REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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VAN MELLE (PHILS.), INC., Petitioner,	**C.T.A. CASE NO. 7018**
	Members:
- versus -	**ACOSTA,** *Chairperson* **BAUTISTA,** and **CASANOVA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** APR 25 2008; 3:00PM

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DECISION

BAUTISTA, *J.*:

The instant Petition for Review seeks the cancellation of an assessment for deficiency income tax in the amount of P9,264,593.29 issued for taxable year 1997.

The following pertinent facts are culled from the records:

Van Melle (Phils.) Inc. (petitioner) is a domestic corporation duly organized and existing under Philippine laws and registered with the Securities and Exchange Commission (SEC).

Commissioner of Internal Revenue (respondent) is the officer of the Bureau of Internal Revenue (BIR) duly appointed and empowered to perform the duties of his office, including, among others, the power to compromise, cancel, and abate tax liabilities pursuant to Section 204(B) of the National Internal Revenue Code (NIRC) of 1997, as amended.

Sometime in 1998, a certain Mario A. Carandang provided information to the Tax Fraud Division of the BIR that petitioner had fraudulently claimed a deduction of approximately P15,000,000.00 from its taxable income in its Annual Income Tax Return for 1997.[1] After verifying the information provided by Mr. Carandang, respondent issued a Letter of Authority against petitioner on December 3, 1999.[2]

On November 4, 2003, petitioner received from respondent a Final Assessment Notice (FAN) dated October 1, 2003[3], covering the taxable year 1997, which states that petitioner had deficiency income tax due to the government in the total amount of P9,264,593.29,[4] inclusive of surcharge, interest, and compromise penalty, computed as follows:

Disallowance Deduction: Inventory Write-Off		
(27,355 cartons of Mentos Pillowpacks 6x300)	$	389,535.20
Existing Forex Rate in 1996	P	26.22
Total amount in Php	P	10,213,612.94
Income Tax Rate		35%
Basic Income Tax Deficiency	P	3,574,762.69
Add: Surcharge (50%)		1,787,381.34
Interest at 20% p.a.		3,902,449.26
TOTAL Income Tax Deficiency	**P**	**9,264,593.29**

In arriving at the income tax deficiency, respondent's position was that petitioner erroneously deducted the amount of $389,535.20, or an equivalent of P10,213,612.94 from its taxable income for the year 1997.[5]

On December 4, 2003, petitioner, through its external auditor, filed with BIR Tax Fraud Division its Protest Letter dated December 4, 2003 which specified its

[1] BIR Records, pages 41-45
[2] BIR Records, page 60
[3] Exhibits "A-1", Docket, page 209
[4] Paragraph 1.3, Joint Stipulation of Facts and Issues (JSFI), Docket, pages 166-167
[5] Paragraph 1.5, JSFI, Docket, page 167

364

factual and legal bases and requested that the deficiency tax assessments be withdrawn and cancelled.

As of June 1, 2004, the BIR had not issued any official action with respect to the Protest Letter.[6] Hence, the instant Petition for Review was filed on July 1, 2004.

In her Answer, respondent alleged the following Special and Affirmative Defenses:[7]

> "4.) The assessment has become final and executory. Petitioner filed a protest on 4 December 2003. Accordingly, under Section 228 of the NIRC, it had 60 days, or until 2 February 2004 to submit supporting documents on its protest. Nonetheless, consistent with petitioner's behavior during the investigation of the case, no document was submitted in support of the protest. In the absence of said documents, supporting the protest, said protest is considered pro-forma, and is worth no more than a scrap of paper. Thus, it is as if no protest was filed and the assessment lapsed into finality.
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> 5.) Since the assessment is already final, there is no relief available to the petitioner from this Honorable Court.
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> 6.) The nature of the falsity of the return of the taxpayer smacks of fraud. As found by the examiners, petitioner deducted from its 1997 revenues an inventory obsolescence account pertaining to goods which no longer belong to it. The entire assessment is premised on petitioner's wrongful change to the expense account of goods belonging to Van Melle Confectionery (Schenzhen) China Ltd. By the very nature of said finding, a design to deceive or mislead on the part of the taxpayer is apparent.
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> 7.) Thus, the imposition of the surcharge is justified by the finding of fraud. Likewise, no defense for prescription can be setup as the assessment was clearly made within 10 years from the discovery of the falsity of the return.
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> 8.) A circumstance indicative of fraudulent intent on the part of petitioner was its obstinate refusal to submit any document for examination for taxable year 1997 during the investigation of the case. Moreover, even after petitioner had filed its protest, it

[6] Paragraph 1.9, JSFI, Docket, page 167
[7] Answer, Docket, pages 139-140

still clings on to its determination to bar examination by its failure to submit documents in support of its allegations in the protest.

9.) The submissions of petitioner do not prove anything. Petitioner cannot refute the assessment by mere denials. Destruction of certain inventories cannot prove that petitioner did not write-off the 27,355 cartons of Mentos Pillowpack 6 x 300 candies.

10.) Petitioner itself admitted that a 100% allowance for inventory obsolescence was provided for on the inventory at year-end of 1997 (par. 33 of petition).

11.) Moreover, it is presumed that tax assessments are correctly and legally made. The burden of assailing the same rests on the party alleging irregularity. Absent such showing, the assessment might be upheld."

During trial, petitioner presented its documentary and testimonial evidence in support of its stand. The Court, however, declared respondent to have waived her right to present evidence considering her failure to do so despite the numerous opportunities she was given.[8] Upon termination of the trial, both parties were ordered to submit their respective Memorandum. Only respondent filed her Memorandum on October 30, 2007.[9] Thus, the case was submitted for decision on November 28, 2007 without petitioner's Memorandum.

The following issues[10] were submitted by both parties for this Court's resolution:

"2.1 Whether or not the assessment has already become final and executory;

2.2 Whether or not the assessment was issued within the prescriptive period provided for under the Tax Code;

[8] Docket, page 326
[9] Docket, pages 347-357
[10] Statement of the Issues, JSFI, Docket, page 168

346

2.3 Whether or not the BIR had proven the factual basis for its finding of fraud on the part of the petitioner to justify its resort to the remedy available to it under Section 222 of the Tax Code;

2.4 Whether or not the BIR had proven the factual basis for its finding of fraud on the part of the petitioner to justify the imposition of the 50% surcharge;

2.5 Whether or not petitioner had, during the taxable year 1997, written-off 27,355 cartons of Mentos Pillowpack 6x300 candies, as identified by the BIR, amounting to US$389,535.20 or the equivalent of P10,213,612.94;

2.6 Whether or not petitioner was the owner of the 27,355 cartons of Mentos Pillowpack 6x300 candies, as identified by the BIR, at the time it expired and became stale on 22 August 1997; and

2.7 Whether or not the said 27,355 cartons of Mentos Pillowpack 6x300 candies, as identified by the BIR, formed part of petitioner's beginning inventory for the taxable year 1998."

We shall first discuss the issues involving the prescription of the assessment.

Respondent contends that the applicable period of assessment is ten (10) years due to petitioner's fraudulent return. Respondent alleges that petitioner erroneously deducted its sales of 27,355 cartons of *Mentos Pillowpacks 6x300* (Mentos) to *Van Melle Confectionery (Shenzen) China, Ltd* (VMSC) from gross income as an *inventory write-off* or *provisions for inventory obsolescence*. According to respondent, such deduction renders the return fraudulent because legal title to the cartons of Mentos had already transferred to VMSC by virtue of the sale. In order to bolster its allegation of *inventory write-off or* fraud, respondent also went to prove that the cartons of Mentos were not transported to VMSC as it remained in petitioner's warehouse until August 22, 1997, or up to the time of its expiration. In other words, respondent contends that though petitioner is no longer the owner of the cartons of Mentos, the latter nevertheless destroyed the same as if it were its

367

own and claimed the destruction thereof as deduction for *inventory write-off*. In proving that a sales agreement existed, respondent's examiners based the assessment on the following documents:

1. Inter-office memos
2. Fax Message Memos
3. Reprocessing Computations
4. Comparative Cost Analysis
5. Facsimile Transmission
6. Inter-company payments
7. Commercial Invoice No. 00063
8. Inter-company Debit Memo
9. Inter-company balance reconciliation
10. Inter-company deliveries reconciliation
11. Regional Headquarters Memos

Respondent's argument has no merit.

Section 203 of the NIRC of 1997, as amended provides for the general rule on the period of limitation to assess, as follows:

> "**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 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."

However, Section 222(a) of the NIRC of 1997, as amended provides for the instances when such period of limitation to assess is extended to ten (10) years, as follows:

> "**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**

368

> **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)*

Fraud, in its general sense, "is deemed to comprise anything calculated to deceive, including all acts, omissions, and concealment involving a breach of legal or equitable duty, trust or confidence justly reposed, resulting in the damage to another, or by which an undue and unconscionable advantage is taken of another.[11] For purposes of determining fraud in the filing of a tax return, the fraud contemplated by law must be 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.[12]

After carefully sifting through the records of the case, the Court finds no trace of fraud in the filing of petitioner's return. At the outset, it must be pointed out that petitioner owns the subject cartons of Mentos. While the sale between petitioner and VMSC cannot be denied, some of the documents (fax message memos[13]) on which respondent's examiners based their assessment also indicated that the same sale was rescinded by VMSC; as VMSC had already written off these stocks and decided not to have them shipped to it anymore. In fact, VMSC questioned the warehousing fees being charged against it by petitioner for "safekeeping" the subject stocks despite being "written off" by VMSC[14]; confirming the said rescission. Rescission creates the obligation to return the things which were the object of the contract,

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[11] *Commissioner of Internal Revenue vs. Estate of Benigno P. Toda, Jr.*, G.R. No. 147188, September 14, 2004
[12] *Jose B. Aznar vs. Court of Tax Appeals, et al.,* G.R. No. L-20569, August 23, 1974
[13] BIR Records, pages 299 and 296
[14] BIR Records, page 296

309

together with their fruits, and the price with its interest.[15] Due to the rescission, the legal title over the said cartons of Mentos belonged to petitioner.

Though petitioner, as owner, could have the cartons of Mentos destroyed due to expiration, it did not do so. Instead, petitioner considered the option of reprocessing these Mentos in order to recover the costs.[16] Equally noteworthy is the fact that a scrutiny of the BIR Certificates of Destruction[17] which lists the candies and package materials that were destroyed reveals that the subject cartons of Mentos were not included in that list. Hence, petitioner did not deduct the cartons of Mentos from its gross income as an *inventory write-off.*

All these circumstances prove that the preparation of the return was not attended by fraud. Besides, even if the mere deduction would be considered as erroneous, that *per se* cannot considered as fraudulent. There must be intent to evade payment of income tax which respondent failed to prove. The documents relied upon by respondent's examiners for the assessment also led to their downfall. Fraud is a question of fact which must be alleged and proved. It is a serious charge and, to be sustained, it must be supported by clear and convincing proof.[18]

There being no fraud, the applicable period of limitation to assess is three (3) years from the filing of the return as provided in Section 203 of the NIRC of 1997, as amended. Since the Annual Income Tax Return for 1997 was filed on March 31, 1998, respondent had until March 30, 2001 to assess petitioner. Unfortunately, the

[15] Article 1385, New Civil Code
[16] BIR Records, page 295
[17] Exhibits "G", "H" and "I", Docket, pages 243-290
[18] *Republic of the Philippines vs. Ker & Company, Ltd.,* G.R. No, L-21609. September 29, 1966

Final Assessment Notice[19] and Formal Letter of Demand[20] were only issued on October 1, 2003, beyond the three-year period to assess.

Considering that the assessment had already prescribed, the Court sees no reason to discuss the rest of the issues relative to the validity of the assessment.

IN VIEW OF THE FOREGOING, the assessment for deficiency income tax in the amount of P9,264,593.29 for taxable year 1997 is hereby **CANCELLED** and **WITHDRAWN** for having been issued beyond the three-year period to assess.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division

[19] Exhibits "A" and "A-1", Docket, pages 208-209
[20] Exhibit "B", Docket, pages 210-213

271