REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

IMA LAND HOLDINGS, INC.,
Petitioner,

\- versus -

C.T.A. CASE NO. 6389

COMMISSIONER OF INTERNAL, REVENUE,
Respondent.

Promulgated:
OCT 07 2004

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D E C I S I O N

The instant Petition for Review is an appeal for the cancellation and withdrawal of the assessments issued by the respondent against petitioner for alleged deficiency income tax of P34,838,618.20 and deficiency value-added tax of P11,460,560.70 or in the aggregate amount of P46,299,178.90 for taxable year 1997.

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with office address at 114 Technology Avenue, Laguna Technopark, Binan, Laguna (*par. 1, Facts Admitted*).

On April 3, 2001, respondent issued against petitioner two Formal Assessment Notices, both numbered 57-00021-97 and dated April 3, 2001, and a Formal Letter of Demand dated March 27, 2001, which were received by petitioner on April 20, 2001, alleging that petitioner has income tax and value-added tax (VAT) deficiencies for the year 1997, in the total amount of P46,299,178.90 (*par. 3, Facts Admitted*), broken down as follows (*Annexes A & B, Petition for Review*):

a.) Deficiency Income Tax			
	Basic Tax	P 18,818,172.00	
	Surcharge	4,704,543.00	
	Interest	11,290,903.20	
	Compromise Penalty	25,000.00	P 34,838,618.20
b.) Deficiency Value-added Tax			
	Basic Tax	P 7,640,373.80	
	Surcharge	3,820,186.90	11,460,560.70
			P 46,299,178.90

The alleged income tax deficiency assessment arose from respondent's disallowance of the interest expense deducted by petitioner from its gross income for the taxable year 1997 for allegedly being unsubstantiated. The alleged VAT deficiency, on the other hand, arose from the disallowance of petitioner's available creditable input tax for the same year on the ground of lack of substantiation (*par. 4, Facts Admitted*).

On May 19, 2001, petitioner duly filed with the respondent, through registered mail, an administrative protest against the aforesaid assessments (*par. 9, Facts Admitted*).

On July 17, 2001, petitioner, through its external auditor, filed with respondent a supplemental protest, reiterating its disagreement to the subject income and VAT deficiency assessments and submitting therewith all the relevant supporting documents to support its position against the merit of the assessments (*par. 10, Facts Admitted*).

Respondent failed to act on the case or resolve the protest and supplemental protest filed by petitioner within the period of one hundred eighty (180) days from July 17, 2001 or until January 13, 2002. Hence, petitioner filed the instant Petition for Review on February 11, 2002 or within thirty (30) days from the last day of the aforesaid 180-day period.

Respondent, in his Answer filed on March 12, 2002, raised the following Special and Affirmative Defenses:

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5. Petitioner was informed of the law and the facts on which the assessments are made, in compliance with Section 228 of the Tax Code;

6. The assessments were issued in accordance with law and regulations;

7. The interest expense of P55,300,000.00 is not deductible for being unsupported;

8. The claimed input taxes are not allowable for being unsupported;

9. The assessment for deficiency value-added tax was issued within the prescriptive period;

10. All presumptions are in favor of the correctness of tax assessments.

In their Joint Stipulation of Facts and Issues filed on May 14, 2002 and approved by this court on June 10, 2002, the parties submitted the following issues for resolution:

1. Whether petitioner was informed of the law and facts on which the assessments are made;

2. Whether petitioner's interest expense in the amount of P55,300,000.00, a legitimate business expense, is unsubstantiated;

3. Whether the claimed input taxes are allowable; and

4. Whether the assessment for the alleged deficiency VAT has already prescribed.

Anent the first issue, petitioner submits that the deficiency income and VAT assessments are void for respondent's failure to inform petitioner of the law and the facts on which the said assessments were made in clear violation of Section 228 of the Tax Code of 1997 as implemented by Section 3.1.4 of Revenue Regulations No. 12-99. According to petitioner, the respondent did not cite the provisions of law, rules or regulations or jurisprudence upon which the assessments were based.

We disagree.

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Section 228 of the Tax Code clearly states that "the taxpayer shall be informed in writing of the facts and the law on which the assessment is made; otherwise, the assessment shall be void." As thus worded, the respondent has the bounden duty to inform the taxpayer not only of the law but more importantly, the surrounding circumstances supporting the assessment, for it is only through a detailed appraisal of its basis that the taxpayer may be able to dispute the imposition or agree with it (*Abbott Laboratories, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5718, February 16, 2001*). The underlying reason of the law is the basic constitutional requirement that "no person shall be deprived of his property without due process of law" (*Subic Power Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6059, May 8, 2003*).

In the case at bar, the records would show that petitioner was sufficiently informed of the facts and the law on which the subject assessments were based.

Attached to the Assessment Notices was the Formal Letter of Demand, which showed the following detailed computations of the alleged 1997 deficiency income tax and VAT assessments:

1. Income Tax Deficiency

Net Income per ITR	P 11,278,760.00
Add: Interest Expense	55,300,000.00
Adjusted Taxable Net Income	P 66,578,766.00
Tax Due	P 23,302,568.00
Less: Tax Credits	4,484,414.00
Tax Deficiency	P 18,818,172.00
Surcharge (25%)	4,704,543.00
Interest	11,290,903.20
Compromise	25,000.00
Total Amount Payable	P 34,838,618.20

2. Value-Added Tax Deficiency

Output VAT per VAT Return	P 7,640,373.80

Less: Payments	-
VAT Deficiency	P 7,640,373.80
Surcharge (50%)	3,820,186.90
Total Amount Payable	P 11,460,560.70

The Details of Discrepancies which petitioner received along with the Assessment Notices and Formal Letter of Demand *(par. 3, Admitted Facts; par. 3, Petition for Review)* stated the following reasons why the subject assessments were issued against petitioner:

1. DISALLOWANCE OF INTEREST EXPENSE – UNSUPPORTED

> The Statutory test of deductibility where it is axiomatic that to be deductible as a business expense, three conditions are imposed, namely: 1) the expense must be ordinary and necessary, 2) it must be paid or incurred within taxable year, and 3) it must be paid or incurred in carrying on a trade or business. In addition, not only must the taxpayer meet the business test, he must substantially prove by evidence or records the deductions claimed under the law, otherwise, the same will be disallowed. The mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deduction.

2. DISALLOWANCE OF INPUT TAX CARRIED OVER FROM PRIOR PERIOD

> Pursuant to Section 4.104 of RR 7-95 and RMO 53-98, the input taxes should be supported by an invoice or receipts showing the information as required under Section 108(a) and 238 of the Code.

To our minds, these explanations are sufficient compliance with the requirements of Section 228 of the NIRC of 1997.

We shall now dwell on the second issue of whether or not petitioner's interest expense in the amount of P55,300,000.00, a legitimate business expense, is unsubstantiated.

Petitioner, in its memorandum, argued that the interest expense of P55,300,000.00 was fully substantiated and that this was confirmed by the Revenue Examiners involved

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in the examination of its books of accounts and accounting records when it was stated in their report that "books and records are in order, in so far as the purported transactions are concerned, and these were duly supported by receipts and invoices" *(Exhibit J)*.

We agree with the petitioner.

A perusal of the two (2) Loan Agreements with Mortgage entered into by petitioner with Isuzu Philippines Corporation on February 26, 1997 (*Exhibits B & O*) reveals that the said loans in the amounts of P168,000,000.00 and P227,000,000.00 bearing annual interest rates of 14% and 14.75%, respectively, were granted to petitioner by Isuzu Philippines Corporation. As found by the Revenue Examiners, the proceeds of the loans were used to purchase the land being leased out to Isuzu Philippines Corporation (*Exhibit J*). Under the said loan agreements, interest shall be paid by petitioner on a quarterly basis. Thus, for the year 1997, the total interest expense incurred by petitioner on the said loans amounted to P55,300,000.00 which petitioner paid in four equal amounts of P13,825,000.00 on July 7, 1997, September 12, 1997, October 28, 1997 and January 8, 1998 as evidenced by Official Receipt Nos. 1863, 2504, 2933 & 3525 (*Exhibits P, Q, R & S*) issued by Isuzu Philippines Corporation to petitioner.

Clearly, petitioner's claimed interest expense should be allowed as deduction from its 1997 gross income pursuant to Section 29(b)(1) of the NIRC of 1977, as amended, to wit:

> (b) *Interest*. — (1) *In general*. — The amount of interest paid or accrued within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business, except on indebtedness incurred or continued to purchase or carry obligation the interest upon which is exempt from taxation as income under this Title.

It was shown that: 1) there was an indebtedness; 2) the indebtedness was that of petitioner; 3) the indebtedness was incurred or paid in connection with petitioner's business; 4) the interest was incurred or paid during the taxable year; and 5) the interest was stipulated in writing (***DELFIN MA. V. CRUZ, JR. VS. THE COURT OF TAX APPEALS AND THE COMMISSIONER OF INTERNAL REVENUE, CA-G.R. SP NO. 25308, APRIL 7, 1992***).

We proceed to the third issue.

The alleged 1997 deficiency VAT assessment of P11,460,560.70 arose from the respondent's disallowance of the amount of P11,498,808.00 reported by petitioner in its 1997 first quarterly VAT return as input taxes from previous quarter which were applied against the 1997 output VAT liability in the sum of P7,640,373.77. Respondent alleged that the input taxes of P11,498,808.00 were unsupported by VAT invoices or receipts as required under Section 4.104 of Revenue Regulations No. 7-95 and RMO 53-98. Petitioner, on the other hand, maintained that the aforesaid input taxes were fully substantiated.

The court finds for the petitioner.

Records show that on April 1, 1997, a Deed of Absolute Sale was executed by and between Laguna Technopark, Inc. and petitioner (*Exhibit C*) whereby the latter purchased a parcel of land from the former for the contract price of P162,372,000.00. However, prior to said date or on December 12, 1996, petitioner paid to Laguna Technopark, Inc. an amount of P81,186,000.00 representing the sum of P64,948,800.00 which is equivalent to 40% of the contract price of P162,372,000.00 and the 10% VAT of

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P16,237,200.00. The said payment was duly supported by a VAT official receipt issued by Laguna Technopark, Inc. to petitioner (*Exhibit I*).

Of the 1996 input tax payment of P16,237,200.00, the amount of P4,738,392.00 was applied by petitioner against the output VAT liability due on its 1996 rental income of P47,383,920.00 (*Exhibit A-5*) while the remaining input taxes of P 11,498,808.00 were carried over in 1997 and credited against petitioner's output VAT liability for the said year.

Evidently, the disallowance of the reported input taxes of P11,498,808.00 which led to the respondent's issuance of the 1997 deficiency VAT assessment of P11,460,560.70 is without factual basis.

Anent the last issue, petitioner contended that the 1997 deficiency VAT assessment was issued beyond the three-year period to assess under Section 203 of the Tax Code of 1977, as amended, in relation to Section 223 of the same Code. On the other hand, respondent argued that the prescriptive period is not three (3) years but ten (10) years because petitioner filed incomplete, erroneous, false and fraudulent VAT returns for taxable year 1997 as it failed to support the input tax carry-over from prior period of P11,498,808.00.

The court concurs with petitioner that the 1997 deficiency VAT assessment was issued beyond the three-year prescriptive period to assess.

Section 203 of the NIRC of 1977, as amended, provides, thus:

> **SEC. 203.** ***Period of limitation upon assessment and collection.*** — Except as provided in the succeeding section, internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such

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> period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

Corollary thereto, then Section 110 of the NIRC, in relation to Section 4.110-1 of Revenue Regulations No. 7-95, provides that "every person liable to pay the value-added tax shall file a quarterly return of the amount of his/its gross sales or receipts within twenty (20) days following the close of each taxable quarter prescribed for each taxpayer."

Pursuant to Section 203 in relation to Section 110 of the NIRC and Section 4.110-1 of Revenue Regulations No. 7-95, the period to assess commences after the last day prescribed by law for the filing of the return. In the case of VAT, it is twenty (20) days following the close of each taxable quarter. Hence, if the return was filed earlier than the last day allowed by law, the period to assess shall still be counted from the last day prescribed for filing of the return. However, if the return was filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed (***HPCO AGRIDEV CORPORATION vs. COMMISSIONER OF INTERNAL REVENUE, CTA CASE NO. 6355, JULY 18, 2002***). Therefore, respondent had until the following dates within which to assess petitioner for deficiency VAT *(year 2000 being a leap year)*:

Period (1997)	Exhibit	Date Filed	Last Day to File Return	Last Day to Assess
1st Qtr.- original return	D-1	4/21/97	4//21/97	4/20/00
amended return	E	9/17/97	-	9/16/00
2nd Qtr.	F	7/21/97	7/21/97	7/20/00
3rd Qtr.	G	10/20/97	10/20/97	10/19/00
4th Qtr.	H	1/20/98	1/20/98	1/19/01

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Moreover, in the aforecited case of HPCO AGRIDEV CORPORATION, this court ruled that:

> xxxThe Supreme Court on several occasions ruled that it is the date when the demand letter or notice of assessment is released, mailed or sent to the taxpayer that constitutes an actual assessment (**Republic vs. Limaco & de Guzman Commercial Co., Inc., 5 SCRA 990; Basilan Estates, Inc. vs. Commissioner of Internal Revenue, et al., 21 SCRA 17**). The law does not require that the demand or notice be received within the prescriptive period. As long as the release thereof is effected before prescription sets in, the assessment is deemed made on time even if the same is actually received by the taxpayer after the expiration of the prescriptive period (**Basilan Estates, Inc. vs. Commissioner, *supra***).

It is undisputed that both the deficiency VAT assessment notice and demand letter were dated April 3, 2001 (*par. 3, Facts Admitted*). Indubitably, the deficiency VAT assessment for the four taxable quarters of 1997 was issued beyond the three-year period to assess.

It must be noted that respondent does not contest the allegation that the assessment was issued beyond the three-year prescriptive period and has, thus, prescribed based on Section 203 of the NIRC of 1977, as amended. In fact, Respondent's position is that the applicable prescriptive period for the assessment in question is ten (10) years as provided under Section 223 of the same Code, which states:

> "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 anytime within ten (10) years after the discovery of the falsity, fraud, or omission: x x x "

The application of Section 223 by the respondent is premised on the theory that petitioner's failure to support the input tax carry-over from 1996 of P11,498,808.00

indicates that petitioner's VAT returns for the taxable year 1997 were false and fraudulent.

This court finds that there is no basis for the application of the ten-year prescriptive period. As earlier discussed, the input tax carry-over of P11,498,808.00 was fully substantiated by a VAT official receipt issued by Laguna Technopark, Inc. to petitioner on December 12, 1996 (*Exhibit I*). Thus, respondent's allegation that petitioner had filed false or fraudulent returns is without factual basis and the ten-year prescriptive period does not apply in the case at bar.

False or fraudulent return as an exception to the period of limitation and to collect taxes provided in Section 223 of the NIRC of 1977, as amended, must be actual not constructive. It must be intentional, consisting of deception willfully and deliberately done or resorted to. Fraud must be proven by clear and convincing evidence amounting to more than mere preponderance. It cannot be justified by mere speculation. This is because fraud is never lightly to be presumed (***Yutivo Sons Hardware Company v. Court of Tax Appeals and Collector of Internal Revenue, 1 SCRA 160***). In order to render a return made by a taxpayer a "false return" within the meaning of Section 223 of the NIRC, there must appear a design to mislead or deceive on the part of the taxpayer, or at least culpable negligence. A mistake, not culpable in respect of its value would not constitute a false return (***Commissioner of Internal Revenue vs. Ayala Hotels, Inc., CA-G.R. SP No. 70025, April 19, 2004***). In fact, the Supreme Court held that "mere falsity of a return does not merit the application of the ten-year prescriptive period. The element of fraud as in the case of taxpayer's intent to evade the payment of the correct amount of

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tax, must be clearly established". ***(Commissioner of Internal Revenue, BF Goodrich Phils., Inc., 303 SCRA 546)***

WHEREFORE, this court finds the subject deficiency income tax and deficiency value-added tax assessments without merit. Accordingly, the two Formal Assessment Notices, both numbered 57-000021-97 and dated April 3, 2001, for deficiency income tax in the amount of P34,838,618.20 and deficiency VAT assessment in the amount of P11,460,560.70 covering the taxable year 1997, are hereby **CANCELLED** and **WITHDRAWN**.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

C E R T I F I C A T I O N

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Justice