Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SPECIAL SECOND DIVISION

YUMEX PHILIPPINES CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8331
For: Assessment nullification

Members:
CASTAÑEDA, JR., Chairperson
CASANOVA, and
MINDARO-GRULLA, JJ.

Promulgated: NOV 28 2013

x- x
10:50 a.m.

DECISION

MINDARO-GRULLA, J.:

This is a Petition for Review filed on September 7, 2011 by Yumex Philippines Corporation as petitioner, against the Commissioner of Internal Revenue (CIR) as respondent for the Court in Division, pursuant to Section 7 (a) (1) of Republic Act (RA) No. 1125, An Act Creating the Court of Tax Appeals, as amended[1], as well as Rule 4, Section 3 (a) (1), in relation to Rule 8, Section 4(a), of the Revised Rules of the Court of Tax Appeals (RRCTA)[2].

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1 Sec. 7. *Jurisdiction.* –The CTA shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
x x x x x x
(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds or internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;
x x x x x x

2 Rule 4. Sec. 3. *Cases within the jurisdiction of the Court in Division.* – The Court in Division shall exercise:
(a) Exclusive original over or appellate jurisdiction to review by appeal the following:

x x x x x x

Petitioner seeks the nullification and setting aside of the assessment issued against petitioner for alleged deficiency improperly accumulated earnings tax for the taxable year 2007.

Petitioner Yumex Philippines Corporation is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines, with principal address at First Cavite Industrial Estate, Special Economic Zone, Bo. Langkaan, 4126, Dasmariñas, Cavite.[3]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR), empowered to perform the duties of her office, including, among others, the power to decide disputed assessments, and such other matters vested in her in the National Internal Revenue Code (NIRC) and other special laws. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

A Notice of Informal Conference dated March 4, 2010, with attached Details of Discrepancy and Preliminary Audit Findings with Schedule 2 Salaries and Compensation and Schedule 1 Fringe Benefits Tax, was issued by Revenue District Officer Edgar B. Tolentino, informing petitioner that the investigation of its accounting records for the taxable year 2007 resulted in a preliminary assessment of income

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(1) Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;

x x x x x x

Rule 8. Sec. 4. *Where to appeal; mode of appeal.* –

(a) An Appeal from a decision or ruling or the inaction of the Commissioner of Internal Revenue on disputed assessments or claim for refund of internal revenue taxes erroneously or illegally collected; the decision or ruling of the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade & Industry, the Secretary of Agriculture, and the Regional Trial Court in the exercise of their original jurisdiction, shall be taken to the Court by filing before it a petition for review as provided in Rule 42 of the Rules of Court. The Court in Division shall act on the appeal.

[3] Par. 1, Joint Stipulation of Facts (JSF), Docket, p. 198; Exhibits "A" and "B".

tax, value-added tax, expanded withholding tax, fringe benefits tax, improperly accumulated earnings tax, and compromise penalty.[4]

Petitioner responded to the preliminary audit findings by filing a letter dated June 2, 2010, stating that it is registered under the Philippine Economic Zone Authority (PEZA) and that it is enjoying payment of special rate on registered activities; thus, the company is not subject to improperly accumulated earnings tax.[5]

Subsequently, respondent sent a letter[6] dated August 12, 2010 and a Summary of Deficiencies[7] to petitioner, which were received by petitioner on August 20, 2010 and August 25, 2010, respectively. Petitioner thereafter sent its reply to respondent's letter dated August 12, 2010.[8]

A Preliminary Assessment Notice (PAN) dated December 16, 2010, with attached Details of Discrepancies, was issued by Regional Director Rodita B. Galanto, finding petitioner liable to pay deficiency income tax, fringe benefits tax, improperly accumulated earnings tax, and compromise penalty.[9]

A Formal Letter of Demand (FLD) dated January 10, 2011 with Details of Discrepancies and Audit Results/Assessment Notice were likewise issued by Regional Director Rodita B. Galanto, finding petitioner liable to pay deficiency income tax in the amount of ₱589,961.46, fringe benefits tax in the amount of ₱1,097,855.50, improperly accumulated earnings tax in the amount of ₱9,077,695.05, and compromise penalty in the amount of ₱25,000.00.[10]

On January 20, 2011, petitioner filed with respondent its Protest on the Formal Letter of Demand dated January

[4] Exhibits "K", "K-2", "K-3", "K-4", "K-5", "K-6", and "K-7".
[5] Exhibit "L".
[6] Exhibit "N".
[7] Exhibit "M".
[8] Exhibit "O".
[9] Exhibit "P".
[10] Exhibits "Q", "Q-1", and "R" to "R-3".

10, 2011, stating that it is registered under PEZA and that it is enjoying payment of special tax rate on registered activities. Hence, the company is not subject to improperly accumulated earnings tax. Petitioner added that all activities of petitioner are registered under PEZA.[11]

Petitioner sent a letter dated February 2, 2011, which was received by respondent on February 4, 2011, informing respondent that it is paying the amount of deficiency income tax amounting to ₱372,106.45 and deficiency fringe benefits tax in the amount of ₱584,355.38, while contesting the amount of interest and penalty. Petitioner likewise stated that it paid in full the total deficiency tax amounting to ₱981,461.83, including compromise penalty of ₱25,000.00 as evidenced by the receipts attached thereto.[12]

After a re-investigation, Revenue District Officer Honorata S. Aguilar issued a letter dated July 25, 2011, informing petitioner that its request for cancellation of civil increments and penalties is subject to the approval of the Commissioner of Internal Revenue or the Deputy Commissioner/Assistant Commissioner/Regional Director, pursuant to Section III(6) of Revenue Memorandum Order No. 19-2007. In the same letter, the RDO reiterated its position on the assessment of improperly accumulated earnings tax and civil increments and further informed petitioner that the whole docket of the case will be forwarded to the Regional Office for pursuance of collection.[13]

Treating the said letter as respondent's Final Decision on Disputed Assessment, petitioner appealed the same by filing the instant Petition for Review before this Court on September 7, 2011.

In her Answer[14] filed on October 14, 2011, respondent alleged the following special and affirmative defenses:

[11] Exhibit "S".
[12] Exhibits "T" to "T-8".
[13] Exhibit "X".
[14] Docket, pp. 96-110.

"9. Respondent reiterates and re-pleads the preceding paragraphs of this Answer as part of her Special and Affirmative Defenses.

10. Petitioner Yumex Philippines Corporation (Yumex, *for brevity*) is liable to pay its deficiency Improperly Accumulated Earnings Tax (IAET) for calendar year 2007 in the aggregate amount of Nine Million Seventy-Seven Thousand Six Hundred Ninety-Five Pesos and 5/100 (Php9,077,695.05) including penalties, surcharges and interest for the following reasons:

10.1 The instant petition should not be given due course by this Honorable Court for lack of merit.

10.2 Respondent respectfully avers that the assessment for taxable year 2007 in the aggregate amount of Php9,077,695.05 was issued in accordance with law and regulations.

10.3 Comprehensive study of petitioner's books of accounts and pertinent accounting records disclosed that it is liable to pay the total deficiency IAET assessment. The pertinent portions of the Memorandum Report dated September 13, 2007 of the examiner who conducted the investigation of petitioner's case are quoted hereunder, *to wit:*

xxx xxx xxx

Corollary thereto, the Memorandum Report of the examiner, who conducted the reinvestigation of petitioner's case, dated July 25, 2011 is quoted hereunder, *to wit:*

xxx xxx xxx

10.4 It is a well-settled rule in taxation that the burden of proof is on the taxpayer to present evidence to show the incorrectness of the assessment.

10.5 In case of disputed assessments, the burden of proof is on the taxpayer to establish the fact that it is indeed not liable for any deficiency taxes subject of the assessment. The failure to show documents that would substantiate a claim that no deficiency taxes are due, would result to upholding the validity of the assessment for deficiency income taxes ***(Camara Steel Industries, Inc. vs. Commissioner of Internal Revenue).***

10.6 Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner, and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments ***(Sy Po vs. Court of Tax Appeals).*** Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notices.

11. Petitioner's contention that the Assessment notices and the Formal Letter of Demand are void because it allegedly failed to state the facts and law on which the assessment was based is bereft of merit.

11.1 Contrary to petitioner's claim, the Assessment notices and the Formal Letter of Demand were issued in accordance with law and regulations. Indubitably, petitioner admitted in its Petition for Review that by reason of the formal letter of demand and assessment notices issued by respondent, petitioner was able to prepare a comprehensive Protest Letter, controverting the alleged erroneous assessment of its deficiency IAET. Petitioner likewise mentioned in its Petition for Review that it 'decided not to contest the assessment for the deficiency income tax and fringe benefit tax in the amount of Php372,106.45 and Php584,355.38, respectively. Thus, it paid the said assessments and notified Regional Director Galanto about the payments in a letter dated February 2, 2011 with attached receipts.' It is respectfully submitted that if petitioner was not sufficiently informed of the facts and the laws on which the assessment was based, it could not have protested in full. Thus, as eloquently ruled by this Honorable Court, 'while the mere filing of a protest letter does not automatically mean that the requirement of Section 228 has not been violated, however, if the taxpayer is able to intelligently argue its case and elucidate the reasons for the assessment, as in this case, then it cannot contradict itself by asserting that it was not informed of the law and facts on which the assessment was made.

11.2 Further, this Honorable Court in the case of *Trustworthy Pawnshop, Inc. vs. Commissioner of Internal Revenue* held that:

'This court on numerous occasions sustained the validity of the assessment despite the alleged failure to inform the petitioner in writing of the law and facts on which the assessment is made if there is evidence showing that the petitioner managed to protest the assessment intelligently and efficiently. Among these cases is the case of Belle Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5930, April 4, 2002, where this court held, thus:

Assuming *arguendo* that petitioner may raise said issue for the first time in this Court, we believe that petitioner was fully informed of the law and the facts on which the assessment is made thus answering the issue in the affirmative.

It bears emphasis that the purpose of aforesaid requirement is to give the taxpayer the opportunity to refute the findings of the examiner and give a more accurate and detailed explanation regarding the proposed assessment(s). As correctly pointed out by respondent, as early as May 14, 1997, which is prior to the issuance of the subject assessments, petitioner already submitted its comments regarding two issues raised by the revenue examiners:

> first, the alleged understatement of 1995 sales of Pinecrest village units by P7.4 million, and second; the reckoning date for the payment of capital gains tax on sales of shares and the documentary stamp tax thereon (pp. 439-442, BIR Records). It is to be noted that these issues constitute the very bases of the assessments which were subsequently issued. Likewise, in its protest letter dated March 1, 1999, petitioner was able to explain in detail and submit documents to support its claim that the assessments were erroneous. Verily, at the time the assessments were issued, petitioner knew very well the law and the facts on which they were based. The purpose of the law having been served, Section 228 of the Tax Code may be deemed to have been complied with.
>
> Since we rule that by petitioner's actual knowledge of the bases of the assessments, the requirement under Section 228 of the Tax Code that 'the taxpayer be informed of the law and the facts on which the assessment is made' is deemed to have been complied with, it follows then that the assessments dated November 27, 1997 are not null and void, even if the same failed to state the law and the facts on which they were based.'

Here, the petitioner was issued a Preliminary Assessment Notice (PAN) which it protested. The fact that petitioner was able to intelligently protest the Preliminary Assessment, Assessment Notice and Amended Assessment Notice, shows that it had actual knowledge of the law and the facts on which the assessment is made. Thus, the aforementioned requirement in Section 228 of the Tax Code is deemed to have been complied with (Belle Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5930, April 4, 2002).

Based on the foregoing, it is respectfully submitted that the allegation of petitioner questioning the validity of the Assessment Notices

> and Formal Letter of Demand on the basis that it allegedly failed to state the facts and law on which the assessment is based has no basis in fact and law."

The case was set for pre-trial conference on November 24, 2011.[15] Petitioner's Pre-Trial Brief[16] was filed on November 11, 2011; while respondent's Pre-Trial Brief[17]was filed on November 14, 2011.

On December 15, 2011, the parties filed with this Court their Joint Stipulation of Facts[18]; which was approved in a Resolution[19] dated December 19, 2011. In the same Resolution, the Court considered the pre-trial terminated and ordered the parties to proceed with the trial on the merits presenting only evidence not covered by their Joint Stipulation of Facts.

During trial, both parties presented their respective documentary and testimonial evidence. Petitioner presented as its witness Leonora Perez-Sangalang, the Division Manager of the Administration Department of petitioner.[20] Petitioner also presented and formally offered Exhibits "A" to "AA"[21], which were admitted as part of its documentary evidence as per this Court's Resolutions dated March 23, 2012[22] and May 22, 2012[23].

The documentary evidence formally offered and admitted are as follows:

Exhibits	Description
A	Certificate of Incorporation dated 24 August 1999 issued by the Securities and Exchange Commission (SEC).

[15] Notice of Pre-Trial Conference issued on October 17, 2011, Docket, p. 112.
[16] Docket, pp. 113-119.
[17] Docket, pp. 185-189.
[18] Docket, pp. 198-200.
[19] Docket, p. 202.
[20] TSN dated February 6, 2012; Exhibit "AA".
[21] Formal Offer of Evidence filed on February 15, 2012, Docket, pp. 297-307.
[22] Docket, pp. 409-413.
[23] Docket, pp. 442-445.

B	Articles of Incorporation dated 3 June 2009, consisting of five (5) pages, duly acknowledged before a notary public.
C	Certificate of Registration dated September 7, 1999 issued by the Philippine Economic Zone Authority (PEZA).
D	Registration Agreement dated 7 September 1999 between PEZA and YPC, consisting of eight (8) pages, duly acknowledged before a notary public.
E	Notice of ITH Extension Approval No. 03-089 dated 29 October 2003 issued by PEZA, consisting of four (4) pages including an attached letter of the same date to the Bureau of Internal Revenue (BIR).
F	Notice of ITH Extension Approval No. 03-099 dated 25 November 2003 issued by PEZA, consisting of four (4) pages, including an attached letter of the same date to the BIR.
G	Supplemental Agreement dated 10 December 2007 between PEZA and YPC, consisting of four (4) pages, duly acknowledged before a notary public.
H	Notarized Affidavit of Start of Commercial Operation dated 11 May 2011.
I	Certification dated 17 January 2011 issued by PEZA with Certificate No. 2011-0433.
J	Certification dated 14 January 2011 issued by PEZA, with Certification No. 2011-0371.
K	Notice of Informal Conference dated 4 March 2010, issued by Revenue District Officer Edgar B.Tolentino, consisting of seven (7) pages including the following attached documents: Details of Discrepancy (**EXHIBIT "K-2"**), Preliminary Audit Findings (**EXHIBIT "K-3"** and **"K-4"**), Schedule 2 Salaries and Compensation (**EXHIBIT "K-5"**), Schedule 1 Fringe Benefits Tax (**EXHIBIT "K-6"**), and Schedule 1 Fringe Benefits Tax (**EXHIBIT "K-7"**).

L	Letter dated 2 June 2010 of YPC to Revenue Distric Officer Edgar B. Tolentino.
M	Summary of Deficiencies.
N	Letter dated 12 August 2010, issued by Revenue District Officer Edgar B. Tolentino, consisting of two (2) pages.
O	Letter dated 25 August 2010 of YPC to Revenue District Officer Edgar B. Tolentino, consisting of six (6) pages including the following attached documents: (a) BIR Ruling [DA-059-03] dated 28 February 2003 (**EXHIBIT "O-2"** and **"O-3"**) and (b) BIR Ruling [DA-392-07] dated 18 July 2007 (**EXHIBIT "O-4"** and **"O-5"**).
P	Preliminary Assessment Notice (PAN) dated 16 December 2010, issued by Regional Director Rodita B. Galanto, consisting of three (3) pages, including the attached Details of Discrepancies (**EXHIBIT "P-2"**).
Q	Formal Letter of Demand (FLD) dated 10 January 2011, issued by Regional Director Rodita B. Galanto, consisting of three (3) pages, including the attached Details of Discrepancies (**EXHIBIT "Q-1"**).
R	**particularly EXHIBIT "R-3"**- Audit Results/ Assessment Notices dated 10 January 2011, issued by Regional Director Rodita B. Galanto, consisting of four (4) pages.
S	Letter dated 19 January 2011 of YPC to Regional Director Rodita Galanto, consisting of two (2) pages.
T	Letter dated 2 Februarly 2011 of YPC to Regional Director Rodita Galanto, consisting of seven (7) pages including the following attached documents: (a) BIR eFPS Payment Confirmation (**EXHIBIT "T-3"**), Payment Confirmation Receipt (**EXHIBIT "T-5"**), Acknowledgement Receipt (**EXHIBIT "T-7"**) and BIR Form No. 605 (**EXHIBIT "T-8"**).
U	Letter dated 8 March 2011 issued by Regional Director Rodita B. Galanto.

V	Letter dated 11 May 2011 issued by Revenue District Officer Honorata S. Aguilar.
W	Letter dated 11 July 2011 of YPC to Revenue District Officer Honorata S. Aguilar.
X	Letter dated 25 July 2011 issued by Revenue District Officer Honorata S. Aguilar.
Y	Annual Income Tax Return for the year 2005, filed by YPC to the BIR on 20 September 2006.
Z	Secretary's Certificate dated 3 February 2011, duly acknowledged before a notary public.
AA	Judicial Affidavit of Leonora Perez-Sangalang dated 11 January 2012.

On the other hand, respondent presented as witnesses Bayani A. Atienza, Jr., Revenue Officer I formerly assigned at Revenue District Office (RDO) No. 54-A, Trece Martires City in 2007[24] and Ernesto Generoso, Revenue Officer I formerly assigned at RDO No. 54-A, Trece Martires City in 2011.[25] Respondent likewise presented and formally offered Exhibits "1" to "21-A"[26], which were admitted as part of her documentary evidence as per this Court's Resolutions dated October 25, 2012[27], December 17, 2012[28], and during the hearing held on March 11, 2013[29].

Respondent's documentary evidence are as follows:

Exhibit	Description
1	Letter of Authority No. 00033096 dated July 14, 2008.
2	Scope of Examination Checklist.

[24] TSN dated June 27, 2012 and March 11, 2013; Exhibit "16".
[25] TSN dated August 29, 2012; Exhibit "20".
[26] Docket, pp. 489-509.
[27] Docket, pp. 525-526.
[28] Docket, pp. 542-544.
[29] Minutes of the hearing dated March 11, 2013, Docket, p. 614.

3	Second Request for Presentation of Records dated August 12, 2008.
4	Memorandum dated October 30, 2008.
5	Memorandum dated December 2, 2008.
6	Final Request for Presentation of Records dated July 2, 2009.
7	Memorandum dated August 6, 2009.
8	Subpoena Duces Tecum dated August 27, 2009.
9	Memorandum dated September 16, 2009.
10	Memorandum dated November 3, 2009.
11	Notice of Informal Conference dated March 4, 2010 with corresponding Summary of Deficiencies, Preliminary Audit Findings and Details of Discrepancies.
12	Memorandum dated August 23, 2010.
12-A	Audit Report on Final Tax-Compromise Penalty.
12-B	Audit Report on Fringe Benefit Tax.
12-C	Audit Report Income Tax.
12-D	Audit Report on Improperly Accumulated Earnings Tax.
13	Preliminary Assessment Notice dated December 16, 2010 and Details of Discrepancies.
14	Formal Letter of Demand dated April 16, 2008 with attached Details of Discrepancies.
14-A	Final Assessment Notice on Income Tax.

14-B	Final Assessment Notice on Fringe Benefit Tax.
14-C	Final Assessment Notice on Improperly Accumulated Earnings Tax.
14-D	Final Assessment Notice on Compromise Penalty.
15	Memorandum dated July 25, 2011.
16	Affidavit of Revenue Officer Bayani A. Atienza, Jr.
16-A	Signature of Affiant Bayani A. Atienza, Jr.
17	Memorandum dated April 12, 2011.
18	Letter dated May 11, 2011.
20	Affidavit of Revenue Officer Ernesto Generoso.
20-A	Signature of Affiant Ernesto Generoso.

Petitioner submitted its Memorandum[30] on December 5, 2012 and Supplemental Memorandum[31] on April 8, 2013. On the other hand, respondent's Memorandum[32] was submitted on April 10, 2013. Thus, in a Resolution dated May 16, 2013, the case was submitted for decision.[33]

Based on the pleadings submitted by the parties, the issues[34] for disposition are as follows:

1. Whether or not respondent's assessment for deficiency improperly accumulated earnings tax for the taxable year 2007 against petitioner is valid and legal;

[30] Docket, pp. 545-574.
[31] Docket, pp. 619-623.
[32] Docket, pp. 624-636.
[33] Docket, p. 640.
[34] Issues to be tried or resolved, petitioner's Pre-Trial Brief, Docket, p. 115; Proposed Issues, respondent's Pre-Trial Brief, Docket, p. 187; Issues, petitioner's Memorandum, Docket, p. 549; Issues, respondent's Memorandum, Docket, p. 625.

2. Whether or not petitioner, as a PEZA-registered Ecozone Export Enterprise, is exempt from improperly accumulated earnings tax; and

3. Whether or not petitioner is liable for deficiency improperly accumulated earnings tax for the taxable year 2007 in the aggregate amount of ₱9,077,695.05 including penalties, surcharges and interest.

Petitioner contends that the subject tax assessment is invalid and illegal because the BIR Commissioner issued the FLD and the Final Assessment Notice (FAN) without giving petitioner an opportunity to answer the PAN, which is in violation of procedural due process.

Respondent counters that petitioner was afforded due process when it was notified of its tax deficiencies. Respondent issued the Letter of Authority and requested the submission of documents to give petitioner the opportunity to present its side. Again, petitioner was apprised that an assessment was being made against it when it received a Notice of Informal Conference with detailed computation of petitioner's tax deficiencies. Petitioner likewise received a PAN and a FLD for the taxable year 2007 and both have attached Details of Discrepancies.

Pertinent to the resolution of the issue at hand are Section 228 of the NIRC of 1997, as amended, and Revenue Regulations (RR) No. 12-99, which provide for the procedure that must be followed in order for an assessment to be valid.

