UNDERSTANDING TAXPAYER'S RIGHTS UNDER THE RUN AFTER TAX EVADERS (RATE) PROGRAM

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INTRODUCTION

I believe all of us have experienced the unpleasant and arduous task of lining up in long queues in government offices for the submission of an application, or after waiting for several hours, then being told to come back the following day just to complete a rather simple ministerial transaction. During these moments, we would wish that government services would somehow be more efficient and less burdensome.

The Tax Code has several provisions that afford protection against the governmental power to tax. There is Section 228, which mandates that the taxpayer be informed in writing of the law and the facts on which the assessment against the taxpayer is made; otherwise, the assessment shall be void. There is also Section 246, which espouses the non-retroactivity of rules, regulations or rulings of the Bureau of Internal Revenue (BIR) if the implementation thereof will prejudice taxpayers, subject to a few exceptions. But perhaps the most important of the protections offered by the Tax Code are those relating to unreasonable examinations. The Tax Code assures a taxpayer "that he will no longer be subjected to further investigation for taxes after the expiration of a reasonable period of time."

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[2] These safeguards are found in Sections 203 and 235 of the Tax Code.

Section 203 of the Tax Code provides that except for the following cases, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of a tax return and, no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period:[3]

(a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return;[4] and

(b) If before the expiration of the three-year period, both the Commissioner and the taxpayer have agreed in writing to its extension.

On the other hand, Section 235 of the Tax Code mandates taxpayers to preserve their books of accounts and other accounting records only until the last day prescribed in Section 203 (three years) except in the following instances:

(a) In case of fraud, irregularity or mistakes, as determined by the BIR Commissioner;

(b) The taxpayer requests for a reinvestigation;

(c) To verify compliance with withholding tax laws and regulations;

(d) To verify capital gains tax liabilities; and

(e) As part of the exercise of the Commissioner's power to obtain information from other persons.

Outside of this three-year period, the taxpayer may dispose of these records as it pleases. The same Section 235 provides that, for income tax purposes, the BIR examination and inspection shall be made only once in a taxable year, subject to the same exceptions discussed above.

The RATE Program

In 2005, the Department of Finance and BIR launched the Run After Tax Evaders (RATE) Program. The objective of the program is to investigate criminal violations of the Tax Code and make tax evaders pay for the taxes due the government. Under this program, the BIR was able to file several criminal cases against media personalities and prominent businessmen. Some of these cases were dismissed by the courts due to the failure of the BIR to prove intent to evade, an important element in tax evasion cases.

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[2] Commissioner of Internal Revenue v. BASF Coating + Inks Phils., Inc., G.R. No. 198677, 26 November 2014 citing Bank of the Philippine Islands v. Commissioner of Internal Revenue, G.R. No. 139736, 17 October 2005.

[3] In a case 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. (Sec. 203)

[4] In such case, the period to assess is extended to ten (10) year from discovery of the fraud or failure to file the return.

Three years later, the BIR issued Revenue Memorandum Order (RMO) No. 24-2008, laying down the policies and guidelines for the RATE cases. Through RMO 24-2008, the BIR explained the rationale for the implementation of the RATE program. It said:

> "Before the inception of the RATE Program, the emphasis on the tax enforcement policy has always been on assessment and collection of taxes. The criminal aspect of any violation of internal revenue laws and regulations was not pursued as long as the taxpayers paid the taxes assessed against them. As such, upon payment and collection of the deficiency taxes, the cases against such erring taxpayers are usually withdrawn or dismissed.
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> However, the Bureau had recently realized that maintaining public confidence in the fairness of the tax system is vital to effective tax administration. By **investigating potential violations of the Tax Code and prosecuting tax offenders**, the taxpaying public would recognize and be aware that the BIR is committed to ensure that everyone is paying their fair share of taxes. Consequently, this would lead to a change in the "risk equation" **since potential tax offenders would now think twice before committing any infraction of our tax laws**." (emphasis supplied)

In essence, RMO 24-2008 confirmed that the RATE program is an investigative proceeding aimed at prosecuting tax offenders, i.e., those who violate the provisions of the Tax Code, as amended, particularly Chapter II, Title X. The collection of taxes is just a collateral benefit.

RMO 24-2008 prescribed the guidelines for the implementation of the program. It stated:

> "2. Letters of Authority (L/A) for RATE cases to be investigated by the National Investigation Division (NID)/Policy Cases Division (PCD) shall be signed by the Deputy Commissioner for Legal & Inspection Group (DCIR-LIG), while L/As for RATE cases in the Regional Office/s (RO) shall be signed by the Regional Director.
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> 3. Issuance of L/As shall **cover only the taxable years where prima facie evidence of fraud or violation of the provisions of the Tax Code (NIRC) has been established** unless the investigation of prior or subsequent years are necessary to determine or trace continuing transactions entered into in the covered year and concluding thereafter, or transactions concluding in the covered year which started in the prior years, or it could be established that the same scheme had also been utilized for the prior and/or subsequent years.
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> 4. For RATE cases, the NID and PCD of the National Office and Special Investigation Division (SID) of the respective Regional Offices may conduct a second examination or inspection of the taxpayer's books of accounts and other accounting records even if the regular audit examination had been conducted thereon, **subject to the provisions of Section 235** of the Tax Code of 1997. However, any payment of deficiency tax or any amount assessed on the first investigation case shall be credited against the assessment in the second case if the findings/discrepancies in the second investigation include the same findings or issues identified during the regular audit covered by the first L/A." (emphasis supplied)

RMO 24-2008 also laid down the criteria for a case to fall under the RATE Program. Per this RMO, <u>all</u> of the following conditions must be present before an audit can fall under the RATE Program:

> "D. CRITERIA
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> To qualify under the RATE Program, a case must conform to the following conditions:
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> (a) Cases representing violations under any of Sections 254, 255, 257 & 258 of the NIRC of 1997, including One-Time Transactions, etc.;
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> (b) High-profile Taxpayers or taxpayers well-known within the community, industry or sector to which the taxpayers belong; and

(c) Estimated basic tax deficiency is at least One Million Pesos (P1,000,000.00) per year and tax type, but priority should be given to tax cases where the aggregate basic tax deficiencies for all types per year is Fifty Million Pesos (P50,000,000.00) or more."

Subsequently, the BIR issued RMO No. 27-2010 (March 2010) - Re-invigorating the Run After Tax Evaders (RATE) Program and Amending Certain Portions of RMO 24-2008. Re-invigoration is an apt term given that the BIR's RATE cases somehow waned after 2008 and was sought to be revived by then new BIR Commissioner Joel Tan-Torre. RMO 27-2010 stressed the need to: (1) conduct a preliminary investigation to establish the existence of *prima facie* evidence of fraud or tax evasion; and (2) adhere to established procedures.

RMO 27-2010 provides:

"II. Policies and Procedures

The following policies and guidelines shall be observed in the development and investigation of RATE cases, in addition to those set forth in the relevant revenue issuances:

A. Development of RATE Cases

1) The development of RATE cases shall be the principal responsibility of the National Investigation Division (NID), and of the Special Investigation Divisions (SIDs). The Taxpayer Lifestyle Check System prescribed in Revenue Memorandum Order No. 19-2010, among others, shall be used in the development of RATE cases.

2) The BIR, through the NID/SIDs, shall coordinate with the concerned government agencies, such as, but not limited to the Department of Justice, the National Bureau of Investigation, the Criminal Investigation and Detection Group (CIDG), and other entities, in the development, investigation and prosecution of RATE cases, and in preventing the concealment/disposal/transfer of assets by taxpayer being investigated under the RATE Program. To this end, the BIR shall initiate the promulgation of appropriate Memoranda of Agreement (MOAs) with the concerned Government Agencies.

3) To expedite the development of RATE cases, the Revenue District Offices (RDOs), the Large Taxpayers Service (LTS) and its District Offices and Divisions, shall act immediately in all requests from the NID or the SIDs for information needed to validate or develop RATE cases. Failure of an RDO/LTS District Office or Division to provide the requested information within fifteen (15) working days from receipt of a request for information shall be considered as sufficient grounds for the imposition of administrative disciplinary action against the concerned office.

4) Upon the discovery of evidence of fraud in the course of a regular audit investigation, the RDO/LTS District Office or Division shall immediately transmit the records of the case to the NID or the SID concerned, for investigation under the RATE Program.

B. Issuance of Letters of Authority for RATE Cases

1) In all RATE cases, a preliminary investigation must first be conducted to establish prima facie evidence of fraud or tax evasion. Such investigation shall include the verification and

determination of the schemes employed and the extent of fraud perpetrated by the subject taxpayer.

2) In the event that, following the conduct of the required preliminary investigation, the NID/SIDs should determine that there is *prima facie* evidence of tax fraud, it shall submit the case, together with a memorandum justifying the issuance of a Letter of Authority (LA) to the Deputy Commissioner-Legal and Inspection Group (DCIR-LIG), through the Assistant Commissioner (Enforcement Service)/the concerned Regional Director, for evaluation.

   The DCIR-LIG shall then evaluate the request, and determine whether the same shall be recommended for approval by the Commissioner of Internal Revenue. If the DCIR-LIG finds a request meritorious, the docket of the case, together with the memorandum-request bearing the concurrence of the DCIR-LIG, shall be forwarded to the Commissioner, for final review and approval.

3) The DCIR-LIG shall likewise conduct the appropriate verification with the Letter of Authority Monitoring System (LAMS), to ascertain whether a LA for a taxpayer for a particular taxable year has already been issued to the concerned taxpayer.

   In the event that, following such verification, it is ascertained that no LA has been previously issued against the concerned taxpayer, a printout of the LAMS search results must be included in the docket of the case, to support the issuance of the requested LA.

4) If, however, it is disclosed that an LA was previously issued for the concerned taxpayer, and that the corresponding investigation has already been commenced or concluded, the DCIR-LIG shall include in the request for issuance of an LA a recommendation and justification for the re-assignment to, or re-opening of the investigation by, the NID/SID concerned. The Commissioner shall then decide whether the investigation shall be continued by the present investigating office, or if the investigation shall be re-assigned to/re-opened by the NID/SID concerned.

5) In the event that the Commissioner should rule in favor of the re-assignment to/re-opening of the tax investigation by the NID/SID, the DCIR-LIG shall inform the RDO/LT District Office or Division concerned, thru the Regional Director/Assistant Commissioner-LTS, of the decision of the Commissioner, and require the transmittal of the docket of the case to the NID/SID, as well as the cancellation of the existing LA.

6) Should the Commissioner approve a request for issuance of an LA, such approval will be communicated to the DCIR-LIG, for the preparation and issuance of the requested LA by the latter. *All LAs issued for RATE cases shall be signed by the DCIR-LIG.*

7) The issuance of LAs shall <u>cover only the taxable year(s) for which prima facie evidence of tax fraud, or of violations of the Tax Code, was established</u> through the appropriate preliminary investigation, unless the investigation of prior or subsequent years is necessary in order to:

   - Determine or trace continuing transactions entered into in the covered year and concluded thereafter, or those transactions concluded in the covered year that were commenced in prior years; or
   - Establish that the same scheme was utilized for prior or subsequent years.

C. Conduct of Investigation

1. The formal investigation of a RATE case, including the examination of the taxpayer's books of accounts, accounting records and third-party records through the issuance of LAs and/or access letters (if warranted), shall be commenced only after prima facie evidence of fraud or

tax evasion has been established. In such investigations, the provisions of Section 235 (Preservation of Books of Accounts and Other Accounting Records) of the Tax Code shall be fully observed." (underscoring supplied)

Both RMOs 24-2008 and 27-2010 prescribe the rules to be observed in developing and conducting RATE cases, to wit:

1) The need for the BIR to separately establish a *prima facie* evidence of fraud or tax evasion before it issues the Letter of Authority (RATE-LA) to the subject taxpayer;

2) The year/s to be audited shall only be for the years where such evidence of fraud was initially established unless the audit of prior or subsequent years is necessary to trace continuing transactions entered into in the covered year and concluded thereafter, or those transactions concluded in the covered year that were commenced in prior years; and

3) During investigation, the three-year rule (with exceptions) for the preservation of books of account shall be fully observed.

Prima Facie Evidence of Fraud

As mentioned, a RATE audit is essentially an investigation of a possible criminal wrongdoing. Given that the proceeding can result in penal sanctions, a RATE audit should not be invoked by the BIR lightly, like a regular audit of taxpayers. Under the rules, the BIR must first establish a ground for such special audit or investigation. It is for this reason that both RMOs 24-2008 and 27-2010 mandate the conduct of a preliminary investigation to ascertain the existence of *prima facie* evidence of fraud or tax evasion before a RATE audit can be pursued.

Upon determination of the existence of fraud or tax evasion, RMO 27-2010 further requires the BIR to submit a report including: (1) the extent of the fraud possibly committed; and (2) a verification and determination of the schemes employed by the taxpayer. Only after this report has been submitted can the BIR-NID recommend the issuance of the RATE-LA to the Deputy Commissioner for Legal and Inspection Group (DCIR-LIG), through the Assistant Commissioner of the Enforcement Service, for large taxpayers, or through the Regional Director, for all other taxpayers.

RMO 27-2010 explains in detail the procedure to be undertaken before the RATE-LA can be issued, to wit:

"B. Issuance of Letters of Authority for RATE Cases

1) In all RATE cases, a preliminary investigation must first be conducted to establish *prima facie* evidence of fraud or tax evasion. Such investigation shall include the verification and determination of the schemes employed and the extent of fraud perpetrated by the subject taxpayer.

2) In the event that, following the conduct of the required preliminary investigation, the NID/SIDs should determine that there is prima facie evidence of tax fraud, it shall submit the case, together with a memorandum justifying the issuance of the Letter of Authority (LA) to the Deputy Commissioner-Legal and Inspection Group (DCIR-LIG), through the Assistant Commissioner (Enforcement Service)/the concerned Regional Director, for evaluation.

   The DCIR-LIG shall then evaluate the request, and determine whether the same shall be recommended for approval by the Commissioner of Internal Revenue. If the DCIR-LIG finds the request meritorious, the docket of the case, together with the memorandum-request

bearing the concurrence of the DCIR-LIG, shall be forwarded to the Commissioner, for final review and approval.

3) The DCIR-LIG shall likewise conduct the appropriate verification with the Letter of Authority Monitoring System (LAMS), to ascertain whether a LA for a taxpayer for a particular taxable year has already been issued to the concerned taxpayer.

   In the event that, following such verification, it is ascertained that no LA has been previously issued against the concerned taxpayer, a printout of the LAMS search results must be included in the docket of the case, to support the issuance of the requested LA.

4) If, however, it is disclosed that an LA was previously issued for the concerned taxpayer, and that the corresponding investigation has already been commenced or concluded, the DCIR-LIG shall include in the request for issuance of an LA a recommendation and justification for the re-assignment to, or re-opening of the investigation by, the NID/SID concerned. The Commissioner shall then decide whether the investigation shall be continued by the present investigating office, or if the investigation shall be re-assigned to/re-opened by the NID/SID concerned.

5) In the event that the Commissioner should rule in favor of the re-assignment to/re-opening of the tax investigation by the NID/SID, the DCIR-LIG shall inform the RDO/LT District Office or Division concerned, thru the Regional Director/Assistant Commissioner-LTS, of the decision of the Commissioner, and require the transmittal of the docket of the case to the NID/SID, as well as the cancellation of the existing LA.

6) Should the Commissioner approve a request for issuance of an LA, such approval will be communicated to the DCIR-LIG, for the preparation and issuance of the requested LA by the latter. All LAs issued for RATE cases shall be signed by the DCIR-LIG."

It is important, therefore, that the taxpayer, being subjected to a RATE investigation, confirms that the above process has indeed been followed by the BIR. If not, the taxpayer should question the legality of the issuance of the RATE-LA as it was not issued in accordance with the BIR's internal rules and violates the taxpayer's right to due process. In *Commissioner of Internal Revenue v. Avon Products Manufacturing, Inc.*,[5] the Supreme Court reminded the BIR that "while the government has an interest in the swift collection of taxes, the Bureau of Internal Revenue and its officers and agents cannot be overreaching in their efforts, but must perform their duties in accordance with law, with their own rules of procedure, and always with regard to the basic tenets of due process." In this case, the Supreme Court ruled that the BIR Commissioner's disregard of the standards and internal rules rendered the deficiency tax assessments null and void.

A taxpayer has the right to require the BIR to present the *prima evidence* of fraud or tax evasion before submitting itself to a RATE investigation. Time and again, our courts have ruled that fraud is a question of fact that should be alleged and proven.[6] Fraud cannot just be alleged in a RATE investigation, particularly when the RATE investigation attempts to disregard the prescriptive periods under Sections 203 and 235 of the Tax Code. As will be discussed, the existence of fraud or tax fraud is an essential element in all RATE investigations.

How is the Existence of Fraud Determined?

[5] G.R. Nos. 201398-99 & 201418-19, 3 October 2018.

[6] Commissioner of Internal Revenue v. Spouses Magaan, G.R. No. 232663, 3 May 2021.

RATE investigations are often initiated by an informant alleging that a particular taxpayer has violated certain provisions of the Tax Code or by the discovery of a substantial discrepancy following a verified third-party information matching. In case the fraud is discovered through third-party information matching, which has been independently verified, the existence of *prima facie* evidence of fraud is confirmed, and the taxpayer now has the burden of disproving the information obtained by the BIR. It is essential that such third-party information is verified, i.e., the BIR made a separate inquiry into the discrepancy with the income payor, in case the discrepancy pertains to sales, or with the supplier, in case the discrepancy relates to purchases.

On the other hand, in case the RATE audit is instigated by an informant, the subject taxpayer has the right to demand the details of the alleged violations, short of identifying the informant's identity. This is part of the due process requirement under Section 228 of the Tax Code which mandates that the taxpayer be informed in writing of the facts on which the assessment against it is made. This will also allow the taxpayer to properly protest the BIR's findings, if any.

In both instances, the taxpayer should insist that the investigation be restricted to the transaction/s in question or similar transactions where such scheme/s may have been applied. In other words, such a RATE investigation should not serve as a blanket authority for the BIR to audit, or re-audit, the entire business operations of the subject taxpayer. The RATE investigation must be focused on the alleged violations of the Tax Code as disclosed by the informant or as discovered through third-party matching and confirmed during a preliminary investigation. No more, no less.

Year/s Covered by the RATE-LA

RMO 27-2010 prescribes that the year to be audited or investigated shall only be for the year/s where such evidence of fraud was initially established. As an exception, the investigation could extend to prior or subsequent years to trace transactions concluded in the covered year that commenced in prior years or continuing transactions entered into in the covered year and concluded thereafter.

A RATE-LA may cover one or more "open" tax years, i.e., tax years within the three-year period discussed in Section 203 of the Tax Code, or multiple years within and/or outside of the open years. In the past, the BIR has limited its investigations to the open years, perhaps mindful of the burden of proof it would need to submit to justify the audit of already prescribed years.

Lately, however, the BIR has been issuing RATE-LAs for taxable years long outside the three-year period to assess. The BIR argues that in fraud cases, the right of the BIR to assess for deficiency taxes is extended to ten (10) years from discovery of the fraud. While it is correct that a RATE-LA can be issued beyond the 3-year period, it is still an exception. And as an exception, the BIR should, before issuing the "out of open period" RATE-LA, demonstrate that: (1) it has performed the procedures set in RMO 27-2010; (2) has confirmed the existence of fraud or tax evasion; and (3) has identified the covered year/s as the year/s when the existence of fraud was ascertained.

This second rule also prohibits what is called the shotgun audit approach. If the investigation will cover more than one year, it is critical that the BIR must have first identified the method adopted by the taxpayer and verified that this same method could have been applied by the taxpayer in prior or subsequent years. To illustrate, a taxpayer, not in the habitual sale of real property, sold a parcel of land and reported the sale at an undervalued price. Later, the BIR was informed of the undervaluation

and, after applying the procedures set in RMO 27-2010, issued the RATE-LA. The RATE-LA, in this case, should only cover the year of the sale. There is no need to extend the covered year to the year/s before or after the sale as the taxpayer is not habitually engaged in the sale of real properties.

And gone are the days when a RATE-LA, or any LA for that matter, authorizes an examination of a taxable year and "unverified prior years." In *Commissioner of Internal Revenue v. Gaw*, the Supreme Court ruled that such an LA contravenes Revenue Memorandum Order No. 43-1990[7] and, as such, is void to the extent that it covers unverified years. However, the LA is valid as to the declared taxable year.[8]

In June 2020, the Court of Tax Appeals (CTA) had the occasion to rule upon the validity of an electronic letter of authority (e-LA) issued by the BIR covering a period beyond the three - year prescriptive period to assess under Section 203 of the Tax Code. While *Hemisphere-Leo Burnett, Inc. v. Commissioner of Internal Revenue*[9] refers to an electronic letter of authority or e-LA and not a RATE-LA, the concept discussed therein is relevant as this could be invoked by the BIR when issuing RATE-LAs beyond the three-year period to assess.

In this case, the taxpayer (Hemisphere-Leo Burnett) received in November 2017 an e-LA from the BIR for the audit of its books of account for the year 2012. Hemisphere-Leo Burnett sought to prohibit the BIR from implementing the e-LA on the ground that the same was issued more than three years after the filing of the 2012 tax returns. It added that its case did not fall under any of the exceptions found in Section 222 of the Tax Code. The CTA ruled that the e-LA is valid since Sections 203 and 222 of the Tax Code do not prohibit the issuance of letters of authority beyond the three-year period.[10] The CTA distinguished an LA from an assessment, as follows:

> "In stark contrast with a tax assessment, the LOA gives notice to the notice that it is under investigation for possible deficiency tax assessment; at the same time, it authorizes or empowers a designated revenue officer to examine, verify, and scrutinize a taxpayer's books and records, in relation to internal revenue tax liabilities for a particular period. The LOA commences the audit process and informs the taxpayer that it is under audit for possible deficiency tax assessment."
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> In view of the foregoing distinction, a tax assessment is always preceded by an LOA, which entails the examination of a taxpayer's books of accounts and other accounting records; **and the issuance of an LOA does not necessarily mean the subsequent issuance of a tax assessment**. Parenthetically, the BIR is not mandated to make an assessment relative to every return filed with it." (emphasis supplied)

This pronouncement is alarming. It opens the door for BIR officials to go after taxpayers for taxable years that have long prescribed, even when the exceptions provided in Section 222 clearly do not apply. While it is true that the issuance of an LA does not equate to an assessment, such principle

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[7] RMO 43-1990 provides that a Letter of Authority (L/A) should "cover a taxable period not exceeding one taxable year. The practice of issuing L/As covering audit of "unverified prior years" is hereby prohibited. If the audit of a taxpayer shall include more than one taxable period, the other periods or years shall be specifically indicated in the L/A."

[8] G.R. No. 248070, dated 1 October 2019.

[9] CTA Case No. 9749, 3 June 2020.

[10] 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 preceeding 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: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

is only applicable in theory. For anyone who has been the subject of a tax audit would know that the purpose of a BIR audit is to assess and, ultimately, to collect. As they say, no taxpayer goes out of a tax audit unscathed.

However, a careful review of *Hemisphere* explains why the CTA ruled the way it did. The CTA was pressed to confirm the validity of the issued LA because Hemisphere-Leo Burnett was unable to present the tax returns that would be the reckoning point of the period to assess. The CTA noted:

> "Moreover, since, as already stated, an LOA commences the audit process and informs the taxpayer that it is under audit for a *possible* deficiency tax assessment, it seems rational that an LOA is no longer warranted when such tax assessment would already be issued beyond the prescriptive period.
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> However, in this case, **We cannot blindly apply the three (3)-year period** under Section 203 of the NIRC of 1997 in relation to the issuance of the subject LOA. *Firstly*, there is no indication of the specific taxes that will be assessed brought about by the examination made under the subject LOA. Thus, and since internal revenue taxes has different last days prescribed by law for the filing of the corresponding tax return vis-à-vis the actual filing dates thereof, We cannot as yet determine the respective reckoning dates for the commencement of the said three(3)-year period.
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> *Secondly*, no tax return was ever presented in evidence by petitioner. Relative thereto, it is incumbent upon a taxpayer, who wants to avail of the benefits of Section 203 of the NIRC of 1997 by setting up prescription as an affirmative defense, to **prove that he submitted a return**. If he fails to do so, the conclusion should be that no such return was filed, in which case the Government has ten (10) years within which to make the corresponding assessments. Thus, at this point, this Court cannot rule that petitioner is entitled to the benefits granted under Section 203 of the NIRC of 1997." (emphasis supplied)

Given that the taxpayer in *Hemisphere* was unable to present its tax returns upon which the CTA can conclude that prescription has set in, it can be said that *Hemisphere* did not create a precedent for the BIR. Therefore, a taxpayer may still question the validity of a RATE-LA (or a regular LA) if issued beyond the 3-year period unless the BIR is able to present *prima facie* evidence of fraud or tax evasion.

3-Year Rule on Preservation of Books

RMO 27-2010 recognizes that an audit under the RATE Program must still observe the 3-year rule for the preservation of books of accounts and accounts under Section 235 of the Tax Code. This rule, however, admits of the following exceptions:

> (a) Fraud, irregularity or mistakes, as determined by the Commissioner;
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> (b) The taxpayer requests reinvestigation;
>
> (c) Verification of compliance with withholding tax laws and regulations;
>
> (d) Verification of capital gains tax liabilities; and
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> (e) In the exercise of the Commissioner's power under Section 5(B) to obtain information from other persons in which case, another or separate examination and inspection may be made. Examination and inspection of books of accounts and other accounting records shall be done in the taxpayer's office or place of business or in the office of the Bureau of Internal Revenue. All corporations, partnerships or persons that retire from business shall, within ten (10) days from the date of retirement or within such period of time as may be allowed by the Commissioner in special cases, submit their books of accounts, including the subsidiary books and other accounting records to the Commissioner or any of his deputies for examination, after which they shall be returned. Corporations and partnerships

> contemplating dissolution must notify the Commissioner and shall not be dissolved until cleared of any tax liability.

A taxpayer required by the BIR, as part of a RATE investigation, to produce its books of accounts and other accounting records that are more than three years old may raise the argument that RMO 27-2010 recognizes and respects the provisions of Section 235 of the Tax Code.

While it can be said that RATE investigations, which are essentially tax fraud audits, fall within the exceptions provided in Section 235 of the Tax Code, it can effectively do so only after the BIR has established the existence of *prima facie* evidence of fraud or tax evasion. Again, mere allegation of the existence of fraud, without showing such evidence will not suffice to extend the period. It is for this reason that "industry-based" RATE investigations, i.e., investigations of certain industries perceived to be low in tax compliance, will fail this requirement since these audits are generally based on perception and not confirmed facts.

And this safeguard should be upheld even if the BIR issues a *Subpoena Duces Tecum* against the taxpayer. Section 266 of the Tax Code (Failure to Obey Summons) assumes that the order is lawful, i.e., not in violation of the Tax Code. It is submitted that an order to submit documents in violation of Section 235 of the Tax Code, i.e., where the BIR fails to present the *prima facie* evidence of fraud, is illegal and does not have any binding effect.

In conclusion, a taxpayer that receives a RATE-LA should not despair. There are enough safeguards afforded to it by the Tax Code and regulations before, during and even after the investigation. RMOs 24-2008 and 27-2010 ensure the taxpayer that no RATE-LA shall be whimsically issued by the BIR and that it may legally raise the defenses under Section 203 and 235 of the Tax Code, among others, if the procedures set out in these issuances are not faithfully observed. As the fraud investigation can cause irreparable damage to one's reputation and ultimately lead to criminal prosecution, the BIR must be reminded that the RATE program must be invoked judiciously. It should never be employed as a fishing expedition.