REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION
****

NORTHERN TOBACCO REDRYING CO., INC., Petitioner,	**CTA Case No. 8857**
	Members:
- versus -	**DEL ROSARIO,** *P.J., Chairperson,* **UY,** and **MINDARO-GRULLA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	***Promulgated:*** JUL 25 2017 2:05 pm

x - x

DECISION

UY, *J.*:

Before this Court is a *Petition for Review* filed on August 5, 2014 by Northern Tobacco Redrying Co., Inc., praying for the declaration of nullity of the Assessment Notices issued against it, covering deficiency income tax, value-added tax (VAT), and documentary stamp tax (DST) for the year ending December 31, 2009 in the aggregate amount of ₱258,471,513.34.

THE FACTS

Petitioner Northern Tobacco Redrying Co., Inc. (NTRC) is a corporation duly organized and existing under Philippine laws with business address at No. 24 Fortune Avenue, Brgy. Fortune, Marikina City.[1] It is registered with the Securities and Exchange Commission (SEC) and was duly issued SEC Certificate No. 126605 by Julio A. Sulit, Jr., Associate Commissioner, on May 21, 1985.[2] Petitioner is likewise registered with the Bureau of Internal Revenue (BIR) and

---

[1] Par. 2, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), Docket, p. 313.
[2] Par. 4, Admitted Facts, JSFI, Docket, p. 314; Exhibit "P-6", Docket, p. 629.

was issued a BIR Certificate of Registration No. 8RC0000049826 duly signed by Atty. Teresita M. Angeles, HREA-LTS-Excise Large Taxpayers.[3]

Respondent is the duly appointed Commissioner of Internal Revenue who holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.[4]

On October 29, 2009, petitioner executed a *Plan of De Facto Merger* with Fortune Tobacco Corporation (FTC).[5] On the same date, petitioner and FTC entered into a *Deed of Assignment*.[6] Both documents contemplate and cover the transfer by petitioner to FTC of the following assets and liabilities as of October 31, 2009, as follows:

ASSETS	
Cash	₱ 12,273,248.30
Accounts Receivable	32,587,200.00
Prepaid Insurance	281,545.00
Advances to Suppliers	2,177,676.78
Land Improvements – Net	1,959,122.33
Buildings – Net	31,832,433.21
Buildings Improvements – Net	24,967,678.77
Machinery and Equipment – Net	12,198,724.94
Transportation Equipment – Net	144,166.80
Office Machines – Furniture and Fixtures – Net	417,935.44
Lab and Medical Equipment – Net	9,880.29
TOTAL ASSETS	**₱ 118,849,611.86**
LIABILITIES	
Accounts Payable	₱ 1,153,900.99
TOTAL LIABILITIES	**₱ 1,153,900.99**

In consideration of the foregoing, FTC agrees to issue in favor of petitioner 2,294,646 shares of FTC, and additional paid in capital of ₱115,401,064.87 recorded in the books of FTC.

---

[3] Par. 5, Admitted Facts, JSFI, Docket, p. 314; Exhibit "P-7", Docket, p. 646.
[4] Par. 2, Admitted Facts, JSFI, Docket, p. 313.
[5] Exhibit "P-8", Docket, pp. 647 to 651.
[6] Exhibit "P-9", Docket, pp. 652 to 655;

On February 23, 2010, a letter-request was filed by Sycip Gorres & Velayo, on behalf of petitioner, with the Law Division of the BIR, requesting for confirmation of their opinion that the transfer of more than 80% of petitioner's total assets and some of the latter's liabilities to FTC in exchange for shares of capital stock of FTC constitutes a *de facto* merger pursuant to Section 40(C)(6)(b) in relation to 40(C)(2) of the National Internal Revenue Code (NIRC) of 1997, as amended.[7]

On May 25, 2010, petitioner, through its duly authorized representative, received the Letter of Authority No. 124-2010-00000060 dated May 14, 2010, authorizing the examination of the books of accounts and other accounting records of petitioner for all internal revenue taxes for taxable year 2009.[8]

A *Waiver of the Defense of Prescription Under the Statute of Limitation of the NIRC* was executed on February 16, 2012 by petitioner, through its President, Angelo Joe L. Ang, and was accepted on March 13, 2012 by the respondent, through Alfredo V. Misajon, Assistant Commissioner, Large Taxpayers Service.[9]

Petitioner then received a *Notice of Informal Conference* dated October 4, 2012, informing the latter of the initial audit findings on the basis of the examination conducted.[10]

Subsequently, on January 28, 2013, a second *Waiver of the Defense of Prescription Under the Statute of Limitation of the NIRC* was executed by petitioner, through its Treasurer, William Wong. This was accepted by the respondent, through Alfredo V. Misajon, OIC-Assistant Commissioner, Large Taxpayers Service, on February 12, 2013.[11]

On September 9, 2013, petitioner, through its duly authorized representative, received the *Preliminary Assessment Notice* (PAN)

---

[7] Exhibit "P-10", Docket, p. 656 to 663.
[8] Par. 6, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), Docket, p. 314; Exhibit "P-11", Docket, p. 664; Exhibit "R-1", BIR Records, p. 5.
[9] Exhibit "P-12", Docket, p. 665; Exhibit "R-5", BIR Records, p. 8.
[10] Par. 7, Admitted Facts, JSFI, Docket, p. 314; Exhibit "P-13", Docket, p. 666; Exhibit "R-6", BIR Records, p. 566.
[11] Exhibit "P-14", Docket, p. 677; Exhibit "R-7", BIR Records, p. 8A.

dated September 2, 2013 together with the Details of Discrepancies.[12]

Petitioner objected to the said PAN on September 25, 2013 via the letter dated September 19, 2013, embodying its *Position Paper to Preliminary Assessment Notice dated September 2, 2013.*[13]

Thereafter, on December 9, 2013, petitioner, through its duly authorized representative, received a copy of the undated *Formal Letter of Demand* together with Audit Result/Assessment Notices Nos. ELTAD II-09-IT-0007, ELTAD II-09-VT-0001, ELTAD II-09-DS-0003, all dated December 5, 2013, assessing it deficiency income tax, VAT and DST for taxable year 2009.[14]

On January 08, 2014, petitioner filed its *Administrative Protest re: Request for Reconsideration* with the BIR, requesting for the setting aside of the deficiency income tax, VAT and DST assessments for taxable year 2009 for being devoid of factual and legal basis.[15]

Claiming inaction on the part of respondent, petitioner filed the instant *Petition for Review* on August 5, 2014.[16]

Upon respondent's *Motion for Extension of Time to File Answer* filed on August 29, 2014,[17] and *Second Motion for Extension of Time to File Answer* filed on October 1, 2014,[18] and within the extended time granted by the Court on October 3, 2014,[19] respondent filed his *Answer* on October 22, 2014,[20] interposing the following special and affirmative defenses, to wit:

---

[12] Par. 8, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), Docket, p. 314; Exhibits "P-15" and "P-16", Docket, pp. 678 to 689; Exhibit "R-9", BIR Records, pp. 831 to 842.
[13] Exhibit "P-17", Docket, pp. 690 to 704; BIR Records, pp. 883 to 896.
[14] Par. 9, Admitted Facts, JSFI, Docket, p. 314; Exhibits "P-1", "P-2", "P-3", "P-3-a", and "P-3-b", Docket, pp. 580 to 586; Exhibits "R-11", "R-11-b", "R-11-c", and "R-11-d", BIR Records, pp. 925 to 933.
[15] Exhibit "P-4", Docket, pp. 587 to 618; BIR Records, pp. 1161 to 1184.
[16] Docket, pp. 6 to 42.
[17] Docket, pp. 204 to 206.
[18] Docket, pp. 209 to 211.
[19] Order dated September 2, 2014, Docket, p. 208; and Resolution dated October 3, 2014, Docket, p. 217.
[20] Docket, pp. 218 to 232.

"4. Respondent incorporates and re-pleads all the foregoing averments and in further support of the Specific Denials herein set forth, respondent respectfully alleges as his defenses that:

The period to assess petitioner has not prescribed.

5. Petitioner expounded in detail that respondent's right to assess has prescribed anchoring its claim on Section 203 of the National Internal Code ('Tax Code'), to wit:

> **SEC. 203. Period of Limitation Upon Assessment and Collection.** – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

6. Respondent disagrees. An exception to the aforementioned rule is when both the taxpayer and the Commissioner have agreed in writing to extend the time for assessment, Section 222 states:

> **SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes.** –
>
> -xxx-
>
> **(b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the**

> **Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agree upon.**
>
> The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agree upon. **(Emphasis supplied).**

7. As here, petitioner voluntarily executed two (2) waivers of the defense of prescription to extend the period of assessment which were accepted by OIC-Assistant Commissioner Alfredo V. Misajon on 13 March 2012 and 12 February 2013, respectively.

8. Accordingly, petitioner's contention that the Final Assessment Notice was issued beyond the three (3) year prescriptive period of assessment deserves no consideration.

9. Petitioner, after belaboring on the expiration of the period of assessment, contended that the waivers are invalid and accordingly did not extend the period to assess because: (1) the date of execution of the first waiver was not indicated; and (2) the signatory of the second waiver was not a responsible official of petitioner.

10. Again, petitioner is gravely mistaken.

11. The first waiver clearly indicates 16 February 2012 as the date of execution of petitioner's President, Angelo Joe L. Ang. Additionally, the notary public who notarized the waiver clearly indicated that the document was executed on 16 February 2012, to wit:

> In the City of Mkna., on this 16th day of Feb. 2012 **personally appeared before me Angelo Joe L. Ang**, with SSS I.D # 03-2529383-5 issued at -- on – in his/her capacity as President of the Corporation known to be and to be the

> same person **who executed the foregoing waiver for and in behalf of the said taxpayer,** and he/she acknowledged to me that the same is the voluntary act and deed of Angelo Joe L. Ang, and that he/she is duly authorized to sign the same. **(Emphasis supplied)**.

12. Thus, petitioner cannot now argue that the date of execution was 'not indicated' in the first waiver just to persuade this Honorable Court that the period to assess has prescribed.

13. As to the second waiver, petitioner insists that its Treasurer, William Wong, was not authorized to sign the waiver in its behalf.

14. Respondent disagrees. An authority to sign the waiver is not needed when the waiver is signed by a responsible official of the Corporation. Revenue Memorandum Order No. 20-1990 states:

> The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon. This written agreement between the Commissioner and the taxpayer is the so-called Waiver of the Statute of Limitations. In the execution of said waiver, the following procedures should be followed:
>
> -xxx-
>
> 2. The waiver shall be signed by the taxpayer himself or his duly authorized representative. **In the case of a corporation, the waiver must be signed by any of its responsible officials.** In case the authority is delegated by the taxpayer to a representative, such delegation should be in writing and duly notarized. **(Emphasis supplied).**

15. Therefore, based on the above-mentioned provision, a responsible official can sign the waiver without a Board Resolution.

16. In the case at hand, William Wong has clearly demonstrated that he is a responsible official of petitioner. In fact, he has consistently signed the Statement of Management's Responsibility in petitioner's Financial Statements and Income Tax Returns, together with Angelo Joe L. Ang.

17. Accordingly, William Wong, from his acts – without objection from the Board of Directors, validly executed the waiver of the defense of prescription.

18. Petitioner's citation of the CIR vs Kudos Metal is clearly misplaced. In the said case, the Honorable Supreme Court invalidated the waiver since it was signed by an accountant of the Corporation- an officer. Clearly, this is not the case here. William Wong, being the treasurer, is an official of petitioner responsible for handling the finances of the Corporation including its dealings with the Bureau of Internal Revenue as clearly demonstrated by his signature in petitioner's Income Tax Returns.

19. Accordingly, petitioner cannot now assert that William Wong is not a responsible official for lack of a notarized written authority issued by the Board of Directors.

20. Moreover, to further bolster respondent's position that petitioner's Treasurer, William Wong, is indeed a responsible officer, respondent wishes to point out Section 253 (d) of the Tax Code – imposing criminal liabilities to responsible officials of the Corporation, to wit:

> **SEC. 253. General Provisions. –**
>
> (a) **Any person convicted of a crime penalized by this Code shall, in addition to being liable for the payment of the tax, be subject to the penalties imposed herein:** Provided, That payment of the tax

ND

> due after apprehension shall not constitute a valid defense in any prosecution for violation of any provision of this Code or in any action for the forfeiture of untaxed articles.
>
> -xxx-
>
> (d) **In the case of associations, partnerships or corporations, the penalty shall be imposed on the** partner, president, general manager, branch manager, **treasurer**, officer-in-charge, and the employees responsible for the violation.
>
> -xxx-
>
> **(Emphasis supplied).**

21. Therefore, the Final Assessment Notice was issued within the period prescribed by law to assess petitioner since there were valid agreement between petitioner and respondent, as evidenced by duly executed waivers of the defense of prescription, to extend the period of assessment.

22. Assuming for the sake of argument that the waivers were invalid, respondent maintains that a false and/or fraudulent return has been filed and accordingly, respondent has ten (10) years to assess petitioner.

23. Section 222 of the Tax Code states that when a false or fraudulent return is filed, the period to assess is ten (10) years from the discovery of the falsity, fraud or omission, specifically:

> **SEC. 222. Exceptions as to Period of Limitations of Assessment and Collection of Taxes.** –
>
> (a) In the case of a **false** or fraudulent **return** with intent to evade tax or of failure to file a return, **the tax may be assessed**, or a proceeding in court for

> the collection of such tax may be filed without assessment, **at any time within ten (10) years after the discovery of the falsity, fraud or omission:** -xxx- **(Emphasis supplied)**.

24. In relation to the aforementioned provision, Revenue Regulations No. 18-2001 ('RR 18-2001') mandates the inclusion of certain information in the Final Adjustment Return and in the audited financial statements in cases of tax-free exchanges of property for shares under Section 40(C)(2) of the Tax Code, viz:

> **SECTION 8. Information to be Included in the Final Adjustment Return and in the Audited Financial Statements Accompanying the Final Adjustment Return; Records to be Maintained by Parties. —**
>
> (a) The transferor and the transferee or the surviving/consolidated corporation, as the case may be, as well as the shareholders of such surviving/ consolidated corporation (in case of a merger or consolidation) **shall enclose with their respective income tax returns for the taxable year in which the tax-free exchange occurred, a copy of the request for ruling filed with, and the corresponding certification/ruling issued by, the Bureau of Internal Revenue, both duly stamped received by the appropriate office of the Bureau of Internal Revenue.**
>
> (b) **Such persons shall likewise include as a note to their respective audited financial statements for the taxable year in which such exchange occurred a statement to the effect that they hold such assets/shares acquired in a tax-free exchange and the year in which such exchange**

> **occurred, and in the succeeding taxable years until the subject property/ies is/are subsequently transferred to another transferee.**
>
> (c) In addition to the foregoing, the parties to the transaction shall maintain permanent records of the transaction, consisting of, among others, the request for ruling, certification or ruling issued by the Bureau of Internal Revenue, the Deed of Assignment/Exchange, or the Articles of Merger, as the case may be, and such other documents as may be required to facilitate the determination of gain or loss from a subsequent disposition of the stocks/unit of participation/interest/properties received or transferred in the exchange. **(Emphasis supplied)**.

25. Tax-free exchange transactions partake of the nature of tax exemptions which are a derogation of the power of taxation of the State. Consequently, they are construed strictly against a taxpayer and liberally in favor of the state. As such, the taxpayer is charged with the heavy burden of proving that it has complied with and satisfied all the statutory and administrative requirements to be entitled thereto.

26. Therefore, a taxpayer cannot unilaterally assert that a transaction it entered into was a tax-free exchange. Compliance with RR-18-2001 is an indispensable requirement to such claim.

27. As here, a careful examination of petitioner's Income Tax Return and accompanying Financial Statements for the taxable year 2009 would show that petitioner did not attach the request for ruling filed with, and the corresponding certification/ruling issued by, the Bureau of Internal Revenue.

28. Accordingly, premised on the afore-quoted provisions of the Tax Code, petitioner's utter failure to comply, despite being aware of the mandatory provisions of RR 18-2001 constitutes an intentional

wrong-doing with the sole intent to evade the taxes due on the exchange transaction it entered into.

29. Therefore, petitioner having filed a false return, the period to assess petitioner for deficiency internal revenue tax has not yet prescribed. Consequently, respondent has ten (10) years from the discovery of such falsity to assess petitioner.

Petitioner is liable to pay deficiency Income Tax, VAT and DST.

Income Tax

30. Petitioner contended that the transaction it entered into is exempt from income tax since it is a tax-fee exchange pursuant to Section 40 (C)(2) of the Tax Code.

31. Respondent disagrees.

32. Tax free exchanges are governed by Section 40(C) paragraph 2 of the Tax Code. It states:

> **SECTION 40. Determination of Amount and Recognition of Gain or Loss. —**
>
> **(C) Exchange of Property. —**
>
> **(1) General Rule. —** Except as herein provided, upon the sale or exchange of property, the entire amount of the gain or loss, as the case may be, shall be recognized.
>
> **(2) Exception. —** No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation —
>
> -xxx-
>
> (a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a

M

corporation, which is a party to the merger or consolidation; or

xxx xxx xxx

33. Tax-free exchange transactions are tax exemptions. Thus, the taxpayer is charged with the heavy burden of proving that he has complied with and satisfied all the statutory and administrative requirements to be entitled thereto.

34. It must be remembered that any claim for exemption shall be allowed only when sufficient proof has been adduced to support the claim. Therefore, a taxpayer insisting on its tax exemption, contrary to the BIR's position, must pay the tax under protest and subsequently claim for a refund should it be proven that it is entitled to the exemption.

35. Accordingly, for an exchange transaction to come within the ambit of the definition of a tax free transaction, all the requisites provided by law must be present; and to confirm the exemption, a tax free exchange ruling must be secured.

36. The importance of which is that if the specific requirements of the law are not present in the transaction alleged to be a tax free exchange transaction, then, a different tax consequence will result therefrom.

37. As here, petitioner, not having secured the tax free exchange ruling, should have initially treated the transaction as taxable and reported it to the Bureau of Internal Revenue. Petitioner cannot unilaterally assume that the exchange transaction it entered into was not subject to tax.

38. Moreover, the exchange transaction petitioner entered into failed to meet the requirements that the transaction must be undertaken for a bona fide business purpose and not solely for the purpose of escaping the burden of taxation. Revenue Memorandum Ruling 1-2002 provides:

> To constitute a de facto merger, the following elements must concur: (1) there must be a transfer of all or substantially all of the properties of the transferor corporation solely for stock; and (2) **it must be undertaken for a bona fide business purpose and not solely for the purpose of escaping the burden of taxation. (Emphasis supplied).**

39. To determine whether a bona fide business purpose exists, each and every step of the transaction shall be considered and the transaction or series of transactions shall be treated as a single unit.

40. Further, the element of permanence and not mere momentary holding is an essential requirement so as to come within the ambit of the phrase 'substantially all the properties of another corporation.'

41. Revenue Memorandum Ruling 1-2002 further provides:

> One basic difference between a de facto merger and a statutory merger is that the Transferor is not automatically dissolved in the case of the former. Likewise, there is no automatic transfer to the Transferee of all the rights, privileges, and liabilities of the Transferor. It is, in fact, in procedure, similar to a transfer to a controlled corporation under the same Section 40(C)(2) of the Tax Code of 1997, **except that at least 80% of the Transferor's assets, including cash, are transferred to the Transferee, with the element of permanence and not merely momentary holding.** However, a de facto merger and a transfer to a controlled corporation are different in that, (1) the Transferor in a de facto merger is a corporation, while in a transfer to a controlled corporation,

ꟿ

> the Transferor may either be a Corporation or an individual, and (2) in a de facto merger, there is no requirement that the transferor gains control (that is, 51% of the total voting powers of all classes of stocks of the Transferee entitled to vote) of the Transferee as a prerequisite to enjoying the benefit of non-recognition of gain or loss. What is essential in a de facto merger is that the Transferee acquires all or substantially all of the properties of the Transferor. **(Emphasis supplied).**

42. Petitioner posited that the element of permanence and not mere momentary holding is not an element of a de facto merger. This is clearly misguided.

43. It bears stressing that the requirement of permanence and not mere momentary holding is proof that the exchange transaction is for a bona fide business purpose and not for the purpose of escaping the burden of taxation. Clearly, without the element of permanence it cannot be said that the transaction was a legitimate business transaction.

44. In the case at hand, petitioner effected the exchange transaction in October 2012. Immediately, however, it entered into a business combination in February 2013. Clearly, this cannot be considered as a bona fide business transaction; but rather a preliminary action on the part of petitioner to escape the burden of taxation.

45. Accordingly, respondent's assessment for deficiency Income Tax in the aggregate amount of ₱164,006,644.70 must stand.

Value-Added Tax

46. Petitioner argued that the exchange transaction was also exempt from Value Added Tax ("VAT") pursuant to Revenue Memorandum Ruling No. 1-2002.

47. Respondent reiterates that the exchange transaction petitioner entered into was not a tax free exchange for failure to meet the elements provided under Revenue Memorandum Circular 1-2002. Accordingly, the exchange transaction is subject to the twelve (12%) VAT.

48. While it is true that it is within the prerogative of management to enter into transaction it deems beneficial for the corporation, this prerogative must be exercised within the bounds of law.

49. As here, petitioner's actions indicated that the exchange transaction was only preliminary to the business combination it subsequently entered into.

50. Accordingly, respondent's assessment for deficiency VAT in the aggregate amount of ₱82,460,540.92 must be upheld.

Documentary Stamp Tax

51. Again, petitioner unilaterally concluded that the exchange transaction was exempt from tax and exempted from Documentary Stamp Tax ("DST").

52. At the risk of being repetitive, respondent manifests that the transaction failed to meet the elements of a tax free exchange transaction under Section 40(C)(2) of the Tax Code.

53. Thus, the transaction is subject to DST pursuant to Section 196 of the Tax Code, to wit:

> **SEC. 196. Stamp tax on Deeds of Sale and Conveyances of Real Property. –** On all conveyances, deeds, instruments, or writings, other than grants, patents or original certificates of adjudication issued by the Government, whereby any land, tenement, or other realty sold shall be granted, assigned, transferred or otherwise conveyed to the purchaser, or purchasers to any other person or persons designated by such purchaser or purchasers, there shall be

> collected a documentary stamp tax, at the rates herein below prescribed, based on the consideration contracted to be paid for such realty or on its fair market value determined in accordance with Section 6(E) of this Code, whichever is higher: Provided, That when one of the contracting parties is the Government the tax herein imposed shall be based on the actual consideration.
>
> (a) When the consideration, or value received or contracted to be paid for such realty after making proper allowance of any encumbrance, does not exceed One thousand pesos (P1,000) fifteen pesos (P15.00).
>
> (b) For each additional One thousand Pesos (P1,000), or fractional part thereof in excess of One thousand pesos (P1,000) of such consideration or value, Fifteen pesos (P15.00).
>
> When it appears that the amount of the documentary stamp tax payable hereunder has been reduced by an incorrect statement of the consideration in any conveyance, deed, instrument or writing subject to such tax the Commissioner, provincial or city Treasurer, or other revenue officer shall, from the assessment rolls or other reliable source of information, assess the property of its true market value and collect the proper tax thereon.

54. Accordingly, absent proof to the contrary, respondent's assessment of deficiency DST in the total amount of P12,004,327.72 must be held as valid."

M

On October 24, 2014, the Court ordered respondent to forward the BIR Records pertaining to the case.[21] In compliance thereto, respondent transmitted the said BIR Records on February 12, 2015.[22]

The Pre-Trial Conference was initially set on February 5, 2015.[23] However, in the Resolution dated January 30, 2015,[24] the Court re-scheduled the Pre-Trial Conference to April 23, 2015, in view of respondent's failure to immediately transmit the BIR Records.

On January 29, 2015, petitioner filed a *Motion To Defer Pre-Trial*.[25] However, on February 2, 2015, the Court issued an order stating that respondent's *Motion To Defer Pre-Trial* is considered moot in view of the aforementioned Resolution dated January 30, 2015.[26]

On February 13, 2015, respondent filed his *Manifestation/Compliance*, explaining that they have no intention to disregard the lawful order of the Court and that the BIR Records were needed for the preparation of the Judicial Affidavits of the witnesses they intend to present.[27]

Respondent filed his *Pre-Trial Brief* on April 10, 2015,[28] while petitioner filed its *Manifestation w/ Motion for Extension of Time to Submit the Judicial Affidavits of Witnesses,* attaching therewith his *Pre-trial Brief* on April 20, 2015.[29]

As directed by the Court during the pre-trial conference held on July 2, 2015,[30] the parties submitted their *Joint Stipulation of Facts and Issues* on July 24, 2015,[31] and the same was approved (except for petitioner's general reservation of the right to present, in the course of the trial, other relevant documents or objects not presently

---

[21] Order dated October 24, 2014, Docket, p. 234.
[22] Docket, p. 248.
[23] Notice of Pre-Trial Conference dated January 6, 2015, Docket, p. 235.
[24] Docket, p. 245.
[25] Docket, pp. 241 to 243.
[26] Docket, p. 246.
[27] Docket, pp. 249 to 251.
[28] Docket, pp. 265 to 268.
[29] Docket, pp. 283 to 292.
[30] Minutes of the hearing held on July 2, 2015, Docket, pp. 304 to 306.
[31] Docket, pp. 313 to 319.

available) in the Resolution dated August 18, 2015.[32] Thereafter, the Court issued its Pre-Trial Order on September 28, 2015.[33]

During trial, petitioner presented documentary and testimonial evidence. Petitioner presented the testimonies of its Accountant, Melody Grace O. Ngo,[34] and practicing Certified Public Accountant, Prudencio Tatunay,[35] who was offered as an expert in the field taxation. It offered Exhibits "P-1", "P-2", "P-3", "P-3-a", "P-3-b", "P-4", "P-5", "P-6", "P-7", "P-8", "P-9", "P-10", "P-11", "P-12", "P-13", "P-14", "P-15", "P-16", "P-17", "P-18", "P-19", "P-19-a", "P-20", "P-21", "P-22", and "P-22-1",[36] which were later admitted by the Court in the Resolution dated January 22, 2016.[37]

For his part, respondent presented the testimonies of Revenue Officers Denver M. Gomez[38] and Flor Jasmin Soriano[39] of the Excise Large Taxpayer Audit Division of the BIR. Respondent formally offered Exhibits "R-1", "R-2", "R-3", "R-4", "R-5", "R-6", "R-7", "R-8", "R-9", "R-10", "R-11", "R-11-b", "R-11-c", "R-11-d", "R-12", "R-12-a", "R-13", and "R-13-a", which were admitted in the Resolution dated May 25, 2016.[40]

In the Resolution dated August 30, 2016,[41] this case was submitted for decision taking into consideration petitioner's *Memorandum For The Petitioner* filed on August 9, 2016[42] and respondent's *Memorandum (For Respondent)* filed on July 25, 2016.[43]

Hence, this Decision.

---

[32] Docket, pp. 502 to 503.
[33] Docket, pp. 519 to 528.
[34] Judicial Affidavit of Melody Grace O. Ngo, Exhibits "P-19" and "P-19-1", Docket, pp. 332 to 344.
[35] Judicial Affidavit of Prudencio F. Tatunay, Exhibits "P-22" and "P-22-1", Docket, pp. 544 to 557.
[36] Formal Offer of Evidence For The Petitioner, Docket, pp. 571 to 579.
[37] Docket, pp. 725 to 726
[38] Judicial Affidavit of Revenue Officer Denver M. Gomez, Exhibits "R-12" and "R-12-a", Docket, pp. 274 to 280.
[39] Judicial Affidavit of Revenue Officer Flor Jasmin R. Soriano, Exhibits "R-13" and "R-13-a", Docket, pp. 259 to 264.
[40] Docket, pp. 762 to 763.
[41] Docket, p. 838.
[42] Docket, p. 809 to 836.
[43] Docket, p. 787 to 801.

MD

THE ISSUE

The parties presented the following issue[44] for this Court's resolution, to wit:

> "Whether the Petitioner is liable to pay deficiency Income Tax, VAT and DST assessment for taxable year 2009 in the amount of P258,471,513.34 inclusive of surcharges and interests."

Petitioner's arguments:

Petitioner contends that the deficiency assessments dated December 5, 2013 were issued in total and wanton disregard of the relevant provisions of the NIRC of 1997, as amended. Petitioner argues that the *Final Assessment Notices* (FAN) were issued outside the period prescribed by law.

Petitioner likewise claims that the first and second waivers are defective and invalid, therefore the assessment which arose therefrom should likewise be considered null and void.

According to petitioner, the first waiver failed to indicate the date of execution which is vital in the validity of the waiver.

As regards the second waiver, petitioner claims that the same was executed by its treasurer, William Wong, whose authority to sign for and on behalf of petitioner was not clearly shown. Allegedly as a treasurer, though he may be considered an official of a corporation, his duties do not in any way involve the execution of waiver. Petitioner also emphasizes that the second waiver was executed after the expiration of the period of assessment. As such, it could not have tolled the running of the prescriptive period.

Further, petitioner vehemently denies and disputes the deficiency assessments and categorically states that it is not liable to pay deficiency income tax, VAT, and DST assessments issued against it. Petitioner submits that the subject assessment arose purely from the transfer of petitioner's assets to FTC pursuant to the *Plan of De Facto Merger*. Considering the tax-free nature of a *de*

---

[44] JSFI, Docket, p. 314.

M

facto merger, petitioner contends that the deficiency assessments for income tax, VAT and DST are without factual and legal bases.

According to petitioner, in order to be liable for income tax, the gain must be realized or received, actually or constructively. In this case, petitioner maintains that it did not receive, whether actually or constructively any income from the transfer. As such, the BIR erred in claiming that it is liable for the payment of income tax.

Petitioner further alleges that the *de facto* merger is exempt from the payment of income tax because the gain, if any, is not recognized for tax purposes. In this case, petitioner claims that the subject transaction falls within the purview of tax-free exchange which is not subject to the payment of taxes because the *de facto* merger possess all the essential requirements necessary to validly warrant the exemption of the petitioner from the payment of tax liabilities.

As to respondent's allegation that the merger failed to meet the *"element of permanence and not merely momentary holding"*, petitioner contends that this has no basis in law and in fact. According to petitioner, *"the element of permanence and not merely momentary holding"* is not one of the requirements stated by the law. Assuming without conceding that *the "element of permanence and not merely momentary holding"* is an essential element of a *de facto* merger, it submits that the subject merger met the said requirement. Contrary to the claim of respondent, the business combination did not result to the transfer of all FTC's assets to the new entity as it is very clear that only selected assets of the parties are subject of the transfer.

Petitioner also stresses that the transfer of assets as a result of the *de facto* merger does not involve a taxable transaction for VAT purposes since it is neither a sale, barter, exchange of goods and services contemplated under tax laws.

As to the DST assessment, petitioner claims that transfer of assets under a tax-free exchange is not subject to DST.

Petitioner likewise points out that the *de facto* merger, which is the subject of assessment, pertains to taxable year 2009, while the business combination or the transfer of assets to PMFTC, Inc. occurred in 2010. Considering that the assessment for 2009 is separate and distinct from the transaction that happened in 2010, petitioner insists that respondent should not have taken the same against the 2009 assessment because the business combination transpired after the close of the taxable year 2009.

Respondent's counter-arguments:

Respondent counter-argues that the period to assess petitioner has not prescribed. He maintains that the FAN was issued within the period prescribed by law to assess petitioner since there were valid agreements between petitioner and respondent to extend the period of assessment; and that petitioner voluntarily executed two (2) waivers of the defense of prescription.

Contrary to the allegation of petitioner, the first waiver clearly indicates the date when it was executed because the notary public who notarized the waiver clearly indicated that the document was executed on February 16, 2012. On the second waiver, respondent stresses that an authority to sign the waiver is not needed when the waiver is signed by a responsible official of the corporation; and that petitioner's treasurer, William Wong, has clearly demonstrated that he is a responsible official of petitioner.

Assuming for the sake of argument that the waivers were invalid, respondent maintains that a false and/or fraudulent return has been filed and accordingly, respondent has ten (10) years to assess petitioner.

As regards the subject exchange transaction, respondent insists that it is not a tax-free exchange transaction. Hence, petitioner is allegedly liable to pay deficiency income tax, VAT and DST. Moreover, considering that tax-free exchange transactions partake the nature of tax exemptions which are a derogation of the power of taxation of the State, they are allegedly construed strictly against the taxpayer and liberally in favor of the State.

According to respondent, for an exchange transaction to come within the ambit of the definition of a tax-free transaction, all the requisites provided by law must be present.

In this case, respondent claims that the exchange transaction entered into by petitioner failed to meet the requirement that the transaction must be undertaken for a *bona fide* business purpose and not solely for the purpose of escaping the burden of taxation. Particularly, respondent points out that the element of permanence and not merely momentary holding must be present in order to prove that the exchange transaction is for a *bona fide* business purpose.

Respondent likewise submits that a tax-free exchange ruling must be secured to confirm the exemption. Not having secured the tax-free exchange ruling, petitioner should have initially treated the transaction as taxable and reported it to the BIR.

THE COURT'S RULING

The instant *Petition for Review* is meritorious.

Before We address the issue raised in the instant petition, it is material to first look into the validity of the subject tax assessments.

An assessment "refers to the determination of amounts due from a person obligated to make payments."[45] In the context in which it is used in the NIRC, an assessment is a written notice and demand made by the BIR on the taxpayer for the settlement of **a due tax liability that is there <u>definitely set and fixed</u>**.[46] Furthermore, an assessment contains not only a computation of tax liabilities, **but also a demand for payment <u>within a prescribed period</u>**.[47]

The tax assessments under the NIRC of 1997 is prescribed to be embodied in a *Formal Letter of Demand* and *Assessment Notice*, in accordance with Section 3.1.4 Revenue Regulations No. 12-99, to wit:

> "3.1.4 *Formal Letter of Demand and Assessment Notice.* — **The <u>formal letter of demand and assessment notice</u> 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

---

[45] *SMI-ED Phil. Technology, Inc. vs. Commissioner of Internal Revenue*, G.R. No. 175410, November 12, 2014.

[46] *Adamson, et al. vs. Court of Appeals, et al.*, G.R. Nos. 120935 and 124557, May 21, 2009.

[47] *Commissioner of Internal Revenue vs. Pascor Realty and Development Corp., et al.*, G.R. No. 128315, June 29, 1999.

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. xxx." *(Emphasis and underscoring supplied)*

In this case, the contents of the undated *Formal Letter of Demand*[48] issued by respondent against petitioner are as follows:

"FORMAL LETTER OF DEMAND

NORTHERN TOBACCO REDRYING CO., INC.
No. 24 Fortune Ave., Brgy. Fortune, Marikina City
T.I.N.: 000-133-300

Gentlemen:

Please be informed that after verification there has been found due from you deficiency income tax, value added tax and documentary stamp tax for calendar year 2009, as shown hereunder:

INCOME TAX
Assessment No. ELTAD II-09-IT-0007

Gain on Transfer of Assets (De Facto Merger)					316,732,409.07
Deficiency Income Tax					95,019,722.72
Add: Interest					
20% p.a.	4/15/10	11/30/13	1325	72.60%	68,986,921.98
TOTAL AMOUNT DUE					164,006,644.70
			9,599.00		

VALUE-ADDED TAX
Assessment No. ELTAD II-09-VT-0001

Transfer of PPE on Plan of De Facto Merger					388,262,350.85
Deficiency VAT					46,591,482.10
Add: Interest					
20% p.a.	1/25/10	11/30/13	1405	76.99%	35,869,058.82
TOTAL AMOUNT DUE					82,460,540.92

DOCUMENTARY STAMP TAX
Assessment No. ELTAD II-09-DS-0003

Deed of Sale and Conveyance of Real Property De Facto Merger	387,690,368.26

---

[48] Exhibits "P-1", and "P-2", Docket, pp. 580 to 583; Exhibit "R-11", BIR Records, pp. 928 to 933.

Tax Rate					1.5/100
Deficiency DST					5,815,355.52
Add: Increments					
Surcharge 25%					1,453,838.88
Interest 20% p.a.	11/5/09	11/30/13	1486	81.42%	4,735,133.32
Total Increments					6,188,972.20
TOTAL AMOUNT DUE					12,004,327.72

Please note that the interest and the total amount due will have to be adjusted if paid beyond November 30, 2013.

The complete details covering the aforementioned discrepancies established during the verification are shown in the accompanying SCHEDULE 1 of this letter of demand.

The 25% Surcharge has been imposed pursuant to the provisions of Section 248(A) of the National Internal Revenue Code as amended by R.A. 8424, which took effect on January 1, 1998, in view of the failure to file any return and pay the tax due thereon.

The 20% interest per annum has been imposed pursuant to the provision of Section 249(B) of the National Internal Revenue Code.

In view thereof, you are requested to pay your aforesaid deficiency income tax, value added tax and documentary stamp tax through the duly authorized agent bank in which you are enrolled, within the time shown in this assessment notice.

Very truly yours,

(Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue"
(Emphases and underscoring supplied)

A careful reading of the foregoing would reveal that it did not definitely set and fixed the due tax liability of petitioner. While it may be true that this undated *Formal Letter of Demand* presents computations of the supposed tax liabilities of petitioner, respectively, it is clear that the interest and total amount due may be still subject to modification if payment thereof is made beyond November 30, 2013. Thus, the said undated *Formal Letter of Demand* hardly falls under the jurisprudential definition of a tax assessment under the NIRC, since it lacks *"a due tax liability that is there definitely set and fixed."*

Furthermore, the said undated *Formal Letter of Demand* does not contain any due date(s) for the payment of the assessed taxes.

In other words, the same request or demand for payment of the supposed tax liabilities of petitioner does not provide a specific date or prescribed period within which to pay the same. And while it points to the "assessment notice" as will show the time for the payment of the said tax liabilities, this Court finds no due date(s) in the corresponding Audit Result/Assessment Notices Nos. ELTAD II-09-IT-0007, ELTAD II-09-VT-0001, ELTAD II-09-DS-0003, all dated December 5, 2013,[49] for the payment thereof. Specifically, the respective spaces in these *Assessment Notices* where the due dates are to be stated remains unaccomplished or blank.

In *Commissioner of Internal Revenue vs. Fitness By Design, Inc.*,[50] the Supreme Court said:

> "...**the Final Assessment Notice is not valid if it does not contain a definite due date for payment by the taxpayer.**
>
> xxx xxx xxx
>
> **The issuance of a valid formal assessment is a substantive prerequisite for collection of taxes.** Neither the National Internal Revenue Code nor the revenue regulations provide for a 'specific definition or form of an assessment.' However, the National Internal Revenue Code defines its explicit functions and effects. **An assessment does not only include a computation of tax liabilities; it also includes a demand for payment within a period prescribed. Its main purpose is to determine the amount that a taxpayer is liable to pay.**
>
> xxx xxx xxx
>
> A final assessment is a notice 'to the effect that the amount therein stated is due as tax and a demand for payment thereof.' This demand for payment signals the time 'when the penalties and interests begin to accrue against the taxpayer and enabling the latter to determine his remedies[.]' Thus, it must be 'sent to and received by the taxpayer, and **must demand payment of the taxes described therein within a specific period**.'

---

[49] Exhibits "P-3", "P-3-a", and "P-3-b", Docket, pp. 584 to 586; Exhibits "R-11-b", "R-11-c", and "R-11-d", BIR Records, pp. 925 to 927.
[50] G.R. No. 215957, November 9, 2016.

M

The disputed Final Assessment Notice is not a valid assessment.

<u>First</u>, it lacks the definite amount of tax liability for which respondent is accountable. It does not purport to be a demand for payment of tax due, which a final assessment notice should supposedly be. An assessment, in the context of the National Internal Revenue Code, is a 'written notice and demand made by the [Bureau of Internal Revenue] on the taxpayer for the settlement of a due tax liability that is there definitely set and fixed.' Although the disputed notice provides for the computations of respondent's tax liability, the amount remains indefinite. It only provides that the tax due is still subject to modification, depending on the date of payment. Thus:

> The complete details covering the aforementioned discrepancies established during the investigation of this case are shown in the accompanying Annex 1 of this Notice. The 50% surcharge and 20% interest have been imposed pursuant to Sections 248 and 249 (B) of the [National Internal Revenue Code], as amended. Please note, *however, that the interest and the total amount due will have to be adjusted if prior or beyond April 15, 2004.* (Emphasis Supplied)

<u>Second</u>, there are no due dates in the Final Assessment Notice. This negates petitioner's demand for payment. Petitioner's contention that April 15, 2004 should be regarded as the actual due date cannot be accepted. The last paragraph of the Final Assessment Notice states that the due dates for payment were supposedly reflected in the attached assessment:

> In view thereof, you are *requested to pay* your aforesaid deficiency internal revenue tax liabilities through the duly authorized agent bank in which you are enrolled *within the time shown in the enclosed assessment notice*. (Emphasis in the original)

However, based on the findings of the Court of Tax Appeals First Division, **the enclosed assessment pertained to remained unaccomplished**.

Contrary to petitioner's view, April 15, 2004 was the reckoning date of accrual of penalties and surcharges and

> not the due date for payment of tax liabilities. **The total amount depended upon when respondent decides to pay. The notice, therefore, did not contain a definite and actual demand to pay.**
>
> Compliance with Section 228 of the National Internal Revenue Code is a substantive requirement. It is not a mere formality. Providing the taxpayer with the factual and legal bases for the assessment is crucial before proceeding with tax collection. **Tax collection should be premised on a valid assessment**, which would allow the taxpayer to present his or her case and produce evidence for substantiation." *(Emphases and underscoring supplied)*

Correspondingly, the inevitable conclusion is that the subject tax assessments are void, and thus, bear no valid fruit.[51]

In view of the finding that the subject tax assessments are invalid, it becomes unnecessary for this Court to address the arguments raised by the parties.

WHEREFORE, in light of the foregoing considerations, the instant *Petition for Review* is hereby **GRANTED**. Accordingly, the subject assessments for income tax, VAT and DST issued by respondent against petitioner for taxable year 2009 are **CANCELLED** and **SET ASIDE**.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

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

---

[51] Refer to *Commissioner of Internal Revenue vs. Reyes*, G.R. Nos. 159694 and 163581, January 27, 2006.

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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
Chairperson
Presiding Justice