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EN BANC

[G.R. No. 247737. August 8, 2023]

MCDONALD'S PHILIPPINES REALTY CORPORATION, *Petitioner*, *v.* **COMMISSIONER OF INTERNAL REVENUE,** *Respondent*.

D E C I S I O N

INTING, *J.*:

Before the Court is a Petition for Review on *Certiorari*[1] under Rule 45 of the Rules of Court filed by McDonald's Philippines Realty Corporation (petitioner or MPRC) assailing the Decision[2] dated October 11, 2018, and the Resolution[3] dated June 10, 2019 of the Court of Tax Appeals (CTA) *En Banc* in CTA EB No. 1638 (CTA Case No. 8766). In the assailed issuances, the *CTA En Banc* upheld with modifications the Final Decision on Disputed Assessment (FDDA) of the Commissioner of Internal Revenue (CIR) and ordered petitioner to pay the amount of ₱9,206,213.06 representing basic deficiency Value-Added Tax (VAT) for calendar year (CY) 2007, surcharge, deficiency interest, and delinquency interest.[4]

The Antecedents

Petitioner is a foreign corporation organized and existing under the laws of Delaware, United States of America. It is licensed to do business in the Philippines and registered with the Bureau of

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1 *Rollo*, pp. 13–71.

2 *Id.* at 72–96. Penned by Associate Justice Cielito N. Mindaro-Grulla as concurred in by Associate Justices Juanito C. Castañeda, Jr., Erlinda P. Uy, Esperanza R. Fabon-Victorino, Ma. Belen M. Ringpis-Liban and Catherine T. Manahan, and dissented by Presiding Justice Roman G. Del Rosario (with Dissenting Opinion).

3 *Id.* at 103–109.

4 *Id.* at 93–94, CTA *En Banc* Decision dated October 11, 2018.

Supreme Court E-Library

Internal Revenue (BIR).[5] It established its Philippine branch for the purpose of purchasing and leasing back two existing restaurant sites to Golden Arches Development Corporation (GADC).[6]

Prior to 2007, petitioner granted *long-term advances* to GADC, the proceeds of which were used by the latter to purchase land and equipment for use in its various restaurants and warehouse. Furthermore, GADC acknowledged that it had *unpaid rentals* due to petitioner.[7]

In 2008, the BIR commenced the audit and examination of petitioner's books of account and other accounting records relative to its revenue taxes for CY 2007.[8]

Subsequently, the BIR issued a *Preliminary Assessment Notice*[9] (PAN) dated September 15, 2010 finding petitioner liable for deficiency income tax (IT), VAT, and documentary stamp tax (DST) for CY 2007 in the aggregate amount of ₱33,432,243.06,[10] inclusive of compromise penalty and interest. Petitioner responded to the PAN on February 23, 2011.[11]

In the meantime, MPRC and the CIR executed two *Waivers of the Defense of Prescription under the Statute of Limitations, viz.*: the first one on December 29, 2010, extending the assessment period to December 31, 2011 (First Waiver); and another one on December 27, 2011, further extending said period to March 31, 2012 (Second Waiver).[12]

On March 30, 2012, or *one day prior to the expiration of the Second Waiver*, petitioner received a copy of the CIR-issued *Formal Letter of Demand with attached Details of Discrepancies*

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[5] *Id.* at 74.

[6] *Id.* at 17, Petition for Review on *Certiorari*.

[7] *Id.* at 122, CTA Division Decision dated December 15, 2016.

[8] *Id.* at 74, CTA *En Banc* Decision dated October 11, 2018.

[9] CTA Third Division *rollo*, pp. 593–594.

[10] *Rollo*, p. 74, CTA *En Banc* Decision dated October 11, 2018.

[11] *Id.* at 75.

[12] *Id.*

Supreme Court E-Library

and Audit/Assessment Notice[13] (FLD/FAN). In the FLD/FAN, the CIR deleted its previous IT and DST assessments and assessed MPRC for deficiency VAT only. In the discussion,[14] the CIR pointed out that MPRC failed to subject to VAT *gross receipts* from interest/rental income amounting to ₱11,080,687.70. Then, it proceeded to assess MPRC deficiency VAT amounting to *₱3,104,836.70*,[15] computed as follows:[16]

Rentals and Interest Receivable		
Beginning balance		₱22,389,808.93
Add: Income during the year		
Rentals	₱41,121,288.00	
Interest income	*25,522,729.00*	66,644,017.00
Total amount available for collection		₱89,033,825.93
Less: Ending balance		34,701,795.53
Collections during the year		₱54,332,030.40
Multiply by: VAT rate		12%
Output tax due		₱6,519,843.65
Less Creditable input tax		0.00
VAT due/payable per audit		₱6,519,843.65
Less VAT payments per returns		5,190,149.13
Basic deficiency VAT due		₱1,329,694.52
Add 20% interest	₱1,110,294.92	
50% surcharge	664,847.26	1,775,142.18
Total deficiency VAT per FLD/FAN		*₱3,104,836.70*

The CIR continued to impose deficiency interest at the rate of 20%. However, it deleted the compromise penalty and imposed a 50% surcharge instead. The CIR explained:

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[13] CTA Third Division *rollo*, pp. 619–622.

[14] *Id.* at 620.

[15] *Id.* at 622.

[16] *Id.*

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The 50% surcharge has been imposed pursuant to the provision of Section 248 (B) of the National Internal Revenue Code, as amended by R.A. No. 8424 x x x in view of your failure to report for [VAT] purposes your aforementioned rental/interest income. *Such omission renders your VAT returns filed for the calendar year 2007 as false or fraudulent returns*.[17] (Italics supplied.)

MPRC protested the assessment on April 26, 2012 *(administrative protest)*.[18] However, the CIR reiterated its VAT deficiency assessment in the FLD/FAN in the FDDA[19] dated January 16, 2014. After adjusting the accrued interest, the CIR found petitioner liable for deficiency VAT of *₱3,595,275.39*,[20] computed as follows:

Basic deficiency VAT due[21]		₱1,329,694.52
Add 20% interest	₱1,600,733.62	
50% surcharge	664,847.26	2,265,580.88
Total deficiency VAT per FDDA		*₱3,595,275.39*

Aggrieved, MPRC elevated the case to the CTA *via* a Petition for Review[22] (judicial protest). The case was raffled to the CTA Third Division (CTA Division) and docketed as CTA Case No. 8766.

Ruling of the CTA Division

In the Decision[23] dated December 15, 2016, the CTA Division found that MPRC derived its interest income from long-term advances and unpaid rentals owing from GADC (collectively,

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17 *Id.* at 619.

18 *Rollo*, p. 75.

19 CTA Third Division *rollo*, pp. 649–653.

20 *Id.* at 649, FDDA dated January 16, 2014.

21 Same as the amount in the FAN/FLD.

22 CTA Third Division *rollo*, pp. 7–39.

23 *Rollo*, pp. 111–142. Penned by Associate Justice Esperanza R. Fabon-Victorino and concurred in by Associate Justice Ma. Belen M. Ringpis-Liban; Associate Justice Lovell R. Bautista was on leave.

Supreme Court E-Library

"*loans due from GADC*") but did not subject them to VAT.[24] It explained that the said loans were transactions in pursuit of, incidental to, or in the course of trade or business, *i.e.*, leasing. Thus, the interest income arising therefrom were subject to VAT pursuant to Section 105,[25] in relation to Section 108(A) of the National Internal Revenue Code of 1997[26] (1997 Tax Code).

On the issue of prescription, the CTA Division explained that the 1997 Tax Code authorizes the CIR to assess MPRC within three years from the last day prescribed by law for the filing of the tax return. In relation thereto, Section 114(A) of the 1997 Tax Code and Revenue Regulations No. 16-2005[27] provides that quarterly VAT returns shall be filed within 25 days after the close of each taxable quarter.[28] Applying the foregoing principles, the CTA Division summarized[29] the filing dates of petitioner's quarterly VAT returns and the corresponding dates on which the period to assess shall prescribe, without considering the effect of any waiver that may have been executed, *viz.*:

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[24] *Id.* at 127.

[25] Section 105 of the National Internal Revenue Code of 1997 (1997 Tax Code) provides:

SEC. 105. *Persons Liable.* — Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.

x x x x

The phrase 'in the course of trade or business' means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.

x x x x (Underscoring supplied.)

[26] Republic Act No. 8424, approved on December 11, 1997.

[27] Consolidated VAT Regulations of 2005, effective November 1, 2005.

[28] *Rollo*, p. 119, CTA Third Division Decision.

[29] *Id.* at 120.

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Period Covered	Filing of Return		
	Actual Date	**Last Day to File**	**Last Day to Assess**
First Quarter	April 20, 2007	April 25, 2007	April 25, 2010
Second Quarter	July 24, 2007	July 25, 2007	July 25, 2010
Third Quarter	October 19, 2007	October 25, 2007	October 25, 2010
Fourth Quarter	March 26, 2008	January 25, 2008	*March 26, 2011*

The CTA Division found that MPRC received the FLD/FAN on *March 30, 2012*. It noted that, "[t]here was no denying on the part of respondent that the assessment notices were issued beyond the three-year period to assess." However, it agreed with the CIR's proposition that MPRC's VAT returns were *false*.

Citing *Aznar v. Court of Tax Appeals*[30] (*Aznar*), which differentiated between a *false return* (*i.e.*, implying a deviation from the truth, which may either be intentional or not) and a *fraudulent return* (*i.e.*, implying an intentional or a deceitful entry with intent to evade payment of tax), the CTA Division found that petitioner's VAT returns deviated from the truth inasmuch as it failed to disclose interest income arising from loans due from GADC amounting to ₱25,522,729.00[31] as being subject to VAT. Based on its finding that the subject returns were *false* as defined in *Aznar*, it applied the extraordinary 10-year assessment period and concluded that the CIR's right to assess had not yet prescribed.[32]

However, the CTA Division reduced petitioner's tax liability on account of the finding of the independent certified public accountant (ICPA) that petitioner had a VAT overpayment of ₱1,680,056.96 for the 4th quarter of CY 2007.[33]

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30 157 Phil. 510 (1974).

31 *Rollo*, p. 128, CTA Third Division. This represents the amount of interest income earned in during 2007, as stated in the FLD/FAN.

32 *Id.*

33 *Id.* at 135.

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Lastly, the CTA Division held that while the assessments for deficiency and delinquency interests were correct, the CIR cannot impose a 50% surcharge, as provided under Section 248(B) of the 1997 Tax Code because *there was no deliberate attempt on the part of the petitioner to evade tax*. It explained that while petitioner did not declare the interest income as part of its gross receipts subject to VAT, it did report the interest income in its 2007 ITR. According to the CTA Division, this supports a conclusion that *petitioner was under the honest belief that its interest income from loans due from GADC was not subject to VAT*.[34]

In fine, MPRC was made liable for deficiency VAT in the reduced amount of ₱2,224,211.02, inclusive of 25% surcharge, and was ordered to pay deficiency interest at the rate of 20% *per annum* on the basic deficiency VAT computed from January 25, 2008 until full payment, and delinquency interest at the rate of 20% *per annum* on the total amount of ₱2,224,211.02 computed from January 17, 2014 until full payment.[35]

Dissatisfied, MPRC elevated the case to the CTA *En Banc* and reiterated its contention that the CIR's right to assess had already prescribed. Further, it contended that its interest income from loans due from GADC were not incurred in the course of trade and business and thus not subject to VAT.[36]

To refute MPRC's argument on prescription, the CIR pointed out that petitioner's undeclared rental/interest corresponds to more than 30% of the total receipts it declared in its 2007 VAT returns. Thus, based on Section 248(B)[37] of the 1997 Tax Code, MPRC's underdeclaration rendered these false or fraudulent.[38]

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[34] *Id.* at 139.

[35] *Id.* at 140–141.

[36] *Id.* at 80, CTA *En Banc* Decision.

[37] Section 248(B) of the 1997 Tax Code:

SEC. 248. *Civil Penalties*. — x x x

(B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the

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Ruling of the CTA En Banc

In the assailed Decision[39] dated October 11, 2018, the CTA *En Banc* also applied the 10-year assessment period, *viz.*:

> Given the circumstances at bar, there is nothing in the Court [*sic*] in Division's Decision which would cause this Court to deviate from its ruling. As already stated, Section 222 mandatorily provides that a false or fraudulent return with intent to evade tax or failure to file a return [*sic*], the tax may be assessed at any time within ten years after the discovery of the falsity, fraud or omission.
>
> The case of *Aznar v. Court of Tax Appeals* is pivotal in this case wherein the Supreme Court ruled in this wise:
>
> > "We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely, "falsity," "fraud" and "omission." *That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due."*

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basis of such return before the discovery of the falsity or fraud: Provided, That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein.

[38] *Rollo*, p. 82, CTA *En Banc* Decision.

[39] *Id.* at 72–95.

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Applying the doctrine in the afore-quoted case, it is evident that petitioner committed falsity in its 2007 Quarterly VAT Returns as it did not declare substantial receipts from its interest income in the amount of ₱25,522,729.00. While the under-declaration in petitioner's gross receipts did not arise from a deliberate attempt to evade tax, nonetheless, its deviation from the truth warrants the application of the ten (10)-year prescriptive period for assessment.

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WHEREFORE, premises considered, the instant petition is PARTIALLY GRANTED. Accordingly, the Final Decision of Disputed Assessment issued by respondent against petitioner covering deficiency VAT for the taxable year 2007 is partly UPHELD WITH MODIFICATIONS. Petitioner is ORDERED TO PAY NINE MILLION TWO HUNDRED SIX THOUSAND TWO HUNDRED THIRTEEN AND 6/100 PESOS (₱9,206,213.06) representing basic deficiency VAT, the 25% surcharge[,] and deficiency and delinquency interests imposed under Sections 248(A)(3) and 249(B) and (C) of the NIRC of 1997, as amended, respectively computed until December 31, 2017:

Basic Deficiency VAT	[₱]1,779,368.82
Add: 25% Surcharge	[₱]444,842.20
Deficiency [i]nterest computed from January 26, 2008 [to] January 17, 2014.	[₱]1,779,368.82 20% *5.9836 years
Subtotal	[₱]2,129,392.60
Total Amount Due as of January 17, 2014 *(Deficiency VAT with surcharge plus Deficiency Interest)*	[₱]4,353,603.63
Deficiency [i]nterest computed from January 18, 2014 [to] December 31, 2017.	[₱]1,779,368.82 20% *3.9562 years
Subtotal	[₱]1,407,895.11
Delinquency interest computed from January 18, 2014 [to] December 31, 2017.	[₱]4,353,603.63 20% *3.9562 years

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Subtotal	[₱]3,444,714.32
TOTAL AMOUNT DUE – December 31, 2017 *(Deficiency VAT with Deficiency interest plus delinquency* [*i*]*nterest)*	[₱]9,206,213.06

Accordingly, in applying the provisions [of] the TRAIN [L]aw, petitioner should be held liable to pay delinquency interest at the rate of 12% on the total unpaid basic deficiency tax, surcharge, deficiency interest as of January 17, 2014 amounting to [₱]4,353,603.63, computed from January 1, 2018 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended by the TRAIN Law.

SO ORDERED.[40] (Emphases omitted; italics in the original, omitted and supplied; underscoring omitted and supplied.)

Restated, the court *a quo* reiterated the CTA Division's finding that MPRC's undeclared interest income (₱25,522,729.00) was *substantial*. It further agreed with the CTA Division that although the underdeclaration was unintentional, pursuant to *Aznar*, mere deviation from the truth justified the application of the exceptional assessment period of 10 years.[41]

Finally, the CTA *En Banc* affirmed the imposition of deficiency and delinquency interests with modifications in that the delinquency interest beginning January 1, 2018 shall be 12% until full payment pursuant to the Section 249(C) of the 1997 Tax Code, as amended by Republic Act No. (RA) 10963,[42] otherwise known as the Tax Reform for Acceleration and Inclusion (TRAIN) Law.[43]

After the court *a quo* denied its subsequent motion for reconsideration in the Resolution[44] dated June 10, 2019, MPRC filed the present action.

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[40] *Id.* at 92–95.

[41] *Id.* at 93.

[42] Approved on December 19, 2017.

[43] *Rollo*, pp. 93-94, CTA *En Banc* Decision.

[44] *Id.* at 103–109.

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MPRC's Arguments

MPRC's main defense against the CIR's tax assessment is prescription. It argues that the CTA *En Banc* erred in applying the extraordinary 10-year assessment period, *viz.*:

(a) The pronouncements of the Supreme Court in Aznar should be read in light of the facts of the case, where after the application of the net worth and expenditures method of tax investigation, the Court therein found that there was a *concealment* of income which placed the government at a disadvantage "so as to prevent its lawful agents from proper assessment of tax liabilities." In view thereof, the Supreme Court applied the extraordinary 10-year prescription period from the time of the discovery of the falsity, fraud or omission in order to protect the government's interest. In the case at bar, it is established that petitioner did not conceal its interest income, as it was clearly shown in its income tax return (ITR) and audited financial statements (AFS). As such, there is no justification for the application of the extraordinary 10-year prescription period in this case because the government was not in any way placed at a disadvantage or prevented from assessing the correct amount of tax.

(b) In order to render a return made by a taxpayer a "false return" within the meaning of Section 222 [of the 1997] Tax Code, there must appear a *design to mislead or deceive* on the part of the taxpayer, or at least culpable negligence.

(c) Applying the *ejusdem generis* rule in statutory construction, the falsity of the return in Section 222(a) [of the 1997] Tax Code should be construed as referring to a false return that it is akin to a fraudulent return with *intent to evade tax*, or tantamount to the non-filing of a return.

(d) The application of the extraordinary 10-year prescription period under Section 222(A) [of the 1997] Tax Code in case of any error or omission in the taxpayer's tax return would render inoperative the 3-year prescription period under Section 203 [of the 1997] Tax Code since all deficiency tax assessments would spring from an error in the return.[45] (Italics supplied.)

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[45] *Id.* at 21–22, Petition for Review on *Certiorari*.

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Stated differently, petitioner claims that the extraordinary 10-year assessment period in case of a *false return* applies only when the falsity is accompanied by a finding that the taxpayer: (a) *concealed* items/transactions that would be subject to tax,[46] (b) *misled/deceived* or acted *negligently*,[47] and/or (c) *intended* to evade tax.[48]

Although the Court defined a false return in *Aznar* as one that deviates from the truth, *whether intentional or not*, MPRC argues, however, that not all errors or omissions justify the application of the extraordinary 10-year assessment period.

First, the application of the extraordinary 10-year period in *Aznar* was warranted under the circumstances because the government was placed at a disadvantage as it was prevented from assessing the correct amount of tax due to the falsity in the return.[49]

Second, the recent rulings on the subject modified the pronouncements in *Aznar*.[50] Citing *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.*[51] (*BF Goodrich*), petitioner argued that "the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return."[52] Further, in *Commissioner of Internal Revenue v. Philippine Daily Inquirer*[53] (*Inquirer*), the Court held that the element of intentional falsity is necessary to warrant the application of the 10-year assessment period.[54]

MPRC contends that in order for a return to be deemed *false* within the meaning of Section 222(a) of the 1997 Tax Code, it must be

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[46] *Id.* at 26–27.

[47] *Id.* at 32.

[48] *Id.* at 37–38.

[49] *Id.* at 27–28.

[50] *Id.* at 26.

[51] 363 Phil. 169 (1999).

[52] *Rollo*, p. 26, Petition for Review on *Certiorari*.

[53] 807 Phil. 912 (2017).

[54] *Rollo*, p. 24, Petition for Review on *Certiorari*.

Supreme Court E-Library

accompanied by an *intent to evade*,[55] such that only mistakes or errors committed *with an intent to evade tax* would warrant the application of the 10-year period.[56] Hence, the CIR must establish that the taxpayer deliberately filed a false return with intent to evade tax and its failure to discharge this burden of proof shall prevent the application of the 10-year period.[57] It further contends that all assessments are necessarily based on errors in tax returns. Consequently, if any such error or omission, whether inadvertent or deliberate with the objective to evade tax, is a falsity within the meaning of Section 222, all assessments shall therefore become imprescriptible because the extraordinary assessment period of 10 years will always apply.[58]

To further bolster its contention, MPRC cites *Collector of Internal Revenue v. Central Azucarera de Tarlac*,[59] where the Court held that in case a taxpayer files an "honest return" or that which he believes complies with the law, the tax authorities cannot apply the extraordinary 10-year period in assessing such taxpayer.[60] "Otherwise, there would practically no period of limitation whatsoever, and every man who made an inaccurate return could have a deficiency assessed against him at any time, because an inaccurate return is not a return made strictly in accordance with the law."[61]

It emphasizes that, as pronounced in *BF Goodrich*, the law on prescription must be interpreted liberally in favor of taxpayers who shall be safeguarded from unreasonable examination, investigation, or assessment. In turn, the exceptions as to the period of limitation of assessment under Section 222 of the 1997 Tax Code are to be strictly construed, not expanded.[62]

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[55] *Id.* at 32–33. Citing *Commissioner of Internal Revenue v. Ayala Hotels, Inc.*, CA-G.R. SP No. 70025, April 19, 2004.

[56] *Id.*

[57] *Id.* at 37.

[58] *Id.*

[59] G.R. Nos. L-11760 & 11761, July 31, 1958.

[60] Relying on *United States v. Mabel Elevator*. (D.C.) 17 (2d) 109, 110 (1925).

[61] *Rollo*, p. 32, Petition for Review on *Certiorari*.

[62] *Id.* at 39.

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Third, assuming for the sake of argument that the CIR's right to assess has not prescribed, petitioner insists that it is not liable for (a) deficiency VAT on interest income derived from loans due from GADC, (b) deficiency interest,[63] and (c) delinquency interest.[64] Petitioner argues that the subject interest income is not subject to VAT[65] because it did not arise in the course of trade or business[66] and was not incidental to petitioner's leasing business.[67]

CIR's Arguments

In contrast, the CIR, represented by the Office of the Solicitor General, is confident that its right to assess did not prescribe because *prima facie* evidence exists that the VAT returns in question are false returns.[68] The CIR counters as follows:

First, the definition of false returns in *Aznar* must be taken to mean that the *mere exclusion* in the return of a taxable item (*i.e.*, non-reporting of interest income due from GADC in the VAT returns) *ipso facto* makes the return false within the meaning of Section 222(a) of the 1997 Tax Code.[69] The CIR posits that this dispenses with the requirement of proof of intent or deceit and allows the extraordinary 10-year assessment period of assessment to apply immediately.[70]

Second, the *Inquirer* case did not supersede *Aznar*[71] considering that the Court did not expressly declare that a return may only be considered false if it is willfully filed.[72] The CIR points out that to the contrary, the pronouncement in *Inquirer* only reiterated the

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63 *Id.* at 48.

64 *Id.* at 53.

65 *Id.* at 44.

66 *Id.* at 45.

67 *Id.* at 47.

68 *Id.* at 177, CIR's Comment.

69 *Id.* at 179.

70 *Id.*

71 *Id.* at 181.

72 *Id.* at 183.

Supreme Court E-Library

Court's earlier position in *Aznar*, that is, a false return is made when the return contains wrong information regardless of intent.[73]

Third, in its 2007 VAT returns,[74] petitioner declared receipts subject to VAT in the first, second, third, and fourth quarters amounting to ₱4,612,816.92, ₱9,295,544.67, ₱6,507,750.11, and ₱22,835,131.00, respectively. However, it failed to report the subject interest income in the aggregate amount of ₱25,522,729.00.[75] Citing Section 248(B) of the 1997 Tax Code, the CIR maintains that MPRC's unreported interest income of more than 30% of the declared VAT-able sales amounts to a substantial underdeclaration and constitutes *prima facie* evidence of false returns.[76]

According to the CIR, this presumption of falsity in case of substantial underdeclaration is in accord with the ruling in *Aznar* that a false return implies a simple "deviation from the truth," whether intentional or not, and even more so when there is an underdeclaration exceeding 30%.[77] Thus, it concludes that while a design to mislead or deceive is necessary for there to be a fraudulent return, it is not a requirement for a false return.[78]

Issues

The main issue in the present case relates to the *timeliness* of the CIR's issuance of the tax assessment. The CTA *En Banc* held that the CIR had *10 years*—not the basic three years—within which to issue the assessment after finding that MPRC had filed a *false return*.

Determining whether the CTA *En Banc* was correct in upholding the subject tax assessment turns upon the resolution of the following questions:

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[73] *Id.*

[74] *Id.* at 180. Also see CTA Third Division *rollo*, pp. 654, 658, 661, and 666.

[75] *Id.*

[76] *Id.* at 180–181, 184.

[77] *Id.* at 185.

[78] *Id.* at 185–186.

Supreme Court E-Library

I. Did the CIR satisfy the requirements to avail itself of the benefit of the extraordinary 10-year assessment period under Section 222(a) of the 1997 Tax Code?

II. If the CIR was not entitled to the 10-year assessment period, alternatively, was the assessment issued within the basic three-year period under Section 203 of the 1997 Tax Code?

Our Ruling

The petition is meritorious.

The Court is tasked to review the CTA *En Banc*'s application of the 10-year assessment period in favor of the tax authorities. This is a question of law cognizable by the Court pursuant to Rule 45 of the Rules of Court.[79] While the Court affirms the CTA's findings that the non-inclusion of MPRC's interest income in its VAT returns was not attended by fraud, the Court does not agree that there had been a substantial underdeclaration in the case at bar. Verily, the tax base of VAT on lease of properties is gross receipts, not income.[80] Thus, for reasons set out below, the Court holds that the 10-year assessment period cannot be applied here and the CIR's authority to assess MPRC for deficiency VAT relative to CY 2007 has prescribed.

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[79] Section 1, Rule 45 of the Rules of Court provides:

SECTION 1. *Filing of petition with Supreme Court*. – A party desiring to appeal by *certiorari* from a judgment, final order or resolution of the Court of Appeals, the Sandiganbayan, the Court of Tax Appeals, the Regional Trial Court or other courts, whenever authorized by law, may file with the Supreme Court a verified petition for review on *certiorari*. The petition may include an application for a writ of preliminary injunction or other provisional remedies and shall raise only questions of law, which must be distinctly set forth. The petitioner may seek the same provisional remedies by verified motion filed in the same action or proceeding at any time during its pendency.

[80] Section 108(A) of the 1997 Tax Code provides:

SEC. 108. *Value-Added Tax on Sale of Services and Use or Lease of Properties*. –

(A) *Rate and Base of Tax*. - There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties.

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Supreme Court E-Library

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In taking their respective positions, the Court observes that the parties have relied on various jurisprudence dealing with the matter of applying the exceptional 10-year period and advanced their respective interpretations of the law and jurisprudence. To weigh between the contrasting views, the Court deems it prudent to first set out the relevant Tax Code provisions and amendments thereto and revisit the Court decisions in their proper statutory context.

A. The CIR's Power to Make Assessments

At the core of the CIR's powers is the authority to make tax assessments. The National Internal Revenue Code of 1939[81] (1939 Tax Code) provides:

> SECTION 15. *Power of Collector of Internal Revenue to Make Assessments*. — When a report required by law as a basis for the assessment of any national internal revenue law shall not be forthcoming within the time fixed by law or regulation, or *when there is reason to believe that any such report is false, incomplete, or erroneous, the Collector of Internal Revenue shall assess the proper tax on the best evidence obtainable*. x x x
>
> x x x x
>
> SECTION 38. General Rule. — The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, *the computation shall be made in accordance with such method as in the opinion of the Collector of Internal Revenue does clearly reflect the income*. x x x (Italics supplied.)

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[81] Commonwealth Act No. 466, June 15, 1939.

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The above-cited provisions were incorporated in Sections 16[82] and 38,[83] respectively, of the National Internal Revenue Code of 1977 (1977 Tax Code),[84] and eventually, found its way to the 1997 Tax Code, *viz.*:

> SEC. 6. *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement*.— x x x
>
> (B) *Failure to Submit Required Returns, Statements, Reports and other Documents*.— When a report required by law as a basis for the assessment of any national internal revenue tax shall not be forthcoming within the time fixed by laws or rules and regulations or when there is reason to believe that any such report is false, incomplete or erroneous, the Commissioner shall assess the proper tax on the best evidence obtainable.
>
> In case a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise files a false or fraudulent return or other document, the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise, *which shall be prima facie correct and sufficient for all legal purposes*. (Italics supplied.)

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[82] Section 16 of the 1977 Tax Code provides:

> Sec. 16. *Power of Commissioner of Internal Revenue to make assessments*. — When a report required by-law as a basis for the assessment of any national internal revenue tax shall not be forthcoming within the time fixed by law or regulation, or when there is reason to believe that any such report is false, incomplete, or erroneous, the Commissioner of Internal Revenue shall assess the proper tax on the best evidence obtainable.
>
> x x x x

[83] Section 38 of the 1977 Tax Code provides:

> Sec. 38. *General rule*. — The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner of Internal Revenue does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year, as defined in Section twenty or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the net income shall be computed on the basis of the calendar year.

[84] Presidential Decree No. 1158, June 3, 1977.

Supreme Court E-Library

The consistent import of these provisions establishes that the CIR is empowered by statute to direct the investigation of any taxpayer for the purpose of assessing the latter's correct tax liability. In the exercise of this authority, the CIR is allowed to, among others, examine a taxpayer's books of account and other accounting records, issue a subpoena, and obtain any relevant information from any person (*i.e.*, the taxpayer himself or any third party).[85] If the information needed to ascertain the correctness of tax is not forthcoming, the CIR may issue an assessment based on the best evidence available. Once the CIR issues an assessment, it shall be presumed correct and sufficient for all legal purposes.

Verily, the above-mentioned powers grant the tax authorities a wide latitude of discretion in dealing with taxpayers at large, so much so that a tax assessment thus issued shall be given the benefit of the presumption of correctness and sufficiency. However, it must be understood that the CIR's assessment powers are not absolute.

B. Prescriptive Period of Assessments

The **basic rule** under the 1997 Tax Code only permits the CIR and his authorized representative a limited time of three years to conclude their investigation and issue a formal assessment based on the audit findings, *viz.*:[86]

> SEC. 203. *Period of Limitation upon Assessment and Collection*.— Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return x x x *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

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[85] Section 5, 1997 Tax Code.

[86] Section 228 of the 1997 Tax Code provides, "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."

Supreme Court E-Library

By exception, the period of assessment may be extended such as in the case of *a false or fraudulent return* or of *non-filing of a return* altogether. The 1939 Tax Code established the *10-year extraordinary period of assessment, viz.*:

SECTION 332. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes*. — (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission. x x x

The 1977 Tax Code maintained the 10-year period but introduced an amendment to the above-cited provision, particularly on taking judicial notice of the fact of fraud in subsequent tax collection proceedings, *viz.*:

SEC. 319. *Exceptions as to period of limitation of assessment and collection of taxes*. — (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof. x x x (Underscoring supplied)

Section 319 of the 1977 Tax Code later became Section 222 of the 1997 Tax Code—the interpretation of which is now at the center of the present controversy:

SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes*.—

(a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission; *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

Supreme Court E-Library

The above-cited provision sets out three separate cases where the extraordinary 10-year assessment period may be invoked: *falsity, fraud*, or *omission* in/of filing a return.[87] The discussion henceforth shall focus on *falsity* and *fraud*, inasmuch as the subject assessment had been based on these grounds.

C. Jurisprudence on the Application of the 10-Year Assessment Period

Below is a summary of key Court rulings dealing with instances where the tax authorities relied on and invoked the extraordinary 10-year assessment period. Here, the Court have categorized the foregoing discussions according to the prevailing Tax Code version *at the time of the tax assessment/s* issued in each case.

i. 1939 Tax Code

• *Aznar*

Aznar dealt with ITRs for the taxable years 1946 to 1951. In the case therein, the tax audit results revealed that within the relevant period, the taxpayer's net worth increased every year. The tax authorities characterized the increases as "*very much more* than the income reported during said years." The CIR cited the incorrect declarations as basis for applying the 10-year assessment period. On appeal the CTA ratiocinated that the "*substantial [underdeclarations]* of income for six consecutive years eloquently demonstrate[d] the falsity or fraudulence of the [ITRs] with an intent to evade the payment of tax."[88]

On review, the Court agreed that the CIR's extension of the assessment period was justified because the subject tax returns were *false*. In its discussion, the Court differentiated among the three instances Section 332(a) of the 1939 Tax Code [now Section 222(a) of the 1997 Tax Code] warranting the application of the extended period, *viz.*:

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[87] *Aznar v. Court of Tax Appeals,* supra note 30.

[88] *Aznar v. Court of Tax Appeals,* supra note 30 at 523. Italics supplied.

Supreme Court E-Library

To our minds we can dispense with these controversial arguments on facts, although we do not deny that the findings of facts by the Court of Tax Appeals, supported as they are by very substantial evidence, carry great weight, by resorting to a proper interpretation of Section 332 of the NIRC. We believe that the proper and reasonable interpretation of said provision should be that in the *three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return*, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which aggregates the situations into three different classes, namely "falsity," "fraud" and "omission." *That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due*.[89] (Italics supplied.)

Verily, the Court referred to a *false return* as one which deviates from the truth, regardless if such deviation had been deliberate or inadvertent. It must be stressed, however, that in *Aznar*, the tax authorities established at the onset that the taxpayer's income per investigation was substantially higher than what he had reported in his returns. To both the CTA and the Court, such *substantial underdeclaration* was sufficient proof of falsity to justify the application of the extended assessment period.

• *BF Goodrich*

In *BF Goodrich*, the tax authorities' examination revealed that, during 1974, the taxpayer sold parcels of land. The CIR noted, however, that the consideration for the sale was insufficient—the actual sale price had been lower than the properties' fair market value. Thus, the CIR treated the difference as a taxable donation and, in 1980, assessed the taxpayer for deficiency donor's tax.

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[89] Id.

Supreme Court E-Library

On appeal, the taxpayer sought to invalidate the assessment, arguing that it was issued beyond the five-year[90] statute of limitations. However, the CTA regarded the sale of the parcels of land at a price below the fair market value as a *falsity*, which justified an extension of the assessment period.

The Court disagreed with the CTA. While the properties were sold for a price lesser than its declared fair market value, this fact "did not constitute a false return which contains wrong information due to mistake, carelessness, or ignorance."[91] The Court explained that "[i]t is possible that real property may be sold for less than adequate consideration for a *bona fide* business purpose; in such event, the sale remains an 'arm's length' transaction."[92] The Court noted that the taxpayer was compelled to sell the property at a lower price and that, while it did not declare any taxable donation, it nonetheless reported the sale in its ITR.

Ultimately, the Court held that the tax authorities failed to show that the subject ITR was filed fraudulently with intent to evade the payment of the correct amount of tax. Thus, the CIR's invocation of the 10-year assessment period was not justified.

ii. 1977 Tax Code

- *Commissioner of Internal Revenue v. Fitness by Design, Inc.*[93] (*Fitness by Design*)

The tax authorities in *Fitness by Design* assessed the taxpayer for alleged deficiency IT, VAT, and DST relative to taxable year 1995. They issued the Final Assessment Notice almost a decade later or on March 17, 2004. The CIR regarded the taxpayer's ITR as false and fraudulent on account of its failure to reflect its true

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[90] Section 331 of the 1939 Tax Code provided a basic assessment period of five years. This was shortened to three years in the 1977 Tax Code (See Section 318, PD No. 1158, as amended by Batas Pambansa Blg. 700, April 5, 1984).

[91] *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.,* supra note 51 at 179, citing *Aznar v. Court of Tax Appeals,* supra note 30 at 533.

[92] *Id.*

[93] 799 Phil. 391 (2016).

Supreme Court E-Library

sales therein. They used this reasoning to invoke the extraordinary 10-year assessment period.

However, the assessment notice served upon the taxpayer did not impute fraud on the part of the petitioner, much less substantiate the CIR's allegations of fraud, which were raised only on appeal. Further, the BIR audit team group supervisor admitted that the information gathered during the investigation did not show that the taxpayer deliberately failed to reflect its true income.

As a result, the Court disallowed the application of the extended period. The Court emphasized that in availing itself of the extraordinary 10-year period, the CIR bears the burden of proving the existence of facts upon which the fraud is based and is obligated to communicate to the taxpayer the basis for its allegations of fraud in the assessment notice, as part of due process.

iii. 1997 Tax Code

- *Samar-I Electric Cooperative v. Commissioner of Internal Revenue*[94] (*Samar Electric*)

Here, the taxpayer was assessed for deficiency withholding tax on compensation (WTC) relative to taxable years 1997 and 1998. In its defense, the taxpayer argued that the assessment was issued in 2002 or beyond the basic three-year assessment period.

However, the Court noted that the taxpayer failed to withhold taxes amounting to ₱2,690,850.91 from its employees' 13th month pay and other benefits. The Court regarded this as a *substantial underdeclaration*, which rendered the subject tax returns false within the meaning of Section 222(a). That the taxpayer failed to refute the falsity, both in fact and in law, allowed the CIR the benefit of the 10-year assessment period.

- *Commissioner of Internal Revenue v. Asalus Corp.*[95] *(Asalus)*

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[94] 749 Phil. 772 (2014).

[95] 806 Phil. 397 (2017).

Supreme Court E-Library

In *Asalus*, the CIR asserted that there was a *substantial understatement* in the taxpayer's income, which exceeded 30% of what was declared in its VAT returns as appearing in its quarterly VAT returns. The CIR used this substantial understatement to justify its application of the extraordinary assessment period.

Similar to *Samar Electric*, the Court also upheld the application of the 10-year period on account of the *substantial underdeclaration* in the taxpayer's return. On this occasion, the Court explained the presumption of falsity and the consequences thereof, *viz.*:

> Under Section 248(B) of the NIRC, there is a *prima facie* evidence of a false return if there is a substantial underdeclaration of taxable sales, receipt or income. The failure to report sales, receipts or income in an amount exceeding 30% what is declared in the returns constitute substantial underdeclaration. A *prima facie* evidence is one which that will establish a fact or sustain a judgment unless contradictory evidence is produced.
>
> In other words, when there is a showing that a taxpayer has substantially underdeclared its sales, receipt or income, there is a presumption that it has filed a false return. As such, the CIR need not immediately present evidence to support the falsity of the return, unless the taxpayer fails to overcome the presumption against it.
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> Applied in this case, the audit investigation revealed that there were undeclared VATable sales more than 30% of that declared in Asalus' VAT returns. Moreover, Asalus' lone witness testified that not all membership fees, particularly those pertaining to medical practitioners and hospitals, were reported in Asalus' VAT returns. The testimony of its witness, in trying to justify why not all of its sales were included in the gross receipts reflected in the VAT returns, supported the presumption that the return filed was indeed false precisely because not all the sales of Asalus were included in the VAT returns.
>
> Hence, the CIR need not present further evidence as the presumption of falsity of the returns was not overcome. Asalus was bound to refute the presumption of the falsity of the return and to prove that it had filed accurate returns. Its failure to overcome the same warranted the application of the ten (10)-year prescriptive period for assessment under Section 222 of the NIRC. To require the CIR to present additional evidence in spite of the presumption provided in Section 248(B) of the NIRC would render the said provision inutile.

Supreme Court E-Library

x x x x

Considering the existing circumstances, the assessment was timely made because the applicable prescriptive period was the ten (10)-year prescriptive period under Section 222 of the NIRC. To reiterate, there was a *prima facie* showing that the returns filed by Asalus were false, which it failed to controvert. Also, it was adequately informed that it was being assessed within the extraordinary prescriptive period.[96] (Italics in the original; underscoring supplied)

Relying on Section 248(B) of the 1997 Tax Code, the Court explained that a *prima facie* case of falsity arises where there is a *substantial underdeclaration* tax return subject of the assessment. *Substantial underdeclaration* within the meaning of the 1997 Tax Code refers to a misstatement, as ascertained by the CIR, which exceeds 30% of the amount reported in the tax return filed originally.

Applying the foregoing to the case, the Court explained that the audit results demonstrated that the income reported in the return was understated by more than 30%. This satisfied the definition of a substantial underdeclaration under the law, which, in turn, shall be regarded as *prima facie* evidence of falsity. For its part, the evidence presented by the taxpayer did not refute the presumption but even supported the conclusion that it failed to report taxable gross receipts in the VAT returns. On account of the taxpayer's failure to overturn the presumption, "the CIR need not present further evidence" as proof of a false return. Thus, the Court held that the application of the 10-year prescriptive period was warranted.

- *Inquirer*

The *Inquirer* case involved the taxpayer's IT and VAT relative to taxable year 2004. Given the basic assessment period, ordinarily, the tax authorities would have had three years from 2004 or until 2007 to issue an assessment, e.g., the right to assess deficiency VAT accruing to the first quarter of 2004 would have prescribed by April 2007.

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[96] *Id.* at 408-411.

Supreme Court E-Library

However, in the course of the audit investigation, the taxpayer executed *three* waivers where it consented to extending the basic three-year assessment period, *viz.*:

	Date of Execution of the Waiver	**Assessment Period Extended Until**
First Waiver	March 21, 2007	June 30, 2007
Second Waiver	June 5, 2007	December 31, 2007
Third Waiver	December 20, 2007	April 30, 2008

The CIR issued a formal assessment finding the taxpayer liable for deficiency IT and VAT, which the taxpayer received on April 17, 2008. In the main, the CIR explained that the audit team cross-referred[97] the purchases recorded by the taxpayer in its books[98] as against the corresponding amounts recorded by the taxpayer's suppliers. The comparison revealed that purchases per the taxpayer's books exceeded the amounts recorded by its suppliers. The CIR interpreted such overstatement of purchases as equivalent to an overdeclaration of deductible input VAT, as well as an underdeclaration of gross income, which results ultimately in understatements of the taxpayer's VAT and IT liabilities, respectively.

Subsequently, the taxpayer filed a judicial protest to the assessment before the CTA. In its Answer, while the CIR could have relied on the basic three-year prescriptive period on account of the Third Waiver, it applied the 10-year extended period, asserting that the taxpayer falsely filed its return for taxable year 2004.

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[97] The BIR employed the Reconciliation of Listing for Enforcement (RELIEF) System: a tool that "can detect tax leaks by matching the data available under the Bureau's Integrated Tax System (ITS) with data gathered from third party sources (*i.e.*, Schedules of Sales and Domestic Purchases, and Schedule of Importations submitted by VAT taxpayers . . ." See *Guidelines and Procedures in the Extraction, Analysis, Disclosure/Dissemination, Utilization, and Monitoring of RELIEF data for Audit and Enforcement Purposes*, Revenue Memorandum Order No. 30-03, approved on September 18, 2003.

[98] Summary List of Purchases.

Supreme Court E-Library

However, the Court rejected the CIR's theory and held that "the mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion"[99] and, as held in *BF Goodrich*, the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return. Put in another way, despite the supposed misstatement of the taxpayer's purchases, the Court did not find this as sufficient evidence to prove intentional falsity on the part of the taxpayer.

The Court also noted that the waivers in the case were meant to extend the basic three-year prescriptive period. This only showed that the CIR, at the outset, did not intend to rely on the 10-year extended period as it did not find any ground to justify its application.

- *Commissioner of Internal Revenue v. Spouses Magaan*[100] (*Spouses Magaan*)

The tax assessment in *Spouses Magaan* stemmed from a complaint-affidavit filed by a confidential informant. It was alleged that the taxpayers earned ₱35,498,477.62 from April 1998 to January 2002, but this income was not declared in their ITR.

The CTA found that the taxpayers received checks from a certain individual but did not report the amounts therefrom as income in their tax returns from 1998 to 2000. However, the tax court disallowed the application of the 10-year period, despite the unreported amounts, because the CIR failed to prove fraud on the part of the taxpayers.

The Court agreed with the CTA and underscored the following:

First, "[i]n the context of Section 222 (A), there is fraud in the filing of a false and deceitful entry with intent to evade the taxes

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[99] *Commissioner of Internal Revenue v. Philippine Daily Inquirer,* supra note 53 at 935, citing *Commissioner of Internal Revenue v. Javier, Jr.*, 276 Phil. 914 (1991).

[100] G.R. No. 232663, May 3, 2021.

due. *The act of filing a fraudulent return must be intentional and not attributable to* '*mistake, carelessness, or ignorance.*'"[101]

Second, "to invoke the 10-year prescriptive period, [the CIR bears the burden of proving] the following with *clear and convincing evidence*: (1) respondents received taxable income; (2) they underdeclared or did not declare the taxable income in their tax returns; and (3) *they intended to evade payment of correct taxes due*."[102] While the taxpayer did not report the amounts attributable to the checks as part of income, the CIR failed to establish that these amounts counted toward their taxable income. The checks were not in the taxpayers' names, and it was not even certain that the accounts into which the checks were deposited were owned by the taxpayers.

Third, if the tax authorities failed to state the factual basis of fraud in an assessment and/or failed to establish that the taxpayer filed a false return with intent to evade the payment of correct taxes, they cannot rely on the extraordinary 10-year period.

- *Commissioner of Internal Revenue v. Unioil Corp.*[103] (*Unioil*)

In *Unioil*, the CIR issued WTC and expanded withholding tax assessments relative to taxable year 2005. The taxpayer sought to invalidate the assessments for having been issued beyond the basic three-year period.

However, the Court found nothing other than the CIR's bare allegation of falsity or fraud in the taxpayer's returns that may accord the CIR the benefit of the exceptional 10-year period. To be sure, the CIR only cited Section 72 of the 1997 Code which refers to a false or fraudulent return but did not particularize the circumstances giving rise to fraud committed by the taxpayer. "On the whole, there is no *prima facie* evidence, much less any

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[101] *Id.*, citing *Commissioner of Internal Revenue v. Philippine Daily Inquirer, Inc.,* supra note 53 at 937.

[102] *Id.*

[103] G.R. No. 204405, August 4, 2021.

Supreme Court E-Library

sort of evidence"[104] that the returns in question had been false or fraudulent.

The Court also observed that the CIR issued the formal assessment only a day before the impending lapse of the basic three-year period. To the Court this hasty issuance was inconsistent with the invocation of the 10-year extraordinary period. It only revealed the CIR's original intention to abide by the basic assessment period.

D. Proof of Falsity or Fraud

i. General Rule

Tax assessments are presumed correct under the law and issued in the regular performance the tax authorities' duty. As a consequence, it is incumbent upon the taxpayer to dispute such correctness and regularity.

Similarly, *tax returns* are presumed to have been prepared and filed by the *taxpayer* in good faith,[105] in observance of the ordinary course of business,[106] and in compliance with the applicable rules and regulations.[107]

Thus, it must be understood that *falsity* and/or, *fraud with respect to any tax return* cannot be presumed to the extent that these are

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[104] *Id.*

[105] In *Collector of Internal Revenue v. Central Azucarera de Tarlac,* supra note 59, the Court held, "The omission of certain taxable items does not require additional returns for the same, and can[not] be regarded as a case of failure to file a return, particularly where the taxpayer's good faith is not questioned and intent to evade tax is not charged. The returns filed, altho[ugh] incomplete, operate as sufficient notice to the Collector of Internal Revenue to make his assessment and start the running of the period of limitation . . ." Citing *Commissioner of Internal Revenue v. Stetson & Ellison Co.* [(C.C.A.) 43 F. (2d) 553], the Court also explained, "It may be true that the filing of a return which is defective or incomplete under Section 239 is sufficient to start the running of the period of limitation x x x At most, these returns were defective or incomplete, but were filed in good faith, and, we think, substantially comply with the requirements of the statute."

[106] Section 3(q), Rule 131, Rules of Court.

[107] Section 3(ff), Rule 131, Rules of Court.

Supreme Court E-Library

relied upon as grounds for the extension of the assessment period to 10 years. In keeping with their duty to preserve due process in tax assessments, as enunciated in *BF Goodrich, Fitness by Design, Samar Electric, Asalus,* and *Spouses Magaan*, **the tax authorities bear the burden of establishing, with *clear and convincing proof*, the existence of grounds warranting the application of the 10-year period**.

ii. Presumption of Falsity or Fraud and the 30% Threshold

To reiterate, the concept of substantial misdeclaration does not appear in the 1939 Tax Code. However, the Court, in *Aznar*, introduced this concept as amounting to a false return to justify the application of the 10-year prescriptive period in interpreting the relevant provision. Notably, the taxpayer therein failed to justify the annual increases in his income or present proof to refute such falsity.

It appears that, as early as *Aznar*, a return containing substantial underdeclaration of income, as ascertained by the CIR, was presumed as *false* unless the taxpayer proves otherwise. This remained as a *jurisprudential* rule until the *presumption of falsity or fraud* in cases of substantial underdeclaration of income or overstatement of deductions was introduced formally in the 1997 Tax Code:

SECTION 248. *Civil Penalties*. —

(A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:

(1) Failure to file any return and pay the tax due thereon as required under the provisions of this Code or rules and regulations on the date prescribed; or

(2) Unless otherwise authorized by the Commissioner, filing a return with an internal revenue officer other than those with whom the return is required to be filed; or

Supreme Court E-Library

(3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or

(4) Failure to pay the full or part of the amount of tax shown on any return required to be filed under the provisions of this Code or rules and regulations, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment.

(B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or **in case a false or fraudulent return is willfully made**, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: *Provided, That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein*. (Emphases and italics supplied.)

In other words, the 1997 Tax Code provided a *statutory measure* to determine whether an *underdeclaration* is *substantial*, as well as an *express presumption* that a return containing a substantial underdeclaration shall be taken as *false or fraudulent* on its face.

Section 248 (B) sets out the following conditions:

1) The CIR ascertains that there is a *misstatement or misdeclaration* in the return, in particular,
   a. an *underdeclaration* of sales, receipts, or income or
   b. an *overstatement* of expenses or other deductions

2) The misstatement is *substantial*, such that it exceeds the corresponding amount declared in the return by *30%.*

Stated differently, when the misstatement or misdeclaration identified by the CIR surpasses the **30% threshold**, the return

Supreme Court E-Library

in question shall be regarded as *prima facie* false or fraudulent. This has two consequences: *First*, as held in *Asalus*, it relieves the CIR of its duty to establish falsity or fraud and, in turn, shifts the burden to the taxpayer, who must then refute the presumption by establishing the absence of these grounds.[108] *Second*, the *prima facie* false or fraudulent return shall serve as sufficient ground for applying the extraordinary period under Section 222(a).

To be clear, the substantial nature of an underdeclaration under Section 248(B) gives rise to a mere presumption of falsity or fraud. It is not conclusive. The taxpayer may overcome the presumption by presenting evidence showing that, in fact, there was no falsity or fraud in the return *within the contemplation of Section 222(a)*.

E. Due Process Requirements When Invoking the 10-Year Period

i. In General

It must be stressed that while the law accords the tax authorities an extended period within which they may investigate the taxpayer and issue a corresponding tax assessment, the law does so **by exception**. Furthermore, it is recognized that the *law on prescription should be liberally construed in favor of the taxpayer*,[109] to afford them protection against unreasonable examination, investigation, or assessment.[110]

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[108] In *Commissioner of Internal Revenue v. Asalus Corp.,* supra note 95, the Court explained: "[i]n other words, when there is a showing that a taxpayer has substantially underdeclared its sales, receipt or income, there is a presumption that it has filed a false return. As such, the CIR need not immediately present evidence to support the falsity of the return, unless the taxpayer fails to overcome the presumption against it."

[109] See *Commissioner of Internal Revenue v. Standard Chartered Bank*, 765 Phil. 102, 114 (2015); *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.,* supra note 51.

[110] See *Commissioner of Internal Revenue v. Bank of the Philippine Islands*, 885 Phil. 288, 301 (2020); *Commissioner of Internal Revenue v. Pilipinas Shell Petroleum Corp.*, 835 Phil. 875, 913 (2018); *Philippine Journalists, Inc. v. Commissioner of Internal Revenue*, 488 Phil. 218 (2004).

Supreme Court E-Library

Thus, when invoking the benefit of the extraordinary 10-year assessment period, as well as the presumption of falsity or fraud, the tax authorities are duty-bound to respect a taxpayer's *fundamental right to due process of the law*. There is due process when the taxpayer is provided with information necessary to mount an *intelligent and timely protest/defense to the assessment*.

Consequently, *first*, the tax authorities are required to *communicate* to the taxpayer, in a clear and adequate manner, the basis for extending the assessment period. Guided by the pronouncements in *Asalus, Fitness by Design*, and *Spouses Magaan*, the tax authorities are obligated to indicate in the *assessment notice* that the extraordinary prescriptive period is being applied and the bases of allegations of falsity or fraud (First Due Process Requirement).

Second, they are likewise *proscribed from adopting a position inconsistent with the invocation of the extended period* or that which will mislead the taxpayer and prejudice its defense (Second Due Process Requirement).

In the past, the Court regarded the following acts performed by the tax authorities as contradictory to the application of the 10-year prescriptive period: (a) prior execution of waivers meant to extend the basic three-year period *(Inquirer)*; (b) hasty issuance of an assessment notice in order to meet the basic three-year deadline (*i.e.*, one day before the last day of the three-day prescriptive period, as in *Unioil*).

ii. Due Process in Invoking the Presumption of Falsity or Fraud

The First and Second Due Process Requirements above must also be complied with particularly when invoking the *presumption of falsity or fraud*. Thus, it shall not be sufficient that the CIR merely ascertains a misstatement or misdeclaration. To avail oneself of the benefit, *first*, the tax authorities must set out in the assessment notice the facts comprising the misstatement or misdeclaration and the manner by which the conditions under Section 248(B) are met and, *second*, there are no circumstances

Supreme Court E-Library

that negate the tax authorities' claim of relying on the 10-year period or those which have misled the taxpayer that it would only be assessed within the basic three-year period.

The Court must reiterate that the conditions under Section 248(B) may be summarized as the 30% threshold, which, by its nature, is derived mathematically. Accordingly, in relation to the Second Due Process Requirement, it is essential for the CIR to *at least disclose the computation by which it ascertained that the misdeclaration in the return surpassed the threshold*, if only to afford the taxpayer an opportunity to refute the correctness or reasonableness of such computation.

iii. False Return

At this juncture, the Court looks back at the wording of Section 222(a). It allows the application of the extended period "[i]n the case of a false or fraudulent return *with intent to evade* tax or of a failure to file a return."

The CIR relies on *Aznar*'s definition: that a return is false if it deviates from the truth, whether such deviation had been deliberate or inadvertent. Thus, when the taxpayer fails to report an item required to be declared in a tax return, *regardless of intent*, the mere exclusion of the item amounts to a falsity that justifies the application of the exceptional 10-year period.[111]

On the other hand, MPRC theorizes that only *intentional* errors or omissions shall make a return "false" and warrants the application of the extended period. Despite the discussion in *Aznar*, the phrase "with intent to evade tax" under Section 222(a) not only refers to a *fraudulent return* but also serves to qualify the definition of a *false return*. It insists that the pronouncement in *Aznar* should be read in light of the specific factual circumstances therein, as well as more recent jurisprudence on the same subject matter.

The Court agrees with MPRC that only *intentional errors* in the return may justify the application of the extraordinary 10-year period.

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[111] *Rollo*, p. 179, CIR's Comment.

Supreme Court E-Library

First, verily, *Aznar* differentiated between a *false* and *fraudulent* return, *viz.*: "[w]hile the first merely implies deviation from the truth, *whether intentional or not*, the second implies intentional or deceitful entry with intent to evade the taxes due." *However, this statement must be construed to be a definition referring to false returns* ***in general***.

To recall, in applying the 10-year exceptional period, the Court in *Aznar* did not inquire into whether the misstatements in the tax returns had been deliberate. Instead, the Court regarded the returns as false on the basis of a *presumption* that arose on account of *substantial underdeclarations* committed by the taxpayer in reporting his income.

Second, the CIR's argument confining the phrase "with intent to evade" to "fraud" only contradicts settled jurisprudence.

Since *Aznar*, the Court has been consistent in the interpretation of what constitutes a *false return* with respect to the application of the 10-year period—***not all types of error or falsehood in a return will make available the 10-year exception under Section 222(a) of the 1997 Tax Code***.[112] The settled rule is that *"the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return."*[113] That there is an under/overstatement, by itself, does not amount to a falsehood[114] for purposes of extending the assessment period.

Declarations in the return pertaining to, for instance, (a) a selling price that is below the fair market value (*BF Goodrich*), (b) purchases the aggregate amount of which, upon audit, exceeds those reported in the suppliers' independent records (*Inquirer*),

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[112] Formerly Section 332(a) of the 1939 Tax Code and Section 319(a) of the 1977 Tax Code.

[113] *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.,* supra note 51; *Commissioner of Internal Revenue v. Philippine Daily Inquirer, Inc.,* supra note 53; *Commissioner of Internal Revenue v. Spouses Magaan,* supra note 100.

[114] *Commissioner of Internal Revenue v. Unioil Corp.,* supra note 103, citing *Aznar v. Court of Tax Appeals,* supra note 30 at 535.

Supreme Court E-Library

or (c) the face amount of checks received but excluded from the computation of taxable income (*Spouses Magaan*) do not *ipso facto* render the return false within the meaning of Section 222(a) of the 1997 Code.[115]

Third, the CIR's interpretation of the law disregards the presumptions that taxpayers have prepared and filed their returns in good faith and have complied with the applicable laws and regulations in doing so. It also gives the CIR and revenue agents unbridled authority to extend and prolong any assessment.

The power to assess authorizes the CIR and its revenue agents to examine a taxpayer's books for the purpose of determining the correct amount of tax. Given the nature of this authority, as pointed out by MPRC, each tax audit will necessarily expose varying errors and/or irregularities in how the taxpayer computed its tax liability. Following the CIR's logic, all such inaccuracies committed by the taxpayer—including mere clerical or typographical errors or arithmetic miscalculations, no matter how trivial—shall render the return false and may be used as a ground to invoke the exceptional 10-year period. To the Court's mind, this creates an opportunity for the CIR to find errors at whim, renders the basic three-year assessment period under Section 203 of the 1997 Tax Code superfluous and inoperative, and extends the assessment period virtually in all tax audits. The Court does not believe that the law intended to grant the tax authorities such an expansive and unlimited power—one that clearly defies due process rights.

F. Summary: Conditions for a Valid Extension of Assessment Period in Case of a False Return

i. Requisites under Section 222(a) of the 1997 Tax Code

- *General Rule – Proof of False or Fraudulent Return*

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[115] Formerly Section 332(a) of the 1939 Tax Code and Section 319(a) of the 1977 Tax Code.

Supreme Court E-Library

Pursuant to Section 222(a) of the 1997 Tax Code, the extraordinary 10-year assessment period may apply in case the taxpayer: (1) filed a false return, (2) filed a fraudulent return, or (3) failed to file a return.

A fraudulent return "implies intentional or deceitful entry with intent to evade the taxes due," while a false return simply "implies deviation from the truth, whether intentional or not."[116]

It must be stressed, however, that a false return within the meaning of Section 222(a) does not refer to false returns in general. To be sure, the extraordinary 10-year assessment period applies to a *false return* when:

(1) the return contains an error or misstatement, and
(2) such error or misstatement was *deliberate or willful*.

Consequently, the Court's ruling in *Aznar* which applied the extraordinary 10-year assessment period under Section 222(a) to false returns in general, *i.e.*, regardless of whether the deviation is intentional or not, is abandoned.

It shall be the CIR's burden to establish the existence of the above-enumerated statutory requisites with clear and convincing evidence.

- *Exception – Prima Facie Evidence of a False or Fraudulent Return (30% Threshold)*

The CIR may be relieved from the above-mentioned burden of proof when there is *prima facie evidence of falsity or fraud*, as defined under Section 248(B) of the 1997 Tax Code.

(1) The CIR ascertains that there is a *misstatement/ misdeclaration* in the return, in particular,

    (a) an *understatement/underdeclaration* of sales, receipts, or income or

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[116] *Aznar v. Court of Tax Appeals,* supra note 30 at 253.

Supreme Court E-Library

(b) an *overstatement/overdeclaration* of expenses or other deductions, and

(2) the misstatement is *substantial*, such that exceeds the corresponding amount declared in the return by 30%.

30% threshold satisfied. There is *prima facie* evidence of falsity or fraud and the burden of proof shifts to the taxpayer. If the taxpayer fails to overcome the presumption, the *prima facie* evidence shall be sufficient to justify the application of the 10-year period.

Taxpayer refutes presumption. If the taxpayer is successful in overturning the presumption (*e.g.*, demonstrating that the misstatement as ascertained by the CIR had been inadvertent or attributable to a mistake or was not deliberate or willful on the part of the taxpayer), the CIR cannot rely on the presumption in proving the taxpayer's intent to evade.

ii. Due Process Requirements

(1) **First Due Process Requirement**. The *assessment notice* issued to the taxpayer must clearly state the following:

(a) that extraordinary prescriptive period (not the basic three-year period) is being applied, and

(b) the bases of allegations of falsity or fraud, *e.g.*, if the CIR seeks to rely on the *presumption of falsity or fraud* particularly, the formal notice to the taxpayer *must set out the computation by which it ascertained that the misdeclaration in the return surpassed the 30% threshold*.

(2) **Second Due Process Requirement**. The tax authorities have not acted in a manner that is inconsistent with the invocation of the extraordinary prescriptive period or have otherwise misled the taxpayer that the basic period will be applied.

G. Applied to the Present Case

Here, both the CTA Division and the CTA *En Banc* held that MPRC's 2007 Quarterly VAT returns are not fraudulent returns. They found no deliberate attempt on the part of MPRC to evade

Supreme Court E-Library

tax considering that it reported its interest income from loans due from GADC in its 2007 ITR.[117]

It is settled that factual findings of the CTA, as a special court with expertise on tax laws, are generally final, binding, conclusive, and accorded respect by the Court.[118] Considering that the above finding of the CTA Division and the CTA *En Banc* is supported by the evidence on record, the Court affirms that MPRC did not deliberately make an underdeclaration in its VAT returns.

Both the CTA Division and the CTA *En Banc* held, however, that MPRC's VAT returns were false returns. They also applied the 10-year extraordinary period to assess pursuant to Section 222(a) of the 1997 Tax Code. Verily, the core issue in the case is whether the falsity in MPRC's VAT returns calls for the application of the extraordinary 10-year period to assess.

As will be discussed below, the Court holds that the application of the extraordinary 10-year period is not warranted in the present case.

To reiterate, a valid extension of the basic assessment period to 10 years is conditioned upon concurrence of the *requisites under Section 222(a) of the 1997 Tax Code* and compliance with *due process requirements*. Hence, the Court inquires, *first*, whether the CIR could benefit from the presumption of falsity or fraud, or otherwise proved intent to evade tax on the part of MPRC and, *second*, whether the CIR, in applying the extraordinary 10-year period, respected MPRC's due process rights.

i. There is no proof that MPRC filed a false return with intent to evade tax

The Court rules that *the CIR cannot benefit from the presumption of falsity or fraud*. As the presumption is unavailable to the CIR, it

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[117] *Rollo*, p. 139, CTA Third Division Decision. *Id.* at 92, CTA *En Banc* Decision.

[118] See *Miguel J. Ossorio Pension Foundation, Inc. v. Court of Appeals and Commissioner of Internal Revenue*, 635 Phil. 573, 585 (2010).

Supreme Court E-Library

has the burden of proving with clear and convincing evidence that the falsity adverted to was done with an intent to evade. However, the Court finds that *the CIR also failed to demonstrate this*.

- *The CIR cannot benefit from the presumption of falsity*

The CIR asserts that there is *prima facie* evidence of a false return because (1) petitioner failed to report interest income in the aggregate amount of ₱25,522,729.00, and (2) this unreported amount is a *substantial underdeclaration* as defined under Section 248(B) of the 1997 Tax Code.

The Court disagrees with the CIR. It cannot benefit from the presumption of falsity for the following reasons:

First, the CIR violated MPRC's due process rights when it applied the 10-year period without properly notifying the latter of the basis thereof.

Below are the pertinent portions of the notices sent by the CIR to petitioner:

FORMAL LETTER OF DEMAND

x x x x

The 50% surcharge has been imposed pursuant to the provision of [S]ection 248 (B) of the National Internal Revenue Code, as amended by R.A. No. 8424 x x x in view of your failure to report for Value-Added Tax purposes your aforementioned rental/interest income. *Such omission renders you VAT returns filed for the calendar year 2007 as false or fraudulent returns*.[119]

FINAL DECISION ON DISPUTED ASSESSMENT

The fifty percent (50%) surcharge is imposed as provided under Section 248(B) of the Tax Code *for filing a false return*.[120]

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[119] See Formal Letter of Demand dated March 15, 2012, CTA Division *rollo*, p. 619.

[120] See Final Decision on Disputed Assessment dated January 16, 2014, *Id.* at 309.

Supreme Court E-Library

It is clear from the foregoing that the CIR involved the presumption of falsity or fraud under Section 248(B) of the 1997 Tax Code. However, the notices contained mere references to the provision. The CIR did not even propound the statutory conditions giving rise to the presumption, much less disclose the computation it used to determine whether the 30% threshold was exceeded.

The CIR's bare references to Section 248(B) in the notices were unclear on the manner by which it satisfied the threshold under the provision. To the Court's mind, this deprived MPRC an opportunity to refute the basis of the computation and, ultimately, to set up an intelligent protest.

Second, even if the Court ignores the above-discussed violation, the CIR's reliance on Section 248(B) remains erroneous.

In its Comment[121] to the present petition, the CIR continues to use the presumption or falsity or fraud to justify its resort to the exceptional 10-year period. This time, it laid out the amounts used to determine whether the 30% threshold was met. Particularly, the CIR now points out that MPRC failed to report the subject interest income in the aggregate amount of ₱25,522,729.00, which accounts to more than 30% of the total VATable receipts MPRC declared in its 2007 returns.[122]

To validate the CIR's assertion, the Court references below the pertinent details of the subject returns, as culled from the CTA Division *rollo*:

Quarter	*Rental Income*[123]
First	₱4,612,816.92
Second	9,295,544.67
Third	6,507,750.11
Fourth	22,835,131.00
Total VAT-able Sales	₱43,251,242.70

[121] *Rollo*, pp. 165-196.

[122] *Id.* at 180.

[123] MPRC's declared receipts in its returns consisted only of rental income.

Supreme Court E-Library

Verily, the alleged unreported interest income of ₱25,522,729.00 is more than 30% or, specifically, 59.01% of the total declared VATable sales, *viz.*:

Alleged undeclared interest income ("Numerator")	₱25,522,729.00
Divide by total receipts declared in VAT returns	43,251,242.70
	0.5901
Multiply by:	100
Percentage (%)	**59.01%**

In its assessment, the CIR imposed VAT on MPRC's interest income which the latter did not declare in its 2007 VAT returns. Both the CTA Division and the CTA *En Banc* confirmed that, if subject to VAT, said interest income shall be taxable under Section 108 of the 1997 Tax Code or as a *sale of services*.[124]

However, for purposes of working out the 30% threshold in MPRC's case, the use of the amount of ₱25,522,729.00 as undeclared sales/numerator is erroneous.

Significantly, the 1997 Tax Code imposes VAT on the following: (a) the sale of goods or properties,[125] (b) the importation of goods,[126] and (c) the sale of services and use or lease of properties.[127] The differentiation is not without significance. While the VAT base in a sale of goods and importation of goods are the *gross selling price* and *landed cost*, respectively, the VAT base in a sale of services and use or lease of properties is *gross receipts*. These terms are expressly defined in the law, *viz.*:

> in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax. The excise tax, if any, on such goods or properties shall form part of the gross selling price.[128] (Italics supplied.)

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[124] *Rollo*, pp. 84–86.

[125] Section 106, 1997 Tax Code.

[126] Section 107, 1997 Tax Code.

[127] Section 108, 1997 Tax Code.

[128] Section 106, 1997 Tax Code.

Supreme Court E-Library

The term 'gross receipts' means the *total amount of money or its equivalent* representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments *actually or constructively received* during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax.[129] (Italics and underscoring supplied.)

Proceeding from this analysis, the proper VAT base would be *gross receipts*. Accordingly, the reasonable assessment would have only regarded as *undeclared receipts* those interests *received or collected* in 2007 but not reported in the VAT returns, excluding amounts which have been earned or accrued but not collected.

However, a careful study of the FLD/FAN[130] and FDDA[131] reveals that the amount of ₱25,522,729.00, which the CIR assessed as *undeclared receipts*, represents *interest income earned* in 2007. While said interest income may have been *earned or accrued*, there is no showing that it has been *actually or constructively received or collected* by MPRC. Inasmuch as accrued interest is not the proper VAT tax base, the amount of ₱25,522,729.00 cannot be used in the 30% threshold computation in MPRC's case.

Notably, in the FLD/FAN, the CIR expressly identified an amount of ₱11,080,687.70 as interest income not subjected to VAT,[132] *viz.*:

x x x From your records showed (sic) that you have not subjected to Value-Added Tax *gross receipts* relating to your interest/rental income in the amount of [₱]11,080.687.70 for which Output Tax x x x should have been remitted to the government . . .

It appears that, based on the tax authorities' own audit results, MPRC's *gross receipts* from interest income amounted only to ₱11,080,687.70. This would have been the proper VAT base in

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[129] Section 108, 1997 Tax Code.

[130] CTA Third Division *rollo*, p. 622, Formal Letter of Demand with attached Details of Discrepancies and Audit/Assessment Notice.

[131] *Id.* at 309, FDDA dated January 16, 2014.

[132] *Id.* at 620. Formal Letter of Demand with attached Details of Discrepancies and Audit/Assessment Notice.

Supreme Court E-Library

MPRC's case and a more accurate representation of undeclared receipts in the 30% threshold computation. Interestingly, this amount is only 25.62%[133] of the total VAT-able sales *(gross receipts)* declared in MPRC's returns.

Stated otherwise, it was obvious at the outset that actual *interest received* would yield a percentage that would fall below the threshold. The tax authorities should have been aware that they could not avail themselves of the presumption of falsity or fraud. The CIR's decision to rely on *accrued interest* even though it was the incorrect VAT base misled both the CTA Division and the CTA *En Banc* into thinking that the threshold was met.

Third, in any case, even if the Court assumes that the presumption arose in favor of the CIR, MPRC was able to dispute it.

To recall, the CTA Division and the CTA *En Banc*[134] arrived at uniform findings that the underdeclaration of MPRC's gross receipts subject to VAT was not deliberate, *viz.*:

> x x x [T]he under-declaration in petitioner's gross receipts on interest income for CY 2007 did not arise from a deliberate attempt on its part to evade tax *but due on the honest belief that it is not subject to VAT. This is supported by the fact that the interest income amounting to ₱25,522,729.00 was indeed reported in petitioner's annual Income Tax Return* for CY 2007.[135]

It is undisputed that while MPRC overlooked its gross receipts from interest income for VAT purposes, it did declare its interest income for IT purposes and disclosed it in its 2007 Financial Statements. Echoing the words of CTA Presiding Justice Roman G. Del Rosario, in his Dissenting Opinion in the assailed CTA *En Banc* Decision, as MPRC ably clarified the reason for the underdeclaration, it cannot be regarded to have fraudulently concealed its interest income.[136]

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[133] ₱11,080,687.70 ÷ ₱43,251,242.70 = 0.25619 or 25.62%.

[134] *Rollo*, p. 93. The CTA *En Banc* adopted the CTA Division's findings and confirmed that the underdeclaration was not deliberate on the part of MPRC.

[135] *Id.* at 139, CTA Third Division Decision.

[136] *Id.* at 101.

Supreme Court E-Library

- *The CIR failed to prove intentional falsity*

The CIR relied wholly on the presumption of falsity or fraud in justifying its application of the extraordinary 10-year period. Aside from its repeated assertion that the underdeclaration was substantial in amount, the CIR does not point to any other circumstance or evidence that could establish that MPRC's failure to report the subject interest income in its VAT returns was willful or intentional. That a misstatement has been sizeable cannot, on its own, be regarded as sufficient proof of an intention to evade tax.

The Court underscores that only intentional and deliberate errors may render the return false for purposes of invoking the extraordinary period under Section 222(a). Certainly, a return may contain errors. However, if the CIR fails to establish that the misstatement was willful on the part of the taxpayer, plain errors—such as that committed by MPRC but expressly recognized by the tax court as not arising from a deliberate attempt to evade tax—cannot justify the application of the 10-year period.

ii. The CIR acted in violation of MPRC's due process rights

As discussed above, due process in invoking the exceptional period 10-year not only *requires* the tax authorities to issue an *assessment notice* to provide clear and adequate information necessary in setting up the taxpayer's protest but also *disallows* the tax authorities from acting in a manner that is inconsistent with the invocation of the extraordinary prescriptive period or would otherwise mislead the taxpayer that the basic period will be applied.

In the present case, the following circumstances negate the CIR's good faith in extending the assessment period:

First, the 2007 VAT assessments were expected to prescribe completely by March 26, 2011[137] or three years counted from the

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[137] *Id.* at 120.

Supreme Court E-Library

filing of MPRC's fourth quarter VAT return. "[T]o afford the CIR ample time to carefully consider the legal and/or factual questions involved in the determination of [MPRC's] tax liabilities"[138] the parties executed two waivers extending the assessment period as follows:

	Date of Execution	Extended Until
First Waiver	December 29, 2010	December 31, 2011
Second Waiver	December 27, 2011	March 31, 2012

Second, the CIR served the FLD/FAN upon MPRC on March 30, 2012 or one day prior to the expiration of the extended deadline set in the Second Waiver.

Similar to the Court's observations in *Inquirer* and *Unioil*, the timing of the waivers' execution and FLD/FAN's issuance and service reveals the CIR's primary objective to obviate the impending expiration of the *basic three-year assessment period* and that, in the first place, it had no intention to extend it. These considerations lead the Court to the conclusion that the CIR invoked the 10-year period as a mere afterthought. In the Court's view, to go through the motions of limiting the audit and assessment within the basic three-year period, only to later on accuse the taxpayer of filing a false return, without so much as a justification therefor, is an arbitrary exercise of the power to assess. The taxpayer cannot be kept in the dark of such serious allegations. Otherwise, the State, on account of the tax authorities' actions, would be depriving the taxpayer of property without due process of the law.

II

Having determined that the extraordinary 10-year period does not apply in the present case, the Court shall now ascertain whether the CIR was at least able to issue a valid assessment within the basic three-year period.

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[138] See Waiver of the Defense of Prescription under the Statute of Limitations of the National Internal Revenue Code, CTA Division *rollo*, p. 70.

Supreme Court E-Library

The parties acknowledged the following: (a) the VAT assessments for the first, second, third, and fourth quarters of 2007 were set to prescribe on April 25, 2010, July 25, 2010, October 26, 2010, and March 26, 2011, respectively; (b) the First Waiver executed on December 29, 2010 extended the assessment period to December 31, 2011; and (c) MPRC received the FLD/FAN on March 30, 2012.

Based on these circumstances, when the parties extended the assessment period on December 29, 2010, the first, second, and third quarters VAT assessments had already prescribed.[139] Anent the fourth quarter VAT return, it is undisputed that petitioner had a VAT overpayment of ₱1,680,056.96.

Significantly, both the CTA Division and the CTA *En Banc* observed that the CIR no longer disputed the issuance of the assessment notices beyond the three-year period.[140] The CIR's Comment does not contain any argument advocating for the timeliness of the assessment relative to the three-year period. It does not even address, much less deny specifically, MPRC's claim that the interest income in question was, in fact, collected in the second quarter of 2007[141] and, thus, would have also prescribed by July 25, 2010.

The circumstances coupled with the CIR's exclusive reliance on the application of the 10-year period suggest an acquiescence of its failure to meet the three-year assessment period.

As the FLD/FAN was issued beyond the basic three-year period and the CIR's invocation of the extraordinary 10-year assessment period is unavailing, the Court holds that the VAT assessments have prescribed. Assessments that have prescribed are void. Thus, it is no longer necessary to discuss the correctness of the VAT assessment.

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[139] As observed by CTA Presiding Justice Del Rosario in his Dissenting Opinion in the Assailed CTA En Banc Decision.

[140] *Rollo*, pp. 82 and 120.

[141] *Id.* at 43, Petition for Review on *Certiorari*.

Supreme Court E-Library

WHEREFORE, the petition is **GRANTED**. The Decision dated October 11, 2018 and the Resolution dated June 10, 2019 of the Court of Tax Appeals *En Banc* in CTA EB No. 1638 (CTA Case No. 8766) are hereby **REVERSED** and **SET ASIDE**.

Accordingly, the deficiency value-added tax assessment against petitioner for calendar year 2007 is hereby **CANCELLED** and **SET ASIDE** on the ground of prescription.

SO ORDERED.

Gesmundo, C.J., Leonen, Hernando, Lazaro-Javier, Zalameda, M. Lopez, Gaerlan, J. Lopez, Marquez, Kho, Jr., and *Singh, JJ.*, concur.

Caguioa, J., see concurring opinion.

Dimaampao, J., see concurring and dissenting opinion.

Rosario, J., on leave.

APPEARANCES OF COUNSEL

Salvador Llanillo & Bernardo for petitioner.
The Solicitor General for respondent.

CONCURRING OPINION

CAGUIOA, *J.*:

I fully concur with the *ponencia*'s abandonment of the Court's ruling in *Aznar v. Court of Tax Appeals*[1] (*Aznar*) which applied the extraordinary 10-year prescriptive period under Section 222(a) of the National Internal Revenue Code of 1997[2] (1997 NIRC) to false returns in general.

I submit this Concurring Opinion only to highlight that the filing of false returns *without intent to evade tax* does not warrant

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[1] 157 Phil. 510 (1974).

[2] Republic Act No. 8424, December 11, 1997.

Supreme Court E-Library

the application of the 10-year prescriptive period under Section 222(a) of the 1997 NIRC.

For context, the crux of the controversy in this case pertains to whether petitioner McDonald's Philippines Realty Corporation (MPRC) should be subject to the ordinary three-year prescriptive period or the extraordinary 10-year prescriptive period for assessment. MPRC asserts that the three-year period is applicable to its situation because it did not file a false return with intent to evade tax. Respondent Commissioner of Internal Revenue (CIR) insists otherwise and maintains that the issuance of the subject assessment was not yet barred by prescription as the 10-year prescriptive period should be applied due to MPRC's submission of a false return. On this note, the Court of Tax Appeals *En Banc* (CTA EB) agreed with the CIR and concluded that MPRC committed falsity in its 2007 Quarterly Value-Added Tax (VAT) returns as it did not declare substantial receipts from its interest income. This deviation from the truth, according to the CTA EB, warrants the application of the 10-year prescriptive period for assessment.

The CIR's power to assess and collect taxes is provided under Section 2 of the 1997 NIRC, which reads:

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

This power to assess and collect taxes is, however, limited by Section 203 of the 1997 NIRC:

> SECTION 203. *Period of Limitation Upon Assessment and Collection*. — Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment

Supreme Court E-Library

for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

As an exception to the ordinary three-year prescriptive period for assessment and collection of taxes, Section 222 of the 1997 NIRC provides:

SECTION 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes*.

(a) In the case of a **false or fraudulent return with intent to evade tax** or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof. (Emphasis supplied)

Like the *ponencia*, I find that the extraordinary 10-year period to assess does **not** apply in the present case — which is a situation of a return being false but without any intent to evade the tax.

A review of relevant jurisprudence on the definition of a "false return" is in order.

In 1974, the Court strictly defined in *Aznar* what constitutes a false return as a "deviation from the truth, whether intentional or not" such that "it becomes easy for revenue officers to claim that there was falsity in the return filed by the taxpayer that would allow the assessment of tax within ten (10) years from the date of discovery."[3]

However, as will be discussed below, subsequent decisions after *Aznar* suggest that the Court had relaxed the strict application of what constitutes a false return.

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[3] Mamalateo and Mamalateo-Jusay, *Tax Rights and Remedies* (2016), p. 777.

Supreme Court E-Library

Almost 25 years after *Aznar*, the Court promulgated the case of *CIR v. B.F. Goodrich Phils., Inc.*[4] (*B.F. Goodrich Phils.*), where the CIR argued that there was "falsity" when the taxpayer sold a property for a price lesser than its declared fair market value thereby justifying the application of the extraordinary prescriptive period to assess. In refusing to apply the 10-year period, the Court held that mere falsity in the return is insufficient to take the questioned assessment out of the ambit of the ordinary prescriptive period to assess. The CIR must prove that the return was filed fraudulently or that the taxpayer intended to evade the payment of correct taxes to justify the application of the 10-year period, to wit:

> Petitioner insists that private respondent committed "falsity" when it sold the property for a price lesser than its declared fair market value. **This fact alone did not constitute a false return which contains wrong information due to mistake, carelessness or ignorance.** It is possible that real property may be sold for less than adequate consideration for a *bona fide* business purpose; in such event, the sale remains an "arm's length" transaction. In the present case, the private respondent was compelled to sell the property even at a price less than its market value, because it would have lost all ownership rights over it upon the expiration of the parity amendment. In other words, private respondent was attempting to minimize its losses. At the same time, it was able to lease the property for 25 years, renewable for another 25. This can be regarded as another consideration on the price.
>
> Furthermore, **the fact that private respondent sold its real property for a price less than its declared fair market value did not by itself justify a finding of false return**. Indeed, private respondent declared the sale in its 1974 return submitted to the BIR. Within the five-year prescriptive period, the BIR could have issued the questioned assessment, because the declared fair market value of said property was of public record. This it did not do, however, during all those five years. **Moreover, the BIR failed to prove that respondent's 1974 return had been filed fraudulently. Equally significant was its failure to prove respondent's intent to evade the payment of the correct amount of tax**.
>
> **Ineludibly, the BIR failed to show that private respondent's 1974 return was filed fraudulently with intent to evade the payment of**

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[4] 363 Phil. 169 (1999).

Supreme Court E-Library

the correct amount of tax. Moreover, even though a donor's tax, which is defined as "a tax on the privilege of transmitting one's property or property rights to another or others without adequate and full valuable consideration," is different from capital gains tax, a tax on the gain from the sale of the taxpayer's property forming part of capital assets, the tax return filed by private respondent to report its income for the year 1974 was sufficient compliance with the legal requirement to file a return. In other words, the fact that the sale transaction may have partly resulted in a donation does not change the fact that private respondent already reported its income for 1974 by filing an income tax return.

Since the BIR failed to demonstrate clearly that private respondent had filed a fraudulent return with the intent to evade tax, or that it had failed to file a return at all, the period for assessments has obviously prescribed. Such instances of negligence or oversight on the part of the BIR cannot prejudice taxpayers, considering that the prescriptive period was precisely intended to give them peace of mind.[5] (Emphasis supplied, italics and citations omitted)

In the 2004 case of *CIR v. Estate of Toda, Jr.*[6] (*Estate of Toda, Jr.*), the Court interpreted Section 269 of the 1986 NIRC (now Section 222 of the 1997 NIRC) differently from *Aznar* — that the phrase "intent to evade tax" qualified the term "false return" and not "fraudulent return," to wit:

Has the period of assessment prescribed?

No. Section 269 of the NIRC of 1986 (now Section 222 of the Tax Reform Act of 1997) read:

Sec. 269. Exceptions as to period of limitation of assessment and collection of taxes. — (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court after the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud or omission: *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for collection thereof.

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5 *Id.* at 179–180.

6 481 Phil. 626 (2004).

Supreme Court E-Library

Put differently, in cases of (1) fraudulent returns; (2) false returns with intent to evade tax; and (3) failure to file a return, the period within which to assess tax is ten years from discovery of the fraud, falsification or omission, as the case may be.[7] (Emphasis and underscoring supplied, italics in the original)

Then in the 2016 case of *Republic of the Phils. v. GMCC United Development Corp., et al.*[8] (*GMCC United Development Corp.*), the Court also refused to apply the 10-year period to assess:

In arguing for the application of the 10-year prescriptive period, petitioner claims that the tax return in this case is fraudulent and thus, the three-year prescriptive period is not applicable.

Petitioner fails to convince that respondents filed a fraudulent tax return. **The respondents may have erred in reporting their tax liability when they recorded the assailed transactions in the wrong year, but such error stemmed from the wrong application of the law and is not an indication of their intent to evade payment. If there were really an intent to evade payment, respondents would not have reported and subsequently paid the income tax, albeit in the wrong year.**[9] (Emphasis supplied, citation omitted)

Still further, in the 2017 case of *CIR v. Philippine Daily Inquirer, Inc.*[10] (*Philippine Daily Inquirer*), the Court, applying the case of *B.F. Goodrich Phils*., categorically declared:

In *Commissioner of Internal Revenue v. Javier*, this Court ruled that fraud is never imputed. The Court stated that it will not sustain findings of fraud upon circumstances which, at most, create only suspicion. The Court added that the **mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion**. The Court explained:

> The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some legal right. Negligence, whether slight or gross, is not

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[7] *Id.* at 642–643.

[8] 802 Phil. 432 (2016).

[9] *Id.* at 448.

[10] 807 Phil. 912 (2017).

Supreme Court E-Library

> equivalent to fraud with intent to evade the tax contemplated by law. It must amount to intentional wrong-doing with the sole object of avoiding the tax.

In *Samar-I Electric Cooperative v. Commissioner of Internal Revenue*, the Court differentiated between false and fraudulent returns. Quoting *Aznar v. Court of Tax Appeals*, the Court explained in *Samar-I* the acts or omissions that may constitute falsity, thus:

> Petitioner argues that Sec. 332 of the NIRC does not apply because the taxpayer did not file false and fraudulent returns with intent to evade tax, while respondent Commissioner of Internal Revenue insists contrariwise, with respondent Court of Tax Appeals concluding that the very "substantial under[ ]declarations of income for six consecutive years eloquently demonstrate the falsity or fraudulence of the income tax returns with an intent to evade the payment of tax."
>
> To our minds we can dispense with these controversial arguments on facts, although we do not deny that the findings of facts by the Court of Tax Appeals, supported as they are by very substantial evidence, carry great weight, by resorting to a proper interpretation of Section 332 of the NIRC. We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situation into three different classes, namely "falsity," "fraud," and "omission." That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.
>
> The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the NIRC should be applicable to normal circumstances, but whenever the government is placed at a disadvantage so as to prevent its lawful agents from

Supreme Court E-Library

> proper assessment of tax liabilities due to false returns, fraudulent return intended to evade payment of tax or failure to file returns, the period of ten years provided for in Sec. 332(a) [of the] NIRC, from the time of discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.

Thus, while the filing of a fraudulent return necessarily implies that the act of the taxpayer was intentional and done with intent to evade the taxes due, the filing of a false return can be intentional or due to honest mistake. In *CIR v. B.F. Goodrich Phils., Inc.*, the Court stated that the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return. In this case, we do not find enough evidence to prove fraud or intentional falsity on the part of PDI.

Since the case does not fall under the exceptions, Section 203 of the NIRC should apply.[11] (Emphasis supplied, citations omitted)

While the Court in *Philippine Daily Inquirer* cited *Aznar* in differentiating between a false and a fraudulent return, it nonetheless recognized and applied the ruling in *B.F. Goodrich Phils.* that "the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return." The Court concluded that since there was no evidence to prove fraud or intentional falsity on the part of the taxpayer, then the three-year, and not the 10-year, prescriptive period applies.

Clearly, in contrast to *Aznar*, the cases of *B.F. Goodrich Phils., Estate of Toda, Jr.*, and *GMCC United Development Corp.* held that mere falsity of a return will not warrant the application of the 10-year prescriptive period for an assessment. It must be established that the filing of a false return was done intentionally or with intent to evade the payment of tax.

Thus, as I see it, the Court's strict definition of false return in *Aznar* (rendered in 1974) was effectively **abandoned** by the Court as early as 1999 in its ruling in *B.F. Goodrich Phils.*, which categorically declared that the main issue it was resolving therein was the prescription provision of Section 332 of the 1939 Tax

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[11] *Id.* at 935–937.

Supreme Court E-Library

Code[12] (now Section 222 of the 1997 NIRC). As the Court notably held:

> For the purpose of safeguarding taxpayers from any unreasonable examination, investigation or assessment, our tax law provides a statute of limitations in the collection of taxes. Thus, the law on prescription, being a remedial measure, should be liberally construed in order to afford such protection. As a corollary, the exceptions to the law on prescription should perforce be strictly construed.[13] (Citation omitted)

That *B.F. Goodrich Phils.* had really abandoned the strict interpretation in *Aznar* is thereafter seen in the promulgation of the case of *Philippine Daily Inquirer* in 2017. The Court cannot ignore its ruling in *Philippine Daily Inquirer* as an authoritative example, because, as in this case, the main issue resolved therein was the prescription provision on the assessment and collection of taxes. Thus, *Philippine Daily Inquirer* affirms the position of the *ponencia* that the strict interpretation in *Aznar* had already been abandoned by *B.F. Goodrich Phils*.

In his Concurring and Dissenting Opinion, Associate Justice Japar B. Dimaampao (Justice Dimaampao) takes a different view urging the Court to revert to the decision in *Aznar*. For Justice Dimaampao, there is no need to abandon *Aznar* because it is more in keeping with the literal wording of Section 222(a) of the 1997 NIRC and the spirit of the law.[14]

I disagree. The Court should not disturb the prevailing current jurisprudence and, through the current *ponencia*, it should now finally and definitively hold that the narrow interpretation in *Aznar* where a "false return" was simplistically understood to mean any "deviation from the truth, whether intentional or not," has been abandoned.

Again, for easier reference, the provision in question reads as follows:

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[12] Commonwealth Act No. 466, June 15, 1939.

[13] *CIR v. B.F. Goodrich Phils., Inc., supra* note 4, at 178.

[14] Dimaampao, *J.*, Concurring and Dissenting Opinion, pp. 7–11.

Supreme Court E-Library

SECTION 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes*.

(a) In the case of a **false or fraudulent return with intent to evade tax** or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof. (Emphasis supplied)

While the above provision shows that the phrase "with intent to evade tax" follows the phrase "fraudulent return," it is absurd to interpret that only a "fraudulent return" is qualified by the phrase "with intent to evade tax" because "fraudulent return" already embraces the intent to avoid tax. In other words, to use "with intent to evade tax" as the modifier of "fraudulent return" is defining a term with its own definition. Borrowing the words of the Court in *Philippine Daily Inquirer* quoting from *Samar-I Electric Cooperative v. CIR*,[15] the filing of a fraudulent return "necessarily implies that the act of the taxpayer was intentional and done with intent to evade the taxes due." The "literal wording" of the law, therefore, as properly applied — and contrary to the position of Justice Dimaampao — is that the phrase "with intent to evade tax" modifies only — as it can only modify — the term "false return."

To continue following *Aznar* is to continue to destroy any significant difference between the three-year and 10-year periods because any error or omission by the taxpayer in his or her return, even if by simple mistake or ignorance will be considered as an assessment under the extraordinary 10-year period.

More importantly, this broad interpretation of what constitutes a false return only widens the door to corruption and abuse of power by tax authorities. In the context of regular tax audits, where findings of under-declared income or over-declared deductions are common, any mistake, no matter if in good faith, will result in triggering the 10-year prescriptive period.

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[15] 749 Phil. 772 (2014).

Supreme Court E-Library

Justice Dimaampao further submits that it would be absurd to presume that the legislative intent behind Section 222(a) of the 1997 NIRC allows for the extraordinary period only when no return is filed and not when a return is filed with errors or inaccuracies. It was suggested that both scenarios equally hinder the taxing authority's collection efforts, and restricting the provision to false returns filed with intent to evade tax limits the government's ability to recover taxes.[16]

With due respect, this is wrong. The distinction between situations in which no return is filed and situations in which false returns are filed without the intent to evade tax is justified by practical and legal considerations. It is important to consider that the prescriptive period for assessment and collection exists to strike a balance between allowing the government to effectively assess and collect taxes ***while also ensuring fairness and protection for taxpayers***. When no return is filed, the taxing authority faces significant challenges in assessing and collecting taxes. The absence of a return deprives the government of any basis for determining the taxpayer's liability, making it difficult to initiate the assessment or collection process. To address this, the law provides for the extraordinary 10-year prescriptive period.

On the other hand, false returns present a different scenario. While errors or inaccuracies in a return may create difficulties for the taxing authority, it is essential to note that the government still has access to the filed returns. The three-year period prescribed for assessing and collecting taxes in such cases strikes a balance between giving the government enough time to identify and address false returns while safeguarding the rights of taxpayers. Furthermore, the three-year period does not preclude the government from assessing and collecting taxes based on false returns. Within this timeframe, the government retains the authority and resources to assess and collect taxes.

Justice Dimaampao raises the question regarding the qualification of false returns with the phrase "with intent to evade tax" and its potential differentiation from fraudulent returns. He

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[16] Dimaampao, *J.*, Concurring and Dissenting Opinion, pp. 10–11.

Supreme Court E-Library

submits that if false returns can be filed with the intent to evade tax, yet not be classified as fraudulent, it may render the word "fraudulent" superfluous.[17] The problem with this formulation is that the premise is false. When a false return is determined by the tax authorities as having an "intent to evade tax," then that false return is a fraudulent return and the 10-year period is triggered.

To repeat, to limit the application of the phrase "with intent to evade tax" solely to fraudulent returns would be redundantly repetitious and overlooks the balancing act provided by Section 222(a), as heretofore already explained.

Indeed, **the subsequent cases after *Aznar* provide a more sound and logical approach in the construction and application of Section 222 of the 1997 NIRC**.

Intent to evade tax or tax evasion refers to the payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due with an accompanying state of mind which is described as being evil, in bad faith, willful, or deliberate and not accidental.[18] On the other hand, fraud, in its general sense, refers to "the deliberate intention to cause damage or prejudice. It is voluntary execution of a wrongful act, or a willful omission, knowing and intending the effects which naturally and necessarily arise from such act or omission."[19] Therefore, to construe that the phrase "with intent to evade tax" as only qualifying the term "fraudulent return," as *Aznar* provided, would render the qualifying phrase superfluous and irrelevant inasmuch as tax evasion and fraud are relatively synonymous. It is a cardinal rule in statutory construction that no word, clause, sentence, provision or part of a statute shall be considered surplusage or superfluous, meaningless, void and insignificant. For this purpose, a construction which renders every word operative is preferred over that which makes some words

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[17] *Id.* at 7–8.

[18] *CIR v. Estate of Toda, Jr., supra* note 6, at 639.

[19] *Pilipinas Shell Petroleum Corporation v. Commissioner of Customs*, 801 Phil. 806, 842 (2016); citation omitted.

Supreme Court E-Library

idle and nugatory.[20] *Ut magis valeat quam pereat*. I submit that the Court should choose the interpretation that gives effect to the whole of the statute and its every word.[21]

In fact, a reading of Section 222 of the 1997 NIRC reveals that the phrase "with intent to evade tax" qualifies a "false return." Under the doctrine of *noscitur a sociis*, the construction of a particular word or phrase, which is in itself ambiguous, or is equally susceptible of various meanings, may be made clear and specific by considering the company of words in which it is found or with which it is associated. In other words, the obscurity or doubt of the word or phrase may be reviewed by reference to associated words.[22] Given that the clause "with intent to evade tax" is in the company of the words "false or fraudulent return," it becomes clear that the qualifying phrase "with intent to evade tax" pertains to the entire category of "false or fraudulent return." This interpretation is supported by the fact that the provision does not separate the words "false" and "fraudulent" by a comma, indicating that they should be read together as a single unit.

Thus, Section 222 of the 1997 NIRC reveals that the phrase "with intent to evade tax" qualifies as well a "false return." This interpretation is consistent with the purpose of the provision, which is to provide exceptions to the general rule on the assessment and collection of taxes on false or fraudulent returns with the intent to evade tax. In other words, not every erroneous return would warrant the application of the 10-year period to assess. It bears to stress that since the 1939 Tax Code up to the 1997 NIRC, the Legislature has remained consistent with the phraseology of the exceptions as to the period of limitation of assessment and collection of taxes. The precursor provision of Section 222 of the 1997 NIRC is Section 332 of the 1939 Tax Code:

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[20] *SM Land, Inc. v. Bases Conversion and Dev't. Authority, et al.*, 741 Phil. 269, 299 (2014); *Allied Banking Corporation v. CA*, 348 Phil. 382 (1998).

[21] *Phil. Health Care Providers, Inc. v. CIR*, 616 Phil. 387, 402 (2009).

[22] *Government Service Insurance System, et al. v. Commission on Audit, et al.*, 674 Phil. 578, 600–601 (2011).

Supreme Court E-Library

SECTION 332. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes*. — (a) In the case of a **false or fraudulent return with intent to evade tax** or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission. (Emphasis supplied)

Furthermore, for purposes of imposing a civil penalty, Section 248(B) of the 1997 NIRC provides a fifty percent (50%) surcharge "in case a false or fraudulent return is **willfully made**," thus:

SECTION 248. *Civil Penalties*. —

. . . .

(B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or **in case a false or fraudulent return is willfully made**, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case, any payment has been made on the basis of such return before the discovery of the falsity or fraud. (Emphasis supplied)

Section 248(B) of the 1997 NIRC affirms my position, as in *B.F. Goodrich Phils.*, that the entry of wrong information due to mistake, carelessness, or ignorance, *without intent to evade tax*, does not warrant the application of the 10-year prescriptive period.

At the risk of being repetitive, in order to render a false return within the ambit of Section 222 of the 1997 NIRC, such filing must be done **willfully or intentionally or with intent to evade the payment of tax**. As emphasized by the Court, the law on prescription should be liberally construed in favor of taxpayers and that, as a corollary, Section 222 of the 1997 NIRC, as an exception to the statute of limitations, should perforce be strictly construed. In *GMCC United Development Corp.*, the Court explained anew the reasons behind the prescriptive period for assessment and collection of internal revenue taxes:

The law prescribing a limitation of actions for the collection of the income tax is beneficial both to the Government and to its citizens; to the Government because tax officers would be obliged to act promptly in the making of assessment, **and to citizens because after the lapse of the period of prescription citizens would have a feeling of security against**

unscrupulous tax agents who will always find an excuse to inspect the books of taxpayers, not to determine the latter's real liability, but to take advantage of every opportunity to molest peaceful, law-abiding citizens. Without such a legal defense[,] taxpayers would furthermore be under obligation to always keep their books and keep them open for inspection subject to harassment by unscrupulous tax agents. The law on prescription being a remedial measure should be interpreted in a way conducive to bringing about the beneficient purpose of affording protection to the taxpayer within the contemplation of the Commission which recommend the approval of the law.[23] (Emphasis supplied)

Justice Dimaampao proposes that only false returns, whether done intentionally or unintentionally, that have a true impact on the government's collection of taxes should qualify for the extended period for assessment and collection. The test should be whether the false entries resulted in actual prejudice to the government, without necessarily a specific intent to evade taxes, and must be of such a degree that the government is prevented from uncovering the same with reasonable efforts.[24]

This proposal is simply an invitation to do judicial legislation that is totally uncalled for. Section 222(a) of the 1997 NIRC is clear and unambiguous. The law states that false returns, filed with the intent to evade tax, are subject to the extraordinary 10-year prescriptive period. **The requirement of specific intent to evade tax is an *essential element* in the determination of whether the extraordinary prescriptive period will apply**.

To adopt Justice Dimaampao's proposed interpretation would introduce an additional requirement that goes beyond what the law prescribes. It would deviate from the express intent and wording of the statute. The clear legislative intent is that the 10-year prescriptive period will apply when false returns with the intent to evade tax are involved. **Moreover, determining the impact on the government's tax collection or the extent of prejudice suffered would require subjective evaluations and may lead**

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[23] *Republic of the Phils. v. GMCC United Development Corp., et al., supra* note 8, at 447, citing *Republic of the Phils. v. Ablaza*, 108 Phil. 1105 (1960).

[24] Dimaampao, *J.*, Concurring and Dissenting Opinion, pp. 11–12.

Supreme Court E-Library

to inconsistent application. This also creates another door for "**unscrupulous tax agents who will always find an excuse to inspect the books of taxpayers, not to determine the latter's real liability, but to take advantage of every opportunity to molest peaceful, law-abiding citizens.**"

In sum, mere falsity of a return does not merit the application of the 10-year prescriptive period. The animating element of fraud as in the case of taxpayer's intent to evade the payment of the correct amount of tax must be clearly established. Hence, in cases of "false returns," the Bureau of Internal Revenue (BIR) should only invoke the 10-year prescriptive period where there is clear and convincing evidence of fraud or intent to evade tax.

To my mind, understanding fraud or intent to evade tax to be the animating element of a "false return" protects taxpayers from tax agents senselessly (or worse, maliciously) invoking the 10-year prescriptive period based on simple discrepancies, **which could have been easily detected by the BIR within the ordinary period of prescription given its bountiful resources and machineries, especially in this age of computerization**. To repeat the wisdom of earlier years, imposing the prescriptive period will compel the BIR to promptly and thoroughly examine the records of the taxpayer, verify the correctness of their returns, assess, and collect deficiency internal revenue taxes, if any. To allow the BIR the 10-year period runs counter to this impetus and leads only to situations of unscrupulous BIR examiners continuing to shag innocent, peaceful, and law-abiding citizens.

In this case, as correctly found by the CTA Division and CTA EB, the under-declaration in MPRC's gross receipts in its 2007 Quarterly VAT returns did not arise from an intent to evade tax. On the contrary, such under-declaration arose from MPRC's honest belief that it was not subject to VAT. More, the fact that MPRC reported its interest income in its annual Income Tax Return for calendar year 2007 is a clear indication that it did not intent to evade tax.

Where such intent to evade tax is absent, the BIR is not justified in invoking the 10-year prescriptive period to assess. Indeed,

Supreme Court E-Library

as between the strict and literal but erroneous interpretation in *Aznar* and the liberal albeit correct ruling in *B.F. Goodrich Phils.*, as affirmed in *Estate of Toda, Jr., GMCC United Development Corp.*, and *Philippine Daily Inquirer*, the Court is now bound to apply the latter because the Court's duty is to give effect not only to the letter of the law, but more importantly, to the spirit and the policy that animate it.

Again, it is a settled rule that the law on prescription is liberally interpreted in favor of taxpayers, while exceptions thereto are strictly construed. Considering that the exception to the statute of limitations principally favors the BIR, the burden to prove the filing of a false return with intent to evade tax rests upon its shoulders.

Unfortunately, in this case, the BIR failed to discharge its burden. Apart from bare claims of falsity of MPRC's return, the BIR failed to clearly demonstrate, as in *B.F. Goodrich Phils., Estate of Toda, Jr., GMCC United Development Corp.*, and *Philippine Daily Inquirer*, that MPRC filed its return with intent to evade the payment of the correct taxes. Verily, inasmuch as intent to evade the payment of tax on the part of MPRC has not been established, the application of the 10-year prescriptive period is not warranted.

For these reasons, I fully concur with the *ponencia*, and accordingly vote to **GRANT** the present Petition, **REVERSE** and **SET ASIDE** the Decision and Resolution of the Court of Tax Appeals *En Banc*, and **CANCEL** the value-added tax assessment against Mcdonald's Philippines Realty Corporation for calendar year 2007 on the ground that the three-year period for assessment has already prescribed.

CONCURRING & DISSENTING OPINION

DIMAAMPAO, *J.*:

I concur in granting the present Petition and cancelling the subject assessment on the ground of prescription. I agree that the Commissioner of Internal Revenue failed to prove that the present

Supreme Court E-Library

case warranted the application of the extraordinary ten-year prescriptive period under Section 222 (a) of the National Internal Revenue Code (NIRC), as amended by Republic Act (RA) No. 8424.[1]

However, I dissent as to the *ponencia*'s abandonment of the doctrine in *Aznar v. Court of Tax Appeals*,[2] which declared that Section 222 (a) (formerly, Section 332 [a]) of the NIRC contemplates both intentional and unintentional false returns, and instead exclusively qualifies "false returns" in the aforementioned provision to returns containing errors made deliberately or willfully with intent to evade taxes.[3]

The relevant provision under consideration is Section 222 (a) of the NIRC, particularly as to the proper characterization of a "false return" which would trigger the extraordinary ten-year period to assess or collect taxes –

> SECTION 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes.—
>
> (a) In the case of a **false** or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof. (Emphasis supplied)

The *cause célèbre* between the majority and this dissent rests on whether a false return under the aforecited provision is necessarily qualified by the phrase "with intent to evade tax," in the same manner as fraudulent returns. It is my humble assertion that it is not.

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[1] An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes, enacted on December 11, 1997.

[2] G.R. No. L-20569, August 23, 1974, 157 Phil. 510-536.

[3] *Ponencia*, p. 34.

Supreme Court E-Library

Section 222 (a) of the present NIRC traces its legislative origins to Section 332 (a) of the NIRC of 1939:[4]

SECTION 332. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. — (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission.

Subsequently, Presidential Decree (PD) No. 69[5] introduced the *proviso* to the effect that in a collection case instituted by the Bureau of Internal Revenue (BIR) involving fraud assessment, which has become final and executory, the fact of fraud shall be judicially taken cognizance of by the court:[6]

Sec. 332. Exceptions as to period of limitation of assessment and collection of taxes. — (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission; Provided, That, in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

Following this amendment, the provision saw no changes up until its present form in the NIRC of 1997.[7]

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[4] Commonwealth Act No. 466, entitled "AN ACT TO REVISE, AMEND AND CODIFY THE INTERNAL REVENUE LAWS OF THE PHILIPPINES," enacted on June 15, 1939.

[5] AMENDING CERTAIN SECTIONS OF THE NATIONAL INTERNAL REVENUE CODE, enacted on November 24, 1972.

[6] Revenue Memorandum Circular No. 09-73, issued on January 9, 1973.

[7] See Section 319 (a) of PD No. 1158, or the NIRC of 1977, enacted on June 3, 1977 –

> SECTION 319. Exceptions as to period of limitation of assessment and collection of taxes.— (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission: Provided, That in a fraud assessment which

Supreme Court E-Library

Having seen little to no changes in its wording or styling since its introduction in 1939, it would be safe to assume that its intended meaning has not changed and even decades old jurisprudence interpreting the provision remains instructive to properly glean the will of the legislative, as the repository of the sovereign power of taxation.[8]

Pertinently, the provision was first interpreted by the Court in the seminal case of *Aznar v. Court of Tax Appeals*,[9] which declared that Section 222 (a) (formerly, Section 332 [a]) of the NIRC recognizes three distinct scenarios: false returns, fraudulent returns with intent to evade taxes, and failure to file returns. The Court then distinguished between the first two in this wise:

> We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that

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has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

See Section 2 of Batas Pambansa Blg. 700, entitled AN ACT AMENDING SECTIONS 318 AND 319 OF THE NATIONAL INTERNAL REVENUE CODE, AS AMENDED, SO AS TO REDUCE THE PERIOD OF LIMITATION FOR ASSESSMENT OF INTERNAL REVENUE TAXES FROM FIVE (5) TO THREE (3) YEARS, enacted on April 5, 1984 –

SECTION 2. Section 319 of the same Code is hereby amended to read as follows:

"Sec. 319. Exceptions as to period of limitation of assessment and collection of taxes. — (a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

[8] See *Abakada Guro Party List v. Ermita*, G.R. Nos. 168056, 168207, 168461, 168463 & 168730, September 1, 2005.

[9] Supra note 2.

the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which aggregates the situations into three different classes, namely "falsity," "fraud" and "omission." That there is a difference between "false return" and "fraudulent return" cannot be denied. **While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.** (Emphasis supplied)

In *Aznar*, the Court found that the taxpayer had filed false returns given that the information therein did not accurately reflect his financial condition at the time based on the evidence presented. The Court also found that the lower court erred in presuming that the returns were fraudulent based solely on the substantial disparity of incomes as reported and determined by the inventory method and on the similarity of consecutive disparities for six years. It held that the intent to evade taxes was actually belied by the Commissioner of Internal Revenue's own findings that resulted in varied tax liability results based on mistakes in the use of the inventory method. This bolstered the taxpayer's defense that the falsity of the returns was merely due to mistake, carelessness, or ignorance of the taxpayer's accountants.[10]

In *Commissioner of Internal Revenue v. Javier, Jr.*,[11] the Court maintained the particular distinction of fraudulent returns as opposed to false returns and stated that "[a] 'fraudulent return' is always an attempt to evade a tax, but a merely 'false return' may not be." It emphasized that the fraud contemplated by the NIRC is "actual and intentional fraud through willful and deliberate misleading of the government agency concerned," and which would induce government "to give up some legal right and place itself at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities."[12]

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[10] Id.

[11] G.R. No. 78953, July 31, 1991, 276 Phil. 914-923.

[12] Id.

Supreme Court E-Library

The doctrine drawing a distinction between false returns and fraudulent returns was then reiterated in subsequent cases,[13] most recently in *Commissioner of Internal Revenue v. Fitness by Design, Inc.*,[14] where the Court clarified that "[a] false return simply involves a 'deviation from the truth, whether intentional or not' while a fraudulent return 'implies intentional or deceitful entry with intent to evade the taxes due.'" Simply put, the line of cases following *Aznar* interpreted Section 222 (a) of the NIRC by not qualifying "false returns" with the subsequent phrase of "with intent to evade taxes."

Contrarily, the case of *Commissioner of Internal Revenue v. Estate of Toda, Jr.*[15] advanced a different interpretation and provided that the three situations contemplated by Section 222 (a)[16] are: (1) fraudulent returns; (2) false returns **with intent to evade tax**; and (3) failure to file a return.[17] The Court then went on to say that the transactions covered by the assessment were a "a tax ploy, a sham, and without business purpose and economic substance" done to circumvent tax laws.[18] Moreover, the Court also held that assuming *arguendo* that there was no fraud, the return was still false as it did not accurately reflect the actual amount gained by the taxpayer from the transaction and was "done with intent to evade or reduce tax liability."[19]

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[13] See *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.*, G.R. No. 104171, February 24, 1999, 363 Phil. 169-181; *Republic v. Marcos II*, G.R. Nos. 130371 & 130855, August 4, 2009, 612 Phil. 355-379; and *Samar-I Electric Cooperative v. Commissioner of Internal Revenue*, G.R. No. 193100, December 10, 2014, 749 Phil. 772-790.

[14] G.R. No. 215957, November 9, 2016, 799 Phil. 391-420.

[15] G.R. No. 147188, September 14, 2004, 481 Phil. 626-645.

[16] Then Section 269 (a) of the NIRC, as renumbered by Executive Order No. 273, entitled "ADOPTING A VALUE-ADDED TAX, AMENDING FOR THIS PURPOSE CERTAIN PROVISIONS OF THE NATIONAL INTERNAL REVENUE CODE, AND FOR OTHER PURPOSES," issued on July 25, 1987.

[17] See *Commissioner of Internal Revenue v. Estate of Toda, Jr.,* supra note 15.

[18] Id.

[19] Id.

Supreme Court E-Library

This was followed by *Commissioner of Internal Revenue v. Asalus Corp.*,[20] where it was implied that the extraordinary ten-year period would only apply for false returns filed with "intent to defraud."

The case of *Commissioner of Internal Revenue v. Philippine Daily Inquirer, Inc.*,[21] appears to echo this doctrine insofar as it concluded that "the entry of wrong information due to mistake, carelessness, or ignorance, **without intent to evade tax**, does not constitute a false return,"[22] citing *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.*[23] as its basis.[24] Notably, the implication of the foregoing statement is that a false return under Section 222 (a) must be attended by intent to evade tax. However, a circumspect analysis of *B.F. Goodrich Phils., Inc.* would show that the Court never expressly drew such a conclusion.

The issue resolved in *B.F. Goodrich Phils., Inc.* was whether or not the BIR's right to assess therein taxpayer for deficiency taxes had already prescribed. The BIR primarily argued that the extraordinary period under Section 222 (a) (then Section 332 [a]) of the NIRC applied due to the falsity in the filed returns given that the property subject of the underlying transaction was sold "for a price lesser than its declared fair market value." The Court rejected this argument in the following manner:

> Nor is petitioner's claim of falsity sufficient to take the questioned assessments out of the ambit of the statute of limitations. The relevant part of then Section 332 of the NIRC, which enumerates the exceptions to the period of prescription, provides:
>
> "SECTION 332. *Exceptions as to period of limitation of assessment and collection of taxes*. — (a) In the case of a false or fraudulent return with intent to evade a tax or of a failure to file

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[20] G.R. No. 221590, February 22, 2017, 806 Phil. 397-413.

[21] G.R. No. 213943, March 22, 2017, 807 Phil. 912-941.

[22] Id. Emphasis supplied.

[23] G.R. No. 104171, February 24, 1999, 363 Phil. 169-181.

[24] See footnote 31 of *Commissioner of Internal Revenue v. Philippine Daily Inquirer, Inc.,* supra note 21.

Supreme Court E-Library

> a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission: . . ."

Petitioner insists that private respondent committed "falsity" when it sold the property for a price lesser than its declared fair market value. **This fact alone did not constitute a false return which contains wrong information due to mistake, carelessness or ignorance.** It is possible that real property may be sold for less than adequate consideration for a *bona fide* business purpose; in such event, the sale remains an "arm's length" transaction. In the present case, the private respondent was compelled to sell the property even at a price less than its market value, because it would have lost all ownership rights over it upon the expiration of the parity amendment. In other words, private respondent was attempting to minimize its losses. At the same time, it was able to lease the property for 25 years, renewable for another 25. This can be regarded as another consideration on the price.

Furthermore, the fact that private respondent sold its real property for a price less than its declared fair market value did not by itself justify a finding of false return. Indeed, private respondent declared the sale in its 1974 return submitted to the BIR. Within the five-year prescriptive period, the BIR could have issued the questioned assessment, because the declared fair market value of said property was of public record. This it did not do, however, during all those five years. **Moreover, the BIR failed to prove that respondent's 1974 return had been filed fraudulently. Equally significant was its failure to prove respondent's intent to evade the payment of the correct amount of tax**.

Ineludibly, the BIR failed to show that private respondent's 1974 return was filed fraudulently with intent to evade the payment of the correct amount of tax. Moreover, even though a donor's tax, which is defined as "a tax on the privilege of transmitting one's property or property rights to another or others without adequate and full valuable consideration," 6 is different from capital gains tax, a tax on the gain from the sale of the taxpayer's property forming part of capital assets, the tax return filed by private respondent to report its income for the year 1974 was sufficient compliance with the legal requirement to file a return. In other words, the fact that the sale transaction may have partly resulted in a donation does not change the fact that private respondent already reported its income for 1974 by filing an income tax return.

Supreme Court E-Library

Since the BIR failed to demonstrate clearly that private respondent had filed a fraudulent return with the intent to evade tax, **or that it had failed to file a return at all**, the period for assessments has obviously prescribed. Such instances of negligence or oversight on the part of the BIR cannot prejudice taxpayers, considering that the prescriptive period was precisely intended to give them peace of mind. (Emphasis and underscoring supplied)

A reading of the Court's discourse readily shows that there was neither an interchanging of the concept of false returns and fraudulent returns, nor was there a qualification that false returns must be attended by an intent to defraud or evade taxes. While the BIR's argument was based only on the "falsity" of the returns, the Court still examined the applicability of all three types of situations under Section 222 (a) (then Section 332 [a]) of the NIRC. As above-quoted there were separate discussions for the three types: the Court first examined whether the subject returns were "false" for "contain[ing] wrong information due to mistake, carelessness or ignorance"; second, it determined whether the returns can be considered to have been filed "fraudulently" for being attended with "intent to evade the payment of the correct tax"; and third, it determined that there was no "fail[ure]" to file a return at all. Undoubtedly, nowhere in its *ratio* did the Court ever directly link intent to evade tax with "false returns."[25] If at all, it shows that *B.F. Goodrich Phils., Inc.* directly followed the framework in *Aznar*, as the former did, in fact, cite the latter as basis,[26] by confining false returns to those "contain[ing] wrong information due to mistake, carelessness or ignorance." Consequently, *Philippine Daily Inquirer, Inc.* may have misunderstood the doctrine in *B.F. Goodrich Phils., Inc.*

More recently, the case of *Commissioner of Internal Revenue v. Spouses Magaan*,[27] seems to follow the interpretation put forth

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[25] See *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.,* supra note 23.

[26] See footnote 13 of *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.,* supra note 23.

[27] G.R. No. 232663, May 3, 2021.

Supreme Court E-Library

in *Estate of Toda, Jr.* where the lines between false returns and fraudulent returns are blurred. In *Spouses Magaan*, fraudulent filing was characterized as "false and deceitful entry with intent to evade the taxes due," and that fraudulent returns must not be attributable to "mistake, carelessness, or ignorance," which is the indication typically associated with false returns in previous cases. It is well to note, however, that *Spouses Magaan* did not involve a determination of "falsity" but a testing of whether the subject returns were fraudulent.

Whether intentionally or unintentionally, there existed two competing schools of thought in jurisprudence for interpreting Section 222 (a) of the Tax Code, which has now been resolved by the majority's abandonment of *Aznar*. As I will further propound on below, I respectfully submit that this is error. It is my considered opinion that the *Aznar* interpretation is better supported not only by the text of the provision and the law as a whole, but also the spirit and impelling purpose behind providing for extraordinary periods to assess and collect taxes.

The Aznar interpretation is more in keeping with the literal wording of Section 222(a) of the NIRC.

First, the most basic rule in statutory construction is that words used in law must be given their ordinary meaning.[28] Indeed, the ordinary meaning of "false" and "fraudulent" support the notion that these are distinct. "False" in its general sense means untrue, deceitful, not genuine, inauthentic, wrong, or erroneous;[29] and "fraud" means a knowing misrepresentation or knowing concealment of a material fact to induce another to act to their detriment.[30] Verily, the key distinction lies in the mental state and objective of the actor. "Fraud" involves an active machination to deceive in order to take advantage or swindle another, whereas "false" has a more general connotation of simply being untruthful.

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[28] See *Republic v. Sereno*, G.R. No. 237428, May 11, 2018.

[29] See *False*, Black's Law Dictionary p. 745 (11th ed. 2019).

[30] See *Fraud*, Black's Law Dictionary p. 802 (11th ed. 2019).

Supreme Court E-Library

Axiomatically, a fraudulent return is always false, but not all false returns are fraudulent. Necessarily, in the context of tax returns, a fraudulent return is always filed to evade taxes, whereas the filing of a false return may or may not result in deficiency taxes.

Second, it is presumed that in enacting a law, the Legislature does not "insert any section or provision which is unnecessary and a mere surplusage; that all provisions contained in a law should be given effect, and that contradictions are to be avoided."[31] As above adumbrated, while there is a correlation between falseness and fraudulence, these are distinct concepts. **If the phrase "with intent to evade tax" similarly qualifies false returns, how would it then differ from fraudulent returns? In what manner may a false return be filed with intent to evade tax, and yet not qualify as a fraudulent return? I submit that such an interpretation would render the word superfluous, which could not have been the intent of the lawmakers.** Moreover, a reading of the provision in its entirety supports the idea that there are three distinct situations contemplated therein. As the Court held in *Aznar*: "[o]ur stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably **by the last portion of the provision which aggregates the situations into three different classes, namely 'falsity,' 'fraud' and 'omission'.**"[32] Undeniably, a contrary interpretation would also render nugatory and ineffective the word "falsity" in Section 222 (a). Furthermore, the *proviso* inserted by PD No. 69 also validates this interpretation. Notably, only the "fact of fraud" in fraud assessments shall be judicially taken cognizance of, and not the fact of "falsity" or "omission." Clearly, the provision itself recognizes a distinction, which the Court must give effect to.

The Aznar interpretation is supported by other provisions of the NIRC.

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[31] *Mcgee v. Republic*, G.R. No. L-5387, April 29, 1954, 94 Phil. 820-825.

[32] Emphasis supplied.

Supreme Court E-Library

Another principle in statutory construction is to read a word or phrase in the context of the entire statute. "The particular words, clauses and phrases in a law should not be studied as detached and isolated expressions, but the whole and every part thereof must be considered in fixing the meaning of any of its parts and in order to produce a harmonious whole."[33]

A reading of the following provisions of the NIRC would show that the law recognizes a distinct concept of a "false return" that is not tied to intent to evade taxes:

SECTION 6. Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.—

x x x x

(B) Failure to Submit Required Returns, Statements, Reports and other Documents.— When a report required by law as a basis for the assessment of any national internal revenue tax shall not be forthcoming within the time fixed by laws or rules and regulations or when there is reason to believe that any such report is **false, incomplete or erroneous**, the Commissioner shall assess the proper tax on the best evidence obtainable.

In case a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise files a **false** or fraudulent return or other document, the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise, which shall be prima facie correct and sufficient for all legal purposes. (Emphasis supplied)

SECTION 51. Individual Return.—

x x x x

(F) Persons under Disability.— If the taxpayer is unable to make his own return, the return may be made by his duly authorized agent or representative or by the guardian or other person charged with the care of his person or property, the principal and his representative or guardian assuming the responsibility of making the return and incurring penalties

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[33] *Kanemitsu Yamaoka v. Pescarich Manufacturing Corp.*, G.R. No. 146079, July 20, 2001, 414 Phil. 211-220.

Supreme Court E-Library

provided for **erroneous, false or fraudulent returns**. (Emphasis supplied)

SECTION 72. Suit to Recover Tax Based on False or Fraudulent Returns.— When an assessment is made in case of any list, statement or return, which in the opinion of the Commissioner was **false** or fraudulent **or contained any understatement or undervaluation**, no tax collected under such assessment shall be recovered by any suit, unless it is proved that the said list, statement or return was **not false** nor fraudulent and **did not contain any understatement or undervaluation**; but this provision shall not apply to statements or returns made or to be made in good faith regarding annual depreciation of oil or gas wells and mines. (Emphasis supplied)

SECTION 269. Violations Committed by Government Enforcement Officers.— Every official, agent, or employee of the Bureau of Internal Revenue or any other agency of the Government charged with the enforcement of the provisions of this Code, who is guilty of any of the offenses hereinbelow specified shall, upon conviction for each act or omission, be punished by a fine of not less than Fifty thousand pesos (₱50,000) but not more than One hundred thousand pesos (₱100,000) and suffer imprisonment of not less than ten (10) years but not more than fifteen (15) years and shall likewise suffer an additional penalty of perpetual disqualification to hold public office, to vote, and to participate in any public election:

x x x x

(f) Making or signing any false entry or entries in any book, or making or signing any **false** certificate or **return**; (Emphasis supplied)

SECTION 272. Violation of Withholding Tax Provision.— Every officer or employee of the Government of the Republic of the Philippines or any of its agencies and instrumentalities, its political subdivisions, as well as government-owned or -controlled corporations, including the Bangko Sentral ng Pilipinas (BSP), who, under the provisions of this Code or rules and regulations promulgated thereunder, is charged with the duty to deduct and withhold any internal revenue tax and to remit the same in accordance with the provisions of this Code and other laws is guilty of any offense hereinbelow specified shall, upon conviction for each act or omission be punished by a fine of not less than Five thousand pesos (₱5,000) but not more than Fifty thousand pesos (₱50,000) or suffer imprisonment of not less than six (6) months and one (1) day but not more than two (2) years, or both:

Supreme Court E-Library

x x x x

(c) Failing or causing the failure to file return or statement within the time prescribed, or **rendering or furnishing a false** or fraudulent **return** or statement required under the withholding tax laws and rules and regulations. (Emphasis supplied)

The Aznar interpretation is more in keeping with the apparent spirit of the law.

While the *Estate of Toda, Jr.* line of cases is concededly more advantageous to taxpayers, it would not be in keeping with the spirit of the law. It is not hard to imagine that Section 222(a) seeks to afford the taxing authority some leeway to recover taxes rightfully due to the government. However, false returns, meaning those that simply do not speak the truth regardless of the taxpayer's intent, are not less onerous or misleading than when no returns are filed. It is absurd to presume that the Legislative would allow the extraordinary period to situations where no return is filed, but not to situations where a return was filed that was rife with errors or inaccuracies. Both are equally disarming to the taxing authority's collection effort. To shoehorn the provision to false returns filed with intent to evade would foreclose avenues for the government to recover taxes. Additionally, and as seen in the provisions above-quoted, the tax code affords remedies to the taxing authority and consequences to taxpayers for the filing of false returns in general, with no particular qualification as to intent. Had lawmakers intended to only cover false returns with intent to evade taxes under the NIRC, they could have used the very same phrasing in the other provisions as found in Section 222 (a). While the *Aznar* interpretation may be less favorable to taxpayers, it is the law. *Dura lex sed lex*.[34]

It bears stressing that the "Courts should not, by construction, revise even the most arbitrary and unfair action of the legislature,

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[34] See *Qatar Airways Co. with Limited Liability v. Commissioner of Internal Revenue*, G.R. No. 238914, June 8, 2020.

Supreme Court E-Library

nor rewrite the law to conform with what they think should be the law. Nor may they interpret into the law a requirement which the law does not prescribe. xxx To do any of such things would be to do violence to the language of the law and to invade the legislative sphere."[35] This doctrine is particularly true in the field of taxation as the power to tax is legislative in nature and all incidents thereof are within the control of the Legislature.[36]

Not all false returns are covered by Section 222(a).

As a point of clarification, I am not advocating that any erroneous entry done by mistake, carelessness, or ignorance should constitute a false return as to justify the application of the extraordinary ten-year prescriptive period. In this regard, the *ponencia* is correct that jurisprudence has been consistent on this point. Nevertheless, what I propose is that only false returns, whether done intentionally or unintentionally, **that have a true impact on the government's collection of taxes should qualify**. In short, we must look into the nature of the "falsity" and its consequent effects. Certainly, not every incorrect entry affects the amount that the government may reasonably collect from taxpayers, and not every entry which results in a decrease of the taxes due is prohibited, as seen in the case of *B.F. Goodrich Phils., Inc.* In the end, the test should be whether the false entries resulted in actual prejudice to the government, without necessarily a specific intent to evade taxes, and must be of such a degree that the government is prevented from uncovering the same with reasonable efforts.

This qualification requiring apparent prejudice to the government is grounded on the title of Section 222 (a) itself insofar as it provides an extraordinary period only for the "assessment and collection of taxes." It is also warranted based on the other above-quoted provisions of the NIRC, especially Sections 6 (B), 51, and 72. It is also further supported by Section 248 (B) the Tax

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[35] *Canet v. Decena*, G.R. No. 155344, January 20, 2004, 465 Phil. 325-334.

[36] See *National Dental Supply Co. v. Meer*, G.R. No. L-4183, October 26, 1951, 90 Phil. 265-269.

Supreme Court E-Library

Code, which make a clear reference to the taxes "lost" on account of the false return:

> Section 248. Civil Penalties. –
>
> x x x x
>
> (B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a **false** or fraudulent return is willfully made, **the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax**, in case, any payment has been made on the basis of such return before the discovery of the falsity or fraud: Provided, That a **substantial underdeclaration of taxable sales, receipts or income**, or a **substantial overstatement of deductions**, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: Provided, further, That **failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return,** and **a claim of deductions in an amount exceeding (30%) of actual deductions**, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein. (Emphasis supplied)

The government still bears the burden of proving falsity.

Relevantly, I am also not asserting that the Court departs from the general rule that the taxing authority bears the burden of proving the fact of falsity or fraudulence. Rather, it is only a recognition that there are some underdeclarations that may fall short of the 30% threshold in Section 248 (B) and may not necessarily be borne from machinations to evade taxes, but may constitute falsity based on a wrong presumption or mistaken notion on the part of the taxpayer. In such instances, the taxing authority should be allowed to prove the fact of falsity to apply the extraordinary ten-year period, if warranted. This interpretation would breathe life into all the provisions of the Tax Code.

As a final point, I must stress that the "falsity" of returns must still be based on facts and law, as is every other aspect of a valid

Supreme Court E-Library

assessment, and that the same being an exception to the ordinary three-year period will still be strictly construed against the taxing authority; any doubt on the existence of the purported falsity and prejudice to the government will be resolved in favor of the taxpayer. By requiring the taxing authority to provide clear basis for a return's purported falsity, I believe that the fears intimated by the *ponencia* on undue extensions of tax audits may be forestalled without needing to abandon *Aznar*.

With the foregoing discourse, I vote to **GRANT** the petition.