REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL THIRD DIVISION

MISSOURI SQUARE, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8688

Members:

FABON-VICTORINO, *Acting Chairperson and*
RINGPIS-LIBAN, *JJ.*

Promulgated:
MAR 2 6 2019
4:10 p.m.

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D E C I S I O N

***Fabon-Victorino, J.*:**

In this Petition for Review[1], filed on August 8, 2013, petitioner Missouri Square, Inc. prays for the cancellation of the assessment issued against it by respondent Commissioner of Internal Revenue (CIR) for alleged deficiency income tax (IT) in the amount of ₱990,393.22, inclusive of increments, for calendar year (CY) 2007.

The facts, as culled from the record, are as follows:

Petitioner Missouri Square, Inc. is a domestic corporation, with office address at No. 101 Connecticut St., Northeast Greenhills, San Juan City.[2]

Respondent, on the other hand, is the Commissioner of the Bureau of Internal Revenue (BIR) with legal authority to decide disputed assessments, refunds of internal revenue

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[1]Docket, pp. 6-17.
[2] Par. b, Joint Stipulation of Facts, Joint Stipulation of Facts and Issues (JSFI), docket, p. 374.

taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On April 24, 2009, respondent, through Revenue District Officer (RDO) Isidro T. Casals, Jr., issued Tax Verification Notice (TVN) 2003 00128699[3], authorizing Revenue Officer (RO) Rodrigo Calar, Jr. and Group Supervisor Hipolito P. Ison to verify supporting documents and/or pertinent records for the examination of petitioner's internal revenue taxes for calendar year (CY) 2007.

On April 28, 2009, petitioner received the First Request for Presentation of Records[4] for examination of certain documents in relation to its internal revenue taxes for CY 2007.

On April 16, 2010, respondent issued a Revalidation Notice[5] for TVN 2003 00128699 on the ground that the report of investigation could not be rendered within the prescribed period.

On June 1, 2011, petitioner received the Preliminary Assessment Notice (PAN) with Details of Discrepancies[6] dated May 27, 2011, assessing it for alleged deficiency IT in the amount of ₱3,141,927.98 for CY 2007.

Petitioner protested the PAN on June 6, 2011.

On July 4, 2011, petitioner received the Formal Letter of Demand/Final Assessment Notice (FLD/FAN) with Details of Discrepancies[7] dated June 30, 2011 finding it liable for alleged deficiency IT in the amount of ₱3,206,655.31 for CY 2007.

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[3] Exhibit "R-1", BIR Records, p. 62.
[4] Exhibit "R-2", BIR Records, p. 61.
[5] Exhibit "R-4", BIR Records, p. 316.
[6] Exhibit "R-8", Attached to Exhibit "R-9", BIR Records, pp. 346-347.
[7] Exhibits "R-10" and "R-11", BIR Records, pp. 376-378.

On July 7, 2011, petitioner filed a Letter-Protest[8] dated July 6, 2011 against the FLD/FAN.

On July 11, 2013, petitioner received the Final Decision on Disputed Assessment (FDDA) with Details of Discrepancies[9], holding it liable for deficiency IT in the amount of ₱990,393.22, inclusive of statutory increments, for CY 2007.

Hence, petitioner elevated its case before the Court in Division *via* the instant Petition for Review filed on August 8, 2013.

In his Answer[10], respondent countered that the assessment has become final, executory and demandable due to petitioner's failure to submit relevant documents in support of its request for reconsideration, citing the Supreme Court's pronouncement in *Metropolitan Bank and Trust Company vs. Commissioner of Internal Revenue* as his authority.

He explained that verification of the documents submitted by petitioner revealed the following: (a) a comparison between sources of input tax credits per financial statements and per return revealed discrepancies which could be construed as unaccounted source of cash leading to the conclusion that there was undeclared source of income subject to tax; (b) certain payments per audit were not supported with sufficient documentary evidence, hence, disallowed as part of cost pursuant to Section 34(A)(1)(b) of the NIRC of 1997, as amended; (c) income payments to professionals and rental payments were not fully reported in the financial statements leading to the conclusion that there were unaccounted source of cash/income that had not been declared; and (d) petitioner failed to subject certain income payments to expanded withholding taxes (EWT) as required under Revenue

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[8]Exhibit "P-3", docket, pp. 260-261.
[9]Exhibit "P-4", docket, pp. 48-50.
[10] Docket, pp. 172-175.

Regulations (RR) No. 2-98, thus, disallowed as deductions from gross income pursuant to Section 34(K) of the NIRC of 1997, as amended.

After the pre-trial conference, the parties filed their Joint Stipulation of Facts and Issues[11] on the basis of which a Pre-Trial Order[12] was issued on October 15, 2014.

During the trial, petitioner presented its Accountant Myliene S. Breis and the Court-commissioned Independent Certified Public Accountant (ICPA) Attorney Conrado M. Briones, to prove the material allegations in its petition.

Myliene S. Breis testified[13] that as petitioner's accountant and book keeper, she represents petitioner in dealing with the BIR concerning any deficiency tax assessments.

In May 2011, petitioner received from respondent a PAN dated May 27, 2011, assessing it for alleged deficiency IT in the amount of ₱3,141,927.98 for CY 2007. Petitioner disputed the said assessment by way of a letter-protest filed on June 6, 2011. However, respondent maintained his assessment against petitioner in the Formal Letter of Demand with attached Assessment Notice (FLD/FAN) dated June 30, 2011, received on July 4, 2011.

This prompted petitioner to refer the FLD/FAN to its counsel, who protested the same on July 7, 2011.

On July 11, 2013, petitioner received the FDDA holding petitioner liable for alleged deficiency IT in the amount of ₱990,393.22, inclusive of interests and penalties, for CY 2007. The deficiency IT for CY 2007 was allegedly based on the following alleged unaccounted purchases and/or unsupported expenses:

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[11] Docket, vol. 1, pp. 374-380.
[12] Docket, vol. 1, pp. 394-402.
[13] Exhibit "P-15", docket, pp. 239-257.

Unaccounted Purchases	₱841,595.65
Unsupported Expenses	5,325.00
Unaccounted Income Payments - Professional fees	27,900.56
Unaccounted Income Payments - Rental fees	16,874.00
Income Payment not subjected to Withholding Tax	482,857.17
TOTAL	**₱1,374,552.38**

Witness Breis further testified that while petitioner agreed to pay the assessment on the alleged unsupported expenses in the amount of ₱5,325.00, it rejected the assessment for unaccounted professional fees of ₱27,900.56 for lack of basis. The witness also found erroneous the contention in the FDDA that the unaccounted purchases were a result of the comparison of petitioner's alleged sources of input tax credits per Audited Financial Statements (AFS) for CY 2007 and per returns filed for CY 2007 as not all items listed in respondent's sources of input tax as shown in the Details of Discrepancies of the FDDA were subject to VAT such as the MERALCO Billing where only a portion thereof was subject to VAT.

She further declared that the alleged unaccounted rental expense was capitalized and recorded as part of "additions" of petitioner's building improvements. Thus, contrary to respondent's finding, it was duly reflected in petitioner's AFS for CY 2007 as part of its Building Improvements account. Further, the withholding tax due thereon was duly withheld and remitted to the BIR.

On the alleged income payments not subjected to withholding tax, the witness explained that the discrepancy was attributable to purchases from suppliers who were not among the top 10,000 private corporations. That being the case, petitioner was not bound to withhold the one percent (1%) withholding tax.

ICPA-Lawyer Conrado M. Briones, who executed a Judicial Affidavit[14] for the presentation of his ICPA Report declared that his examination and verification of petitioner's

[14] Exhibit "P-45", docket, pp. 488-505.

documents revealed that: (1) out of the ₱841,595.65 unaccounted purchases found by the BIR, the amount of ₱768,458.28 should be reversed and set aside; (2) the unaccounted rental payments amounting to ₱16,874.95 was indeed part of Building Improvements presented as part of Property and Equipment in petitioner's 2007 AFS and the corresponding taxes were properly withheld; and (3) out of the ₱482,857.17 alleged income payments not subjected to withholding tax, the amount of ₱394,597.01 should be reversed and set aside.

On June 15, 2015, petitioner rested its case and formally offered its documentary evidence[15] which per Resolution[16] dated September 29, 2015 were admitted except Exhibit P-9, P-9-a, P-10, and P-10-a.

For his part, respondent presented Revenue Officer (RO) Rodrigo Calar, Jr., whose testimony on direct examination was however stricken off the record due to his repeated failure to appear for his cross-examination by petitioner's counsel.

In view of the said development, respondent presented the Group's Supervisor of the investigating team, **Hipolito P. Ison**, who testified that the instant case was assigned to RO Rodrigo Calar, Jr. for the examination and verification of petitioner's accounting and other business records for CY 2007 by virtue of a Tax Verification Notice (TVN) No. 2003-00128699 dated April 24, 2009.

After the assignment, a First Notice for presentation of records was sent to petitioner on April 28, 2009. However, due to petitioner's non-submission of tax/accounting records, they were not able to conclude and render a report within the prescribed period. Hence, a Revalidation Notice dated April 16, 2010 was issued and served to petitioner informing the latter of their authority to continue the audit investigation, which they did.

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[15] Docket, pp. 566-581.
[16] Docket, pp. 1093-1094.

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After the investigation, RO Calar, Jr. prepared a Memorandum recommending the issuance of PAN to petitioner as the result of the investigation revealed that it was liable for deficiency IT in the amount of ₱3,077,200.66.

The PAN with attached Details of Discrepancies was issued followed by the FAN/FLD, which petitioner received on July 4, 2011 and protested on July 7, 2011.

After considering petitioner's protest to the FAN/FLD, respondent, through OIC-Revenue District Officer Ma. Nimfa P. De Villa, issued the FDDA with Details of Discrepancies, holding that petitioner failed to refute the validity of respondent's findings that petitioner had deficiency IT in the amount of ₱990,393.22, inclusive of statutory increments for CY 2007.

The ICPA capped his testimony saying that the FDDA with Details of Discrepancies was served and received by petitioner on July 7, 2013.

On January 31, 2018, respondent rested his case with the admission of all his documentary exhibits.[17]

On April 11, 2018, the instant case was deemed submitted for decision with petitioner's filing of its Memorandum[18] on March 9, 2018 and per Records Verification Report dated April 4, 2018, stating that respondent failed to file his memorandum within the period granted.

THE ISSUE

The lone issue submitted by the parties for the determination of the Court is as follows:

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[17] Resolution, docket, pp. 1210-1211.
[18] Docket, vol. 3, pp. 1213-1229.

WHETHER PETITIONER IS LIABLE FOR DEFICIENCY INCOME TAX FOR TAXABLE YEAR ENDING 31 DECEMBER 2007.

THE COURT'S RULING

As in other assessment cases, the timeliness of the filing of the instant Petition for Review is very significant for the Court to acquire the legal competence to hear and determine the same.

Section 228[19] of the National Internal Revenue Code (NIRC) of 1997, as amended, provides that a taxpayer adversely affected by the decision of the Commissioner of Internal Revenue (CIR) may appeal to the Court of Tax Appeals (CTA) within thirty (30) days from receipt of the said decision; otherwise, the same shall become final, executory and demandable.

It is undisputed that on July 11, 2013, petitioner received respondent's FDDA with attached Details of Discrepancies, finding it liable for alleged deficiency IT for CY 2007. Thus, petitioner had thirty (30) days from such receipt, or until August 12, 2013[20], within which to appeal respondent's adverse decision. Evidently, the instant

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[19]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.

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

[20] August 10, 2013 fell on a Saturday.

Petition for Review was seasonably filed on August 8, 2013 bestowing the Court with the authority to take cognizance of the same pursuant to Section 7(a)(1) of Republic Act (RA) No. 1125, as amended by RA No. 9282.[21]

On the merits of the case, a thorough review of the record reveals that no Letter of Authority (LOA) was issued authorizing the investigating RO Rodrigo Calar, Jr. to conduct of examination or audit of petitioner's books of accounts and other accounting records for all its internal revenue taxes for CY 2007. This issue was however not raised by any of the parties during the trial or in any of their pleadings filed with the Court. On this regard, Section 1 of Rule 14 of the Revised Rules of the Court of Tax Appeal (RRCTA) provides:

> SECTION 1. *Rendition of judgment.* - The Court shall decide the cases brought before it in accordance with Section 15, paragraph (1), Article VIII of the 1987 Constitution. xxx.
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> In deciding the case, the **Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case**. (*Emphasis supplied*)

The Supreme Court best explained the essence of the provision in the case of *Commissioner of Internal Revenue v. Lancaster Philippines, Inc.*[22](*Lancaster* case), as follows:

> On whether the CTA can resolve an issue which was not raised by the parties, **we rule in the affirmative**.

[21]Sec. 7. *Jurisdiction.* - The CTA shall exercise:
(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:
(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; xxx.

[22] G.R. 183408, July 12, 2017.

> Under Section 1, Rule 14 of A.M. No. 05-11-07-CTA, or the Revised Rules of the Court of Tax Appeals, **the CTA is not bound by the issues specifically raised by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case**. The text of the provision reads:
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> > SECTION1. *Rendition of judgment.* - xxx
> >
> > In deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case.
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> The above section is clearly worded. On the basis thereof, the CTA Division was, therefore, well within its authority to consider in its decision the question on the scope of authority of the revenue officers who were named in the LOA even though the parties had not raised the same in their pleadings or memoranda. The CTA En Banc was likewise correct in sustaining the CTA Division's view concerning such matter. (*Emphases supplied*)

Clearly, the Court is not bound by the issues specifically raised by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case.

The assessment issued by respondent in this case is a nullity because there was no valid grant of authority.

It must be emphasized that before any revenue officer may conduct an examination or assessment, there must first be a valid grant of authority to do the same.

Section 6(A) of the National Internal Revenue Code of 1997, as amended, clothe respondent with the power to authorize the examination of any taxpayer and the assessment of the correct amount of tax due, to wit:

> SEC. 6. *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.* -
>
> (A) *Examination of Returns and Determination of Tax Due.* -After a return has been filed as required under the provisions of this Code, **the Commissioner or his duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax**: *Provided, however,* That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer." (*Emphasis supplied*)

Corollarily, Section 13 of the NIRC of 1997, as amended, provides that a Letter of Authority is the authority given to the appropriate revenue officer assigned to perform assessment functions, to wit:

> SEC. 13. *Authority of a Revenue Officer.* - Subject to the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, **a Revenue Officer assigned to perform assessment functions in any district may, pursuant to a Letter of Authority issued by the Revenue Regional Director, examine taxpayers within the jurisdiction of the district in order to collect the correct amount of tax, or to recommend the assessment of any deficiency tax due** in the same manner that the said acts could have been performed by the Revenue

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> Regional Director himself. (*Emphasis supplied*)

In the case of *Commissioner of Internal Revenue vs. Sony Philippines, Inc.*,[23] the Supreme Court held:

> Based on Section 13 of the Tax Code, a Letter of Authority or LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. It empowers or enables said revenue officer to examine the books of account and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax. The very provision of the Tax Code that the CIR relies on is unequivocal with regard to its power to grant authority to examine and assess a taxpayer.
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> xxx xxx xxx
>
> **Clearly, there must be a grant of authority before any revenue officer can conduct an examination or assessment. Equally important is that the revenue officer so authorized must not go beyond the authority given. In the absence of such an authority, the assessment or examination is a nullity**. (*Boldfacing supplied*)

The above pronouncement was echoed in the more recent case of *Medicard Philippines, Inc. vs. Commissioner of Internal Revenue,*[24] where the Supreme Court elucidated the importance of the issuance of LOA and that the absence thereof violates the taxpayer's right to due process, as follows:

> ***The absence of an LOA violated MEDICARD's right to due process***

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[23] G.R. No. 178697, November 17, 2010.
[24] G.R. No. 222743, April 5, 2017.

An LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. It empowers or enables said revenue officer to examine the books of account and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax. **An LOA is premised on the fact that the examination of a taxpayer who has already filed his tax returns is a power that statutorily belongs only to the CIR himself or his duly authorized representatives**. Section 6 of the NIRC clearly provides as follows:

xxx xxx xxx

Based on the afore-quoted provision, it is clear that unless authorized by the CIR himself or by his duly authorized representative, through an LOA, an examination of the taxpayer cannot ordinarily be undertaken. The circumstances contemplated under Section 6 where the taxpayer may be assessed through best-evidence obtainable, inventory-taking, or surveillance among others has nothing to do with the LOA. These are simply methods of examining the taxpayer in order to arrive at the correct amount of taxes. **Hence, unless undertaken by the CIR himself or his duly authorized representatives, other tax agents may not validly conduct any of these kinds of examinations without prior authority.**

xxx xxx xxx

In this case, there is no dispute that no LOA was issued prior to the issuance of a PAN and FAN against MEDICARD. Therefore, no LOA was also served on MEDICARD. The LN that was issued earlier was also not converted into an LOA

> contrary to the above quoted provision. Surprisingly, the CIR did not even dispute the applicability of the above provision of RMO 32-2005 in the present case which is clear and unequivocal on the necessity of an LOA for the assessment proceeding to be valid.
>
> xxx xxx xxx
>
> The Court cannot convert the LN into the LOA required under the law even if the same was issued by the CIR himself. *(Emphasis supplied)*

It is therefore plain that a revenue officer must be clothed with authority before proceeding with an examination or assessment of the taxpayer concerned. More importantly, the said authority must be embodied in a Letter of Authority and not in a mere notice to the taxpayer.

In the case at bar, the assessment and examination of petitioner's internal revenue taxes for TY 2007 was conducted by virtue of a Tax Verification Notice, and not by valid LOA. This was admitted by respondent's own witness RO Hipolito P. Ison,[25] as follows:

> "4. Q. You mentioned that you and revenue officer RedrigoCalar, Jr. were assigned to conduct the audit investigation of the books of accounts and accounting records of Missouri Square, Inc. for the year 2007, can you elaborate on that?
>
> A. **The case was assigned to us by Revenue District Officer Isidro T. Casals, Jr. <u>under Tax Verification Notice (TVN) #2003-00128699 dated 24 April 2009</u> authorizing RO Calar and myself to conduct the audit investigation.**

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[25]Exhibit "R-14", docket, vol. 3, p. 1162.

5. Q. I am showing to you a document denominated as Tax Verification Notice # 2003-00128669 dated 24 April 2009 marked as '**Exhibit R-1**', is this the document you are referring to?

   A. Yes, this the Tax Verification Notice (TVN) I was referring to.

6. Q. Are you authorized to perform the examination which you have just mentioned? And if you are, do you have proof of such authority?

   A. Yes, I am and yes, I have proof. **The said TVN authorizes me**." (*Emphases supplied*)

Considering that the revenue officers who conducted the examination of petitioner's books of account and other accounting records was not validly authorized to do so under a validly issued Letter of Authority, the subject tax assessment or examination issued against petitioner was void.

It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it. Hence, despite the natural reluctance to surrender part of one's hard-earned income to the taxing authorities, every person who is able to must contribute his share in the running of the government. The government for its part, is expected to respond in the form of tangible and intangible benefits intended to improve the lives of the people and enhance their moral and material values. This symbiotic relationship is the rationale of taxation and should dispel the erroneous notion that it is an arbitrary method of exaction by those in the seat of power. 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, as it has here, that the law has not been observed.[26]

WHEREFORE, the instant *Petition for Review* is hereby **GRANTED**. Accordingly, the undated Final Decision on Disputed Assessment with Details of Discrepancies received by petitioner of July 11, 2013, and the assessment issued by respondent Commissioner of Internal Revenue are hereby **CANCELLED** and **WITHDRAWN**.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

I concur:

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

ATTESTATION

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.

ESPERANZA R. FABON-VICTORINO
Associate Justice
Acting Chairperson

[26] *Commissioner of Internal Revenue vs. San Miguel Corporation*, G.R. Nos. 205045 and 205723, January 25, 2017, citing the case of *Commissioner of Internal Revenue vs. Algue, Inc., et al.*, G.R. No. L-28896, February 17, 1988.

CERTIFICATION

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