REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

ROCA SECURITY AND INVESTIGATION AGENCY, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA EB No. 1523
(CTA Case No. 8718)

Present:

DEL ROSARIO, *PJ*
CASTAÑEDA, JR.
BAUTISTA,
UY,
CASANOVA,
FABON-VICTORINO,
MINDARO-GRULLA,
RINGPIS-LIBAN,
MANAHAN, *JJ.*

Promulgated:

MAR 07 2018 11:25 a.m.

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DECISION

***Fabon-Victorino, J.*:**

Before the Court is the Petition for Review dated October 19, 2016 filed by petitioner Roca Security and Investigation Agency, Inc., assailing the Decision dated July 21, 2016 and Resolution dated September 16, 2016, both rendered by the Court in Division which affirmed with modifications the disputed assessment for deficiency income tax (IT) and improperly accumulated earnings tax (IAET) in the reduced amount of ₱2,082,763.36, plus deficiency and delinquency interests.

The facts established during trial of the case are undisputed.

Petitioner is a domestic corporation, with business address at 1716 Honradez St., Barangay 437, Sampaloc, Manila. It is a registered taxpayer under Certificate of Registration No. OCN 1RC0000253629 with Taxpayer Identification No. (TIN) 000-085-243-000.

Respondent, on the other hand, is the Commissioner of the Bureau of Internal Revenue (BIR) vested with authority to rule on disputed assessments, cancel and abate tax liabilities pursuant to the National Internal Revenue Code (NIRC) of 1997, as amended. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On April 15, 2010, petitioner filed its Annual Income Tax Return (ITR) for the year 2009.

On September 17, 2010, petitioner received the electronic Letter of Authority No. 20100001373 with the First Request for Presentation of Records. It likewise received on even date, the Second Request and Final Request for Presentation of Records.

On May 16, 2012, a Subpoena Duces Tecum with No. RR6-2012-0228 was issued ordering petitioner to appear before the BIR and submit its books of accounts and other accounting records for the year 2009.

On October 12, 2012, respondent sent petitioner a Post Reporting Notice with Details of Computation of its alleged tax liability.

On March 25, 2013, respondent issued a Preliminary Assessment Notice (PAN) against petitioner for alleged deficiency IT in the amount of ₱7,719,617.21 and deficiency IAET amounting to ₱960,076.64, including increments, for the year 2009. It was received by petitioner on April 3, 2013.

On April 18, 2013, petitioner filed a Letter of Protest against the PAN.

On April 12, 2013, a Formal Letter of Demand (FLD) with Details of Discrepancies and Assessment Notices with Nos. 32-09-IT-4995 and 32-09-IAET-4996 were issued which petitioner received on April 19, 2013. Petitioner protested the FLD on May 16, 2013.

In the Letter dated September 10, 2013, respondent affirmed the assessed tax deficiencies on the ground that petitioner failed to submit relevant documents in support of its protest. The same letter informed petitioner that the said letter shall constitute as the Final Decision on the Disputed Assessment (FDDA).

On October 9, 2013, petitioner elevated the matter to the Court in Division via Petition for Review.

After trial, the Court in Division rendered the assailed Decision dated July 21, 2016, partially granting the Petition for Review by affirming the assessments with modifications, as follows:

> WHEREFORE, premises considered, the instant Petition for Review is PARTIALLY GRANTED. Accordingly, the deficiency income tax and improperly accumulated earnings tax assessments for taxable year 2009 are AFFIRMED with MODIFICATIONS and petitioner is ORDERED TO PAY the modified amount of P2,082,763.36 inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Tax Type	Basic Tax	25% Surcharge	Total
Income Tax	₱ 1,577,522.93	₱ 394,380.73	₱ 1,971,903.66
IAET	88,687.76	22,171.94	110,859.70
Total	₱ 1,666,210.69	₱ 416,552.67	₱ 2,082,763.36

> In addition, petitioner is ORDERED TO PAY:
>
> (a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax and improperly accumulated earnings tax computed from the dates indicated below until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended:

n/

Tax Type	Basic Tax	Deficiency Interest Computed From
Income Tax	₱ 1,577,522.93	April 15, 2010
IAET	₱ 88,687.76	January 15, 2011

(b) Delinquency interest at the rate of 20% per annum on the total amount of P2,082,763.36 and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from September 25, 2013 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

The above Decision was effectively affirmed when the Court in Division denied petitioner's plea for reconsideration for lack of merit, in the similarly assailed Resolution dated September 16, 2016.

Hence, this appeal through a Petition for Review before the Court *En Banc*.

Petitioner contends that the subject assessment should be invalidated for being in the nature of a "jeopardy assessment," or an assessment issued without basis in any full or partial audit. The issuance of the FLD at a rapid pace of barely 16 days from the issuance of the PAN clearly indicates that the final assessment is without basis, hence, void for having been issued in violation of petitioner's right to due process.

Petitioner likewise takes exception when the Court in Division affirmed the disallowance of 50% of petitioner's operating expenses as deduction from its taxable gross income on the basis that the same were unsupported by any evidence.

Petitioner argues that the Court erred when it strictly implemented RMC No. 23-2000 which is the basis of the 50% disallowed deduction on some of its operating expenses due to failure to present evidence thereon. According to petitioner, these operating expenses pertain to

Representation & entertainment, taxes and licenses, transportation expense, communication expense, gasoline & oil, insurance & bonds, and office supplies.

The failure to present supporting documents to substantiate the said operating expenses was because its accounting records and books of account for 2009 were destroyed during inundation caused by typhoon Ondoy on September 26, 2009. Under this obtaining circumstance, the Court in Division should have tempered the application of RMC No. 23-2000, since the loss of the documents to substantiate petitioner's operating expenses was entirely due to reason beyond its control.

Petitioner also finds erroneous the ruling of the Court in Division that it failed to withhold taxes on cost of services in the amount of ₱4,948,562.33, hence, the said amount is disallowed as deduction from petitioner's gross income.

According to petitioner, respondent initially held that it failed to withhold taxes on its cost of services in the total amount of ₱15,855,730.76, thus disallowing the said amount as deduction from its gross income. However, the Court in Division ruled that only the amount of ₱4,948,562.33 should be disallowed as deduction for failure to withhold taxes thereon.

Petitioner claims that the cost of services in the total amount of ₱15,855,730.76 is not subject to withholding tax. It explains the said amount comprises the salaries of its security guards who are minimum wage earners, thus, it is not obligated to withhold taxes from these salaries. In other words, the disallowance of the said deductions from petitioner's gross income should be reversed.

As to the other disallowed items, namely, ammunition and training, utilities, and repair and maintenance, petitioner theorizes that their disallowance due to non-withholding is likewise without any basis, hence, should be reversed. For petitioner, respondent failed to prove that these items are subject to EWT enumerated under Section 2.57.2 of RR No.2-98.

Finally, the Court in Division erred in affirming the imposition of IAET on it on the basis of a strict application of Section 3 of RR No. 2-2001 dated February 12, 2001.

The determination of whether the accumulation of earnings is proper should be left to its sound discretion, as it is in the best position to make such determination, given that it is more familiar with its line of business.

By affirming the imposition of IAET, the Court in Division effectively allowed respondent, who has no sufficient knowledge on petitioner's business, to supplant the latter's more informed business decision.

As a security agency, with hundreds of security guards in its employ, petitioner's accumulation of earnings as contingency funds for accidents and injuries to third persons, and for losses due to the negligence of its security guards fielded to its clients is proper. Such contingency fund and petitioner's corporate expansion, more than justify the accumulation of earnings upon which IAET should not be imposed.

Further, petitioner is a moderate sized corporation whose capital stock is only three million pesos, of which only ten thousand pesos have actually been subscribed. From the assailed Decision, petitioner's taxable income for 2009 amounts to only ₱1,266,967.95 while its retained earnings from previous years amount to only ₱4,375,885.16, with accumulated earnings as of the end of the year 2009 of only ₱5,262,762.72. The said modest accumulated earnings do not justify the imposition of a penalty in the form of IAET designed to compel the distribution of earnings.

For the foregoing arguments, respondent counters that the subject assessment is not a jeopardy assessment issued without the benefit of audit. His witness Benilda Sanchez testified that she conducted a thorough examination of the available books of accounts and accounting records submitted by petitioner which revealed that it is liable for deficiency taxes as reflected in her audit report.

