REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC
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COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**CTA EB No. 1139** (CTA Case No. 8331)
	Present:
- versus -	**DEL ROSARIO,** *P.J.*, **CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, COTANGCO-MANALASTAS,** and **RINGPIS-LIBAN,** *JJ.*
YUMEX PHILIPPINES CORPORATION, Respondent.	**Promulgated:** JAN 19 2016 2:40 p.m.

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RESOLUTION

UY, *J.*:

For resolution is the **"MOTION FOR RECONSIDERATION"** of the Commissioner of Internal Revenue (CIR) filed on August 28, 2015, seeking the reversal and setting aside of Our Decision promulgated on August 11, 2015, together with the **"OPPOSITION (TO THE MOTION FOR RECONSIDERATION)"** filed by Yumex Philippines Corporation (YPC) on September 14, 2015. The dispositive portion of the assailed Decision reads:

> "**WHEREFORE**, in the light of the foregoing considerations, the instant Petition for Review is hereby **DENIED**, for lack of merit. The Decision dated November 28, 2013 and Resolution dated March 3, 2014, issued by the Court in Division in CTA Case No. 8331 are hereby **AFFIRMED**.

SO ORDERED."

In support of her Motion, the CIR raises the following grounds, to wit:

1. The Court *En Banc* erred in ruling that the Second Division of this Court committed no error in considering the propriety or impropriety of the issuance of the PAN, FLD and FAN;

2. Assuming non-issues could be utilized in deciding a case; still the Court erred in readily believing respondent's belated allegation that the assessment is invalid as the PAN and FAN were received on the same day; and

3. The Court *En Banc* erred in denying the deficiency IAET assessment for petitioner's alleged failure to provide prima facie basis for the same.

The CIR contends that the simultaneous receipt by respondent of the Preliminary Assessment Notice dated December 16, 2010 (PAN) and Formal Letter of Demand dated January 10, 2011 with Details of Discrepancies and Audit Results/Assessment Notice (FLD/FAN) resulting in denial of due process was never an issue in this case. According to the CIR, the proper reckoning point to examine if an issue exist or not is the filing of the Answer. Considering that the original Petition for Review did not raise as an issue the date of receipt of the PAN and FLD/FAN, the Answer filed by the CIR on October 14, 2011 could not have addressed said issue and it would be the height of absurdity to expect the CIR to raise a defense on a matter that is not even assailed.

Moreover, the CIR points out that the non-existence of said issue is confirmed in YPC's Pre-Trial Brief dated November 21, 2011 and Joint Stipulation of Facts and Issues dated December 13, 2011. It was only in the Supplemental Memorandum dated April 4, 2013 that YPC suddenly raised the issue on the date of receipt of the PAN and FLD/FAN; thus, it was clearly an error on the part of the Second Division of this Court to decide the case based on an issue raised long after trial and after the parties had rested their cases.

Anent the second ground, the CIR asserts that the proper reckoning point is the date when the assessment made was officially released, mailed or sent to the taxpayer. The CIR points out that the PAN was mailed on December 17, 2010 while the FLD/FAN was mailed on January 10, 2011, as evidenced by the registry receipts attached to petitioner's Exhibits 13 and 14 found on the BIR records. Thus, utilizing these proper reckoning periods, it was clearly an error for the Court *En Banc* to readily believe YPC's belated assertion that its simultaneous receipt of the PAN and FLD/FAN was tantamount to a denial of due process.

Furthermore, the CIR claims that it is the height of absurdity for YPC to belatedly assail the assessment process through a supplemental memorandum when it already paid for most of the items of the subject assessment and was even requesting for the cancellation of some increments. Thus, YPC is already estopped from questioning the validity of the assessments.

With regard to the third ground, the CIR avers that based on Section 29(2) of the National Internal Revenue Code (NIRC) of 1997 and the case of *Cyanamid Philippines, Inc. vs, Court of Appeals, et al.*,[1] mere accumulation of earning or profits of the corporation beyond the reasonable needs of the business shall be determinative of the purpose to avoid tax and the burden of proof to establish that the profits accumulated were not beyond the reasonable needs of the company, remained on the taxpayer.

Moreover, the CIR argues that the factual basis of improperly accumulated earnings tax assessment against YPC was clearly spelled out. According to the CIR, the improperly accumulated earnings tax was imposed on YPC's registered activity under the Income Tax Holiday (ITH) and not on its registered activities under the five percent (5%) special rate.

On the other hand, in its Opposition, YPC contends that the Court *En Banc* did not err in holding that the Second Division of this Court may rule on the propriety or impropriety of the issuance of the PAN and FLD/FAN. According to YPC, records of the case show it made sufficient allegations in its Petition for Review which clearly put into issue the propriety of the issuance of the PAN and FLD/FAN. And even assuming that its Petition for Review failed to put into issue the irregular issuance of the PAN and FLD/FAN, said issue was joined when YPC, without objection from the CIR, adduced evidence regarding these matters and the CIR presented the testimony of Revenue Officer Bayani Atienza which confirmed YPC's simultaneous receipt of the PAN and FLD/FAN.

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[1] G.R. No. 108067, January 20, 2000.

YPC further contends that pursuant to Section 1, Rule 14 of the Revised Rules of the Court of Tax Appeals, the Court in deciding a case may not limit itself to issues stipulated by the parties but may rule upon related issues necessary to achieve an orderly disposition of the case. Thus, the Court *En Banc* was correct in ruling that the propriety of the issuance of the subject PAN and FLD/FAN is a related issue in determining the validity and correctness of the assessments, which the Second Division of this Court may consider.

Moreover, YPC asserts that the Court *En Banc* did not err in ruling that the CIR failed to comply with due process requirements in issuing the subject assessment. According to YPC, the CIR cannot deny that she prematurely issued the FLD/FAN without first giving YPC the opportunity to contest the PAN because her own witness, Revenue Officer Atienza, admitted during his cross-examination that YPC receive the PAN and FLD/FAN simultaneously. Thus, by failing to give YPC the opportunity to contest the PAN, the CIR whimsically disregarded the due process requirements under Section 3.1.2 of the Revenue Regulation No. 12-99.

Finally, YPC maintains that the subject assessment for deficiency improperly accumulated earnings tax lacks legal basis because under Republic Act (RA) No. 7916 in relation to Revenue Regulations (RR) No. 02-01, YPC, as a PEZA-registered enterprise, is exempt from improperly accumulated earnings tax whether or not its registered activities enjoy an ITH or the 5% special tax rate.

THE COURT *EN BANC*'S RULING

Petitioner's Motion for Reconsideration lacks merit.

This Court is not precluded from adjudicating issues not stipulated by the parties.

The CIR avers that the Court in Division erred in ordering the cancellation of the assessment based on a matter that was not even raised as an issue in the pleadings and was never subject of litigation.

We do not agree. This Court is not precluded from ruling on issues not stipulated by the parties.

It bears to reiterate that under paragraph 2, Section 1, Rule 14 of the Revised Rules of the Court of Tax Appeals, "[i]n deciding a case, the Court (CTA) may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case." In the instant case, the determination as to whether or not the subject PAN and FLD/FAN were valid and correct, entails resolving the issue of whether or not said assessments were properly issued in accordance with requirements of due process.

Moreover, as pointed out in the assailed Decision, YPC, as petitioner in CTA Case No. 8331, made sufficient allegations in its Petition for Review regarding the issuance and receipt of the subject PAN and FLD/FAN. In addition, YPC, without objection from the CIR, offered during trial, sufficient documentary and testimonial evidence to prove the same. Thus, while the simultaneous receipt of the PAN and FLD/FAN was not explicitly stipulated as an issue in the pleadings, the Second Division of this Court committed no error in considering this matter in the resolution of the instant case. The action of the said Court in Division was in consonance with Section 5, Rule 10 of the 1997 Revised Rules on Civil Procedure, which provides as follows:

> "SEC. 5. *Amendment to conform to or authorize presentation of evidence.* – **When issues not raised by the pleadings are tried with the express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings.** Such amendment of the pleadings as may be necessary to cause them to conform to evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; **but failure to amend does not affect the result of the trial of these issues**. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so with liberality if the presentation of the merits of the action and the ends of substantial justice will be subserved thereby. The court may grant a continuance to enable the amendment to be made." *(Emphasis supplied).*

Based on the foregoing rule, issues not raised by the pleadings may be tried by express or implied consent of the parties, as if they had been raised in the pleadings and the court can validly resolve them. The general rule is that a judgment must conform to the pleading and the theory of the action under which the case is tried. But court may also rule and render judgment on the basis of the evidence before it, even though the relevant pleading has not been previously amended, so long as no surprise or prejudice to the adverse party is thereby caused and there is express or implied consent to the presentation of evidence.[2]

