REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

UNIOIL CORPORATION,
Petitioner,

- versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8000

Members:

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

Promulgated:
OCT 4 2011
ABFernandez 10:05 a.m.

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DECISION

COTANGCO-MANALASTAS, *J.*:

STATEMENT OF THE CASE

This Petition for Review seeks the cancellation and withdrawal of the assessment for deficiency withholding tax on compensation and deficiency expanded withholding tax in the aggregate amount of P536,801.10, inclusive of interests, issued by the Commissioner of Internal Revenue (respondent) against Unioil Corporation (petitioner) for taxable year ending December 31, 2005.

STATEMENT OF FACTS

Petitioner is a corporation duly organized and existing under Philippine laws, with office address at 2707 West Wing, PSE Center, Ortigas, Pasig City.[1]

Respondent is the Commissioner of the Bureau of Internal Revenue (BIR), with address at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On January 26, 2009, petitioner received a Formal Letter of Demand and Final Assessment Notice (FAN)[2] finding petitioner liable for deficiency withholding tax on compensation and deficiency expanded withholding tax for the year ending December 31, 2005. The relevant details are as follows:

I. DEFICIENCY WITHHOLDING TAX ON COMPENSATION		
Taxable Salaries per Investigation	P	3,106,737.64
Taxable Salaries per Alphalist		559,070.00
Salaries not subjected to Withholding Tax	**P**	**2,547,667.64**
Tax Due per Investigation	P	319,623.33
Less: Tax paid per Returns		40,948.91
Deficiency Withholding Tax on Compensation		278,674.42
Add: 20% interest p.a. (January 17, 2006 to February 13, 2009)		173,159.89
Total Deficiency Withholding Tax on Compensation	**P**	**451,834.31**
II. DEFICIENCY EXPANDED WITHHOLDING TAX		
Professional Fees	P	8,023.60
Payment to contractors/subcontractors		44,380.72
Deficiency Expanded Withholding Tax	P	52,404.32
Add: 20% interest p.a. (January 17, 2006 to February 13, 2009)		32,562.47
Total Deficiency Expanded Withholding Tax	**P**	**84,966.79**

Petitioner filed its protest to the FAN on February 25, 2009[3] and submitted its supporting documents on April 24, 2009[4].

Thereafter, petitioner filed the instant Petition for Review on November 20, 2009, considering that respondent failed to act on its protest and the one hundred eighty (180)-day period had already expired.

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[1] Par. 2.2, Joint Stipulation of Facts (JSF), *rollo*, p. 119.
[2] Par. 2.4, JSF, *rollo*, p. 119; Exhibit "A".
[3] Exhibit "B".
[4] Exhibit "C".

On December 14, 2009, respondent filed her Answer[5], where she raised the following Special and Affirmative Defenses:

> "5. All presumptions are in favor of the correctness of the Assessment;
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> 6. The herein Petitioner was fully appraised of the facts and the law on which the Final Assessment was issued. The Final Assessment Notice, Demand Letter and Details of Discrepancies which were all together sent at the same time to the Petitioner, contained, in detail, the manner of computation, the facts on which the assessment was based and the provisions of the law used in arriving at such deficiency assessment;
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> 7. Contrary to the allegations of the Petitioner, not all supporting documents were not submitted to completely support or rebut the assessment issued against the herein Petitioner;
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> 8. The Respondent had acted on the protest of the subject taxpayer. However, Respondent failed to issue its final resolution on the protest at the time the instant Petition was filed before this Honorable Court;
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> 9. The right to collect the withholding tax liability of the Petitioner has not prescribed. The withholding tax is merely being held by the Petitioner as an agent of the Government and Petitioner could not unjustly enrich itself by failing to remit the tax it withheld at the expense of the Government under the principle of *solutio indebiti*;
>
> 10. Section 72 of the National Internal Revenue Code was used by the Assessment Division as its authority to assess the herein Petitioner for its deficiency taxes. The assessment was based on the underdeclaration or undervaluation of the salaries account of the Petitioner which resulted in the Deficiency Withholding Tax on Compensation;
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> 11. As per audit investigation, it was determined that various income payments were not fully subjected to expanded withholding tax as required under Revenue Regulations No. 2-98, particularly the accounts of Professional Fees, Payment to Contractors, Repairs and Maintenance-Labor, Advertising and Manpower Services;"

[5] *Rollo*, pp. 88-90.

During trial, petitioner offered in evidence Exhibits "A" to "D", which were all admitted, except for Exhibit "B", in a Resolution dated September 8, 2010. For her part, respondent offered in evidence Exhibits "1" to "11", and were all admitted, except for Exhibits "3" to "3-A", in a Resolution dated June 10, 2011.

The case was submitted for decision on August 9, 2011[6], considering petitioner's "Memorandum" filed on July 14, 2011 and the report of the Court's Judicial Records Division that respondent failed to file her memorandum.

STATEMENT OF ISSUES

The parties submitted the following issues[7] for this Court's disposition:

> "1. Whether or not Petitioner is liable for deficiency withholding tax on compensation for the year ending 31 December 2005.
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> 2. Whether or not Petitioner is liable for deficiency expanded withholding tax for the year ending 31 December 2005.
>
> 3. Whether or not the right of Respondent to assess the deficiency withholding tax on compensation and deficiency expanded withholding tax, against Petitioner, has already prescribed."

RULING OF THE COURT

Petitioner opposes the assessments for the alleged deficiency withholding tax on compensation and deficiency expanded withholding tax arguing that respondent's right to issue the said assessments had already prescribed. It explains that in accordance with Section 203 of the National Internal Revenue Code (NIRC) of 1997, as amended, respondent has three years to assess national internal revenue taxes, counted from the date prescribed by law for filing of returns or from the actual date of filing, whichever comes later.

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[6] Resolution dated August 9, 2011, *rollo*, p. 465.
[7] *Rollo*, pp. 120-121.

According to petitioner, respondent had until December 9, 2008 to issue the assessments considering that the withholding tax returns for November 2005 were filed in December 2005. It concludes that the Final Assessment Notice issued on January 26, 2009 is null and void for being issued beyond the three-year prescriptive period.

Petitioner also contends that the issuance of the Final Assessment Notice has several procedural flaws. First, the FAN failed to apprise petitioner of the specific provision of the law or rules and regulations upon which the assessments were based and second, petitioner did not receive a Preliminary Assessment Notice prior to the issuance of the FAN, contrary to the procedures outlined in Revenue Regulations (RR) No. 12-99.

Furthermore, petitioner asseverates that it is not liable for deficiency withholding tax on compensation because respondent has no basis in saying that the salaries and wages declared in its return do not match those reported in its Income Statement because respondent's proof thereon has not been admitted by this Court for her failure to present the original copy.

Likewise, petitioner claims that it is not subject to expanded withholding tax, putting forward the following explanations:

1. There is no basis for the assessment of deficiency expanded withholding tax on Professional Fees because payments to general professional partnerships are exempt from the imposition of withholding tax under Section 2.57.5 of RR No. 2-98, as amended and Section 26 of the NIRC of 1997, as amended, does not subject general professional partnerships to income tax;
2. There is no basis for the assessment of deficiency expanded withholding tax on Repairs and Maintenance and expanded withholding tax on Advertising and Promotion. Expanded withholding tax is collected on income payments to contractors but the amounts declared under "Repairs and Maintenance" in its Income Tax Returns for the year 2005 are not income payments to

contractors but are payments for supplies, parts, and materials used for the repairs and maintenance done. In the same vein, the amount declared under Advertising and Promotions in its Income Tax Returns are not income payments in advertising agencies but payments to media; and

3. There is no basis in the assessment of deficiency expanded withholding tax on Manpower Services and that there are certain errors and inconsistencies as regards the details of discrepancy of deficiency expanded withholding tax as stated in Schedule I of the Final Assessment Notice.

After weighing the parties' arguments and pieces of evidence, this Court finds for petitioner.

The Court will first settle the procedural issues raised by petitioner, particularly, the allegation that petitioner did not receive a Preliminary Assessment Notice; an indispensable requirement to satisfy petitioner's right to due process.

The right of taxpayers to procedural due process in the issuance of assessment is clearly decreed in Section 228 of the National Internal Revenue Code of 1997, as amended, to wit:

> "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 preassessment notice shall not be required in the following cases:
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> (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
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> (b) When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent; or
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> (c) When a 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 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.*)

Corollary to the above provision is Section 3 of Revenue Regulations No. 12-99. It defined the due process requirement in the issuance of assessments, *viz*:

"SECTION 3. *Due Process Requirement in the Issuance of a Deficiency Tax Assessment.* —

3.1 Mode of procedures in the issuance of a deficiency tax assessment:

3.1.1 *Notice for informal conference.* — The Revenue Officer who audited the taxpayer's records shall, among others, state in his report whether or not the taxpayer agrees with his findings that the taxpayer is liable for deficiency tax or taxes. If the taxpayer is not amenable, based on the said Officer's submitted report of investigation, the taxpayer shall be informed, in writing, by the Revenue District Office or by the Special

Investigation Division, as the case may be (in the case of Revenue Regional Offices) or by the Chief of Division concerned (in the case of the BIR National Office) of the discrepancy or discrepancies in the taxpayer's payment of his internal revenue taxes, for the purpose of 'Informal Conference,' in order to afford the taxpayer with an opportunity to present his side of the case. If the taxpayer fails to respond within fifteen (15) days from date of receipt of the notice for informal conference, he shall be considered in default, in which case, the Revenue District Officer or the Chief of the Special Investigation Division of the Revenue Regional Office, or the Chief of Division in the National Office, as the case may be, shall endorse the case with the least possible delay to the Assessment Division of the Revenue Regional Office or to the Commissioner or his duly authorized representative, as the case may be, for appropriate review and issuance of a deficiency tax assessment, if warranted.

3.1.2 *Preliminary Assessment Notice (PAN).* — If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, the said Office shall issue to the taxpayer, at least by registered mail, a Preliminary Assessment Notice (PAN) for the proposed assessment, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based (see illustration in ANNEX A hereof). If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall be considered in default, in which case, a formal letter of demand and assessment notice shall be caused to be issued by the said Office, calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties.

3.1.3 *Exceptions to Prior Notice of the Assessment.* — The notice for informal conference and the preliminary assessment notice shall not be required in any of the following cases, in which case, issuance of the formal assessment notice for the payment of the taxpayer's deficiency tax liability shall be sufficient:

(i) When the finding for any deficiency tax is the result of mathematical error in the computation of the tax appearing on the face of the tax return filed by the taxpayer; or

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

(iii) When a 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

> (iv) When the excise tax due on excisable articles has not been paid; or
>
> (v) 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.
>
> 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* (see illustration in ANNEX B hereof). 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."

Apparent from the afore-quoted provision of law and regulations are the requirements that must be observed to conform with the "requirement of procedural due process", which is vital to the validity of an assessment.

First is the sending of a notice for informal conference to the taxpayer accompanied by a Summary of Findings or Report of Investigation. After the informal conference and if the Commissioner of Internal Revenue or her duly authorized representative finds that taxes should be assessed, the taxpayer will be notified in writing in the form of a Preliminary Assessment Notice. The PAN will state the basis of the assessment.

The taxpayer is given fifteen (15) days from receipt of the PAN to make a reply, failing so, a formal letter of demand and assessment notice shall be issued calling for payment of the taxpayer's deficiency tax liability. If the taxpayer disagrees with or wishes to protest the assessment, it must send a letter to the BIR indicating its protest, stating the reasons therefor, and submitting such proof as may be necessary. The assessment then becomes a disputed assessment on which the CIR may render a decision.[8]

Undisputedly, the issuance of a PAN is part of the due process requirement in the assessment of taxes and its indispensability is confirmed when the law and regulations enumerated the only instances when it may not be issued. In fact, in the recent case of *Commissioner of Internal Revenue vs. Metro Star Superama, Inc.*[9], the Supreme Court upheld the importance of issuing a PAN in complying with the due process requirement. Pertinent portions of the decision state:

> "xxx are the requirements of due process satisfied if only the FAN stating the computation of tax liabilities and a demand to pay within the prescribed period was sent to the taxpayer?
>
> The answer to these questions require an examination of Section 228 of the Tax Code which reads:
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> xxx xxx xxx
>
> Indeed, Section 228 of the Tax Code clearly requires that the taxpayer must first be informed that he is liable for deficiency taxes through the sending of a PAN. He must be informed of the facts and the law upon which the assessment is made. The law imposes a substantive, not merely a formal, requirement. To proceed heedlessly with tax collection without first establishing a valid assessment is evidently violative of the cardinal principle in administrative investigations - that taxpayers should be able to present their case and adduce supporting evidence.
>
> This is confirmed under the provisions R.R. No. 12-99 of the BIR which pertinently provide:
>
> xxx xxx xxx
>
> From the provision quoted above, it is clear that the sending of a PAN to taxpayer to inform him of the **assessment made is but part of the 'due process requirement in the issuance of a deficiency tax assessment,' the absence of which renders nugatory any assessment** made by the tax authorities. The use of the word ***'shall'* in subsection 3.1.2 describes the mandatory nature of the service of a PAN**. The persuasiveness of the right to due process reaches both substantial and procedural rights and the failure of the CIR to strictly

[8] *Commissioner of Internal Revenue vs. Isabela Cultural Corporation*, G.R. No. 135210, July 11, 2001.
[9] G.R. No. 185371, December 8, 2010.

> comply with the requirements laid down by law and its own rules is a denial of Metro Star's right to due process. Thus, for its failure to send the PAN stating the facts and the law on which the assessment was made as required by Section 228 of R.A. No. 8424, the assessment made by the CIR is void." (*Emphasis supplied*)

In the case at bar, petitioner denied receiving the Preliminary Assessment Notice. It follows that it is incumbent upon respondent to prove the receipt of the subject assessment notice by contrary evidence. However, records lay bare of clear and convincing evidence to show that petitioner indeed received a PAN.

Respondent offered in evidence a draft Preliminary Assessment Notice (*Exhibit "9"*) and a PAN dated November 27, 2008 (*Exhibit "10"*) to establish, among others, that a PAN was issued in compliance with existing revenue issuances; but the same failed to show that they were sent to petitioner, either through personal delivery or mail. No other documentary or testimonial evidence was submitted by respondent to disprove petitioner's alleged non-receipt of the PAN and respondent's failure to do so leads to the conclusion that no PAN was really issued. While there are instances when the non-issuance of a PAN prior to a FAN is allowed, the same are unavailing because the instant case is not among those enumerated.

In sum, respondent's failure to strictly comply with the notice requirements as laid down in Section 228 of the NIRC of 1997, as amended, and RR No. 12-99 amounts to the denial of petitioner's right to due process, effectively voiding the assessments issued.

It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for the lack of the motive power to activate and operate it. Despite the natural reluctance to surrender part of one's hard-earned income to taxing authorities, every person who is able to must contribute his share in the running of the government.[10] However, well enshrined is the constitutional mandate that no person shall be deprived of his property without due process of law. Thus, the Revenue Commissioner or her duly authorized representatives are expected to give accord to procedures laid down in law or regulations in assessing or collecting taxes. Taxpayers owe honesty to government just as government owes fairness to taxpayers.[11]

In view of the foregoing, there is no reason for the Court to discuss the other issues and arguments of the parties considering that a void assessment bears no fruit.

WHEREFORE, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, the assessments for deficiency withholding tax on compensation and deficiency expanded withholding tax in the total amount of P536,801.10, inclusive of interests, for taxable year 2005 are hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

AMELIA R. COTANGCO- MANALASTAS
Associate Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

[10] *Commissioner of Internal Revenue vs. Algue, Inc., et. al.*, L-28896, February 17, 1988.
[11] *Commissioner of Internal Revenue vs. Tokyo Shipping Co., Ltd, et. al.,* G.R. No. 68252, May 26, 1995.

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.

LOVELL R. BAUTISTA
Associate Justice
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.

ERNESTO D. ACOSTA
Presiding Justice