Republic of the Philippines
Supreme Court
Manila

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**G.R. No. 221590**
	Present:
- versus -	CARPIO, *J., Chairperson,* PERALTA, MENDOZA, PERLAS-BERNABE,* and LEONEN, *JJ.*
ASALUS CORPORATION, Respondent.	Promulgated: 22 FEB 2017

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DECISION

MENDOZA, *J.*:

This petition for review on *certiorari* seeks to reverse and set aside the July 30, 2015 Decision[1] and the November 6, 2015 Resolution[2] of the Court of Tax Appeals *(CTA) En Banc* in CTA EB No. 1191, which affirmed the April 2, 2014 Decision[3] of the CTA Third Division *(CTA Division).*

The Antecedents

On December 16, 2010, respondent Asalus Corporation *(Asalus)* received a Notice of Informal Conference from Revenue District Office *(RDO)* No. 47 of the Bureau of Internal Revenue *(BIR)*. It was in connection with the investigation conducted by Revenue Officer Fidel M. Bañares II

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* Designated additional member per Special Order No. 2416-P dated January 4, 2017.
[1] Penned by Associate Justice Caesar A. Casanova with Associate Justice Juanito C. Castañeda Jr., Associate Justice Lovell R. Bautista, Associate Justice Erlinda P. Uy, Associate Justice Esperanza R. Fabon-Victorino, Associate Justice Cielito N. Mindaro-Grulla, Associate Justice Amelia R. Cotangco-Manalastas and Associate Justice Ma. Belen M. Ringpis-Liban concurring, and Presiding Justice Roman G. del Rosario dissenting; *rollo*, pp.14-27.
[2] Id. at 35-38.
[3] Penned by Associate Justice Esperanza R. Fabon-Victorino with Associate Justice Ma. Belen M. Ringpis-Liban concurring and Associate Justice Lovell R. Bautista on leave; id. at 197-211.

(Bañares) on the Value-Added Tax *(VAT)* transactions of Asalus for the taxable year 2007.[4] Asalus filed its Letter-Reply,[5] dated December 29, 2010, questioning the basis of Bañares' computation for its VAT liability.

On January 10, 2011, petitioner Commissioner of Internal Revenue *(CIR)* issued the Preliminary Assessment Notice *(PAN)* finding Asalus liable for deficiency VAT for 2007 in the aggregate amount of ₱413, 378, 058.11, inclusive of surcharge and interest. Asalus filed its protest against the PAN but it was denied by the CIR.[6]

On August 26, 2011, Asalus received the Formal Assessment Notice *(FAN)* stating that it was liable for deficiency VAT for 2007 in the total amount of ₱95,681,988.64, inclusive of surcharge and interest. Consequently, it filed its protest against the FAN, dated September 6, 2011. Thereafter, Asalus filed a supplemental protest stating that the deficiency VAT assessment had prescribed pursuant to Section 203 of the National Internal Revenue Code *(NIRC)*.[7]

On October 16, 2012, Asalus received the Final Decision on Disputed Assessment[8] *(FDDA)* showing VAT deficiency for 2007 in the aggregate amount of ₱106,761,025.17, inclusive of surcharge and interest and ₱25,000.00 as compromise penalty. As a result, it filed a petition for review before the CTA Division.

The CTA Division Ruling

In its April 2, 2014 Decision, the CTA Division ruled that the VAT assessment issued on August 26, 2011 had prescribed and consequently deemed invalid. It opined that the ten (10)-year prescriptive period under Section 222 of the NIRC was inapplicable as neither the FAN nor the FDDA indicated that Asalus had filed a false VAT return warranting the application of the ten (10)-year prescriptive period. It explained that it was only in the PAN where an allegation of false or fraudulent return was made. The CTA stressed that after Asalus had protested the PAN, the CIR never mentioned in both the FAN and the FDDA that the prescriptive period would be ten (10) years. It further pointed out that the CIR failed to present evidence regarding its allegation of fraud or falsity in the returns.

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[4] Id. at 43.
[5] Id. at 136.
[6] Id. at 43-44.
[7] Id. at 44.
[8] Id. at 130-132.

The CTA wrote that "the three instances where the three-year prescriptive period will not apply must always be alleged and established by clear and convincing evidence and should not be anchored on mere conjectures and speculations,[9] before the ten (10) year prescriptive period could be considered. Thus, it disposed:

> WHEREFORE, the instant Petition for Review is hereby GRANTED. Accordingly, the deficiency VAT assessment for taxable year 2007 and the compromise penalty are hereby CANCELLED and WITHDRAWN, on ground of prescription.
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> SO ORDERED.[10]

The CIR moved for reconsideration but its motion was denied.

The CTA En Banc Ruling

In its July 30, 2015 Decision, the CTA *En Banc* sustained the assailed decision of the CTA Division and dismissed the petition for review filed by the CIR. It explained that there was nothing in the FAN and the FDDA that would indicate the non-application of the three (3) year prescriptive period under Section 203 of the NIRC. It found that the CIR did not present any evidence during the trial to substantiate its claim of falsity in the returns and again missed its chance to do so when it failed to file its memorandum before the CTA Division.

The CTA *En Banc* further explained that the PAN alone could not be used as a basis because it was not the assessment contemplated by law. Consequently, the allegation of falsity in Asalus' tax returns could not be considered as it was not reiterated in the FAN. The dispositive portion thus reads:

> WHEREFORE, premises considered, the present Petition for Review is hereby DENIED, and accordingly, DISMISSED for lack of merit.
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> SO ORDERED.[11]

The CIR sought the reconsideration of the decision of the CTA *En Banc*, but the latter upheld its decision in its November 6, 2015 resolution.

Hence, this petition.

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[9] Id. at 208.
[10] Id. at 210.
[11] Id. at 26.

ISSUES

I

WHETHER PETITIONER HAD SUFFICIENTLY APPRISED RESPONDENT THAT THE FAN AND FDDA ISSUED AGAINST THE LATTER FALLS UNDER SECTION 222(A) OF THE 1997 NIRC, AS AMENDED;

II

WHETHER RESPONDENT'S FAILURE TO REPORT IN ITS VAT RETURNS ALL THE FEES IT COLLECTED FROM ITS MEMBERS APPLYING FOR HEALTHCARE SERVICES CONSTITUTES "FALSE" RETURN UNDER SECTION 222(A) OF THE 1997 NIRC, AS AMENDED; AND

II

WHETHER PETITIONER'S RIGHT TO ASSESS RESPONDENT FOR ITS DEFICIENCY VAT FOR TAXABLE YEAR 2007 HAD ALREADY PRESCRIBED.[12]

The CIR, through the Office of the Solicitor General *(OSG)*, argues that the VAT assessment had yet to prescribe as the applicable prescriptive period is the ten (10)-year prescriptive period under Section 222 of the NIRC, and not the three (3) year prescriptive period under Section 203 thereof. It claims that Asalus was informed in the PAN of the ten (10)-year prescriptive period and that the FAN made specific reference to the PAN. In turn, the FDDA made reference to the FAN. Asalus, on the other hand, only raised prescription in its supplemental protest to the FAN. The CIR insists that Asalus was made fully aware that the prescriptive period under Section 222 would apply.

Moreover, the CIR asserts that there was substantial understatement in Asalus' income, which exceeded 30% of what was declared in its VAT returns as appearing in its quarterly VAT returns; and the underdeclaration was supported by the judicial admission of its lone witness that not all the membership fees collected from members applying for healthcare services were reported in its VAT returns. Thus, the CIR concludes that there was *prima facie* evidence of a false return.

The Position of Asalus

In its Comment/Opposition,[13] dated April 22, 2016, Asalus countered that the present petition involved a question of fact, which was beyond the ambit of a petition for review under Rule 45. Moreover, it asserted that the

[12] Id. at 50-51.
[13] Id. at 247-274.

findings of fact of the CTA Division, which were affirmed by the CTA *En Banc*, were conclusive and binding upon the Court. It posited that the CIR could not raise for the first time on appeal a new argument that "the FDDA and the FAN need not explicitly state the applicability of the ten-year prescriptive period and the bases thereof as long as the totality of the circumstances show that the taxpayer was 'sufficiently informed' of the facts in support of the assessment. Based on the totality of the circumstances, it was informed of the facts in support of the assessment."[14]

Asalus reiterated that the CIR, either in the FAN or the FDDA, failed to show that it had filed false returns warranting the application of the extraordinary prescriptive period under Section 222 of the NIRC. It insisted that it was not informed of the facts and law on which the assessment was based because the FAN did not state that it filed false or fraudulent returns. For this reason, Asalus averred that the assessment had prescribed because it was made beyond the three (3)-year period as provided in Section 203 of the NIRC.

The Reply of the CIR

In its Reply,[15] dated August 15, 2016, the CIR argued that the findings of the CTA might be set aside on appeal if they were not supported with substantial evidence or if there was a showing of gross error or abuse. It repeated that there was presumption of falsity in light of the 30% underdeclaration of sales. The CIR emphasized that even Asalus' own witness testified that not all the membership fees collected were reported in its VAT returns. It insisted that Asalus was sufficiently informed of its assessment based on the prescriptive period under Section 222 of the NIRC as early as when the PAN was issued.

On another note, the CIR manifested that Asalus' counsels made use of insulting words in its Comment, which could have been dispensed with. Particularly, it highlighted the use of the following phrases as insulting: "even to the uninitiated," "petitioner's habit of disregarding firmly established rules of procedure," "twist establish facts to suit her ends," "just to indulge petitioner," and "she then tried to calculate, on her own but without factual basis." It asserted that "[w]hile a lawyer has a complete discretion on what legal strategy to employ in a case, the overzealousness in protecting his client's interest does not warrant the use of insulting and profane language in his pleadings xxx."[16]

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[14] Id. at 262.
[15] Id. at 285-302.
[16] Id. at 297.

The Court's Ruling

There is merit in the petition.

It is true that the findings of fact of the CTA are, as a rule, respected by the Court, but they can be set aside in exceptional cases. In *Barcelon, Roxas Securities, Inc. (now known as UBP Securities, Inc.) v. Commissioner of Internal Revenue*, this Court in *Toshiba Information Equipment (Phils.), Inc. v. Commissioner of Internal Revenue*,[17] explicitly pronounced —

> Jurisprudence has consistently shown that this Court accords the findings of fact by the CTA with the highest respect. In *Sea-Land Service, Inc. v. Court of Appeals* [G.R. No. 122605, 30 April 2001, 357 SCRA 441, 445-446], this Court recognizes that the Court of Tax Appeals, which by the very nature of its function is dedicated exclusively to the consideration of tax problems, has necessarily developed an expertise on the subject, and its conclusions will not be overturned unless there has been an abuse or improvident exercise of authority. **Such findings can only be disturbed on appeal if they are not supported by substantial evidence or there is a showing of gross error or abuse on the part of the Tax Court.** In the absence of any clear and convincing proof to the contrary, this Court must presume that the CTA rendered a decision which is valid in every respect.[18] [Emphasis supplied]

After a review of the records and applicable laws and jurisprudence, the Court finds that the CTA erred in concluding that the assessment against Asalus had prescribed.

Generally, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, or where the return is filed beyond the period, from the day the return was actually filed.[19] Section 222 of the NIRC, however, provides for exceptions to the general rule. It states that in the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the assessment may be made within ten (10) years from the discovery of the falsity, fraud or omission.

In the oft-cited *Aznar v. CTA*,[20] the Court compared a false return to a fraudulent return in relation to the applicable prescriptive periods for assessments, to wit:

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[17] 529 Phil. 285 (2006).
[18] Id. at 794-795.
[19] Section 203of the NIRC.
[20] 157 Phil. 510 (1974).

> 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."
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> xxx 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 seggregates 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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> 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 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) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.
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> There being undoubtedly false tax returns in this case, We affirm the conclusion of the respondent Court of Tax Appeals that Sec. 332 (a) of the NIRC should apply and that the period of ten years within which to assess petitioner's tax liability had not expired at the time said assessment was made. (Emphasis supplied)

Thus, a mere showing that the returns filed by the taxpayer were false, notwithstanding the absence of intent to defraud, is sufficient to warrant the application of the ten (10) year prescriptive period under Section 222 of the NIRC.

Presumption of Falsity of Returns

In the present case, the CTA opined that the CIR failed to substantiate with clear and convincing evidence its claim that Asalus filed a false return. As it noted that the CIR never presented any evidence to prove the falsity in the returns that Asalus filed, the CTA ruled that the assessment was subject to the three (3) year ordinary prescriptive period.

The Court is of a different view.

Under Section 248(B) of the NIRC,[21] 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.[22]

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.

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

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[21] In case of wilful 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 wilfully made, the penalty to be imposed shall be fifty (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 a failure to report sales, receipts or income in an mount exceeding thirty percent (30%) of that declared per return, and a claim of deduction in an amount exceeding thirty (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.

[22] Black's Law Dictionary (9th Edition).

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.

Substantial Compliance of Notice Requirement

The CTA also posited that the ordinary prescriptive period of three (3) years applied in this case because there was no mention in the FAN or the FDDA that what would apply was the extraordinary prescriptive period and that the CIR did not present any evidence to support its claim of false returns.

Again, the Court disagrees.

It is true that neither the FAN nor the FDDA explicitly stated that the applicable prescriptive period was the ten (10)-year period set in Section 222 of the NIRC. They, however, made reference to the PAN, which categorically stated that "[t]he running of the three-year statute of limitation as provided under Section 203 of the 1997 National Internal Revenue Code (NIRC) is not applicable xxx but rather to the ten (10) year prescriptive period pursuant to Section 222(A) of the tax code xxx."[23] In *Samar-I Electric Cooperative v. COMELEC*,[24] the Court ruled that it sufficed that the taxpayer was substantially informed of the legal and factual bases of the assessment enabling him to file an effective protest, to wit:

> Although the FAN and demand letter issued to petitioner were not accompanied by a written explanation of the legal and factual bases of the deficiency taxes assessed against the petitioner, the records showed that respondent in its letter dated April 10, 2003 responded to petitioner's October 14, 2002 letter-protest, explaining at length the factual and legal bases of the deficiency tax assessments and denying the protest.
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> **Considering the foregoing exchange of correspondence and documents between the parties, we find that the requirement of Section 228 was substantially complied with.** Respondent had fully informed petitioner *in writing* of the factual and legal bases of the deficiency taxes assessment, which enabled the latter to file an "effective" protest, much unlike the taxpayer's situation in *Enron*. Petitioner's right to due process was thus not violated. [Emphasis supplied]

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[23] *Rollo*, p. 139.
[24] G.R. No. 193100, December 10, 2014, 744 SCRA 459.

Thus, substantial compliance with the requirement as laid down under Section 228 of the NIRC suffices, for what is important is that the taxpayer has been sufficiently informed of the factual and legal bases of the assessment so that it may file an effective protest against the assessment. In the case at bench, Asalus was sufficiently informed that with respect to its tax liability, the extraordinary period laid down in Section 222 of the NIRC would apply. This was categorically stated in the PAN and all subsequent communications from the CIR made reference to the PAN. Asalus was eventually able to file a protest addressing the issue on prescription, although it was done only in its supplemental protest to the FAN.

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.

A Reminder

A lawyer is indeed expected to champion the cause of his client with utmost zeal and competence. Such exuberance, however, must be tempered to meet the standards of civility and decorum. Rule 8.01 of the Code of Professional Responsibility mandates that "[a] lawyer shall not, in his professional dealings, use language which is abusive, offensive or otherwise improper." In *Noble v. Atty. Ailes*,[25] the Court cautioned lawyers to be careful in their choice of words as not to unduly malign the other party, to wit:

> Though a lawyer's language may be forceful and emphatic, it should always be dignified and respectful, befitting the dignity of the legal profession. The use of intemperate language and unkind ascriptions has no place in the dignity of the judicial forum. In *Buatis Jr. v. People*, the Court treated a lawyer's use of the words "lousy," "inutile," "carabao English," "stupidity," and "satan" in a letter addressed to another colleague as defamatory and injurious which effectively maligned his integrity. Similarly, the hurling of insulting language to describe the opposing counsel is considered conduct unbecoming of the legal profession.
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> **On this score, it must be emphasized that membership in the bar is a privilege burdened with conditions such that a lawyer's words and actions directly affect the public's opinion of the legal profession. Lawyers are expected to observe such conduct of nobility and**

[25] A.C. No. 10628, July 1, 2015, 761 SCRA 1.

> **uprightness which should remain with them**, whether in their public or private lives, and may be disciplined in the event their conduct falls short of the standards imposed upon them. Thus, in this case, it is inconsequential that the statements were merely relayed to Orlando's brother in private. **As a member of the bar, Orlando should have been more circumspect in his words, being fully aware that they pertain to another lawyer to whom fairness as well as candor is owed.** It was highly improper for Orlando to interfere and insult Maximino to his client.
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> Indulging in offensive personalities in the course of judicial proceedings, as in this case, constitutes unprofessional conduct which subjects a lawyer to disciplinary action. **While a lawyer is entitled to present his case with vigor and courage, such enthusiasm does not justify the use of offensive and abusive language.** The Court has consistently reminded the members of the bar to abstain from all offensive personality and to advance no fact prejudicial to the honor and reputation of a party. xxx[26] [Emphases supplied]

While the Court recognizes and appreciates the passion of Asalus' counsels in promoting and protecting its interest, they must still be reminded that they should be more circumspect in their choice of words to argue their client's position. As much as possible, words which undermine the integrity, competence and ability of the opposing party, or are otherwise offensive, must be avoided especially if the message may be delivered in a respectful, yet equally emphatic manner. A counsel's mettle will not be viewed any less should he choose to pursue his cause without denigrating the other party.

WHEREFORE, petition is **GRANTED.** The July 30, 2015 Decision and the November 6, 2015 Resolution of the Court of Tax Appeals *En Banc* are **REVERSED** and **SET ASIDE**. The case is ordered **REMANDED** to the Court of Tax Appeals for the determination of the Value Added Tax liabilities of the Asalus Corporation.

SO ORDERED.

JOSE CATRAL MENDOZA
Associate Justice

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[26] Id. at 8-9..

WE CONCUR:

ANTONIO T. CARPIO
Associate Justice
Chairperson

DIOSDADO M. PERALTA
Associate Justice

ESTELA M. PERLAS-BERNABE
Associate Justice

MARVIC M.V.F. LEONEN
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ANTONIO T. CARPIO
Associate Justice
Chairperson, Second Division

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice