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FIRST DIVISION

[G.R. No. 222476; May 5, 2021]

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*, *v.* **YUMEX PHILIPPINES CORPORATION,** *Respondent*.

D E C I S I O N

GESMUNDO, *C.J.*:

Before the Court is a petition for review on *certiorari* filed under Rule 45 of the Rules of Court seeking the reversal of the August 11, 2015 Decision[1] and January 19, 2016 Resolution[2] of the Court of Tax Appeals *(CTA) En Banc* in CTA EB No. 1139. In its assailed decision, the CTA *En Banc* denied the petition for review of Commissioner of Internal Revenue *(petitioner)* and effectively affirmed the November 28, 2013 Decision[3] of the CTA Special Second Division *(CTA Division)* in CTA Case No. 8331 which cancelled and set aside the assessment against Yumex Philippines Corporation *(respondent)* for deficiency improperly accumulated earnings tax *(IAET)* for the taxable year 2007.

Antecedents

On March 4, 2010, a Notice of Informal Conference was issued by the Revenue District Officer *(RDO)* to respondent informing the latter that the investigation of its accounting records for the

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[1] *Rollo*, pp. 52-63; penned by Associate Justice Erlinda P. Uy, with Presiding Justice Roman G. Del Rosario and Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Caesar A. Casanova, Esperanza R. Fabon-Victorino, Cielito N. Mindaro-Grulla, Amelia R. Cotangco-Manalastas, and Ma. Belen M. Ringpis-Liban, concurring.

[2] Id. at 7-17; penned by Associate Justice Erlinda P. Uy, with Presiding Justice Roman G. Del Rosario and Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Caesar A. Casanova, Esperanza R. Fabon-Victorino, Amelia R. Cotangco-Manalastas, and Ma. Belen M. Ringpis-Liban, concurring (Associate Justice Cielito N. Mindaro-Grulla on leave).

[3] Id. at 96-121; penned by Associate Justice Cielito N. Mindaro-Grulla, with Associate Justices Juanito C. Castañeda, Jr. and Caesar A. Casanova, concurring.

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taxable year 2007 resulted in a preliminary assessment of income tax, value-added tax, expanded withholding tax, fringe benefits tax, IAET, and compromise penalty.[4]

Replying to the preliminary audit findings, respondent wrote petitioner regarding its status as a corporation registered under the Philippine Economic Zone Authority *(PEZA)* which allows it to enjoy payment of a special rate on registered activities; hence, it is not subject to IAET.[5]

Subsequently, petitioner sent the letter[6] dated August 12, 2010 and a Summary of Deficiencies to respondent, which were received by the latter on August 20, 2010 and August 25, 2010, respectively. Respondent thereafter sent its reply letter dated August 25, 2010.

A Preliminary Assessment Notice *(PAN)* dated December 16, 2010, with attached Details of Discrepancies, was issued by the Bureau of Internal Revenue *(BIR)* Regional Director *(RD)*, finding respondent liable to pay deficiency income tax, fringe benefits tax, IAET, and compromise penalty. A Formal Letter of Demand *(FLD)* dated January 10, 2011, was likewise issued by the RD, finding respondent liable to pay: deficiency income tax (₱589,961.46), fringe benefits tax (₱1,097,855.50), IAET (₱9,077,695.05), and compromise penalty (₱25,000.00).[7]

On January 20, 2011, respondent filed a protest on the FLD asserting its status as a PEZA-registered entity; and that since all of its activities are registered under PEZA, it is therefore fully exempt from the IAET.[8]

On February 4, 2011, petitioner received a letter dated February 2, 2011 from respondent, stating that the latter is paying a total amount of ₱981,461.83, consisting of the basic deficiency income tax (₱372,106.45), basic deficiency fringe benefits tax

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[4] Id. at 97-98.

[5] Id. at 98.

[6] Id. at 364-365.

[7] Id. at 373-374. The amounts stated include the basic deficiency tax, interest, surcharge, and compromise penalty.

[8] Id. at 98-99.

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(₱584,355.38), and compromise penalty (₱25,000.00). However, respondent contested the amounts of interest and penalty on its deficiency income and fringe benefit taxes and expressed its hope that petitioner will waive the same.[9] Respondent still did not pay its deficiency IAET.

After a reinvestigation, the RDO issued a letter dated July 25, 2011, acknowledging payment by respondent of the basic deficiency taxes on income and fringe benefits, plus compromise penalty; and informing respondent that its request for cancellation of the civil increments and penalties thereon is subject to the approval of petitioner or the Deputy Commissioner/Assistant Commissioner/ RD, pursuant to Section III (6) of Revenue Memorandum Order (RMO) No. 19-2007. The RDO reiterated her position and stood by the assessment of the IAET and its corresponding civil increments. She advised respondent that the whole docket of the case will be forwarded to the Regional Office for pursuance of collection.[10]

Respondent considered the above-mentioned letter as petitioner's Final Decision on Disputed Assessment, and appealed the same by filing a Petition for Review before the CTA Division on September 7, 2011.

CTA Division Ruling

On November 28, 2013, the CTA Division rendered its Decision granting respondent's petition and setting aside the assessment issued against the latter for IAET. It agreed with respondent's contention that the subject tax assessment is invalid and illegal because the BIR issued the FLD and the Final Assessment Notice *(FAN)* without giving respondent an opportunity to answer the PAN, which is a violation of procedural due process.

The CTA Division held that petitioner violated Sec. 228 of the National Internal Revenue Code (NIRC) of 1997 and the provisions of Revenue Regulations (RR) No. 12-99, which grant a taxpayer a period of fifteen (15) days within which to reply to the PAN. It also ruled that the assessment must be cancelled for

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[9] Id. at 382.

[10] Id. at 391.

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lack of factual basis. Based on its scrutiny of the records, the CTA Division found that petitioner, in computing respondent's alleged deficiency IAET, actually applied the IAET rate on respondent's income from its registered activities which enjoy Income Tax Holiday *(ITH)*. In contrast, there is nothing in petitioner's reports, notices, and letters which would specifically show the unregistered activities from which the alleged taxable income mentioned in the PAN and FLD/FAN was derived.

Petitioner filed a motion for reconsideration which was denied by the CTA Division in its March 3, 2014 Resolution.[11]

Petitioner elevated its case *via* a petition for review before the CTA *En Banc*.

CTA En Banc Ruling

In its August 11, 2015 Decision, the CTA *En Banc* denied petitioner's petition. It held that the CTA Division did not err in considering the propriety or impropriety of the issuance of the PAN and FLD/FAN. Rejecting petitioner's contention that the matter was never raised as an issue by respondent during trial, it pointed out that respondent made sufficient allegations in its petition for review before the CTA Division, as well as offered both documentary and testimonial evidence during the trial, regarding the dates of issuance by petitioner and receipt by respondent of the PAN and FLD/FAN. At any rate, whether or not respondent specifically raised the issue of simultaneous receipt of the subject PAN and FLD/FAN in its pleadings or during the trial is of no moment. The CTA is not precluded from considering other related issues, not otherwise stipulated by the parties, which may be necessary to achieve a just and orderly disposition of the cases, in accordance with Sec. 1, Rule 14[12] of the 2005 Revised Rules of the CTA *(RRCTA)*.

The CTA *En Banc* stressed that Sec. 3.1.2 of RR No. 12-99, in relation to Sec. 228 of the NIRC, gives the taxpayer fifteen

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[11] Id. at 133-136.

[12] "SECTION 1. *Rendition of Judgment*. — x x x

In deciding the case, the Court may not limit itself to the issues stipulated the parties but may also rule upon related issues necessary to achieve an orderly disposition of the case."

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(15) days from receipt of the PAN to respond to the same before petitioner shall issue an FLD/FAN. In this case, petitioner did not provide respondent with such opportunity to contest the issued PAN; and thus, there was a violation of respondent's due process.

Additionally, the CTA *En Banc* declared that the CTA Division was correct in ruling that there was no factual basis for the deficiency IAET assessment. Respondent, as a PEZA-registered enterprise, is expressly exempted from the imposition of IAET under Sec. 4 (g) of RR No. 2-2001,[13] which made no distinction whether the concerned corporation or enterprise enjoys the ITH or the special five percent (5%) tax regime on its registered activities.

Petitioner's motion for reconsideration was likewise denied by the CTA *En Banc* in its January 19, 2016 Resolution.[14]

Hence, petitioner comes before this Court through the instant Petition.

ISSUES

For resolution in this petition are the following issues: (1) whether or not the CTA Division can take cognizance of the issue of the invalidity of the assessment against respondent for allegedly having been issued in violation of respondent's due process; (2) whether or not the PAN and FLD/FAN are invalid because they were issued by the BIR in violation of respondent's right to due process; and (3) whether or not respondent can be assessed for deficiency IAET.

Petitioner's Arguments

Petitioner assails the CTA *En Banc* for upholding the CTA Division's ruling that the issuance of the PAN and FLD/FAN by the BIR was in violation of respondent's right to due process, even when respondent did not raise the same as an issue in its petition for review before the CTA Division. It was clear error for the CTA Division to decide the case based on respondent's

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[13] "Subject: Implementing the Provision on Improperly Accumulated Earnings Tax under Section 29 of the Tax Code of 1997," February 12, 2001.

[14] *Rollo*, pp. 70-80.

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belated assertion of impropriety — raised long after the trial and the submission of the case for decision.[15]

Even granting that the aforementioned issue had been timely raised, petitioner submits that the PAN and FLD/FAN were properly issued by the BIR in compliance with RR No. 12-99. Sec. 3.1.7 of said regulations allows constructive service of the PAN by providing that "x x x if the notice to the taxpayer herein required is served by registered mail, and no response is received from the taxpayer within the prescribed period from date of the posting thereof in the mail, the same shall be considered actually or constructively received by the taxpayer." Petitioner asserts that, in this case, the dates when the PAN and FLD/FAN had been sent can be easily seen in the registry return cards, which are part of the BIR records. The PAN was mailed on December 17, 2010, and fifteen (15) days therefrom,[16] the BIR still had not received any response from respondent. Consequently, petitioner considered the PAN to have been constructively served upon respondent under Sec. 3.1.2 of RR No. 12-99 and the FLD/FAN could already be issued by January 10, 2011.

In the alternative, petitioner argues that even assuming the BIR failed to observe the due process requirements under RR No. 12-99, respondent had been afforded the opportunity to protest the assessment notices. In fact, it was able to request for a re-investigation.

Petitioner further noted that respondent had already paid for most of the items of assessment brought about by the very same assessment process it now assails. Respondent had even requested the cancellation of some requested increments.[17]

Petitioner invokes Sec. 29 (C) (2) of the NIRC as the legal basis for the IAET assessment against respondent. According to the said provision, the mere fact that earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the

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[15] Id. at 30-33.

[16] The 15th day fell on January 1, 2011, a Saturday and National Holiday. The next working day would be January 3, 2011, a Monday.

[17] *Rollo*, pp. 34-36.

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business shall be determinative of the purpose to avoid imposing the tax upon its shareholders or members, unless the corporation, by the clear preponderance of evidence, shall prove the contrary.

Petitioner then maintains that there is sufficient factual basis for the IAET assessment. Petitioner clarified that respondent had two types of registered activities: (1) those enjoying ITH; and (2) those under the five percent (5%) special rate. The IAET was being imposed on the income derived from respondent's registered activity under the ITH, specifically identified as the Backlight, PCBA, PCBM, and CAD Design activities, and not from those under the preferential tax rate. Since respondent did not contest the foregoing BIR findings in its protest against the assessment and, instead, merely argued that its earnings were not subject to IAET, then such factual findings are considered as undisputed issues under 3.1.5 of RR No. 12-99.

Petitioner also contends that aside from the heavy burden on respondent to prove that the IAET assessment was not warranted, it is well-settled that all presumptions are in favor of the correctness of tax assessments.[18]

Respondent's Arguments

Respondent posits that the CTA did not err in finding that it was denied due process by the BIR when the latter issued the FLD/FAN without giving respondent the opportunity to answer the PAN within the period provided in RR No. 12-99.[19]

Respondent avers that it raised the invalidity of the issuance of the aforesaid assessment notices in its petition for review before the CTA Division. It specifically alleged in paragraphs 9 and 10 thereof that "[W]ithout waiting for [respondent's] receipt of the PAN and the lapse of [respondent's] time to respond to the PAN, Regional Director Galano issued a Formal Letter of Demand dated January 10, 2011 with an attached Details of Discrepancy and the corresponding Audit Results/Assessment Notices assessing [respondent] the following deficiency taxes for the year 2007

[18] Id. at 40-41.

[19] Id. at 273-274.

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x x x"; and "[O]n January 18, 2011, [respondent] received the PAN as well as the Formal Letter of Demand and Audit Results/ Assessment Notices issued by Regional Director Galano." During the trial, respondent's witness, Ms. Leonora Perez-Sangalang, also testified through her judicial affidavit that respondent received the PAN and FLD/FAN on the same day.[20]

As for the documentary evidence cited by petitioner, respondent points out that Exhibits 13 and 14 of the CTA Records pertain to the PAN and FLD/FAN, neither of which includes a registry return card. Since petitioner was not able to adduce evidence of posting, then the rule on constructive service does not apply. The fact remains that respondent received the PAN and the FLD/FAN simultaneously or on the same day. Thus, petitioner failed to comply with the due process requirements under Sec. 3.1.2 of RR No. 12-99.[21]

Respondent insists that the nullity of the subject assessments was not cured by its subsequent protest of the FLD/FAN and payment of other uncontested assessments.[22]

On the legal basis of the IAET assessment, respondent reiterates the CTA's ruling that Sec. 4 of RR No. 2-2001 exempts from IAET, without any distinction or qualification, enterprises duly registered with PEZA under Republic Act No. 7916, such as respondent. Nonetheless, respondent stresses that it was able to prove during the trial that it was justified in not distributing its earnings and profits to its shareholders in the year 2007 because these were reserved for its new projects, specifically, the manufacture of Heat Run Oven-Controlled Rack, which began operations on June 4, 2007, per the testimony of respondent's witness, Ms. Perez-Sangalang. Petitioner neither cross-examined said witness nor presented countervailing evidence.[23]

The Court's Ruling

The petition has no merit.

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[20] Id. at 274-280.

[21] Id. at 280-285.

[22] Id. at 287.

[23] Id. at 287-293.

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The Court recognizes that the findings of the CTA can only be disturbed on appeal if they are not supported by substantial evidence or if there is a showing of gross error or abuse on the part of the tax court,[24] but petitioner failed to establish that any of said compelling reasons exist in this case.

As the CTA *En Banc* held, the CTA Division was justified in ruling on the issue that respondent was denied due process even though it was not expressly raised by respondent in its petition for review. Sec. 1, Rule 14 of the RRCTA provides that "[i]n 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." Herein, the issue of the validity of the assessment against respondent also necessarily requires the determination of the matter of the proper issuance of said assessment in accordance with the requirements of due process. In addition, there were sufficient allegations in respondent's petition for review on the dates of issuance by the BIR and receipt by respondent of the PAN and FLD/FAN, as well as documentary and testimonial evidence to establish the essential facts for resolution of the issue which were presented during the trial without any objection from petitioner. This could be deemed as petitioner's implied consent to try the issue, recognized under Sec. 5, Rule 10[25] of the Revised Rules of Court, which applies suppletorily to the RRCTA.

Proceeding to the issue of violation of respondent's due process, Sec. 228 of the NIRC mandates petitioner to inform the taxpayer in writing of the law and the facts on which the assessment is made; otherwise, the assessment is void. Said provision reads:

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[24] *Commissioner of Internal Revenue v. GJM Phils. Manufacturing, Inc.*, 781 Phil. 816, 825 (2016).

[25] **SECTION 5.** *Amendment to conform to or authorize presentation of evidence*. — When issues not raised by the pleadings are tried with the express or implied consent of the parties they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so with

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SECTION 228. *Protesting of Assessment*. — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: Provided, however, That a pre-assessment notice shall not be required in the following cases:

x x x x

The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

To implement the procedural and substantive rules on assessment of national internal revenue taxes, the BIR issued RR No. 12-99, Sec. 3 of which provides:

SECTION 3. *Due Process Requirement in the Issuance of a Deficiency Tax Assessment*. —

3.1 Mode of procedures in the issuance of a deficiency tax assessment:

3.1.1 *Notice for informal conference*. — The Revenue Officer who audited the taxpayer's records shall, among others, state in his report whether or not the taxpayer agrees with his findings that the taxpayer is liable for deficiency tax or taxes. If the taxpayer is not amenable, based on the said Officer's submitted report of investigation, the taxpayer shall be informed, in writing, by the Revenue District Office or by the Special Investigation Division, as the case may be (in the case of Revenue Regional Offices) or by the Chief of Division concerned (in the case of the BIR National Office) of the discrepancy or discrepancies in the taxpayer's payment of his internal revenue taxes, for the purpose of "Informal Conference," in order to afford the taxpayer with an opportunity to present his side of the case. If the taxpayer fails to respond within fifteen (15) days from date of receipt of the notice for informal conference, he shall be considered in default, in which case, the Revenue District Officer or the Chief of the Special Investigation Division of the Revenue Regional Office, or the Chief of Division in the National Office,

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liberality if the presentation of the merits of the action and the ends of substantial justice will be subserved thereby. The court may grant a continuance to enable the amendment to be made.

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as the case may be, shall endorse the case with the least possible delay to the Assessment Division of the Revenue Regional Office or to the Commissioner or his duly authorized representative, as the case may be, for appropriate review and issuance of a deficiency tax assessment, if warranted.

3.1.2 *Preliminary Assessment Notice (PAN).* — If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, the said Office shall issue to the taxpayer, at least by registered mail, a Preliminary Assessment Notice (PAN) for the proposed assessment, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based x x x. **If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall be considered in default, in which case, a formal letter of demand and assessment notice shall be caused to be issued by the said Office, calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties.**

x x x x

3.1.4 *Formal Letter of Demand and Assessment Notice*. — The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void x x x. The same shall be sent to the taxpayer only by registered mail or by personal delivery. If sent by personal delivery, the taxpayer or his duly authorized representative shall acknowledge receipt thereof in the duplicate copy of the letter of demand, showing the following: (a) His name; (b) signature; (c) designation and authority to act for and in behalf of the taxpayer, if acknowledged received by a person other than the taxpayer himself; and (d) date of receipt thereof.

Clearly from the aforequoted provisions, the taxpayer has fifteen (15) days from date of receipt of the PAN to respond to the said notice. Only after receiving the taxpayer's response or in case of the taxpayer's default can respondent issue the FLD/FAN.

Per the evidence on record, the BIR issued a PAN dated December 16, 2010, which it posted by registered mail the

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next day, December 17, 2010. It then issued and mailed the FLD/FAN on January 10, 2011. Although posted on different dates, the PAN and FLD/FAN were both received by the Post Office of Dasmariñas, Cavite, on January 17, 2011, and served upon and received by respondent on January 18, 2011. Under the circumstances, respondent was not given any notice of the preliminary assessment at all and was deprived of the opportunity to respond to the same before being given the final assessment.

In *Commissioner of Internal Revenue v. Avon Products Manufacturing, Inc. (Avon case)*,[26] the Court enjoined strict observance by the BIR of the prescribed procedure for issuance of the assessment notices with due regard for the taxpayers' constitutional rights. It is mandatory that the BIR not only inform the taxpayer through the PAN, FLD, and FAN of the facts, law and regulations, and jurisprudence on which the assessment against it is based, but it must also accord the taxpayer the opportunity to be heard through the entire process, *i.e.*, from tax investigation until tax assessment. Pertinent portions of the *Avon Case* are reproduced below:

> The Bureau of Internal Revenue is the primary agency tasked to assess and collect proper taxes, and to administer and enforce the Tax Code. To perform its functions of tax assessment and collection properly, it is given ample powers under the Tax Code, such as the power to examine tax returns and books of accounts, to issue a subpoena, and to assess based on best evidence obtainable, among others. However, these powers must "be exercised reasonably and [under] the prescribed procedure." The Commissioner and revenue officers must strictly comply with the requirements of the law, with the Bureau of Internal Revenue's own rules, and with due regard to taxpayers' constitutional rights.
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> x x x x
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> The importance of providing the taxpayer with adequate written notice of his or her tax liability is undeniable. Under Section 228, it is explicitly required that the taxpayer be informed in writing of the law and of the facts on which the assessment is made; otherwise, the assessment shall be void. Section 3.1.2 of Revenue Regulations No. 12-99 requires the Preliminary Assessment Notice to show in detail the facts

[26] G.R. Nos. 201398-99 & 201418-19, October 3, 2018.

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and law, rules and regulations, or jurisprudence on which the proposed assessment is based. Further, Section 3.1.4 requires that the Final Letter of Demand must state the facts and law on which it is based; otherwise, the Final Letter of Demand and Final Assessment Notices themselves shall be void. Finally, Section 3.1.6 specifically requires that the decision of the Commissioner or of his or her duly authorized representative on a disputed assessment shall state the facts and law, rules and regulations, or jurisprudence on which the decision is based. Failure to do so would invalidate the Final Decision on Disputed Assessment.

"The use of the word 'shall' in Section 228 of the [National Internal Revenue Code] and in [Revenue Regulations] No. 12-99 indicates that the requirement of informing the taxpayer of the legal and factual bases of the assessment and the decision made against him [or her] is mandatory." This is an essential requirement of due process and applies to the Preliminary Assessment Notice, Final Letter of Demand with the Final Assessment Notices, and the Final Decision on Disputed Assessment.

On the other hand, the taxpayer is explicitly given the opportunity to explain or present his or her side throughout the process, from tax investigation through tax assessment. Under Section 3.1.1 of Revenue Regulations No. 12-99, the taxpayer is given 15 days from receipt of the Notice for Informal Conference to respond; otherwise, he or she will be considered in default and the case will be referred to the Assessment Division for appropriate review and issuance of deficiency tax assessment, if warranted. Again, under Section 228 of the Tax Code and Section 3.1.2 of Revenue Regulations No. 12-99, the taxpayer is required to respond within 15 days from receipt of the Preliminary Assessment Notice; otherwise, he or she will be considered in default and the Final Letter of Demand and Final Assessment Notices will be issued. After receipt of the Final Letter of Demand and Final Assessment Notices, the taxpayer is given 30 days to file a protest, and subsequently, to appeal his or her protest to the Court of Tax Appeals.

The Court, in *Commissioner of Internal Revenue v. Metro Star Superama, Inc.*,[27] stressed the importance of the PAN, in particular, as a substantive, and not just a formal, due process requirement, thus:

Indeed, Section 228 of the Tax Code clearly requires that the taxpayer must first be informed that he is liable for deficiency taxes through the sending of a PAN. He must be informed of the facts and the law upon

[27] 652 Phil. 172 (2010).

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which the assessment is made. The law imposes a substantive, not merely a formal, requirement. To proceed heedlessly with tax collection without first establishing a valid assessment is evidently violative of the cardinal principle in administrative investigations — that taxpayers should be able to present their case and adduce supporting evidence.

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From the provision quoted above, it is clear that the sending of a PAN to taxpayer to inform him of the assessment made is but part of the "due process requirement in the issuance of a deficiency tax assessment," the absence of which renders nugatory any assessment made by the tax authorities. The use of the word *"shall"* in subsection 3.1.2 describes the mandatory nature of the service of a PAN. The persuasiveness of the right to due process reaches both substantial and procedural rights and the failure of the CIR to strictly comply with the requirements laid down by law and its own rules is a denial of Metro Star's right to due process. Thus, for its failure to send the PAN stating the facts and the law on which the assessment was made as required by Section 228 of R.A. No. 8424, the assessment made by the CIR is void.

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It is an elementary rule enshrined in the 1987 Constitution that no person shall be deprived of property without due process of law. In balancing the scales between the power of the State to tax and its inherent right to prosecute perceived transgressors of the law on one side, and the constitutional rights of a citizen to due process of law and the equal protection of the laws on the other, the scales must tilt in favor of the individual, for a citizen's right is amply protected by the Bill of Rights under the Constitution. Thus, while "taxes are the lifeblood of the government," the power to tax has its limits, in spite of all its plenitude. Hence in *Commissioner of Internal Revenue v. Algue, Inc.*, it was said —

> Taxes are the lifeblood of the government and so should be collected without unnecessary hindrance. On the other hand, such collection should be made in accordance with law as any arbitrariness will negate the very reason for government itself. It is therefore necessary to reconcile the apparently conflicting interests of the authorities and the taxpayers so that the real purpose of taxation, which is the promotion of the common good, may be achieved.

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> It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for the lack of the motive power to activate and operate it. Hence, despite the natural reluctance to surrender part of one's hard-earned income to taxing authorities, every person who is able to must contribute his share in the running of the government. The government for its part is expected to respond in the form of tangible and intangible benefits intended to improve the lives of the people and enhance their moral and material values. This symbiotic relationship is the rationale of taxation and should dispel the erroneous notion that it is an arbitrary method of exaction by those in the seat of power.
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> **But even as we concede the inevitability and indispensability of taxation, it is a requirement in all democratic regimes that it be exercised reasonably and in accordance with the prescribed procedure.** If it is not, then the taxpayer has a right to complain and the courts will then come to his succor. For all the awesome power of the tax collector, he may still be stopped in his tracks if the taxpayer can demonstrate . . . that the law has not been observed.[28] (emphasis in the original)

That respondent was able to file a protest to the FLD/FAN is of no moment. In *Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue*,[29] the BIR ignored RR No. 12-99 and did not issue to the taxpayer, Pilipinas Shell Petroleum Corporation *(PSPC)*, a notice for informal conference and a PAN as required; and as a result, deprived PSPC of due process in contesting the formal assessment levied against it. The Court pronounced therein that "[w]hile PSPC indeed protested the formal assessment, such does not denigrate the fact that it was deprived of statutory and procedural due process to contest the assessment before it was issued." The Court once more reminded the BIR to be more circumspect in the exercise of its functions as the power of taxation is also sometimes called the power to destroy and, therefore, should be exercised with caution to minimize injury to the proprietary rights of the taxpayer.[30]

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[28] *Id.* at 184-188.

[29] 565 Phil. 613 (2007).

[30] *Id.* at 656, citing *Roxas v. Court of Tax Appeals*, 131 Phil. 773, 780-781 (1968).

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Neither does the payment by respondent of the other items in the FLD/FAN, particularly, the basic deficiency income and fringe benefits taxes and compromise penalty, preclude it from questioning the validity of the issuance of the assessment notices. The manner by which the assessment is issued is a distinct matter in itself from the contents of the assessment. Respondent's voluntary payment, while it may be viewed as acknowledgement of its tax deficiencies for some of the assessed items, is not necessarily an outright waiver of its right to question the impropriety of the issuance of the assessment notices, especially in this case wherein respondent consistently protested the IAET assessment against it. The fact that respondent's right to due process was violated because it was denied the opportunity to respond to the PAN remains glaringly evident and cannot be deemed erased or cured by respondent's volitional payment of other assessed items.

Sec. 3.1.2 of RR No. 12-99 explicitly grants the taxpayer fifteen (15) days from **receipt** of the PAN to file a response. If the taxpayer fails to do so within the prescribed period, it will be considered in default and only then shall petitioner or his duly authorized representative issue to the taxpayer an FLD/FAN demanding payment of the assessed deficiency tax, surcharges, and penalties. In the instant case though, the BIR did not ascertain respondent's date of receipt of the PAN before issuing the FLD/FAN, but merely invoked Sec. 3.1.7 of RR No. 12-99 on constructive service, which states that "[i]f the notice to the taxpayer herein required is served by registered mail, and no response is received from the taxpayer within the prescribed period from date of posting thereof in the mail, the same shall be considered actually or constructively received by the taxpayer."

However, considering that Sec. 3.1.2 of RR No. 12-99 specifically governs the PAN while Sec. 3.1.7 of the same regulations pertains generally to the constructive service of notices, the former takes precedence in application to the instant case in determining the period allotted for the taxpayer to respond to a PAN. It is a rule of statutory construction that a special and specific provision prevails over a general provision irrespective of their relative position in the statute. *Generalia specialibus non derogant*. Where there is in the same statute a particular enactment

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and also a general one which in its most comprehensive sense would include what is embraced in the former, the particular enactment must be operative, and the general enactment must be taken to affect only such cases within its general language as are not within the provisions of the particular enactment.[31]

Moreover, the reliance by petitioner and the BIR on constructive service of notice is unavailing and not justified by the circumstances. The PAN was posted through registered mail so there are easily records available by which the BIR could have determined whether or not respondent actually received the notice and the date of such receipt. The BIR did not offer any explanation as to why it did not verify first these details with the post office, which would have been the more prudent thing to do instead of immediately considering respondent to have already constructively received the PAN for purposes of issuing the FLD/FAN. Petitioner's insistence on constructive notice is unwarranted and arbitrary when there is uncontroverted evidence of respondent's date of actual receipt of the PAN on January 18, 2011, simultaneously with the FLD/FAN.

Ultimately, the IAET assessment issued in this case by the BIR against respondent in violation of the latter's right to due process is null and void.

In any event, the IAET assessment against respondent also lacked legal and factual bases as found by both the CTA Division and *En Banc*.

The IAET is imposed under Sec. 29 of the NIRC, which reads:

SECTION 29. *Imposition of Improperly Accumulated Earnings Tax*. —

(A) *In General*. — In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof, an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.

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[31] *Commissioner of Customs v. Court of Tax Appeals*, 232 Phil. 641, 645-646 (1987).

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(B) *Tax on Corporations Subject to Improperly Accumulated Earnings Tax*. —

(1) *In General*. — The improperly accumulated earnings tax imposed in the preceding Section shall apply to every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(2) *Exceptions*. — The improperly accumulated earnings tax as provided for under this Section shall not apply to:

(a) Publicly-held corporations;

(b) Banks and other [non-bank] financial intermediaries; and

(c) Insurance companies.

(C) *Evidence of Purpose to Avoid Income Tax*. —

(1) *Prima Facie Evidence*. — The fact that any corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax on its shareholders or members.

(2) *Evidence Determinative of Purpose*. — The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by the clear preponderance of evidence, shall prove to the contrary.

RR No. 2-2001[32] particularly identified additional corporations which are not subject to IAET, to wit:

SECTION 4. *Coverage*. — The 10% Improperly Accumulated Earnings Tax (IAET) is imposed on improperly accumulated taxable income earned starting January 1, 1998 by domestic corporations as defined under the Tax Code and which are classified as closely-held corporations. Provided, however, that Improperly Accumulated Earnings Tax shall not apply to the following corporations:

a) Banks and other non-bank financial intermediaries;

b) Insurance companies;

c) Publicly-held corporations;

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[32] *Supra* note 13.

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d) Taxable partnerships;

e) General professional partnerships;

f) Non-taxable joint ventures; and

g) **Enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under R.A. 7916**, and enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under R.A. No. 7227, as well as other enterprises duly registered under special economic zones declared by law which enjoy payment of special tax rate on their registered operations or activities in lieu of other taxes, national or local. (emphasis supplied)

It is undisputed that respondent is registered with the PEZA as an Ecozone Export Enterprise and, as such, it asserts exemption from IAET by virtue of Sec. 4 (g) of RR No. 2-2001.

