REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

COMPANIA DE GARAY, INC., Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE, Respondent.

CTA CASE NO. 9540

Members:

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

Promulgated:

SEP 24 2019

10:00 a.m.

x- -x

DECISION

CASTAÑEDA, JR., *J.*:

THE CASE

In this Petition for Review, petitioner Compania De Garay, Inc. seeks for the Court to declare void Assessment Notice No. RR-16-099-082-2016 for deficiency Income Tax, Value Added Tax and Compromise Penalty for taxable year 2012.

THE FACTS

Petitioner alleges that it is a corporation duly organized and existing under the laws of the Philippines, with principal office at Sayre Highway, Poblacion Sur, Don Carlos, Bukidnon. It operates under the business style Garay General Merchandise, engaged in the business of buying and selling various goods and merchandise and duly registered with the Bureau of Internal Revenue (BIR), District 99 under TIN 006252194000.[1]

Respondent is the Commissioner of the BIR, duly appointed to exercise the powers and perform the duties of his office including, *inter alia*, the power to decide disputed assessments, refunds of internal revenue taxes, fees, other charges, and penalties imposed in relation thereto, or other matters arising under the Tax Code. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On August 26, 2014, petitioner received Letter Notice (LN) No. 099-RLFTRS-12-00-00032,[2] finding a one hundred percent (100%) under-declaration on sales in the amount of P2,678,944.64. On even date, petitioner likewise received a letter[3] dated August 12, 2014 from the BIR affording it the opportunity to reconcile the said discrepancy. Consequently, the BIR issued a Follow-up Letter[4] dated September 8, 2014 to remind petitioner of the above-findings.

On September 23, 2015, petitioner through its President – Florentine T. Garay, executed a Waiver of the Defense of Prescription under Statute of Limitations of National Internal Revenue Code (NIRC).[5]

On October 13, 2015,[6] petitioner received a Notice of Informal Conference dated October 5, 2015 with attached Computation Sheet[7] from the BIR.

On December 10, 2015,[8] petitioner received the Preliminary Assessment Notice (PAN) dated December 2, 2015.[9] On December 22, 2015,[10] petitioner sent its Reply to the PAN. ge

[1] Petition for Review, par. 1, Docket, p. 13.
[2] Exhibits "R-1" and "P-2", BIR Records, pp. 1-4.
[3] Exhibit "R-2", BIR Records, p. 5; Exhibit "P-1", Docket, p. 397.
[4] Exhibit "R-3", BIR Records, p. 6.
[5] Exhibit "P-3", Docket, p. 297.
[6] Exhibit "P-4", Docket, p. 298.
[7] Exhibit "P-5", Docket, p. 299.
[8] Petition for Review, par. 6, Docket, p. 15.
[9] Exhibit "P-6", Docket, pp. 300-304.
[10] Exhibit "P-7", Docket, p. 305.

On January 29, 2016,[11] petitioner received the Formal Demand Letter and the subject Assessment Notice No. RR-16-099-082-2016.[12] On February 23, 2016, petitioner sent its Letter Protest dated February 22, 2016.[13] In its Protest, petitioner raised the non-issuance of a Letter of Authority (LOA) and the propriety of requiring it to submit a Summary List of Sales and Purchases.

Thereafter, the BIR sent its Reply[14] dated February 29, 2016 to the said Letter Protest, granting petitioner a period of sixty (60) days from filing of its protest to submit relevant supporting documents. On February 1, 2017,[15] petitioner received a copy of the Final Decision on Disputed Assessment (FDDA) dated January 12, 2017 where the BIR upheld its assessment. Thus, on February 24, 2017,[16] petitioner filed the instant Petition for Review.

On May 30, 2017, respondent filed his Answer[17] where he raised, among others, that it is within the ambit of respondent's power to issue an assessment other than by force of a Letter of Authority (LOA).

On June 6, 2017, the Court issued a Notice of Pre-Trial Conference.[18] On August 7, 2017, petitioner filed its Pre-Trial Brief of Petitioner,[19] while on November 7, 2017, respondent filed his Respondent's Pre-Trial Brief.[20] On February 20, 2018, the Court issued its Pre-Trial Order.[21]

During hearing, petitioner presented its lone witness, Maria Lydiar R. Garay[22] – General Manager of petitioner. Petitioner likewise filed its Formal Evidence[23] on April 12, 2018.

On the other hand, respondent presented the following witnesses: (1) Catherine C. Gican[24] – Revenue Officer I at Revenue

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[11] Petition for Review, par. 8, Docket, p. 16.
[12] Exhibit "P-8", Docket, pp. 306-313.
[13] Exhibit "P-9", Docket, pp. 314.
[14] Exhibit "P-10", Docket, p. 319.
[15] Exhibit "P-11", Docket, pp. 320-321.
[16] Docket, pp. 12-20.
[17] Docket, pp. 64-77.
[18] Docket, pp. 81-82.
[19] Docket, pp. 96-102.
[20] Docket, pp. 119-123.
[21] Docket, pp. 278-284.
[22] Exhibit "P-12", Docket, pp. 104-111.
[23] Docket, pp. 288-291.
[24] Exhibit "R-14", Docket, pp. 128-135.

District Office (RDO) No. 100 – Ozamiz City; and (2) Ommukhalthom S. Umpar[25] – Revenue Officer I at RDO No. 98 – Cagayan De Oro City. On June 25, 2018, respondent also filed his Formal Offer of Evidence.[26]

On October 25, 2018, the Court, among others, required the parties to submit their respective memoranda. On December 3, 2018, respondent filed his Memorandum[27] while on November 27, 2018, petitioner filed its Petitioner's Memorandum.[28] On January 11, 2019,[29] the Court issued a Resolution submitting the case for decision. Hence, this Decision.

THE ISSUE

The parties stipulated the following issue: Whether the petitioner is liable for deficiency Income Tax, Value Added Tax and Compromise Penalty amounting to P258,666.20, P674,379.67 and P8,000.00, respectively, under Assessment Notice RR-16-099-082-2016 or a total amount of P941,045.87.[30]

After evaluation of the parties' pleadings, the issue to be resolved by the Court is whether the subject assessment is valid despite the absence of an LOA.

THE RULING

The Court rules in petitioner's favor.

An LN is not equivalent to an LOA. In the absence of an LOA, the assessment is a nullity

In *Medicard Philippines, Inc. v. Commissioner of Internal Revenue*,[31] the Supreme Court comprehensively discussed the nature of an LN and an LOA *vis-à-vis* the BIR's RELIEF System which was likewise utilized in this case. Further, the Supreme Court stated that

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[25] Exhibit "R-13", Docket, pp. 169-175.
[26] Docket, pp. 350-356.
[27] Docket, pp. 390-400.
[28] Docket, pp. 402-413.
[29] Resolution, Docket, p. 417.
[30] Stipulated Issue, Pre Trial Order, Docket, p. 279.
[31] G.R. No. 222743, April 5, 2017.

an LN cannot be converted into an LOA. In the absence of authority to conduct an examination or assessment, such assessment or examination is a nullity. *We* quote the pertinent discussion of the Supreme Court, as follows:

> "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.
>
> Based on the afore-quoted provision, it is clear that unless authorized by the CIR himself or by his duly authorized representative, through an LOA, an examination of the taxpayer cannot ordinarily be undertaken. The circumstances contemplated under Section 6 where the taxpayer may be assessed through best-evidence obtainable, inventory-taking, or surveillance among others has nothing to do with the LOA. These are simply methods of examining the taxpayer in order to arrive at the correct amount of taxes. Hence, unless undertaken by the CIR himself or his duly authorized representatives, other tax agents may not validly conduct any of these kinds of examinations without prior authority. *gc*

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 RMO, several offices of the BIR are tasked with specific functions relative to the RELIEF System, particularly with regard to LNs. Thus, the Systems Operations Division (SOD) under the Information Systems Group (ISG) is responsible for: (1) coming up with the List of Taxpayers with discrepancies within the threshold amount set by management for the issuance of LN and for the system-generated LNs; and (2) sending the same to the taxpayer and to the Audit Information, Tax Exemption and Incentives Division (AITEID). After receiving the LNs, the AITEID under the Assessment Service (AS), in coordination with the concerned offices under the ISG, shall be responsible for transmitting the LNs to the investigating offices [Revenue District Office (RDO)/Large Taxpayers District Office (LTDO)/Large Taxpayers Audit and Investigation Division (LTAID)]. At the level of these investigating offices, the appropriate action on the LNs issued to taxpayers with RELIEF data discrepancy would be determined.

RMO No. 30-2003 was supplemented by RMO No. 42-2003, which laid down the ***'no-contact-audit approach'*** in the CIR's exercise of its power to authorize any examination of taxpayer arid the assessment of the correct amount of tax. The *no-contact-audit approach* includes the process of computerized matching of sales and purchases data contained in the Schedules of Sales and Domestic Purchases, and Schedule of Importation submitted by VAT taxpayers under the RELIEF System pursuant to RR No. 7-95, as amended by RR Nos. 13-97, 7-99 and 8-2002. This may also include the matching of data from other information or returns filed by the taxpayers with the BIR such as Alphalist of Payees subject to Final or Creditable Withholding Taxes.

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.

xxx xxx xxx *92*

In this case, there is no dispute that no LOA was issued prior to the issuance of a PAN and FAN against MEDICARD. Therefore no LOA was also served on MEDICARD. The LN that was issued earlier was also not converted into an LOA contrary to the above quoted provision. Surprisingly, the CIR did not even dispute the applicability of the above provision of RMO 32-2005 in the present case which is clear and unequivocal on the necessity of an LOA for the assessment proceeding to be valid. Hence, the CTA's disregard of MEDICARD's right to due process warrant the reversal of the assailed decision and resolution.

In the case of *Commissioner of Internal Revenue v. Sony Philippines, Inc.*, the Court said that:

> Clearly, there must be a grant of authority before any revenue officer can conduct an examination or assessment. Equally important is that the revenue officer so authorized must not go beyond the authority given. **<u>In the absence of such an authority, the assessment or examination is a nullity</u>**.

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 the 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 than 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.

Contrary to the ruling of the CTA *en banc*, an LOA cannot be dispensed with just because none of the financial books or records being physically kept by MEDICARD was examined. To begin with, Section 6 of the NIRC requires an authority from the CIR or from his duly authorized representatives before an examination 'of a taxpayer' may be made. The requirement of authorization is therefore not dependent on whether the taxpayer may be required to physically open his books and financial records but only on whether a taxpayer is being subject to examination.

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 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.
>
> That the BIR officials herein were not shown to have acted unreasonably is beside the point because the issue of their lack of authority was only brought up during the trial of the case. What is crucial is whether the proceedings that led to the issuance of VAT deficiency assessment against MEDICARD had the prior approval and authorization from the CIR or her duly authorized representatives. Not having authority to examine MEDICARD in the first place, the assessment issued by the CIR is inescapably void."*(Citations omitted)*

As categorically declared by the Supreme Court, lack of authority to examine, *i.e.*, absence of an LOA, renders the assessment issued by respondent inescapably void. Here, the subject assessment was issued without the issuance of an LOA. Hence, following the ruling of the Supreme Court in *Medicard*, Assessment Notice No. RR-16-099-082-2016 is likewise void. As such, the grant of the instant Petition is in order.

WHEREFORE, the instant Petition for Review is **GRANTED**. Accordingly, the assessments under Assessment Notice No. RR-16-099-082-2016 for deficiency Income Tax, Value Added Tax and Compromise Penalty for taxable year 2012 are **CANCELLED** and **SET ASIDE**.

SO ORDERED.

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

WE CONCUR:

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

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.

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

CERTIFICATION

Pursuant to Article VIII, Section 13 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.

ROMAN G. DEL ROSARIO
Presiding Justice