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May 31, 1963

JOSE YNZA,
Petitioner,

-versus- C.T.A. CASE No. 308

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

D E C I S I O N

This is an appeal from the decision of respondent holding petitioner liable for deficiency income taxes in the total amount of ₱29,343.94 for the years 1946 to 1951, inclusive of 50% surcharge imposed for the years 1946 to 1949.

Petitioner is a co-owner with his sister, Julia Ynza, of three sugar cane haciendas in Negros Occidental which were managed and administered by Atty. Hugo P. Rodriguez during the years 1946 to 1950. It was the administrator who possessed greater knowledge of the facts and figures of the farming business (Exhibit B-39, p. 247, CTA rec.); handled and controlled the funds; and reported the receipts and disbursements of the haciendas to the bookkeeper, who was appointed by petitioner and his sister. And about the only participation of the owners of the haciendas was to receive remittances from time to time (Id. at p. 246). In December, 1950, petitioner, losing trust in the administrator, dismissed him and filed an action before the Court of First Instance of Manila to compel the latter to render an accounting of his administration and to reimburse to petitioner (plaintiff therein) whatever amount might be due him as co-owner of the haciendas. Judgment having been rendered by the Court of First Instance in favor of petitioner (plaintiff therein), both parties appealed to the Court of Appeals which dismissed the complaint.

During the pendency of the appeal before the Court of Appeals, respondent Collector (now Commissioner) of Internal Revenue ordered the investigation of petitioner's income tax liabilities for the years 1946 to 1951. Revenue Examiner Benjamin F. Joven, in his report dated January 7, 1954 (Exhibit 36, pp. 159-161, BIR rec.), determined that there were understatements of income and overstatements of expenses in petitioner's returns for 1946 and 1948, which were prepared and filed by the administrator, Atty. Hugo P. Rodriguez, on February 26, 1947 and February 26, 1949, respectively; and that petitioner failed to file income tax returns for the years 1947 and 1949. Actually, a return for the year 1949 was prepared and filed by the administrator on March 24, 1950. Hence, Revenue Examiner Joven recommended the assessment of income tax deficiencies for the years 1946 to 1951 and the imposition of the 50% fraud penalty for the years 1946 to 1949. In this connection, it must be stated that in the verification of petitioner's income tax liability for 1946 to 1949, Revenue Examiner Joven took into account the financial statements and different schedules of accounts prepared by independent Certified Public Accountants, C. Miller & Co. and S. B. Agudo, which were submitted to the Court of Appeals as exhibits (Exhibit 36, p. 161, BIR rec.).

On the basis of the Examiner's report, respondent issued deficiency income tax assessment notices against petitioner for the years 1948 to 1951 in the aggregate amount of ₱22,135.58 (Exhibits 16, 21, 28 and 35, pp. 108, 117, 138 & 157, BIR rec.), which notices were received by petitioner on October 12, 1954 (p. 269, CTA rec.). Later, petitioner requested for a detailed explanation of the assessments, which explanation was given to him.

On February 15, 1955, petitioner received the deficiency income tax assessments for 1946 and 1947 in the respective amounts of ₱2,851.49 and ₱4,356.87 (Exhibits 8 and 2, pp. 91 & 99, BIR rec.).

In his subsequent letters, petitioner claimed that his tax liabilities for 1946 to 1949, if any, have already prescribed under Section 331 of the Tax Code, and that the disallowed items in the returns for 1950 and 1951 are deductible under Section 30 of the same Code. Consequently, he requested for the withdrawal of the deficiency assessments, which request was denied by respondent. From this denial, petitioner appealed to us on August 16, 1956.

The issues raised by the parties for our consideration are as follows:

1. Whether or not the right of respondent to assess and collect the income tax deficiencies for the years 1946 to 1949 has already prescribed; and

2. Whether or not the expenses claimed by petitioner in his tax returns for 1950 and 1951 are deductible from his gross income.

As regards the first issue, respondent contends that the alleged substantial underdeclaration of income and overdeclaration of expenses in the tax returns in question indicate fraud with intent to evade the payment of tax on the part of petitioner. There being fraud, it is argued that respondent has ten (10) years from the discovery of the fraud within which to assess the deficiencies, which ten (10) years had not yet expired at the time of the assessments. Consequently, it is suggested to us that his right to assess the same has not prescribed.

As afore-stated, the deficiency assessments for

1946 to 1949 were based upon the report of Revenue Examiner Joven, who took into consideration the financial statements and different schedules of accounts prepared by C. Miller & Co. and S. B. Agudo. But, as stated by the Court of Appeals in its decision in Ynza vs. Rodriguez, CA-G.R. No. 11301-R, "the finding of Agudo is not reliable" (See Exhibit B-39, p. 250, CTA rec.). Since their basis is not reliable, it logically follows that the assessments for 1946 to 1949 are equally not reliable. If the examination of the Revenue Agent in arriving at his conclusions is clearly erroneous and the figures resulting from this investigation were accepted by the Commissioner in determining the deficiency, the deficiency must fail (pp. 156-157, Mertens, Law of Federal Income Taxation, Vol. 9, citing J. Paul Blundon, 32 BTA 285; Enoch A. Osborn, T.C. Memo-Op. Dkt 35932 (1953); Bright Star Battery Co. (New York) T.C. Memo-Op. Dkt. 2351 (1944)). By analogy, a deficiency, which is based upon unreliable figures of a Revenue Examiner, must also fail. This being so, the respondent's charge of fraud arising from the alleged petitioner's understatements of income and overstatements of expenses cannot be sustained.

There being no fraud, respondent's right to assess the deficiencies for the years 1946, 1948 and

1949 should have been availed of within five years from the filing of the returns (Sec. 331, N.I.R.C.). And it appearing that these three returns were filed on February 26, 1947, February 26, 1949 and March 24, 1959, respectively, and the deficiency assessment corresponding to the year 1946 was received on February 15, 1955 and those for 1948 and 1949 on October 12, 1954, we find that the respondent has assessed the deficiencies for 1946 and 1948 beyond the five-year period provided for by law. Consequently, his right to assess and collect the deficiencies for 1946 and 1948 has prescribed. However, he has assessed the deficiency for 1949 within the statutory period.

Furthermore, petitioner failed to file a return for his 1947 income. Under Section 332(a) of the Tax Code, respondent had a right to assess the deficiency for the said year within ten (10) years after the discovery of the omission on January 7, 1954. Since the deficiency assessment for 1947 was received on February 15, 1955, it is obvious that the right to assess the said deficiency has not prescribed. And in view of this finding that the deficiency for 1947 was seasonably assessed, we are constrained to affirm this assessment, including the 50% surcharge (See Sec. 72, Tax Code), notwithstanding the fact that the same is based upon the unreliable financial statements and schedules of accounts of S. B. Agudo. Petitioner's failure to file the corresponding return has deprived us of better data for determining the correct amount of tax due from petitioner for the tax year 1947.

Finally, with respect to the deficiency assessment for 1949, we are equally compelled to withhold approval of the same. It must be noted that respondent made this assessment on the belief that no return for 1949 was filed. As it turned out that a return was so filed, the deficiency assessment for said tax year cannot be sustained as against the return. Consequently, the income tax due from petitioner should be as reported in his return for 1949.

We will now come to the second issue.

Petitioner contends that the expenses claimed but disallowed by respondent in his income tax returns for 1950 and 1951 are allowable deductions from gross income pursuant to Section 30(a)(1) of the Tax Code.

The disallowed items are as follows:

1950

Unauthorized payment	₱4,250.00
Tractor's expense	1,324.21
Agricultural and miscellaneous expenses	527.34
	₱6,101.55

1951

Tractor's expense	₱ 631.00

Miscellaneous expenses	₱	521.60
Other maintenance expense ..		210.45
		₱1,363.05

The item of ₱4,250.00, claimed as loss deduction, represents the payment of a loan obtained by petitioner during the war from Doña Rosario Montilla Vda. de Abello. It is contended on behalf of petitioner that the payment for the loan should, under the Ballantyne Scale, be only ₱250.00. Since the administrator paid ₱4,250 more, the said amount is unauthorized payment and is a deductible loss. As found by the Court of Appeals, petitioner has no valid reason to complain, for the creditor merely exercised her discretion to collect this amount in pursuance of an agreement with petitioner (See Exhibit B-39, p. 243, CTA rec.). Therefore, there is no loss, and the sum of ₱4,250.00 is not deductible from gross income.

With respect to the items representing tractor's expenses for the years 1950 and 1951 in the respective amounts of ₱1,324.21 and ₱631.00 and agricultural and miscellaneous expenses for 1950 in the sum of ₱527.34, they are deductible expenses from the gross income for the same were expended for repair of tractor, gasoline, strandesol, oil, mobilcrude, seedling, stationery, and wages of the tractor driver and assistant. These disbursements were duly recorded in the books of petitioner and backed up by supporting documents. It is obvious that they were actual ordinary and necessary expenses incurred in the business of petitioner and hence are deductible.

Finally, the item "miscellaneous expenses" in the amount of ₱521.60 represents living expenses in the house in Hacienda Nervion and the item "other maintenance expense" amounting to ₱210.45 was incurred for the repair of house and bridge. Living expenses are personal expenses which are not deductible. The expenses for the repairs of the residential house and bridge are not allowable as they partake of the nature of personal expenses (See 4 Merten's Federal Income Taxation, p. 39, Sec. 25A-18).

In sum, considering the above findings, the deficiency income tax assessment of petitioner for the years 1947, 1950 and 1951 should be computed as follows:

1947

Net income as per investigation ...	₱22,475.35
Deduct personal exemption	1,000.00
Amount of income subject to tax ...	₱21,475.35
Tax due thereon	₱ 2,904.58
Plus 50% surcharge	1,452.29
Deficiency income tax	₱ 4,356.87

1950

Net income per return	₱29,098.11
Add: Unauthorized payment	4,250.00
Net income	₱33,348.11
Less: Personal exemption	1,800.00
Net taxable income	₱31,548.11

Tax due thereon	₱ 7,177.00
Less: Tax already paid and assessed	5,829.00
Deficiency income tax	₱ 1,348.00

1951

Net income as per return		₱38,530.98
Add: Miscellaneous expense.	₱521.60	
Other maintenance exp.	210.00	731.60
Net income		₱39,262.58
Deduct personal exemption		1,800.00
Net taxable income		₱37,462.58
Tax due thereon		₱ 9,307.00
Less: Tax already paid and assessed		9,063.00
Deficiency income tax		₱ 244.00

WHEREFORE, the decision of the respondent should be, as it is hereby, modified. Petitioner is ordered to pay the total amount of ₱5,948.87 as deficiency income taxes for the years 1947, 1950 and 1951, plus the statutory delinquency penalties thereon. Without pronouncement as to costs.

SO ORDERED.

Manila, May 31, 1963.

AUGUSTO M. LUCIANO
Associate Judge

I CONCUR:

ROMAN M. UMALI
Associate Judge