

# **Fitness by Design, Inc. v. Commissioner on Internal Revenue**

### **Facts**

**Background and Initial Actions:**

1. **March 17, 2004:** The Commissioner of Internal Revenue (CIR) assessed Fitness by Design, Inc. (FBD) with a deficiency income tax for the tax year 1995 totaling ₱10,647,529.69.
2. FBD filed a protest against the assessment, arguing it was issued beyond the three-year prescriptive period under Section 203 of the Tax Code. Additionally, FBD highlighted that it had been incorporated only on May 30, 1995, implying no earnings for that tax year.
3. **February 1, 2005:** CIR issued a warrant of distraint and/or levy against FBD leading FBD to file a Petition for Review on March 1, 2005, before the Court of Tax Appeals (CTA), reiterating the prescription defense (CTA Case No. 7160).

**Response and Allegations:**

1. CIR refuted the prescription claim, stating under Section 222(a) of the 1997 Tax Code, the right to assess had not prescribed due to alleged fraud or omission by FBD in its 1995 return.
2. CIR claimed FBD's 1995 Income Tax Return (filed on April 11, 1996) was false and fraudulent with deliberate underreporting of sales.
3. CIR revealed findings from revenue officers indicating FBD had business operations in 1995, accumulating ₱7,156,336.08 in sales, and hence filed fraudulent income and failed to file VAT returns.

**Discovery and Testimonies:**

1. Preliminary hearing on prescription was conducted upon FBD's motion.
2. FBD's former bookkeeper testified that CPA Leonardo Sablan illegally possessed and turned over FBD's records to the BIR.
3. Despite issued subpoenas to Sablan and requests to BIR officers, the CTA denied these motions citing irrelevance and informer protection under Republic Act No. 2338.
4. Arguments centered on whether documents acquired by Sablan were illegally obtained and impacted the prescription period.

### **Issues**

1. **Prescription of Tax Assessment:**
  - Whether the issuance of assessment against FBD had prescribed.

- Whether the 1995 tax return filed by FBD was false or fraudulent.
2. **Illegality of Document Acquisition:**
    - Legality of how the BIR obtained documents crucial to the deficiency assessment.
  3. **Relevance of Subpoenas and Written Interrogatories:**
    - Relevance of subpoenaed testimonies and documents to the issues at hand,
    - Conflict with the informer protection provision.
  4. **Constitutional and Procedural Allegations:**
    - Violation of due process and rights to examine witnesses and secure evidence.
    - Compliance of the BIR with CTA's order to produce all relevant records.

### **### Court's Decision**

1. **Prescription:**
  - The Court found that under Section 222(a) of the Tax Code, the ten-year period applies in cases of fraud. Therefore, despite FBD's claim of prescription under the three-year rule, the ten-year period negated this defense due to allegations of fraudulent conduct.
2. **Document Legality:**
  - The Court held the legality of document acquisition by the BIR was not material to the prescription issue. The BIR, under Section 5's broad authority, could obtain and use relevant taxpayer information without it being illegal for tax assessment purposes, even without taxpayer consent.
3. **Subpoenas and Informer Protection:**
  - The Court sided with the CTA's discretion and found no grave abuse in denying subpoenas or interrogatories to avoid revealing the informer's identity, as per Republic Act No. 2338. FBD's stated purpose of eliciting document whereabouts did not outweigh the informer protection accorded by law.
4. **Constitutional Rights:**
  - Since the CTA proceedings against FBD were not criminal, rights regarding witness examinations pertinent to criminal cases were not applicable.
5. **Order Compliance:**
  - Subpoena for document production was rendered unnecessary due to ongoing CTA enforcement of its order requiring all case-related records from the BIR.

### ### **\*\*Doctrine\*\***

#### 1. **\*\*Prescription and Fraud:\*\***

- Assessment can be extended to a ten-year prescriptive period in instances of fraud or false tax returns (Section 222(a) of the Tax Code).

#### 2. **\*\*Inquisitorial Authority of BIR:\*\***

- The BIR's broad statutory power permits document acquisitions necessary for tax assessments, even absent taxpayer consent (Section 5 of the Tax Code).

#### 3. **\*\*Informer Protection:\*\***

- The sanctity of informer protection under Republic Act No. 2338 must be maintained, prohibiting unnecessary revelations in tax disputes.

### ### **\*\*Class Notes\*\***

- **\*\*Prescription Period:\*\*** Differentiation between the three-year general rule (Section 203) and ten-year fraud exception (Section 222(a)).

- **\*\*Broad Powers of BIR:\*\*** Authority under Section 5 enables the examination of any taxpayer's books and records.

- **\*\*Informer Doctrine:\*\*** Republic Act No. 2338 shields informers' identities except under malicious circumstance verification.

- **\*\*Legal Process:\*\*** Procedural consistency in issuing subpoenas to avoid moot requests due to compliance orders.

### ### **\*\*Historical Background\*\***

This case is historically relevant as it elucidates the extensive powers vested in the BIR to combat tax evasion and underscores the judiciary's role in protecting informer identities. It aligns with efforts to enhance tax compliance and underscores jurisprudence on taxpayer rights vis-à-vis revenue enforcement mechanisms.