Contrary to petitioner's protestation, it was accorded due process as it was given the right to be heard particularly through its protest letters and request for reinvestigation. In fact, its request for reinvestigation was granted and petitioner was notified thereof in the Letter dated May 7, 2013 with a request for submission of additional supporting documents. Despite the opportunity granted, petitioner failed to submit any.

The foregoing clearly debunks petitioner's complaint that there was undue haste in the issuance of the assailed deficiency tax assessments and that the merits of its protest were not considered by the BIR.

Anent the 50% disallowed deduction on its operating expenses on the ground that petitioner failed to present evidence thereon, respondent opines that the burden of proof rests upon petitioner who is contesting the assessment, which is presumed correct unless contrary proof is presented.

Respondent also agrees with the findings of the Court in Division that petitioner failed to withhold taxes on cost of services in the amount of ₱4,948,562.33, hence, the said amount was disallowed as deduction from petitioner's gross income. As found by the Court in Division, not all of petitioner's security guards were paid below or at minimum wage, in which case, withholding was not required.

As regards the other items, petitioner failed to prove that the said items were not among those subject to EWT under RR No. 02-98, hence subject to tax.

Lastly, petitioner utterly failed to establish the need that would justify its accumulation of retained earnings. Allegedly, the imposition of IAET was only proper under Section 29 of the NIRC, as amended, and Section 3 of RR No. 2-2001. In this case, petitioner was unable to present any proof to establish the need to accumulate retained earnings. In fact, it was only in its memorandum filed with the Court in Division that petitioner belatedly indicated its intention to use the accumulation of earning for its expansion plan and as contingency fund. However, the allegation remained just that without any substantiation thereto.

The instant Petition was submitted for decision on March 8, 2017.[1]

THE RULING OF THE COURT

Section 228 of the NIRC, as amended, pertinently provides, thus:

> 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: x x x
>
> **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 ours)

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[1] Resolution dated March 8, 2017.

It is clear from the foregoing provision that a taxpayer must be informed in writing of the legal and factual bases of the tax assessment made against him. The use of the word "shall" in the legal provision indicates the mandatory nature of the requirements laid down therein.[2] Its purpose is to aid the taxpayer in making a reasonable protest, if necessary.[3] Note, that requirement is substantive, not merely formal. Thus, violation thereof renders the assessment void.

As stated in the provision, the taxpayer may respond or protest the initial assessment within the 15-day period prescribed under the following provision and only after the expiration of the same may the Commissioner or his duly authorized representative issue an assessment based on his findings.

Section 3 of Revenue Regulations (RR) No. 12-99,[4] as amended by RR No. 18-2013, [5] issued by respondent provides as follows:

> SECTION 3. Due Process Requirement in the Issuance of a Deficiency Tax Assessment. –
>
> 3.1 Mode of procedure in the issuance of a deficiency tax assessment:
>
> 3.1.1 Preliminary Assessment Notice (PAN). – If after review and evaluation 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 a Preliminary Assessment Notice (PAN) for the proposed assessment. It shall show in detail the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based x x x.
>
> 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 Final Assessment Notice (FLD/FAN) shall be

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[2] Commissioner of Internal Revenue vs. United Salvage and Towage (Phils.), Inc., G.R. No. 197515, July 02, 2014.
[3] Id.
[4] Dated September 6, 1999.
[5] Dated November 28, 2013.

> issued calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties.
>
> If the taxpayer, within fifteen (15) days from date of receipt of the PAN, responds that he/it disagrees with the findings of deficiency tax or taxes, an FLD/FAN shall be issued within fifteen (15) days from filing/submission of the taxpayer's response, calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties. (emphasis supplied)
>
> x x x x x x x x x

Thus, a taxpayer has fifteen (15) days from receipt of the PAN to respond or file a protest thereto. It is only upon the lapse of this 15-day period, with or without a response/protest from the taxpayer, that the CIR or his legally authorized representative may issue the FLD or final assessment notice.

In this case, the PAN was issued on March 25, 2013,[6] and received by petitioner on April 3, 2013.[7] Hence, petitioner had 15 days or until April 18, 2013, to file its protest to the PAN.[8]

Record however reveals that respondent issued the FLD with assessment notices 6 days before the 15-day period to file protest expired, or on April 12, 2013[9]. Evidently, the FLD was prematurely issued in violation of petitioner's right to due process.

It may be argued that the premature date of issuance of the FLD on April 12, 2013 may be ignored as the FLD was received by petitioner on April 19, 2013,[10] or a day after the 15-day period to protest/respond to the PAN lapsed. After all, petitioner was able to file its protest to the PAN on April 18, 2013, or one (1) day before receipt of the FLD.

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[6] Exhibit R-7, docket volume 2 pp. 623-624.
[7] Par. 5, Facts Admitted, Joint Stipulation of Facts and Issues dated February 18, 2014, docket volume 1 p.172.
[8] Par. 6, Facts Admitted, Joint Stipulation of Facts and Issues dated February 18, 2014, docket volume 1 p.172.
[9] Exhibit P-8, docket volume 1 pp. 306-308; Exhibit R-10, docket volume 2 pp. 628-630.
[10] Par. 7, Facts Admitted, Joint Stipulation of Facts and Issues dated February 18, 2014, docket volume 1 p.172.

The proposition is obviously specious and repugnant to the purpose for which the 15-day period is prescribed under the rules. The 15-day period provides the taxpayer the opportunity to fully exercise its right to due process, which includes the right to be heard and adduce evidence in its behalf. In fact, the 15-day period may not even be sufficient to collect and collate evidence to dispute the assessment especially if it pertains to several taxable periods or one involving numerous transactions or parties. Surely, the premature issuance of the FLD precluded petitioner from its full use of the 15-day period to respond or file protest to the PAN.

It cannot also be denied that with the premature issuance of the FLD on April 12, 2013, any argument or evidence adduced by petitioner in support of its protest against the PAN was pointless, if not moot, for at that time, respondent was already dead-set or bent on upholding the assessment as contained in the PAN. This indubitably constitutes denial of due process as petitioner was not given the opportunity to dispute and present evidence against the PAN, before the final assessment was issued.

Basic is the rule that tax collection should be premised on a valid assessment, one that would allow the taxpayer to present his or her case and produce evidence for substantiation.[11]

The right of the taxpayer to be accorded due process, or the right to be heard, as provided under Section 228 of the NIRC, as amended, commences at the inception of the assessment process, the issuance of the PAN included.

The essence of the PAN and the right of the taxpayer to be accorded the opportunity to contest it, have been emphasized by respondent himself through R.R. No. 12-99 and have been upheld by no less than the Final Arbiter when it ruled that the failure of respondent to strictly comply with the requirements laid down by law and by his own regulations through R.R. No. 12-99 constitutes violation of due process. The relevant portion of the Decision reads as

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[11] Commissioner of Internal Revenue vs. Fitness By Design, Inc., G.R. No. 215957, November 9, 2016.

follows:

> 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:
>
>> 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. x x x
>>
>> 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.

x x x.

From the provision quoted above, it is clear that the sending of a PAN to the 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 comply with the requirements laid down by law and its own rules is a denial of Metro Stars 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.[12] (emphasis ours)

Since the law imposes a substantive requirement, providing the taxpayer with the factual and legal bases for the assessment is crucial before proceeding with tax collection[13]. This requirement in the issuance of assessment conforms with the constitutional mandate that no person shall be deprived of his or her property without due process of law.

Finally, between the power of the State to tax and an individual's right to due process, the scale favors the right of the taxpayer to due process.

With the FLD having been issued in violation of petitioner's right to due process, the assessment contained therein is therefore void. With this finding, discussion in the other issues raised becomes unnecessary.

WHEREFORE, the Petition for Review dated October 19, 2016 filed by Roca Security and Investigation Agency, Inc. is hereby **GRANTED**. The Decision dated July 21, 2016, and the Resolution dated September 16, 2016, both rendered by the Court in Division are **REVERSED** and **SET ASIDE**.

Consequently, the assessment in the Formal Letter of Demand and Assessment Notices for deficiency income tax

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[12] Commissioner of Internal Revenue vs. Metro Star Superama, Inc., G.R. No. 185371, December 8, 2010.

[13] Commissioner of Internal Revenue vs. Fitness By Design, Inc., G.R. No. 215957, November 9, 2016.

(IT) and improperly accumulated earnings tax (IAET) for the year 2009 is **CANCELLED and WITHDRAWN**.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ON LEAVE
ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

CERTIFICATION

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.

ROMAN G. DEL ROSARIO
Presiding Justice