

**SIGNIFICANT DECISIONS OF THE COURT OF TAX APPEALS
February 2014**

Assessment

1. A representative office is not liable for income tax and value-added tax.

Taxpayer is a representative office of Shinko Electric Industries Co., Ltd., a company organized and existing under the laws of Japan. It was assessed by the Bureau of Internal Revenue (BIR) for deficiency income tax and VAT for the fiscal year ending March 31, 2007. The assessment for deficiency income tax was due to disallowances of expenses as well as for alleged unexplained source of funds resulting to undeclared income. The assessment for VAT is also due to the alleged unexplained source of funds resulting to undeclared income.

Based on the definition of a representative office, it is fully subsidized by its head office. Its subsidy is in the form of foreign inward remittances from its head office abroad which is utilized to cover its expenses. In such case, the foreign inward remittance cannot be considered "income" or flow of wealth, but a subsidy. This subsidy represents a capital or fund which is distinct from income. It follows that unspent remittances, which must be considered a mere subsidy, should not be considered income subject to tax. With more reason, duly substantiated expenses paid out of the subsidy could not be considered part of taxable income. Hence, inasmuch as a representative office is not allowed to derive income from sources within the Philippines and is fully subsidized by its head office, it is not subject to Philippine income tax. Likewise, inasmuch as representative offices do not derive income from the Philippines and are fully subsidized by the head office, representative offices are exempt from VAT. **(Shinko Electric Industries Co., Ltd. vs. Commissioner of Internal Revenue, CTA Case No. 8213, February 10, 2014)**

2. Non-issuance of a preliminary assessment notice is a violation of due process, which makes the assessment void.

Taxpayer was assessed by the BIR for deficiency taxes, for which Final Assessment Notices (FAN) and Formal Letter of Demand (FLD) were issued. Later, a preliminary collection letter (PCL) was issued by the Commissioner of Internal Revenue and later a Final Notice Before Seizure. The taxpayer then filed a petition for review before the CTA. One of the arguments of the taxpayer is that the FAN and the PCL are null and void since it never received a preliminary assessment notice (PAN).

According to the Court, except in cases where a prior notice of assessment is not required, a PAN is a vital component or an indispensable requirement before the BIR can issue a FAN/FLD. The used of the word "shall" is imperative, operating to impose a duty which should be enforced.

Accordingly, in the absence of proof of receipt by the taxpayer of the PAN, it was not accorded due process in the issuance of assessment. **(SVI Information Services Corporation vs. Commissioner of Internal Revenue, CTA Case No. 8496, February 10, 2014)**

3. Falsity must be established by clear and sufficient evidence to warrant the application of the 10-year prescriptive period for the assessment of taxes.

Taxpayer was assessed by the BIR for various deficiency taxes. Among the arguments raised by the taxpayer against the assessment is that it had prescribed, having been issued beyond the three-year prescriptive period for the issuance of an assessment. On the part of the BIR, it argued that the declarations in the tax returns were deficient and did not disclose the truth regarding the correct amount of income subject to tax, thus, it rendered the subject returns “false”. As such, the taxpayer may be assessed within ten (10) years from the discovery of said falsity.

Citing the case of *Aznar vs. Court of Appeals*¹, the Court ruled that mere falsity of a return does not merit the application of the 10-year prescriptive period, unless it can be shown that the return was made with a design to mislead or deceive on the part of the taxpayer, or at the very least show culpable negligence. The BIR merely relied on the tax returns, as well as the financial statements and trial balance to substantiate its claim that the returns submitted were false. This is not enough to merit the application of the 10-year period. Such falsity must be established by clear and sufficient evidence. **(ESS Manufacturing Company, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 7958, February 14, 2014)**

4. Absent any explanation regarding the factual basis of the results of the surveillance, the taxpayer cannot be deemed to be informed about the basis of the assessment.

Taxpayer received from the BIR a 48-Hour Notice alleging that the BIR conducted a 10-day surveillance, as a result of which, taxpayer was found liable for deficiency VAT. Taxpayer filed its explanation arguing that it is not liable for the alleged deficiency VAT. Subsequently, taxpayer received a 5-Day VAT Compliance Notice (VCN) reiterating demand for payment of the alleged deficiency VAT. After the BIR denied the taxpayer’s plea and holding the latter liable for the alleged deficiency VAT, taxpayer filed a petition for review before the CTA. The taxpayer argued that the assessment is without basis.

The CTA agreed with the taxpayer. According to the CTA, the 5-Day VCN, on its face, shows that it did not state the provisions violated by the taxpayer, in contravention of the requirements in RMO 003-09. Also, the 48-Hour Notice and the 5-Day VCN did not provide details of the findings of the investigating office. This failed to sufficiently inform the taxpayer of the issues/violations that should be rectified. The Court also noted that it cannot determine the basis of the BIR’s findings regarding the sales amounts during the surveillance period. The BIR did not describe how the surveillance was conducted nor did it explain the methods used in arriving at the estimates. Without such information, the sales amounts used cannot be considered as *prima facie* valid as they appear to have been arrived at without any basis. Absent any explanation regarding the factual basis of the results of the surveillance, the taxpayer cannot be deemed to be informed about the basis of the assessment. **(Eric Auxiliary Services**

¹ G.R. No. L-20569, August 23, 194

Corporation/Sacred Heart Gas Station vs. Commissioner of Internal Revenue, CTA Case No. 8315, February 17, 2014)

Tax Refund

5. Import entry and internal revenue declarations are required to be machine validated as proof of payment of tax.

Taxpayer's claim for refund of input taxes were denied on the ground, among others, that the import entry and internal revenue declarations (IEIRD) were not machine validated. On appeal to the Court *En Banc*, taxpayer argued that Sections 110(A) and 113(A) of the NIRC and Section 4.110-8 and 4.113-1 of Revenue Regulations No. 16-2005 do not require that IEIRDs should be machine validated.

The Court agreed that Sections 110(A) and 113(A) of the NIRC and Section 4.110-8 and 4.113-1 of Revenue Regulations No. 16-2005 do not require IEIRDs to be machine validated. However, paragraphs 2.3 and 2.3.1 of Customs Order No. 2-95, dated September 8, 1995, require IEIRDs to be machine validated as proof of payment. Therefore, the IEIRDs must be machine validated in order to be considered as proof. **(Philex Mining Corporation vs. Commissioner of Internal Revenue, CTA EB Case No. 939, February 12, 2014)**

Jurisdiction of the Court

6. The CTA has jurisdiction to entertain a petition seeking the annulment of a Forty Eight Hour Notice and Five Day VAT Compliance Notice.

Taxpayer received from the BIR a 48-Hour Notice alleging that the BIR conducted a 10-day surveillance, as a result of which, taxpayer was found liable for deficiency VAT. Taxpayer filed its explanation arguing that it is not liable for the alleged deficiency VAT. Subsequently, taxpayer received a 5-Day VAT Compliance Notice (VCN) reiterating demand for payment of the alleged deficiency VAT. After the BIR denied the taxpayer's plea and holding the latter liable for the alleged deficiency VAT, taxpayer filed a petition for review before the CTA. The BIR argued, among others, that the case is not within the jurisdiction of the CTA since the 48-Hour Notice and the 5-Day VCN should not be treated as assessment notice.

According to the CTA, its jurisdiction is not limited to cases involving disputed assessment but also decisions over "other matters". The term "other matters" would refer to those cases which do not necessarily involve disputed assessments or refunds but controversies arising under the NIRC or other laws administered by the BIR. The subject matter of the case involves the nullification of the 48-Hour Notice and 5-DAY VCN. They were issued pursuant to the power of the Commissioner under the NIRC. The controversy falls within the meaning of "other matters". **(Elric Auxiliary Services Corporation/Sacred Heart Gas Station vs. Commissioner of Internal Revenue, CTA Case No. 8315, February 17, 2014)**