BINALBAGAN ESTATE, INC.,
Petitioner,

- versus - June 29, 1957 C.T.A. CASE NO. 253

SILVERIO BLAQUERA, Collector
of Internal Revenue,
Respondent.

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DECISION

This is an appeal interposed by the petitioner, Binalbagan Estate, Inc., seeking to declare null and void all the reassessments made by the respondent of the income tax liabilities of the petitioner for the years 1951, 1952 and 1953, and the refund of the total amount of ₱444,035.26 representing alleged overpayment of income taxes for said years.

The petitioner is a domestic corporation organized for the purpose of operating a sugar central, with tangible capital assets having a total original acquisition value of ₱7,797,994.69. Before the last war, it had a daily production capacity of from 6,000 to 7,000 piculs of sugar. During the war, around 40% to 50% of its tangible assets were destroyed or suffered damages, and its books and records were lost. Preparatory to resuming its operations after the war, the corporation undertook to reconstitute its books and records. The task of reconstitution was entrusted to its accountant, Mr. Eugenio Ramos, with the assistance of Messrs. Cion and Domingo, two employees of the Philippine National Bank which owned around 99.5% of petitioner's capital stock. Mr. Ramos evaluated the assets of petitioner at ₱824,559.91. Admittedly, this valuation, which was entered in 1945 in the reconstituted books, did not include the value of petitioner's sugar quota of 296,525.856 piculs. In 1946, upon the advice of the late President Roxas and the Council of State in order to achieve economy in their rehabilitation and reconstruction and to achieve the lowering of the operating cost of milling sugar in the Binalbagan sugar district of Negros Occidental, the petitioner and Isabela Sugar Co. agreed to merge into a new corporation to be known as Binalbagan-Isabela Sugar Co., Inc. (Biscom for short), with a capital stock divided into 400,000 non par value shares. Prior to the organization of the Biscom, a committee of sugar central experts, composed of Mr. T. C. Westly, general superintendent of Del Carmen & Calamba Sugar Estate, as Chairman, and Messrs. Raymundo Robles, a mechanical engineer previously connected with different sugar centrals, and Gonzalo G. Guillen, as members, was created to appraise the properties of the merging sugar companies for the purpose of determining their contributions to, and participations in, the capitalization of Biscom. This committee, in its report, valued the tangible assets of the petitioner at ₱2,541,134.69, and those of Isabela Sugar Co. at ₱2,466,062.80. In making the appraisal, the Westly Committee proceeded to make the valuation item by item. To arrive at a definite price or value of a particular item, it considered the original value and then deducted the amount needed for reparation thereof. In ascertaining the prices of the replacement parts, it considered the fair market value prevailing at the time of appraisal, and, sometimes, the original value, minus wear and tear. It took the committee about one month to make the appraisals and the report. In consideration of the transfer to Biscom of the tangible assets of petitioner, thereby valued at ₱2,541,134.69 by the Westly Committee, and sugar quota of ₱296,525.856 piculs, which respondent's counsel admitted had a current value of ₱5.00 per picul or a total value of ₱1,482,629.28 at the time of conversion or exchange, the petitioner received 216,000 non par value shares of Biscom's authorized capital stock, 3 shares of which were issued to the qualifying incorporators designated by petitioner. In 1948, three small sugar centrals, namely, Kabankalan, Salvador Serra and Vidaurrazaga y Mota, contributed their capital assets to the Biscom in exchange of 72,323 Biscom shares, 39,055 of which were issued in consideration of a voting trust executed by said sugar centrals in favor of petitioner from petitioner's original shares, thus reducing petitioner's equity in Biscom to 176,945 shares. In 1951, the petitioner sold 176,941 of its shares to the Philippine Planters' Investment Co. for

₱6,192,935.00, payable in installments. It retained four (4) shares in pursuance of the contract of sale authorizing petitioner to have a representation in the Board of Directors of the Biscom until the price is fully paid. In the same year, the petitioner received an initial payment of ₱1,500,000.00; in 1952, ₱380,764.47, ₱4,296.97 of which was for interest; and in 1953, ₱1,231,710.75, ₱13,878.26 of which was for interest. These receipts, including the sundry profits and miscellaneous credits to surplus, were reported in petitioner's income tax returns for the corresponding tax years, and income tax, as reflected in the returns, in the amounts of ₱14,327.00, ₱37,446.00 and ₱139,617.00 was paid. In the computation of the income tax, as reflected in the returns, the petitioner used the book (Ramos) value of ₱824,559.91 as the acquisition value of the shares sold to the Philippine Planters Investment Co.; it deducted at once the book value from the first installment of ₱1,500,000.00; it took into account as income only 50% of the profit returned for each year as taxable and it set forth certain deductions which were not allowable. On November 27, 1954, the respondent Collector of Internal Revenue assessed against the petitioner the respective sums of ₱267,246.00, ₱36,030.00 and ₱127,949.00, including in the latest sum the tax due on miscellaneous charges to surplus applicable to previous periods in the aggregate amount of ₱3,259.60, as deficiency income taxes for the tax years 1951, 1952 and 1953, which the petitioner paid under protest. Petitioner's request for refund having been denied, the present appeal was filed.

Both parties admit that the income tax returns filed by the petitioner are erroneous. The petitioner is now willing to apportion the acquisition cost of the shares sold to the Philippine Planters' Investment Co. in proportion to the installment received in order to get the correct profit for each particular tax year; it is also willing to consider 100% of its yearly net profit as taxable; it is further willing to forego the deductions disallowed by the respondent Collector of Internal Revenue. And above all, it admits the mistake of setting forth in the returns the book value of ₱824,559.91 as the acquisition cost of the shares sold which according to it was arbitrary and unreasonably low.

The only issue involved in this case is: What is the correct acquisition value of the 176,941 shares which the petitioner sold to the Philippine Planters' Investment Co.?

The respondent maintains that the correct acquisition value of the shares is the book (Ramos) value of ₱824,559.91. Upon the other hand, the petitioner contends that it is the value of the tangible assets on the amount of ₱2,541,134.69 as determined by the Westly Committee plus the sugar quotas of 296,525.856 piculs valued at ₱1,482,629.28 or a total of ₱4,023,763.97.

At the outset, we wish to lay emphasis on the fact that, aside from the unrelated incomes during the years 1951 and 1953, respondent's deficiency assessment was directed to the profit or income realized from the sale of the shares to the Philippine Planters' Investment Co. From the evidence adduced during the hearing of this case, two separate taxable transactions project into the light. One is the transaction involving the conversion by exchange of the capital assets of the petitioner into the Biscom shares. The other is the transaction regarding the disposition by sale of petitioner's shares (converted assets) in favor of the Philippine Planters' Investment Co. But, as respondent's deficiency assessment was directed fundamentally to the profit or income arising from said sale, we shall therefore limit ourselves to the second transaction -- to the sale of petitioner's 176,941 Biscom shares in favor of the Philippine Planters' Investment Co.

We shall now proceed to determine the correct acquisition value of the 176,941 Biscom shares which the petitioner sold to the Philippine Planters' Investment Co. in order to ascertain the taxable income arising from the sale. As afore-stated, the 216,000 no par shares were received by the petitioner in exchange of its assets, which consists of tangible properties valued by the Westly Committee at ₱2,341,134.69 and sugar quota of 296,575.856 piculs, which, as admitted by respondent's counsel, had a current value of

₱5.00 per picul or a total current value of ₱1,482,-629.28. The law provides that "in case of the exchange of one piece of property for another, the property received in exchange shall be considered as the equivalent of money in a sum equal to its fair market value on the date on which the exchange was made." (Sec. 35-c, Nat. Int. Rev. Code.) In the determination of such value, the "appraisal depends in large part upon the ability and reliability of the appraiser's care with which the appraisal is made, and the familiarity of the appraiser with the property." (Mertens, Law of Fed. Income Taxation, Vol. 10-A, Sec. 59.06, p. 15.)

The valuation of petitioner's tangible assets at ₱2,541,134.69 was arrived at by men whose ability as appraisers is not disputed by respondent. Mr. Westly, by reason of his position as General Superintendent of Del Carmen & Calamba Sugar Estate, was familiar with the properties he was called upon to appraise and was in our opinion highly qualified to appraise petitioner's tangible assets. From the evidence presented, it appears that Messrs. Robles and Guillen, who are both engineers with years of experience in various sugar centrals are just as qualified as Mr. Westly. Indubitably, they were in a better position to determine approximately, if not accurately, the value of the tangible properties than the members of the Rates Committee. The integrity of these three men as appraisers cannot be doubted. One of the members represented the petitioner; the other, Isabela Sugar Co. It may be said that these two members represented conflicting interests. Each had to see that the assets of the other's principal were not unduly overpriced to the prejudice of his own principal's interests. The three appraisers spent about one month in their task, making the valuation item by item. For these observations alone, we believe that the valuation of the Westly Committee should be accorded considerable weight. Upon the other hand, we cannot give the same weight to the valuation of the Ramos Committee principally because it was based not on fair market value but on book value. Moreover, there is no showing regarding their familiarity with the properties in question and the care with which their appraisal was made. An appraisal of this kind requires technical knowledge of machineries, which, we believe Messrs. Ramos, Gian and Domingo did not possess.

Moreover, from the mathematical aspect, we are inclined to give more credit to the Westly appraisal as expressing, more or less correctly, the value of petitioner's tangible assets, which were exchanged for the Biscom shares, than to the Ramos valuation of ₱824,559.91. As heretofore stated, the total original acquisition value of petitioner's tangible capital assets was ₱7,797,994.69. Around 40% to 50% of these assets was destroyed during the war. The Westly appraisal of ₱2,541,134.69 is 30.68% of the original acquisition value of petitioner's tangible capital assets. The Ramos valuation which was made earlier than the Westly Committee appraisal is only 9.45% of the original acquisition value of petitioner's tangible capital assets. Considering that further depreciation in the tangible properties occurred up to the Westly Committee appraisal, it is obvious that this appraisal is a more or less correct valuation of said properties.

But above all, the Westly Committee appraisal was adopted in the agreement between Isabela Sugar Co. and the petitioner, which was then practically owned by the Philippine National Bank, to organize the Biscom. It was embodied as Annex "A" in the Articles of Incorporation of Biscom, which was duly registered in the Securities & Exchange Commission. Having been thus adopted, embodied and registered, there is no room for doubt that as between the Westly Committee appraisal and the Ramos valuation, the former expresses more approximately, if not more accurately, the correct acquisition value of petitioner's tangible assets. Consequently, considering that respondent's counsel admitted that the sugar quota of 296,526.856 piculs had a current total ac- value of ₱1,482,629.28, we find that the correct acquisition value of the 216,000 shares was ₱4,023,763.97. However, inasmuch as the 39,055 shares were conveyed to the three sugar centrals in consideration of the voting trust and four (4) shares were withheld or retained by petitioner, the 176,941 shares disposed of by way of sale to the Philippine Planters' Investment Co. had an acquisition value of ₱4,023,673.02, not ₱4,023,638.34 as erroneously computed by petitioner.

To obtain the taxable income arising from the receipts of sale of the 176,941 shares, the following mathematical formula, as admitted by both parties, is should be applied:

$$\frac{\text{Gross Profit}}{\text{Selling Price}} \times \text{Installment Received} = \text{Profit for the Year}$$

Regarding the percentage of gain that should be taken into account in computing the net income of petitioner, which it now submits should be 100%, it is well to state here that Section 34 (b) of the Tax Code is applicable only to a taxpayer other than a corporation. "x x x. As respects corporations, since there are no similar provisions cutting down the amount of the gain or loss, capital gains or losses are fully taken into account." (Federal Income Taxation (Cases & Materials) by Surrey & Warren, Part I, p. 478). It follows that the income of petitioner is taxable to the extent of 100%.

Regarding the assessments on the sundry profits of ₱12.00 returned in 1951 and the credits to surplus of ₱231.00 and ₱8,217.47, respectively, reported in 1951 and 1953, we find for the respondent Collector of Internal Revenue for the reason that said assessments were not contested by the petitioner. For the same reason, we hold as taxable the miscellaneous charges to surplus applicable to previous periods totalling ₱3,259.60, which, though not reported, were nevertheless included in the assessment for 1953.

Respondent argues against the consideration of the sugar quota in fixing the acquisition value of the shares sold to the Philippine Planters' Investment Co.

It is contended that the sugar quota, having been acquired free and without cost before the war, cannot be expected to have or acquire any acquisition cost for purposes of determining any profit realized from the sale of the Biscom shares. This argument is without merit. We are called upon to determine the profit accruing from the sale of the shares. It is true that petitioner acquired the sugar quota free. But at the time of the conversion by exchange of the sugar quota into Biscom shares, the sugar quota, as admitted by respondent's counsel, had a current value. Since the sugar quota had then a current value and formed part of the consideration in the conversion by exchange into shares, which shares were subsequently sold, they should therefore be taken into account in ascertaining the acquisition value of the shares for the purpose of fixing the profit realized from said sale (sec. 35-c, Nat. Int. Rev. Code).

As regards the book (Ramos) valuation, the respondent charges the petitioner with equitable estoppel or estoppel _in pais_. He avers that the petitioner having represented in its books that the value of its assets was only ₱824,559.91, it cannot now be permitted to repudiate it. We cannot agree with the proposition that estoppel _in pais_ should be made to operate against the petitioner. In order to constitute this kind of estoppel the respondent must have relied on or acted upon the book (Ramos) valuation to his prejudice — to the prejudice of the government which he now represents (see Central Impr. Co. v. Cambria Steel Co., 210 Fed. 696.) In the case at bar, the respondent did not present evidence to prove that the government has been prejudiced by his reliance on the book valuation of ₱824,559.91. And we cannot perceive how the government could have been prejudiced thereby. On the contrary, should we sanction the use of the book valuation in computing the taxable profit accruing from the sale of the shares merely because of such reliance, the government would stand to collect taxes in excess of what is legally due. In this eventuality, it would be the petitioner, not the government, who would be prejudiced. Moreover, a taxpayer should be given an opportunity to correct honest and innocent mistakes in his returns (Rhode Island Hospital Trust Co. vs. Commissioner, 29 F 2d 339; Union P. R. Co. vs. Bowers, 24 F 2d 788).

In view of all the foregoing, we find that the income taxes due from the petitioner during the tax years 1951, 1952 and 1953 to be in the respective amounts of ₱64,613.00, ₱23,523.00 and ₱91,419.00, or in the total amount of ₱179,555.00. It appearing that for the same years, the petitioner paid the sums of ₱281,573.00, ₱73,476.00 and ₱267,566.00, or a total of ₱622,615.00 as income taxes, there is therefore an overpayment of ₱443,060.00.

WHEREFORE, the assessment of November 27, 1954 is modified and the respondent Collector of Internal Revenue is hereby ordered to refund to the petitioner, Binalbagan Estate, Inc., the sum of ₱443,060.00, with legal interest thereon from the date of payment. Without special pronouncement as to costs.

SO ORDERED.

Manila, Philippines, June 29, 1957.

AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge