REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PACKAGING PRODUCTS CORPORATION,
Petitioner,

- versus -

C.T.A CASE NO. 4464

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JAN 11 1995

x - x

DECISION

This is an appeal presented to this Court seeking to set aside the assessment issued by respondent for alleged deficiency manufacturer's sales tax for the taxable year 1986.

Petitioner is a domestic corporation organized and existing under and by virtue of Philippine laws. It is engaged in the manufacture, distribution and sale of corrugated cartons to selected clients. The nature of its business being such, it is required by law to file the manufacturer's sales tax quarterly returns and pay the sales tax due within twenty days after the end of each taxable quarter. As petitioner opted for the fiscal year basis in the payment of its taxes beginning July 1, and ending June 30 of every year, it filed its quarterly returns on the following dates:

PERIOD COVERED	DATE FILED
1st quarter - July to September	October 21, 1985
2nd quarter - October to December	January 20, 1986
3rd quarter - January to March	April 21, 1986
4th quarter - April to June	July 21, 1986

(see Exhibits "L", "L-1", "L-2" and "L-3").

In a letter dated February 22, 1988 (Exhibit "C") with the heading "Notice to Taxpayer", the BIR through Mr. Eliseo Pitargue, Chief of the Tax Fraud Division informed the petitioner of the findings made by its Examiners with regard to petitioner's tax liabilities for the taxable year 1986 detailed as follows:

Deficiency Sales Tax	=	P 165,815.73
Overclaimed Tax Credit	=	8,171,926.32
T O T A L	=	P8,337,742.05

The notice also contained a schedule for a preliminary conference where petitioner will be given an opportunity to present its side and file its objections to the findings, if any.

Petitioner consequently paid its deficiency sales tax of P165,815.73 plus P41,453.93 as 25% surcharge and P77,248.14 as 20% interest per annum paying a total of P284,517.80 as evidenced by Payment order No. 2827978 (Exhibit "B-1") and Confirmation Receipt No. 14609505 (B-2) both dated May 31, 1988. This tax payment did not include the alleged overclaimed tax credit of

P8,171,926.32 as computed by the Examiner of the BIR as petitioner believed that it is not liable for this amount. More than a year later, respondent in another letter dated July 4, 1989 notified petitioner that the alleged overclaimed Tax credit has been reduced from P8,171,926.32 to only P1,038,272.28 and again scheduled a preliminary conference for the petitioner to present its side.

In a letter dated October 16, 1989 but received by petitioner on January 11, 1990 (Exhibits "D", "D-1" and "D-2" respectively), respondent assessed petitioner of a deficiency sales tax of P2,433,775.15 arising from untaxed sales and overclaimed tax credits for the taxable year 1986 but since petitioner had previously paid the amount of P284,517.80 corresponding to untaxed sales, it was only required to pay the total amount of P2,149,257.35 payable within thirty (30) days upon receipt of the letter. The deficiency sales tax was computed and detailed in the said letter as follows:

Deficiency sales tax	P1,038,272.28
Add: 25% Surcharge	259,568.07
20% Interest	851,417.00
TOTAL AMOUNT DUE AND PAYABLE	P2,149,257.35

On February 9, 1990, petitioner made a formal protest against the aforesaid assessment which was received by respondent on the same date (Exhibits "E" and "E-1"), presenting the following arguments:

> 1) the right of the Government to assess has already prescribed.- Petitioner alleged that it filed its final percentage tax return on July 21, 1986 for the fiscal year ending June 30, 1986 and assessment was sent or mailed on January 3, 1990 which is three(3) years, five(5) months and thirteen(13) days from the date the final return was filed on July 21, 1986, thus the three year prescriptive period for an internal revenue tax to be assessed has already lapsed pursuant to Section 203 of the Tax Code.
>
> 2) the questioned assessment is defective. It lacks the needed details and particulars to determine the basis of the assessed amount.

Respondent in a letter dated April 23, 1990 and received by petitioner on May 9, 1990 (Exhibits "G" and "G-1"), denied the formal protest thus prompting the petitioner to file a petition for review with this Court on June 8, 1990.

The petition is anchored on the same points raised by petitioner in his formal protest; that the government's right to assess has prescribed and that the assessment lacks legal and factual basis. On the second point raised, petitioner went further on to state that the tax credit allocated to its scrap inventory should be allowed against the sales tax due on the finished article as against the theory of respondent that the sales tax allocated to ordinary and necessary manufacturing spoilages or scraps could not be credited thus giving rise to an overclaimed tax credit.

Respondent in his answer, presented the following special and affirmative defenses:

SPECIAL AND AFFIRMATIVE DEFENSES

4. Respondent repleads and incorporates the foregoing allegations as if copied in full herein;

5. Petitioner filed false business tax returns. Thus, respondent has the power to assess the tax within ten (10) years after the discovery of the falsity as provided under Section 332 (now Section 223) of the NIRC. This authority of respondent has been upheld no less than by the Supreme Court in the case of **Aznar vs. CTA and Collector**, 58 SCRA 519 [1974]:

> "We believe that the proper and reasonable interpretation of said provision should be 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, x x x at any time within ten(10) years after the discovery of the (1) falsity, (2) fraud, and (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 segregate 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 deceitful

entry with intent to evade the taxes due." (underlining supplied)

"The ordinary period of prescription of five(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 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(10) years provided for in Sec. 332(a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced."

5. The above interpretation of the Supreme Court of Section 332 (now Section 332 of the NIRC of 1988) still stands, and the taxpayer whose returns are false, even if not fraudulent, may still be assessed the correct taxes within ten(10) years from date of discovery.

6. The deficiency assessment arose from overclaimed tax credits computed as follows:

Deferred sales tax credits - Beg.		P 2,799,541.10
Add: Tax credits from purchases		12,988,406.70
Tax credit available		P15,787,947.80
Less: Tax credit allocated to scrap inventory	P506,166.83	
Ending balance for 1986 Tax credits	534,591.86	
Total		1,040,758.69
Total Tax credits available		P14,747,189.11
Less: Tax credits claimed per return		15,785,461.39
Overclaimed tax credits		P 1,038,272.28
Add: 25% surcharge		259,568.07
20% Interest from 07/20/86 to 10/31/89		851,417.00
Total Amount Due and Payable		P 2,149,257.35

7. Records of the case show that petitioner was given ample time and opportunity to discuss the details and particulars of this assessment but it failed to rebut the findings of respondent's examiners;

8. The assessment in question was issued in accordance with law.

Before us for resolution are two issues, to wit:

> 1) Whether or not the right of the government to assess the taxpayer has prescribed;
>
> 2) Whether or not the petitioner is liable to the deficiency sales tax of P2,149,257.35 based on an alleged overclaimed sales tax credits in 1986.

We find the issue of prescription vital to the resolution of this case and so we should first discuss its points head on.

It is the contention of the petitioner that the government's right to assess deficiency sales taxes has already prescribed citing the applicable law as its fulcrum:

> **SECTION 203.** *Period of limitation upon assessment and collection.*- Except as provided in the succeeding section, internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment 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-year period shall be counted from the day the return was filed. For the 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. (National Internal Revenue Code)

The records show that petitioner adopted the fiscal year basis for its accounting period and filed its manufacturer's sales tax returns quarterly as required by law on the following dates:

	DATE FILED
1st quarter-July to September	10/21/85
2nd quarter-October to December	1/20/86
3rd quarter-January to March	4/21/86
4th quarter-April to June	7/21/86

(see Exhibits "L", "L-1", "L-2", "L-3")

Respondent communicated with the petitioner on several instances through letters which were captioned "Notice To Taxpayer" informing the petitioner of the findings of the Examiner as regards its tax deficiencies. The final assessment notice with a demand to pay the deficiency taxes dated October 16,1989 was sent by registered mail on January 3, 1990 as evidenced by its envelope post-marked by the BIR office with the said date and was received by the petitioner on January 11, 1990. (Exhibit "D", "D-1" and "D-3")

Respondent has no quarrel with the fact that the assessment was sent and mailed to the petitioner beyond the three year period prescribed by law. In her answer, respondent admitted the allegations of petitioner with regard to the dates when such assessment was mailed and finally received by petitioner. However, as a special and affirmative defense, she asserts that the petitioner filed false business tax returns thus the government has the right to assess the tax within ten years from the discovery of the falsity as provided under Section 223 of the Tax Code, quoted thus:

> **SECTION 223.** *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 the 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.

To further bolster her contention, respondent quoted portions of the decisions handed down by the Supreme Court in the case of Aznar vs. CTA and Collector, 58 SCRA 519.(supra).

This Court however finds flaws in the argument of respondent that are too obvious to ignore one of which is shown in the assessment letter itself. Said letter (Exhibit D) does not contain any indication: that the business tax returns filed by petitioner are false. Additions to the sales tax deficiency demanded by respondent only mentioned a 25% surcharge and a 20 %

interest instead of a 50% surcharge as provided by Section 248 of the Tax Code (section 282 of the 1986 Tax Code) quoted as follows:

> **SECTION 282.**
>
> (b) In case of willful neglect to file the return within the period prescribed by this Code or 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.

Furthermore, during the hearings of the case, counsel for respondent as well as its witnesses failed to establish the fact of falsity but instead focused its testimonies and cross-examination on defending the amount which it considers as an overclaimed sales tax credit made by petitioner for the taxable year 1986.

One of the disputable presumptions provided in Rule 131, Section 3, (ff) of the Rules of Court is that the law has been obeyed, therefore the burden of proving that the return filed was false lies upon the respondent and records and testimonies during the hearings show that respondent failed to destroy this presumption. If the three year period for assessment has expired at the time of mailing of the notice of deficiency, the burden is on the Commissioner to show that the five-year (ten years under Philippine law) was applicable (Merten's Law of Federal Income Taxation, Volume 10, 57 37 page 79).-

The Supreme Court in the case of **Commissioner vs. Ayala Securities Corporation**, (70 SCRA 204) also placed the burden of proving the falsity or fraud in the return on the Commissioner of Internal Revenue when it ruled thus:

> "On the issue of whether Sec. 331 or Sec. 332 (a) of the National Internal Revenue Code should apply to this case, there is no iota of evidence presented by the petitioner as to any fraud or falsity on the return with intent to evade payment of tax, not even in the income tax assessment (Exh. 5) nor in the letter-decision of February 18,1963 (Exh. G), nor in his answer to the petition for review. Petitioner merely relies on the provisions of Section 25 of the National Internal Revenue Code, violation of which according to petitioner, presupposes the existence of fraud. But this is begging the question and we do not subscribe to the view of the petitioner."

The prescriptive periods provided in the Tax Code are clear and the principle behind the fixing of such periods is explained by the Supreme Court in the case of Republic vs. Ablaza (108 Phil 1105), thus :

> "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 properly in the making of assessments 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 keep their books and keep them open for inspection subject to harassment by unscrupulous tax agents."

Moreover, the fact that the respondent and the petitioner differ in the interpretation of the law with regard to the availment of tax credits on sales taxes does not necessarily make the data contained in the return of the petitioner false. In order to render a return made by a taxpayer a "false return", within the meaning of the original and amended section 2781 Rev. St., there must appear, if not a design to mislead or deceive on the part of the taxpayer at least culpable negligence. A mistake, not culpable in respect of its value would not constitute such false return (Words and Phrases, Volume 16, page 173).

We find that there is no clear showing that the return filed by petitioner is false. Therefore, the ten-year period to assess deficiency taxes is not applicable to the case at bar. Hence, the questioned assessment is null and void having been filed beyond the three-year period prescribed by law. We are inclined to believe that the defense of falsity of return was a mere afterthought conjured by respondent to rationalize the late assessment.

Inasmuch as the right of the government to assess the sales tax deficiency of petitioner had already prescribed, we do not find any reason to delve into the other issues involved in this case.

WHEREFORE, in view of the foregoing, the questioned assessment is hereby set aside and the Commissioner of Internal Revenue is ordered to cease and desist from enforcing the aforementioned assessment and collection of the tax subject matter of this petition.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that the decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals