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FIRST DIVISION

[G.R. No. 166387, January 19, 2009]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. ENRON SUBIC POWER CORPORATION, RESPONDENT.

D E C I S I O N

CORONA, J.:

In this petition for review on certiorari under Rule 45 of the Rules of Court, petitioner Commissioner of Internal Revenue (CIR) assails the November 24, 2004 decision[1] of the Court of Appeals (CA) annulling the formal assessment notice issued by the CIR against respondent Enron Subic Power Corporation (Enron) for failure to state the legal and factual bases for such assessment.

Enron, a domestic corporation registered with the Subic Bay Metropolitan Authority as a freeport enterprise,[2] filed its annual income tax return for the year 1996 on April 12, 1997. It indicated a net loss of P7,684,948. Subsequently, the Bureau of Internal Revenue, through a preliminary five-day letter,[3] informed it of a proposed assessment of an alleged P2,880,817.25 deficiency income tax.[4] Enron disputed the proposed deficiency assessment in its first protest letter.[5]

On May 26, 1999, Enron received from the CIR a formal assessment notice [6] requiring it to pay the alleged deficiency income tax of P2,880,817.25 for the taxable year 1996. Enron protested this deficiency tax assessment.[7]

Due to the non-resolution of its protest within the 180-day period, Enron filed a petition for review in the Court of Tax Appeals (CTA). It argued that the deficiency tax assessment disregarded the provisions of Section 228 of the National Internal Revenue Code (NIRC), as amended,[8] and Section 3.1.4 of Revenue Regulations (RR) No. 12-99 [9] by not providing the legal and factual bases of the assessment. Enron likewise questioned the substantive validity of the assessment.[10]

In a decision dated September 12, 2001, the CTA granted Enron's petition and ordered the cancellation of its deficiency tax assessment for the year 1996. The CTA reasoned that the assessment notice sent to Enron failed to comply with the requirements of a valid written

notice under Section 228 of the NIRC and RR No. 12-99. The CIR's motion for reconsideration of the CTA decision was denied in a resolution dated November 12, 2001.

The CIR appealed the CTA decision to the CA but the CA affirmed it. The CA held that the audit working papers did not substantially comply with Section 228 of the NIRC and RR No. 12-99 because they failed to show the applicability of the cited law to the facts of the assessment. The CIR filed a motion for reconsideration but this was deemed abandoned when he filed a motion for extension to file a petition for review in this Court.

The CIR now argues that respondent was informed of the legal and factual bases of the deficiency assessment against it.

We adopt *in toto* the findings of fact of the CTA, as affirmed by the CA. In *Compagnie Financiere Sucres et Denrees v. CIR,* [11] we held:

> We reiterate the well-established doctrine that as a matter of practice and principle, [we] will not set aside the conclusion reached by an agency, like the CTA, especially if affirmed by the [CA]. By the very nature of its function, it has dedicated itself to the study and consideration of tax problems and has necessarily developed an expertise on the subject, unless there has been an abuse or improvident exercise of authority on its part, which is not present here.

The CIR errs in insisting that the notice of assessment in question complied with the requirements of the NIRC and RR No. 12-99.

A notice of assessment is:

> [A] declaration of deficiency taxes issued to a [t]axpayer who fails to respond to a Pre-Assessment Notice (PAN) within the prescribed period of time, or whose reply to the PAN was found to be without merit. The Notice of Assessment shall inform the [t]axpayer of this fact, and that the report of investigation submitted by the Revenue Officer conducting the audit shall be given due course.
>
> The formal letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall **state the fact, the law, rules and regulations or jurisprudence on which the assessment is based, otherwise the formal letter of demand and the notice of assessment shall be void**. (emphasis supplied)[12]

Section 228 of the NIRC provides that the taxpayer shall be informed in writing of the law and the facts on which the assessment is made. Otherwise, the assessment is void. To implement the provisions of Section 228 of the NIRC, RR No. 12-99 was enacted. Section 3.1.4 of the revenue regulation reads:

> 3.1.4. *Formal Letter of Demand and Assessment Notice.* - The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly

> authorized representative. **The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void.** The same shall be sent to the taxpayer only by registered mail or by personal delivery. xxx (emphasis supplied)

It is clear from the foregoing that a taxpayer must be informed in writing of the legal and factual bases of the tax assessment made against him. The use of the word "shall" in these legal provisions indicates the mandatory nature of the requirements laid down therein. We note the CTA's findings:

> In [this] case, [the CIR] merely issued a formal assessment and indicated therein the supposed tax, surcharge, interest and compromise penalty due thereon. The Revenue Officers of the [the CIR] in the issuance of the Final Assessment Notice did not provide Enron with the written bases of the law and facts on which the subject assessment is based. [The CIR] did not bother to explain how it arrived at such an assessment. Moreso, he failed to mention the specific provision of the Tax Code or rules and regulations which were not complied with by Enron.[13]

Both the CTA and the CA concluded that the deficiency tax assessment merely itemized the deductions disallowed and included these in the gross income. It also imposed the preferential rate of 5% on some items categorized by Enron as costs. The legal and factual bases were, however, not indicated.

The CIR insists that an examination of the facts shows that Enron was properly apprised of its tax deficiency. During the pre-assessment stage, the CIR advised Enron's representative of the tax deficiency, informed it of the proposed tax deficiency assessment through a preliminary five-day letter and furnished Enron a copy of the audit working paper[14] allegedly showing in detail the legal and factual bases of the assessment. The CIR argues that these steps sufficed to inform Enron of the laws and facts on which the deficiency tax assessment was based.

We disagree. The advice of tax deficiency, given by the CIR to an employee of Enron, as well as the preliminary five-day letter, were not valid substitutes for the mandatory notice in writing of the legal and factual bases of the assessment. These steps were mere perfunctory discharges of the CIR's duties in correctly assessing a taxpayer.[15] The requirement for issuing a preliminary or final notice, as the case may be, informing a taxpayer of the existence of a deficiency tax assessment is markedly different from the requirement of what such notice must contain. Just because the CIR issued an advice, a preliminary letter during the pre-assessment stage and a final notice, in the order required by law, does not necessarily mean that Enron was informed of the law and facts on which the deficiency tax assessment was made.

The law requires that the legal and factual bases of the assessment be stated in the formal letter of demand and assessment notice. Thus, such cannot be presumed. Otherwise, the express provisions of Article 228 of the NIRC and RR No. 12-99 would be rendered nugatory. The alleged "factual bases" in the advice, preliminary letter and "audit working papers" did not suffice. There was no going around the mandate of the law that the legal and factual bases of the assessment be stated in writing in the formal letter of demand accompanying the assessment notice.

We note that the old law merely required that the taxpayer be notified of the assessment made by the CIR. This was changed in 1998 and the taxpayer must now be informed not only of the law but also of the facts on which the assessment is made. [16] Such amendment is in keeping with the constitutional principle that no person shall be deprived of property without due process.[17] In view of the absence of a fair opportunity for Enron to be informed of the legal and factual bases of the assessment against it, the assessment in question was void. We reiterate our ruling in *Reyes v. Almanzor, et al.*:[18]

> Verily, taxes are the lifeblood of the Government and so should be collected without unnecessary hindrance. However, such collection should be made in accordance with law as any arbitrariness will negate the very reason for the Government itself.

WHEREFORE, the petition is hereby **DENIED.** The November 24, 2004 decision of the Court of Appeals is **AFFIRMED** .

No costs.

SO ORDERED.

Puno, (Chairperson), Carpio, Azcuna, and *Leonardo-De Castro, JJ.,* concur.

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[1] Penned by Associate Justice Magdangal M. De Leon and concurred in by Associate Justices Romeo A. Brawner (deceased) and Mariano C. Del Castillo of the Ninth Division of the Court of Appeals. *Rollo*, pp. 68-74.

[2] It is entitled to a 5% preferential rate pursuant to RA 7227 (Bases Conversion and Development Act of 1992).

[3] *Rollo*, p. 78. Paragraph 8, Joint Stipulation of Facts and Issues, C.T.A. Case No. 5993, dated April 18, 2000, states: "Prior to the issuance of the FAN, the Petitioner was informed of the proposed assessment by the way of a Preliminary Five (5) day Letter From Revenue District Office No. 19; xxx."

[4] Id., p. 41.

[5] Id., pp. 78, 81-88.

[6] FAN No. 019-44-96-0000371 dated May 12, 1999. Id., p. 89.

[7] Dated June 14, 1999. Id, pp. 90-101.

[8] Section 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
The taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise the assessment shall be void.

[9] Dated September 6, 1999.

[10] The arguments raised were: (a) the supervision fees reimbursed by the Subic Power Corporation (SBC) and Batangas Power Corporation (BPC) were not subject to tax as these represented the actual cost incurred by Enron in the performance of its obligations under the Operating and Maintenance Supervision Agreement; (b) the plant restoration cost incurred in 1996 should be allowed as a deductible expense; (c) the plant insurance expense formed part of its direct cost that should be allowed as a deduction from its "gross income earned"; and (d) the tax withheld by the National Power Corporation on its bank deposit interests should be allowed as tax credit.

[11] G.R. No. 133834, 28 August 2006, 499 SCRA 664, 669.

[12] http://www.bir.gov.ph/taxpayerrights/taxpayerrights.htm.

[13] *Rollo*, p. 109.

[14] Id. at 114-118.

[15] *CIR v. Reyes,* G.R. No. 159694, 27 January 2006, 480 SCRA 382, 393.

[16] Id.

[17] Constitution, Art. III, Sec. 1.

[18] G.R. Nos. 49839-46, 26 April 1991, 196 SCRA 322, 329.

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