REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
Quezon City

Third Division

AIRGLOBE, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 9466

Members:

UY, *Chairperson*
RINGPIS-LIBAN, *and*
MODESTO-SAN PEDRO, *JJ.*

Promulgated:
FEB 19 2020
4:14 p.m.

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DECISION

RINGPIS-LIBAN, J.:

The Case

This is a Petition for Review filed by Petitioner Airglobe, Inc. against Respondent Commissioner of Internal Revenue ("CIR") on September 09, 2016, seeking the cancellation and withdrawal of the Final Decision dated June 28, 2016 issued by Respondent on the alleged deficiency income tax, value added tax ("VAT"), expanded withholding tax ("EWT"), withholding tax on compensation ("WTC"), and compromise penalty, plus penalties and interests, in the total amount of Php32,798,593.79 for the fiscal year ending in June 2007.[1].

The Facts

Petitioner Airglobe, Inc. is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with office address at S-322 Pair Pags Center, Ninoy Aquino Avenue, Pasay City.[2]

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1 Docket, Pre-Trial Order dated May 10, 2018, Statement of the Case, p. 317.
2 *Id.*, Joint Stipulation of Facts and Issues (JSFI), Facts Admitted, Par. 1, p. 290.

Respondent Bureau of Internal Revenue ("BIR"), through the CIR, is the agency of the government tasked with the enforcement of revenue laws and the collection of taxes and duties. Respondent is being represented in this case by the legal officers of the Legal Division, Revenue Region No. 8, Makati City, with office address at 2/F Legal Division, BIR Bldg., No. 313 Sen. Gil Puyat Avenue, Makati City.[3]

On January 24, 2011, Petitioner received the Formal Assessment Notice ("FAN") dated January 14, 2011, assessing it for deficiency income tax, VAT, EWT, and WTC, in the amount Php23,225,322.51, Php7,742,661.12, Php78,614.15, and Php139,827.16, respectively, for the year 2007.[4]

Petitioner filed its Formal Protest dated February 21, 2011 against the FAN on February 23, 2011, praying, *inter alia*, for a reinvestigation of the same.[5] The BIR then granted the request for reinvestigation *via* the letter dated March 14, 2011.[6]

On April 25, 2011, Petitioner transmitted pertinent documents in support of its protest against the FAN.[7]

On August 04, 2011, Petitioner received the Final Decision on Disputed Assessment ("FDDA") dated July 28, 2011, issued by Regional Director Jaime B. Santiago, denying Petitioner's protest and reiterating the assessments in the amounts of Php24,430,076.57, Php8,135,862.73, Php83,599.11, and Php149,095.38, representing alleged income tax, VAT, EWT, and WTC deficiencies for the year 2007.[8]

Thereafter, on September 02, 2011, Petitioner filed the Appeal dated September 01, 2011 before the Office of the CIR.[9]

Petitioner received, on August 10, 2016, the Final Decision dated June 28, 2016 promulgated by then Commissioner Kim Jacinto-Henares, denying its appeal.[10]

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3 *Id.*, JSFI, Facts Admitted, Par. 2, p. 290.
4 *Id.*, Exhibits "P-1", "P-1-A" "P-1-B", "P-1-C", "P-1-D", and "P-1-E", pp. 345 to 355; JSFI, Facts Admitted, Par. 3, p. 290.
5 *Id.*, Exhibit "P-2", pp. 356 to 363; JSFI, Facts Admitted, Par. 4, p. 291.
6 Exhibit "R-10", BIR Records, p. 507.
7 Docket, Exhibit "P-3", pp. 364 to 366.
8 *Id.*, Exhibit "P-4", pp. 367 to 371; JSFI, Facts Admitted, Par. 5, p. 291.
9 *Id.*, Exhibit "P-5", pp. 372 to 379; JSFI, Facts Admitted, Par. 6, p. 291.
10 *Id.*, Exhibit "P-6", pp. 380 to 397; JSFI, Facts Admitted, Par. 7, p. 291.

Petitioner filed the instant Petition for Review on September 09, 2016.[11] This case was initially raffled to this Court's First Division.

On November 29, 2016, Respondent filed his *Answer*,[12] interposing the following special and affirmative defenses, to wit:

"**<u>SPECIAL AND AFFIRMATIVE DEFENSES</u>**

1) Respondent reiterates and repleads the preceding paragraphs of the answer as part of his Special and Affirmative Defenses;

2) The argument of the Petitioner that is it not liable for the alleged income tax, VAT, expanded withholding tax, withholding tax on compensation and compromise penalty, plus penalties and interests, in the total amount of Php32,798,593.79 for the taxable year 2009 is misplaced;

3) Moreover, the argument of the Petitioner that the deficiency tax assessments lack factual and legal bases is unwarranted;

4) **<u>Income Tax</u>**
   a. **Unaccounted receipts: P28,643,486.50.** – Comparison of Petitioner's receipts per income as against the purchases declared by its customers per BIR Form 2307 showed a difference amounting to P28,643,486.50. Section 2.57.2(E) of Revenue Regulations 2-98, as amended states that:

> '**(E)** ***Income payments to certain contractors*** – On gross payments to the following contractors, whether individual or corporation – Two percent (2%)
>
> x x x
>
> (4) other contractors –
>
> x x x
>
> (c) Transportation contractors which include common carriers for the carriage of goods and merchandise of whatever kind by land, air or water, where the gross payments by the payor to the same

[11] *Id.*, pp. 11 to 34.
[12] *Id.*, pp. 107 to 117.

> payee amounts to at least two thousand pesos (P2,000) per month, regardless of the number of shipments during the month.'

Applying the foregoing provision, tax withheld by each of the customers of the Petitioner is equivalent to 2% of its total sales, which is subject to income tax rate of 35% pursuant to Section 27 of the NIRC of 1997 in relation to Section 32 of the same code, as amended;

b. **Disallowed income payments for non-withholding P1,521,376.00.** – Comparison of Petitioner's income payments subject to withholding tax claimed per financial statement/income tax return as against the alphalist disclosed that it has not subjected to withholding tax its purchases of goods and services hence disallowed pursuant to Section 34(k) of the NIRC, as amended, which states that '...any amount paid or payable which is otherwise deductible from, or taken into account in computing the gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this section,..';

c. **Salaries and wages not subjected to withholding tax: P1,284,203.35.**-Refer to the explanation in the preceding paragraph;

d. **NOLCO: P546,733.00.**-Verification disclosed that Petitioner's operation resulted in net operating loss as reflected in its ITR. The tax benefit of this amount has already been forwarded to s[ucce]eding periods as provided under Section 34 (D) of the NIRC. It states:

> '*Net Operating Loss Carry-over.* – The net operating loss of the business or enterprise for any taxable year immediately preceding the current taxable year, which had not been previously offset as deduction from gross income shall be carried over as a deduction from gross income for the next three (3) consecutive taxable years immediately following the year of such loss....'

e. **Unsupported creditable withholding tax: P210,562.45.**- Upon verification, it was disclosed that Petitioner's creditable withholding tax claimed per ITR amounting to Php210,562.45 was not supported with sufficient evidence in violation of Section 2.58.3 (B) of Revenue Regulations No. 2-98, as amended;

f. **Excess Credits and MCIT: P5,861,082.00.**-Verification of Petitioner's ITR disclosed that there was an excess income tax payment, hence, not to be allowed as tax credit in the computation of deficiency income tax for the current year, considering that the excess amount shall be credited against the income tax due for the taxable quarter/years immediately succeeding the taxable quarters/years in which the excess credit arose pursuant to Section 2.58.3 under RR2-98.

As to the MCIT, it was not allowed as tax credit against the computed deficiency income tax, considering that the said amount shall be carried over and credited against the normal income tax for the three(3) immediately succeeding taxable year in compliance with Section 27 (E) (1) (2) of the NIRC;

5.) <u>Value-Added Tax</u>

a. **Receipts not subjected to VAT: P28,477,854.60** – In relation to the discussion in income tax, Petitioner failed to declare the amount of P28,477,854.60 as gross revenue subject to VAT, pursuant to Section 108 of the NIRC;

b. **Unsupported input tax from prior year: P195,098.68**- Comparison of the BIR Form 2550Q filed by the Petitioner for the periods 4th Quarter of 2006 and 1st Quarter of 2007 revealed a discrepancy in the amount of input tax being claimed. Such discrepancy has been disallowed as input tax pursuant to Section 110 of the NIRC;

c. **Unsupported input tax from current purchases: P65,562.60-** Verification disclosed that Petitioner's input tax per VAT returns amounting to P65,562.60 was not supported by receipts/invoices and are coming from non-VAT receipts and invoices, hence, the same has been disallowed in accordance with Section 110 of the NIRC, in relation to Section 113 and 237 of the NIRC;

d. **Excess input tax carried over to next quarter: P6,090,289.61** – The excess input tax amounting to P6,090,289.61 was not applied against the allowable input tax in computing deficiency VAT since this shall be carried over to the next succeeding periods/quarter(s) as provided under Section 110 (B) of the NIRC;

6. **Expanded Withholding Tax**
   Basic tax due: P8,519.05- Verification disclosed that Petitioner has not paid the appropriate expanded withholding tax due on various income payments in violation of Section 2.57.2 of Revenue Regulation No. 2-98, as amended by Revenue Regulations No. 17-2003;

7. **Withholding Tax on Compensation**
   Basic tax due: P86,298.47 – Verification disclosed that Petitioner has not paid the appropriate withholding tax on compensation due on a portion of payment of salaries and wages amounting to P1,284,203.35 pursuant to Section 2.80 of Revenue Regulation 2-98, as amended;

8. **Imposition of 50% Surcharge**
   The fifty percent (50%) surcharge has been imposed on income tax and VAT pursuant to Section 248 (B) of the NIRC, as amended, for failure to report receipts in an amount exceeding thirty percent (30%) of that declared per return. Be it noted that the BIR's findings are not based on presumptions but on actual facts taken from the documents presented.

9. **Prescription**
   Petitioner interposes prescription so as to exculpate it from its tax liabilities. To that, suffice it to state that allegations of prescription must be clearly shown. Since prescription is one of the affirmative defenses of the taxpayers, 'it is incumbent upon [it] to positively establish when the prescriptive period started to run and when the same ended.' (Taligaman Lumber Co. v. Collector, G.R. No. L-15716, March 31, 1962)

   Under Section 222(a) of the 1997 Tax Code, it is clearly provided that:

> 'In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission.'

In relation thereto, this Court sitting En Banc in the case of CDL Hotels (Phils.) Corporation vs. CIR, CTA EB Case No. 339, August 10, 2009, held that:

> 'While the prescriptive period for assessment is three years as prescribed under Section 203 of the 1997 NIRC, as amended; however, Section 222 of the 1997 NIRC provided for exceptions to the period of limitation of assessment and collection taxes. We quote:
>
> 'SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. –
>
> (a) In case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed or a proceeding in court for the collection of such tax may be filed without assessment, at any time within (10) years after the discovery of the falsity, fraud or omission:...;
>
> (b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessments after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by a subsequent written agreement made before the expiration of the period previously agreed upon.
>
> xxx xxx xxx'
>
> A reasonable understanding of the foregoing law is that false return is different from fraudulent return with intent to evade tax or from failure to file a return. The above provision should be interpreted to mean a separation of

the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return. The difference between 'false return' and 'fraudulent return' cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due. The ordinary period of prescription of 3 years within which to assess tax liabilities under Sec. 203 of the 1997 NIRC, as amended, should be applicable to normal circumstances; but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent returns intended to evade payment of tax or failure to file returns, the period of ten years as provided for in Section 222 of the 1997 NIRC, as amended, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.

In the case at bar, although Petitioner filed its monthly return as mandated by law, it failed to declare thereto the income subject to the tax under the belief that the income supposedly subject to the withholding tax is not an income but a deductible expense. The returns filed by Petitioner can be considered as false return because it deviated from the truth when no income was declared, when in truth there was an income subject to tax. Being considered as false return, it is immaterial if Petitioner intentionally omitted to declare its income subject to final withholding tax or not.

Considering that Petitioner's return is false, the applicable prescriptive period would be ten years from the discovery of falsity. In the case at bar, the latest return filed was on January 11, 1999, while the FAN was issued on January 29, 2002, such period being within the ten year period it follows that the assessment had not yet prescribed.

Moreover, the Supreme Court had ruled that **the filing of deficient returns which prevent the Commissioner of Internal Revenue from computing the proper taxes is tantamount to non-filing. The Commissioner had to determine and assess the**

> **taxes on data obtained, not from the return, but from other sources. Hence, the assessment for deficiency final withholding tax, therefore, has not prescribed**.' (Emphasis supplied)

Applying the foregoing rule and jurisprudence in the case at bar, a close scrutiny of the income tax, VAT, expanded withholding tax and withholding tax on compensation returns filed by Petitioner clearly revealed that Respondent's declaration made therein were substantially deficient in amount and did not disclose the truth regarding the correct amount of income subject to tax compared to the amount remitted to the BIR.

Hence, the FAN dated January 14, 2011 issued by the Respondent for deficiency income tax, value-added tax, expanded withholding tax and withholding tax on compensation for taxable year 2007 was validly made within the ten (10) years prescriptive period from the discovery of the said falsity under Section 222(a) of the 1997 Tax Code;

Moreover, Section 223 of the 1997 Tax Code provides that:

> 'The running of the Statute of Limitations provided in Section 203 and 222 on the marking of assessment and the beginning of distraint or levy or a proceeding in court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint of levy or a proceeding in court and for sixty (60) days thereafter; xxx xxx xxx'

Corollary thereto, Section 3.1.5 of Revenue Regulations No. 12-99 provides:

> '3.1.5 17. Disputed Assessment. The taxpayer or his duly authorized representative may protest administratively against the aforesaid letter of demand and assessment notice within thirty (30) days from date of receipt thereof. If there are several issues involved in the formal letter of demand and assessment notice but the taxpayer only disputes or

> protests against the validity of some of the issues raised, the taxpayers shall be required to pay the deficiency tax or taxes attributable to the undisputed issues, in which case, a collection letter shall be issued to the taxpayer calling for payment of said deficiency tax, inclusive of the applicable surcharge and/or interest. No action shall be taken on the taxpayer's disputed issues until the taxpayer has paid the deficiency tax or taxes attributable to the said undisputed issues. **The prescriptive period for assessment or collection of the tax or taxes attributable to the disputed issues shall be suspended.**
>
> xxx xxx xxx xxx' (Emphasis supplied)

Based on the foregoing rules, the prescriptive period for the collection of taxes shall be suspended in cases of disputed assessments. In this case, the Petitioner filed a protest against the FAN on February 23, 2011. Said protest was denied and the FDDA was issued on July 28, 2011. The Petitioner elevated to the Commissioner of Internal Revenue its protest to the FDDA on September 2, 2011. During the period when the Petitioner filed its protest to the FAN and FDDA, the assessment on its deficiency taxes remains disputed, thus, precluding the Commissioner to enforce collection. Stated otherwise, the prescriptive period for the collection of taxes was suspended when the filing of the protest to the FAN and FDDA was made by the Petitioner. It was only after the decision was rendered on the appeal to the FDDA can the Respondent enforce the collection of deficiency income tax, value-added tax, expanded withholding tax and withholding tax on compensation for taxable year 2007. To enforce collection within five years from the issuance of FAN would be unjust since the assessment of deficiency taxes remains disputed. Therefore, the period to collect the deficiency taxes through the issuance of the service of warrant has not yet prescribed.

10. Assessments are prima facie presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. (Aban, Law of Basic Taxation in the Philippines, 1st Edition, p. 109);

> 11. Finally, Petitioner should be reminded that taxes are important because it is the lifeblood of the government and so should be calculated without unnecessary hindrance. (Commissioner vs. Algue, Inc. L-28896, 17 February 1988). Taxes are enforced proportional contribution from persons and property levied by the state, thus, no one is considered entitled to recover that which he must give up to another – Non videtur quisquam id capere quod ei necesse est alii restitutere."

The pre-trial conference was initially set on March 23, 2017.[13] However, at the scheduled date thereof, Respondent's counsel, Atty. Yvette C. Tenefrancia, moved to dismiss this case for failure of Petitioner's counsel to appear despite due notice. The Court granted the motion, and the instant case was dismissed.[14]

Petitioner then filed a Motion for Reconsideration on April 07, 2017.[15] The Court granted the said Motion for Reconsideration in its Resolution dated September 28, 2017.[16] Consequently, the Court set again the pre-trial conference to, and was held on, February 08, 2018.[17]

In the meantime, Petitioner's Pre-Trial Brief was filed on January 19, 2017;[18] while Respondent's Pre-Trial Brief was filed through registered mail on February 28, 2017.[19]

On February 27, 2018, the parties filed their Joint Stipulation of Facts and Issues ("JSFI").[20] In the Resolution dated March 14, 2018,[21] the Court approved the said JSFI, and deemed the termination of the Pre-Trial. The Court subsequently issued the Pre-Trial Order dated May 10, 2018.[22]

Trial ensued.

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[13] *Id.*, Notice of Pre-Trial Conference dated January 06, 2017, pp. 119 to 120.
[14] *Id.*, Minutes of the hearing held on, and Order dated, March 23, 2017, pp. 262 to 264.
[15] *Id.*, pp. 266 to 269.
[16] *Id.*, pp. 279 to 281.
[17] *Id.*, Resolution dated September 28, 2017, pp. 279 to 281; Minutes of the hearing held on, and Order dated, February 08, 2018, pp. 282 to 284, and 286 to 289, respectively.
[18] *Id.*, pp. 121 to 126.
[19] *Id.*, pp. 260 to 267.
[20] *Id.*, pp. 290 to 296.
[21] *Id.*, p. 298.
[22] *Id.*, pp. 317 to 328.

Petitioner offered documentary and testimonial evidence. As regards testimonial evidence, Petitioner proffered the testimony of Ms. Jocelyn Custorio, its General Accountant.[23]

On June 22, 2018, Petitioner filed its Formal Offer of Evidence.[24] In the Resolution dated August 06, 2018,[25] the Court admitted Petitioner's exhibits, except for Exhibit "P-36", for failure to identify the same.

On the other hand, Respondent likewise presented documentary and testimonial evidence. With respect to testimonial evidence, Respondent offered the testimony of Ms. Karen Joy D. Lutching, Revenue Officer ("RO") 2 of the Assessment Section.[26]

On September 18, 2018, Respondent submitted to this Court the entire BIR records of Petitioner's tax case.[27]

Pursuant to the Order dated September 25, 2018,[28] this case was transferred to this Court's Third Division.

On October 03, 2018, Respondent filed a Manifestation with Motion to Admit Formal Offer of Evidence,[29] which the Court granted and admitted the attached Respondent's Formal Offer of Exhibits.[30] Thereafter, in the Resolution dated January 17, 2019,[31] the Court admitted Respondent's exhibits, except for Exhibits "R-5", "R-6" and "R-7", for failure to present the originals for comparison.

The Memorandum (For the Petitioner) was filed on February 20, 2019.[32] On the other hand, Respondent filed through registered mail a Manifestation with Motion to Admit Memorandum on February 22, 2019.[33]

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23 *Id.*, Exhibit "P-37", pp. 130 to 142, and 469 to 481; Minutes of the hearing held on, and Order dated, June 14, 2018, pp. 329 to 332.
24 *Id.*, pp. 334 to 344.
25 *Id.*, pp. 489 to 490.
26 *Id.*, Exhibit "R-11", pp. 249 to 258; Order dated September 18, 2018, pp. 491 to 492.
27 *Id.*, Compliance, p. 493.
28 *Id.*, p. 494.
29 *Id.*, pp. 495 to 502.
30 *Id.*, Resolution dated October 09, 2018, p. 509.
31 *Id.*, pp. 513 to 514.
32 *Id.*, pp. 515 to 546.
33 *Id.*, pp. 549 to 564.

In the Resolution dated March 08, 2019,[34] the Court: (1) noted and granted Respondent's Manifestation with Motion to Admit Memorandum; and (2) deemed the instant case submitted for decision.

The Issues

The parties submit the following issues[35] for this Court's resolution, to wit:

1. Whether Petitioner is liable for the alleged income tax, value-added tax, expanded withholding tax, withholding tax on compensation and compromise penalty, plus penalties and interests, in the total amount of Thirty-Two Million Seven Hundred Ninety-Eight Thousand Five Hundred Ninety-Three and 79/100 Pesos (Php32,798,593.79) all for taxable year 2007; and

2. Whether the FAN issued for taxable year 2007 against Petitioner representing alleged income tax, VAT, EWT, WTC deficiencies and the right of the Government through the BIR to collect such alleged deficiency taxes had prescribed pursuant to Sections 203 and 222 of the National Internal Revenue Code ("NIRC") of 1997, as amended.

Petitioner's Arguments

Petitioner argues that the present assessment is void for being issued without a valid authority; that the alleged Revalidation/Reassignment Notice and Letter of Authority ("LOA") were not offered as evidence; that the non-observation of the 15-day period to protest the Preliminary Assessment Notice ("PAN") violates Petitioner's right to due process which renders the present assessment void; that the present assessment is barred by prescription; and that the imposition of the fifty percent (50%) surcharge is without basis.

As to the merit of the assessment on income tax deficiency, Petitioner states that it derived from (1) the adjustments made to income; (2) the disallowance of creditable withholding tax for being unsupported; (3) the recoveries of Net Operating Loss Carryover ("NOLCO"), excess tax credits carried over to succeeding periods, and Minimum Corporate Income Tax ("MCIT") utilized by Petitioner, as a method used by Respondent to arrive at the

[34] *Id.*, Resolution dated March 08, 2019, p. 567.
[35] *Id.*, JSFI, Issues, pp. 291 to 292.

alleged Petitioner's real taxable income. As to the adjustments to income, it allegedly consists of three items, to wit: (1) unaccounted receipts - Php28,643,486,486.50; (2) disallowed income payments for non-withholding - Php1,521,376.00; and (3) salaries not subject to withholding - Php1,284,203.35.

Petitioner posits that its gross receipts for income tax purposes should only be the agency service fee it collected from its clients and exclude the salaries and contributions provided by the clients, because it was merely administered by Petitioner for its clients.

With respect to the disallowed income for non-withholding, Petitioner expresses that Respondent did not inform the former of being part of the Top 10,000 private corporations which required to withhold one percent (1%) on the purchase of goods and two percent (2%) on the purchase of services.

According to Petitioner, revenue examiners has found different amount of salaries and wages per alphalist and the one reported as deduction per Income Tax Return ("ITR"), with the amount reflected in the Financial Statement ("FS"). Petitioner explains that the purported difference was caused by several factors. Allegedly, the salaries reflected in the FS include compensation paid to key management personnel wherein some of them were non-resident foreign citizens not employed by Petitioner but working for affiliated offices in Singapore and Malaysia.

Petitioner further insists that the assessment on deficiency income tax as regards its alleged unsupported creditable withholding tax claimed per ITR was void for lack of factual basis. Respondent has allegedly failed to inform Petitioner on the said factual details of the assessment.

Allegedly, the issue pertaining to NOLCO, excess credit and MCIT is beyond the scope of the subject assessments.

With regard to the assessment on VAT deficiency, Petitioner claims that it has no factual and legal basis.

Respondent's Counter-arguments

Respondent counter-argues that Petitioner is liable for payment of deficiency income tax, VAT, EWT, WTC, and compromise penalty, plus penalties and interests, in the total amount of Php32,798,593.79, all for taxable year 2007; and that his right to assess and to collect the subject deficiency taxes has not prescribed.

Discussion/Ruling

The instant Petition for Review has merit.

This Court resolves to raise, and rule on, the following related issue, which it deems as necessary to achieve an orderly disposition of the instant case, before looking into the issues or matters raised by the parties, if still warranted under the premises, to wit:

"Whether or not the subject tax assessments are valid."

Relative thereto, Section 1, Rule 14 of the 2005 Revised Rules of the Court of Tax Appeals, reads as follows:

> "RULE 14
> JUDGMENT, ITS ENTRY AND EXECUTION
>
> SECTION 1. – *Rendition of judgment* – xxx
>
> In deciding a case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case."

Based on the foregoing provision, this Court is not bound by the issues specifically raised by the parties, but may also rule upon related issues necessary to achieve an orderly disposition of the case.[36]

Needless to state, the determination of whether the subject tax assessments are valid is not only related to the issues raised by the parties, but is also crucial, since taxpayers, including Petitioner, must not be held liable under an invalid tax assessment, if such is the case.

There is no showing that the RO who examined Petitioner's books of accounts for the year

[36] Commissioner of Internal Revenue v. Lancaster Philippines, Inc., G.R. No. 183408, July 12, 2017.

2007 was authorized through an LOA. In the absence of a valid authority, the subject tax assessments are inescapably void.

Section 6(A) of the NIRC of 1997, as amended, reads:

> "SEC. 6. **Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. –**
>
> (A) *Examination of Returns and Determination of Tax Due.* - After a return has been filed as required under the provisions of this Code, **the Commissioner or his duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax**: *Provided, however,* That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer."[37]

Based on the foregoing provision, an authority emanating from Respondent or his duly authorized representative is required before an examination and an assessment may be made against a taxpayer.

Relative thereto, Section 13 of the NIRC of 1997, as amended, provides that the authority of an RO to examine or to recommend the assessment of any deficiency tax due must be exercised pursuant to an LOA, to wit:

> "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, pursuant to a Letter of Authority 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."[38]

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37 *Emphasis and underscoring supplied.*
38 *Emphasis and underscoring supplied.*

Thus, a grant of authority must be made through an LOA, assigning an RO to perform tax assessment functions, and in order that such officer may validly examine taxpayers and collect the correct amount of tax, or to recommend the assessment of any deficiency tax due.

In *Medicard Philippines, Inc. v. Commissioner of Internal Revenue*,[39] the Supreme Court emphasized the importance and significance of an LOA in examining the books of accounts and other accounting records of taxpayers and in assessing internal revenue taxes, to wit:

> "An LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. **It empowers or enables said revenue officer to examine the books of account and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax. An LOA is premised on the fact that the examination of a taxpayer who has already filed his tax returns is a power that statutorily belongs only to the CIR himself or his duly authorized representatives.** Section 6 of the NIRC clearly provides as follows:
>
>> SEC. 6. *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.* –
>>
>> (A) Examination of Return and Determination of Tax Due. – After a return has been filed as required under the provisions of this Code, **<u>the Commissioner or his duly authorized representative may authorize the examination of any taxpayer</u>** and the assessment of the correct amount of tax: Provided, however, That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer.
>>
>> x x x x (Emphasis and underlining Ours)
>
> Based on the afore-quoted provision, it is clear that **<u>unless authorized by the CIR himself or by his duly authorized representative, through an LOA</u>, an examination of the taxpayer cannot ordinarily be undertaken.** The circumstances contemplated under Section 6 where the taxpayer may be assessed

[39] G.R. No. 222743, April 05, 2017.

through best-evidence obtainable, inventory-taking, or surveillance among others has nothing to do with the LOA. These are simply methods of examining the taxpayer in order to arrive at the correct amount of taxes. **Hence, unless undertaken by the CIR himself or his duly authorized representatives, other tax agents may not validly conduct any of these kinds of examinations <u>without prior authority</u>.**

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

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

xxx xxx xxx

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

xxx xxx xxx

That the BIR officials herein were not shown to have acted unreasonably is beside the point because the issue of their lack of authority was only brought up during the trial of the case. **What is crucial is whether the proceedings that led to the issuance of VAT deficiency assessment against MEDICARD had the prior approval and authorization from the CIR or her duly**

authorized representatives. **<u>Not having authority to examine MEDICARD in the first place, the assessment issued by the CIR is inescapably void</u>.**"[40]

Based on the foregoing doctrinal pronouncements, an RO must be authorized, **through an LOA**, in order that the said officer may validly examine the books of accounts and other accounting records of a taxpayer. In the absence of an LOA, the tax assessments issued by the BIR against such taxpayer is void.

In this case, to prove that RO Karen Joy D. Lutching was authorized to conduct the investigation on Petitioner's deficiency income tax, VAT, EWT, and WTC for taxable year 2007, Respondent presented the testimony of the said RO. On direct examination, she testified as follows:

"6.Q: How did you come to know Petitioner in this case?
A: I came to know the Petitioner in this case **when I received the Revalidation/Reassignment Notice dated May 6, 2009 with reference to the Letter of Authority No. 000044111 dated July 29, 2008, authorizing me** and Group Supervisor Cherryflor C. Dela Cruz **to continue the examination of books of accounts and other accounting records of the Petitioner for the taxable year 2007.**

7.Q: What did you do when the case was reassigned to you?
A: I effected the service of the said Revalidation/ Reassignment Notice to the Petitioner on May 18, 2009."[41]

Upon cross examination, RO Lutching testified as follows:

"ATTY. MONTENEGRO:

Q: Can you proceed to Question No. 6. You mentioned that you came across Petitioner because of the revalidation dated May 6, 2009 referring to a Letter of Authority dated July 29, 2008, is that right?

MS. LUTCHING:

A: Yes.

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[40] *Emphasis and underscoring supplied.*
[41] Docket, Exhibit "R-11", Judicial Affidavit of Karen Joy D. Lutching, p. 250; *Emphasis supplied.*

ATTY. MONTENEGRO:

Q: **Do you recall if there was any other or whether there was a new Letter of Authority issued by the Regional District named herein specifically?**

MS. LUTCHING:

A: I have a revalidation notice.

ATTY. MONTENEGRO:

Q: Yes. Aside from those documents mentioned in your answer, was there a new Letter of Authority issued?

MS. LUTCHING:

A: No. Under my name, Sir?

ATTY. MONTENEGRO:

Yes.

MS. LUTCHING:

A: No."[42]

Based on her testimony, RO Lutching's authority to continue the examination of Petitioner's books of accounts and other accounting records for taxable year was derived from the supposed Revalidation/Reassignment Notice dated May 06, 2009 with reference to the LOA No. 000044111 dated July 29, 2008. However, Respondent did not present in evidence the said documents. Without the same documents, this Court cannot determine the veracity of the said testimony.

[42] Transcript of Stenographic Notes (TSN) during the hearing held on September 18, 2018, pp. 7 to 8; *Emphasis supplied.*

We cannot assign probative value, or solely rely, on RO Lutching's testimony as regards her authority to continue Petitioner's examination. This is so because testimonial evidence is self-serving,[43] and is easy of fabrication.[44]

In fine, Respondent failed to prove that RO Lutching was so authorized, through an LOA, to examine Petitioner's records. Correspondingly, since RO Lutching had no valid authority, the subject tax assessments are inescapably void.

But even granting that RO Lutching was authorized through an LOA, the subject tax assessments are still void on other grounds, *i.e.*, there was a violation of Petitioner's due process rights, and the said tax assessments do not fall under the jurisprudential definition of a tax assessment.

There was violation of Petitioner's right to due process

Verily, it is an elementary rule enshrined in the 1987 Constitution that no person shall be deprived of property without due process of law. As such, Section 228 of the NIRC of 1997, as amended, provides for the taxpayer's right to procedural due process in the issuance of a deficiency assessment, to wit:

> "SEC. 228. **Protesting of Assessment. — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings**: *Provided, however,* That a pre-assessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> **The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.**
>
> **Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the**

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[43] *See* Morales, et al. v. Court of Appeals, et al., G.R. No. 117228, June 19, 1997.

[44] Government Service Insurance System v. Court of Appeals, et al., G.R. No. 52080, May 28, 1993.

> **Commissioner or his duly authorized representative shall issue an assessment based on his findings.**"[45]

Implementing the foregoing provision, Section 3.1.2 of Revenue Regulations ("RR") No. 12-99,[46] provides as follows:

> "SECTION 3. ***Due Process Requirement in the Issuance of a Deficiency Tax Assessment. –***
>
> 3.1 Mode of procedure in the issuance of a deficiency tax assessment:
>
> xxx xxx xxx
>
> 3.1.2 *Preliminary Assessment Notice (PAN).* – If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, **the said Office shall issue to the taxpayer, at least by registered mail, a Preliminary Assessment Notice (PAN) for the proposed assessment**, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based (see illustration in ANNEX A hereof). **If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall be considered in default, in which case, a formal letter of demand and assessment notice shall be issued by the said Office**, calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties."[47]

Based on the foregoing provision, part of the due process requirement in the issuance of a deficiency tax assessment is the issuance and service of the PAN. Moreover, Petitioner is given fifteen (15) days from receipt of the PAN within which to respond thereto, before the issuance of the FAN by the BIR.

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[45] *Emphasis supplied.*

[46] SUBJECT: Implementing the Provisions of the National Internal Revenue Code of 1997 Governing the Rules on Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extra-Judicial Settlement of a Taxpayers Criminal Violation of the Code Through Payment of a Suggested Compromise Penalty.

[47] *Emphasis supplied.*

In *Commissioner of Internal Revenue v. Metro Star Superama, Inc.*,[48] the Supreme Court held:

> "...**it is clear that the sending of a PAN to taxpayer to inform him of the assessment made is but part of the 'due process requirement in the issuance of a deficiency tax assessment,' the absence of which renders nugatory any assessment made by the tax authorities**. The use of the word '*shall*' in subsection 3.1.2 describes the mandatory nature of the service of a PAN. The persuasiveness of the right to due process reaches both substantial and procedural rights and the failure of the CIR to strictly comply with the requirements laid down by law and its own rules is a denial of Metro Star's right to due process. **Thus, for its failure to send the PAN stating the facts and the law on which the assessment was made as required by Section 228 of R.A. No. 8424, the assessment made by the CIR is void.**"[49]

In this case, the subject PAN was never introduced in evidence. Thus, this Court cannot conclude whether the same was indeed issued and served to Petitioner. In any event, it must be mentioned that RO Lutching further testified as to the issuance and service of the PAN. However, even when We are to consider the unsubstantiated testimony of the said RO, We find that there is still a violation of the due process rights of Petitioner.

RO Lutching's testimony, relative to the service of the PAN, are quoted as follows:

<u>On direct examination</u>:

"26.Q: What transpired next after the issuance of the Notice of Informal Conference, if any?
A: **A PAN dated December 29, 2010 with attached Details of Discrepancies was issued.**

27.Q: What transpired next after the issuance of PAN with attached Details of Discrepancies?
A: **A Formal Assessment Notice (FAN) with attached Details of Discrepancies dated January 14, 2011 was issued.**"[50]

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[48] G.R. No. 185371, December 08, 2010.
[49] *Emphasis supplied.*
[50] Docket, Exhibit "R-11", Judicial Affidavit of Karen Joy D. Lutching, p. 252; *Emphasis supplied.*

Upon cross examination:

"ATTY. MONTENEGRO:

Now, Ms. Witness, I would like to go to Question No. 26. You mentioned a Preliminary Assessment Notice dated December 29, 2010 was issued.

Q: Would you know if this Preliminary Assessment Notice was served to the Petitioner or the taxpayer?

MS. LUTCHING:

A: Can I see again the (interrupted).

ATTY. TENEFRANCIA:

Your Honors, may the witness be allowed to (interrupted).

JUSTICE UY:

Yes. What is your question Atty. Montenegro about the PAN.

ATTY. MONTENEGRO:

Q: **Does she remember if it was served to the taxpayer?**

MS. LUTCHING:

A: The Preliminary Assessment Notice was received by Joe Costaño for AirGlobe.

ATTY. MONTENEGRO:

Q: What date was it received?

MS. LUTCHING:

A: Dated December 30, 2010.

ATTY. MONTENEGRO:

Q: Is it the date? December 30 is a holiday. How were you able to serve it on a holiday? Were you the one who served it?

MS. LUTCHING:

A: I cannot remember at all, Sir.

ATTY. MONTENEGRO:

Q: So, December?

MS. LUTCHING:

A: 30, 2010."[51]

Based on her testimony, the supposed PAN was served to Petitioner on December 30, 2010. Counting the fifteen-day period required under the aforequoted Section 3.1.2 of RR No. 12-99 from the said date, Petitioner had until January 14, 2011 within which to respond to the said PAN. Considering, however, that the subject FAN was issued on January 14, 2011,[52] the BIR apparently failed to observe part of the due process requirement in the issuance of a deficiency tax assessment, since Petitioner was not given the full fifteen-day period within which to respond to the PAN. In other words, the BIR failed to wait for the fifteen-day period to lapse before issuing the subject FLD; and thus, violating Petitioner's right to due process.

Apropos, tax assessments issued in violation of the due process rights of a taxpayer are null and void.[53]

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51 TSN during the hearing held on September 18, 2018, pp. 8 to 9; *Emphasis supplied.*
52 Docket, Refer to Exhibit "P-1", p. 345; JSFI, Facts Admitted, Par. 3, p. 290.
53 Commissioner of Internal Revenue v. Avon Products Manufacturing, Inc., G.R. Nos. 201398-99, and 201418-19, October 03, 2018.

WHEREFORE, in light of the foregoing considerations, the instant Petition for Review is **GRANTED**. Accordingly, Respondent's Final Decision dated June 28, 2016 on the alleged deficiency income tax, VAT, EWT, WTC, and compromise penalty, plus penalties and interests, in the total amount of Php32,798,593.79 for the fiscal year ending in June 2007 is hereby **WITHDRAWN** and **SET ASIDE**.

SO ORDERED.

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice

ATTESTATION

I attest that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ERLINDA P. UY
Associate Justice
Chairperson

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Presiding Justice