REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**C.T.A. EB No. 82** (C.T.A. CASE NO. 6389)
-versus-	*Present:* ACOSTA, *Presiding Justice* CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, PALANCA-ENRIQUEZ, *JJ.:*
IMA LAND HOLDINGS, INC., Respondent.	Promulgated: MAR 0 9 2006

x- -x

D E C I S I O N

***CASTAÑEDA, JR., J.*:**

This is a Petition for Review of the Decision dated 7 October 2004 of the then Court of Tax Appeals (the Court in Division) in CTA Case No. 6389 cancelling the assessments against respondent for deficiency income tax and value-added tax (VAT) covering the taxable year 1997 and of the Resolution dated 6 April 2005 denying herein petitioner's Motion for Reconsideration of the Decision. The total deficiency assessments against respondent is P46,299,178.90 consisting of P34,838,618.20 for deficiency income tax and P11,460,560.70 for deficiency VAT.

The facts as found by the Court in Division are as follows:

> On April 3, 2001, petitioner issued against respondent two Formal Assessment Notices, both numbered 57-00021-97 and dated April 3, 2001, and a Formal Letter of Demand dated March 27, 2001, which were received by respondent on April 20, 2001. The total amount of the deficiency assessments for income tax and VAT is P46,299,178.90.

a.)	Deficiency Income Tax		
	Basic Tax	P18,818,172.00	
	Surcharge	4,704,543.00	
	Interest	11,290,903.20	
	Compromise Penalty	25,000.00	
			P34,838,618.20
b.)	Deficiency Value-added Tax		
	Basic Tax	P 7,640,373.80	
	Surcharge	3,820,186.90	
			11,460,560.70
	Total		P46,299,178.90

> The alleged income tax deficiency assessment arose from the BIR's disallowance of the interest expense deducted by respondent from its gross income for the taxable year 1997 for allegedly being unsubstantiated. The alleged VAT deficiency, on the other hand, arose from the disallowance of respondent's available creditable input tax for the same year on the ground of lack of substantiation.

> On May 19, 2001, respondent filed an administrative protest against the aforesaid assessments.

> On July 17, 2001, respondent, through its external auditor, filed with the BIR a supplemental protest, reiterating its disagreement with the income and VAT deficiency assessments and submitting therewith all the relevant supporting documents to support its position.

> The Commissioner failed to act on the protest and supplemental protest within the period of one hundred eighty (180) days from July 17, 2001 or until January 13, 2002. As a result of the Commissioner's inaction, respondent filed a Petition for Review on

al

February 11, 2002 with the CTA. The petition was filed within thirty (30) days from the last day of the aforesaid 180-day period.

The parties submitted four issues for resolution:

1. Whether or not respondent was informed of the law and facts on which the assessments are made;
2. Whether or not respondent's interest expense in the amount of P55,300,000.00 is unsubstantiated;
3. Whether the claimed input taxes are allowable; and
4. Whether the assessment for the alleged deficiency VAT has already prescribed.

After trial on the merits, the Court in Division ruled that the Commissioner of Internal Revenue sufficiently complied with the requirements of Section 228 of the NIRC of 1997:

> "In the case at bar, the records would show that petitioner was sufficiently informed of the facts and the law on which the subject assessments were based."

With respect to the deductibility of the respondent's interest expense, the Court in Division ruled that it should be allowed as a proper deduction from its 1997 gross income pursuant to Section 29 (b) (1) of the NIRC of 1977, thus:

> "A perusal of the two (2) Loan Agreements with Mortgage entered into by petitioner with Isuzu Philippines Corporation on February 26, 1997 *(Exhibits B & O)* reveals that the said loans in the amounts of P168,000,000.00 and P227,000,000.00 bearing annual interest rates of 14% and 14.75%, respectively, were granted to petitioner by Isuzu Philippines Corporation. As found by the Revenue Examiners, the proceeds of the loans were used to purchase the land being leased out to Isuzu Philippines Corporation *(Exhibit J)*. Under the said loan agreements, interest shall be paid by petitioner on a quarterly basis. Thus, for the year 1997, the total interest expense incurred by petitioner on the said loans amounted to P55,300,000.00 which petitioner paid in four equal amounts of P13,825,000.00 on July 7, 1997, September 12, 1997, October 28, 1997 and January 8, 1998 as evidenced by Official Receipt Nos.

62

1863, 2504, 2933 & 3525 *(Exhibits P, Q, R & S)* issued by Isuzu Philippines Corporation to petitioner."

On the deficiency VAT assessment, the Court in Division ruled in favor of respondent herein IMA Land Holdings, Inc., as follows:

"Records show that on April 1, 1997, a Deed of Absolute Sale was executed by and between Laguna Technopark, Inc. and petitioner *(Exhibit C)* whereby the latter purchased a parcel of land from the former for the contract price of P162,372,000.00. However, prior to said date or on December 12, 1996, petitioner paid to Laguna Technopark, Inc. an amount of P81,186,000.00 representing the sum of P64,948,800.00 which is equivalent to 40% of the contract price of P162,372,000.00 and the 10% VAT of P16,237,200.00. The said payment was duly supported by a VAT official receipt issued by Laguna Technopark, Inc. to petitioner *(Exhibit I)*.

Of the 1996 input tax payment of P16,237,200.00, the amount of P4,738,392.00 was applied by petitioner against the output VAT liability due on its 1996 rental income of P47,383,920.00 *(Exhibit A-5)* while the remaining input taxes of P11,498,808.00 were carried over in 1997 and credited against petitioner's output VAT liability for the said year.

Evidently, the disallowance of the reported input taxes of P11,498,808.00 which led to the respondent's issuance of the 1997 deficiency VAT assessment of P11,460,560.70 is without factual basis."

Anent the last issue, the Court ruled that the 1997 deficiency VAT assessment was issued beyond the three-year prescriptive period to assess as prescribed by Section 203 of the NIRC of 1977:

"Pursuant to Section 203 in relation to Section 110 of the NIRC and Section 4.110-1 of Revenue Regulations No. 7-95, the period to assess commences after the last day prescribed by law for the filing of the return. In the case of VAT, it is twenty (20) days following the close of each taxable quarter. xxx xxx xxx. Therefore, respondent had until the following dates within which to assess petitioner for deficiency *VAT (year 2000 being a leap year)*:

63

Period (1997)	Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
1st Qtr.				
original return	D-1	4/21/97	4//21/97	4/20/00
amended return	E	9/17/97	-	9/16/00
2nd Qtr.	F	7/21/97	7/21/97	7/20/00
3rd Qtr.	G	10/20/97	10/20/97	10/19/00
4th Qtr.	H	1/20/98	1/20/98	1/19/01

xxx xxx xxx

> It is undisputed that both the deficiency VAT assessment notice and demand letter were dated April 3, 2001 *(par. 3, Facts Admitted)*. Indubitably, the deficiency VAT assessment for the four taxable quarters of 1997 was issued beyond the three-year period to assess."

On October 22, 2004, the Commissioner of Internal Revenue filed a Motion for Reconsideration invoking the following grounds: 1) that the interest expense is unsupported and therefore not deductible; and 2) that the deficiency assessment for VAT was issued within the prescriptive period.

The Motion for Reconsideration was denied by the Court in a Resolution dated April 6, 2005.

Hence, this appeal by the Commissioner of Internal Revenue to the Court *En Banc*.

The sole issue presented by the petitioner is:

> WHETHER OR NOT RESPONDENT IS LIABLE FOR DEFICIENCY INCOME TAX OF P34,838,618.20 AND DEFICIENCY VAT OF P11,460,560.70 FOR TAXABLE YEAR 1997.

The grounds relied upon by the petitioner are as follows:

1. The Tax Court erred in holding that the interest expense is duly substantiated.

2. The Tax Court erred in holding that the claimed input tax is properly supported.

3. The Tax Court erred in holding that the ten-year prescriptive period to assess cannot be made to apply in the instant case.

According to the petitioner, the Honorable Court's finding that the interest expense is duly substantiated is based "mainly on the report of Revenue Examiner Andres A. Andres that respondent's books and records are in order. The Court failed to take into account the testimony of petitioner's witness, Lea R. Bustonera, that the interest expense was disallowed for being unsupported pursuant to Section 34 of the National Internal Revenue Code and Revenue Memorandum Order 53-98. Petitioner's witness Lea R. Bustonera testified that:

> "xxx Interest expense must be substantiated by sufficient documentary evidences and the other official records. These documents were not found in the said Docket submitted to our end, Assessment Division, Revenue Region No. 9." (TSN, 25 June 2003, pp. 14-16)

Petitioner argues that the testimony of the said witness cannot just be ignored by this Honorable Court considering that reports of revenue examiners in the district level are automatically reviewed by the Review and Evaluation Unit, Office of the Regional Director. In addition, petitioner avers that "as testified to by Revenue Officer Lea

lar

R. Bustonera of the Review and Evaluation Section, Assessment Division, Revenue Region No. 9, San Pablo City, no documentary evidences and other official records were found in the docket submitted to their end. It must be stressed that matters not raised in the administrative level cannot be raised for the first time on appeal" invoking the case of *Aguinaldo Industries Corporation vs. Commissioner of Internal Revenue and Court of Tax Appeals*, G.R. No. L-29790, February 25, 1982. Moreover, petitioner argues that the interest expense for January 1998 should not be deductible because it was paid only in 1998. Hence, the same was not incurred or paid during the taxable year 1997.

On the issue of the cancellation of the deficiency VAT assessment, petitioner argues that the Honorable Court failed to take into account that the transaction involved is a sale of goods, hence, should have been supported by VAT sales invoice. Petitioner likewise argues that "[r]espondent failed to properly support the amount of P11,498,808.00 which it claimed as input tax carried over from the prior period. Thus, the persistent failure of respondent to present its books of accounts for various taxable years/prior years, left the petitioner no option but to resort to his power under Section 6 (B) of the National Internal Revenue Code, which is to assess the proper tax

66

on the best evidence obtainable. Thus, for filing incomplete and false returns, the prescriptive period is not three (3) years but ten (10) years from the discovery of the falsity of the returns. Hence, the deficiency VAT assessment was issued within the prescriptive period.

Respondent filed its Comment on June 14, 2005 asserting the following arguments:

1. Petitioner's grounds are a mere rehash of the grounds enumerated in his Motion for Reconsideration in C.T.A. Case No. 6389;

2. The interest expense of P55,300,000.00 disallowed by the petitioner was fully substantiated by documents such as the two (2) Loan Agreements with Mortgage entered into by petitioner with Isuzu Philippines Corporation *(Exhibits B & O)* and official receipts for the payments of interest issued by Isuzu Philippines Corporation to petitioner *(Exhibits P, Q, R & S)*;

3. Section 29 (b) (1) of the NIRC of 1997 provides that interest expense as an allowable deduction from gross income could either be paid or accrued within the taxable year;

4. Petitioner's theory that the official receipt presented by respondent is not the appropriate evidence to prove the payment of value-added tax is wanting in logic and legal basis. Evidently, Official Receipt No. 2522, which was presented by respondent during trial before the Court in Division, fully and convincingly substantiates respondent's payment of VAT in the amount of P16,237,200.00 in favor of Laguna Technopark Inc."; and

5. The assessment notices and demand letters issued by petitioner against respondent, both dated April 3, 2001, were issued beyond the three-year period to assess pursuant to Section 203 of the NIRC of 1997, as amended.

67

THE COURT'S RULING

The Petition for Review is bereft of merit.

Petitioner's claim that respondent's interest expense is unsubstantiated based on the testimony of its witness, Lea R. Bustonera of the Assessment Division of the BIR, that she could not find the supporting documents in the "Docket submitted to our end, Assessment Division, Revenue Region No. 9" is untenable.

The interest expense is
<u>properly substantiated</u>

The absence of documentary evidence in the BIR "docket" of the assessment case cannot be taken conclusively as proof that the interest expense is not adequately supported. In fact, petitioner's claim that the interest expense is unsubstantiated is contrary to the finding of the Court in Division that:

> "A perusal of the two (2) Loan Agreements with Mortgage entered into by petitioner with Isuzu Philippines Corporation on February 26, 1997 (*Exhibits B & O*) reveals that the said loans in the amounts of P168,000,000.00 and P227,000,000.00 bearing annual interest rates of 14% and 14.75%, respectively, were granted to petitioner by Isuzu Philippines Corporation. As found by the Revenue Examiners, the proceeds of the loans were used to purchase the land being leased out to Isuzu Philippines Corporation (*Exhibit J*). Under the said loan agreements, interest shall be paid by petitioner on a quarterly basis. Thus, for the year 1997, the total interest expense incurred by petitioner on the said loans amounted to

68

> P55,300,000.00 which petitioner paid in four equal amounts of P13,825,000.00 on July 7, 1997, September 12, 1997, October 28, 1997 and January 8, 1998 as evidenced by Official Receipt Nos. 1863, 2504, 2933 & 3525 (*Exhibits P, Q, R* & *S*) issued by Isuzu Philippines Corporation to petitioner."[1]

Indeed, Exhibits P, Q, R and S constitute sufficient proof that the interest expense claimed by the respondent as deductions from its gross income were incurred in the conduct of its business operations in the year 1997 pursuant to Sec. 29 (b) (1) of the NIRC of 1977, as amended, which provides:

> (b) *Interest.* – (1) *In general.* – The amount of interest paid or accrued within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business, except on indebtedness incurred or continued to purchase or carry obligation the interest upon which is exempt from taxation as income under this Title.

The above-cited provision speaks of interest *paid or accrued* within a taxable year. Therefore, respondent's interest payment for the last quarter of 1997 although paid in January 8, 1998 is a proper deduction from its 1997 gross income because it was already accrued as at December 31, 1997.

We concur with the ruling of the Court in Division that the ruling in the case of *Aguinaldo Industries Corporation vs. CIR and CTA*, *supra*, "is inapplicable in the case at bar considering that respondent's disallowance of the interest expense of P55,300,000.00 was already

---

[1] Decision, *IMA Land Holdings, Inc. vs. Commissioner of Internal Revenue*, C.T.A. Case No. 6389, Oct. 7, 2004, C.T.A. Case No. 6389, p. 6.

raised by petitioner in its protest letter dated May 17, 2001"[2]. In fact, respondent's protest letter *(Exhibit L)* pointed out that in the Details of Discrepancies attached to petitioner's Formal Letter of Demand dated 27 March 2001 the ground for the disallowance is that the interest expense is **"unsupported"** which is diametrically opposed to the tenor of a letter dated February 22, 1999 *(Exhibit K)* of Revenue District Officer Enrique F. Suministrado of Revenue District No. 57, San Pedro, Laguna that respondent's *"**books and records are in order** except for the interest charges amounting to P55,300,000.00 which we believe should be capitalized xxx"* as well as the Memorandum dated February 16, 1999 *(Exhibit J)* of the Revenue Examiner who examined respondent's books and records which states that *"(m)y examination revealed that the books and records are in order, in so far as the purported transactions are concerned, and **these were duly supported by receipts and invoices**".* Clearly, the disallowance of respondent's interest expense was put in issue at the administrative level.

The assessment notice for deficiency VAT is not binding for having been issued beyond the prescriptive period

---

[2] Resolution, *IMA Land Holdings, Inc. vs. Commissioner of Internal Revenue*, C.T.A. Case No. 6389, April 6, 2005, p. 2.

70

We concur with the ruling of the Court in Division that there is no falsity in the VAT returns filed by the respondent that would warrant the extension of the prescriptive period to ten (10) years. Respondent offered in evidence its *Exhibit I* which is an official receipt (O.R. No. 2522) issued by Laguna Technopark, Inc. dated December 12, 1996 showing a total payment of P81,186,000 made by the respondent representing a 40% downpayment on the purchase price of the real property and output VAT of P16,237,200 to prove the veracity of its input tax carried over from the prior year. Thus, there was no deviation from the truth. As aptly stated in the Resolution of the Court in Division dated April 6, 2005:

> "We do not agree. Without clear and convincing evidence that petitioner had filed a false and fraudulent VAT return for the first quarter of 1997, the ten-year prescriptive period cannot be made to apply in the instant case. The mere fact that the prior period input tax credit of P11,498,808.00 was supported by a VAT official receipt rather than a VAT sales invoice as required under the law did not render petitioner's VAT return for the first quarter of 1997 false nor fraudulent. Let it be stressed that respondent disallowed the said input VAT for allegedly not being supported by VAT invoices or receipts as required under Section 4.104 of Revenue Regulations No. 7-95 and RMO 53-98 (*Exhibit 3-a; page 101, BIR Records*)."

Since falsity of the VAT returns was not established by the petitioner, he had only three years within which to assess the respondent for its VAT liabilities. Sec. 203 of the NIRC of 1977, as

71

amended, provides that petitioner has only three years to assess any deficiency tax due from a taxpayer, thus:

> SEC. 203. *Period of limitation upon assessment and collection.* — Except as provided in the succeeding section, internal revenue taxes shall be assessed within three 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-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.

We agree with the finding of the Court in Division that the BIR could have issued a binding assessment against the respondent only until January 19, 2001 as shown by the following table contained in the assailed Decision:

Period (1997)	Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
1st Qtr.				
original return	D-1	4/21/97	4//21/97	4/20/00
amended return	E	9/17/97	-	9/16/00
2nd Qtr.	F	7/21/97	7/21/97	7/20/00
3rd Qtr.	G	10/20/97	10/20/97	10/19/00
4th Qtr.	H	1/20/98	1/20/98	1/19/01

It is undisputed that the deficiency VAT Assessment was issued only on April 3, 2001 which date is already beyond the three year period within which the BIR could make an assessment under Section 203 of the 1977 NIRC. Clearly, the assessment for deficiency VAT against the respondent "was made after the prescriptive period had expired and, therefore, was no longer binding"[3].

WHEREFORE, the petition for review is hereby **DENIED** for lack of merit. Accordingly, the assailed Decision dated October 7, 2004 and the Resolution dated April 6, 2005 are **AFFIRMED**.

SO ORDERED.

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

We Concur:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

---

[3] *Commissioner of Internal Revenue vs. Ayala Securities Corporation and The Honorable Court of Tax Appeals,* G.R. No. L-29485. March 31, 1976 (70 SCRA 204)

73

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of this Court before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice

74