REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE KIM S. JACINTO-HENARES & REGIONAL DIRECTOR JONAS DP. AMORA, REVENUE REGION NO. 7, QUEZON CITY, Petitioners,	**CTA EB NO. 1798 (CTA Case No. 8824)**
-versus-	**Present:** **Del Rosario,** *P.J.,* **Castañeda, Jr., Uy, Fabon-Victorino, Mindaro-Grulla, Ringpis-Liban, Manahan, Bacorro-Villena,** *and* **Modesto-San Pedro,** *JJ*
SPARKLAND REALTY, INC., Respondent.	Promulgated: AUG 13 2019 3:10 p.m.

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DECISION

RINGPIS-LIBAN, J.:

Before the Court *En Banc* is a Petition for Review filed by petitioner[1] Commissioner of Internal Revenue (CIR) to seek nullification of the Decision[2] dated November 3, 2017 (assailed Decision), the dispositive portion thereof reads:

[1] Respondent in CTA Case No. 8824.
[2] Rollo, CTA EB Case No.1798, pp. 9-34.

"**WHEREFORE**, premises considered, the instant Petition for Review is **GRANTED**. Accordingly, the Formal Letter of Demand and Assessment Notices, all dated December 5, 2013, for deficiency income tax, value-added tax, and compromise penalty for taxable year 2010 are **CANCELLED** and **SET ASIDE**.

SO ORDERED."

and the Resolution[3] dated February 12, 2018 (assailed Resolution) of the same First Division of the Court (Court in Division) denying the CIR's Motion for Reconsideration, the dispositive portion thereof reads:

"**WHEREFORE**, premises considered, respondents' **Motion for Reconsideration** is **DENIED** for lack of merit.

SO ORDERED."

THE FACTS

The facts as stated in the assailed Decision[4] are as follows:

"Petitioner[5] Sparkland Realty, Inc. is a corporation duly organized and existing under and by virtue of the laws of the Philippines, with principal office address at Unit 107, Cluster D, Golfhill Terraces, Manotoc Drive, Capitol Hills, Balara, Quezon City.

Respondent[6] Commissioner is the then Commissioner of the Bureau of Internal Revenue (BIR), the government agency tasked, among others, to collect national internal revenue taxes. Respondent Regional Director is the then Regional Director of Revenue Region No. 7, Quezon City, who issued the letter dated April 11, 2014 denying petitioner's protest. The office address of respondent Commissioner is located at the BIR National Office Building, Agham Road, Diliman, Quezon City; while respondent Regional Director's office address is at BIR Revenue Region No. 7, Quezon City.

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[3] Rollo, pp. 35-41.
[4] Citations omitted.
[5] Respondent Sparkland Realty, Inc. ("Sparkland") in this case.
[6] Petitioner in this case.

On November 29, 2011, respondents issued a Letter Notice No. 039-RLF-10-00-00427, informing petitioner that a computerized matching was conducted by respondents on the information/data provided by third-party sources against the declarations made by petitioner on its VAT returns, which disclosed a discrepancy. Then, a Follow-up Letter was issued on January 19, 2012. Respondents subsequently issued a Letter of Authority (LOA) No. LOA-039-2013-00000173 on February 16, 2013, authorizing Revenue Officer Dirce Diaz and Group Supervisor Werlita Quimson to examine petitioner's books of accounts and other accounting records for all internal revenue taxes for the period from January 1, 2010 to December 31, 2010.

Petitioner filed its Quarterly Income Tax Returns for the 1st, 2nd, and 3rd quarters of TY 2010 and Annual Income Tax Return (AITR) for TY 2010 on April 7, 2010, July 7, 2010, November 8, 2010, and April 15, 2011, respectively. Petitioner likewise filed its Monthly VAT Returns and Quarterly VAT returns for TY 2010.

A Contract of Lease was entered into by petitioner and Manila-Oslo Renewable Enterprise Inc. (MOREI) and was notarized on October 15, 2010. The said contract was amended on January 31, 2011.

Thereafter, a Post Reporting Notice with Details of Discrepancies and Preliminary Assessment Notice (PAN) with Details of Discrepancies were issued on May 27, 2013 and November 5, 2013, respectively, assessing petitioner for deficiency income tax, VAT, and compromise penalty.

On December 5, 2013, respondent issued a Formal Letter of Demand (FLD) with Details of Discrepancies and Assessment Notices (FANs), which petitioner received on February 19, 2014, assessing the latter for deficiency income tax, VAT, and compromise penalty in the respective amounts of P3,517,017.57, P1,437,081.29, and P11,000.00, or in the aggregate amount of 4,965,098.86, to wit:

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As such, petitioner protested the said FLD on March 19, 2014. However, despite the said protest, respondents issued a letter dated April 11, 2014, stating that petitioner failed to file a protest on the assessment for TY 2010; and requested the latter to pay the deficiency taxes or appeal the said decision to the Court of Tax Appeals.

Consequently, petitioner filed the instant Petition for Review before this Court on May 23, 2014."

The CIR filed his Answer[7] on July 18, 2014.

The Pre-trial of the case was held on March 12, 2015.[8] During the pre-trial conference, the parties were given a period of twenty (20) days, or until April 1, 2015 to file their Joint Stipulations of Facts and Issues.

On March 31, 2018, the parties filed their Joint Stipulations of Facts and Issues.[9] Thereafter, the Court issued the Pre-Trial Order[10] dated April 28, 2015.

As agreed upon by the parties, the issue presented before the Court in Division is "Whether or not petitioner is liable to pay deficiency Income Tax in the amount of P3,517,017.57, VAT in the amount of P1,437,081.29 and Compromise penalty in the amount of P11,000.00 for the year 2010.

Trial thereafter ensued wherein both parties presented their respective evidence. On October 26, 2016, the CIR filed his Memorandum,[11] while Sparkland filed its Memorandum on November 7, 2016.[12]

In the Resolution[13] dated November 16, 2016, the Court in Division deemed the case submitted for decision.

On November 3, 2017, the Court in Division rendered the assailed Decision. On February 12, 2018, the Court in Division issued the questioned Resolution.

Aggrieved, the CIR filed before the Court *En Banc* this Petition for Review[14] on March 2, 2018.

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[7] Docket, CTA Case No. 8824, pp. 138-142.
[8] Ibid. p. 236-239.
[9] Ibid. pp. 244-249.
[10] Ibid. pp. 303-315.
[11] Ibid., pp.427-434.
[12] Ibid., pp.435-459.
[13] Ibid. p. 461.
[14] Rollo CTA EB Case No. 1798, pp. 1-8, with Annexes.

In the Resolution[15] dated April 20, 2018, Sparkland was directed by the Court *En Banc* to file its comment in this case.

On June 7, 2018, Sparkland filed its "Comment".[16]

In the Resolution dated July 6, 2018,[17] the Court gave due course to this Petition for Review and the parties were given a period of thirty (30) days within which to file their respective memoranda.

On August 10, 2018, the CIR filed his "Memorandum"[18] while Sparkland filed its Memorandum[19] on September 27, 2018.

In the Resolution[20] dated October 9, 2018, the instant case was deemed submitted for decision.

THE ISSUE

The main issue in this case is whether or not the Court in Division erred in granting Sparkland Realty, Inc.'s Petition for Review, thereby cancelling the deficiency Income Tax, VAT and Compromise penalty assessments issued by the CIR against Sparkland Realty, Inc. for taxable year 2010.

THE ARGUMENTS

The CIR contends that the Court erred in ruling that it conducted an audit on Sparkland without any authority and only based the audit on the Letter Notice; that the Court in Division erred in ruling that the FLD and FAN are void; and that the Court in Division erred in ruling that Sparkland had no income for taxable year 2010.

On the other hand, Sparkland counter-argues that the two issues raised by the CIR were already settled and resolved by the Court in Division in its favor; and that Sparkland is not liable for any deficiency income tax and value added tax as it has no income or valuable transaction for the year 2010.

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[15] Ibid. pp. 53-54.
[16] Ibid. pp.55-68.
[17] Ibid pp. 62-63.
[18] Ibid. pp. 72-78.
[19] Ibid., pp. 79-92.
[20] Ibid., pp. 94-95.

THE RULING OF THE COURT *EN BANC*

Timeliness of the Petition

On November 8, 2017, the CIR received the Decision of the Court in Division. On November 21, 2017, the CIR filed a Motion for Reconsideration[21] of the said Decision. On February 12, 2018, the Court in Division issued the assailed Resolution denying the CIR's motion. Said Resolution was received by the CIR on February 20, 2018.

From receipt of the said Resolution on February 20, 2018, the CIR has until March 7, 2018 within which to file the Petition for Review. On March 2, 2018, the CIR filed the instant Petition for Review. Hence, this Petition for Review was timely filed.

Petitioner failed to show any reason why the Decision and Resolution should be reversed

After a careful review of the CIR's arguments and the records of the case, the Court *En Banc* finds that the Court in Division had fully and exhaustively resolved the issues raised in the petition. The Court *En Banc* notes that the arguments presented herein are a mere rehash, in fact, quoted verbatim, of the arguments offered by the CIR in his Motion for Reconsideration before the Court in Division, in the instant Petition for Review and in his Memorandum.

The Court notes that the first two issues presented by the CIR, *i.e. the Court in Division erred in ruling that the CIR conducted an audit on Sparkland without any authority and only based on a Letter Notice and in ruling that the FLD and FAN are void*, were already settled in the assailed Resolution. The revenue officers were armed with an LOA when they conducted an audit on Sparkland's accounts.

As correctly ruled by the Court in Division is its Resolution[22] dated February 12, 2018:

> "The court revisits the case of *Medicard Philippines, Inc. vs. Commissioner of Internal Revenue*, and considers the ruling of the Supreme Court that after an LN has serve its purpose, the revenue officer should have properly secured a letter of authority

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[21] Docket, CTA Case No. 8824, pp. 521-524.
[22] Pages 3-6.

(LOA) before proceeding with the further examination and assessment of the petitioner, to wit:

> "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.
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> xxx xxx xxx
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> 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.
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> 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 the 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 handling 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.

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9. **In case the above discrepancies remained unresolved at the end of the One Hundred and Twenty (120)-day period, the revenue officer (RO) assigned to handle the LN shall recommend the issuance of [LOA] to replace the LN**. The head of the concerned investigating office shall submit a summary list of LNs for conversion of LAs (using the herein prescribed format in Annex 'E' hereof) to the OACIR-LTS/ORD for the preparation of the corresponding LAs with the notation 'This LA cancels LN No. _______'

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The Court cannot convert the LN into the LOA required under the law even if the same was issued by the CIR himself. Under RR No. 12-2002, LN is issued to a person found to have underreported sales/receipts per date 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 10 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. xxx"

In this case, the LOA-039-2013-00000173 was issued for further tax audit investigation against petitioner after the issuance of LN No. 039-RLF-10-00-00427. Likewise, the LOA was issued before the FLD and FAN were issued.

Based on the foregoing, the Court partially reconsiders the assailed Decision and rules that the FLD and FAN are valid."

Hence, the revenue officers have authority to conduct an audit on Sparkland's accounts.

The assessments on deficiency Income Tax, deficiency VAT and Compromise penalty should be cancelled

The CIR insists that Sparkland earned income for taxable year 2010, that when the Letter Notice was served upon Sparkland informing it of the discrepancy as a result of the computer matching, Sparkland did not refute the discrepancy thru submission of necessary documents that would attest its allegations; and that Sparkland presented supporting documents only when it filed its Petition for Review, hence, it is estopped from challenging the result of the investigation.

Sparkland presented the following documents to show that it had no income for taxable year 2010: 1st, 2nd and 3rd Quarterly Income Tax Returns for taxable year 2010,[23] Annual Income Tax Return for taxable year 2010,[24] Contract of Lease,[25] Addendum to the Contract of Lease,[26] Certification issued by the Office of the City Building Official of Makati City,[27] official receipts,[28] Certification issued by MOREI,[29] and Certificates of Creditable Tax Withheld at Source[30] to prove that it had no income for TY 2010.

After consideration, the Court *En Banc* resolves that Sparkland was able to prove that its business operations did not start prior to January 2011. Hence, the Court is Division did not err in holding that the assessments for deficiency Income Tax, VAT and Compromise penalty for taxable year 2010 should be cancelled.

As correctly ruled in the assailed Decision[31]:

> "Income tax is assessed on income received from property, activity or service that produces the income because the Tax Code stands as an indifferent neutral party on the matter of where income comes from. The three elements in the imposition of income tax are: (1) there must be gain or profit, (2) that the gain or profit is realized or received, actually or constructively, and (3) it is not exempted by law or treaty from income tax. Any business purpose as to why or how the income was earned by the taxpayer is not a requirement. As such, the imposition or assessment of

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[23] Exhibits "P-4", "P-5", and "P-6".
[24] Exhibit "P-7".
[25] Exhibit "P-22".
[26] Exhibit "P-23".
[27] Exhibit "P-20".
[28] Exhibits "P-24" and "P-26".
[29] Exhibit "P-66".
[30] Exhibits "P-28" and "P-29".
[31] Docket, CTA Case No. 8824, pages 490-494.

income tax is made only when there was an income, and such income was received or realized by the taxpayer.

The Contract of Lease, the Addendum of the Contract of Lease, the Certification issued by the Office of the City Building Official of Makati City, and the official receipts prove that petitioner's business operation did not start until January 2011. These pieces of evidence corroborate the testimonial evidence presented by petitioner, to wit:

'9). You mentioned that SRI did not have any income for the year 2010. Was the BIR informed of this fact and were the appropriate returns filed with the BIR on time?

A. Yes mam, our Income Tax Returns and Value Added Tax Declaration for the year 2010 show that we have no operations. These Income Tax Returns have been timely filed with the BIR and forms part of the records of the corporation. xxx

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10). You mentioned that the only source of SRI is the lease of its only property in Makati City. To whom was the property first leased and when did the lease commence?

A. It was leased to Manila-Oslo Renewable Enterprise, Inc. ('MOREI'). The contract of lease was signed on 15 October 2010 for a term of two (2) years which was supposed to commence on December 1, 2010 or such date that the leased premises is ready for occupancy. However, petitioner SRI was unable to completely finish the residential house in time for the original projected commencement date. So an addendum to the contract of lease was executed by the parties to adjust the commencement date to 14 January 2011 and shall be effective until 13 January 2013.

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12). So was any of the rental income from the Contract of lease with lessee MOREI received in year 2010?

A. No rental income from the Contract of Lease with MOREI was received in year 2010.

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19). You mentioned that there is a difference in the accounting method used by SRI and MOREI. What is this difference that you are referring to?

A. SRI uses the accrual method of accounting while lessee MOREI appears to be using cash basis method when the lessee claimed input taxes when the checks for the rentals were prepared even though there was no actual payment of rentals yet.

20). What do you mean by the accrual method that you are using?

A. In accrual method, the income is recognized when earned regardless of when cash is received and expense is recognized when incurred regardless of when paid.

21). How about the cash basis method of accounting used by the lessee MOREI?

A. In cash basis method, the income is recognized when received regardless of when earned, and expense is recognized when the check payment was prepared regardless of when incurred or actually paid.

22). So, how did the difference in the accounting method result in an erroneous finding of tax deficiency?

A. The difference in accounting method created a 'timing difference' in the recording of the transaction which could be a source of erroneous finding of tax deficiency.

23). What do you mean by 'timing difference'?

A. In this case, lessee MOREI recorded the total amount of checks dated December 9, 2010 and December 14, 2011, representing the total rentals for the entire two year of lease as expense as early as December 2010, the time they prepared the checks for SRI, even if rental expenses are actually incurred on a monthly basis as per the contract of lease and the checks were delivered to SRI only on 2011. On the other hand, since petitioner SRI uses accrual basis method of accounting, the rental income from MOREI was reported as the rentals accrued which is on a monthly basis. Thus, the timing difference refers to the difference in time when lessee MOREI reported its rental expense and when lessor SRI reported its rental income.

The foregoing testimony was corroborated by the testimony of Mr. Edward M. De Leon, the Senior Manager for Tax and Compliance of MOREI, to wit:

'4. In connection with the lease of the Makati property, are you aware that your company issued a certification in connection with the audit of BIR of Sparkland Realty, Inc. for taxable year 2010?

A. Yes mam. Our company issued the Certification dated 8 May 2014. I was the one who issued the signed the said certification.

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8. Did you review your records? What are your findings?

A. Upon our review and inspection of our records, we confirmed that the only rental payments we made to Sparkland was for the monthly rentals of the Makati property for the period corresponding to January 2011 to January 2013. We did not make any rental payment to Sparkland for the year 2010. Confusion may have been due to the timing difference in reporting. We reported the rental payments as prepaid rent upon the preparation of the check. Sparkland may have reported the same when they received the payment or when they became due by virtue of the contract.

9. What was the reason for this timing difference?

A. The timing difference was due to the technical limitations of our old accounting system in processing advance payments and issuing postdated checks. Our old accounting system is only capable of recognizing the input VAT upon preparation of check regardless of when the same was released to the payee, when encashed or when it was actually due. In case of rental payment for Sparkland for the period of January 2011 to January 2013, we prepared the postdated checks for the advance payments of the two year rentals in December 2010 although the rentals were actually paid and the post-dated checks were received and encashed only on the succeeding years of 2011 onwards.'

It must be pointed out that respondents did not cross-examine any of petitioner's witnesses to elicit important facts that may disprove petitioner's claim that it had no income for TY 2010.

In sum, petitioner has sufficiently proven that it had no income for taxable year 2010.

As regards the compromise penalty, petitioner's 1st, 2nd, and 3rd Quarterly Income Tax Returns for TY 2010 and Monthly VAT Returns for TY 2010 disprove the non-submission and non-filing of Quarterly Income Tax Returns and Monthly VAT Returns as stated in the assessment for compromise penalty."

The findings of fact by the CTA in Division are not to be disturbed without any showing of grave abuse of discretion considering that the members of the Division are in the best position to analyze the documents presented by the parties.[32]

There being no new matters or issues raised in the Petition for Review before this Court and there being no reversible error committed by the Court in Division, this Court finds no cogent reason to disturb the assailed Decision and Resolution.

[32] *Republic of the Philippines, represented by the Commissioner of Internal Revenue vs. Team (Phils.) Energy Corporation (formerly Mirant (Phils.) Energy Corporation)*, G. R. No. 188016, January 14, 2015, citing Sea-Land Service, Inc. vs. Court of Appeals, G.R. No. 122605, April 30, 2001.

WHEREFORE, premises considered, the Petition for Review is **DENIED** for lack of merit. The assailed Decision dated November 3, 2017 and the assailed Resolution dated February 12, 2018 are **AFFIRMED**.

SO ORDERED.

Ma. Belen S.

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

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

ERLINDA P. UY
Associate Justice

(On Leave)
ESPERANZA R. FABON-VICTORINO
Associate Justice

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

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
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