REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PAZ PEREZ GARCIA,
Petitioner,

- versus - C.T.A. CASE No. 756

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.
x- - - - - - - - - - - - -x

D E C I S I O N

This is an appeal from the decision of respondent holding petitioner liable for the sums of ₱21,882.00 and ₱2,711.00 as deficiency income tax for 1951 and 1952, respectively.

Petitioner is a real property owner of Quezon province and is engaged in business as copra dealer. After the death of her first husband, Abelardo Fajardo, with whom she had two children, she contracted, on April 10, 1947, a second marriage with Tomas Garcia. Due to the latter's repeated conjugal infidelities and abandonment of the conjugal dwelling, petitioner filed a petition for legal separation which was granted by the Court of First Instance of Quezon on June 1, 1955, on the ground that Tomas Garcia "led a life of extravagance and vice devoted to 'wine, women and song and gambling'". (See Exhs. H to H-4, pp. 80-84, CTA rec.)

For the years 1951 and 1952, petitioner filed her income tax returns on March 31, 1952 and March 1, 1953,

155

reporting therein taxable net incomes in the sums of ₱32,120.90 and ₱8,568.54, respectively. After investigation and examination of said income tax returns, respondent, in a letter dated January 24, 1958, assessed against petitioner the sums of ₱21,882.00 and ₱2,711.00 as deficiency income tax for 1951 and 1952, respectively, computed and itemized as follows:

<u>42-A-682-51</u>

Net income per return		₱36,320.90
Add:		
1. Undeclared salary of husband, Tomas Garcia		6,000.00
2. Bad debts written off (not declared as income before)		2,321.00
3. Underdeclared income on real estate sales		30,860.36
4. Interest income received by the children due from deposits with the Phil. Nat. Bank, Lucena Branch		139.27
Total net income per investigation		₱75,641.53
Less Exemptions:		
Personal	- ₱3,000.00	
Additional	- 1,200.00	4,200.00
Taxable net income		₱71,441.53
Income tax due thereon		₱23,483.00
Less: Amount already assessed .		8,895.00
Deficiency income tax		₱14,588.00
50% Surcharge		7,294.00
TOTAL AMOUNT STILL DUE		₱21,882.00

<u>42-A-474-52</u>

Net income per return	₱12,768.54
Add:	
1. Undeclared salary of husband, Tomas Garcia	6,000.00

2. Wages of coconut planters .	₱1,779.63
3. Interest income received by children from deposits with the Phil. Nat. Bank, Lucena Branch	107.79
Total net income per investigation	₱20,655.96
Less: Exemptions Personal - ₱3,000.00 Additional 1,200.00	4,200.00
Net income subject to tax	₱16,455.96
Income tax due thereon	₱ 2,769.00
Less: Amount already assessed	962.00
Deficiency tax due	₱ 1,807.00
50% Surcharge	904.00
TOTAL AMOUNT STILL DUE	₱ 2,711.00

(Exh. 10, pp. 34-35, BIR rec.;
Exhs. 7 & 9, pp. 24 & 26, BIR rec.)

Dissatisfied with the above assessment, petitioner, in a letter dated February 24, 1958, contested the same and asked for its withdrawal. In a letter dated July 31, 1958, respondent informed petitioner that a reinvestigation would be made provided she executed a waiver of the statute of limitations. Failing to get any reply from petitioner, respondent, on February 2, 1960, wrote a letter denying petitioner's protest and reiterated his previous demand for the payment of the deficiency income tax. On February 15, 1960, petitioner wrote another letter to respondent reiterating her protest contained in her letter of February 24, 1958, which protest was again denied by respondent in a letter dated February 24, 1960. From this denial, petitioner instituted, on March 9, 1960, the instant petition for review.

The issues involved in this case are summarized as follows:

1. Whether or not the right of the Government to assess the deficiency income tax for 1951 has already prescribed; and

2. Whether or not the deficiency income tax assessment is in accordance with law.

Petitioner contends that the right of respondent to assess the deficiency income tax for the year 1951 has already prescribed under Section 331 of the Revenue Code, inasmuch as from March 31, 1952, the date her income tax return for said year was filed, to January 24, 1958, when the deficiency income tax assessment was issued, more than five years had elapsed. On the other hand, respondent avers that since petitioner's income tax return for 1951 was fraudulent, he has ten years from the discovery of the fraud on March 30, 1955 within which to assess said tax, pursuant to Section 332(a) of the Revenue Code.

Respondent cited the following circumstances allegedly constituting fraud in the filing of petitioner's income tax return for 1951 -

(a) The petitioner and her husband instead of filing a consolidated return for the taxable year 1951 as husband and wife, filed separate returns and each

> claimed a personal exemption of ₱3,000.00 each, or a total of ₱6,000.00;
>
> (b) Petitioner charged off the amount of ₱2,321.00 as alleged uncollected bad debts which, she admitted during the trial, as unsupported by any evidence, hence, fictitious; and
>
> (c) The acquisition cost of the copra land converted into a subdivision was overstated resulting in the understatement of net gain. (Respondent's Memorandum, p. 132, CTA rec.)

Petitioner claims that she did not file a consolidated return for the year 1951 because during that year she and her husband "had virtually been separated _de facto_" and she was not in a position to determine his income and other activities. (See Respondent's Memorandum, p. 96, CTA rec.) The filing by petitioner of a separate income tax return is sought to be justified under Section 45(d) of the Revenue Code which provides -

> (d) _Husband and wife_.- In the case of married persons, whether citizens, resident or nonresident aliens, only one consolidated return for the taxable year shall be filed by either spouse to cover the income of both spouses; _but where it is impracticable for the spouses to file one consolidated return_, each spouse may file his separate return of income, but the returns so filed shall be consolidated for the purpose of the tax prescribed under this Title. (Underlining supplied.)

Indeed, the above provision authorizes the filing of a separate return of income if it is impracticable for the spouses to file a consolidated return. The

159

word "impracticable" has been defined as "not practicable, incapable of being performed or accomplished by the means employed or at command, or infeasible." (See Webster's New Int'l Dictionary [1954], p. 1251.)

It appears that during the year in question, Tomas Garcia had repeatedly abandoned the conjugal dwelling and had led a life of profligacy and philandering; and although he continued to live with petitioner and to receive an annual salary of ₱6,000.00, as administrator of her copra plantation, the spouses apparently were not living harmoniously, as in fact the pettition of the wife for legal separation was granted by the Court of First Instance of Quezon. Under these circumstances, it can hardly be concluded that the filing by petitioner of her income tax return independently of her husband was unwarranted, that is, assuming that her husband had taxable income in that year, which, as will hereafter be shown, is not the case.

It is true that in petitioner's return she claimed a personal exemption of ₱3,000.00 as a married person and the husband also claimed an exemption of ₱3,000.00 as husband of petitioner, but this circumstance is not to be considered as indicative of an intention to defraud the Government of lawful revenue. Neither spouse could have done otherwise because they were married persons who were not then legally separated. And it could not have had any adverse effect on the Government because the law makes it an obligation of the Bureau of Internal Revenue to consolidate the returns of the spouses and to compute the income tax on the basis of the consolidated income.

There is, however, one important point which must be considered, and that is, whether or not there was any legal obligation on the part of the husband to file an income tax return. Is the compensation paid by the wife to the husband, or vice versa, for services rendered to the other, taxable income to the payee? We are of the opinion that the salary paid by one spouse to the other is not taxable income to the payee; and neither may it be treated as a deductible expense on the part of the payor. What should have been done in this case is for respondent to disallow the deduction of the salary paid by petitioner to her husband in her income tax return, if a deduction for said amount was claimed by petitioner. Considering the confused situation brought about not only by petitioner, who can hardly be blamed for failure to understand the law, but also by the examiner of the Bureau of Internal Revenue who investigated the case, the commission of fraud in filing an income tax return apart from that of her husband can hardly be attributed to petitioner.

In connection with the amount of ₱2,321.00 charged off as bad debts, it cannot likewise be concluded that petitioner's failure to substantiate the same makes it fictitious and fraudulent. For as testified by petitioner she had already forgotten the names of her tenants and other persons to whom she had extended the loans, and that she could no longer produce the documents evidencing them because they were retained by her accountant who prepared her income tax return and whose whereabouts she can not now determine. (Pp. 14-16, 22, 27-29, t.s.n.) Respondent has not contradicted this testimony and we have no reason to doubt its veracity. Moreover, considering that said loans must have been granted prior to 1951 and that petitioner's life had been burdened with multifarious business problems and marital troubles, it is possible that she could no longer recollect the details of said transactions. Under Section 337 of the Revenue Code, a taxpayer is required to preserve his books of accounts and records only for a period of five years from the date of the last entry. (See Basilan Estates, Inc. v. Commissioner, G.R. No. L-22492, Sept. 5, 1967.)

Petitioner inherited real properties from her father, the late Don Filemon Perez, who died in 1944. In 1951, she sold several residential lots with a total area of around 2,000 square meters for ₱66,056.22 (see Exh. 3, supra; p. 29, t.s.n.). In her income tax return for said year, she deducted the amount of ₱33,000.00, which she claimed as the acquisition cost of the lots, from the selling price of ₱66,056.22, and from the resulting difference of ₱33,056.00, which she treated as a long term capital gain, she declared a taxable gain of ₱16,528.11 (50% of ₱33,056.22). On the basis of said return, respondent claims that petitioner fraudulently overstated the acquisition cost of said lots since the cost thereof, as found by his examiner, was only ₱12,707.75, thus resulting in the understatement of net gain.

We agree with the contention of respondent that in computing the gain derived from the sale of said lots, petitioner should have considered its appraised value for purposes of the inheritance tax instead of its fair market value at the time of the death of the decedent, pursuant to the Revenue Code and the regulations implementing it. (See Sec. 35/b/, Revenue Code; Sec. 139, Rev. Regs. No. 2.) Nonetheless, we do not think that this fact alone constitutes fraud in the filing of the return in the absence of positive and convincing proof that it was deliberately or intentionally made to reduce her tax liabilities.

Another basis of respondent for imputing fraud in the filing of the return is -

> (c) The acquisition cost of the copra land converted into a subdivision was overstated resulting in the understatement of net gain. (Respondent's Memorandum, supra.)

Fraud is a question of fact and the circumstances constituting the same must be alleged and proved. Since respondent limited himself to the mere allegation of fraud without showing evil motive or intent to evade tax on the part of petitioner, its imposition cannot be sustained.

> It is a cardinal rule in taxation that fraud is a question of fact and the circumstances constituting it must be alleged and proved (Commissioner of Internal Revenue v. Gonzales, et al., G.R. No. L-19495, November 24, 1966). Fraud is never presumed because it is a serious charge (Yutivo Sons Hardware Co. v. Court of Tax Appeals, et al., G.R. No. L-13203, Jan. 28, 1961); it must be alleged and proved, at least satisfactorily if not conclusively by one who alleges its existence (De Roda v. Balk, 48 Phil. 104; De Santos v. Bank of the P.I., 66 Phil. 38; Menzi & Co. v. Bastida, 63 Phil. 16; Arroyo v. Granada and Gentero, 18 Phil. 484; Gomez v. Domingo, CTA Case No. 1168, Feb. 15, 1964). Moreover, the burden of proof in tax cases involving fraud will not be sustained where respondent introduces no affirmative evidence but rests only on inferences to be drawn from collateral facts (Balter, Fraud under Federal

> Tax Law, par. 112, 1953 ed.; Ayala Securities Corporation v. Commissioner of Internal Revenue, CTA No. 1346, June 20, 1968). And since a "false or fraudulent return with intent to evade tax" involves a state of mind, there must be an actual evil motive or intent to evade taxes or wilfully acted contrary to the truth and with the taxpayer's knowledge of the falsity of the declaration. To be considered are all of the facts and circumstances incident to the preparation of the alleged fraudulent return (Balter, Fraud under Federal Tax Law, par. 113, 1953 ed.). (Estate of William J. Shaw, et al. vs. Comm. of Int. Rev., CTA Case 779, Aug. 23, 1968; Underlining supplied.)

On the other hand, a reasonable inference can be drawn from the facts and circumstances of this case that the overstatement of the acquisition cost of the lots stemmed from petitioner's mistake in the interpretation of a difficult question of law and her honest reliance on the advice of her accountant. Taxation is a complicated matter, at least from the viewpoint of the layman. (See Brinker vs. Coll., CTA Case 366, July 17, 1959.) Not many persons are conversant with the intricate provisions of the Revenue Code and the regulations implementing them, and to an ordinary layman, like petitioner herein, honest mistakes in the interpretation of the law are to be expected.

Respondent cited the case of The Collector of Internal Revenue vs. Pedro Bautista, 105 Phil. 1326, unpublished, to support his assertion of fraud. We believe that said case is not applicable to the case at bar because the taxpayer therein never disputed the imposition of the fraud penalty. Moreover, the intent to evade the tax was clearly established in that case which is not so in the present case.

On the basis of the foregoing findings, we hold that no fraud was committed by petitioner in the filing of her income tax return for 1951. There being no fraud, the Government has only 5 years from the filing of the return within which to assess the tax, pursuant to Section 331 of the Revenue Code. From March 31, 1952, when the income tax return for 1951 was filed, to January 24, 1958, when the assessment was issued, more than five years had elapsed, hence, the right of the Government to assess has already prescribed. Since the assessment of the deficiency income tax for 1951 is already barred by the statute of limitations, there is no deficiency in respect thereof. (See Sec. 14, Rep. Act No. 1125.)

For the year 1952, the disputed items are as follows -

1. Undeclared salary of husband	₱6,000.00
2. Wages of coconut planters..	1,779.63
3. Interest income from PNB...	107.79

As stated in connection with the 1951 deficiency income tax assessment, the salary of ₱6,000.00 paid by petitioner to her husband is not a taxable income to the husband and neither is it a deductible expense on the part of the wife. We take it, however, that the said amount was deducted by petitioner from her gross income in 1952, and for this reason, the same should have been merely disallowed as such deduction. Although the ultimate effect is the same, we have decided to treat said item as a nondeductible expense and not as an undeclared income.

Petitioner incurred expenses in the amount of ₱1,779.63 in connection with the planting of young coconut trees. Respondent disallowed these expenses on the ground that they are capital expenditures. The expenses incurred in the planting of coconut trees resulted in the acquisition of an asset which has an economically useful life of many years. It cannot be questioned that coconut trees thrive for many years. Consequently, the disallowance of said expenses should be sustained.

Respondent included, as part of petitioner's net income for 1952, the interest received by her children from their deposits with the Philippine National Bank, Lucena Branch, in the amount of ₱107.69, pursuant to

Section 45(e) of the Revenue Code which provides -

> (e) Return of parent to include income of children.- The income of unmarried minors derived from property received from a living parent shall be included in the return of the parent, except (1) when the gift tax has been paid on such property, or (2) when the transfer of such property is exempt from the gift tax.

The facts bearing on the said amount of ₱107.79, representing interest on bank deposits of petitioner's two minor children, are quite vague. Respondent has assumed that the deposits of the two minor children in the branch of the Philippine National Bank in Lucena were gifts coming from petitioner, and from this the conclusion has been drawn that the deposits came from petitioner as gifts. Assuming the correctness of this conclusion, the said amount of ₱107.79 as interest on said deposits cannot be considered taxable income to petitioner. In order that the income derived by unmarried minor children from property received as a gift from a living parent may be taxable to the latter, the gift must be subject to the gift tax and such tax has not been paid. (See Sec. 45(e), Revenue Code, quoted above.) Obviously, the bank deposit of each of said two minor children could not have amounted to ₱5,000.00. Under the law, gifts made by parents to each of their children not exceed-

188

ing ₱5,000.00 are exempt from the gift tax. (See Secs. 109 and 110, Revenue Code.)

Lastly, there is no basis for respondent to impose the 50% surcharge on petitioner's income tax return for 1952. The facts surrounding the filing of petitioner's 1952 income tax return are similar to the facts related to the 1951 return.

WHEREFORE, the decision appealed from is hereby modified. Petitioner is declared not liable for any deficiency income tax for 1951 but is liable for the sum of ₱1,782.00 as deficiency income tax for 1952, computed as follows:

Net income per return		₱12,768.54
Add unallowable deductions -		
Salary paid to husband Tomas Garcia ..	₱6,000.00	
Wages of coconut planters	1,779.63	7,779.63
Net income		₱20,548.17
Less exemptions:		
Personal	₱3,000.00	
Additional	1,200.00	4,200.00
Net taxable income		₱16,348.17
Income tax due		₱ 2,744.00
Less amount already assessed and paid		962.00
Deficiency tax		₱ 1,782.00

Accordingly, petitioner is hereby ordered to pay the aforesaid sum of ₱1,782.00 representing deficiency income tax for 1952. If the said amount is not paid within thirty days from the date this decision becomes final and executory, petitioner shall also be liable for the surcharge of 5% and 1% monthly interest as provided in Section 51(e) of the National Internal Revenue Code, subject to the limitation prescribed therein. No costs.

SO ORDERED.

Quezon City, July 31, 1969.

R. M. Umali
ROMAN M. UMALI
Presiding Judge

I CONCUR:

RAMON L. AVANCEÑA
Associate Judge