

## SEC. 306 OF THE NATIONAL INTERNAL REVENUE CODE: A NOVEL CONCEPT OF PRESCRIPTION

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### I. Prefatory Statement:

At common law, there were no fixed periods for the commencement of suits,<sup>1</sup> and as a general rule, where there was no statute of limitations applicable to the case, there could be no default arising from mere lapse of time.<sup>2</sup> Nevertheless, pleas of limitation were allowed long before there was any statute on the subject, based on the theory that after a long lapse of time during which the claimant made no assertion of his rights, in a personal demand, a presumption was raised that the obligation had been paid or discharged,<sup>3</sup> and in case of real state, that a conveyance had been executed but was lost.<sup>4</sup> These judicial fictions, though largely based on the consideration of expediency, were justified, in the reasoning of the court, by the evident justness of their effects.<sup>5</sup> It would not, therefore, be difficult to reach the conclusion that the concept of prescription was, at the start, basically Machiavellian.

The term "limitation of Action" has been defined to mean a bar to the remedy or the plaintiff's cause of action occasioned by the lapse of time since the cause of action arose.<sup>6</sup> The term "limitation" in this connection, has been defined as being the time at the end of which no action at law or suit in equity can be maintained.<sup>7</sup> Thus, any law which

creates a condition of the enforcement of a right to be performed within a fixed time may be defined as a statute of limitation.<sup>8</sup>

### II. Nature of Prescription:

Prescription is a matter of defense. Inasmuch as statutes of limitations are now generally regarded with favor by the courts,<sup>9</sup> it is the consensus of the authorities that the defense of the statute of limitation stands upon the same plane as any other legal defense.<sup>10</sup> The Rules of Court mentions the same as one of the defenses available in an action.

A plea of the statute of limitation is a personal defense<sup>11</sup> and is one to which, in proper circumstances, all men are entitled as a matter of right.<sup>12</sup> The right to assert the statute of limitation as a complete defense is considered to be property within the protection of the constitutional guaranty of due process of law.<sup>13</sup> The right of a party after the statute has run to take advantage of the defense it affords is a vested one, which cannot be taken from him without his consent,<sup>14</sup> and which cannot be affected by the fact that he may have put it in motion by his own wrong.<sup>15</sup> Such statutes may control future procedure in reference to previously existing cause of action, with the law in force at the time the action is brought determining the right of a party to sue.<sup>16</sup> However, the defense of prescription is a personal privilege which any party may avail himself or not, and which he may waive as he deems fit.

### III. Underlying Policy:

In its immediate effect, a statute of limitation is, ordinarily, for the benefit of the individuals. However, viewed broadly, it embodies important public policy considerations in that it stimulates activity, punishes negligence, and promotes repose by giving security and stability to human affairs.<sup>17</sup> Thus, statutes of limitation rest upon reasons of sound public policy in that they tend to promote the peace and welfare of society, safeguard against fraud and oppression, and compel the settlement of claims within a reasonable period after their origin and while the evidence remains fresh in the memory of the witnesses.<sup>18</sup>

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<sup>1</sup> *Brooklyn Bank v. Barnaby*, 197 NY 210, citing *Smith v. Mitchell*, 24 SCL (Rice) 316.

<sup>2</sup> *Haucstein v. Lynham*, 100 US 493, 25 L. Ed. 628.

<sup>3</sup> *American Jurisprudence*, 1st Ed. Vol. 51, sec. 243 et seq.

<sup>4</sup> 3 Am. Jur. 2d. 81 citing *Sterling v. Sterling*, 211 Md 493; *Sollers v. Sollers*, 77 Md 148; and *People v. System Properties, Inc.*, 2 Ny 2d 330.

<sup>5</sup> *Welles-Khan Co. v. Klein*, 81 Fla 524; *Union Cent Life Insurance Co. v. Spinks*, 119 Ky 201, 83 SW 615.

<sup>6</sup> *Christmas v. Russel*, 5 Wall (US) 290, 18 L. Ed. 475.

<sup>7</sup> *Campbell v. Holt*, 115 US 620; *Housing Authority of Union City v. Commonwealth Trust Co.*, 25 NJ 330.

<sup>8</sup> *Hay v. Baraboo*, 127 Wis 1, 105 Nw 654.

<sup>9</sup> *Wood v. Carpenter*, 101 US 135, 25 L. Ed. 807.

<sup>10</sup> *Wheeler v. Castor*, 11 Md 347, 92 Nw 381.

<sup>11</sup> *Tolbert v. Birmingham*, 262 Ala 674.

<sup>12</sup> *Quitmeyer v. Theroux*, 144 Mont 302 citing *Pappas v. Brait hwaite*, 117 Mont 568.

<sup>13</sup> *Board of Education v. Blodgett*, 155 III 441.

<sup>14</sup> *McCarthy v. White*, 21 Cal 495.

<sup>15</sup> *San Antonio Real Estate v. Stewart*, 94 Tex 441, 61 W 386.

<sup>16</sup> *Patterson v. Gaines*, 6 How (US) 550, 12 L. Ed. 553 citing *Mulvay v. Boston*, 197 Mass. 178, 83 Ne 402.

<sup>17</sup> *Kyle v. Green Acres at Varona, Inc.*, 44 Nj 100.

<sup>18</sup> *Baron v. Kurn*, 349 Mo 1202.

#### IV. General Aims and Purposes:

The primary purpose of a statute of limitation is to compel the exercise of a right of action within a reasonable time so that the opposing party has a fair opportunity to defend himself.<sup>19</sup> Statutes of limitations are founded upon the general experience of mankind that claims which are valid are not usually allowed to remain neglected if the right to sue thereon exists.<sup>20</sup> They are designated to prevent undue delay in bringing suits or claims and to suppress fraudulent and stale claims from being asserted, to the surprise of the parties or their representatives, when all the proper evidences are lost, or the facts have become obscure from the lapse of time or the defective memory of death or removal of witnesses.<sup>21</sup> Clearly, the purpose of a limitation on time within which an action may be commenced is to insure repose and to require that claims be advanced while the evidence to rebut them is still fresh.

The mischief which the statute of limitation is intended to remedy is the inconvenience resulting from delay in the assertion of a legal right which is practicable to assert. Thus, while one of the purposes of the statute is to relieve a court from dealing with stale claims, where the facts in dispute occurred long ago that evidence was either forgotten or manufactured, there is another element of a more substantive character in the protection of the potential defendant from protracted fear of litigation.<sup>22</sup> And in order to encourage promptness in the bringing of actions, the statute restricts to fixed arbitrary periods the time within which rights otherwise unlimited, may be asserted.

#### V. Effect of Prescription:

A statute of limitation does not confer a right of action. Ordinarily, the time bar of the statute will not afford a basis for affirmative relief in behalf of one in whose favor the statutory period has run.<sup>23</sup> The sole effect of the statute, as a rule, is to bar the remedy by action<sup>24</sup> and it does not discharge the obligation or liquidate a debt.<sup>25</sup>

There has been some difference of opinion among authorities whether at least in the absence of an expression of the legislature in this particular respect, the running of a statute of limitation operates to extinguish merely the remedy or to extinguish the substantive right as well as the remedy. The general rule in this respect supported by a great preponderance of authorities on the subject, is that a statute of limita-

<sup>19</sup> Housing Authority of Union City v. Commonwealth Trust Co., 25 NJ 330.

<sup>20</sup> Webb v. State Harbor Com. 18 Wall (US) 57.

<sup>21</sup> Chase Securities v. Donaldson, 25 US 304.

<sup>22</sup> Pearson v. Northeast Airlines, 309 F 2d, 553.

<sup>23</sup> Packhaber v. Henz, 152 Cal 419, 93 P 114.

<sup>24</sup> 51 Am. Jur. 2d 606-607.

<sup>25</sup> Id.

tion operates on the remedy only and does not extinguish the substantive right.<sup>26</sup> Under this rule, the courts have regarded true statutes of limitation as doing no more than cut-off resort to the courts for the enforcement of the substantive claim or right. The theory is that the rule of prescription is not a bar to the exercise of the right or power, but rather is the public policy that intervenes and prevents one from enforcing a right against another.<sup>27</sup> Thus, the bar of the statute of limitation converts a legal obligation into moral one<sup>28</sup> which the law will not lend its aid to enforce. Note however, that while the remedy to enforce the right by an action in court is barred, the right may nonetheless be enforced by some other remedies which are not barred.<sup>29</sup>

A general rule laid down by authorities requires that prescriptive periods must be reasonable: i.e., it must afford the opposing party ample time to bring the action. Conversely, a period which does not afford a party full opportunity to sue before the bar takes effect is unreasonable.<sup>30</sup> It has also been held that the legislature has no power to cut-off an existing remedy entirely, since this would amount to a denial of justice.<sup>31</sup> All statutes of limitations must proceed from the theory that the party has full opportunity afforded him to try his right in the courts, and where the statute would operate so as to bar all recovery without any allowance of time for the commencement thereof in the future, it is usually deemed to be unconstitutional in its operation on vested rights.<sup>32</sup>

#### VI. Prescriptive Period under Sec. 306, NIRC:

The National Internal Revenue Code, in Sec. 306 thereof, provides as follows:

Sec. 306. — Recovery of tax erroneously or illegally collected. No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been filed with the Commissioner; but such suit or proceeding may be maintained whether or not such tax, penalty, or sum has been paid under protest or duress. *In any case, no such suit or proceeding shall be begun after the expiration of two years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment:*  
x x x x x. (Underscoring supplied)

<sup>26</sup> Campbell v. Haverhill, 155 610; Michigan Ins. Bank v. Eldred, 130 US 6 93; Kozan v. Comstock (CA5 La) 270 F 2d 839; Morrison v. Baltimore and O.R. Co., 40 App D.C. 391; Fuller v. Knight 241 Ala 257; Wassell v. Readson, 11 Ark 705; Western Coal and Mining Co. v. Jones, 27 Cal 2d 819.

<sup>27</sup> Fuller v. Knight, 241 Ala 257.

<sup>28</sup> Balmer v. Long, 104 Kan 408, 179 P 371.

<sup>29</sup> United States v. Whited and Wheelless, 246 US 552, 62 L Ed 427.

<sup>30</sup> Hite v. West Columbia, 220 SC 59, 66 SE 2d 427.

<sup>31</sup> Coleman v. Superior Court, 135 Cal App 74; Re Estate of Brown (Fla), 117 So 2d 478.

<sup>32</sup> Herrick v. Boquillas Land and Cattle Co., 200 US 96.

The law lays down 4 elements necessary to maintain an action for the recovery of taxes illegally or erroneously paid; namely,

1. actual payment of the tax and/or penalty;
2. payment was illegal and/or erroneous;
3. formal claim filed with the Commissioner; and,
4. suit is brought within 2 years from date of payment.

The crucial question is the determination of the time from which the two-year period is to be computed. Before the revision of the Code, the law, as well as the judicial pronouncements on the matter were very explicit and emphatic in enunciating that "when a tax was originally collected legally, the running of the prescriptive period of two years should commence not from the date of payment, but from the happening of the supervening cause that entitled the taxpayer to a refund." Moreover, the claim for refund with the Commissioner and the subsequent action in the Court of Tax Appeals regarding the refund should all be done within the said period.<sup>33</sup> A refinement of this rule was made in a case where the Court held that the running of the two-year prescriptive period commenced from the happening of the supervening cause only where it could be shown that at the time of payment, the collection of the tax was legal.<sup>34</sup> Furthermore, the claim for refund with the Bureau of Internal Revenue and the subsequent appeal to the Court of Tax Appeals must be filed within the two-year period. In the event the Commissioner takes time in deciding the claim and the period of two years is about to end, the suit must be started in the Court of Tax Appeals before the end of the two-year period without awaiting the decision of the Commissioner.<sup>35</sup>

The recent case of Commissioner of Internal Revenue v Central Azucarera Don Pedro<sup>36</sup> gives the best illustration of the law before the amendment. As a consequence of certain importation, the respondent Central as assessed by the Bureau of Internal Revenue to pay a certain sum by way of compensating tax. The Central paid the tax under protest on the ground that it had a pending application for tax exemption with the Board of Industries under R.A. 3127. When it applied for a tax credit, the Commissioner denied the same resulting in the institution of the present action. The only issue presented for resolution was whether the prescriptive period of two years was applicable.

The Court of Tax Appeals held that the statutory provision was not applicable since it referred to tax erroneously or illegally collected or in

<sup>33</sup> Commissioner of Internal Revenue v. National Power Corporation, G.R. No. L-18874, January 30, 1970.

<sup>34</sup> Commissioner of Internal Revenue v. Insular Lumber Co., G.R. No. L-24221, December 11, 1967.

<sup>35</sup> Commissioner of Internal Revenue v. Victorias Milling Co., Inc., G.R. No. L-24108, January 3, 1968.

<sup>36</sup> G.R. No. L-28467, February 28, 1973 (49 SCRA 474).

any manner wrongfully collected, citing the decision in Muller & Phipps (Manila), Ltd. v Collector of Internal Revenue.<sup>37</sup> In the aforesaid case, the Court ruled that the computation of the prescriptive period for bringing action should logically start from the date of payment since the collection thereof start from the date of payment since the collection thereof was tainted with illegality or error from the beginning, and therefore, from that moment, there was basis for the claim as well as for the cause of action in the suit. However, in connection with the claim of the respondent Central, the basis thereof was the tax exemption granted by the Board of Industries under R. A. 3127. Before the application for such exemption was approved, there was absolutely no basis for the Central to file a claim with the Commissioner or to commence an action in court.

The petitioner suggested that the respondent could have refused to pay the tax if only to forestall the running of the two-year prescriptive period while its application for tax exemption was pending. The suggestion was not only unrealistic because non-payment of the tax would prevent the release of the goods from the customs custody, but altogether unjustified since the tax was due and payable and its collection was neither illegal or erroneous. In fact, the petitioner admitted that as a matter of policy, an applicant for tax exemption under R. A. 3127 was not allowed to withdraw the importation covered by said application from customs custody without the pre-payment of the compensating tax thereon.

Under Sec. 7, R. A. 3127, the granting of tax exemption to an applicant engaged in a basic industry retroacts to the date of the filing of the application. If it were the grant of tax exemption by the Board of Industries which gives rise to the right to file a claim for tax credit or refund with the Commissioner, what then would be the period within which the claim should be filed and when would it begin to run?

The case of Muller & Phipps, supra, was relied upon by the Court of Tax Appeals in reversing the action of the petitioner. In that case, advance sales taxes were paid on imported raw materials upon their withdrawal from customs custody. Subsequently, since not all of the materials could be used, the importer shipped back a portion of it to its supplier in the United States and then filed a claim for the refund of the corresponding amount of advance sales taxes which it had paid. The Collector denied the claim and the importer went to the Court of Tax Appeals. The petition for review was, however filed beyond the two-year period fixed by law and the Court of Tax Appeals dismissed the same upon motion of the Collector. On appeal to the Supreme Court, the Court held that the two-year period provided by law could not apply

<sup>37</sup> March 20, 1958, 103 Phil. 145.

on the ground that the advance sales tax in question was not erroneously or illegally collected but that although it was legitimately due when paid, the taxpayer subsequently became entitled to a partial refund by reason of a supervening circumstance: namely, the re-exportation of the imported materials. The ruling was subsequently clarified in a later case<sup>38</sup> where it was held that the two-year prescriptive period was intended to govern all kinds of refund of internal revenue taxes. But at the same time, a precaution was made to the effect that since in those cases the tax sought to be refunded was collected legally, the running of the two-year period should commence not from the time of payment but from the happening of the supervening cause which entitled the taxpayer to a refund. In fine, when the tax sought to be refunded was illegally or erroneously collected, the period of prescription should commence from the date the tax was paid; but where the tax was legally collected, the prescriptive period should be counted from the date of the occurrence of the supervening cause which gave rise to the right of refund. To this extent, the ruling in the Muller & Phipps was modified.

#### VII. The Law as Amended:

With the enactment of P. D. 69 in November 24, 1972 and the subsequent related decrees, the foregoing judicial interpretation of the prescriptive period for the recovery of taxes illegally or erroneously collected was totally abandoned. The very fine distinctions made by the Supreme Court relative to the time from which prescription runs, were rendered obsolete. As worded in the amendment, the law does not take into consideration the happening of a supervening cause which may entitle a taxpayer to a refund, so that with or without the same, no action for recovery or refund may be instituted or maintained after the lapse of two years from the date of payment. Two interesting situations may be envisioned at this point. Suppose a taxpayer has been paying a specific internal revenue tax for the last five years, and subsequently the tax is declared by the Court illegal, and consequently null and void ab initio. Can the taxpayer recover the full amount paid? Note that a void law confers no right and imposes no obligations. Certainly, to deny him recovery will amount to a denial of justice. Will the provision of Sec. 306 now yield to the requirement of justice and equity? Suppose a taxpayer were erroneously made to pay an internal revenue tax and reasonably instituted an action to recover the same, but the court is not able to render judgment until after the expiration of the two-year period. May the taxpayer still recover the taxes paid erroneously?

If the law were to be strictly applied, a taxpayer may not recover anything under either of the two hypothetical situations. This will, how-

ever, result in a distortion of the elementary principle of justice which only a feeble-minded individual can possibly conceive. It will amount to the licensing of confiscation of property which can only find justification in a regime of tyranny. On the other hand, may the ruling in the Central Azucarera Don Pedro case be adopted notwithstanding the amendment of the law? It would seem that this is the more humane option considering the fact that a strict interpretation of the law may work grave injustice to taxpayers who may find themselves without any remedy. However, will it not result in judicial legislation made effective by not giving force and effect to the final proviso of the law which denied resort to courts after the expiration of two years from date of payment "regardless of any supervening cause that may arise?" Will the principle DURA LEX SED LEX apply?

#### VIII. Conclusion:

Preventive remedies are not usually accorded to one complaining of illegal taxation.<sup>39</sup> On the grounds of public policy, the law discourages suits for the purpose of recovering taxes alleged to be illegally levied and collected. Provided payment is deemed involuntary, a tax which is unlawful or collected under an unconstitutional statute may, as a rule, be recovered at common law in an action of assumpsit for money had and received.<sup>40</sup> Otherwise, it may not be recovered directly in the absence of a law authorizing the refunding of such tax payment or permitting action for its recovery.

In some jurisdictions, designated officials are authorized to refund taxes illegally paid. In some states, the right is given by a statute to recover by action illegal taxes paid. Philippine tax law has both remedies. However, it must be borne in mind that the remedies must be exercised in the manner provided by the law and the remedies must be sought in like manner. Note too that a tax refund is a matter of grace and a statute of nonclaim not complied with is an effective bar to its recovery in law or equity.<sup>41</sup>

Sometimes, conditions are attached to the right to a refund which, to the extent that they are not defects in the form or sufficiency of the claim, must be complied with. One such condition is the making of the claim within the specified time. The general conclusion to be drawn from the few American cases touching on the point is that, ordinarily at least, under statute providing that a claim or application for a refund must be made or filed within a stated time after the right to the refund accrues, the right will be deemed to accrue as of the date of payment.<sup>42</sup>

<sup>38</sup> Commissioner of Internal Revenue v. Insular Lumber Co., 21 SCRA 1237.

<sup>39</sup> Minturn v. Hays, 2 Cal 590.

<sup>40</sup> Atchison, T. & S.F.R. Co. v. O'Connor, 223 US 280.

<sup>41</sup> State ex rel Victor Chemical Works v. Gav. (Fla) 74 So 2d 560.

<sup>42</sup> Broadwell v. Board of Commissioners, 88 Okla. 147.