REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

INTEGRATED SOLUTIONS TECHNOLOGY LIMITED, *Petitioner,*	**CTA Case No. 9608**
-versus-	Members:
	DEL ROSARIO, *P.J., Chairperson, and,*
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	**MANAHAN**, *JJ.*
	Promulgated:
	AUG 2 6 2020 10:42am

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DECISION

MANAHAN, J.:

This involves a *Petition for Review* filed by Integrated Solutions Technology Limited (Petitioner) on June 5, 2017, praying for the cancellation and setting aside of the assessment issued by respondent Commissioner of Internal Revenue (CIR) for alleged deficiency income tax, value-added tax (VAT), expanded withholding tax (EWT), withholding tax on compensation (WTC), final withholding tax (FWT), documentary stamp tax (DST), and compromise penalty for taxable year (TY) 2013 in the aggregate amount of ₱29,299,632.51[1]

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[1] Summary of the Case, Pre-Trial Order November 10, 2017, Docket – Vol. II, p. 612.

THE PARTIES

Petitioner is a regional operating headquarter (ROHQ) and existing under the laws of the Philippines, with principal place of business at the 5th floor, Sterling Centre, Ormaza corner Dela Rosa Streets, Legaspi Village, Makati City.

Respondent is being sued in his official capacity as the CIR who holds office at the 5th floor, Bureau of Internal Revenue (BIR) National Office Building, Quezon City. He is represented in this case by the legal officers of the Legal Division, Revenue Region No. 8, Makati City with office address at the 2/F Legal Division, BIR Bldg., No. 313 Sen. Gil Puyat Ave., Makati City.

THE FACTS

On September 18, 2014, petitioner received the Letter of Authority (LOA) No. LOA-047-2014-00000513 dated September 17, 2014, authorizing Revenue Officer (RO) Gerardo Nuestro and Group Supervisor (GS) Medina Lopez, to examine petitioner's books of accounts for all internal revenue taxes for the period January 1, 2013 to December 31, 2013.[2]

On January 9, 2017, petitioner received, through registered mail, the Preliminary Assessment Notice (PAN) dated December 28, 2016.[3]

Subsequently, the BIR issued a Formal Assessment Notice (FAN) dated January 13, 2017, and the same was received by petitioner, likewise through registered mail, on January 18, 2017.[4]

On February 17, 2017, petitioner filed its protest against the FAN through registered mail.[5] However, the same was denied in a decision dated April 25, 2017 (Final Decision on Disputed Assessment or FDDA), which was received by petitioner *via* registered mail on May 8, 2017.[6]

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[2] Par. 4, Summary of Admitted Facts, JSFI, Docket – Vol. II, p. 601.
[3] Par. 6, Summary of Admitted Facts, JSFI, Docket – Vol. II, p. 601.
[4] Par. 7, Summary of Admitted Facts, JSFI, Docket – Vol. II, p. 601.
[5] Par. 8, Summary of Admitted Facts, JSFI, Docket – Vol. II, p. 601.
[6] Par. 9, Summary of Admitted Facts, JSFI, Docket – Vol. II, p. 601.

On June 5, 2017, petitioner filed the instant Petition for Review with the Court.[7] The case was initially raffled to the Second Division of this Court.

On August 11, 2017, respondent filed his *Answer*[8] to the Petition for Review.

The Pre-Trial Conference was initially set on September 14, 2017.[9] Eventually, however, the pre-trial conference was reset to, and held on, October 12, 2017.[10]

In the meantime, respondent's Pre-Trial Brief was filed on September 7, 2017,[11] while petitioner's Pre-Trial Brief was submitted on October 9, 2017.[12]

On September 18, 2017, respondent submitted the BIR Records to the Court.[13]

On October 26, 2017, the parties filed their Joint Stipulation of Facts and Issues (JSFI),[14] which was approved and adopted by the Court in the Pre-Trial Order dated November 10, 2017,[15] thereby terminating the pre-trial proceedings.

During trial, petitioner presented its documentary and testimonial evidence. Petitioner offered the testimonies of its select officers and employee, namely: (1) Ms. Maricar Y. Santiago,[16] Finance Manager; (2) Mr. Mark S. Romanillos,[17] Administrative Staff; and (3) Ms. Dulce P. Young,[18] General Manager and Resident Agent.

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[7] Docket – Vol. I, pp. 10 to 26.
[8] Docket – Vol. I, pp. 75 to 83.
[9] *Notice of Pre-Trial Conference* dated August 24, 2017, Docket – Vol. I, pp. 86 to 87.
[10] Minutes of the hearing held on, and Order dated October 12, 2017, Docket – Vol. II, pp. 579 to 580.
[11] Docket – Vol. I, pp. 92 to 99.
[12] Docket – Vol. I, pp. 121 to 129.
[13] Refer to Minute Resolution dated September 20, 2017, Docket – Vol. I, p. 101.
[14] Docket – Vol. II, pp. 600 to 608.
[15] Docket – Vol. II, pp. 612 to 626.
[16] Exhibit "P-73", Docket – Vol. I, pp. 133 to 144; Minutes of the hearing held on, and Order dated, January 24, 2018, Docket – Vol. II, pp. 636 to 637.
[17] Exhibit "P-72", Docket – Vol. I, pp. 482 to 488; Minutes of the hearing held on, and Order dated, November 22, 2017, Docket – Vol. II, pp. 627 to 628.
[18] Exhibit "P-71", Docket – Vol. I, pp. 505 to 519; Minutes of the hearing held on, and Order dated, November 22, 2017, Docket – Vol. II, pp. 627 to 628.

On January 29, 2018, the Petitioner's Formal Offer of Exhibits was filed.[19] Respondent filed his Comment (To Petitioner's Formal Offer of Evidence) on January 31, 2018.[20]

In the Resolution dated March 14, 2018,[21] the Court admitted petitioner's Exhibits, *except* for Exhibits "P-2", "P-2-1", "P-2-2," and "P-2-3", for its failure to present the originals for comparison.

Petitioner then filed its Motion for Reconsideration (Of the Resolution Dated 14 March 2018; With Offer of Profuse Apologies) on March 26, 2018,[22] praying for the Court to reconsider its Resolution dated March 14, 2018 by issuing a new one after allowing the following:

> "1. Alternatively, the admission of Exhibits 'P-2', 'P-2-1', 'P-2-2', and 'P-2-3', as faithful reproductions of Philpost Proof of Delivery Tracking No. AC388164720ZZ, upon a comparison with the originals found in respondent's records in the custody of the Honorable Court, or the admission of Exhibits 'P-2', 'P-2-1', 'P-2-2', and 'P-2-3', upon the presentation of their certified true copies to be obtained from the Makati Central Postal Office;
>
> 2. The setting of a commissioner's hearing in order that the provisional marking of Exhibits 'P-2', 'P-2-1', 'P-2-2', and 'P-2-3' may be improved to that of faithful reproductions of the originals or certified true copies;
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> 3. The submission of a supplemental formal offer of evidence should the Honorable Court find merit and grant petitioner's motion for reconsideration, to reflect the correction engendered by said grant of reconsideration; and
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> 4. Other reliefs as are just and equitable."

Respondent, however, failed to file his comment thereon.[23]

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[19] Docket – Vol. II, pp. 638 to 665.
[20] Docket – Vol. II, pp. 1095 to 1096.
[21] Docket – Vol. II, pp. 1099 to 1100.
[22] Docket – Vol. II, pp. 1101 to 1104.
[23] Records Verification dated April 23, 2018 issued by the Judicial Records Division of this Court, Docket – Vol. II, p. 1110.

In the Resolution dated June 29, 2018,[24] the Court allowed the setting of a commissioner's hearing for the comparison and/or marking of Exhibits "P-2", "P-2-1", "P-2-2" and "P-23"; and found the submission of Supplemental Formal Offer of Evidence unnecessary.

However, due to the failure of petitioner to bring the originals of the above-mentioned exhibits during the scheduled commissioner's hearing, and its failure to submit the certified true copies or even specify the page in the BIR Records from where the alleged originals can be found, the Court found no reason to admit the abovementioned denied Exhibits, and thus, denied petitioner's Motion for Reconsideration (Of the Resolution Dated 14 March 2018 with Offer of Profuse Apologies) in its Resolution dated August 10, 2018.[25]

In the Order dated September 24, 2018,[26] the instant case was transferred to the First Division of this Court.

Respondent likewise presented his documentary and testimonial evidence. The lone witness presented was Ms. Sharon S. Zafe,[27] Revenue Officer I of the BIR.

Respondent's Formal Offer of Exhibits with Manifestation was filed on April 26, 2019. [28] Petitioner filed its Comment/Opposition (To Respondent's Formal Offer of Exhibits with Manifestation) on May 6, 2019.[29] In a Resolution dated July 10, 2019, [30] the Court admitted respondent's Exhibits.

In view of the filing of the Memorandum for Respondent on August 13, 2019,[31] and the Memorandum of Petitioner on

[24] Docket – Vol. II, pp. 1112 to 1113.
[25] Docket – Vol. II, pp. 1117 to 1118.
[26] Docket – Vol. II, p. 1120
[27] Exhibit "R-4", Docket – Vol. I, pp. 107 to 112; Minutes of the hearing held on, and Order dated, March 12, 2019, Docket – Vol. II, pp. 1134 to 1138.
[28] Docket – Vol. II, pp. 1143 to 1147.
[29] Docket – Vol. II, pp. 1150 to 1157.
[30] Docket – Vol. II, pp. 1162 to 1169.
[31] Docket – Vol. II, pp. 1170 to 1179. cm

August 15, 2019,[32] the instant case was submitted for decision on August 29, 2019.[33]

THE ISSUES

The issues submitted by the parties for resolution of this Court as culled from the JSFI, are as follows:[34]

> "1. Whether or not petitioner is liable to pay the total amount of ₱29,299,632.51 for deficiency Income Tax, VAT, EWT, WTC, DST, FWT, and compromise penalty for TY 2013;
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> 2. Whether or not the FAN is valid when received by petitioner during the 15-day period given to petitioner to respond to the PAN;
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> 3. Whether or not the assessment for VAT is barred by prescription; and,
>
> 4. Whether or not the subject assessment issued by respondent against petitioner covering deficiency Income Tax, VAT, EWT, WTC, FWT and compromise penalty for TY 2013 is proper with legal and factual bases."

Petitioner's arguments:

Petitioner argues that it is not liable to pay the total amount of ₱29,299,632.51 for various deficiency taxes because this finding of alleged liability is unsupported by a valid LOA and that the denial of its protest is based on respondent's gross misapprehension of a material fact. More significantly, petitioner asserts that the FAN is not valid because it was issued within the fifteen (15)-day period to respond to the PAN thereby violating its right to due process. Further, petitioner assails the validity of the FAN for having been issued beyond the three (3)-year period provided under Section 203 of the 1997 National Internal Revenue Code (NIRC), as amended, and that the assessments issued by respondent against petitioner covering

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[32] Docket – Vol. II, pp. 1181 to 1199.

[33] Resolution dated August 29, 2019, Docket – Vol. II, p. 1203.

[34] Statement of the Issues, JSFI, Docket – Vol. II, pp. 601 to 602.

deficiency income tax, VAT, EWT, and WTC, DST, and FWT for taxable year 2013, were without legal and factual bases.

Respondents' counter-arguments:

In his Answer filed on August 11, 2017, respondent interposed the following Special and Affirmative Defenses:

"**SPECIAL AND AFFIRMATIVE DEFENSES**

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

Due Process Requirement

2) Petitioner claims that its right to due process was violated. This argument should be denied. This Court in the case of GST Philippines, Inc. vs. Commissioner of Customs and Secretary of Finance, C.T.A. Case No. 7133 citing Supreme Court case Haydee C. Casimiro vs. Filipino T. Tandog. G.R. No. 146137, June 08, 2005, held that:

> 'The essence of procedural due process is embodied in the basic requirement of notice and a real opportunity to be heard. In administrative proceedings, such as in the case at bar, procedural due process simply means the opportunity to explain one's side or the opportunity to seek a reconsideration of the action or ruling complained of. 'To be heard' does not mean only verbal arguments in court; one may be heard also through pleadings. Where opportunity to heard, either through oral arguments or pleadings, is accorded, there is no denial of procedural due process.'

In this case, the Petitioner was afforded due process because it was able to reply and/or file its protest to the notices that were issued or sent to it. The petitioner was able to file its protest to the FAN. Clearly, petitioner was given notice and the opportunity to present its side.
Further, the PAN and FAN were served to the Petitioner on the date of its issuance which is on December 28, 2017 and January 13, 2017, respectively. Furthermore, Revenue Regulations No. 18-2013 allows the substitute service of notices when personal service is not practicable. In this case, the PAN and FAN were served to the Petitioner through registered mail.

Income Tax

3) Disallowed Expenses due to Non-withholding- Verification disclosed that Petitioner did not withhold the appropriate withholding tax due on its income payments. Section 34 (K) of the NIRC expressly provides 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, Sections 58 and 81 of this Code.' Hence, these expenses have been disallowed pursuant to the above provision of the law.

4) Unsupported Travel Expenses- Audit disclosed that Petitioner did not provide supporting documents or evidence to support its expenses amounting to ₱2,480,708.31 in violation of Section 34 (A) (1) (b) of the NIRC, as amended, which states that 'No deductions from gross income shall be allowed under Subsection (A) hereof unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or adequate records: (i) the amount of expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and or conduct of the trade, business or profession of the taxpayer'. Therefore, the said amount has been disallowed as deduction from its gross income pursuant to the aforementioned provision of the law.

5) Disallowed Bonuses- Verification disclosed that Petitioner is suffering from net loss so there is no sense of paying cash bonus when a firm is in distress. Giving an extra bonus at a time when a company has declared a net operating loss is not payment in good faith and not normal to the business, hence, the said bonuses are disallowed as deductions from gross income pursuant to Section 34 (A) (1) (a) of the NIRC, which states that 'There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession, xxx xxxx'

6) Undeclared Income from excess funding received- Verification disclosed that the excess funding received from IST Ltd (BVI) represents income constructively received since the stated amount has been credited to Petitioner's account without substantial limitation or restriction, hence, assessed pursuant to Section 32 of the NIRC.

7) Undeclared Income from excess funding received- Investigation disclosed that Petitioner used an account of 'Accounts Payable to/from Related Parties' which could represent fictitious liabilities pursuant to the Unnumbered Ruling dated February 5, 1974 which states that 'Fictitious loans and payables, unrecorded sales or income, overstatement of expenses and understatement of assets, such as merchandise inventories, equipment and receivable or any other understatements, or we may add including overstatement, actually give rise to untaxed income, and therefore, the taxpayer should, to the extent that they represent untaxed income, include such determined amount as part of his untaxed income.' Therefore, this was assessed pursuant to Section 32 of the NIRC.

Value-Added Tax

8) Undeclared Receipts-Verification disclosed that VAT returns did not present any sales and failed to present evidence that such services were actually rendered to ITS Limited (BVI), a corporation organized under the Territory of the British Virgin Island, hence, assessed pursuant to Section 108 of the NIRC.

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 taxpayer, '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, 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 of taxes. We quote:

'SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. —

(a) In case of 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 assessment 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 VAT 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 sales subject to tax.

Hence, the FAN dated January 13, 2017 issued by the Respondent for deficiency income tax, value-added tax, expanded withholding tax and withholding tax on compensation, documentary stamp tax, and final withholding tax for taxable year 2013 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;

Expanded Withholding Tax

10) Petitioner failed to withhold/remit the correct Expanded Withholding Tax on the income payments previously disallowed as deduction from its Gross Income, therefore, it is liable to pay pursuant to Section 2.57.2 of RR No. 2-98, as amended.

Withholding Tax on Compensation a

11) Petitioner failed to withhold/remit the required Withholding Tax on the income payments previously disallowed as deduction from its Gross Income, therefore, it is liable to pay pursuant to Section 2.57.2 of RR No. 2-98, as amended.

Documentary Stamp Tax

12) Verification disclosed that Petitioner failed to pay the documentary stamp tax on cash funding for the taxable year 2013. The documentary stamp tax due is substantially a tax on transaction on documents, hence assessed pursuant to Section 179 of the NIRC.

Final Withholding Tax

13) Verification disclosed that Petitioner failed to pay final withholding tax due on the Microsoft license purchased and constructively paid to IST Ltd. (BVI), hence, assessed pursuant to Section 28 (B) of the NIRC.

14) 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);

15) 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."*

To elaborate on the aforequoted defenses, respondent maintains that petitioner was afforded due process since it was able to file its protest to the PAN and FAN; that petitioner failed to disclose in its VAT returns the correct amount of sales subject to tax, thus, the subject FAN was validly issued within the ten (10)-year prescriptive period from discovery of the falsity under Section 222 (a) of the 1997 NIRC, as amended.

Respondent concluded his arguments by quoting the oft-repeated doctrine that tax assessments are *prima facie* correct and made in good faith, hence, the taxpayer has the duty of proving otherwise, and that in the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed.

RULING OF THE COURT

We shall first delve on the argument raised by petitioner regarding the lack of an LOA which renders the instant tax assessment void and without any effect.

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

> "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." (Emphasis supplied).

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

Relative thereto, Sections 10 and 13 of the 1997 NIRC, as amended, provide that the authority of a revenue officer (RO) to examine or to recommend the assessment of any deficiency tax due must be exercised pursuant to an LOA, to wit:

> "SEC. 10. *Revenue Regional Director.* — Under rules and regulations, policies and standards formulated by the Commissioner, with the approval of the Secretary of Finance, **the Revenue Regional Director shall, within the region and district offices under his jurisdiction, among others**: xxx
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> xxx xxx xxx
>
> (c) **Issue Letters of Authority for the examination of taxpayers within the region**;
>
> xxx xxx xxx." (Emphases supplied)
>
> "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." (Emphasis supplied)

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

In the case of *Medicard Philippines, Inc. vs. Commissioner of Internal Revenue*,[35] 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. The High Court made therein the following pronouncements, 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

[35] G.R. No. 222743, April 5, 2017.

> 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 **unless authorized by the CIR himself or by his duly authorized representative, through an LOA, an examination of the taxpayer cannot ordinarily be undertaken**. The circumstances contemplated under Section 6 where the taxpayer may be assessed 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 without prior authority**.

xxx xxx xxx

In the case of *Commissioner of Internal Revenue v. Sony Philippines, Inc.*,[36] 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. In the absence of such an authority, the assessment or examination is a nullity. (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**

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[36] 649 Phil. 519 (2010). *an*

> **led to the issuance of VAT deficiency assessment against MEDICARD had the prior approval and authorization from the CIR or her duly authorized representatives. Not having authority to examine MEDICARD in the first place, the assessment issued by the CIR is inescapably void.**" (Emphases supplied)

Based on the foregoing, 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 shall be rendered void.

Moreover, any re-assignment/transfer of cases to another RO or another group of ROs requires the issuance of a new LOA.

Section C (1) and (5) of Revenue Memorandum Order (RMO) No. 43-90 dated September 20, 1990, [37] explicitly provides for the requirement of the issuance of a *new* LOA in cases of re-assignment/transfer of cases to another RO, as follows:

> "C. Other policies for issuance of L/As.
>
> 1. **All audits/investigations, whether field audit or office audit, should be conducted under a Letter of Authority**.
>
> 2. The duplicate of each internal revenue tax return which is specifically indicated in the L/A shall be attached thereto, unless a return is not required under the Tax Code to be filed therefor or when the taxpayer has not filed a return or the Assessment Branch has certified that no return is on file therein or the same cannot be located.
>
> 3. A Letter of Authority should cover a taxable period not exceeding one taxable year. The practice of issuing L/As covering audit of 'unverified prior years' is hereby prohibited. If the audit of a taxpayer shall include more than one taxable period, the other periods or years shall be specifically indicated in the L/A.
>
> xxx xxx xxx
>
> 5. **Any re-assignment/transfer of cases to another RO(s), and revalidation of L/As which have already expired, shall require the issuance of a new L/A, with the corresponding notation thereto, including the previous**

[37] SUBJECT: Amendment of Revenue Memorandum Order No. 37-90 prescribing revised policy guidelines for Examination of Returns and Issuance of Letters of Authority to Audit.

Group Supervisor (GS(L/A? number and date of issue of said L/As". (Emphasis supplied)

It is thus clear, that all audit investigations must be conducted by a designated RO, duly authorized to perform audit and examination of taxpayer's books and accounting records, pursuant to an LOA and that in case of re-assignment or transfer of cases to another RO, it is mandatory that a new LOA shall be issued in favor of the latter.

In the instant case, it is undisputed that petitioner received the subject LOA No. 047-2014-00000513 dated September 17, 2014 on September 18, 2014, authorizing ROs Gerardo Nuestro and GS Medina Lopez to examine petitioner's books of accounts for all internal revenue taxes for the period January 1, 2013 to December 31, 2013.[38]

However, it was RO Sharon S. Zafe and Group Supervisor (GS) Arthur Benjamin T. Padilla who continued the examination of petitioner's books of accounts and other accounting records for taxable year 2013, as shown in the Notice of Continuance of Audit/Investigation, issued by Revenue District Officer Atty. Shirley A. Calapatia,[39] and who recommended the issuance of a PAN against petitioner. [40]

Even respondent's lone witness, RO Zafe, admitted that she continued the audit of petitioner's books of accounts and accounting records through a Memorandum of Assignment, and not through an LOA. Pertinent portions of her Judicial Affidavit, as well as her response to the clarificatory questions of the Court, are herein quoted for ready reference, to wit:

Judicial Affidavit of Ms. Zafe :[41]

"6 Q: How did you come to know the petitioner in this case?
A: I came to know the petitioner in this case when I received the Memorandum of Assignment dated May 19, 2016 referring the case of Integrated Solutions Technology Ltd. in connection with the Letter of Authority No. SN:Ela201100080829 dated September 17, 2014, authorizing me and Group Supervisor Arthur

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[38] Par. 4, Summary of Admitted Facts, JSFI, Docket – Vol. I, p. 601; Exhibit "P-4", Docket – Vol. II, p. 670.
[39] Exhibit "P-8", Docket – Vol. II, p. 676.
[40] Exhibit "R-1", BIR Records, pp. 430 to 432.
[41] Exhibit "R-4", Docket – Vol. I, pp. 108 to109.

Benjamin Padilla to continue the audit/investigation to replace the previously assigned Revenue Officer Gerardo Nuestro.

7. Q: What did you do when the case was assigned to you, if any?
A: I effected the service of the notice of continuance of audit/investigation together with the list of documents to be submitted to the petitioner.

8. Q: What transpired next after you served the said notice of continuance of audit/investigation, if any?
A: **I conducted the investigation of the books of accounts and accounting records of petitioner and submitted an investigation report to the Regional Director on July 29, 2016.**

x x x

16.Q: What transpired next after you submitted the investigation report, if any?
A: A Preliminary Assessment (PAN) dated December 28, 2016 with attached of Details of Discrepancies was issued to the petitioner.

x x x

22.Q: What transpired next after the PAN dated December 28, 2016 with attached Details of Discrepancies was issued, if any?
A: A Final Assessment Notice (FAN) dated January 13, 2017 with attached Details of Discrepancies was issued to the petitioner x x x"

Clarificatory Question of the Court: [42]

"JUSTICE DEL ROSARIO:
x x x
By the way, you conducted an investigation on the basis of a Memorandum of Assignment, is it not?

MS. ZAFE:
A. Yes, your Honors.

JUSTICE DEL ROSARIO:
Is your name among those authorized under a Letter of Authority?

MS. ZAFE:
A. The Letter of Authority was not under my name.

x x x

[42] Transcript of Stenographic Notes at the hearing held on March 12, 2019, pp. 27 to 28.

JUSTICE DEL ROSARIO:

It is only by virtue of a Memorandum of Assignment that you conducted an investigation?

MS. ZAFE:

A. **Yes, your Honors**.

JUSTICE DEL ROSARIO:

Who was the signatory or the BIR official who signed the Memorandum of Assignment?

MS. ZAFE:
A. It's the **Revenue District Officer, Atty. Shirley Calapatia**." (Emphases supplied)

Clearly, RO Zafe and GS Padilla acted without valid authority when they continued the examination/audit of petitioner's internal revenue tax liability for taxable year 2013 in violation of the aforementioned relevant provisions of the NIRC as amended. Hence, the resulting assessments for deficiency income tax, EWT, WTC, FWT, VAT, and DST for taxable year 2013 are void for lack of a valid LOA.

In the CTA *En Banc* case of *Composite Materials, Inc. vs. CIR,*[43] which was affirmed by the Supreme Court in the case of *CIR vs. Composite Materials, Inc.,*[44] it was held that a Referral Memorandum does not give authority to the new set of revenue examiners to conduct an examination of the taxpayer's records but rather an LOA validly issued by the Revenue Regional Director. We quote relevant portions of the CTA *En Banc* decision, as follows:

> "In the case at bar, it is undisputed that the person who conducted the examination of petitioner CMI's records Revenue Officer Mary Anne P. Cruz, is not among the revenue officers authorized in LOA No. 0008746 dated September 9, 2008. Evidently, Revenue Officer Mary Anne P. Cruz is not authorized under LOA No. 0008746 to examine petitioner CMI.
>
> xxx xxx xxx
>
> The Referral Memorandum signed by the Revenue District Officer does not give authority to Revenue Officer Mary Anne P. Cruz to conduct examination of petitioner CMI's records. On the contrary, pursuant to Sections 10 and 13 of the NIRC of 1997,

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[43] CTA *EB* No. 1314, August 15, 2017.
[44] G.R. No. 238352, September 12, 2018.

as amended, it is the Revenue Regional Director who may issue an LOA."

Another valid point raised by petitioner to invalidate the subject assessment is the issuance of the FAN prior to the lapse of the fifteen (15) day period to respond to the PAN. Petitioner asserts that this is violative of its right to due process.

We agree with petitioner.

Section 228 of the NIRC of 1997, as amended, provides, in part, as follows:

> "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: xxx
>
> 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 Commissioner or his duly authorized representative shall issue an assessment based on his findings.**
>
> xxx xxx xxx." (Emphasis supplied)

To implement the foregoing provision, Section 3.1.1 of Revenue Regulations (RR) No. 12-99[45], as amended by RR No. 18-2013[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:

[45] 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.

[46] SUBJECT: Amending Certain Sections of Revenue Regulations No. 12-99 Relative to the Due Process Requirement in the Issuance of a Deficiency Tax Assessment.

> 3.1.1 *Preliminary Assessment Notice (PAN).* – If after review and evaluation 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 a Preliminary Assessment Notice (PAN) for the proposed assessment. It shall show 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 Final Assessment Notice (FLD/FAN) shall be issued calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties.**
>
> If the taxpayer, within fifteen (15) days from date of receipt of the PAN, responds that he/it disagrees with the findings of deficiency tax or taxes, an FLD/FAN shall be issued within fifteen (15) days from filing/submission of the taxpayer's response, calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties." (Emphases supplied)

As earlier cited, Section 228 of the NIRC of 1997, as amended, states that the taxpayer shall be required to respond to the PAN within a period to be prescribed by implementing rules and regulations. In turn, Section 3.1.1 of RR No. 12-99, as amended, prescribes, as part of due process in the issuance of tax assessments, that a taxpayer has fifteen (15) days within which to respond to the PAN, before the said taxpayer can be considered in default. After the lapse of the said period, it is only then that the BIR may issue an FLD.

In *Commissioner of Internal Revenue vs. Avon Products Manufacturing, Inc., etseq.*,[47] the Supreme Court said:

> **"Tax assessments issued in violation of the due process rights of a taxpayer are null and void. While the government has an interest in the swift collection of taxes, the Bureau of Internal Revenue and its officers and agents cannot be overreaching in their efforts, but must perform their duties in accordance with law, with their own rules of procedure, and always with regard to the basic tenets of due process.**

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[47] G.R. Nos. 201398-99 and 201418-19, October 3, 2018.

> **The 1997 National Internal Revenue Code, also known as the Tax Code, and revenue regulations allow a taxpayer to file a reply or otherwise submit comments or arguments with supporting documents at each stage in the assessment process. Due process requires the Bureau of Internal Revenue to consider defenses and evidence submitted by the taxpayer** and to render a decision based on these submissions. **Failure to adhere to these requirements constitutes a denial of due process and taints the administrative proceedings with invalidity."** (Emphases supplied)

Based on the foregoing doctrinal pronouncements, respondent or the BIR is mandated to perform its assessment functions in accordance with, and strict adherence to, law, and its implementing rules and regulations, and always with due regard to the basic tenets of due process. In case respondent or the BIR fails to observe due process, it shall have the effect of rendering the deficiency tax assessment void, and of no force and effect.

In this case, it is admitted that the subject PAN dated December 28, 2016[48] was received by petitioner on January 9, 2017.[49] By virtue of the aforequoted Section 3.1.1 of RR No. 12-99, as amended, petitioner had fifteen (15) days from such receipt of the said PAN, or until January 24, 2017, within which to respond thereto. However, the subject FAN was issued on January 13, 2017, and the same was received by petitioner on January 18, 2017[50], which are both before the lapse of the said 15-day period for petitioner to respond to the PAN. In other words, the BIR failed to wait for the prescribed fifteen-day period to lapse before issuing and serving the subject FAN. Thus, the said FAN was issued prematurely, thereby depriving petitioner of the opportunity to be heard on the PAN, in violation of the due process requirement in the issuance of tax assessments.

Correspondingly, since the subject deficiency tax assessments were issued in violation of petitioner's due process rights, the same are null and void. As such, said deficiency tax assessments bear no valid fruit,[51] and must not be given any effect.

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[48] Exhibit "P-11", Docket – Vol. II, pp. 681 to 686.
[49] Par. 6, Summary of Admitted Facts, JSFI, Docket – Vol. II, p. 601; Exhibit "P-12-3", Docket – Vol. II, p. 687.
[50] Par. 7, Summary of Admitted Facts, JSFI, Docket – Vol. I, p. 601.
[51] Refer to *Commissioner of Internal Revenue vs. Liquigaz Philippines Corporation, etseq.*, G.R. Nos. 215534 and 215557, April 18, 2016; *Commissioner of Internal*

In view of the finding that the FDDA or assailed Decision and the subject tax assessments are invalid, it becomes unnecessary to address the other issues and respective arguments raised by both parties.

WHEREFORE, in light of the foregoing considerations, the instant Petition for Review is **GRANTED.**

Accordingly, the FDDA dated April 25, 2017, denying petitioner's protest, is **REVERSED** and **SET ASIDE**. Furthermore, the FAN dated January 13, 2017, assessing petitioner of deficiency income tax, EWT, WTC, FWT, VAT, DST, and compromise penalty for the year 2013, in the total amount of ₱29,299,632.51, is **CANCELLED** and **SET ASIDE.**

CATHERINE T. MANAHAN
Associate Justice

I CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

Revenue vs. Metro Star Superama, Inc., G.R. No. 185371, December 8, 2010; and *Commissioner of Internal Revenue vs. Pilipinas Shell Petroleum Corp.*, G.R. No. 197945, July 9, 2018.

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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice