REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

LUDO & LUYM CORPORATION,
Respondent.

CTA EB NO. 1559
(CTA Case No. 8613)

Present:

Del Rosario, *PJ*,
Castañeda, Jr.,
Bautista,
Uy,
Casanova,
Fabon-Victorino,
Mindaro-Grulla,
Ringpis-Liban, and
Manahan, *JJ.*

Promulgated:

JUN 08 2018 10:22a.m.

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DECISION

CASTAÑEDA, JR., *J.*:

This Petition for Review filed by petitioner Commissioner of Internal Revenue, seeks to reconsider and modify the Court of Tax Appeals (CTA) 3rd Division's Decision dated August 8, 2016[1] and Resolution dated November 10, 2016,[2] respectively.

For easy reference, the dispositive portion of the assailed Decision dated August 8, 2016 reads:

[1] Decision, penned by Associate Justice Lovell R. Bautista, CTA 3rd Division Docket, Vol. 2, pp. 980-1002.
[2] Resolution, penned by Associate Justice Lovell R. Bautista, CTA 3rd Division Docket, Vol. 3, pp. 1027-1031.

"**WHEREFORE**, premises considered, the instant Petition for Review is hereby **GRANTED**. Audit Result/Assessment Notice under Assessment No. VT-123-LA 7074-07-13-07 issued by respondent against petitioner for deficiency VAT for CY 2007 and Audit Result/Assessment Notice under Assessment No. IT-123-LA 7074-07-13-06 issued by respondent against petitioner for deficiency income tax for CY 2007 are hereby **CANCELLED** and **WITHDRAWN**.

SO ORDERED."[3]

On the other hand, the assailed Resolution dated November 10, 2016 reads:

"**WHEREFORE**, premises considered, respondent's Motion for Partial Reconsideration filed on August 31, 2016 is hereby **DENIED** for lack of merit.

SO ORDERED."[4]

THE FACTS

The following are the facts as found by the CTA 3rd Division:

"On July 1, 2008, the Large Taxpayers District Office – Cebu ('LTDO'), Cebu Office of the BIR issued Letter of Authority No. 00007074 for the examination of petitioner's [now respondent] books of accounts for CY 2007 covering all internal revenue taxes, which petitioner received on July 16, 2008.

On September 23, 2010, petitioner received a letter from the Large Taxpayer Service ('LTS') dated September 22, 2010, informing the former of the results of the investigation, and inviting petitioner to an informal conference on September 29, 2010.

On March 16, 2011, the LTS issued a Preliminary Assessment Notice ('PAN') informing petitioner of its assessment for deficiency income tax, VAT, and expanded withholding tax ('EWT') for CY 2007 in the aggregate amount of Php194,543,838.71. Under the PAN, petitioner was given a period of fifteen (15) days within which to reply. Petitioner received the PAN on March 17, 2011.

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[3] See Note 1, pp. 1000-1001.
[4] See Note 2, p. 1030.

On April 11, 2011, the LTS issued a Final Assessment Notice ('FAN') informing petitioner of its assessment for deficiency income tax, VAT, and EWT for CY 2007 in the aggregate amount of Php195,542,828.83, which petitioner received on even date. Under the FAN, respondent found the following discrepancies:

Income Tax

a) Additional Gross Income [Php]22,333.52 for purchases from POM's Ventures
b) Alleged fictitious expenses arising from alleged bank overdrafts or negative balance in the amount of [Php]154,964,207.83 which it added to the taxable income of petitioner for CY 2007
c) Disallowance of Interest Expense in the amount of [Php]223,794,203.46
d) Disallowed Bad Debts in the amount of [Php]2,665,255.75
e) Disallowed Miscellaneous Expense in the amount of [Php]2,104,216.74
f) Disallowed Other Expenses not subject to Expanded Withholding Tax in the amount of [Php]167,609,715.92
g) CWT Disallowance in the amount of [Php]762.64
h) Compromise Penalty for failure to submit audited financial statement

Value-Added Tax

i) Additional Taxable Sales in the amount of [Php]1,540,088[.00]
j) Disallowance on Input – expenses with no corresponding documents ([Php]18,848,210.95)

Withholding Tax - Expanded

k) Deficiency Expanded Withholding Tax [Php]5,290,293.41.

On December 21, 2011, LTS issued a Final Decision on Disputed Assessment ('FDDA') stating that it has reconsidered the assessment against petitioner. Petitioner received the FDDA on January 3, 2012. The FDDA stated:

Income Tax

a) Additional Gross Income [Php]22,333.52 for purchases from POM's Ventures

b) Alleged fictitious expenses arising from alleged bank overdrafts in the amount of [Php]80,425,042.37 which it added to the taxable income of petitioner for [CY] 2007
c) Disallowance of Interest Expense in the amount of [Php]223,794,203.46
d) Disallowed Bad Debts in the amount of [Php]2,665,255.76
e) Disallowed Miscellaneous Expense in the amount of [Php]982,771.79
f) Additional Gross Income on Unrecorded Purchases in the amount of [Php]180,250.45
g) CWT Disallowance in the amount of [Php]762.64
h) Compromise Penalty for failure to submit audited financial statement

Value-Added Tax

i) Additional Taxable Sales in the amount of [Php]1,540,088[.00]
j) Disallowance on Input Tax allegedly claimed on fictitious expenses ([Php]154,964,207.83 and Miscellaneous Expenses ([Php]2,104,216.74).

On January 30, 2012, petitioner filed with the Commissioner of Internal Revenue ('CIR') a motion for reconsideration against the FDDA.

On February 1, 2012 and February 23, 2012, petitioner filed a Supplement to the Motion for Reconsideration and a Second Supplement to the Motion for Reconsideration, respectively.

On January 29, 2013, petitioner received the letter issued by the CIR (the 'CIR's Decision') with attached Audit Result/ Assessment Notice under Assessment Nos. IT-123-LA 7074-07-13-06 and VT-123-LA 7074-07-13-07. The CIR's Decision denied petitioner's motion for reconsideration. The CIR found that the tax liability of petitioner is, as follows:

	Tax Type	Basic Tax	Increment	Total
I.	Income Tax	Php 12,134,027.21	Php 17,702,382.17	Php 29,836,409.38
II.	VAT	11,196,276.32	16,831,224.16	28,027,500.48
Total		**Php 23,330,303.53**	**Php 34,533,606.33**	**Php 57,863,909.86**

Within thirty (30) days from receipt of the CIR's Decision, or on February 27, 2013, petitioner filed the instant Petition for Review. Jc

On June 11, 2013, respondent filed his Answer interposing his Special and Affirmative Defenses.

Respondent [now petitioner] and petitioner [now respondent] filed their Pre-Trial Briefs on January 13, 2014 and February 14, 2014, respectively. On March 17, 2014, the parties filed their Joint Stipulation of Facts and Issues ('JSFI'). Accordingly, a Pre-Trial Order was issued by this Court on March 24, 2014.

On June 26, 2014, petitioner filed its Formal Offer of Evidence ('FOE') xxx.

On April 6, 2015, respondent filed his FOE xxx. In a Resolution promulgated on June 30, 2015, the Court admitted all respondent's exhibits.

In compliance with this Court's Resolution dated June 30, 2015, which ordered the parties to file their respective memoranda within thirty (30) days from receipt thereof, petitioner filed its Memorandum on September 3, 2015. Respondent, on the other hand, filed a Manifestation on September 10, 2015 stating that he will be adopting his arguments raised in his Answer dated June 11, 2013 as his memorandum.

On September 15, 2015, this Court promulgated a Resolution submitting the case for decision; hence, this Decision."

On August 8, 2016 and November 10, 2016, the CTA 3rd Division promulgated the assailed Decision and Resolution, respectively.

In the assailed Decision, the Court in Division affirmed petitioner's assessments, as follows: (1) fictitious expenses arising from bank overdrafts with Eastwest Banking Corporation and International Exchange Bank; (2) disallowed bad debts; and (3) disallowed miscellaneous expense. However, the Court in Division cancelled the assessments in relation to: (1) disallowance of interest expense; (2) additional gross income on unrecorded purchases. Further, it held that petitioner's VAT assessment had already prescribed.

On December 15, 2016, petitioner filed the instant Petition for Review. On March 15, 2017, the Court required the parties to submit their memoranda. On April 20, 2017, respondent filed its Memorandum[5] through

[5] Court *En Banc* Docket, pp. 79-93.

registered mail. On the other hand, petitioner failed to file his Memorandum.[6] On July 19, 2017, the case was submitted for decision. Hence, this Decision.

THE ISSUES

The issues to be resolved by this Court are: (1) Whether respondent is liable for deficiency income tax and Value-Added Tax for taxable year 2007 in the total amount of ₱57,863,909.86; and (2) Whether the VAT assessment is already barred by prescription.

THE RULING

The Court *En Banc* denies the Petition.

Alleged fictitious expenses arising from bank overdrafts

As discussed in the assailed Decision,[7] petitioner added to taxable income per investigation as fictitious expenses pursuant to Revenue Audit Memorandum Order (RAMO) No. 01-00, the following bank accounts with negative balances:

Chinabank	₱(305,587.36)
LBP	(11,775,609.37)
Eastwest	(39,713,919.87)
iBank	(28,629,925.77)
Total	**₱(80,425,042.37)**

On the other hand, respondent argues that the assessment is based on mere analysis, allegations, and assumptions. It also asserts that the negative balances resulted from non-posting or erroneous posting of deposits and fund transfers in its books.

- **Chinabank**

As explained in the assailed Decision, respondent submitted bank reconciliation with supporting documents[8] to prove that the bank overdraft was a result of non-posting of transactions in its books. Further, it submitted a bank statement showing a zero ending balance as of January 13, 2006.

[6] Records Verification, Court *En Banc* Docket, p. 96.
[7] Annex "A", Petition for Review, Court *En Banc* Docket, p. 30.
[8] Exhibits "P-8" to "P-8-B", "P-8-E" to "P-8-F",Court in Division Docket, Vol. 2, pp. 543-546, 551-552.

However, the Court in Division was not convinced that the bank statement showing zero ending balance of the account proved the closure of the said account.

The Court in Division explained that based on respondent's trial balance, there was no transaction in either of the two Chinabank accounts for CY 2007 and the net negative amount of ₱305,587.36 was the carried over balance from the end of CY 2006.

The trial balance of respondent, from which petitioner based its audit/assessment, corroborates the zero ending balance of the account. Thus, the Court in Division ruled that there was no bank overdraft.

- **Land Bank of the Philippines**

Respondent presented a bank statement[9] for the period covering November 30, 2007 to December 31, 2007, which showed an ending balance of ₱166,230.78. Thus, the Court in Division ruled that there was no bank overdraft.

- **EastWest Bank**

Based on the Court-commissioned Independent CPA (ICPA) findings[10], respondent's account with EastWest Bank has a positive balance of ₱7,831,550.01 (US$ 144,524.25) as of December 31, 2007.

However, the Court in Division noted that the documents submitted by and used the by the ICPA were not pre-marked or offered as evidence. Thus, they were not admitted by the Court as forming part of the records of the case. [11] For failure to substantiate the positive balance in its account with EastWest Bank, respondent likewise failed to disprove petitioner's disallowance of fictitious expense.

- **iBank**

Respondent asserts that its iBank accounts were closed in 2006, as shown in its Bank Statements and Bank Certifications[12] issued by iBank (now Union Bank of the Philippines). *fr*

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[9] Exhibit "P-9-A", Court in Division Docket, Vol. 2, p. 556.
[10] Exhibit "P-18", Court in Division Docket, Vol. 1, pp. 395-396.
[11] Annex "A", Petition for Review, Court *En Banc* Docket, p. 32.
[12] Exhibits "P-10" to "P-10-E", Court in Division Docket, Vol. 2, pp. 562-568.

However, the Court in Division found that the documents submitted failed to prove that the iBank accounts were closed. Further, the accounts to which the bank statements and certifications pertain cannot be ascertained because petitioner failed to provide the details of each account. Consequently, the Court in Division sustained the disallowance of fictitious expenses pertaining to the bank overdrafts in EastWest and iBank accounts in the aggregate amount of ₱68,343,845.64.[13]

As a general rule, tax assessments by tax examiners are presumed correct and made in good faith. All presumptions are in favor of the correctness of a tax assessment.[14] Thus, the burden of proof is on respondent to prove that the bank overdrafts were inexistent.

Here, respondent admitted that the negative balances resulted from non-posting or erroneous postings of deposits and fund transfers from one bank to another. What was involved was administrative inefficiency and lack of coordination.[15] Furthermore, the financial statements[16] presented were not audited and certified by an Independent Certified Public Accountant.

While petitioner adduced documents such as bank reconciliations with attachments,[17] bank statements,[18] and bank certifications,[19] these pieces of evidence do not fully substantiate its assertion that there was no bank overdraft in EastWest Bank and that its iBank accounts were closed.

Additionally, as noted by the Court in Division, the documents[20] submitted by respondent and used by the ICPA were not pre-marked or offered as evidence. Hence, they were not admitted as forming part of the records of the case.

Thus, the Court in Division aptly ruled that the disallowance of the fictitious expenses arising from bank overdrafts in East West and iBank accounts is valid.

Disallowed Interest Expense

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[13] Annex "A", Petition for Review, Court *En Banc* Docket, pp. 31-32.
[14] *Commissioner of Internal Revenue v. Hantex Trading Co., Inc.*, G.R. No. 136975, March 31, 2005.
[15] Arguments/Discussion, Petition for Review, Docket, Vol. 1, p. 13.
[16] Exhibit "P-7", Docket, Vol. 2, pp. 534-540.
[17] Exhibits "P-8", "P-8-A", "P-8-B", "P-8-E", "P-8-F", "P-9-B", "P-9-C", "P-9-F", Docket, Vol. 2, pp. 543-546, 551-552, 558-561.
[18] Exhibits "P-8-G", "P-9", "P-9-A", "P-10", "P-10-A", "P-10-D", "P-10-E", Docket, Vol. 2, pp. 554-557, 562-564, 567-568.
[19] Exhibits "P-10-B" to "P-10-C", Docket, Vol. 2, pp. 565-566.
[20] Referred to as Exhibits "A-1.a.1-1" to "A-1-d.6" (inside a brown envelope).

As discussed in the assailed Decision, BSP *Circular No. 202, series of 1999* is not applicable *vis-à-vis* the deductibility of respondent's interest expense.

According to the Court in Division, the BSP exercises supervisory and regulatory powers over banks and quasi-banks. Further, the Court in Division explained that respondent is engaged in the business of processing and selling coconut oil and other products, which does not fall within the jurisdiction of the BSP.[21] Thus, the Court in Division cancelled the disallowance of interest expense in the amount of ₱223,794,203.46.

Meanwhile, petitioner asserts that the principal basis for the disallowance of interest expense is anchored on Revenue Regulations No. (RR) 13-2000, and not on BSP *Circular No. 202.*[22] In this regard, Section 3 of RR 13-2000, implementing Section 34(B) of the National Internal Revenue Code (NIRC) of 1997, as amended, provides the requirements for deductibility of interest expense, to wit:

> "SECTION 3. Requisites for Deductibility of Interest Expense. — In general, subject to certain limitations, the following are the requisites for the deductibility of interest expense from gross income, viz:
>
> (a) There must be an indebtedness;
> (b) **There should be an interest expense paid or incurred upon such indebtedness;**
> (c) The indebtedness must be that of the taxpayer,
> (d) The indebtedness must be connected with the taxpayer's trade, business or exercise of profession;
> (e) The interest expense must have been paid or incurred during the taxable year;
> (f) The interest must have been stipulated in writing;
> (g) **The interest must be legally due;**
> (h) The interest payment arrangement must not be between related taxpayers as mandated in Sec. 34(B)(2)(b), in relation to Sec. 36(B), both of the Tax Code of 1997;
> (i) The interest must not be incurred to finance petroleum operations; and
> (j) In case of interest incurred to acquire property used in trade, business or exercise of profession, the same was not treated as a capital expenditure."

There should be an interest expense 𝓃

[21] Annex "A", Petition for Review, Court *En Banc* Docket, p. 34.
[22] Court *En Banc* Docket, p. 12.

paid or incurred upon such indebtedness

Petitioner posits that respondent had a total of ₱1.995 billion loans from various banks with no corresponding payments. Petitioner further posits that the disallowance was already understandable because no evidence was submitted by respondent to prove that the interest expense was paid or incurred upon its indebtedness.[23]

As examined by the ICPA, respondent's outstanding loans amounted to ₱1,992,563,685.51. The analysis and the findings of the ICPA[24] are presented below:

