REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PRECISION ELECTRONICS REALTY CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 6013

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
NOV 26 2002

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DECISION

The instant Petition for Review is an appeal for the cancellation and withdrawal of the deficiency income tax assessment issued by the respondent against petitioner for the fiscal year ended March 31, 1996 in the aggregate amount of P13,372,229.74.

The facts based on the parties' Joint Stipulation of Facts and Issues are as follows:

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with business address at Ortigas Avenue Extension, Bo. Mapandan, Taytay, Rizal.

On April 13, 1999, respondent issued Formal Assessment Notice No. 00288 and demand letter against petitioner, alleging that petitioner has deficiency income tax liabilities for the fiscal year ended March 31, 1996 in the aggregate amount of P13,372,229.74. Said Formal Assessment Notice and demand letter issued by the Bureau of Internal Revenue (BIR) were received by petitioner on April 20, 1999.

The income tax assessment arose from the disallowance of the interest expense incurred by petitioner during the fiscal year ended March 31, 1996 in the amount of P23,902,885.00.

The said interest expense in the amount of P23,902,885.00 was disallowed as a deduction from petitioner's gross income on the ground that such interest expense falls among the non-deductible interest expense under Section 29 of the National Internal Revenue Code (NIRC). The disputed interest was paid by petitioner on loans extended by one of its stockholders, Matsushita Electric Philippines Corporation ("MEPCO"). The examiner disallowed said interest expense on the belief that petitioner and MEPCO are related taxpayers as contemplated under the Tax Code (*Petition for Review, paragraph 9 (b)*).

On May 20, 1999, petitioner, through its external auditor, duly filed with the BIR an administrative protest against the subject income tax assessment in accordance with Section 228 of the NIRC of 1997.

On July 19, 1999, petitioner, again through its external auditor, filed with the BIR a supplemental protest reiterating its disagreement with the subject income tax assessment and submitting therewith all the relevant documents to support its position against the merit of the assessment.

As there was no action on the part of respondent, petitioner filed the instant petition on February 14, 2000 in order to comply with Section 228 of the 1997 NIRC, giving the taxpayer adversely affected by the inaction of the respondent a period of thirty

(30) days from the lapse of the one hundred eighty (180)-day period, or from January 15, 2000, the right to appeal to this court.

In his Answer, filed on March 21, 2000, respondent raised the following Special and Affirmative Defenses:

> "5. That he reiterates and repleads the preceding paragraphs of this Answer as part of his Special and Affirmative Defenses;
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> 6. That investigation of the petitioner's internal tax liabilities for the fiscal year ended March 31, 1996 revealed a tax obligation of P13,372,229.74 as deficiency income tax;
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> 7. That the subject deficiency income tax assessment No. 00288 dated April 13, 1999 was issued in accordance with law and pertinent regulations; and
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> 8. That all presumptions are in favor of the correctness of tax assessments (**CIR vs. Construction Resources of Asia, Inc.** 145 SCRA 671) and the burden of proof to prove otherwise is upon the petitioner."

On June 24, 2002, this case was submitted for decision sans the evidence and memorandum of the respondent.

The parties likewise stipulated the issues to be resolved by this court, namely:

1. Whether or not the formal assessment notice issued by respondent is void for failure to state in detail the law and the facts upon which the assessment is based as required under Section 228 of the NIRC of 1997;
2. Whether or not petitioner and Matsushita Electric Philippines Corporation (MEPCO) are related taxpayers as defined under then Section 30 of the NIRC of 1977, as amended; and
3. Whether or not the interest payments made by petitioner to Matsushita Electric Philippines Corporation during the fiscal year ended March 31, 1996

are allowable deductions from its gross income as contemplated under then Section 29 (b) of the NIRC of 1977, as amended.

(*page 85, CTA Records, Statement of Issues, Joint Stipulation of Facts and Issues*)

After considering the attending facts, the evidence adduced solely by petitioner and the applicable laws and jurisprudence, we find for the petitioner.

At the outset, the court wishes to point out that the Tax Reform Act of 1997 covers assessments issued on or after January 1, 1998 (*Resolution, National Steel Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5574, August 10, 1998; Resolution, Filipinas-Eslon Manufacturing Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5663, February 17, 1999; Resolution, Seven Seas Resorts and Leisure, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5957, February 21, 2000; BIR Ruling No. 22-98 dated February 19, 1998.)* Since the subject formal assessment notice and demand letter for the subject deficiency income tax assessment were issued on April 13, 1999, the provisions of the 1997 Tax Code shall apply.

Inasmuch as Section 228 of the 1997 Tax Code is the crux of contention, the same is hereunder quoted for easy reference:

> "**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:
>
> x x x   x x x   x x x

> **"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 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 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*)

To implement this provision, the Department of Finance (DOF), on September 6, 1999, issued Revenue Regulations (RR) No. 12-99, particularly Section 3.1.4, which provides that:

> "**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.**" (*Emphasis supplied*)

From the foregoing, it is correct to surmise that Section 228 specifically requires that the taxpayer must be informed of the factual and legal basis of the assessment in writing at the time that the assessment notice was received. The said section clearly provides that 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.

Petitioner argues that an examination of the demand letter (*Petition for Review, Annex "A-1"*) would reveal that the requirements of Section 228 of the NIRC, as amended, and RR No. 12-99 were not complied with. According to petitioner, the said demand letter did not indicate how the disallowed interest from loans in the amount of P23,902,885.00 was arrived at or how was it computed. Moreover, the legal basis for disallowing the said deduction for interest was allegedly not sufficiently clarified and that it was able to comprehend and protest the assessment only after examination by petitioner's external auditor of the BIR docket (i.e., examiner's report, etc.) and after interviewing the BIR examiner (*Petitioner's Memorandum, page 10; CTA Records, page 207*). Petitioner cited the case of **Sunnyvale Development Corporation vs. Commissioner of Internal Revenue,** CTA Case No. 5730, January 4, 2001, where this court ruled that where the assessment notice and the accompanying demand letter failed to state the law and the facts on which the assessment was based, the same is void in accordance with Section 228 of the NIRC, as amended.

We do not agree.

Contrary to petitioner's contention, the assessment notice issued by respondent on April 13, 1999 indicated the legal basis for the disallowance, specifically, the interest from loans obtained from affiliated company under Section 29 of the NIRC. Likewise, petitioner cannot claim that the demand letter did not indicate how the disallowed interest from loans in the amount of P23,902,885.00 was arrived at because it was the same amount stated in its 1996 Income Tax Return claimed by petitioner as a deduction from gross income (*page 121, CTA Records*).

The tenor of its protest-letter indicate that petitioner clearly understood the nature of the assessment issued against it. Petitioner managed to comprehensively explain why the interest expense should be allowed as a legitimate business expense. Petitioner could not have intelligently protested the questioned assessment had it not been aware of the basis thereof. Consequently, it negates the allegation that petitioner did not know the basis of the assessment.

Petitioner further asserts that respondent did not issue a preliminary assessment notice nor conduct a preliminary conference before issuing the formal assessment notice that could have at least informed petitioner of the facts and the law on which the assessment would be based. Noteworthy is the fact that this argument was raised by petitioner only for the first time in its memorandum. It was not raised in the protest letter dated May 20, 1999 nor in its supplemental letter dated July 19, 1999. It was also not raised in the petition for review filed on February 14, 2000. In the case of **Belle Corporation vs. Commissioner of Internal Revenue**, CTA Case No. 5930, April 4, 2002, citing the case of **San Juan Structural and Steel Fabricators, Inc. vs. Court of Appeals**, 296 SCRA 631, this court held that "(i)t is well-settled that points of law, theories and arguments not brought to the attention of the trial court need not be, and ordinarily will not be considered by the reviewing court, as they cannot be raised for the first time on appeal. Allowing a party to change horses in midstream, as it were, is to run roughshod over the basic principles of fair play, justice and due process." Accordingly, it would not merit this court's accommodation.

The second and third issues shall be discussed jointly as they are interrelated.

Section 30(b)(3) of the NIRC of 1977, as amended, lays down the rules for determining whether two corporations are related taxpayers, to wit:

> "**Section 30(b)(3)** – Except in the case of distributions in liquidation, **between two corporations more than fifty per centum in value of the outstanding stock of each of which owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was under the law applicable to such taxable year, a personal holding company or a foreign personal holding company**." (*Emphasis supplied*)

As aptly cited by the petitioner, in the case of **Katuparan Realty Corporation vs. CIR, CTA Case No. 4373, February 14, 1993,** the above provision of law was applied by this court in this manner:

> "**Explicitly, Section 31(b)(3) of the Tax Code requires that in order for two corporations to be considered related taxpayers, more than fifty (50%) percent of the outstanding stock of each must be owned, directly or indirectly, by or for the same individual**. In the case at bar, it has been sufficiently established that for the taxable year in question, IBM Philippines Inc. owned only 29% of the outstanding capital stock of petitioner Katuparan Realty Corporation. The "IBM Retirement Plan Trust Fund" owned 70% of Katuparan's capital stock, while the directors owned 1%. However, the ownership of 70% of petitioner's outstanding capital stock by the "IBM Retirement Plan Trust Fund" does not make IBM Philippines Inc. the owner/holder of such 70% stocks of Katuparan. (As petitioner claims, such 70% stockholding of the IBM Retirement Plan Trust Fund cannot be attributed to IBM Philippines.) The reason is that all the benefits under the plan are payable exclusively to the employees of IBM and that IBM does not exercise control over the retirement trust fund since the same is managed by the independent trustee, Far East Bank and

> Trust Company. This was testified to by petitioner's treasurer, Mr. Cecilio C. Amoranto, during the hearing." (*Emphasis supplied*)

From the foregoing, it is clear that the requisite laid down in Section 30(b)(3) before two corporations may be considered related taxpayers is not present in the subject case. The requirement of more than fifty percent (50%) direct or indirect ownership of the corporation to be considered as "related taxpayers" was not satisfied.

The stockholders of record of petitioner as of March 31, 1996 and the number of shares held by each stockholder are as follows (*par. 8, Facts Admitted, Stipulation of Facts and Issues, page 83, CTA Records)*:

MEPCO Employees Retirement Plan	7,421,392
Matsushita Electric Philippines Corporation	5,122,267
Jesus V. Del Rosario	262,005
Yoshihiro Hama	1
Yoshikazu Tanaka	1
Antonio R. Punzalan	1
Mamerto Z. Mondragon	1
TOTAL	12,805,668

(*Stipulation of Facts and Issues*)

The Secretary's Certificate (*Exhibit "S"*), identified and authenticated by Atty. Mamerto Mondragon during the February 12, 2001 hearing, shows that MEPCO has only 39.99% ownership of petitioner (*Exhibit "S-2"*). Likewise, it showed that the majority stockholder is MEPCO Employees Retirement Plan, with a 57.95% ownership of petitioner (*Exhibit "S"*). Viewing the present case in the light of the Katuparan Realty case and the above-mentioned provision, we conclude that attributing such stockholdings to MEPCO is baseless, in fact and in law. Apparently, the assumption made by respondent that petitioner and MEPCO, the corporate lender, are related taxpayers is simply without basis.

In disallowing the interest expense, respondent relied on Section 29(b)(2) (now Section 34 (B) of the NIRC of 1997) as its legal basis. However, the said section is not applicable to the case at bar. Section 29 (b)(2) provides:

> "**Section 29. Deductions from gross income. –**
>
> x x x x x x x x x
>
> (b) Interest
> (2) No deductions shall be allowed in respect of interest under the succeeding sub-paragraphs:
>
> x x x x x x x x x
>
> (ii) If both the taxpayer and the person to whom payment has been made or is made are persons specified under Section 30 (b)."

Under Section 30(b) of the old Tax Code, *supra*, it is clear that petitioner and MEPCO are not related taxpayers, since no individual, directly or indirectly, owns more than fifty percent (50%) of the outstanding stock of each as shown by the actual stockholdings of petitioner. Considering that the lender and the borrower are not related taxpayers, Section 29(b)(2), therefore, does not apply.

All the above factors lead to the conclusion that there exists in truth, in fact and in law, a creditor-debtor relationship between petitioner and MEPCO. And since the interest payments made by petitioner to MEPCO have been duly substantiated by official receipts issued by MEPCO to petitioner (*Exhibits "E" to "Q"*), the said payments claimed by petitioner as income tax deduction are valid, legal and deductible.

It bears stressing that respondent in this case presented no evidence to controvert the evidence adduced by petitioner. In fact, on February 20, 2002, respondent was considered by this court to have waived his right to present evidence for failure to present his case for three (3) consecutive trial dates. Considering that this is a case of assessment, respondent should have submitted clear and convincing evidence to warrant the upholding of his very own assessment but counsel for the respondent failed on his duty to defend said assessment.

WHEREFORE, in view of the foregoing, the court finds the instant petition meritorious and in accordance with law. Accordingly, the deficiency income tax assessment issued by respondent against petitioner for the fiscal year ended March 3, 1996 in the aggregate amount of P13,372,229.74 is hereby **CANCELLED AND WITHDRAWN.**

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Judge

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 Judge