REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL THIRD DIVISION

CENTRAL LUZON DRUG CORPORATION, Petitioner,	CTA CASE NO. 8952 Members:
-versus-	FABON-VICTORINO, *Acting Chairperson* and RINGPIS LIBAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: NOV 14 2018 3:42 p.m.

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DECISION

Fabon-Victorino, J.:

In its Petition for Review filed on December 19, 2014, petitioner Central Luzon Drug Corporation prays for the nullification and cancellation of the deficiency income tax (IT), value-added tax (VAT), expanded withholding tax (EWT) and documentary stamp tax (DST) assessments issued against it by respondent Commissioner of Internal Revenue (CIR), inclusive of compromise penalties, interests and surcharges, in the aggregate amount of ₱1,146,686,052.85 for taxable year (TY) 2009.

THE FACTS

Petitioner Central Luzon Drug Corporation is a domestic corporation with business address at No. 28 Shaw Boulevard, Pasig City, Metro Manila. It is engaged in the business of operating drug stores in Region 3 – Central Luzon.

Respondent, on the other hand, is the Commissioner of the Bureau of Internal Revenue (BIR) who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

In 2009, petitioner operated 52 drug stores under the name Mercury Drug. Each store was covered by a Franchise Agreement[1] between petitioner and Mercury Drug Corporation (MDC).

On May 14, 2010, respondent issued Letter of Authority (LOA) No. 116-2010-0000100[2] authorizing the examination of petitioner's books of accounts and other accounting records for all internal revenue taxes for TY 2009 pursuant to the Conglomerate Audit Program under Revenue Memorandum Order (RMO) No. 36-2010.

On June 14, 2012, petitioner executed a Waiver of the Defense of Prescription[3] (Waiver) which was accepted by respondent on June 26, 2012.

On June 25, 2013, respondent issued a Notice of Informal Conference (NIC)[4] to petitioner finding it liable for deficiency IT, VAT, EWT, withholding tax on compensation (WTC) and DST, in the aggregate amount of ₱1,033,544,165.43 for TY ended December 31, 2009.

On March 10, 2014, petitioner received the Preliminary Assessment Notice (PAN)[5] which, except for the deletion of the finding on deficiency WTC of ₱3,021,907.78, merely reiterated the audit findings in the NIC.

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[1] Exhibit "P-1".
[2] Exhibit "P-2".
[3] Exhibit "P-7".
[4] Exhibit "P-8".
[5] Exhibit "P-10".

On March 27, 2014, petitioner filed its Protest to the PAN[6] which respondent did not consider on the ground that it was filed beyond 15 days from receipt of the PAN.

On May 5, 2014, respondent issued a Formal Letter of Demand (FLD), reiterating the assessments in the PAN, and Assessment Notices all dated May 5, 2014[7], finding petitioner liable for deficiency IT, VAT, EWT and DST in the aggregate amount ₱1,111,072,693.79 for TY ended Dec. 31, 2009.

On June 4, 2014, petitioner filed its protest against the FLD together with the supporting documents[8] and requested for reinvestigation of its case.

On November 21, 2014, petitioner received through personal service a copy of the Final Decision on Disputed Assessment (FDDA)[9], which substantially reiterated the assessments in the FLD, finding it liable for deficiency taxes in the aggregate amount of ₱1,146,686,052.85 for TY 2009.

On December 19, 2014, petitioner filed the instant Petition for Review[10] before the Court.

In his Answer[11], respondent primarily argues that the questioned assessment for deficiency IT, VAT, EWT and DST was issued in accordance with law, rules and jurisprudence. Moreover, his right to assess petitioner for deficiency VAT and EWT for TY 2009 has not yet prescribed. Petitioner is likewise estopped from assailing the validity of the waiver/s since it already derived benefit therefrom.

According to respondent the subject deficiency IT assessment emanated from the following: a) income payments which were not subjected to EWT in the amount of ₱19,581,991.71; b) unrecorded sales in the amount of ₱350,011.77; c) unpaid December purchases from MDC, which were not subjected to EWT in the amount of

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[6] Exhibit "P-11".
[7] Exhibit "P-12".
[8] Exhibit "P-13".
[9] Exhibit "P-14".
[10] Docket, vol. 1, pp. 14 to 40.
[11] Docket, vol. 1, pp. 98 to 116.

₱226,348,772.64; d) discrepancy in the property and equipment as stated in the Financial Statements (F/S) vis-à-vis the VAT Returns in the amount of ₱748,880.58; e) disallowed royalty expense in the amount of ₱42,949,440.00; and f) unaccounted/unsupported payable to MDC in the amount of ₱571,805,938.44.

Insofar as the deficiency VAT assessment is concerned, respondent contends that a comparison of petitioner's sales per Summary Alphalist of Withholding Taxes (SAWT) from its customers purchases subjected to EWT reveals unrecorded sales of ₱350,011.77. As to deficiency VAT assessment arising from disallowed input tax, petitioner is liable in the amount of ₱392,256,863.63.

Petitioner is also liable for deficiency EWT arising from its expenses not subjected to EWT in the amount of ₱245,930,764.35, plus the transactions it failed to subject to DST.

To shore up his stance, respondent invokes the tenet that tax assessments by the tax examiners are presumed correct and made in good faith, thus, the taxpayer is duty bound to prove otherwise. Failure on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify upholding of his assessment.

After the Pre-trial Conference, the parties filed their Joint Stipulation of Facts[12] on May 8, 2015.

On June 11, 2015, the Court issued a Pre-Trial Order[13] thereby terminating the pre-trial proceeding.

Trial ensued during which petitioner presented Cyre M. Clores, Wilson C. Chua and Michael L. Aguirre, as his witnesses.

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[12] Docket, vol. 2, pp. 647-655.
[13] Docket, vol. 2, pp. 661-672.

Witness, **Cyre M. Clores** testified[14] that as petitioner's Finance and Administration Manager since January 2006, he oversees the accounting, finance and tax matters of petitioner's business. Petitioner is a franchisee of MDC and operates fifty-two (52) drugstores under the name "Mercury Drug".

Pursuant to Conglomerate Audit Program of the BIR under RMO No. 36-2010, respondent issued LOA-116-2010-00000100 dated May 14, 2010[15] for the examination of petitioner's internal revenue taxes for TY 2009. During the investigation, respondent requested for documents and petitioner complied per transmittal letters dated August 11, 2010, August 10, 2011, October 22, 2012 and May 27, 2013[16]. Petitioner also executed a Waiver dated June 14, 2012[17] valid until June 30, 2013 and signed by petitioner's President, Jacinto J. Concepcion[18].

After the investigation, respondent issued a NIC dated June 25, 2013[19] finding petitioner liable for deficiency IT, VAT, EWT, WTC and DST in the aggregate amount of ₱1,033,544,165.43 for TY ended December 31, 2009. During the conference on August 27, 2013, petitioner submitted Reconciliation of Discrepancy for TY 2009[20] and refuted the finding as contained in the NIC.

On March 10, 2014, petitioner received a PAN[21] which merely restated the findings in the NIC except the alleged deficiency WTC of ₱3,021,907.78 which was deleted. On March 13, 2014, petitioner requested for an extension of time to file its protest to the PAN and submitted a Waiver executed by its President. On March 27, 2014, petitioner filed its Protest to the PAN[22], which respondent did not consider.

On May 6, 2014, petitioner received the FLD and Assessment Notices dated May 5, 2014, [23] assessing it for

[14] Exhibits "P-34", "P-35", "P-34-A" and "P-35-A".
[15] Exhibit "P-2".
[16] Exhibits "P-3" to "P-6".
[17] Exhibit "P-7".
[18] Exhibit "P-7-1".
[19] Exhibit "P-8".
[20] Exhibit "P-9".
[21] Exhibit "P-10".
[22] Exhibit "P-11".
[23] Exhibit "P-12".

deficiency IT, VAT, EWT and DST in the aggregate amount of ₱1,111,072,693.79 for TY ended December 31, 2009. The said FLD was almost a replica of the PAN only that it contained a computation of the interests imposed.

On June 4, 2014, petitioner filed its Protest to the FLD with supporting documents and a request for reinvestigation[24]. Thereafter, respondent issued the assailed FDDA[25], which was received on November 21, 2014, finding petitioner liable for deficiency IT, VAT, EWT and DST in the total amount of ₱1,146,686,052.85, inclusive of interest, compromise penalty and surcharges. This propelled the filing of the instant Petition for Review by petitioner before this Court.

According to the witness, petitioner's deficiency IT assessment of ₱493,746,577.66 arose from some items in petitioner's 2009 Annual Income Tax Return (AITR) [26] which respondent disallowed, namely: net loss per return, income payment not subjected to EWT, unrecorded sales, unpaid December purchases from MDC, royalty expense, discrepancy – property & equipment and unaccounted/unsupported payables to MDC.

He explained that in 2009, petitioner incurred the net loss of ₱62,170,945.00 as shown in its AITR, respondent however reflected a zero net loss in the computation of petitioner's deficiency IT assessment. Thus, the "taxable income per audit" in the FDDA was overstated in the amount of net loss per its 2009 AITR.

Respondent also disallowed petitioner's purchases from MDC on December 21 and 31, 2009 in the sum of ₱226,348,772.64 on the ground that they were not subjected to EWT, hence, they could not be claimed as deduction from gross income pursuant to Section 34(K) of the NIRC of 1997, as amended. Contrary to respondent's observation, petitioner made regular payments on its purchases from MDC with the corresponding 1% EWT thereon. Petitioner did not claim its December purchases from MDC as deduction in its 2009 gross

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[24] Exhibit "P-13".
[25] Exhibit "P-14".
[26] Exhibit "P-15".

income given that they formed part of petitioner's ending inventory of ₱441,150,228.71 as petitioner used the first-in, first-out (FIFO) method of accounting for inventories[27], as indicated in its Audited F/S for 2009[28].

Anent the deficiency IT assessment allegedly due to unaccounted/unsupported payables to MDC in the amount of ₱571,805,938.44, respondent simply deducted petitioner's ending inventory of ₱441,150,228.71 from its outstanding accounts payable to MDC in the amount of ₱1,012,956,167.15. He opined that accumulation of huge payable to MDC was a violation of Stipulation No. 10 of its Franchise Agreement which required petitioner to settle its liabilities to MDC on a weekly basis. Petitioner however already explained to respondent that such provision had been discontinued effective February 2009 due to difficulties of weekly reconciliation of payments for the 52 stores. Further, during the audit, petitioner submitted bank records and bank reconciliations to the BIR examiner to prove that it was no longer remitting 80% of its sales to MDC.

Respondent further disallowed the amount of ₱42,949,440.00 for royalty expense which he considered as distribution of dividends disguised as royalty and not as ordinary and necessary expense contemplated under Section 34 of the NIRC. The royalty expense, according to the witness, was paid in consideration for the use of Mercury Drug's name and other services and privileges actually rendered to petitioner by MDC, *i.e,* promotions and advertising; lending of rent-free signboard; system instructions for inventory management and accounting control; assistance in the proper alignment of stocks in display in order to afford maximum store comfort for customers and personnel; and personnel training. Per the Franchise Agreement, the royalties to MDC were equivalent to 1.5% of gross sales.

With respect to the disallowed amount of ₱19,581,991.71, the same covered expenses and/or costs of petitioner's branches pertaining to their payments to electric cooperatives, direct suppliers and payments out of petty cash expenses. Petitioner's expenses pertaining to payments to

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[27] Exhibit "P-16-1".
[28] Exhibit "P-16".

electric cooperatives were exempt from EWT pursuant to Republic Act (R.A.) No. 6938, as implemented under Revenue Regulations (RR) No. 20-2001, while the disallowed expenses pertaining to payments to direct suppliers, the same were consistently subjected to withholding on a cash basis. The disallowed expense relative to petty cash funds of the 52 stores were mere reimbursements and disbursements of petty expenditures.

Respondent likewise disallowed the amount of ₱350,011.77, which represents the difference between petitioner's sales to Mercury Group of Companies, Inc. (MGCI), Trinity and San Miguel. Respondent treated the said amount as unrecorded sales, when in truth they were recorded in the cash receipts book of petitioner.

With regard the adjustment captioned as discrepancy – property & equipment vs per VAT returns in the amount of ₱748,880.58, the said amount corresponds to the difference between the amount reported as additions to Property & Equipment in the 2009 Audited F/S and the amount reported under the Capital Goods in the VAT returns as undeclared income. Such difference arose from the erroneous classification of domestic purchases of capital goods as domestic purchases of services in the VAT returns and other non-VAT suppliers not subjected to VAT.

On the deficiency VAT assessment of ₱647,939,507.49, respondent allegedly computed it by disallowing the following items in petitioner's Quarterly VAT Return for the First Quarter of 2009[29], *i.e,* a) unrecorded sales; b) cash overage; c) disallowed input tax: 1) on purchases with invalid Tax Identification Number (TIN), 2) on December purchases from MDC, 3) from purchases from MDC without TIN of purchases, 4) from royalty expense, 5) from Mercury Group supported by DM only, and 6) excess input tax carried over to succeeding years.

On the first item of disallowance/adjustment captioned as "unrecorded sales per Master file Extraction for EWT", the amount of ₱350,011.77 represents the difference between petitioner's sales to MGCI, Trinity and San Miguel compared

[29] Exhibit "P-22".

with the petitioner's customers' purchases subjected to EWT. Respondent also treated the said difference as unrecorded sales as petitioner did not claim the creditable withholding tax (CWT) thereon. However, the said sales were recorded in petitioner cash receipts books with the corresponding branch charge invoices issued and simultaneously punched to its branches POS/Cash Register Machines.

The amount of ₱27,159,932.66 under "Input tax on December purchases from MDC ownership of which still belongs to MDC with no TIN of purchaser", was also disallowed by respondent on the wrong premise that that the ownership of the goods purchased belonged to MDC as they were purchased on credit. But the ownership of the purchased goods actually belonged to petitioner even before their full payment. Petitioner paid the goods and the 12% passed-on VAT to MDC was remitted to the BIR giving petitioner the right to claim for input taxes on said purchases. Also, contrary to respondent's asseveration, petitioner's charge invoices indicated the quantity, unit cost and description of goods only that the said details and information were contained in the Delivery Receipts, which support the Charge Invoices.

Respondent as well disallowed input tax on purchases with invalid TIN saying that the TINs of the suppliers in the BIR Database were different from the TINs indicated on the receipts or invoices issued by petitioner's suppliers. However, the said purchases were not from MDC. Moreover, respondent did not provide petitioner with the suppliers TINs as indicated in the BIR Database. To reconcile the alleged discrepancies, petitioner submitted documents consisting of list of suppliers indicating the correct TINs together with photocopies of the suppliers' official receipts and invoices and certificate of registrations.

The royalty expenses were also erroneously disallowed since petitioner's claim was supported by collection receipts and not merely by debit memos as claimed by respondent. The same with the petitioner's input tax on its purchases of services to MGCI. Admittedly, petitioner submitted only the photocopies of the duplicate official receipts as their originals could not be located which information was made known to respondent. In any event, since petitioner paid input tax to

MGCI, which in turn remitted the same to the BIR, petitioner is entitled to use and benefit from it.

Further, the witness considered respondent's right to assess deficiency EWT for the months of January to May 2009 prescribed. Besides, petitioner's income payments were already subjected to withholding tax. Also the bulk of the deficiency EWT assessment arose from petitioner's purchases from MDC, which were already paid by petitioner, as evidenced by its Summary List of Purchases (SLP) and Monthly Alphalist of Payees subject to EWT.

The assessment for deficiency DST in connection with the lease with Q Square Enterprises Inc (Q Square) is also incorrect as it was already paid by petitioner's lessor as early as September 4, 2007, as evidenced by BIR Form 2000 and RCBC's BTR-BIR deposit slip indicating payment of ₱17,304.00 on September 4, 2007 with taxpayer's name of Q Square Enterprises, Inc. with TIN 221-582-594-000[30]. The DST payment covered the whole lease period from November 1, 2007 to October 31, 2022.

Witness Clores claimed that it was he who filed petitioner's Protest to the FAN on March 27, 2014, or 17 days after receipt thereof on March 10, 2014. He also declared that the original Charge Invoices issued by MDC to petitioner were lost and efforts to locate them proved futile.

Finally, the witness opined that petitioner should not be made liable to pay the assessed deficiency EWT since it regularly paid the corresponding 1% withholding tax to MDC for every purchase.

Wilson C. Chua, also by way of Judicial Affidavit[31], testified that he is MDC's Vice-President and has been with MDC since May 9, 1983. In 2009, he was MDC's Assistant Vice President for Finance (AVP-Finance). He prepared, supervised and monitored MDC's submissions with and payment of taxes to the BIR.

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[30] Exhibits "P-31" and "P-31-A".
[31] Exhibits "P-36" and "P-36-A".

Petitioner is a franchisee of MDC which operates Mercury Drug stores in Region 3. It informed MDC about the present case saying that it needed to prove that MDC reported to the BIR its sales to petitioner and paid the 12% VAT on petitioner's purchases for 2009. Upon request[32] for relevant documents MDC furnished petitioner with the following: duplicate originals or the accounting copies of the Charge Invoices issued by MDC to petitioner in 2009, Debit and Credit Memos issued by MDC to petitioner, VAT Returns and Summary List of Sales.

The witness declared that MDC reported to the BIR its total sales for 2009, inclusive of its sales to petitioner, as reflected in its Quarterly VAT Returns[33], and paid the corresponding output tax for 2009. MDC's Quarterly VAT Returns were also supported by Summary List of Sales (SLS)[34] and SLP, which were also submitted to the BIR, to show that output tax generated from the total MDC sales, including the sales to petitioner.

To aid petitioner in proving its payment of VAT on its purchases from MDC for 2009, MDC allowed petitioner to formally request[35] the BIR for a certification that the SLS filed by MDC in 2009 with the BIR included petitioner. Acting on the said request, the BIR confirmed that petitioner was included in MDC's SLS for April to December 2009[36]. In any event, MDC priorly provided petitioner with printouts of the 2009 SLS. From the said inquiry, he discovered that the BIR did not receive MDC's SLS for the 1st Quarter of 2009 as it was only electronically filed. Be that as it may, the BIR acknowledged receipt of MDC's 1st Quarter VAT Return for 2009 as well as its corresponding payment for the said period[37].

The witness claimed that MDC issues Charge Invoices to its franchisees to evidence the sale of goods. Since the BIR only approved one set of invoices for MDC, i.e., Charge Invoice, MDC uses it for both retail and wholesale of its merchandise. But due to limited space, the Charge Invoice

[32] Exhibit "P-41".
[33] Exhibits "P-37" to "P-40".
[34] Exhibits "P-42" to "P-42-gg".
[35] Exhibit "P-44".
[36] Exhibit "P-45".
[37] Exhibits "P-37" and "P-37-A".

cannot indicate the quantity, unit cost and description of goods in wholesale transactions as required, the said details and information are indicated instead in the Delivery Receipts, attached to the Charge Invoices.

The Court-commissioned Independent Certified Public Accountant **(ICPA) Michael L. Aguirre** testified that he conducted the examination, audit and evaluation of petitioner's voluminous documents in support of its defense against respondent's assessment for 2009 covering EWT, VAT and IT.

Per his ICPA Report[38] dated September 17, 2015, petitioner is liable to pay deficiency tax in the total amount of ₱2,768,086.18 consisting of ₱105,003.53 (IT); ₱238,554.12 (VAT); and ₱2,424,528.53(EWT), exclusive of penalties and surcharges.

In addition, the ICPA affirmed that all the examined supplier's invoices contained petitioner's TIN. His verification of the SLPs and SLS revealed a difference of ₱840,306.50 due to timing difference which is of no moment and will self-correct in the subsequent period. He verified not only the SLSs and SLPs but also the supporting documents such as the invoices issued by petitioner's suppliers and official receipts, all of which contained petitioner's TIN.

Petitioner rested after formal offer of its evidence[39] per Resolution dated March 9, 2016[40].

On the other hand, respondent's lone witness, Revenue Officer III (RO) **Josa C. Gomez** testified[41] that she has been with the BIR since 1989 and currently with the Regular Large Taxpayer Audit Division (RLTAD)1. Her duties include investigation, examination, and reinvestigation of internal revenue tax cases and such other duties and functions as may be assigned to her from time to time.

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[38] Exhibits "P-48" and "P-48-1".
[39] Docket, vol. 3, pp. 1396-1422.
[40] Docket, vol. 4, pp. 1965-1969.
[41] Exhibits "R-15" and "R-15.1".

She conducted the audit of petitioner's internal revenue taxes for the period January 1 to December 31, 2009. While she admitted that no LOA was issued in her favor, she believed that the Memorandum of Assignment (MOA) dated February 25, 2013[42] was issued pursuant to LOA-116-2010-00000100 dated May 14, 2010[43] issued in favor of the original investigating revenue officers. By virtue of the MOA, she continued the audit as the previous handling RO was transferred to another office.

Upon receipt of the docket of the case[44], she sent petitioner a written request for additional documents[45] necessary for the proper conduct of the audit/investigation of all its internal revenue taxes. After finding petitioner liable for deficiency taxes, she issued the NIC dated June 25, 2013[46]. Petitioner was granted time to submit additional corroborating evidence to refute the initial assessment but it failed, hence, she submitted a Memorandum[47] for the issuance of a PAN.

Thereafter, a PAN with attached Details of Discrepancies[48] was issued against petitioner to which petitioner failed to timely file a protest[49] or provide the supporting documents prompting her to prepare a Memorandum[50] for the issuance of a FAN and FLD. On May 6, 2014, petitioner received the FLD[51] with attached assessment notices[52] and details of discrepancies dated May 5, 2014.

The witness further testified that petitioner's President, Jacinto J. Concepcion executed several Waivers[53] which extended respondent's right to assess.

On June 4, 2014, petitioner filed a Protest against the FLD. This was followed by a request for extension of time to submit supporting documents filed on August 1, 2014, on the

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42 Exhibit "R-2".
43 Exhibit "R-1".
44 Exhibit "R-20".
45 Exhibit "R-3".
46 Exhibit "R-4".
47 Exhibit "R-5".
48 Exhibit "R-6".
49 Exhibit "R-8".
50 Exhibit "R-7".
51 Exhibit "R-9".
52 Exhibits "R-9-a" to "R-9-d".
53 Exhibits "R-10" to "R-13".

ground that 70% of its 2009 BIR documents were damaged due to typhoon "Glenda". In a letter dated July 3, 2014[54], petitioner informed respondent that it would partially settle its deficiency tax liabilities in the amount of ₱1,077,680.97. In a letter dated August 11, 2014[55] received by petitioner on August 29, 2014, respondent denied petitioner's request for extension because upon ocular inspection[56], respondent discovered that the documents allegedly damaged were not relevant to petitioner's protest.

On August 29, 2014, petitioner submitted some documents in support of its Protest to the FLD but they were no longer considered. Upon her recommendation in the Memorandum dated September 8, 2014[57], the assailed FDDA was issued on November 20, 2014[58].

RO Gomez confirmed that her authority to conduct the audit investigation against petitioner for the period January 1 to December 31, 2009 was only based on MOA No. LOA-116-2013-0421 dated February 25, 2013. While she admitted that there was no Electronic Letter of Authority issued in her name similar to that currently being issued by respondent, nevertheless a valid LOA was presented to petitioner. Further, petitioner received a copy of the Waiver signed by the Assistant Commissioner of the Large Taxpayer Service on July 17, 2012.

Per the Resolution dated September 9, 2017[59], respondent rested after his Formal Offer of Evidence on March 23, 2017[60].

On December 1, 2017[61], the case was submitted for decision considering petitioner's Memorandum filed on November 24, 2017[62], and respondent's Memorandum[63] filed on October 26, 2017.

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[54] Exhibit "R-14".
[55] Exhibit "R-17".
[56] Exhibits "R-15" and "R-16".
[57] Exhibit "R-18".
[58] Exhibit "R-19".
[59] Docket, vol. 4, pp. 2021-2022.
[60] Docket, vol. 4, pp. 1986-1995.
[61] Docket, vol. 4, p.2117.
[62] Docket, vol. 4, pp. 2054-2112.
[63] Docket, vol. 4, pp. 2023-2043.

THE ISSUE

The lone issue as stipulated by the parties[64] is as follows:

> Whether petitioner is liable to pay the assessed amount of ₱1,146,686,052.85 as deficiency income tax, value-added tax, expanded withholding tax and documentary stamp tax for taxable year 2009

THE RULING OF THE COURT

Petitioner argues that the deficiency tax assessments issued by respondent against it are erroneous and without any legal and/or factual bases, unreasonable, arbitrary and beyond its capacity to pay. Further, the deficiency VAT assessment for the 1st Quarter of 2009 and the deficiency EWT assessment for the months of January to May 2009 had already prescribed. Lastly, they are void for lack of a valid LOA authorizing RO Josa Gomez to conduct tax examination against it and for lack of electronic LOA required under RMO No. 69-10 and RMO No. 62-10.

Respondent however claims that the assessments he issued were all in accordance with law, rules and jurisprudence, hence, petitioner is liable to pay all the assessed deficiency taxes. And contrary to petitioner's stance his right to assess it for deficiency VAT and EWT for 2009 has not prescribed. Moreover, petitioner is estopped from assailing the validity of the Waiver since it already derived benefit from the same when it asked for more time in relation to the audit/examination. Finally, tax assessments are presumed correct and made in good faith and the taxpayer must prove otherwise. In the absence of proof of any irregularities, an assessment must not be disturbed.

As it appears, the crux of the controversy is the authority of the investigating RO to conduct tax audit. On the matter,

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[64] JSFI, docket, vol. 2, p. 651.

Section 6(A), in relation to Section 13 of the NIRC of 1997, as amended, is instructive:

> SECTION 6. Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. —
>
> (A) Examination of Returns and Determination of Tax Due. — After a return has been filed as required under the provisions of this Code, the Commissioner or [his/her] duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax: Provided, however, That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer xxxx

With respect to the authority to examine the taxpayer through respondent's authorized representative, the general rule is found in Section 7 in relation to Sections 10 and 13 of the NIRC of 1997, as amended, to wit:

> SEC 7. Authority of the Commissioner to Delegate Power. - The Commissioner may delegate the powers vested in him under the pertinent provisions of this Code to any or such subordinate officials with the rank equivalent to a division chief or higher, subject to such limitations and restrictions as may be imposed under rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner: xxx
>
> SEC. 10. Revenue Regional Director. - Under rules and regulations, policies and standards formulated by the Commissioner, with the approval of the Secretary of Finance, the Revenue Regional Director shall, within the region and district offices under his jurisdiction, among others:
>
> xxx xxx xxx
>
> (c) Issue Letters of Authority for the examination of taxpayers within the region; xxx

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> SECTION 13. Authority of a Revenue Officer. — Subject to the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, a Revenue Officer assigned to perform assessment functions in any district may, pursuant to a Letter of Authority issued by the Revenue Regional Director, examine taxpayers within the jurisdiction of the district in order to collect the correct amount of tax, or to recommend the assessment of any deficiency tax due in the same manner that the said acts could have been performed by the Revenue Regional Director himself.

Plainly, the power to make assessments is primarily lodged with respondent. The power to issue LOA in relation to the power of respondent to make assessments is expressly delegated to the Revenue Regional Director.

In addition, RMO No. 38-88 provides for the policies and standards governing LOA. Under the said RMO, a LOA is valid only for a period of 120 days and will be invalidated thereafter unless revalidated after submission of a Progress Report. Further, a revalidation shall be covered by the issuance of a new LOA under the name(s) of the same investigating officer(s), and the superseded LOA(s) shall be attached to the new LOA issued.

Moreover, RMC No. 43-90[65], on policy guidelines for the audit/investigation and issuance of letters of authority to audit provides:

> xxx xxx xxx
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> **4. Any reassignment/transfer of cases to another RO(s), and revalidation of L/As which have already expired, shall require the issuance of a new L/A**, with the corresponding notation thereto, including the previous L/A,

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[65] Amendment of Revenue Memorandum Order No. 37-90 Prescribing Revised Policy Guidelines for Examination of Returns and Issuance of Letters of Authority to Audit, Dated September 20, 1990.

> number and date of issue of said L/As. (emphasis supplied)

A cardinal rule in statutory construction is that, where the law speaks in clear and categorical language, or the terms of the statute are clear and unambiguous and free from doubt, there is no room for interpretation or construction and no interpretation or construction is called for; there is only room for application.[66]'

Moreover, the use of the word "shall" connotes a mandatory order and denotes an imperative obligation and is inconsistent with the idea of discretion.

Therefore, the use of the word "shall" in RMO No. 43-90 can only mean that the issuance of a new LOA in cases of reassignment or transfer of investigation is mandatory. Hence, before an assessment can be made, the RO conducting the audit must first be authorized to do so. Absent such new LOA, any assessment issued resulting from such audit is void.

Further, *BIR's General Audit Procedures and Documentation*[67]*41 ("BIR's GAPD")* provides the following:

> 5. How often can a Letter of Authority be revalidated? A Letter of Authority is revalidated through the issuance of a new LA. However, a Letter of Authority can be revalidated-
>
> Only once, for LAs issued in the Revenue Regional Offices or the Revenue District Offices; or
>
> Twice, in the case of LAs issued by the National Office.
>
> Any suspended LA(s) must be attached to the new LA issued (RMO 38-88).

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[66] *Fort Bonifacio Development Corporation v. Commissioner of Internal Revenue,* G.R. Nos. 175707, 180035, 181092, November 19, 2014, 740 SCRA 640.
[67] BIR's General Audit Procedures and Documentation, https:/jwww.bir.gov.ph/index.php/taxpayer-bill-of-rights.html.

In the case of *Commissioner of Internal Revenue v. Sony Philippines, Inc.*[68] the Supreme Court held that there must be a grant of authority before any revenue officer may conduct an examination or assessment and that the authorized revenue officer must not go beyond the authority given him or her. In the absence of such authority, the assessment or examination is a nullity.

The Supreme Court affirmed the Sony case ruling in the recent case of *Medicard Philippines, Inc. v. Commissioner of Internal Revenue*[69], where it was emphasized that the absence of a LOA violated the therein taxpayer's right to due process; accordingly, the assessment thereon was declared void, *viz.*:

> An LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. It empowers or enables said revenue officer to examine the books of account and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax. An LOA is premised on the fact that the examination of a taxpayer who has already filed his tax returns is a power that statutorily belongs only to the CIR himself or his duly authorized representatives. x x x.
>
> xxx xxx xxx
>
> . . . **[I]t is clear that unless authorized by the CIR himself or by his duly authorized representative, through an LOA, an examination of the taxpayer cannot ordinarily be undertaken.** The circumstances contemplated under Section 6 where the taxpayer may be assessed through best-evidence obtainable, inventory-taking, or surveillance among others has nothing to do with the LOA. These are simply methods of examining the taxpayer in order to arrive at the correct amount of taxes. **Hence, unless undertaken by the CIR himself or his duly authorized**

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[68] G.R. No. 178697, November 17, 2010, 635 SCRA 234.
[69] G.R. No. 222743, April 5, 2017, citing *Commissioner of Internal Revenue v. Sony Philippines, Inc.*, G.R. No. 178697, November 17, 2010, 635 SCRA 234.

> **representatives, other tax agents may not validly conduct any of these kinds of examinations without prior authority.**
>
> xxx xxx xxx
>
> **That the BIR officials herein were not shown to have acted unreasonably is beside the point because the issue of their lack of authority was only brought up during the trial of the case. What is crucial is whether the proceedings that led to the issuance of VAT deficiency assessment against MEDICARD had the prior approval and authorization from the CIR or her duly authorized representatives. Not having authority to examine MEDICARD in the first place, the assessment issued by the CIR is inescapably void.** (emphases supplied)

Based on all the foregoing rules and jurisprudence, an authority from respondent or his duly authorized representative is required before an examination/audit of a taxpayer may be made, such authority comes in the form of a LOA. The LOA is a proof that the person/s named therein is/are authorized to conduct the necessary investigation/ audit. It is an express grant of authority. Thus, in the absence of a valid LOA, the assessment or examination is a nullity.

In the case at bar, the record shows that LOA-116-2010-00000100 issued on May 14, 2010[70] authorized ROs Maribel Serafica, Olivia Sison, Walter Batoon, Reynoso Bravo, Daniella Gabaon, Julietta Tubilla and GS Erlinda Ulgado of LT Regular Audit Division I to examine petitioner's books of accounts and other accounting record for all internal revenue taxes for the period from January 1, 2009 to December 31, 2009 pursuant to RMO No. 36-2010. On the other hand, MOA No. LOA-116-2013-1421 issued more than three years thereafter, or on February 25, 2013[71], authorized RO Gomez to continue the tax audit/investigation of petitioner's internal revenue tax liabilities for TY 2009 as the previously assigned

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[70] Exhibit "R-1".
[71] Exhibit "R-2".

ROs were transferred to another district office, pursuant to LOA-116-2010-00000100 issued on May 14, 2010.

Significantly, per LOA-116-2010-00000100 issued on May 14, 2010, RO Gomez was not among the revenue officers originally authorized to audit/examine petitioner's books of account and other accounting records. As admitted, RO Gomez only had MOA No. LOA-116-2013-1421 issued on February 25, 2013 as basis of her authority to continue the already started audit. After her investigation, RO Gomez recommended the issuance of the PAN, FAN and FLD, and FDDA against petitioner.

Clearly, the requirement of the law was not complied with. The MOA for the continuance of audit signed by the Chief of LT Regular Audit Division I is certainly not sufficient basis for RO Gomez's authority to examine petitioner for it cannot in any way be deemed equivalent to a LOA. In other words, RO Gomez acted without authority when she conducted the audit of petitioner, hence, the assessment subsequently issued by respondent is null and void.

Let it be stressed that a LOA is the proof that the person/s named therein is/are authorized to conduct the necessary investigation/audit, it is an express grant of authority. Thus, absent the necessary issuance of a new LOA specifically naming the person to whom the case will be reassigned with the corresponding annotation per RMO No. 43-90, there is no authority to conduct the investigation/audit. Consequently, the assessment is null and void. And a void assessment bears no valid fruit.[72]

Since the subject deficiency tax assessments are clearly void for lack of authority of the examining RO, discussion on the other issues raised becomes unnecessary.

WHEREFORE, the instant Petition for Review filed on December 19, 2014 by petitioner Central Luzon Drug Corporation, is hereby **GRANTED**.

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[72] Commissioner of Internal Revenue v. Azucena T. Reyes, Azucena T. Reyes v. Commissioner of Internal Revenue, G.R. Nos. 159694 and 163581, respectively, January 27, 2006, 480 SCRA 382.

Accordingly, the Final Decision on Disputed Assessment issued by respondent Commissioner of Internal Revenue dated November 20, 2014, affirming the Formal Letter of Demand and Final Assessment Notice issued against petitioner, for alleged deficiency Income Tax, Value-Added Tax, Expanded Withholding Tax and Documentary Stamp Tax in the aggregate amount of ₱1,146,686,052.85 for TY 2009, is hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

I Concur:

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

ATTESTATION

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

ESPERANZA R. FABON-VICTORINO
Associate Justice
Acting Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice