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# SECOND DIVISION

# [ G.R. No. 221590, February 22, 2017 ]

## COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. ASALUS CORPORATION, RESPONDENT.

## D E C I S I O N

**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 (*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 P413,378,058.11, 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 P95,681,988.64, 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 P106,761,025.17, inclusive of surcharge and interest and P25,000.00 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.

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.
>
> 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.
>
> 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.

**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 (lO)-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 iin 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 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]

## 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:

> 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."
>
> xxxx
>
> 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.**
>
> 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.
>
> 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