

## SECOND DIVISION

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

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, V.  
LANCASTER PHILIPPINES, INC., RESPONDENT.

### DECISION

**MARTIRES, J.:**

This is a Petition for Review on Certiorari<sup>[1]</sup> under Rule 45 of the Rules of Court seeking to reverse and set aside the 30 April 2008 Decision<sup>[2]</sup> and 24 June 2008 Resolution<sup>[3]</sup> 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<sup>[4]</sup> and 12 December 2007 Resolution<sup>[5]</sup> of the CTA First Division (*CTA Division*) in CTA Case No. 6753.

### THE FACTS

The facts<sup>[6]</sup> 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.

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

After the conduct of an examination pursuant to the LOA, the BIR issued a *Preliminary Assessment Notice (PAN)*<sup>[8]</sup> 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.<sup>[9]</sup> 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	-0-
per ITR	
Add: Adjustments-	11,496,770.18
Disallowed purchases	
Adjusted	P11,496,770.18
Taxable	
Income per	
Investigation	

#### INCOME TAX DUE - Basic

April 1 - December 31, 1998	
(9/12 x P11,496,770.18 x 34%)	P 2,913,676.4
January 1 - March 31, 1999	
(3/12 x P11,496,770.18 x 33%)	<u>948,483.54</u>

Income tax still	P
due per	3,880,159.94
investigation	
Interest	2,560,905.56
(6/15/99 to 10/15/02) .66	

Compromise 25,000  
Penalty

**TOTAL** **P**  
**DEFICIENCY** **6,466,065.50**  
**INCOME TAX**

#### **DETAILS OF DISCREPANCIES**

Assessment No. LTAID 11-98-00007

**A. INCOME TAX (P3,880,159.94)** - 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 P11,496,770.18 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.<sup>[10]</sup>

Lancaster replied<sup>[11]</sup> 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.<sup>[12]</sup>

Invoking the same provisions of the law cited in the assessment, *i.e.*, Sections 43<sup>[13]</sup> and 45<sup>[14]</sup> of the National Internal Revenue Code (*NIRC*), in conjunction with Section 45<sup>[15]</sup> 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.

Subsequently on 6 November 2002, Lancaster received from the BIR a final assessment notice (FAN),<sup>[16]</sup> 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 P11,496,770.18, as a consequence of the disallowance of purchases claimed for the **taxable year ending 31 March 1999**.

Lancaster duly protested<sup>[17]</sup> the FAN. There being no action taken by the Commissioner on its protest, Lancaster filed on 21 August 2003 a petition for review<sup>[18]</sup> 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<sup>[19]</sup> 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 P6,466,065.50 SHOULD BE CANCELLED AND WITHDRAWN BY RESPONDENT.

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

**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 **P6,466,065.50**, covering the fiscal year from April 1, 1998 to March 31, 1999.<sup>[20]</sup>

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

Aggrieved, the CIR sought recourse<sup>[23]</sup> 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.<sup>[24]</sup>

The CTA En Banc likewise denied<sup>[25]</sup> the motion for reconsideration from its Decision,

Hence, this petition.

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

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.<sup>[26]</sup>

**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.

The law vesting unto the CTA its jurisdiction is Section 7 of Republic Act No. 1125 (*R.A. No. 1125*),<sup>[27]</sup> 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