Section 228 of the NIRC of 1997 reads:

> "SEC. 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:

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 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." *(Emphasis supplied)*

Section 3 of Revenue Regulations No. 12-99 states:

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

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

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 the Special Investigation Division, as the case may be (in the case Revenue Regional 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 xxx **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 payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties.**

xxx xxx 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 xxx 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: xxx" *(Emphasis supplied)*

In other words, after the Revenue Officer conducts a re-investigation of the records of a taxpayer for alleged deficiency tax liability, the taxpayer shall be notified in writing of the findings for purposes of an Informal Conference. If there exists a sufficient basis to assess the taxpayer for any deficiency tax, a Preliminary Assessment Notice shall be issued and be sent to the taxpayer. The taxpayer is then given fifteen days to make a Reply and is also permitted to examine the records and present his arguments in writing. If the taxpayer fails to respond to the PAN, the taxpayer shall then be sent a Formal Letter of Demand and Assessment Notice, which shall state the facts and the law on which the assessment was based. The taxpayer may file a protest on such assessment within thirty days. After filing the protest, the taxpayer must submit the relevant supporting documents within sixty days, otherwise the assessment shall become final.

A careful perusal of the records would show that respondent failed to comply with the procedural requirements in assessing petitioner. Records reveal that the PAN dated December 16, 2010[35] and the Formal Letter of Demand dated January 10, 2011[36] were both received by the Post Office of Dasmariñas, Cavite on January 17, 2011. Also, it appears from petitioner's copy of the PAN that the same was actually received by petitioner on January 18, 2011.[37] It is also noted that petitioner's witness, Leonora Perez-Sangalang, testified, by way of a Judicial Affidavit executed on January 11, 2012[38], that the PAN, the FLD and the Audit Results/Assessment Notice regarding improperly accumulated earnings tax were all received by petitioner on January 18, 2011. The date of receipt by petitioner of respondent's FLD and FAN may also be inferred from the protest filed by petitioner on the FLD, which stated that the FLD was received on January 18, 2011[39] and the letter of petitioner addressed to the BIR dated February 2, 2011, which mentioned that the Audit Results/Assessment Notice was received on January 18, 2011.[40] Thus, it appears that the FLD and the Audit Results/Assessment Notice dated January 10, 2011 were issued without giving petitioner the

[35] Exhibit "13".
[36] Exhibit "14".
[37] Exhibit "P".
[38] Exhibit "AA".
[39] Exhibit "S".
[40] Exhibit "T".

opportunity to protest the PAN which was received by petitioner only on January 18, 2011.

In the case of *Commissioner of Internal Revenue vs. Metro Star Superama, Inc.*[41], it was held that the sending of a PAN to taxpayer to inform him of the assessment made is part of the "due process requirement in the issuance of a deficiency tax assessment," the absence of which renders nugatory any assessment made by tax authorities. The use of the word "shall" in Subsection 3.1.2 of RR No. 12-99 describes the mandatory nature of the service of a PAN. According to the Supreme Court, the persuasiveness of the right to due process reaches both substantial and procedural rights and the failure of the BIR Commissioner to strictly comply with the requirements laid down by law and its own rules is a denial of Metro Star's right to due process. Hence, for failure to send the PAN stating the facts and the law on which the assessment was made as required by Section 228 of the NIRC of 1997, the Supreme Court declared the assessment void.

In the same vein, under Section 228 of the NIRC of 1997, in relation to Section 3.1.2 of Revenue Regulations No. 12-99, it is mandated that the taxpayer shall be required to respond to Preliminary Assessment Notice within fifteen (15) days from the date of receipt of the PAN. As such, it is considered to be part of the "due process requirement in the issuance of a deficiency tax assessment". In issuing the FLD together with the FAN at the time when the PAN was not yet received by petitioner, respondent effectively disregarded petitioner's right to be notified of the PAN as well as its right to respond to the said PAN. Thus, respondent's failure to give petitioner the opportunity to respond to the PAN as required in the above-mentioned provisions makes the assessment issued by the BIR Commissioner void.

In the earlier case of *Pilipinas Shell Petroleum Corporation vs. Commissioner of Internal Revenue,*[42] the

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[41] G.R. No. 185371, December 8, 2010.
[42] G.R. No. 172598, December 21, 2007.

Supreme Court found therein that respondent ignored RR No. 12-99 and did not issue to petitioner a notice for informal conference and a preliminary assessment notice, as required. For being formally defective, the Suprme Court found the November 15, 1999 formal letter of demand and assessment notice void. According to the Supreme Court, while petitioner indeed protested the formal assessment, such does not denigrate the fact that it was deprived of statutory and procedural due process to contest the assessment before it was issued.

Similarly, in this case, while petitioner was able to protest the FLD and the FAN, petitioner was still deprived of statutory and procedural due process to contest the assessment before it was issued since the FLD and the FAN were received by petitioner on the same day petitioner received the PAN.

One of the most basic and fundamental precepts of law enshrined in the Constitution is that no person shall be deprived of his property without due process of law (Section 1, Article III of the 1987 Constitution). The pervasiveness of the right to due process reaches out to both substantive and procedural rights, regardless of their source, be it the Constitution, or only a statute or a rule of court.[43]

In the same case of *Commissioner of Internal Revenue vs. Metro Star Superama, Inc.*[44], the Supreme Court, citing the case of *Commissioner of Internal Revenue vs. Algue, Inc., et al.*[45], made the following disquisitions:

> "Taxes are the lifeblood of the government and so should 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

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[43] *BPI Data Systems Corporation (formerly Filipinas Management and Leasing Services, Inc.) vs. Commissioner of Internal Revenue*, CTA Case No. 4530, January 12, 1994.
[44] G.R. No. 185371, December 8, 2010.
[45] G.R. No. L-28896, February 17, 1988.

> the taxpayers so that the real purpose of taxation, which is the promotion of the common good, may be achieved.
>
> xxx xxx xxx
>
> It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for the 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 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.
>
> But even as we concede the inevitability and indispensability of taxation, **it is a requirement in all democratic regimes that it be 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 xxx that the law has not been observed**." (*Emphasis supplied*)

Respondent violated Section 228 of the NIRC of 1997 and the provisions of Revenue Regulations No. 12-99, which give the taxpayer a period of fifteen days within which to reply to the PAN. In view of respondent's violation of petitioner's right to due process, the assessment would thus be considered void.

Aside from respondent's violation of petitioner's right to due process, the assessment must be cancelled for lack of factual basis.

Upon examination of the reports, notices and letters issued by respondent, it appears that respondent herself is uncertain as to whether the assessment was made on petitioner's income derived from exempt registered activities or from activities other than those registered activities. The said inconsistencies in the factual basis of the assessment raise doubts as to the correctness of the subject assessment.

In verifying the basis of the assessment issued by respondent, the Court examined the PAN[46] and the FLD[47] which show that the ten percent (10%) improperly accumulated earnings tax rate was imposed on the **taxable income (other than on its registered activity)** in the amount of ₱49,078,851.75. As explained by respondent in the Details of Discrepancies of the PAN and of the FLD[48], the taxpayer has improperly accumulated earnings that **pertain to the income accrued other than on its registered activities which were also declared under income tax holiday**.

However, upon further scrutiny, records reveal that respondent actually applied the improperly accumulated earnings tax rate on petitioner's income from its registered activities.

The Preliminary Audit Findings[49] and Summary of Deficiencies[50] show that the 10% improperly accumulated earnings tax rate was imposed on the **taxable income (exempt registered activity),** the amount of which is similar to the amount of taxable income mentioned in respondent's PAN and FLD, which is ₱49,078,851.75. In the Memorandum Report dated August 23, 2010, which recommended the issuance of the PAN against petitioner, it was found that petitioner failed to subject the accumulated taxable income to improperly accumulated earnings tax with respect to its **income under Income Tax Holiday Regime on its registered activities.**[51] This is bolstered by the testimony of Revenue Officer Atienza, the Revenue Officer who conducted the investigation on petitioner's tax liabilities

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[46] Exhibit "P"; Exhibit "13".
[47] Exhibit "Q"; Exhibit "14".
[48] Exhibits "P-2" and "Q-1".
[49] Exhibit "K-3".
[50] Exhibit "M".
[51] Exhibit "12".

for the taxable year 2007, saying that **the basis of the assessment in subjecting petitioner to improperly accumulated earnings tax came from income on registered activities (backlight, PCBA, PCBM, diemold and CAD design) enjoying Income Tax Holiday** and not on the registered activities (wiring harness and insulation) enjoying the five percent (5%) special rate.[52]

What is clear from the foregoing is that in arriving at the assessed improperly accumulated earnings tax, respondent applied the improperly accumulated earnings tax rate on petitioner's income from its registered activities enjoying Income Tax Holiday.

There is nothing in the reports, notices and letters issued by respondent which would specifically show the unregistered activities from which the alleged taxable income mentioned in the PAN, the FLD and the FAN was derived. Taking into consideration the inconsistencies in the findings of respondent as to the basis of petitioner's tax liability, the assessment against petitioner for improperly accumulated earnings tax clearly has no factual basis.

The imposition of improperly accumulated earnings tax is provided in Section 29 of the NIRC of 1997, as amended, to wit:

> "SEC. 29. *Imposition of Improperly Accumulated Earnings Tax.* -
>
> *(A)* *In General.* - In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof, an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.
>
> *(B)* *Tax on Corporations Subject to Improperly Accumulated Earnings Tax.* - ℂ

[52] Exhibit "16".

(1) *In General*. - The improperly accumulated earnings tax imposed in the preceding Section shall apply to **every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.**

(2) *Exceptions*. - The improperly accumulated earnings tax as provided for under this Section shall not apply to:

(a) Publicly-held corporations;
(b) Banks and other nonbank financial intermediaries; and
(c) Insurance companies." *(Emphasis supplied)*

Corollary to Section 29 of the NIRC of 1997 is Section 7 of Revenue Regulations No. 02-01, which states:

"SECTION 7. *Determination of Purpose to Avoid Income Tax*. - The fact that a corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. Likewise, **the fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members**. In both instances, the corporation may, by clear preponderance of evidence in its favor, prove the contrary.

For purposes of these Regulations, the term 'holding or investment company' shall refer to a corporation having practically no activities except holding property, and collecting the income therefrom or investing the same.

The following are *prima facie* instances of accumulation of profits beyond the reasonable needs of a business and indicative of purpose to avoid income tax upon shareholders:

(a) Investment of substantial earnings and profits of the corporation in unrelated business or in stock or securities of unrelated business;

(b) Investment in bonds and other long-term securities;

(c) Accumulation of earnings in excess of 100% of paid-up capital, not otherwise intended for the reasonable needs of the business as defined in these Regulations." *(Emphasis supplied)*

It must be emphasized that the provision (formerly Section 25 of the old National Internal Revenue Code of 1977) on improperly accumulated earnings discouraged tax avoidance through corporate surplus accumulation. When corporations do not declare dividends, income taxes are not paid on the undeclared dividends received by the shareholders. The tax on improper accumulation of surplus is essentially a penalty tax designed to compel corporations to distribute earnings so that the said earnings by shareholders could, in turn, be taxed.[53]

Notably, to create a presumption that the income pertains to improperly accumulated earnings, respondent should have at least established any of the above-mentioned *prima facie* instances of accumulation of profit beyond the needs of the business which is indicative of purpose to avoid income tax upon shareholders.

In the instant case, there was nothing in the assessment issued by respondent which would show that the income from which the improperly accumulated earnings tax rate was applied actually pertains to earnings and profits which petitioner permitted to accumulate instead of being divided or distributed for the purpose of avoiding the income tax with respect to its shareholders, or that the said income pertains to earnings and profits which petitioner permitted to accumulate beyond the reasonable needs of the business. Thus, the Court must cancel the assessment for lack of factual basis.

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[53] *Cyanamid Philippines, Inc. vs. The Court of Appeals, et. al.*, G.R. No. 108067, January 20, 2000.

It is true that all presumptions are in favor of the correctness of a tax assessment. However, the *prima facie* correctness of a tax assessment does not apply upon proof that an assessment is utterly without foundation, meaning it is arbitrary and capricious. Where the BIR has come out with a "naked assessment," *i.e.*, without any foundation character, the determination of the tax due is without rational basis.[54]

In order to stand the test of judicial scrutiny, the assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption. Hence, assessment should not be based on mere presumptions no matter how reasonable or logical said presumptions may be.[55]

The presumption of correctness of the assessment does not apply considering that respondent's conclusion that petitioner has income accrued from activities other than its registered activities, which should allegedly be subject to improperly accumulated earnings tax, is not based on actual facts but mere presumption, and considering further that the presumption of correctness was already negated by the inconsistencies noted in the reports, notices and letters issued by respondent.

In view of the Court's findings that petitioner was not accorded due process in the issuance of the subject assessment and that the assessment lacks factual basis, the assessment for deficiency improperly accumulated earnings tax issued against petitioner should be cancelled and set aside.

WHEREFORE, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, the

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[54] *Commissioner of Internal Revenue vs. Hantex Trading Co., Inc.*, G.R. No. 136975, March 31, 2005.

[55] *Commissioner of Internal Revenue vs. Island Garment Manufacturing Corporation and the Court of Tax Appeals,* G.R. No. L-46644, September 11, 1987, citing *Commissioner of Internal Revenue vs. Alberto D. Benipayo,* G.R. No. L-13656, January 31, 1962.

assessment issued by respondent against petitioner for deficiency improperly accumulated earnings tax is hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

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

WE CONCUR:

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

CAESAR A. CASANOVA
Associate Justice

A T T E S T A T I O N

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.

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

C E R T I F I C A T I O N

Pursuant to Article VIII, Section 13 of the Constitution, and the 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