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ANTONIO E. QUEROL,
Petitioner,

- versus - C.T.A. CASE NO. 320

COLLECTOR OF INTERNAL
REVENUE,
Respondent.

October 7 /59

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D E C I S I O N

The petitioner filed his income tax returns for the calendar years 1947, 1948, 1949 and 1950 on February 28, 1948, February 28, 1949, February 24, 1950 and February 27, 1959, respectively (Exhibits "A" & "1", BIR rec. p. (22) 21; Exhibits "B" & "2", BIR rec. p. (14) 15; Exhibits "C" & "3", BIR rec. p. (8) 9; Exhibits "D" & "4", BIR rec. p. (2) 3), claiming as deductions, among others, items representing expenses for repairs of houses, depreciations, bad debts, and sundry expenses.

Sometime in 1951, the Bureau of Internal Revenue issued Income Tax Assessment Notice No. 24-A-36-51/47, imposing "an income tax for the amount of expenses (₱9,004.34)" the petitioner incurred in the repair of his house (Exhibits "O" & "11-A", BIR rec. p. (25) 24). In a letter dated December 14, 1951 and addressed to the respondent, thru the Deputy Provincial Treasurer of San Fernando, La Union, the petitioner requested for a reconsideration of the assessment (Exhibits "O" & "11-A"). Not receiving a reply thereto, the petitioner, on May

25, 1953, wrote to the Municipal Treasurer of San Fernando, La Union, reiterating his request for reconsideration (Exhibits "P" & "11", p. (26) 25).

Upon investigation (Exhibit "11-B-1", BIR rec. p. (27) 26; see also BIR rec. p. (29) 28), BIR examiner Elpidio P. Rivera, on July 10, 1954, recommended to the Provincial Revenue Agent of San Fernando, La Union, the denial of the petitioner's request for reconsideration of the 1947 assessment, and the assessment of income taxes for the years 1947-1950 in the total amount of ₱2,258.16, plus compromise penalty for violation of Rev. Reg. No. V-1 in the amount of ₱200.00 (Exhibit "12", BIR rec. p. (28) 27).

Meanwhile, on July 7, 1954, Examiner Rivera submitted his reports of examinations of the petitioner's income tax returns for the years from 1947 to 1950 (Exhibit 12-A, BIR rec. p. (24) 23; see also pp. (16) 17, (10) 11, (4) 5, BIR rec.). These reports of examinations were later returned for further investigation (Exhibit "Q", BIR rec. p. (33) 32). Upon reinvestigation, Examiner Rivera submitted his reports of examinations, recommending the following assessments against the petitioner:

1 9 4 7

Net Income per return		₱ 2,746.39
Add: Disallowances:		
1. Repairs to be capitalized:		
Cost of repairs	₱9,044.22	
Less: 10% depreciation allowance	904.42	8,139.30
2. Depreciation on old fully depreciated building		640.00

Net income per investigation		₱11,526.69
Less: Personal exemptions		2,500.00
Income subject to tax		₱ 9,026.69
Amount of tax due		₱ 753.51

(Exhibit "8", BIR rec. p. (32) 31.)

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Net Income per return			₱ 2,903.85
Add: Disallowances:			
1. Depreciation of old building fully depreciated		₱ 330.00	
2. Repairs to be capitalized:			
Cost of repairs	₱1,561.00		
Less 10% depreciation allowable	156.10	1,404.90	
3. Bad debts		480.00	2,214.90
Net income per investigation			₱ 5,118.75
Less: Personal exemptions			2,500.00
Net income subject to tax			₱ 2,618.75
Amount of income tax due			₱ 97.14

(Exhibit "9", BIR rec. p. (19) 20.)

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Net Income per return		₱ 1,282.99
Add: Disallowances:		
1. Depreciation of old fully depreciated building	₱ 180.00	
2. Bad debts	520.00	
3. General expenses	404.13	1,104.13
4. Undeclared income on purchase of car from the Reliance Motors, Inc.		8,000.00
Net income per investigation		₱10,387.12
Less: Personal exemptions		2,500.00
Net income subject to tax		₱ 7,887.12
Amount of income tax due		605.32
Add: 50% surcharge (underdeclaration)		302.66
Total tax and surcharge due		₱ 907.98

(Exhibit "5", BIR rec. p. (13) 14.)

