

# Defining Falsity of False Returns

Catherine T. Manahan\*

I. INTRODUCTION.....	354
II. BACKGROUND: TAX CODE PROVISIONS .....	356
III. <i>AZNAR V. COURT OF TAX APPEALS</i> .....	360
IV. <i>COMMISSIONER OF INTERNAL REVENUE V. B. F. GOODRICH PHILS., INC.</i> .....	363
V. <i>COMMISSIONER OF INTERNAL REVENUE V. AYALA HOTELS, INC.</i> .....	365
VI. <i>ESTATE OF FIDEL F. REYES V. COMMISSIONER OF INTERNAL REVENUE</i> .....	366
VII. CONCLUSION.....	369

## I. INTRODUCTION

More often than not, whenever the word “tax” is used, it engenders negative vibes, unsavory feelings, and ethical dilemma. People who refuse to comply with their tax obligations honestly or who just outrightly boycott any form of tax payment justify their position by citing the alleged graft and corrupt practices accompanying the tax collection process and the inadequate, if not misguided, allocation and utilization of the tax proceeds by the government.

The traditional role of taxation is to provide the major source of revenues for the running of government operations.<sup>1</sup> In addition, it can also

---

\* '84 LL.B., University of the Philippines College of Law. The author is currently a Tax Director of Isla Lipana & Co., the Philippine member firm of PricewaterhouseCoopers global network, and a senior legal advisor of Cabrera Lavadia & Associates. She was the president of the Tax Management Association of the Philippines, Inc. in 1999 and has several published works in BusinessWorld, Asia Today International, and Practical Asian Tax Strategies.

This Article is an expansion of the author’s work, *The Falsity of False Returns*, which was published in the October/November 2006 issue of the Client Advisory Letter, a regular publication of Isla Lipana & Co.

*Cite as* 55 ATENEO L.J. 354 (2010).

1. JOAQUIN G. BERNAS, S.J., *THE 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES: A COMMENTARY* 800 (2009 ed.).

serve as a social equalizer by helping close the gap between the rich and the poor through a progressive system of taxation<sup>2</sup> that imposes higher tax rates on those belonging to the upper income bracket;<sup>3</sup> exempts those marginal income earners below from paying any income tax;<sup>4</sup> and encourages donations to charitable and social welfare groups to democratize wealth by granting tax exemptions and tax deduction incentives to donors.<sup>5</sup> Furthermore, it can also be a moral tool in helping curb social sins such as alcoholism or nicotine addiction by imposing prohibitive excise taxes on the domestic consumption of alcohol and cigarettes,<sup>6</sup> at least in the ideal plane, because in reality, even the common *tao* will still set aside an amount from their meager earnings to indulge in these vices in order to escape from their poverty-stricken existence.

Given the multifarious role of taxation in the conduct of civil society, the Tax Code<sup>7</sup> contains punitive provisions to discourage any act that will undermine the correct and timely collection and payment of taxes such as the non-availability of injunction to restrain tax collection,<sup>8</sup> and the

- 
2. PHIL. CONST. art. VI, § 28, ¶ 1. This section provides that the “rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation.”  
*See also* BERNAS, *supra* note 1, at 800 (“The explicit mention of progressive taxation in this provision reflects the wish of the Convention that the legislature, following the social justice command[,], should use the power of taxation as an instrument for a more equitable distribution of wealth.”).
  3. *See, e.g.* An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424, § 24 (1997).
  4. *See* An Act Amending Sections 22, 24, 34, 35, 51, and 79 of Republic Act No. 8242, As Amended, Otherwise Known as The National Internal Revenue Code of 1997, Republic Act No. 9504, § 2 (2008) (“[M]inimum wage earners as defined in Section 22 (HH) of this Code shall be exempt from the payment of income tax on their taxable income.”).
  5. *See, e.g.* TAX REFORM ACT OF 1997, § 34 (H).
  6. *See* An Act Increasing the Excise Tax Rates Imposed on Alcohol and Tobacco Products, Amending for the Purpose Sections 131, 141, 142, 143, 144, 145, and 288 of the National Internal Revenue Code of 1997, As Amended [Sin Tax Law], Republic Act No. 9334 (2004).
  7. Tax Code as used in this Article refers to the TAX REFORM ACT OF 1997, as amended.
  8. TAX REFORM ACT OF 1997, § 218. This section provides:  
SEC. 218. Injunction not Available to Restrain Collection of Tax. — No court shall have the authority to grant an injunction to restrain the collection of any national internal revenue tax, fee or charge imposed by this Code.

imposition of fines, interest, surcharge, and even [the] criminal penalty of imprisonment once there is final conviction.<sup>9</sup> To balance this otherwise lopsided pro-government slant in the tax law, the statute of limitations, or what is commonly known as the period of prescription,<sup>10</sup> is also provided in the Tax Code to ensure a fair and rational interplay between the right of the government to assess and collect tax, on the one hand, and the right of the taxpayer to be spared from endless tax investigations of relentless revenue examiners, on the other hand.

This Article will attempt to analyze, examine, and critique the interplay of these Tax Code provisions on penalties and prescription, and how they were interpreted by our legal luminaries on the bench based on selected Supreme Court, Court of Appeals (CA), and Court of Tax Appeals (CTA) decisions.

## II. BACKGROUND: TAX CODE PROVISIONS

Filing of tax returns and payment of taxes do not mark the end of the compliance by taxpayers. They are further exposed to the next stage which is the conduct of tax investigation by the Bureau of Internal Revenue (BIR) after the tax filing and payment phase.<sup>11</sup> At this stage, the relevant issue to

---

9. See TAX REFORM ACT OF 1997, Title X — Statutory Offenses and Penalties.

10. Generally, internal revenue taxes shall be *assessed* within three years after the last day for filing of the return, or if filed beyond the period prescribed by law, from the day the return was filed. Any internal revenue assessed within the period of limitation may be *collected* within five years following such assessment. See TAX REFORM ACT OF 1997, §§ 203 & 222.

11. TAX REFORM ACT OF 1997, § 5. This section provides:

SEC. 5. *Power of the Commissioner to Obtain Information, and to Summon, Examine, and Take Testimony of Persons.* — In ascertaining the correctness of any return, or in making a return when none has been made, or in determining the liability of any person for any internal revenue tax, or in collecting any such liability, or in evaluating tax compliance, the Commissioner is authorized:

- (A) To examine any book, paper, record, or other data which may be relevant or material to such inquiry;
- (B) To obtain on a regular basis from any person other than the person whose internal revenue tax liability is subject to audit or investigation, or from any office or officer of the national and local governments, government agencies and instrumentalities, including the Bangko Sentral ng Pilipinas and government-owned or -controlled corporations, any information such as, but not limited to, costs and volume of production, receipts or sales and gross incomes of taxpayers, and the names, addresses, and financial statements of corporations, mutual fund companies, insurance companies, regional operating headquarters of multinational

consider for both the BIR and the taxpayer is the period within which the BIR can exercise its right to assess and collect internal revenue taxes for a particular taxable period.

Tax assessment and collection are governed by a legal time capsule called statute of limitations or period of prescription. The statute of limitations is generally defined as an enactment which limits or restricts the time within which an action may be brought.<sup>12</sup> Its purpose is “to suppress fraudulent and stale claims from springing up at great distances of time and surprising the parties or their representatives when the facts have become obscure from the lapse of time or the defective memory or death or removal of witnesses.”<sup>13</sup>

The general period of prescription for tax assessment and collection is embodied in Sections 203, 222, and 223 of the Tax Code, which are partly quoted below:

SEC. 203. Period of Limitation upon Assessment. — Except as provided in Section 222, *internal revenue taxes shall be assessed within three (3) years* after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case

---

companies, joint accounts, associations, joint ventures of consortia and registered partnerships, and their members;

- (C) To summon the person liable for tax or required to file a return, or any officer or employee of such person, or any person having possession, custody, or care of the books of accounts and other accounting records containing entries relating to the business of the person liable for tax, or any other person, to appear before the Commissioner or his duly authorized representative at a time and place specified in the summons and to produce such books, papers, records, or other data, and to give testimony;
- (D) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry; and
- (E) To cause revenue officers and employees to make a canvass from time to time of any revenue district or region and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care, management or possession of any object with respect to which a tax is imposed.

The provisions of the foregoing paragraphs notwithstanding, nothing in this Section shall be construed as granting the Commissioner the authority to inquire into bank deposits other than as provided for in Section 6(F) of this Code.

12. 4 ARTURO M. TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES 36 (2002).

13. *Sinaon v. Sorongon*, 136 SCRA 407, 410 (1985).

where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed.<sup>14</sup>

SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. — (a) *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 ten (10) years after the discovery of the falsity, fraud or omission.*<sup>15</sup>

SEC. 223. Suspension of Running of Statute of Limitations. — The running of the Statute of Limitations provided in Sections 203 and 222 on the making of assessment and the beginning of distraint or levy or a proceeding in court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or levy or a proceeding in court and for sixty (60) days thereafter; when the taxpayer requests for a reinvestigation which is granted by the Commissioner; when the taxpayer cannot be located in the address given by him in the return filed upon which a tax is being assessed or collected.<sup>16</sup>

The purpose and rationale behind the statute of limitations has been well expounded in *Commissioner of Internal Revenue v. B. F. Goodrich*<sup>17</sup> wherein the Court ruled:

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. 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.*<sup>18</sup>

A corollary provision dealing with false or fraudulent returns and thereby imposing a 10-year period of limitation of assessment is found in Section 248(B) of the Tax Code and is quoted herein:

SEC. 248. Civil Penalties. —

...

(B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: Provided, That a substantial under declaration of taxable sales, receipts or

14. TAX REFORM ACT OF 1997, § 203 (emphasis supplied).

15. *Id.* § 222 (emphasis supplied).

16. *Id.* § 223.

17. *Commissioner of Internal Revenue v. B.F. Goodrich*, 303 SCRA 546 (1999).

18. *Id.* at 554 (emphasis supplied).

income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute *prima facie* evidence of a false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (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 herein.<sup>19</sup>

Given the double punitive measures slapped against a taxpayer who declares a false return, namely, (1) the extension of the period of prescription from three to 10 years and (2) the imposition of a 50% surcharge on the tax paid, the need to understand the concept and underlying characteristics of a false return in contrast with a fraudulent one becomes more compelling and acquires paramount importance. The discussion that ensues attempts to analyze and critique selected jurisprudence on the application of these twin sanctions of extended period of prescription and 50% surcharge on false and/or fraudulent tax returns.

### III. *AZNAR V. COURT OF TAX APPEALS*

The case of *Aznar v. Court of Tax Appeals*<sup>20</sup> involves a taxpayer who was assessed with deficiency income tax for six consecutive taxable years (i.e., 1946 to 1951) due to his gross under-declaration of taxable income.<sup>21</sup> Utilizing the net worth and expenditure method of tax investigation, the BIR discovered a glaring disparity between the net worth and the taxable income of the taxpayer for those covered years, yielding an under-declaration of his income by 227% for 1946, 564% for 1947, 95% for 1948, 486% for 1949, 2,946% for 1950 and 490% for 1951.<sup>22</sup> These substantial under-declarations of income for six consecutive years were noted by the court and were made the indicia of the falsity of the income tax returns, which led to the first issue of the case as to whether or not it warranted the application of the longer period of prescription, i.e., 10 years, as against the five-year period (now three years).<sup>23</sup> The taxpayer in this case argued that Section 332 (now Section 222) of the Tax Code does not apply because the taxpayer did not file false and fraudulent returns with intent to evade tax.<sup>24</sup> The BIR answered and the Court upheld that the very “substantial under-declarations of income for six consecutive years eloquently demonstrate the

---

19. TAX REFORM ACT OF 1997, § 248 (B) (emphasis supplied).

20. *Aznar v. Court of Tax Appeals*, 58 SCRA 519 (1974).

21. *Id.* at 523.

22. *Id.* at 541.

23. *Id.* at 531.

24. *Id.*

falsity or fraudulence of the income tax returns with an intent to evade the payment of tax.”<sup>25</sup> Furthermore, the Court expounded on the concept of false returns as being distinct from fraudulent returns with intent to evade taxes, as contemplated under the pertinent section of the Tax Code.<sup>26</sup> The Court ruled that:

We believe that the proper and reasonable interpretation of said provision should be that *in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely — ‘falsity,’ ‘fraud[,]’ and ‘omission.’ That there is a difference between “false return” and “fraudulent return” cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.*<sup>27</sup>

Based on this decision, the Court has categorized wrongful entries, intentional or unintentional, or mistakes made, whether in good faith or in bad faith, appearing on the face of tax returns, as “falsity” which constitutes a legal ground for the imposition of the 10-year period of prescription. Thus, on the strength of the *Aznar* doctrine, BIR examiners conducting regular tax audits, who, logically and as a matter of course, would always come up with tax findings of either under-declaration of income or over-declaration of deductions, or both, for example, could mercilessly raise the argument of false return giving rise to the 10-year period of prescription. The result would be a biased, irregular, inconsistent, and lackadaisical implementation of the statutory principle that the statute of limitations is a remedial measure, and therefore, should be strictly construed against the taxing authority and liberally in favor of the taxpayer as pronounced in the *B.F. Goodrich*. A speedy resolution of contentious issues between the taxpayer and the BIR, which are obvious from the face of the returns, may be wanting and far from happening within the three-year period of prescription. Thus, adopting this definition of a false return as simply a “deviation from the truth, whether intentional or unintentional,”<sup>28</sup> and using this criterion for purposes of imposing the 10-year statute of limitations can be highly prejudicial to the fundamental rights of the taxpayer, particularly the right to a speedy disposition of cases.

---

25. *Id.* at 532.

26. *Aznar*, 58 SCRA at 532.

27. *Id.* (emphasis supplied).

28. *Id.* at 532.

*Aznar* also tackled the issue on the imposition of the 50% surcharge on the deficiency income taxes attributable to the false returns as earlier described.<sup>29</sup> The argument of the taxpayer was that there may have been false returns filed due to the mistakes of his accountant employees, but there were no proven fraudulent returns with intent to evade taxes on his part which would warrant the imposition of the fraud penalty of 50% surcharge.<sup>30</sup> The Court went into the details of the falsity in order to resolve the question as to whether fraud can be deduced from the substantial disparity of incomes which characterized the said false returns.<sup>31</sup> After concluding that it was not only the taxpayer who committed mistakes in his reporting of income but also the Commissioner of Internal Revenue in his use of the inventory method of tax investigation,<sup>32</sup> the Court eliminated the 50% fraud penalty and imposed only the five per cent (now 25%) surcharge,<sup>33</sup> expounding that:

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 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 ... It must amount to intentional wrongdoing with the sole object of avoiding the tax. It necessarily follows that a mere mistake cannot be considered as fraudulent intent.<sup>34</sup>

If one were to examine the seemingly contradictory position that the Court took here, i.e., a loose interpretation of "false return" on the imposition of the longer period of prescription from five to 10 years, on the one hand, and a rigid stance on the application of fraud penalty of 50% for such false returns, on the other hand, there is a need to search for a reconciling principle so as to rationalize this dualistic, bipolar approach.

---

29. *Id.* at 541.

30. *Id.*

31. *Id.* at 542.

32. *Id.*

33. *Aznar*, 58 SCRA at 543.

34. *Id.* at 542-43 (emphasis supplied).

IV. *COMMISSIONER OF INTERNAL REVENUE v. B. F. GOODRICH PHILS., INC.*

The case of *Commissioner of Internal Revenue v. B.F. Goodrich Phils., Inc.*<sup>35</sup> is an illuminating case on the softening of the Court's stance on the scope and coverage of "false return" in contrast with the *Aznar* experience. As a background, the taxpayer in this case sold a piece of real property at a price which was lower than its declared fair market value (FMV).<sup>36</sup> The final assessment notice of the BIR was issued beyond the normal three-year statute of limitations.<sup>37</sup> Hence, the taxpayer raised the defense of prescription.<sup>38</sup> The BIR, however, countered that since the taxpayer filed a false return, which is attributable to the selling price being lower than the FMV, then the prescriptive period is 10 years instead of three years.<sup>39</sup> Ruling on the falsity arising from the selling price lower than its declared market value, the Court held that:

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. In the present case, the private respondent was compelled to sell the property even at a price less than its market value, because it would have lost all ownership rights over it upon the expiration of the parity amendment. In other words, private respondent was attempting to minimize its losses.

...

[T]he fact that private respondent sold its real property for a price less than its declared 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.*

...

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,*

---

35. *B.F. Goodrich*, 303 SCRA 546 (1999).

36. *Id.* at 550.

37. *Id.*

38. *Id.* at 552.

39. *Id.* at 555.

*considering that the prescriptive period was precisely intended to give them peace of mind.*<sup>40</sup>

What remarkably stand out from the foregoing *ratio decidendi* of the case are the defense of the taxpayer against the charge of falsity that was recognized by the court and the failure of the BIR to clearly prove that the taxpayer filed a fraudulent return with intent to evade tax. Departure from the BIR-prescribed formula for FMV such as the zonal value for real properties does not necessarily result in a false declaration if there is a *bona fide* purpose for such a decision. Contractual decisions made by parties that may result in lower tax payables do not automatically fall under falsity leading to the status of a false return, especially if the same are not underlain by any willful or deliberate intent to evade taxes. Other examples that can justify a lower selling price for properties include instances when such properties are occupied by squatters or if the party selling is in a hurry to dispose of such properties since he is migrating out of the country. Thus, the *Aznar* doctrine, which generally defined “false return” as any deviation from the truth, whether intentional or not, has undergone some rational ramifications and delimitations.

Another interesting point notable from *B.F. Goodrich* was the observation of the Court that there were public records available on the FMV of the property which the BIR could have easily accessed within the regular five-year (now three) prescriptive period to assail the selling price that was declared by the taxpayer in the tax return.<sup>41</sup> BIR did not have to wait for 10 years to issue the assessment against the taxpayer over this alleged underpayment of taxes since such falsity was obvious, an observation which could, in context, be reconciled with the following court ratiocination in the *Aznar*, to wit:

The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the [Tax Code] should be applicable to normal circumstances, but *whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent returns intended to evade payment of tax or failure to file returns, the period of ten years provided for ... from the time of discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.*<sup>42</sup>

Thus, reconciling *Aznar* and *B.F. Goodrich* on the applicability of the 10-year prescriptive period to false returns, one can surmise and safely conclude that only if the falsity is of such nature that it could not be easily recognized by the revenue examiners or lawful agents from the face value of the tax

---

40. *Id.* at 555-57 (emphasis supplied).

41. *B.F. Goodrich*, 303 SCRA at 556.

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

returns nor evaluated against available public documents and basic provisions of the law, and thus depriving the BIR from coming up with a valid and accurate tax assessment leading to a correct revenue collection for the government, will such falsity give rise to the application of the 10-year prescriptive period versus the normal three-year period. Interestingly, the Court in *B.F. Goodrich* also included the absence of any fraudulent return with intent to evade tax as another reason for upholding the three-year prescriptive period, thus dismissing the BIR's appeal on the ground of prescription.

V. *COMMISSIONER OF INTERNAL REVENUE v. AYALA HOTELS, INC.*

The case of *Commissioner of Internal Revenue v. Ayala Hotels, Inc.*,<sup>43</sup> which was decided by the Court of Appeals, involves a deficiency income tax assessment issued against the taxpayer for failure to report in its income tax return (ITR) the rental income from improvements introduced by its lessees.<sup>44</sup> The Final Assessment Notice was issued only after five and a half years from the time the taxpayer filed its ITR.<sup>45</sup> The regulation allegedly violated here was Section 49 of Revenue Regulations No. 2 which requires, among others, the lessor to report as income the FMV of the completed buildings or improvements on its leased property.<sup>46</sup> Thus, the taxpayer raised the issue of prescription as a defense, but the BIR, citing the *Aznar* doctrine, countered with the application of the 10-year period due to the false return filed by the taxpayer, the falsity being derived from the alleged unreported rental income.<sup>47</sup> BIR's position was that this unreported income can be legally considered a fraudulent act with intent to evade tax and that even if there was no willful intent to understate its rental income, the mere filing of a false return even without any intent to evade tax is embraced by the 10-year prescriptive period, citing *Aznar*.<sup>48</sup>

The CA aptly ruled as follows:

Reliance on the *Aznar* ... with regard to the issue of prescription is misplaced. Although in the said case, the Supreme Court ruled that a 'false return' merely implies a deviation from the truth, whether intentional or not, such pronouncement should not be given a sweeping application in all cases where a mistake in ITR entries are made by taxpayers. Otherwise, any mistake, however slight, in a return filed by a taxpayer in good faith

---

43. *Commissioner of Internal Revenue v. Ayala Hotels, Inc.*, CA-G.R. SP No. 70025, Apr. 19, 2004.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

would justify the application of the ten-year prescriptive period for assessment. Consequently, the protection provided for under Section 203 of the [Tax Code] is rendered nugatory. *Logically therefore, not all “false returns” would call for an application of Section 222 of the [Tax Code]. Only “false returns” which are filed by a taxpayer with intent to evade tax should warrant an application of the ten-year prescriptive period.*

In order to render a return made by a taxpayer a ‘false return’ within the meaning of Section 222 of the Tax Code, *there must appear a design to mislead or deceive on the part of the taxpayer, or at least culpable negligence.* A mistake, not culpable in respect of its value, would not constitute a false return.<sup>49</sup>

The case held that there is a false or fraudulent return if any of the following are present:

- (1) There is *intentional* substantial under-declaration of income.
- (2) There is *intentional* overstatement of deductions.
- (3) There is *intentional* under-declaration of selling price and overvaluation of cost or property sold.
- (4) *Recurrence* of the understatement of income or overstatement of deductions for more than one taxable year.<sup>50</sup>

This Court upheld the CA decision in its Minute Resolution dated 11 April 2005 in *Commissioner of Internal Revenue v. Ayala Hotels, Inc.*<sup>51</sup> Said resolution was not an adjudication on the merits but merely a declaration that the judgment sought to be reviewed has now become final and executory.<sup>52</sup>

The question now to resolve is whether the *Ayala Hotels* ruling can be deemed the later jurisprudence on the legal interpretation of “false return,” and thus, supersedes the *Aznar* doctrine. More specifically, the issue is whether a minute resolution of the Court can be considered a judicial

---

49. *Ayala Hotels*, CA-G.R. SP No. 70025, Apr. 19, 2004 (emphasis supplied).

50. *Id.* (citing BENJAMIN D. TEODORO & HECTOR S. DE LEON, *THE LAW ON INCOME TAXATION* 496-97 (9th ed. 1998)). *See also* *Commissioner of Internal Revenue v. Ayala Securities Corporation*, 70 SCRA 204, 209-10 (1976) (It was held that “(f)raud is a question of fact and the circumstances constituting fraud must be alleged and proved in the court below ... Fraud is never lightly presumed because it is a serious charge.”).

51. *Commissioner of Internal Revenue v. Ayala Hotels, Inc.*, G.R. No. 163595, Apr. 11, 2005 (Minute Resolution).

52. *Id.*

decision, and therefore forms part of the law of the land under Article 8 of the Civil Code of the Philippines.<sup>53</sup>

In *Joaquin-Agregado v. Yamat*,<sup>54</sup> the Court ruled squarely on this matter, as follows:

The Supreme Court is not compelled to adopt a definite and stringent rule on how its judgment shall be framed. It has long been settled that this Court has the discretion to decide whether a ‘minute resolution’ should be used in lieu of a full-blown decision in any particular case ... *A minute resolution denying a petition for review of a decision of the CA can only mean that the Supreme Court agrees with or adopts the findings and conclusions of the CA, and deems the CA decision as correct.*<sup>55</sup>

#### VI. ESTATE OF FIDEL F. REYES v. COMMISSIONER OF INTERNAL REVENUE

Contrary to the earlier proposition that this Author suggested, the case of *Estate of Fidel F. Reyes v. Commissioner of Internal Revenue*,<sup>56</sup> which is a relatively recent CTA case on false returns, relied on the *Aznar* doctrine in resolving the issues on the applicability of 10-year prescriptive period and the imposition of the 50% fraud penalty instead of the *Ayala Hotels* ruling. Unlike the earlier cases which involved deficiency income tax assessments, this case pertains to deficiency estate taxes imposed on the estates of spouses Fidel and Teresita Reyes.<sup>57</sup> The falsity surrounding the estate tax returns is attributed to a number of factors such as the wrong interpretation and application of the vanishing deductions in the computation of the estate tax liability of each of the parties concerned, the erroneous classification of the properties into conjugal or paraphernal/capital, and the failure to claim standard deductions, among others.<sup>58</sup> The returns, just like in *Aznar*, have been prepared by an accountant.<sup>59</sup> Yet despite such factual scenario where some of the mistakes committed by the taxpayers even benefited the tax authority (e.g., inclusion of some properties in the return that have already been subjected to the Comprehensive Agrarian Reform Program (CARP) and turned over to the government, failure to claim the standard deductions

---

53. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, art. 8 (1950) (“Judicial decisions applying or interpreting the laws or the Constitution shall form a part of the legal system of the Philippines.”).

54. *Joaquin-Agregado v. Yamat*, G.R. No. 181107, Mar. 20, 2009 (Minute Resolution).

55. *Id.* (emphasis supplied).

56. *Estate of Fidel F. Reyes v. Commissioner of Internal Revenue*, CTA EB Case No. 189, CTA Case No. 6747, Mar. 21, 2007.

57. *Id.*

58. *Id.*

59. *Id.*

and family home deductions, etc.), the court was strictly applying the *Aznar* doctrine, to wit:

In this case, petitioners, in fact, candidly stated in their Petition for Review that they committed mistakes in the interpretation of the law and in the declaration of the property that made the estate tax return filed a false return, but maintained that these mistakes were done in good faith. *However, the law does not make any qualification as to the falsity of the return which would render the return a 'false return.'* *The law does not distinguish a false return made in good faith or false return made in bad faith, as long as a false return is filed, the taxpayer is covered by Section 222 (a) [of the Tax Code].*

...

*Moreover, the errors committed by petitioners, even considering that it was a simple mistake or a mere oversight, cannot be disregarded because of the substantial amount of deficiency in the estate tax.*<sup>60</sup>

A deeper study of this case reveals that the factor used by the CTA in upholding the application of the 10-year prescriptive period on the false return, despite the lack of any willful intent to defraud the government by the taxpayers, was the substantial amount of unpaid deficiency estate tax that resulted from such errors or mistakes committed by them, citing Section 248(B) of the Tax Code. If one examines thoroughly the provisions of the aforementioned Section 248(B), this pertains to the imposition of the 50% fraud penalty and not to the application of the 10-year prescriptive period.

Reviewing the criteria laid down by the earlier cases, i.e., that only if the false returns were filed by the taxpayer with the intent to evade tax that the 10-year prescriptive period should be imposed (*Ayala Hotels*); that if the falsity was obvious on the face of the returns and public records were accessible, then the five-year period to assess would suffice (*B.F. Goodrich*); and that whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities, then the 10-year period of prescription must apply (*Aznar*), the current case squarely meets the *Ayala Hotels* and *B.F. Goodrich* criteria for the non-applicability of the 10-year prescriptive period. The BIR in *Estate* could have easily deduced the errors on the face of the return and from the available records supporting the initial tax computation by the taxpayers. The government was also not placed at a disadvantage since nothing was preventing the BIR from arriving at its correct tax assessment within the three-year prescriptive period. The resulting underpayment of taxes due to the wrong interpretation and application of the law on vanishing deductions, for example, an item of tax deduction that is not easily comprehensible to ordinary mortals dealing with taxes, could have been easily marked and noted by the BIR during the three-year period without need to wait out the full 10-year prescriptive

---

60. *Id.* (emphasis supplied).

period to assess. It is the position of this Author that even if there was underpayment of taxes attributable to an overstatement of deductions due to a mistake or erroneous application of the provisions of law and not a deliberate and intentional intent to evade the payment of taxes, the normal prescriptive period of the years should still be observed. As the CA held in *Ayala Hotels* to wit:

In order to render a return made by a taxpayer a ‘false return’ within the meaning of Section 222 of the Tax Code, there must appear, a *design to mislead or deceive on the part of the taxpayer, or at least culpable negligence*. A mistake, not culpable in respect of its value would not constitute a false return.<sup>61</sup>

Analyzing again the *Estate* decision in the light of the immediately aforequoted ruling in *Ayala Hotels*, it could be deduced that if an understatement of income or overstatement of deductions in the tax return resulted in a substantial impairment in the amount of taxes collected by the government, this could be considered a mistake culpable in respect of its value, thus rendering such false return subject to the 10-year period of prescription under Section 222 of the Tax Code.

As to the imposition of the 50% penalty on these false estate tax returns, the CTA agreed with the taxpayer on its non-applicability to the case at hand, and ruled that:

Section 248(B) imposes the surcharge of fifty percent (50%) only in two instances. First, in case of willful neglect to file the return within the period prescribed, and second, in case a false or fraudulent return is willfully made. Thus, it is not enough that the taxpayer failed to file the required tax return or that the return is false to justify the imposition of the 50% for fraud. The law is clear that a “false or fraudulent return is willfully made.” It must be emphasized that *respondent did not present evidence to directly prove that there was a willful intention on the part of the petitioners to evade the payment of taxes*. What is evident in this case is the negligence and mistake of the petitioners in the interpretation of the law that caused the deficiencies found by the respondent in this assessment ... *The government was not induced to give up some legal right and place itself at a disadvantage so as to prevent its lawful officers from proper assessment of tax liabilities because petitioners did not conceal anything. Error or mistake of law is not fraud.*

...

[I]t is evident that the *false return was not willfully made, hence, petitioners should not be held liable for the 50% surcharge under Section 248(B)*.<sup>62</sup>

---

61. *Ayala Hotels*, CA-G.R. SP No. 70025, Apr. 19, 2004 (emphasis supplied).

62. *Estate of Fidel F. Reyes*, CTA EB Case No. 189, CTA Case No. 6747, Mar. 21, 2007 (citing *Commissioner of Internal Revenue v. Javier, Jr.*, 199 SCRA 831-32 (1991)) (emphasis supplied).

## VII. CONCLUSION

The jurisprudence on “false return” is continually evolving. This Article is a modest attempt to understand its historical evolution as to its definition and application vis-à-vis the critical concepts of statute of limitations/period of prescription and the fraud penalty which materially affect the bill of rights of the taxpayers. Hopefully, the discussion of the parameters and delimitations laid down by the selected court decisions in refuting the imposition of the 10-year prescriptive period and/or the 50% fraud penalty will equip the taxpayers in coping with tax assessment notices that may carry these items. Fiscal adequacy is without doubt vital to a sustainably efficient and effective government. Hitting the revenue targets, however, must be balanced by the other equally important tax administration principles of administrative feasibility and equity or theoretical justice. Taxpayers are entitled to a modicum of respect and due process lest the BIR forgets the underlying rationale for public service.