	Lender	Outstanding Balance	Interest Rate (%)	Interest Expense per Ludo Books	Interest Expense as Recomputed
a.	BPI-FCDU	109,750,355.00	8.19	10,123,823.07	8,988,379.57
b.	BPI-PESO	138,500,000.00	16.50	17,504,861.09	22,852,500.00
c.	FEBTC-FCDU	57,629,715.00	12.86	7,274,528.23	7,409,049.05
d.	FEBTC-PESO	96,864,635.64	17.25	14,691,136.43	16,709,149.65
e.	PCIB-PESO	360,726,567.97	11.00	36,473,464.08	39,679,922.48
f.	MBTC-PESO	847,195,911.90	12.00	85,660,919.97	101,663,509.43
g.	PNB-FCDU	186,829,500.00	7.20	22,365,577.09	13,451,724.00
h.	UBP-FCDU	67,067,000.00	11.50	7,814,570.87	7,712,705.00
i.	UBP-PESO	21,000,000.00	18.50	4,034,333.31	3,940,000.00
j.	UCPB-SA	72,000,000.00	16.52	12,376,000.00	11,893,192.67
k.	UCPB-TRUST	35,000,000.00	14.31	5,474,989.32	5,008,500.00
	TOTAL	**₱1,992,563,685.51**		**₱223,794,203.46**	**₱239,308,631.85**

[23] Petition for Review, Court *En Banc* Docket, p. 12.
[24] Exhibit "P-18", Docket, Vol. 1, p. 402.

The Court in Division explained that respondent is legally bound to pay its loan obligations, including interests due thereon, by virtue of the loan agreement/promissory notes[25] it entered into.[26]

As discussed in the assailed Decision[27], respondent uses the accrual method of accounting. In other words, respondent accrues interest expense as incurred, although not yet paid.

The Court in Division explained that the accrual of income and expense is permitted when the *all-events test*, *i.e.*, the right to income or liability should be fixed and that the amount of such income or liability be determined with reasonable accuracy, is met.[28] It held that the accrual method relies upon the taxpayer's right to receive amounts or its obligation to pay them, in opposition to actual receipt or payment, which characterizes the cash method of accounting. Amounts of income accrue where the right to receive them become fixed or where there is created an enforceable liability. Similarly, liabilities are accrued when fixed and determinable in amount, without regard to the indeterminacy merely of the time of payment.[29]

Under the accrual method of accounting, respondent recorded its interest expense in the total amount of ₱223,794,203.46 on the date of their occurrence, and not on the date in which they were actually paid for.

Thus, petitioner-appellee complied with the requirement that there should be an interest expense paid or **incurred** upon its indebtedness.

The interest must be legally due

Petitioner asserts that the loans were already contingent liabilities, and there was no reasonable expectation that the amount will be paid in due course.[30] He cites Sections 1 and 4 of BSP *Circular No. 202 Series of 1999*, to wit:

> "SECTION 1. Non-performing loans – Definition. Non-performing loans shall, as a general rule, refer to loan accounts whose principal and/or interest is unpaid for thirty (30) days or more after due date or after they have become past due in accordance with existing rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual or annual installments, in

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[25] Exhibits " P-11-C" to "P-11-Z", "P-11-AA" to "P-11-JJ", "P-11-LL" to "P-11-QQ", Docket, Vol. 2, pp. 575-615.
[26] Annex "A", Petition for Review, Court *En Banc* Docket, p. 35
[27] Annex "A", Petition for Review, Court *En Banc* Docket, p. 35.
[28] Annex "A", Petition for Review, Court *En Banc* Docket, p. 35.
[29] Annex "A", Petition for Review, Court *En Banc* Docket, p. 35.
[30] Petition for Review, Court *En Banc* Docket, pp. 12-13.

> which case, the total outstanding balance thereof shall be considered non-performing.
>
> In the case of loans payable in monthly installments, the total outstanding balance thereof shall be considered non-performing when three (3) or more installments are in arrears.
>
> Restructured loans which do not meet the requirements to be treated as a performing loan under Section 2 of this Circular shall be considered non-performing. **All items in litigation** as defined in the Manual of Accounts for Banks shall be considered non-performing loans.
>
> "SECTION 4. Accrual of Interest Earned on Loans. No accrual of interest income is allowed if a loan has become non-performing as defined under this circular. **Interest on non-performing loans shall be taken up as income only when actual payments thereon are received.**"

Based on the above cited provision, petitioner contends, by analogy, that since banks are not allowed to recognize interest receivable/income on non-performing loans, the corresponding interest expense of respondent is not legally due and demandable.[31]

To reiterate, BSP *Circular No. 202 Series of 1999* pertains to reporting of interest receivable/income on non-performing loans which **applies to banks only.** Respondent's line of business simply does not fall within the jurisdiction of the BSP.

Meanwhile, the Court in Division noted that respondent is already in default in the payments, and some of its loans are already subjects of litigation. Thus, it ruled that its indebtedness were already due and demandable.[32] On this score, the Court *En Banc* agrees with the Court in Division.

The indebtedness must be connected with the taxpayer's trade, business or exercise of profession

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[31] Petition for Review, Court *En Banc* Docket, p. 13.
[32] Annex "A", Petition for Review, Court *En Banc* Docket, p. 35.

A review of the records shows that the taxable year of the unaudited financial statements[33] and the date of the promissory notes[34] supporting the loans obtained were different. Further, the unaudited financial statements do not provide adequate disclosures. Hence, they cannot be used as tools to determine if the loans were used in its trade or business. At any rate, respondent proffered its Memorandum of Agreement[35] and Promissory Notes.[36]

Upon closer scrutiny, some of the said promissory notes revealed that some of the loans were working capital loans.[37]However, the other promissory notes presented do not indicate the purposes of the loans, as shown below:

Date of Loan	Maturity Date	Bank	PN No.	Amount	Rate (%) p.a.	Purpose	Exhibit No.
6/22/1998	7/22/1998	BPI	01008321.08	Php139,000,000.00	16.5%.	-	"P-11-C"
9/24/1999	3/22/2000	PCIBank	3660003899	USD 275,000.00	11.0%	Working Capital	"P-11-D"
9/27/1999	3/24/2000	PCIBank	3660003999	USD 298,000.00	11.0%	Working Capital	"P-11-E"
4/14/1999	10/11/1999	PCIBank	3660001499	USD192,000.00	11.0%	Working Capital	"P-11-F"
4/20/1999	10/15/1999	PCIBank	3660001599	USD 902,000.00	11.0%	Working Capital	"P-11-G"
4/21/1999	10/18/1999	PCIBank	3660001699	USD 719,000.00	11.0%	Working Capital	"P-11-H"
5/5/1999	10/29/1999	PCIBank	3660001799	USD 331,000.00	11.0%	Working Capital	"P-11-I"
5/7/1999	11/3/1999	PCIBank	3660001899	USD 490,000.00	11.0%	Working Capital	"P-11-J"
6/4/1999	12/1/1999	PCIBank	3660002299	USD 384,000.00	11.0%	Working Capital	"P-11-K"
6/11/1999	12/8/1999	PCIBank	3660002399	USD 150,000.00	11.0%	Working Capital	"P-11-L"
7/2/1999	12/17/1999	PCIBank	3660003499	USD 222,000.00	11.0%	Working Capital	"P-11-M"
7/21/1999	1/17/2000	PCIBank	3660003599	USD 328,500.00	11.0%	Working Capital	"P-11-N"
7/23/1999	1/19/2000	PCIBank	3660003399	USD 194,000.00	11.0%	Working Capital	"P-11-O"
8/4/1999	1/31/2000	PCIBank	3660003299	USD 123,000.00	11.0%	Working Capital	"P-11-P"
9/15/199	3/13/2000	PCIBank	3660003799	USD 307,000.00	11.0%	Working Capital	"P-11-Q"
7/28/1999	1/24/2000	PCIBank	3660003199	USD 120,000.00	11.0%	Working Capital	"P-11-R"
8/16/1999	2/11/2000	PCIBank	3660003699	USD 338,000.000	11.0%	Working Capital	"P-11-S"
6/10/1999	6/5/2000	Metrobank	317047.10123.000.99	USD 250,000.000	10.0%	-	"P-11-T"
6/14/1999	6/8/2000	Metrobank	317047.10166.000.99	USD 500,00.00	10.0%	-	"P-11-U"
6/17/1999	6/9/2000	Metrobank	317047.10174.000.99	USD 1,000,000.00	10.0%	-	"P-11-V"
6/24/1999	6/16/2000	Metrobank	317047.10352.000.99	USD 875,000.00	10.0%	-	"P-11-W"
6/28/1999	6/22/2000	Metrobank	317047.10395.000.99	USD 560,000.00	10.0%	-	"P-11-X"
7/1/1999	6/23/2000	Metrobank	317047.10425.000.99	USD 325,000.00	10.0%	-	"P-11-Y"
7/15/1999	7/7/2000	Metrobank	317047.10697.000.99	USD 205,000.00	9.5%	-	"P-11-AA"
7/19/1999	7/13/2000	Metrobank	317047.10743.000.99	USD 585,000.00	9.5%	-	"P-11-BB"
7/26/1999	7/20/2000	Metrobank	317047.10867.000.99	USD 100,000.00	9.5%	-	"P-11-CC"
7/30/1999	7/24/2000	Metrobank	317047.10948.000.99	USD 685,000.00	9.5%	-	"P-11-DD"
9/30/1999	9/22/2000	Metrobank	317047.12355.000.99	USD 596,000.00	9.75%	-	"P-11-EE"

[33] Exhibit "P-7", Docket, Vol. 2, pp. 534-540.
[34] Exhibits "P-11-C" to "P-11-Z", "P-11-AA" to "P-11-JJ", "P-11-LL" to "P-11-QQ", Docket, Vol. 2, pp. 575-615.
[35] Exhibit "P-11-A", Docket, Vol. 2, pp. 570-573.
[36] Exhibits "P-11-C" to "P-11-Z", "P-11-AA" to "P-11-JJ", "P-11-LL" to "P-11-QQ", Docket, Vol. 2, pp. 575-615.
[37] Exhibits "P-11-D" to "P-11-S", "P-11-OO" to "P-11-QQ", Docket, Vol. 2, pp. 576-591, 609-615.

10/1/1999	9/25/2000	Metrobank	317047.12444.000.99	USD 190,000.00	9.75%	-	"P-11-FF"
10/7/1999	9/29/2000	Metrobank	317047.12525.000.99	USD 114,000.00	9.75%	-	"P-11-GG"
10/11/1999	NONE	Metrobank	NONE	USD 179,000.00	9.75%	-	"P-11-HH"
10/14/1999	NONE	Metrobank	NONE	USD 271,000.00	9.75%	-	"P-11-II"
10/27/1999	NONE	Metrobank	NONE	USD 3,947,000.00	10.25%		"P-11-JJ"
9/27/1999	3/24/2000	Unionbank	87/99/309	Php 16,000,000.00	19.0%	Working Capital	"P-11-OO"
7/19/1999	7/13/2000	Unionbank	87/99/241	USD 30,000.00	11.5%	Working Capital	"P-11-MM"
8/6/1999	2/2/2000	Unionbank	87/99/262	USD 248,000.00	11.5%	Working Capital	"P-11-NN"
5/17/1999	5/11/2000	Unionbank	87/99/161	USD 866,000.00	11.5%	Working Capital	"P-11-LL"
10/11/1999	4/7/2000	Unionbank	87/99/320	Php 5,000,000.00	18.0%	Working Capital	"P-11-PP"
10/27/1999	4/24/2000	Unionbank	87/99/341	USD 256,000.00	11.5%	Working Capital	"P-11-QQ"

Notwithstanding the presentation of the above stated promissory notes, the same cannot be reconciled with the schedule of bank loans presented by respondent.[38] Thus, it cannot be ascertained which of the following bank loans pertain to loans with working capital purpose.

According to the respondent's Vice President for Finance and Administration, Mr. Cyril O. Borja, respondent was affected by the 1997 financial crisis.[39] He pertinently states in his Judicial Affidavit that:

> "5. QUESTION: Can you tell the court what happened to LuDo & Luym Corporation starting in 1997?
>
> ANSWER: **Ludo was hit hard by the 1997 financial crisis.** It was saddled by huge loans which by now amounted to ₱1.995 billion. Its operations had to be downscaled to the barest minimum. Prior to the 1997 financial crisis, it had employed around 800 employees. Now, it is operating with only 69 employees."

However, no evidence was presented to corroborate the contention that respondent does not have adequate cash on hand or asset liquidity to cover the daily operational expenses. Additionally, loans were obtained in the year 1999, two (2) years after the 1997 financial crisis.

Based on Section 3 of Revenue Regulations No. 13-2000, respondent failed to comply with the 4th requisite for the deductibility of interest expense. In other words, respondent failed to prove that the indebtedness is connected with its trade or business. Jr

[38] Exhibit "P-11", Docket, Vol. 2, p. 569.
[39] Question No. 5, Amended Judicial Affidavit, Docket, Vol. 1, p. 450.

Even so, respondent will still not be liable for any deficiency income tax for CY 2007, computed as follows:

	MCIT	Normal
Total Gross Income per ITR	₱28,503,578.44	₱28,503,578.44
Less: Deductions		301,675,214.99
Taxable Income per ITR		**(273,171,636.55)**
Add: Disallowed Expenses		
Fictitious Expenses – arising from bank overdrafts		68,343,845.64
Interest Expense		223,794,203.46
Bad Debts		2,665,255.75
Miscellaneous		982,771.79
Taxable Income per investigation	**₱28,503,578.44**	**₱22,614,440.09**
Tax Due (₱22,614,440.09 x 35%)		**₱7,915,054.03**
Less: Payments/Credits		
Prior Year's Excess Credit		10,493,516.00
Creditable Tax Withheld for the First Three Quarters		1,030,788.20
Creditable Tax Withheld for the First Three Quarters		400,444.69
Tax Overpayment		**₱(4,009,694.86)**

Considering the foregoing, the Court *En Banc* rules that the findings of the Court in Division with respect to the alleged fictitious expenses arising from bank overdrafts should be upheld. On the other hand, the above interest expense should be added to respondent's taxable income as disallowed expense. At any rate, even if the said amount of interest expense is added to respondent's taxable income, petitioner is still not liable for any deficiency income, as shown above.

The VAT assessment had already prescribed

Finally, petitioner asserts that his right to assess respondent's deficiency VAT has not yet prescribed because respondent filed false or fraudulent return. Thus, the tax may be assessed within ten (10) years after the discovery of the falsity. According to petitioner, this is evident from the final decision signed by former Commissioner Kim Jacinto Henares where she imposed a fifty percent (50%) surcharge against petitioner.

The Court *En Banc* finds petitioner's assertion untenable. *jc*

In *Commissioner of Internal Revenue v. Asalus Corporation*,[40] the Supreme Court explained the *doctrine on the presumption of falsity of returns*, as follows:

> " Under Section 248(B) of the NIRC, there is a *prima facie* evidence of a false return if there is a substantial underdeclaration of taxable sales, receipt or income. The failure to report sales, receipts or income in an amount exceeding 30% what is declared in the returns constitute substantial underdeclaration. A *prima facie* evidence is one which that will establish a fact or sustain a judgment unless contradictory evidence is produced.
>
> In other words, when there is a showing that a taxpayer has substantially underdeclared its sales, receipt or income, there is a presumption that it has filed a false return. As such, the CIR need not immediately present evidence to support the falsity of the return, unless the taxpayer fails to overcome the presumption against it.
>
> Applied in this case, the audit investigation revealed that there were undeclared VATable sales more than 30% of that declared in Asalus' VAT returns. Moreover, Asalus' lone witness testified that not all membership fees, particularly those pertaining to medical practitioners and hospitals, were reported in Asalus' VAT returns. The testimony of its witness, in trying to justify why not all of its sales were included in the gross receipts reflected in the VAT returns, supported the presumption that the return filed was indeed false precisely because not all the sales of Asalus were included in the VAT returns.
>
> Hence, the CIR need not present further evidence as the presumption of falsity of the returns was not overcome. Asalus was bound to refute the presumption of the falsity of the return and to prove that it had filed accurate returns. Its failure to overcome the same warranted the application of the ten (10)-year prescriptive period for assessment under Section 222 of the NIRC. To require the CIR to present additional evidence in spite of the presumption provided in Section 248(B) of the NIRC would render the said provision inutile."

Under *Asalus*, the presumption of falsity arises when there is a showing that a taxpayer has substantially underdeclared its sales, receipt or income.

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[40] G.R. No. 221590, February 22, 2017.

In the instant case, there is no showing that respondent has substantially underdeclared its sales, receipt or income. Meanwhile, the presumption of falsity of returns cannot arise by mere assertion that the former commissioner imposed surcharge against respondent. Hence, in the absence of proof of substantially underdeclared sales, receipt or income, the presumption of falsity of returns cannot be applied. Therefore, respondent had only three (3) years to assess respondent's deficiency VAT under Section 203 of the NIRC of 1997, as amended.

Considering the foregoing, the Court *En Banc* sees no cogent reason to disturb the Court in Division's conclusion that petitioner's right to assess respondent's deficiency VAT had already prescribed.

To conclude, aside from the interest expense that should be added to respondent's taxable income as disallowed expense, the conclusions reached by the Court in Division in the assailed Decision is in order. Meanwhile, with respect to the said interest expense, considering that even if the same is disallowed, the overall effect would still be in favor of respondent, as it may either result to a net loss if the normal income tax is applied, or to a tax overpayment if the Minimum Corporate Income Tax is applied, as discussed above.

WHEREFORE, the instant Petition for Review is **DENIED**, for lack of merit. Accordingly, the Decision of the CTA 3rd Division in CTA Case No. 8613 is **AFFIRMED**.

SO ORDERED.

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

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

(On Leave)

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