REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*	CTA EB No. 1664 (CTA Case No. 8866)
-versus-	*Present*: DEL ROSARIO, P.J., CASTAÑEDA, JR., UY, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN, and MANAHAN, *JJ.*
NORTHERN TOBACCO REDRYING CO., INC., *Respondent.*	Promulgated: JAN 31 2019 9:17 a.m.

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DECISION

MINDARO-GRULLA, J.:

Submitted for decision of this Court En Banc is a Petition for Review filed by the Commissioner of Internal Revenue under Section 3(b), Rule 8 of the 2005 Revised Rules of the Court of Tax Appeals[1], as amended, seeking the reversal of the Decision dated 23 February 2017[2] and the Resolution[3] dated 18 May 2017 rendered by the Third

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[1] RULE 8, Sec 3. Who may appeal; period to file petition.- x x x

> (b) A party adversely affected by a decision or resolution of a Division of the Court on a motion for reconsideration or new trial may appeal to the Court by filing before it a petition for review within fifteen days from receipt of a copy of the questioned decision or resolution. Upon proper motion and the payment of the full amount of the docket and other lawful fees and deposit for costs before the expiration of the reglementary period herein fixed, the Court may grant an additional period not exceeding fifteen days from the expiration of the original period within which to file the petition for review. (Rules of Court, Rule 42, sec. 1a)

[2] Penned by Associate Justice Lovell R. Bautista, concurred in by Associate Justice Esperanza R. Fabon-Victorino and Associate Justice Ma. Belen M. Ringpis-Liban, En Banc Docket, pp. 22-57

[3] Id., pp. 59-63

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Division of this Court, the dispositive portions of which, respectively, read as follows:

Decision dated February 23, 2017:

"In view of the foregoing, the present Petition for Review is hereby **PARTIALLY GRANTED**. Petitioner is hereby **ORDERED TO PAY** deficiency IT, WTC and EWT in the reduced amount of Php199,415.80, inclusive of the twenty five percent (25%) surcharge imposed under *Section 248(A)(3) of the 1997 NIRC*, computed as follows:

TAX TYPE	BASIC	25% SURCHARGE	TOTAL
IT	Php 157,663.18	Php 39,415.80	Php 197,078.98
WTC	782.39	195.60	977.99
EWT	1,087.07	271.77	1,358.84
TOTAL	**Php 159,532.64**	**Php 39,883.16**	**Php 199,415.80**

In addition, petitioner is also **ORDERED TO PAY**:

1. Deficiency interest at the rate of twenty percent (20%) *per annum* on the basic deficiency IT, WTC and EWT computed from the dates indicated below until full payment thereof, pursuant to *Section 249(B) of the NIRC;* and

TAX TYPE	BASIC	DEFICIENCY INTEREST COMPUTED FROM
IT	Php 157,663.18	April 15, 2011
WTC	782.39	January 15, 2011
EWT	1,087.07	January 15, 2011

2. Delinquency interest at the rate of twenty percent (20%) *per annum* on the amount Php 199,415.80, representing the basic deficiency IT, WTC and EWT and the corresponding twenty five percent (25%) surcharge, and on the twenty percent (20%) deficiency interest which have accrued as aforestated in item (1), computed from December 16, 2013 until full payment thereof, pursuant to *Section 249(C) of the NIRC.*

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SO ORDERED."

Resolution dated May 18, 2017:

"**WHEREFORE**, respondent's Motion for Partial Reconsideration (Re: Decision Promulgated 23 February 2017) is hereby **DENIED** for lack of merit.

SO ORDERED."

The following facts of the case as recited by the Third Division in its Decision and as established by evidence on record[4], are as follows:

"On February 25, 2010, petitioner (now respondent), (as transferor) and Fortune Landequities and Resources Inc. ("FLRI"), a domestic corporation, (as transferee) entered into a Deed of Transfer[5] whereby petitioner agreed to transfer ownership over certain parcels of land located in Vigan, Ilocos Norte to FLRI in exchange for a total of 5,722 (4,292 additional subscription and 1,430 unpaid original subscription) common shares in FLRI.

On June 7, 2010, FLRI filed its Request for Tax-Free Exchange Ruling of Transfer of Land in Exchange for Shares of Stock[6] with the BIR Law Division. On even date, an Application and Joint Certification[7] (BIR Form No. 1927) was likewise filed.

On July 19, 2011, petitioner received Letter of Authority ("LOA") No. 124-2011-00000048 dated July 19, 2011, authorizing Revenue Officers ("RO") Nicanor San Juan, Ponciano Garma, Lamberto Vasquez, and Group Supervisor ("GS") Ronalda Camba to examine petitioner's books of accounts and accounting records for all internal revenue taxes for the period running from January 1, 2010 to December 31,2010.

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[4] Division Docket, Joint Stipulation of Facts, pp. 610-617.
[5] Id., Exhibit "P-8", pp.376-378.
[6] Id., Exhibit "9", pp. 380-392.
[7] Id., Exhibit "P-9-C", pp. 716-725.

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On March 11, 2013, a Memorandum of Assignment was issued by OIC-Chief, Excise LT Audit Div II Lindagrace B. Sagun ("OIC Chief Sagun") to ROs Romualdo I. Plocios, Melinda M. Rugayan, and Lolita G. Sabado, and GS Samuel C. Reyes, to continue the audit or investigation against petitioner, replacing the previously-assigned RO Roque Doloiras, Jr.

On March 14, 2013, petitioner, through Debbie Ting-Alcantara ("Ms. Alcantara"), received a letter[8], with attached List of Requirements[9], from OIC Chief Sagun dated March 13, 2013, informing petitioner of the change of ROs and GS authorized to conduct audit.

On July 22, 2013, a Final Report was submitted by ROs Plocios, Rugayan, Sabado, Lilia G. Pascual and GS Reyes to OIC-Assistant Commissioner LTS Alfredo V. Misajon, recommending the issuance of a Notice for Informal Conference ("NIC") against petitioner.

On August 30, 2013, petitioner received an NIC issued by OIC-Assistant Commissioner LTS Misajon.

On October 21, 2013, ROs Plocios, Rugayan, Sabado, Pascual and GS Reyes submitted a Memorandum to OIC-Assistant Commissioner LTS Misajon, recommending the issuance of a Preliminary Assessment Notice ("PAN") against petitioner.

On November 22, 2013, petitioner, through Ms. Alcantara received a PAN, with an assessment for deficiency IT, VAT, WTC, EWT, DST and IAET in the total amount of Php86,613,710.78, inclusive of surcharges, interest, and compromise penalties.

On December 4, 2013, ROs Plocios, Rugayan, Sabado, Pascual and GS Reyes submitted a Memorandum to OIC-Assistant Commissioner LTS

[8] Id., Exhibit "R-2", p.216.
[9] Id., Exhibit "R-3", pp.214-215.

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Misajon, recommending the issuance of a Formal Assessment Notice ("FAN") against petitioner for failure to file a protest to the PAN.

On December 16, 2013, petitioner, likewise through Ms. Alcantara, received a Formal Letter of Demand ("FLD") with an assessment for deficiency IT, VAT, WTC, EWT, DST and IAET in the total amount of Php89,823,645.18, inclusive of surcharges, interest, and compromise penalties, along with the Final Assessment Notices ("FANs") issued on December 11, 2013, detailed as follows:

KIND OF TAX	BASIC TAX	SURCHARGE	INTEREST	COMPROMISE PENALTY	TOTAL
IT	Php 9,636,748.11	Php -	Php 5,227,605.82	Php 50,000.00	Php 14,914,353.93
VAT	6,608,093.99	-	3,892,438.93	50,000.00	10,550,532.92
WTC	215,300.47	-	127,410.69	16,000.00	358,711.16
EWT	5,349.32	-	3,165.62	1,500.00	10,014.94
DST	1,280,140.00	320,035.00	764,576.77	25,000.00	2,389,751.77
IAET	37,489,949.72	9,372,487.43	4,687,843.31	50,000.00	61,600.280.46
TOTAL	**PHP 55,235,581.61**	**9,692,522.43**	**24,703,041.14**	**192,500.00**	**89,823,645.18**

On January 15, 2014, petitioner filed an administrative protest with the Large Taxpayers Service, requesting for a reconsideration of the FLD and the FANs.

There being no action on its protest, petitioner filed the present Petition for Review on August 12, 2014.

On October 13, 2014, respondent filed his Answer by registered mail, interposing Special and Affirmative Defenses, in sum: (1) that the period to assess has not prescribed; and (2) that petitioner is liable to pay deficiency IT, VAT, WTC, EWT, DST and IAET.

Respondent and petitioner filed their respective Pre-trial Briefs on February 20,2015 and March 12, 2015.

On April 6, 2015, the parties filed their Joint Stipulation of Facts and Issues ("JSFI"); thus, a Pre-Trial Order was issued on April 20, 2015.

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Petitioner presented the following witnesses: (1) Ms. Melody Grace O. Ngo, its Accounting Officer; and (2) Mr. Prudencio F. Tatunay, the Court-appointed Independent Certified Public Accountant ("ICPA").

On October 14, 2015, Formal Offer of Evidence for the Petitioner was filed, offering Exhibits "P-1" to "P-9," "P-9-A" to "P-9-J," "P-10," "P-10-A," "P-11" to "P-13," "P-15," "P-15-A" to "P-15-D,""P-15-D-1," "P-16," "P-16-A," "P-17," and "P-18." This was resolved by the Court in its Resolution dated November 16, 2015, admitting all of petitioner's evidence, save for Exhibit "P-18" for not being properly marked.

Respondent presented its sole witnesses, RO Plocios, one of the ROs assigned to petitioner's case.

On February 26, 2016, Respondent's Formal Offer of Evidence was filed, offering Exhibits "R-1" to "R-9," "R-9-a" to "R-9-f," "R-10," and "R-10-a."

In its April 11, 2016 Resolution, the Court admitted all of respondent's offered exhibits, and ordered the parties to file their respective memoranda within thirty (30) days from receipt thereof.

After both parties were granted extension/s, petitioner and respondent then filed their Memoranda on June 1, 2016, and June 14, 2016, respectively.

On June 14, 2016, the Court promulgated a Resolution submitting the case for decision."

The Third Division of this Court rendered the assailed Decision dated February 23, 2017, which ruled that the transfer of land is a tax-free exchange transaction, and that the assessment for respondent Northern Tobacco Redrying Co., Inc's (NTRCI) VAT (1st to 3rd quarters), EWT (January to November) and WTC (January to November) has already prescribed, thereby reducing its tax liability.

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Aggrieved, the CIR filed a motion for reconsideration therefrom, which was denied by the Third Division on May 18, 2017 for lack of merit. Hence, this Petition for Review was filed.

We rule to DENY the Petition.

At the outset, the arguments raised by the CIR in his Petition for Review are a mere rehash of his previous arguments raised before the Court in Division, which have been duly considered and exhaustively discussed by the Court in the assailed Decision. Nonetheless, the Court shall pass upon the arguments to fully settle the issues in this case.

In the instant petition, the CIR insists that NTRCI is liable to pay deficiency IT, WTC, EWT, VAT, and DST. He further avers that NTRCI, not having secured the tax-free exchange ruling, should have initially treated the transaction as taxable and reported it to the BIR. Compliance with Revenue Regulation (RR) No. 18-2001 is an indispensable requirement.

The CIR likewise claims that the period of prescription is within ten (10) years after the discovery of the falsity pursuant to Section 222(a) of the NIRC of 1997, as amended.

The arguments raised are without merit. An in-depth examination of the transaction involved in this case shows that there was no gain derived from the transaction. The Court revisits Section 40(C)(2) of the 1997 NIRC, as amended, which provides as follows:

> "SEC. 40. Determination of Amount and Recognition of Gain or Loss. -
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> xxx xxx xxx
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> (C) Exchange of Property. -
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> (1) General Rule. - Except as herein provided, upon the sale or exchange of property,

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the entire amount of the gain or loss, as the case may be, shall be recognized.

(2) Exception. - No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation –

(a) A corporation, which is a party to a merger or consolidation, exchanged property solely for stock in a corporation, which is a party to the merger or consolidation; or

(b) A shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock of another corporation also a party to the merger or consolidation; or

(c) A security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such a corporation, solely for stock or securities in another corporation, a party to the merger or consolidation.

No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation: Provided, That stocks issued for services shall not be considered as issued in return for property." (Emphasis supplied)

Accordingly, several revenue issuances were promulgated by the CIR relevant to Section 40(C)(2), foremost of which was Revenue Regulations No. (RR) 18-2001 dated November 13, 2001. RR 18-2001 was promulgated for the purpose of providing guidelines to monitor the basis of the properties transferred and shares received in a tax-free exchange under Section 40(C)(2), thus:

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"SUBJECT: Guidelines on the Monitoring of the Basis of Property Transferred and Shares Received, Pursuant to a Tax-Free Exchange of Property for Shares under Section 40(C)(2) of the National Internal Revenue Code of 1997, Prescribing the Penalties for Failure to Comply with such Guidelines, and Authorizing the Imposition of Fees for the Monitoring Thereof.

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SECTION 1. Scope. - Pursuant to Section 244, in relation to Sections 40(C)(2), 58(E), 269, and 275 of the National Internal Revenue Code of 1997 (Tax Code of 1997), **these Regulations are hereby promulgated for the purpose of providing the guidelines in the proper monitoring of the basis of properties transferred, and shares received, pursuant to a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997, and to establish the policies governing the imposition of fees for the monitoring thereof**." (Emphasis supplied)

On November 29, 2001, CIR Rene G. Bañez issued Revenue Memorandum Ruling No. (RMR) 01-2001 which clarified and harmonized the existing guidelines on the tax consequences of property for shares exchanges under Sections 40(C)(2). The relevant provision states:

"SUBJECT: Tax Consequences of Tax-Free Exchange of Property for Shares of Stock of a Controlled Corporation Pursuant to Section 40(C)(2) of the National Internal Revenue Code of 1997

TO: All Internal Revenue Officers and Others Concerned

Pursuant to Section 4, in relation to Sections 40(C)(2),(4),(5),(6),175,176,and196, and pertinent provisions of Titles II, IV and VII of the National Internal Revenue Code of 1997 (Tax Code of 1997), **this Revenue Memorandum Ruling is issued to consolidate, provide, clarify and harmonize**

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<u>the existing guidelines on the tax consequences of a non recognition transaction consisting of a tax-free exchange of property for shares of stock under Section 40(C)(2) of the Tax Code of 1997</u>. This Revenue Memorandum Ruling shall apply solely and exclusively to, and may be relied upon only in situations in which the facts are substantially similar to the facts stated below, but subject to the principles of substance over form.

I. FACTS

1. A domestic corporation (the "Transferor") owns certain property, consisting, for example, of the following:

2. X Corporation (the "Transferee") is a domestic corporation.

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3. The Transferor transfers the property to the Transferee. In exchange, the Transferee issues shares to the Transferor out of the unissued portion of its existing authorized capital stock, or, if such existing authorized capital stock is insufficient, out of shares from an increase in the Transferee's authorized capital stock. The Transferor does not receive any money or property other than the afore mentioned shares of the transferee.

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7. As a result of the above-mentioned transfer, the Transferor acquires at least 51% of the total outstanding capital stock of the Transferee entitled to vote.

II. TAX CONSEQUENCES

1. Income tax. The Transferor shall not recognize any gain or loss on the transfer of the property to

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the Transferee. Consequently, the Transferor will not be subject to capital gains tax, income tax, or to creditable withholding tax on the transfer of such property to the Transferee. Neither may the transferor recognize a loss, if any, incurred on the transfer. The last paragraph of Section 40(C)(2) and (6)(c) of the Tax Code of 1997 state:

> 'No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation: Provided, That stocks issued for services shall not be considered as issued in return for property.'
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> '(c) The term 'control', when used in this Section, shall mean ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote.'

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III. ADDITIONAL FACTS AND VARIATIONS NOT AFFECTING TAX CONSEQUENCES

The following additional facts or variations will not affect the tax consequences of the transaction, as described above:

1. In no. 1 of "I. Facts" stated above, if the total number of Transferors does not exceed five persons, whether such persons are natural persons or juridical persons.

2. In no. 7 of "I. Facts" stated above, the tax consequences are not affected by whether the Transferor is/was a shareholder prior to the transaction, or that, prior to the transaction, the Transferor already possessed control of the Transferee by owning 51% or more of the total

> outstanding capital stock of the Transferee entitled to vote. In such a case, the Transferor is deemed to have acquired 'further control' of the Transferee, which places the transaction within the purview of Section 40(C)(2) of the Tax Code of 1997.
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> xxx xxx xxx"

Relative thereto, in 2011, the Supreme Court *En Banc*, in *Commissioner of Internal Revenue v. Filinvest Development Corporation*[10], upheld the CTA's cancellation of the income tax assessment on the alleged gain recognized from the transfer of parcels of land by FDC. The Supreme Court decided in favor of FDC and stated that the properties-for-shares transfer qualified as a tax-free exchange under then Section 34(C)(2) of the NIRC, now Sections 40(C)(2). The decision reads in pertinent part:

> "Sec. 34. Determination of amount of and recognition of gain or loss. –
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> xxx xxx xxx
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> (c) Exception – x x x
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> No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for shares of stock in such corporation of which as a result of such exchange said person, alone or together with others, not exceeding four persons, gains control of said corporation,· Provided, That stocks issued for services shall not be considered as issued in return of property.
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> As even admitted in the 14 February 2001 Stipulation of Facts submitted by the parties, the requisites for the non-recognition of gain or loss under the foregoing provision are as follows: (a) the transferee is a corporation; (b) the transferee exchanges its shares of stock for property lies of the transferor; (c) the transfer is made by a person, acting alone or together with others, not exceeding four persons; and, (d) as a result of the exchange the transferor, alone or together with

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[10] Consolidated cases of G.R. No. 163653 and G.R. No. 167689, July 19,2011.

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others, not exceeding four, gains control of the transferee. Acting on the 13 January 1997 request filed by FLI, the BIR had, in fact, acknowledged the concurrence of the foregoing requisites in the Deed of Exchange the former executed with FDC and FLI by issuing BIR Ruling No. S-34-046-97. With the BIR's reiteration of said ruling upon the request for clarification filed by FLI, there is also no dispute that said transferee and transferors subsequently complied with the requirements provided for the non-recognition of gain or loss from the exchange of property for tax, as provided under Section 34 (c) (2) of the 1993 NIRC.

Then as now, the CIR argues that taxable gain should be recognized for the exchange considering that FDC's controlling interest in FLI was actually decreased as a result thereof. For said purpose, the CIR calls attention to the fact that, prior to the exchange, FDC owned 2,537,358,000 or 67.42% of FLI's 3,763,535,000 outstanding capital stock. Upon the issuance of 443,094,000 additional FLI shares as a consequence of the exchange and with only 42,217,000 thereof accruing in favor of FDC for a total of 2,579,575,000 shares, said corporation's controlling interest was supposedly reduced to 61.03% when reckoned from the transferee's aggregate 4,226,629,000 outstanding shares. Without owning a share from FLI's initial 3,763,535,000 outstanding shares, on the other hand, FAI's acquisition of 420,877,000 FLI shares as a result of the exchange purportedly resulted in its control of only 9.96% of said transferee corporation's 4,226,629,000 outstanding shares. On the principle that the transaction did not qualify as a tax-free exchange under Section 34 (c)(2) of the 1993 NIRC, the CIR asseverates that taxable gain in the sum of P263,386,921.00 should be recognized on the part of FDC and in the sum of P3,088,711,367.00 on the part of FAI.

The paucity of merit in the CIR's position is, however, evident from the categorical language of Section 34 (c)(2) of the 1993 NIRC which provides that gain or loss will not be recognized in case the exchange of property for stocks results in the control of the transferee by the transferor, alone or with other transferors not exceeding four persons. Rather than isolating the same as proposed by the CIR, FDC's 2,579,575,000 shares or 61.03% control of FLI's 4,226,629,000 outstanding shares should, therefore, be appreciated in combination with the 420,877,000 new shares issued to FAI which represents 9. 96% control of said transferee corporation. Together FDC's 2,579,575,000 shares (61.03%) and FAI's 420,877,000 shares (9.96%) clearly add up to 3,000,452,000 shares or 70.99% of FLI's 4,226,629,000 shares. Since the term 'control' is clearly defined as 'ownership of stocks in a corporation possessing at least fifty-one percent of the total voting power of classes of stocks entitled to one vote' under Section 34 (c) (6) [c] of the 1993 NIRC, the exchange of property for stocks between FDC F AI and FLI clearly qualify as a tax-free transaction under paragraph 34 (c) (2) of the same provision.

Against the clear tenor of Section 34 (c) (2) of the 1993 NIRC, the CIR cites then Supreme Court Justice Jose Vitug and CTA Justice Ernesto D. Acosta who, in their book Tax Law and Jurisprudence, opined that said provision could be inapplicable if control is already vested in the exchange or prior to exchange. Aside from the fact that the 10 September 2002 Decision in CTA Case No. 6182 upholding the tax-exempt status of the exchange between FDC, FAI and FLI was penned by no less than Justice Acosta himself, FDC and FAI significantly point out that said authors have acknowledged that the position taken by the BIR is to the effect that 'the law would apply even when the exchanger already has control of the corporation at the time of the exchange.' This was confirmed when, apprised in FLI' s request for clarification about the change of percentage of ownership of its outstanding capital stock, the BIR opined as follows: x x x"

In sum, the requisites for the non-recognition of gain under or loss under Section 40(C)(2) of the 1997 NIRC are

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as follows: (1) the transferee is a corporation; (2) the transferee exchanges its shares of stock for property/ies of the transferor; (3) the transfer is made by a person, acting alone or together with others, not exceeding four (4) persons; and, (4) as a result of the exchange the transferor, alone or together with others not exceeding four (4), gains control of the transferee.

Section 40(C)(2) speaks of control being acquired 'alone or together with others, not exceeding four persons.' The control requirement is sufficiently met when after the transfer, the transferors, not more than five, collectively become the owners of at least 51% of the equity of the transferee, or if already owning 51%, increase their equity further in the transferee corporation. It is not required that each of the several transferors individually gains control or individually increases his/her interest. What is important is that each of the transferors, numbering not more than five, collectively increases their equity in the transferee corporation by 51% or more.

Based on the foregoing, the Court *En Banc* agrees with the Court in Division that NTRCI's exchange transaction with FLRI has satisfied all of the above-mentioned requisites.

Records reveal that NTRCI, together with Fortune Tobacco Corporation (FTC), Dominium Realty and Construction Co. (DRCC), Parity Packaging Corporation (PPC), and Orecla Realty Inc., (ORI), transferred several parcels of land in exchange for FLRI's shares of stocks. Consequently, the combined ownership increased their ownership up to 99% resulting in gaining control over FLRI.

After the exchange, the capital structure of FLRI is as follows:

SUBSRCIBER	NO. OF SHARES	PERCENTAGE
FTC	334,295	34.82240%
PPC	29,522	3.07521%
DRCC	14,459	1.50615%
NTRCI	5,722	0.59604%
ORI	575,997	59.99969
TOTAL	**99.99948%**	
Harry C. Tan	1	0.00010%
Lucio K. Tan	1	0.00010%
Christopher Nelson	1	0.00010%
Varinia Elero	1	0.00010%

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Raymond Miranda	1	0.00010%
TOTAL	**960,000**	**100.00000%**

Anent the CIR's claim that a tax-free exchange ruling must be secured as required under RR No. 18-01 before petitioner can avail of the tax exemption under Section 40(C)(2) of the NIRC of 1997, as amended, the Court finds no basis for such requirement.

In *Commissioner of Internal Revenue v. Dakudao & Sons Incorporated*[11], this Court affirmed the refund claim of Dakudao, a domestic corporation, for the VAT paid on its assignment of two parcels of land to Metro South Davao Property Corporation (MSDPC), a domestic corporation, in exchange for MSDPC shares. In the case, it was stated that as a result of the exchange, Dakudao gained 75% control of the MSDPC. This Court then held that a prior confirmatory ruling from the BIR under RR 18-2001 is not a condition *sine qua non* for the tax exemption of the property-for-share transaction:

> "Furthermore, RR No. 18-2001 which petitioner relies on for the denial of the claim for refund by respondent merely provides for guidelines in the monitoring of the properties as well as shares of stocks, which are involved in a tax-free exchange under Section 40(C)(2) of the NIRC. The Revenue Regulations does not deal with a requirement to apply for a ruling as a prerequisite for the entitlement of the exemption. **RR No. 18-2001 shows nothing therein explicitly requiring a party, in exchanging property for shares of stocks, to first secure a BIR confirmatory certification or tax ruling before it can avail itself of tax exemption or tax refund**.
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> Such can be readily seen from the RR itself.
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> > 'Subject: Guidelines on the Monitoring of the Basis of Property Transferred and Shares Received, Pursuant to a Tax-Free Exchange of Property for Shares under Section 40(C)(2) of the National Internal Revenue Code of 1997, Prescribing the

[11] CTA EB No. 1150, May 12, 2015, CTA Case No. 8501.

> Penalties for Failure to Comply with such Guidelines, and Authorizing the Imposition of Fees for the Monitoring Thereof.
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> xxx xxx xxx
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> Section 1. Scope. -Pursuant to Section 244, in relation to Sections 40(C)(2), 58(E), 269, and 275 of the National Internal Revenue Code of 1997 (Tax Code of 1997), these Regulations are hereby promulgated for the purpose of providing the guidelines in the proper monitoring of the basis of properties transferred, and shares received, pursuant to a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997, and to establish the policies governing the imposition of fees for the monitoring thereof.'

These being considered, the Court is of the position that <u>securing a BIR ruling under RR No. 18-2001 is not a condition sine qua non for the availment of tax exemption.</u>" (Underscoring supplied)

Thus, contrary to the position taken by the CIR, RR No. 18-2001 merely provides the guidelines in monitoring tax-free exchange of property. The BIR ruling required thereon serves to monitor the tax-free properties in order that in cases of subsequent sales of said properties, they shall be taxed accordingly.

Stated differently, the BIR ruling/certification required under RR No. 18-2001 is for determining gain or loss on a subsequent sale or disposition of property subject of the tax-free exchange, and not as a precondition for availment of a tax exemption.

In view of the foregoing, the Court *En Banc* finds it no longer necessary to discuss the issue of prescription considering that NTRCI is exempt from paying IT, VAT, and DST on the subject transfer of properties.

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In the same vein, considering that there is no dispute as to NTRCI's tax liabilities for IT, EWT and WTC, there is no reason to disturb the findings of the Court in Division.

WHEREFORE, the petition is **DENIED**. The Decision of the Third Division of this Court in CTA Case. No. 8866 dated 23 February 2017, and its Resolution dated 18 May 2017, are **AFFIRMED with MODIFICATION** in the computation of the deficiency interest and delinquency interests in view of the effectivity of Republic Act No. 10963 (TRAIN Law) on January 1, 2018 and the issuance of Revenue Regulations No. 21-2018[12] dated September 14, 2018.

Petitioner is hereby **ORDERED TO PAY** deficiency IT, WTC and EWT in the total amount of Six Hundred Forty One Thousand One Hundred Eighty-Five Pesos and 99/100 (Php641,185.99), inclusive of the 25% surcharge and deficiency and delinquency interests imposed under Sections 248(A)(1)(3) and 249(B) and (C) of the NIRC of 1997, as amended, respectively computed until December 31, 2017 as follows[13]:

	IT	WTC	EWT	TOTAL
BASIC	Php 157,663.18	Php 782.39	Php 1,087.07	**Php 199,415.80**
25%	39,415.795	195.5975	271.7675	**39,883.16**
Deficiency Interest 4/16/11-01/15/14 (157,663.18x20%x2.753yrs)	86,809.3469			
01/16/11-01/15/14 (782.39x20%x3yrs)		469.434		**87,931.0229**
01/16/11-01/15/14 (1,087.07x20%x3yrs)			652.242	
Total Amount Due as of January 15, 2014	**Php 283,888.322**	**Php 1,447.4215**	**Php 2,011.0795**	**Php 287,346.823**
Deficiency Interest 01/16/14-12/31/17 (157,663.18x20%x3.959yrs)	124,837.706			**126,317.944**
01/16/14-12/31/17 (782.39x20%x3.959yrs)		619.496402		
01/16/14-12/31/17 (1,087.07x20%x3.959yrs)			860.742026	
Delinquency Interest				

[12] Regulations Implementing Section 249 (Interest) of the National Internal Revenue Code (NIRC) of 1997, as amended under Section 75 of the Republic Act (RA) No. 10963 or the "Tax Reform for Acceleration and Inclusion (TRAIN Law)

[13] Section 6 of Revenue Regulations No. 21-2018 dated September 14,2018.

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01/16/14-12/31/17 (283,888.322x20%x3.959yrs)	224,782.773			**227,521.214**
01/16/14-12/31/17 (1,447.4215x20%x3.959yrs)		1,146.06834		
01/16/14-12/31/17 (2,011.0795x20%x3.959yrs)			1,592.37275	
Total Amount Due as of December 31, 2017	**Php 633,508.801**	**Php 3,212.98624**	**Php 4,464.19428**	**Php 641,185.99**[14]

In addition, petitioner is liable to pay delinquency interest at the rate of 12%[15] on the total unpaid basic deficiency tax, surcharge and deficiency interest as of January 15, 2014 amounting to Php283,888.322 for IT, Php1,447.4215 for WTC and P2,011.0795 for EWT, or in the aggregate amount of Php287,346.823, computed from January 1, 2018 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended by Republic Act No. 10963, also known as Tax Reform for Acceleration and Inclusion (TRAIN).

SO ORDERED.

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

WE CONCUR:

(With Concurring and Dissenting Opinion)
ROMAN G. DEL ROSARIO
Presiding Justice

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

ERLINDA P. UY
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

14 Rounded off.

15 Section 2 of Revenue Regulations No. 21-2018 dated September 14, 2018.

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 En Banc.

ROMAN G. DEL ROSARIO
Presiding Justice

REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

NORTHERN TOBACCO REDRYING CO., INC.,
Respondent.

CTA EB NO. 1664
(CTA Case No. 8866)

Present:
DEL ROSARIO, PJ,
CASTAÑEDA, JR.,
UY,
FABON-VICTORINO,
MINDARO-GRULLA,
RINGPIS-LIBAN, and
MANAHAN, JJ.

Promulgated:

JAN 3 1 2019 4:17 p.m.

x- x

CONCERNING AND DISSENTING OPINION

DEL ROSARIO, PJ.:

I concur with the *ponencia* of my learned colleague, the Honorable Associate Justice Cielito N. Mindaro-Grulla, in so far as it denies the Petition for Review filed by the Commissioner of Internal Revenue (CIR) but solely on the ground that the assessments issued against respondent are void for having been issued without a valid Letter of Authority (LOA). As a consequence of the assessment being declared void, I cannot give my assent to the *ponencia* in so far as it affirms the assailed Decision and Resolution of the Court in Division which ordered respondent to pay deficiency income tax, withholding tax on compensation and expanded withholding tax for taxable year 2010, albeit with modification on the computation of deficiency and delinquency interests.

I submit that the assessments issued against respondent are void. A careful perusal of the records discloses the following:

- Letter of Authority (LOA) No. 124-2011-00000048 dated July 19, 2011 was issued by petitioner, through Assistant Commissioner

Zenaida G. Garcia, Large Taxpayers Service, which **authorized Revenue Officers (RO) Nicanor San Juan, RO Ponciano Garma, Lamberto Vasquez and Group Supervisor (GS) Ronaldo Camba**, to examine respondent's books of accounts and other accounting records for all internal revenue taxes for taxable year 2010;

- Memorandum of Assignment (MOA) numbered ELT AD II-2013-MOA-0100 dated March 11, 2013[1] was issued to **RO Romualdo I. Plocios, RO Melinda M. Rugayan, RO Lolita G. Sabado, and GS Samuel C. Reyes** for the continuation of the audit or investigation, to replace the previously assigned RO Roque Doloiras, Jr., who was transferred to another division.

- **There is nothing on record which would show that RO Doloiras, Jr. was authorized by an LOA.**

In ***Commissioner of Internal Revenue vs. Lancaster Philippines, Inc.,***[2] the Supreme Court, citing Section 1, Rule 4 of A.M. No. 05-11-07- CTA, or the Revised Rules of the Court of Tax Appeals, declared that the CTA can resolve the issue on the authority of the ROs to conduct the audit, albeit the same was not raised by the parties in their pleadings or memoranda. For want of valid LOA, the Supreme Court ultimately resolved to declare the assessment void.

Moreover, in ***Medicard Philippines Inc. vs. Commissioner of Internal Revenue,***[3] the Supreme Court emphasized the importance of an LOA and the authority of ROs who conducted the audit and examination of the taxpayer. It went on further to declare as **void the subject disputed assessment for lack of an LOA authorizing the ROs to examine the taxpayer's books of account and other accounting records.**

While respondent failed to raise the issue of lack of an LOA which authorizes RO Romualdo I. Plocios, RO Melinda M. Rugayan, RO Lolita G. Sabado and GS Samuel C. Reyes to conduct and continue the audit, the Court is not precluded from considering this issue as the absence of a valid LOA renders an assessment intrinsically void. The importance of the ROs' authority to conduct the audit cannot be over-emphasized as it goes into the issue of the validity of the assessment.

An officer of the Bureau of Internal Revenue (BIR) cannot simply subject a taxpayer to audit without valid authority issued for that purpose.[4] RMO No. 43-90 specifies the policy guidelines in

[1] Exhibit R-1, BIR Records, p. 213.
[2] G.R. No. 183408, July 12, 2017.
[3] G.R. No. 222743, April 5, 2017.
[4] Section 13 of the National Internal Revenue Code of 1997, as amended.

the issuance of LOAs to audit. It likewise identifies and limits the BIR Officials who are authorized to issue LOAs, *viz.*:

> "D. Preparation and issuance of L/As.
>
> xxx
>
> 4. For the proper monitoring and coordination of the issuance of Letter of Authority, **the only BIR officials authorized to issue and sign Letters of Authority are the Regional Directors, the Deputy Commissioners and the Commissioner**. For the exigencies of the service, **other officials may be authorized to issue and sign Letters of Authority but <u>only upon prior authorization by the Commissioner himself</u>**." *(Boldfacing supplied)*

RMO No. 43-90 is explicit that the continuation of audit by a revenue officer other than the officer named in a previous LOA, **requires the issuance of a <u>new</u> LOA**:

> "C. Other policies for issuance of L/As.
>
> 1. **All audits/investigations, whether field or office audit, should be conducted under a Letter of Authority**.
>
> xxx
>
> 5. **<u>Any re-assignment/transfer of cases to another RO(s)</u>**, and revalidation of L/As which have already expired, **<u>shall require the issuance of a new L/A</u>, with the corresponding notation thereto, including the previous L/A number and date of issue of said L/As**." *(Boldfacing supplied)*

More specifically, for taxpayers under the Large Taxpayers Service, RMO No. 29-07 enumerates the BIR Officials who have the authority to issue and approve LOAs for the conduct of the audit, *viz.*:

> "II. AUDIT POLICIES AND GUIDELINES
>
> 1. The Chief, Large Taxpayers Audit & Investigation Divisions/LTDOs shall draw a list of taxpayers selected for audit under its current selection criteria. The list shall state the name of taxpayer selected for audit, the nature of business, the amount of gross sales/receipts, the selection code, the PSIC code, and the corresponding amount of tax paid for the period. The said list shall

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Sec. 13. Authority of a Revenue Officer. — Subject to the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, **a Revenue Officer assigned to perform assessment functions** in any district may, **<u>pursuant to a Letter of Authority</u>** issued by the **Revenue Regional Director**, examine taxpayers within the jurisdiction of the district in order **to collect the correct amount of tax, or to recommend the assessment of any deficiency tax due** in the same manner that the said acts could have been performed by the Revenue Regional Director himself." *(Boldfacing and underscoring supplied)* be submitted to the Assistant Commissioner/Head Revenue Executive Assistant, Large Taxpayers Service for approval, copy furnished the Commissioner of Internal Revenue.

2. **All Letters of Authority (LOAs) shall be issued and approved by the Assistant Commissioner/Head Revenue Executive Assistants**." (Emphasis supplied)

Had the MOA been accorded the same legal effect as an LOA itself, then RMO No. 43-90 would not have categorically stated that *"revalidation of L/As ... shall require the issuance of a new L/A."* The use of the phrase *"shall require the issuance of new L/A"* emphasizes the mandatory nature of the said requirement. Needless to say, the BIR has the duty of exacting compliance therewith as it has the burden of ensuring that the right of the government to assess and collect tax deficiencies would not be defeated by its failure to comply with its own rules.

In the present case, while the MOA cannot be treated as an LOA as precisely, any re-assignment of cases requires the issuance of a new LOA, **its fatal infirmity is further highlighted by the fact that it was signed and issued by the OIC-Chief of Excise LT Audit Div. II and not by the Assistant Commissioner of the Large Taxpayer Service.**

The issuance of LOAs is not just a plain ministerial act but calls for the exercise of discretion by the Assistant Commissioner of the Large Taxpayer Service. The authority to issue LOAs, which was delegated to the Assistant Commissioner by the CIR under RMO No. 29-07, cannot be further delegated to the OIC-Chief of Excise LT Audit Div. II. Truth to tell, **there is nothing on record which shows that the Assistant Commissioner has the power to further delegate the duty of issuing LOAs for taxpayers under the Large Taxpayer Service or to substitute another in his place**. On this point, the pronouncement in ***NPC Drivers and Mechanics Association, (NPC DAMA) vs. The National Power Corporation***[5] is instructive, *viz.*:

> "We agree with petitioners. In enumerating under Section 48 those who shall compose the National Power Board of Directors, the legislature has vested upon these persons the power to exercise their judgment and discretion in running the affairs of the NPC. Xxx xxx xxx. It is to be presumed that in naming the respective department heads as members of the board of directors, the legislature chose these secretaries of the various executive departments on the basis of their personal qualifications and acumen which made them eligible to occupy their present positions.

[5] G.R. No. 156208, September 26, 2006.

> as department heads. **Thus, the department secretaries cannot delegate their duties as members of the NPB, much less their power to vote and approve board resolutions, because it is their personal judgment that must be exercised in the fulfillment of such responsibility**.
>
> Xxx, the rule enunciated in the case of *Binamira v. Garrucho* is relevant in the present controversy, to wit:
>
>> **An officer to whom a discretion is entrusted cannot delegate it to another, the presumption being that he was chosen because he was deemed fit and competent to exercise that judgment and discretion, and unless the power to substitute another in his place has been given to him, he cannot delegate his duties to another**.
>
> Xxx." *(Citations omitted; Boldfacing supplied)*

In fine, there is no denying that no new LOA was issued to RO Romualdo I. Plocios, RO Melinda M. Rugayan, RO Lolita G. Sabado, and GS Samuel C. Reyes by the Assistant Commissioner of the Large Taxpayer Service in relation to their investigation of respondent's tax liability for taxable year 2010. This procedural lapse, or the absence of a new LOA, rendered the assessment issued pursuant thereto void. Being a void assessment, the same bears no fruit[6] and must be slain at sight.

All told, I **VOTE** to: i) **DENY** the Petition for Review filed by the Commissioner of Internal Revenue; ii) **REVERSE** the Decision dated February 23, 2017 and Resolution dated May 18, 2017 of the Court in Division in CTA Case No. 8866; and, iii) **CANCEL** and **SET ASIDE** the Final Assessment Notices and Formal Letter of Demand, all dated December 11, 2013, issued against respondent Northern Tobacco Redrying Co., Inc. for deficiency income tax, value-added tax, withholding tax on compensation, expanded withholding tax, documentary stamp tax and improperly accumulated earnings tax for taxable year 2010.

ROMAN G. DEL ROSARIO
Presiding Justice

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