

The 1990s Tax Credit Scam: A Cautionary Tale

Justice Lovell R. Bautista*

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I. INTRODUCTION

Before we delve into the cautionary tale, let us begin with an attempt at defining a Tax Credit Certificate (TCC).

In layman's terms, a TCC represents a company's claim for tax credits, which it may use either to pay its taxes, duties, charges, and fees due to the National Government or to trade with other companies which, in turn, use them to claim tax credits.¹ Now, what is a tax credit?

* '84 LL.M., University of Pennsylvania; '82 LL.B., Ateneo De Manila University School of Law. The Author is the Chairman of the Court of Tax Appeals' Third Division. Before his appointment to the Court of Tax Appeals on 2 January 2003, the Author was a Senior Partner from 1993 to 2002 at the Balmeo, Bautista, and Peñasales Law Office, specializing in tax advisory and advocacy. He was also the Managing Partner at an accounting firm, Bautista, De Vera & Co., and a Tax Partner at an auditing firm, KPMG Fernandez, Santos, and Lopez, from 1991 to 1992. He is a member of the American Bar Association. He was admitted to practice before the United States Tax Court on 12 May 1986. He was also a Professor at the San Sebastian College of Law from 1988 to 2002.

Cite as 55 ATENEO L.J. 271 (2010).

1. Jocelyn Uy, Tax credit scam whistle-blower cleared of contempt, *available at* http://services.inquirer.net/print/print.php?article_id=20070706-75126 (last accessed Aug. 30, 2010).

In *Pilipinas Shell Petroleum Corporation (PSPC) v. Commissioner of Internal Revenue*,² the Supreme Court describes a tax credit in this wise:

A tax credit is not specifically defined in our Tax Code,³ but Article 21 of E.O. 226⁴ defines a tax credit as ‘any of the credits against taxes and/or duties equal to those actually paid or would have been paid to evidence which a tax credit certificate shall be issued by the Secretary of Finance or his representative, or the Board of Investments (BOI), if so delegated by the Secretary of Finance.’⁵ ... A tax credit generally refers to an amount that may be ‘subtracted directly from one’s total tax liability.’⁶ It is therefore an ‘allowance against the tax itself’⁷ or ‘a deduction from what is owed’⁸ by a taxpayer to the government. In R.R. 5-2000,⁹ a tax credit is defined as ‘the amount due to a taxpayer resulting from an overpayment of a tax liability or erroneous payment of a tax due.’¹⁰

A TCC is defined by the Bureau of Internal Revenue (BIR) as:

a certification, duly issued to the taxpayer named therein, by the Commissioner or his duly authorized representative, reduced in a BIR Accountable Form in accordance with the prescribed formalities, acknowledging that the grantee-taxpayer named therein is legally entitled a tax credit, the money value of which may be used in payment or in satisfaction of any of his internal revenue tax liability (except those excluded), or may be converted as a cash refund, or may otherwise be disposed of in the manner and in accordance with the

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2. *Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue*, 541 SCRA 316, 339-40 (2007).
 3. *Id.* (citing An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424 (1997), as amended by Republic Act No. 8761 and Republic Act No. 9010).
 4. *Id.* (citing The Omnibus Investment Code of 1987 [OMNIBUS INVESTMENT CODE], Executive Order No. 226, as Amended, art. 21 (1987)).
 5. *Id.*
 6. *Id.* (citing BLACK’S LAW DICTIONARY 1501 (8th ed. 1999)).
 7. *Id.* at 341 (citing WEST’S TAX LAW DICTIONARY 177-78 (1993)).
 8. *Pilipinas Shell*, 541 SCRA at 339-40 (citing ORAN’S DICTIONARY OF THE LAW, 124 (3d ed. 2000)).
 9. *Id.* (citing Bureau of Internal Rev. Reg. No. 5-2005 (July 19, 2000)).
 10. *Id.*

limitations, if any, as may be prescribed by the provisions of these Regulations.¹¹

From the above definitions, it is clear that a TCC is an undertaking by the government through the BIR or the Department of Finance (DOF), acknowledging that a taxpayer is entitled to a certain amount of tax credit from either an overpayment of income taxes, a direct benefit granted by law or other sources and instances granted by law such as on specific unused input taxes and excise taxes on certain goods. As such, a tax credit is transferable in accordance with pertinent laws, rules, and regulations.¹² Once a TCC is issued, it can be used by the holder either to settle its tax obligations or assign it to other firms.

There are different types of TCCs according to the Department of Finance.¹³ These TCCs are classified according to the incentive laws which govern them, scilicet:

- (1) Executive Order No. 226 (Omnibus Investment Code of 1987), as amended by Republic Acts 7918¹⁴ and 7369:¹⁵ Tax credits on raw materials and domestic breeding stock for firms registered with the Board of Investments.¹⁶
- (2) Section 106 of the Tariff and Customs Code of the Philippines (TCCP), as amended:¹⁷ Tax credits on imported raw materials.¹⁸

11. Bureau of Internal Revenue, Prescribes the Regulations Governing the Manner of Issuance of Tax Credit Certificates and the Conditions for Their Use, Revalidation and Transfer, Rev. Reg. No. 5-2000, § 1 (b) (2000). *See also Pilipinas Shell*, 541 SCRA at 430.

12. *Id.*

13. Department of Finance Center, Incentive Laws Administered, *available at* http://taxcredit.dof.gov.ph/services_ila.htm (last accessed Aug. 30, 2010).

14. An Act Amending Article 39, Title III or Executive Order No. 226, Otherwise Known as the Omnibus Investments Code of 1987 as Amended, and For Other Purposes, Republic Act No. 7918 (1995).

15. An Act Granting Tax and Duty Exemption and Tax Credit on Capital Equipment, Republic Act No. 7369 (1992).

16. *Id.*

17. An Act to Revise and Codify the Tariff and Customs Laws of the Philippines [TARIFF AND CUSTOMS CODE], Republic Act No. 1937 as Amended, (1978).

- (3) Section 112 of the National Internal Revenue Code (NIRC): Tax credits on creditable input VAT due or paid, attributable to zero-rated or effectively zero-rated sales.¹⁹

18. *Id.* § 106. Section 106 provides for tax credits on “all fuel imported into the Philippines which is afterwards used for the propulsion of vessels of Philippine registry engaged in trade with foreign countries, or in the coastwise trade” and on articles made from imported materials or domestic materials “upon the exportation of articles manufactured or produced in the Philippines, including the packing, covering, putting up, marking or labeling thereof.”

Id.

19. TAX REFORM ACT OF 1997, § 112. This section provides:

Refunds or Tax Credits of Input Tax. —

- (A) *Zero-rated or Effectively Zero-rated Sales.* — Any VAT-registered person, whose sales are zero-rated or effectively zero-rated may, within two (2) years after the close of the taxable quarter when the sales were made, apply for the issuance of a tax credit certificate or refund of creditable input tax due or paid attributable to such sales, except transitional input tax, to the extent that such input tax has not been applied against output tax: *Provided, however,* That in the case of zero-rated sales under Section 106(A)(2)(a)(1),(2) and (B) and Section 108 (B)(1) and (2), the acceptable foreign currency exchange proceeds thereof had been duly accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP): *Provided, further,* That where the taxpayer is engaged in zero-rated or effectively zero-rated sale and also in taxable or exempt sale of goods of properties or services, and the amount of creditable input tax due or paid cannot be directly and entirely attributed to any one of the transactions, it shall be allocated proportionately on the basis of the volume of sales.[.]
- (B) *Capital Goods.* — A VAT-registered person may apply for the issuance of a tax credit certificate or refund of input taxes paid on capital goods imported or locally purchased, to the extent that such input taxes have not been applied against output taxes. The application may be made only within two (2) years after the close of the taxable quarter when the importation or purchase was made.
- (C) *Cancellation of VAT Registration.* — A person whose registration has been cancelled due to retirement from or cessation of business, or due to changes in or cessation of status under Section 106(C) of this Code may, within two (2)

- (4) Republic Act No. 7844 (Export Development Act of 1994): Tax credits for increase in export revenues.²⁰
- (5) Section 9 of Republic Act No. 8479 (An Act Deregulating the Downstream Oil Industry): Tax credits on domestic capital equipment for companies registered with the Board of Investments in refining, storage, marketing and distribution of petroleum products.²¹
- (6) Section 35 of Republic Act 8550 (Philippine Fisheries Code of 1998): Tax credits on fuel consumption of commercial fishing vessel operators engaged in fishing in the high seas.²²

years from the date of cancellation, apply for the issuance of a tax credit certificate for any unused input tax which may be used in payment of his other internal revenue taxes.

Id.

An Act Amending the National Internal Revenue Code, as Amended, and For Other Purposes [NATIONAL INTERNAL REVENUE CODE], Republic Act No. 8424, § 112 (1997).

- 20. An Act to Develop Exports As a Key Towards the Achievement of the National Goals Towards the Years 2000 [EXPORT DEVELOPMENT ACT OF 1994], Republic Act No. 7844 (1994).
- 21. An Act Deregulating the Downstream Oil Industry and For Other Purposes [DOWNSTREAM OIL DEREGULATION ACT OF 1998], Republic Act No. 8479, § 9 (1998).
- 22. An Act Providing for the Development, Management, and Conservation of the Fisheries and Aquatic Resources, Integrating All Laws Pertinent Thereto, and For Other Purposes [FISHERIES CODE], Republic Act No. 8550, § 9 (1998).

Section 35. *Incentives for Commercial Fishers to Fish Farther into the Exclusive Economic Zone.* — In order to encourage fishing vessel operators to fish farther in the EEZ and beyond, new incentives for improvement of fishing vessels and acquisition of fishing equipment shall be granted in addition to incentives already available from the Board of Investments (BOI). Such incentives shall be granted subject to exhaustive evaluation of resource and exploitation conditions in the specified areas of fishing operations. The incentive shall include, but not be limited to:

...

- (3) commercial fishing operator of Philippine registry engaged in fisheries in the high seas shall be entitled to

The entity, which processes the foregoing types of tax credits is called the One Stop Shop Inter-Agency Tax Credit and Duty Drawback Center (the Center). It was created under Administrative Order No. 266²³ in relation to E.O. No. 226, and is a composite body managed by four government agencies, *viz.*: the Department of Finance, the Bureau of Internal Revenue, the Bureau of Customs (BOC), and the Board of Investments (BOI).²⁴ To guide taxpayers, the Center created the following table for reference as to which processing group will handle each type of TCC:²⁵

TYPES OF TAX CREDIT ISSUED			
INCENTIVE LAW	TAX CREDIT FORM NO.	USES	PROCESSING GROUP
E.O. No. 266	OSS-Center Form No. 0301 series of 2005	Duty Portion: for payment of duties and taxes at the Bureau of Customs (BOC). VAT Portion: for payment of internal revenue tax, excluding withholding tax, for which the Tax Credit Certificate (TCC) holder is directly liable at the Bureau of Internal Revenue (BIR).	Investment Incentives Group
Section 106 of the Tariff and Customs Code of the Philippines (TCCP)	OSS-Center Form No. 0302 series of 2006	For payment of duties and taxes at the BOC.	Duty Drawback Group

duty and tax rebates on fuel consumption for commercial fisheries operations. Guidelines shall be promulgated within ninety (90) days from the effectivity of this Code by the Department.

Id.

23. Creating A One-Stop-Shop Inter-Agency Tax Credit And Duty Drawback Center (Center) For The Processing Of All Tax Credits And Duty Drawbacks, Defining Its Powers, Duties And Functions, And For Other Purposes, Administrative Order No. 226 (1992).
24. *Pilipinas Shell*, 541 SCRA at 326.
25. Department of Finance Center, Types of Tax Credit Issued, *available at* http://taxcredit.dof.gov.ph/services_ttci.htm (last accessed Aug. 30, 2010).

Section 112 of the National Internal Revenue Code (NIRC)	OSS-Center Form No. 0303 series of 2005	For payment of internal revenue tax, excluding withholding tax, for which the TCC holder is directly liable at the BIR.	Tax and Revenue Group
R.A. No. 7844	OSS-Center Form No. 0301 series of 2005		Investment Incentives Group
Section 9 of R.A. No. 7849	OSS-Center Form No. 0301 series of 2005	Duty Portion: for payment of duties and taxes at the BOC. VAT Portion: for payment of internal revenue tax, excluding withholding tax, for which the TCC holder is directly liable at the BIR.	Investment Incentives Group
Section 35 of R.A. No. 8550	OSS-Center Form No. 0301 series of 2005	Duty Portion: for payment of duties and taxes at the BOC. VAT Portion: for payment of internal revenue tax, excluding withholding tax, for which the TCC holder is directly liable at the BIR.	Investment Incentives Group

II. THE CAUTIONARY TALE: *The Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue Cases*

At present, the Philippine tax credit system is centralized and more organized, thanks in part to the Center's website which offers and provides the necessary assistance to TCC holders. The government's initiative to lobby for such integration was an off-shoot of the controversial tax credit scam which happened in 1995 to the middle of 1998. Media reported that the scam allegedly defrauded the government of ₱ 2,005,000,000.00 in revenues through the illegal utilization of fraudulently obtained TCCs²⁶ and led to the indictment of a former finance assistant secretary, other finance officials and several businessmen for graft charges.²⁷ The subject TCCs appeared to have

26. Iris C. Gonzales, BIR Unit Acts to Prevent Repeat of Tax Credit Scam, *available at*

<http://www.philstar.com/Article.aspx?articleId=519567&publicationSubCategoryId=66> (last accessed Aug. 30, 2010).

27. Edson C. Tandoc, Jr. Raps Filed in Tax Credit Scam: Plunder, Graft, Estafa for P74-M Fraud, *available at* <http://newsinfo>.

been sold to other companies which then used them to pay their tax obligations. It was also reported that the principal suspects in the scam were a husband and wife who owned the companies which sold the TCCs and who are still facing 83 criminal cases pending at the Sandiganbayan. The couple was also charged for plunder before the Office of the Ombudsman, *estafa* thru falsification of public documents, and grave misconduct, among others.²⁸ The couple is said to have evaded arrest by fleeing abroad.²⁹

One of the companies which acquired said TCCs and which was dragged into the dispute was Pilipinas Shell Petroleum Corporation (PSPC). The TCCs involved fall under the first category previously cited, i.e., E.O. No. 226 or the Omnibus Investment Code of 1987, which grants tax credits equivalent to the National Internal Revenue Taxes and Customs duties paid on the supplies, raw materials and semi-manufactured products used in the manufacture, processing or production of export products and forming parts thereof.

PSPC is the Philippine subsidiary of the international petroleum giant Shell³⁰ and is engaged in the business of refining and marketing a wide range of petroleum products. From 1988 to 1997, PSPC paid certain excise tax liabilities using TCCs assigned and transferred to it by entities that, like itself, are registered with the BOI.³¹ The TCC transfers to, and utilization thereof by, PSPC were all approved by the appropriate government agencies, namely the BOI and subsequently, the Center and were all approved, and accepted, by the BIR, as payment of PSPC's excise tax liabilities.³²

How PSPC acquired and used the subject TCCs is described below:³³

[inquirer.net/inquirerheadlinesnation /view/20090320-195150/Raps-filed-in-tax-credit-scam](http://inquirer.net/inquirerheadlinesnation/view/20090320-195150/Raps-filed-in-tax-credit-scam) (last accessed Aug. 30, 2010).

28. BIR asks Canada's help vs. tax credit scam suspects, GMA News TV, available at <http://www.gmanews.tv/story/110563/bir-asks-canada39s-help-vs-tax-credit-scam-suspects> (last accessed Aug. 30, 2010).

29. Tandoc, *supra* note 27.

30. *Pilipinas Shell*, 541 SCRA at 326.

31. *Id.*

32. *Id.* at 327.

33. *Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue*, CTA Case No. 6003, Aug. 2, 2004. (Acosta, J., concurring) (Castañeda, J., dissenting). This decision was penned by the Author.

- (1) PSPC and the transferor executed Deeds of Assignment over the TCCs, subject to the due approval by the relevant government agencies.
- (1) PSPC was advised of the BOI's or the Center's approval of the transfer when the transferor presented to it the TCC, with an annotation by the BOI or the Center of such approval at the reverse side of the TCC.
- (2) PSPC then requested the BOI or the Center for authority to utilize the transferred TCCs as payment of its tax liabilities and thereafter, Tax Debit Memoranda (TDM) were issued by the BOI or the Center to signify such authority.
- (3) Thereafter, PSPC presented the BOI's or the Center's TDMs and the corresponding TCCs to the BIR with written requests for the BIR to accept the transferred TCCs as payment of its excise tax liabilities. The BIR then issued its own TDMs in exchange for the TCCs which it then retained to signify its acceptance of the said TCCs as valid tax payments by PSPC.
- (4) PSPC then requested the BIR Revenue District Office to issue an 'Authority to Accept Payment of Excise Taxes' (ATAPET), which served as the return for excise taxes being paid by PSPC, as well as an instruction to the BIR's Authorized Agent Banks (AABs) to accept PSPC's payments in the form of BIR TDMs and PSPC's checks for any balance or difference between the excise taxes being paid and the BIR TDMs.
- (5) PSPC then tendered/turned over the BIR TDMs and PSPC's checks to the BIR's AABs in full and final payment of the relevant excise taxes, as evidenced by the AAB's stamped acknowledged of receipt on the face of the ATAPET.

PSPC's acceptance of the TCC transfers, and utilization of the same in payment of its excise taxes were never subject to any question or challenge.³⁴ Its involvement surfaced after a post-audit in the mid-1990s which revealed that more than 10 companies were allegedly responsible for defrauding the government of ₱ 2,005,000,000.00 through the fraudulent use of TCCs.³⁵

34. *Id.*

35. *Uy, supra* note 1.

The BIR, believing that PSpC fraudulently purchased TCCs from a number of BOI-registered transferors, assessed PSpC deficiency excise taxes for the taxable years 1992 and 1994 to 1997.³⁶ To prove and establish its innocence, PSpC had no other recourse but to lodge three separate cases against the Commissioner of Internal Revenue (CIR) with the Court of Tax Appeals (CTA).

A. CTA Case No. 5660: The First Round

The first case was docketed as CTA Case No. 5660,³⁷ which stemmed from a collection letter sent by the BIR to PSpC on 22 April 1998, demanding payment of the sum of ₱ 1,705,028,008.06 as unpaid specific taxes for the years 1992 and 1994 to 1997, inclusive of delinquency surcharges and interest.³⁸ The 22 April 1998 collection letter was issued by the BIR and served upon PSpC without a prior pre-assessment and/or assessment notice. Aggrieved, PSpC questioned via a protest letter dated 29 April 1998, the BIR's attempt to collect the above amount.³⁹ Thereafter, PSpC received a reply dated 16 June 1998 signed by the Regional Director of Revenue Region No. 8 of the BIR, denying its protest, and reiterating the demand on PSpC to pay the aforementioned amount of taxes. Eventually, PSpC elevated the matter to the CIR by way of a request for reconsideration dated 9 July 1998.⁴⁰

Before the CIR could act on the request for reconsideration, the Regional Director issued warrants of garnishment against the bank accounts of PSpC. As such, PSpC was constrained to file a Petition for Review with the CTA on 21 July 1998, mainly to suspend the collection of the taxes being collected through the warrants of garnishment.⁴¹ On 22 July 1998, upon request by PSpC, the CIR issued a letter lifting the aforesaid warrants of garnishment. On 16 November 1998, the CTA dismissed said petition for having been prematurely filed in view of

36. *Pilipinas Shell*, 541 SCRA at 327.

37. *Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue*, CTA Case No. 5660, Nov. 16, 1998.

38. *Pilipinas Shell*, 541 SCRA at 327.

39. *Id.*

40. *Pilipinas Shell Petroleum Corporation*, CTA Case No. 6003.

41. *Id.*

PSPC's request for reconsideration (which was deemed an administrative appeal) with the CIR still pending at that time.⁴²

B. CTA Case No. 5728: The Second Round

Because of the inaction of the CIR on PSPC's administrative appeal despite the lapse of the 180-day period provided for under Section 228⁴³ of the Tax Code, PSPC filed on 2 February 1999 a second petition for review, docketed as CTA Case No. 5728.⁴⁴ After trial on the merits, the CTA ruled that the use by PSPC of the TCCs was legal and valid, and the CIR's attempt to collect alleged delinquent taxes and penalties from PSPC without an assessment constitutes a denial of due process.⁴⁵

The *fallo* of the decision⁴⁶ reads as follows:

In the light of all the foregoing, the instant petition for review is granted. The collection letter issued by the Respondent dated 22 April 1998 is considered withdrawn and he is enjoined from any attempts to collect from petitioner the specific tax, surcharge and interest subject of this petition.⁴⁷

Undaunted, the CIR went to the Court of Appeals (CA) *via* a Petition for Review docketed as CA-G.R. SP No. 55329. According to the Supreme Court, this case was consolidated with the similarly situated case of

42. *Id.*

43. TAX REFORM ACT OF 1997, § 228, ¶ 6.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.

Id.

44. *Pilipinas Shell Petroleum Corporation*, CTA Case No. 6003.

45. *Id.*

46. *Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue*, CTA Case No. 5728, July 23, 1999. (This Decision was penned by Justice Amancio Q. Saga with Justices Acosta and De Veyra concurring.)

47. *Pilipinas Shell*, 541 SCRA at 328.

Petron Corporation under CA-G.R. SP No. 55330.⁴⁸ To date, the CA has yet to render a Decision thereon.⁴⁹

C. CTA Case No. 6003: Pilipinas Shell Found Not at Fault

Meanwhile, despite the pronouncement of the CTA in its 23 July 1999 Decision in CTA Case No. 5728 that the “transfers to and utilization by PSPC of the TCCs were valid and legal,”⁵⁰ the Center, in a series of letters to PSPC dated 31 August, 1 September, and 18 October 1999, revived the issue relating to the transfers to and utilization by PSPC of certain TCCs subject of CTA Case No. 5728, by requiring the latter to submit to the Center copies of sales invoices and delivery receipts showing consummation of sale transactions of PSPC’s products to certain TCC transferors, purportedly in connection with an ongoing post-audit of TCC issuances and transfers, under pain of cancellation of the TCC transfers if PSPC fails to comply with the requirement.⁵¹

PSPC requested for time to respond to the said Center letters by way of a letter to the Center dated 29 September 1999 wherein it requested to be given until 29 October 1999 to respond.⁵² In its reply dated 18 October 1999, the Center gave PSPC until 31 October 1999 to file its response. 31 October 1999 being a Sunday, and the next two days being holidays, PSPC’s response was delivered to, and received by the Center on 3 November 1999, which was the deadline granted. In its response, PSPC stated, among other matters, that the requirement to submit the documents mentioned in the Center’s letters and the threatened sanction if PSPC fails to comply, have no legal basis because the applicable law, rules and regulations only require that both transferor and transferee are BOI-registered entities.⁵³ On the very same date (3 November 1999) that the Center received the aforesaid 29 October 1999 response of PSPC, the former wrote a letter dated 3 November 1999 stating that the TDMs enumerated in the list attached

48. *Id.*

49. *Id.*

50. *Pilipinas Shell Petroleum Corporation*, CTA Case No. 5729.

51. *Pilipinas Shell Petroleum Corporation*, CTA Case No. 6003.

52. *Id.*

53. *Id.*

thereto, as well as the corresponding TCCs and TCC transfers had been canceled by the Center.⁵⁴

In a letter dated 4 November 1999, PSPC asked the Center to reconsider the cancellation of the TDMs, related TCCs and their transfers, as set forth in its letter dated 3 November 1999. In said request for reconsideration, PSPC argued that the cancellation was made without the Center having had the opportunity and benefit of considering PSPC's letter response dated 29 October 1999 and without PSPC having been heard on the matter of Center Excom Resolution No. 03-05-99, which PSPC learned of for the very first time through reference thereto made in the 3 November 1999 Center letter. The Center did not reply to PSPC's request for reconsideration.⁵⁵

On 22 November 1999, PSPC received an assessment letter dated 15 November 1999 from the CIR for deficiency excise taxes, surcharge and interest based on the first batch lists of canceled TDMs issued against its TCCs.⁵⁶ PSPC protested the assessment letter which was denied by the BIR, forcing it to file a third petition for review with the CTA, docketed as CTA Case No. 6003.⁵⁷

After trial on the merits, the CTA granted PSPC's petition for review and ruled that "respondent [the CIR] failed to prove with convincing evidence that the TCCs transferred to PSPC were fraudulently issued as respondent's finding of alleged fraud was merely speculative."⁵⁸

The CTA further found that neither the CIR nor the Center could provide "what sales figures were used as basis for the TCCs to issue, as they merely based their conclusions on the audited financial statements of the transferors which did not clearly show the actual export sales of transactions from which the TCCs were issued."⁵⁹

The CTA also held that "the machinery and equipment cannot be the basis in concluding that transferor could not have produced the volume of products indicated in its BOI registration"⁶⁰ and that "the

54. *Id.*

55. *Id.*

56. *Id.*

57. *Pilipinas Shell Petroleum Corporation*, CTA Case No. 6003.

58. *Pilipinas Shell*, 541 SCRA at 330.

59. *Id.*

60. *Id.*

Center erroneously based its findings of fraud on two possibilities: either the transferor did not declare its export sales or underdeclare them. Thus, no specific fraudulent acts were identified or proven. The CTA Division concluded that the TCCs transferred to PSPC were not fraudulently issued.”⁶¹

In the same ruling, the issue on whether or not a TCC transferee should be a supplier of capital equipment, materials, or supplies was also answered. The CTA ruled in the negative, finding that the 29 August 1989 Memorandum of Agreement (MOA) between the DOF and BOI specifying such requirement was not incorporated in the Implementing Rules and Regulations (IRR) of Executive Order No. 226.⁶² According to the CTA, only the 5 October 1982 MOA between the then Ministry of Finance (MOF) and BOI was incorporated in the IRR of EO 226, and while the 29 August 1989 MOA amended the 5 October 1982 MOA, the fact that it was not incorporated in the IRR still remained true. Also, according to the CTA, the 29 August 1989 MOA not being published, “it is ineffective and could not bind nor prejudice third parties.”⁶³

The CTA disposed of the case in this wise: “*In view of all the foregoing, the instant petition is hereby granted. Accordingly, the assessment issued by the respondent dated 15 November 1999 against petitioner is hereby canceled and set aside.*”⁶⁴

D. CTA EB No. 64: A Reversal

Since the ruling of the CTA Division in CTA Case No. 6003 was adverse to the CIR, his next recourse was to file a petition for review with the CTA *en banc*, which was docketed as CTA EB No. 64. This time the CIR won as the CTA *en banc*⁶⁵ reversed the author’s *ponencia* in CTA Case No. 6003 by holding that PSPC was liable to pay the alleged excise tax deficiencies arising from the cancellation of the TDM issued against its

61. *Id.*

62. *Id.*

63. *Id.* at 331.

64. *Pilipinas Shell Petroleum Corporation*, CTA Case No. 6003 (emphasis supplied).

65. *Pilipinas Shell Petroleum Corporation v. Commissioner of Internal Revenue*, CTA EB No. 64, Apr. 28, 2006. (This Decision was penned by Associate Justice Erlinda P. Uy with Justices Castañeda, Casanova, and Palanca-Enriquez concurring; and Justices Bautista and Acosta dissenting.)

TCCs which were used to pay some of its excise tax liabilities for the years 1992 and 1994 to 1997.

The CTA *en banc* made the following disquisition:

First, the finding of the DOF that the TCCs had no monetary value was undisputed. Consequently, there was a non-payment of excise taxes corresponding to the value of the TCCs used for payment. Since it was PSPC which acquired the subject TCCs from a third party and utilized the same to discharge its own obligations, then it must bear the loss.

Second, the TCCs carry a suspensive condition, that is, their issuance was subject to post audit in order to determine if the holder is indeed qualified to use it. Thus, until final determination of the holder's right to the issuance of the TCCs, there is no obligation on the part of the DOF or BIR to recognize the rights of the holder or assignee. And, considering that the subject TCCs were canceled after the DOF's finding of fraud in its issuance, the assignees must bear the consequence of such cancellation.

Third, PSPC was not an innocent purchaser for value of the TCCs as they contained liability clauses expressly stipulating that the transferees are solidarily liable with the transferors for any fraudulent act or violation of pertinent laws, rules, or regulations relating to the transfer of the TCC.

Fourth, the BIR was not barred by estoppel as it is a settled rule that in the performance of its governmental functions, the State cannot be estopped by the neglect of its agents and officers. Although the TCCs were confirmed to be valid in view of the TDM, the subsequent finding on post audit by the Center declaring the TCCs to be fraudulently issued is entitled to the presumption of regularity. Thus, the cancellation of the TCCs was legal and valid.

Fifth, the BIR's assessment did not prescribe considering that no payment took effect as the subject TCCs were canceled upon post audit. Consequently, the filing of the tax return sans payment due to the cancellation of the TCCs resulted in the falsity and/or omission in the filing of the tax return which put them in the ambit of the applicability of the 10-year prescriptive period from the discovery of falsity, fraud, or omission.⁶⁶

Finally, the CTA *en banc* applied the ruling in *Aznar v. Court of Tax Appeals*⁶⁷ where the Supreme Court held that without proof that the taxpayer participated in the fraud, the 50% fraud surcharge is not

66. *Pilipinas Shell*, 541 SCRA at 333-31 (emphasis supplied).

67. *Aznar v. Court of Tax Appeals*, 54 SCRA 519 (1974).

imposed, but the 25% late payment and the 20% interest *per annum* are applicable.⁶⁸

Presiding Justice Ernesto D. Acosta and the Author dissented from the opinion of the majority and stood pat on the Author's *ponencia* in CTA Case No. 6003.

E. G.R. No. 172598: THE FINAL DETERMINATION

Aggrieved by the ruling of the CTA *en banc*, PSPC brought its case to the Supreme Court where it was able to obtain affirmative relief. The Supreme Court reinstated the 2 August 2004 *ponencia* in CTA Case No. 6003 and declared with finality that the assessment of the CIR for deficiency excise taxes against PSPC for 1992 and 1994 to 1997 is "canceled and declared without force and effect for lack of legal basis."⁶⁹

The Supreme Court tackled four issues in its Decision: (1) assessment of excise tax deficiencies; (2) cancellation of TCCs; (3) imposition of surcharges and interests; and (4) non-compliance with statutory and procedural due process.

1. Assessment of Excise Tax Deficiencies

The Supreme Court ruled that the assessment issued by the CIR against PSPC was erroneous and bereft of any factual and legal basis. Thus, it held that the CTA *en banc* made an error in affirming the CIR's assessment.⁷⁰

In overturning the 2 August 2004 Decision of the CTA Division, the Court first held that the CTA *en banc* misapplied Article 1181 of the Civil Code⁷¹ and expounded on the matter as follows:

68. *Pilipinas Shell*, 541 SCRA at 334.

69. *Id.* at 361.

70. *Id.* at 338.

71. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, art. 1181 (1950). Article 1181 provides for the manner of acquisition of rights as well as their extinguishment in conditional obligations: "In conditional obligations, the acquisition of rights, as well as the extinguishment or loss of those already acquired, shall depend upon the happening of the event which constitutes the condition."

Id.

Art. 1181 tells us that the condition is suspensive when the acquisition of rights or demandability of the obligation must await the occurrence of the condition. However, Art. 1181 does not apply to the present case since the parties did NOT agree to a suspensive condition. Rather, specific laws, rules, and regulations govern the subject TCCs, not the general provisions of the Civil Code. Among the applicable laws that cover the TCCs are E.O. 226 or the Omnibus Investments Code, Letter of Instructions No. 1355,⁷² E.O. 765,⁷³ RP-US Military Agreement, Sec. 106 (c) of the Tariff and Customs Code, Sec. 106 of the NIRC, BIR Revenue Regulations (RRs), and others. Nowhere in the aforementioned laws does the post-audit become necessary for the validity or effectivity of the TCCs. Nowhere in the aforementioned laws is it provided that a TCC is issued subject to a suspensive condition.⁷⁴

The Supreme Court did not agree with the CTA *en banc*'s ruling that a condition suspends the effectivity of the TCCs as payment until after the post-audit and declared that the said ruling strains the very nature of a TCC. The TCCs are immediately valid and effective after their issuance.⁷⁵ Said the Supreme Court,

As aptly pointed out in the dissent of Justice Lovell Bautista in CTA EB No. 64, this is clear from the Guidelines and Instructions found at the back of each TCC, which provide:

(1) This Tax Credit Certificate (TCC) shall entitle the grantee to apply the tax credit against taxes and duties until the amount is fully utilized, in accordance with the pertinent tax and customs laws, rules and regulations.⁷⁶

...

(4) To acknowledge application of payment, the One-Stop-Shop Tax Credit Center shall issue the corresponding Tax Debit Memo (TDM) to the grantee.

72. Providing Incentives for Internal Exports, Letter Of Instructions No. 1355 (1983).

73. Temporarily Modifying the Rates of Import Duty on Wheat Under Section 104 of The Tariff And Customs Code Of 1978 (Presidential Decree No. 1464), As Amended, Executive Order No. 765 (2008).

74. *Pilipinas Shell*, 541 SCRA at 338-39.

75. *Id.* at 339.

76. *Id.* at 341 (emphasis supplied).

The authorized Revenue Officer/Customs Collector to which payment/utilization was made shall accomplish the Application of Tax Credit portion at the back of the certificate and affix his signature on the column provided.⁷⁷

The foregoing guidelines cannot be clearer on the validity and effectivity of the TCC to pay or settle tax liabilities of the grantee or transferee, as they do not make the effectivity and validity of the TCC dependent on the outcome of a post-audit. In fact, if we are to sustain the appellate tax court, it would be absurd to make the effectivity of the payment of a TCC dependent on a post-audit since there is no contemplation of the situation wherein there is no post-audit. Does the payment made become effective if no post-audit is conducted? Or does the so-called suspensive condition still apply as no law, rule, or regulation specifies a period when a post-audit should or could be conducted with a prescriptive period? Clearly, a tax payment through a TCC cannot be both effective when made and dependent on a future event for its effectivity. Our system of laws and procedures abhors ambiguity.⁷⁸

The Supreme Court further declared that the very purpose of the TCC would be defeated if the TCCs are considered to be subject to a suspensive condition, in this case post-auditing. There having no guarantee that the government would honor the TCC as payment for taxes, no investor would take the risk of utilizing TCCs without prescribed grounds or limits as to the exercise of said post-audit.⁷⁹

Concluding that the TCCs were not subject to post-audit as a suspensive condition, the Supreme Court ruled that the TCCs

are valid and effective from their issuance. As such, in the present case, if the TCCs have already been applied as partial payment for the tax liability of PSPC, a post-audit of the TCCs cannot simply annul them and the tax payment made through said TCCs. Payment has already been made and is as valid and effective as the issued TCCs. The subsequent post-audit cannot void the TCCs and allow the respondent to declare that utilizing canceled TCCs results in nonpayment on the part of PSPC.⁸⁰

Second, the Supreme Court held that the TCCs were only subjected to conditions found on its face. These are:

77. *Id.* (emphasis supplied).

78. *Id.*

79. *Id.* at 342.

80. *Pilipinas Shell*, 541 SCRA at 342.

- (1) Post-audit and subsequent adjustment in the event of computational discrepancy;
- (2) A reduction for any outstanding account/obligation of herein claimant with the BIR and/or BOC; and
- (3) Revalidation with the Center in case the TCC is not utilized or applied within one year from date of issuance/date of last utilization.⁸¹

The said conditions clearly showed that the post-audit contemplated in the TCCs pertained to computational discrepancies that may have resulted from the transfer and utilization of the TCC and not to their genuineness or validity.⁸²

Third, as regards the post-audit the Center conducted on the transferred TCCs, the Supreme Court ruled that it was misplaced to delve into their issuance and validity on alleged violations by PSPC of the 29 August 1989 MOA between the DOF and BOI. The Supreme Court held that

[a]s may be recalled, the Center required PSPC to submit copies of pertinent sales invoices and delivery receipts covering sale transactions of PSPC products to the TCC assignors/transferrers purportedly in connection with an ongoing post-audit. As correctly protested by PSPC but which was completely ignored by the Center, PSPC is not required by law to be a capital equipment provider or a supplier of raw material and/or component supplier to the transferrers. What the law requires is that the transferee be a BOI-registered company similar to the BOI-registered transferrers.⁸³

Fourth, the Supreme Court did not see the liability clause of the TCCs as a suspensive condition relative to the result of the post-audit. The said liability clause provides that “both the transferor and the transferee shall be jointly and severally liable for any fraudulent act or violation of the pertinent laws, rules and regulations relating to the *transfer* of this tax credit certificate.”⁸⁴

For the Supreme Court, the liability clause clearly provided only for solidary liability relative to the *transfer* of the TCCs from the original grantee to a transferee, and it did not provide that the transferee will be

81. *Id.*

82. *Id.*

83. *Id.* at 343.

84. *Id.* at 346 (emphasis supplied).

liable in case the validity of the TCC issued to the original grantee is impugned or is declared to have been fraudulently procured by the said original grantee.⁸⁵

Thus, the solidary liability, if any, applies only to the sale of the TCC to the transferee by the original grantee. Any fraud or breach of law or rule relating to the issuance of the TCC by the Center to the transferor or the original grantee is the latter's responsibility and liability. The transferee in good faith and for value may not be unjustly prejudiced by the fraud committed by the claimant or transferor in the procurement or issuance of the TCC from the Center. It is not only unjust but well-nigh violative of the constitutional right not to be deprived of one's property without due process of law. Thus, a re-assessment of tax liabilities previously paid through TCCs by a transferee in good faith and for value is utterly confiscatory, more so when surcharges and interests are likewise assessed.⁸⁶

Fifth, the Supreme Court held that "PSPC cannot be blamed for relying on the Center's approval for the transfers of the subject TCCs and the Center's acceptance of the TCCs for the payment of its excise tax liabilities."⁸⁷ PSPC was not faulted in relying on the BIR's acceptance of the TCCs as payment for its excise tax liabilities.

The reliance was found to be supported by the fact that the subject TCCs have passed through stringent reviews starting from the claims of the transferors, their issuance by the Center, the Center's approval for their transfer to PSPC, the Center's acceptance of the TCCs to pay PSPC's excise tax liabilities through the issuance of the Center's TDM, and finally the acceptance by the BIR of the subject TCCs as payment through the issuance of its own TDM and ATAPETs. "Therefore, PSPC cannot be prejudiced by the Center's turnaround in assailing the validity of the subject TCCs which it issued in due course."⁸⁸

Lastly, the Supreme Court held that the Center could no longer cancel the TCCs because the same had already been canceled after being applied to PSPC's excise tax liabilities. When the subject TCCs were accepted by the BIR through the issuance of TDM and the ATAPETs, the subject TCCs were duly canceled.⁸⁹

85. *Id.* (emphasis supplied).

86. *Pilipinas Shell*, 541 SCRA at 346.

87. *Id.*

88. *Id.* at 349.

89. *Id.*

The tax credit of a taxpayer evidenced by a TCC is used up or, in accounting parlance, debited when applied to the taxpayer's internal revenue tax liability, and the TCC canceled after the tax credit it represented is fully debited or used up. A credit is a payable or a liability. A tax credit, therefore, is a liability of the government evidenced by a TCC. Thus, the tax credit of a taxpayer evidenced by a TCC is debited by the BIR through a TDM, not only evidencing the payment of the tax by the taxpayer, but likewise deducting or debiting the existing tax credit with the amount of the tax paid.⁹⁰

...

In the instant case, with due application, approval, and acceptance of the payment by PSPC of the subject TCCs for its then outstanding excise tax liabilities in 1992 and 1994 to 1997, the subject TCCs have been canceled as the money value of the tax credits these represented have been used up. Therefore, the DOF through the Center may not now cancel the subject TCCs as these have already been canceled and used up after their acceptance as payment for PSPC's excise tax liabilities. What has been used up, debited, and canceled cannot anymore be declared to be void, ineffective, and canceled anew.

Besides, it is indubitable that with the issuance of the corresponding Tax Debit Memo (TDM), not only is the TCC canceled when fully utilized, but the payment is also final subject only to a post-audit on computational errors. Under R.R. 5-2000, a TDM is

a certification, duly issued by the Commissioner or his duly authorized representative, reduced in a BIR Accountable Form in accordance with the prescribed formalities, acknowledging that the taxpayer named therein has duly paid his internal revenue tax liability in the form of and through the use of a Tax Credit Certificate, duly issued and existing in accordance with the provisions of these Regulations. *The Tax Debit Memo shall serve as the official receipt from the BIR evidencing a taxpayer's payment or satisfaction of his tax obligation.* The amount shown therein shall be charged against and deducted from the credit balance of the aforesaid Tax Credit Certificate.⁹¹

Thus, with the due issuance of TDM by the Center and TDM by the BIR, the payments made by PSPC with the use of the subject TCCs have been effected and consummated as the TDMs serve as the official receipts evidencing PSPC's payment or satisfaction of its tax obligation. Moreover, the BIR not only issued the corresponding TDM,

90. *Id.* at 350.

91. *Id.* at 351 (citing Rev. Reg. No. 5-2005).

but it also issued ATAPETs which doubly show the payment of the subject excise taxes of PSPC.⁹²

2. Cancellation of TCCs

The Supreme Court held that the CTA *en banc* erred in sustaining the cancellation by the Center of the subject TCCs which PSPC used in paying some of its excise tax liabilities. It explained thus:

The subject TCCs after being fully utilized in the settlement of PSPC's excise tax liabilities have been canceled, and thus cannot be canceled anymore. For being immediately effective and valid when issued, the subject TCCs have been duly utilized by transferee PSPC which is a transferee in good faith and for value.⁹³

The Supreme Court found no reason to rule on the claim that fraud was committed by the TCC claimant. It was pronounced that the issue in the case did not "dwell on the validity of the TCCs procured by the transferor from the Center but on whether fraud or breach of law attended the transfer of said TCCs by the transferor to the transferee."⁹⁴

The finding of the CTA *en banc* that there was fraud in the procurement of the subject TCCs is, therefore, irrelevant and immaterial to the instant petition. Moreover, there are pending criminal cases arising from the alleged fraud. We leave the matter to the anti-graft court especially considering the failure of the affiants to the affidavits to appear, making these hearsay evidence.⁹⁵

3. Imposition of Surcharges and Interests

The Supreme Court ruled that there is no basis for the imposition of late payment surcharges and interests considering that PSPC has duly settled its excise tax liabilities for 1992 and 1994 to 1997 through the legal use of the subject TCCs.⁹⁶

4. Non-Compliance with Statutory and Procedural Due Process

The Supreme Court agreed with PSPC's contention that the CIR violated its statutory and procedural right to due process in the issuance of the assessment. It elucidated in this manner:

92. *Pilipinas Shell*, 541 SCRA at 352.

93. *Id.*

94. *Id.*

95. *Id.* at 353.

96. *Id.* at 357.

While this has likewise been mooted by our discussion above, it would not be amiss to state that PSPC's rights to substantive and procedural due process have indeed been violated. The facts show that PSPC was not accorded due process before the assessment was levied on it. The Center required PSPC to submit certain sales documents relative to supposed delivery of IFOs [Industrial Fuel Oil] by PSPC to the TCC transferors. PSPC contends that it could not submit these documents as the transfer of the subject TCCs did not require that it be a supplier of materials and/or component supplies to the transferors in a letter dated ... [29 October 1999] which was received by the Center on ... [3 November 1999]. On the same day, the Center informed PSPC of the cancellation of the subject TCCs and the TDM covering the application of the TCCs to PSPC's excise tax liabilities. The objections of PSPC were brushed aside by the Center and the assessment was issued by respondent on ... [15 November 1999], without following the statutory and procedural requirements clearly provided under the NIRC and applicable regulations.

What is applicable is R.R. 12-99,⁹⁷ which superseded R.R. 12-85,⁹⁸ pursuant to Sec. 244 in relation to Sec. 245 of the NIRC implementing Secs. 6, 7, 204, 228, 247, 248, and 249 on the assessment of national internal revenue taxes, fees, and charges. The procedures delineated in the said statutory provisos and R.R. 12-99 were not followed by respondent, depriving PSPC of due process in contesting the formal assessment levied against it. Respondent ignored R.R. 12-99 and did not issue PSPC a notice for informal conference and a preliminary assessment notice, as required. PSPC's ... [4 November 1999] motion for reconsideration of the purported Center findings and cancellation of the subject TCCs and the TDM was not even acted upon.⁹⁹

PSPC was merely informed that it is liable for the amount of excise taxes it declared in its excise tax returns for 1992 and 1994 to 1997 covered by the subject TCCs via the formal letter of demand and assessment notice. For being formally defective, the ... [15 November 1999] formal letter of demand and assessment notice is void. Paragraph 3.1.4 of Sec. 3, R.R. 12-99 pertinently provides:

97. Bureau of Internal Revenue, Implements The Provisions Of The National Internal Revenue Code Of 1997 Governing The Rules On Assessment Of National Internal Revenue Taxes, Fees And Charges, Rev. Reg. No. 12-99 (1999).

98. Bureau of Internal Revenue, Rev. Reg. No. 12-85 (1985).

99. *Id.* at 358-59.

3.1.4 Formal Letter of Demand and Assessment Notice. — The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand calling for payment of the taxpayer's deficiency tax or taxes *shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, otherwise, the formal letter of demand and assessment notice shall be void.* The same shall be sent to the taxpayer only by registered mail or by personal delivery.

In short, respondent merely relied on the findings of the Center which did not give PSPC ample opportunity to air its side. While PSPC indeed protested the formal assessment, such does not denigrate the fact that it was deprived of statutory and procedural due process to contest the assessment before it was issued.¹⁰⁰

Not only did PSPC win its tax assessment case in the highest court of the land, but it also achieved victory when its officers were cleared of any involvement in the tax credit scam involving the alleged fraud that the transferors of the subject TCCs perpetrated, *viz.*:

We note in passing that PSPC and its officers were not involved in any fraudulent act that may have been undertaken by the transferors of subject TCCs, supported by the finding of the Ombudsman Special Prosecutor Leonardo P. Tamayo that Pacifico R. Cruz, PSPC General Manager of the Treasury and Taxation Department, who was earlier indicted as accused in OMB-0-99-2012 to 2034 for violation of Sec. 3 (e) and (j) of R.A. 3019,¹⁰¹ as amended, otherwise known as the "Anti-Graft and Corrupt Practices Act," for allegedly conspiring with other accused in defrauding and causing undue injury to the government, did not in any way participate in alleged fraudulent activities relative to the transfer and use of the subject TCCs.

In a Memorandum addressed to then Ombudsman Aniano A. Desierto, the Special Prosecutor Leonardo P. Tamayo recommended dropping Pacifico Cruz as accused in Criminal Case Nos. 25940-25962 entitled *People of the Philippines v. Antonio P. Belicena, et al.*, pending before the Sandiganbayan Fifth Division for lack of probable cause. Special Prosecutor Tamayo found that Cruz's involvement in the transfers of the subject TCCs came after the applications for the transfers had been duly processed and approved; and that Cruz could not have been part of the conspiracy as he cannot be presumed to have knowledge of the irregularity, because the 1989 MOA, which prescribed the additional requirement that the transferee of a TCC should be a supplier of the

100. *Id.* at 360 (emphasis supplied).

101. Anti-Graft And Corrupt Practices Act, Republic Act No. 3019 (1960).

transferor, was not yet published and made known to private parties at the time the subject TCCs were transferred to PSPC. The Memorandum of Special Prosecutor Tamayo was duly approved by then Ombudsman Desierto. Consequently, on ... [31 May 2000], the Sandiganbayan Fifth Division, hearing Criminal Case Nos. 25940-25962, dropped Cruz as accused.¹⁰²

Because of the havoc that the tax credit scam wreaked on the business community, the government was forced to put in place several safeguard measures to prevent it from happening again.¹⁰³

III. CONCLUSION

What happened to PSPC brings to mind the axiom or principle in commerce of *caveat emptor* which is a Latin term meaning “let the buyer beware. It is a general rule of law that a purchaser assumes the risk of his/her purchase. The intent of the rule is to place a duty of care on the buyer in selecting an item and putting forth appropriate inquiry before completing the sale.”¹⁰⁴ In the author’s opinion, the PSPC case should serve as a cautionary tale for TCC holders and transferees alike, who unlike PSPC which was found to be an innocent transferee for value, may find themselves taken advantage of by unscrupulous individuals or firms. As the old adage goes, it is always better to be safe than sorry.

102. *Pilipinas Shell*, 541 SCRA at 353-54.

103. Gonzales, *supra* note 26.

104. BLACK’S LAW DICTIONARY 222 (6th ed. 1990).