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Net income per return		₱ 2,857.65
Add: Disallowances:		

1. General expenses, medical profession without voucher	₱ 654.10
2. General expenses, medical profession without voucher	305.00
3. General expenses, medical profession without voucher	172.60
Net income per investigation	₱ 3,989.30
Less: Personal exemptions	3,000.00
Net income subject to tax	₱ 989.30
Amount of income tax due	₱ 49.47

(Exhibit "10", BIR rec. p. 7.)

On February 9, 1955, the respondent issued tax assessment notices of the petitioner's income tax liabilities in the following amounts:

Assessment Notice No.	Amount Due	Year	Exhibit No.
24-7-60498-54-47	₱753.51	1947	"7"
24-7-214132-54-48	97.14	1948	"7-A"
24-7-1636-54-49	907.98	1949	"7-B"
24-7-213147-54-50	49.47	1950	"7-C"

On February 19, 1955, the petitioner returned to the respondent the tax assessment notices, and requested enlightenment as to how the assessments were arrived at (Exhibit "F", CTA rec., p. 11). Without answering the request, the respondent, on September 14, 1956, issued a warrant of distraint and levy against the properties of the petitioner to satisfy the amount of ₱1,808.10, representing income tax for the years 1947-1950, plus the legal increments thereof (Exhibit "6", BIR rec., p. 60). In pursuance of this warrant of distraint and levy, the municipal treasurer of San Fernando, La Union, on September 19, 1956, distrained and levied the petitioner's residential house (Exhibit "H", CTA rec. p. 16).

On September 22, 1956, the petitioner filed before this Court a petition for review, seeking, among other things, to restrain the respondent from executing the warrant of distraint and levy and from selling his real property, particularly, his residential house. On the incidental question of whether or not the respondent should be enjoined from executing the warrant of distraint and levy on the properties of the petitioner, this Court, in its resolution of October 17, 1956, held that the right of the respondent to collect the alleged income tax liability in question through summary methods was barred by prescription, and therefore, declared null and void the warrant of distraint and levy issued by the respondent on September 14, 1956 as having been issued in violation of Section 51(d) of the Revenue Code. Consequently, it ordered the respondent and/or his representative to desist from taking further proceedings thereunder and to return to the petitioner the property seized, the sale at public auction of which was set for October 28, 1956 (CTA rec., pp. 28-31).

On March 17, 1959, the petitioner filed a motion for leave to amend his petition for review to the end that the real matter in dispute and all matters in the action in dispute may be completely determined in a single proceeding. Finding the motion meritorious, this Court, on March 18, 1959, admitted the amended petition for review. On April 8, 1959, the respondent filed his answer thereto.

The issues in this case may be briefly summarized as follows:

(1) Whether or not the right of the respondent to assess the income taxes due from the petitioner Antonio E. Querol for the calendar years 1947 and 1948 has prescribed;

(2) Whether or not the assessments made by the respondent with respect to the income taxes of the petitioner for the calendar years 1949 and 1950 are legal; and

(3) Whether or not the petitioner is liable for 50% surcharge on the alleged income tax for the calendar year 1949.

The petitioner contends that, inasmuch as more than five years have elapsed from the time he filed his income tax returns for the calendar years 1947 and 1948 on February 28, 1948 and February 28, 1949, respectively, up to the time when the respondent assessed the corresponding income taxes, the right of the latter to assess said taxes has already prescribed under Section 331 of the National Internal Revenue Code. On the other hand, the respondent argues that the income tax returns filed by the taxpayer were false, and therefore, under the provisions of Section 332 of the Tax Code, his right to assess the same has not prescribed.

The pertinent provisions relied upon by the parties are quoted hereunder:

"SEC. 331. Period of limitation upon assessment and collection.--Except as provided in the succeeding section, internal-revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. For the purposes of this section a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day: Provided, That this limitation shall not apply to cases already investigated prior to the approval of this Code."

"SEC. 332. Exceptions as to period of limitation of assessment and collection of taxes.--(a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission. x x x"

The present issue of prescription turns upon the question of whether or not the petitioner's returns for 1947 and 1948 were false or fraudulent with intent to evade the payment of taxes.

It is contended, on behalf of the respondent, that the 1947 net income of the petitioner in the sum of ₱2,746.89 was false because the same was evidently underdeclared. This contention is based upon the rationale that, on September 9, 1947, the petitioner was able to buy a Ford car for ₱2,000.00 while his son was still taking up medicine; that considering his social standing (being one of the prominent families) in the community, his net income of ₱2,746.89 could hardly meet his family's living allowance for one year; that the petitioner accumulated, during the years prior to 1951, real estate holdings with a total assessed value of ₱46,125.00; that the sum of ₱230.00, claimed in the 1947 return as bad debts, was fictitious because the petitioner was on the "actual receipts" basis and, therefore, he could not possibly have "receivables" in his books of accounts from which said bad debts could be deducted; and that the "sundries" in the sum of ₱300.00 and the ₱9,004.34, claimed as deductions under Schedules "B" and "E" of the 1947 return, point to the falsity of the said return.

As regards the 1948 return, it is equally contended that the same was false with intent to evade the payment of taxes for the reason that the deductions claimed therein, except the items consisting of expense for the purchase of seeds and taxes, were either fictitious or inflated with the evident purpose of minimizing, if not altogether evading, the payment of legitimate income tax.

We cannot agree to the proposition that the petitioner's return for 1947 was false or fraudulent with intent to evade the payment of taxes. The fact that the petitioner reported a net income of ₱2,746.89 in 1947, and bought a car for ₱2,000.00 while his son was still studying medicine does not establish the falsity or fraud of the return, in the absence of a showing that the purchase price of the car and the expenses incurred in the studies of the son came or could have come from the petitioner's income in 1947.

The pretense that the petitioner's net income in 1947 was underdeclared and, therefore, false because the same could hardly meet his family's living allowance for one year is without merit. There is no showing as to how much the petitioner spent for his family's living in 1947, or that his family's living allowance was so big as to warrant the conclusion that his net income in the said year was underdeclared. In default of such showing, we cannot conclude that the petitioner's net income in 1947 was underdeclared.

The accumulation by the petitioner of real estate holdings with a total assessed value of ₱46,125.00 is not indicative of the falsity or underdeclaration of the petitioner's reported income in 1947, in the absence of a proof that the real estate holdings were acquired or could have been acquired with money earned by the petitioner in 1947.

The mere fact that the 1947 return was made on the basis of actual receipts and payments, and therefore, the petitioner could not possibly have receivables from which the bad debts may be deducted does not necessarily establish the fictitiousness or non-existence of the bad debts. The lack of receivables serves only as a ground for the disallowance of the claimed deduction for bad debts.

Similarly, the mere fact that the petitioner claimed as deductions sundries amounting to ₱300.00 and the cost of the repair of a house in the sum of ₱9,004.34 does not warrant the conclusion that the 1947 return was false or fraudulent with intent to evade the payment of taxes. There must be a clear and convincing evidence that there was an intent to evade the payment of taxes.

Relative to the respondent's imputation that the 1948 return was false with intent to evade the payment of taxes we find no evidentiary basis therefor.

Fraud is never presumed. (De Roda v. Lelk, et al., 48 Phil. 104; De Santos v. Bank of the Philippine Islands, 66 Phil. 38; La Cia. General de Tabacos v. Abad, 13 Phil. 391; Menzi & Co. v. Bastida, 63 Phil. 16; Arroyo v. Granada & Gentero, 18 Phil. 484.) It is fundamental that the fact of fraud must be proved by the Commissioner by clear and convincing evidence (Boyett v. Commissioner 204 F(2d) 205; Griffiths v. Commissioner 50 F(2d) 782). In the case at bar, the respondent failed to prove clearly and convincingly that the petitioner's returns for 1947 and 1948 were false or fraudulent with intent to evade the payment of taxes.

Finally, it is to be observed that the income tax assessment notices for the calendar years 1947 and 1948 do not indicate that the fraud penalty of 50% was imposed on the petitioner. Even Examiner Rivera did not recommend, in his reports of examinations of the returns for the said years, the imposition of the fraud penalty. These observations strongly belie the respondent's imputation of fraud in the filing of the petitioner's returns for 1947 and 1948. Moreover, the fact that the fraud penalty of 50% is not sought to be collected from the petitioner is an admission that the respondent himself does not believe that the former is guilty of fraud (see Central Azucarera de Tarlac v. Collector of Internal Revenue, C.T.A. Case No. 75, November 8, 1956).

Having ruled that the returns for the years 1947 and 1948 were not false or fraudulent with intent to evade the payment of taxes, it follows that the provisions of Section 331 of the Tax Code should be applied for the purpose of determining whether or not the right of the respondent to assess the income tax liabilities of the petitioner for the said years has already prescribed.

The petitioner's contention that the right of the respondent to assess the 1947 income tax has prescribed is without merit. It must be observed that the initial assessment on said tax was effected sometime in 1951, or within five years from the filing of the 1947 return. But due to the petitioner's request for reconsideration, his tax liability for 1947 was reinvestigated, thus affording the petitioner an opportunity to dispute the correctness of the assessment. Having persuaded the respondent to make the re-investigation, which resulted in the final assessment of February 9, 1955, it would be unfair for petitioner to claim that the right of the respondent to determine said tax liability is now barred by law. To uphold the view of the petitioner would be lending aid to his evasion of tax liability on the mere technical ground of prescription (see The Collector of Internal Revenue vs. Suyoc Consolidated Mining Company, et al., G. R. No. L-11527, November 25, 1958).

With regard to the income taxes for 1948, we find that the right of respondent to assess the same has already prescribed, the assessment notice therefor having been issued on February 9, 1955 or 5 years, 11 months and 10 days after the filing of the income tax return.

We come now to the question of whether or not the assessments made by the respondent with respect to the income taxes of the petitioner for 1949 and 1950 are legal.

It is well-settled in this jurisdiction that an assessment is presumed to be correct. The taxpayer has the burden of proving that the same is incorrect or illegal (Interprovincial Autobus Co., Inc. vs. Collector of Internal Revenue, G.R. No. L-6741, January 31, 1956). In the instant case, the petitioner limited himself to the propositions that the right of the respondent to assess the 1947 and 1948 income taxes has prescribed and that the 1949 and 1950 assessments were incorrect or illegal, thereby refusing to assume the burden of proving the incorrectness or illegality of the assessments for the years 1947 and 1948. Consequently, in default of evidence overthrowing the presumption of its correctness or illegality, we take it that the assessment for 1947 is correct or legal.

Let us now go into the disputed items of the 1949 and 1950 assessments.

1949 RETURN

In the 1949 return, the petitioner claimed a depreciation deduction of ₱180.00 on a house of strong materials which was acquired by him in 1937. This claim was totally disallowed on the ground that the building was already fully depreciated in 1947.

It is incontrovertible that the building in question was acquired by the petitioner in 1937. Therefore, its depreciable life lasted only 10 years, or until 1947. Obviously, as correctly determined by the respondent, the petitioner could not longer claim depreciation deduction for the building in 1949.

The petitioner also claimed a deduction, consisting of bad debts, in the total amount of ₱520.00. The respondent totally disallowed this claim for the reason that there were no "records of accounts receivable nor letters of demand."

To claim bad debt deductions under the law, the debts due to the taxpayer should be (1) actually ascertained to be worthless and (2) charged off within the same taxable year. (Sec. 30(e) (1), National Internal Revenue Code; Shangkuan v. Collector of Internal Revenue, C.T.A. Case No. 19, March 23, 1955). The petitioner's conclusion that these debts were worthless or uncollectible because the debtors told his collector that they were poor and could not pay the same is not sufficient to establish their worthlesseness or uncollectibility. A mere statement by the debtor that he is unable to pay, unaccompanied by the creditor's investigation of such inability, is not sufficient to sustain a bad debt deduction. (Hutchison v. Commissioner, 13 BTA 1187; T.T. Word Supply, 41 BTA 965.)] In the case at bar, the petitioner did not conduct an inquiry or investigation to ascertain the inability of his debtors to pay. Consequently, we are constrained to affirm the disallowance of the petitioner's claim for bad debt deductions.

The petitioner claimed as deductions sundry expenses totalling ₱1,212.40, of which the sum of ₱404.13 was disallowed on the ground that the expenses were not supported by papers or vouchers.

Section 30(a) (1) of the Tax Code authorizes the deduction from gross income of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. It is incumbent upon the taxpayer to prove that the expenses claimed as deduction are ordinary and necessary.

The petitioner did not show that the sundry expenses of ₱1,212.40 were wholly ordinary and necessary. And in default of supporting papers or vouchers, we cannot ascertain whether the same were wholly ordinary or necessary. Similarly, we are constrained to affirm the respondent's determination disallowing the deduction claim in the amount of ₱404.13 as presumptively correct or legal.

The respondent added to the taxable income of the petitioner the sum of ₱8,000.00, the purchase price of a Buick car which the latter bought from the Reliance Motors, Inc. in 1949. He presumed that the ₱8,000.00 was undeclared income in 1949, thereby imposing a 50% surcharge on the amount of income tax due.

As testified by the petitioner, the ₱8,000.00 with which he purchased the Buick car came from his pre-war savings deposit in the Postal Savings Bank (t.s.n., p. 11); proceeds from his insurance policy with the Sun Life Assurance Co. of Canada which matured in 1942 and was settled in 1946 (t.s.n., p. 12; see also Exhibit "J", CTA rec. p. 106); rental receipts from the U.S. Army for the occupation of his land in Rosario and Agoo, La Union (t.s.n., p. 14; see also Exhibit "J-1", CTA rec. p. 107); and his wife's pre-war savings account with Monte de Piedad (t.s.n., p. 15; see also Exhibit "I-1", CTA rec. p. 104). This testimonial evidence is not contradicted. Having been shown, without contradiction, that the ₱8,000.00 was an income earned prior to 1949, the same could not be taxed in 1949.

1950 RETURN

In the 1950 return, the petitioner claimed the following deductions: sundry expenses in business or profession - ₱1,949.90 (Schedule B of Exhibits "D" & "4"); total expenses in farming - ₱1,163.25 (Schedule C of Exhibits "D" & "4"); and total expenses incurred in rental properties - ₱1,033.70 (Schedule E of Exhibits "D" & "4"). On the ground that these expenses were not supported by papers or vouchers, the respondent disallowed them to the extent of ₱654.10, ₱305.00 and ₱172.60, respectively.

Again, it may be stated that the petitioner did not show that the claimed expense deductions for 1950 were wholly ordinary and necessary. And in the absence of supporting papers or vouchers, we cannot determine whether said expenses were ordinary and necessary or otherwise. In view of this situation, we have no other alternative, but to affirm the respondent's disallowance of the expenses to the extent of the respective amounts of ₱654.10, ₱305.00 and ₱172.60 on the ground that the respondent's determination is presumed to be correct.

In connection with the third issue of whether or not the petitioner is liable for 50% surcharge, it is the theory of the respondent that the money with which the

Buick car was purchased was undeclared income for 1949. Since the purchase price of the car was satisfactorily shown to have come from earnings made prior to 1949, and should not therefore be declared in the 1949 return, the imposition of the fraud penalty of 50% lacks legal basis.

IN VIEW OF ALL THE FOREGOING, the decision appealed from is hereby modified. The petitioner is ordered to pay to the respondent or his authorized representative the sum of ₱798.26, computed in Annex "A" hereof, plus 5% surcharge for late payment and interest at the rate of 1% per month from March 16, 1955. Without special pronouncement as to costs.

SO ORDERED.

Manila, October 7, 1959.

MARIANO NABLE
Presiding Judge

I concur:

AUGUSTO M. LUCIANO
Associate Judge

I abstain:

ROMAN M. UMALI
Associate Judge

ANNEX "A"

1 9 4 7

Net income per return		₱ 2,746.89
Add: Disallowances:		
1. Cost of repairs to be capitalized (₱9,004.23):		
Amount claimed in return ...	₱9,004.34	
10% depreciation allowable..	900.42	
Amount disallowed		8,103.92
2. Depreciation on old building fully depreciated		640.00
Net income per findings		₱11,490.81
Less: Personal exemption		2,500.00
Income subject to tax		₱ 8,990.81
Amount of tax due		₱ 748.80

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Net income per return		₱ 1,282.99
Add: Disallowances:		
1. Depreciation of old fully depreciated building	₱ 180.00	
2. Bad Debts	520.00	
3. General expenses	404.13	1,104.13
Net income per findings		₱ 2,387.12
Less: Personal exemptions		2,500.00
Net income subject to tax		-.--
Amount of income tax due		-.--

1 9 5 0

Net income per return		₱ 2,857.65
Add: Disallowances:		
1. General expenses	₱ 654.10	
2. Expenses on farming	305.00	
3. Expenses on rental property.	172.60	1,131.70
Net income per findings		₱ 3,989.35
Less: Personal exemptions		3,000.00
Net income subject to tax		₱ 989.35
Amount of tax due		₱ 49.46

S U M M A R Y

Income tax due for 1947	₱748.80
Income tax due for 1950	49.46
Total tax due	₱798.26

27