REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

Oct. 31, 1964

LEONARDO S. VILLA,
Petitioner,

- versus - C.T.A. CASE NO. 1048

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

This is an appeal from the decision of respondent assessing against and demanding from petitioner the payment of income taxes for the years 1951, 1952, 1953, 1954 and 1956, in the respective amounts of ₱14,055.78, ₱32,378.11, ₱1,725.34, ₱8,141.15 and ₱38.81, inclusive of 50% fraud penalty, 1/2% monthly interests and compromise penalties for late filing of income taxes, or a total amount of ₱56,339.19; and additional residence taxes and surcharges for the years from 1951 to 1957 in the total amount of ₱244.00.

Petitioner, Leonardo S. Villa, a doctor of medicine, derived his income from his professional fees; payments of hospitalized patients; salaries from the estate of Tereso Villa, Inc., University of Southern Philippines, and the Pepsi Cola Co.; rentals of hospital building, apparatus and equipment; fees from a public bath; receipts from the Biliran Estate; and dividends from Visayan Electric Co. In addition, petitioner's wife operated the Arcon Gasoline Station, dealing in gasoline, kerosene, lubricating oil and rubber tires. Aside from operating a gasoline station, she was also engaged in a retail store business.

For the years 1951, 1952, 1953, 1954 and 1956, petitioner and his wife filed consolidated income tax returns. The 1951 return was filed on April 2, 1952, supported by a balance sheet (Exhs."D" & "E") and profit and loss statements duly certified by a certified public accountant. The 1952 return was filed on March 30, 1953, supported by profit and loss statements (see Exh. "8") and a balance sheet (Exh. "E") certified by accountant Manuel V. Cabaluna. The 1953 return (Exh. "C") was filed on February 26, 1954, supported by profit and loss statements and a balance sheet (Exh. "K") also certified by accountant Manuel V. Cabaluna. The 1954 return was filed on March 31, 1955, equally supported by profit and loss statements, as certified correct by petitioner himself. And the 1956 return was filed on March 23, 1957 and was likewise supported by profit and less statements certified by petitioner and his wife.

The petitioner and his wife reported net incomes in the amounts of ₱11,156.64, ₱10,364.92, ₱6,939.88, ₱7,801.34, for the years from 1951, 1952, 1953 and 1954, respectively, and a net loss of ₱3,449.71 for the year 1956.

Believing that the returns and the financial records of petitioner did not reflect the net income of the spouses, respondent caused the investigation and determination of their income tax liability by the use of the networth or inventory method of investigation. In establishing the opening net worth of petitioner and his wife, respondent used as basis the balance sheets of the Immaculate Concepcion Hospital, and the Arcon Gasoline Station, which were owned and operated by the spouses. Similarly, the ending net worth for the years in question were based mainly on the financial statements of the petitioners for the said years and on the records of the City Assessor, City Engineer and Register of Deeds. But with respect to the cash balances, respondent made his own cash analysis by reconstructing the cash account from the profit and loss statements of the two businesses. Consequently, it was concluded by respondent that the spouses under-declared their incomes for the years in question in the amounts appearing below:

	Net Income Per Tax-payer's Return	Net Income Per Investigation	Net Income Underdeclared
1951	₱ 11,156.64	₱ 41,998.10	₱ 30,841.36
1952	10,364.92	70,804.97	60,440.05
1953	6,939.88	17,766.34	10,826.46
1954	7,801.34	33,847.96	26,046.62
1956	(3,449.71) (loss)	9,005.76	8,005.76

It was also determined that petitioner did not pay the correct amount of additional residence taxes, which amount is not contested by petitioner.

On the basis of the finding and report made by Revenue Examiner Corpus on June 30, 1959, respondent, on February 23, 1961 (Exh. "A"), assessed against and demanded from petitioner the payment of income taxes for 1951, 1952, 1953, 1954 and 1956, the respective amounts of ₱14,055.78, ₱32,378.11, ₱1,725.34, ₱8,141.15 and ₱38.81, inclusive of 50% surcharge, 1/2% monthly interests and compromise penalties; and additional residence tax in the total amount of ₱244.00, inclusive of surcharge, for the years 1951 to 1957. Said assessment

ment of respondent was received by petitioner on April 7, 1961.

From the decision assessing petitioner for the above taxes, he filed an appeal with this Court.

The issues presented for determination are as follows:

(1) Whether or not the right of respondent to assess the deficiency income taxes for the years 1951, 1952, 1953, 1954 and 1956 against petitioner has prescribed; and if in the negative

(2) Whether or not petitioner is liable for the amounts of deficiency income taxes assessed against him for the years in question.

With respect to the first issue, petitioner contends that pursuant to Section 331 of the Tax Code, respondent's right to assess deficiency income taxes for the years in question had prescribed since more than five years had elapsed from the time the returns were filed. On the other hand, respondent contends otherwise, urging that inasmuch as petitioner had filed false and fraudulent returns, he has ten (10) years from the time of discovery of the falsity or fraud or from June 30, 1959, within which to assess and collect the deficiency income taxes.

The resolution of the first issue hinges upon a finding of whether or not the returns filed by petitioner were false and fraudulent with intent to evade tax. It is to be noted that the imputation of falsity and fraud is based upon respondent's determination of substantial underdeclarations of income allegedly perpetuated by petitioner. But these alleged substantial underdeclarations resulted from errors committed by respondent. As afore-stated, in establishing petitioner's opening net worth, respondent used as basis, the balance sheets of the hospital and the gasoline station. While the figures of the resulting net worth are not contested by petitioner, yet it is argued that this net worth reflects only the financial position of the ownership of petitioner and his wife in these two businesses. And it does not correctly indicate their personal financial position, which must necessarily include their non-business assets. It is erroneous to consider only the financial position of their corporate ownership, for the spouses must have non-business assets as well. The disregard of these non-business assets naturally decreased their opening net worth.

Moreover, respondent deducted some liabilities from the assets and arbitrarily disregarded other deductible items. Thus, he failed to include in his computation the following deductible liabilities and additional investments:

1951

Salaries payable	₱	189.79
Arcon Station Expense		155.90
De Villa (Additional investment)		2,261.50
Rosa Villa (Additional investment)		20,461.87
Doctors Fees		13,208.18
Laboratory Fees		734.55
Total	₱	37,011.79

1952

E. R. Squibb	₱	120.76
Doctors Fees Payable		1,126.68
Laboratory Fees Payable ...		264.55
Rosa Villa (Additional investment)		4,640.51
Liability to Shell Co.		14,522.11
Total	₱	20,674.61

1953

Accounts Payable	₱ 4,315.92
Veco	457.70
Rosa Villa (Additional investment)	809.33
E. R. Squibb & Sons	120.76
Total	₱ 5,703.71

The exclusion of the above-enumerated amounts effected an increase in the net worth for the corresponding tax year.

Finally, the ending cash balances determined in respondent's working papers (Exhs. "B" & "4", Vol. 1, BIR Rec.) were not taken from petitioner's financial statements. They were arrived at by adding to the cash balance at the beginning of the year all the incomes reported for that year and deducting therefrom all the expenses corresponding to the same year, as found in petitioner's profit and loss statements. This procedure of computing the cash balances is undoubtedly erroneous as all cash transactions should be taken into account and should not be limited only to receipts from income and disbursements for expenses. We note that disbursements for payments of obligations, purchases of assets and payments for other items not classified as expenses were likewise not considered. Similarly, receipts from receivables and other non-income items were not included in the cash analysis. Consequently, the resulting cash balance at the end of each year is far from accurate, and cannot be a proper basis for reflecting the increase in net worth.

Now, deducting the liabilities, additional investments, and cash payments not taken into account in respondent's computation, the net incomes of petitioner for the tax years in question would appear to be as follows:

1951

Net income per respondent's investigation		₱ 41,998.10
Less: Liabilities & additional investments not taken into account		37,011.79
Net income		₱ 4,986.31

1952

Net income per respondent's investigation		₱ 70,804.97
Less: Increase in value of hospital building by appraisal of City Assessor ...	₱ 26,655.12	
Liabilities & additional investments not taken into account	20,674.61	
Disbursements not taken up in cash analysis:		
Payment on principal portion of RFC loan	8,803.97	
Cost of constructing public bath & bldg.	5,960.00	
Accounts payable - P. N. B.	17,263.15	
Total deductions.....................		₱79,356.85
Net income		(₱ 8,551.88)

1953

Net income per respondent's investigation		₱ 17,766.34
Less: Liabilities & additional investments not taken into account	₱5,703.71	
Disbursements not taken up in cash analysis:		
Cost of air conditioning unit	1,250.00	
Payments on RFC loan	8,803.97	
Total deductions		15,757.68
Net income		₱ 2,008.66

1954

Net income per respondent's investigation		₱33,847.96
Less: Disbursements not taken up in cash analysis:		
Dispensary & Nurses home	₱2,000.00	
Copra drier & warehouse	5,760.00	
Tractor	19,200.00	
Carromata	500.00	
Payment on RFC loan	8,803.97	
Total deductions		₱36,263.97
Net income		(₱2,416.01)

1956

Net income per respondent's investigation	₱ 9,005.76
Less: Payment on RFC loan not taken up in cash analysis	8,803.97
Net income	₱ 201.97

From the above computation, it is to be observed that the incomes of petitioner in the tax year 1951 amounts to ₱4,986.31; in 1953 to ₱2,008.66; and in 1956 to ₱201.97. These resulting net incomes are not substantial enough to warrant the charge that the filing of the corresponding tax return was attended with fraud with intent to avoid tax, considering that the determination of undeclared income by means of the net worth method is not always accurate.

In view of our finding that the alleged substantial underdeclarations of income resulted from the errors committed by respondent, we believe and so hold that the falsity and fraud charged by respondent cannot be sustained. Therefore, respondent had only five (5) years from the filing of the tax returns within which to make the corresponding assessments.

And since the deficiency assessment in question was made on February 23, 1961, it follows that the right of respondent to assess the deficiencies for the years 1951, 1952, 1953 and 1954 has prescribed.

This leaves us to determine whether or not petitioner is liable for the deficiency assessment for the year 1956. In this connection, we observe that the assessed deficiency tax amounts only to ₱38.31. Similarly, we note that respondent failed to deduct the cash payment of ₱8,803.95 made on account of the RFC loan. The deduction of this disbursement item would not leave a taxable net income to petitioner for the year 1956. It would consequently erase the alleged deficiency tax of ₱38.31.

IN VIEW OF THE FOREGOING CONSIDERATIONS, with the exception of that portion regarding the additional residence taxes and surcharges for the years 1951 to 1957 in the amount of ₱244.00, for which we hold petitioner liable, the decision appealed from is hereby reversed. The petitioner is ordered to pay to the Commissioner of Internal Revenue or his representative the sum of ₱244.00, as additional residence tax and surcharge, without pronouncement as to costs.

SO ORDERED.

Quezon City, October 31, 1964.

MARIANO NABLE
Presiding Judge

WE CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

(Sgd.) ROMAN M. UMALI
Associate Judge

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