REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

AYALA SECURITIES CORPORATION,
Petitioner,

versus CTA CASE NO. 1346

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

x - - - - - - - - - - - - x June 20/68

D E C I S I O N

This is a petition to review the decision of respondent demanding from petitioner payment of ₱758,687.04 as 25% surtax on its accumulated surplus for 1955, imposed by Section 25 of the National Internal Revenue Code, inclusive of the ½% monthly interest from June 20, 1959 to February 21, 1961.

Petitioner, a duly registered domestic corporation, is engaged in real estate business, investment in shares of stocks, general mercantile business, manufacturing and brokerage (pp. 16-17, t.s.n.). In 1955, it had an outstanding and paid-up capital stock of ₱1,750,000.00 valued at ₱10.00 per share (Exh. 2, pp. 123-124, BIR rec. & Exh. 6, pp. 202-203, BIR rec.).

On November 29, 1955, petitioner filed its corporate income tax return for the fiscal year ended September 30, 1955 (Exhs. A & 1, p. 43, BIR rec.), attaching therewith an audited statement of its financial status as of September 30, 1955 which showed a surplus of ₱2,758,442.37 (Exh. B, p. 29, BIR rec.). The income tax of ₱420,053.00 due on this return was paid by petitioner on February 14, 1956 and May 14, 1956 (Exhs. C & C-1).

On February 21, 1961, after investigating petitioner's income tax return for the fiscal year ended September 30, 1955, respondent assessed and demanded from petitioner payment of ₱758,687.04, representing surtax on its accumulated surplus and the ½% monthly interest, computed as follows:

Unreasonably accumulated of surplus	₱2,758,442.37
25% tax due thereon under Section 25 of the Revenue Code	689,611.00
Add: ½% monthly interest from June 20, 1959 to Feb. 21, 1961	69,076.04
TOTAL AMOUNT DUE	₱ 758,687.04

Petitioner received the said deficiency tax assessment on March 21, 1961 (Exhs. D to D-3; admitted in par. 1, Answer, p. 16, CTA rec.). On April 21, 1961, petitioner, through its auditor, filed with respondent a lengthy protest assailing the legality and validity of the tax assessment and requested the reconsideration and cancellation thereof on the grounds that: (1)

the retention of the surplus of ₱2,758,442.37 was indispensable for the operation of its business; and (2) the right of the Government to assess the 25% surtax had already prescribed. (Exhs. E & 6, pp. 189-203, BIR rec.; admitted in par. 1, Answer, p. 16, CTA rec.) In a letter of respondent dated June 21, 1961, petitioner was advised by respondent that the pending tax case would be reinvestigated provided that a waiver of the statute of limitations is executed by petitioner (Exh. F; see also pp. 207-208, BIR rec.). Petitioner, however, refused to execute said waiver claiming that respondent's income tax assessment for the fiscal year ended September 30, 1955 had already prescribed (pp. 95-96, t.s.n.).

On February 21, 1963, petitioner received from respondent, through the Chief, Manila Examiners, a letter dated February 18, 1963, calling its attention to the unpaid income tax assessment of ₱758,687.04 and at the same time demanding the payment thereof within five (5) days from receipt of said letter (Exh. G; see also p. 6, CTA rec.). By considering that the said letter is a decision on its protest and request for reconsideration, petitioner filed with this

Court on March 7, 1963 the present petition for review (p. 1, CTA rec.).

The issues submitted by the contending parties to this Court for resolution are the following:

1. Whether or not this Court has jurisdiction to take cognizance of the case under Section 7(1) of Republic Act No. 1125;

2. Whether or not the right of respondent to assess the deficiency income tax has already prescribed under Section 331 of the Revenue Code, in relation to Section 332(a) of the same Code; and

3. Whether or not the retention of the surplus of ₱2,758,442.37 was for the reasonable needs of petitioner's business.

<u>First Issue</u> -

Respondent assails and impugns the jurisdictional right of the Court to entertain the case because no decision has as yet been rendered by him on the protest of petitioner which could be appealed to this Court under the provisions of Section 7(1) of Republic Act No. 1125. Relying on the same provisions of law, petitioner claims that the letter of respondent dated February 18, 1963 is tantamount to a decision on its protest which is directly appealable to this Court.

Section 7(1) of Republic Act No. 1125 provides that the Court of Tax Appeals has exclusive jurisdiction to review by appeal "decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereof, or other matters arising under the National Internal Revenue Code or other law administered by the Bureau of Internal Revenue." The word "decisions" has been interpreted to mean the decisions of the Commissioner of Internal Revenue on a disputed assessment or on the protest of the taxpayer against the assessment and not the assessment itself (see Commissioner of Internal Revenue v. Villa, et al., L-23988, January 2, 1968; St. Stephen's Assn. v. Collector of Internal Revenue, 104 Phil. 314).

When petitioner questioned the legality and validity of respondent's assessment in its protest dated April 21, 1961 and requested him to reconsider or cancel the same, it became a "disputed assessment." Petitioner has, therefore, the right to appeal to this Court upon receipt of the decision of respondent on the disputed assessment, pursuant to Section 7(1) of Republic Act No. 1125. On February 18, 1963, or almost two (2) years from the date of petitioner's protest, respondent through the Chief, Manila Examiners, addressed a letter to petitioner reiterating the demand for payment of the income tax and interest of ₱758,-687.04 originally assessed against it within five (5) days from the receipt thereof. In effect, the said letter of respondent is a decision on the disputed income tax assessment which is appealable to this Court. This is so because, when respondent reiterated his demand despite the vigorous opposition and vehement protest filed by petitioner, respondent's letter of February 18, 1963 is tantamount to a denial of the protest and a clear indication of his firm stand against the reconsideration of the deficiency income tax assessment. This view is further strengthened by the continued refusal of petitioner to execute the waiver of the statute of limitations despite the lapse of almost two (2) years from the date of its protest.

The rule is well-settled that, if the taxpayer's request for reconsideration is denied by respondent or the original tax assessment is maintained by him, the decision of respondent appealable to this Court is the letter-decision of respondent denying the taxpayer's request for reconsideration or cancellation of the tax assessment in question)(St. Stephen's Assn. v. Collector, _supra_; Baguio Country Club v. Collector, 4 Phil. Tax Journal 554; Roman Catholic Archbishop v. Collector, 7 Phil. Tax Journal 255; Philippine Planters Investment Co. v. Commissioner of Internal Revenue, CTA Case No. 1266, November 11, 1962). Consequently, the letter-decision of respondent, dated February 18, 1963, on the disputed assessment is appealable to this Court. We hold, therefore, that this Court has jurisdiction to entertain petitioner's appeal under Section 7(1) of Republic Act No. 1125.

The decision of the Supreme Court in the case of Commissioner of Internal Revenue v. Leonardo S. Villa, et al., _supra_, invoked by respondent, is not in point. In that case, the original tax assessment was appealed by the taxpayer to this Court. In the present case, the letter-decision of respondent on petitioner's protest is the subject of the appeal.

Second Issue -

Petitioner contends that, since its income tax return for the fiscal year ended September 30, 1955 was filed on November 29, 1955 and the income tax assessment was issued by respondent only on February 21, 1961 (see Petitioner's Memo., p. 47, CTA rec.), the assessment in question has already prescribed under Section 331 of the National Internal Revenue Code which provides as follows:

> SEC. 331. <u>Period of limitation upon assessment and collection</u>.— 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: <u>Provided</u>, That this limitation shall not apply to cases already investigated prior to the approval of this Code.

Respondent counters by alleging that the income tax return filed by petitioner was fraudulent and, therefore, he has ten (10) years from the discovery of the fraud within which to assess the tax under Section 332(a) of the Revenue Code. In support of respondent's contention, he argues that -

> "Section 25 of the National Internal Revenue Code is a penal provision directed against corporations permitting their gains or profits to accumulate with the <u>intent to evade payment of lawful income taxes</u> on its individual stockholders. Since the imposition of the 25% surtax is admittedly a penalty and the

> intent to evade payment of taxes is an inherent quality of the violation, the return filed must necessarily be false and/or fraudulent and the applicable provision of law with regard to the prescriptive period within which to assess is Section 332(a) of the Tax Code, and not Section 331 of the same Code." (Respondent's Memo., p. 97, CTA rec.)

In short, respondent maintains the view that it is not necessary for him to prove that petitioner's income tax return was fraudulent because fraud is inherent in the violation of Section 25 of the Revenue Code. We cannot subscribe to the novel theory of respondent. It is a cardinal rule in taxation that fraud is a question of fact and the circumstances constituting it must be alleged and proved (Commissioner of Internal Revenue v. Gonzales, et al., G. R. No. L-19495, November 24, 1966). Fraud is never presumed because it is a serious charge (Yutivo Sons Hardware Co. v. Court of Tax Appeals, et al., G. R. No. L-13203, January 28, 1961); it must be alleged and proved, at least satisfactorily if not conclusively by one who alleges its existence (De Roda v. Balk, 48 Phil. 104; De Santos v. Bank of the P. I., 66 Phil. 38; Menzi & Co. v. Bastida, 63 Phil. 16; Arroyo v. Granada A. Centero, 18 Phil. 484; Gomez v. Domingo, CTA Case No. 1168, February 15, 1964.

Moreover, the burden of proof in tax cases involving fraud will not be sustained where respondent introduces no affirmative evidence but rests only on inferences to be drawn from collateral facts (Balter, Fraud under the Federal Tax Law, par. 112, 1953 ed.). Besides, if we were to uphold respondent's theory, we would establish a destructive presumption that every corporation, which has unreasonably accumulated surplus, would at all times be considered guilty of fraud although the accumulation thereof may have been done in good faith. We are of the opinion, therefore, that Section 25 of the Revenue Code does not establish a presumption of bad faith because good faith is generally presumed in the absence of proof to the contrary (20 Am. Jur. 223).

In the case at bar, respondent has the burden of proving clearly and convincingly the existence of fraud. Unfortunately, respondent has failed to submit to the Court any piece of evidence showing the existence of fraud. The income tax assessment against petitioner (Exh. 5) and the letter-decision of respondent denying petitioner's protest (Exh. G) did not impute fraud in petitioner's income tax return or declaration. The said failure of respondent is an eloquent argument against the very existence of fraud and the willful intent to evade the payment of income tax (see Gomez v. Domingo, supra).

Even in the answer to the petition for review, respondent did not allege fraud. In fact, the trial of this case was centered mainly on the question of whether or not the retention of surplus was for the reasonable needs of petitioner's business. It was only in respondent's memorandum that he alleged for the first time the existence of fraud. In a case where respondent was similarly situated, our Supreme Court held:

> "The Commissioner claim that fraud attended the filing of the return; that this being so, Section 332(a) of the Tax Code would apply. It may be well to note that the assessment letter itself (Exhibit 22) did not impute fraud in the return with intent to evade payment of the tax. Precisely, no surcharge for fraud was imposed. In his answer to the petition for review filed by Lilia Yusay in the Court of Tax Appeals, the Commissioner alleged no fraud. Instead, he broached the insufficiency of the return as barring the commencement of the running of the statute of limitations. He raised the point of fraud for the first time in the proceedings, only in his memorandum filed with the Tax Court subsequent to resting his case. Said Court rejected the plea of fraud for lack of allegation and proof, and ruled that the return, although not accurate, was sufficient to start the period of prescription.
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> "Fraud is a question of fact. The circumstances constituting it must be alleged and proved in the court below. And the finding of said court as to its existence and non-existence

> is final unless clearly shown to be erroneous. As the court a quo found that no fraud was alleged and proved therein, We see no reason to entertain the Commissioner's assertion that the return was fraudulent." (Comm. of Int. Rev. v. Gonzales, et al., G. R. No. L-19495; underscoring supplied.)

Inasmuch as fraud has not been alleged and proven satisfactorily by respondent, the period of limitation for income tax assessment is five (5) years from the filing of petitioner's income tax return, according to Section 331 of the Tax Code, supra. (See Republic of the Philippines v. Rita Lim De Yu, G.R. No. L-17438, April 30, 1964.) (Since petitioner filed its income tax return for the fiscal year ended September 30, 1955 on November 29, 1955, respondent has the right to assess the deficiency income tax not later than November 29, 1960. The assessment in question having been issued by respondent on February 21, 1961 and received by petitioner on March 22, 1961, or more than five (5) years from the date of filing the return, the right of the Government to assess the deficiency tax in question has already prescribed.)

Third Issue -

Having arrived at the conclusion that the right of respondent to assess the 25% surtax has prescribed under Section 331 of the Revenue Code, it is idle and purposeless for the Court to dwell further into the merits of the case.

WHEREFORE, the decision of the respondent Commissioner of Internal Revenue assessing petitioner the amount of ₱758,687.04 as 25% surtax and interest is reversed. Accordingly, said assessment of respondent for 1955 is hereby cancelled and declared of no force and effect. Without pronouncement as to costs.

SO ORDERED.

Quezon City, June 20, 1968.

ESTANISLAO R. ALVAREZ
Associate Judge

I CONCUR:

RAMON L. AVANCEÑA
Associate Judge

Presiding Judge Roman M. Umali did not take part.