The BIR, in its questioned assessment, distinguished between respondent's income from certain registered activities which have been granted ITH extension[33] and its income from the rest of its registered activities which are subject to the preferential five percent (5%) tax rate. It argues that only the latter is exempt from IAET as the registered enterprises exempt under Sec. 4 (g) of RR No. 2-2001 should all be enjoying the special tax rate.

The Court is not persuaded and finds the following interpretation of the CTA *En Banc* to be in accord with the rules on statutory construction:

As the Court *En Banc* sees it, the use of comma in Section 4(g) signifies independence of one thing from the others included in the enumeration, such that, the particular portion contemplates three different groups excluded from the coverage of the imposition of the improperly accumulated tax, to wit: (1) enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under RA No. 7916; (2) enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under RA No. 7227 (BCDA); and (3) other enterprises duly registered under special economic zones declared by law.

Moreover, qualifying words restrict or modify only the words or phrases to which they are immediately associated, and not those distantly

[33] *Rollo*, pp. 343-346.

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or remotely located. Thus, the phrase *"which enjoy payment of special tax rate on their registered operations or activities in lieu of other taxes, national or local"* applies only to corporations belonging to the third group — other enterprises duly registered under special economic zones declared by law.

On the other hand, PEZA-registered enterprises and those registered pursuant to the BCDA, are exempted from the imposition of the improperly accumulated earnings tax, without further qualification. Section 4(g) made no distinction whether a corporation duly registered with the PEZA or registered pursuant to the BCDA enjoys an ITH or the special tax regime at a rate of 5% on its registered activities. In other words, the fact of registration with the PEZA under RA No. 7916 or pursuant to the BCDA under RA No. 7227 alone excludes a corporation or enterprise from the coverage of corporations upon which improperly accumulated earnings tax may be imposed.[34]

Furthermore, the IAET assessment against respondent is factually groundless.

According to Sec. 29 (C) (2) of the NIRC, "[t]he fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by the clear preponderance of evidence, shall prove to the contrary." RR No. 2-2001 expounded on this, as follows:

SECTION 7. *Determination of Purpose to Avoid Income Tax*. — The fact that a corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members. Likewise, the fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members. In both instances, the corporation may, by clear preponderance of evidence in its favor, prove the contrary.

For purposes of these Regulations, the term *"holding or investment company"* shall refer to a corporation having practically no activities except holding property, and collecting the income therefrom or investing the same.

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[34] *Id.* at 16.

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The following are *prima facie* instances of accumulation of profits beyond the reasonable needs of a business and indicative of purpose to avoid income tax upon shareholders:

a. Investment of substantial earnings and profits of the corporation in unrelated business or in stock or securities of unrelated business;

b. Investment in bonds and other long-term securities;

c. Accumulation of earnings in excess of 100% of paid-up capital, not otherwise intended for the reasonable needs of the business as defined in these Regulations.

In order to determine whether profits are accumulated for the reasonable needs of the business as to avoid the imposition of the improperly accumulated earnings tax, the controlling intention of the taxpayer is that which is manifested at the time of accumulation, not subsequently declared intentions which are merely the product of afterthought. A speculative and indefinite purpose will not suffice. The mere recognition of a future problem or the discussion of possible and alternative solutions is not sufficient. Definiteness of plan/s coupled with action/s taken towards its consummation are essential. (emphasis supplied)

The BIR simply assessed respondent for IAET by imposing the ten percent (10%) IAET tax rate on all of the latter's income from registered activities enjoying ITH without first establishing *prima facie* why it deemed such income as improperly accumulated. Respondent is clearly not a holding or investment company; and nowhere in the PAN, Details of Discrepancies, or the FLD/FAN did the BIR expressly describe any of the *prima facie* instances of improperly accumulated earnings and profits.

For its part, respondent was able to prove that it had accumulated its earnings from previous years for a reasonable business purpose. Respondent needed funds for a new project, *i.e.*, the manufacture of Heat Run Oven-Controlled Rack, which started commercial operations in June 2007 and was also duly registered with the PEZA. Respondent had to acquire new machinery and equipment as well as a separate exclusive building space for the project. Petitioner did not cross-examine respondent's witness on this matter or present evidence to refute that respondent's

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accumulated income was actually for a reasonable need in its business operations.

WHEREFORE, the petition is **DENIED** for lack of merit. The August 11, 2015 Decision and January 19, 2016 Resolution of the Court of Tax Appeals *En Banc* in CTA EB No. 1139 are hereby **AFFIRMED**.

SO ORDERED.

Caguioa, Carandang, Zalameda and *Gaerlan, JJ.*, concur.

APPEARANCES OF COUNSEL

The Solicitor General for petitioner.
J. Calida & Associates Law Firm for respondent.