Lit

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ENRON SUBIC POWER CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5993

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

SEP 12 2001

x - x

DECISION

The case at bar seeks the cancellation of Petitioner's alleged 1996 deficiency tax assessment, as per Final Assessment Notice (FAN) No. 019-44-96-0000371 dated May 12, 1999, in the amount of P2,880,817.25.

As represented, Petitioner is a corporation duly organized and existing under Philippine Laws. It is registered with the Subic Bay Metropolitan Authority (SBMA) as a Subic Bay Freeport (SBF) Enterprise entitled to the 5% preferential tax rate under Republic Act No. 7227, otherwise known as the "Bases Conversion and Development Act of 1992."

On April 15, 1997, Petitioner filed its Annual Income Tax Return (ITR) covering taxable year 1996 showing a net loss of P7,684,948.00 (Exhibits "B" and "B-1").

On May 26, 1999, Petitioner received from Respondent Formal Assessment Notice ("FAN") No. 019-44-96-0000371 dated May 12, 1999 for alleged deficiency income tax and covering taxable year 1996, computed as follows:

1.	Tax Due	P1,852,422.00
2.	Add: Surcharge	463,105.50
	Interest	540,289.75
	Compromise Penalty	25,000.00
3.	Total Amount Payable	P2,880,817.25

Petitioner had assumed that the alleged deficiency taxes due to the Government was arrived at in the same manner as discussed earlier with the revenue examiners during the pre-assessment stage, in the total amount of P2,880,817.25 broken down as follows:

	Per ITR	Adjustments	Final
Revenues:			
Standby fees	P56,360,422.00	-	P56,360,422.00
Energy fees	585,753.00	-	585,753.00
Others – Net	4,144,895.00	-	4,144,895.00
O&M Supervision fee – SPC		P16,261,031.00	16,261,031.00
O&M Supervision fee – BPC		13,750,087.00	13,750,087.00
TOTAL REVENUE	P61,091,070.00		P91,102,188.00
Less: Direct Costs:			
Cost of sales	P22,054,884.00	P15,116,447.00	P 6,938,437.00
Lease Payments	25,210,968.00	-	25,210,968.00
Salaries & wages	16,147,327.00	-	16,147,327.00
Insurance expense	1,865,670.00	1,865,670.00	-
Building & grounds	709,992.00	-	709,992.00
Utility expense	379,040.00	-	379,040.00
Depreciation & amortization	188,810.00	-	188,810,00
Employee benefits	148,276.00	-	148,276.00
Maintenance expenses	40,338.00	-	40,338.00
TOTAL DEDUCTIONS	P66,745,305.00		P49,763,188.00
Taxable Income	P(5,654,235.00)		P41,339,000.00
Tax Due	-		P 2,066,950.00
Less: Tax Credits	(356,424.00)	141,896.00	(214,528.00)
Basic Tax Due			P 1,852,422.00
Add: 25% surcharge			463,105.50
20% interest p.a.			540,289.75
Compromise penalty			25,000.00
Total Deficiency Income Taxes			P 2,880,817.25

(Paragraph 3 of Petition for Review as admitted in Paragraph 1 of the Answer; Paragraph 5, Joint Stipulation of Facts; Exhibit "A" and "A-1").

On June 15, 1999, Petitioner, through its external auditors, filed with the Respondent, through the Regional Director of Revenue Region No. 4 in San Fernando, Pampanga, its protest letter dated June 14, 1999, pursuant to Section 228 of the Tax Code, as amended. Said protest letter specified the factual and legal basis of the protest against said alleged deficiency 5% tax assessment, and further requested that the said deficiency tax assessment be withdrawn and cancelled (Paragraph 4 of Petition for Review as admitted in Paragraph 1 of the Answer; Paragraph 4 Joint Stipulation of Facts).

As of December 12, 1999, which is the one hundred eightieth (180th) day from the date that Petitioner had filed its protest, Respondent had not yet acted upon the protest against the alleged deficiency tax assessment against Petitioner (Paragraph 5 of the Petition for Review as admitted in paragraph 1 of the Answer; Paragraph 5, Joint Stipulation of Facts).

On January 10, 2000, Petitioner filed with this Court the instant Petition for Review contesting the deficiency tax assessment of P2,880,817.25.

Petitioner presents the proposition as reason of the Petition for Review that it is not liable for the deficiency income tax assessment for the year 1996 in the amount of P2,880,817.25 on the following grounds, thus:

(1) the assessment is null and void under Section 228 of the Tax Code for failure of the Respondent to mention or disclose the factual and legal basis of the assessment;

(2) the payments/operational maintenance supervision fees received by Petitioner from Subic Power Corporation (SPC) in the total amount of P16,261,031.00, and from Batangas Power Corporation (BPC) in the total amount of P13,750,087.00, as a result of their separate Operation and Maintenance Supervision Agreements (O & M Agreements), are reimbursements for its actual expenses incurred for the operation and maintenance of their respective Subic and Batangas power plant facilities without any mark-up or profit, hence, do not constitute income, and therefore should not be subjected to the 5% tax on gross income earned;

(3) the disallowed cost of sales amounting to P15,116,447.00, which is a portion of the restoration costs of the Subic power stations is a deductible expense for 1996 as the Energy Conversion Agreement between Petitioner and National Power Corporation (NAPOCOR) was valid only until the end of 1997 and that said restoration costs were being incurred by the Petitioner on the asset which it did not even possess actual ownership, hence, there is no basis to capitalize the restoration costs of the power stations and amortize said amount over the plant's estimated life, thus, it concluded that for purposes of matching cost against revenues, it correctly treated restoration costs as expense for the year 1996, the year in which they are incurred;

(4) the disallowed insurance expense amounting to P1,865,670.00 is a direct cost, it being a contractual obligation and an integral part of the power plant's direct expenses without which Petitioner could not have pursued its SBMA registered activity, as such, a deductible expense for purposes of the 5% tax on gross income earned in the same manner that depreciation, financing charges, rent and utility charges for machineries, equipment and building are allowed as deductions; and

(5) the disallowance by Respondent of the tax credits amounting to P141,896.00, on ground that the same is on interest income of a Subic Bay Freeport Enterprise from bank deposits subject to the 5% preferential tax rate, was not supported by evidence, hence, it submitted that there is no legal and/or factual basis to reduce its allowable tax credits, as the same were not tax credits on any tax imposed on interest income but taxes withheld by NAPOCOR creditable to any 5% tax liability of Petitioner, duly supported by withholding tax certificates.

Respondent disputes the asseverations of Petitioner and raised the herein Special and Affirmative Defenses, thus:

> "3. Prior to the issuance of the assessment, Petitioner was informed of the proposed assessment and the basis thereof which it protested. Hence, the requirement under Section 22C of the Tax Code that the taxpayer shall be informed of the law and the facts on which the assessment is made, is deemed to have been complied with.
>
> 4. The amount of P30,011,118.00 paid by Subic Power Corporation (SPC) and Batangas Power Corporation (BPC) as reimbursements for the alleged actual costs incurred by Petitioner in the performance of its obligations under the Operation & Maintenance Supervision Agreement (O & M) is not deductible, as it is a fact that SPC, BPC and Petitioner are all operated and/or controlled by Enron Development Corporation, a U.S. based company, which fact makes these companies inter-related.
>
> It is no secret that "reimbursement" of so-called actual costs is a common practice applied by companies for the purpose of reducing, avoiding, or altogether escaping the payment of taxes.
>
> 5. Contrary to the allegation of Petitioner that the restoration costs of the power plants were charged in full against income as costs of sale, since there is no discernible future benefits which it may derive, the fact is that Petitioner agreed to the restoration in order to corner a much bigger contract for the construction of another power plant now operated by Subic Power Corporation.
>
> Obviously, Petitioner derived the benefit of a bigger contract when it agreed to do the restoration. Hence, the costs should be capitalized.
>
> 6. While insurance may be a necessary expense, it does not necessarily mean a direct cost that may be deductible from gross income. As a matter of fact, Revenue Regulations No. 1-95, as amended, explicitly excluded as allowable deduction from gross income "insurance expense" other than those incurred in the importation of goods.
>
> 7. With respect to the tax credit claimed by Petitioner, suffice it to say that it is totally unsupported by documents or other evidence.
>
> 8. The assessment was issued in accordance with law and regulations.

9. All presumptions are in favor of the correctness of tax assessments."

The issues that come to fore for the consideration of the Court, as stated in the Joint Stipulation of Facts and Issues submitted to the Court by the parties on April 19, 2000 (p. 63, docket) are as follows:

> "1. Whether or not Petitioner, as required under Section 228 of the Tax Code, has been informed in writing of the law and the facts on which the assessment was made;
>
> 2. Whether or not the amount Petitioner claimed as reimbursements for alleged actual costs incurred in the performance of obligations under the O & M Agreements with Subic Power Corporation and Batangas Power Corporation, is part of Petitioner's gross income;
>
> 3. Whether or not the restoration costs of power plants claimed by Petitioner as costs of sale in the amount of P15,116,447.00 are deductible expenses;
>
> 4. Whether or not the insurance claimed by Petitioner in the amount of P1,865,670.00 is deductible from Petitioner's gross income earned; and
>
> 5. Whether or not there is basis for Petitioner's claim for tax credit in the amount of P141,896.00."

It seemed to the Court that there was no compliance on the part of Respondent of Section 228 of the Tax Code and Section 3.1.4 of Revenue Regulations No. 12-99. The said provision of law and regulation clearly provides that:

> "**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.
>
> (a) When the finding for any deficiency tax is the result of mathematical error in the computation of the tax as appearing on the face of the return; or

(b) When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent, or

(c) When the taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year; or

(d) When the excise tax due on excisable articles has not been paid; or

(e) When an article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, traded or transferred to non-exempt persons.

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. (emphasis supplied).

x x x x x x x x x

REVENUE REGULATIONS NO. 12-99

"**Sec. 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. <u>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</u>. The same shall be sent to the taxpayer only by registered mail or by personal delivery. If sent by personal delivery, the taxpayer or his duly authorized representative shall acknowledge receipt thereof in the duplicate copy of the letter of demand, showing the following: (a) His name; (b) signature; (c) designation and authority to act for and in behalf of the taxpayer, if acknowledged received by a person other than the taxpayer himself, and (d) date of receipt thereof." (underlining supplied)

The law is clear and unambiguous. The Respondent is mandated to inform and disclose to the taxpayer in writing the factual nature and the legal basis of the assessment. Failure to comply with the same will render the assessment null and void.

In the case at bar, Respondent merely issued a formal assessment and indicated therein the supposed tax, surcharge, interest and compromise penalty due thereon. The Revenue Officers of the Respondent in the issuance of the Final Assessment Notice did not provide the Petitioner with the written bases of the law and facts on which the subject assessment is based. Respondent did not bother to explain how it arrived at such an assessment. Moreso, he failed to mention the specific provision of the Tax Code or rules and regulations which were not complied with by Petitioner.

Stated otherwise, the Formal Assessment Notice (Exhibit "A") only itemized the deductions disallowed and included the same in the gross income and imposed the preferential tax rate of 5% on some items categorized by Petitioner as costs, without providing the facts and basis in law of the disallowance and deficiency tax assessment.

The Respondent's witness himself, Mr. Edison del Agua, the BIR Revenue Examiner who conducted the examination on the books of the Petitioner admitted that, he was not aware of the BIR-issued regulation concerning the manner of issuing assessment notices or Revenue Regulations No. 12-99, viz:

"Atty. Montero:

Q. Mr. Witness, are you aware of the provision of Revenue Regulations No. 12-99?

Mr. Agua

A. I am not ...

Atty. Montero:

Q. On the manner of protesting assessment and issuance of Assessment Notices, Mr. Witness?

Mr. Agua:

A. I have heard of that regulation but I have not read the contents, Sir" (TSN of Mr. Edison del Agua, January 9, 2001, p. 37)

Thus the FAN that was issued could not have complied with Revenue Regulations No. 12-99 as the Revenue Officer who issued the same was not even aware of the applicable regulations.

Moreover in the case entitled **Sunnyvale Development Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5730, January 4, 2001**, the Court ruled that:

"x x x But it is required that 'the taxpayers shall be informed in writing of the law and the facts on which the assessment is made, otherwise, the assessment shall be void'(Sec. 228)

It is evident from the record in this case, that the assessment notice issued by the Respondent against Petitioner for deficiency donor's tax did not indicate how the tax base of P3,206,230.87 was arrived at and why it was being subjected to donor's tax x x x. The accompanying demand letter also failed to state the law and the facts on which the assessment was based x x x. Hence, the same is void in accordance with Section 228 of the Tax Code, as amended."

It further ruled that:

"It bears stressing that not only the assessment for deficiency donor's tax is found to be void but the assessments for deficiency income x x x. For the income tax assessment, the assessment notice did not indicate the reasons for disallowing the amounts of deductions pertaining to taxes and licenses, depreciation, association dues and miscellaneous expense." (emphasis supplied)

This Court likewise ruled in the case of **Abbott Laboratories, Inc. vs. Commissioner of Internal Revenue CTA Case No. 5718, February 16, 2001** that:

"Section 228 of the 1997 Tax Code in part provides thus:

> 'The taxpayers shall be informed in writing of the laws and the facts on which the assessment is made, otherwise, the assessment shall be void.'

Clearly, Section 228 of the National Internal Revenue Code requires the respondent to inform the taxpayer in writing of the law and the facts on which the assessment is made; otherwise the assessment shall be void. As thus worded, the respondent has the bounden duty to inform the taxpayer not only of the law but more importantly, the surrounding circumstances supporting the assessment, for it is only through a detailed appraisal of its basis that the taxpayer may be able to dispute the imposition or agree with it."

Thus, the Court finds that the Final Assessment Notice (Exhibit "A") and demand letter sent to Petitioner, do not meet the requirements of a written notice provided under Section 228 of the Tax Code, as amended, and the requirements of the form prescribed in Annex "B" of Revenue Regulations No. 12-99. Consequently, the assessment against the Petitioner should be considered void as explicitly provided for in Section 228 of the Tax Code, as amended, and Section 3.1.4 of Revenue Regulations No. 12-99.

Having thus held that the subject assessment issued by Respondent against Petitioner null and void, the Court finds it unnecessary to delve into, and pass upon, the other issues presented by the parties.

IN THE LIGHT OF ALL THE FOREGOING, the instant Petition for Review is hereby **GRANTED**. Accordingly, the assessment issued by the Respondent against the Petitioner for the year 1996, particularly Formal Assessment Notice No. 019-44-96-

0000371 dated May 12, 1999 for deficiency income tax amounting to P2,880,817.25 is hereby **ORDERED CANCELLED** and **WITHDRAWN.**

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge