A Case for False Returns

Eric R. Recalde[*]

I. INTRODUCTION 953
II. OVERVIEW 956
A. Prescriptive Period
B. Fraud Penalty
C. Use of Best Evidence Obtainable
D. A False Return is Different From an Erroneous Return
E. Statutory Presumption
F. Fraudulent Returns
G. Omitted Returns
H. False Returns
III. SUMMARY 978

I. INTRODUCTION

This Article treats of the proper application of the extraordinary prescriptive period under the National Internal Revenue Code of 1997,[1] particularly in situations where the case is alleged to involve the filing of a *false return*.

---

* '14 LL.M., University of Cambridge; '09 LL.M., San Beda University School of Law; '02 J.D., San Beda University School of Law. The Author is the Head of the Tax Department and a Partner of the Angara Abello Concepcion Regala & Cruz Law Offices (ACCRA). He is a Certified Public Accountant (CPA), and he ranked 11th in the September 1996 CPA Licensure Examinations. He also ranked third in the 2002 Philippine Bar Examinations. He sits as a professorial lecturer at the San Beda University Graduate School of Law. He is a taxation lecturer at the Jurists Bar Review Center.

Cite as 65 ATENEO L.J. 953 (2021).

1. An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [NAT'L INTERNAL REVENUE CODE], Republic Act No. 8424 (1997).

Section 222 (a) of the Tax Code[2] permits a belated assessment against a taxpayer in three instances: (a) false returns, (b) fraudulent returns, and (c) omitted returns.[3] In these three instances, the Bureau of Internal Revenue (BIR) may issue an assessment within 10 years from the discovery of the falsity, fraud, or omission.[4] Invariably, the courts uphold the assessment when the taxpayer is unable to dispute by way of evidence the BIR's allegation of substantial under-declaration of revenues or over-declaration of the taxpayer's costs and expenses.[5] The BIR invokes the statutory presumption provided in Section 248 (B) of the Tax Code, which in turn is its statutory basis to levy an additional 50% fraud penalty.[6] The view of the regulators, it seems, is that such statutory presumption may be invoked to justify an extended prescriptive period, considering they are in *pari materia*. This is easy to appreciate in cases of fraudulent or omitted returns, as both provisions incorporate the element of willfulness.[7] It is, however, controversial in the case of a *false return*.

There are a good number of reasons why the current view on the interplay of these provisions must be revisited. The seminal case of *Aznar v. Court of Tax Appeals*[8] demonstrates that there is reason to differentiate their interpretation and application. A belated assessment may be justified when there are false returns in the absence of willfulness.[9] However, the imposition of a fraud penalty is certainly unjustified in the absence of such element.[10]

In terms of elements, the law in force (the 1939 Tax Code),[11] which the Supreme Court applied in *Aznar*, was more lenient towards the application of the extended prescriptive period than that of the levy of the fraud penalty.[12]

---

2. *Id.* § 222 (a).
3. *Id.*
4. *Id.*
5. *See* Commissioner of Internal Revenue v. Hantex Trading Co., Inc., G.R. No. 136975, 454 SCRA 301, 329 (2005).
6. NAT'L INTERNAL REVENUE CODE, § 248 (B).
7. *Id. See also id.* § 222 (a).
8. Aznar v. Court of Tax Appeals, G.R. No. L-20569, 58 SCRA 519 (1974).
9. *Id.* at 532.
10. *Id.* at 543.
11. An Act to Revise, Amend and Codify the Internal Revenue Laws of the Philippines, Commonwealth Act No. 466 (1939) [hereinafter 1939 NAT'L INTERNAL REVENUE CODE].
12. *See id.* §§ 331 & 332 (a).

The current rule, with the introduction of the above statutory presumption, makes it easier for the BIR to justify a belated assessment.

Further, *Aznar* did not clarify what was meant by a *false return*.[13] Was it a case of unintentional non-declaration of the transaction in the return? Or an unintentional misdeclaration or mistreatment of the transaction in the return? In practice, the BIR, due to its limited investigation procedure, may not discover non-declaration of transactions.[14] It may, however, discover mistreatment or misdeclaration of transactions.[15] The facts in *Aznar* described non-declarations, not mistreatment or misdeclarations of transactions. Thus, the often-quoted Supreme Court characterization of when there is false return (i.e., there is a mere deviation from the truth) in *Aznar* should be understood in that context.[16]

This issue has practical importance. The BIR can easily provide the purported factual basis to invoke the statutory presumption under Section 248 (B) of the Tax Code for the levy of fraud penalty, and by implication, for the issuance of a belated assessment.[17] For this purpose, the BIR may use indirect methods of investigation leading to the use of the *best evidence obtainable*.[18] This certainly can cause unnecessary pressure to taxpayers. Worse, this may also open the gates to corruption.

---

13. *See Aznar*, 58 SCRA at 532 (emphasis supplied). The Court explained that while a false return "merely implies deviation from the truth, whether intentional or not, [a fraudulent return] implies intentional or deceitful entry with intent to evade the taxes due." *Id.*

14. *See* Bureau of Internal Revenue, Re-invigorating the Run After Tax Evaders (RATE) Program, and Amending Certain Portions of RMO No. 24-2008, Revenue Memorandum Order No. 27-2010 [Rev. Memo. Circ. No. 27-2010], ¶ II (B) (1) (March 15, 2010). "In all [Run After Tax Evaders (RATE) Program] cases, a preliminary investigation must first be conducted to establish prima facie evidence of fraud or tax evasion. Such investigation shall include the verification and determination of the schemes employed and the extent of fraud perpetrated by the subject taxpayer." *Id.*

15. *See Aznar*, 58 SCRA at 523. The Bureau of Internal Revenue's findings indicated that the taxpayer incorrectly declared his income in his income tax returns from 1946 to 1951. *Id.*

16. *Id.*

17. NAT'L INTERNAL REVENUE CODE, § 248 (B).

18. *Id.* § 6 (B) (emphasis supplied).

In questioning assessments, taxpayers have the burden of proof.[19] Once issued, assessments are presumed correct.[20] Taxpayers must question such assessments and, if there is already a clear attempt for collection, secure a suspension order from the Court of Tax Appeals (CTA).[21] As petitioners, they must pay the prescribed filing fees.[22] Substantial assessments, which could cover seven years (as the most recent years could be considered *open years*) require the payment of substantial filing fees.[23] To preclude collection through administrative remedies of distraint and levy, taxpayers must post the prescribed bond.[24] The law permits the CTA to require a bond of up to twice the amount of the questioned assessments as a condition for the issuance of a suspension order.[25] It was a welcome development when the Supreme Court set out guidance on the extent of the bond that the CTA may require or when the CTA may even dispense with the posting of a bond.[26] To dispute the statutory presumptions and request the reduction or dispensation of the bond may not be easy, especially when the relevant records are no longer available.

II. OVERVIEW

The succeeding discussion will preliminarily describe the purpose of prescriptive periods, delineate the distinctions between the regular and extra-ordinary periods, and identify the circumstances when the fraud penalty may apply. The discussion will also include instances where there could be a risk

19. Collector of Internal Revenue v. Bohol Land Transportation Co., 107 Phil. 965, 974 (1960).

20. *Id.*

21. 2005 REVISED RULES OF THE COURT OF TAX APPEALS, rule 10, § 2.

22. *See* Manchester Development Corporation v. Court of Appeals, G.R. No. 75919, 149 SCRA 562, 569 (1987). "The Court acquires jurisdiction over any case only upon the payment of the prescribed docket fee." *Id.*

23. *See* NAT'L INTERNAL REVENUE CODE, § 248 (B) (emphasis supplied). The "failure to report sales, receipts[,] or income in an amount exceeding ... 30% of that declared per return" constitutes a substantial under-declaration. *Id.*

24. 2005 REVISED RULES OF THE COURT OF TAX APPEALS, rule 10, § 6.

25. *Id.*

26. Spouses Pacquiao v. Court of Tax Appeals, G.R. No. 213394, 789 SCRA 19, 43-44 (2016); Tridharma Marketing Corporation, v. Court of Tax Appeals, G.R. No. 215950, 794 SCRA 126, 135 (2016); & Privatization and Management Office v. Court of Tax Appeals, G.R. No. 211839, 897 SCRA 231, 239 (2019).

that a regulator may overstep the rights of a taxpayer, based on an erroneous application of the statutory presumptions under the law.

The primary objective of this Article is to explain why *false returns* are not the same as *erroneous returns*. The audit procedure meant to detect false returns is certainly not the same as that for erroneous returns. Invariably, false returns are inextricably linked to cases when the BIR may properly use the *best evidence obtainable*.[27] The statutory presumption does not exist for the BIR to conveniently circumvent the strict rule against the application of the extra-ordinary prescriptive period.

This Article aims to evoke a positive discourse, from the citizenry, the courts, and the regulators, on the limitations of the use of presumptions under Section 248 (B), and the concept of false returns that can justify the issuance of belated assessments under Section 222 (a) of the Tax Code.

A. Prescriptive Period

It is said that "tax provisions are not all about raising revenue. Our Legislature has provided safeguards and remedies beneficial to both the taxpayer, to protect against abuse; and the Government, to promptly act for the availability and recovery of revenues."[28]

Republic v. Ablaza[29] has clarified that the law does not intend to disadvantage the Government so as to prevent its lawful agents from assessing the proper tax.[30] It is meant to be beneficial both to the Government and to the taxpayers.[31] Thus,

> [it] is beneficial ... to the Government because tax officers would be obliged to act promptly in the making of assessment, 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

27. *See* NAT'L INTERNAL REVENUE CODE, § 6 (B) (emphasis supplied).

28. Commissioner of Internal Revenue v. The Stanley Works Sales (Phils.), Incorporated, G.R. No. 187589, 743 SCRA 642, 654 (2014).

29. Republic v. Ablaza, 108 Phil. 1105 (1960).

30. *Id.* at 1108. *See also* Commissioner of Internal Revenue v. Philippine Global Communication, Inc., G.R. No. 167146, 506 SCRA 427, 440 (2006).

31. *Ablaza*, 108 Phil. at 1108.

> obligation to always keep their books and keep them open for inspection subject to harassment by unscrupulous tax agents.[32]

Normally, the audit is commenced towards the middle or end of the prescriptive period. This practice, whether intentionally done (to extract a bigger assessment owing to hefty deficiency or delinquency interest) or brought about by sheer limited manpower of the BIR to conduct the audit, should be revisited. The Supreme Court highlighted that the statute of limitations principally intends to afford protection to the taxpayer.[33] The same "shall be construed and applied liberally in favor of the taxpayer and strictly against the Government."[34] Its exceptions should be strictly construed.[35] "[N]egligence or oversight on the part of the BIR cannot prejudice taxpayers, considering that the [statute of limitations] was precisely intended to give [the taxpayer] peace of mind."[36]

As a rule, the Commissioner is given a period of only three years to issue a deficiency assessment or commence "a proceeding in court without assessment for the collection of [deficiency] tax ... ."[37] If made beyond such period, the assessment is void.[38] The law provides that "if the assessment or collection of any tax is barred by [the] statute of limitations, the decisions of the Court to that effect shall be considered as its decision that there is no deficiency in respect of such tax."[39] It is for this reason the law refers to Section 203 of the Tax Code,[40] the provision that describes the ordinary prescriptive period, in setting the record-retention period. [41]

---

32. *Id.*
33. Philippine Journalists, Inc. v. Commissioner of Internal Revenue, G.R. No. 162852, 447 SCRA 214, 227 (2004). "For the purpose of safeguarding taxpayers from any unreasonable examination, investigation[,] or assessment, our tax law provides a statute of limitations in the collection of taxes." *Id.*
34. Bank of the Philippine Islands v. Commissioner of Internal Revenue, G.R. No. 139736, 473 SCRA 205, 226 (2005).
35. *Id.*
36. Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc., G.R. No. 104171, 303 SCRA 546, 557 (1999).
37. NAT'L INTERNAL REVENUE CODE, § 203.
38. An Act Creating the Court of Tax Appeals, Republic Act No. 1125, § 14 (1954).
39. *Id.*
40. NAT'L INTERNAL REVENUE CODE, § 203.
41. *Id.* § 235.

Section 222 (a) of the Tax Code, however, provides an extended prescriptive period for assessment of taxes under special circumstances, to wit —

> 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 filed without assessment, at any time within [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.[42]

The law sets a 10-year period since "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[.]"[43] The transaction or transactions in question are not brought to the attention of the BIR, specifically when the taxpayer does not file the corresponding tax return, or fails to report, or intentionally misdescribes the same in the filed tax return.[44]

B. Fraud Penalty

Related to the extra-ordinary period is the levy of the fraud penalty. It is imposed "in case of willful neglect to file the return within the period prescribed by [the] Code or by rules and regulations, or in case a false or fraudulent return is willfully made" by the taxpayer.[45] In either case, the law prescribes the element of "willfulness."[46] Thus, it is not enough that the taxpayer failed to file the prescribed return or that the return filed is false to justify the levy of the 50% surcharge.[47] The omission to file or the filing of a false return must be willfully made.[48]

---

42. *Id.* § 222 (a) (emphasis supplied).

43. *Aznar*, 58 SCRA at 532.

44. *Id.*

45. NAT'L INTERNAL REVENUE CODE, § 248 (B).

46. *Id.*

47. *See* Commissioner of Internal Revenue v. Javier, Jr, G.R. No. 78953, 199 SCRA 824, 832 (1991). The Court affirmed the deletion by Court of Tax Appeals of the 50% surcharge imposed as a fraud penalty because there was no showing of any actual or intentional fraud through the willful and deliberate misleading of the Bureau of Internal Revenue. *Id.*

48. *Id.*

False returns and fraudulent returns both involve deviation from truth.[49] In *Aznar*, for purposes of the application of the fraud penalty, the Supreme Court emphasized there should be an intent to avoid tax.[50] Its presence may also lead to prosecution for tax evasion.[51]

C. Use of Best Evidence Obtainable

To aid the BIR in issuing assessments, the law permits the use of the *best evidence obtainable*.[52]

Under Section 6 (B) in relation to Section 6 (C) of the Tax Code, the Commissioner of Internal Revenue (CIR) may issue assessments based on the *best evidence obtainable*, when the prescribed report "shall not be forthcoming within the time fixed by laws or rules and regulations or when there is reason to believe that any such report is false, incomplete or erroneous[.]"[53] Such situations include

> [w]hen it is found that a person has failed to issue receipts and invoices in violation of the requirements of Sections 113 and 237 of [the National Internal Revenue] Code, or when there is reason to believe that the books of accounts or other records do not correctly reflect the declarations made or to be made in a return required to be filed under the provisions of [the] Code[.][54]

The resulting assessments "shall be prima facie correct and sufficient for all legal purposes."[55] Section 6 (B) of the Tax Code treats a scenario where there is non-filing of error, falsity, or fraud in the report or return.[56]

49. *See Aznar*, 58 SCRA at 532.
50. *Aznar*, 58 SCRA at 543.
51. NAT'L INTERNAL REVENUE CODE, § 254.
52. *Id.* § 6 (B) (emphasis supplied).
53. *Id.* (emphasis supplied).
54. *Id.* § 6 (C).
55. *Id.* § 6 (B).
56. *Id.* The provision applies to a situation when "a person fails to file a required return or other document at the time prescribed by law, or willfully or otherwise files a false or fraudulent return or other document[.]" NAT'L INTERNAL REVENUE CODE, § 6 (B).

Notably, this provision mentions an erroneous return.[57] Willful intent is clearly not an element, and may be invoked in case a person "*willfully or otherwise* files a false or fraudulent return ... ."[58] This has been the rule since the 1939 Tax Code, Section 51 of which specifically authorized the Collector to "make a return upon information obtained ... or require the necessary corrections to be made" in case of refusal or *neglect* to make a return and in cases of *erroneous*, false, or fraudulent returns.[59] The Supreme Court has also clarified that the use of the best evidence obtainable is also permitted if the taxpayer's books and records are not available for examination or unreliable.[60]

D. A False Return is Different From an Erroneous Return

At this juncture, it should be emphasized that both Sections 222 (a)[61] and 248 (B)[62] do not explicitly use the term "erroneous." Such term is only included in Section 6 (B) of the Tax Code, lumped together with false, fraudulent, and omitted returns that will justify the use of best evidence obtainable.[63]

The legal sanction on the use of best evidence obtainable was originally provided in Section 51 (d) under the 1939 Tax Code,[64] to wit —

> (d) Refusal or neglect to make returns; fraudulent returns, etc. — In cases of refusal or neglect to make a return and in cases of *erroneous, false, or fraudulent returns*, the Collector of Internal Revenue shall, upon the discovery thereof, at any time *within three years* after said return is due, or has been made, make a return upon information obtained as provided for in this code or by existing law, or require the necessary corrections to be made, and the assessment made by the Collector of Internal Revenue thereon shall be paid by such person or corporation immediately upon notification of the amount of such assessment.[65]

57. *Id.* The Commissioner shall assess the proper tax on the best evidence obtainable "when there is reason to believe that any such report is false, incomplete[,] or erroneous." *Id.*
58. *Id.* (emphasis supplied).
59. 1939 NAT'L INTERNAL REVENUE CODE, § 51 (d) (emphasis supplied).
60. *See Hantex Trading Co., Inc.*, 454 SCRA at 327.
61. NAT'L INTERNAL REVENUE CODE, § 222 (A).
62. *Id.* § 248 (B).
63. *Id.* § 6 (B).
64. 1939 NAT'L INTERNAL REVENUE CODE, § 51 (d).
65. *Id.* (emphases supplied).

Section 51 (d) initially set a special prescriptive period to issue an income tax assessment "in cases of refusal or neglect to make a return and in cases of *erroneous*, *false*, or fraudulent returns[.]"[66] The then Section 331 provided a generic five-year ordinary prescriptive period.[67] In *Collector of Internal Revenue v. Villegas*,[68] the Supreme Court explained that for income tax purposes, the three-year prescriptive period was only a limitation on the right of the CIR to assess and collect through summary remedies.[69] It was not, however, a limitation upon the right of the Government to sue for unpaid taxes (i.e., through a proceeding in court without assessment).[70] Section 332 of the Tax Code, in turn, generically provided a 10-year prescriptive period if there was "*falsity*, fraud, or omission."[71] It did not cover an erroneous return.[72]

Republic Act No. 2343,[73] a law passed in 1959 that first introduced the principle of self-assessment, did not remove such distinction when it amended Section 51 (d).[74] Neither did it alter the scope of Section 332 (now Section 222, providing for the extra-ordinary prescriptive period), since the same was not the subject of amendments.[75] From the 1939 Tax Code up to the present Tax Code, Section 332 has limited its application to taxpayer's "failure to file a return" or filing of a "false or fraudulent return with intent to evade tax."[76] It has not covered the taxpayer's (unintentional) filing of an erroneous return.

Republic Act No. 2343 amended Section 51 (d) of the 1939 Tax Code by (1) changing its scope from "refusal or neglect to make returns, fraudulent returns, etc." to "interest on deficiency[,]" and (2) removing the special

---

66. *Id.* (emphasis supplied).
67. *Id.* § 331.
68. Commissioner of Internal Revenue v. Villegas, 56 Phil. 554 (1932).
69. *Id.* at 561.
70. *Id. See also* Collector of Internal Revenue v. Avelino, 100 Phil. 327, 331 (1956).
71. 1939 NAT'L INTERNAL REVENUE CODE, § 332 (a) (emphasis supplied).
72. *Id.*
73. An Act to Amend Certain Sections of Commonwealth Act Numbered Four Hundred Sixty-Six, Otherwise Known as the National Internal Revenue Code, as Amended, and for Other Purposes, Republic Act No. 2343 (1959).
74. *Id.* § 8.
75. *Id.*
76. Section 332 (a) of the 1939 National Internal Revenue Code was virtually reproduced as the first sentence of Section 222 (a) of the present National Internal Revenue Code. *See* NAT'L INTERNAL REVENUE CODE, § 222 (a).

prescriptive period for income tax assessments.[77] The generic provisions of Section 332 (together with Section 331, now Section 203 that provides for the ordinary prescriptive period) remained.[78] Since then, both Sections 331 and 332 have been the uniform provisions on prescription for all internal revenue taxes, including income taxes.[79]

Republic Act No. 2343 simply suppressed the controversial paragraph (d) and provided a shorter three-year prescriptive period for income tax assessment.[80] This applies to the "refusal ... to make a return[,]"[81] which is now termed "failure to file a return" under the present Section 222.[82] Such "refusal" was more accurately described as "willful neglect to file the return" under the then Section 72,[83] which has been reproduced in the present Section 248 (B).[84] It is likewise applicable to the filing of "false or fraudulent returns," placing them in the same category of "neglect to make returns" and "erroneous returns."[85] In contrast, they have been well segregated into two categories with respect to non-income taxes:

(1) For purposes of imposing a penalty, Section 72 provided: (i) a 50% surcharge "in case of willful neglect to file the return" and "in case a false or fraudulent return is willfully made[;]"[86] and (ii) a 25% surcharge "[i]n case of any failure to make ... a return ... not due to willful neglect[.]"[87] There was no 25% delinquency surcharge for non-income taxes. The first category is now

77. Republic Act No. 2343, § 8.

78. Republic Act. No. 2343 did not amend Section 331 or 332 of the 1939 Tax Code.

79. *See* NAT'L INTERNAL REVENUE CODE, § 203. All "internal revenue taxes shall be assessed within three [ ] years [from] the last day prescribed by law for the filing of the return," subject to the exceptions provided in Section 222. *Id.*

80. 1939 NAT'L INTERNAL REVENUE CODE, § 51.

81. *Id.*

82. NAT'L INTERNAL REVENUE CODE, § 222 (a).

83. 1939 NAT'L INTERNAL REVENUE CODE, § 72.

84. NAT'L INTERNAL REVENUE CODE, § 248 (B).

85. 1939 NAT'L INTERNAL REVENUE CODE, § 51.

86. *Id.* § 72.

87. *Id.*

covered by the present Section 248 (B),[88] and the second by the present Section 248 (A).[89]

(2) For purposes of prescription, Section 331 provided the ordinary prescriptive period,[90] and Section 332 provided the extra-ordinary prescriptive period, specifically for filing a "false or fraudulent return with intent to evade tax" or "failure to file a return[.]"[91] As mentioned, Section 331[92] became the present Section 203,[93] while Section 332[94] became the present Section 222 (a).[95]

To avoid such a controversial scenario, Republic Act No. 2343 amended Section 51 (d).[96] Thus:

Timeline	Provision	Scope
Pre-Republic Act No. 2343	Section 51 (d)	Special three-year prescriptive period for income tax only
	Section 331	Ordinary prescriptive period (implicitly) for other internal revenue taxes
	Section 332	Extra-ordinary prescriptive period (implicitly) for other internal revenue taxes
Post-Republic Act No. 2343	Section 51 (d)	Became the provision on deficiency interest
	Section 331	Because of the change in scope of Sec. 51 (d), this has become the provision on ordinary

88. NAT'L INTERNAL REVENUE CODE, § 248 (B).

89. *Id.* § 248 (A).

90. 1939 NAT'L INTERNAL REVENUE CODE. § 331.

91. *Id.* § 332.

92. *Id.* § 331.

93. NAT'L INTERNAL REVENUE CODE, § 203.

94. 1939 NAT'L INTERNAL REVENUE CODE. § 332.

95. NAT'L INTERNAL REVENUE CODE, § 222 (a).

96. Republic Act No. 2343, § 8.

		prescriptive periods for all internal revenue taxes
	Section 332	Because of the change in scope of Sec. 51 (d), this has become the provision on extra-ordinary prescriptive periods for all internal revenue taxes

The present Tax Code has incorporated certain provisions of Section 51 into Section 6 (B), providing in its second paragraph that

> [i]n case a person fails to file a required return or other document ... or *willfully or otherwise files a false* or fraudulent *return* or other document, the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise[.][97]

Its first paragraph, in turn, has remained unchanged. It has authorized the Commissioner to issue an assessment on the basis of the best evidence obtainable when a report "shall not be forthcoming ... or when there is reason to believe that any such report is false, incomplete or erroneous[.]"[98]

This has been the same provision since the 1939 Tax Code.

Section 6 (B) uses the term *erroneous* to characterize only a report (and not a return) because its first paragraph (describing a report as basis for the assessment) has been taken from Section 15 of the Tax Code, while its second paragraph (as mentioned above) has been taken from Section 51 of the 1939 Tax Code.[99] Section 15 pertained to non-income taxes, while Section 51 pertained to income taxes.[100] Presently, there is no more distinction between income and non-income taxes, both of which must be covered by a return.

97. NAT'L INTERNAL REVENUE CODE, § 6 (B), para. 2 (emphases supplied).

98. *Id.*

99. 1939 NAT'L INTERNAL REVENUE CODE, §§ 15 & 51 (emphasis supplied).

100. *Id.*

E. Statutory Presumption

"Willfulness" or "intent to avoid tax," as a requirement to impose the fraud penalty, is a state of mind.[101] In *Commissioner of Internal Revenue v. Javier, Jr.*,[102] the Supreme Court cited *Aznar*, explaining that

> the fraud contemplated by law ... 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. *Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by law.* It must amount to intentional wrong-doing with the sole object of avoiding the tax. *It necessarily follows that a mere mistake cannot be considered as fraudulent intent* [especially] if both the [taxpayer] and [the] Commissioner of Internal Revenue committed mistakes ... .[103]

In *Javier, Jr.*, the Supreme Court ruled that the fraud penalty should not apply, considering that "the fraud contemplated by law is *actual* and not constructive."[104] In this case, the Supreme Court resolved the issue on

> whether ... a taxpayer who merely state[d] as a footnote in his income tax return that a sum of money that he erroneously received and already spent [was] the subject of a pending litigation and there did not declare it as income was liable to pay the 50% penalty for filing a fraudulent return.[105]

The Supreme Court found certain circumstances showed that Javier, in filing the questioned return, "was guided, not by that 'willful and deliberate intent to prevent the Government from making a proper assessment[,]' which would constitute fraud, but by an honest doubt as to whether or not the 'mistaken remittance' was subject to tax."[106] Moreover, Javier literally "laid his cards on the table" for the Commissioner to examine.[107] Hence, it ruled that the non-imposition of the 50% surcharge on Javier was proper.[108]

The private respondent in *Javier, Jr.* cited American jurisprudence describing the rule in fraud cases that the proof "must be clear and

101. *Aznar*, 58 SCRA at 543.

102. Commissioner of Internal Revenue v. Javier, Jr, G.R. No. 78953, 199 SCRA 824, 832 (1991).

103. *Id.* at 831 (citing *Aznar*, 58 SCRA at 543) (emphases supplied).

104. *Javier, Jr.*, 199 SCRA at 831 (citing *Aznar*, 58 SCRA at 543) (emphasis supplied).

105. *Javier, Jr.*, 199 SCRA at 825.

106. *Id.* at 830.

107. *Id.* at 831.

108. *Id.* at 832.

convincing."[109] Such proof "must be stronger than the 'mere preponderance of evidence' which would be sufficient to sustain a judgment on the issue of correctness of the deficiency itself apart from the fraud penalty."[110]

In light of the above requirements, a rule of evidence had to be introduced that would presumptively establish the taxpayer's state of mind to justify a fraud penalty.

The law now allows the BIR to only prove certain basic facts to justify the levy of the fraud penalty.[111] Upon such proof, the law shifts the burden on the taxpayer to prove that the BIR-established under-declaration or over-declaration, as the case may be, is not willful.[112]

Section 248 (B) of the Tax Code establishes an objective presumption:

> (1) A substantial under[-]declaration of taxable sales, receipts or income, or a substantial overstatement of deductions ... shall constitute *prima facie* evidence of a false or fraudulent return[.][113]
>
> (2) Failure to report sales, receipts or income in an amount exceeding [30%] of that declared per return, and a claim of deductions in an amount exceeding (30%) of actual deductions, shall render the taxpayer liable for substantial [under-declaration] of sales, receipts[,] or income or for overstatement of deductions, as mentioned [t]herein.[114]

The 30% deficiency tax is considered a substantial under-declaration of income, which constitutes prima facie evidence of false or fraudulent return under Section 248 (B).[115]

1. Misuse of the Statutory Presumption

It is common for taxpayers to commit a mistake in recording and accounting for their transactions. To date, there has been no perfect accounting system

109. *Javier, Jr.*, 199 SCRA at 829 (citing Griffiths v. Commissioner of Internal Revenue, 50 F. 2d 782, 786 (1931) (U.S.)).

110. *Javier, Jr.*, 199 SCRA at 829 (citing Maddas v. Commissioner of Internal Revenue, 40 B.T.A. 572, 578 (1939) (U.S.)).

111. NAT'L INTERNAL REVENUE CODE, § 248 (B).

112. *See Aznar*, 58 SCRA at 543.

113. NAT'L INTERNAL REVENUE CODE, § 248 (B) (emphasis supplied).

114. *Id.*

115. Commissioner of Internal Revenue v. Gonzalez, G.R. No. 177279, 633 SCRA 139, 163 (2010).

that will preclude such mistake. Thus, the law has to set the 30% materiality threshold, which separates a simple from material error in the recording of transactions.[116]

The typical issue is when is there "failure to report sales, receipts, or income" or "a claim of deduction" in an amount exceeding 30% of that declared per return (in the case of the former) or of actual deduction (in the case of the latter)?

In practice, the BIR tries to discharge its burden of proof by presenting sheer discrepancy between the amount of the relevant account shown in the tax return and the audited financial statements and/or the general ledger.[117] The discrepancy can easily be ascertained in the course of regular audit.[118] The BIR typically usually uses the substantial discrepancy to justify a belated assessment.[119]

Theoretically, a mere discrepancy is insufficient and should not immediately shift the burden to the taxpayer in disproving the purported established presumption. The BIR (as demonstrated in *Javier, Jr.*) must establish that the taxpayer's act should have "induced [the Government] to give up some legal right and place itself at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities ... ."[120] In other words, the fraud penalty and the extra-ordinary prescriptive period only apply when the

---

116. Commissioner of Internal Revenue v. Asalus Corporation, G.R. No. 221590, 818 SCRA 543, 555 (2017).

117. *See* Kepco Philippines Corporation v. Commissioner of Internal Revenue, G.R. No. 179356, 608 SCRA 207, 213 (2009).

> A general ledger is a record of a business entity's accounts which make up its financial statements. Information contained in a general ledger is gathered from source documents [including] account vouchers, purchase orders[,] and sales invoices. In case of variance between the source document and the general ledger, the former is preferred.

Kepco Philippines Corporation, 608 SCRA at 213.

118. *See* Philippine National Oil Company v. Court of Appeals, G.R. No. 109976, 457 SCRA 32, 126 (2005). "After investigation or audit, the BIR can issue an assessment for any deficiency tax still due from the taxpayer." *Id.*

119. *See* NAT'L INTERNAL REVENUE CODE, § 6 (C) (The provision applies when there is reason to believe that a taxpayer's books of account or other records do not correctly reflect the declarations made or which should be made in a return.).

120. *Javier, Jr.*, 199 SCRA at 832

BIR is placed at a disadvantage from issuing an assessment on account of the taxpayer's omission or machination.[121]

Instead of simply presenting a discrepancy, the BIR must establish that the taxpayer "has failed to issue receipts and invoices in violation of the requirements of Sections 113 and 237 of [the] Code,"[122] or that there exists "reason to believe that the books of accounts or other records do not correctly reflect the declarations made or to be made in a return required to be filed under the provisions of [the] Code[.]"[123] In other words, the actual transaction (i.e., the truth) is *not* reflected in the source documents (e.g., invoices, official receipts), the ledgers and journals, in the audited financial statements, and eventually the tax returns.

F. Fraudulent Returns

There is fraud when the taxpayer "willfully attempts in any manner to evade or defeat any tax ... ."[124] "The fraud contemplated by law is 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."[125] In *Spouses Pacquiao v. Court of Tax Appeals*,[126] the Supreme Court explained that fraud must be duly established,[127] considering the following:

(1) "A preliminary investigation must first be conducted *before* a Letter of Authority (LA) is issued."[128] Under Revenue Memorandum Order 27-10, such investigation must "establish prima facie evidence of fraud or tax evasion[,]" and include "the verification and determination of the schemes employed and the extent of fraud perpetrated by the subject taxpayer[.]"[129]

---

121. *Id.*

122. NAT'L INTERNAL REVENUE CODE, § 6 (C).

123. *Id.* § 128 (A) (3).

124. *Id.* § 254.

125. *Aznar*, 58 SCRA at 543.

126. Spouses Pacquiao v. Court of Tax Appeals, G.R. No. 213394, 789 SCRA 19 (2016).

127. *Id.* at 48.

128. *Id.*

129. *Id.* (citing Rev. Memo. Circ. 27-2010, ¶ II (B) (1)) (emphasis supplied).

(2) The assessment must be based on facts, and not on "'estimates based on best possible sources.'"[130] "The presumption of the correctness of an assessment, being a mere presumption, cannot be made to rest on another presumption."[131]

In case a fraud assessment becomes final and executory, "the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof."[132] This modified the ruling of the Supreme Court in *Republic v. Ker & Company, Ltd.*[133] that fraud must still be alleged and proved in the judicial action for collection, notwithstanding the finality of a fraud assessment.[134]

If the taxpayer files a fraudulent return, he/she may be prosecuted for tax evasion[135] and may not extinguish his civil liability through a compromise.[136]

Further, "fraud is a question of fact ... ."[137] The circumstances constituting it must be properly alleged and proven.[138] Thus, in *Commissioner of Internal Revenue v. Gonzales*,[139] the Supreme Court en banc did not declare a return to be fraudulent even if the return was observed to be substantially

130. *Spouses Pacquiao*, 789 SCRA at 50.

131. *Id.* (citing Collector of Internal Revenue v. Benipayo, G.R. No. L-13656, 4 SCRA 182, 185 (1962)).

132. NAT'L INTERNAL REVENUE CODE, § 222 (a).

133. Republic v. Ker & Company, Ltd., G.R. No. L-21609, 18 SCRA 207 (1966). (In this case, the Commissioner argued that Ker & Co. filed a false return, and since the fraud penalty of a 50% surcharge was imposed in the deficiency income tax assessment, which had become final and executory, the finding of the Commissioner as to the existence of fraud had also become final and need not be proved.).

134. *Id.* at 215.

135. NAT'L INTERNAL REVENUE CODE, § 254.

136. *Id.* § 204 (B).

137. *Ker & Company, Ltd.*, 18 SCRA at 215.

138. *Id.*

139. Commissioner of Internal Revenue v. Gonzales, G.R. No. L-19495, 18 SCRA 757 (1966).

defective.[140] The Supreme Court noted that the CIR failed to prove the fact of fraud before the CTA.[141]

G. Omitted Returns

There is failure to file a return not only when the taxpayer omitted to file a return, but also when he/she filed a substantially deficient return.[142] This was the case in *Gonzales*. While the Supreme Court did not declare the return to be fraudulent, the Supreme Court found that the return filed was "so deficient that it prevented the Commissioner from computing the taxes due on the estate[,] ... as though no return was made."[143] Thus, the period to assess ran from the date of discovery instead of from the filing of the deficient return, and the 10 year prescriptive period was applied.[144]

The law treats simple "failure to file a return" differently from "willful neglect to file a return."[145] The taxpayer is liable for the 25% surcharge in the former, and 50% surcharge in the latter.[146] Under Section 72 of the 1939 Tax Code, a taxpayer may in fact be excused from the 25% surcharge if the failure is not willful and due to a reasonable cause.[147] The difference in treatment should likewise be applied in the application of the relevant prescriptive period.

---

140. *Id.* at 767-68. In *Gonzales*, the Supreme Court found that the period to assess could not have begun to run during the filing of the return, to wit —

> First, the return was incomplete. It declared only ninety-three parcels of land representing about 400 hectares and left out ninety-two parcels covering 503 hectares[.] Said huge under[ ]declaration could not have been[ ] the result of an oversight or mistake. ...
>
> Second, the return mentioned no heir. Thus, no inheritance tax could be assessed.

Id.

141. *Id.* at 766.

142. *Id.* at 767-68.

143. *Id.* at 767.

144. *Gonzales*, 18 SCRA at 768-69.

145. NAT'L INTERNAL REVENUE CODE, § 248, (A) (1) & (B).

146. *Id.*

147. 1939 NAT'L INTERNAL REVENUE CODE, § 72.

H. False Returns

Aznar differentiates a false return from a fraudulent return as follows —

> 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.[148]

There is falsity when there is "deviation from truth," but the taxpayer has no intent to evade any tax.[149] In *Aznar*, the BIR doubted the veracity of the taxpayer's reported income considering his stature as a wealthy person.[150] It conducted an investigation and, using the net worth and expenditures methods of tax investigation, issued a deficiency assessment.[151] It should be recalled these indirect methods of investigation seek to account for the increase in net worth (assets net of liabilities) of the taxpayer.[152] Up to the extent the taxpayer could not account for such increase vis-à-vis his/her reported income, the unexplained increase shall be disputably presumed to be an undeclared income.[153]

In *Aznar*, the Court of Tax Appeals observed 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."[154] In concluding that there was a false return for the purpose of prescription, and there undoubtedly being false tax returns, the Supreme Court affirmed the application by the Court of Tax Appeals of Section 332 (a)

---

148. *Aznar*, 58 SCRA at 532 (emphasis supplied).

149. *Id.*

150. *Id.* at 523.

151. *Id.*

152. *See* Brown, PC, Net Worth Method of Proving Income, *available at* https://www.browntax.com/tax-law-library/methods-of-proof/net-worth-method-of-proving-income (last accessed Jan. 8, 2021) [https://perma.cc/2RB8-VDXX].

153. Bureau of Internal Revenue v. Court of Appeals, G.R. No. 197590, 741 SCRA 536, 551 (2014). The theory behind the expenditure method "is that when the amount of the money that a taxpayer spends during a given year exceeds his [or her] reported or declared income and the source of such money is unexplained, it may be inferred that such expenditures represent unreported or undeclared income." *Id.*

154. *Aznar*, 58 SCRA at 541 (emphasis supplied).

of the NIRC, concluding that the 10-year period within which to assess the petitioner's tax liability had not expired when the assessment was made.[155]

It should be emphasized the "substantial under declarations of income" or the deviation from the truth in *Aznar* was due to *unintentional non-declaration* of certain transactions.[156] It was not due to *mistreatment* or *misdeclaration* of the reported transactions. In other words, there was no error in the tax return. In case of mistreatment or misdeclaration of the transaction in the tax return, there must be "intentional or deceitful entry with intent to evade the taxes due" for the extraordinary prescriptive period to apply.[157]

According to the Supreme Court in *Aznar*, the purpose of the 10-year prescriptive period is to remedy the disadvantageous situation created by the filing of a false or fraudulent return, which prevents government agents from properly assessing tax liabilities.[158] The Supreme Court also ruled that there must be evidence establishing a willful filing of false or fraudulent returns, and that mere reliance on presumptions is not enough.[159] "Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by the law."[160]

1. Rule When Fraud Penalty Applies in False Returns

The rule is markedly different when the fraud penalty may be made to apply.[161] The element of intent is required.[162] There must be an intentional non-declaration of the transaction or transactions in the filed return.[163]

---

155. *Id.* at 532.

156. *Id.* at 543 (emphasis supplied).

157. *Id.* at 532.

158. *Id.*

159. *Id.* at 543.

160. *Aznar*, 58 SCRA at 543.

161. *See* Commissioner of Internal Revenue v. Air India, G.R. No. 72443, 157 SCRA 648, 655 (1988).

162. *Air India*, 157 SCRA at 655.

163. *Id.*

This element of willfulness was lacking in *Aznar*.[164] Thus, the Supreme Court did not impose the fraud penalty, notwithstanding its application of the extra-ordinary prescriptive period.[165]

The Supreme Court observed there might have been false returns by mistake filed by Mr. Matias H. Aznar, as those returns were prepared by his accountant employees, but there were no proven fraudulent returns with intent to evade taxes that would justify the imposition of the 50% surcharge authorized by law as fraud penalty.[166] Thus,

> [a]s could be readily seen from the above rationalization of the lower court, no distinction has been made between false returns (due to mistake, carelessness or ignorance) and fraudulent returns (with intent to evade taxes). The lower court based its conclusion on the petitioner's alleged fraudulent intent to evade taxes on the substantial difference between the amounts of net income on the face of the returns as filed by him in the years 1946 to 1951 and the net income as determined by the inventory method utilized by both respondents for the same years. The lower court based its conclusion on a presumption that fraud can be deduced from the very substantial disparity of incomes as reported and determined by the inventory method and on the similarity of consecutive disparities for six years. Such a basis for determining the existence of fraud (intent to evade payment of tax) suffers from an inherent flaw when applied to this case. It is very apparent here that the respondent Commissioner of Internal Revenue, when the inventory method was resorted to in the first assessment, concluded that the correct tax liability of Mr. Aznar amounted to ₱723,032.66. ... After a reinvestigation the same respondent, in another assessment dated [16 February] 1955, concluded that the tax liability should be reduced to ₱381,096.07. This is a crystal-clear, indication that even the respondent Commissioner of Internal Revenue with the use of the inventory method can commit a glaring mistake in the assessment of petitioner's tax liability. When the respondent Court of Tax Appeals reviewed this case on appeal, it concluded that petitioner's tax liability should be only ₱227,788.64. The lower court in three instances (elimination of two buildings in the list of petitioner's assets beginning [31 December] 1949, because they were destroyed by fire; elimination of expenses for construction in petitioner's assets as duplication of increased value in buildings, and elimination of value of house and lot in petitioner's assets because said property was only given as collateral) supported petitioner's stand on the wrong inclusions in his lists of assets made by the respondent Commissioner of Internal Revenue, resulting in the very

164. *Aznar*, 58 SCRA at 542-43.

165. *Id.* at 543.

166. *Id.* at 541.

> substantial reduction of petitioner's tax liability by the lower court. The foregoing shows that it was not only Mr. Matias H. Aznar who committed mistakes in his report of his income but also the respondent Commissioner of Internal Revenue who committed mistakes in his use of the inventory method to determine the petitioner's tax liability. The mistakes committed by the Commissioner of Internal Revenue which also involve very substantial amounts were also repeated yearly, and yet we cannot presume therefrom the existence of any taint of official fraud.
>
> From the above exposition of facts, we cannot but emphatically reiterate the well[-]established doctrine that fraud cannot be presumed but must be proven. As a corollary thereto, we can also state that fraudulent intent could not be deduced from mistakes however frequent they may be, especially if such mistakes emanate from erroneous entries or erroneous classification of items in accounting methods utilized for determination of tax liabilities. The predecessor of the petitioner undoubtedly filed his income tax returns for the years 1946 to 1951 and those tax returns were prepared for him by his accountant and employees. It also appears that petitioner in his lifetime and during the investigation of his tax liabilities cooperated readily with the [BIR] and there is no indication in the record of any act of bad faith committed by him.
>
> The lower court's conclusion regarding the existence of fraudulent intent to evade payment of taxes was based merely on a presumption and not on evidence establishing a willful filing of false and fraudulent returns so as to warrant the imposition of the fraud penalty. The fraud contemplated by law is 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. Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by the law. It must amount to intentional wrong-doing with the sole object of avoiding the tax. It necessarily follows that a mere mistake cannot be considered as fraudulent intent, and if both petitioner and respondent Commissioner of Internal Revenue committed mistakes in making entries in the returns and in the assessment, respectively, under the inventory method of determining tax liability, it would be unfair to treat the mistakes of the petitioner as tainted with fraud and those of the respondent as made in good faith.
>
> We conclude that the 50% surcharge as fraud penalty authorized under Section 72 of the Tax Code should not be imposed, but eliminated from the income tax deficiency for each year from 1946 to 1951, inclusive.[167]

---

167. *Id.* at 541–43.

2. Recent Explanations of False Returns

In *Samar-I Electric Cooperative v. Commissioner of Internal Revenue*,[168] the Supreme Court reiterated the difference between "false return" and "fraudulent return," as established in *Aznar*.[169] "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."[170]

In *Commissioner of Internal Revenue v. Asalus Corporation*,[171] the Supreme Court held that because of Section 248 (B) of the Tax Code, "there is a prima facie evidence of a false return if there is a substantial under[-]declaration of taxable sales, receipt[,] or income."[172] The Supreme Court thus now considers failure to report sales, receipts, or income in an amount exceeding 30% as a substantial under-declaration, which gives rise to a presumption that the taxpayer has filed a false return.[173]

In *Commissioner of Internal Revenue v Philippine Daily Inquirer*,[174] the Supreme Court clarified that "while the filing of a fraudulent return necessarily implies that the act of the taxpayer was intentional and done with intent to evade the taxes due, the filing of a false return can be intentional or due to honest mistake."[175] Likewise, in *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.*,[176] "the Court stated that the entry of wrong information due to mistake, carelessness, or ignorance, without intent to evade tax, does not constitute a false return."[177]

168. Samar-I Electric Cooperative v. Commissioner of Internal Revenue, G.R. No. 193100, 744 SCRA 459 (2014).

169. *Id.* at 471.

170. *Id.*

171. Commissioner of Internal Revenue v. Asalus Corporation, G.R. No. 221590, 818 SCRA 543 (2017).

172. *Id.* at 555.

173. *Id.*

174. Commissioner of Internal Revenue v. Philippine Daily Inquirer, G.R. No. 213943, 821 SCRA 350 (2017).

175. *Id.* at 378.

176. Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc., G.R. No. 104171, 303 SCRA 546 (1999).

177. *Philippine Daily Inquirer*, 821 SCRA at 378 (citing *B.F. Goodrich Phils., Inc.*, 303 SCRA at 555).

There is false return when a transaction is not reflected in the return (like in *Aznar*), not when the BIR simply *disputes its proper treatment in the return*.[178] In *B.F. Goodrich Phils., Inc.*,[179] the Supreme Court resolved the main issue of prescription, explaining that

> [f]or the purpose of safeguarding taxpayers from any unreasonable examination, investigation or assessment, our tax law provides a statute of limitations in the collection of taxes. Thus, the law on prescription, being a remedial measure, should be liberally construed in order to afford such protection. As a corollary, the exceptions to the law on prescription should perforce be strictly construed.
>
> ...
>
> Clearly, *Section 15 does not provide an exception to the statute of limitations on the issuance of an assessment*, by allowing the initial assessment to be made on the basis of the best evidence available. Having made its initial assessment in the manner prescribed, the commissioner could not have been authorized to issue, beyond the five-year prescriptive period, the second and the third assessments under consideration before us.
>
> ...
>
> Petitioner insists that private respondent committed 'falsity' when it sold the property for a price lesser than its declared fair market value. This fact alone did not constitute a false return which contains wrong information due to mistake, carelessness or ignorance. It is possible that real property may be sold for less than adequate consideration for a *bona fide* business purpose; in such event, the sale remains an 'arm's length' transaction.
>
> Furthermore, the fact that private respondent sold its real property for a price less than its declared fair market value did not by itself justify a finding of false return. Indeed, *private respondent declared the sale in its 1974 return submitted to the BIR*. Within the five-year prescriptive period, the BIR could have issued the questioned assessment, because the declared fair market value of said property was of public record. This it did not do, however, during all those five years. *Moreover, the BIR failed to prove that respondent's 1974 return had been filed fraudulently. Equally significant was its failure to prove respondent's intent to evade the payment of the correct amount of tax.*
>
> Ineludibly, the BIR failed to show that private respondent's 1974 return was filed fraudulently with intent to evade the payment of the correct amount of tax. Moreover, even though a donor's tax, which is defined as 'a tax on the privilege of transmitting one's property or property rights to another or

178. *B.F. Goodrich Phils., Inc.*, 303 SCRA at 555.

179. *Id.*

> others without adequate and full valuable consideration,' is different from capital gains tax, a tax on the gain from the sale of the taxpayer's property forming part of capital assets, the tax return filed by private respondent to report its income for the year 1974 was sufficient compliance with the legal requirement to file a return. In other words, the fact that the sale transaction may have partly resulted in a donation does not change the fact that private respondent already reported its income for 1974 by filing an income tax return.
>
> Since the BIR failed to demonstrate clearly that private respondent had filed a fraudulent return with the intent to evade tax, or that it had failed to file a return at all, the period for assessments has obviously prescribed. Such instances of negligence or oversight on the part of the BIR cannot prejudice taxpayers, considering that the prescriptive period was precisely intended to give them peace of mind.
>
> Based on the foregoing, a discussion of the validity and legality of the assailed assessments has become moot and unnecessary.[180]

III. SUMMARY

From the preceding discussions, it is clear that a false return is different from an erroneous return. It only refers to cases where the taxpayer did not report a transaction in its return, not when the taxpayer only mistreated or mis-declared a transaction. The latter may only justify a belated assessment if made "with intent to evade tax."

A mere substantial discrepancy may also not justify a belated assessment. The BIR must establish the possible source of such discrepancy (i.e., transactions that are not reported in the tax returns), and the failure of the taxpayer "to issue receipts and invoices in violation of the requirements of Sections 113 and 237 of [the] Code, or when there is reason to believe that the books of accounts or other records do not correctly reflect the declarations made or to be made in a return required to be filed under the provisions of [the] Code."[181] In other words, the actual transaction (i.e., the truth) is not reflected in the source documents (e.g., invoices, official receipts), the ledgers and journals, the audited financial statements, and eventually the tax returns.

---

180. *Id.* at 554-57 (emphases supplied).

181. NAT'L INTERNAL REVENUE CODE, § 6, ¶ C.

Commissioner of Internal Revenue v. Asalus Corporation[182] should be understood in this context.

The table below summarizes the treatment of various types of returns, the relevant prescriptive period, the possibility of the use of best evidence obtainable, and the propriety of a fraud penalty.

Particulars	Description	Prescriptive Period	Use of Best Evidence Obtainable	Civil Penalty
Erroneous Return	Transactions are declared but unintentionally mistreated in the tax return	Three-year prescriptive period	Permissible	No civil penalty if the deficiency assessment is paid within the period indicated in the BIR notice
				With 25% civil penalty if the deficiency assessment is *not* paid within the period indicated in the BIR notice
False Return	Transactions are not declared in the return, with or without	Three-year prescriptive period if without	Permissible	Where the "willful" element is absent,

182. Commissioner of Internal Revenue v. Asalus Corporation, G.R. No. 221590, 818 SCRA 543 (2017).

	intent to evade the tax	intent to evade the tax		there is no civil penalty if the deficiency assessment is paid within the period indicated in the BIR notice. With 25% civil penalty if the deficiency assessment is *not* paid within the period indicated in the BIR notice.
				Where the "willful" element is present, there will be a 50% civil penalty.
				Where the "willful" element is absent, there will be no civil penalty if the

				deficiency assessment is paid within the period indicated in the BIR notice. With 25% civil penalty if the deficiency assessment is *not* paid within the period indicated in the BIR notice.
		10-year prescriptive period if with intent to evade the tax	Permissible	Where the "willful" element is present, there will be a 50% civil penalty.
Fraudulent Return	Transactions are declared but intentionally mistreated in the tax return	Three-year prescriptive period	Permissible	There will be a 50% civil penalty
		10-year prescriptive		
Omitted Return	Omission to file the return may or may not be attended with	Three-year prescriptive period if without	Permissible	25% civil penalty

	intent to evade the tax	intent to evade the tax		
		10-year prescriptive period if with intent to evade the tax	Permissible	50% civil penalty