REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

THIRD DIVISION

TOLEDO POWER COMPANY,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 7571

Members:

BAUTISTA, *Chairperson*
PALANCA-ENRIQUEZ, *and*
COTANGCO-MANALASTAS, *JJ.*

Promulgated:

MAY 13 2011
ABFernando 2:00p.m.

x- x

DECISION

BAUTISTA, *J.*:

Before the Court is the Petition for Review filed by Toledo Power Company on February 6, 2007, seeking the cancellation of the Formal Letter of Demand for alleged deficiency value-added tax (VAT) covering taxable year 2002 and for failure to pay annual registration fee.

Petitioner Toledo Power Company is a general partnership duly organized and existing under and by virtue of the laws of the Philippines.[1]

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[1] Exhibits "A" and "B"

It is registered with and authorized by the Energy Regulatory Commission (ERC) to operate facilities used in the generation of electricity. It is likewise registered with the Bureau of Internal Revenue (BIR) as a VAT taxpayer with Tax Identification No. 003-883-626-000.[2]

Petitioner is principally engaged in the business of power generation and the subsequent sale thereof to the National Power Corporation, private electric utilities and electric cooperatives, and the carrying on of all businesses incident thereto, including but not limited to the sale of the by-products of power generation.[3]

Respondent Commissioner of Internal Revenue is the chief of the Bureau of Internal Revenue, the government agency charged with the assessment and collection of all national internal revenue taxes, fees and charges, and the enforcement of all forfeitures, penalties and fines connected therewith.

Petitioner filed an administrative claim for refund and issuance of tax credit certificate of its unutilized input value-added tax on domestic purchases of goods/services and importation of goods related to zero-rated sale of services in the amount of P14,254,013.27. As a result of said application, respondent issued Letter of Authority No. 00077453 dated February 2, 2004 to examine petitioner's books of accounts and accounting records.[4]

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[2] Exhibits "C" and "D"
[3] Par. 1.4, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), docket, pp. 156-157
[4] Par. 1.7, Admitted Facts, JSFI, docket, p. 157

Based on petitioner's claim for refund or tax credit for taxable year 2002, a Preliminary Assessment Notice (PAN), dated January 25, 2006, was issued by respondent and was received by petitioner on February 9, 2006. The PAN alleged that there are disallowed input taxes of P4,567,588.93 and unrecognized output VAT on sales amounting to P18,736,441.50, which resulted in deficiency VAT payable of P19,173,254.49, inclusive of increments; and that the failure to pay the annual registration fee for taxable year 2002 resulted in deficiency registration fee of P1,027.50, including surcharge and interest.[5]

On April 12, 2006, petitioner received a Formal Letter of Demand with Details of Discrepancies and Assessment Notices, all dated April 3, 2006, assessing petitioner for the following deficiency taxes:[6]

Assessment No. 83-VAT-13-2002-2006-3-083

I. VALUE ADDED TAX			
Per Application of Tax Credit/Refund (as appearing also per VAT Return as of December 31, 2002)			P (14,254,013.27)
Less: Findings per investigation			
Disallowed Input Tax		P 4,567,588.93	
Unrecognized VAT Output			
VAT Output per Investigation	P 349,861.22		
VAT Output per return on Sales Discrepancy	304,030.05	45,831.17	
Sales per ITR			
Gross	632,223,511.00		
Less: Sales ret. & disc.	5,159,579.00		
Net Sales	627,063,932.00		
Add: Other Income	3,460,054.00		
Total Sales	630,523,986.00		
Less: Export Sales per VAT Return	439,660,958.77		
Vatable Sales	190,863,027.23		
Less: Vatable Sales per Investigation	3,498,612.23		
Vatable Sales with missing invoices	187,364,415.00		

[5] Exhibit "L"
[6] Exhibit "M"

VAT Rate	10%	18,736,441.5		23,349,861.60
VAT Deficiency			P	9,095,848.33
Add: 50% surcharge	4,547,924.17			
20% interest (01/26/03 to 03/30/06)	5,780,916.94			10,328,841.11
Total VAT Deficiency			P	19,424,689.44

Assessment No. 83-VAT-13-2002-2006-3-084

II. ANNUAL REGISTRATION FEE				
Basic Registration Fee			P	500
Add: Surcharge	P	125		
Compromise Penalty		200		
Interest (02/01/02 to 03/30/06)		416.39		741.39
Total Deficiency Registration Fee			P	1,241.39

On May 12, 2006, petitioner filed with respondent its protest on said assessments.[7]

On July 26, 2006, petitioner received a letter from the BIR dated July 10, 2006, requesting documentary evidence for proper evaluation of the merits of the protest and attaching the composition and reasons for the disallowed input taxes amounting to P4,567,588.93.[8]

Since respondent failed to resolve petitioner's protest, petitioner filed a Petition for Review before this Court on February 6, 2007.

In his Answer[9] filed on April 27, 2007, respondent raised the following Special and Affirmative Defenses:

> "4. After a thorough investigation, for the taxable year 2002, the bulk of the company's income came from sale of electricity, which is zero-rated vat. However, the company also have income subject to vat realized from the sale of scrap to various buyers.

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[7] Exhibit "I"
[8] Par. 1.10, Admitted Facts, JSFI, docket, p. 159
[9] Docket, pp. 87-92

5. A 10-day Preliminary Notice dated June 16, 2005 was sent informing the taxpayer that their claims of excess input tax in the total amount of P14,254,013.27 was decreased to P8,181,626.89 due to disallowances on the input taxes. As a reply, subject taxpayer submitted some of the official receipts to substantiate the disallowances. Thus, a re-evaluation and/or re-verification was made, and the disallowances on the input tax was reduced to P4,567,688.93.

6. A comparison on the supported schedule of sales and VAT Returns revealed an unrecognized output tax in the total amount of P45,831.17. The gross sales per income tax return with its financial statements and the sales recognized per vat returns showed a discrepancy of sales which was treated as sales subject to vat. This discrepancy was substantiated by the missing invoices and/or official receipts which, per verification on the schedule of sales, were not all recorded. Thus, it resulted that instead of refundable VAT subject taxpayer is now liable for the value-added tax deficiency in the total amount of P12,582,741.52.

7. To inform the taxpayer on the result of the re-evaluation and/or re-verification, a preliminary notice dated October 28, 2005 was served on subject taxpayer giving it 5 days to refute the findings. However, subject taxpayer asked for an extension with in which to support its allegations up to Nov. 29, 2005. On the given definite schedule, subject taxpayer submitted its comments on the findings and reconciliation of gross receipts vs. amount per VAT return.

8. The three-year prescription of the government's right to assess is not without exceptions. Section 222(a) of the 1997 Tax Code, as amended, specifically provides the following, to wit:

> **'SEC. 222. Exceptions as to Period of Limitation 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, <u>at any</u>

time within ten (10) years after the discovery of the falsity, fraud or omission: Provided, that in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

(b) xxx xxx xxx' (underscore supplied)

Corollarily, under Section 248 (B) of the same Code, the following is being provided:

'SEC. 248. **Civil Penalties.** – xxx xxx xxx

(B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: *Provided*, that a substantial under declaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: *Provided, further*, that failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned therein." (underscores supplied)

Upon examination and evaluation, there are sales subject to vat of Toledo Power Corporation with missing invoices which amounted to P187,364,415.00 which represent 98% of the total sales subject to vat for the

> taxable year 2002. In other words, only 2% of the total sales subject to vat had been substantiated with invoices during the investigation. Clearly, there exists a substantial underdeclaration of taxable sales, receipts or income which constitute a prima facie evidence in this case of a false and fraudulent return, thus granting this Bureau the right to assess within 10 years after discovery of the falsity, fraud or omission pursuant to Section 222 of the 1997 Tax Code, as amended."

On June 27, 2007, petitioner filed a Reply[10] thereto.

Pre-trial conference was scheduled on August 23, 2007.

On September 25, 2007, the parties filed their Joint Stipulation of Facts and Issues, which was approved on October 1, 2007.[11]

During trial, both parties presented documentary and testimonial evidence in support of their respective claims and contentions.

On October 19, 2010, the Court submitted the case for decision, considering respondent's Memorandum[12] filed on September 6, 2010 and petitioner's Memorandum[13] filed on October 11, 2010.[14]

The following are the stipulated issues[15] for our resolution:

> "2.1 Whether or not the Respondent has lost its right to assess the alleged deficiency value-added taxes and annual registration fees by reason of prescription.
>
> 2.2 Whether or not the Petitioner underdeclared its vatable receipts amounting to P187,364,415.00, or by an amount exceeding 30% of that declared in its 2002 VAT returns.

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[10] Docket, pp. 107-114
[11] Docket, p. 179
[12] Docket, pp. 1152-1160
[13] Docket, pp. 1169-1208
[14] Docket, p. 1210
[15] Docket, pp. 159-160

2.3 Whether or not Respondent's Letter of Authority includes the authority to examine Petitioner's other tax liabilities and compliance.

2.4 Assuming arguendo that Petitioner's (*sic*) right to assess deficiency VAT has not prescribed, whether or not the Formal Letter of Demand is void for failure to inform the Petitioner of the facts on which the assessment was based.

2.5 Assuming arguendo that Petitioner's (*sic*) right to assess deficiency VAT has not prescribed, whether or not Petitioner properly reported its vatable sales in its 2002 quarterly VAT returns.

2.6 Assuming arguendo that Petitioner's (*sic*) right to assess deficiency VAT has not prescribed, whether or not sales of generated power by Petitioner for taxable year 2002 are subject to zero percent (0%) VAT pursuant to the EPIRA, its implementing rules and regulations and the Tax Code of 1997.

2.7 Assuming arguendo that Petitioner's (*sic*) right to assess deficiency VAT has not prescribed, whether or not Petitioner failed to pay the annual registration fee for taxable year 2002 amounting to P1,241.39 including interest and surcharge."

Petitioner asserts that respondent has lost the right to assess the alleged deficiency value-added taxes and annual registration fees by reason of prescription. It contends that Section 203 of the National Internal Revenue Code (NIRC) provides that respondent is given the power to assess taxes within three (3) years after the last day prescribed by law for the filing of the return. It reasons that since it did not sign any waiver of the defense of prescription for internal revenue tax liabilities for taxable year 2002, the assessment has already prescribed.

Petitioner further asseverates that the provision raised by respondent, which is Section 248(B) of the NIRC, cannot be given effect since said provision does not extend the period within which respondent can assess taxes. Petitioner points out that said provision is captioned "Civil Penalties." As worded, the only legal effect of having a *prima facie* evidence of a false or fraudulent return under Section 248(B) of the NIRC is the imposition of a surcharge equivalent to fifty percent (50%) of the tax or of the deficiency tax.

Lastly, it asserts that the assessment is void for failure of respondent to clearly and properly inform petitioner of the facts and the law on which the assessment is made. It claims that the details of the disallowed input taxes should be stated in the Formal Letter of Demand and not anywhere else so that it may be given sufficient time to effectively protest and furnish respondent with competent and valid supporting documents.

Respondent counters that its right to assess has not yet prescribed. It contends that the three-year period to assess is not without exceptions. He maintains that Section 222(a) of the NIRC provides that in case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed at any time within ten (10) years after discovery of the falsity, fraud or omission.

Respondent avers that only 2% of the total sales subject to VAT had been substantiated with invoices during investigation. He asserts that there exist substantial underdeclarations of taxable sales, receipts or income which constitute a *prima facie* evidence of false and fraudulent return; thus giving respondent the right to assess within ten years from discovery of the falsity, fraud or omission.

Section 228[16] of the NIRC provides that the taxpayer must be informed in writing of the law and the facts upon which a tax assessment is based; otherwise, the assessment is void.

To implement this provision, the BIR issued Revenue Regulations (RR) No. 12-99[17], Section 3.1.4 of which states:

> "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" (*Emphasis supplied*)

In the present case, the Formal Letter of Demand with Details of Discrepancies and Assessment Notice issued against petitioner are not valid. Said notices failed to state the legal and factual bases of the assessment for deficiency value-added tax in violation of Section 228 of the NIRC.

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[16]"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:
xxx xxx xxx
The taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void."

[17] "Implementing the Provisions of the National Internal Revenue Code of 1997 Governing the Rules on Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extra-judicial Settlement of a Taxpayer's Criminal Violation of the Code Through Payment of a Suggested Compromise Penalty"

A careful perusal of the facts stated in the Details of Discrepancies shows that the details stated therein are not sufficient to afford petitioner the opportunity to intelligently answer the assessment as well as prepare documentary evidence to support its protest.

Respondent failed to indicate the basis of the disallowance of the input taxes amounting to P4,568,588.93. Further, respondent neglected to state the schedule or the composition of the supposed disallowed input tax, VAT output per investigation, and the vatable sales per investigation.

In fact, in *Commissioner of Internal Revenue vs. Enron Subic Power Corporation*[18], the Supreme Court held that --

> "**The law requires that the legal and factual bases of the assessment be stated in the formal letter of demand and assessment notice. Thus, such cannot be presumed.** Otherwise, the express provisions of Article 228 of the NIRC and RR No. 12-99 would be rendered nugatory. The alleged 'factual bases' in the advice, preliminary letter and 'audit working papers' did not suffice. There was no going around the mandate of the law that the legal and factual bases of the assessment be stated in writing in the formal letter of demand accompanying the assessment notice.
>
> We note that the old law merely required that the taxpayer be notified of the assessment made by the CIR. This was changed in 1998 and the taxpayer must now be informed not only of the law but also of the facts on which the assessment is made. Such amendment is in keeping with the constitutional principle that no person shall be deprived of property without due process. In view of the absence of a fair opportunity for Enron to be informed of the legal and factual bases of the assessment against it, the assessment in question was void. We reiterate our ruling in *Reyes v. Almanzor, et. al.*:

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[18] G.R. No. 166387, January 19, 2009

> Verily, taxes are the lifeblood of the Government and so should be collected without unnecessary hindrance. However, such collection should be made in accordance with law as any arbitrariness will negate the very reason for the Government itself."

Moreover, Section 203 of the NIRC provides that respondent only has three years to assess and collect an internal revenue tax, 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."

Pursuant to the afore-quoted provision, the three-year period to assess commences from the date of actual filing of the return or from the last day prescribed by law for the filing of such return, whichever comes later. Applying the rule to the present case, the last day to file and pay value-added tax is on the twenty-fifth day following the close of each taxable quarter. So if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. Thus, respondent had until the following dates within which to assess petitioner for the subject deficiency value-added tax for taxable year 2002:

Year 2002	Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
1st Qtr	E	4/25/02	04/25/02	04/25/05
2nd Qtr	F	7/25/02	07/25/02	07/25/05
3rd Qtr	G	10/25/02	10/25/02	10/25/05
4th Qtr	H	1/27/03[19]	01/27/03	01/27/06

Clearly, the Formal Letter of Demand and Assessment Notice both dated April 3, 2006 and received by petitioner on April 12, 2006[20] are beyond the three-year prescriptive period within which respondent could make an assessment for deficiency VAT for taxable year 2002.

Assuming however that the three-year period will not apply due to respondent's allegation of fraud, the Court still cannot take cognizance of the same due to respondent's failure to prove the existence of fraud. Mere allegation is not evidence and is not equivalent to proof. Hence, it is important that respondent's allegation of fraud be proven during trial.

Since the assessment issued by respondent is invalid, it cannot in turn be used as a basis to collect tax.

As to the annual registration fee assessment, the Court finds that the imposition of the same is clearly misplaced.

Section 236(B) of the NIRC provides that the annual registration fee in the amount of five hundred pesos for every separate or distinct establishment or place of business shall be paid on or before the last

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[19] January 25, 2003 fell on a Saturday
[20] Exhibit "M"

day of January. In this case, petitioner's annual registration fee should be payable on or before January 31, 2002.

A review of the BIR revenue official receipt[21] (ROR 2000-01464910 dated January 30, 2002, for payment of Annual Registration in the amount of P500.00) and Payment Form[22] (BIR Form No. 0605 dated January 30, 2002, for payment of Annual Registration in the amount of P500.00) clearly proves that petitioner paid its annual BIR registration fee for taxable year 2002.

WHEREFORE, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, the assessments for deficiency value-added tax and annual registration fee issued by respondent are hereby **CANCELLED**.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

OLGA PALANCA-ENRIQUEZ
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

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[21] Exhibit "P"
[22] Exhibit "Q"

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.

LOVELL R. BAUTISTA
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, 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.

ERNESTO D. ACOSTA
Presiding Justice