REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

En Banc

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*	**CTA *EB* NO. 1340** (CTA Case No. 8541)
	Present:
-versus -	***Del Rosario, P.J.*** ***Castañeda, Jr.,*** ***Bautista,*** ***Uy,*** ***Casanova,*** ***Fabon-Victorino,*** ***Mindaro-Grulla,*** ***Ringpis-Liban,** and* ***Manahan, JJ.***
ANSI AGRICULTURAL PRODUCTS, INC., *Respondent.*	**Promulgated:** JAN 30 2017 3:06 p.m.

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DECISION

BAUTISTA, J:

The Case

Submitted for decision to the Court of Tax Appeals ("CTA") *En Banc* under *Section 4(b)*[1], *Rule 8 of the 2005 Revised Rules of the CTA, as amended ("RRCTA")*, is a Petition for Review of the Decision[2] dated

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[1] "SEC. 4. *Where to appeal; mode of appeal.* –

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(b) An appeal from a decision or resolution of the Court in Division on a motion for reconsideration or new trial shall be taken to the Court by petition for review as provided in Rule 43 of the Rules of Court. The Court *En Banc* shall act on the appeal."

[2] *Records, CTA Case No. 8541, Assailed Decision,* pp. 583-606; penned by Presiding Justice Roman G. Del Rosario, with Associate Justices Erlinda P. Uy, and Cielito N. Mindaro-Grulla concurring.

April 20, 2015 ("Assailed Decision"), and the Resolution[3] dated July 9, 2015 ("Assailed Resolution"), rendered by the CTA First Division ("Court in Division") in CTA Case No. 8541.

The dispositive portions of the Assailed Decision and the Assailed Resolution read as follows:

Assailed Decision

> **WHEREFORE,** premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED.** Accordingly, the assessment for deficiency income tax issued by respondent against petitioner covering taxable year 2009 is hereby **AFFIRMED WITH MODIFICATION**. Accordingly, petitioner is **ORDERED TO PAY** the amount of P[hp]1,365,323.25, inclusive of 25% surcharge imposed under *Section 248(A)(3) of the [1997 National Internal Revenue Code, as amended ("1997 NIRC")]*, computed as follows:

Taxable income per ITR			P[hp]	2,993,060.13
Add: Disallowed bad debts expense			[]	3,640,862.00
Taxable income after adjustment			P[hp]	6,633,922.13
Income Tax Due			P[hp]	1,990,176.64
Less: Tax credits/payments:				
Payments per BIR-ITS	P[hp]	45,709.13		
Prior year's excess credits other than MCIT		846,908.91		
Creditable tax withheld		5,300.00	[Php]	897,918.04
Basic Deficiency Income Tax			**P[hp]**	**1,092,258.60**
25% Surcharge				273,064.65
Total			**P[hp]**	**1,365,323.25**

> In addition, petitioner is **ORDERED TO PAY** the following:
>
> (a) deficiency interest at the rate of twenty percent (20%) *per annum* on the basic deficiency income tax in the amount of P[hp]1,092,258.60 computed from April 15, 2010, until full payment thereof pursuant to *Section 249(B) of the [1997 NIRC]*; and
>
> (b) delinquency interest at the rate of twenty percent (20%) *per annum* on the total amount due of P[hp]1,365,323.25 and on the 20% deficiency interest which have accrued as

[3] *Records, Assailed Resolution,* pp. 629-633; penned by Presiding Justice Roman G. Del Rosario, with Associate Justices Erlinda P. Uy, and Cielito N. Mindaro-Grulla concurring.

> stated in the immediately preceding paragraph, computed from July 26, 2012 until full payment thereof pursuant to *Section 249(C)(3) of the [1997 NIRC].*
>
> **SO ORDERED.**[4]

Assailed Resolution

> **WHEREFORE,** premises considered, the Motion for Partial Reconsideration (Notice of Decision promulgated on April 20, 2015) of respondent Commissioner of Internal Revenue is hereby **DENIED** for lack of merit.
>
> **SO ORDERED.**[5]

On August 12, 2015, petitioner Commissioner of Internal Revenue ("CIR") filed the instant Petition for Review[6] with the CTA *En Banc,* docketed as CTA *EB* No. 1340, praying "that the instant Petition for Review be dismissed for lack of factual and legal bases [*sic*], and that judgment be rendered ordering petitioner [*sic*] to pay the deficiency tax assessments stated in the Formal Letter of Demand [("FLD")] and Assessment Notices, plus increments until fully paid."[7]

The Parties[8]

Petitioner CIR, is the Chief of the Bureau of Internal Revenue ("BIR"), an administrative body under the control and supervision of the Department of Finance, with powers and duties, among others, to assess and collect all national internal revenue taxes, and to decide disputed assessments.

Respondent ANSI Agricultural Products, Inc. ("AAPI"), is a domestic corporation created and formed under the laws of the Philippines. It is registered with the BIR as a VAT-exempt company engaged in trading of agricultural raw materials, animal feeds, and animal feed ingredients/supplement on a wholesale and retail basis

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[4] *Records, Assailed Decision,* pp. 605-606; emphases retained, emphases in italics ours.
[5] *Id., Assailed Resolution,* p. 633; emphases retained.
[6] *Rollo, CTA EB No. 1340, Petition for Review,* pp. 6-47, with annexes.
[7] *Id.* at 12.
[8] *Records, Assailed Decision,* pp. 583-584.

with business address at 55-C Lincoln Street, Barangay San Antonio, San Francisco Del Monte, Quezon City, Philippines.

The Facts

As stated in the Assailed Decision, the factual antecedents of the case are as follows:

> A Letter of Authority (LOA 2009) No. 00031820 dated June 24, 2010 was issued against [AAPI] on June 29, 2010 for the investigation of its tax for the period January 1, 2009 to December 31, 2009.
>
> After investigation, a Preliminary Assessment Notice [("PAN")] dated July 12, 2011 was received by [AAPI] on July 13, 2011 informing [AAPI] of a deficiency income tax for the calendar year ending December 31, 2009.
>
> On July 27, 2011, [AAPI] filed a letter of protest dated July 25, 2011 with the Quezon City Assessment Division, Revenue Region No. 7, BIR, explaining its position, and by way of response, to the PAN dated July 12, 2011.
>
> Thereafter, an Assessment Notice together with a [FLD] No. 038-B083-09 dated August 12, 2011 was issued upon, and was received by [AAPI], on August 17, 2011.
>
> On September 8, 2011, [AAPI] protested the Assessment dated August 12, 2011 in a letter dated September 7, 2011.
>
> On October 7, 2011, [AAPI] received a letter from [the CIR] dated September 26, 2011 informing [AAPI] that its letter-protest has been forwarded to the Revenue Region 38, North, Quezon City.
>
> In a Letter-Notice to Taxpayer dated October 12, 2011 received on October 18, 2011 by [AAPI], [the CIR] informed [AAPI] of the re-assignment of Letter of Authority and the continuance of examination of books of accounts and other accounting records.
>
> A considerable length of time had elapsed but no examination of books of accounts and other accounting records was done by [the CIR]. Likewise, no action was taken on [AAPI]'s protest. As events turned out, more than one (1)

year had passed when [AAPI] finally received on July 26, 2012 a letter dated July 6, 2012 from [the CIR] denying its protest, on the ground that "you have failed to submit documents in support of your protest," which said letter constitutes the final decision of [the CIR] in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the *[1997 NIRC]* or other laws administered by the BIR which this Honorable Court exercises exclusive appellate jurisdiction to review by appeal under *[Republic Act] R.A. [No.] 1125.*

On August 28, 2012, [AAPI] filed *via* registered mail the Petition for Review, which the Court received on September 5, 2012, praying for the reversal and cancellation of [the CIR]'s final decision on disputed assessment [("FDDA")]. In support thereof, [AAPI] ascribes the following errors allegedly committed by [the CIR], *viz.:*

> 1. [The CIR] has committed grave abuse of discretion amounting to lack of, or excess of jurisdiction in rendering the final decision dated July 6, 2012, which is adverse to the herein [AAPI], based only on [AAPI]'s alleged failure to submit documents, which is based on pure technicality and not on the merits;
>
> 2. [The CIR]'s decision on the assessment was not proper and correct and not in accordance with law.

On September 25, 2012, [the CIR] filed h[is] Answer. Thereafter, [he] filed a Motion for Leave of Court (To File Amended Answer), with attached Amended Answer on October 23, 2012, which was granted in a Resolution dated December 14, 2012. In [his] Amended Answer, [the CIR] averred the following special and affirmative defenses:

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During pre-trial conference, the parties entered into admissions, stipulation of facts, definition of issue, identification of witnesses and documentary evidence, and eventually submitted their Joint Stipulation of Facts and Issues [("JSFI")] on March 11, 2014. The Court approved the JSFI and terminated pre-trial in the Resolution dated March 17, 2014.

Both parties eventually presented their respective testimonial and documentary evidence. [AAPI]'s formally

> offered evidence, consisting of *Exhibits* "P-1" to "P-13-1[,"] were admitted in the Resolution promulgated on July 8, 2014, with the exception of an unmarked document described as 2009 Books of Accounts (General Journal) which was offered as *Exhibit* "P-8[."] [The CIR]'s formal offer of evidence filed on October 13, 2014, consisting of *Exhibits* "R-1" to "R-8-a[,"] were all admitted in the Resolution dated November 28, 2014.
>
> With the filing of [the CIR]'s Memorandum on January 23, 2015 and without memorandum from [AAPI] *per* Records Verification report dated February 5, 2015, this case was submitted for decision on February 12, 2015.[9]

On April 20, 2015, the Court in Division promulgated the Assailed Decision partially granting the Petition for Review, while affirming with modification the assessment for deficiency income tax issued by the CIR against AAPI, covering deficiency income tax for taxable year 2009; and ordering AAPI to pay the amount of Php1,365,323.25 inclusive of twenty five percent (25%) surcharge imposed under *Section 248(A)(3) of the 1997 NIRC*.[10] It also ordered AAPI to pay deficiency interest pursuant to *Section 249(B) of the 1997 NIRC* and delinquency interest pursuant to *Section 249(C)(3) of the 1997 NIRC*.[11]

On May 11, 2015, CIR filed his Motion for Partial Reconsideration (Notice of Decision promulgated on April 20, 2015)[12] ("Motion for Partial Reconsideration"), to which AAPI filed its Comment On/Or Opposition To Respondent's Motion for Partial Reconsideration[13] ("Comment/Opposition") on June 9, 2015.

On July 9, 2015, the Court in Division promulgated the Assailed Resolution denying CIR's Motion for Partial Reconsideration for lack of merit.[14]

On August 12, 2015, the CIR filed the present Petition for Review with the Court *En Banc*.[15]

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[9] *Records, Assailed Decision,* pp. 584-588; emphases retained, emphases in italics ours.
[10] *Id.* at 605-606.
[11] *Id.*
[12] *Id., Motion for Reconsideration,* pp. 607-611.
[13] *Id., Comment On /Opposition To Respondent's Motion for Partial Reconsideration,* pp. 615-623.
[14] *Id., Assailed Resolution,* pp. 629-633.
[15] *Rollo, Petition for Review,* pp. 6-47, with annexes; entitled "*Commissioner of Internal Revenue v. ANSI Agricultural Products, Inc.,*" p. 6.

On September 2, 2015, the Court *En Banc* issued a Resolution[16] requiring AAPI to file its comment, not a motion to dismiss.

On October 13, 2015, AAPI filed its Comment On, and/or Opposition To (CIR's Petition for Review).[17]

On December 22, 2015, the Court *En Banc* issued a Resolution giving due course to the Petition for Review and ordering the parties to file their respective Memoranda.[18]

With the filing of the CIR's Memorandum[19] on February 16, 2016, and AAPI's Memorandum[20] on February 29, 2016, the Court *En Banc* resolved[21] to submit the case for decision on March 22, 2016; hence, this Decision.

The Issue[22]

WHETHER THE OFFSETTING OF AAPI'S RECEIVABLE ACCOUNT FROM SWIFT FOODS, INC. WITH ITS OWN PAYABLE ACCOUNT TO THE SAME DEBTOR-CREDITOR, AS A CONSEQUENCE OF THE PARTIAL SETTLEMENT OF THE LATTER'S PRIOR DEBT, WILL NOT PRODUCE ANY TAXABLE INCOME.

Petitioner's Arguments[23]

The CIR argues that income is wealth which flows into the taxpayer other than mere return of capital; that, as stated in the FLD, the undeclared other income amounting to Php2,310,495.50 representing the amount payable to Swift Foods, Inc. ("Swift") that was unilaterally declared to be condoned and offset against its receivable from said company should have been reported as part of taxable income; that pursuant to *Revenue Audit Memorandum Order ("RAMO") No. 1-2000*, the amount received by respondent from Swift

[16] *Rollo*, pp. 49-50.
[17] *Id.* at 52-62.
[18] *Id.* at 68-69.
[19] *Id., Memorandum*, pp. 70-77.
[20] *Id., Memorandum (for Respondent ANSI)*, pp. 78-97.
[21] *Id.* at 101-102.
[22] *Rollo, Petition for Review*, p. 9.
[23] *Id., Memorandum*, pp. 72-75.

is a taxable income; that income from the sale of dressed chickens that was received from Swift flowed into the coffers of AAPI; that tax assessments by examiners are presumed correct and made in good faith; and that in the absence of proof of any irregularity in the performance of official duties, an assessment will not be disturbed.

***Respondent's Counter-Arguments*[24]**

On the other hand, AAPI contends that the income derived from the sale of dressed chicken is not a taxable income, the same being a result of the offsetting of its receivable account from Swift with its own payable account to the latter in partial settlement of Swift's prior debt to AAPI; that as early as 2005, there was already an indication and risk of non-collection; that by the second half of 2005, Swift offered to make partial payments by allowing AAPI to pick up from its non-moving inventory of dressed chicken as that was the only means by which it can partially pay AAPI, thus reducing its receivable accounts from Swift to Php2,866,862.00.

It maintains that the sale on credit to Swift was already reported and the supposed income derived from it was already declared, recognized, with the tax already paid; that since it was not paid, it remained under accounts receivables; that once an account receivables is paid, there is no income recognized; that there will be double taxation if the CIR will insist on an unreported income when there is really none; that the CIR failed to present any argument which has basis in fact and in law other than his interpretation; that the CIR misconstrued and misapplied the provisions of the law on income, more particularly *Sections 31 and 32 of the 1997 NIRC* and *RAMO No. 1-2000;* that the CIR failed to sufficiently show that the Assailed Decision is not supported and is contrary to evidence presented and applicable law; and that the grounds relied upon by the CIR are a mere rehash of the claim in the Motion for Partial Reconsideration, which has already been properly taken up and thoroughly discussed and passed upon by the Court in Division.

The Ruling of the Court En Banc

The Petition for Review is without merit.

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[24] *Rollo, Memorandum (for Respondent ANSI),* pp. 84-96.

Under the accrual basis of accounting, revenue is recognized when it is earned (when products are delivered or services are provided), and realized (cash is received) or realizable (there is reasonable expectation that cash will be received in the future).[25]

In 2004, AAPI sold animal feed ingredients to Swift for a total value of Php6,768,357.50.[26] This was recorded in the books as an increase in Accounts Receivable (due from Swift) and Sales.[27] At this point, income was already recognized by AAPI and there was already a debt whereby AAPI is creditor and Swift is debtor.

In early 2005, Swift made partial payments to AAPI totaling Php700,000.00, which was recorded as an increase in Cash and a decrease in Accounts Receivable (due from Swift).[28] Afterwards, Swift had financial difficulties and entered into a swap agreement with AAPI, who received old-stock chickens from Swift worth Php2,310,495.50, this was recorded by AAPI as an increase in Purchases and Accounts Payable (due to Swift).[29] Hence, a second debt arose wherein AAPI is debtor and Swift is creditor.

In 2009, offsetting was done in the books wherein the amount of Php2,310,495.50 was deducted from Accounts Receivable (due from Swift) and Accounts Payable (due to Swift). Swift likewise made several small payments totaling to Php891,000.00, hence, there was an increase in Cash and a decrease in Accounts Receivable (due from Swift).[30] As for the balance of Php2,866,862.00 in the Accounts Receivable (due from Swift) account, this was written off after several demands, follow-ups and visits.[31]

In this case, the revenue of AAPI from its sale of animal feed ingredients was already earned and realizable at the time the receivable was recognized in taxable year 2004, when income tax arising therefrom was due and presumably paid. To recognize income and to demand payment of income tax in taxable year 2009 from AAPI on the same revenue, upon offsetting, will effectively re-impose a tax which was already paid. The value of the dressed

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[25] *Statement of Financial Accounting Concepts No. 5, par. 83.*
[26] *Records, Exhibit "13," Judicial Affidavit of Emerenciana Anselmo Mandia,* p. 496.
[27] *Id.*
[28] *Id.* at 497.
[29] *Id.* at 497-498.
[30] *Id.* at 499.
[31] *Id.*

chickens was simply applied to the outstanding debt of Swift that was due to AAPI through legal compensation.

Under *Article 1278 of the Civil Code of the Philippines,* compensation shall take place when two persons, in their own right, are creditors and debtors of each other. Compensation may be total or partial.[32] In order to have a valid offsetting or legal compensation, the following requisites[33] must be complied with, to wit:

1. That each one of the obligors is bound principally, and that he/she/it be at the same time a principal creditor of the other;

2. That both debts consist in a sum of money, or if the things due are consumable, they be of the same kind, and also of the same quality if the latter has been stated;

3. That the two debts be due;

4. That both debts are liquidated and demandable; and

5. That no retention or controversy, commenced by third persons and communicated in due time to the debtor, exists over said debts.

There is no question that the foregoing requisites are present in the case at bar, to wit: *(1)* there are two debts, the pre-existing debt of Swift in favor of AAPI, and the debt of APPI from its purchase of dressed chickens from Swift; *(2)* in both debts, Swift and AAPI are principally bound to each other as debtor and/or creditor; *(3)* both debts are due, liquidated and demandable; and *(4)* there is no retention or controversy in relation to both debts. Therefore, when AAPI accepted Swift's offer to "swap" its debts, albeit in the form of dressed chickens, AAPI merely deducted the value thereof from Swift's indebtedness to it.

[32] *Article 1281, Civil Code of the Philippines.*
[33] *Article 1279, Civil Code of the Philippines.*

In fact, evidence on record show that no income was realized when the offsetting was made. As aptly discussed by the Court in Division:

> Income denotes a flow of wealth during a definite period of time. For income to be taxable, the following requisites must exist:
>
> (1) there must be gain;
> (2) the gain must be realized or received; and
> (3) the gain must not be excluded by law or treaty from taxation.
>
> Offsetting of [AAPI]'s receivable account from Swift [] with its own payable account to the same debtor-creditor, as a consequence of the partial settlement of the latter's prior debt, will not produce any taxable income as there is no gain realized therefrom. With the reduction of the receivable account to the extent of the offsetted payable account, no new income is recognized as the supposed income was already previously recognized during the year the sale on credit was made, and the related tax therefrom was already paid.
>
> xxx xxx xxx
>
> Apparently, offsetting of receivable account from Swift [] with that of [AAPI]'s own payable accounts with the same debtor-creditor does not involve 'revenue accounts' but involved only the 'balance sheet' accounts, which are called 'permanent accounts[."] There is no income realized during the time the receivable and payable accounts were offsetted in petitioner's books in 2009 as the related income of the offsetted receivable account of P[hp]2,310,495.50 was already recognized at the time of sale in 2004.[34]

Moreover, the issue raised in the instant Petition for Review was already addressed by the Court in Division in resolving the CIR's Motion for Reconsideration, to wit:

> With respect to the substance of the motion, the Court finds the same bereft of merit.
>
> It is to be stressed that [the CIR] **assessed** the alleged "undeclared other income" of P[hp]2,310,495.50 **due to**

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[34] *Records, Assailed Decision,* pp. 601-605.

offsetting of accounts made by [AAPI] as shown in the details of discrepancy of the [FLD], *viz.*:

> "b. Undeclared other income **(P[hp]2,310,495.50)** - Verification disclosed that the **said amount represents payable to Swift [] which was unilaterally declared to be condoned and offsetted against its receivable from the said company**. Such amount should have been reported as part of taxable income, hence, was added back pursuant to *Sections 31 and 32 of the [1997 NIRC] and [RAMO No.] 1-2000." (Boldfacing supplied)*

The parties even jointly stipulated on the issue of whether the payable amount to Swift [] (which was unilaterally declared condoned and offsetted against [AAPI]'s receivable from the same company) should have been reported as part of taxable income.

On the other hand, in support of h[is] position that offsetting of accounts produced taxable income, [the CIR] is now asserting that the payment received by [AAPI] from Swift [] in the form of dressed chicken[s] is income, and that when such dressed chicken[s] were eventually sold, the income derived therefrom is taxable.

The Court already made an extensive discussion on the issue of offsetting of accounts, and sees no reason to modify or reverse the assailed Decision. As previously ruled, offsetting of [AAPI]'s receivable account from Swift [] with its own payable account to the same debtor-creditor, as a consequence of the partial settlement of the latter's prior debt, will not produce any taxable income as there was no gain realized therefrom. There was no flow of wealth at the time the offsetting of accounts was made, or even at the time [AAPI] received payment in kind. The related income of the offset receivable account of P[hp]2,310,495.50 was already recognized at the time of sale on credit to Swift [] in the year 2004.

xxx xxx xxx[35]

Likewise, the Court *En Banc* cannot sustain the CIR's contention that the income derived from the sale of the dressed chickens is taxable income. AAPI was assessed based on the offsetting that was

[35] *Records, Assailed Resolution*, p. 632; emphases retained, italics supplied.

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made, CIR cannot now claim that it was the sale of the dressed chicken that was the source of the taxable income. Thus as correctly ruled by the Court in Division:

> The additional point raised by respondent pertaining to the taxability of the supposed income on the subsequent sale of the dressed chicken is immaterial to the present controversy. As earlier emphasized, the factual basis of the assessed deficiency income tax on "undeclared other income" was due to petitioner's offsetting of accounts. Respondent cannot be allowed to change the theory or the factual basis of her assessment as this would be offensive to the basic tenets of justice and due process.

It is true that tax assessments by examiners are presumed correct and made in good faith and that the taxpayer has the duty to prove otherwise. However, in the instant case, AAPI was able to prove that no income was realized in the offsetting of its debts from Swift with the amount due to it from the latter's debt.

It has been held time and again that in balancing the scales between the power of the State to tax and its inherent right to prosecute perceived transgressors of the law on one side, and the constitutional rights of a citizen to due process of law and the equal protection of the laws on the other, the scales must tilt in favor of the individual, for a citizen's right is amply protected by the Bill of Rights under the Constitution. Thus, while taxes are the lifeblood of the government, the power to tax has its limits, in spite of all its plenitude. Even as the Court *En Banc* concede the inevitability and indispensability of taxation, it is a requirement in all democratic regimes that it be exercised reasonably and in accordance with the prescribed procedure.[36]

WHEREFORE, premises considered, the Petition for Review is hereby **DENIED** for lack of merit. Accordingly, the Decision dated April 20, 2015 and the Resolution dated July 9, 2015 of the Court in Division, are hereby **AFFIRMED** and **UPHELD.**

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[36] *Commissioner of Internal Revenue v. United Salvage and Towage (Phils.), Inc.*, G.R. No. 197515, July 2, 2014, 729 SCRA 113.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

CERTIFICATION

Pursuant to *Article VIII, Section 13 of the Constitution,* it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice