REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

ERLINDA CORTES BRINKER,
Petitioner,

- versus -

C.T.A. CASE NO. 366

July 17, 1959

COLLECTOR OF INTERNAL REVENUE,
Respondent.

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# D E C I S I O N

The respondent assessed against the petitioner the sum of ₱35,369.20, as deficiency income tax for the year 1950, plus surcharges, interest and "compromise", computed and itemized as follows:

| | |
|---|---|
| Net income as per return --- | ₱15,800.00 |
| Add: Additional income ½ of ₱110,000.00 ------ | 55,000.00 |
| Net income as per investigation ------------- | ₱70,800.00 |
| Less personal exemption ---- | 3,000.00 |
| Amount subject to tax ------ | ₱67,800.00 |
| Tax due thereon ----------- | ₱21,852.00 |
| Less amount already assessed --------------- | 1,892.00 |
| Balance ------------------ | ₱19,960.00 |
| Add: 50% surcharge -------- | ₱ 9,980.00 |
| Total -------------------- | ₱29,940.00 |
| Add: 5% surcharge --------- | 1,497.00 |
| 1% monthly interest from March 15, 1956 to April 15, 1957 ---- | 3,892.20 |
| Compromise ---------- | 40.00 |
| TOTAL AMOUNT DUE --------- | ₱35,369.20 |

Upon failure of petitioner to secure a reconsideration of respondent's assessment, she has appealed the case to this Court for review.

It appears that Judge Bienvenido A. Tan, as attorney-in-fact, filed the income tax return of petitioner for the year 1950, reporting a gross income of

₱43,200.00, deductions in the sum of ₱27,400.00, and a net income of ₱15,800.00. In due time, an assessment was made on the basis of said return in the sum of ₱1,892.00, which amount was paid on April 20, 1951.

Upon investigation of said income tax return, it was disclosed that petitioner sold sometime in 1950 two parcels of land situated in Bulacan for the sum of ₱110,000.00 which was not included in her income tax return for that year. Efforts were exerted to determine the cost of acquisition of said property for the purpose of determining the gain derived from the sale thereof, but neither petitioner nor her attorney-in-fact could supply the necessary information. Accordingly, treating the two parcels of land as capital assets held for more than one year by the taxpayer, respondent considered the entire selling price of ₱110,000.00 as capital gain, 50% of which in the sum of ₱55,000.00 is the taxable net capital gain, pursuant to Section 34(b)(2) of the National Internal Revenue Code. The sum of ₱55,000.00 was added to the net income reported in petitioner's income tax return, thereby giving rise to the deficiency income tax assessment mentioned above.

In this appeal, petitioner has questioned the correctness of the assessment on two grounds, to wit:

> "4. That the assessment of the said tax in 1956 was erroneous because the said assessment did not take into consideration the purchase price of the said fishpond and the improvements introduced into the said fishpond from the date of acquisition to the date of sale;



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> "5. That the said assessment is also erroneous because it alleged that the filing of the income tax return of Mrs. Brinker for the year 1950 was fraudulent and on that basis assessed a surcharge of 50% when the truth of the matter was the said income tax return was made in good faith and without any intention to defraud the government." (Pars. 4 and 5, Petition for Review.)

The evidence of record shows that the two parcels of land in question were sold by Judge Tan, by authority of petitioner, to one Manuel Hipolito sometime in August, 1950. The purchase price of ₱110,000.00 was paid by the buyer and was received by petitioner in that year. Therefore, the gain derived by petitioner from the sale of said property formed part of her income in that year and taxable in the same year. The Revenue Code provides:

> "Sec. 39. Period in which items of gross income included.- The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under Section 38, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

The fact that the formal deed of sale was executed by petitioner in February, 1951 does not affect the taxability of the income in 1950. At any rate, the deed of sale executed in 1951 merely confirmed the deed of sale executed by her attorney-in-fact in 1950 when the purchase price was paid to and actually received by her.]

Petitioner claims that it was error for respondent to have considered the entire gross selling price of P110,000.00 as the capital gain and 50% thereof as the taxable net capital gain, without taking into account the acquisition cost or the fair market value thereof at the time of acquisition. Section 35 of the Revenue Code provides:

> "Sec. 35. Determination of gain or loss from the sale or other disposition of property.- The gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, shall be determined in accordance with the following schedule:
>
> (a) In the case of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen.
>
> (b) In the case of property acquired on or after March first, nineteen hundred and thirteen, the cost thereof if such property was acquired by purchase or the fair market price or value as of the date of the acquisition if the same was acquired by gratuitous title."

The gain (which means the income) derived or loss sustained from the sale or other disposition of property is the difference between the selling price and the cost to the taxpayer of such property. Section 35 lays down the rules for determining the cost. In the case of property acquired before March 1, 1913, the cost is the fair market price or value of the property as of said date. Where the property was acquired on or after March 1, 1913, the cost is the purchase price, if the property was acquired by purchase, or the fair market price or value as of the date of acquisition, if acquired by gratuitous title. And in the case of property acquired by gift or by inheritance, the fair market price or value is determined in accordance with the rules laid down in Sections 138 and 139 of Revenue Regulations No. 2 (39 O.G. 325).

In this case, it is not clear when and how the property was acquired. On January 22, 1957, counsel for petitioner submitted to the Conference Staff of the Bureau of Internal Revenue a statement purportedly signed by petitioner stating that she acquired the property by inheritance. (Pp. 43-44, B.I.R. records.) However, in the petition for review filed with this Court on April 16, 1957, it is alleged that the assessment made by respondent is erroneous "because the said assessment did not take into consideration the purchase price of the said fishpond", the necessary implication being that the property was acquired by purchase. During the hearing of this case, no evidence was presented to show how the property was acquired. No evidence was also presented as to the cost of the property. In these circumstances, we are constrained to sustain the decision of respondent holding that the entire selling price of the property is the capital gain, 50% of which is the net capital gain, in accordance with Section 34 of the Revenue Code.

It is also alleged that respondent erred in not allowing the deduction of at least ₱20,000.00, representing "the cost of building the fishponds and maintaining the same over the past years." (Page 5, Memorandum for Petitioner.) During the hearing, Judge Tan declared:

> "Q. Do you know how much money you spent in converting these lands into fishponds?
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> "A. I am not sure of the exact amount. The last one is, more or less, not less than ₱20,000.00.
>
> "Q. Do you have any voucher to substantiate that petitioner herein spent ₱20,000.00?
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> "A. Yes, sir, we have all the vouchers for this ₱20,000.00 because (in) my experience with the Bureau of Internal Revenue is that they require vouchers for every item of expenses but, unfortunately, the City of Manila - all buildings - was burned and Mrs. Brinker's properties were burned.
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> "Q. So you don't have any voucher now?
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> "A. We don't have any now."
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> (T.s.n., p. 8; page 5, Memorandum for Petitioner.)

We take it from the foregoing testimony of Judge Tan that the sum of "not less than ₱20,000.00" was spent in converting the two parcels of land in question into fishponds; that the expenses were covered by vouchers; and that the vouchers were burned or destroyed in Manila during the last war. There is no evidence as to when the expenditures were incurred, and whether they were incurred in one year or through a period of years. It would seem, however, that the alleged expense for improvements was in the nature of a capital expenditure which is not deductible under Section 30(a) of the Revenue Code, but which may be amortized through-out the estimated life of the improvements under Section 30(f).

"No evidence has been presented as to the nature of the said 'farming expenses' other than the bare statement of petitioner that they were spent for the 'development and cultivation of (his) property.' No specification has been made as to the actual amount spent for purchase of tools, equipment or materials, or the amount spent for improvements. Respondent claims that the entire amount was spent exclusively for clearing and developing the farm which were necessary to place it in a productive state. It is not, therefore, an ordinary expense but a capital expenditure. Accordingly, it is not deductible but it may be amortized, in accordance with Section 75 of Revenue Regulations No. 2, cited above. See also Section 31 of the Revenue Code which provides that in computing net income, no deduction shall in any case be allowed in respect of any amount paid out for new buildings or for permanent improvements, or betterments made to increase the value of any property or estate.

"In order that an item of expenditure may be deductible, it is required that each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. (Sec. 76, Rev. Regulations No. 2.) Petitioner having failed to comply with this requirement, we agree with respondent that the claimed deduction must be disallowed." (Santiago Gancayco v. Collector of Internal Revenue, C.T.A. No. 287, November 14, 1957.)

Respondent committed no error in refusing to allow the deduction of the sum of ₱20,000.00 from the gross income of petitioner in 1950.

In addition to the deficiency income tax, respondent seeks to collect from petitioner the fraud



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penalty, 50% surcharge, pursuant to Section 72 of the Revenue Code. Petitioner claims that the imposition of the fraud penalty is not proper considering that the failure of Judge Tan to include the selling price of the Bulacan property in the income tax return of petitioner for 1950 was not due to any intention to evade payment of the tax.

We have scanned the records of this case very carefully to find out the reason or reasons relied upon by respondent to justify the imposition of the fraud penalty. In his report of February 28, 1956, Assistant Examiner Raymundo Medalla stated:

> "As per investigation, the taxpayer failed to include in her return the proceeds from the sale of her property, as would be noted in the attached Report of Examination and worksheet. As this failure to include the proceeds from the aforesaid sale is considered as a willful intent to evade tax, the undersigned could not help but impose the 50% fraud-penalty upon the deficiency income tax." (Page 3, B.I.R. records.)

The Conference Staff of the Bureau of Internal Revenue which reviewed the case, in its memorandum dated March 1, 1957, submitted to and approved by respondent, expressed the following opinion:

> "The claim of counsel that the addition of 50% for a fraudulent return is erroneous on the ground that the original return was filed by Judge B. A. Tan, Attorney-in-fact for the taxpayer who allegedly had no control over the disposed property and, therefore, could not file a truthful return in connection with the sale thereof, cannot be considered a sufficient reason for the exclusion of the 50% surcharge provided for in section 72 of the National Internal Revenue Code in view of the substantial amount of the

undeclared income, which is ₱55,000.00, as compared to the income of ₱15,800.00 declared in the income tax return of the taxpayer for the year 1950. This view of the Conference Staff is supported by the observation made by the Court of Tax Appeals in the income tax case of former Speaker Eugenio Perez (B.T.A. Case No. 189, decided on February 13, 1956, p. 11), quoted as follows:

> '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.)' (Underscoring supplied)" (Pp. 46-47, B.I.R. records.)

The final decision of respondent rejecting petitioner's protest against the imposition of the fraud penalty reads:

> "Civil Case No. 519 of the Court of First Instance of Bulacan, entitled 'Manuel Hipolito v. Erlinda Dolores Cortez y Ochoa, et al.', wherein your father, Hon. Bienvenido A. Tan, was one of the defendants, was filed on December 14, 1950. The subject matter of the aforesaid case, as you very well know, was the two parcels of land which your father, in representation of Mrs. Erlinda Dolores Cortez y Ochoa, sold to Mr. Manuel Hipolito on or about August 5, 1950. It is, therefore, rather amazing that your father could not have known of this transaction at the time he filed the 1950 income tax return for Mrs. Erlinda Cortez y Ochoa." (Page 65, B.I.R. records.)

Finally, counsel for the Government, in support of respondent's decision imposing the fraud penalty, allege:

> "That Judge Bienvenido A. Tan, petitioner's attorney-in-fact who filed petitioner's return for 1950, knew fully well in 1950 that petitioner realized profits from the sale of her lands may be gleaned from the following pronouncements of the Court of First Instance of Bulacan:
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> > '... y en su consecuencia el codemandado Bienvenido A. Tan actuando como representante autorizado de los dueños de las dos parcelas de terreno, Erlinda Dolores Cortez y Ochoa y Eugene Brinker, otorgo el 14 de Agosto de 1950 en la Ciudad de Manila la correspondiente escritura de venta de las dos parcelas de terreno objecto de la demanda.' (p. 3, of Exh. '1', also marked Exh. 'A';) see also par. 5, 7, 8 & 9 of Exh. '1-A,' pp. 32-33, C.T.A. Rec.)
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> "Yet significantly, petitioner's 1950 income tax return is silent on this income from the sale of her lands. Petitioner should know that income realized by her from any source whatever in 1950 (Sec. 29(a), Tax Code) is includible in her 1950 income tax return." (Page 6, Memorandum for Respondent.)

It appears from the foregoing that the sole basis for the imposition of the fraud penalty by respondent against petitioner in this case is that the profit which she realized from the sale of two parcels of land in Bulacan was not reported in her income tax return for 1950. There is no allegation of fact from which any inference may be drawn that the failure to include the transaction in petitioner's income tax return was due to an intention to evade payment of the tax. Section 72 of the Revenue Code imposes the 50% fraud penalty in case a false or fraudulent return or list is willfully made, which simply means that the taxpayer must be shown to have had an intention to evade payment of the tax in filing a false or fraudulent return to warrant imposition of the penalty.

> "Section 72 of the Revenue Code provides that in case a false or fraudulent return is willfully made, the Collector of Internal Revenue (now Commissioner) shall add to the tax a surcharge of 50% of the amount of such tax. The rule is well settled that in order that the fraud penalty may be imposed it is essential that a false or fraudulent return be willfully filed, that is, with intent to evade tax. Did petitioner willfully file a false or fraudulent return for 1948 with intent to evade tax?
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> "The decision of respondent on this point reads:
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> > 'The imposition of the 50% fraud penalty is in accordance with law. There is in this case an element of fraud when he deliberately failed to report as income the dividends received by him in 1948 and of deducting items not allowed by law.' (Decision of respondent dated Sept. 23, 1954, pp. 5-6; Exh. 1 for respondent; Exh. G. for petitioner.)
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> x x x
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> "As to the first ground, the only allegation is that petitioner deliberately failed to report as income the Financing shares received by him as dividend. No allegation has been made that the failure to report such income was due to any intention to evade payment of the tax. The fraud penalty provided in Section 72 of the Revenue Code can not therefore be imposed solely on the ground that petitioner deliberately failed to report the value of the Financing shares received by him as dividend. While it may be true that a finding of

fraud by the Commissioner of Internal Revenue is presumptively correct, yet when the taxpayer has shown, as in this case, that the failure to report an income is due to an honest belief that it is not taxable, it is incumbent upon respondent to prove the existence of fraud. As aptly stated by the Supreme Court:

> 'Fraud cannot be presumed: it must be alleged and proved, at least satisfactorily, if not conclusively by one who alleges its existence. (De Roda v. Lalk, 48 Phil. 38; Arroyo v. Granada and Centeno, 18 Phil. 484.) The rule is founded on public policy to guard against the speculative tendencies of the human mind and its readiness to accept as fact theories that appeal to the imagination.' (Hilado v. Assad, G. R. No. L-6397, Aug. 31, 1955.)" (Yule v. Araneta, C.T.A. No. 84, July 8, 1958.)

The evidence of record shows that sometime in August, 1950, Judge Tan negotiated the sale of two parcels of land in Bulacan owned by petitioner, who was and still is residing in the United States. He found a buyer, one Manuel Hipolito, who offered to buy the property for ₱110,000.00. Judge Tan sent a cable to petitioner who accepted the offer also by cable. At the same time, petitioner stated that upon payment by the buyer of the purchase price and the receipt thereof by Judge Tan, the corresponding power of attorney would be sent to the latter. Upon receipt of the purchase price, Judge Tan executed a deed of sale in favor of the buyer anticipating that the power of attorney promised by petitioner would be received. For reasons which do not appear of record, petitioner



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failed to send to Judge Tan the promised power of attorney. Since the deed of sale executed by Judge Tan in favor of the buyer could not be registered with the Register of Deeds of Bulacan, and presumably feeling apprehensive lest petitioner might not go through with the transaction, Manuel Hipolito instituted an action on December 14, 1950 against petitioner and her husband, including Judge Tan and one Celedonio Monton as parties defendants, to compel petitioner to execute the corresponding deed of sale and for damages. Before the case could be decided, petitioner, instead of merely executing a power of attorney in favor of Judge Tan, executed in the United States on February 7, 1951, the necessary deed of sale, and a decision was rendered by the Court of First Instance of Bulacan on August 31, 1951, authorizing registration of said deed of sale. It was, therefore, only in 1951 that the case was finally settled.

In these circumstances, it is alleged that Judge Tan could not have included the transaction in petitioner's return for 1950. At the time that he filed the return for petitioner on February 10, 1951, he was of the belief that the profit realized from the sale of the two parcels of land should be included in the return of petitioner for 1951, petitioner having executed the deed of sale only on February 7, 1951 in the United States. But it is contended by counsel for the Government that Judge Tan "knew fully well in 1950 that petitioner realized profits from the sale of her lands," and that petitioner "should know that income realized by her from any source whatever in 1950 . . . is includible in her 1950 income tax return."

We are with respondent and with counsel for the Government that income realized by a taxpayer in a certain year must be reported in his income tax return for that year. But not many persons know when income, under the Income Tax Law, is realized; and not many persons know in what year income realized must be reported in their income tax returns. Taxation is a complicated matter, at least from the viewpoint of the layman. Oftentimes, it takes judicial intervention to finally determine when an item of income is taxable income and when it must be reported. We do not mean by this that every taxpayer should be free from any liability for failure to report income earned by him in the year it must be legally reported, irrespective of the reason or reasons for noncompliance with the statutory requirement. The law imposes penalties in varying degrees for failure to file returns and for filing false and fraudulent returns. In the case of the fraud penalty, the law requires as a condition for its imposition that the taxpayer, in filing a false or incorrect return, intended to evade payment of the tax. The intention to evade payment of the tax must be clearly established.

In the instant case, the mere allegation that the taxpayer knew or should know that she realized income from the sale of her lands in 1950 and that she should know that the income should have been reported in her income tax return for 1950 is not enough to warrant imposition of the penalty. Then, too, the allegation that Judge Tan "knew fully well in 1950 that petitioner realized profits from the sale of her lands" is not borne out by the evidence. The records show that Judge Tan knew very little about the lands sold by petitioner. He did not know, for instance, how the property was acquired by petitioner and the cost or fair market value thereof at the time of acquisition, which are factors essential for the proper determination of the gain derived from the sale of said property. Not even the Government has been able to determine these facts, despite years of investigation which was started in 1953. And it is for this reason that respondent was compelled to decide, and we believe correctly, that the entire selling price is the capital gain derived by petitioner from the sale. Undoubtedly, the decision bears quite heavily upon petitioner, but nonetheless justified because it was brought about mainly by her own indifference or plain ignorance of the law. She failed or refused to respond to the request of our consulate in New York for the purpose of taking her deposition.

We have also found in the income tax return of petitioner a note of Judge Tan which reads: "Note: I can not answer many of the questions for lack of information. This return is filed to comply with the law." (See page 5, B.I.R. records.) To us this is very significant. It was a voluntary and honest admission on the part of Judge Tan that he was not in a position to file a true and correct return for lack of adequate information. It was an open and frank invitation for the Bureau of Internal Revenue to do what was proper under the circumstances.

The Conference Staff of the Bureau of Internal Revenue, in recommending that the imposition of the fraud penalty be sustained, cited the case of Perez v. Araneta, B.T.A. Case No. 189, decided by this Court on February 13, 1956,[1] from which the following was quoted:

> "'Among the circumstances generally recognized as justifying the imposition of the fraud penalty are: (1) intentional understatement of income, <u>substantial in amount per se or substantial in relation to the total reported income</u>; (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.) (Underscoring supplied)."

The portion "substantial in amount <u>per</u> se or substantial in relation to the total reported income" was underscored, the Conference Staff stressing that the underscored portion justifies imposition of the fraud penalty, the understatement of income, it is alleged, being substantial in amount. (See pages 8-9, supra.) The emphasis has been misplaced. As a result, the above quotation taken from our decision in the Perez case has not been correctly understood. More important than the amount of the understatement is the require-

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[1]Affirmed in G. R. No. L-10507, May 30, 1958.

ment that the understatement of income be intentional.

We are, therefore, of the opinion that it was error for respondent to have imposed the fraud penalty against petitioner.

Counsel for petitioner raised the issue of prescription of the right of the Government to assess the deficiency income tax against petitioner for the first time in his memorandum dated March 12, 1959. This is improper. At any rate, we find from the records that petitioner, represented by her attorney-in-fact, signed a contract of "WAIVER OF THE STATUTE OF LIMITATIONS UNDER THE NATIONAL INTERNAL REVENUE CODE" on March 26, 1956. (See page 30, B.I.R. records.) There is no claim or pretense that the contract is not valid and binding.

Included in the assessment is the sum of ₱40.00 as compromise. It is now well settled that the imposition and collection by respondent of penalties in the guise of compromise, in the absence of compromise agreements validly entered into between the taxpayers and respondent, are unauthorized and illegal, and must be stopped.

IN LINE WITH THE FOREGOING OPINION, the decision appealed from is hereby modified, and petitioner is ordered to pay to respondent the deficiency income tax in the sum of ₱19,960.00 within thirty days from the date this decision becomes final. If the said amount, or any part thereof, is not paid with said period, respondent shall add to the unpaid amount the sur-

DECISION -
CT.A. CASE NO. 366



charge of 5% and 1% monthly interest from the date of delinquency to the date of payment. No costs.

SO ORDERED.

Manila, July 17, 1959.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge