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HEIRS OF THE DECEASED
FLORENCIO REYES, et al.,
Petitioners,

- versus - C.T.A. CASE NO. 2288

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

Mar 17/75

D E C I S I O N

Petitioners have appealed from respondent's final decision assessing against and demanding from the late Florencio Reyes deficiency income tax for 1964 amounting to P135,368.42, computed as follows:

22-AR-530378-69/64

Net income per return - - - - - - - - -		P216,677.36
Add: Additional Income:		
1. Gain in the sale of land:		
Concepcion, Tarlac-	P184,331.48	
Polo, Bulacan - - -	15,283.00	199,614.48
Net income per investigation - - - -		P416,291.84
Less: Personal exemption - - - - - -		1,800.00
Amount subject to tax - - - - - - - -		P414,491.84
Tax due thereon - - - - - - - - - - - -		P213,930.00
Less: Amount already assessed - - - -		99,211.00
Balance - - - - - - - - - - - - - - - -		P114,719.00
Add: 1/2% monthly interest from 4-20-65 to 4-20-68 - - - - - - -		20,649.42
TOTAL AMOUNT DUE & COLLECTIBLE		P135,368.42

On March 18, 1969, Revenue Examiner Bienvenido T. Lobrin investigated the decedent's 1964 individual income tax return. He reported to respondent Commissioner of Internal Revenue that, in 1964, the sales of the decedent's real properties made by him personally during his lifetime are subject to the ordinary gains tax under Section 34 of the National Internal Revenue Code, the pertinent portion of which reads as follows:

> SEC. 34. Capital gains and losses. - (a) Definitions. - As used in this Title -
>
> (1) Capital assets. - The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (f) of Section thirty; or real property used in the trade or business of the taxpayer.
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> xx xx xx xx xx xx
>
> (b) Percentage taken into account. - In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:
>
> (1) One hundred per centum if the capital asset has been held for not more than twelve months;
>
> (2) Fifty per centum if the capital asset has been held for more than twelve months.
>
> xx xx xx xx xx xx

The heirs of the late Florencio Reyes protested the above-stated assessment on two grounds, namely: (1) the said assessment is illegal and invalid because it was not issued against the "estate of the said deceased"; and (2) his heirs were not given the opportunity to explain that the real properties sold by their deceased father in 1964 were capital assets.

Petitioners' protest was denied and disregarded by the respondent Commissioner of Internal Revenue when he issued a warrant of distraint and levy against the decedent's estate. Hence, this appeal.

The main issues submitted to this Court for resolution are the following:

(1) Whether or not the 1964 deficiency income tax assessment issued personally against the deceased Florencio Reyes was void *ab initio*; and

(2) Whether or not the profits realized in 1964 by the decedent from the sale of his real properties located in Tarlac and Bulacan were capital gains.

FIRST ISSUE:

Petitioners emphatically contend that since the disputed assessment was issued personally against their deceased father and not against the decedent's estate, the assessment in question is void *ab initio*. It is to be noted, however, that under Section 51 of the National Internal Revenue Code, before and after its amendment, in relation to Section 193 of Revenue Regulations No. 2, otherwise known as the Income Tax Regulations, all income tax assessments shall be issued against the persons subject thereto. However, if the individual taxpayer subject to income tax is already dead, the claims for income taxes may be properly presented in the intestate or testate proceedings of the deceased who owes them.[1] In brief, the income tax assessment issued against the deceased taxpayer individually is validly and legally made although the

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[1] Knowles v. Govt. of the P. I., 60 Phil. 461

collection thereof should be made against his estate or his heirs to the extent of the amount of property in their possession or the inheritance received by them from their deceased father.[1] It is clear therefore, that, if the income declared and the tax paid by the deceased taxpayer is erroneous, the respondent Commissioner of Internal Revenue has the power to assess and collect the additional income tax upon his return even after the death of the said taxpayer.[2]

Accordingly, we hold that the 1964 deficiency income tax assessment issued personally against Mr. Florencio Reyes was validly and legally made even after his death. After all, there is no provision in the National Internal Revenue Code requiring that the income tax assessment be issued against the estate of the deceased taxpayer except where the income tax returns are filed for the estate of the decedent under Section 56(3) of the same Code. In such a case, the deficiency income tax assessment should be issued against the estate of the deceased because it is the entity subject thereto.

SECOND ISSUE:

All classes of property not specifically excluded by Section 34(a) of the National Internal Revenue Code, *supra*, are capital assets. Under the provisions thereof, the

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[1]Commissioner of Int. Rev. v. Pineda, G. R. No. L-22734
Sept. 15, 1967

[2]Gov't. of the P. I. v. Pamintuan, 55 Phil. 13

following are ordinary assets, namely:

> 1. Stock in trade of the taxpayer or other property of a kind which would properly be excluded in the inventory of the taxpayer if on hand at the close of the taxable year;
>
> 2. Property held by the taxpayer primarily for sale to the customers in the ordinary course of his trade or business;
>
> 3. Property used in the trade or business which is subject to allowance for depreciation provided in subsection (f) of Section 30 of the Revenue Code; and
>
> 4. Real property used in the trade or business of a taxpayer.

Petitioners contend that the Tarlac and Bulacan real properties sold by their deceased father during his lifetime are capital assets and, therefore, the net gains realized from the sales thereof are only subject to 50% for income tax purposes. On the other hand, Revenue Examiner Bienvenido T. Lobrin considered the same real properties as ordinary assets and, therefore, the gains realized from the sales thereof are ordinary gains subject to full income tax under Section 34(b)(1) of the Tax Code. In concluding that the Tarlac and Bulacan real properties sold by the deceased are capital assets, Revenue Examiner Lobrin averred that the same properties were used in the "trade or business of the said taxpayer" as a "real estate dealer" under Section 194(s) of the National Internal Revenue Code.

The 1964 individual income tax return of the late Florencio Reyes and the inclosures attached thereto show that his total supposed rental income amounted to

₱185,794.05 and ₱10,500.00 thereof represents income of the Tarlac agricultural land which he reportedly acquired during the Japanese occupation. (See Supplement to 1964 income tax return - Schedule of Income Producing Properties, pp. 6 & 9, BIR rec.) The supposed rental income of the Tarlac property was paid by Mr. Jose Tobias. (p. 6, BIR rec.)

From the 1964 income tax return of the late Florencio Reyes and its inclosures, this Court is agreeable with the view of respondent that the Tarlac agricultural land, which was sold by the deceased during his lifetime, is an "ordinary asset" because it is one of the properties used in his "trade or business" as a real estate dealer. In the first place, he was duly provided with the real estate dealer's privilege tax in 1964. (Exh. 1-B-1, p. 8, BIR rec.) Secondly, he received ₱10,500.00 from Mr. Jose Tobias as supposed rental income of the Tarlac property. Thirdly, Mrs. Teresa R. Ignacio, daughter of the deceased Florencio Reyes testified that her father have no tenant who tilled the parcels of land in question during his lifetime and particularly in 1964. (T.s.n. p. 18). Fourthly, the decedent's income tax return and its inclosures failed to disclose any expenses for the cultivation of the Tarlac agricultural land such as seedlings, fertilizer, harvesting, irrigation, share of tenants, etc., which would justify that the same property was used exclusively for agricultural purposes. And finally, "the Tax Code's provision on so called long term capital gains constitutes a statute of partial exemption. In view of the familiar and settled rule that tax exemptions are construed in strictissimi juris against the taxpayer and liberally in favor of the taxing authority, the field of application of the term 'capital assets' is necessarily narrow, while its exclusions must be interpreted broadly. Consequently, it is the taxpayer's burden to bring himself clearly and squarely within the terms of a tax-exempting statutory provision, otherwise all fair doubts will be resolved against him." x x x. (Tuason v. Lingad, G. R. No. L-24248, July 31, 1974. underscoring supplied).

In assailing vigorously respondent's view that the Tarlac agricultural land is an ordinary asset, petitioners claim that the same property was acquired by the late Florencio Reyes for investment purposes and, therefore, it should be treated as a capital asset. Suffice it to say, any real property which was primarily held for rent is an ordinary asset. Thus, in the case of Coll. of Int. Rev. v. Bautista, G. R. No. L-12250, May 27, 1959, our Supreme Court held as follows:

> Thus the issue boils down to whether or not the aforementioned property was "used in the trade or business of the taxpayer." The Court of Tax Appeals answered the question in the affirmative, for the following reasons, which are well taken:
>
> > "The records show that the said property of petitioners was never occupied by petitioners as their residence. It was primarily held for rent. It is apparent that said property was used in the trade or business of petitioners and is, therefore, an ordinary asset. It follows that gain derived

from the sale of said property is
taxable in full." (Underscoring ours.)

After resolving the second question at issue, two (2) other collateral issues were raised by petitioners' counsel to reduce the 1964 deficiency income tax assessment issued personally against the late Florencio Reyes, to wit:

1. The real properties of the said decedent were sold in installment and not on cash basis because the down payment for the total purchase price does not exceed 25% thereof; and
2. The agricultural lands sold by the deceased Florencio Reyes are conjugal partnership properties, one-half of which belong to the estate of the late Salud Elchico, wife of the deceased Florencio Reyes.

It is the theory of petitioners that the gains derived from the sales of the decedent's properties should be declared for income tax purposes during the year when the installment payment was received by the seller in proportion to the gains realized by him during the taxable year. This view is untenable because a taxpayer has the option to declare his income either in cash or on accrual basis under Section 39 of the National Internal Revenue Code. As the late Francisco Reyes had opted to declare his gains from the sale of real properties on a cash basis, petitioners are now powerless to revoke the option exercised by their deceased father.

It is also the theory of the petitioners that the gains realized by their deceased father from the sales of the real properties in question should be divided equally between their deceased parents and taxed separately because the said gains were made from the sales of conjugal partnership properties. This theory and allegation of petitioners were repudiated in the Order of Judge Arsenio Santos, dated July 15, 1964, of the Court of First Instance of Manila in Special Proceedings No. 30210 entitled Intestate Estate of Salud Elchico de Reyes (Florencio Reyes, Administrator), wherein Judge Santos stated, among others, as follows:

> Another ground of the oppositors is that the money with which the said 2/4 portion was bought did not belong exclusively to the administrator but to the conjugal fund. This was also gainsaid by the said administrator as the price in the acquisition of the said portion was charged against his own and private fund. We gather also in said conferences that when the administrator purchased the disputed portion, he was already a widower, which appears in the certificate of title covering the whole parcel of land. (Exh. B, p. 41, CTA Rec.)

With respect to the gains derived by the late Florencio Reyes from the sale of the Bulacan property, respondent utterly failed to adduce any evidence that the said property was used in the trade or business of the deceased Florencio Reyes and it is, therefore, a capital asset. Consequently, we hold that the late Florencio Reyes correctly declared in his 1964 income tax returns the amount of P15,283.00 as 50% of gains derived from the sale of the Bulacan property in question.

In the light of the foregoing, there is still due and collectible from the estate of the late Florencio Reyes the 1964 deficiency income tax in the amount of ₱124,737.80, computed as follows:

Net income per return - - - - - - - - -	₱216,677.36
Add: Gain from the sale of Tarlac property - - - - - - - - - - - - -	184,331.48
Net income per investigation - - - -	₱401,008.84
Less: Personal exemption - - - - - -	1,800.00
Amount subject to tax - - - - - - - -	₱399,208.84
Tax due thereon - - - - - - - - - - - -	₱204,921.00
Less: Amount already assessed - - - -	99,211.00
Balance - - - - - - - - - - - - - - - -	₱105,710.00
Add: 1/2% mo. int. from 4-20-65 to 4-20-68 - - - - - - - - - - - -	19,027.80
TOTAL AMOUNT DUE & COLLECTIBLE.......	₱124,737.80

WHEREFORE, the decision of the respondent Commissioner of Internal Revenue is modified. Petitioners and/or administratrix of the estate of the late Florencio Reyes are hereby ordered to pay, jointly and severally, the respondent Commissioner of Internal Revenue or his collection agent the sum of ₱124,737.80 as 1964 deficiency income tax and penalty of the said deceased on or before this decision becomes final; otherwise the additional penalties prescribed by Section 51 of the National Internal Revenue Code shall be imposed and collected.

SO ORDERED.

Quezon City, March 12, 1975.

ESTANISLAO R. ALVAREZ

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

RAMON L. AVANCEÑA
Associate Judge

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