REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

FLUOR DANIEL PHILIPPINES, INC.,
Respondent.

CTA EB NO. 921
(CTA Case No.7793)

Present:

DEL ROSARIO, *P.J.*,
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA,
FABON-VICTORINO,
MINDARO-GRULLA,
COTANGCO-MANALASTAS,
RINGPIS-LIBAN, *JJ.*

Promulgated:

AUG 22 2013

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DECISION

DEL ROSARIO, P.J.:

THE CASE

This is a Petition for Review filed by the Commissioner of Internal Revenue ("CIR") pursuant to Section 3(b) of Rule 8 of the Revised Rules of the Court of Tax Appeals ("RRCTA") seeking the nullification of the Decision promulgated on April 17, 2012 ("assailed Decision") and the Resolution promulgated on July 4, 2012 ("assailed Resolution") of the former Second Division of the Court of Tax Appeals ("CTA-Second Division) in CTA Case No. 7793 entitled *"Fluor Daniel Philippines, Inc. vs.*

Commissioner of Internal Revenue", the respective dispositive portions of which read:

Decision dated April 17, 2012:

> "**WHEREFORE**, the Petition for Review is hereby **GRANTED**. The assessments for deficiency Final Withholding Tax on its software maintenance service fees for the year 2004 are hereby **CANCELLED** and **SET ASIDE**.
>
> **SO ORDERED**."

Resolution dated July 4, 2012:

> "**WHEREFORE**, respondent's Motion for Reconsideration is hereby **DENIED** for lack of merit.
>
> **SO ORDERED**."

THE PARTIES

Petitioner is the Commissioner of Internal Revenue (CIR) charged with the duty of assessing and collecting internal revenue taxes. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.[1]

Respondent Fluor Daniel Philippines, Inc. (FDPI) is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office located at Asian Star Building, 2402-2404 Asean Drive, Muntinlupa City.[2]

THE ANTECEDENT FACTS

The antecedent facts, as found by the CTA-Second Division, are as follows:

> "A Formal Letter of Demand dated April 16, 2007 was issued by respondent assessing petitioner the alleged deficiency taxes for 2004 comprising Income Tax, Value-Added Tax (VAT) and Expanded Withholding Tax (EWT).

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[1] *Rollo*, p. 20.
[2] *Id.*

The assessments, together with interest and compromise, totaling One Hundred Forty-Four Million Five Hundred Thirty-Six Thousand Eight Hundred Sixty-Six Pesos and 21/100 centavos (P144,536,866.21), are broken down as follows:

	Basic Tax	Interest	Compromise	Total
Income Tax	7,562,819.61	3,125,965.44	25,000.00	10,713,785.05
VAT	40,028,389.09	16,344,925.54	25,000.00	56,398,314.63
EWT	53,195,715.83	24,204,050.70	25,000.00	77,424,766.53
Total	**100,786,924.53**	**43,674,941.68**	**75,000.00**	**144,536,866.21**

Included in the EWT assessment was the alleged deficiency EWT on petitioner's payments of maintenance service fees for software maintenance (the "software maintenance service fees") to Fluor International, Inc. (FII), a non-resident foreign corporation. Respondent claimed that, since there was no documentary evidence to show the nature of the contract between petitioner and FII, the software maintenance fees should be treated as income from services and, thus, subject to EWT at 32%.

Thereafter, petitioner filed an administrative protest (Request for Reinvestigation/Reconsideration) on May 18, 2007.

In the said protest, petitioner explained that respondent's assessment for EWT on its software maintenance service fees lacks legal basis considering that they were paid to FII, a resident of the U.S. which is not engaged in trade or business and, has no permanent establishment (PE) in the Philippines. Thus, FII cannot be subjected to tax on the fees received pursuant to Article 8 (1) of the Tax Treaty between the Republic of the Philippines and the United States of America (the RP-US Tax Treaty).

Petitioner, likewise, applied for the abatement of penalties, surcharges and interest on February 27, 2008 pursuant to Section 204 (B) of the 1997 Tax Code as implemented through Revenue Regulations No. 15-2007, with respect to the deficiency VAT assessment.

In response to petitioner's protest, respondent issued a Final Decision on Disputed Assessment (FDDA) dated March 3, 2008 and the same was received by petitioner on May 9, 2008. In the FDDA, respondent cancelled the income tax and partially cancelled the VAT assessment, **but issued an assessment for final withholding tax on petitioner's payments of software maintenance service fees in lieu of the previous EWT assessment appearing in the Formal Letter of Demand dated April 16, 2007.** Hence, respondent issued a final deficiency assessment of P21,939,457.85, computed as follows:

Final Withholding Tax (inclusive of increments)	Php21,368,659.46
VAT (inclusive of increments)	P570,798.39
Total	**Php21,939,457.85**

In changing the assessment from deficiency EWT to deficiency final withholding tax (FWT), respondent argued that the software maintenance fees should be considered as "license generating royalty income", citing RMC No. 44-05 as her basis. Thus, she maintained that the software maintenance service fees should have been subjected to the preferred rate of 15% under Article 13 of the RP-US Tax Treaty.

On the basis of the FDDA, which constitutes a denial of petitioner's protest, petitioner filed its Petition for Review before this Court on June 10, 2008, in accordance with the provision of Section 228 of the National Internal Revenue Code of 1997 (NIRC 1997) which provides:

xxx xxx xxx

In her Answer, filed on August 20, 2008, respondent averred the following Special and Affirmative Defenses:

8. Petitioner is liable to pay the final withholding tax on the alleged software maintenance service fees being paid to Fluor International Incorporated (FII) for the following reasons:

8.1 FII failed to comply with the provision of Revenue Memorandum Order No. 01-2000 dated November 25, 1999 entitled "Procedures for Processing Tax Treaty Relief Application". Under said RMO, it is provided that any availment of the tax treaty provisions must be preceded by <u>an application for treaty relief with the International Tax Affairs Division (ITAD)</u> of the Bureau of Internal Revenue.

The implementation of the said RMO is in harmony with the objectives of the contracting states to ensure that the granting of the benefits under the tax treaties are enjoyed by the persons or corporations duly entitled to the same. In this way, the consequences of any erroneous interpretation and/or application of the treaty provisions with which the Philippines is a signatory to (i.e., claim for tax refund/credit for overpayment of taxes, or deficiency tax liabilities for underpayment) can be averted before proceeding with the transactions and/or paying the tax liability covered by the tax treaty.

It is quite noteworthy to say that the <u>power to interpret</u> the provisions of the Code and other tax laws as provided for under Section 4 of the National Internal Revenue Code shall be under the exclusive and original jurisdiction of the Commissioner of Internal Revenue, subject to review by the Secretary of Finance.

'Findings of administrative officials and agencies who have acquired expertise because their jurisdiction is confined to specific matters are generally accorded not only respect but at the time even finality' (Ibid., citing Motoomull v. Dela Paz, 187 SCRA 743). Interpretations by officers of laws

> which are entrusted to their administration, are entitled to great respect *(Anscor Container Corporation v. Court of Tax Appeals, et al., CA-GR SP No. 38052, August 31, 1998)*

In **Mirant (Philippines) Operations Corporation (formerly: Southern Energy-Asia Pacific Operations [Phils.] Inc. vs. Commissioner of Internal Revenue** *under CTA-E.B. No. 40 (CTA Case No. 6382) promulgated on June 7, 2005*, the Court held that:

> 'A foreign corporation wishing to avail of the benefits of the tax treaty should invoke the provisions of the tax treaty and prove that indeed the provision of the tax treaty applies to it, before the benefits may be extended to such corporation. In other words, a resident or non-resident foreign corporation shall be taxed according to the provision of the National Internal Revenue Code, unless it is shown that the treaty provisions apply to said corporation, and that, in case the same are applicable, the option to avail of the tax benefits under the tax treaty has been successfully invoked.'

Nowhere in the records of the case was it shown that FII observed the provision of said order. To evince this, a copy of ITAD certification dated July 11, 2008 stating that FII has not secured any tax treaty relief applications before petitioner commenced the filing of the instant petition is hereto attached as 'Annex A' and made an integral part hereof.

Granting for the sake of argument that there are various BIR Rulings as well as ITAD Rulings which might find application to petitioner's circumstances, still, said rulings would not be applicable because not one of the rulings pertain[s] to the foreign corporation such as FII. BIR Rulings are issued based on the facts and circumstances surrounding particular issue/s in question and are resolved on a case-to-case basis. It would be erroneous to invoke the ruling in a specific case which have no bearing to the case of petitioner.

Guided by the foregoing provision, since FII failed to comply with the provisions of RMO 01-2000, it shall be taxed according to the provisions of the National Internal Revenue Code.

8.2 Under Revenue Memorandum Circular (RMC) No. 77-2003 entitled 'Classification of Payments for Software for Income Tax Purposes' dated November 18, 2003, the term 'Royalties' as generally used means:

> 'Payment of any kind received as a consideration for the use of, or the right to the use, any copyright of literary, artistic or scientific work including cinematographic (sic) films or (sic) films or tapes used for radio or television

> broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment or for information concerning industrial, commercial or scientific experience. The term 'use' as contained herein shall include the reselling or distribution of software.
>
> Software is generally assimilated as a literary, artistic, or scientific work protected by the copyright laws of various countries including the Philippines, thus, payments in consideration for the use of, or the right to use a copyright or a copyrighted article relating to software are generally royalties.

The contract executed between petitioner Fluor Daniel Philippines, Inc. (FDI) and Fluor International Incorporated (FII) states that petitioner is granted free access and usage of the software however petitioner is being charged a monthly maintenance service fee. In addition, the presence of the following terms/conditions appear:

a. A non-exclusive, non transferrable free authority to access or use the software upon request of petitioner;

b. Petitioner shall not make use of the software for time-sharing or otherwise allow its use by third parties without prior written approval of FII;

c. Petitioner is not permitted to make any copies of the software for distribution to third parties;

d. Petitioner is permitted to make and distribute to employees copies of documentation and related materials, but only to the extent that such reproduction and distribution is necessary to petitioner's access or use of the software in accordance with the Agreement;

e. Petitioner shall not decompile, disassemble or reverse-engineer the software or any portion thereof, nor modify or adapt the software or documentation, nor create derivative works.

The nature of the contract shows that FII does not transfer all substantial rights to the taxpayer. A transaction does not constitute a sale or exchange because not all substantial rights have been transferred is classified as a <u>license generating royalty income</u> as provided for under Revenue Memorandum Circular (RMC) No. 44-2005 entitled 'Taxation of Payments Software' dated September 1, 2005.

The contract reveals that petitioner is granted authority to use and the right to use the copyright relating to software. The usage and access of the software is limited to the terms and conditions by FII which are stipulated in the contract. Such that, if petitioner fails to comply, it may be subject to cancellation of the contract. FII, therefore, retains full and direct control over petitioner's access and usage of the software. Hence, it loses the character of being 'free' because of [sic] the grant of authority is subject to various restrictions.

Consequently, any consideration received by FII for the use of, or the right to use the copyright of the software shall be considered royalties within the definition of RMC 77-2003 and not just a simple 'maintenance service fee' as claimed by petitioner.

The petitioner claims that the 'maintenance service fees' are considered After-sales (sic) Service citing as their basis RMC No. 77-2003. After-sales Service, as embodied in said RMC, is defined as follows:

> 'Contracts for the use of the software are often accompanied with the provision of services (e.g., installation, maintenance and customization of the software) by the personnel of the relevant foreign licensor/owner or of the relevant local subsidiary, reseller and/or distributor. Payments as consideration for after-sales service in a mixed contract are not royalties alone, but will include income from services. The appropriate course to take with such contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated payments according to the various parts of what is being provided under the contract, and then to apply to each part of it the proper tax treatment therefor. Thus, the part of the payments representing use of, or the right to use, copyright relating to software will be treated as royalties and taxable as such. The other part of the payments representing the provision of services will be treated as income from services and taxed as such.'

The governing RMC speaks that for the payment/consideration to be qualified as 'after-sales service', there must be a precedent sale of either a License or a System which consists of series of software each containing trade secrets and know-how that are considered proprietary, confidential, and of significant commercial value to FII. In this case, the software is a component and the right to use is given to make the system useful to the end-user.

The contract between petitioner and FII does not show that a license or system was sold to petitioner by FII. Petitioner was only granted free, authority/access or usage of the software necessary in the performance of their activities. Therefore, since there is no prior sale to speak of, then the alleged maintenance service fee cannot be categorized as an 'after sales-service'.

Time and again, where the law speaks in clear and categorical language, there is no room for interpretation, vacillation, or equivocation; there is room only for application.

Furthermore, the contract to be perfected must be accompanied with the provision of services which may be for installation, maintenance and customization of the software. Apparently, the contract does not provide for the scope, specific and exact details relative to the technical support, advice and assistance to be provided by the petitioner on account of the alleged maintenance of services. It also fails to show the manner and method as to how this alleged maintenance services shall be done and the covered period during which said maintenance services is to run. Suffice it to say that the aforementioned matters are necessary to warrant petitioner's payment of said alleged fees.

A careful study under Article 3 of the contract: Compensation and Method of Payment reveals that a term 'maintenance service fee' is to be paid monthly by petitioner for every Home Office and Field Staff per project hour executed in its office. It is clear that the monthly payment was billed for every use, or right to use the software provided by FII.

In addition, it is worth stressing that the alleged maintenance service fee is not to be paid in full but paid on a monthly basis. Neither does it state the specific period during which said payment shall commence and end. If said payments were for the purpose of reimbursement of cost and recovery charges as claimed by petitioner, then the payment should have at least reached a period of finality at a certain point in time. However, no agreement were undertaken to address the issue on the duration of payments to be made by petitioner. Therefore, the obligation of petitioner connotes payment in perpetuity or until such time that petitioner and/or FII exists or the least, unless and until one of the parties revoke the contract.

Likewise, it can be gleaned that no mixed contract was ever created as asserted by petitioner. Such being the case, there is no need to apportion the whole amount of the stipulated payments for royalties on one hand and income from services on the other. In view thereof, since no specific provision for maintenance was entered into by the parties, the monthly maintenance service fee shall be considered as royalties and not an 'after-sales service'. It shall represent payments for the use of, or the right to use copyright relating to software and shall be taxable as such.

With respect to the appropriate taxes for which petitioner should be held liable arising from the payment of royalties, RMC 77-2003 further states that under the section 'Modes of Acquiring Software and the Relevant Tax Treatment Thereof' that, a local end-user may acquire license to use software directly from the foreign licensor/owner of the software. Payments made by the end-user to the licensor/owner as royalties are subject to thirty-two (32%) income tax based on the gross amount thereof as that imposed on royalties derived by a non-resident foreign corporation (Section 28 [B] [1], NIRC), withheld and collected by the subsidiaries, resellers, or distributors making the payments (Section 2.57-1 [I] [1], RR 2-98). However, if the foreign licensor/owner is a resident of a country which has an existing treaty with the Philippines, royalties paid thereto are subject to the reduced tax rates on royalties under the relevant tax treaty, provided the conditions prescribed therein are complied with by the licensor/owner.

The existing Tax Treaty between the United States and the Philippines, Article 13 on Royalties provides:

> '2. However, the tax imposed by that other Contracting State shall not exceed —
>
> a. In the case of United States, 15% of the gross amount of royalties, and
> b. In the case of the Philippines, the least of:
>   1. 25% of the gross amount of royalties
>   2. 15% 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; and
>   3. The lowest rate of the Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state.'

Taking into consideration the preceding section of the Treaty, the rate of 32% is then reduced to 15% of the gross amount of royalties because the royalties are paid by a corporation registered with the Philippine Board of Investments and engaged in preferred areas of activities which is the least applicable rate for the tax deficiency report.

It is quite important to note that Article 3, Note 3 of the contract between petitioner and FII further states that "All taxes payable in the Philippines shall be the responsibility of the taxpayer".

9. Petitioner erroneously asserts that assessment for final withholding tax constitutes a new assessment.

In the Formal Letter of Demand dated April 16, 2007, a 32% Expanded Withholding Tax was assessed against petitioner. At that time, it is submitted that the respondent considered the transaction as an after-sales service wherein the owner or the licensor for the software petitioner is utilizing will receive income from services. Thus, the rate of 32% was applied to said transaction. The oversight was however rectified in the Final

Decision on Disputed Assessment (FDDA). This error was occasioned by the fact that during the period the Final Assessment Notice was made, no documentary evidence was presented by petitioner to show the nature of the contract between petitioner and the owner or the licensor of the software. It was only at the time petitioner filed its administrative protest that the contract between the petitioner and FII was produced by petitioner.

Considering the foregoing, respondent was under the duty to charge petitioner the appropriate tax due in the FDDA. Hence, from the Withholding Tax-Expanded category, the tax due from petitioner was reclassified as Final Withholding Tax (Section 28 [B] [1], NIRC in relation to Section 2.57-1 [I] [1], RR 2-98.

The 32% rate applied to royalties derived by petitioner was further reduced to 15% on account of the RP-US Tax Treaty, as petitioner is a resident of the United States. To comply with the mandate of the tax treaty, the rate provided therein was applied.

10. Petitioner in its quest to defeat payment of the assessed alleged deficiency final withholding tax, cited the ruling on CTA EB No. 113 dated September 19, 2006 (CTA Case No. 6656) entitled Commissioner of Internal Revenue vs. Deutsche Bank AG Manila Branch where it was held that petitioner (Bureau of Internal Revenue) cannot change the basis of assessment without complying with the provisions of Section 228 and Section 203 of the NIRC. However, let it be stressed that in the above-mentioned case, petitioner (Bureau of Internal Revenue) for the first time sought alternative relief already in the Memorandum stage of the trial.

Likewise, in **Aguinaldo Industries Corp. Fishing Net Division vs. Commissioner of Internal Revenue, et al., (112 SCRA 136)**, which was mentioned in the above-mentioned case, the Court held that:

> 'To allow the litigant to assume a different posture when he comes before the court and challenge the position he had accepted at the administrative level, would be to sanction a procedure whereby the court — which is supposed to review administrative determinations — would not review but determine and defy for the first time, a question not raised in the administrative forum. This cannot be permitted for the same reason that underlies the requirement of prior exhaustion of administrative remedies to give administrative authorities the prior opportunity to decide controversies within its competence, and in much the same way that, on the judicial level, issues not raised in the lower court cannot be raised for the first time on appeal.'

Petitioner is misplaced in citing the previous cases above-mentioned. Said cases are not applicable to the issues at hand, first and foremost, the 'change of assessment' was made after petitioner has filed its administrative protest. To reiterate, the change of category from the Withholding Tax Expanded Category to Final Withholding Tax occurred only during the preparation of the Final Decision on Disputed Assessment (FDDA) because it was only during that time that petitioner produced the contract entered into by petitioner and FII. Had it not been for that relevant document, the amendment would not have occurred. This document, in effect, proved that petitioner is subject to Final Withholding Tax. The respondent has no other option but to charge petitioner the appropriate and correct tax assessment.

The basis of assessment in holding petitioner [liable] for the alleged deficiency final withholding tax is RMC No. 77-2003 which is stated in the Final Assessment Notice. It is the very same basis used and applied in the Final Decision on Disputed Assessment. Petitioner was informed in writing of the law and facts on which the assessment is made at the outset. Such being the case, the assessment is valid and no violation of due process was committed.

11.To reiterate, it is clear that petitioner was given the opportunity to challenge the assessment, refute the claim of the respondent, and be heard in the proper forum and during trial by presentation of its pertinent evidence to substantiate its claim. In fact, the change in the assessment was precisely an offshoot of due process accorded to petitioner.

12.The right of respondent to assess, thus, has not yet prescribed. The change of category is not considered as an assessment enough to prevent the respondent from charging petitioner the appropriate taxes. It is not considered a new assessment. Consequently, respondent can still correct the appropriate tax due.

13.With regard to petitioner's VAT deficiency which involves the difference between total amount issued with VAT Official Receipts during the year and income reported as vatable transactions amounting to Php5,686,494.96, the VAT imputed was duly considered, consequently, deficiency was adjusted to reflect the correct taxable basis of Php3,223,193.69. Hence, the total Value Added Tax due inclusive of increments is Php570,798.39. Copy of the computation of said deficiency is attached hereto as Annex 'B' and made an integral [part] hereof.

Out of the VAT deficiency, the petitioner admitted the basic VAT deficiency in the amount of P326,519.37 as evidenced by the deposit made by petitioner of said amount on February 27, 2008 and a letter from petitioner likewise dated February 27, 2008 addressed to the Large Taxpayers Service admitting the above-mentioned circumstance. Copy of said documents are attached as annex[es] 'C' and 'D' and made an integral part hereof. However, petitioner denied payment of legal increments consisting of interest for the period from April 25, 2005 to March 31, 2008, penalty for non-compliance with invoicing requirements and compromise. In relation thereto, it was noted

> that petitioner filed an Application for Abatement Program under Revenue Regulations No. 15-2007 on February 27, 2008 with regard to corresponding interest and compromise penalties. Said issues are yet to be resolved by respondent on account of the pending Petition for Review filed before this Honorable Court by petitioner. Copy of said Application for Abatement is attached hereto as Annex 'E' and made an integral part hereof.
>
> With regard to the penalty for non-compliance with invoicing requirements, said increment occurred because of petitioner's failure to regularly issue the registered official receipt for each and every zero-rated transaction which gave rise to the above-mentioned VAT deficiency assessment.
>
> xxx xxx xxx'
>
> Both parties presented evidence, both testimonial and documentary, to prove their case. On February 22, 2011, this Court ordered the parties to file their respective Memorandum [sic] within fifteen (15) days from receipt of the said Resolution. In a Resolution dated May 3, 2011, the case was submitted for decision taking into consideration petitioner's Memorandum filed on January 31, 2011 and respondent's Memorandum filed on May 2, 2011." (Emphasis supplied)

As aforestated, the CTA-Second Division rendered its assailed Decision on April 17, 2012 granting the Petition for Review.

On May 4, 2012, a "Motion for Reconsideration" was filed by petitioner CIR. Respondent FDPI filed its "Comment (Re: Respondent's Motion for Reconsideration dated May 3, 2012) on June 11, 2012.

On July 4, 2012, the CTA-Second Division issued a Resolution denying the Motion for Reconsideration for lack of merit. Petitioner CIR received the Resolution on July 4, 2012.

On July 19, 2012, petitioner CIR filed a "Motion for Extension of Time to File Petition for Review"[3] before the Court *En Banc*. In a Resolution[4] dated July 20, 2012, the Court *En Banc* granted petitioner CIR a final and non-extendible period of fifteen (15) days from July 24, 2012 or until August 8, 2012, within which to file her Petition for Review. OM

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[3] *Rollo*, pp. 1-4.
[4] *Rollo*, p. 6.

On August 10, 2012,[5] petitioner CIR filed her Petition for Review,[6] via registered mail. The Court *En Banc* received the Petition for Review on August 23, 2012.

In a Resolution[7] dated September 12, 2012, the Court *En Banc* ordered respondent FDPI to file its Comment on the Petition for Review within ten (10) days from notice. Petitioner CIR was given a period of five (5) days from receipt of respondent FDPI's Comment to file a reply thereto.

On October 22, 2012, respondent FDPI filed its Comment[8] via registered mail, which the Court *En Banc* received on October 30, 2012.

In a Resolution[9] dated February 5, 2013, the Court *En Banc* noted that petitioner CIR failed to file its reply to respondent FDPI's Comment. The Court *En Banc* gave due course to the Petition for Review and ordered the parties to file their respective Memoranda within thirty (30) days from receipt of the Resolution.

On May 8, 2013, the Court *En Banc* submitted the case for decision,[10] taking note of the Memorandum[11] filed by respondent FDPI on April 15, 2013 and petitioner CIR's failure to file her Memorandum within the period prescribed by the Court.[12]

ISSUES

In her Petition for Review, petitioner CIR reiterated the stipulated issues as stated in the parties' Joint Stipulation of Facts and Issues, to wit:

> "1. Whether petitioner CIR complied with the due process requirements under Section 228 of the 1997 Tax Code.
>
> 2. Whether petitioner CIR's right to assess respondent FDPI for 2004 has prescribed.

[5] Work at the Court of Tax Appeals was suspended due to heavy rains brought about by southwest monsoon.
[6] *Rollo*, pp. 19-53.
[7] *Rollo*, pp. 92-93.
[8] *Rollo*, pp. 98-109.
[9] *Rollo*, pp. 115-116.
[10] *Rollo*, pp. 139-140.
[11] *Rollo*, pp. 121-136.
[12] *Rollo*, p. 137.

3. Whether the change of category of the assessed deficiency tax from Withholding Tax Expanded to Final Withholding Tax in the Final Decision on disputed Assessment is a new assessment.

4. Whether respondent FDPI is liable for Final Withholding Taxes for the year 2004.

5. Whether the software maintenance service fee paid by respondent FDPI to Fluor Intercontinental Incorporated (FII) is considered royalties within the definition of Revenue Memorandum Circular (RMC) No. 77-2003, as further amended by RMC 44-2005.

6. Whether respondent FDPI is required to secure a tax treaty application prior to the filing of the instant Petition before it can avail of the benefits under the RP-US Tax Treaty as laid down under Revenue Memorandum Circular (RMC) No. 01-2000, dated November 25, 1999.

7. Assuming that respondent FDPI is liable for Final Withholding Taxes for the year 2004, whether respondent FDPI is liable for the Final Withholding Tax of 32% or at the reduced rate of 15%.

8. Whether respondent FDPI is liable to pay legal increments consisting of interest and compromise penalties of [for] non-compliance with VAT invoicing requirements.

9. Whether respondent FDPI is liable to pay twenty five (25%) percent surcharge and twenty (20%) percent annual interest for late payment from [issuance of] FDDA dated 3 March 2008 until fully paid pursuant to Sections 248 and 249 of the NIRC."[13]

PETITIONER CIR'S ARGUMENTS

Petitioner CIR argues that respondent FDPI was not deprived of due process when the assessment was changed from Expanded Withholding Tax (EWT) as found in the Final Assessment Notice (FAN) to Final Withholding Tax (FWT) in the Final Decision on Disputed Assessment (FDDA). Petitioner CIR claims that respondent FDPI never presented any documentary evidence to prove the nature and character of the contract between it and the owner of the software license until the time of the issuance of the FAN. When respondent FDPI protested the FAN through a request for reinvestigation, it appended with its protest the contract dated January 1, 2004 between respondent FDPI and Fluor International, Incorporated (FII), the licensor/provider of the software being used by respondent FDPI. Based on the said contract, petitioner CIR determined that the maintenance service fees remitted to the licensor should be treated as licensed generating royalty income under Section 5 of Revenue

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[13] *Rollo*, pp. 22-23.

Memorandum Circular (RMC) No. 44-05, subject to FWT. This change should not be interpreted as a new assessment but rather a re-evaluation of assessment, as a result of the reinvestigation conducted by petitioner CIR at the instance of respondent FDPI. Respondent FDPI was aware that the basis for which it was assessed deficiency FWT in the FDDA is the very same basis for which the deficiency EWT in the FAN was present, and that basis would be the software expenditures of respondent FDPI.

Petitioner CIR also posits that the CTA-Second Division erred when it ruled that RMC No. 44-05 which took effect on September 1, 2005 has no retroactive application. Petitioner CIR insists that at the time of the issuance of the FDDA, RMC No. 44-05 was already in existence; hence, there can be no retroactive application to speak of as the same may very well be applied in the case of respondent FDPI.

Petitioner CIR further avers that whether the category is EWT or FWT, the same should not be controlling due to the fact that EWT or FWT are not considered taxes but only a manner/method employed by petitioner CIR in collecting the payment of income tax.

In addition, petitioner CIR points out that respondent FDPI failed to comply with Revenue Memorandum Order (RMO) No. 01-2000 relative to the filing of a prior application for tax treaty relief with the International Tax Affair Division (ITAD) of the Bureau of Internal Revenue (BIR). While the payments to FII are within the coverage of the RP-US Tax Treaty, FII has to comply with the provisions of RMO No. 01-2000 in order to avail of the benefits of the said treaty.

Petitioner CIR asseverates that respondent FDPI's treatment relative to its use of the software casts doubt on the manner as to how the usage of the software was accounted for by respondent FDPI. The software maintenance service fees paid by respondent FDPI to FII are clearly royalties, within the definition of RMC No. 77-2003, as amended by RMC No. 44-2005. Thus, respondent FDPI, as the withholding agent, is liable for deficiency FWT for taxable year 2004 on its payment of software maintenance service fees to FII.

Finally, petitioner CIR opposes respondent FDPI's stance that since it received the FDDA only on May 9, 2008, the new assessment for FWT covering taxable year 2004 was issued after prescription has already set in. According to petitioner CIR, the last day prescribed by law for filing income tax return for taxable year 2004 was on April 15, 2005. The counting of the three-year period shall be reckoned from April 16, 2005. The FAN was issued on April 16, 2007 and the same was received by respondent on April 24, 2007. Thus, the assessment was issued within the prescriptive period.

RESPONDENT FDPI'S COUNTER-ARGUMENTS

Respondent FDPI insists that the deficiency FWT assessment in the FDDA is a new assessment. The EWT assessment in the FAN was based on RMC No. 77-03 while the FWT assessment in the FDDA was based on RMC No. 44-05.

Respondent FDPI also argues that since it was not given the opportunity to refute or counter the FWT assessment at the administrative level, the issuance of the FWT assessment through the FDDA violates the requirements imposed by Section 228 of the National Internal Revenue Code of 1997 (1997 NIRC), as amended and as implemented by Revenue Regulations (RR) No. 12-99.

Respondent FDPI claims that petitioner CIR's argument that she could not have properly assessed respondent FDPI with FWT on the software maintenance service fees as her examiner failed to see the contract between respondent FDPI and FII during her audit investigation only confirms that petitioner CIR assessed respondent FDPI based on mere presumption and not on actual facts. This manner of assessment clearly violates the rule that assessments must be based on actual facts and not on mere presumptions. If petitioner CIR intended to assess respondent FDPI for FWT on royalties, she could have done so on the basis of the documents presented by respondent FDPI during audit.

In addition, respondent FDPI asserts that petitioner CIR harped for the first time on RMC No. 44-05 as the basis for classifying the software maintenance service fees as royalties and imposing FWT thereon. The concept of license generating royalty income in RMC No. 44-05 became relevant only on September 1, 2005 when RMC No. 44-05 was issued. Said concept was nowhere to be found in RMC No. 77-03. RMC No. 44-05 cannot be retroactively applied to respondent FDPI's 2004 payments to FII, without prejudicing its constitutionally protected rights.

Lastly, respondent FDPI avers that the change in the assessment from EWT under the FAN to FWT under the FDDA is considered a new assessment which was issued by petitioner CIR beyond the three-year prescriptive period prescribed under Section 203 of the 1997 NIRC, as amended.

THE COURT EN BANC'S RULING

The Court *En Banc* resolves to deny the petition.

As aptly pointed out by respondent FDPI, there is nothing novel in the arguments raised in the instant Petition for Review. Indeed, the arguments raised by petitioner CIR in the instant Petition for Review are mere rehash of the arguments set forth in her Memorandum dated May 2, 2011 as well as her Motion for Reconsideration dated May 3, 2012, both filed with the CTA-Second Division. Suffice it to say, the CTA-Second Division carefully addressed these arguments in the assailed Decision and assailed Resolution. Be that as it may, the Court *En Banc* deems it worthwhile to reiterate the points emphasized by the CTA-Second Division.

The FWT assessment issued against respondent FDPI, as contained in the FDDA, is void for lack of legal basis. In assessing respondent FDPI for deficiency FWT, petitioner CIR classified the software maintenance service fees paid by respondent FDPI to FII as "license generating royalty income" and imposed FWT thereon pursuant to RMC No. 44-05.

A close perusal of RMC No. 44-05, which was issued on September 1, 2005, reveals that its application is specifically limited to software payments paid or payable starting from its effectivity date. Section 9 of RMC No. 44-05 is quoted hereunder:

> "SECTION 9. Effectivity. — This Circular shall take effect immediately and shall cover software payments paid or payable starting said effectivity date."

Thus, the Court *En Banc* upholds the CTA-Second Division's disquisition that RMC No. 44-05 could not be used as basis in assessing respondent FDPI for deficiency FWT for the year 2004, *viz:*

> "*First*, a careful reading of respondent's FDDA would show that CIR primarily anchors the change of classification of petitioner's deficiency taxes from EWT to FWT on Section 5 of RMC No. 44-05 where she classified the software service maintenance fees as "license generating royalty income." **However, after reviewing the provisions of the said circular, this Court finds that the same is not applicable in the instant case in view of the non-retroactive application of the circulars promulgated by respondent. It is very clear under Section 9 of the RMC No. 44-05 that such circular only covers software payments paid or payable from the date of effectivity of the same, which is September 1, 2005. But, as can be gleaned from the records, the subject of the questioned assessment covers taxable**

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> **year 2004, thus respondent could not possibly use the provisions of the said circular as her basis in changing her earlier assessment.** In a long line of cases, the High Tribunal has consistently ruled that the rulings, circulars, rules and regulations promulgated by the Commissioner of Internal Revenue would have no retroactive application if to so apply them would be prejudicial to the taxpayers.
>
> *Second,* **the concept of "license generating royalty income" in RMC No. 44-05, is nowhere to be found in RMC No. 77-03. Hence, the retroactive application by the respondent of RMC No. 44-05 has no leg to stand on.**" (Emphases supplied)

In fine, since RMC No. 44-05 was issued only on September 1, 2005 and respondent FDPI's payments to FII were made in the year 2004, RMC No. 44-05 cannot be applied for purposes of assessing respondent FDPI for FWT on its payments of software maintenance service fees for such clearly contravenes the explicit mandate under Section 9 of RMC No. 44-05. Interestingly, it even ignores Section 246 of the NIRC of 1997, as amended, which provides that "any revocation, modification or reversal of any rules and regulations, rulings or circulars, shall not be given retroactive application."

In view of the foregoing, the Court *En Banc* affirms the CTA-Second Division's assailed Decision which cancelled and set aside the FWT assessment on respondent FDPI's payments of software maintenance service fees for the year 2004. To reiterate, the FWT assessment is null and void for lack of legal basis.

Since the FWT assessment issued against respondent FDPI is null and void, and consequently, bears no fruit,[14] the resolution of the remaining stipulated issues reiterated by petitioner CIR in the instant Petition for Review is no longer necessary for the disposition of the case.

There being no reversible error committed by the CTA-Second Division, the Court *En Banc* finds no cogent reason to modify, much less, reverse the assailed Decision and assailed Resolution of the CTA-Second Division.

WHEREFORE, premises considered, the Petition for Review is hereby **DENIED**. Accordingly, the assailed Decision promulgated on April 17, 2012 and the assailed Resolution promulgated on July 4, 2012 by the CTA-Second Division in CTA Case No. 7793 entitled *"Fluor Daniel*

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[14] Commissioner of Internal Revenue vs. Metro Star Superama, Inc., G.R. No. 185371. December 8, 2010.

Philippines, Inc. vs. Commissioner of Internal Revenue" are hereby **AFFIRMED**.

SO ORDERED.

ROMAN G. DEL ROSARIO
Presiding Justice

WE CONCUR:

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

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

(On Leave)
AMELIA R. COTANGCO-MANALASTAS
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
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 *En Banc*.

ROMAN G. DEL ROSARIO
Presiding Justice