Correspondingly, when YPC offered in evidence the date of receipt of the PAN and FLD/FAN,[3] as identified by YPC's witness, Ms. Leonora Perez-Sangalang;[4] and raised the same matter during cross-examination of the CIR's witness, Revenue Officer Bayani A. Atienza, without objection on the part of the CIR,[5] the Second Division of this Court can validly treat the pleadings as if they had been amended to conform to the evidence presented during trial and proceed to decide the case based on all the evidence before it.[6] Thus, there was no error on the part of the said Court in Division when it considered the simultaneous receipt of the PAN, FAN and FLD in ruling on the validity of the issuance of said assessments.

The 15-day period of the taxpayer to respond to the PAN is an essential part of the due process requirements in the issuance of deficiency tax assessments.

The CIR strongly insists that there was no denial of due process in this case because the PAN and FLD/FAN were officially mailed to YPC on separate dates.

Again, We do not agree with the CIR.

Section 228 of the NIRC of 1997, and Section 3 of RR No. 12-99,[7] respectively provides:

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[2] *Panganiban vs. Spouses Roldan,* G.R. No. 163053, November 25, 2009.
[3] Exhibit "P-1", Division Docket (CTA Case No. 8331) – Vol. 1, p. 356.
[4] Exhibit "AA", Division Docket (CTA Case No. 8331) – Vol. 1, p. 218.
[5] Transcript of Stenographic Notes during the hearing held on June 27, 2012, pp. 44 to 48.
[6] See *Spouses Dela Cruz vs. Concepcion,* G.R. No. 172825, October 11, 2012, citing *Royal Cargo Corporation vs. DFS Sports Unlimited, Inc.*, G.R. No. 158621, December 10, 2008.
[7] SUBJECT: Implementing the Provisions of the National Internal Revenue Code of 1997 Governing the Rules on Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extrajudicial Settlement of a Taxpayer's

"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: xxx

xxx xxx xxx

The taxpayers 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 <u>required</u> 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.

xxx xxx xxx." *(Emphasis supplied)*

"SECTION 3. *Due Process Requirement in the Issuance of a Deficiency Tax Assessment.* —

3.1 Mode of procedures in the issuance of a deficiency tax assessment:

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). <u>If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall</u>

Criminal Violation of the code through payment of a Suggested Compromise Penalty.

> 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 payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties. *(Underscoring supplied).*

Based on the aforequoted provisions, in the event that the CIR or her duly authorized representative finds any deficiency taxes due against a taxpayer, a PAN shall be issued to him. The taxpayer shall be required to respond to the PAN within fifteen (15) days from receipt thereof. If he fails to respond to the PAN within the period prescribed, he shall be declared in default, in which case, the CIR or her duly authorized representative shall cause the issuance of a FLD/FAN against the taxpayer.

Clearly, the act of simply mailing the PAN and FLD/FAN to the taxpayer on separate dates is not enough to satisfy the requirements of due process. Receipt by the taxpayer of the PAN and the opportunity to respond thereto within 15-days from receipt thereof are essential parts of the requirements of due process which the CIR cannot simply ignore.

In this case, records show that while the PAN and FLD/FAN were mailed to YPC on separate dates, December 17, 2010[8] and January 10, 2011,[9] respectively, YPC received copies of both the PAN and the FLD/FAN on January 18, 2011.[10] Evidently, when the CIR issued the FLD/FAN, she did not even wait for YPC to receive the PAN and respond thereto. By doing so, the CIR effectively deprived YPC of its right to due process.

Indeed, what is offensive to due process is the denial of the opportunity to be heard.[11] The essence of due process is simply an opportunity to be heard or, as applied to administrative proceedings, an opportunity to explain one's side or an opportunity to seek a reconsideration of the action or ruling complained of.[12] As long as the parties are given the opportunity to be heard before judgment is rendered, the demands of due process are sufficiently met.[13]

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[8] BIR Records, pp. 161 to 163.
[9] BIR Records, pp. 164 to 166.
[10] Exhibit "P-1", Division Docket (CTA Case No. 8331) – Vol. 1, p. 356.
[11] *Flores vs. Montemayor,* G.R. No. 170146, June 8, 2011.
[12] *Demaala vs. Sandiganbayan and Ombudsman,* G.R. No. 173523, February 19, 2014.
[13] *Arroyo et al. vs. Rosal Homeowner's Association,* G.R. No. 175155, October 22, 2012.

Improperly Accumulated Earnings Tax does not apply to enterprises duly registered with the PEZA under R.A. No. 7916.

It is the CIR's position that pursuant to Section 4(g) of RR No. 2-2001 in relation to Section 29 of the NIRC of 1997, as amended, YPC, a PEZA registered enterprise, is excepted from improperly accumulated earnings tax only with respect to improperly accumulated income earned from registered activities under special tax rate of 5% and not on income earned from registered activities subject to ITH.

The CIR is mistaken.

Improperly accumulated earnings tax does not apply to enterprises duly registered with the PEZA under RA No. 7916, without qualification as to whether the subject corporation or enterprise enjoys an ITH or a special tax rate on its registered activities. This is the clear import of Section 4 of RR No. 02-01,[14] which reads as follows:

> "SECTION 4. *Coverage* – The 10% Improperly Accumulated Earnings Tax (IAET) is imposed on improperly accumulated taxable income earned starting January 1, 1998 by domestic corporations as defined under the Tax Code and which are classified as closely-held corporations. Provided, however, that **Improperly Accumulated Earning Tax shall not apply to the following corporations:**
>
> a) Banks and other non-bank financial intermediaries;
> b) Insurance companies;
> c) Publicly-held corporations;
> d) Taxable partnerships;
> e) General professional partnerships;
> f) Non-taxable joint ventures; and
> g) <u>Enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under R.A. 7916, and enterprises registered pursuant to the Bases Conversion</u>

[14] SUBJECT: IMPLEMENTING THE PROVISIONS ON IMPROPERLY ACCUMULATED

> and Development Act of 1992 under R.A. 7227, as well as other enterprises duly registered under special economic zones declared by law *which enjoy payment of special tax rate on their registered operations or activities in lieu of other taxes, national or local." (Emphasis, underscoring and italics supplied).*

As the Court *En Banc* sees it, the use of comma in Section 4(g) signifies independence of one thing from the others included in the enumeration,[15] such that, the particular portion contemplates three different groups excluded from the coverage of the imposition of the improperly accumulated tax, to wit: (1) enterprises duly registered with the Philippine Economic Zone (PEZA) under RA No. 7916; (2) enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under RA No. 7227 (BCDA); and (3) other enterprises duly registered under special economic zones declared by law.

Moreover, qualifying words restrict or modify only the words or phrases to which they are immediately associated, and not those distantly or remotely located.[16] Thus, the phrase "*which enjoy payment of special tax rate on their registered operations or activities in lieu of other taxes, national or local*" applies only to corporations belonging to the third group – other enterprises duly registered under special economic zones declared by law.

On the other hand, PEZA registered enterprises and those registered pursuant to the BCDA, are exempted from the imposition of the improperly accumulated earnings tax, without further qualification. Section 4(g) made no distinction whether a corporation duly registered with the PEZA or registered pursuant to the BCDA enjoys an ITH or the special tax regime at a rate of 5% on its registered activities. In other words, the fact of registration with the PEZA under RA No. 7916 or pursuant to the BCDA under RA No. 7227 alone excludes a corporation or enterprise from the coverage of corporations upon which improperly accumulated earnings tax may be imposed.

Considering that YPC is an enterprise duly registered with the PEZA under RA No. 7916,[17] no improperly accumulated earnings tax

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[15] See *Castillo-Co vs. Barbers*, 290 SCRA 717, 723 (1998).
[16] *Funa*, CANONS OF STATUTORY CONSTRUCTION, 2nd ed., 2012, pp. 280 to 281.
[17] Exhibits "C" and "D", Division Docket (CTA Case No. 8331) – Vol. 1, pp. 314 to 322.

under Section 29 of the NIRC of 1997, in relation to Section 4 of RR No. 02-01, should be applied to YPC.

In the light of the foregoing discussion, the Court *En Banc* finds no reason to reverse, modify or amend the assailed Decision.

WHEREFORE, premises considered, the instant Motion for Reconsideration filed by the CIR on August 28, 2015 is hereby **DENIED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

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

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

(On Leave)
CIELITO N. MINDARO-GRULLA
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

Ma. Belen
MA. BELEN M. RINGPIS-LIBAN
Associate Justice