REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

A BROWN CO., INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 6357

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 07 2004

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DECISION

This case involves tax deficiency assessments covering taxable year 1997 made by respondent against petitioner. The petitioner seeks the cancellation of the above disputed tax assessments inclusive of increments.

The facts of the case as culled from the records and evidence are as follows:

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines and holds office at the Xavier Estates, Upper Balulang, Cagayan de Oro, Philippines.

Pursuant to the Letter of Authority No. 21938 dated November 6, 1998, the Bureau of Internal Revenue (BIR), through its Revenue District Office No. 39, South Quezon City (RDO 39) conducted a tax investigation/examination of the books of accounts and other accounting records of petitioner A Brown Co., Inc. (ABCI) for the period 1997.

In addition to the opening of petitioner's books for examination, two (2) requests for presentation of records were made to which the petitioner complied by submitting copies of certain books of accounts and other documents such as the 1997

VAT Returns, 1997 Income Tax Return, 1997 Trial Balance, 1997 Lease Contracts and working papers of the accounting firm of Laya Mananghaya.

Subsequently, on November 10, 1999, petitioner received from respondent, through RDO 39, a letter numbered 39-707 formally informing the petitioner of the Report of Investigation and that for the year 1997 it is liable for a Total Deficiency Income Tax of P4,511,035.67.

On January 4, 2001, more than a year after the issuance of the Report of Investigation, respondent issued a Preliminary Assessment Notice (PAN) against petitioner finding it liable for income tax deficiency, deficiency documentary stamp tax (DST) and deficiency value-added tax (VAT) in the amount of P119,419,076.68, P236,059.08 and P12,824,527.42, respectively (*Annex "A", Petition for Review*). The said PAN gave the petitioner fifteen (15) days from receipt thereof to present its side. However, the letter and assessments were sent to petitioner's previous principal address at Antonia Center Condominium, 94 Kamuning Road, Quezon City despite respondent's knowledge of petitioner's change of principal office. It was only the Building Administrator of Antonia Center who sent the same to petitioner on January 15, 2001.

However, as early as January 19, 2001, without awaiting for petitioner's reply or the lapse of the required fifteen (15) day period, the BIR had issued a set of unnumbered Assessments, together with the Formal Demand and Details of Discrepancy (*Annexes "B" to "E", Petition for Review*) and sent to petitioner's previous principal office at 573 Gloria Street, Marick Subdivision, Sto. Domingo, Cainta, Rizal. The same letter and assessments were received by petitioner on January 30, 2001.

On February 5, 2001, another set of unnumbered Assessment, together with the Formal Demand and the Details of Discrepancy (*Annexes "G" to "K", Petition for Review*), identical in form and substance to the first set of Assessment, was received at petitioner's previous principal office at Antonia Center Condominium, 94 Kamuning Road, Quezon City.

On March 1, 2001, petitioner ABCI filed a Protest to the subject Assessment Notices (*Annex "L", Petition for Review*) and subsequently, submitted all the relevant supporting documents to justify the protest.

On November 26, 2001, there being no action on the part of the BIR, petitioner filed this Petition for Review.

The issues proposed by the petitioner are as follows:

1. Whether or not respondent faithfully complied with the requirements in Section 228 of the National Internal Revenue Code and Revenue Regulations 12-85 and 12-99, and Revenue Memorandum Order 37-94; and
2. Whether or not the assessments were arbitrary and in violation of the constitutional rights of petitioner ABCI to due process.

After considering the attending facts, the evidence adduced and the applicable laws and jurisprudence, the court finds for the petitioner.

Inasmuch as **Section 228 of the NIRC** is the crux of contention, the same is hereby quoted for easy reference, to wit:

> "**Section 228. Protesting of Assessment.** – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first **notify the taxpayer of his findings**: Provided, however, That a pre-assessment notice shall not be required in the following cases:

(a) When the finding for any deficiency tax is the result of mathematical error in the computation of the tax as appearing on the face of the return; or

(b) When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent; or

(c) When a taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year; or

(d) When the excise tax due on excisable articles has not been paid; or

(e) When an article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, traded or transferred to non-exempt persons.

The taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from the filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable." *(Emphasis supplied)*

Likewise, Revenue Regulations Nos. 12-85 and 12-99, and Revenue Memorandum Order 37-94 provide similar procedural requirements that must be followed in order to sustain the validity and legality of an assessment.

The pertinent provisions of **Revenue Regulation No. 12-85** are quoted as follows:

> "**Section 1. Post-reporting notice**. – Upon receipt of the report of finding, the Division Chief, Revenue District Officer or Chief, Office Audit Section, as the case may be, shall send to the taxpayer a notice for an informal conference before forwarding the report to higher authorities for approval. The notice which is Annex "A" hereof shall be accompanied by a summary of findings as basis for the informal conference.
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> In case where the taxpayer has agreed in writing to the proposed assessment, or where such proposed assessment has been paid, the required notice may be dispensed with.
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> xxx
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> **Section 2. Notice of proposed assessment.** – When the Commissioner or his duly authorized representative finds that taxes should be assessed, he shall first notify the taxpayer of his findings in the attached prescribed form as Annex "B" hereof. The notice shall be made in writing and sent to the taxpayer at the address indicated in his return or at his last known address as stated in his notice of change of address. xxx
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> **Section 3. Time to reply. – Venue for filing reply.** –
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> (a) Regional Office cases – **The taxpayer shall reply within a period of fifteen (15) days from receipt of the pre-assessment notice**. In meritorious cases and upon written request of the taxpayer an extension maybe granted within which to respond, but in no case shall the extension exceed a total of ten (10) days. xxx
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> **Section 4. Examination of records. In case the taxpayer responds to the notice within the above-prescribed period, he or his duly authorized representative shall be allowed to examine the records of the case and to present his arguments in writing protesting the proposed assessment.** Thereafter, the Commissioner or his authorized representative shall, on the basis of the evidence on record, decide whether or not to approve the report as a prelude to the issuance of the corresponding assessment notice.

Section 5. Failure to reply to pre-assessment notices; issuance of assessment. – In the event the taxpayer fails to respond to the pre-assessment notice within the above prescribed period, or when the Commissioner or his duly authorized representative finds the response to be without merit, he should be informed of such fact and the report of investigation shall be given due course." *(Emphasis supplied)*

Revenue Regulation No. 12-99 states as follows:

"**Section 3. Due Process requirement in the Issuance of a Deficiency Tax Assessment.** - xxx

3.1.1 Notice for informal conference. – The Revenue Officer who audited the taxpayer's records shall, among others, state in his report whether or not the taxpayer agrees with his findings that the taxpayer is liable for deficiency tax or taxes. If the taxpayer is not amenable, based on the said officer's submitted report of investigation, the taxpayer shall be informed, in writing, by the Revenue District Office or by any Special Investigation Division, as the case may be (in the case of Revenue Offices) or by the Chief of Division concerned (in the case of the BIR National Office) of the discrepancy or discrepancies in the taxpayer's payment of his internal revenue taxes, for the purpose of "**Informal Conference**," in order to afford the taxpayer with an opportunity to present his side of the case. **If the taxpayer fails to respond within fifteen (15) days from date of receipt of the notice for informal conference,** he shall be considered in default in which case, the Revenue District Officer or the Chief of the Special Investigation Division of the Revenue Regional Office, or the Chief of Division in the National Office, as the case may be, shall endorse the case with the least possible delay to the Assessment Division of the Revenue Regional Office or to the Commissioner or his duly authorized representative, as the case may be for appropriate review and issuance of a deficiency tax assessment, if warranted.

3.1.2 Preliminary Assessment Notice (PAN). – If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, the said Office shall issue to the taxpayer, at least by registered mail, a **Preliminary Assessment Notice (PAN)** for the proposed assessment, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based (see illustration in ANNEX A hereof). **If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall be considered in default,** in which case, a formal letter of demand and assessment notice shall be caused to be issued by the said Office, calling for the payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties. xxx

3.1.4 Formal Letter of Demand and Assessment Notice. – The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void (see illustration in ANNEX B hereof). The same shall be sent to the taxpayer only by registered mail or by personal delivery. If sent by personal delivery, the taxpayer or his duly authorized representative shall acknowledge receipt thereof in the duplicate copy of the letter of demand, showing the following: (a) His name; (b) signature; (c) designation and authority to act for and in behalf of the taxpayer, if acknowledged received by a person other than the taxpayer himself; and (d) date of receipt thereof. xxx" *(Emphasis supplied)*

Revenue Memorandum Order No. 37-94, which governs the "procedures on the preparation, approval and release of assessment notices and demand letters" further provides thus:

"xxx

C. Review of Reports of Investigation and Service of Pre-assessment Notices. –

"xxx

"2. The aforementioned reviewing offices, after having reviewed the report of investigation, shall send a pre-assessment notice to the taxpayer, indicating therein the basis of the assessment, and a **definite time frame within which he may protest the same if he is not agreeable.** If the taxpayer files his protest within the period prescribed in the aforementioned notice, the same reviewing offices shall likewise decide whether the protest conforms with existing requirements and whether or not to give due course to the protest. **The reviewing office shall then inform the taxpayer in writing of the result of the resolution of his protest.**

If the pre-assessment notice is not protested within the prescribed period, **the reviewing office shall then issue a letter of demand and assessment notice to the taxpayer."***(Emphasis supplied)*

The foregoing provisions of law and rules and regulations clearly enumerate the procedural due process requirements that must be strictly followed in order to sustain the validity and legality of an assessment. First, a notice for informal conference shall be sent to the taxpayer accompanied by a Summary of Findings or Report of Investigation. Following the informal conference, the Commissioner or his duly authorized representative, if he finds that taxes should be assessed shall again notify the taxpayer in writing in the form of a Pre-Assessment Notice (PAN).

The taxpayer is then given fifteen (15) days from receipt to make a reply. In addition, the taxpayer is permitted to examine the records of the case and to present his arguments in writing. Only then, can the Commissioner or his authorized representative, on the basis of the evidence on record, decide whether or not to approve the report as a prelude to the issuance of the corresponding assessment. A subsequent notice is then required to notify the taxpayer of the fact that he either failed to respond to the pre-assessment notice or that his response is without merit.

In the case before us, the records show that the respondent failed to comply with these prerequisites.

First, the Report of Investigation which respondent sent to the petitioner prior to the issuance of the pre-assessment notice indicated that there is a finding of deficiency income tax of only P4,511,035.67 (*Exhibit "G-1-a"*). If ever a pre-assessment should properly issue against the petitioner, the same should have reflected the findings made on the Report of Investigation. Instead, the pre-assessment notice completely departed from result of the Report of Investigation by increasing the alleged tax liabilities of the petitioner.

Secondly, the law and the rules and regulations issued pursuant thereto clearly give the taxpayer the right to reply to the pre-assessment notice. The period given to the taxpayer is fifteen (15) days from receipt of the Preliminary Assessment Notice. Here, the same was withheld from the petitioner.

The records indicate that the respondent issued the Preliminary Assessment Notice on January 4, 2001. However, on the same date, respondent, through registered mail, sent the Preliminary Assessment Notice to petitioner ABCI's former address in Antonia Center Condominium, 94 Kamuning Road, Quezon City. On January 15, 2001, the Building Administrator of Antonia Center Condominium received the mailed Preliminary Assessment Notice and forwarded it to petitioner the same day.

Assuming that there was a proper service of the Preliminary Assessment Notice on January 15, 2001, it is clear that petitioner had until January 30, 2001 within which to file a Reply.

Nevertheless, as early as January 19, 2001 or merely four (4) days after the Preliminary Assessment Notice was received at petitioner's previous address, and without waiting for the lapse of the mandatory 15-day period for petitioner to reply, respondent had already issued the subject assessments. Such actuations reveal a disposition to prejudge petitioner as liable for assessment, even before it could be given a chance to be heard. It cannot be argued that the issuance of a Preliminary Assessment Notice may be legally dispensed with inasmuch as the situation of the present case is not one of the excepted circumstances justifying the issuance of an Assessment without the Preliminary Assessment.

Moreover, the Preliminary Assessment and Assessment Notices were sent to the wrong addresses. The Preliminary Assessment Notice and one of the first of the two sets of questioned assessments were sent both to 94 Antonia Center, Kamuning Road, Quezon City. The other set of questioned assessments was sent to 573 Gloria

Marick Subd., Sto. Domingo, Cainta, Rizal. These were done despite the fact that petitioner had already informed respondent of its change of addresses as well as its transfer to another Revenue District Office. The record proves that respondent knew at that time that petitioner's principal office was at Sitio Harangan, Plaza Aldea, Tanay, Rizal as respondent was already communicating to petitioner at this address, evidenced by his letter dated January 11, 2000, classifying petitioner as a Large Taxpayer (*Annex "N", Petition for Review*).

The sending of the Preliminary Assessment Notice and the Assessment Notice to the wrong address may only be seen as an attempt to mislead or confuse petitioner, especially as to the period to reply thereto or to file a Protest. Noteworthy is the fact that the period given under the law and the rules and regulations are very material, and call for such stringent obligation upon a taxpayer, that a delay to reply or to file a Protest would make the Assessment final and executory.

Clearly, the issuance of the questioned assessments is in blatant violation of Section 228 of the NIRC, the provisions of Revenue Regulations Nos. 12-85 and 12-99, and Revenue Memorandum Order No. 37-94.

The question now is "Would these violations render null and void the subject assessments?"

A review of the prevailing jurisprudence on the matter proves that the answer is in the affirmative.

In **Commissioner of Internal Revenue vs. Algue, Inc.**, *G.R. No. L-28896, February 17, 1988, (158 SCRA 9)*, the Supreme Court explained the *raison d'etre* behind this strict adherence to the prescribed procedure:

> **"Taxes are life blood of the government and so shall be collected without unnecessary hindrance. On the other hand, such collection should be made in accordance with law as any**

> **arbitrariness will negate the very reason for government itself. It is therefore necessary to reconcile the apparently conflicting interests of the authorities and the taxpayers so that the real purpose of taxation, which is the promotion of the common good, may be achieved**. xxx
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> It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it. Hence, despite the natural reluctance to surrender part of one's hard-earned income to the taxing authorities, every person who is able to must contribute his share in the running of the government. The government, for its part, is expected to respond in the form of tangible and intangible benefits intended to improve the lives of the people and enhance their moral and material values. This symbiotic relationship is the rationale of taxation and should dispel the erroneous notion that it is an arbitrary method of exaction by those in the seat of power.
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> "**But even as we concede the inevitability and indispensability of taxation, it is a requirement in all democratic regimes that is exercised reasonably and in accordance with the prescribed procedure. If it is not, then the taxpayer has a right to complain and the courts will then come to his succor. For all the awesome power of the tax collector, he may still be stopped in his tracks if the taxpayer can demonstrate, as it has here, that the law has not been observed.**" *(Emphasis supplied)*

Similarly, the CTA on numerous occasions provided assistance to taxpayers whose rights to due process were disregarded. In **BPI Data System Corp. vs. CIR**, *CTA Case No. 4530, January 12, 1994*, the court ruled against the respondent when he failed to give the taxpayer a chance to respond to a pre-assessment notice before issuing an assessment. The CTA explained its decision in this manner:

> "**One of the most basic and fundamental precept of law enshrined in the Constitution is that no person shall be deprived of his property without due process of law (Sec. 1, Art. III, 1987 Constitution). The pervasiveness of the right to due process reaches out both substantive and procedural rights, regardless of their source, be it the constitution, or only a statute or a rule of court (Tupas vs. Court of Appeals, 193 SCRA 597). The procedure granted by law under Section 229 of the National Internal Revenue Code is a statutory right of the taxpayer that cannot be wantonly disregarded without violating the taxpayer's right to due process.**

> **In the observance of procedural due process, this court is always mindful that a taxpayer being made liable with his property be given an opportunity to be heard which is one of its essential elements (Banco Español vs. Palanca, 37 Phil. 921). With the failure of the respondent to strictly comply with the procedure prescribed by law and the failure of the petitioner to receive a copy of the alleged assessment, the latter was not afforded its right to be heard for it was denied the opportunity to protest or dispute the alleged assessment**. The respondent utterly failed to establish that the assessment it has conducted is a disputed assessment whereby 'the taxpayer questions an assessment and asks the Collector to reconsider or cancel the same because he believes he is not liable therefore. (**Morales vs. Collector of Internal Revenue**, *17 SCRA 1018*).
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> Had the taxpayer been given an opportunity to dispute the questioned assessment, then the same may have been given due consideration. In the absence of any showing that administrative remedies granted by law has been properly exhausted or that the petitioner failed to file a protest on the assessment within the prescribed period despite receipt thereof, this Court could not bestow the presumption of correctness on the said assessment. xxx" *(Emphasis supplied)*

Likewise, in the case of **Caltex (Philippines), Inc. vs. CIR**, *CTA Case No. 5664, October 4, 2000*, the CTA, in declaring the questioned assessments null and void, opined:

> "xxx this Court is of the opinion that herein respondent committed an **arbitrary act tantamount to a violation of petitioner's right to procedural due process when the former issued the assessment in question.** Petitioner has assiduously denounced the lack of prior notice for an informal conference and a pre-assessment notice attending the issuance of the assailed assessment, as required under BIR Revenue Regulation No. 12-85 which was issued pursuant to Section 229 of the Tax Code, as amended. Inexplicably, records bear that respondent did nothing to disprove petitioner's alleged non-receipt of notices."

To reiterate, the respondent committed grave violations of the law and regulations when he issued the subject Assessments. The above violations go against the values of right to due process held dearly by the judiciary. And this court is not about to exempt this instant case from the same principle it has long enshrined.

WHEREFORE, the subject assessments are hereby declared as null and void, cancelled and set aside.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

We concur:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Justice