Republic of the Philippines
Supreme Court
Manila

FIRST DIVISION

N O T I C E

Sirs/Mesdames:

Please take notice that the Court, First Division, issued a Resolution dated **November 23, 2021** *which reads as follows:*

"G.R. No. 242354 ***(Commissioner of Internal Revenue, petitioner v. Ludo and Luym Corporation, respondent).***

This is an appeal by *certiorari* seeking to reverse and set aside the June 8, 2018 Decision[1] and September 27, 2018 Resolution[2] of the Court of Tax Appeals *(CTA) En Banc* in CTA EB No. 1559. The CTA *En Banc* affirmed the August 8, 2016 Decision[3] and November 10, 2016 Resolution[4] of the CTA Division in CTA Case No. 8613, which cancelled and withdrew the assessment issued by Commissioner of Internal Revenue *(petitioner)* against Ludo and Luym Corporation *(respondent)*.

Antecedent

On March 16, 2011, the Bureau of Internal Revenue's Large Taxpayer Service *(BIR-LTS)* issued a Preliminary Assessment Notice *(PAN)* informing respondent of its assessment for deficiency income tax, value-added tax *(VAT)*, and expanded withholding tax *(EWT)* for calendar year *(CY)* 2007.[5] The BIR-LTS then issued a Final

- over – twelve (12) pages ...

73-A

[1] *Rollo*, pp. 55-72; penned by Associate Justice Juanito C. Castaneda, Jr., with Presiding Justice Roman G. Del Rosario, Associate Justices Lovell R. Bautista, Erlinda P. Uy, Caesar A. Casanova, Esperanza R. Fabon-Victorino, Cielito N. Mindaro-Grulla, Ma. Belen M. Ringpis-Liban (On Leave), and Catherine T. Manahan, concurring.

[2] Id. at 74-78; penned by Associate Justice Juanito C. Castaneda, Jr., with Presiding Justice Roman G. Del Rosario, Associate Justices Erlinda P. Uy (On Leave), Esperanza R. Fabon-Victorino, Cielito N. Mindaro-Grulla (On Leave), Ma. Belen M. Ringpis-Liban, and Catherine T. Manahan, concurring.

[3] Id. at 80-102; penned by Associate Justice Lovell R. Bautista with Associate Justices Esperanza R. Fabon-Victorino and Ma. Belen M. Ringpis-Liban, concurring.

[4] Id. at 104-108.

[5] Id. at 13.

Assessment Notice *(FAN)* on April 11, 2011. Despite respondent's protest against the FAN, the BIR-LTS issued a Final Decision on Disputed Assessment *(FDDA)* against respondent on January 3, 2012.[6] The FDDA reads as follows:

> Income Tax
>
> a. Additional Gross Income Php22,333.52 for purchases from POM's Ventures
> b. Alleged fictitious expenses arising from alleged bank overdrafts in the amount of Php80,425,042.37 which it added to the taxable income of respondent for CY 2007
> c. Disallowance of Interest Expense in the amount of Php223,794,203.46
> d. Disallowed Bad Debts in the amount ofPhp2,665,255.76
> e. Disallowed Miscellaneous Expense in the amount of Php982,771.79
> f. Additional Gross Income on Unrecorded Purchases in the amount of Php180,250.45
> g. CWT Disallowance in the amount ofPhp762.64
> h. Compromise Penalty for failure to submit audited financial statement in the amount of Php25,000.00
>
> Value-Added Tax
>
> i. Additional Taxable Sales in the amount of Php1,540,088.00
> j. Disallowance on Input Tax allegedly claimed on fictitious expenses Php154,964,207.83 and Miscellaneous Expenses [Php2,104,216.74]. (citations omitted)

Respondent moved for reconsideration[7] of the FDDA. On January 29, 2013, respondent received petitioner's decision denying respondent's motion for reconsideration and finding respondent liable to pay deficiency income tax and VAT for CY 2007, plus surcharge, in the aggregate amount of ₱57,863,909.86.[8]

Respondent thus filed a petition before the CTA on February 27, 2013, appealing petitioner's decision.[9] Before the CTA, respondent argues that the assessments for deficiency income tax and VAT for CY 2007 were erroneous and ultimately barred by prescription.

- over -
73-A

---

[6] Id. at 14.
[7] *Rollo*, p. 15, respondent filed a Motion for Reconsideration on January 30, 2012, Supplement to the Motion for Reconsideration on February 1, 2012, and Second Supplement to the Motion for Reconsideration on February 23, 2012.
[8] Id.
[9] Id.

The CTA Division Ruling

In its August 8, 2016 Decision, the CTA Division granted respondent's petition and cancelled the assessment for deficiency income tax and VAT.

Under Section 203 of the 1997 Tax Code, internal revenue taxes shall be assessed within three years from the last day prescribed by law for filing of the return or from the day the return was filed, whichever is later. The details on respondent's filing of returns relevant to this case are presented below:

Tax Returns for CY 2007	Date of Actual Filing	Last Day to File Return	Last Day to Assess
Income Tax Annual Return	April 15, 2008	April 15, 2008	April 15, 2011
VAT 1st Quarter Return	April 25, 2007	April 25, 2007	April 25, 2010
VAT 2nd Quarter Return	July 24, 2007	July 25, 2007	July 25, 2010
VAT 3rd Quarter Return	October 30, 2007	October 25, 2007	October 30, 2010
VAT 4th Quarter Return	January 30, 2008	January 25, 2008	January 30, 2011

Considering that respondent received the FAN on April 11, 2011, it is clear that the assessment for deficiency income tax for CY 2007 was timely made, while the assessment for deficiency VAT had already prescribed.

After its review of the parties' arguments and evidence on record, the CTA Division cancelled petitioner's assessment of the following items: (a) disallowed fictitious expenses arising from bank overdrafts in respondent's accounts with China Banking Corporation and Land Bank of the Philippines – ₱12,081,196.73; disallowed interest expenses – ₱223,794,203.46; (c) additional gross income on unrecorded purchases – ₱180,250.45; (d) disallowed excess tax credits – ₱11,852,215.56; and (e) 50% surcharge for false return – of ₱6,067,013.61.[10]

The CTA Division, however, sustained petitioner's assessment of the following items: (a) disallowed fictitious expenses pertaining to overdrafts in respondent's accounts with EastWest Banking Corporation and International Exchange Bank - ₱68,343,845.64; (b) disallowed bad debts – ₱2,665,255.75; and (c) disallowed miscellaneous expenses – ₱982,771.79.[11]

- over -
73-A

[10] Id. at 20.
[11] Id.

Even taking into account the valid assessed items against respondent, the CTA Division ruled that respondent is not liable for any deficiency income tax for CY 2007. It pointed out that under Sec. 27(E)(1) of the 1997 Tax Code, when the Minimum Corporate Income Tax *(MCIT)* is higher than the normal income tax, then the MCIT should be imposed. It computed respondent's MCIT *vis-à-vis* its normal income tax as follows:[12]

		MCIT		Normal
Total Gross Income *per* ITR	Php	28,503,578.24	Php	28,503,578.24
Less: Deductions				301,675,214.99
Taxable Income *per* return	Php	28,503,578.24	Php	(273,171,636.75)
Add: Disallowed Expenses				
Fictitious Expenses - arising from bank overdrafts				68,343,845.64
Bad debts				2,665,255.75
Miscellaneous				982,771.79
Taxable income *per* investigation	Php	28,503,578.24	Php	(201,179,763.57)
MCIT Due (28,503,578.24 x 2%)	Php	570,071.56		
Less: Payments/Credits				
Prior Year's Excess Credits		10,493,516.04		
Creditable Tax Withheld for the First Three Quarters		1,030,788.20		
Creditable Tax Withheld for the Fourth Quarter		400,444.69		
Total Tax Credits	Php	1,431,232.89		
Tax Overpayment	**Php**	**(11,354,677.37)**		

As the foregoing table shows, in applying the normal income tax, respondent will have a net loss of ₱201,179,763.57; while in applying MCIT, respondent will have an overpayment of ₱11,354,677.37. Either way, respondent is not liable for any deficiency income tax for CY 2007.

The dispositive portion of the CTA Division decision is quoted thus:

> **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 [petitioner] against [respondent] for deficiency VAT for CY 2007 and Audit Result/Assessment Notice under Assessment No. IT-123-LA 7074-07-13-06 issued by [petitioner] against [respondent] for deficiency income tax for CY 2007 are hereby **CANCELLED** and **WITHDRAWN.**
>
> **SO ORDERED.**[13]

- over -

73-A

[12] Id. at 100.
[13] Id. at 100-101.

Petitioner filed its motion for partial reconsideration, which was denied by the CTA Division in its November 10, 2016 Resolution. Aggrieved, petitioner filed its appeal before the CTA *En Banc*.

The CTA En Banc Ruling

While the CTA *En Banc* affirmed the ruling of the CTA Division in its June 8, 2018 Decision, it disallowed the deduction of interest expense in the amount of ₱223,794,203.46 for respondent's failure to comply with the requirements under Sec. 3 of Revenue Regulations No. 13-2000.[14] According to the CTA *En Banc,* respondent failed to prove that the indebtedness was incurred in connection with its trade or its business.[15]

Nonetheless, the CTA *En Banc* ratiocinated that even with the disallowance of the interest expense, the overall effect would still be in respondent's favor as it may either result in (a) a net loss if the normal income tax is applied, or (b) a tax overpayment if the MCIT is applied.[16] It presented the following computation:[17]

	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 Credits		10,493,516.00
Creditable Tax Withheld for the First Three Quarters		1,030,788.20
Creditable Tax Withheld for the [Fourth] Quarters		400,444.69
Tax Overpayment		**₱(4,009,694.86)**

Ultimately, the CTA *En Banc* denied respondent's petition for review and affirmed the assailed decision of the CTA Division.

- over -
73-A

[14] Subject: Implementing Section 34(B) of the Tax Code of 1997 on the Requirements for Deductibility of Interest Expense from the Gross Income of a Taxpayer.
[15] *Rollo*, pp. 67-68.
[16] Id. at 71.
[17] Id. at 69.

Petitioner filed its motion for reconsideration on June 28, 2018. However, the same was denied by the CTA *En Banc* in its September 27, 2018 Resolution.

ISSUES

Petitioner filed the present petition for review, raising the following issues:

I

> WHETHER THE CTA *EN BANC* ERRED IN CANCELLING AND WITHDRAWING PETITIONER'S ASSESSMENTS ON RESPONDENT'S DEFICIENCY INCOME TAX AND VAT FOR CY 2007 IN THE AGGREGATE AMOUNT OF ₱57,863,909.86; [AND]

II

> WHETHER THE CTA *EN BANC* ERRED IN RULING THAT THE PETITIONER'S RIGHT TO ASSESS RESPONDENT OF DEFICIENCY VAT FOR CY 2007 HAD ALREADY PRESCRIBED.[18]

After respondent submitted its comment and petitioner filed a manifestation *in lieu* of a reply, the Court now resolves the petition.

The Court's Ruling

The petition is without merit.

The Court is bound by the factual findings of the CTA.

Prefatorily, it must be pointed out that the instant petition raises questions of fact requiring a review, examination, evaluation, or weighing of the probative value of evidence presented by the parties, which the Court does not have the jurisdiction to do, barring the presence of any exceptional circumstance, as it is not a trier of facts.[19] Judicial review under Rule 45 of the Rules of Court is confined only to errors of law and does not extend to questions of fact.[20]

[18] Id. at 17-18.
[19] *Commissioner of Internal Revenue. v. Philippine National Bank,* 744 Phil. 299, 307 (2014).
[20] *Commissioner of Internal Revenue v. Apo Cement Corp.,* 805 Phil. 441, 463 (2017).

The factual findings of the CTA Division and the CTA *En Banc* bind this Court. The Court acknowledges that the members of the CTA Division are in the best position to analyze the documents presented by the parties.[21] As a specialized court dedicated exclusively to the resolution of tax problems, the CTA has accordingly developed an expertise on the subject of taxation. Thus, its decisions are presumed valid in every aspect and will not be overturned on appeal, unless the Court finds that the questioned decision is not supported by substantial evidence or there has been an abuse or improvident exercise of authority on the part of the tax court[22] neither of which exceptional circumstances was convincingly established by petitioner to be present in this case.

The CTA Division and CTA *En Banc* were consistent in finding that respondent was not liable for any deficiency income tax for CY 2007 and that petitioner's right to assess respondent for deficiency VAT for CY 2007 had already prescribed. A perusal of the decisions of the CTA Division and *En Banc* reveals that the merits of the deficiency income tax assessment against respondent were already exhaustively discussed therein. The tax court, in Division and *En Banc,* had meticulously reviewed each item of the assessment and weighed the corresponding evidence of both parties. Hence, the Court finds no cogent reason to disturb the ruling of the CTA Division and *En Banc* as to which items of the assessment for deficiency income tax was sufficiently proved by petitioner or refuted by respondent through their respective evidence.

The Court shall not entertain new issues and arguments raised for the first time on appeal.

The Court notes that petitioner has repeatedly raised novel arguments to justify the disallowances of some of respondent's deductions and tax credits that were **not** made apparent in the FDDA nor were previously raised before the CTA Division and/or *En Banc.*

As regards the interest expense in the amount of ₱223,794,203.46, the FDDA and the CIR's decision clearly state that the interest expense was disallowed pursuant to Sec. 4 of BSP

[21] *Republic v. Team (Phils.) Energy Corp.*, 750 Phil. 700, 717 (2015).
[22] *Coca-Cola Bottlers Philippines, Inc. v. Commissioner of Internal Revenue,* 826 Phil. 329, 346-347 (2018), citing *Sitel Philippines Corporation v. Commissioner of Internal Revenue,* 805 Phil. 464, 480-481 (2017).

Circular No. 202, series of 1999;[23] thus, the CTA Division accordingly cancelled the assessment for said item after a determination that BSP Circular No. 202, series of 1999, applies only to banks and not to respondent which is engaged in the business of processing and selling coconut oil and other products.[24] However, petitioner had alleged for the first time, in its appeal before the CTA *En Banc,* that respondent's interest expense was disallowed as a deduction from its gross income because it failed to comply with the requirements under Revenue Regulations No. 13-2000.[25]

Petitioner likewise failed to dispute or assail before the CTA *En Banc* the ruling of the CTA Division invalidating for lack of basis the disallowance of respondent's excess tax credits.[26] However, petitioner now avers before this Court that it disallowed respondent's excess tax credits in the amount of ₱11,852,215.56 because respondent failed to show that it had actually withheld and paid or remitted the alleged overpaid taxes to the BIR.

The Court cannot allow belated changes in petitioner's theory - issues and arguments not presented before the lower courts cannot be raised for the first time on appeal.[27] Introducing new matters and justifications for the disallowances at this stage of the proceedings is offensive to the rules of fair play, justice, and due process.[28] In the case of *Philippine Ports Authority v. City of Iloilo,*[29] the Court ruled:

> As a rule, a party who deliberately adopts a certain theory upon which the case is tried and decided by the lower court will not be permitted to change theory on appeal. Points of law, theories, issues and arguments not brought to the attention of the lower court need not be, and ordinarily will not be, considered by a reviewing court, as these cannot be raised for the first time at such late stage. Basic considerations of due process underlie this rule. It would be unfair to the adverse party who would have no opportunity to present further evidence material to the new theory,

- over -
73-A

---

[23] Section 4, BSP Circular No. 202, series of 1999 provides:

Sec. 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 therein are received.

[24] *Rollo,* p. 93.

[25] Id. at 63.

[26] Id. at 127.

[27] *Edison (Bataan) Cogeneration Corp. v. Commissioner of Internal Revenue,* 817 Phil. 495, 508 (2017); *Commissioner of Internal Revenue v. Euro-Philippines Airline Services, Inc.,* 836 Phil. 744, 751-752 (2018); *Del Rosario v. Bonga,* 402 Phil. 949, 957-958 (2001); *Commissioner of Internal Revenue v. Mirant Pagbilao Corporation,* 535 Phil. 481, 489 (2006).

[28] *Edison (Bataan) Cogeneration Corp. v. Commissioner of Internal Revenue,* id. at 508; *Manila Electric Company v. Benamira,* 501 Phil. 621, 638 (2005).

[29] 453 Phil. 927, 934-935 (2003); *see* also *Chinatrust (Phils.) Commercial Bank v. Turner,* 812 Phil. 1, 16-17 (2017).

> which it could have done had it been aware of it at the time of the hearing before the trial court. To permit petitioner in this case to change its theory on appeal would thus be unfair to respondent, and offend the basic rules of fair play, justice and due process. (citations omitted)

Furthermore, it is settled that the formal letter of demand and assessment notice shall state the facts, jurisprudence, and law on which the assessment was based.[30] In the case of *Commissioner of Internal Revenue v. Fitness by Design, Inc.*,[31] the Court ruled that informing the taxpayer of both the legal and factual bases of the assessment is mandatory, and that such requirement enables the taxpayer to make an effective protest or appeal of the assessment or decision. It is in line with the constitutional mandate that no person shall be deprived of his or her property without due process of law.

In the same vein, belatedly justifying an assessment based on factual or legal grounds not cited in the formal demand, nor raised before the CTA Division and/or the CTA *En Banc,* cannot be allowed in violation of respondent's constitutional right to due process.

There being no false or fraudulent return, the three-year period to assess deficiency VAT had already prescribed.

Petitioner contends that its right to assess respondent's deficiency VAT has not yet prescribed because respondent filed a false or fraudulent return, thus, the tax may be assessed within ten (10) years after the discovery of the falsity.

Petitioner maintains that the under-reporting of taxable sales through undeclared purchases and substantial under-declaration of income by overstating the deductions from the gross income clearly indicate the filing of false returns for VAT and income tax.[32] Petitioner also argues that the filing of a false or fraudulent return was evident from the final decision signed by former Commissioner Kim Jacinto Henares where she imposed a fifty percent (50%) surcharge against petitioner.

The Court disagrees.

- over -
73-A

---

[30] Section 3.1.4., BIR Revenue Regulations No. 12-99.
[31] 799 Phil. 391, 409-410 (2016).
[32] *Rollo*, p. 36.

According to Sec. 222(a),[33] in relation to Sec. 248(B),[34] of the 1997 Tax Code, as amended, the failure on the part of the taxpayer to report sales, and receipts of income in an amount exceeding thirty percent (30%) of what is declared in its returns, constitutes substantial under-declaration, which is a *prima facie* evidence of a false return. As the Court expounded in *Commissioner of Internal Revenue v. Asalus Corporation*:[35]

> 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.

The CTA *En Banc,* therefore, was correct in ruling that such presumption of falsity of returns cannot arise by mere assertion that the former Commissioner imposed surcharge against respondent.[36] In the absence of proof of substantially underdeclared sales, receipt, or income, the presumption of falsity of returns cannot be applied.

- over -

73-A

---

[33] SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* –
(a) 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: *Provided,* That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

[34] SEC. 248. *Civil Penalties.* – *x x x*
(B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: *Provided,* That a substantial under-declaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute *prima facie* evidence of a false or fraudulent return: *Provided, further,* That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial under-declaration of sales, receipts or income or for overstatement of deductions, as mentioned herein.

[35] 806 Phil. 397, 408-409 (2017).

[36] *Rollo,* p. 71, per CTA *En Banc* Decision.

Petitioner herein failed to establish that respondent had substantially underdeclared its sales, receipt, or income. Per petitioner's findings, respondent's *Taxable Sales per Investigation* amounted to ₱205,284,457.59 and its *Taxable Sales per Return* for the same period amounted only to ₱192,854,624.04. Petitioner thus claims that the difference of ₱12,429,815.55 could only mean that there were additional taxable sales on underdeclared purchases.[37] Assuming *arguendo* that petitioner's allegations are true, the amount still does not constitute 30% of the sales reported per VAT return, as shown below:

Taxable Sales per Return	**₱192,854,624.04**
Add: Undeclared Sales per CIR Recon	**12,429,815.55**
Remaining Vatable Sales per CIR Audit	₱205,284,457.59
Percentage of Assessed Additional Sales to Total Sales Reported per Return (₱12,429,815.55/ ₱192,854,624.04)	**6.44517%**

Since there is no substantial under-declaration of sales, there arises no *prima facie* evidence of false return which may warrant the application of the ten-year prescriptive period to assess. Thus, both the CTA *En Banc* and the CTA Division correctly held that the right of respondent to assess petitioner for deficiency VAT for CY 2007 had already prescribed in three (3) years.

WHEREFORE, the present appeal by *certiorari* of petitioner Commissioner of Internal Revenue is **DENIED** for lack of merit.

SO ORDERED." ***Lopez, M., J., on official leave.***

By authority of the Court:

LIBRADA C. BUENA
Division Clerk of Court

by:

MARIA TERESA B. SIBULO
Deputy Division Clerk of Court
73-A

- over -

[37] Id. at 35.

The Solicitor General
134 Amorsolo Street, Legaspi Village
1229 Makati City

LITIGATION DIVISION
BUREAU OF INTERNAL REVENUE
Room 703, BIR National Office Building
Agham Road, Diliman
1101 Quezon City

Court of Tax Appeals
National Government Center
Diliman, 1101 Quezon City
(CTA EB No. 1559)
(CTA Case No. 8613)

BADUEL ESPINA & ASSOCIATES
Counsel for Respondent
3rd Floor, GMC Plaza Building
Legaspi Extension cor. MJ Cuenco
Avenue, 6000 Cebu City

Public Information Office (x)
Library Services (x)
Supreme Court
(For uploading pursuant to A.M.
No. 12-7-1-SC)

Philippine Judicial Academy (x)
Supreme Court

Judgment Division (x)
Supreme Court

73-A

UR