REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

GRAPHIC ARTS SERVICE, INC.,
MARIO GUERRERO and
ALFREDO GUERRERO,
Petitioners,

- versus - C.T.A. CASE NO. 2954

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

July 18/84

D E C I S I O N

Petition for review of the decision of respondent Commissioner of Internal Revenue denying (1) the protest of petitioner Graphic Arts Service, Inc., on the assessment issued against it for deficiency income tax for the year 1974 in the amount of ₱687,628.22; and (2) the claim for refund of the amounts of ₱21,029.50 and ₱16,776.00 representing 50% fraud penalty imposed on petitioners Alfredo Guerrero and Mario Guerrero, respectively, for the taxable year 1974.

The antecedent facts that gave rise to the present controversy, which are not disputed, are narrated in respondent's memorandum: (pp. 187-190, CTA records.)

> Petitioner Graphic Arts Service, Inc. (hereinafter referred to as Graphic, for brevity) is a family corporation engaged in the business of printing and publication of various magazines. Petitioners Mario and Alfredo, both surnamed Guerrero, father and son, are among the officers and directors of Graphic of which they own 50% of the outstanding shares of stock. In the year

under review, Doña Elena Guerrero, wife of petitioner Mario Guerrero, was the vice-president of Graphic.

Respondent, on the basis of a written denunciation, dated 13 July 1975, conducted an investigation of the tax liabilities of the three petitioners. As a result, deficiency assessments, all dated 22 August 1975, were issued by respondent to the three petitioners as follows:

	Deficiency Income Tax plus interest
Graphic	₱4,948.64
Mario Guerrero	4,276.68
Alfredo Guerrero	904.32

In the assessment-letters respondent stated that since petitioners have already paid the assessed amounts, the case is considered closed and terminated.

Thereafter, on the basis of another confidential information, dated 1 September 1975, respondent caused a re-investigation of petitioners tax liabilities.

Petitioners notwithstanding repeated requests, and the issuance of a _subpoena duces tecum_ for the production of their books of accounts, objected to the second tax examination claiming that it is a violation of Section 324 of the Tax Code.

Respondent justified the re-investigation on the ground that since petitioners' returns are tainted with fraud, Section 324 of the Tax Code, which protects taxpayers from multiple examinations, does not apply.

Pursuant to Section 16 of the Tax Code, on the basis of the best evidence obtainable, respondent, on recommendation of his examiners, issued three separate letters assessing petitioners' deficiency income tax for 1974, as follows:

Graphic	₱687,628.22
Mario Guerrero	60,307.00
Alfredo Guerrero	75,597.69

inclusive of 50% surcharge and 14% annual interest.

In a letter dated 15 July 1977, petitioners protested the new deficiency tax assessments. Petitioners Mario and Alfredo Guerrero offered to settle the assessments against them in the aggregate sum of ₱104,713.26, inclusive of interest up to 15 July 1977, conditioned upon the exclusion of the 50% fraud penalty. Respondent denied the protest and the offer of settlement in a letter dated 31 March 1978 (Exh. 17, p. 146, BIR rec.)

The instant petition for review was filed on 24 May 1978.

On 5 December 1978, petitioners Mario and Alfredo Guerrero paid under protest the deficiency income tax assessments against them in the amounts of ₱60,307.00 and ₱75,597.69, both inclusive of 50% fraud penalty.

At the outset, as stated earlier, the disputed deficiency assessments for the year 1974 were issued against petitioners as a result of a re-investigation conducted by respondent on the basis of a written denunciation. Due to petitioners' objection and refusal to have their books and accounting records examined for the second time, respondent assessed petitioners for deficiency income taxes on the best evidence obtainable, that is, on the information submitted by informant Florentino Cuevas, Jr. in his letter dated September 1, 1975, together with 17 journal entries and his hand written comments. (Exhs. "R-GR", pp. 46-51, BIR records;

Exh. "12", pp. 92-95, BIR records.) It is thus clear beyond doubt that the deficiency income tax assessments under consideration were not issued in violation of Section 337 (now Section 324) of the National Internal Revenue Code which provides that taxpayers' books of accounts and other accounting records shall be subject to examination only once in a taxable year.

Section 337 (now Section 324) of the National Internal Revenue Code at the time material to this case requires that books of accounts and other accounting records must be preserved for at least five years from the date of the last entry, and are subject to examination and inspection at any time by internal revenue officers. However, examination and inspection may be made only once in a taxable year during the five-year period they are required to be preserved, except in cases of fraud, irregularity or mistake, or unless the taxpayer requests otherwise.

In ordering the re-investigation of petitioners, it is to be noted that respondent acted on a letter dated September 1, 1975 of Florentino Cuevas, Jr. informing the Commissioner of Internal Revenue of the alleged tax evasion devices, indicated by the journal entries specified therein and written comments of informant, used by petitioners in lessening their 1974 income tax liabilities. However, in re-investigating the 1974 income tax liabilities of petitioners, respondent's examiners did not conduct an examination and inspection of their books of accounts and other accounting records as petitioners objected to and refused a second examination of their books and records. As stated above, respondent assessed petitioners for deficiency income taxes upon the best evidence obtainable pursuant to Section 16 of the National Internal Revenue Code. It seems clear therefore that when respondent issued the deficiency income tax assessments under consideration, petitioners' books of accounts and other accounting records were not subjected to examination and inspection for a second time in the same year.

Under Section 16 of the Tax Code, the Commissioner of Internal Revenue has the power to make tax assessments on the best evidence obtainable when there is reason to believe that the return is false, incomplete or erroneous, or in cases wherein taxpayers have refused to make return. (See also Sec. 51(b), NIRC; Sec. 195, Rev. Regs. No. 2.) It has been held that the Commissioner of Internal Revenue is authorized to make subsequent reassessment to collect additional sums covered by the original assessment provided it is done within the prescriptive period. (See Collector of Internal Revenue vs. Batangas Transportation Co., 102 Phil. 822.) Since the deficiency income tax assessments in question were issued not on the basis of a second examination and inspection of petitioners' books of accounts and other accounting records, their issuance could not be in violation of Section 337 (now Section 324) of the National Internal Revenue Code.

Part I - Assessment against Petitioner Graphic Arts Service, Inc.

This brings us to the issue presented by the parties as to whether or not the amount of ₱687,628.22 representing deficiency income tax assessment against petitioner Graphic Arts Service, Inc., has legal and factual basis.

Based on the best evidence obtainable, respondent found petitioner Graphic Acts Service, Inc., liable for deficiency income tax in the amount of ₱687,628.22, inclusive of surcharges and penalties, due to unallowable deductions and additional incomes itemized hereunder: (Exh. "11-C", p. 96, BIR records.)

UNALLOWABLE DEDUCTIONS & ADDITIONAL INCOMES

1. Fictitious expenses charged to Production Cost:

a.	Scripts and manuscripts	₱ 20,305.00
b.	Illustrations and Letterings . .	7,000.00
c.	Paper in Rolls	89,873.32

d.	Paper in Reams	26,875.00
e.	Inks and Solvents	32,219.37
f.	Stitching & Packing	40,159.33
g.	Stitching & Packing Supplies . .	5,350.00
h.	Parts and Supplies	29,546.80
i.	Metal Plates	17,500.00
j.	Films	10,351.05
	Total per JV # 648, 650, 653, 656, 657, 662, 665 & 683	₱279,179.87

2. Fictitious expenses charged to Selling Expense:

a.	Trucking, hauling & freight JV # 660 & 683	₱ 54,995.16

3. Fictitious expenses charged to Administrative Expense:

a.	Travel & transportation	₱ 5,782.93
b.	Employees benefits	11,405.77
c.	Office Supplies	11,656.74
d.	Postage	639.01
e.	Special bonus	279,411.00
	Total per JV # 670 & Resolution of Ex. Committee	₱308,895.45

4. Personal Expenses of Corporate Officers Charged to Production Cost:

a.	Stitching & Packing	₱ 74.40
b.	Films	122.80
c.	Printing Cost	236.25
	Total per JV # 666 & 678	₱ 433.45

5. Personal Expenses of Corporate Officers Charged to Administrative Expenses:

a.	Miscellaneous	₱ 25,934.76
b.	Repairs & Maintenance	15,578.13
c.	Insurance	12,154.96
d.	Travel & Transportation	11,531.70
e.	Rent	8,356.07
f.	Leasehold improvements	5,812.07
g.	Postage	2,332.36
h.	Vacation & Sick Leave	1,219.20
i.	Legal, medical & audit fees . .	960.00
j.	Representation	164.55
k.	Donations	350.00
l.	Employees benefits	142.00
	Total per JV # 666, 671, 674, 676 & 678	₱ 84,535.80

6.	Undeclared Inventory as of 12/31/74. .	₱250,000.00
7.	Undeclared Printing Income	115,000.00
	Total Adjustments	₱1,093,039.73

Respondent's disallowance of the expenses charged to production cost, selling and administrative expenses was anchored on informant's allegation that through adjusting journal entries made at the end of the year under review, per Journal Vouchers Nos. 648, 650, 653, 656, 657, 660, 662, 665, 670, 683 and 687, petitioner "Graphic Arts Service, Inc., had fraudulently reduced its true net taxable income by increasing its production cost, selling and administrative expenses through various charges that were actually fictitious expenses". (See examiner's report, Exhibit "F", p. 67, BIR records.)

As shown by the journal entries, petitioner increased its expenses by setting up in its books at the end of the year 1974, accrued expenses which were allegedly fictitious.

To rebut informant's allegation, petitioner Graphic Arts Service, Inc. presented voucher checks evidencing payment in 1975 of these accrued expenses, together with supporting documents such as sales invoices, slips, official receipts, accounts payable vouchers and other papers, to prove that these expenses paid were actually incurred in 1974.

All the documents adduced for this purpose are mere xerox copies, the originals of which were allegedly lost in a fire on December 14, 1981 which destroyed the office of petitioner's counsel where these were supposedly kept at the time. (Exhs. "Y", "Y-1" and "Y-2".) As these xerox copies could not be compared with the originals, they should be subjected to closer scrutiny, the unreliability as convincing evidence of xerox copies standing alone being well-known.

The voucher checks presented by petitioner showing payments in 1975 of expenses appear to be in order. What needs verification are the supporting documents, to determine whether the expenses paid were those which petitioner claims to have been accrued in 1974.

The findings arrived at, after a careful examination of the supporting documents, are as follows: (See Annexes "A", "B", "C", "D" and "E".)

1. Fictitious expense charged to production cost:

a. Scripts	₱20,305.00
Illustrations	7,000.00
Total (Exhs. "U-GR-1" to "U-GR-338"	₱27,305.00

The supporting documents for the voucher checks in payment of articles and illustrations for petitioner's publications are printed slips showing the payee, the title of the article, the magazine where it was published, the magazine series number, the date of issue and other particulars. The dates of issue of the magazines where the articles were published, as reflected in the printed slips are for the year 1974; however, various discrepancies will be noted in these dates of issue, to wit:

1. The same magazines with the same series numbers have different dates of issue in 1974, especially in the month of December.

2. Although these magazines appear to be published weekly, the sequence of the dates of issue does not follow the sequence of the magazine numbers.

3. There are slips paid for in the early part of 1975 for articles published in the months of February, March, April and May, purportedly for 1974, but most often with no year of issue indicated. It seems doubtful that payment to contributors would be delayed for several months considering that the amounts are small. It is more probable that these publications were for 1975.

4. In several slips, the magazine numbers are blurred or not specified, making it difficult to verify the correctness of the date of issue.

In view of the abovestated inconsistencies, these slips which were issued by petitioner cannot be considered of any evidentiary value. Our findings confirm informant's comment that "there are no actual accounts due therefor, as scripts and illustrations are always paid in advance before actual publication". (Exh. "12", p. 95, BIR rec.)

Respondent's determination that these expenses are not deductible is therefore sustained.

b.	Paper in rolls	₱ 89,873.32
	Paper in reams	26,875.00
	Total	₱116,748.32

Several of the sales invoices for the above expenses, although dated in December, 1974, were received in the months of March and April, 1975, and paid in May, 1975. Ordinarily, the date of delivery of goods is acknowledged in the delivery receipt or sales invoice, whichever is presented at the time of delivery. So that the date of receipt in the sales invoice is presumed to be the date of delivery of the goods, in the absence of any other evidence indicating otherwise. Thus, these supplies delivered in 1975 were expenses for 1975 and should not be taken up as 1974 expenses.

Accordingly, only the amount of ₱16,230.00 may be allowed as purchases of papers in 1974, the balance of ₱100,518.32 should be disallowed. (See Annex "A".)

c.	Stitching and packing	₱40,159.33
	Stitching and packing supplies	5,350.00
	Parts and supplies	29,546.80
	Total	₱75,056.13

The sales invoices submitted to justify the stitching and packing expenses show the same discrepancies found in the sales invoices for paper in rolls and reams. After taking these discrepancies into account, the stitching and packing expenses paid, appearing to have been incurred in 1974 amounts to ₱53,038.45, hence the difference of ₱22,017.68 is not allowable as a deductible expense for 1974. (See Annex "B".)

d.	Inks and solvents	₱32,219.37
	Metal plates	17,500.00
	Films	10,351.05
	Total	₱60,070.42

As can be ascertained from the voucher checks and sales invoices presented by petitioner to substantiate these expenses, outstanding accounts in 1974 for these materials amounting to ₱100,599.27 were paid in 1975. Since these expenses alleged to be fictitious amount only to ₱60,070.42, the evidence offered by petitioner is sufficient to establish their existence. (See Annex "C".)

2. Fictitious expenses charged to selling expense:

a. Trucking, hauling and freight ₱54,995.16

The voucher checks in payment of trucking, hauling and freight expenses have no supporting documents, except for a few accounts payable vouchers. Accounts payable vouchers are prepared by petitioner's accounting department upon receipt of invoices or statements to take up the liabilities for merchandise or services. At the proper time, these are paid by voucher checks. Without the supporting papers such as the invoices or statements, these vouchers standing alone cannot prove that the payments made were for the accrued expenses in question. As petitioner failed to substantiate the trucking, hauling and freight expenses, respondent's disallowance of the total amount of ₱54,995.16 should be sustained. (See Annex "D".)

3. Fictitious expenses charged to administrative expense:

a.	Travel and transportation	₱ 5,782.93
b.	Employees benefits	11,405.77
c.	Office supplies	11,656.74
d.	Postage	639.01
e.	Special bonus	279,411.00

With the exception of the special bonus, the expenses charged to administrative expense under Journal Voucher No. 670 were likewise evidenced by petitioner with voucher checks and sales invoices. But as in the previous sales invoices presented for other expenses, the dates of receipts and deliveries of some of these invoices were for 1975. In several payments by voucher checks, the dates when the expenses were incurred were not even specified. In view of these discrepancies only the amounts of ₱4,987.49 for employees benefits, ₱9,296.50 for office supplies and ₱446.60 for postage may be allowed as deductions.

The remaining balances in the amounts of ₱6,418.28 for employees benefits, ₱2,360.24 for office supplies and ₱192.41 for postage can not be considered as expenses for 1974. The travel and transportation expenses in the amount of ₱5,782.93, disallowed not because it is fictitious but on the ground that it represents actual personal expenses of the company officers and should not be chargeable to the company (t.s.n., pp. 191-192, March 27, 1981), can not be allowed as a deduction for lack of any justification on the part of petitioner. (See Annex "E".)

It is alleged by informer that a special bonus amounting to ₱279,411.00 covered by an executive committee resolution dated December 18, 1974 (Exhibit "T-GR"), specifying no particular recipients and distribution was dependent upon the president's discretion, was still undistributed as of September, 1975. (See informant's letter, p. 49, BIR records.) That "the special bonus was declared purposely to reduce income tax due. The original resolution specifically provided that the bonus was to be paid on May 31, 1975 in the amount of ₱104,411.00 to employees and ₱175,000.00 to officers-owners. The bonus, however, was never distributed and paid to the recipients as stated in the resolution". (Informant's comments, p. 92, BIR records; t.s.n., pp. 192-193, March 27, 1981.)

To refute informant's charge, petitioner presented receipts showing partial payments of the bonus in 1979 as follows: (Exhs. "X-GR", "X-1-GR" & "X-2-GR".)

Exhibit	Date	Name	Payment	Balance	Total
X-GR	5-9-79	Alfredo Guerrero	₱ 8,537.40	₱ 61,622.70	₱ 70,160.10
X-1-GR	5-9-79	Elena Roces	16,972.80	122,509.17	139,481.97
X-2-GR	5-9-79	Xavier Guerrero	8,489.80	61,279.13	69,768.93
Total			₱34,000.00	₱245,411.00	₱279,411.00

It is apparent from petitioner's exhibits that the special bonus of ₱279,411.00 was meant to be distributed only to the abovenamed officer-owners and was not in reality intended for the other employees. Bonuses voted at the end of the year, when annual profits are known, are particularly suspect as intended as a distribution of earnings. (Mertens, Law of Federal Income Taxation, Vol. 4A, Chapter 25, pp. 340 & 341.) More so in this case, where the recipients are the officer-owners. That the partial payments of this bonus were made to the officer-owners five years after it was declared further lends credence to informant's allegation that the bonus declaration was not made in good faith and as compensation for services actually rendered.

It is incumbent upon petitioner to prove that the bonus payments were reasonable compensation for services actually rendered and not merely a distribution of profits or a scheme to reduce tax payments. Aside from presenting the abovementioned receipts, petitioner gave no satisfactory explanation for the bonus distribution. Thus, having failed to justify this expense, petitioner is not entitled to its deduction.

4.	Personal expenses of corporate officers charged to production cost	₱ 433.45
	Personal expenses of corporate officers charged to administrative cost	84,535.80
	T o t a l	₱84,969.25

On the disallowed expenses charged to production cost and administrative expenses per Journal Vouchers Nos. 666, 671, 674, 676 and 678, amounting to ₱84,969.25, informant testified that having prepared these journal vouchers himself, he knows that these are not fictitious but are expenses for the personal benefit of the particular corporate officers. (t.s.n., pp. 193-195, March 27, 1981.) In his handwritten comments on these journal entries, informant specified the personal uses for which these expenses were spent. (pp. 94-95, BIR records.)

As shown in the journal entries (pp. 47-48, BIR records), these expenses which were previously charged to the "Due from Officers/Employees" account were subsequently reclassified and taken up as company expenses at the end of the year. The burden rests on petitioner to prove that these entries were not made to reduce advances to officers and increase corporate expenses.

Petitioner Graphic Arts Service, Inc. in its memorandum does not dispute the correctness of these journal vouchers as recorded. In fact, it cites these journal vouchers as covering these expenses. (Petitioners' memorandum, pp. 160-162, CTA records.) But aside from arguing that in an earlier examination respondent found nothing wrong with the treatment of these expenses, except for ₱6,300.00 unsupported expenses, petitioner introduced no other evidence to controvert informant's claim. Section 66, Revenue Regulations No. 2, requires that any claim for deduction must be substantiated by record showing in detail the amount and nature of the expenses incurred.

Under the circumstances, respondent did not err in his determination of the amounts of ₱84,535.80 and ₱433.45 as personal expenses of the corporate officers not chargeable to company expenses.

5. Undeclared printing income ₱115,000.00

Informant's comment on the undeclared printing income of ₱115,000.00 (Exh. "12", p. 93, BIR records) is as follows:

"This represents upward adjustments of printing charges for printing Woman's Home Companion published by R.T. Reyes and Associates Publishing, Inc. prior to acquisition by Graphic Arts Service, Inc. of 70% of its shares of stock. This price adjustment was debited to R.T. Reyes and Associates Publishing, Inc. and was recorded in their books as an adjustment to Graphic Arts Service, Inc.'s previous bills. However, since the previous owners had not ratified the price adjustments, the entries therefor in both books were reversed to reduce the printing income of Graphic Arts Service, Inc."

Petitioner maintains that the reversing entry is justifiable as the charges were not yet acceptable to R.T. Reyes and Associates at that time. It was only in June, 1975, that an agreement was reached between petitioner Graphic Arts Service, Inc. and R.T. Reyes and Associates regarding the increase of printing charges by means of board resolutions. (Exhs. "V-GR" and "W-GR"; t.s.n., pp. 122-125, January 22, 1981.)

There is no controversy with regard to Graphic Arts Service, Inc.'s 70% ownership in R.T. Reyes and Associates Publishing, Inc.. Petitioner's witness, the general manager of Graphic Arts Service, Inc., testified that sometime in 1974 petitioner acquired 70% of R.T. Reyes and Associates. (t.s.n., p. 91, December 5, 1980.) If petitioner had already the controlling interest in R.T. Reyes and Associates in 1974, then there would have been no reason for reversing the entry charging R.T. Reyes and Associates for additional printing charges, as there would have been no question about its acceptances, petitioner being in control of R.T. Reyes and Associates by the end of that year. Petitioner's board resolution in

1975 authorizing a retroactive increase in printing charges (Exh. "V-GR") and R.T. Reyes and Associates' conformity thereto (Exh. "W-GR") were therefore mere formalities and paper transactions. Having been earned in 1974, the printing income of ₱115,000.00 should be taken up as income in 1974, as properly determined by respondent.

6. Undeclared inventory as of December 31, 1974 ₱250,000.00

It is alleged by respondent's informant that he understated petitioner's 1974 year-end inventory by ₱250,000.00, "for which a certification that more than ₱200,000.00 in inventories were excluded from the actual list submitted to the Bureau of Internal Revenue, was issued to the external auditors, Guzman, Bocaling & Co." (Exh. "R-GR", p. 51, BIR records.)

On the other hand, witness for petitioner Virgilio Torres, a partner of Guzman, Bocaling & Co., in his testimony before the Court, denied requiring such a certification of underdeclaration from informant (t.s.n., p. 4, August 4, 1981). This year-end inventory which appears in the financial statement ending December 31, 1974 that Guzman, Bocaling & Co. prepared for Graphic Arts Service, Inc. (Exh. "M-GR") is the same as the Physical Count Inventory for the year ending December 31, 1974 submitted to the Bureau of Internal Revenue on

January 29, 1975 (Exh. "M-1-GR") conducted and signed by the Chief Accountant, the Internal Auditor and approved by the General Manager of Graphic Arts Service, Inc.

Informant claims that he prepared the listing of these inventories and that he understated it by ₱250,000.00. However, the records do not show that he had a hand in the physical count or listing. Neither could he produce a copy of the understated inventory allegedly given to the external auditors Guzman, Bocaling & Co. (t.s.n., pp. 29-32, July 20, 1981.)

As against the certification of the external auditors and those who participated in the physical count, informant's unsupported allegation cannot prevail.

In resume, the unallowable deductions and additional income as determined by the Court are as follows:

1. Fictitious expenses charged to production cost:

Scripts and manuscripts . . .	₱ 20,305.00	
Illustrations and letterings.	7,000.00	
Paper in rolls and paper in reams	100,518.32	
Stitching and packing; Stitching and packing supplies; Parts and supplies . . .	22,017.68	₱149,841.00

2. Fictitious expenses charged to selling expense:

Trucking, hauling and freight	₱ 54,995.16

3. Fictitious expenses charged to administrative expense:

Travel transportation . . .	₱ 5,782.93	
Employees benefits . . .	6,418.28	
Office supplies	2,360.24	
Postage, telephone and telegrams	192.41	
Special bonus	279,411.00	₱294,164.86

4.	Personal expenses of corporate officers charged to production cost:	₱ 433.45
5.	Personal expenses of corporate officers charged to administrative expense	₱ 84,535.80
6.	Undeclared printing income	₱115,000.00
	Total adjustments	₱698,970.27

Petitioner Graphic Arts Service, Inc. disputes respondent's imposition of the 50% fraud penalty contending that the alleged fictitious expenses, the personal expenses of the corporate officers and the undeclared incomes have all been amply justified.

Petitioner's contention is devoid of merit.

Of the total adjustments to petitioner's 1974 net income amounting to ₱1,093,039.73 as per respondent's deficiency assessment, consisting of unallowable dedections amounting to ₱728,039.73 and additional incomes in the sum of ₱365,000.00, petitioner was able to justify only expenses in the amount of ₱144,069.46 and an undeclared income of ₱250,000.00 or a total of ₱394,069.46, which is 36% of the total adjustments. The Court found the balance of ₱698,970.27 as correctly determined by respondent. (See foregoing resume.)

If petitioner Graphic Arts Service, Inc. could substantiate only the amount of ₱144,069.46 as expenses out of a total of ₱728,039.73 disallowed by respondent, then it is a clear indication that petitioner had in fact intentionally overstated deductions to reduce its taxable income.

Among the circumstances generally recognized as justifying the imposition of the fraud penalty are: (1) intentional understatement of income, substantial in amount _per se_ or substantial in relation to the total reported income; (2) intentional overstatement of deductions, substantial in amount _per se_ or substantial in relation to the total reported income; and (3) recurrence of the understatement of income or overstatement of deductions for more than one tax year. (Balter, Fraud Under Federal Tax Law, 2nd ed. /1953/, p. 226, cited in Perez v. Araneta, B.T.A. No. 189, Feb. 13, 1956, affd. in L-10507, 103 Phil. 1167, unpub.; Coll. v. Reyes, 104 Phil. 1061, unpub.)

In the case at bar, the intentional overstatement of deductions, together with the understated income, is not only substantial in amount _per se_ but also substantial in relation to the total reported income. Petitioner declared a net income of ₱598,967.26 in its 1974 tax return (Exh. "D-GR"). The total adjustment to net income in the amount of ₱698,970.27 as verified by the Court is 117% of petitioner's net income. Considering this substantial adjustment in relation to net income, the conclusion is inevitable that petitioner Graphic Arts Service, Inc. filed fraudulent income tax returns in 1974. It follows that the imposition of the 50% surcharge is in accordance with Section 72 of the Tax Code.

In line with the foregoing, the deficiency income tax of petitioner Graphic Arts Service, Inc. for 1974 is computed as follows:

Net income per original investigation.	₱ 612,477.76
Add: Total adjustment	698,970.27
Net income per re-investigation . . .	₱1,311,448.03
Tax due thereon	₱ 499,007.00
Income tax already paid	204,367.00
Deficiency income tax	₱ 244,640.00
Add: 50% surcharge	122,320.00
14% int. from 4/16/75 to 5/31/77	72,780.39
Total amount due and collectible . . .	₱ 439,740.39

Part II - Assessment against Petitioners Alfredo Guerrero and Mario Guerrero

Coming to the question as to whether or not the income tax returns of petitioners Alfredo Guerrero and Mario Guerrero are tainted with fraud, the deficiency income tax assessment against petitioner Alfredo Guerrero for 1974 in the amount of ₱75,579.69, inclusive of penalties, was brought about by his failure to declare as income for 1974 commissions in the amount of ₱79,578.43, while the deficiency income tax assessment of ₱60,307.00 against petitioner Mario Guerrero was due to the non-inclusion of his wife's (Mrs. Elena R. Guerrero) salary of ₱54,000.00 in their 1974 income tax return. Both petitioners admit to their failure to declare said part of their income in their respective tax return, but insist that the omissions were inadvertent and that there was no intent to evade the payment of taxes. After having paid the deficiency assessments, petitioners Alfredo Guerrero and Mario Guerrero seek the refund of the 50% surcharge which they had paid as fraud penalty in the amounts of ₱21,029.50 and ₱16,776.00, respectively.

Petitioners question the imposition of the 50% fraud penalty averring that such failure to include part of their income in their respective income tax return was not intentional on their part, but was attributable to informant Florentino Cuevas, Graphic Arts Service, Inc. comproller at that time, to whom they entrusted the preparation of their income tax returns.

On the other hand, respondent argues that "where a false return is in fact signed by the taxpayer, the fact of personal knowledge of the false contents of the return and willfulness of its filing can be imputed or inferred". (Juan D. Nassr v. Commissioner of Internal Revenue, CTA Case No. 1668, July 24, 1970, certiorari denied in L-32659, Oct. 19, 1970.) (Respondent's Memorandum, p. 201, CTA records.)

The fact that the return is signed by the taxpayer is not by itself sufficient to justify the imposition of the 50% fraud penalty. Other factors have to be considered, the most important of which is that the filing of the false return be intentional. As cited by respondent in his memorandum: (p. 199, CTA records)

> "To justify the imposition of fraud penalty, it must be shown (1) that the return was signed by the taxpayer, although prepared by a bookkeeper; (2) that the return is false and taxpayer knew, or could have known the return to be false; (3) that the return was filed willfully with intent to evade the payment of taxes. (Lurding v. United States, 179 F 2d 418, 422; Erlinda Brinker vs. Coll. of Int. Rev., CTA 366, July 17, 1959.) The intent to evade taxes reflects the taxpayer's evil state of mind (Balter, on cit. p. 394). In other words, the filing of false or fraudulent return must be without justifiable excuse, or without ground for believing that it is lawful. (United States v. Murduck, 290 US 389; Balter, ibid., p. 38)"

The spoilage commissions due Alfredo Guerrero for 1974 were not paid to him directly but were simply credited to his account. (See Journal Voucher No. 672, p. 46, BIR records.) In the case of Mario Guerrero, he and his wife had several sources of income as shown in Schedule I, Exh. "A-MG" (p. 35, BIR records). There exists then the possibility that the non-inclusion of these incomes in their returns could have been due to oversight.

By his own admission, informant Florentino Cuevas supervised the preparation of the income tax returns of petitioners, while it was being prepared by a member of his accounting staff. He testified that he noticed that the salary of Mrs. Guerrero in the amount of ₱54,000.00 and the commissions of Alfredo Guerrero amounting to

₱79,578.43 were not reported in their respective income tax return. (t.s.n., pp. 197-198, March 27, 1981.) It is strange that informant did not make the necessary corrections, considering that he was entrusted with the preparation of said returns, and yet he does not claim that he had received instructions from petitioners Mario and Alfredo Guerrero to exclude portions of their income from their income tax returns.

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 fraud. It must be intentional wrongdoing with the sole object of avoiding the tax. (Aznar vs. Court of Tax Appeals, L-20569, Aug. 23, 1974, 58 SCRA 519.) Moreover, it is a well settled rule that fraud is not to be presumed, it is incumbent upon respondent to prove its existence. Respondent has not shown that the filing of the false returns was without justifiable excuse. To warrant the imposition of the 50% fraud penalty, the intent to evade payment of taxes must be clearly established. Having failed to do so, respondent should refund the 50% fraud penalty collected from petitioners Alfredo Guerrero and Mario Guerrero in the amount of ₱21,029.50 and ₱16,776.00, respectively, for the taxable year 1974.

Conclusion

WHEREFORE, the decision of respondent Commissioner of Internal Revenue under review is modified as indicated in the above opinion of the Court. Accordingly:

(1) Petitioner Graphic Arts Service, Inc., is hereby ordered to pay to respondent Commissioner of Internal Revenue the sum of ₱439,740.39 as deficiency income tax for 1974, plus 5% surcharge and 14% annual interest from June 1, 1977 to the date of full payment but not to exceed the amount corresponding to three years pursuant to Section 51(e) of the 1977 National Internal Revenue Code.

(2) Respondent Commissioner of Internal Revenue is hereby ordered to refund to petitioners Alfredo Guerrero and Mario Guerrero the amounts of ₱21,029.50 and ₱16,776.00, respectively, which petitioners had paid as 50% fraud penalty for the taxable year 1974, less 5% surcharge and 14% additional interest on their respective deficiency income tax for 1974 from June 1, 1977 to the date of payment on December 5, 1978, as increments incident to delinquency provided for under Section 51(e) of the 1977 National Internal Revenue Code.

SO ORDERED.

Quezon City, Metro Manila, July 18, 1984.

AMANTE FILLER
Presiding Judge

WE CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

ALEX Z. REYES
Associate Judge

ANNEX "E"

Supporting documents for:
J.V. No. 12-670 - Exhibits U-6-CR-1 to U-6-CR-131 - 131 Exhibits

Exhibit No. of Voucher Check	Exhibit No. of Statement or Invoice	Exhibit No. of A/P Voucher	Exhibit No. of O.R.	Payee	Date of Statement or Invoice	Date Paid Voucher Check	Date of Official Receipt	Amount per Statement or Invoice	Amount paid per Voucher Check	Findings – Allowed: Travel & Transportation	Findings – Allowed: Postage, Telephone & Telegram	Findings – Allowed: Employees Benefit	Findings – Allowed: Office Supplies	Findings – Disallowed	Reason for Disallowance
1	-	3	2	Radio Communications of the P.I.		1-30-75	2-20-75		P 143.98		P 143.98				
4	6	5		Radio Communications of the P.I.	10-31-74	2-28-75		P 179.11	179.11		179.11				
7	-	9	8	Radio Communications of the P.I.		3-25-75	4-11-75		123.51		123.51				
10	11	-	-	Phil. Long Distance Tel. Co.	Jan. account	1-31-75		191.06	191.06					P 191.06	Jan. '75 A/C - See Statement of Account
12	15	14	13	Mercury Drug Corp.	11-19-74	1-30-75	2-5-75	1,100				P 1,100			
"	16	-	"	Same invoice as Exhibit 15				-							
"	17	-	"	Mercury Drug Corp.	11-23-74	" " "		256	2,146.70				P 256		
"	19	18	"	" " "	11-12-74	" " "		305.70					305.70		
"	21	20	"	" " "	10-14-74	" " "		485					485		
22	23-34	-	22	Merced Drug House	Dec. accounts	1-28-75	4-5-75	774.13	1,395.32			774.13			
"	36-46	35	"	" " "	Nov. accounts	" " "	" " "	621.19				621.19			
47	48-59	-	-	Merced Drug House	Jan. '75 accounts	4-28-75		908.57	908.57					908.57	Blurred dates of invoices; Date of request of U-6-CR-49 is 1-11-75
60	61	-	-	Mercury Drug Corp.	12-5-74	7-31-75		320	320			320			
62	63	-	-	Rhea Pharmaceutical Corp.	no date	3-25-75		174.61	174.61					174.61	No date of invoice
64	65	-	-	Mercury Drug Corp.	12-4-74	6-20-75		478.15	2,829.20				478.15		
"	66	-	-	" " "	12-5-74	" " "		1,052.25					1,052.25		
"	67	-	-	" " "	12-21-74	" " "		1,298.80					1,298.80		
68	68	-	-	Rhea Pharmaceutical Corp.	12-3-74	4-29-75		1,489.12	1,489.12			1,489.12			
69	70	-	-	ABM Sison Hospital	Dec. account	6-30-75		300	450			300			
"	71	-	-	" " "	" "	" " "		150				150			
72	74-82	73	-	Merced Drug House	Feb. '75 accounts	4-29-75		373.42	373.42					373.42	Feb. '75 A/C See Exh. 73
83	84-95	-	-	" " "	March '75 accounts	5-31-75		487.84	487.84					487.84	March '75 A/Cs See date rec'd of Exhs. 87 & 88
96	97	-	-	Mercury Drug Corp.	10-7-74	5-30-75		279.70	1,131.90					279.70	March '75 A/CS - See date received of Exhs. 97 & 100
"	98	-	-	" " "	12-6-74	" " "		56.25						56.25	
"	99	-	-	" " "	12-6-74	" " "		244.75						244.75	
"	100	-	-	" " "	12-6-74	" " "		551.20						551.20	
101	102	-	-	Merced Drug House	12-1-74	6-30-75		11.30	38.05			11.30			
"	103	-	-	" " "	12-3-74	" " "		10.20				10.20			
"	104	-	-	" " "	12-4-74	" " "		16.55				16.55			
105	106	-	-	ABM Sison Hospital	Dec. account	7-30-75		195	195			195			
107	-	-	-	Cecilio Jimenez	-	1-16-75			1,330					1,330	No date when expense was incurred
108	-	-	-	Cecilio Jimenez	-	4-14-75			1,330					1,330	No date when expense was incurred
109	-	-	-	Cecilio Jimenez	-	7-14-75			1,480					1,480	No date when expense was incurred
110	-	-	-	Cecilio Jimenez	-	8-18-75			1,528					1,528	1975 cash advance
111	112	P.O. 113	-	Primo Bautista, Jr.	1-13-75	1-18-75		140	140					140	See invoice 1975 expense
114	-	-	115	Modern Business Methods, Inc.	-	2-6-75	12-11-74		1,320					1,320	No invoice; O.R. issued months before payment
116	-	P.O. 118	117	IBM Philippines	-	4-1-75	no date		301.55					301.55	No invoice - no date when expense was incurred
119	121	-	120	Mission Marketing Corp.	1974	4-29-75	no date		570.60				570.60		
122	123	-	-	Dagdagan Press	12-11-74	5-7-75	-	4,850	4,850				4,850		
124	-	P.O. 126	125	Modern Business Methods, Inc.	-	5-15-75	6-25-75		1,043.50					1,043.50	No invoice - no date when delivered
127	-	128-131	-	Remington Paper & Stationeries	12-74	5-30-75		3,341.40	3,341.40					3,341.40	1975 purchases - see invoices for dates of delivery
									P29,812.44		P 446.60	P 4,987.49	P 9,296.50	P 15,081.85	

ANNEX "B"

Supporting documents for:
J.V. No. 12-656 - Exhibits U-2-GR-1 to U-2-GR-50
J.V. No. 12-662 - Exhibits U-4-GR-1 to U-4-GR-50 - 50 Exhibits
J.V. No. 12-683 - Exhibits U-7-GR-1 to U-7-GR-50

Exhibit No. of Voucher Check	Exhibit No. of R Q - Invoice	Exhibit No. of A/P Voucher	Exhibit No. of O.R.	Payee	Date of Invoice	Date Paid Voucher Check	Date of O.R.	Amount per Invoice	Amount paid per Voucher Check	Findings: Allowed	Findings: Disallowed	Reason for Disallowance
1	2	3	-	Jaeb Enterprises	12-12-74	1-30-75	-	₱ 1,137.60	₱ 1,137.60	₱ 1,137.60		
4	7	6	5	Graphics Marketing Corp.	12-28-74	2-28-75	3-1-75	1,470	7,966.90	1,470		
"	8	"	"	" " "	12-28-74	" " "	" " "	3,481.90		3,481.90		
"	9	"	"	" " "	1-03-75	" " "	" " "	2,205			₱ 2,205	Purchase Orders dtd. 1-3-75
"	10	"	"	" " "	1-03-75	" " "	" " "	810			810	" " " " " "
11	13	12	-	Pamas Trading Co.	11-26-74	1-30-75	-	400	800	400		
"	14	15	-	" " "	" " "	" " "	-	400		400		
16	18	17	-	Printers Supplies Market Co.	12-28-74	3-25-75	-	1,500	1,500	1,500		
19	21	20	-	Garcia's Store	12-31-74	1-29-75	-	6,200	6,200	6,200		
22	24	23	-	Double Line Gen. Mdse.	11-19-74	1-2-75	-	1,955	1,955	1,955		
25	26	-	-	V.C. has no payee	blurred	3-25-75	-	3,100	3,100	-	3,100	Invoice date blurred
27	28	-	-	Double Line Gen. Mdse.	no date	5-30-75	-	3,270	3,270	-	3,270	Invoice - no date
29	30	-	-	Dica Fiber Industries	12-01-74	6-30-75	-	6,200	6,200	6,200		
31	31	-	-	Jaeb Enterprises	12-16-74	6-30-75	-	3,100	3,100	-	3,100	Invoice received 4-28-75 P.O. dated 4-5-75
32	33	-	-	Graphic Marketing Corp.	11-27-74	1-18-75	-	10,200	10,200	10,200		
34	34	-	-	F. Pecho Trading	12-25-74	6-30-75	-	1,925	7,700	-	1,925	Invoice received March '75
"	"	-	-	" " "	12-4-74	" " "	-	3,850			3,850	Invoice received March '75
"	"	-	-	" " "	12-21-74	" " "	-	1,925		1,925		
35	36	-	-	Alba Trading Co., Ltd.	Received 4-28-75	6-30-75	-	3,750	3,750	-	3,750	Invoice received March '75
37	38	-	-	The Ault & Wiborg Co.	12-5-74	1-30-75	-	1,186.25	4,389.45	1,186.25		
"	39	-	-	" " " "	12-20-74	" " "	-	3,203.20		3,203.20		
40	41	-	-	Printers Supplies Market Co.	12-31-74	1-3-75	-	1,500	3,569.50	1,500		
"	42	-	-	" " " "	12-31-74	" " "	-	300		300		
"	43	-	-	" " " "	12-11-74	" " "	-	1,769.50		1,769.50		
44	45	-	-	Printers Supplies Market Co.	12-9-74	2-28-75	-	3,575	10,210	3,575		
"	46	-	-	" " " "	12-12-74	" " "	-	1,350		1,350		
"	47	-	-	" " " "	12-13-74	" " "	-	250		250		
"	48	-	-	" " " "	12-20-74	" " "	-	4,475		4,475		
"	49	-	-	" " " "	12-23-74	" " "	-	500		500		
"	50	-	-	" " " "	12-21-74	" " "	-	60		60		
									₱75,048.45	₱ 53,038.45	₱22,010	