PETRA M. VDA. DE FERNANDEZ
and CONCEPCION MARTINEZ,
Petitioners,

- versus - C.T.A. CASE NO. 935

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

x - - - - - - - - - - - - - - x

CONCEPCION MARTINEZ and PETRA
M. VDA. DE FERNANDEZ,
Petitioners,

- versus - C.T.A. CASE NO. 1262

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

12/23/70

x - - - - - - - - - - - - - - x

D E C I S I O N

On July 20, 1960, respondent assessed petitioners in the amounts of ₱45,726.37, ₱41,990.70 and ₱41,918.13 as corporate income tax, inclusive of administrative penalties and interests for failure to file income tax returns for the years 1951 to 1953, the subject matter in C.T.A. No. 935. Subsequently, on December 20, 1961, another assessment was made against petitioners in the amounts of ₱24,849.65, ₱33,590.08, ₱29,898.70, ₱50,466.69, ₱43,162.80 and ₱46,412.99 as income tax for the years 1954 to 1959, the subject matter in C.T.A. No. 1262. Having failed to secure a reconsideration of the said assessments, petitioners appealed to this Court. These cases have been jointly heard as they involve the same issues.

It appears that Concepcion Leyba y Buzon died intestate in the City of Manila on February 16, 1930, leaving two daughters, the petitioners Petra M. Vda. de Fernandez and Concepcion Martinez, as her only heirs. In a project of partition executed by petitioners on February 14, 1931, the estate which consisted mainly of 32 parcels of land located in the City of Manila and the improvements thereon were adjudicated pro-indiviso in equal shares to the said two sisters. Instead of partitioning said parcels, the sisters, eight years later, transferred the titles of said properties to their names in undivided equal shares and the properties remain undivided up to the present, earning income from rentals. The said properties are administered by the Martinez Leyba Inc., a corporation organized and engaged in r[illegible] estate business since before the second world war. [illegible] tioners are the principal stockholders of this co[illegible] tion. From 1951 to 1959 alone, petitioners earn[illegible] following income from the said properties:

Year		Gross Income	Net Income
1951	--------	₱206,637.68	₱152,217.34
1952	--------	194,379.97	142,072.40
1953	--------	187,268.45	141,876.49
1954	--------	159,868.60	104,812.59
1955	--------	18[illegible],259.00	131,956.77
1956	--------	194,602.00	120,494.82
1957	--------	[illegible],465.00	162,605.50

1958 --------	₱230,631.00	₱161,686.87
1959 --------	242,938.15	166,402.99
Total -------	₱1,808,049.85	₱1,284,125.77

In 1950, petitioners received war damage payments in the sum of ₱175,000.00. Constructions and reconstructions were undertaken on some of the aforesaid lots in 1950, 1951 and 1955. For these purpose, petitioners spent ₱68,986.50 in 1950, ₱10,000.00 in 1951 and ₱130,000.00 in 1955. To enhance the value of one of the lots, petitioners bought an adjoining parcel for ₱200,000.00 in 1957. Later in the year, they sold to the Martinez Leyba Inc. a lot for ₱160,000.00.

Petitioners' share in the income of the properties subject of this case are reported in their individual income tax return and, in their financial statements, the set up is called "joint account" by which petitioners mean that "the income realized as reported in these statements come from the properties jointly owned by the sisters."

The main issues involved in these cases are:

1. Whether petitioners herein are liable to the payment of corporate income tax;

2. Whether the right of the respondent to assess the income tax for the years 1951 to 1954 has already prescribed; and

3. Whether petitioners are liable for administrative penalties and interest for failure to file returns.

Unregistered partnerships are subject to the income tax on corporations under Section 24 of the National Internal Revenue Code in relation to Section 84(b) of the same Code which reads as follows:

> Sec. 84. Definitions. - When used in this Title -
>
> (b) The term "corporation" includes partnerships, no matter how created or organized, joint-stock companies, joint accounts (cuentas en participación), associations or insurance companies, but does not include duly registered general copartnerships (compañias colectivas).

Petitioners now urge that they have not formed an unregistered partnership and they are mere co-owners of properties, hence are not subject to the income tax on corporations.

Article 1767 of the Civil Code of the Philippines provides:

> By the contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.

Pursuant to this article, the essential elements of a partnership are two, namely: (a) an agreement to contribute money, property or industry to a common fund; and (b) intent to divide the profits among the contracting parties. If these two elements concur it is immaterial that the parties termed their relationship as mere co-ownership for it is not what the parties call their agreement but the true nature thereof that controls the legal effects of their acts. Thus, in Florencio Reyes, et al., vs. Comm. of Int. Rev., et al., (G.R. No. L-24020-21, July 29, 1968) petitioners therein bought a lot and building registering the property in their names as owners pro indiviso and letting for rent the building to different lessees. The Supreme Court considered petitioners therein as partners and not mere co-owners since the property was bought to be operated for profits.

Upon consideration of all the facts and circumstances surrounding the case, we are satisfied that petitioners have formed a partnership engaged in real estate business for profits because:

1. None of the properties in question appears to be devoted to residential purposes or to other personal uses of petitioners. All the lots have been leased separately to several persons from their acquisition in 1930 to the present. From 1951 to 1959 alone petitioners netted ₱1,438,125.86. The lots are all under the administration and management of a third party, the Martinez Leyba, Inc., a corporation engaged in real estate business.

From these one receives a pooling of resources by petitioners not only for the preservation and enjoyment of property which is the purpose of co-ownership (Padilla, Civil Code, Annotated, 1956 Edition, Vol. II, p. 139) but also for profitable business operations. It is pervasive in the set up that a number of real properties has been placed in the hands of Martinez Leyba, Inc. to constitute a business enterprise.

2. One of the distinctions between co-ownership and partnership is in the purpose of each. While co-ownership is for the preservation and common enjoyment of property, partnership is for the increase of capital through profits. In this respect it is significant that petitioners bought a parcel of land in 1957 for ₱200,000 from the resources of their original properties to enhance the value of a property which bordered said purchased property. This purchase is clearly not an act of preservation and common enjoyment and is quite a revealing transaction for it clearly suggests that the co-ownership had purposes other than the preservation and common enjoyment of their inherited properties.

3. No plausible explanation has been offered by petitioners as to why the properties in question have not been partitioned by them up to the present, a lapse of 40 years. The explanation that the partition of some lots will diminish their economic value considering their

natural conformation and that there is no way of partitioning said lots so that petitioners may be equally situated from the economic point after partition, sounds hollow. Under this explanation these properties will never be partitioned because ideal partition can be done but rarely. The properties are not hard to partition. In cases involving numerous lots, 31 lots in this case, the allocations may be made by lots with equitable adjustments if the circumstances so require. It may not be amiss to say at this juncture that the fact that in 1957 petitioners bought a parcel of land from the resources of the inherited properties to enhance the value of one of said properties, and the fact that they undertook constructions and reconstructions on the properties earlier show that they had no intention of dissolving the ostensible co-ownership of the properties between them. On the contrary, their obvious intention was to continue keeping them under ostensible co-ownership and in the meantime use them for business in that guise.

To our mind, the collective effect of the foregoing circumstances clearly indicates that petitioners have constituted a partnership.

Petitioners contend that since these properties were inherited by them then it can not be said that they have capital contributions to justify the existence of a partnership. This Court held in Lorenzo T. Oña, et al vs.

The Commissioner of Internal Revenue, C.T.A. Case No. 617, July 31, 1961, that the use of properties inherited pro indiviso for business by the heirs who are owners in common thereof gives rise to an unregistered partnership among the heirs subject to the income tax for corporation under Section 84 of the Revenue Code in relation to Section 24 of the same Code. It is hardly necessary to say that if the inherited property and its income are used for business by the co-owners then their respective shares and their income are in effect their contributions to the partnership.

In the case at bar, the returns of petitioners for 1951, 1952, 1953 and 1954 were due for filing on March 1, 1952, March 1, 1953, March 1, 1954 and March 1, 1955, respectively. It is now urged that the Government's right to assess the taxes in question expired on May 15, 1957, May 15, 1958, May 15, 1959 and May 15, 1960, respectively. Petitioners obviously forget that no returns for the partnership were ever made; the returns were made in the individual income tax returns of the petitioners. Such returns are not valid returns for the unregistered partnership and their filing cannot be the start of the prescriptive period for the assessment of the partnership, and hence the ten-year period for assessment should be counted from the discovery of the failure to file. (Republic vs. Jalandoni, G. R. No. L-18384, Sept. 20, 1965; Coll. of Int. Rev. vs. Pineda, G. R. No. L-14522, May 31, 1961.) It is not clear from the evidence as to when such discovery was made and the presumption of regularity of official acts as well as the rule that he who alleges prescription has the duty of proving it, militate against petitioners.)

(We agree with petitioners that they are not liable for the 25% surcharge because their failure to file a return as a corporation as provided in Section 46 of the Revenue Code was in good faith. Petitioners did file returns for the income of the properties in question in their individual income tax returns. Considering the surrounding circumstances and the nature of this case, one can easily believe that the omission was in good faith in line with the decision of the Supreme Court in Collector of Internal Revenue v. The Batangas Transportation Company and Laguna Tayabas Bus Company, G. R. No. L-9692, Jan. 6, 1958.)

It appears that the appealed decision imposed a compromise penalty in both cases. Needless to say, the Commissioner of Internal Revenue has no power to impose a compromise penalty without consent of the taxpayer.

As to the compromise penalty in the total amount of ₱250.00, it is now a wellsettled doctrine that compromise penalty cannot be imposed or collected without the agreement and conformity of the taxpayer. (Collector of Internal Revenue v. University of Santo Tomas, et al., G. R. Nos. L-11274 & L-11280, Nov. 28, 1958; The Coll. of Int. Rev. v. Bautista, et al., G. R. Nos. L-12250 & L-12259, May 27, 1959; The Philippines International Fair, Inc. vs. Coll. of Int. Rev., G. R. Nos. L-12928 & L-12932, March 31, 1962.)

The tax due from the partnership for the years 1951 to 1959 is computed as follows:

1951

Net income per investigation	₱152,217.00
Tax due thereon	₱ 34,621.00
Add: ½% monthly interest from 6-20-59 to 7-20-60	2,250.37
TOTAL AMOUNT DUE	₱ 36,871.37

1952

Net income per investigation	₱142,072.00
Tax due thereon	₱ 31,780.00
Add: ½% monthly interest from 6-20-59 to 7-20-60	2,065.70
TOTAL AMOUNT DUE	₱ 33,845.70

1953

Net income per investigation	₱141,876.00
Tax due thereon	₱ 31,725.00
Add: ½% monthly interest from 6-20-59 to 7-20-60	2,062.13
TOTAL AMOUNT DUE	₱ 33,787.13

1954

Net income per investigation	₱104,813.00
Tax due thereon	₱ 21,347.00
Add: ½% monthly interest from 6-20-59 to 12-20-61	3,202.12
TOTAL AMOUNT DUE	₱ 24,549.12

1955

Net income per investigation ----	₱131,956.77
Tax due thereon ----------------	₱ 28,947.90
Add: ½% monthly interest from 6-20-59 to 12-20-61 --------	4,342.18
TOTAL AMOUNT DUE --------------	₱ 33,290.08

1956

Net income per investigation ----	₱120,494.82
Tax due thereon ----------------	₱ 25,738.00
Add: ½% monthly interest from 6-20-59 to 12-20-61 -------	3,860.70
TOTAL AMOUNT DUE --------------	₱ 29,598.70

1957

Net income per return ----------			₱162,605.50
Add: Unaccounted profit from the sale of real estate:			
Sale per document registered with the Register of Deeds, Manila, 1957 ----		₱154,000.00	
Deduct: Acquisition cost evidenced by the assessed value for 1943 --------		76,518.00	
Profit ----------		₱ 77,482.00	
50% thereof -----		₱ 38,741.00	
Less: Net amount already reported by Petra Martinez Vda. de Fernandez --₱8,520			
By Concepcion Martinez --------	8,520	17,040.00	21,701.00
Net income per investigation ----			₱184,306.50
Tax due thereon ----------------			₱ 43,605.82
Add: ½% monthly interest from 6-20-59 to 12-20-61 -------			6,540.87
TOTAL AMOUNT DUE --------------			₱ 50,146.69

1958

Net income per investigation ----	₱161,686.87
Tax due thereon ------------------	₱ 37,272.00
Add: ½% monthly interest from 6-20-59 to 12-20-61 ---------	5,590.80
TOTAL AMOUNT DUE ---------------	₱ 42,862.80

1959

Net income per investigation ----	₱166,402.99
Tax due thereon ------------------	₱ 41,920.90
Add: ½% monthly interest from 4-19-60 to 12-20-61 ---------	4,192.09
TOTAL AMOUNT DUE ---------------	₱ 46,112.99

RÉSUMÉ

1951 ----------	₱36,871.37
1952 ----------	33,845.70
1953 ----------	33,787.13
1954 ----------	24,549.12
1955 ----------	33,290.08
1956 ----------	29,598.70
1957 ----------	50,146.69
1958 ----------	42,862.80
1959 ----------	46,112.99
TOTAL -----	₱331,064.58

WHEREFORE, petitioners are hereby ordered to pay within thirty (30) days from the date this decision becomes final the amount of ₱331,064.58 as income tax due from the partnership for the years 1951 to 1959. In addition to the said amount, petitioners are hereby ordered to pay 5% surcharge and 1% monthly interest on the said sum, from the date of notice and demand by respondent to the date of payment, subject to the limitation provided in Section 51(e) of the National Internal Revenue Code. With costs against petitioners.

SO ORDERED.

Quezon City, December 23, 1970.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge