

**REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY**

FIRST DIVISION

**ANSI AGRICULTURAL
PRODUCTS, INC.,**

Petitioner,

-versus-

**COMMISSIONER OF INTERNAL
REVENUE,**

Respondent.

CTA CASE NO. 8541

Members:

**DEL ROSARIO, PJ
UY, and
MINDARO-GRULLA, JJ.**

Promulgated:

APR 20 2015 ; 4:05 p.m.

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DECISION

DEL ROSARIO, P.J.:

THE CASE

The present case seeks the review of the final decision rendered by respondent Commissioner of Internal Revenue, through the Bureau of Internal Revenue's (BIR) Regional Director of Revenue Region 7, denying the protest of petitioner on the alleged deficiency income tax assessment in the amount of P2,274,559.92 for the year 2009.

THE PARTIES

Petitioner ANSI Agricultural Products, Inc. is a domestic corporation created and formed under the laws of the Philippines. It is registered with BIR as VAT-exempt company engaged in trading of agricultural raw materials, animal feeds and animal feed ingredients/supplement on wholesale and retail basis with business address at 55-C Lincoln Street, Barangay San Antonio, San Francisco Del Monte (SFMD), Quezon City, Philippines.¹

Respondent, Commissioner of Internal Revenue (CIR), is the Chief of the BIR, an administrative body under the control and supervision of the

¹ Pre-Trial Order (PTO), par. 1; Docket, pp. 219 and 220.

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Department of Finance, with powers and duties, among others, to assess and collect all national internal revenue taxes, and to decide disputed assessments. She rendered the assailed decision and resolution dated July 6, 2012 thru her authorized representative, the Regional Director, Revenue Region No. 7, Quezon City.²

THE FACTS

A Letter of Authority (LOA 2009) No. 00031820 dated June 24, 2010 was issued against petitioner on June 29, 2010 for the investigation of its tax for the period January 1, 2009 to December 31, 2009.³

After investigation, a Preliminary Assessment Notice (PAN) dated July 12, 2011 was received by petitioner on July 13, 2011 informing petitioner of a deficiency income tax for the calendar year ending December 31, 2009.⁴

On July 27, 2011, petitioner filed a letter of protest dated July 25, 2011 with the Quezon City Assessment Division, Revenue Region No. 7, BIR, explaining its position, and by way of response, to the PAN dated July 12, 2011.⁵

Thereafter, an Assessment Notice together with a Formal Letter of Demand No. 038-B083-09 dated August 12, 2011 was issued upon, and was received by petitioner, on August 17, 2011.⁶

On September 8, 2011, petitioner protested the Assessment dated August 12, 2011 in a letter dated September 7, 2011.⁷

On October 7, 2011, petitioner received a letter from respondent dated September 26, 2011 informing petitioner that its letter-protest has been forwarded to the Revenue Region 38, North, Quezon City.⁸

In a Letter-Notice to Taxpayer dated October 12, 2011 received on October 18, 2011 by petitioner, respondent informed petitioner of the re-

² PTO, par. 2; Docket, p. 220.

³ PTO, par. 10; Docket, p. 221; Exhibit "R-2".

⁴ PTO, par. 11; Docket, p. 221.

⁵ PTO, par. 12; Docket, p. 221.

⁶ PTO, par. 13; Docket, p. 221.

⁷ PTO, par. 14; Docket, p. 221.

⁸ PTO, par. 15; Docket, p. 221.

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assignment of Letter of Authority and the continuance of examination of books of accounts and other accounting records.⁹

A considerable length of time had elapsed but no examination of books of accounts and other accounting records was done by respondent. Likewise, no action was taken on petitioner's protest. As events turned out, more than one (1) year had passed when petitioner finally received on July 26, 2012 a letter dated July 6, 2012 from respondent denying its protest, on the ground that "you have failed to submit documents in support of your protest," which said letter constitutes the final decision of the respondent CIR 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 (NIRC) or other laws administered by the BIR which this Honorable Court exercises exclusive appellate jurisdiction to review by appeal under R.A. 1125.¹⁰

On August 28, 2012, petitioner filed via registered mail the Petition for Review, which the Court received on September 5, 2012, praying for the reversal and cancellation of respondent's final decision on disputed assessment. In support thereof, petitioner ascribes the following errors allegedly committed by respondent, *viz.*:

1. Respondent CIR has committed grave abuse of discretion amounting to lack of, or excess of jurisdiction in rendering the final decision dated July 6, 2012, which is adverse to the herein petitioner, based only on petitioner's alleged failure to submit documents, which is based on pure technicality and not on the merits;
2. Respondent's decision on the assessment was not proper and correct and not in accordance with law.

On September 25, 2012, respondent filed her Answer.¹¹ Thereafter, she filed a Motion for Leave of Court (To File Amended Answer), with attached Amended Answer¹² on October 23, 2012, which was granted in a Resolution¹³ dated December 14, 2012. In her Amended Answer,¹⁴ respondent averred the following special and affirmative defenses:

⁹ PTO, par. 16; Docket, p. 222.

¹⁰ PTO, par. 17; Docket, p. 222.

¹¹ Docket, p. 42.

¹² Docket, pp. 49-56.

¹³ Docket, p. 79.

¹⁴ Docket, p. 51

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“SPECIAL AND AFFIRMATIVE DEFENSES

8. The assessment for calendar year 2009 deficiency income tax was issued in accordance with applicable law and regulations. The factual and legal bases of the assessments are contained in the Formal Letter of Demand (FLD) and Final Assessment Notice (FAN).

9. As alleged by Petitioner in its Petition, it received the PAN on July 13, 2011 and the FAN and FLD on August 17, 2011. Subsequently, it filed its Letter of Protest for the PAN on July 27, 2011 and for the FAN on September 8, 2011. However, the Petitioner failed to submit the required documents within sixty (60) days from the filing of the letter of protest, hence, the assessment have already become final, executory and demandable. Consequently, this Honorable Court cannot anymore exercise jurisdiction over Petitioner’s Petition for Review.

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10. A perusal of Annex ‘F’ of the Petition for Review purporting to be a protest letter does not stand the test as required under RR 12-99 and likewise, nowhere in said letter indicates that what was mentioned therein as a reply to the PAN is copied for the FAN.

Likewise, assuming without admitting that Petitioner’s Annex ‘F’ is a proper protest letter, be it for reconsideration or reinvestigation, the same did not suspend the running of the prescriptive period *[sic]* which to file this Petition before this Honorable Court. Hence, it is respectfully submitted that the filing of this Petition for Review after the prescriptive period results in the lack of jurisdiction of this Honorable Court over this case.

11. Further, Section 228 of the 1997 National Internal Revenue Code provides that an assessment

‘xxx may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from the filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become file *(sic)*.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period, otherwise, the decision shall become final, executory and demandable.

12. Since Petitioner received denial of its administrative protest on July 26, 2012, it had until August 25, 2012 to file a petition for review

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before the Court of Tax Appeals. It filed one, however, on September 5, 2012, hence, it was filed out of time. For a motion for reconsideration of the denial or the administrative protest does not toll the 30-day period to appeal to the Court of Tax Appeals.

13. Assuming *por arguendo* that the instant Petition was filed within *[sic]* period provided by law, the details of discrepancy disclosed the following:

Deficiency Income Tax

- a. Verification disclosed that bad debts expense failed to meet substantiation requirements under Section 34 (e) of the NIRC of 1997, as amended in relation to RR-5-99 as amended by RR-25-2002. Therefore, disallowed as expense and assessed with corresponding income tax.
- b. Verification disclosed that the said amount represents payable to Swift Foods, Inc. which was unilaterally declared to be condoned and offsetted against its receivable from the same company. Such amount should have been reported as part of taxable income, hence, was added back pursuant to Section 31 and 32 of the NIRC of 1997, as amended Audit Memorandum Order (RAMO) I-2000.”

During pre-trial conference, the parties entered into admissions, stipulation of facts, definition of issue, identification of witnesses and documentary evidence,¹⁵ and eventually submitted their Joint Stipulation of Facts and Issues¹⁶ (JSFI) on March 11, 2014. The Court approved the JSFI and terminated pre-trial in the Resolution¹⁷ dated March 17, 2014.

Both parties eventually presented their respective testimonial and documentary evidence. Petitioner’s formally offered evidence,¹⁸ consisting of Exhibits “P-1” to “P-13-1”, were admitted in the Resolution¹⁹ promulgated on July 8, 2014, with the exception of an unmarked document described as 2009 Books of Accounts (General Journal) which was offered as Exhibit “P-8”. Respondent’s formal offer of evidence filed on October 13, 2014, consisting of Exhibits “R-1” to “R-8-a”, were all admitted in the Resolution²⁰ dated November 28, 2014.

¹⁵ Docket, pp. 185 & 188.

¹⁶ Docket, p. 212.

¹⁷ Docket, p. 217.

¹⁸ Docket, p. 263.

¹⁹ Docket, p. 522.

²⁰ Docket, p. 563.

With the filing of respondent's Memorandum²¹ on January 23, 2015 and without memorandum from the petitioner as per Records Verification report²² dated February 5, 2015, this case was submitted for decision on February 12, 2015.²³

ISSUES

The parties jointly stipulated the following issues for the resolution of the Court, to wit:

1. Whether or not petitioner's bad debts expenses meet the substantiation requirements under the pertinent provisions on bad debts in Section 34(e) of the NIRC of 1997;
2. Whether said amount represents payable to Swift Foods, Inc. (which was unilaterally declared to be condoned and offsetted against its receivable from the same company) should have been reported as part of taxable income, hence was added back pursuant to Section 31 and Section 32 of the NIRC of 1997, as amended and Revenue Audit Memorandum Order (RAMO) 1-2000;
3. Whether or not petitioner is liable for deficiency income tax in the amount of Php2,274,559.92; and,
4. Whether or not the assessments made against petitioner is proper, correct and with legal and factual bases.²⁴

Aside from the foregoing stipulated issues, the Court deems it appropriate to also resolve the contention raised by respondent that the Court cannot exercise jurisdiction over the case as the assessment already became final, executory and demandable.

THE RULING OF THE COURT

The disputed assessment has not yet attained finality

Respondent claims that the assessment already became final, executory and demandable for petitioner's failure to submit the required

²¹ Docket, p. 570.

²² Docket, p. 579.

²³ Docket, p. 581.

²⁴ Docket, p. 223.

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documents within sixty (60) days from the filing of its protest pursuant to Section 228 of the NIRC of 1997, as amended,²⁵ which provides:

“SECTION 228. Protesting of Assessment. — xxx

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.”

Notably, there are two (2) kinds of protest stated in the above-quoted provision of the NIRC, namely: (i) request for reconsideration and (ii) request for reinvestigation. While Revenue Regulation (RR) No. 12-99 (*the implementing regulation of Sec. 228 of the NIRC*) does not define the two kinds of protest, prior revenue issuance, *i.e.*, Revenue Regulations No. 12-85, provided their definition, and distinguished these two types of protest in this manner:

“(a) **Request for reconsideration**-- refers to a plea for a re-evaluation of an assessment on the basis of *existing records* without need of additional evidence. It may involve both a question of fact or of law or both.

(b) **Request for reinvestigation**—refers to a plea for re-evaluation of an assessment on the basis of newly-discovered evidence or additional evidence that a taxpayer intends to present in the investigation. It may also involve a question of fact or law or both.”

In *Commissioner of Internal Revenue vs. Philippine Global Communication, Inc.*,²⁶ the Supreme Court held that the main difference between these two types of protests lies in the records or evidence to be examined by internal revenue officers, whether these are existing records or newly discovered or additional evidence.

While the law requires a taxpayer to submit all relevant supporting documents within sixty (60) days from the filing of the protest, the requirement is more appropriately confined to protest by way of a request for reinvestigation. To be sure, said type of protest contemplates a situation where a taxpayer would present newly discovered evidence or additional evidence. In the case of a request for reconsideration, the above-stated requirement appears inappropriate since the re-evaluation of assessment is based on existing records.

²⁵ Docket, pp. 53 and 576.

²⁶ G. R. No. 167146, October 31, 2006.

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Notwithstanding the foregoing distinction, if the protest letter does not categorically state that the taxpayer is requesting for “reinvestigation” or “reconsideration,” as in the case at bar, the same is to be treated as letter of reinvestigation and reconsideration.²⁷

The alleged non-submission therefore of supporting documents should not at all be considered as a fatal infirmity as petitioner’s protest - - *being also in the nature of a request for reconsideration* - - requires only re-evaluation of existing records.

In any case, respondent failed to specify the documents which petitioner allegedly failed to submit within the 60-day period from the filing of the protest, thus, the Court cannot make a determination on the relevance of such documents. In ***Metropolitan Bank and Trust Co. vs. Commissioner of Internal Revenue***²⁸ (*Metrobank*) the Supreme Court has this to say:

“The Court cannot simply accept the allegation of the CIR that Metrobank failed to submit the relevant supporting documents within 60 days from the filing of its protest on 17 January 2003, when the CIR does not even identify what these documents are. If the Court does not know what particular documents Metrobank purportedly failed to submit in support of its protest, then the Court likewise cannot make a determination on the relevance of such documents.”

Besides, the protest letter shows that petitioner in fact submitted a document, *i.e., statement/ledger print-out from Swift Foods* as an attachment thereto, which may be considered to be its compliance with the requirement of submission of relevant supporting documents within the 60-day period from protest.

The term “*relevant supporting documents*” should be understood as those documents necessary to support the legal basis in disputing a tax assessment as determined by the taxpayer. The BIR can only inform the taxpayer to submit additional documents. The BIR cannot demand what type of supporting documents should be submitted. Otherwise, a taxpayer will be at the mercy of the BIR, which may require the production of documents that a taxpayer cannot submit.²⁹

The assessment was properly made as it contains factual

²⁷ Commissioner of Internal Revenue vs. Wyeth Suaco Laboratories, Inc., G.R. No. 76281, September 30, 1991.

²⁸ G.R. No. 178797, August 4, 2009.

²⁹ Commissioner of Internal Revenue vs. First Express Pawnshop Company, Inc., G.R. Nos. 172045-46, June 16, 2009

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and legal bases, and the same was issued in accordance with tax law and its implementing revenue regulations.

The arguments presented by petitioner in its Petition for Review pertain to the alleged incorrectness of the final decision on disputed assessment, including the items of assessment itself.³⁰

Respondent argues that the disputed assessment was issued in accordance with applicable law and regulations, and the factual and legal bases of the assessments are contained in the Formal Letter of Demand (FLD) and Final Assessment Notice (FAN).³¹

The FLD issued by respondent against petitioner is reproduced below for reference and discussion purposes, viz.:

“ANSI AGRICULTURAL PRODUCTS, INC.

No. 55 Lincoln St., Brgy. San Antonio

SFDM, Quezon City

TIN: 212-414-762-000

Gentlemen:

Please be informed that after investigation there has been found due from you deficiency income tax for the calendar year ending December 31, 2009, as shown hereunder:

<u>DEFICIENCY INCOME TAX</u>		
Taxable income per ITR		P2,993,060.13
Adjustments per investigation		
Disallowed bad debts expense	P3,640,862.00	
Undeclared other income	<u>2,310,495.50</u>	<u>5,951,357.50</u>
Taxable income per investigation		<u>P8,944,417.63</u>
Income Tax Due		P2,683,325.29
Less: Tax credits/payments:		
Payments per BIR-ITS	P 45,709.13	
Prior year's excess credits other than MCIT	846,908.91	
Creditable tax withheld	<u>5,300.00</u>	<u>897,918.04</u>
Deficiency Income Tax		P1,785,407.25
Add: 20% Interest p.a. (04.16.10 to 8.29.11)		<u>489,152.67*</u>
TOTAL AMOUNT DUE		<u>P2,274,559.92*</u>

*Please note that the interest and the total amount due will have to be adjusted if paid beyond August 29, 2011.

The complete details covering the factual and legal basis of the aforementioned discrepancies established during the investigation of this case are shown hereunder:

³⁰ Docket, pp. 14-18.

³¹ Docket, pp. 52, 575 & 576.

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DEFICIENCY INCOME TAX

- a. Disallowed bad debts expense (P3,640,862.00) – Verification disclosed that bad debts expense failed to meet substantiation requirements under Section 34(E) of the NIRC of 1997, as amended in relation to RR 5-99 as amended by RR 25-2002. Therefore, disallowed as expense and assessed with corresponding income tax.**
- b. Undeclared other income (P2,310,495.50) - Verification disclosed that the said amount represents payable to Swift Foods, Inc. which was unilaterally declared to be condoned and offsetted against its receivable from the said company. Such amount should have been reported as part of taxable income, hence, was added back pursuant to Sections 31 and 32 of the NIRC of 1997, as amended and Revenue Audit Memorandum Order (RAMO) 1-2000.**

The 20% interest per annum has been imposed pursuant to the provisions of Section 249(B) of the National Internal Revenue Code (NIRC) of 1997, as amended.

In view thereof, you are hereby requested to pay the aforesaid tax liability through the duly authorized agent bank in which you are enrolled within the time shown in the enclosed assessment notice. If payment has been made, it is requested that the Assessment Division be furnished with a copy of Payment Form BIR (0605) and the Official Receipt issued by accredited bank.

In case of failure to pay within the prescribed period stated in the Assessment(,) the 25% surcharge will be imposed pursuant to the provisions of Section 248(A) of the National Internal Revenue Code, as amended by R.A. 8424.

We hope that you will give this matter your preferential attention.”
(*Boldfacing supplied*)

The disputed assessment was made pursuant to Section 228 of the NIRC of 1997, as amended, vis-à-vis RR No. 12-99, with a detailed statement of the law and facts on which it was based.

Compliance with the procedures outlined in RR 12-99³² for the issuance of assessment is evident on record. The BIR issued a Notice of

³² 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

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Informal Conference³³ dated February 14, 2011 allowing petitioner to arrange for an informal conference if it does not agree with the findings anent the reported income tax deficiency. Informal conference subsequently ensued as petitioner itself recognized in its letter dated March 7, 2011, which the BIR received on March 8, 2011.³⁴ The BIR issued the PAN dated July 12, 2011, which was received by petitioner on July 13, 2011 informing petitioner of a deficiency income tax for the calendar year ending December 31, 2009.³⁵ After petitioner filed on July 27, 2011 (*the fifteenth day from receipt of PAN*) its letter protest against the PAN,³⁶ the FAN and FLD No. 038-B083-09 dated August 12, 2011 were issued, and the same were received by petitioner on August 17, 2011.³⁷

Special Investigation Division, as the case may be (in the case 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, 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 (see illustration in ANNEX A hereof). 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.

3.1.3 Exceptions to Prior Notice of the Assessment. — xxx

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 (see illustration in ANNEX B hereof). 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.

³³ Exhibit "R-3".

³⁴ BIR Records, pp. 379-380

³⁵ Exhibit "R-5"; par. 11, Pre-Trial Order, Docket, p. 221.

³⁶ BIR Records, pp. 395-398; par. 12, Pre-Trial Order, p. 221.

³⁷ Exhibits "R-6" and "R-6-A"; par. 13, Pre-Trial Order, p. 221.

Clearly, the FAN and FLD No. 038-B083-09 were issued in accordance with Section 228 of the NIRC of 1997, as amended and Section 3 of RR No. 12-99.

The Court shall now proceed to resolve the issue pertaining to the propriety or impropriety of the items of assessment, *i.e., disallowance of bad debts expense for alleged failure to meet substantiation requirement, the alleged undeclared income resulting from offsetting of payable and receivable accounts of petitioner, and the imposition of twenty percent (20%) deficiency interest.*

***Disallowed bad debts expenses
failed to meet the
substantiation requirements***

The BIR disallowed petitioner's bad debts expense of P3,640,862.00 for failure to meet substantiation requirements under Section 34(E) of the NIRC of 1997, as amended in relation to RR No. 5-99 as amended by RR No. 25-2002.³⁸ Petitioner, on the other hand, maintains that the conditions for its deductibility as set forth in the aforesaid law and regulations were actually met.³⁹

Deductions for income tax purposes partake of the nature of tax exemptions and are strictly construed against the taxpayer, who must prove by convincing evidence that he is entitled to the deduction claimed.⁴⁰

Section 34 (E) of the NIRC of 1997, as amended provides:

“SECTION 34. Deductions from Gross Income. — Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), there shall be allowed the following deductions from gross income:

xxx

xxx

xxx

(E) Bad Debts. —

³⁸ Exhibit “R-6-A”.

³⁹ Docket, p. 16.

⁴⁰ Philex Mining Corporation vs. Commissioner of Internal Revenue, G.R. No. 148187, April 16, 2008.

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(1) In General. — Debts due to the taxpayer actually ascertained to be worthless and charged off within the taxable year except those not connected with profession, trade or business and those sustained in a transaction entered into between parties mentioned under Section 36(B) of this Code: Provided, That recovery of bad debts previously allowed as deduction in the preceding years shall be included as part of the gross income in the year of recovery to the extent of the income tax benefit of said deduction.”

Section 3 of RR No. 5-99, as amended by RR No. 25-02⁴¹ provides:

“Sec. 3. Requisites for valid deduction of bad debts from gross income. — The requisites for deductibility of bad debts are:

- (1) There must be an existing indebtedness due to the taxpayer which must be valid and legally demandable;**
- (2) The same must be connected with the taxpayer's trade, business or practice of profession;**
- (3) The same must not be sustained in a transaction entered into between related parties enumerated under Sec. 36(B) of the Tax Code of 1997;**
- (4) The same must be actually charged off the books of accounts of the taxpayer as of the end of the taxable year; and**
- (5) The same must be actually ascertained to be worthless and uncollectible as of the end of the taxable year.**

Before a taxpayer may charge off and deduct a debt, he must ascertain and be able to demonstrate with reasonable degree of certainty the uncollectibility of the debt. The Commissioner of Internal Revenue will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor in determining whether a debt is worthless, or the assigning of the case for collection to an independent collection lawyer who is not under the employ of the taxpayer and who shall report on the legal obstacle and the virtual impossibility of collecting the same from the debtor and who shall issue a statement under oath showing the propriety of the deductions thereon made for alleged bad debts. Thus, where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of those facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction.

⁴¹ Subject: Amending Revenue Regulations No. 5-99, Further Implementing Section 34(E) of the Tax Code of 1997 on the Requirements for Deductibility of Bad Debts from Gross Income

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In the case of banks, the Commissioner of Internal Revenue shall determine whether or not bad debts are worthless and uncollectible in the manner provided in the immediately preceding paragraph. Without prejudice to the Commissioner's determination of the worthlessness and uncollectibility of debts, the taxpayer shall submit a Bangko Sentral ng Pilipinas/Monetary Board written approval of the writing off of the indebtedness from the banks' books of accounts at the end of the taxable year.

Also, in no case may a receivable from an insurance or surety company be written-off from the taxpayer's books and claimed as bad debts deduction unless such company has been declared closed due to insolvency or for any such similar reason by the Insurance Commissioner." (Boldfacing supplied)

To be entitled to bad debts expense as a deduction, it is incumbent upon petitioner to prove by preponderance of evidence its compliance with the afore-quoted requirements of Section 3 of RR No. 5-99, as amended by RR No. 25-02.

Based on records, petitioner convincingly established the following: (i) *existence of indebtedness due to petitioner*, (ii) *the said indebtedness due to petitioner is in connection with its business*, and (iii) *the amounts due to petitioner were actually charged off in its books of accounts*. The parties jointly stipulated the fact that petitioner had business transactions with Swift Foods, Inc. and Nueva Swine Valley, Inc. related to, and in connection with, their respective trade or business for the year 2005. Swift Foods, Inc. and Nueva Swine Valley, Inc. incurred indebtedness to petitioner in the amount of P2,866,862.00 and P774,000.00, respectively. The amounts have been declared as bad debts and have not been paid.⁴²

Respondent, however, questioned petitioner's determination of worthlessness of the latter's accounts receivable from Swift Foods, Inc. and Nueva Swine Valley, Inc. She asserted that petitioner failed to exert diligent efforts to collect the debt, as it failed to file a collection case against its debtor, which is a requisite before considering a debt as worthless pursuant to *Philippine Refining Company vs. Court of Appeals*, G.R. No. 118794, May 8, 1996.⁴³

Petitioner counter-argues that no less than its President exerted diligent effort to collect its receivable from Swift Foods, Inc. from 2004 to 2009 by repeatedly requesting for payment, visiting, communicating and

⁴² Pre-Trial Order, Docket, p. 220.

⁴³ Docket, pp. 572-575.

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calling up people-in-charge from Swift Foods, Inc. Allegedly, petitioner repeatedly brought them statements of accounts calling Swift Foods, Inc.'s attention of its outstanding liability but its diligent efforts had been unsuccessful as they did not bear positive results. Accordingly, it did not file a collection case in court because it would further increase its own losses by incurring legal charges and litigation costs. Petitioner further averred that its failure to collect until year 2011, which is seven (7) years after it sold the goods to Swift Foods, Inc., is an evidence of worthlessness of this receivable.⁴⁴

As to its accounts receivable from Nueva Swine Valley, Inc., which is outstanding since 2005, petitioner contended that it likewise exerted effort to collect diligently. Allegedly, after the check which secured said debtor's debt bounced, petitioner was deceived into believing that Nueva Swine Valley, Inc. had honest intention to fulfill its obligation for as long as it does not make harsh move to sue said debtor. Nueva Swine Valley, Inc.'s officers at first had been talking to petitioner's President asking him to stretch out his patience and consideration as they experienced financial difficulty. Eventually in 2008, Nueva Swine Valley, Inc. absconded from its obligation as their office was closed and no one was left to deal with petitioner regarding the settlement of the debt. The lawyer, who was consulted by petitioner on its concern as to whether it can still sue Nueva Swine Valley, Inc. to demand payment, responded that petitioner's right to collect had already prescribed.⁴⁵

In determining whether a debt is worthless, RR No. 25-02 provides that all pertinent evidence, including the value of the collateral and the financial condition of the debtor, or the assigning of the case for collection to an independent collection lawyer, will have to be considered. RR No. 25-02 further states that where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of those facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction.

In *Philippine Refining Company (now known as "Unilever Philippines [PRC], Inc.") vs. Court of Appeals*⁴⁶ (PRC case), the Supreme Court recognized certain steps in proving that a taxpayer exerted diligent efforts to collect the debts, viz: (1) sending of statement of accounts; (2) sending of collection letters; (3) giving the account to a lawyer for collection; and (4) filing a collection case in court.

⁴⁴ Docket, p. 15.

⁴⁵ Docket, pp. 15-16.

⁴⁶ G.R. No. 118794, May 8, 1996.

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In the case at bar, petitioner failed to show compliance with the outlined steps in collecting debts from Swift Foods, Inc. and Nueva Swine Valley, Inc. regarding the sending of statement of accounts and collection letters, giving/assigning of the account to a lawyer for collection, and the filing of a collection case in court. In particular, while petitioner alleged that it sent statement of accounts to Swift Foods, Inc., the same is unsubstantiated by evidence. Similarly, the testimony⁴⁷ of its Accountant in the person of Emerenciana Anselmo Mandia that petitioner's agents and President made several follow-ups and visit to Swift Foods, Inc. to demand payment and that it sent Nueva Swine Valley, Inc. statements of account which the latter refused to sign is simply self-serving evidence *sans* probative value. In **PRC** case, the Supreme Court held:

We find that said accounts have not satisfied the requirements of the 'worthlessness of a debt.' **Mere testimony of the Financial Accountant of the Petitioner explaining the worthlessness of said debts is seen by this Court as nothing more than a self-serving exercise which lacks probative value. There was no iota of documentary evidence** (e.g., collection letters sent, report from investigating fieldmen, letter of referral to their legal department, police report/affidavit that the owners were bankrupt due to fire that engulfed their stores or that the owner has been murdered, etc.), **to give support to the testimony** of an employee of the Petitioner. **Mere allegations cannot prove the worthlessness of such debts** in 1985. Hence, the claim for deduction of these thirteen (13) debts should be rejected." (*Boldfacing supplied*)

Thus, in the absence of supporting documentary evidence, petitioner's allegation and the testimony of its witness are too weak and unconvincing to establish that petitioner exerted diligent efforts to collect and that its receivables are worthless.

The audited comparative Financial Statements⁴⁸ of Swift Foods, Inc. for 2004 and 2005, 2008 and 2009, and 2011 and 2012, which were presented by petitioner, do not persuade the Court that said debtor is really incapable of settling its obligation with petitioner.

An independent auditor reported that Swift Foods, Inc.'s total current liabilities exceeded its total current assets as of December 31, 2005, which condition accordingly may have an effect on its ability to continue operating in the normal course of business.⁴⁹ Nonetheless, such financial condition should not *ipso facto* lead the Court to a conclusion that Swift Foods, Inc.'s debt to petitioner will not anymore be paid even in the future. In fact, the

⁴⁷ Exhibit "P-13"; April 29, 2014 Transcript of Stenographic Notes.

⁴⁸ Exhibits "P-3", "P-9", and "P-10".

⁴⁹ Exhibit "P-3".

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Balance Sheet⁵⁰ of Swift Foods, Inc. as of December 31, 2012, which reflects the whole picture of its financial condition, discloses the following amounts (*in thousands*):

ASSETS**Current Assets**

Cash and cash equivalents	P 84,074
Receivables	157,353
Inventories	1,567
Biological assets	4,938
Other current assets	372
Total Current Assets	248,304

Noncurrent Assets

Investment properties	417
Property, plant and equipment	108,125
Other noncurrent assets	255
Total Noncurrent Assets	108,797
TOTAL ASSETS	P 357,101

LIABILITIES AND EQUITY**Current Liabilities**

Accounts payable and accrued liabilities	P 192,673
Bank Loan	-
Trust receipts and acceptances payable	-
Total Current Liabilities	192,673

Noncurrent Liabilities

Deferred income tax liabilities	32,157
Retirement benefits liability	25,308
Total Noncurrent Liabilities	57,465
Total Liabilities	250,138

Equity

Capital stock	1,868,411
Capital in excess of par value	1,291,172
Deficit	(2,941,638)
Cost of preferred treasury shares	(110,982)
Total Equity	106,963
TOTAL LIABILITIES AND EQUITY	P 357,101

(*Boldfacing supplied*)

Clearly, Swift Foods, Inc.'s total assets of P357,101,000.00 consisting of total current assets of P248,304,000.00 and total non-current assets of P108,797,000.00 as of December 31, 2012 is more than enough to pay its total liabilities of P250,138,000.00.

⁵⁰ Exhibit "P-10"; Docket, p. 438.

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Aside from the foregoing observation, the Court also notes that petitioner failed to establish that it is not related to Swift Foods, Inc. and Nueva Swine Valley, Inc. Needless to say, such circumstance is an equally important requirement for deductibility of bad debts expense pursuant to Section 3(3) of RR No. 5-99, as amended by RR 25-02.

Offsetting of petitioner's receivable account from Swift Foods, Inc. with its own payable account to the same debtor-creditor, as a consequence of the partial settlement of the latter's prior debt, will not produce any taxable income.

The BIR assessed petitioner of undeclared other income of P2,310,495.50 representing the receivable amount of petitioner from Swift Foods, Inc. which was condoned or offsetted against its own payable amount to Swift Foods, Inc. The BIR concludes that such amount should have been reported as part of taxable income, hence, was added back pursuant to Sections 31 and 32 of the NIRC of 1997, as amended and Revenue Audit Memorandum Order (RAMO) 1-2000.⁵¹

Petitioner explains that its total accounts receivable from Swift Foods, Inc. amounted to P5,177,357.50 for sales it made in 2004. In 2005, Swift Foods Inc. offered to make partial payments not in a form of cash, but by means of its non-moving inventory of dressed chicken, which petitioner accepted. It was able to get P2,310,495.50 total worth of said inventory of dressed chicken but the same was sold at a loss. Eventually, its uncollectible account from Swift Foods, Inc. was reduced to P2,866,862.00.⁵²

Petitioner argues that there is no unreported income because there is no new money coming into the company. The sale on credit to Swift Foods, Inc. was already reported, the supposed income derived therefrom was already declared and recognized, and the tax was already paid. Not having been paid, it remained under accounts receivables and when it is paid (*in this case, it was paid in kind*), there is no income recognized as the supposed income was already previously recognized and the tax was already paid. Petitioner claims that there would be double taxation on this transaction if

⁵¹ Exhibit "R-6-A".

⁵² Docket, p. 17.

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the BIR will insist on its findings of an unreported income even when there is really none.⁵³

Income denotes a flow of wealth during a definite period of time.⁵⁴
For income to be taxable, the following requisites must exist:

- (1) there must be gain;
- (2) the gain must be realized or received; and
- (3) the gain must not be excluded by law or treaty from taxation.⁵⁵

Offsetting of petitioner's receivable account from Swift Foods, Inc. with its own payable account to the same debtor-creditor, as a consequence of the partial settlement of the latter's prior debt, will not produce any taxable income as there is no gain realized therefrom. With the reduction of the receivable account to the extent of the offsetted payable account, no new income is recognized as the supposed income was already previously recognized during the year the sale on credit was made, and the related tax therefrom was already paid.

In her Judicial Affidavit,⁵⁶ petitioner's witness Emerenciana Anselmo Mandia illustrated how petitioner booked its relevant business transactions with Swift Foods, Inc., *namely: the time it sold on credit its product to Swift Foods, Inc., the payments in the form of cash made by Swift Foods, Inc., the time it took the dressed chicken inventory as additional partial payment of Swift Foods, Inc.'s previous debt, and the offsetting of receivable and payable accounts*, to wit:

"13. Regarding the account of Swift, how were the accounts incurred?

Petitioner sold animal feed ingredients to Swift from November 5, 2004 up to December 20, 2004 covering 8 sales transactions for a total value of P6,768,357.50. (breakdown per Annex A).

14. What record if any do you have of this account?

These transactions were **recorded in the books as:**

Dr. Accounts Receivable – Trade . . P6,768,357.50
Cr. Sales P6,768,357.50

⁵³ Docket, p. 17.

⁵⁴ Chamber of Real Estate and Builders' Association, Inc. vs. The Hon. Executive Secretary Alberto Romulo, et al., G.R. No. 160756. March 9, 2010.

⁵⁵ Id.

⁵⁶ Exhibit "P-13".

See Exhibit A – 2004 Books of Accounts (Sales Book)⁵⁷

15. What happened to Swift's account afterwards, if any?

Swift issued partial payments to Petitioner from January 28, 2005 up to March 11, 2005 (4 partial payments) for a total of only P700,000.00 (breakdown per Annex B).

16. What record if any do you have of these payments?

These payments **were recorded in the books as:**

<u>Dr. Cash</u>	<u>P700,000.00</u>
<u>Cr. Accounts Receivable –Trade</u>	<u>P700,000.00</u>

See Exhibit B – 2005 Books of Accounts (Cash Receipts Books)⁵⁸

17. What happened to the Swift Account after that, if any?

Swift failed to make any payment to Petitioner from March 11, 2005 until July 2005 due to financial difficulty.

18. What do you mean by financial difficulty?

Swift was losing money. It was in the newspapers and also in their Audited Financial Statements 2005/2004. The SEC Annual Report for that year highlighted their financial failure. See Exhibit C, SEC Report.

Swift openly announced in public and in the newspapers that their poultry business had become unprofitable. The results of operations of Swift rendered them incapable of fulfilling their billions of financial obligations.

See Exhibit I – News articles about Swift status⁵⁹

See Exhibit J – Swift Audited Financial Statement 2009/2008⁶⁰

See Exhibit K – Swift Audited Financial Statements 2012/2011⁶¹

19. What happened **after Swift failed to make payment?**

Petitioner agreed to Swift's offer for swap by which to collect the account by buying old-stock frozen chicken from Swift worth P2,310,495.50 (see breakdown per Annex C) which Petitioner eventually sold to other customers at a loss. The purchase of frozen chicken happened from August 5, 2005 to December 5, 2005.

20. What record if any do you have of this purchase?

The purchase by Petitioner from Swift was recorded in the books as:

⁵⁷ Actually marked and offered as Exhibit "P-1".

⁵⁸ Actually marked and offered as Exhibit "P-2".

⁵⁹ Actually marked and offered as Exhibit "P-8".

⁶⁰ Actually marked and offered as Exhibit "P-9".

⁶¹ Actually marked and offered as Exhibit "P-10".

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Dr. Inventory Purchases P2,310,495.50

Cr. Accounts Payable –Trade P2,310,495.50

See Exhibit D – 2005 Books of Accounts (Purchase Book).⁶²

21. What was your responsibility over this swap arrangement, if any?

I was personally overseeing the swap arrangement with Swift, to offset the purchase of the chicken and the accounts receivables. The chicken was initially purchased on credit because:

- a. Petitioner was uncertain about the feasibility of swap arrangement, we were still hoping that we could still collect cash and not old dressed chicken,
- b. Petitioner has never bought chicken in its entire history as a company, we have never had any experience selling dressed chicken and did not know how we could convert them to cash, and
- c. Of course, in the end, **the chicken were sold at a loss.**

22. What record if any do you have of this loss?

See Exhibit E – 2005 Books of Accounts (Sales Book)⁶³ showing loss from sale of chicken (sold at price much lower than purchase price in Exhibit D).

23. You mentioned making the offsetting, can you explain how you did that?

In 2009, I did the final offsetting in the books, the amount of chicken purchased was deducted from the total liability of Swift to Petitioner. Petitioner reduced the outstanding Accounts Receivable from Swift by offsetting still outstanding payable to Swift as follows:

Dr. Accounts Payable Trade P2,310,495.50

Cr. Accounts Receivable Trade P2,310,495.50

See Exhibit G – 2009 Books of Account (General Journal).⁶⁴

24. What happened after you made the offsetting?

The offsetting reduced Accounts Receivable from Swift to P2,866,862.00 but NO INCOME WAS REALIZED OUT OF THIS OFFSET, merely a reduction of receivable.

25. After that, what happened to the Swift account, if any?

From June 20, 2007 up to July 16, 2009, Swift made several partial payments of small amounts, mostly P20,000 per transaction (breakdown per Annex D) which totaled P891,000.

⁶² Actually marked and offered as Exhibit “P-4”.

⁶³ Actually marked and offered as Exhibit “P-5”.

⁶⁴ Actually marked and offered as Exhibit “P-7”.

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26. What record if any do you have of these payments?

These payments were recorded in the books as follows:

Dr. Cash P891,000.00
Cr. Accounts Receivable – Trade P891,000.00

See Exhibit F – 2007 to 2009 Books of Accounts (Cash Receipts Book)⁶⁵

27. **After these payments**, what balance remained?

Swift had a remaining balance of P2,866,862.00 after that.
(Emphasis supplied)

To summarize in a *T-account* form the movement of the receivable and payable accounts pertaining to petitioner's transactions with Swift Foods, Inc., the same would disclosed the following:

<u>Transactions:</u>	<u>Accounts Receivable - Trade</u>		<u>Accounts Payable - Trade</u>	
	<i>Debit</i>	<i>Credit</i>	<i>Debit</i>	<i>Credit</i>
1. Sale on credit to Swift Foods, Inc. in 2004	6,768,357.50			
2. Partial payment in 2005		700,000.00		
3. Accepted Swift's offer to swap old stock chicken in 2005				2,310,495.50
4. Offsetting in 2009		2,310,495.50	2,310,495.50	
5. Partial payment from 2007 to 2009		891,000.00		
Total	6,768,357.50	3,901,495.50	2,310,495.50	2,310,495.50
Balance	2,866,862.00			-

Apparently, offsetting of receivable account from Swift Foods, Inc., with that of petitioner's own payable accounts with the same debtor-creditor does not involve 'revenue accounts' but involved only the 'balance sheet' accounts, which are called 'permanent accounts'. There is no income realized during the time the receivable and payable accounts were offsetted in petitioner's books in 2009 as the related income of the offsetted receivable account of P2,310,495.50 was already recognized at the time of sale in 2004.

⁶⁵ Actually marked and offered as Exhibit "P-6".

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***The twenty percent (20%)
deficiency interest is
sanctioned by law.***

In the FAN and FLD, the BIR imposed twenty percent (20%) interest pursuant to Section 249(B) of the NIRC of 1997, as amended. Petitioner, however, disagrees with such imposition arguing that it has no basis in fact and in law.

Contrary to petitioner's contention, Section 249 (B) of the NIRC of 1997 provides that "any deficiency in the tax due shall be subject to 20% interest as prescribed in Section 249 (A) of the NIRC, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof."⁶⁶ As the law is clear and categorical, the BIR's imposition of 20% interest on deficiency tax must therefore be sustained.

WHEREFORE, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessment for deficiency income tax issued by respondent against petitioner covering taxable year 2009 is hereby **AFFIRMED WITH MODIFICATION**. Accordingly, petitioner is **ORDERED TO PAY** the amount of P1,365,323.25, inclusive of 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Taxable income per ITR		P2,993,060.13
Add: Disallowed bad debts expense		<u>P3,640,862.00</u>
Taxable income after adjustment		<u>P6,633,922.13</u>
Income Tax Due		P1,990,176.64
Less: Tax credits/payments:		
Payments per BIR-ITS	P 45,709.13	
Prior year's excess credits other than MCIT	846,908.91	
Creditable tax withheld	<u>5,300.00</u>	<u>897,918.04</u>
Basic Deficiency Income Tax		<u>P1,092,258.60</u>
25% Surcharge		<u>273,064.65</u>
Total		<u>P1,365,323.25</u>

⁶⁶ SEC. 249. *Interest.* –

(A) In General. – There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.

(B) Deficiency Interest. – Any deficiency in the tax due, as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

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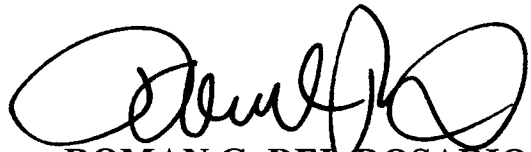
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In addition, petitioner is **ORDERED TO PAY** the following:

(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax in the amount of P1,092,258.60 computed from April 15, 2010, until full payment thereof pursuant to Section 249 (B) of the NIRC of 1997, as amended; and,

(b) delinquency interest at the rate of twenty percent (20%) per annum on the total amount due of P1,365,323.25 and on the 20% deficiency interest which have accrued as stated in the immediately preceding paragraph, computed from July 26, 2012 until full payment thereof pursuant to Section 249(C)(3) of the NIRC of 1997, as amended.

SO ORDERED.


ROMAN G. DEL ROSARIO
Presiding Justice


WE CONCUR:


ERLINDA P. UY
Associate Justice


CIELITO N. MINDARO-GRULLA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.


ROMAN G. DEL ROSARIO
Presiding Justice