REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

YAN AN CARGO CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE No. 9865

Members:

CASTAÑEDA, JR., *Chairperson, and*
BACORRO-VILLENA, *JJ*.

Promulgated: JUN 01 2021
1:20 p.m.

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DECISION

BACORRO-VILLENA, J.:

At bar is a Petition for Review[1] filed by petitioner Yan An Cargo Corporation (**petitioner**) seeking the cancellation and withdrawal of the deficiency income tax (**IT**) and value-added tax (**VAT**) assessments for taxable year (**TY**) 2010 amounting to ₱28,007,743.63, inclusive of increments.

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1 Filed on 29 June 2018, Division Docket, pp. 10-21.
Pursuant to Section 3(a)(1) of Rule 4 on Jurisdiction of the Court of the *2005 Revised Rules of the Court of Tax Appeals, as amended.*
...
SEC. 3. *Cases within the jurisdiction of the Court in Divisions.* – The Court in Divisions shall exercise:
(a) Exclusive original or appellate jurisdiction to review by appeal the following:
...
(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[.]

Petitioner is a corporation duly organized and existing under the laws of the Republic of the Philippines, with principal address at Long Se Lee Bldg., Burgos Extension, Villamonte, Bacolod City, Negros Occidental.

Respondent Commissioner of Internal Revenue (**respondent/CIR**), on the other hand, is vested with the authority to to decide, among others, cases involving disputed assessments and other matters arising under the National Internal Revenue Code (**NIRC**) of 1997, as amended, and other laws administered by the Bureau of Internal Revenue (**BIR**).

The antecedent facts follow.

On 24 February 2012, respondent issued Letter Notice (**LN**) No. 077-RLF-10-00-00263[2] to petitioner. The LN was based on a computerized matching of information or data allegedly from third party sources, indicating discrepancies against the declarations in petitioner's VAT returns for TY 2010.

More than a year later or on 11 July 2013, petitioner received a Preliminary Assessment Notice (**PAN**) dated 26 June 2013. Petitioner then replied thereto.[3]

On 03 September 2013, respondent issued a Formal Letter of Demand[4] (**FLD**) with Details of Discrepancy, holding petitioner liable for deficiency IT and VAT, itemized as follows:

Tax Type	Basic Tax	50% Surcharge	Interest computed up to 31 October 2013	Total
Income Tax	₱9,896,309.65	₱4,948,154.82	₱5,035,242.35	₱19,879,706.82
VAT	3,958,523.75	1,979,261.87	2,190,251.19	8,128,036.81
Total				**₱28,007,743.63**

2 BIR Records, p. 1.
3 Paragraph 10, Memorandum for the Petitioner, Division Docket, p. 307.
4 Exhibit "P-1", id., pp. 243-245.

Petitioner received the FLD on 03 October 2013. Disagreeing with the assessment, it filed a Protest[5] on 22 October 2013. Later, its Protest was denied in the Final Decision on Disputed Assessment[6] (**FDDA**) dated 09 January 2014, received on 24 January 2014.

On 21 February 2014, petitioner elevated the said FDDA to respondent himself *via* a Motion for Reconsideration (**MR**).[7] On 09 May 2018, respondent denied petitioner's MR with finality[8] (**CIR's Decision**) and the latter received the same on 31 May 2018.

Aggrieved, petitioner filed the instant Petition for Review on 29 June 2018. Respondent filed his Answer[9] on 08 October 2018.

On 15 October 2018, the Court issued a Notice of Pre-Trial Conference[10], setting the Pre-Trial Conference on 06 December 2018. Accordingly, respondent filed his Pre-Trial Brief[11] on 28 November 2018, wheareas petitioner filed its Pre-Trial Brief[12] on 10 January 2019.

During the Pre-Trial Conference on 17 January 2019, the Court ordered the parties to appear before the Philippine Mediation Center-Court of Tax Appeals (**PMC-CTA**) on 11 February 2019 for mediation proceedings.[13] The mediation, however, proved to be unsuccessful. The court proceedings then continued wherein the Pre-Trial Conference was set anew on 10 October 2019.[14]

At the re-scheduled Pre-Trial Conference, the parties were ordered to submit within fifteen (15) days their Joint Stipulation of Facts and Issues (**JSFI**).[15] Accordingly, the parties filed their JSFI[16] on 25 October 2019, which the Court approved and adopted in the Pre-Trial

5 Exhibit "P-2", id., pp. 246-249.
6 Exhibit "P-3", id., pp. 257-258.
7 Exhibit "P-4", id., pp. 259-262.
8 See Decision, Exhibit "P-5", id., pp. 273-279.
9 Id., pp. 78-90.
10 Id., pp. 91-92.
11 Id., pp. 98-102.
12 Id., pp. 112-118.
13 See Resolution dated 17 January 2019, Division Docket, p. 179.
14 See Resolution dated 13 September 2019, id., p. 196.
15 See Order dated 10 October 2019, id., p. 198.
16 Id., pp. 205-210.

Order[17] dated 08 November 2019. The pre-trial was thereafter terminated accordingly.

When trial subsequently ensued, petitioner presented as lone witness its Treasurer, Ms. Perla S. Chua (**Chua**), who executed a Judicial Affidavit[18] in lieu of her direct testimony.

On the witness stand, Chua testified that she is familiar with the assessment issued against petitioner. She communicated with petitioner's lawyers for assistance in properly disputing the same. Later, she identified the documents relating to the subject assessment.

On cross-examination[19], respondent's counsel asked Chua if she has evidence to prove that petitioner received the CIR's Decision only on 31 May 2018 as petitioner claimed. She replied that the BIR sent the letter to petitioner's old office address, but they nevertheless immediately got a hold of it.

Petitioner did not conduct any redirect examination. Instead, petitioner's counsel manifested that there was a cover letter attached to the CIR's Decision dated 28 May 2018. Chua confirmed that it was the same letter she identified during her cross-examination. The said document was later on marked as Exhibit "P-8".[20]

Petitioner thereafter filed its Formal Offer of Evidence with Motion to Transfer Marking of Exhibit "P-8" (**FOE**) on 25 November 2019.[21] In the Resolution[22] dated 12 December 2019, the Court admitted all of petitioner's exhibits and granted the transfer of the marking of Exhibit "P-8" to the original copy of the letter found on page 301 of the BIR Records.

At the hearing set for the presentation of respondent's evidence in chief, respondent's counsels manifested that they will no longer

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17 Id., pp. 215-218.
18 Exhibit "P-7", id., pp. 119-132.
19 TSN dated 18 November 2019, pp. 6.
20 Id., pp. 6-8.
21 Division Docket, pp. 223-228.
22 Id., pp. 287-288.

present evidence. The parties were then granted thirty (30) days within which to file their respective memoranda.[23]

Petitioner filed its Memorandum[24] on 29 June 2020, while respondent filed a Manifestation[25] on 21 July 2020 stating that he will adopt the arguments contained in his Answer as his Memorandum. The Court then submitted the case for decision.[26]

ISSUES

The parties stipulated on the following issues to be resolved by the Court[27]:

I.

WHETHER THE DEFICIENCY TAX ASSESSMENT IN THE FINAL ASSESSMENT NOTICE (FAN)/FORMAL LETTER OF DEMAND (FLD) HAVE FACTUAL AND LEGAL BASES; and,

II.

WHETHER PETITIONER YAN AN CARGO CORPORATION IS LIABLE FOR DEFICIENCY INCOME TAX (IT) AND DEFICIENCY VALUE-ADDED TAX (VAT) AMOUNTING TO ₱28,007,743.63.

ARGUMENTS

Petitioner claims that the FLD and the FDDA lack factual and legal bases. According to it, Section 228[28] of the NIRC of 1997, as amended, requires that the FLD and assessment notice should contain the facts, law, rules and regulations, or jurisprudence on which the assessment is based; otherwise, the assessment shall be void.

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23 See Order dated 27 January 2020, id., p. 294.
24 Id., pp. 305-320.
25 Id., pp. 324-327 .
26 See Resolution dated 13 July 2020, id., pp. 322.
27 Issues, JSFI, id., p. 206.
28 **Sec. 228**. *Protesting of Assessment.* – ...

...

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.

...

Likewise, petitioner is unconvinced that a taxpayer's supposed non-recognition of an expense (as a result of the undeclared purchases) could be prejudicial to the government. It posits that if a taxpayer does not claim an expense, then the taxpayer has overstated its income and therefore paid more that what is actually due. It is thus wrong for respondent to construe the undeclared purchases as undeclared income resulting in deficiency IT and VAT. It maintains that an assessment should not be predicated on inference or assumptions.

Similarly, petitioner insists that the use of the cost of sales ratio and gross profit rate for purposes of the assessment is without any legal mooring.

Lastly, petitioner assails the validity of the assessment for want of authority on the part of the revenue officers (**ROs**) to conduct an audit investigation. According to it, even the case records are wanting of any proof that respondent or his duly authorized representatives issued any Letter of Authority (**LOA**) authorizing the ROs to examine petitioner's books for TY 2010. Such absence of an LOA should thus invalidate the assessment against it.

Contrariwise, respondent maintains that the FLD and the FDDA have bases in fact and in law. The LN data showed a discrepancy in purchases amounting to ₱6,770,887.01 arising from the purchase of freight and forwarding services. Under petitioner's record, such purchase is considered as "Freight-Out Expense" which is further classified as Direct Cost in the Income Tax Return (**ITR**) and Financial Statements filed; thus, the cost-ratio of 17.03% attributable to the same was used in computing the under-declared revenue of ₱39,758,584.91. Deducting therefrom the cost of freight and forwarding services of ₱6,770,887.01 yielded an additional gross income of ₱32,987,697.90, which was added to the taxable income of ₱202,500.93 (as declared in the ITR) to arrive at the adjusted taxable income of ₱33,190,198.83. Consequently, the adjusted taxable income results in a deficiency IT of ₱19,879,706.82. Corollary, the computed under-declared sales revenue above has a ripple effect on the VAT, as the alleged under-declared income should be subject to 12% VAT. After deducting the amount of input VAT allowed, the resulting deficiency VAT amounts to ₱8,128,036.81. According to respondent, both the deficiency IT and

VAT are subject to the 50% surcharge for underdeclaration of sales exceeding 30% of that declared in the ITR plus 20% interest.

Respondent is firm on his position that the assessment against petitioner is valid and lawful and that it should be accorded the presumption of correctness (and petitioner has the burden to prove otherwise).

Furthermore, respondent casts doubt on the timeliness of the filing of the instant Petition for Review. He points out that the cover letter (attaching the CIR's Decision) was dated 28 May 2018. According to him, petitioner did not offer proof that it actually received the letter on 31 May 2018; thus, it is possible that petitioner received the same on the date of its issuance or on 28 May 2018. Reckoning the 30-day appeal period from 28 May 2018, the filing of the instant Petition for Review on 29 June 2018 was beyond the reglementary period.

The Court's ruling follows.

Before the Court proceeds to resolve the principal issues in herein petition, We deem it propitious to first discuss respondent's claim that petitioner did not file the instant case on time.

In assailing the timeliness of the filing of the present petition, respondent asserts that the records are bereft of evidence to prove that petitioner received the CIR's Decision denying its MR on 31 May 2018. The CIR's Decision itself was dated 09 May 2018 and the cover letter was dated 28 May 2018. Thus, according to respondent, there is a possibility that petitioner received the letter on 28 May 2018 and thus, counting 30 days therefrom, the last day to file the Petition for Review was on 27 June 2018. Accordingly, the filing of the Petition for Review on 29 June 2018 was beyond the appeal period.

The records, however, show otherwise. The original copy of the 28 May 2018 cover letter[29] (attaching the CIR's Decision) indicates that it was mailed only on 31 May 2018, the same day petitioner received the

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29 Marked as Exhibit "P-8", BIR Records, p. 301.

same. Clearly, the last day for filing of the Petition for Review was on 02 July 2018; hence, the present petition was timely filed.

Proceeding to the substantive issues raised against respondent's assessment, We find that, indeed, no LOA was issued to the ROs for the examination and audit of petitioner's books. The records yield that what was issued was a mere LN.

It is well-settled in our jurisprudence that the absence of an LOA is a violation of the taxpayer's right to due process which renders the assessment null and void. Moreover, an LN is different from an LOA and the issuance of the former does not equate to the issuance of the latter to validate an otherwise void assessment. In *Medicard Philippines, Inc. v. Commisioner of Internal Revenue*[30], the Supreme Court elucidated in this wise:

> ...
>
> 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:
>
> > **SEC. 6.** *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.* –
> >
> > (A) **Examination of Return and Determination of Tax Due.** – After a return has been filed as required under the provisions of this Code, <u>**the Commissioner or his duly authorized representative**</u> **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.
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> ...

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[30] G.R. No. 222743, 05 April 2017; Citations omitted, emphasis and underscoring in the original text.

With the advances in information and communication technology, the Bureau of Internal Revenue (BIR) promulgated RMO No. 30-2003 to lay down the policies and guidelines once its then incipient centralized Data Warehouse (DW) becomes fully operational in conjunction with its Reconciliation of Listing for Enforcement System (RELIEF System). This system can detect tax leaks by matching the data available under the BIR's Integrated Tax System (ITS) with data gathered from third-party sources. Through the consolidation and cross-referencing of third-party information, discrepancy reports on sales and purchases can be generated to uncover under declared income and over claimed purchases of goods and services.

...

Under this policy, even without conducting a detailed examination of taxpayer's books and records, if the computerized/manual matching of sales and purchases/expenses appears to reveal discrepancies, the same shall be communicated to the concerned taxpayer through the issuance of LN. The LN shall serve as a discrepancy notice to taxpayer similar to a Notice for Informal Conference to the concerned taxpayer. Thus, under the RELIEF System, a revenue officer may begin an examination of the taxpayer even prior to the issuance of an LN or even in the absence of an LOA with the aid of a computerized/manual matching of taxpayers' documents/records. Accordingly, under the RELIEF System, the presumption that the tax returns are in accordance with law and are presumed correct since these are filed under the penalty of perjury are easily rebutted and the taxpayer becomes instantly burdened to explain a purported discrepancy.

Noticeably, both RMO No. 30-2003 and RMO No. 42-2003 are silent on the statutory requirement of an LOA before any investigation or examination of the taxpayer may be conducted. As provided in the RMO No. 42-2003, the LN is merely similar to a Notice for Informal Conference. However, for a Notice of Informal Conference, which generally precedes the issuance of an assessment notice to be valid, the same presupposes that the revenue officer who issued the same is properly authorized in the first place.

With this apparent lacuna in the RMOs, in November 2005, RMO No. 30-2003, as supplemented by RMO No. 42-2003, was amended by RMO No. 32-2005 to fine tune existing procedures in handing assessments against taxpayers' issued LNs by reconciling various revenue issuances which conflict with the NIRC. Among the objectives in the issuance of RMO No. 32-2005 is to prescribe procedure in the resolution of LN discrepancies, conversion of LNs to LOAs and assessment and collection of deficiency taxes.

IV. POLICIES AND GUIDELINES

...

> **8. In the event a taxpayer who has been issued an LN refutes the discrepancy shown in the LN**, the concerned taxpayer will be given an opportunity to reconcile its records with those of the BIR within One Hundred and Twenty (120) days from the date of the issuance of the LN. However, the subject taxpayer shall no longer be entitled to the abatement of interest and penalties after the lapse of the sixty (60)-day period from the LN issuance.
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> **9. In case the above discrepancies remained unresolved at the end of the One Hundred and Twenty (120)-day period, the revenue officer (RO) assigned to handle the LN shall recommend the issuance of [LOA] to replace the LN.** The head of the concerned investigating office shall submit a summary list of LNs for conversion to LAs (using the herein prescribed format in Annex "E" hereof) to the OACIR-LTS/ORD for the preparation of the corresponding LAs with the notation "This LA cancels LN No. ____________________"
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> ...

The Court cannot convert the LN into the LOA required under the law even if the same was issued by the CIR himself. Under RR No. 12-2002, LN is issued to a person found to have underreported sales/receipts per data generated under the RELIEF System. Upon receipt of the LN, a taxpayer may avail of the BIR's Voluntary Assessment and Abatement Program. If a taxpayer fails or refuses to avail of the said program, the BIR may avail of administrative and criminal remedies, particularly closure, criminal action, or audit and investigation. Since the law specifically requires an LOA and RMO No. 32-2005 requires the conversion of the previously issued LN to an LOA, the absence thereof cannot be simply swept under the rug, as the CIR would have it. In fact Revenue Memorandum Circular No. 40-2003 considers an LN as a notice of audit or investigation only for the purpose of disqualifying the taxpayer from amending his returns.

The following differences between an LOA and LN are crucial. First, an LOA addressed to a revenue officer is specifically required under NIRC before an examination of a taxpayer may be had while an LN is not found in the NIRC and is only for the purpose of notifying the taxpayer that a discrepancy is found based on the BIR's RELIEF System. Second, an LOA is valid only for 30 days from date of issue while an LN has no such limitation. Third, an LOA gives the revenue officer only a period of 120 days from receipt of LOA to

> conduct his examination of the taxpayer whereas an LN does not contain such a limitation. Simply put, LN is entirely different and serves a different purpose that an LOA. Due process demands, as recognized under RMO No. 32-2005, that after an LN has serve its purpose, the revenue officer should have properly secured an LOA before proceeding with the further examination and assessment of the petitioner. Unfortunately, this was not done in this case.
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> ...
>
> The BIR's RELIEF System has admittedly made the BIR's assessment and collection efforts much easier and faster. The ease by which the BIR's revenue generating objectives is achieved is no excuse however for its non-compliance with the statutory requirement under Section 6 and with its own administrative issuance. In fact, apart from being a statutory requirement, an LOA is equally needed even under the BIR's RELIEF System because the rationale of requirement is the same whether or not the CIR conducts a physical examination of the taxpayer's records: to prevent undue harassment of a taxpayer and level the playing field between the government's vast resources for tax assessment, collection and enforcement, on the one hand, and the solitary taxpayer's dual need to prosecute its business while at the same time responding to the BIR exercise of its statutory powers. The balance between these is achieved by ensuring that any examination of the taxpayer by the BIR's revenue officers is properly authorized in the first place by those to whom the discretion to exercise the power of examination is given by the statute.
>
> ...

Indubitably, considering that respondent's assessment against petitioner was not made pursuant to an LOA, such assessment is void and the latter cannot be made liable to pay for deficiency IT and VAT.

With the foregoing, the Court deems it unnecessary to delve further into the specific items of the assessment.

WHEREFORE, premises considered, the Petition for Review filed on 29 June 2018 by Yan An Cargo Corporation is hereby **GRANTED**. The assessment against petitioner Yan An Cargo Corporation for deficiency income tax and value-added tax for taxable year 2010 embodied in the Formal Letter of Demand dated 03 September 2013 is hereby **CANCELLED**. Respondent Commissioner of Internal Revenue is hereby **ENJOINED** from enforcing the collection of the deficiency taxes arising from the said Formal Letter of Demand.

SO ORDERED.

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

I CONCUR:

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

<u>ATTESTATION</u>

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
2nd Division Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ROMAN G. DEL ROSARIO
Presiding Justice