	1,443,475.00
Total	**P 21,107,180.00**
Withholding Tax Rate	2%
Basic	P 422,143.60
Less: Tax Paid per Return	383,837.67
Balance	**P38,305.93**

2. **Rent** – your financial statements clearly showed the breakdown of rental expenses as follows:

OUTSIDE SERVICES	AMOUNTS
Direct Cost	P 1,606,845.00
General & Administrative Expenses	18,012,117.00
Other Expenses	4,003,287.00
Total	**P28,622249.00**
Withholding Tax Rate	5%
	P 1,181,112.45

   Per available returns filed only P46, 710.52 was paid thereby leaving a balance of P1,134,402.22. Your statement that your company remitted the Expanded Withholding Tax on rental without documentary evidence cannot be considered as basis for cancellation of the findings per record.

3. **Legal and Professional Fees** – In the absence of documentary evidence that payments under legal and professional fees were to general professional partnership, the findings cannot be adjusted. The list that was submitted as breakdown of payments to general professional partnership is not sufficient evidence to establish the fact of payments to the identified entities. Moreover, this was not presented during the time of verification for validation purposes. It is not even part of your previous protest letters.

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4. **Marketing and Promo** – It was considered as part of advertising and other business agencies for lack of substantiation. This list that has been submitted as breakdown of marketing and promo may only be considered if fully supported by source documents to be validated by a Revenue Officer.

5. **Director's Fee** – Deficiency withholding on this item was not rebutted by submitting documentary evidence you merely stated that the company duly withhold and remitted the Expanded Withholding Tax on the director's fee but no proof of remittance has been submitted.

6. **Management Fee** – No records were submitted to show that the recipient of the management fee is exempt from income tax and consequently to withholding tax.

B. Expanded Withholding Tax on Compensation

The deficiency withholding tax on compensation per preliminary assessment notice dated May 14, 2008 has been deleted due to submission of BIR Form 1601-C returns and proof of payment.

Finally, we also reiterate our position in our reply letter dated July 28, 2008 that Thunderbird Pilipinas Hotel and Resorts, Inc. is subject to income tax because of the passage of Republic Act (RA) No. 9337 which amended some of the provisions of the exemption of government corporations, agencies or instrumentalities which includes PAGCOR but was deleted under RA No. 9337. The imposition of the tax on your income was therefore amply discussed in the aforementioned reply letter.

7.2 Petitioner reiterated its protest in a letter dated 18 February 2009, to which, respondent replied through a letter dated 24 February 2009. Quoted hereunder are the relevant portions thereof:

> "As regards your latest contention on the withholding tax on management fees amounting to P1,979,199.86 that it has been rendered a non-resident foreign corporation for services rendered entirely outside the Philippines and therefore not subject to withholding tax, such allegation cannot be given due course since no documentary evidence has been submitted to show the payment to an alleged non-resident foreign corporation and the nature of the services rendered has not been verified to justify withdrawal of the assessment. Moreover, no evidence was presented to prove that the transaction is indeed exempt from withholding tax.
>
> "Your discussion on the tax exemption from VAT is not applicable in this case since the assessment issued pertains to income and withholding tax only. For income tax deficiency, the same cannot be withdrawn based on the reasons previously provided that Thunderbird Pilipinas Hotels and Resorts, Inc. is subject to income tax because of the passage of Republic Act (RA) No. 9337 which amended some of the provisions of the National Internal Revenue Code (NIRC) of 1997, particularly on exemption of government corporations, agencies or instrumentalities

which includes PAGCOR but was deleted under RA No. 9337."

7.3 As discussed earlier, petitioner's obstinate failure to present the required documents for audit does not affect the validity of the assessment. On the contrary, it only bolsters the findings respondent's examiners because failure to comply with the aforementioned notices implies non-existence of the required documents.

7.4 With the passage of RA No. 9337 on 01 July 2005, PAGCOR's tax exemption has been effectively removed, relegating it to the status of an ordinary corporation. In fact in one case, the Supreme Court said " The Philippines Amusement and Gaming Corporation (PAGCOR) is not exempt from income taxes anymore." Thus, for the taxable year in which petitioner was assessed, there is no exemption from which it may benefit from its dealings with PAGCOR.

7.5 In the case of Commissioner of Internal Revenue vs. Bank of the Philippines Island's, the Supreme Court held:

> "Tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments."

Based on the foregoing, the presumption of correctness stands and the assessment remains indubitable.

8. Petitioner was afforded due process in the assessment of its tax liabilities for taxable year 2006.

8.1 On 16 January 2008, respondent sent a Notice of Informal Conference to petitioner, notifying the latter of the finding of the revenue officer assigned to the case pursuant to Section 228 of the National Internal Revenue Code of 1997 in relation to RR No. 12-99. The Notice of Informal Conference was received by petitioner on 16 January 2008.

8.2 On 17 June 2008, petitioner received from respondent a Preliminary Assessment Notice dated 14 May 2008 that appraised the former of its deficiency IT, EWT and WTC for taxable year 2006 in the aggregate amount of P14,949,710.45.

8.3 Respondent sent a Formal Letter of Demand (FLOD) dated October 2008 to petitioner appraising the former of the fact that there is still due from it deficiency IT and EWT for taxable year 2006 in the aggregate amount P15,331,711.00.

8.4 Petitioner also received Assessment Notices Nos. IT-03-06-241-973-218 for deficiency IT; WE-03-06-241-973-218 for deficiency EWT for taxable year 2006.

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9. As a consequence of filing a *pro forma* protest, the assessment has become final and executory, thus, barring petitioner from filing a Petition for Review before the Court of Tax Appeals.

9.1 Section 228 of the NIRC of 1997 reads in part:

> "Such assessment may be protested administratively by a 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."

As discussed above, petitioner has consistently failed to submit documents from the time of audit up to its protest. Petitioner cannot now seek recourse from the Honorable Court due to the finality of the assessment.

10. All told, the following facts are made clear: (i) petitioner was required by respondent to submit relevant documents for audit but the former failed to comply despite several notices; (ii) petitioner was assessed deficiency IT and EWT for taxable year 2006 based on the best evidence obtainable; (iii) petitioner was notified of such assessment based on laws, rules and jurisprudence; and (iv) the assessment is final, executor and unappealable.

On July 1, 2009, petitioner filed its Comment (to Respondent's Motion to Admit Attached Comment) and Reply (to Respondent's Comment)[23].

On July 3, 2009, the Court promulgated a Resolution[24] granting the respondent's Motion to Admit Attached Comment (Re: Comment on Petitioner's Motion to Suspend Collection of Taxes) and Motion to Admit Attached Answer; thus, admitting respondent's Comment (Re: Comment on Petitioner's Motion to Suspend Collection of Taxes) and Answer. Also, the Court noted petitioner's Manifestation of the advance copies of its pleadings. The Court, however, denied petitioner's Motion to Suspend Collection of Tax as it was not verified and the facts and grounds alleged in support of said motion, together with the testimony of its witness, Mr. Elmer Pedrezuela, do not merit a favorable resolution since there was no concrete showing that respondent is carrying out the threatened enforcement of collection by administrative summary remedies.

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[23] *Rollo*, pp. 128-135.
[24] *Rollo*, pp. 138-141.

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On July 24, 2009, petitioner filed another Motion to Suspend Collection of Tax[25]. This time, it attached a verification.

On August 3, 2009, as it appears that the collection of the assessed deficiency income tax and withholding tax in the total amount of P15,331,711.00 will jeopardize the interest of petitioner, the Court ordered the petitioner to post an acceptable surety bond in the amount of P30,663,422.00 within ten(10) days from notice and to comply with the requirements under AM. 04-7-02 SC dated July 20, 2004. The grant of petitioner's Motion to Suspend Collection of Tax shall be subject to the fulfillment of the Court's conditions.

On August 25, 2009 and September 18, 2009, respondent[26] and petitioner[27], respectively filed their Pre-trial Briefs.

The Joint Stipulation of Facts and Issues (JSFI)[28] was filed by the parties. A corresponding Resolution[29] dated October 14, 2009 approved said JSFI and thereafter terminated the pre-trial.

On October 19, 2009, petitioner filed its Submission (of Surety Bond)[30].

On November 13, 2009, the Court issued a Resolution[31] approving petitioner's surety bond and enjoining the CIR form collecting the subject deficiency taxes.

During trial, the petitioner and respondent both presented their respective testimonial and documentary evidence in support of their positions.

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[25] *Rollo*, pp. 142-168.
[26] *Rollo*, pp. 180-185.
[27] *Rollo*, pp. 215-224.
[28] *supra*.
[29] *Rollo*, p. 140.
[30] *Rollo* pp. 254-281.
[31] *Rollo*, pp. 289-291.

On January 16, 2012, the Court promulgated a resolution[32] ordering both parties to submit their respective memoranda within thirty (30) days from receipt of the resolution.

Both petitioner and respondent filed for an extension of time to file their respective memoranda.

On March 23, 2012, petitioner filed its Memorandum[33] while respondent filed her Memorandum on March 30, 2012.

On April 10, 2012, the Court issued a Resolution[34] submitting the case for decision.

THE ISSUES

By agreement of the parties, the issues to be tried and resolved in this case as enumerated in their Joint Stipulation of Facts and Issues are the following:

1. Whether or not the alleged deficiency income and expanded withholding tax assessments for taxable year ended December 31, 2006 in the aggregate amount of P15,331,711.00, inclusive of interest and compromise penalties, should be cancelled and withdrawn for lack of factual and legal bases, particularly –

   Income Tax

   11.1 Whether petitioner is liable for the alleged deficiency income tax of the five percent (5%) based on its gross taxable income of P151,683,405.00 for taxable year 2006.

   11.2 Whether petitioner is subject to 5% gross income tax on its gaming revenues pursuant to its Memorandum of Agreement and License issued by PAGCOR for petitioner's operations of casino within the PPSEFZ.

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[32] *Rollo*, p. 1123.
[33] *Rollo*, pp. 1129-1165.
[34] *Rollo*, p. 1188.

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Expanded Withholding Tax

11.3 Whether petitioner was classified and duly notified by the BIR as among the top ten thousand (10,000) corporations pursuant to Revenue Regulations No. 17-2003 date June 1, 2003.

11.4 Whether petitioner allegedly failed to withhold the amount of P38,308.93 on payment of outside Services for taxable year 2006.

11.5 Whether petitioner allegedly failed to withhold the amount P1,134,402.22 on payment of rent for taxable year 2006.

11.6 Whether petitioner allegedly failed to withhold the amount of P759,895.33 on payment of Legal and Professional Fees for taxable year 2006.

11.7 Whether petitioner allegedly failed to withhold the amount of P62,761.90 on payment of Marketing and Promotions for taxable year 2006.

11.8 Whether petitioner allegedly failed to withhold the amount of P10,279.99 on payment of Director's Fees for taxable year 2006.

11.9 Whether petitioner allegedly failed to withhold the amount of P1,979,199.86 on payment of Management Fees for taxable year 2006.

11.10 Whether petitioner is liable to pay a compromise penalty of P4,000.00 on alleged non-fling of monthly remittance tax returns for the months January to March 2006 and alphabetical list of payees for taxable year 2006.

THE DECISION OF THE COURT

The Court shall discuss the issues in *seriatim*.

I. <u>Income Tax</u>

On the first issue, the controversy basically lies on whether or not PAGCOR is still exempt from income tax.

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The petitioner, as the licensee/contractee of PAGCOR, alleges that it is exempt from income tax pursuant to PD 1869. It avers that PD 1869[35] exempts PAGCOR from income tax and other taxes, except 5% of franchise tax on gross revenues or earnings, and that said exemption granted shall inure to the benefit of and extend to the corporation(s), association(s), agency(ies) or individuals with which PAGCOR has any contractual relationship in connection with the operations of the casino(s) authorized to be conducted in the franchise.

Further, petitioner highlights its reliance to PAGCOR's tax exemption as its consideration in the contractual relationship with PAGCOR and that petitioner acted in good faith and complied with the requirements demanded by PAGCOR.

The petitioner's reasoning is bereft of merit.

The issue on whether PAGCOR is still exempt from payment of income tax is not novel. The Supreme Court has already ruled in the case of *Abakada Guro Party List vs. Honourable Secretary Ermita, et al., GR No. 168056, September 1, 2005*, that the Philippine Amusement and Gaming Corporation is not exempt from income taxes anymore.

More direct and firm was the pronouncement by the Supreme Court of the removal of PAGCOR's exemption in the more recent case of *Philippine Amusement and Gaming Corporation (PAGCOR) vs. The Bureau of Internal Revenue, represented herein by Hon. Jose Mario Buñag, GR No. 172087, March 15, 2011* (PAGCOR case), wherein it was emphasized that with the passage of Republic Act (RA) No. 9337[36], PAGCOR is no longer exempt from corporate income tax. Pertinent to quote the disquisition of the Supreme Court in the PAGCOR case, to wit:

> **Under Section 1 of R.A. No. 9337, amending Section 27 (c) of the National Internal Revenue Code of 1977, petitioner is no longer exempt**

[35] The charter creating PAGCOR.
[36] Effectivity is on November 1, 2005.

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from corporate income tax as it has been effectively omitted from the list of GOCCs that are exempt from it. Petitioner argues that such omission is unconstitutional, as it is violative of its right to equal protection of the laws under Section 1, Article III of the Constitution:

> Sec. 1. No person shall be deprived of life, liberty, or property without due process of law, nor shall any person be denied the equal protection of the laws.

In *City of Manila v. Laguio, Jr.,* this Court expounded the meaning and scope of equal protection, thus:

> Equal protection requires that all persons or things similarly situated should be treated alike, both as to rights conferred and responsibilities imposed. Similar subjects, in other words, should not be treated differently, so as to give undue favor to some and unjustly discriminate against others. The guarantee means that no person or class of persons shall be denied the same protection of laws which is enjoyed by other persons or other classes in like circumstances. The "equal protection of the laws is a pledge of the protection of equal laws." It limits governmental discrimination. The equal protection clause extends to artificial persons but only insofar as their property is concerned.
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> x x x x
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> Legislative bodies are allowed to classify the subjects of legislation. If the classification is reasonable, the law may operate only on some and not all of the people without violating the equal protection clause. The classification must, as an indispensable requisite, not be arbitrary. To be valid, it must conform to the following requirements:
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> 1) It must be based on substantial distinctions.
> 2) It must be germane to the purposes of the law.
> 3) It must not be limited to existing conditions only.
> 4) It must apply equally to all members of the class.

It is not contested that before the enactment of R.A. No. 9337, petitioner was one of the five GOCCs exempted from payment of corporate income tax as shown in R.A. No. 8424, Section 27 (c) of which, reads:

> (c) Government-owned or Controlled Corporations, Agencies or Instrumentalities. - The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies or instrumentalities owned and controlled by the Government, except the Government Service and Insurance Corporation (GSIS), the Social Security System (SSS), the Philippine Health Insurance Corporation (PHIC), the Philippine Charity Sweepstakes Office (PCSO), and the **Philippine Amusement and Gaming Corporation (PAGCOR)**, shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in similar business, industry, or activity.

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A perusal of the legislative records of the Bicameral Conference Meeting of the Committee on Ways on Means dated October 27, 1997 would show that **the exemption of PAGCOR from the payment of corporate income tax was due to the acquiescence of the Committee on Ways on Means to the request of PAGCOR that it be exempt from such tax.** The records of the Bicameral Conference Meeting reveal:

> HON. R. DIAZ. The other thing, sir, is we --- I noticed we imposed a tax on lotto winnings.
>
> CHAIRMAN ENRILE. *Wala na, tinanggal na namin yon.*
>
> HON. R. DIAZ. *Tinanggal na ba natin yon*?
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> CHAIRMAN ENRILE. *Oo.*
>
> HON. R. DIAZ. Because I was wondering whether we covered the tax on --- Whether on a universal basis, we included a tax on cockfighting winnings.
>
> CHAIRMAN ENRILE. No, we removed the ---
>
> HON. R. DIAZ. I . . . (inaudible) *natin yong lotto*?
>
> CHAIRMAN ENRILE. ***Pati* PAGCOR *tinanggal* upon request.**
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> CHAIRMAN JAVIER. Yeah, Philippine Insurance Commission.
>
> CHAIRMAN ENRILE. Philippine Insurance --- Health, health ba. *Yon ang* request *ng* Chairman, I will accept. (laughter) *Pag-Pag-ibig yon, maliliit na sa tao yon.*
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> HON. ROXAS. Mr. Chairman, I wonder if in the revenue gainers if we factored in an amount that would reflect the VAT and other sales taxes---
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> CHAIRMAN ENRILE. No, we're talking of this measure only. We will not --- (discontinued)
>
> HON. ROXAS. No, no, no, no, from the --- arising from the exemption. Assuming that when we release the money into the hands of the public, they will not use that to --- for wallpaper. They will spend that eh, Mr. Chairman. So when they spend that---
>
> CHAIRMAN ENRILE. There's a VAT.
>
> HON. ROXAS. There will be a VAT and there will be other sales taxes no. Is there a quantification? Is there an approximation?
>
> CHAIRMAN JAVIER. Not anything.
>
> HON. ROXAS. So, in effect, we have sterilized that entire seven billion. In effect, it is not circulating in the economy which is unrealistic.
>
> CHAIRMAN ENRILE. It does, it does, because this is taken and spent by government, somebody receives it in the form of wages

and supplies and other services and other goods. They are not being taken from the public and stored in a vault.

CHAIRMAN JAVIER. That 7.7 loss because of tax exemption. That will be extra income for the taxpayers.

HON. ROXAS. Precisely, so they will be spending it.

The discussion above bears out that under R.A. No. 8424, the exemption of PAGCOR from paying corporate income tax was not based on a classification showing substantial distinctions which make for real differences, but to reiterate, the exemption was granted upon the request of PAGCOR that it be exempt from the payment of corporate income tax.

With the subsequent enactment of R.A. No. 9337, amending R.A. No. 8424, PAGCOR has been excluded from the enumeration of GOCCs that are exempt from paying corporate income tax. The records of the Bicameral Conference Meeting dated April 18, 2005, of the Committee on the Disagreeing Provisions of Senate Bill No. 1950 and House Bill No. 3555, show that it is the legislative intent that PAGCOR be subject to the payment of corporate income tax, thus:

THE CHAIRMAN (SEN. RECTO). Yes, Osmeña, the proponent of the amendment.

SEN. OSMEÑA. Yeah. Mr. Chairman, one of the reasons why we're even considering this VAT bill is we want to show the world who our creditors, that we are increasing official revenues that go to the national budget. Unfortunately today, Pagcor is unofficial.

Now, in 2003, I took a quick look this morning, Pagcor had a net income of 9.7 billion after paying some small taxes that they are subjected to. Of the 9.7 billion, they claim they remitted to national government seven billion. Pagkatapos, there are other specific remittances like to the Philippine Sports Commission, etc., as mandated by various laws, and then about 400 million to the President's Social Fund. But all in all, their net profit today should be about 12 billion. That's why I am questioning this two billion. **Because while essentially they claim that the money goes to government, and I will accept that just for the sake of argument. It does not pass through the appropriation process. And I think that at least if we can capture 35 percent or 32 percent through the budgetary process, first, it is reflected in our official income of government which is applied to the national budget, and secondly, it goes through what is constitutionally mandated as Congress appropriating and defining where the money is spent and not through a board of directors that has absolutely no accountability.**

REP. PUENTEBELLA. Well, with all due respect, Mr. Chairman, follow up lang.

There is wisdom in the comments of my good friend from Cebu, Senator Osmeña.

SEN. OSMEÑA. And Negros.

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REP. PUENTEBELLA. And Negros at the same time ay Kasimanwa. But I would not want to put my friends from the Department of Finance in a difficult position, but may we know your comments on this knowing that as Senator Osmeña just mentioned, he said, "I accept that that a lot of it is going to spending for basic services," you know, going to most, I think, supposedly a lot or most of it should go to government spending, social services and the like. What is your comment on this? This is going to affect a lot of services on the government side.

THE CHAIRMAN (REP. LAPUS). Mr. Chair, Mr. Chair.

SEN. OSMEÑA. It goes from pocket to the other, Monico.

REP. PUENTEBELLA. I know that. But I wanted to ask them, Mr. Senator, because you may have your own pre-judgment on this and I don't blame you. I don't blame you. And I know you have your own research. But will this not affect a lot, the disbursements on social services and other?

REP. LOCSIN. Mr. Chairman. Mr. Chairman, if I can add to that question also. Wouldn't it be easier for you to explain to, say, foreign creditors, how do you explain to them that if there is a fiscal gap some of our richest corporations has [been] spared [from] taxation by the government which is one rich source of revenues. Now, why do you save, why do you spare certain government corporations on that, like Pagcor? So, would it be easier for you to make an argument if everything was exposed to taxation?

REP. TEVES. Mr. Chair, please.

THE CHAIRMAN (REP. LAPUS). Can we ask the DOF to respond to those before we call Congressman Teves?

MR. PURISIMA. Thank you, Mr. Chair.

Yes, from definitely improving the collection, it will help us because it will then enter as an official revenue although when dividends declare it also goes in as other income. (sic)

x x x x

REP. TEVES. Mr. Chairman.

x x x x

THE CHAIRMAN (REP. LAPUS). Congressman Teves.

REP. TEVES. **Yeah. Pagcor is controlled under Section 27, that is on income tax. Now, we are talking here on value-added tax. Do you mean to say we are going to amend it from income tax to value-added tax, as far as Pagcor is concerned?**

THE CHAIRMAN (SEN. RECTO). **No. We are just amending that section with regard to the exemption from income tax of Pagcor.**

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REP. NOGRALES. Mr. Chairman, Mr. Chairman. Mr. Chairman.

THE CHAIRMAN (REP. LAPUS). Congressman Nograles.

REP. NOGRALES. Just a point of inquiry from the Chair. What exactly are the functions of Pagcor that are VATable? What will we VAT in Pagcor?

THE CHAIRMAN (REP. LAPUS). This is on own income tax. This is Pagcor income tax.

REP. NOGRALES. No, that's why. Anong i-va-Vat natin sa kanya. Sale of what?

x x x x

REP. VILLAFUERTE. Mr. Chairman, my question is, what are we VATing Pagcor with, is it the . . .

REP. NOGRALES. Mr. Chairman, this is a secret agreement or the way they craft their contract, which basis?

THE CHAIRMAN (SEN. RECTO). **Congressman Nograles, the Senate version does not discuss a VAT on Pagcor but it just takes away their exemption from non-payment of income tax.**

Taxation is the rule and exemption is the exception. The burden of proof rests upon the party claiming exemption to prove that it is, in fact, covered by the exemption so claimed. As a rule, tax exemptions are construed strongly against the claimant. Exemptions must be shown to exist clearly and categorically, and supported by clear legal provision.

In this case, PAGCOR failed to prove that it is still exempt from the payment of corporate income tax, considering that Section 1 of R.A. No. 9337 amended Section 27 (c) of the National Internal Revenue Code of 1997 by omitting PAGCOR from the exemption. **The legislative intent, as shown by the discussions in the Bicameral Conference Meeting, is to require PAGCOR to pay corporate income tax; hence, the omission or removal of PAGCOR from exemption from the payment of corporate income tax**. It is a basic precept of statutory construction that the express mention of one person, thing, act, or consequence excludes all others as expressed in the familiar maxim *expressio unius est exclusio alterius*. Thus, the express mention of the GOCCs exempted from payment of corporate income tax excludes all others. Not being excepted, petitioner PAGCOR must be regarded as coming within the purview of the general rule that GOCCs shall pay corporate income tax, expressed in the maxim: *exceptio firmat regulam in casibus non exceptis*. (Emphasis and underscoring provided)

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It is very clear in the foregoing pronounced PAGCOR case that PAGCOR's exemption was already eliminated, hence, it is now subject to income tax. Thus, petitioner, as the licensee or contractee of PAGCOR, cannot rely with the exemption of PAGCOR to renege on its obligation to pay the proper income tax.

Petitioner attempts to argue that the PAGCOR case[37] establishes a new doctrinal interpretation of Section 13(2)(a) and (b) of PD 1869 with respect to the corporate income tax liability of PAGCOR and should be applied prospectively. Petitioner avers that the new doctrine should not apply to parties who relied on the old doctrine and acted thereon in good faith. And considering that PAGCOR, in the exercise of its government, places it in the category of an agency or instrumentality of the Government from which contracts entered into by it for valuable consideration are covered by the non-impairment clause of the Constitution.

The petitioner's arguments are unmeritorious.

The line of argument by petitioner has been adequately addressed and ruled upon by the Supreme Court in the PAGCOR case, *viz*:

> Petitioner further contends that Section 1 (c) of R.A. No. 9337 is null and void *ab initio* for violating the non-impairment clause of the Constitution. Petitioner avers that laws form part of, and is read into, the contract even without the parties expressly saying so. Petitioner states that the private parties/investors transacting with it considered the tax exemptions, which inure to their benefit, as the main consideration and inducement for their decision to transact/invest with it. Petitioner argues that the withdrawal of its exemption from corporate income tax by R.A. No. 9337 has the effect of changing the main consideration and inducement for the transactions of private parties with it; thus, the amendatory provision is violative of the non-impairment clause of the Constitution.
>
> Petitioner's contention lacks merit.
>
> The non-impairment clause is contained in Section 10, Article III of the Constitution, which provides that no law impairing the obligation of contracts shall be passed. The non-impairment clause is limited in application to laws that derogate from prior acts or contracts by enlarging, abridging or in any manner changing the intention of the parties. There is impairment if a subsequent law changes the terms of a contract between the parties, imposes new conditions,

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[37] *Supra.*

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dispenses with those agreed upon or withdraws remedies for the enforcement of the rights of the parties.

As regards franchises, Section 11, Article XII of the Constitution provides that **no franchise or right shall be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress** when the common good so requires.

In ***Manila Electric Company v. Province of Laguna***, the Court held that **a franchise partakes the nature of a grant, which is beyond the purview of the non-impairment clause of the Constitution**. The pertinent portion of the case states:

> While the Court has, not too infrequently, referred to tax exemptions contained in special franchises as being in the nature of contracts and a part of the inducement for carrying on the franchise, these exemptions, nevertheless, are far from being strictly contractual in nature. *Contractual tax exemptions, in the real sense of the term and where the non-impairment clause of the Constitution can rightly be invoked, are those agreed to by the taxing authority in contracts, such as those contained in government bonds or debentures, lawfully entered into by them under enabling laws in which the government, acting in its private capacity, sheds its cloak of authority and waives its governmental immunity.* Truly, tax exemptions of this kind may not be revoked without impairing the obligations of contracts. These contractual tax exemptions, however, are not to be confused with tax exemptions granted under franchises. **A franchise partakes the nature of a grant which is beyond the purview of the non-impairment clause of the Constitution. Indeed, Article XII, Section 11, of the 1987 Constitution, like its precursor provisions in the 1935 and the 1973 Constitutions, is explicit that no franchise for the operation of a public utility shall be granted except under the condition that such privilege shall be subject to amendment, alteration or repeal by Congress as and when the common good so requires.**

In this case, PAGCOR was granted a franchise to operate and maintain gambling casinos, clubs and other recreation or amusement places, sports, gaming pools, *i.e.*, basketball, football, lotteries, etc., whether on land or sea, within the territorial jurisdiction of the Republic of the Philippines. **Under Section 11, Article XII of the Constitution, PAGCOR's franchise is subject to amendment, alteration or repeal by Congress such as the amendment under Section 1 of R.A. No. 9377. Hence, the provision in Section 1 of R.A. No. 9337, amending Section 27 (c) of R.A. No. 8424 by withdrawing the exemption of PAGCOR from corporate income tax, which may affect any benefits to PAGCOR's transactions with private parties, is not violative of the non-impairment clause of the Constitution**. (Emphasis and underscoring provided)

Indeed, it cannot be said the there was a violation of the non-impairment clause of the Constitution.

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Petitioner finally argues that since it is duly registered enterprise with the PPSEFZ, it is entitled to the benefits applicable to the Subic Special Economic and Freeport Zone under RA No. 7227 and other Export Processing Zones, pursuant to Section 5 of Proclamation no. 216, thus, such is subject to 5% of gross income tax in lieu of the gross income earned by all business and enterprises. It avers that its payment for license fee/gross gaming revenue of 25% to PAGCOR is inclusive of the 5% income tax imposed on "gross revenues".

Again, the contention of petitioner lacks merit.

The assessment by the respondent is based on a 5% computation, not on the regular rate of 35% basic income tax computation. The 5% computation by the respondent clearly recognizes the privilege of the petitioner as a duly registered enterprise in the PPSEFZ.

The Court, further, does not agree with the argument of petitioner that its payment of the 25% license fee/gross gaming revenue is already inclusive of the 5% income tax imposed on gross revenues. The 25% license fee/gross gaming revenue paid by petitioner is different and distinct from the income tax to which petitioner is being assessed. The 25% gross gaming revenue is being paid by virtue of the License[38] entered into by petitioner with PAGCOR. It is based on the aggregate gross gaming revenue of the Fiesta Casino.[39] On the other hand, 5% income tax is based on the total gross revenues of the petitioner regardless from where it is obtained and even if not specifically originating from the Fiesta Casino. Thus, the Court is not convinced that the 25% license fee/gross gaming tax is inclusive of the 5% income tax as there was no substantial evidence nor argument presented by petitioner to bolster the same.

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[38] Exhibit "CCC".
[39] Exhibit "CCC-1".

Therefore, finding the arguments of the petitioner to be unmeritorious with regard petitioner's income tax, the Court upholds the assessment of the respondent, computed as follows:

I. Income Tax	
Gross Taxable Income per Return	P 151,683,405.43
Add: Purchases Paid not in the name of Thunderbird	11,068,373.43
Taxable Income	P 162,751,778.43
	5%
Tax Due	P 8,137,588.92
Less: Basic Tax Paid	553,418.67
Basic Income Tax Deficiency	P 7,584,170.25

II. Expanded Withholding Tax

Upon comparison of the expenses subject to EWT as reflected on petitioner's Audited Financial Statements[40] and those of petitioner's BIR Forms No. 1601-E[41], respondent assessed petitioner the amount of P5,414,109.74 deficiency EWT for taxable year 2006, computed as follows:

	Outside Services	**Rent**	**Legal and Professional Fees**	**Management Fee**	**Marketing and Promo**	**Director's Fee**
Direct Cost	P 3,869,039.00	P 1,606,845.00	-	-	-	-
Gen & Admin Expenses	15,794,666.00	18,012,117.00	P 3,967,247.00	P13,397,504.00	P3,138,095.00	P1,333,791.00
Other Expenses	1,443,475.00	4,003,287.00	2,206,984.00	-	-	-
Total	P 21,107,180.00	P23,622,249.00	P 6,174,231.00	P13,397,504.00	P3,138,095.00	P1,333,791.00
Tax Rate	2%	5%	15%	15%	2%	10%
Basic EWT Due	P 422,143.60	P 1,181,112.45	P 926,134.65	P 2,009,625.60	P 62,761.90	P 133,379.10
Less: EWT Paid per Return	383,837.67	46,710.23	166,239.32	30,425.74	-	123,099.11
Deficiency EWT	**P 38,305.93**	**P 1,134,402.22**	**P 759,895.33**	**P 1,979,199.86**	**P 62,761.90**	**P 10,279.99**

[40] Exhibit "S".
[41] Exhibit "B", "C", "D", "E", "F", "G", "H", "I", "J", "K", "L".

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A. Expanded Withholding Tax on Outside Services

Petitioner alleges that it duly withheld and remitted the EWT on its payments for outside services. Also, it alleges that some of its payments for outside services do not require the withholding of tax since petitioner is not among the top 10,000 corporations and has not been notified as such by the BIR.

On the other hand, respondent avers that petitioner is liable to pay for some of the outside services irrespective of whether it was notified as one of the top 10,000 corporation, pursuant Revenue Regulations (RR) No. 30-2003.

The Court finds respondent's argument meritorious.

The requirement to withhold is provided under RR No. 30-2003 dated December 12, 2003, which amended pertinent provisions of RR Nos. 2-98, 8-98 and 17-2003.

Section 4 of RR No. 30-2003 provides:

> **Section 4. Income Payments to other Contractors.** – Sec. 2.57.2(E) of Revenue Regulations No. 2-98, as amended, is hereby further amended to correct the typographical error in RR 17-2003 to read as follows:
>
> "*Sec. 2.57.2. Income payments subject to creditable withholding tax and rates prescribed thereon.* –
>
> xxx xxx
>
> (E) Income payments to certain contractors. – On gross payments to the following contractors, whether individual or corporate – Two percent (2%)
>
> (1) General engineering contractors. -
> xxx xxx
> (2) General building contractors. –
> xxx xxx
> (3) Specialty contractors. –
> xxx xxx
> (4) Other contractor. –
> xxx xxx

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Upon review, it appears that petitioner failed to submit any documentary evidence showing that the income payments for outside services do not fall in any of the transactions subject to 2% EWT under Section 2.57.2(E) of RR No. 2-98, as amended by RR No. 30-2003.

It is already well-settled that tax assessments by tax examiners are presumed correct and made in good faith, with the taxpayer having the burden of proving otherwise. Failure to present proof of error in the assessment will justify the judicial affirmance of said assessment.[42] Hence, petitioner is liable for the EWT on outside services amounting to P38,305.93, computed as follows:

OUTSIDE SERVICES	AMOUNTS
Direct Cost	P 3,869,039.00
General and Administrative Expenses	15,794,666.00
Other Expenses	1,443,475.00
Total	P 21,107,180.00
Withholding Tax Rate	2%
Basic	P 422,143.60
Less: Tax Paid Per Return	383,837.67
Adjusted Basic Deficiency EWT	**P 38,305.93**

B. Expanded Withholding Tax on Rent

As to EWT on rent, petitioner submits that the amount of rent expense booked in its 2006 books of account includes "Deferred Rent Expense" account in the amount of P14,201,733.00 which was recorded as expense in the books of petitioner purely for compliance with Philippine Accounting Standards (PAS) No. 17 on Leases but was not claimed as expense for income tax purposes. This was indicated on Line 115[43] of petitioner's Annual Income Tax Return for taxable year 2006[44] wherein the amount of P14,201,733.00 was reflected as a reconciling item on petitioner's net income per books as against its taxable income. Thus, the

[42] Marcos II *vs.* CA, et al., G.R. No. 120880, June 5, 1997.
[43] Exhibit "A-2".
[44] Exhibit "A".

said deferred rent expense was never claimed as deduction from its gross income for taxable year 2006.

In his Judicial Affidavit dated February 24, 2010[45], Mr. Elmer R. Pedrezuela, petitioner's Financial Controller, explained that the "rent expense" booked as deferred rent expense for accounting purposes pertains to the lease of properties by petitioner from the Bases Conversion Development Authority (BCDA) and Poro Point Management Corporation (PPMC). A lease agreement[46] was entered into by petitioner with BCDA and PPMC that covers the lease of the following properties: former Voice of America facilities and land; Poro Point Cottages, San Fernando Coral Promenade and Tourism Complex, all of which are situated in Brgy. Poro, San Fernando City, La Union.

The lease agreement notably provides that petitioner is entitled to non-payment of lease rentals for a period of six (6) months for the 4.8 hectare former VOA facilities and Twenty-four (24) months for the 60.7 hectare Tourism Complex, with regular escalation of lease payments, thus, the amount of lease payments varies per year.

On the other hand, respondent avers that petitioner's contention of remittance of the EWT on rental without documentary evidence cannot cancel said assessment.

The Court agrees with petitioner's assertion.

Section 2.57.4 of RR No. 2-98, as amended, prescribes the time of withholding of the subject EWT as follows:

> Sec. 2.57.4. *Time of withholding.* — The obligation of the payor to deduct and withhold the tax under Section 2.57 of these Regulations arises at the time an income payment is paid 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

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[45] Exhibit "W".
[46] Exhibit "T".

> "payable" refers to the date the obligation becomes due, demandable or legally enforceable.
>
> Provided, however, that where income is not yet paid or payable but the same has been recorded as an expense or asset, whichever is applicable, in the payor's books, the obligation to withhold shall arise in the last month of the return period in which the same is claimed as an expense or amortized for tax purposes.

Accordingly, petitioner is required to withhold EWT on its rental when it is either paid, becomes payable or was accrued or claimed as expense for income tax purposes, whichever comes first.

The Deferred Rent Expense of P14,201,733.00 was not yet paid or payable in 2006 but was reported in petitioner's audited financial statements for financial statement purposes to comply with PAS No. 17. Moreover, it appears that petitioner did not accrue or claimed the amount of P14,201,733.00 as deductible expense for income tax purposes[47]. Thus, pursuant to Section 2.57.4 of RR No. 2-98, petitioner is not mandated to withhold 5% EWT on the Deferred Rent of P14,201,733.00. Consequently, said amount of P14,201,733.00 should be deducted from the total tax base of P23,622,249.00 reducing the basic deficiency EWT on rent to P424,315.57, computed as follows:

Rent reflected as part of:		
Direct Cost	P	1,606,845.00
Gen & Admin Expenses		18,012,117.00
Other Expenses		4,003,287.00
Total Rentals	P	23,622,249.00
Less: Deferred rent expense		14,201,733.00
Total Rent subject to EWT	P	9,420,516.00
Tax Rate		5%
Basic Deficiency EWT	P	471,025.80
Less: Tax Paid per Return		46,710.23
Adjusted Basic Deficiency EWT	P	**424,315.57**

[47] Exhibit "A-2".

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C. Expanded Withholding Tax on Legal and Professional Fees

Petitioner alleges that the account "Legal and Professional Fees" included accruals and/or payments made to general professional partnerships (GPPs) as follows: a) P795,000.00 to Punongbayan & Araullo (P&A); and (b) P216,233.38 to Fortun Narvasa Salazar Law Office (Fortun Narvasa), which are not subject to income tax and consequently to EWT pursuant to Section 22(B) in relation to Section 27 of the NIRC of 1997, as amended.

Respondent, however, alleges that the list submitted by the petitioner as breakdown of payments to GPPs is not sufficient evidence to establish the fact of payment.

The Court agrees with petitioner.

Indeed, income payments made to professional partnerships as juridical persons are exempt from income tax *vis-à-vis* the expanded withholding tax. The partners of the GPPs are the ones liable, in their individual capacity, for the payment of income tax pursuant to Section 26 of the NIRC of 1997. This was elucidated by the Supreme Court in the case of *Rufino R. Tan, et al. vs. Ramon R. del Rosario Jr., as Secretary of Finance and Jose U. Ong, as Commissioner of Internal Revenue*[48], to *wit*:

> "'Exempt partnerships', upon the other hand, are not similarly identified as corporations nor even considered as independent taxable entities for income tax purposes. A general professional partnership is such an example. Here, the partners themselves, not the partnership, although it is still obligated to file an income tax return (mainly for administration and data), are liable for the payment of income tax in their individual capacity computed on their respective and distributive shares of profits. In the determination of the tax liability, a partner does so as an individual, and there is no choice on the matter. In fine, under the Tax Code on income taxation, the general professional partnership is deemed to be no more than a mere mechanism or a flow-through entity in the generation of income by, and the ultimate distribution of such income to, respectively, each of the individual partners."

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[48] GR. Nos. 109289 and 109446, October 3, 1994.

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Petitioner submitted Certificates of Corporate Filing/Information[49] issued by the Securities and Exchange Commission in order to prove that P&A and Fortun Narvasa are GPPs.

In support of the professional fees paid to Fortun Narvasa, petitioner presented its "Transaction Reprint Journal"[50] showing the amount of P216,223.38 as legal fees due to Fortun Narvasa and "Manual Payments Reprint Journal"[51] showing that the amount of P216,223.38 was debited to "Trade Payables" and credited to "Cash".

However, the Court finds the said documents insufficient to prove actual payment of the amount of P216,223.38 to Fortun Narvasa. Petitioner should have presented billing statements, invoices or official receipts issued by Fortun Narvasa.

As regards the accruals and/or payments made to P&A, petitioner submitted a print-out of its "Computer Checks Posting Journal"[52], P&A official receipts[53], P&A billing statements[54], and Reconciliation of Audit Fee for the year ending December 31, 2006[55].

A perusal of Bill No. 128026[56] issued by P&A to petitioner covering the audit of petitioner's 2006 financial statements shows that the agreed audit fee for the year 2006 amounted to P400,000.00 and a monthly retainer fee of P15,000.00 for the months of October, November and December 2006. Thus, audit fees due to P&A for the year 2006 amounted to P445,000.00[57].

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[49] Exhibits "PP" and ""UU".
[50] Exhibit "QQ".
[51] Exhibit "RR".
[52] Exhibits "X", "AA", "DD" and "GG".
[53] Exhibits "Y", "BB", "EE" and "HH".
[54] Exhibits "Z", "CC", "FF" and "II".
[55] Exhibit "OO".
[56] Exhibit "II".
[57] P400,000.00 plus P45,000.00 (P15,000/month x 3 months).

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In sum, the basic deficiency EWT on legal and professional fees should be adjusted to P693,145.33, computed as follows:

Legal and Professional Fees	P 6,174,231.00
Less: Payments to GPPs	445,000.00
Legal and Professional Fees subject to EWT	P 5,729,231.00
Tax Rate	15%
Basic Deficiency EWT	P 859,384.65
Less: Tax paid per Return	166,239.32
Adjusted Basic Deficiency EWT	P **693,145.33**

D. Expanded Withholding Tax on Management Fee

Petitioner alleges that the amount of Management Fees appearing in the audited financial statements pertains to payments made to Thunderbird Resorts, Inc. (TRI), a non-resident foreign corporation providing management services to petitioner outside the Philippines. Said service is pursuant to a Casino Management Consultancy Agreement[58] entered into by both parties on April 1, 2006.

Invoking Section 23(F) of the NIRC of 1997, as amended, in relation to Section 42(A) of the NIRC of 1997, as amended, petitioner maintains that services performed outside the Philippines by a foreign corporation, such as TRI, is not subject to Philippine income tax and consequently to withholding tax.

Respondent opposes such claims of petitioner and further argues that petitioner failed to submit documentary evidence to show payment to an alleged non-resident foreign corporation nor was there evidence that the nature of the services or the transactions was truly exempt.

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[58] Exhibit "VV".

The Court finds respondent's argument meritorious.

Section 23(F) of the NIRC of 1997, as amended, in relation to Section 42(A) of the same Code, states that 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.

For the Court to clearly establish non-liability of the petitioner, It finds support to the "Source of Income" doctrine. In the case of *CIR vs. Baier-Nickel, GR No. 153793, August 29, 2006,* the "source of income" was explained by the Supreme Court, to *wit*:

> The Court reiterates the rule that **"source of income" relates to the property, activity or service that produced the income**. With respect to rendition of 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**. There is therefore no merit in petitioner's interpretation which equates source of income in labor or personal service with the residence of the payor or the place of payment of the income.
>
> xxx xxx xxx
>
> **The decisive factual consideration here is not the capacity in which respondent received the income, but the sufficiency of evidence to prove that the services she rendered were performed in Germany**. Though not raised as an issue, the Court is clothed with authority to address the same because the resolution thereof will settle the vital question posed in this controversy.
>
> The settled rule is that tax refunds are in the nature of tax exemptions and are to be construed *strictissimi juris* against the taxpayer. To those therefore, who claim a refund rest the burden of proving that the transaction subjected to tax is actually exempt from taxation. (Emphasis and underscoring provided)

Analyzing the evidence presented by petitioner, the Court is not convinced that the services were indeed performed outside the Philippines. While TRI's office is not in the Philippines, the actual services can actually be performed here in the Philippines, considering that the subject of the service, which is the Casino, is actually located in the Philippines. The actual performance of the services is important for the Court to determine.

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After scrutiny of the records of the case, it appears that petitioner failed to discharge the burden of proving that the performance of the services was done outside the Philippines and exempt from the application of income tax. Thus, the Court finds petitioner liable for EWT on Management Fees in the amount of P1,979,199.86 as assessed by respondent.

E. Expanded Withholding Tax on Marketing and Promotion

Petitioner maintains that it is not liable for the deficiency EWT on Marketing and Promotion because petitioner is not among the top 10,000 corporation. Furthermore, petitioner alleges that there are no other provisions in RR No. 2-98, as amended, which can be used as basis for the withholding tax of its payments for Marketing and Promotion. It opines that the Marketing and Promotion expenses should not be considered as part of payments for advertising and other business agencies.

Respondent counters that petitioner failed to withhold and remit the taxes due for petitioner's Marketing and Promotion expenses. She further alleges that the list[59] that has been submitted as breakdown of Marketing and Promotion may only be considered if fully supported by source documents.

The Court agrees with respondent.

Petitioner failed to submit documentary proofs in order for the Court to verify the actual nature of its Marketing and Promotion expenses. Thus, respondent's deficiency EWT assessment amounting to P62,761.90 on Marketing and Promotion is upheld.

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[59] BIR Records, p.430.

F. Expanded Withholding Tax on Director's Fees

The assessed EWT on Director's Fees in the amount of P102,799.90 arose from the discrepancy between the director's fees per audited financial statements and per BIR Forms No. 1601-E filed by petitioner for taxable year 2006, as computed below:

Per Audited Financial Statements	P 1,333,791.00
Per BIR Returns (1601-E)	1,230,991.10
Difference	**P 102,799.90**

Petitioner alleges that it duly withheld and remitted the EWT on the director's fees. The respondent asserts the contrary.

After further study and analysis, the Court agrees with respondent.

The records of the case do not show that petitioner was able to account for the discrepancy in the director's fees of P102,799.90. Consequently, petitioner should be held liable for the corresponding 10% EWT of P10,279.99.

In summary, petitioner is liable to pay basic deficiency EWT in the amount of P1,228,806.72, computed as follows:

	Amount
Deficiency EWT on Outside Services	P 38,305.93
Deficiency EWT on Rent	424,315.57
Deficiency EWT on Legal and Professional Fees	693,145.33
Deficiency EWT on Management Fees	1,979,199.86
Deficiency EWT on Marketing and Promotions	62,761.90
Deficiency EWT on Director's Fee	10,279.99
Total	**P 3,208,008.58**

The compromise penalty imposed by respondent in the amount of P4,000.00 is hereby cancelled as there is no compromise agreement entered into by the parties.

To end, it is worthy to note that assessments are prima facie presumed correct and made in good faith. It is the taxpayer and not the BIR who has the duty of proving otherwise. In the absence of proof of any irregularity in the performance of official duties, an assessment will not be disturbed. Failure to present proof of error in the assessment will justify judicial affirmance of said assessment.[60]

WHEREFORE, premises considered, the assessments against petitioner covering deficiency income tax and EWT for taxable year 2006 are hereby **AFFIRMED** with some modifications.

Accordingly, petitioner is hereby **ORDERED** to pay respondent deficiency income tax and EWT for taxable year 2006 in the respective amounts of **P12,488,946.65 and P5,440,870.44**, inclusive of 25% surcharge and 20% deficiency interest imposed pursuant to Sections 248 A(3) and 249(B) of the NIRC of 1997, computed as follows:

Deficiency Income Tax		
	Basic Tax Due	P 7,584,170.25
	Add: 25% Surcharge	1,896,042.56
	20% Interest (04/16/07 to 04/09/09)	3,008,733.84
	Total Amount Due	**P12,488,946.65**
Deficiency EWT		
	Basic Tax Due	P 3,208,008.58
	Add: 25% Surcharge	802,002.15
	20% Interest (01/16/07 to 04/09/09)	1,430,859.72
	Total Amount Due	**P 5,440,870.44**
GRAND TOTAL – DEFICIENCY INCOME TAX AND EWT		**P17,929,817.09**

[60] *CIR vs. CA*, 242 SCRA 313-314.

Likewise, petitioner is **ORDERED** to pay delinquency interest at the rate of 20% per annum on the total deficiency taxes of **P17,929,817.09** computed from April 10, 2009 until full payment thereof pursuant to Section 249(C)(3) of the 1997 NIRC.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice