REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

ESTATE OF FIDEL F. REYES and ESTATE OF TERESITA R. REYES, *Petitioners,*	**C.T.A. E.B. NO. 189 (C.T.A. CASE NO. 6747)**
	Present:
-versus-	ACOSTA, Presiding Justice, CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, and PALANCA-ENRIQUEZ, JJ.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	**Promulgated:** MAR 2 1 2007

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DECISION

PALANCA-ENRIQUEZ, J.:

Central in this controversy is the issue as to whether or not the petitioners are liable to pay the 50% fraud penalty for filing false returns.

THE CASE

This question is the subject of this Petition for Review filed by the Estates of Fidel F. Reyes and Teresita R. Reyes (hereafter "petitioners") under *Section 11* of *Republic Act No. 9282 (An Act Expanding the Jurisdiction of the Court of Tax Appeals)*, in relation to *Rule 43 of the 1997 Rules of Civil Procedure, as amended*, which seeks the review of the Decision dated January 16, 2006 of the First Division of this Court in C.T.A. Case No. 6747 entitled "Estate of Fidel F. Reyes and Estate of Teresita R. Reyes vs. Commissioner of Internal Revenue", the dispositive portion of which reads as follows:

> "**WHEREFORE**, premises considered, the assessments against the estates of Spouses Fidel and Teresita Reyes are hereby **AFFIRMED** but in the reduced amounts of P1,286,751.53 and P1,508,326.84, respectively, computed as follows:

I. ESTATE OF FIDEL REYES

	Per Respondent's Review	Add/(Deduct) Adjustments	Per Court's Finding
Real Properties - Conjugal	P 13,160,494.00	(P 481,307.00)	P12,679,187.00
Real Properties - Exclusive	5,813,532.33	(2,249,793.00)	3,563,739.33
Personal Properties - Conjugal	10,000.00	1,353,041.69	1,363,041.69
Personal Properties - Exclusive	1,353,041.69	(1,353.041.69)	0.00
Gross Estate	P20,337,068.02	(P2,731,100.00)	P17,605,968.02
Less: Exclusive Properties			3,563,739.33
Gross Conjugal Estate			P14,042,228.69
Less: Conjugal Deductions			
a. Funeral Expenses			(P59,260.00)
b. Claims against the Estate			(1,358,412.36)
Net Conjugal Estate			P12,624,556.33
Less: 1/2 share of surviving spouse (P12,624,556.33/2)			6,312,278.16
Net Estate			P 6,312,278.17
Add: Exclusive Properties			3,563,739.33
Total Net Estate			P 9,876,017.50

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Less: Family Home		(1,000,000.00)
Net Taxable Estate		P 8,876,017.50
Estate Tax Due		P 1,046,402.63
Less: Payment on 12/29/1997		251,031.51
Payment on 7/29/1998		297,582.00
Deficiency Estate Tax		P 497,789.12
Add: 50% Surcharge		248,894.56
20% Interest (7/24/97 to 12/30/02)		540,067.85
Total Amount Due		P 1,286,751.53
II. ESTATE OF TERESITA REYES		
Gross Estate (Share from exclusive and conjugal properties)		P 11,959,390.99
Less: Deductions		
a. Funeral Expense	P 200,000.00	
b. Accrued/Unpaid taxes	422,486.59	
c. Claim against the Estate	100,000.00	
Subtotal	P 722,486.59	
d. Vanishing Deductions	663,027.01	1,385,513.60
Net Estate		P10,573,877.39
Less: Family Home	P1,000,000.00	
Standard Deductions	1,000,000.00	
Medical Expenses	95,801.47	2,095,801.47
Net Taxable Estate		P 8,478,075.92
Estate Tax Due		P 986,711.39
Less: Payment on 2/24/1999	P 268,377.60	
Payment on 10/17/2001	53,672.52	322,050.12
Deficiency Estate Tax		P 664,661.27
Add: 50% Surcharge		332,330.64
20% Interest (2/25/99 to 12/30/02)		511,334.93
Total Amount Due		P 1,508,326.84

Accordingly, the estates of Fidel F. Reyes and Teresita R. Reyes are hereby **ORDERED TO PAY** the respondent the amounts of P1,286,751.53 and P1,508,326.84, respectively, representing deficiency/delinquency estate taxes for taxable years 1997 & 1998. In addition, 20% delinquency

> interest is imposed thereon from December 31, 2002 until the respective amounts are fully paid pursuant to Section 249 (C) (3) of the 1997 NIRC. However, the assessments for deficiency donor's tax in the amount of P216,632.54 and compromise penalty in the amount of P37,900 are hereby **CANCELLED**.
>
> **SO ORDERED**."

and the Resolution dated May 22, 2006, denying petitioner's "Motion for Partial Reconsideration" and "Supplement to the Motion for Partial Reconsideration", the dispositive portion of which reads:

> "**WHEREFORE**, there being no justifiable reason to overturn Our Decision, petitioner's Motion for Partial Reconsideration and Supplement to the Motion for Partial Reconsideration are hereby **DENIED** for lack of merit.
>
> **SO ORDERED**."

THE FACTS

In their "Joint Stipulation of Facts and Issues", the parties stipulated as follows:

> "1. Petitioners are represented by Priscilla Reyes-Pacheco, as Administrator of the two estates.
>
> 2. An estate tax return pursuant to the Voluntary Assessment Program (VAP) under Revenue Memorandum Order No. 58-97 was filed for the estate of Fidel F. Reyes on 29 December 1997.

3. Again on 29 June 1998, an amended estate tax return was filed for the same estate of Fidel F. Reyes.

4. On 24 February 1999, an estate tax return was filed for the estate of Teresita R. Reyes.

5. On 17 October 2001, the estate of Teresita R. Reyes paid an additional estate tax pursuant to the Voluntary Assessment Program (VAP) under Revenue Regulation No. 8-2001.

6. On April 21, 2002, a Preliminary Assessment Notice (PAN) was issued to the petitioners.

7. On 29 November 2002, respondent issued two (2) sets of "Formal Letter of Demand" with their corresponding Final Assessment Notices (FAN) attached therewith to the petitioners which the latter received.

8. Consequently, Petitioners filed their administrative protest against the Final Assessment Notices with the Office of the Regional Director of Revenue Region No. 7, Quezon City, Metro Manila on 4 February 2003.

9. On 28 February 2003, respondent wrote a letter to petitioners through undersigned counsel in reply to their abovementioned protest dated 3 February 2003 advising the former that said protest has been forwarded to the Revenue District Office No. 40 of Cubao, Quezon City, for appropriate action.

10. The investigation of the petitioner's estate tax liabilities revealed a tax obligation of P8,814,179.17 as deficiency/delinquency estate tax, donor's tax, and compromise penalty."

In his answer filed on October 21, 2003, respondent Commissioner of Internal Revenue (hereafter "respondent") alleged by way of special and affirmative defenses: that the investigation of petitioner's estate tax liabilities revealed a tax obligation of P8,814,179.17 as deficiency/delinquency estate tax, donor's tax, and compromise penalty; that the subject deficiency/delinquency tax assessments were issued in accordance with law and pertinent regulations and have substantially complied with the provisions of *Section 228* of the *National Internal Revenue Code of 1997* (hereafter *"NIRC of 1997"*)*, as amended*, relative to the taxpayer being informed in writing of the facts and law in which the assessment is based; that the deficiency/delinquency tax assessments were based on the following: (a) deficiency/delinquency estate tax in the amount of P6,766,193.05 for the Estate of Fidel F. Reyes was assessed on the basis of the failure to declare exclusive/capital and conjugal properties left by the late Fidel F. Reyes, but the same is without any legal justification, being neither recorded nor declared in the estate tax return resulting to the understatement of the reported taxable estate; (b) deficiency/delinquency estate tax in the amount of P1,793,453.58 for the Estate of Teresita R. Reyes was assessed on the basis of the existence of

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some discrepancy in the estate tax return of the late Teresita R. Reyes and the verification disclosed that some of the conjugal properties reported to the estate tax return belong to her late husband, Fidel F. Reyes and there was also an overstatement of vanishing deductions claimed; (c) that in view of the foregoing, such failure and omission renders the estate tax returns filed false returns which can be assessed within 10 years from the discovery of falsity, fraud or omission; (d) deficiency/delinquency donor's tax in the amount of P216,632.54 was assessed as a result of the partition of the estate, per extrajudicial settlement concurred by all the parties, pursuant to *Sections 98 to 104 of the NIRC of 1997*; (e) Compromise Penalty in the amount of P37,900.00 for violation of *Section 255,* in relation to *Section 275 of the NIRC* relative to late filing/payment of estate and donor's tax; (f) the 50% surcharge was imposed, pursuant to the provisions of *Section 248(B) of the NIRC*, in relation to *Section 332 [now 222(a)] of the NIRC*; and (g) the 20% interest per annum has been imposed, pursuant to the provisions of *Section 249(b), now Section 249(B) of the NIRC*; and (h) finally, that all presumptions are in favor of the correctness of tax assessments and the burden of proof to prove otherwise is upon the petitioner.

After trial on the merits, the First Division rendered the assailed decision in the terms earlier set forth.

Not satisfied, petitioner moved for a partial reconsideration of the same, which the First Division denied in its Resolution dated May 22, 2006.

Hence, the present Petition for Review.

ISSUES

Petitioners raised the following assignment of errors:

I

THE FIRST DIVISION ERRED WHEN IT RULED THAT THE RIGHT OF RESPONDENT TO ASSESS PETITIONERS OF DEFICIENCY ESTATE TAXES HAS NOT YET PRESCRIBED.

II

THE FIRST DIVISION LIKEWISE ERRED WHEN IT IMPOSED THE 50% SURCHARGE ON THE DEFICIENCY ESTATE TAXES DUE ON THE ESTATES OF BOTH FIDEL F. REYES AND TERESITA R. REYES WITHOUT LEGAL BASIS.

On July 19, 2006, without necessarily giving due course to the petition, We required respondent to file his comment on the petition, within ten (10) days from notice.

For failure of respondent to file his comment despite the expiration of the prescribed period, the petition was deemed submitted for decision.

THE COURT *EN BANC'S* RULING

The petition is partly meritorious.

***First Issue**: Prescription of the Period to Assess in Relation to the Definition of a "False Return"*

The first vital issue to be decided here is whether the right of the Commissioner of Internal Revenue to assess deficiency estate taxes had already prescribed at the time the final Assessment Notice was issued on November 29, 2002.

Petitioners mainly argue that respondent's right to assess deficiency estate taxes due had long prescribed considering that the Final Assessment Notice against the estates of Fidel Reyes and Teresita Reyes was issued only on November 29, 2002, when the estate tax return of Fidel Reyes was filed on December 29, 1997, while the estate tax return of Teresita Reyes was filed and paid on February 24, 1999, which was apparently beyond the three (3) year period to assess. Petitioners further argue that the returns should not be treated as a false return under *Section 222* of the *National Internal Revenue Code of 1997* (hereafter "*NIRC of*

1997"), as amended, as the underdeclaration of properties was a result of failure to correctly classify and declare in the estate tax return the properties of the late Fidel F. Reyes as conjugal or exclusive.

Respondent, on the other hand, maintains that the failure and omission of petitioners to declare exclusive/capital and conjugal properties left by Fidel Reyes renders the estate tax returns filed as false returns, which can be assessed within ten (10) years from the discovery of the falsity, fraud or omission.

What, therefore, constitutes "false return" to warrant the application of the ten-year prescriptive period?

The applicable laws are *Sections 203* and *222* of the *NIRC of 1997*, as amended, which provide:

> "SEC. 203. Period of Limitation Upon Assessment and Collection. — Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

"SEC. 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. —

(a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.

(b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon.

(c) Any internal revenue tax which has been assessed within the period of limitation as prescribed in paragraph (a) hereof may be collected by distraint or levy or by a proceeding in court within five (5) years following the assessment of the tax.

(d) Any internal revenue tax, which has been assessed within the period agreed upon as provided in paragraph (b) hereinabove, may be collected by distraint or levy or by a proceeding in court within the period agreed upon in writing before the expiration of the five (5)-year period. The period so agreed upon may be extended by subsequent written agreements made before the expiration of the period previously agreed upon.

(e)Provided, however, That nothing in the immediately preceding Section and paragraph (a) hereof shall be construed to authorize the examination and investigation

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or inquiry into any tax return filed in accordance with the provisions of any tax amnesty law or decree."

Pursuant to the above provisions, respondent has three (3) years from the filing of the returns to assess petitioners of any internal revenue tax. The exception is when there is a finding of falsity or fraud in the filing of said returns, in which case, the prescriptive period to assess is ten (10) years from the discovery of such falsity or fraud.

The main question lies on the correct interpretation of the application of the qualifying words "with intent to evade tax" to a false return and fraudulent return under *Section 222 (a)* of the *NIRC of 1997, as amended,* to warrant the application of the ten (10) year prescriptive period to assess the taxpayer.

Petitioners invoke the decision of the Court of Appeals in *Commissioner of Internal Revenue vs. Ayala Hotels, Inc. (CA-G.R. SP. No. 70025, April 19, 2004)*, pertinent portion of which reads as follows:

> "In interpreting the above provision, it is important to note that commentaries consider two (2) groups of exceptions provided for in Section 222: The first, where there is a failure to file the required return; and the second, where there is a return filed but the same is false or fraudulent and made with intent to evade tax. It appears that the phrase 'with intent to evade tax' qualifies not only

the word 'fraudulent' but also the word 'false', having been grouped together as one category under the exceptions.

Under the rules of statutory construction, the qualifying words 'with intent to evade tax' should refer to both the words 'false' and 'fraudulent' since these words are not separated by a comma. If it was the intent of the lawmakers to qualify only the word 'fraudulent' then the same should have been treated separately or at the very least, the words 'false' and 'fraudulent' should have been separated by a comma to show separate treatment of the two."

On the other hand, the First Division citing the case of *Aznar vs. Court of Tax Appeals* (*58 SCRA 519*) ruled:

"The Supreme Court in the case of Aznar vs. Court of Tax Appeals, already resolved this issue when it made a distinction between 'false' and 'fraudulent' returns as provided for by the law. To quote:

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

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> The ordinary period of prescription of five (5) years [now three (3) years] within which to assess tax liabilities under Section 331 of the NIRC [now Section 203] should be applicable to normal circumstances, but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent return intended to evade payment of tax or failure to file return, the period of ten years provided for in Section 332 (a) NIRC [now Section 222(a)], from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.'
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> Based on the above pronouncements, false returns do not necessary mean with intent to evade taxes, otherwise, there will be no distinction between false and fraudulent returns and the law would not have provided for the distinct situations. Simply put, whenever intent to evade taxes exists, fraud already exists. To apply petitioners' interpretation that both false and fraudulent returns require the 'intent to evade taxes' element would mean that in false returns, fraud also necessarily exists because of the requirement of the intent to evade payment correct taxes accompanying the falsity."

In the Aznar case, the Supreme Court ruled that no 50% final surcharge under the then *Section 72, now Section 247 (b) of the NIRC of 1997,* is applicable in the absence of fraud on the part of the taxpayer, notwithstanding the applicability of the ten-year prescriptive period from discovery of the fraud, falsity or omission under the then *Section 332 (a), now Section 222 of the NIRC of 1997.*

Petitioners' contention that the *Aznar case* cannot be applied in this present case has no basis. Although in this case, there is no recurrence of underdeclaration of taxes due, as compared with the *Aznar case*, still, there are substantial underdeclaration of taxable estate and overstatement of vanishing deductions, which renders the estate tax returns filed a "false return" contemplated under *Section 222 (a)* that warrants the application of the ten (10) year period to assess.

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

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

Section 248 (B) of the NIRC of 1997, as amended, provides that a substantial underdeclaration of receipts or a substantial overstatement of deductions shall constitute prima facie evidence of a false or fraudulent return.

After a careful evaluation of the evidence on record, We find that there is a clear substantial overstatement of vanishing deductions. Petitioners claim a total of P10,680,355.43, as vanishing deductions *(Exhibit "C-2"),* when in fact only the amount of P663,027.01 *(Decision of the First Division dated January 16, 2006)* can be claimed as vanishing deductions in the computation of the taxable estate of Teresita Reyes. The glaring difference of more than ten (10) million pesos, which is actually more than 30% of the actual deductions, renders petitioners liable for overstatement of deductions pursuant to *Section 248 (B) of the NIRC of 1997, as* amended. Further, the underdeclaration of the properties of Fidel Reyes for the determination of the proper estate tax due of more than one (1) million pesos is also substantial, in conformity with the above ruling.

As aptly ruled by the First Division:

> "In the case at bar, the bases for the falsity of the returns are the substantial underdeclaration of properties in the amounts of P497,789.12 and P664,661.27 for the estates of Fidel F. Reyes and Teresita R. Reyes and overstatement of vanishing deductions in the amount of

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P10,680,355.43 for the estate of Teresita R. Reyes. In the case of Packaging Products Corporation, the absence of falsity of the return stemmed from different interpretation of the law with regard to the availment of tax credits on sales taxes.

Indeed, there is no indicia of fraud in the instant case. The estates of Fidel and Teresita Reyes, through Administrator Pacheco, availed of the VAP of the government and even included properties not forming part of the estates which negate any deceitful intention to defraud the government of revenues. However, the Court is convinced that petitioners filed false returns taking into account that:

1) Despite having reported conjugal and paraphernal properties, both real and personal, the estate of Fidel Reyes failed to declare basic deficiency estate tax worth P497,789.12;

2) Instead of the vanishing deductions claimed of P10,680,355.43, the estate of Teresita R. Reyes may only claim vanishing deductions of P663,027.01. The failure to correctly include deductions actually incurred by the taxpayer, in effect lowered deficiency estate tax of the estate of Teresita Reyes; and

3) The estate of Teresita R. Reyes did not report basic deficiency estate tax in the sum of P664,661.27.

To reiterate, in the filing of false returns, intention to evade taxes need not exist. A fraudulent return is always an attempt to evade a tax, but a merely false return may not be. The filing of a false return is sufficient to warrant assessment of ten (10) years from date of discovery of the falsity.

Having established that petitioners filed false returns, We therefore hold that the subject deficiency estate tax assessments were issued within the prescribed period mandated by law.

Under Section 203 of the 1997 NIRC, the assessment period for estate tax deficiency is within three (3) years from the expiration of the due date or the actual date of the return, whichever is later. Petitioners are required to file estate tax returns within six (6) months from the demise of the decedents.

Pursuant to Section 222(a), there are three instances when the three (3)-year prescriptive period to assess deficiency taxes do not apply, namely: a) false returns; b) fraudulent returns with intent to evade tax; and c) failure to file returns.

In any of these situations, the Commissioner of Internal Revenue is given the option to dispense with assessment and proceed to collect delinquency taxes or he may assess the taxpayer within ten (10) years from discovery of the falsity, fraud or omission.

In the case at bar, the assessments dated November 29, 2002 and received by the petitioners on January 7, 2003, although issued beyond three (3) years from the filing of the estate returns of the estates of Fidel F. Reyes and Teresita R. Reyes on December 29, 1997 and February 24, 1999, respectively, were issued within the prescribed period of ten (10) years. xxx"

Accordingly, We sustain the findings of the First Division that the Final Assessment Notice against the estates of Fidel Reyes and Teresita Reyes, which was issued on November 29, 2002, was well within the ten (10) year prescriptive period to assess.

Second Issue: *Imposition of the 50% surcharge*

The second issue which appears to be of vital importance in this case centers on the First Division's imposition of the 50% surcharge authorized by law as fraud penalty.

Petitioners insist that the 50% surcharge under *Section 248 (B)* of the *NIRC of 1997*, as amended, should not be imposed by the First Division as the intent to evade tax was already ruled out in its assailed Decision when it found "no indicia of fraud in the instant case". Further, petitioners' interpretation of the law is that the presence of the qualifying word "willfully" necessarily implies that it is possible that false or fraudulent returns are not willfully filed. Thus, for the 50% penalty to be imposed, the filing of the false or fraudulent return must have been willfully or intentionally made. And since *Section 248 (B)* is a penal provision, the same must be liberally construed in favor of the taxpayer.

We agree with the petitioners.

Section 248 of the NIRC of 1997, as amended, provides:

"SEC. 248. Civil Penalties. -

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> (B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: Provided, That a substantial under declaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return: Provided, further, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein."

In interpreting *Section 248 (B),* the First Division ruled in its Resolution dated May 22, 2006:

> "A perusal of the foregoing shows that the law affixes the disjunctive article "or" to delineate false from fraudulent returns. When "or" is used the various members of the sentence are to be taken separately. Thus, the filing of a false return or fraudulent return cannot be classified as one act which should be qualified "with intent to evade taxes". xxx"

We agree with the First Division in so far as its interpretation that the aforequoted *Section 248 (B)* applies to both false and fraudulent returns. However, it bears stressing that *Section 248 (B)* contains the

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qualifying words "willfully made". A careful reading of *Section 248 (B)* shows that the law is very explicit in imposing the civil penalty of 50% surcharge in case a false or fraudulent return is willfully made. It cannot be said that the qualifying word "willfully" is only applicable to fraudulent returns because of the presence of the conjunction word "or" between false and fraudulent return. The word "or" is a coordinating conjunction which is a linking word used to connect words, phrases, or group of words in a sentence *(Mauricio C. Ulep, Basic Legal Writing, 1st Edition 2002, p.112).* Consequently, as applied in *Section 248 (B)*, the word "or" denotes the intention of the framers of the Tax Code to connect both false and fraudulent; likewise, the presence of the linking verb "is" associates both types of return to the qualifying words "willfully made". In this sense, the words "willfully made" should be interpreted to refer to both false and fraudulent returns.

Section 248 (B) imposes the surcharge of fifty percent (50%) only in two instances. First, in case of willful neglect to file the return within the period prescribed, and second, in case a false or fraudulent return is willfully made. Thus, it is not enough that the taxpayer failed to file the required tax return or that the return is false to justify the imposition of

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the 50% for fraud. The law is clear that "a false or fraudulent return is willfully made". It must be emphasized that respondent did not present evidence to directly prove that there was a willful intention on the part of petitioners to evade the payment of taxes. What is evident in this case is the negligence and mistake of the petitioners in the interpretation of the law that caused the deficiencies found by the respondent in his assessments. However, We find no actual and intentional fraud through willful and deliberate misleading of the government agency concerned, the Bureau of Internal Revenue. The government was not induced to give up some legal right and place itself at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities because petitioners did not conceal anything. Error or mistake of law is not fraud *(Commissioner of Internal Revenue vs. Javier, Jr., 199 SCRA 824).*

The word "willfully" carries the idea, when used in connection with an act forbidden by law, that the act must be done knowingly or intentionally; that, with knowledge, the will consented to, designed, and directed the act *(U.S. vs. Bull, 15 Phil 19).* Further, a willful act may be described as one done intentionally, knowingly, and purposely, without justifiable excuse, as distinguished from an act done carelessly, thoughtlessly, heedlessly, or inadvertently. A willful act differs essentially from a negligent act. The one is positive and the other negative *(Black's Law Dictionary, 6th Edition, p. 1599)*. The Supreme Court has ruled that the word willful in a statute means "not merely voluntary but with a bad purpose; in other words, corruptly" *(US vs. Ah Chong, 15 SCRA 498)* and "premedidated; malicious; done with intent, or with bad motive or purpose, or with indifference to the natural consequence" *(Commissioner of Internal Revenue vs. Court of Appeals, 257 SCRA 224)*.

The First Division in its decision ruled out the element of fraud in this instant case, thus, petitioners have no intention to willfully file a false return to evade payment of taxes.

The following circumstances attendant to the case at bar show that in filing the questioned returns, the petitioners were guided not by that "willful and deliberate intent to prevent the Government from making a proper assessment" which constitute fraud:

First, the availment of a Voluntary Assessment Program of the BIR, thereby exposing itself to further investigation of its books of account and other accounting records by the government;

Second, the other errors in computing the taxes paid by the estates, such as the inclusion of other properties no longer owned by the estate or have no more market value and failure to deduct the standard deduction of P1,000,000.00 and family home which were all beneficial to the government;

Third, the petitioners further paid additional taxes under the VAP.

In the Aznar case, fraud in relation to the filing of income tax return, was discussed in this manner:

> "xxx the fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some legal right. Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by law. It must amount to intentional wrong-doing with the sole object of avoiding the tax. It necessarily follows that a mere mistake cannot be considered as fraudulent intent, and if both petitioner and respondent Commissioner of Internal Revenue committed mistakes in making entries in the returns and in the assessment, respectively, under the inventory method of determining tax liability, it would be unfair to treat the mistakes of the petitioner as tainted with fraud and those of the respondent as made in good faith."

To reiterate, the fraud contemplated by law is actual not constructive. Fraud is never imputed and the courts never sustain findings of fraud upon circumstances which, at most, create only

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suspicion and the mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion *(Yutivo Sons Hardware Co. vs. Court of Tax Appeals, 1 SCRA 160; Commissioner of Internal Revenue vs. Javier, Jr., 199 SCRA 824)*. Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by the law. It must amount to intentional wrong-doing with the sole object of avoiding the tax *(Aznar vs. Court of Tax Appeals, 58 SCRA 519)*. It necessarily follows that a mere mistake cannot be considered as fraudulent intent to evade tax.

For all the foregoing, We hold, therefore, that the imposition of the fraud penalty in this case is not justified by the extant facts. With the conclusion of the First Division and affirmed by Us that petitioners had filed a false return, but there was no fraud, it is evident that the false return was not willfully made, hence petitioners should not be held liable for the 50% fraud surcharge under *Section 248 (B)*. The conclusion that petitioners should not be held to pay for the 50% fraud surcharge is coherent with the ruling out of the existence of fraud by the First Division.

We conclude that the 50% surcharge, as fraud penalty authorized under *Section 248 (B) of the NIRC of 1997*, should not be imposed, but eliminated from the deficiency estate taxes for the taxable years 1997 and 1998.

Therefore, the penalty that is applicable in the case at bar is the 25% late payment surcharge pursuant to *Section 248 (A)* of the *NIRC of 1997, as amended*, which provides:

> "SEC. 248. Civil Penalties. —
> (A) There shall be imposed, in addition to the tax required to be paid, a penalty equivalent to twenty-five percent (25%) of the amount due, in the following cases:
>
> xxx xxx
>
> (3) Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or
>
> xxx xxx."

WHEREFORE, premises considered, the decision of the First Division, dated January 16, 2006, in C.T.A. Case No. 6747 is **MODIFIED** in so far as the imposition of the 50% fraud penalty is concerned, and **AFFIRMED** in all other respects.

Accordingly, petitioners are **ORDERED TO PAY** to the Commissioner of Internal Revenue the sums of P1,162,304.25 and

P1,342,161.52 respectively, representing deficiency/delinquency estate taxes for taxable years 1997 and 1998, computed as follows:

I. ESTATE OF FIDEL REYES

	Per Respondent's Review	Add/(Deduct) Adjustments	Per Court's Finding
Real Properties - Conjugal	P 13,160,494.00	(P481,307.00)	P12,679,187.00
Real Properties - Exclusive	5,813,532.33	(2,249,793.00)	3,563,739.33
Personal Properties - Conjugal	10,000.00	1,353,041.69	1,363,041.69
Personal Properties - Exclusive	1,353,041.69	(1,353.041.69)	0.00
Gross Estate	P20,337,068.02	(P2,731,100.00)	P17,605,968.02
Less: Exclusive Properties			3,563,739.33
Gross Conjugal Estate			P14,042,228.69
Less: Conjugal Deductions			
a. Funeral Expenses			(P59,260.00)
b. Claims against the Estate			(1,358,412.36)
Net Conjugal Estate			P12,624,556.33
Less: 1/2 share of surviving spouse (P12,624,556.33/2)			6,312,278.16
Net Estate			P 6,312,278.17
Add: Exclusive Properties			3,563,739.33
Total Net Estate			P 9,876,017.50
Less: Family Home			(1,000,000.00)
Net Taxable Estate			P 8,876,017.50
Estate Tax Due			P 1,046,402.63
Less: Payment on 12/29/1997			251,031.51
Payment on 7/29/1998			297,582.00
Deficiency Estate Tax			P 497,789.12
Add: 25% Surcharge			124,447.28
20% Interest (7/24/97 to 12/30/02)			540,067.85
Total Amount Due			**P 1,162,304.25**

II. ESTATE OF TERESITA REYES

Gross Estate (Share from exclusive and conjugal properties)		P 11,959,390.99
Less: Deductions		
a. Funeral Expense	P 200,000.00	
b. Accrued/Unpaid taxes	422,486.59	
c. Claim against the Estate	100,000.00	

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Subtotal	P 722,486.59	
d. Vanishing Deductions	663,027.01	1,385,513.60
Net Estate		P10,573,877.39
Less: Family Home	P1,000,000.00	
Standard Deductions	1,000,000.00	
Medical Expenses	95,801.47	2,095,801.47
Net Taxable Estate		P 8,478,075.92
Estate Tax Due		P 986,711.39
Less: Payment on 2/24/1999	P 268,377.60	
Payment on 10/17/2001	53,672.52	322,050.12
Deficiency Estate Tax		P 664,661.27
Add: 25% Surcharge		166,165.32
20% Interest (2/25/99 to 12/30/02)		511,334.93
Total Amount Due		**P 1,342,161.52**

In addition, 20% delinquency interest is hereby imposed thereon from December 31, 2002 until the respective amounts are fully paid pursuant to *Section 249 (C) (3) of the NIRC of 1997, as amended.*

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice