

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

WILLIAM LI YAO,
Petitioner,

versus

C. T. A. CASE NO. 30

COLLECTOR OF INTERNAL
REVENUE,
Respondent.

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D E C I S I O N

This is an appeal from a decision of the respondent Collector of Internal Revenue dated August 10, 1954, assessing against, and demanding of, the petitioner William Li Yao, the total sum of ₱1,505,-768.54 for alleged deficiency income taxes for the years 1945 to 1951, inclusive of surcharges.

The assessment in question, which bears the stamp of approval of the respondent Collector of Internal Revenue, was arrived at by a third investigating team headed by BIR Examiner Conrado Quesada employing the so-called Net Worth-Expenditure (Inventory) Method under authority of section 38 in relation to section 15 of the National Internal Revenue Code when the taxpayer does not employ the regular method of accounting or if the method employed by him does not clearly reflect his true income.

As appearing in the working sheet, Exhibit 8, of BIR Examiner Conrado Quesada, the head of the third investigating team, the alleged income tax deficiency for the years in question totalling ₱1,505,768.54 inclusive of surcharges, are broken down from year to year as follows:

1945

Investment in Li Yao & Co. (Himself)	₹ 29,131.38
Personal accounts in Li Yao & Co.	3,700.00
Personal accounts in Li Yao & Co. (bonus)	8,207.12
Personal properties	500.00
Net Worth on December 31, 1945	₹ 41,538.50
Less Net Worth January 1, 1945	12,500.00
Increase in net worth	₹ 29,038.50
Add: Personal and living expenses	20,000.00
Net income as per investigation	₹ 49,038.50
Less: Personal exemptions	3,500.00
Amount subject to tax	₹ 45,538.50
Tax due thereon	2,523.08
Less tax paid or assessed	1,111.74
Deficiency tax due	₹ 1,411.34
50% surcharge	705.67
Total amount due for 1945	₹ 2,117.01

1946

Shares of stock-Republic Textiles, N. J., U.S.A.	₹ 350,000.00
Investment: Li Yao (Himself)	145,509.20
Personal account Li Yao & Co. (a/c # 2)	1,967.57
Personal properties (F & F)	850.00
Net Worth December 31, 1946	498,326.77
Less net worth December 31, 1945	41,538.50
Increase in net worth	₹ 456,788.27
Add: Personal and living expenses	20,000.00
Net income per investigation	₹ 476,788.27
Less: Personal exemption	3,500.00
Net Taxable income	₹ 473,288.27
Tax due thereon	₹ 193,358.37
Less tax paid or assessed	2,538.76
Deficiency tax	₹ 190,819.61
50% surcharge	95,409.81
Total amount of tax due and collectible	₹ 286,229.42

1947

Shares of stock - Republic Textiles, Inc., New Jersey, U.S.A.	₹ 350,000.00
Investments: Li Yao & Co. (Himself)	171,607.54
Personal accounts Li Yao & Co. (a/c # 2)	5,995.91
Personal accounts Li Yao & Co. (Tan Ho Ti)	6,000.00
Personal Property (F & F)	850.00
Net worth as of December 31, 1947	₹ 534,453.45
Less: Net worth as of December 31, 1946	498,326.77
Increase in net worth	₹ 36,126.68
Add: Personal and living expenses	20,000.00
Net income per investigation	₹ 56,126.68
Less: Personal exemptions	3,500.00
Net taxable income	₹ 52,626.68
Tax due thereon	₹ 10,968.00
Tax paid or assessed	10,055.78
Deficiency tax	₹ 912.22
50% surcharge	456.11
Total amount of tax due and collectible	₹ 1,368.33

DECISION -
C. T. A. CASE NO. 30

- 3 -

1948

Cash - Bank of America	₹ 3,651.59
Shares of Stock - Republic Textiles, Inc New Jersey, U S	350,000.00
Investments: Li Yao & Co (Himself)	167,532.17
Investment: Li Yao & Co. (Wife)	2,000.00
Investment: Tan Bee, Cu Yek Chin & Co.	30,000.00
Personal accounts Li Yao (Acct # 2)	20,000.00
Personal properties (F & F)	1,750.00
Net worth December 31, 1948	₹ 574,933.76
Less: Net worth December 31, 1947	534,453.45
Increase in net worth	₹ 40,480.31
Add: Personal and living expenses	20,000.00
Net income per investigation	₹ 60,480.31
Less: Personal exemptions	3,500.00
Net taxable income	₹ 56,980.31
Tax due thereon	₹ 12,274.10
Tax paid or assessed	700.34
Deficiency tax	11,573.76
50% surcharge	5,786.88
Total amount of the tax due and collect- ible	₹ 17,360.64

1949

Cash - Bank of America	₹ 1,214.81
Time deposit - China Banking Corporation	60,000.00
Shares of stock - Rep. Textiles, N. J. U. S. A.	350,000.00
Investments: Li Yao & Co. (Himself)	169,175.93
Investments: Li Yao & Co. (Wife)	2,000.00
Investments: Tan Pee, Cu Yek Chin & Co.	30,000.00
Investments: Li Chay Too Sons, Inc.	166,533.32
Real property (Inherited land)	9,387.49
Real property (Inherited building)	₹ 23,938.09
Less depreciation	2,393.81
Personal accounts, Li Yao & Co. (a/c # 2)	53,800.00
Personal accounts, Li Yao & Co. (Tan Ho Ti a/c # 2)	10,000.00
Personal properties (F & F)	1,750.00
Net Worth December 31, 1949	₹ 875,505.83
Less: Net worth December 31, 1948	574,933.76
Increase in net worth	₹ 300,472.07
Add: Personal and living expenses	20,000.00
Taxable income before inheritance	₹ 320,472.07
Less: Personal exemptions	3,500.00
Taxable income before inheritance	₹ 316,972.07
Less: Inheritance	72,392.91
Net taxable income	₹ 244,579.16
Tax due	₹ 87,794.83
Tax paid or assessed	538.07
Deficiency tax	₹ 87,256.76
50% surcharge	43,628.38
Total amount of tax due and collectible	₹ 130,885.14

DECISION -
C. T. A. CASE NO. 30

- 4 -

1950

Cash - Bank of America	₹ 44,404.63
Investment: Li Yao & Co. (Himself)	261,467.69
Investment: Li Yao & Co. (Wife)	55,179.89
Investment: Ferin (Himself & Wife)	260,000.00
Investment: Ferin (Through others)	390,000.00
Investment: Tan Pee, Cu Yek Chin & Co.	30,000.00
Investment: Li Chay Too Sons, Inc.	166,533.32
Real Property (land)	9,387.49
Real Property (building) ₹23,938.09	
Less depreciation 4,787.62	19,150.47
Accts. Rec. Li Chay Too Sons, Inc.	20,000.00
Personal Property: Race Horses	18,500.00
Furniture & Fixtures	2,150.00
Automobile	4,000.00
Net worth December 31, 1950	₹1,280,773.50
Less: Net worth December 31, 1949	875,405.83
Increase in net worth	₹ 405,367.67
Add: Personal and living expenses	20,000.00
Net income per investigation	₹ 425,367.67
Less: Personal exemptions	4,200.00
Taxable net income	₹ 421,167.67
Tax due thereon	218,009.00
Tax paid or assessed	3,837.00
Deficiency tax	₹ 214,172.00
50% surcharge	107,086.00
Total amount of tax due and collectible	₹ 321,258.00

1951

Cash - Security Bank & Trust Co.	₹ 1,400.00
Cash - Bank of America	1,034.74
Investment: Li Yao & Co. (Himself)	283,966.84
Investment: Li Yao & Co. (Wife)	55,179.89
Investment: Ferin (Himself & Wife)	320,000.00
Investment: Ferin (Through others)	480,000.00
Investment: Tan Pee, Cu Yek Chin & Co.	30,000.00
Investment: Li Chay Too Sons, Inc.	166,533.32
Real property (land)	9,387.48
Real property (building) ₹23,938.09	
Less depreciation 9,181.43	16,756.66
Accounts receivable: Ferin	750,000.00
Li Chay Too Sons, Inc.	20,000.00
Personal property: Race Horses	18,500.00
Furniture & Fixtures	2,400.00
Automobile	4,000.00
Net Worth as of December 31, 1951	₹2,159,158.94
Less net worth as of December 31, 1950	1,280,773.50
Increase in net worth	878,385.44
Add: Personal and living expenses	20,000.00
Net income per investigation	₹ 898,385.44
Less: Personal exemptions	4,800.00
Net taxable income	₹ 893,585.44
Tax due thereon	₹ 500,671.00
Less: Tax paid or assessed	2,971.00
Deficiency tax	₹ 497,700.00
50% surcharge	248,850.00
Total amount due and collectible	₹ 746,550.00

Before proceeding to decide the factual, as well as legal, issues in this case, we shall first give the background of petitioner and the present assessment against him for a clearer understanding of all the issues involved.

The petitioner William Li Yao is a naturalized Filipino of Chinese parents and is the eldest son of a prosperous local businessman by the name of Li Chay Too who died sometime in 1948. After the death of his father, the petitioner being the eldest of the children and favorite of his father, was entrusted with the management of the business affairs of the family. In 1945, he organized Li Yao & Company, a limited co-partnership with himself as managing partner. From 1948 to February, 1955, petitioner also owned shares and was president of the Li Chay Too & Sons, Inc., a corporation capitalized by him and his four brothers. In 1950 he organized a corporation known as the Far East Realty & Investment Co., (also known as FERIN for short) of which he was stockholder and president.

It is admitted that from these three business enterprises, the petitioner received during the years covered by this appeal, salaries, bonuses and dividends.

By his own admission, the petitioner gambles. Sometime in 1950, he was the owner of nine (9) race horses which he acquired by purchase from Aurelio P. Reyes and the late Johnny Ysmael assessed by BIR Examiner Quesada in the total amount of ₱18,500.00 but which the petitioner claims to be worth only ₱11,500.00.

Although the petitioner is a naturalized Filipino citizen, he was by his own admission during the years subject of the present review, a very active member in the Chinese community in the raising of funds for civic and charitable purposes. Presumably, because of his well-known opulence, his reputation as a free spender and his capacity to contribute big amounts out of his own personal funds, he was made treasurer of several organizations engaged in raising funds for civic and charitable purposes. In 1950, he was designated Chairman of the Community Chest for Chinese throughout the Philippines, and treasurer of the Manila Police Trust Fund. In 1951, he was appointed by then Secretary of National Defense Ramon Magsaysay, treasurer in charge of contributions from the entire Chinese community for our expeditionary forces in Korea. At one time or another he also took charge of raising funds for the Philippine Anti-Tuberculosis Society.

It is admitted, and on this score there is no dispute between the parties, that for the years 1945 to 1951, inclusive, the petitioner filed income tax returns for which he paid the corresponding taxes thereon as declared, in the following manner:

<u>YEAR</u>	<u>NET INCOME</u>	<u>INCOME TAX PAID</u>
1945	₱ 23,138.50	₱ 918.31
1946	16,520.09	1,393.42
1947	37,898.34	5,923.57
1948	12,118.02	700.34

DECISION -
C. T. A. CASE NO. 30

- 7 -

1949	₱ 10,869.74	₱ 538.07
1950	18,644.46	3,837.00
1951	22,097.00	2,971.00

Sometime in 1948, the income tax returns for the years 1945 to 1947 of the petitioner were verified by respondent and deficiency income taxes in the total amount of ₱5,470.98 were assessed against him for said years in the following manner:

<u>YEAR</u>	<u>ORIGINAL TAX</u>	<u>DEFICIENCY TAX</u>	<u>TOTAL TAX</u>
1945	₱ 918.31	₱ 193.43	₱ 1,111.74
1946	1,393.42	1,145.34	2,538.76
1947	<u>5,923.57</u>	<u>4,132.21</u>	<u>10,055.78</u>
	<u>₱ 8,235.30</u>	<u>₱ 5,470.98</u>	<u>₱ 13,706.28</u>

which the petitioner readily paid.

Sometime in the early part of 1952, the respondent Collector of Internal Revenue, believing perhaps that the petitioner had not reported his true income in his returns for the past seven years ordered his re-investigation for possible additional tax deficiencies. For this purpose, three teams of investigators were formed. The first team headed by BIR Supervisor Felipe Aquino, with BIR Examiner Conrado Quesada as one of its members, after examining the books of petitioner for about eight months, recommended in their memorandum, Exhibit "N" (Urgent Motion) dated July 30, 1952, a deficiency income tax assessment against the petitioner in the total amount of ₱898,794.03 for the years 1945 to 1951, inclusive, employing for this purpose the ordinary and not the Net Worth-Expenditure (Inventory) Method of investigation.

DECISION -
CASE NO. 30

- 8 -

The then Collector of Internal Revenue Saturnino David was apparently not satisfied with the findings of his investigators as could be seen in his memorandum, Exhibit "BBBBB", dated January 15, 1953, to the Acting Chief of the BIR Intelligence Division. So, a second team of investigators was formed composed of Messrs. Vicente Z. Lasquety, Pastor Blanco, E. M. Trinidad, and B. Francisco to investigate once again the deficiency income tax liability of petitioner for the years in question "as a means of strengthening the Government's position in asserting the proposed deficiency.." In their first report, Exhibit "J" Urgent Motion, dated June 30, 1953, this second team recommended a deficiency income tax assessment of ₱2,722,030.33 against the petitioner for the said years employing for this purpose the Net-Worth-Expenditure (Inventory) Method of investigation with emphasis on bank withdrawals. The respondent Collector of Internal Revenue was again not satisfied with this last finding of his investigators so he ordered a re-investigation by the same team. Employing similar method but allowing deductions for alleged liabilities furnished by petitioner, the team modified its first finding by reducing the assessment from ₱2,722,030.33 to ₱30,119.43 as may be seen in their official ^{re} report, Exhibit "K", Urgent Motion, dated September 2, 1953. Again, after wasting almost nine months investigating the deficiency tax liability of petitioner, the Collector of Internal Revenue was not satisfied with this last finding of his second

team so a third investigating team was formed headed by BIR Examiner Conrado Quesada. The third team, employing once again the Net Worth-Expenditure Method of investigation and after spending almost nine months for this purpose, recommended an assessment of ₱1,505,768.54 against the petitioner as may be seen in the working sheet, Exhibit 8, of BIR Examiner Quesada. The respondent Collector of Internal Revenue was apparently satisfied with this assessment. On August 10, 1954, he sent a formal letter of demand subject of the present appeal, to petitioner for the afore-mentioned amount as deficiency income taxes for the years in question thereby adopting as his own the findings of the third investigating team headed by BIR Examiner Quesada.

Mention should likewise be made of the fact that aside from these three investigations, the petitioner was also subjected to another investigation sometime in 1951 by the Ways and Means Committee of Congress headed by Congressman Cipriano Allas.

The principal issues that have been raised by the parties, as may be gathered from their well-prepared and exhaustive memoranda, may be summarized as follows:

1. What are the assets and liabilities of the petitioner that should be considered in determining his net worth as of the end of each year beginning from 1945 to 1951, inclusive?;

2. Whether or not the Net Worth-Expenditure (Inventory) Method of investigation should be applied

under the circumstances surrounding this case for the purpose of determining the taxable net income of petitioner for the years in question?;

3. Whether or not certain non-taxable income and non-deductible items have been properly considered in determining the net income of petitioner subject to income tax?;

4. Whether or not the 50% fraud penalty should be imposed upon the taxpayer?; and

5. Whether or not the right of the government to assess and collect the deficiency income taxes in question has prescribed, in the light of the statute of limitations generally and specifically applicable to income taxes?

We shall now proceed to decide these issues in the order given above.

But before doing so, however, we would like to point out that the barometric rise and fall of the deficiency income tax assessments against the petitioner for the same period of years (1945 to 1951) by the three investigating teams created by the Collector of Internal Revenue to investigate the tax liability of petitioner has, in the mind of the Court, considerably weakened the case for the government. The enormous discrepancies ranging at times to over a million pesos in the findings of the different investigating teams particularly of the second team which at first found the petitioner liable for ₱2,722,-030.33 and subsequently for only ₱30,119.43, goes to prove that the Government agents entrusted with the

DECISION -
C. T. A. CASE NO. 30

- 11 -

task were either too harsh and unreasonable or were much too liberal towards the petitioner in their investigation of his tax liability. The highly disproportionate findings of the three teams, which petitioner's counsel have pointed out in bold relief to their advantage, has lead this Court to believe that the three different investigating teams created by the Collector of Internal Revenue for the purpose of investigating the deficiency income tax liability of petitioner were not sure of their stand; that their investigation was oftentimes a hit-and-miss affair; that there was no coordination in their work and that one group was out to impress their superiors with a fantastic assessment and the other to handle the taxpayer with kid gloves. True indeed, as pointed out by respondent's counsel, the Collector of Internal Revenue disregarded the memorandum reports of the first two investigating teams and adopted as his own only the findings and recommendations of the third team headed by BIR Examiner Quesada. But then, the official written reports of the first two teams, Exhibits "N", "J", "K" Urgent Motion, form part of the BIR records and were introduced in evidence by the petitioner to prove that each investigating team made a finding grossly disproportionate from that of the others. This state of uncertainty, coupled with the fact that an actress by the name of Maria Corazon seems to have marred during the investigation the official dealings between BIR Examiner Quesada and the petitioner, have to a considerable extent

affected the prima facie presumption of correctness of respondent's final assessment now subject of this appeal. In view of these circumstances, we have found it necessary, in fairness to petitioner, to scrutinize with distrust the different disputed items appearing in the working sheet, Exhibit 8, of BIR Examiner Quesada and to concede to the taxpayer the benefit of doubt where doubt exists.

On the other hand, notwithstanding some flagrant errors committed by the third investigating team headed by BIR Examiner Quesada, in the computation of petitioner's deficiency income tax liability for the years in question, and the deficient manner by which said examiner investigated this case, we find ourselves with no other alternative but to sustain - as we shall hereinafter discuss more exhaustively - respondent's contention that the circumstances of this case permit and warrant the use of the Net Worth-Expenditure (Inventory) Method of investigation as applied by the respondent in arriving at the alleged deficiency income tax assessment of ₱1,505,768.54.

Having thus resolved primarily the use of the Net Worth Method in favor of respondent, the first issue therefore revolves around the inclusion or exclusion of certain assets and liabilities of petitioner to form part of his net worth at the end of each calendar year.

As a requisite to the use of the "increase in net worth method" the parties presented evidence to

DECISION -
C. T. A. CASE NO. 30

- 13 -

establish the assets and liabilities of petitioner at the beginning of 1945 to serve as a basis in the computation of the opening net worth. Both parties are agreed that the petitioner owned personal properties at the beginning of the year 1945 in the sum of ₱500.00 and that he had no liabilities. There is some dispute, however, on the question whether the opening net worth of petitioner also includes funds claimed as held in trust by petitioner's father Li Chay Too, Sr. in the sum of ₱159,910.89 or only ₱12,000.00 as respondent contends. This sum of ₱12,000.00 forms part of the investment of petitioner in Li Yao & Co.

One of the requisites in the application of the Net Worth Method is the fixing of the net worth at the end of each year. The admitted assets as well as the disputed items forming part of the net worth of petitioner at the end of each calendar year from 1945 to 1951, inclusive, may be summarized as follows:

Assets and Liabilities
as of the end of December 31, 1945:

Admitted Assets:-

Investment - Li Yao & Co. (Personal)	₱ 29,131.38
Personal Accounts: Li Yao & Co.	3,700.00
Li Yao & Co. (Bonus)	8,207.12
Personal properties - others	500.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Funds held in trust by father, Li Chay Too	₱144,000.00	n o n e

DECISION -
C. T. A. CASE NO. 30

- 14 -

Assets and Liabilities
as of the end of Decem-
ber 31, 1946:

Admitted Assets:

Investment - Li Yao & Co. (Personal)	₹ 145,509.20
Personal Accounts - Li Yao & Co. (a/c # 2)	1,967.57
Personal properties - others	850.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Cash Funds from loans	₹ 90,032.43	n o n e
Republic Textiles - shares of stocks	n o n e	₹350,000.00

Liabilities:

Loans Payable	100,000.00	n o n e
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Assets and Liabilities
as of the end of Decem-
ber 31, 1947:

Admitted Assets:

Investment - Li Yao & Co. (Personal)	₹171,607.54
Personal Accounts: Li Yao & Co. (a/c # 2)	5,995.91
Li Yao & Co. (Tan Ho Ti)	6,000.00
Personal properties - others	850.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Assets:		
Cash funds from loans	₹ 78,036.52	n o n e
Republic Textiles - shares of stock	n o n e	₹350,000.00

Liabilities:

Loans Payable	100,000.00	n o n e
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Assets and Liabilities
as of the end of Decem-
ber 31, 1948:

Admitted Assets:-

Bank of America	₹ 3,651.59
Investments: Li Yao & Co. (Personal)	167,532.17
Li Yao & Co. (wife)	2,000.00
Personal account - Li Yao & Co.	2,000.00
Personal properties - others	1,750.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Assets:		
Cash funds from loans	₹90,384.93	n o n e
Shares of stock - Republic Textiles	n o n e	₹350,000.00
Investments in Tan Pee		
Cu Yek Chim & Co.	n o n e	30,000.00
Liabilities:		
Loans Payable	₹140,000.00	n o n e

Assets and Liabilities
as of the end of Decem-
ber 31, 1949:

Admitted Assets:

Bank of America	₹	1,214.81
Investments: Li Yao & Co. (Personal)		169,175.93
Li Yao & Co. (Wife)		2,000.00
Investments in Li Chay Too Sons, Inc.		166,533.32
Real Properties (Inherited)		9,387.49
Building after deducting depreciation		21,544.28
Personal Account: Li Yao & Co. (a/c # 2)		53,800.00
Li Yao & Co. (Tan Ho Ti a/c # 2)		10,000.00
Personal properties - others		1,750.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Assets:		
China Banking Corp. time deposit	n o n e	₹ 60,000.00
Republic Textiles - shares of stock	n o n e	350,000 00
Investments in Tan Pee Cy Yek Chim & Co.	n o n e	30,000.00
Liabilities:		
Loans Payable	₹253,000.00	n o n e

Assets and Liabilities
as of the end of Decem-
ber 31, 1950:

Admitted Assets:

Bank of America	₹	44,404.64
Investments: Li Yao & Co. (Personal)		261,467.69
Li Yao & Co. (Tan Ho Ti, a/c # 2)		55,179.89
Investments in Ferin, Li Yao and his wife		260,000.00
Investments in Li Chay Too Sons, Inc.		166,533.32
Real Properties, land inherited		9,387.49
Building, net after providing depreciation		19,150.47
Accounts receivable from Li Chay Too Sons		20,000.00
Personal properties: Automobile		4,000.00
Others		2,150.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Assets:		
Investment in Ferin (through others)	n o n e	₹390,000.00
Investment in Tan Pee Cu Yek Chim & Co.	n o n e	30,000.00
Personal Properties - Race horses	₹ 11,500.00	18,500.00
Liabilities:		
Loans Payable	580,500.00	n o n e

Assets and Liabilities
as of the end of Decem-
ber 31, 1951:

Admitted Assets:

Security Bank and Trust Co.	₱ 1,400.00
Bank of America	1,034.74
Investments:	
Li Yao & Co. (Personal)	283,966.84
Li Yao & Co. (Tan Ho Ti, a/c #2	55,179.89
Investments in FERIN, Li Yao	
and his wife	320,000.00
Investments in Li Chay Too	
Sons, Inc.	166,533.32
Land Inherited	9,387.49
Building after providing for	
depreciation	16,756.66
Accounts Receivable from FERIN	750,000.00
Accounts Receivable from Li Chay	
Too Sons, Inc.	20,000.00
Personal properties: Automobile	4,000.00
Others	2,400.00

Disputed Items:

	<u>Per Li Yao</u>	<u>Per BIR</u>
Assets:		
Investments in		
FERIN thru others	none	₱480,000.00
Investments in Tan		
Pee Cu Yek Chim		
& Co.	none	30,000.00
Personal properties		
Race horses	₱ 11,500.00	18,500.00
Liabilities:		
Loans Payable	1,355,500.00	none

Let us first go into the disputed items.

A S S E T S

THE OPENING NET WORTH OF PETITIONER
AS OF JANUARY, 1945

The government is required, when the Net Worth Method is employed, to establish by clear, positive and convincing evidence the "opening net worth" of the taxpayer. In this particular case, upon the examination made by BIR Examiner Quesada of the balance sheet of Li Yao and Company as of 1945 and seeing that the investments indicated therein to the credit of petitioner was ₱12,000.00, the former immediately concluded that such investment together with the latter's personal properties in the sum of ₱500.00 or a total of ₱12,500.00, constituted

his beginning net worth. BIR Examiner Quesada made no further investigation beyond this source of evidence except interviewing Gloria Pineda, petitioner's private secretary and accountant, and examining the 1945 balance sheet of Li Yao & Company. He did not inquire from petitioner himself as to his properties that may form part of the beginning net worth. The finding of Examiner Quesada on this score, though hastily done, was readily adopted by respondent in the computation of petitioner's deficiency income tax liability thus granting him an opening net worth of only ₱12,500.00. Considering the limited scope of Quesada's investigation, we cannot give much credit to it. We find the explanation given by the petitioner on the witness stand as to the amount of his assets at the beginning of 1945 which is corroborated by other evidence more plausible.

The petitioner testified that there was held in trust, funds in the name of Li Chay Too, Jr. by his father, Li Chay Too, Sr. since 1942 in the amount of ₱159,910.89 genuine Philippine Currency which was buried in his father's bodega during the Japanese occupation; that before the last world war he was also known as Li Chay Too, Jr.; that after the liberation, the said amount kept for him in trust by his father was excavated from its hiding place and was released to him gradually; and, that he later on went into business in his own name using the said funds obtained from his father totalling ₱159,910.89.

We find the testimony of petitioner on this

point quite credible in the absence of proof to the contrary, considering that during the Japanese occupation, persons were generally prone to hoard money in Philippine Currency in the belief that the so-called Japanese or "Mickey Mouse" money would not be redeemed after the war - as in fact it was never redeemed - while on the other hand, the genuine pre-war Philippine currency would always be considered as legal tender after liberation. Moreover, it appears that before the war and after the liberation, petitioner operated a business of his own separate and distinct from that of his father. This is corroborated by witnesses Bi Huan Chay and Dy Po alias Ty Se Eng who had been dealing with petitioner even before the war and is supported by an ante litis declaration of petitioner in his application for naturalization, Exhibit 122, that he had been in business as far back as 1940. Immediately after the liberation, the petitioner organized the Li Yao & Co., Ltd. contributing ₱12,000.00 as his initial share of the capital (Exhibit AAAA) which capital contribution was subsequently increased in the later part of 1945 by ₱4,000.00 (Exhibit AAAA-1). As explained by petitioner, Li Yao and Co. was converted into a general partnership (Exhibit BBBB), the funds of which were obtained from the Li Chay Too, Jr. funds previously held in trust by his father. The fact that petitioner was in business even before the war is further corroborated by his immigration record in the name of Li Chay Too, Jr. and by the fact that the same

*No evidence
other than
his own
statement*

|| how

DECISION -
C. T. A. CASE NO. 30

- 19 -

person appears to have filed income tax returns and was duly investigated as a taxpayer by the Ways and Means Committee of the House of Representatives sometime in 1951, then headed by Congressman Cipriano Allas, to which committee BIR Examiner Epifanio Paragas was assigned. BIR Examiner Paragas himself admits in his certification, Exhibit "A" Urgent Motion, that for the years 1936, 1937, 1938 and 1940, Li Chay Too "Jr." had a total income of ₱159,910.89. We find this evidence convincing enough to sustain the finding that the beginning net worth of petitioner as of 1945, should include the sum of ₱159,910.89 representing funds of Li Chay Too, Jr. held by his father Li Chay Too, Sr. and not alone the ₱12,000.00 appearing in the records of Li Yao & Company plus the value of petitioner's personal properties in the amount of ₱500.00 which are admitted by both parties.

same amount credited to Li Chay Too the father

Since we have found, as we do find, that at the beginning of 1945, the net worth of William Li Yao was ₱159,910.89 and since it is admitted that a portion thereof in the total amount of ₱16,000.00 was invested in Li Yao & Co. during the year 1945, it necessarily follows that at the end of that year, the available fund held in trust for Li Chay Too, Jr. or petitioner himself, was only ₱143,910.89 after deducting from the original sum, his initial investments in Li Yao & Co. In the absence of better proof to the contrary, therefore, we have decided to premise the opening net worth of petitioner at

₱160,410.89 which includes his investments in Li Yao & Co. and his personal properties worth ₱500.00.

SHARES OF STOCKS IN THE REPUBLIC
TEXTILES, INC. OF NEW JERSEY,
U. S. A., IN THE AMOUNT OF ₱350,000
FROM 1946 TO 1949

Another contested item consists of the shares of stocks allegedly owned by petitioner in the Republic Textiles, Inc. of New Jersey, U. S. A. in the amount of ₱350,000.00 which was considered by BIR Examiner Quesada as an asset of petitioner for the years 1946, 1947, 1948 and 1949.

It has been clearly shown by the petitioner that the Republic Textiles, Inc. of New Jersey is a small indenting firm which came into existence only on June 24, 1948, as evidenced by a photostat copy of its Certificate of Incorporation, Exhibit "N", Urgent Motion, duly authenticated by Felino Meñez, Filipino Vice-Consul for New York. Nowhere in the aforementioned certificate of incorporation does the name of the petitioner appear either as incorporator or stockholder. In fact, the secretary of the Republic Textiles, Inc. of New Jersey issued a duly authenticated certification, Exhibit "I-1", dated September 22, 1954, to the effect that "MR. William Li Yao a Philippine citizen residing at 549 Nueva Street, Manila, P.I. has never been a stockholder of Republic Textiles, Inc. from the time of its inception to this date." Respondent's own witness, George Litton, a well-known local textile dealer, testified that he knows the Republic Textiles, Inc. of New

Jersey and saw for himself during one of his post-war visits to the United States that it was a very small corporation with a meager capital of only \$5,000.00 engaged in the indenting business and that the nature of the business of said corporation does not require a large capital with which to operate.

In the face of all these evidences, we cannot sustain the finding of respondent to the effect that petitioner invested the amount of ₱350,000.00 in shares of stocks of the Republic Textiles, Inc. of New Jersey from 1946 to 1949. Obviously, from the evidence presented by petitioner of which we have no reason to doubt, it would have been both physically and legally impossible for petitioner to own shares of stocks in the said corporation as early as 1946 when the same was organized only in 1948. On the other hand, the only evidence introduced by the respondent and upon which BIR Examiner Quesada based his conclusion that the said amount was an investment or asset of the petitioner for the years 1946 to 1949, are the unsigned letters, Exhibits 12 and 14, purportedly written by petitioner to the Republic Textiles, Inc. and the latter's unsigned reply thereto, Exhibit 13. But as explained by petitioner and his secretary, Oscar Vergara, who likewise testified before this Court, the aforesaid letters were written by him (Vergara) on his own initiative without petitioner's consent and were contrived by him (Vergara) solely for the purpose of bolstering the credit standing of his employer here and abroad and

to help him raise additional funds for his numerous ventures. In fact, according to petitioner, he objected to the use of the aforementioned letters for the purpose intended by his secretary, Oscar Vergara. As between the unsigned letters, Exhibits 12, 13 and 14, on the one hand, and the Articles of Incorporation of the Republic Textiles Inc. of New Jersey and the certification of the secretary of said corporation showing that the petitioner was never a stockholder of the same since its organization up to the present time, on the other, we find the latter evidence of more weight. Thus, we find the contention of petitioner that at no time between 1946 and 1949 was he a stockholder of the Republic Textiles, Inc., to be true and correct, and therefore, the alleged investment of ₱350,000.00 in the said corporation should not be considered as his asset for the years 1946 to 1949 as erroneously considered by the respondent.

INVESTMENT OF ₱30,000.00
IN TAN PEE, CU YEK CHIM & CO.

BIR Examiner Quesada, in the course of his investigation of petitioner's income tax deficiency for the years in question, considered among his unreported assets an investment of ₱30,000.00 in the firm of Tan Pee, Cu Yek Chim & Co., Inc. representing thirty (30) shares of stocks of said corporation. His finding in this regard is based on the fact that in the Stock Certificate Book of Tan Pee, Cu Yek Chim & Co., Inc., there is an entry which shows that on November 18,

1948, thirty (30) shares of stocks of said corporation were issued to petitioner. Stub No. 106 of the Stock Certificate Book of said corporation, Exhibit 17, for ten (10) shares, and Stub No. 107 of the same book, Exhibit 19, for 20 shares, clearly show that a total of thirty (30) shares were issued in the name of petitioner by the corporation on November 18, 1948. It appears, and this fact is admitted by petitioner, that these shares originally belonged to Tan Pee, petitioner's father-in-law.

Respondent contends that pursuant to section 35 of Act 1459, otherwise known as the "Corporation Law," there has been a valid legal transfer of said shares of stocks to petitioner and therefore the same should be considered as forming part of his assets for the years 1948 to 1951. However, in order to destroy the presumption of valid legal transfer of ownership of the aforementioned shares in his name for a consideration, the petitioner and his father-in-law offered the following explanation: that Tan Pee, petitioner's father-in-law, became seriously ill in 1948 and was in such imminent danger of death that he decided to transfer to him (petitioner) the shares in question without any consideration because of Tan Pee's love and affection for his (petitioner's) wife, Juanita Tan Ho Ti; and, that neither he nor his wife Juanita was ever informed of this transfer until 1952, when Tan Pee recovered his health and decided to recall said transfer by requesting petitioner to endorse the stock certificates, Exhibits 18 and 20, back to him.

We find this explanation quite weak to rebut the presumption that the transfer of said shares of stocks was made for a valid consideration and in the ordinary course of business. If, as claimed by Tan Pee, it was his profound love for his daughter, as well as his failing health, which prompted him in 1948 to transfer said shares without consideration, why did he not transfer the same directly to his daughter but instead to his son-in-law, a professed gambler and a playboy who admittedly keeps a secret notebook containing a list of his girl friends? Moreover, it will be noted from the evidence for the petitioner, that when the petitioner and his wife needed money to invest in Li Yao and Co. it was petitioner's wife and not he who obtained a loan of ₱50,000.00 from Tan Pee. It was his wife who also signed the promissory notes.

Petitioner's counsel contend that the petitioner never became the owner of the shares in question-- that the transfer was a meaningless act-- because it was neither a donation mortis causa nor a donation inter vivos. If this be so, then it does not sit well on the lips of petitioner's witness, Tan Pee, to repudiate the transfer while on the other hand - in the same breath - he would want us to believe that the transfer was sincere, well-meant and motivated by his state of health and profound love for his daughter whom he wanted to protect in the event of his untimely death.

In the absence of better and convincing proofs

to the contrary, as a general rule the corporate books and records are the best evidence against stockholders with respect to subscription of stocks and as to their stock holdings (p. 548, Vol. 5 - Fletcher Cyclopedia Corporation).

With respect to this disputed item of ₱30,000.00, we find it to be an unreported asset of petitioner for the years 1948 to 1951, as found by the respondent.

CASH FUNDS FROM LOANS

In "Annex B" of petitioner's memorandum, there are three entries showing that there was cash on hand at the end of the years 1946, 1947 and 1948, the sums of ₱90,032.43, ₱78,036.52 and ₱90,384.73, respectively, which it is claimed should be taken up as part of the assets of the petitioner for those years. After obtaining loans from the following persons -

Iy Suan	1946	₱20,000.00
Li Yek	1946	30,000.00
Go Se Un	1946	20,000.00
Teodoro Santos	1946	30,000.00
Ong Tiao Seng	1948	20,000.00
Li Chiu Ka	1948	20,000.00

the petitioner claims that he acquired the corresponding cash as part of his assets and in turn incurred from these persons the corresponding liabilities. At the end of each year, the petitioner claims to have left as balances of the cash loaned the amounts first indicated above after investing a part in other assets.

Based on the evidence which we shall discuss

DECISION -
C. T. A. CASE NO. 30

- 26 -

hereafter under liabilities in a more detailed manner, we are giving credence only to the obligations owing to the first-four persons named above incurred in 1946 and consequently, we must consider that the petitioner could have cash on hand from such loans at the end of the year 1948 only out of the liabilities previously incurred. We therefore, find and hold that the amount of assets in the form of cash obtained from these loans should be only as follows:

1946	₱ 90,032.43
1947	78,036.52
1948	50,384.93

₱60,000.00 TIME DEPOSIT WITH
THE CHINA BANKING CORPORATION AS
OF THE END OF 1949.

In his working sheet, Exhibit 8, BIR Examiner Quesada listed among the assets of petitioner as of the end of 1949, a time deposit of ₱60,000.00 with the China Banking Corporation which was made in the name of petitioner. It is admitted that this amount was deposited by petitioner in said bank during the year 1949. However, petitioner questions Quesada's finding in this regard claiming that the amount in question, though deposited in his name, should not have been treated as part of his assets for that particular year because the same was held by him merely in trust for and in behalf of a certain James Li. He claims that James Li, who is one of his intimate friends, came to the Philippines from Hongkong in 1949 carrying with him \$30,000.00 in cash which he intended to invest in the local textile business. Petitioner avers that the sum was entrusted to him

by said person with instructions to deposit the amount with the China Banking Corporation pending its final investment, as he in fact did by depositing the sum in his (petitioner's) name with the aforesaid bank. It is further alleged that the amount in question was never invested in the textile business, as agreed upon, because of our foreign exchange and import control laws. Consequently, in 1950, the money was allegedly withdrawn upon instructions of James Li, and delivered to an emissary of the latter by the name of Chen Heng. To corroborate his testimony, petitioner presented the records of the China Banking Corporation, Exhibits "VVVV" and "VVVV-1", and an employee of said bank by the name of Leonardo Solidum to prove that in 1949 he did in fact deposit to his credit \$30,000.00 in cash with the China Banking Corporation.

As we see it, the records, Exhibits "VVVV" and "VVVV-1", of the China Banking Corporation and the testimony of Leonardo Solidum tend to prove only one thing - that \$30,000.00 in cash were deposited with the China Banking Corporation in petitioner's name in 1949. As to the allegation that the sum belonged to James Li and not to the petitioner, we have the sole testimony of the latter uncorroborated by any documentary or testimonial evidence. Neither James Li nor Chen Heng, the supposed emissary, were presented in Court to corroborate petitioner's claim that the money in question really belonged to James Li. Neither was it explained why these two persons

544

were not brought before this Court to corroborate petitioner's claim regarding the ownership of the \$30,000.00.

The testimony of petitioner, standing by itself, without benefit of corroboration either by documentary or testimonial evidence, cannot overcome the presumption established under section 69 (j), Rule 123 of the Rules of Court, "that things which a person possesses, or exercises acts of ownership over, are owned by him".

By way of further elaboration, it should be noted that the amount of \$30,000.00 or ₱60,000.00 which James Li allegedly delivered to petitioner for safekeeping and investment in the textile business is quite substantial. This notwithstanding, petitioner failed to produce in support of his allegation regarding the ownership of the sum in question, even one piece of documentary evidence say a receipt; the partnership agreement; a written authority from James Li authorizing him to withdraw the \$30,000.00 or ₱60,000.00 from the China Banking Corporation and to deliver the amount to one Chen Heng; or a receipt from the latter to petitioner acknowledging receipt of the amount for James Li. On the other hand, with respect to his alleged liabilities which we are going to take up later in this decision, particularly that loan of ₱30,000.00 which he claims to have obtained from his sister Li Hong Eng, the petitioner readily presented the promissory note, Exhibit "JJJ", evidencing the indebtedness.

According to the petitioner, his father placed

DECISION -
C. T. A. CASE NO. 30

- 29 -

him on probation before releasing to him in full the Li Chay Too. Jr. funds amounting to approximately ₱160,000.00. He showed his worth as a promising young businessman, so he claims, and thus won the full confidence of his sire. We ask: As a shrewd and promising young businessman and considering the big amount involved in his alleged transaction with James Li, did it not occur to petitioner to require a counter receipt from the emissary, Chen Heng, before delivering to the latter the amount of ₱60,000.00 intended for James Li for his (petitioner's) personal protection just in case those two should deny having received the amount. And if the said amount was returned by check issued by petitioner from his deposit with the China Banking Corporation, would not the cancelled check be one of the best corroborative evidence regarding the ownership of the sum in question?

A businessman, and for that matter any taxpayer, who does not keep books of accounts or to say the least a systematic record of his transactions, should be prepared to face adverse consequences if, upon being involved in a ruinous tax litigation, he encounters all kinds of obstacles in his attempt to sustain his case.

We are therefore constrained to hold that the uncorroborated testimony of petitioner regarding the ownership of the \$30,000.00 or ₱60,000.00 is much too strained to deserve credibility. The finding of the respondent that this amount forms part

of the hidden assets of the petitioner as of the end of 1949 is therefore sustained.

INVESTMENT IN FERIN OF ₱390,000.00 IN
1950 (Exhibit 8-FFF) AND ₱480,000.00
IN 1951 (Exhibit 8-III).

In his working sheet, Exhibit 8, BIR Examiner Quesada considered all the shares of stocks of FERIN in the total amount of ₱390,000.00 in 1950 (Exhibit 8-FFF) and ₱480,000.00 in 1951 (Exhibit 8-III) as assets of the petitioner although they stand recorded in the books of said corporation as belonging to other persons in the following manner:

<u>Stockholder</u>	<u>1950</u>	<u>1951</u>
Murray Goldberg	₱170,000.00 increased to	₱215,000.00
Vicente Duazo	85,000.00 increased to	100,000.00
Gloria Pineda	25,000.00 increased to	40,000.00
Delfin Fulay	85,000.00 increased to	100,000.00
Carmen McFerran	<u>25,000.00</u>	<u>25,000.00</u>
T o t a l	<u>₱390,000.00</u>	<u>₱480,000.00</u>

Examiner Quesada's finding with respect to these two items is based principally on the ground that Carmen McFerran, who appears to have invested ₱25,000.00 in said corporation has never filed an income tax return after the liberation. And with respect to the other four who did, it is claimed that their returns do not show enough income to render credible the substantial investments in FERIN attributed to them. Examiner Quesada also gave much significance to the close relationship existing between petitioner and his employees, Gloria Pineda and Delfin Fulay, and the relationship of employer and employee existing

between petitioner's mother and Vicente Duazo.

In deciding the question as to the ownership of the ₱30,000.00 worth of shares in Tan Pee, Cu Yek Chim & Co. registered in the name of petitioner during the years 1948 to 1951, we adopted the generally accepted rule that in the absence of positive proofs to the contrary, the corporate books and records of a corporation are the best evidence against stockholders with respect to subscription of stocks and as to their stock holdings.

Applying the same rule in the instant case of the shares of stocks of FERIN registered in the names of Murray Goldberg, Carmen McFerran, Vicente Duazo, Delfin Fulay and Gloria Pineda, we hold that the corporate books and records of said corporation are the best evidence with respect to the stockholdings of these persons. The burden of proof is on the government to show that these persons were utilized for some ulterior motive by petitioner as dummies, and that the subscriptions and paid-up capital listed in their respective names actually belong to petitioner.

The respondent presented three income tax returns, Exhibits 111, 112, 113, of Murray Goldberg; two of Gloria Pineda, Exhibits 61 and 62; three of Vicente Duazo, Exhibits 63, 64 and 65; and two of Delfin Fulay, Exhibits 66 and 67, to prove that their respective incomes as reflected in their returns are much too small as compared to their big investments in FERIN. And with respect to Carmen McFerran, who

from the records of the Bureau of Internal Revenue, has never filed any income tax return before, during and after the period of her ₱25,000.00 investment in FERIN, the respondent argues that with more reason she could not have been in a financial position to invest such a big amount in said corporation. In addition to these grounds, the respondent points out that Gloria Pineda was employed as private secretary and accountant of the petitioner at the time she invested ₱25,000.00 in FERIN; that Delfin Fulay was his bodyguard and driver and Vicente Duazo, a bodyguard and driver of petitioner's mother. Ergo, they must be dummies of petitioner.

Petitioner's counsel contend on the other hand that the income reflected in one's return or the failure to file one are not important factors in the determination of the issue as to whether or not a person is financially capable of investing money in a corporation or partnership. And by way of alternative argument, counsel maintain that even granting that the above-named persons particularly Gloria Pineda, Delfin Fulay and Vicente Duazo are mere dummies because of their financial inability to invest the amounts imputed to them in FERIN as reflected in their respective income tax returns, this fact, standing by itself, cannot serve as a logical basis to consider them dummies of petitioner. It is argued that they could have as well been the dummies of other persons as in the case of Vicente Duazo who, it is possible, could be the dummy of petitioner's mother,

he being her driver and bodyguard and not of the petitioner.

Of the five, Gloria Pineda and Delfin Fulay are the two persons upon whom suspicion could rest because of their close association with petitioner. As we have said, Gloria Pineda is the private secretary and accountant of petitioner and Delfin Fulay is his driver and bodyguard. However, with respect to Gloria Pineda, who is single, her income tax returns Exhibits 58, 59, 60, 61 and 62 for 1946 to 1951, inclusive, show that she had a total net income of ₱25,299.50 during those years. From these returns, it is quite apparent that the investment of ₱25,000.00 attributed to her in 1950 which was increased to ₱40,000.00 in 1951 is not far beyond her reach. The relationship of employer and employee between petitioner and Gloria Pineda cannot be considered, therefore, as a decisive factor in determining whether she could well afford to invest ₱40,000.00 in the corporation headed by her employer.

The case of Delfin Fulay, who is admittedly a bodyguard and driver of petitioner, is quite different. The books of FERIN show that Delfin Fulay invested ₱85,000.00 in said corporation in 1950, which he increased to ₱100,000.00 in 1951. His income tax return for the years 1949, Exhibit 66, and his return for 1951, Exhibit 67, show that he had a total net income of only ₱8,560.00 during those two years. Could it be possible for a mere hireling like Delfin Fulay, with such a moderate income, to have invested

such an enormous amount as ₦100,000.00 in FERIN? The investment of Fulay in FERIN is so highly disproportionate to his income, that we find it impossible to believe the investment to be his own. And if the investment did not come from his own personal funds with his meager salary as driver and bodyguard, from who else could it have come but petitioner, considering the latter's admission that he purposely saw to it that the incorporators of FERIN were his close friends and persons whom he could trust. From all appearances, the petitioner could not have chosen a person more trustworthy than Delfin Fulay, the "Man Friday" entrusted with the protection of his life and limb.

The case of Vicente Duazo, who is admittedly a bodyguard and driver of petitioner's mother would seem at first blush to be entirely different from that of Delfin Fulay as far as relationship with petitioner is concerned. It appears from the evidence for the respondent that Vicente Duazo declared a net income in his return for 1948, Exhibit 63, the amount of ₦2,345.00; for 1949, Exhibit 64, the amount of ₦1,640.00 and for 1950, Exhibit 65, the amount of ₦3,480.00 or a total of ₦7,465.00. His investment in FERIN in 1950 was ₦85,000.00 and in 1951, it was increased to ₦100,000.00. It will be noted that the net income of Vicente Duazo for three years (1948, 1949, 1950) is much less than that of Delfin Fulay for two years (1949, 1951). Yet, far from being just a mere coincidence, they invested ₦25,000.00 each

in FERIN on August 25, 1950. On September 13, 1950, they invested ₦30,000.00 each in the same corporation. On September 25, 1950, they invested an additional ₦30,000.00 each. Lastly, on January 23, 1951, they both invested an additional ₦15,000.00 thus increasing the total amount of their investment in FERIN to ₦100,000.00 each. This striking similarity in the amounts invested by Duazo and Fulay in FERIN, and the glaring fact that the different amounts were invested at the same time, let alone the disparity in the amounts of their respective incomes, has lead us to the conclusion that the investments of these two persons in said corporation came from only one source. And the evidence on record indubitably point to petitioner as the source considering his admission that after the death of his father, he was entrusted with the business affairs of his family he being the eldest son and favorite of the deceased.

With respect to Murray Goldberg and Carmen McFerran, we find the evidence for the petitioner sufficiently convincing to sustain the conclusion that these two owned the shares registered in their respective names with FERIN as we had found in the case of Gloria Pineda. It appears that Goldberg was, at the time of his investment, the representative of several manufacturing firms in America aside from his own company, the Republic Textiles, Inc. of New Jersey. And with respect to Carmen McFerran, we have the testimony of Alfredo Veloso, whose credibility we have no reason to doubt. Veloso declared that

Carmen's family is well-to-do; that some members of her family used to gamble heavily sometimes losing as much as by the thousands; and, that her father was a high ranking official in the China Banking Corporation.

We find, therefore, that of the ₱390,000.00 worth of shares in FERIN registered in 1950 in the names of the five persons mentioned above, which the respondent considered fully as personal investments of petitioner, only ₱170,000.00 worth belong to petitioner viz., the shares registered in the names of Vicente Duazo and Delfin Fulay whom we have held to be dummies of petitioner. The balance of ₱220,000.00 should be considered as personal investments of Murray Goldberg, Gloria Pineda and Carmen McFerran and not that of petitioner.

And for 1951, the ₱200,000.00 worth of shares registered in the names of these same two persons (Duazo and Fulay) should likewise be considered as investments of petitioner in FERIN, leaving a balance of ₱280,000.00 which should be considered as belonging exclusively to Murray Goldberg, Gloria Pineda and Carmen McFerran.

CHECKS OF LI CHAY TOO SONS INC.
AND LI YAO & CO. FOR ₱200,000.00
AND ₱50,000.00, RESPECTIVELY.

BIR Examiner Quesada, after discovering that the initial capital of FERIN in the amount of ₱250,000.00 came from two checks issued by Li Chay Too Sons, Inc. and Li Yao and Co., immediately concluded that the amounts in question belonged to petitioner solely

because the latter was a stockholder of the two corporations.

We find this conclusion rather precipitate and unreasonable.

The respondent does not deny that Li Yao & Co. as well as Li Chay Too Sons, Inc. are two independent corporations endowed with separate and distinct personalities from that of petitioner. There is not the least insinuation on the part of respondent that the two corporations are mere fronts or alter egos of petitioner. It is likewise admitted by respondent that neither Li Chay Too Sons, Inc. nor Li Yao & Co., is owned solely by petitioner. The fact, therefore, that the two checks came from these two corporations to provide FERIN with its initial capital does not necessarily mean that the said amount is petitioner's own investment as found by the investigating agents. Under section 69(f) and (g), Rule 123, of the Rules of Court, there is that presumption that money paid by one to another was due to the latter and that the ordinary course of business has been followed. With these presumptions in mind and in the absence of positive proofs to dispute it, we may safely conclude, therefore, that the payments in question were made by Li Chay Too Sons, Inc. and Li Yao & Co. and not by petitioner. Granting, for the sake of argument, that the petitioner was a controlling stockholder of both corporations at the time said payments were made to FERIN, this fact standing by itself cannot serve as a reasonable basis

for the conclusion that Li Chay Too Sons, Inc. and Li Yao & Co. are mere alter egos of petitioner. A presumption cannot be drawn from another presumption. (Manning vs. John Hancock Mutual Loan and Insurance Co. 100 U. S. 693, 25 L. Ed. 761) In other words, we cannot infer that the aforesaid shares of stocks belong to petitioner, simply because he was at the time an officer and stockholder of the two corporations who appear to have paid for the shares.

On the other hand, we consider quite plausible the explanation of petitioner to the effect that checks were exchanged for cash to facilitate and simplify the transactions concerning the opening investments in FERIN after going over and checking the corresponding entries in the books of Li Chay Too Sons, Inc. and Li Yao & Co. It should be noted that BIR Examiner Quesada derived his conclusion regarding this alleged investment in FERIN in the amount of ₱250,000.00, which he considered as petitioner's own investment, solely on the books of accounts of said corporation. He did not bother to examine the books of the other two corporations on this particular item. Had he done so, as is naturally to be expected of him if he were after the true facts, he would have undoubtedly understood that the transaction as explained by petitioner was a usual practice adopted and common to all the three corporations concerned. We notice from the books of accounts of these three corporations that from time to time they issue checks in exchange for cash which are entered in the corporate books,

DECISION -
C. T. A. CASE NO. 30

- 39 -

as was done with respect to the two checks now in question amounting to ₱250,000.00. As explained by an accountant of these corporations and an expert witness who took the witness stand for petitioner, these checks were issued in exchange for cash as they appear in the books, there being an entry of cash as well as entries of disbursements charged against the checking accounts of said corporations. BIR Examiner Quesada, however, refused to give credit to the entries simply because they were not entered with all the necessary details and for lack of supporting vouchers showing the names of the persons from whom the cash had been received. Be that as it may, from the standpoint of both Li Chay Too Sons, Inc. and Li Yao & Co., Inc., these requirements imposed by BIR Examiner Quesada would not have materially altered the financial position, much less the cash position, of the two corporations. Even respondent's expert witness, Dr. Felipe Ollada, former Chairman of the Board of Accountancy, admitted that even if the entries had been more detailed as expected by the government agents, they would have arrived at the same result. From the standpoint of FERIN, which obviously was more concerned with the receipt of the sum of money, this "exchange for cash" transaction is explained by the fact that cash received by it was made in payment of investments and the corresponding shares of stocks were issued in exchange for such payments. The logical conclusion, therefore, would be that the issue of the shares of stocks was made

to the person making the payment. As explained by petitioner, he received all of the payments for the shares of stocks in cash so in turn he had to exchange the cash for checks of the two corporations, to protect himself from the danger of carrying large amounts of cash to be deposited with the China Banking Corporation in the name of FERIN. We concur in the view of petitioner's counsel that the issuance of the checks in exchange for cash did not materially affect the financial, much less the cash positions, of any of these corporations, because the payments were conveniently made in checks simply to facilitate and expedite the transactions regarding the opening investments in the FERIN.

BANK OF AMERICA CHECK NO.
A-318953 FOR ₱160,000.00

Respondent gives as additional ground in support of his finding that all of the incorporators of FERIN are mere dummies of petitioner, the discovery by BIR Examiner Quesada of Bank of America Check No. BA-318593 in the amount of ₱160,000.00 issued from the personal funds of petitioner and used for the purchase of a parcel of land from the Heirs of D. Tuazon, Inc. by FERIN. According to respondent, petitioner tried to hide this asset of his in FERIN by making it to appear that the said incorporators increased their investments in FERIN. On the other hand, petitioner came out with an explanation, to show why he had to use his personal funds for the purchase of said parcel of land from the Heirs of D.

Tuazon, Inc. According to him, some of the incorporators of FERIN like Murray Goldberg, paid for the increase of their shares of stocks in post-dated checks. Inasmuch as time was of the essence for the successful and immediate closure of the contract of sale between FERIN and the Heirs of D. Tuazon, Inc., the petitioner had to advance the amount of ₱160,000.00 by issuing his own Bank of America check as part payment to complete the ₱400,000.00 down payment of the land purchased. This had to be done, according to petitioner, because the President of the Heirs of D. Tuazon, Inc. did not like to accept post-dated checks. Petitioner explained that of this amount of ₱160,000.00, ₱64,000.00 belonged to him and his wife as part payment of their subscription to the increased capitalization of FERIN, and the remaining amount of ₱96,000.00 were provided by him temporarily by way of accommodation to cover the post-dated checks paid by other subscribers of FERIN. Petitioner further testified that he subsequently deposited the said post-dated checks in his bank account when they became due, to reimburse himself of the cash advanced for him.

Petitioner's explanation with respect to this particular item has not been contradicted by respondent. And what is more, there is no showing that respondent made any attempt to verify the same or to investigate the veracity of any statements related thereto. We note further that the bank account of petitioner, Exhibit 31, for the month of September

DECISION -
C. T. A. CASE NO. 30

- 42 -

1950, during which the payment was made, shows that after such payment, petitioner deposited in his bank account the sum of ₱37,005.70. In the absence of evidence to the contrary, coupled with respondent's failure to investigate thoroughly and follow the leads furnished by petitioner on this point, we have to give due credit to the explanation of petitioner on this particular item which, from all appearances, is highly probable. The amount of ₱160,000.00 paid by funds belonging to petitioner should not, therefore, be considered as an investment of petitioner in FERIN but merely an accommodation loan given by petitioner to FERIN. Hence, it should not be considered as forming part of his unreported assets in the form of hidden investments in said corporation as found by the respondent.

RACE HORSES ASSESSED AT ₱18,500

In his computation, Exhibit 8, of petitioner's deficiency income tax liability for the years in question, BIR Examiner Quesada, included as part of the assets of the petitioner under the column personal properties for the years 1950 and 1951, a stable of nine (9) race horses which he assessed without much ado in the total amount of ₱18,500.00.

The petitioner admits that he acquired by purchase, eight (8) of these horses from A. P. Reyes sometime in 1950 for ₱9,000.00 and another from the late Johnny Ysmael for ₱2,500.00 or a total of ₱11,500.00.

Neither the petitioner nor the respondent pre-

sented any documentary evidence, say the deeds of sale of the nine (9) horses or the corresponding receipts of payment, upon which this Court may base with accuracy its assessment of this asset.

However, taking judicial notice of the documentary evidence presented before this Court in C. T. A. Case No. 42, entitled "A. P. Reyes vs. Collector of Internal Revenue" we find Exhibits LL, TT and TTT, which confirm petitioner's declaration that sometime in 1950, he paid A. P. Reyes ₱9,000.00 for eight race horses.

With this confirmation, we find the valuation given by petitioner of the nine (9) horses owned by him in 1950 and 1951, in the total amount of ₱11,500.00 more reliable and convincing than the amount fixed by BIR Examiner Quesada.

LIABILITIES

The petitioner, in order to offset the increase of his net worth as determined by the respondent, submitted a long list of alleged liabilities incurred during the taxable years in question to whittle down the enormous deficiency income tax assessment arrived at by respondent thru the inventory method. All of these alleged liabilities are from loans incurred in favor of private parties numbering around thirty-four (34) as listed in petitioner's Exhibit "QQQQ".

These alleged liabilities may be divided into two general classifications, namely, those loans incurred by petitioner for the FERIN amounting to ₱750,000.00 and personal loans obtained for his own

account totalling approximately ₱1,355,500.00 unpaid or outstanding as of the end of 1951.

Although in practically all instances the petitioner produced the promissory notes evidencing the indebtedness and in some instances the receipts evidencing payment, BIR Examiner Quesada disregarded all of them as genuine liabilities including one obligation where the creditor went to the extent of suing the petitioner in court for the recovery of the amount loaned. The petitioner on the other hand maintains that all of these loans should have been credited in his favor by the respondent in the determination of his deficiency income tax liability.

We cannot adopt either extremes as suggested by the petitioner and the respondent. In fairness to all parties concerned, the surrounding circumstances of each loan must be looked into. A judicial sieve, so to speak, must be employed to separate the chaff from the grain, the obviously fictitious loans from the apparently genuine ones.

While it is true that as a general rule, when a person admits either orally or in writing that he owes money to another, his sole manifestation or admission to this effect would suffice without need of further corroborations, it being an admission against pecuniary interest (section 7, Rule 123, Rules of Court), the same rule cannot and should not apply to tax cases when the obvious purpose of the taxpayer in making such admission is to minimize his tax liability. (Richmond vs. Anchuelo, 4 Phil. 596;

Lim Chingco vs. Terararay, 5 Phil. 120; People vs. Tolentino, 69 Phil. 715.) In other words, an admission by the taxpayer that he owes money to another, is a double bladed weapon. It might be an admission against the taxpayer's pecuniary interest or a statement intended to serve his own purpose depending on whichever would suit his personal convenience. Like the defense of alibi in criminal cases, which is so easily manufactured and usually so unreliable (People vs. Timbang, 74 Phil. 294), in tax cases, it is just as easy to concoct a litany of fictitious loans to reduce one's tax liability, especially so if this is the last remedy left to the unscrupulous taxpayer to save himself from financial ruin.

On our part we come out with the general proposition that when a taxpayer claims he owes money to another for the purpose of reducing his tax liability, particularly when the Net Worth-Expenditure (Inventory) Method of investigation is employed against him, his admission must be corroborated by other evidence independent of the admission itself. For example, the promissory note, if there be any, should be produced for the inspection of the Court and government counsel. The alleged creditor must be produced in Court to confirm the taxpayer's admission and to give government's counsel an opportunity to cross-examine him, unless he is dead, outside of the Philippines or unable to testify for one reason or another. If the taxpayer is in business, his books as required of him by the National Internal Revenue Code should

be produced showing the corresponding entry or entries of his alleged liabilities. If for one reason or another the alleged creditor is not available as a witness, his financial capacity to extend the loan should at least be established.

We realize that without these requisites, we would be opening the flood-gates to wholesale tax frauds and abetting the skillful evasion of taxes. We would be establishing a bad precedent by indiscriminately accepting as genuine liabilities, loans evidenced by the mere say so of a taxpayer or by giving weight to promissory notes which bear the earmarks of an eleventh hour effort to minimize the taxpayer's liability. After all, a promissory note drawn by a taxpayer is nothing more than a statement of an alleged liability the truth of which can never be ascertained unless it is corroborated by some other evidence other than the note itself.

With these requisites enumerated above as guiding factors, let us now examine the alleged liabilities of petitioner for the account of FERIN, as well as the personal loans obtained for his own account.

ACCOUNTS RECEIVABLE FROM FERIN IN
THE AMOUNT OF ₱750,000.00

The loans incurred by petitioner for FERIN appear in the balance sheet of the corporation for the year 1951 as accounts receivable from FERIN, in the total amount of ₱750,000.00. Inasmuch as BIR Examiner Quesada saw this amount appearing in the cash receipts and cash account books of FERIN, he

DECISION -
C. T. A. CASE NO. 30

- 47 -

considered the same as forming part of the assets of petitioner for the year 1951. The evidence on this point however does not sustain BIR Examiner Quesada's conclusion.

It has been definitely established to the satisfaction of this Court that by virtue of a resolution, Exhibit "B", Urgent Motion, of the Board of Directors of the FERIN, dated February 10, 1951, the petitioner was granted authority to negotiate and contract loans in his name for the benefit of the corporation in an amount not exceeding ₱750,000.00. Pursuant to said resolution, petitioner allegedly contracted loans from the following persons in the amounts stated opposite their names:

Murray Goldberg	₱ 150,000
Louis Batt	200,000
Edward Garinger	100,000
J. Crisostomo Chavez	100,000
Li Chiok Eng (sister)	50,000
Li Siu Eng (sister)	50,000
Li Hong Eng (sister)	30,000
Jose P. Bengzon	10,000
Li Bee Eng (sister)	20,000
Li Kim Po (cousin)	30,000
Dee K. Chiong	10,000
	<u>₱ 750,000</u>

While we do not doubt the authority given to petitioner by FERIN to contract in his name the loans listed above by virtue of a resolution of the Board of Directors of said corporation, such an authority does not, however, render ipso facto indisputably genuine all the loans obtained by him by virtue of such authority.

The requisites we have heretofore enumerated must still be met with respect to these loans as well

as the other alleged personal loans of petitioner.

LIABILITIES ALLOWED

After going over the mass of evidence regarding these loans, with the requirements we have imposed as guiding factors, we find that the following have all the earmarks of genuineness.

MURRAY GOLDBERG'S LOAN OF ₱150,000.00:- This loan is evidenced by a promissory note executed on November 28, 1951, a photostatic copy of which is marked as Exhibit "HHHH". This loan appears to have been unpaid up to the present. Goldberg was not presented to corroborate petitioner's testimony regarding the loan because, as admitted by respondent's counsel, he is a non-resident alien.

Respondent bases the inability of Goldberg to extend such a loan mainly on the fact that in his income tax returns for 1947, Exhibit 113; 1949, Exhibit 112 and 1950, Exhibit 111, he declared a total net income of only ₱22,838.23.

The evidence shows, however, that Goldberg is the representative of several manufacturing firms in America aside from his own company, the Republic Textiles, Inc. of New Jersey. It is not a remote possibility that the amount loaned came from his income in the United States.

Moreover, he was a substantial stockholder of FERIN and as such there was good reason for him to help out the corporation.

LOUIS BATT'S LOAN OF ₱200,000.00:- The loan is evidence by a promissory note, Exhibit C, Urgent Motion, dated November 25, 1951, and appears to have been

paid on July 3, 1952, as evidenced by a voucher marked Exhibit D, Urgent Motion. Batt was a supplier of textiles of many firms in Manila since before the war and is one of the owners of a manufacturing company in New York. Like Goldberg, Batt is admittedly a non-resident alien and therefore his failure to take the witness stand to corroborate petitioner's testimony should not be held against the petitioner.

Edward Garinger's loan of ₱100,000.00: This loan is evidenced by a promissory note, Exhibit F, Urgent Motion, dated November 23, 1951, and appears to have been paid on July 7 and 14, 1952, as appearing in the vouchers, Exhibits G and G-1, Urgent Motion. The promissory note, Exhibit F, Urgent Motion, is even of United States print.

Garinger was a supplier of textiles of Li Chay Too Sons, Inc. and Li Yao & Co. and was naturally interested in maintaining the goodwill of petitioner as well as the two corporations managed by the petitioner and with whom Garinger was doing big business. The money which he loaned to FERIN could have come from his income in the United States where he was a resident.

Jose P. Bengzon's loan of ₱10,000.00: This loan is evidenced by a promissory note, Exhibit III, dated November 18, 1951. The loan was paid by petitioner with FERIN funds sometime in July, 1952 as evidenced by Exhibit D, Urgent Motion. The creditor, a former Secretary of Justice, took the witness stand

and confirmed the testimony of petitioner. We do not doubt the credibility of this witness as well as his financial capacity to extend the loan.

Dee K. Chiong's loan of ₱10,000.00: Although this loan is not evidenced by a promissory note because, as explained by the creditor himself, he is a very close friend of petitioner, we find it to be a valid liability of the latter. This creditor, who is the Vice-President of the China Banking Corporation, took the witness stand and confirmed the testimony of petitioner. He testified that the petitioner subsequently paid the obligation in full. We do not doubt in the least the credibility of this creditor as well as his financial capacity to extend the loan.

Li Siu Eng's loan of ₱50,000.00: This loan is evidenced by a promissory note, Exhibit QQQ, which was partially paid in the amount of ₱20,000.00 by the petitioner as evidenced by the receipt, dated October 12, 1954 appearing on the back of the same promissory note. The creditor, who is a sister of petitioner, took the witness stand to corroborate her brother's testimony. This creditor also explained the source of the money loaned to her brother.

Li Hong Eng's loan of ₱30,000.00: This loan is evidenced by a promissory note, Exhibit JJJ, dated November 21, 1951. The creditor, who is a sister of petitioner, took the witness stand to corroborate her brother's testimony. She explained the source of the money loaned to her brother. The loan appears

to be still unpaid up to the present time. The creditor declared that she has demanded payment of the amount from her brother but due to financial difficulties the latter has not been able to settle the same as yet.

LI BEE ENG'S LOAN OF ₱20,000.00:- This loan is evidenced by a promissory note, Exhibit VVV, dated November 20, 1951. At the time the loan was extended, the creditor, who is the youngest sister of petitioner, was only nine years old. The loan was given by Ty Suan, mother of petitioner and guardian of Li Bee Eng. Ty Suan took the witness stand and explained the circumstances under which the loan was granted. She also declared that her daughter Li Bee Eng had at least ₱20,000.00 as her share in the inheritance from the estate of her father, Li Chay Too Sr.

LI KIM PO'S LOAN OF ₱30,000.00:- This loan is evidenced by a promissory note, Exhibit YYY, dated November 21, 1951. The loan appears to have been fully paid on July 7, 1952, as evidenced by Exhibit YYY-1 from the funds of FERIN as shown by the voucher marked Exhibit D, Urgent Motion. This creditor took the witness stand and explained the circumstances surrounding the loan and the source of the amount loaned. It appears from the evidence for the petitioner, that this creditor filed income tax returns for the years 1947, 1948 and 1951, Exhibits ZZZ, ZZZ-1 and ZZZ-2 showing a total net income for those years of ₱13,051.13.

From the evidence, we accept this loan as a legitimate and settled liability of petitioner.

DISALLOWED LIABILITIES

We are not convinced by the evidence presented by petitioner in support of the following loans and therefore consider them as fictitious and non-existing.

J. CRISOSTOMO CHAVEZ'S LOAN OF ₱100,000.00:-

Although this loan is evidenced by a duplicate promissory note, Exhibit JJJJ, we find the explanation of petitioner regarding the reproduction of the original note marked Exhibit 55-A from which Exhibit JJJJ was taken, to be highly fantastic. This alleged creditor was seen by the Court on several occasions loitering in the Court premises during the early stages of the trial of this case. However, when his turn came to testify as witness for the respondent, he could not be served with a summon. He was cited by respondent's counsel precisely to confirm or repudiate the contents of an affidavit which he executed dated July 6, 1955 denying having made such a loan. Considering the past criminal record of this alleged creditor, his failure to testify before this Court upon being cited to do so and the explanation of petitioner regarding the two controversial promissory notes, Exhibits 55 and JJJJ, which we believe to be much too strained and fantastic, we cannot give credit to this alleged liability of petitioner.

LI CHIOK ENG'S LOAN OF ₱50,000.00:- Although this loan is evidenced by a promissory note (p. 177, Vol. III, BIR rec.), we cannot accept it as genuine liability of petitioner for failure on the part of the latter to present her as a witness to corroborate

his testimony. No explanation was offered by petitioner why this alleged creditor, who is his sister, was not presented as a corroborative witness like the rest of his three sisters.

In resumé, we find that of the ₱750,000.00 worth of loans contracted by petitioner in his name for the FERIN, only ₱600,000.00 worth thereof may be considered as his legitimate liabilities. The alleged loans in favor of J. Crisostomo Chavez for ₱100,000.00 and Li Chiok Eng for ₱50,000.00 are fictitious liabilities of petitioner based on the quantum of evidence we have heretofore set for taxpayers in support of alleged liabilities.

OTHER ALLEGED LIABILITIES OF PETITIONER
INCURRED FOR HIS OWN PERSONAL ACCOUNT

ALLOWED LIABILITIES

We find the evidence in support of the existence of the following loans to be satisfactory and therefore declare them to be legitimate liabilities of petitioner.

CHUA GUI TIAN'S LOAN OF ₱20,000.00:- Chua Tian testified that he loaned ₱20,000.00 to petitioner as evidenced by the promissory note, Exhibit GGG, dated December 27, 1949. According to the creditor, the loan has not been paid up to the present and he has not pressed for its payment because he is a "compadre" and a very good friend of petitioner. He further declared that the loan extended to his "compadre" came mostly from money borrowed from others, the amount of ₱1,000.00 having come from his eldest brother; ₱3,000.00 from a second brother; ₱2,000.00 from a cousin, and another ₱2,000.00 from another cousin. The rest of the money according

to this witness, came from his savings of \$8,000.00 which he accumulated in Kunning Hinam Province, China, some years ago during the time when he was engaged there in the purchase and sale of cosmetics and other articles. According to this creditor, he has partly paid off the loans he contracted from his brothers to accommodate petitioner.

The respondent maintains that this loan should be disregarded because of the discrepancy in the date appearing in the original note, Exhibit GGG, and the photostat, Exhibit 116. Whereas in the original promissory note, the date appears to be December 27, 1949, the photostat is dated December 27, 1948. This discrepancy has been satisfactorily explained by petitioner. According to him, his clerk who copied the original of the promissory note committed a typographical error and it was a photostat of said reproduction which he submitted to the investigators.

LI BAN CHIONG'S LOAN OF ₱13,000.00:- Li Ban Chiong, a Chinese merchant, testified that he loaned petitioner the sum of ₱13,000.00 as evidenced by the promissory note, Exhibit SS, dated December 29, 1949. According to this creditor, who is a brother of petitioner, the money loaned came partly from his savings and partly from his inheritance. We have no cause to doubt the financial capacity of this creditor to lend petitioner the aforesaid amount. Neither can we disregard the liability simply because the creditor is a brother of petitioner. Borrowing among brothers is a common everyday occurrence.

JUANITA ONG'S LOAN OF ₱30,000.00:- This loan is evidenced by a promissory note, Exhibit KKKK, dated July 15, 1949. The creditor Juanita Ong, who is a sister-in-law of petitioner's wife, explained the circumstances surrounding the loan and the source of the money which she loaned to petitioner. The loan was paid on November 20, 1953, as evidenced by the receipt, Exhibit KKKK-1.

GO BUN CHIONG'S LOAN OF ₱20,000.00:- Go Bun Chiong, a Chinese merchant, and brother-in-law of petitioner's wife, testified that he loaned to the petitioner the sum of ₱20,000.00 as evidenced by the promissory note, Exhibit LLLL, dated August 20, 1951. According to this creditor, the loan was paid sometime in March, 1955. He further testified that it was petitioner's wife who signed the promissory note for her husband, but that he had always considered petitioner to be his debtor. Go Bun Chiong's income tax returns for 1948, 1949 and 1950, Exhibits HHH, HHH-1 and HHH-2 show that he had a total net income of ₱27,007.73 during those three years, thereby disproving the claim of respondent as to his financial inability to extend a loan of ₱20,000.00 to the couple in 1951.

UN AH CHIONG'S LOAN OF ₱5,000.00:- This loan is evidenced by a promissory note, Exhibit KKK, dated January 8, 1951. The creditor testified regarding the loan which according to him is still unpaid up to the present as well as the source of the amount loaned to petitioner in the sum of ₱5,000.00. It appears from the testimony of this witness that he was employed in the firm, Tan Pee Cu Yek Chim & Company at a salary of ₱250.00 per

month, with free board, lodging, plus allowance for laundry and haircut during the time when he extend the loan in question. And from his income tax returns for 1947 to 1950, Exhibits LLL, LLL-1, LLL-2 and LLL-3, it appear that he had a total net income during those years of ₱10,300.00. We find the testimony of this witness quite credible as well as his financial capacity to extend the loan of ₱5,000.00 to petitioner.

PO SIAO KIM'S LOAN OF ₱10,000.00:- This loan is evidenced by a promissory note, Exhibit MMM, dated January 14, 1950. The note is signed by petitioner's wife and is guaranteed by Li Yao & Company. The creditor took the witness stand and admitted having extended said loan to petitioner. He explained the source of the amount loaned by stating that ₱6,000.00 came from his savings; and ₱4,000.00 was borrowed from his two cousins, Felix and Severino Ty. The savings of ₱6,000.00, according to this witness, came from his salary as Manager of Farmacia Shanghai, a department of Li Yao & Company. He declared that this loan in his favor is still unpaid, and no attempt was made by him to collect the same because he does not need the money for the present. We find the testimony of creditor Po Siao Kim quite convincing and credible regarding the loan as well as his financial capacity to extend the loan of ₱10,000.00 to petitioner's wife.

LUIS C. LEMA alias LUIS CHU TONG'S LOAN OF ₱10,000.00:- This loan is evidenced by a promissory note, Exhibit OOO, dated March 15, 1950. The creditor, who is an old friend of petitioner, took the witness stand to confirm the existence of the loan. He de-

DECISION -

C.T.A. CASE NO. 30

- 57 -

clared that the loan has not been paid up to the present although repeated demands for its payment was made to the petitioner. He further explained that the money he loaned to petitioner came from his business. His income tax return, Exhibit PPP, for the year 1949, shows a net income of ₱35,849.25.

We have no reason to doubt the credibility of this witness as well as his financial capacity to extend a loan of ₱10,000.00 to petitioner.

TY SUAN'S LOAN OF ₱197,500.00:- Ty Suan, mother of petitioner, declared that she loaned money to her son, the petitioner herein, on four occasions: ₱20,000.00 on January 13, 1946, as evidenced by the promissory note, Exhibit RRR; ₱87,500.00 on August 24, 1950 as evidenced by the promissory note, Exhibit SSS; ₱70,000.00 on August 29, 1950 as evidenced by the promissory note, Exhibit TTT; and, ₱20,000.00 on October 3, 1950 as evidenced by the promissory note, Exhibit UUU, or a total of ₱197,500.00.

Ty Suan declared that the money she loaned to her son came from her savings during the lifetime of her deceased husband Li Chay Too amounting to about ₱150,000.00 and from her conjugal interest in his textile business which was converted into cash amounting to about ₱150,000.00. In the extrajudicial settlement of the estate of the deceased Li Chay Too, Exhibit 125, it appears that the textile business which he had left was worth ₱335,197.61 and ₱284,238.31 of this amount was allocated to Ty Suan, as surviving spouse. We have

574

no doubt as to the credibility of witness Ty Suan as well as her financial capacity to extend a loan of ₱197,500.00 to her son, the petitioner herein. As we have said in the case of loans between brothers, loans between mother and son and vice versa are not uncommon.

TAN PEE'S LOAN OF ₱50,000.00:- According to Tan Pee, father of petitioner's wife, his daughter, Juanita borrowed from him the sum of ₱50,000.00 for petitioner Li Yao. This was made on three occasions: ₱10,000.00 on January 1, 1950 as evidenced by the promissory note, Exhibit YY; ₱20,000.00 on January 16, 1950, as evidenced by the promissory note, Exhibit ZZ; and ₱20,000.00 on March 15, 1950, as evidenced by the promissory note, Exhibit AAA or a total of ₱50,000.00. According to this creditor, who does read or speak English proficiently, these promissory notes were made in English in substitution for the temporary vales which were made in Chinese characters. We find this explanation regarding the execution of substitute promissory notes in English quite plausible. Tan Pee further declared that this obligation of ₱50,000.00 has not been paid up to the present. His income tax returns, Exhibits BBB, CCC, DDD, EEE and FFF, for the years 1946 to 1950, inclusive, show a total net income of ₱236,673.96.

We have no reason to doubt the testimony of this creditor regarding the loans in the total amount of ₱50,000.00 which he extended to his daughter and his son-in-law as well as his financial capacity to extend such loan.

TAN SAM YU'S LOAN OF ₱10,000.00:- This creditor, who is a brother of petitioner's wife, testified that he loaned the amount of ₱10,000.00 to petitioner thru the latter's wife on January 20, 1950, as evidenced by the promissory note, Exhibit MM. The note was guaranteed by Li Yao & Co. This creditor also explained the source of the money he loaned to his brother-in-law. His income tax returns, Exhibits OO, PP, QQ and RR for the years 1947 to 1950, inclusive, show that he had a total net income of ₱20,232.64 during those four years. According to this creditor, the loan has not been paid up to the present.

From the evidence adduced, we find this loan to be a legitimate liability of petitioner existing up to the present time.

DY PO ALIAS TY SE ENG'S LOAN OF ₱25,000.00:- Dy Po alias Ty Se Eng testified that he extended a loan to petitioner in the amount of ₱25,000.00 on October 4, 1950 as evidenced by the promissory note, Exhibit AA. It appears that this creditor is an uncle of petitioner. He has not pressed payment of the obligation from petitioner up to now because of their relationship. According to this creditor, even before the war he had savings in the amount of ₱30,000.00 which he entrusted to Li Chay Too for safekeeping when he went to China in 1941. His net income from 1947 to 1951, inclusive, as reflected in his income tax returns, Exhibits BB, CC, DD, EE and FF, show a total net income of ₱43,454.71. We find this loan to be a legitimate liability of petitioner.

GO SE UN'S LOAN OF ₱20,000.00:- This obligation is evidenced by a promissory note, Exhibit WWW, dated February 15, 1946. Go Se Un, who was a boyhood friend of petitioner, took the witness stand to confirm the existence of the loan in his favor. He also explained the source of the money which he loaned to petitioner. According to this creditor, petitioner has not yet paid him the indebtedness up to the present. He has not pressed for payment because he is not in bad need of money while on the other hand the petitioner is short of cash.

The income tax returns, Exhibits XXX, XXX-1 and XXX-2, of Go Se Un for the years 1949 to 1951, inclusive, show a total net income of ₱12,650.00.

We accept this loan as a legitimate liability of petitioner.

TEODORO SANTOS' LOAN OF ₱30,000.00:- This loan is evidenced by a promissory note, Exhibit OOOO, dated January 4, 1946. According to the petitioner, he paid ₱20,000.00 of this obligation on April 12, 1955, leaving a balance of ₱10,000.00 as evidenced by the type-written receipt signed by the creditor, Teodoro Santos, appearing at the back of Exhibit OOOO.

Teodoro Santos was not presented as a witness for the petitioner to confirm the existence of the loan nor the fact of payment. Instead, a certified true copy, Exhibit EEEE, of the complaint filed by said creditor against petitioner (C.F.I. Manila Civil Case No. 27532) for the recovery of the balance of ₱10,000.00, was presented to corroborate petitioner's testimony. The com-

plaint, Exhibit EEEE, filed by Teodoro Santos against petitioner, quotes verbatim the contents of the promissory note, Exhibit OOOO. In paragraph III thereof, the plaintiff Teodoro Santos admits having received from the petitioner the sum of ₱20,000.00 on April 12, 1955, in partial payment of the obligation of ₱30,000.00 in question leaving a balance of ₱10,000.00 which is the subject of the civil suit.

With the testimony of petitioner and Exhibit EEE, we find this obligation of ₱10,000.00 to be a legitimate liability of petitioner. It is highly inconceivable, as respondent would want us to believe, that petitioner purposely concocted the aforesaid complaint against him in connivance with Teodoro Santos -- thereby destroying his credit standing in the community -- solely for the purpose of reducing his present tax liability.

LI YEK'S LOAN OF ₱30,000.00:- This loan is evidenced by a promissory note, Exhibit PPPP, dated February 10, 1946. Li Yek, the alleged creditor, was not presented as a witness by petitioner to confirm the existence of the loan. According to him, the said person is now dead. Respondent's counsel did not present any evidence to disprove the allegation of petitioner regarding this matter. Neither was there any serious attempt on the part of BIR Examiner Quesada to find the whereabouts of this creditor.

This obligation has been fully settled on January 3, 1951, according to petitioner, as evidenced by the type-written receipt, Exhibit PPPP-2, with the signature of Li Yek appearing thereon.

In the absence of proof to the contrary, we accept as credible the testimony of petitioner regarding this liability as well as the genuineness and due execution of Exhibits PPPP and PPPP-2.

DISALLOWED LOANS

Applying the requisites heretofore stated as to the quantum of evidence we expect before giving credit to the taxpayer as regards his liabilities contracted from loans, we find the following alleged indebtedness of petitioner short of such requirements.

It is to be admitted that the alleged loans of petitioner in favor of Ong Tiao Seng for ₱20,000.00; Li Chiu Ka for ₱20,000.00; Li Tong Na for ₱20,000.00; Ko Chiu Seng for ₱10,000.00; Carlos M. Go for ₱10,000.00; and, Dee Hong alias Lim Siong for ₱25,000.00 are all evidenced by promissory notes. However, none of these alleged creditors of petitioner were presented before this Court to confirm the existence of such loans. Neither was there any satisfactory explanation offered by petitioner nor his counsel to show why they failed to produce these alleged creditors as they had done with respect to the rest.

The alleged loan in favor of Arturo Mercado for ₱10,000.00 is evidenced by a promissory note (p. 170, Vol. 2, BIR record). However, like the six others just mentioned above, he was not presented as a witness to confirm the existence of the alleged loan. True indeed, petitioner tried to explain such failure with respect to this creditor by claiming that the latter was sick during the trial of this case. This notwithstanding, we still

cannot accept this alleged obligation of petitioner in favor of Arturo Mercado as a legitimate liability, in spite of his explanation, for failure on his part and his counsel to present a medical certificate in support of such allegation. Moreover, had petitioner's counsel requested us, we could have ordered the taking of the deposition of this supposedly sick creditor for petitioner's benefit.

For the same reasons that we have disallowed the alleged liability of petitioner in favor of Arturo Mercado, we are also disallowing the alleged liability of petitioner in favor of Go Hoc in the amount of ₱20,000.00 supposedly incurred in 1950.

ONG CHIU alias ONG BENG HUY'S LOAN OF ₱30,000.00:-

This loan is evidenced by a promissory note, Exhibit 57 (p. 169, Vol. 2, BIR record) dated August 29, 1951. The note is signed by petitioner's wife, Juanita Tan Ho Ti, in favor of Mr. and Mrs. Ong Chiu.

Neither of these two creditors was presented before this Court to confirm the existence of the loan, as petitioner did with respect to a great majority of his other creditors.

The respondent presented, on the other hand, a Chinese by the name of Benjamin Ong Chiu who denied having extended the loan of ₱30,000.00 mentioned in the promissory note, Exhibit 57. The petitioner tried to counteract this damaging testimony by alleging that the Benjamin Ong Chiu, who testified before this Court, is not the same Ong Chiu alias Ong Beng Huy, who loaned petitioner

the amount of ₱30,000.00 mentioned in Exhibit 57. In support of this allegation, petitioner presented a certification, Exhibit EEEEE, of the Bureau of Immigration, showing there are no less than nine (9) Chinese bearing the same name of Ong Chiu registered in the aforesaid Bureau. The real creditor of petitioner, according to him, is one Ong Chiu alias Ong Beng Huy, the person who sued him on September 15, 1955, in the Court of First Instance of Manila (Civil Case No. 27488), Exhibit FFFF, for the recovery of another alleged unpaid debt of ₱30,000.00 (not in question in this appeal) incurred by the petitioner in favor of said person sometime in December 20, 1953.

We note that with respect to this alleged creditor, as well as the other creditors who were not presented before us to confirm the existence of the questioned loans and where no valid explanation was given for such failure, the petitioner's counsel have this blanket explanation to offer:

"A couple of these have requested Li Yao to dispense with their testimony, giving some reason or another why they do not like to testify. Li Yao consulted his lawyers on what to do with them -- whether they should be subpoenaed and compelled to confirm their loans to Li Yao or not -- but said lawyers advised Li Yao that it might not be advisable to compel said creditors to come to court. It would only antagonize them and they might sue Li Yao for the payment of their loans, which would mean additional headaches and more trouble for the petitioner." (p. 148 of Petitioner's Memorandum)

Obviously, the alleged fear of antagonizing these creditors who did not appear before us, was unwarranted with respect to Ong Chiu alias Ong Beng Huy, because

from petitioner's own evidence, Exhibit FFFF, the "headache" was already there when this creditor filed a civil suit against petitioner on September 15, 1955 for the collection of another indebtedness of ₦30,000.00, at a time when the trial of the instant case was still going on before us. We note from our records, that the trial of the instant case ended November 21, 1955.

With the break of hostilities between the two, while the present appeal was still being heard before us, petitioner's counsel should then have requested us by compulsory process to compel the alleged creditor to appear and confirm the existence of the loan and incidentally to destroy the damaging testimony of respondent's witness, Benjamin Ong Chiu. Upon petitioner's request, we could have even gone further, in the interest of justice, by holding Ong Chiu alias Ong Beng Huy, the supposed creditor of petitioner, liable for contempt had he failed to appear before us to testify after being summoned to do so. Petitioner's counsel failed to take any of these steps for the protection of their client's interest. The non-production of this alleged creditor has lead us to the conclusion that he is either a fictitious person, or, if he is not, the willful suppression of his testimony raises the presumption that it would have been adverse to petitioner had said creditor been presented (section 69 (e) Rule 69, Rules of Court).

The blanket explanation quoted above by petitioner's counsel with respect to the other creditors who were

not placed on the witness stand and where no valid explanation was given for such failure, is just as puerile as with respect to the case of Ong Chiu alias Ong Beng Huy, whose alleged loan we are now discussing. Why should a person turn hostile and feel resentful simply because he is asked by his debtor to confirm before a court of justice a legitimate loan which he extended to him? On the contrary, if the loan were really true, the creditor should be more than willing to confirm the existence of the same for his personal protection. His reluctance to testify in this case to confirm the loan, might be used against him as lack of sincerity in the event that he decides to sue petitioner before another court for the collection of the amount of the indebtedness. Thus, we are more inclined to believe that with respect to those creditors who were not placed on the witness stand to corroborate petitioner's testimony and for whom no valid explanation was offered for such failure, they are either fictitious creditors, or, if they really exist, they were not willing to stick out their necks too far for petitioner by committing purposeful perjury.

GEORGE FERNANDEZ LEE'S LOAN OF ₱32,500.00:- We find it unnecessary to decide one way or the other the alleged loan of petitioner from George Fernandez Lee inasmuch as petitioner himself admits that the inclusion of this loan in his original list of liabilities was an inadvertent mistake on his part. In fact, the name of this alleged creditor does not appear in the amended list, Exhibit QQQQ, submitted by him.

LEGALITY OF THE NET WORTH-EXPENDITURE
(INVENTORY) METHOD OF INVESTIGATION IN
THIS JURISDICTION AND THE PROPRIETY OF
ITS USE IN THE PRESENT CASE

After the liberation, the government has become aware of numerous tax evasions which were not noticeable in cleverly prepared books of account or income tax returns of many taxpayers. Tax evasion became evident only from extraordinary increase or "bulge" in the wealth of taxpayers which were grossly disproportionate as compared to the corresponding income shown in their tax returns. To ferret out these tax evaders and to discover tax evasion behind the maze of skillful concealment, the government has of late resorted to the extensive use of the Net Worth-Expenditure (Inventory) Method of investigation to determine tax deficiencies. The validity and propriety of this method is now raised squarely before this Court.

In the case of Eugenio Perez vs. J. Antonio Araneta, Acting Collector of Internal Revenue (B.T.A. Case No. 189 decided on February 13, 1956) as well as the recent one of Aurelio P. Reyes vs. The Collector of Internal Revenue (C.T.A. Case No. 42, decided on July 26, 1956), this Court sanctioned the use of such method by the Collector of Internal Revenue under authority of sections 15 and 38 of the National Internal Revenue Code, when the circumstances of the case warrant the use of such method.

As a matter of fact, one of the distinguished lawyers of petitioner in the present case, concedes this prerogative to the Collector of Internal Revenue (p. 41, Vol. 1 Formilleza, Commentaries on the National Internal Revenue Code).

The Commissioner of Internal Revenue of the United States, under section 41 of the Federal Internal Revenue Code of 1939, from which sections 15 and 38 of our National Internal Revenue Code are patterned, is given the same authority. The United States Supreme Court has invariable sustained the use of said method of investigation in both civil and criminal case.

The bone of contention in the present case seems to be not the right or authority of respondent to use the method employed by him, but rather the propriety of its use.

In Holland vs. U. S. (348 U. S. 121-1954) the Supreme Court of the United States laid down five requisites or conditions for the proper use of the Net Worth-Expenditure (Inventory) Method of investigation which are as follows:

(1) That the taxpayer does not keep books, or his books so inadequate that they do not reflect his true income;

(2) That there must be an opening net worth established with reasonable certainty to serve as a starting point from which to calculate future increases in the taxpayer's assets;

(3) That the government must track down all relevant leads furnished by the taxpayer reasonably susceptible of being checked;

(4) That the government must show a probable source of income from which it could equate increase in net worth with unreported taxable income; and

(5) That proper adjustments must be made for personal and other non-deductible expenditures as well as for non-taxable receipts and for depreciation.

Petitioner's counsel maintain that requisites Nos. 1, 3 and 4 have not been met by respondent in the

case at bar.

We shall take up the first and fourth requisites jointly, they being closely interrelated.

With respect to the first, petitioner has openly admitted that during the taxable years now in question, he has not kept books of accounts and other records except a secret note book containing the list of his creditors and the names and addresses of his girl friends which he requested this Court not to produce for "security" reasons.

Petitioner tried to justify his failure to keep and maintain such book by alleging that his income is derived solely from salaries, dividends and bonuses received in his capacity as President and Manager of the three companies he organized. It is claimed that since he was not in business of his own, there was, therefore, no obligation on his part to keep books of accounts, under section 5 of the Bookkeeping Regulations dated March 17, 1947. Consequently, the respondent committed an error in applying the Net Worth-Expenditure (Inventory) Method against him for not keeping books of accounts. We cannot sustain petitioner's theory on this point. From his own admission, it appears that petitioner indulged in all forms of gambling at one time or another. During the years 1950 to 1951, he admitted having bought and maintained a stable of nine (9) race horses. These admissions do not dispel the reasonable probability that from his gambling activities he derived income in the form of cash prizes on his horses from the two racing clubs besides winning bets on them.

We cannot believe that these nine (9) race horses which petitioner admittedly bought from A. P. Reyes and the late Johnny Ysmael in 1950 for ₱11,500.00 were acquired by him solely as a hobby to satisfy his fondness for animals. It is of common knowledge that it takes a lot of money to buy and maintain race horses and usually, when one buys them, it is for business purposes. From these admissions, we can fairly conclude that petitioner had quite extensive gambling activities not only in horse racing, but also in other forms of wagering, from which it is very probable that he derived considerable income. Nevertheless, he has not kept any record of his transactions involving his race horses during the period of almost two years that he owned them. Neither did he keep a record of his income or losses from his other gambling activities. Neither has the petitioner included the income or losses from such activities in his annual income tax returns for the years now in question.

On the question as to whether or not under the circumstances, petitioner should have kept adequate books of accounts and records, we have in reply, section 334 of the National Internal Revenue Code which reads:

"Sec. 334. Corporations, companies, partnerships, or persons required to keep books of accounts.- All corporations, companies, partnerships, or persons required by law to pay internal revenue taxes shall keep a journal and a ledger, or their equivalents: Provided, however, That those whose gross quarterly sales, earnings, receipts, or output do not exceed five thousand pesos shall keep and use a simplified set of Bookkeeping records duly authorized by the Secretary of Finance wherein all transactions and results of operations are shown and from which all taxes due the Government may readily and accurately be ascertained and determined anytime of the year"

The above provision clearly states that persons required by law to pay internal revenue taxes, (this includes income taxes under section 18 (a), National Internal Revenue Code), must keep a journal and a ledger, or their equivalents or in certain cases simplified bookkeeping records. The reason for such requirement is stated in the law itself, viz, in order "that all taxes due the government may readily and accurately be ascertained and determined anytime of the year." One of the obligations of the petitioner as a taxpayer is to declare his true income in his income tax returns. Inherent to this duty is the further requirement "that he maintain adequate records of some kind to show the amount of income received by him each year and the nature and the basis of any deductions claimed." (Halle v. Commissioner, 7 TC 245 (1946) aff'd 175 F 2d 500 (1949) cert. den. 338 U.S. 949), so that the income tax or any other tax due the government may be readily and accurately ascertained and determined anytime of the year not only by the taxpayer, but also by the different tax collection agencies of the government. Unless this requirement is complied with, taxpayers may, and probably with impunity, simply resort to the underdeclaration of their taxable income rendering it almost impossible for revenue officials to determine accurately the amount of taxes properly due to the government.

Petitioner contends that a taxpayer like himself, whose income is derived solely from salaries, bonuses and dividends is not required under section 334 of the

National Internal Revenue Code to keep books of accounts. We find this contention untenable, considering petitioner's situation, where it clearly appears that he had in fact derived income during the years 1945 to 1951, inclusive, from sources other than salaries alone. In section 7, Revenue Regulations No. V-1, Department of Finance, which is quoted with approval on page 968, Vol. II of Formilleza's Commentaries of the National Internal Revenue Code, the exception from keeping books and records seems to apply only in those case where the only source of income of the taxpayer is his salary. Dividends earned from a corporation or partnership do not fall under the category of a salary.

Thus, in view of the admitted failure of petitioner to comply with the requirement regarding the keeping of adequate books of accounts and records and it appearing that he is not covered by the exemption, the respondent did not, therefore, err in assessing him the proper tax on the best evidence obtainable. In fact, after employing the inventory method against petitioner, it appears from our computation shown in the latter part of this decision that the net income determined is very far greater or substantially larger than the declared income in petitioner's annual income tax returns for 1945 to 1951, inclusive, as to indicate by persuasive evidence that there had been unreported income or an understatement of income (Mikelberg v. Commissioner [1954] 23 TC 342; Estate of George Curry v. Commissioner [1954] 23 TC 305). In ~~Emmich~~ vs. United States 298 Fed. 5

(6th Cir. 1924) it was held "that indirect evidence may be used to establish the undisclosed income of a gambler who cannot produce books or records of accounts." "The term 'Net Worth Method' has acquired a connotation embracing all circumstantial methods of proving income." In the United States, "the Net Worth Method has generally been used when the taxpayer's records were either inadequate or not available." (The Net Worth Doctrine by John H. Mitchell, appearing on pages 1345, 1347, 1349, Vol. 14 Institute on Federal Taxation, 1956 edition.) "Evidence that a man is engaged in the gambling business, coupled with the absence of records, has been held sufficient proof of a likely source." (Campodonico vs. United States, 222 F-2d-310).

Petitioner argues that the records of the corporations and partnership from which he derived his income (salaries, dividends and bonuses) are sufficient and therefore it was unnecessary for him to keep separate books of accounts and records. We find this argument without merit, for it has been held that the net worth method may be used not only to demonstrate a substantial variation from the reported income, but also to suggest the untrustworthiness of those records, standing by themselves, from which the taxpayer's net income had been determined and at the same time reconstruct and serve as proof of the unreported income, so as to fix the correct net income of the taxpayer (Bryan v. Commissioner, [1954] 209 F 2d 922; Morris Lipsitz v. Commissioner [1954] 21 TC 917 aff'd 220 F 2d 871; Hurley

v. Commissioner [1954] 22 TC 1256; Thomas v. Commissioner [1955] 223 F 2d 83; Fred Ziegler v. Commissioner [1952] 11 CCH Tax Ct Mem. 572, aff'd [1953] 207 F 2d 784). Even if we were to concede what petitioner admits by his own computation, Annex B, Memorandum for Petitioner" to be his "true" income, one would readily see that the figures appearing therein are far in excess of his originally declared income thereby indicating a gross misdeclaration or underdeclaration in his original income tax returns.

Another argument of petitioner against the use of the Net Worth-Expenditure Method of investigation against him is that his income tax returns has not been shown to be inaccurate by the respondent and even if found to be inaccurate, the Collector should nevertheless compute the petitioner's income on his accounting method of actual cash receipts and disbursements. We find this view just as unmeritorious. As heretofore stated, petitioner's income tax returns are inaccurate and do not clearly reflect his true income, thus justifying a re-computation of the same by respondent. In making such re-computation of petitioner's income, section 38 of our National Internal Revenue Code does not limit the respondent Collector of Internal Revenue to the regular or ordinary methods of accounting employed by the taxpayer (Morris Lipsitz v. Commissioner, supra; Eugene Vasallo v. Commissioner [1955] 23 TC 656). As a matter of fact, the Collector is not even required by law to exhaust adjusting whatever books or records the taxpayer has in determining his net income. (H. A. Hurley v. Commissioner [1954] 22 TC 1256). On the other hand,

section 38, which is a copy of section 41 of the Federal Tax Code of 1939, expressly authorizes the Collector of Internal Revenue to determine the net income of the taxpayer upon any reasonable basis or method as will clearly reflect such income and therefore the Collector may also look elsewhere for evidence of the taxpayer's correct income (Eugene Vasallo v. Commissioner, supra; Bryan v. Commissioner, supra; Halle v. Commissioner, supra). While it is argued here that the "increase in net worth method" is not an accounting method, nevertheless it is proof or evidence of income of the taxpayer (Estate of Bartlett v. Commissioner [1954] 22 TC 1228). From the fact that after reasonably allowing what appears to be valid assets and liabilities of petitioner, this Court has found that there has been a considerable increase in his wealth, we believe and so hold that the method employed by the respondent in the determination of his real tax liability justified.

In support of our finding as to the fourth requisite which we have held was sufficiently met by respondent, we have this to add. It appears that since 1945 up to 1951, the petitioner was at one time or another in full control of the financial activities of those firms of which he was either Manager or President or both. He had practically the sole authority to determine the expenditures of the three firms as well as to authorize and approve all their transactions. This unprecedented and practically unlimited authority of petitioner was such that he could have used the same

to his personal advantage by the simple expedient of channelling funds to himself one way or another to suit his personal convenience. This circumstance, coupled with the fact that petitioner gambled; that he maintained a stable of nine (9) race horses in 1950 and 1951 from which he undoubtedly won cash prizes as well as winnings from bettings now and then; and the fact that he also earned income from salaries, bonuses and dividends, provide a sufficient basis as to the probable sources of income to warrant the use of the Net Worth Method employed by respondent.

It is also contended by petitioner that the government has failed to comply with the third requisite for the proper application of the method employed, by its failure to follow all relevant leads furnished by petitioner.

While it is true that the government has the duty to track down all relevant leads furnished by the taxpayer in order to forestall serious injustice to him, we have eliminated such a contingency by giving the petitioner herein all the benefit of doubt where doubt exist. We have discussed all the possible leads in connection with the factual issues of this case granting allowances for liabilities and disregarding alleged assets when the evidence for the government is weak and unconvincing. We have taken this course of action mindful of the fact that our duty is not to sustain the findings of the respondent at all cost but to see that justice is done.

Let us now proceed to the fifth requisite — the adjustments for non-deductible expenses and for non-taxable items necessarily a part of the proper application of the Net Worth Method of investigation.

With respect to the adjustment for personal expenses of petitioner, we believe that the determination made by respondent for the years 1945 to 1947 was without basis. The respondent based his finding as to petitioner's living expenses for said years on the fact that he made considerable bank withdrawals during the period. In the course of the investigation, the petitioner failed to present the cancelled checks and check stubs corresponding to these withdrawals. The respondent thus concluded that these withdrawals constituted personal and living expenses for the corresponding years. The petitioner has explained to the satisfaction of the Court the fallacy of this finding admitting at the same time that while this case was still pending before the Bureau of Internal Revenue, his counsel, Attorney Modesto Formilleza, offered to compromise the case by conceding the amount of a minimum of ₱15,000.00 and a maximum of ₱20,000.00 as personal and living expenses of petitioner for the years 1948 to 1951, inclusive. Petitioner has explained his enormous bank withdrawals by stating that they arose from cash exchanges and accommodations made for other persons. The withdrawals also included funds held in trust by him for others including the funds which he collected for charity which he deposited temporarily in his bank account. In the absence of

proof to the contrary, we accept as satisfactory and plausible the explanation given by petitioner. It should be noted that the offer of compromise made by petitioner's counsel was limited only for the years 1948 to 1951, inclusive. Therefore, petitioner's personal and living expenses should be fixed in the amount of ₦20,000.00 a year from the years 1948 to 1951, inclusive. In view of the absence of evidence as to his living expenses for the years 1945 to 1947, inclusive, petitioner should be credited with the amount for which he in turn is entitled by way of personal exemptions.

A credit or adjustment of ₦72,392.91 should be allowed against petitioner's increase in net worth for 1949 which both parties admit to be attributable to inheritance received by him and thus beyond the reach of income taxes under section 29-b of the National Internal Revenue Code. However, for all of the years involved in which an income tax has been paid, the petitioner should be subject to an adjustment for the non-deductible item of income taxes under section 30-c of the National Internal Revenue Code, paid for the years as indicated hereunder as follows:

<u>Income Tax</u> <u>Paid</u>	<u>Year Paid and Year</u> <u>Non-Deductible</u>
₦ 918.31	1946
1,393.42	1947
10,394.55	1948
700.34	1949
538.07	1950
3,837.00	1951

FRAUD AND 50% PENALTY

A factor which has considerably increased the petitioner's liability in the decision appealed from, is the imposition by the respondent of the 50% surcharge as fraud penalty for the taxable years in question.

The possible sources of fraud in income tax cases seem limitless and the ingenuity of the taxpayer plus the complexity of our tax laws add up to a very vast field for tax evasion. Congress has advisedly refrained in the National Internal Revenue Code from giving a specific definition and a detailed description of the different ways by which fraud could be committed in tax cases. Presumably, the omission was purposely done to ~~close~~ the doors to calculated evasion of the terms used and quibblings about their precise import. It can be said, however, that the issue of fraud is a ~~factual~~ question the determination of which depends on the careful consideration of the facts and circumstances surrounding the conduct of the taxpayer incident to the preparation of his return. And when is a return to be considered fraudulent? On this point, the pertinent provisions of sections 72 and 332 of the National Internal Revenue Code read as follows:

"Sec. 72.- Surcharges for failure to render returns and for rendering false and fraudulent returns.- The Collector of Internal Revenue shall assess all income taxes. In case of willful neglect to file the return or list within the time prescribed by law, or in case a false or fraudulent return is willfully made, the Collector of Internal Revenue shall add to the tax or to the deficiency of the tax, in case any payment has been made on the basis of said returns before the discovery of the

falsity or fraud, a surcharge of fifty per centum of the amount of such tax or deficiency tax. x x x"

x

x

x

"Sec. 332. 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 a 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 falsity, fraud, or omission. x x x"

From the foregoing provisions of law, it is apparent that fraud could be attributed to the taxpayer only when he has filed a false return with intent to evade the payment of taxes. In other words, fraud is a question of willfulness or intent.

On the question of fraud, whether it relates to taxation or not, the principle is well-settled that fraud can never be presumed; it must be alleged and proved, at least satisfactorily if not conclusively by one who alleges its existence. (De Roda v. Lakk, 48 Phil. 104; De Santos v. Bank of the Phil. Islands, 66 Phil. 38; La Cia. Gen. de Tabacos v. Obed, 13 Phil. 391; Menzi & Co. v. Bastida, 63 Phil. 16; Arroyo v. Granada & Centro, 16 Phil. 484). The respondent in the case at bar, having alleged fraud, it is incumbent upon him to prove the existence of the same. Unlike in criminal prosecutions, however, the degree of proof required on the issue of fraud need not rise to "proof beyond reasonable doubt." It is enough that the same be "clear and convincing", (Griffiths v. Comm., 50 F (2d) 782 cited by Mertens, Law of Federal Income Taxa-

tion, Vol. 10, p. 29) that is, it must be stronger than the "mere preponderance of evidence" which would be sufficient to sustain a judgment on the issue of correctness of the deficiency itself apart from the fraud penalty (Frank A. Maddas, 40 BTA 572, aff'd F (2d) 548 (CCA 3rd, 1940)).

Since proof of fraud must center on "willfulness" as its crucial core, and "willfulness" being enmeshed as it must be with "intent" and "state of mind", it is hardly susceptible of proof by direct evidence. Circumstantial evidence is therefore admissible on the issue of fraud (U.S. v. Commerford, 64 F (2d) 28, 30 cited by Balter, Fraud Under the Federal Tax Law, p. 394).

With these basic considerations in mind, we come to the issue of fraud in the case at bar. In the light of the evidence introduced by both the parties, we are satisfied that unreported income have been proved by the government. We believe further that the records and circumstances herein overwhelmingly indicate that petitioner's failure to report such large amounts of income as shown by his income tax returns for the taxable years in question was due to fraud with intent to evade his legitimate obligation to the government.

In our detailed analysis of the assets and liabilities of petitioner, we pointed out certain items like for example the alleged loan given by Chavez to petitioner in the amount of \$100,000.00 which we held to be fictitious, and the alleged investments of Vicente Duazo and Delfin Fulay in FERIN which we held to be peti-

tioner's own using those two as his dummies. These circumstances, plus some others, have brought forth in bold relief petitioner's intent to pay a lesser tax than that actually due from him. Moreover, from petitioner's own computation, (Annex B, Memorandum for Petitioner) it is admitted that there has been an actual and substantial underdeclaration of his income for some of the years in question and that the understatement has occurred in more than one year. In said computation, petitioner admits a deficiency income tax liability for the years now in review in the total amount of ₦49,398.04 exclusive of surcharges. Obviously, this admitted tax deficiency of petitioner running to five figures cannot be imputed to an honest mistake, a slight oversight or a negligible error in mathematical computation. The willful omission of income, a deliberate and intentional failure to report substantial items of receipt, has been considered to be substantial evidence of fraud. (p. 26, Vol. 10, Merten's Law of Federal Income Taxation) From the foregoing, we hold that petitioner was guilty of fraud in his income tax declarations for the years 1948 to 1951, inclusive, and therefore the decision of the respondent appealed from with respect to the imposition of the fraud penalty of 50%, is sustained.

PRESCRIPTION

Lastly, it is averred that the power of respondent to assess against, and collect from, the petitioner deficiency income taxes for the years 1945 to 1948, inclusive, has prescribed under section 331 of the National Internal Revenue Code which limits the right of collection by

judicial action to five (5) years after the return was filed.

It is almost trite to repeat what the Supreme Court has held in several cases, that under section 51 (d) of the National Internal Revenue Code, the right of the government to collect income taxes through summary administrative methods is limited to three (3) years after the return is due or has been filed. (Collector of Internal Revenue vs. Villegas 56 Phil. 554; Collector of Internal Revenue vs. Haygood 65 Phil. 520; Philippine Sugar Estate Development Co. vs. Posadas 68 Phil. 216 and Juan de la Viña vs. El Gobierno de Filipinas, G.R. No. 42669, January 29, 1938.)

Under section 331 of the National Internal Revenue Code, the period of limitation within which the Collector of Internal Revenue may assess and collect by judicial action is five (5) years after the return was filed.

However, in those cases where a false or fraudulent return was filed with intent to evade taxes, as we have found in the present case of petitioner, the period of limitation is ten (10) years after the discovery of the falsity or fraud as prescribed in section 332 (a) of the National Internal Revenue Code. With respect to the issue of prescription, therefore, the petitioner is governed by the last mentioned section of the National Internal Revenue Code and not section 331 thereof.

FOR ALL THE FOREGOING CONSIDERATIONS, the decision appealed from is modified, and the petitioner is hereby ordered to pay to the respondent Collector of Internal Revenue, the sum of ₱424,536.77, as deficiency income tax

DECISION -
C.T.A. CASE NO. 30

- 84 -

and surcharge for the years 1948, 1949, 1950 and 1951,
more particularly itemized as follows:

<u>1945</u>	
Assets admitted by parties	₱ 41,538.50
Add assets established at trial:	
Funds held in trust by father, Li Chay	
Too	<u>143,910.89</u>
Net Worth as of December 31, 1945	₱185,449.39
Less Net Worth as of January 1, 1945:	
Assets admitted by Parties	₱ 500.00
Add assets proven at trial	
Funds held in trust by father, Li Chay	
Too	<u>159,910.89</u>
Increase in net worth in 1945	₱ 25,038.50
Add non-deductible expenditures:	
Personal living and family expenses.	<u>3,500.00</u>
Net income	₱ 28,538.50
Less personal exemptions	<u>3,500.00</u>
Amount subject to tax	<u>₱ 25,038.50</u>
Tax due thereon	<u>₱ 1,082.31</u>
Less tax already paid	<u>1,111.74</u>
No deficiency tax due	<u>(₱ 29.43)</u>

1946

Assets admitted by both parties	₱148,326.77
Add assets established at trial:	
Cash funds from loans	<u>90,032.43</u>
Total assets	₱238,359.20
Liabilities established at trial	<u>100,000.00</u>
Net worth as of December 31, 1946 ...	₱138,359.20
Less net worth as of Jan. 1, 1946 ...	<u>185,449.39</u>
Decrease in net worth in 1946	(₱ 47,090.19)
Add non-deductible expenditures:	
Personal living & family expenses..	3,500.00
Income tax paid in previous year ..	<u>918.31</u>
Net loss	(₱ 42,671.88)
No deficiency tax due.	

1947

Assets admitted by parties	₱184,453.45
Add assets established at trial:	
Cash funds from loans	<u>78,036.52</u>
Total Assets	₱262,489.97
Liabilities established at trial	<u>100,000.00</u>
Net worth as of December 31, 1947	₱162,489.97
Less net worth as of Jan. 1, 1947 ...	<u>138,359.20</u>

Increase in net worth in 1947	₱ 24,130.77
Add: non deductible expenditures:	
Personal, living and family expenses	3,500.00
Income tax paid in previous year..	1,393.42
Net Income	₱ 29,024.19
Less personal exemptions	3,500.00
Amount subject to tax	₱ 25,524.19
Tax due thereon	₱ 3,795.32
Less tax already paid	10,055.78
No deficiency tax due	(₱ 6,260.46)

1948

Assets admitted by parties	₱176,933.76
Add assets established at trial:	
Cash funds from loans	50,384.93
Investments in Tan Pee Cu	
Yek Chim & Co.	30,000.00
Total Assets	₱257,318.69
Less liabilities established at trial	100,000.00
Net Worth as of December 31, 1948 ..	₱157,318.69
Less net worth as of Jan. 1, 1948 ..	162,489.97
Decrease in net worth in 1948	(₱ 5,171.28)
Add non deductible expenditures:	
Personal, living and family expenses	20,000.00
Income tax paid in previous year..	11,394.55
Net Income	₱ 26,223.27
Less personal exemptions	3,500.00
Amount subject to tax	₱ 22,723.27
Tax due thereon	₱ 3,179.11
Less tax already paid	700.34
Deficiency tax	₱ 2,478.77
Add: 50% surcharge	1,239.38
Total tax due	₱ 3,718.15

1949

Assets admitted by parties	₱435,405.83
Add assets established at trial:	
China Banking Corporation -	
Time Deposit	60,000.00
Investment in Tan Pee Cu	
Yek Chim & Co.	30,000.00
Total Assets	₱525,405.83
Liabilities established at trial:...	163,000.00
Net Worth as of December 31, 1949 ..	₱362,405.83
Less net worth as of Jan. 1, 1949 ..	157,318.69
Increase in net worth in 1949	₱205,087.14
Add non deductible expenditures:	
Personal, living and family expenses	20,000.00
Income tax paid in previous year..	700.34
Net Income	₱225,787.48
Less personal exemptions	3,500.00

DECISION -
C.T.A. CASE NO. 30

- 86 -

Net Income before deduction of inheritance	₹ 222,287.48
Less inheritance	72,392.91
Amount subject to tax	₹ 149,894.57
Tax due thereon	₹ 47,137.82
Less tax already paid	538.07
Deficiency tax	₹ 46,599.75
Add: 50% surcharge	23,299.87
Total tax due	₹ 69,899.62

1950

Assets admitted by parties	₹ 842,273.50
Add assets established at trial:	
Investments in Tan Pee Cu	
Yek Chim & Co.	30,000.00
Investments in FERIN through others	170,000.00
Race Horses	11,500.00
Total Assets	₹1,053,773.50
Liabilities established at trial..	445,500.00
Net worth as of Dec. 31, 1950	₹ 608,273.50
Less net worth as of January 1, 1950	362,405.83
Increase in net worth in 1950	₹ 245,867.67
Add: non deductible expenditures:	
Personal, living and family expenses	20,000.00
Income tax paid in previous year	538.07
Net Income	₹ 266,405.74
Less personal exemptions	4,200.00
Amount subject to tax	₹ 262,205.74
Tax due thereon	₹ 125,977.00
Less tax already paid	3,837.00
Deficiency tax	₹ 122,140.00
Add: 50% surcharge	61,070.00
Total tax due	₹ 183,210.00

1951

Assets admitted by parties	₹1,630,658.94
Add assets established at trial:	
Investments in Tan Pee Cu	
Yek Chim & Co.	30,000.00
Investments in FERIN through others	200,000.00
Race Horses	11,500.00
Total Assets	₹1,872,158.94
Liabilities established at trial..	1,040,500.00
Net worth as of Dec. 31, 1951	₹ 831,658.94
Less net worth as of Jan. 1, 1951.	608,273.50
Increase in net worth	₹ 223,385.44
Add: non deductible expenditures:	
Personal, living and family expenses	20,000.00
Income tax paid in previous year	3,839.00

DECISION -
C.T.A. CASE NO. 30

- 87 -

Net Income	₱ 247,222.44
Less personal exemptions	4,800.00
Amount subject to tax	₱ 242,422.44
Tax due thereon	₱ 114,777.00
Less tax already paid	2,971.00
Deficiency tax	₱ 111,806.00
Add: 50% surcharge	55,903.00
Total tax due	<u>₱ 167,709.00</u>

Summary of Tax Due

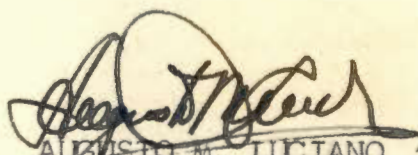
1945	none
1946	none
1947	none
1948	₱ 3,718.15
1949	69,899.62
1950	183,210.00
1951	<u>167,709.00</u>

Total tax due ₱ 424,536.77

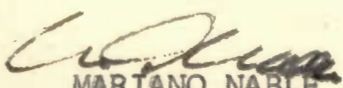
With costs against petitioner.

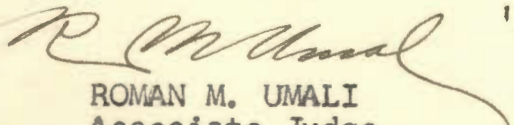
SO ORDERED.

Manila, Philippines, July 31, 1956.


AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:


MARIANO NABLE
Presiding Judge


ROMAN M. UMALI
Associate Judge

604