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of Court of the MTC, Sta. Cruz, Laguna, and to furnish the FMD, CMO, OCA with a copy of the machine validated deposit slip as proof of partial restitution of the shortages incurred in the Fiduciary Fund account, in order to finalize the herein audit.

Elizabeth R. Tengco, former Clerk of Court II of the Municipal Trial Court, Sta. Cruz, Laguna, is **DIRECTED** within ten (10) days from notice to **PAY and DEPOSIT** the amount of ₱774,603.91, ₱569,851.39, ₱124,595.40, ₱64,866.00, and ₱1,000.00 representing shortages in the Clerk of Court Fiduciary Fund, Judiciary Development Fund, Special Allowance for the Judiciary Fund, General Fund, and Mediation Fund, respectively, or a total of **₱1,534,916.70** by depositing said amounts to their respective accounts.

The Legal Division of the Office of the Court Administrator is likewise **DIRECTED to INITIATE** appropriate criminal proceedings against respondent Tengco, with deliberate dispatch.

SO ORDERED.

Sereno, C.J. (Chairperson), Perlas-Bernabe, and *Caguioa, JJ.,* concur.

Del Castillo, J., on official leave.

SECOND DIVISION

[G.R. No. 183408. July 12, 2017]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **LANCASTER PHILIPPINES, INC.**, *respondent.*

SYLLABUS

1. TAXATION; COURT OF TAX APPEALS (CTA); REPUBLIC ACT NO. 1125 (AN ACT CREATING THE COURT OF

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TAX APPEALS); JURISDICTION OF THE COURT OF TAX APPEALS; THE JURISDICTION OF THE CTA IS NOT LIMITED ONLY TO CASES WHICH INVOLVE DECISIONS OR INACTIONS OF THE COMMISSIONER OF INTERNAL REVENUE (CIR) ON MATTERS RELATING TO ASSESSMENTS OR REFUNDS BUT ALSO INCLUDES OTHER CASES ARISING FROM THE NATIONAL INTERNAL REVENUE CODE (NIRC) OR RELATED LAWS ADMINISTERED BY THE BUREAU OF INTERNAL REVENUE (BIR).— The law vesting unto the CTA its jurisdiction is Section 7 of Republic Act No. 1125 *(R.A. No. 1125)* x x x. Under the aforecited provision, the jurisdiction of the CTA is not limited only to cases which involve decisions or inactions of the CIR on matters relating to assessments or refunds but also includes other cases arising from the NIRC or related laws administered by the BIR. Thus, for instance, we had once held that the question of whether or not to impose a deficiency tax assessment comes within the purview of the words "*other matters arising under the National Internal Revenue Code*." The jurisdiction of the CTA on such ***other matters arising under the NIRC*** was retained under the amendments introduced by R.A No. 9282.

2. ID.; ID.; ID.; ID.; ISSUE ON WHETHER THE REVENUE OFFICERS WHO HAD CONDUCTED THE EXAMINATION ON THE TAXPAYER EXCEEDED THEIR AUTHORITY PURSUANT TO THE LETTER OF AUTHORITY MAY BE CONSIDERED AS COVERED BY THE TERMS "OTHER MATTERS" UNDER SECTION 7 OF R.A. NO. 1125, AS AMENDED.— It must be stressed that the assessment of internal revenue taxes is one of the duties of the BIR. x x x. In connection therewith, the CIR may authorize the examination of any taxpayer and correspondingly make an assessment whenever necessary. Thus, to give more teeth to such power of the CIR, to make an assessment, the NIRC authorizes the CIR to examine any book, paper, record, or data of any person. The powers granted by law to the CIR are intended, among other things, to determine the liability of any person for any national internal revenue tax. It is pursuant to such pertinent provisions of the NIRC conferring the powers to the CIR that the petitioner (CIR) had, in this case, authorized its revenue officers to conduct an examination of the books of

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account and accounting records of Lancaster, and eventually issue a deficiency assessment against it. From the foregoing, it is clear that the issue on whether the revenue officers who had conducted the examination on Lancaster exceeded their authority pursuant to LOA No. 00012289 may be considered as covered by the terms "other matters" under Section 7 of R.A. No. 1125 or its amendment, R.A. No. 9282. The authority to make an examination or assessment, being a matter provided for by the NIRC, is well within the exclusive and appellate jurisdiction of the CTA.

3. **ID.; ID.; ID; ID.; THE COURT OF TAX APPEALS IS NOT BOUND BY THE ISSUES SPECIFICALLY RAISED BY THE PARTIES BUT MAY ALSO RULE UPON RELATED ISSUES NECESSARY TO ACHIEVE AN ORDERLY DISPOSITION OF THE CASE.—** Under Section 1, Rule 14 of A.M. No. 05-11-07-CTA, or the Revised Rules of the Court of Tax Appeals, the CTA is not bound by the issues specifically raised by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case. The text of the provision reads: SECTION 1. *Rendition of judgment*. – x x x In deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case. The above section is clearly worded. On the basis thereof, the CTA Division was, therefore, well within its authority to consider in its decision the question on the scope of authority of the revenue officers who were named in the LOA even though the parties had not raised the same in their pleadings or memoranda, The CTA En Banc was likewise correct in sustaining the CTA Division's view concerning such matter.

4. **ID.; NATIONAL INTERNAL REVENUE CODE (NIRC); TAX ASSESSMENT; A VALID LETTER OF AUTHORITY (LOA) DOES NOT NECESSARILY CLOTHE VALIDITY TO AN ASSESSMENT ISSUED ON IT, AS WHEN THE REVENUE OFFICERS DESIGNATED IN THE LOA ACT IN EXCESS OR OUTSIDE OF THE AUTHORITY GRANTED THEM UNDER SAID LOA; AN ASSESSMENT ISSUED AGAINST A TAXPAYER IS VOID, WHERE THE TAXABLE YEAR COVERED BY THE ASSESSMENT IS OUTSIDE OF THE PERIOD SPECIFIED IN THE LOA.—** The audit process normally commences with the issuance by

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the CIR of a Letter of Authority. The LOA gives notice to the taxpayer that it is under investigation for possible deficiency tax assessment; at the same time it authorizes or empowers a designated revenue officer to examine, verify, and scrutinize a taxpayer's books and records, in relation to internal revenue tax liabilities for a ***particular period***. x x x. [A] valid LOA does not necessarily clothe validity to an assessment issued on it, as when the revenue officers designated in the LOA act in excess or outside of the authority granted them under said LOA. [I]n the earlier case of *CIR v. Sony, Phils., Inc.*, we affirmed the cancellation of a deficiency VAT assessment because, while the LOA covered "***the period 1997*** *and unverified prior years*, " the said deficiency was arrived at based on the records of a later year, from ***January to March 1998***, or using the fiscal year which ended on 31 March 1998. x x x. The present case is no different from *Sony* in that the subject LOA specified that the examination should be for the taxable year 1998 only but the subsequent assessment issued against Lancaster involved disallowed expenses covering the next fiscal year, or the period ending 31 March 1999. x x x. The taxable year covered by the assessment being outside of the period specified in the LOA in this case, the assessment issued against Lancaster is, therefore, void.

5. ID.; ID.; ACCOUNTING METHODS; THE NIRC DOES NOT PRESCRIBE A UNIFORM, OR SPECIFIC, METHOD OF ACCOUNTING; THUS, THE TAXPAYER MAY ADOPT OTHER METHODS OF ACCOUNTING APPROVED BY THE CIR, EVEN WHEN NOT EXPRESSLY MENTIONED IN THE NIRC, IF SUCH METHOD WOULD ENABLE THE TAXPAYER TO PROPERLY REFLECT ITS INCOME; THE CROP METHOD OF ACCOUNTING IS AUTHORIZED UNDER RAM NO. 2-95.— An accounting method is a "set of rules for determining when and how to report income and deductions." The provisions under Chapter VIII, Title II of the NIRC cited above enumerate the methods of accounting that the law expressly recognizes, to wit: (1) Cash basis method; (2) Accrual method; (3) Installment method; (4) Percentage of completion method; and (5) Other accounting methods. Any of the foregoing methods may be employed by any taxpayer so long as it reflects its income properly and such method is used regularly. The peculiarities of the business or occupation engaged in by a taxpayer would

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largely determine how it would report incomes and expenses in its accounting books or records. The NIRC does not prescribe a uniform, or even specific, method of accounting. Too, other methods approved by the CIR, even when not expressly mentioned in the NIRC, may be adopted if such method would enable the taxpayer to properly reflect its income. Section 43 of the NIRC authorizes the CIR to allow the use of a method of accounting that in its opinion would clearly reflect the income of the taxpayer. An example of such method not expressly mentioned in the NIRC, but duly approved by the CIR, is the **'crop method of accounting'** authorized under RAM No. 2-95.

6. ID.; ID.; ID.; ID.; A TAXPAYER IS AUTHORIZED TO EMPLOY WHAT IT FINDS SUITABLE FOR ITS PURPOSE SO LONG AS IT CONSISTENTLY DOES SO.— The crop method recognizes that the harvesting and selling of crops do not fall within the same year that they are planted or grown. This method is especially relevant to farmers, or those engaged in the business of producing crops who, pursuant to RAM No. 2-95, would then be able to compute their taxable income on the basis of their crop year. On when to recognize expenses as deductions against income, the governing rule is found in the second sentence of Subsection F cited above. The rule enjoins the recognition of the expense (or the deduction of the cost) of crop production *in the year that the crops are sold* (when income is realized). In the present case, we find it wholly justifiable for Lancaster, as a business engaged in the production and marketing of tobacco, to adopt the crop method of accounting. A taxpayer is authorized to employ what it finds suitable for its purpose so long as it consistently does so, and in this case, Lancaster does appear to have utilized the method regularly for many decades already. Considering that the crop year of Lancaster starts from October up to September of the following year, it follows that all of its expenses in the crop production made within the crop year starting from October 1997 to September 1998, including the February and March 1998 purchases covered by purchase invoice vouchers, are rightfully deductible for income tax purposes in the year when the gross income from the crops are realized.

7. ID.; ID.; ID.; ID.; RAM NO. 2-95; DOES NOT STRICTLY REQUIRE THAT FOR THE EXPENSE TO BE DEDUCTIBLE, THE INCOME TO WHICH SUCH

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EXPENSE IS RELATED TO BE REALIZED IN THE SAME YEAR THAT IT IS PAID OR INCURRED.— In essence, the matching concept, which is one of the generally accepted accounting principles, directs that the expenses are to be reported in the same period that related revenues are earned. It attempts to match revenue with expenses that helped earn it. The CIR posits that Lancaster should not have recognized in FY 1999 the purchases for February and March 1998. Apparent from the reasoning of the CIR is that such expenses ought to have been deducted in FY 1998, when they were supposed to be paid or incurred by Lancaster. In other words, the CIR is of the view that the subject purchases match with revenues in 1998, not in 1999. A reading of RAM No. 2-95, however, clearly evinces that it conforms with the concept that the expenses *paid* or *incurred* be deducted in the year in which gross income from the sale of the crops is *realized*. Put in another way, the expenses are matched with the related incomes which are eventually earned. Nothing from the provision is it strictly required that for the expense to be deductible, the income to which such expense is related to be realized in the same year that it is *paid* or *incurred*. As noted by the CTA, the crop method is an unusual method of accounting, unlike other recognized accounting methods that, by mandate of Sec. 45 of the NIRC, strictly require expenses be taken in the same taxable year when the income is '*paid* or *incurred*,' or '*paid or accrued*,' depending upon the method of accounting employed by the taxpayer.

8. ID.; ID.; ID.; REVENUE MEMORANDUM CIRCULAR (RMC) NO. 22-04; WHERE THERE IS CONFLICT BETWEEN THE NIRC INCLUDING ITS IMPLEMENTING RULES AND REGULATIONS, ON ACCOUNTING METHODS AND THE GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP), THE FORMER SHALL PREVAIL; THE RAM NO. 2-95 PREVAILS OVER ANY GAAP, INCLUDING THE MATCHING CONCEPT AS APPLIED IN FINANCIAL OR BUSINESS ACCOUNTING.— Even if we were to accept the notion that applying the 1998 purchases as deductions in the fiscal year 1998 conforms with the generally accepted principle of matching cost against revenue, the same would still not lend any comfort to the CIR. Revenue Memorandum Circular *(RMC)* No. 22-04, entitled "*Supplement to Revenue Memorandum Circular*

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No. 44-2002 on Accounting Methods to be Used by Taxpayers for Internal Revenue Tax Purposes" dated 12 April 2004, commands that where there is conflict between the provisions of the Tax Code (NIRC), including its implementing rules and regulations, on accounting methods and the generally accepted accounting principles, the former shall prevail. RAM No. 2-95 is clear-cut on the rule on when to recognize deductions for taxpayers using the crop method of accounting. The rule prevails over any GAAP, including the matching concept as applied in financial or business accounting.

APPEARANCES OF COUNSEL

BIR Litigation Division for petitioner.
Ricardo R. Querrer, Jr. for respondent.

D E C I S I O N

MARTIRES, *J.*:

This is a Petition for Review on Certiorari[1] under Rule 45 of the Rules of Court seeking to reverse and set aside the 30 April 2008 Decision[2] and 24 June 2008 Resolution[3] of the Court of Tax Appeals (*CTA*) En Banc in CTA EB No. 352.

The assailed decision and resolution affirmed the 12 September 2007 Decision[4] and 12 December 2007 Resolution[5] of the CTA First Division *(CTA Division)* in CTA Case No. 6753.

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[1] *Rollo,* pp. 8-26.

[2] *Id*. at 28-44; Penned by Associate Justice Olga Palanca-Enriquez, and concurred in by Presiding Justice Ernesto D. Acosta, Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista and Caesar A. Casanova. Associate Justice Erlinda P. Uy was on official business.

[3] *Id*. at 46-47.

[4] *Id*. at 48-56; Penned by Presiding Justice Ernesto D. Acosta, and concurred in by Associate Justices Lovell R. Bautista and Caesar A. Casanova.

[5] *Id*. at 58-60.

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THE FACTS

The facts[6] are undisputed.

Petitioner Commissioner of Internal Revenue *(CIR)* is authorized by law, among others, to investigate or examine and, if necessary, issue assessments for deficiency taxes.

On the other hand, respondent Lancaster Philippines, Inc. *(Lancaster)* is a domestic corporation established in 1963 and is engaged in the production, processing, and marketing of tobacco.

In 1999, the Bureau of Internal Revenue *(BIR)* issued Letter of Authority (*LOA*) No. 00012289 authorizing its revenue officers to examine Lancaster's books of accounts and other accounting records for all internal revenue taxes due from ***taxable year 1998 to an unspecified date***. The LOA reads:

SEPT. 30 1999

LETTER OF AUTHORITY

LANCASTER PHILS. INC.
11th Flr. Metro Bank Plaza
Makati City

SIR/MADAM/GENTLEMEN:

The bearer(s) hereof RO's Irene Goze & Rosario Padilla to be supervised by GH Catalina Leny Barrion of the Special Team created pursuant to RSO 770-99 is/are authorized to examine your books of accounts and other accounting records for all internal revenue taxes for the period from taxable year, 1998 to _____, 19__. He is/[t]hey are provided with the necessary identification card(s) which shall be presented to you upon request.

It is requested that all facilities be extended to the Revenue Officer(s) in order to expedite the examination.

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[6] The salient portions are culled from the CTA *En Banc* Decision.

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You will be duly informed of the results of the examination upon approval of the report submitted by the aforementioned Revenue Officer(s).[7]

After the conduct of an examination pursuant to the LOA, the BIR issued a *Preliminary Assessment Notice (PAN)*[8] which cited Lancaster for: 1) overstatement of its purchases for the ***fiscal year April 1998*** to ***March 1999***; and 2) noncompliance with the generally accepted accounting principle of proper matching of cost and revenue.[9] More concretely, the BIR disallowed the purchases of tobacco from farmers covered by Purchase Invoice Vouchers (PIVs) for the months of ***February*** and ***March 1998*** as deductions against income for the ***fiscal year April 1998*** to ***March 1999***. The computation of Lancaster's tax deficiency, with the details of discrepancies, is reproduced below:

INCOME TAX:	
Taxable Income per ITR	-0-
Add: Adjustments-Disallowed purchases	11,496,770.18
Adjusted Taxable Income per Investigation	₱11,496,770.18
INCOME TAX DUE – Basic	
April 1 – December 31, 1998 (9/12 x ₱11,496,770.18 x 34%)	₱ 2,913,676.4
January 1 – March 31, 1999 (3/12 x ₱11,496,770.18 x 33%)	948,483.54
Income tax still due per investigation	₱ 3,880,159.94
Interest (6/15/99 to 10/15/02) .66	2,560,905.56
Compromise Penalty	25,000
TOTAL DEFICIENCY INCOME TAX	**₱ 6,466,065.50**

[7] *Rollo*, p. 36.

[8] *Id*. at 30 and 49; The PAN was received by Lancaster on 19 September 2002.

[9] Records, p. 71; Joint Stipulation of Facts.

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DETAILS OF DISCREPANCIES
Assessment No. LTAID II-98-00007

A. INCOME TAX (₱3,880,159.94) – Taxpayer's fiscal year covers April 1998 to March 1999. Verification of the books of accounts and pertinent documents disclosed that there was an overstatement of purchases for the year. Purchase Invoice Vouchers (PIVs) for February and March 1998 purchases amounting to ₱11,496,770.18 were included as part of purchases for taxable year 1998 in violation of Section 45 of the National Internal Revenue Code in relation to Section 43 of the same and Revenue Regulations No. 2 which states that the Crop-Basis method of reporting income may be used by a **farmer** engaged in producing crops which take more than one (1) year from the time of planting to the time of gathering and disposing of crop, in such a case, the entire cost of producing the crop must be taken as deduction in the year in which the gross income from the crop is realized and that the taxable income should be computed upon the basis of the taxpayer's annual accounting period, (fiscal or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping with the books of the taxpayer. Furthermore, it did not comply with the generally accepted principle of proper matching of cost and revenue.[10]

Lancaster replied[11] to the PAN contending, among other things, that for the past decades, it has used an entire ***'tobacco-cropping season'*** to determine its total purchases covering a one-year period from ***1 October*** up to ***30 September of the following year*** (as against its fiscal year which is from ***1 April*** up to ***31 March of the following year***); that it has been adopting the 6-month timing difference to conform to the matching concept (of cost and revenue); and that this has long been installed as part of the company's system and consistently applied in its accounting books.[12]

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[10] *Rollo*, pp. 37-38.

[11] Records, p. 71; Lancaster filed its Reply to the PAN on 3 October 2002.

[12] *Id*.

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Invoking the same provisions of the law cited in the assessment, *i.e.*, Sections 43[13] and 45[14] of the National Internal Revenue Code *(NIRC)*, in conjunction with Section 45[15] of Revenue Regulation No. 2, as amended, Lancaster argued that the February and March 1998 purchases should not have been disallowed. It maintained that the situation of farmers engaged in producing tobacco, like Lancaster, is unique in that the costs, *i.e.*, purchases, are taken as of a different period and posted in the year in which the gross income from the crop is realized. Lancaster concluded that it correctly posted the subject purchases in the fiscal year ending March 1999 as it was only in this year that the gross income from the crop was realized.

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[13] SECTION 43. *General Rule*. – The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income.

If the taxpayer's annual accounting period is other than a fiscal year, as defined in Section 22(Q), or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the taxable income shall be computed on the basis of the calendar year.

[14] SECTION 45. *Period for which Deductions and Credits Taken*. –The deductions provided for in this Title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed, ***unless in order to clearly reflect the income, the deductions should be taken as of a different period***.

In the case of the death of a taxpayer, there shall be allowed as deductions for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period. (emphasis supplied)

[15] If a farmer is engaged in producing crops which takes more than a year from the time of planting to the time of gathering and disposing, the income therefrom may be computed upon the ***crop basis***; but in any such cases ***the entire cost of producing the crop must be taken as a deduction in the year in which the gross income from the crop is realized***. (underscoring supplied)

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Subsequently on 6 November 2002, Lancaster received from the BIR a final assessment notice *(FAN)*,[16] captioned *Formal Letter of Demand and Audit Result/Assessment Notice LTAID II IT-98-00007*, dated 11 October 2002, which assessed Lancaster's deficiency income tax amounting to ₱11,496,770.18, as a consequence of the disallowance of purchases claimed for the ***taxable year ending 31 March 1999***.

Lancaster duly protested[17] the FAN. There being no action taken by the Commissioner on its protest, Lancaster filed on 21 August 2003 a petition for review[18] before the CTA Division.

The Proceedings before the CTA

In its petition before the CTA Division, Lancaster essentially reiterated its arguments in the protest against the assessment, maintaining that the tobacco purchases in February and March 1998 are deductible in its fiscal year ending 31 March 1999.

The issues[19] raised by the parties for the resolution of the CTA Division were:

I

WHETHER OR NOT PETITIONER COMPLIED WITH THE GENERALLY ACCEPTED ACCOUNTING PRINCIPLE OF PROPER MATCHING OF COST AND REVENUE;

II

WHETHER OR NOT THE DEFICIENCY TAX ASSESSMENT AGAINST PETITIONER FOR THE TAXABLE YEAR 1998 IN THE AGGREGATE AMOUNT OF ₱6,466,065.50 SHOULD BE CANCELLED AND WITHDRAWN BY RESPONDENT.

After trial, the CTA Division granted the petition of Lancaster, disposing as follows:

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[16] Exhibit folder; Exhibit "I".

[17] Records, pp. 17-19.

[18] *Id*. at 1-9.

[19] *Id*. at 152-153 and 162.

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IN VIEW OF THE FOREGOING, the subject Petition for Review is hereby **GRANTED.** Accordingly, respondent is **ORDERED** to **CANCEL** and **WITHDRAW** the deficiency income tax assessment issued against petitioner under Formal Letter of Demand and Audit Result/Assessment Notice No. LTAID II IT-98-00007 dated October 11, 2002, in the amount of **₱6,466,065.50**, covering the fiscal year from April 1, 1998 to March 31, 1999.[20]

The CIR moved[21] but failed to obtain reconsideration of the CTA Division ruling.[22]

Aggrieved, the CIR sought recourse[23] from the CTA En Banc to seek a reversal of the decision and the resolution of the CTA Division.

However, the CTA En Banc found no reversible error in the CTA Division's ruling, thus, it affirmed the cancellation of the assessment against Lancaster. The dispositive portion of the decision of the CTA En Banc states:

WHEREFORE, premises considered, the present Petition for Review is hereby **DENIED DUE COURSE,** and, accordingly **DISMISSED** for lack of merit.[24]

The CTA En Banc likewise denied[25] the motion for reconsideration from its Decision.

Hence, this petition.

The CIR assigns the following errors as committed by the CTA En Banc:

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[20] *Rollo*, p. 56.

[21] *Id*. at 32. The CIR filed the "Motion for Reconsideration" on 2 October 2007.

[22] *Id*. at 33. The CTA Division denied, through a Resolution, the CIR's "Motion for Reconsideration" on 12 December 2007.

[23] *Id*. The CIR filed the "Petition for Review" before the CTA *En Banc*.

[24] *Id*. at 43.

[25] *Id*. at 46-47. The CTA *En Banc* issued the assailed Resolution on 24 June 2008.

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I.

THE COURT OF TAX APPEALS EN BANC ERRED IN HOLDING THAT PETITIONER'S REVENUE OFFICERS EXCEEDED THEIR AUTHORITY TO INVESTIGATE THE PERIOD NOT COVERED BY THEIR LETTER OF AUTHORITY.

II.

THE COURT OF TAX APPEALS EN BANC ERRED IN ORDERING PETITIONER TO CANCEL AND WITHDRAW THE DEFICIENCY ASSESSMENT ISSUED AGAINST RESPONDENT.[26]

THE COURT'S RULING

We deny the petition.

I.

The CTA En Banc did not err when it ruled that the BIR revenue officers had exceeded their authority.

To support its first assignment of error, the CIR argues that the revenue officers did not exceed their authority when, upon examination (of the Lancaster's books of accounts and other accounting records), they verified that Lancaster made purchases for February and March of 1998, which purchases were not declared in the latter's fiscal year from 1 April 1997 to 31 March 1998. Additionally, the CIR posits that Lancaster did not raise the issue on the scope of authority of the revenue examiners at any stage of the proceedings before the CTA and, consequently, the CTA had no jurisdiction to rule on said issue.

On both counts, the CIR is mistaken.

A. The Jurisdiction of the CTA

Preliminarily, we shall take up the CTA's jurisdiction to rule on the issue of the scope of authority of the revenue officers to conduct the examination of Lancaster's books of accounts and accounting records.

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[26] *Id*. at 18.

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The law vesting unto the CTA its jurisdiction is Section 7 of Republic Act No. 1125 *(R.A. No. 1125)*,[27] which in part provides:

Section 7. *Jurisdiction*. – The Court of Tax Appeals shall exercise exclusive appellate jurisdiction to review by appeal, as herein provided:

> (1) Decisions of the Collector of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto, or ***other matters*** arising under the National Internal Revenue Code or other law or part of law administered by the Bureau of Internal Revenue; x x x (emphasis supplied)

Under the aforecited provision, the jurisdiction of the CTA is not limited only to cases which involve decisions or inactions of the CIR on matters relating to assessments or refunds but also includes other cases arising from the NIRC or related laws administered by the BIR.[28] Thus, for instance, we had once held that the question of whether or not to impose a deficiency tax assessment comes within the purview of the words *"other matters arising under the National Internal Revenue Code."*[29]

The jurisdiction of the CTA on such ***other matters arising under the NIRC*** was retained under the amendments introduced by R.A No. 9282.[30] Under R.A. No. 9282, Section 7 now reads:

Sec. 7. *Jurisdiction*. — The CTA shall exercise:

a. Exclusive appellate jurisdiction to review by appeal, as herein provided:

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[27] Approved on 16 June 1954. The petition of Lancaster before the CTA Division was filed on 21 August 2003, or prior to the amendment of R.A. No. 1125.

[28] See *CIR v. Hambrecht & Quist Philippines, Inc.*, 649 Phil. 446, 455 (2010).

[29] See *Meralco Securities Corp. v. Savellano,* 203 Phil. 173 (1982).

[30] Approved on 30 March 2004, the law expanded the jurisdiction of the CTA and elevated its rank to a collegiate court, with the same rank as the Court of Appeals. R.A. No. 9282 was already in effect at the time the assailed decisions of the CTA Division and CTA En Banc were promulgated.

> 1. Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or ***other matters*** arising under the National Internal Revenue or other laws administered by the Bureau of Internal Revenue;
>
> 2. Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or ***other matters*** arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period of action, in which case the inaction shall be deemed a denial; x x x." (emphasis supplied)

Is the question on the authority of revenue officers to examine the books and records of any person cognizable by the CTA?

It must be stressed that the assessment of internal revenue taxes is one of the duties of the BIR. Section 2 of the NIRC states:

> Sec. 2. *Powers and Duties of the Bureau of Internal Revenue*. – The Bureau of Internal Revenue shall be under the supervision and control of the Department of Finance and its powers and duties shall comprehend the ***assessment*** and collection of all national internal revenue taxes, fees, and charges, and the enforcement of all forfeitures, penalties, and fines connected therewith, including the execution of judgments in all cases decided in its favor by the Court of Tax Appeals and the ordinary courts.
>
> The Bureau shall give effect to and administer the supervisory and police powers conferred to it by this Code or other laws. (emphasis supplied)

In connection therewith, the CIR may authorize the examination of any taxpayer and correspondingly make an assessment whenever necessary.[31] Thus, to give more teeth to

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[31] Section 6 of the NIRC provides:

> Sec. 6. *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement*. –

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such power of the CIR, to make an assessment, the NIRC authorizes the CIR to examine any book, paper, record, or data of any person.[32] The powers granted by law to the CIR are intended, among other things, to determine the liability of any person for any national internal revenue tax.

It is pursuant to such pertinent provisions of the NIRC conferring the powers to the CIR that the petitioner (CIR) had, in this case, authorized its revenue officers to conduct an examination of the books of account and accounting records of Lancaster, and eventually issue a deficiency assessment against it.

From the foregoing, it is clear that the issue on whether the revenue officers who had conducted the examination on Lancaster exceeded their authority pursuant to LOA No. 00012289 may be considered as covered by the terms "other matters" under Section 7 of R.A. No. 1125 or its amendment, R.A. No. 9282. The authority to make an examination or assessment, being a matter provided for by the NIRC, is well within the exclusive and appellate jurisdiction of the CTA.

On whether the CTA can resolve an issue which was not raised by the parties, we rule in the affirmative.

(A) Examination of Return 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.

[32] Sec. 5 of the NIRC provides:

Sec. 5. *Power of the Commissioner to Obtain Information, and to Summon, Examine, and Take Testimony of Persons*. – In ascertaining the correctness of any return, or in making a return when none has been made, or in determining the liability of any person for any internal revenue tax, or in collecting any such liability, or in evaluating tax compliance, the Commissioner is authorized:

(A) To examine any book, paper, record, or other data which may be relevant or material to such inquiry; x x x

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Under Section 1, Rule 14 of A.M. No. 05-11-07-CTA, or the Revised Rules of the Court of Tax Appeals,[33] the CTA is not bound by the issues specifically raised by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case. The text of the provision reads:

> SECTION 1. *Rendition of judgment.* – x x x
>
> In deciding the case, the Court may not limit itself to the issues stipulated by the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case.

The above section is clearly worded. On the basis thereof, the CTA Division was, therefore, well within its authority to consider in its decision the question on the scope of authority of the revenue officers who were named in the LOA even though the parties had not raised the same in their pleadings or memoranda. The CTA En Banc was likewise correct in sustaining the CTA Division's view concerning such matter.

B. The Scope of the Authority of the Examining Officers

In the assailed decision of the CTA Division, the trial court observed that LOA No. 00012289 authorized the BIR officers to examine the books of account of Lancaster for the taxable year 1998 only or, since Lancaster adopted a fiscal year *(FY)*, for the period ***1 April 1997*** to ***31 March 1998***. However, the deficiency income tax assessment which the BIR eventually issued against Lancaster was based on the disallowance of expenses reported in ***FY 1999***, or for the period ***1 April 1998*** to ***31 March 1999***. The CTA concluded that the revenue examiners had exceeded their authority when they issued the assessment against Lancaster and, consequently, declared such assessment to be without force and effect.

We agree.

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[33] Took effect on 15 December 2005, or before C.T.A. Case No. 6753 was submitted for decision.

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The audit process normally commences with the issuance by the CIR of a Letter of Authority. The LOA gives notice to the taxpayer that it is under investigation for possible deficiency tax assessment; at the same time it authorizes or empowers a designated revenue officer to examine, verify, and scrutinize a taxpayer's books and records, in relation to internal revenue tax liabilities for a ***particular period***.[34]

In this case, a perusal of LOA No. 00012289 indeed shows that the period of examination is the taxable year 1998. For better clarity, the pertinent portion of the LOA is again reproduced, thus:

> The bearer(s) hereof x x x is/are authorized to examine your books of accounts and other accounting records for all internal revenue taxes for the period from **taxable year, 1998** to _____, 19__. x x x." (emphasis supplied)

Even though the date after the words "taxable year 1998 to" is unstated, it is not at all difficult to discern that the period of examination is the whole taxable year 1998. This means that the examination of Lancaster must cover the FY period from 1 April 1997 to 31 March 1998. It could not have contemplated a longer period. The examination for the full taxable year 1998 only is consistent with the guideline in Revenue Memorandum Order (RMO) No. 43-90, dated 20 September 1990, that the LOA shall cover a taxable period ***not exceeding one taxable year***.[35] In other words, absent any other valid cause, the LOA issued in this case is valid in all respects.

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[34] Revenue Audit Memorandum Order No. 2-95.

[35] The pertinent portion of Section C of Revenue Memorandum Order No. 43-90 reads:

> 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. (emphasis supplied)

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Nonetheless, a valid LOA does not necessarily clothe validity to an assessment issued on it, as when the revenue officers designated in the LOA act in excess or outside of the authority granted them under said LOA. Recently in *CIR v. De La Salle University, Inc.*[36] we accorded validity to the LOA authorizing the examination of DLSU for "*Fiscal Year Ending **2003** and Unverified Prior Years" and correspondingly held* the assessment for taxable year 2003 as valid because this taxable period is specified in the LOA. However, we declared void the assessments for taxable years **2001** and **2002** for having been *unspecified* on separate LOAs as required under RMO No. 43-90.

Likewise, in the earlier case of *CIR v. Sony, Phils., Inc.,*[37] we affirmed the cancellation of a deficiency VAT assessment because, while the LOA covered *"**the period 1997** and unverified prior years,"* the said deficiency was arrived at based on the records of a later year, from ***January to March 1998**,* or using the fiscal year which ended on 31 March 1998. We explained that the CIR knew which period should be covered by the investigation and that if the CIR wanted or intended the investigation to include the year 1998, it would have done so by including it in the LOA or by issuing another LOA.[38]

The present case is no different from *Sony* in that the subject LOA specified that the examination should be for the taxable year 1998 only but the subsequent assessment issued against Lancaster involved disallowed expenses covering the next fiscal year, or the period ending 31 March 1999. This much is clear from the notice of assessment, the relevant portion of which we again restate as follows:

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[36] G.R. Nos. 196596, 198841 and 198941, 9 November 2016.

[37] 649 Phil. 519 (2010).

[38] *Id*. at 530-531.

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INCOME TAX:		
Taxable Income per ITR		-0-
Add:	Adjustments-Disallowed purchases	11,496,770.18
	Adjusted Taxable Income per Investigation	₱11,496,770.18
INCOME TAX DUE – Basic		
	April 1 – December 31, 1998 (9/12 x ₱11,496,770.18 x 34%)	₱ 2,913,676.4
	January 1 – March 31, 1999 (3/12 x ₱11,496,770.18 x 33%)	948,483.54
Income tax still due per investigation		₱ 3,880,159.94
Interest (6/15/99 to 10/15/02) .66		2,560,905.56
Compromise Penalty		25,000
TOTAL DEFICIENCY INCOME TAX		**₱ 6,466,065.50**

(emphasis supplied)

The taxable year covered by the assessment being outside of the period specified in the LOA in this case, the assessment issued against Lancaster is, therefore, void.

This point alone would have sufficed to invalidate the subject deficiency income tax assessment, thus, obviating any further necessity to resolve the issue on whether Lancaster erroneously claimed the February and March 1998 expenses as deductions against income for FY 1999.

But, as the CTA did, we shall discuss the issue on the disallowance for the proper guidance not only of the parties, but the bench and the bar as well.

II.

The CTA En Banc correctly sustained the order cancelling and withdrawing the deficiency tax assessment.

To recall, the assessment against Lancaster for deficiency income tax stemmed from the disallowance of its February and March 1998 purchases which Lancaster posted in its fiscal year

ending on 31 March 1999 *(FY 1999)* instead of the fiscal year ending on 31 March 1998 *(FY 1998)*.

On the one hand, the BIR insists that the purchases in question should have been reported in FY 1998 in order to conform to the generally accepted accounting principle of proper matching of cost and revenue. Thus, when Lancaster reported the said purchases in FY 1999, this resulted in overstatement of expenses warranting their disallowance and, by consequence, resulting in the deficiency in the payment of its income tax for FY 1999.

Upon the other hand, Lancaster justifies the inclusion of the February and March 1998 purchases in its FY 1999 considering that they coincided with its crop year covering the period of October 1997 to September 1998. Consistent with Revenue Audit Memorandum (*RAM*) No. 2-95,[39] Lancaster argues that its purchases in February and March 1998 were properly posted in FY 1999, or the year in which its gross income from the crop was realized. Lancaster concludes that by doing so, it had complied with the matching concept that was also relied upon by the BIR in its assessment.

The issue essentially boils down to the ***proper timing when Lancaster should recognize its purchases in computing its taxable income***. Such issue directly correlates to the fact that Lancaster's '*crop year'* does not exactly coincide with its fiscal year for tax purposes.

Noticeably, the records of this case are rife with terms and concepts in accounting. As a science, accounting[40] pervades

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[39] The pertinent provision cited by Lancaster reads:

II. Accounting Methods x x x

F. Crop Year Basis is a method applicable only to farmers engaged in the production of crops which take more than a year from the time of planting to the process of gathering and disposal. Expenses paid or incurred are deductible in the year the gross income from the sale of the crops are realized.

[40] *Black's Law Dictionary*, Sixth Edition, defines *'Accounting'* as "[a]n act or a system of making up or settling accounts, consisting of a statement of account with debits and credits arising from relationship of parties. x x x The methods under which income and expenses are determined for tax

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many aspects of financial planning, forecasting, and decision making in business. Its reach, however, has also permeated tax practice.

To put it into perspective, although the foundations of accounting were built principally to analyze finances and assist businesses, many of its principles have since been adopted for purposes of taxation.[41] In our jurisdiction, the concepts in business accounting, including certain generally accepted accounting principles (GAAP), embedded in the NIRC comprise the rules on tax accounting.

To be clear, the principles under financial or business accounting, in theory and application, are not necessarily interchangeable with those in tax accounting. Thus, although closely related, tax and business accounting had invariably produced concepts that at some point diverge in understanding or usage. For instance, two of such important concepts are taxable income and business income (or accounting income). Much of the difference can be attributed to the distinct purposes or objectives that the concepts of tax and business accounting are aimed at. Chief Justice Querube Makalintal made an apt observation on the nature of such difference. In *Consolidated Mines, Inc. v. CTA,*[42] he noted:

> While taxable income is based on the method of accounting used by the taxpayer, it will almost always differ from accounting income. This is so because of a fundamental difference in the ends the two concepts serve. Accounting attempts to ***match cost against revenue***. Tax law is aimed at ***collecting revenue***. It is quick to treat an item as income, slow to recognize deductions or losses. Thus, the tax law

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purposes. Major accounting methods are the cash basis and the accrual basis. Special methods are available for the reporting of gain on installment sales, recognition of income on construction projects (*i.e.*, the completed-contract and percentage-of-completion methods), and the valuation of inventories (*i.e.*, last-in first-out and first-in first-out).

[41] It is not suggested, however, that tax rules do not influence accounting practice. It is generally recognized that certain tax incentives do have certain repercussionary effect on accounting approach and practice.

[42] 157 Phil. 608 (1974).

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will not recognize deductions for contingent future losses except in very limited situations. Good accounting, on the other hand, requires their recognition. Once this fundamental difference in approach is accepted, income tax accounting methods can be understood more easily.[43] (emphasis supplied)

While there may be differences between tax and accounting,[44] it cannot be said that the two mutually exclude each other. As already made clear, tax laws borrowed concepts that had origins from accounting. In truth, tax cannot do away with accounting. It relies upon approved accounting methods and practices to effectively carry out its objective of collecting the proper amount of taxes from the taxpayers. Thus, an important mechanism established in many tax systems is the requirement for taxpayers to make a return of their true income.[45] Maintaining accounting books and records, among other important considerations, would in turn assist the taxpayers in complying with their obligation to file their income tax returns. At the same time, such books

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[43] *Id*., footnote 1 citing 33 Am. Jur. 2d 688; also cited (as a footnote) in *CIR v. Central Luzon Drug Corporation,* 496 Phil. 307, 320-321 (2005).

[44] The BIR, through Revenue Memorandum Circular No. 22-04, dated 12 April 2004, recognized the differences between GAAP and the provisions of the NIRC and its implementing rules and regulations. It provides:

I. Background.

From time to time, the Accounting Standard Council (ASC) approves and adopts certain generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS) which shall be used as the basis for the recording of financial transactions and preparing financial statements for businesses in the Philippines. It has been observed that the generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS) approved and adopted may from time to time be different from the provisions of the National Internal Revenue Code of 1997 (Tax Code) and the rules and regulations Implementing said Tax Code. This Revenue Memorandum Circular is hereby issued to put forth the definitive rule in case there [are] differences between what is contained in the Tax Code and such rules and regulations issued in relation thereto, and that of the generally accepted accounting principle (GAAP) and generally accepted auditing standards (GAAS) as approved and adopted by ASC.

[45] For income tax purposes, the provisions relating to returns are contained in Chapter IX of the NIRC.

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and records provide vital information and possible bases for the government, after appropriate audit, to make an assessment for deficiency tax whenever so warranted under the circumstances.

The NIRC, just like the tax laws in other jurisdictions, recognizes the important facility provided by generally accepted accounting principles and methods to the primary aim of tax laws to collect the correct amount of taxes. The NIRC even devoted a whole chapter on accounting periods and methods of accounting, some relevant provisions of which we cite here for more emphasis:

CHAPTER VIII

ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

Sec. 43. ***General Rule.*** – The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income.

If the taxpayer's annual accounting period is other than a fiscal year, as defined in Section 22(Q), or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the taxable income shall be computed on the basis of the calendar year.

Sec. 44. ***Period in which Items of Gross Income Included.*** – The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under Section 43, any such amounts are to be properly accounted for as of a different period.

In the case of the death of a taxpayer, there shall be included in computing taxable income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

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Sec. 45. ***Period for which Deductions and Credits Taken.*** – The deductions provided for in this Title shall be taken for the taxable year in which **'*paid or accrued*'** or **'*paid or incurred*,'** dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income, the deductions should be taken as of a different period. In the case of the death of a taxpayer, there shall be allowed as deductions for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

Sec. 46. ***Change of Accounting Period.*** – If a taxpayer, other than an individual, changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of Section 47.

x x x x x x x x x

Sec. 48. ***Accounting for Long-term Contracts.*** – Income from long-term contracts shall be reported for tax purposes in the manner as provided in this Section.

As used herein, the term '***long-term contracts***' means building, installation or construction contracts covering a period in excess of one (1) year.

Persons whose gross income is derived in whole or in part from such contracts shall report such income upon the basis of percentage of completion.

The return should be accompanied by a return certificate of architects or engineers showing the percentage of completion during the taxable year of the entire work performed under contract.

There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.

If upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return.

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Sec. 49. ***Installment Basis.*** –

(A) ***Sales of Dealers in Personal Property.*** – Under rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year, which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(B) ***Sales of Realty and Casual Sales of Personality.*** – In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding One thousand pesos (₱1,000), or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed twenty-five percent (25%) of the selling price, the income may, under the rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, be returned on the basis and in the manner above prescribed in this Section.

As used in this Section, the term **'*initial payments*'** means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(C) ***Sales of Real Property Considered as Capital Asset by Individuals.*** — An individual who sells or disposes of real property, considered as capital asset, and is otherwise qualified to report the gain therefrom under Subsection (B) may pay the capital gains tax in installments under rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

(D) ***Change from Accrual to Installment Basis.*** – If a taxpayer entitled to the benefits of Subsection (A) elects for any taxable year to report his taxable income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded." (emphasis in the original)

We now proceed to the matter respecting the accounting method employed by Lancaster.

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An accounting method is a "set of rules for determining when and how to report income and deductions."[46] The provisions under Chapter VIII, Title II of the NIRC cited above enumerate the methods of accounting that the law expressly recognizes, to wit:

(1) Cash basis method;[47]
(2) Accrual method;[48]
(3) Installment method;[49]
(4) Percentage of completion method;[50] and
(5) Other accounting methods.

Any of the foregoing methods may be employed by any taxpayer so long as it reflects its income properly and such method is used regularly. The peculiarities of the business or occupation engaged in by a taxpayer would largely determine how it would report incomes and expenses in its accounting books or records. The NIRC does not prescribe a uniform, or even specific, method of accounting.

Too, other methods approved by the CIR, even when not expressly mentioned in the NIRC, may be adopted if such method would enable the taxpayer to properly reflect its income. Section 43 of the NIRC authorizes the CIR to allow the use of a method of accounting that in its opinion would clearly reflect the income of the taxpayer. An example of such method not expressly mentioned in the NIRC, but duly approved by the CIR, is the **'crop method of accounting'** authorized under RAM No. 2-95. The pertinent provision reads:

II. Accounting Methods

x x x x x x x x x

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[46] *Consolidated Mines, Inc. v. CTA, supra* note 42 at 613-614; *CIR v. Isabela Cultural Corporation*, 544 Phil. 288, 495 (2007).

[47] Sec. 45, NIRC.

[48] *Id*.

[49] Sec. 49, NIRC.

[50] Sec. 48, NIRC.

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F. Crop Year Basis is a method applicable only to farmers engaged in the production of crops which take more than a year from the time of planting to the process of gathering and disposal. Expenses paid or incurred are deductible in the year the gross income from the sale of the crops are realized.

The crop method recognizes that the harvesting and selling of crops do not fall within the same year that they are planted or grown. This method is especially relevant to farmers, or those engaged in the business of producing crops who, pursuant to RAM No. 2-95, would then be able to compute their taxable income on the basis of their crop year. On when to recognize expenses as deductions against income, the governing rule is found in the second sentence of Subsection F cited above. The rule enjoins the recognition of the expense (or the deduction of the cost) of crop production ***in the year that the crops are sold*** (when income is realized).

In the present case, we find it wholly justifiable for Lancaster, as a business engaged in the production and marketing of tobacco, to adopt the crop method of accounting. A taxpayer is authorized to employ what it finds suitable for its purpose so long as it consistently does so, and in this case, Lancaster does appear to have utilized the method regularly for many decades already. Considering that the crop year of Lancaster starts from October up to September of the following year, it follows that all of its expenses in the crop production made within the crop year starting from October 1997 to September 1998, including the February and March 1998 purchases covered by purchase invoice vouchers, are rightfully deductible for income tax purposes in the year when the gross income from the crops are realized. Pertinently, nothing from the pleadings or memoranda of the parties, or even from their testimonies before the CTA, would support a finding that the gross income from the crops (to which the subject expenses refer) was actually realized by the end of March 1998, or the closing of Lancaster's fiscal year for 1998. Instead, the records show that the February and March 1998 purchases were recorded by Lancaster as *advances* and later taken up as *purchases* by the close of the crop year in September 1998, or as stated

very clearly above, *within the fiscal year 1999*.[51] On this point, we quote with approval the ruling of the CTA En Banc, thus:

> Considering that [Lancaster] is engaged in the production of tobacco, it applied the crop year basis in determining its total purchases for each fiscal year. Thus, [Lancaster's] total cost for the production of its crops, which includes its purchases, must be taken as a deduction in the year in which the gross income is realized. Thus, We agree with the following ratiocination of the First Division:
>
> > Evident from the foregoing, the crop year basis is one unusual method of accounting wherein the entire cost of producing the crops (including purchases) must be taken as a deduction in the year in which the gross income from the crop is realized. Since the petitioner's crop year starts in October and ends in September of the following year, the same does not coincide with petitioner's fiscal year which starts in April and ends in March of the following year. However, the law and regulations consider this peculiar situation and allow the costs to be taken up at the time the gross income from the crop is realized, as in the instant case.
>
> [Lancaster's] fiscal period is from April 1, 1998 to March 31, 1999. On the other hand, its crop year is from October 1, 1997 to September 1, 1998. Accordingly, in applying the crop year method, all the purchases made by the respondent for October 1, 1997 to September 1, 1998 should be deducted from the fiscal year ending March 31, 1999, since it is the time when the gross income from the crops is realized.[52]

The matching principle

Both petitioner CIR and respondent Lancaster, it must be noted, rely upon the concept of matching cost against revenue to buttress their respective theories. Also, both parties cite RAM 2-95 in referencing the crop method of accounting.

We are tasked to determine which view is legally sound.

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[51] TSN, 9 August 2004, p. 21.

[52] *Rollo*, pp. 41-42.

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In essence, the matching concept, which is one of the generally accepted accounting principles, directs that the expenses are to be reported in the same period that related revenues are earned. It attempts to match revenue with expenses that helped earn it.

The CIR posits that Lancaster should not have recognized in FY 1999 the purchases for February and March 1998.[53] Apparent from the reasoning of the CIR is that such expenses ought to have been deducted in FY 1998, when they were supposed to be paid or incurred by Lancaster. In other words, the CIR is of the view that the subject purchases match with revenues in 1998, not in 1999.

A reading of RAM No. 2-95, however, clearly evinces that it conforms with the concept that the expenses *paid* or *incurred* be deducted in the year in which gross income from the sale of the crops is *realized*. Put in another way, the expenses are matched with the related incomes which are eventually earned. Nothing from the provision is it strictly required that for the expense to be deductible, the income to which such expense is related to be realized in the same year that it is *paid* or *incurred*. As noted by the CTA,[54] the crop method is an unusual method of accounting, unlike other recognized accounting methods that, by mandate of Sec. 45 of the NIRC, strictly require expenses be taken in the same taxable year when the income is '*paid* or *incurred,*' or '*paid* or *accrued,*' depending upon the method of accounting employed by the taxpayer.

Even if we were to accept the notion that applying the 1998 purchases as deductions in the fiscal year 1998 conforms with the generally accepted principle of matching cost against revenue, the same would still not lend any comfort to the CIR. Revenue Memorandum Circular (*RMC*) No. 22-04, entitled "*Supplement to Revenue Memorandum Circular No. 44-2002 on Accounting Methods to be Used by Taxpayers for Internal Revenue Tax*

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[53] *Id*. at 21.

[54] *Id*. at 41.

Purposes"[55] dated 12 April 2004, commands that where there is conflict between the provisions of the Tax Code (NIRC), including its implementing rules and regulations, on accounting methods and the generally accepted accounting principles, the former shall prevail. The relevant portion of RMC 22-04 reads:

II. Provisions of the Tax Code Shall Prevail.

All returns required to be filed by the Tax Code shall be prepared always in conformity with the provisions of the Tax Code, and the rules and regulations implementing said Tax Code. Taxability of income and deductibility of expenses shall be determined strictly in accordance with the provisions of the Tax Code and the rules and regulations issued implementing said Tax Code. *In case of difference between the provisions of the Tax Code and the rules and regulations implementing the Tax Code, on one hand, and the generally accepted accounting principles (GAAP) and the generally accepted accounting standards (GAAS), on the other hand, the provisions of the Tax Code and the rules and regulations issued implementing said Tax Code shall prevail.* (italics supplied)

RAM No. 2-95 is clear-cut on the rule on when to recognize deductions for taxpayers using the crop method of accounting. The rule prevails over any GAAP, including the matching concept as applied in financial or business accounting.

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[55] Dated 12 April 2004. https://www.bir.gov.ph/images/bir_files/old_files/pdf/1764rmc22_04.pdf. Last visited 5 April 2017. Even though the present case pertains to the taxable year 1998, RMC 22-04, which was issued by the BIR only in 2004, could very well be applied reasonably based on the principle that interpretative rules issued by an administrative agency are given retroactive effect as of the date of the effectivity of the statute. Perusing the text of RMC 22-04, it is clear that by recognizing the supremacy of the provisions of the Tax Code over generally accepted accounting principles or auditing standards (GAAP or GAAS), the circular did no more than interpret the statute (Tax Code) being administered by the BIR. When this case arose in 1998, the Tax Code provisions had long been in effect. Following the principle enunciated here, it cannot be doubted that, as of 1998, the pertinent Tax Code provisions and implementing rules (on accounting methods) should, whenever conflict arises, prevail over generally accepted accounting principles.

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In sum, and considering the foregoing premises, we find no cogent reason to overturn the assailed decision and resolution of the CTA. As the CTA decreed, Assessment Notice LTAID II IT-98-00007, dated 11 October 2002, in the amount of ₱6,466,065.50 for deficiency income tax should be cancelled and set aside. The assessment is void for being issued without valid authority. Furthermore, there is no legal justification for the disallowance of Lancaster's expenses for the purchase of tobacco in February and March 1998.

WHEREFORE, the petition is **DENIED**. The assailed 30 April 2008 Decision and 24 June 2008 Resolution of the Court of Tax Appeals En Banc are **AFFIRMED**. No costs.

SO ORDERED.

Carpio (*Chairperson*), *Peralta,* and *Mendoza, JJ.,* concur.

Leonen, J., on leave but left his vote concurring with the *ponencia*.

SECOND DIVISION

[G.R. No. 188057. July 12, 2017]

HILLTOP MARKET FISH VENDORS' ASSOCIATION, INC., *petitioner, vs.* **HON. BRAULIO YARANON, City Mayor, Baguio City, HON. GALO WEYGAN, City Councilor and Chairman Anti-Vice Coordinating Task Force, and the CITY GOVERNMENT OF BAGUIO,** *respondents.*

SYLLABUS

1. CIVIL LAW; CIVIL CODE OF THE PHILIPPINES; OBLIGATIONS AND CONTRACTS; LEASE; BEING A CONSENSUAL CONTRACT, A LEASE IS PERFECTED