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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ISABELO P. LIM,
Petitioner,

versus

April 21/69

CTA CASE NOS. 846 & 869

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

These are separate appeals from two decisions of respondent: the first (CTA Case No. 846) holding petitioner liable for ₱775,466.00 as deficiency income tax and penalties for 1955 to 1957; and, the other (CTA Case No. 869) assessing petitioner the total of ₱515,190.19 as deficiency income tax and penalties for 1951 to 1953, and at the same time denying petitioner's claim for refund of ₱195,647.54 paid as income tax.

Petitioner, a Filipino, with address at 208 Vicenta Building., Nueva-Escolta Sts., Manila, is the president of Limpan Investment Corporation. He filed his individual income tax returns for 1951 to 1957, inclusive, and declared and reported therein the following:

Year	Net Taxable Income	Tax Due
1951	₱ 4,025.00	₱ 263.00
1952	2,001.00	100.00

1953	10,020.00	1,224.00
1954	2,850.00	168.00
1955	5,488.00	438.00
1956	6,792.00	463.00
1957	9,380.00	799.00
T o t a l	₱ 40,556.00	₱3,455.00

(Exhs. 13-C to 13-I, BIR rec., CTA Cases Nos. 846 & 869.)

On July 12, 1956, the Department of Finance received an unsigned letter dated June 30, 1956 denouncing petitioner for acquiring considerable real properties and suggested that an investigation be conducted to ascertain whether petitioner's mother, Vicenta Vda. de Lim, had been transferring her properties to petitioner, her only son, to avoid the payment of future estate and inheritance taxes. (Exh. L, p. 53, BIR rec., CTA Case No. 869.) This denunciation was referred to respondent for investigation (p. 4, BIR rec., CTA Case No. 869) and he assigned the case to Revenue Examiners Cesar M. Valdez and Ladislao S. Jimenez. On April 22, 1957, they recommended that petitioner be assessed for deficiency income taxes for 1951, 1952, 1953 and 1955, in the sums of ₱373,641.00, ₱10,455.00, ₱150,610.50 and ₱50,589.00, respectively, or a total of ₱585,295.00 (Exh. 8, pp. 60-64, BIR rec., CTA Case No. 869). These deficiencies were arrived at by the revenue examiners through the use of the "net worth-expenditures method" of investigation as petitioner had refused to show his records and books of accounts and to reveal his total net taxable income for 1946 to 1955. As shown in the income tax returns, petitioner's net income is very much less than the total cost of the buildings constructed by him and the amount invested by him within the same period. (Exh. 5, supra.)

On April 25, 1957, respondent informed petitioner of the proposed assessment. (Exh. 15, p. 65, BIR rec., CTA Case 869.) In reply thereto, petitioner's counsel, Mr. J. S. Pamintuan, disclaimed liability of his client for deficiency income taxes. (Exhs. 16 & 22, pp. 67-76, BIR rec., CTA Case 869.) However, as petitioner allegedly failed to substantiate his objections to the proposed assessment, respondent on November 6, 1957 assessed petitioner for deficiency income taxes and penalties in the total of ₱586,495.50 for 1951, 1952, 1953 and 1955. (Exh. 24, pp. 89-90, BIR rec., CTA Case No. 869.)

On December 12, 1957, petitioner requested respondent to reinvestigate and reconsider the above assessment. (Exh. 25, p. 91, BIR rec., CTA Case No. 869.) No action appears to have been taken on the said request. On October 31, 1958, however, respondent reiterated his demand for the payment of the amounts assessed against petitioner. On the same date, respondent issued a notice of seizure and sale of the shares of stock of petitioner in the Limpan Investment Corporation. (Exhs. 33 & 34, pp. 15-19, BIR rec., CTA Case No. 846.) On December 13, 1958, petitioner requested respondent to suspend the distraint on his properties until his request for reconsideration is decided. (Exh. 37, p. 33, BIR rec., CTA Case No. 846.) On January 15, 1959, respondent held in abeyance the sale of petitioner's shares in the Limpan Investment Corporation and granted his request for reinvestigation but only after he had executed a waiver of the statute of limitations, and filed a surety bond of ₱50,889.00 to answer for the 1955 deficiency income tax assessment. (Exhs. 38, 39, 40 & 41, pp. 36-41, BIR rec., CTA Case No. 846.)

In a letter dated January 24, 1959, petitioner specified the grounds of his request for reinvestigation. (Exh. 43, p. 44, BIR rec., CTA Case No. 846.) On August 6, 1959, <u>petitioner paid ₱129,000.00</u> under O. R. No. A-606231 and, in a letter dated August 11, 1959, requested that the said amount be applied to cover any deficiency income tax that may be finally assessed for the years in question (1951-1957). He further requested that the surety bond previously filed to answer for the 1955 deficiency income tax be cancelled. (Exh. 44, pp. 53-54, BIR rec., CTA Case No. 846.)

On October 30, 1959, Revenue Examiners Emiliano C. Montoya and Flaridel M. Mingoa submitted a report to respondent recommending the denial of petitioner's request for reconsideration because petitioner had only shown to them his bank balances for years subsequent to the period covered by the assessment. This act of petitioner was considered by the said revenue examiners as a deliberate concealment of income. In a separate report of the same date, they recommended to respondent that petitioner be assessed for deficiency income taxes for 1956 and 1957 and that the assessment for 1955 be increased from ₱50,889.00 to ₱147,611.50 as a result of the inclusion in petitioner's assets of ₱118,895.70 representing the loan receivable from Limpan Investment Corporation. (Exh. 46, pp. 111-112, BIR rec., CTA Case No. 846.)

On January 28 and 29, 1960, petitioner made payments amounting to ₱66,647.54 under O. R. Nos. A-1139677 and A-1139690 in partial settlement of his tax liabilities to justify the cancellation of the surety bond he had previously filed (pp. 142 & 147, BIR rec., CTA Case No. 846).

On April 13, 1960, respondent assessed petitioner the sums of ₱147,612.00, ₱502,465.00 and ₱125,389.00, as deficiency income taxes and penalties for 1955, 1956 and 1957, respectively, computed as follows:

<u>AR-2099-59/55</u>

Increase in Net Worth during 1955. . .	₱212,785.70
Add: Estimated Personal & family expenses	5,400.00
Net income per investigation.	₱218,186.00
Less: Personal & additional exemptions	5,400.00
Amount subject to tax	₱212,786.00
Tax due thereon	₱ 98,180.00
Less: Amount already assessed. . . .	439.00
B a l a n c e	₱ 97,741.00
Add: 50% surcharge	48,871.00
Compromise	1,000.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE	₱147,612.00

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Increase in Net Worth during 1956 . .	₱754,986.90
Add: Estimated Personal & family expenses	5,400.00
Net income per investigation.	₱760,387.00
Less: Personal & additional exemptions	5,400.00
Amount subject to tax	₱754,987.00
Tax due thereon	₱334,773.00
Less: Amount already assessed. . . .	463.00
B a l a n c e	₱334,310.00
Add: 50% surcharge	167,155.00
Compromise	1,000.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE	₱502,465.00

<u>90-AR-8270-59/57</u>

Increase in Net Worth during 1957. ..	₱235,330.00
Add: Estimated Personal & family expenses	6,000.00
Net income per investigation	₱241,330.00
Less: Personal & additional exemptions	6,000.00
Amount subject to tax	₱235,330.00

Tax due thereon	₱ 83,725.00
Less: Amount already assessed. .	799.00
B a l a n c e	₱ 82,926.00
Add: 50% surcharge	41,463.00
Compromise	1,000.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE	₱125,389.00

(See Exh. 49, pp. 149-150, BIR rec., CTA Case No. 846.)

Petitioner allegedly received the above-assessment on May 11, 1960 and filed his petition for review on June 10, 1960, which was docketed as CTA Case No. 846.

On March 16, 1960, petitioner requested the refund of ₱195,647.54 paid by him on August 6, 1959 and January 28 & 29, 1960. (Exh. 50, p. 156, BIR rec., CTA Case No. 846.) On June 3, 1960, respondent denied petitioner's claim for refund; reiterated his deficiency income tax assessments for 1955 to 1957; and assessed petitioner, after deducting the payments made by him, the total of ₱515,190.19 as deficiency income tax and penalties for 1951 to 1953, computed as follows:

Deficiency tax - 1951	₱373,641.00
1952	10,455.00
1953	150,610.50
Total deficiency taxes due.	₱534,706.50
5% surcharge on ₱534,706.00	26,735.33
1% int. on ₱534,706.00 from 11/29/57 to 8/6/59	108,147.08
Total	₱669,588.91
Less: Payment on August 6, 1959. .	129,000.00
Balance unpaid.	₱540,588.91
1% int. on ₱405,706.50 from 8/7/59 to 1/29/60	23,395.87
New Total	₱563,984.78

Net Total		₱563,984.78
Less: Payment on 1/29/60		66,647.54
Balance unpaid		₱497,337.24
1% int. on ₱339,058.96 from 1/30/60 to 6/30/60		16,952.95
Compromise in extrajudicial settlement:		
1951	₱300.00	
1952	300.00	
1953	300.00	900.00
T o t a l		₱515,190.19

(Exh. 51, pp. 165-166, BIR rec., CTA Case No. 846.)

The said assessment was received by petitioner on June 23, 1960. On July 23, 1960, petitioner filed with this Court a petition for review, docketed as CTA Case No. 869, which was amended on January 18, 1962.

The two cases (CTA Cases Nos. 846 & 869) were heard jointly inasmuch as the parties and the issues involved therein are identical (p. 25, CTA rec., Case No. 869; p. 2, t.s.n.).

On November 22, 1967, after the said cases have already been submitted for decision, we reset them for hearing for the reception of evidence as to the probable sources of petitioner's income aside from rentals from which his net worth increases might have been derived inasmuch as the records do not clearly establish this point (pp. 246-247, CTA rec., Case No. 846.) Despite the scheduled hearing, however, no additional evidence on the other sources of petitioner's income was adduced during the said hearing (p. 249, CTA Rec. No. 846).

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

1. Whether or not respondent was justified in using the "net worth-expenditures method" of tax investigation in determining deficiency income taxes;

2. Whether or not the deficiency income tax assessments are correct and valid; and

3. Whether or not the right of respondent to assess the deficiency income tax for 1951 has already prescribed under Section 331 of the National Internal Revenue Code, in relation to Section 332(a) of the same Code.

First Issue:

Petitioner questions the validity of the use of the net worth-expenditures method of investigation in determining the deficiency income tax from year to year. The use of the net worth-expenditures method is sanctioned by respondent's authority to reconstruct income. (See 1965 P-H Federal Taxes, par. 6873.) This authority springs from the provisions of Sections 15 and 38 of the National Internal Revenue Code. In fact, our Supreme Court has sustained and upheld respondent Commissioner of Internal Revenue in the use of the net-worth expenditures (inventory method) in determining the taxpayers' deficiency income taxes. (See the cases of Perez, G.R. No. L-10507, May 30, 1958; Li Yao, G.R. No. L-11875, Dec. 28, 1963; Avelino, G. R. Nos. L-14847 and L-17715, Sept. 19, 1961 and July

31, 1963; Maria Castro, G. R. No. L-12174, Apr. 26, 1962; and A. P. Reyes, G.R. Nos. L-11534 and L-11558, Nov. 25, 1958.)

Second Issue:

The basic concept of the "net worth increase method" (inventory method) in determining deficiency income tax of a taxpayer is as follows:

> . . . If the government can prove with reasonable certainty the taxpayer's "net worth," i.e., excess of assets over liabilities at a given date or starting point, generally December 31st of a given year, if the taxpayer is on the calendar year basis, and if the government is then able to prove by independent evidence such as bank deposits or purchase of assets, that the taxpayer's net worth has increased at the end of the tax year in question, then the inference is reasonable and therefore permissible that the increase in net worth, plus a reasonable allowance for living expenses for the period, and plus or minus adjustments for other items such as taxes paid, insurance premiums, depreciation, etc., represents income to the taxpayer. (Harry Braham Balter, Fraud Under Federal Tax Law, 1953 ed., p. 421.)

Aside from the "net worth increase method" of proving unreported income of a taxpayer, there is also the so-called "expenditure method". The essence of the expenditure method is reflected when a taxpayer has made large cash expenditures during a given year which exceeds all his known cash resources plus his reported income in his income tax return. This situation gives rise to the inference that the taxpayer has in fact earned more income than he has reported. However, the theory and elements of the "expenditures and net worth increase method" of determining deficiency income tax are practically identical. (See Rothwacks, Meyer on Tax Fraud Cases, Practice and Procedure, Section of Taxation, American Bar Assn., Mathew Bender & Co., Inc. 1951, p. 59.)

The yearly increase in net worth (unexplained wealth) or excess of yearly expenditures over known cash resources plus reported income of a taxpayer are the bases of respondent's deficiency income tax assessments in this case. However, the requisites for the application of the net worth-expenditures method of proving unreported income as discussed by the courts, tax authorities and commentators on the subject, are the following:

1. The taxpayer's books and records do not clearly reflect the income; the taxpayer has no books of accounts and records, or, if he has books and records, he refuses to produce or submit them for investigation and examination by authorized revenue officials and employees.

2. There is evidence of a possible source or sources of income to account for the yearly

increases in the net worth or expenditures.

3. There is a fixed starting point or opening net worth at the beginning of a taxable year or prior to it, wherein the taxpayer's financial condition can be affirmatively established with some definiteness.

4. The circumstances are such that the method clearly reflect the taxpayer's income with reasonable accuracy and certainty, and just and proper additions of personal expenses and other non-deductible expenditures were made, and correct, fair and equitable credit adjustments were given by eliminating non-taxable items such as inheritance, gifts, 50% capital gain, etc.)

The foregoing requisites appear to be present in this case. Petitioner refuses to produce his books of accounts and records for investigation by revenue examiners; rentals from real property are possible sources of petitioner's income; there is an opening net worth at the beginning of a taxable year or prior to it; and the method clearly reflects the taxpayer's yearly income subject, however, to the weight of evidences, testimonial and documentary, submitted to the Court for its evaluation.

The first condition for the use of the expenditures and net worth method is self-explanatory. The second condition imposes upon the revenue examiner the duty of ascertaining the likely source from which the yearly increases of the taxpayer's net worth or expenditures have been derived. Our Supreme Court, however, has relaxed the rule when in the Perez case, supra, it emphatically declared that the Government need not prove in a civil case the specific source of the taxpayer's income because the acquisitions of property are normally derived from the accumulation of taxable income. It is incumbent upon the taxpayer to prove how much acquisition was made from non-taxable sources like gifts, inheritances, loans, etc. The third condition is the most important of the four requirements because it is the cornerstone of any net worth case. If the starting point or opening net worth is uncertain and inaccurate, the net worth method of proving unreported income collapses, or the income tax supposedly due is adversely affected by sharp and abrupt reduction of the tax. The fourth condition is the end-product of the requirements for the successful use or application of the expenditures and net worth method of proving unreported yearly income.

<u>Opening Net Worth of
Mr. MABELO P. LIM
on December 31, 1950</u>.

The investigating revenue examiners reported to respondent that the beginning or opening net worth of petitioner on December 31, 1950 amounted to <u>₱85,259.60</u> consisting of cash on hand and land in the amounts of ₱15,799.60 and ₱73,950.00, respectively, less ₱4,490.00 as reserve for depreciation of building. Petitioner claimed, however, that his opening net worth should be <u>₱810,100.00</u> consisting of cash on hand, land, and buildings and elevator in the respective amounts of ₱192,-000.00, ₱47,600.00 and ₱570,000.00.

Petitioner alleged that his cash on hand on December 31, 1950 amounted to ₱192,500.00. This allegation is partially substantiated. Petitioner testified that four (4) debtors paid him a total of ₱111,000.00 from 1945 to 1950 but his pretensions were neither supported by any documentary evidence nor corroborated by the said debtors. Consequently, the said amount will be excluded from petitioner's opening net worth.

Petitioner also testified that in 1950 or earlier he received ₱16,500.00 from the War Damage Commission in payment of his war damage claim but the only evidence submitted to the Court is a copy of the claim application which in itself is not an evidence of payment. He further testified that in 1950 he had cash on hand amounting to ₱10,000.00 to be used for subsistence, maintenance and needs of his family. The testimonial evidence of petitioner on this point was based on conclusions and generalities which is self-serving. We hold, therefore, that the total of ₱26,500.00 should be excluded from petitioner's opening net worth.

Petitioner's cash in bank on December 31, 1950, which is supported by documentary evidence, is itemized and listed as follows:

1.	Monte de Piedad and Savings Bank - Savings a/c No. 5317 . . . . (Exh. 14-A, p. 128 CTA Case No. 846.)	₱22,772.15
2.	Philippine Bank of Commerce - Current A/c with Vicenta Vda. de Lim . . . . (Exh. 14-A; id.) (½ of ₱29,166.83)	14,583.42
3.	Philippine National Bank A/c No. 24924 (Exh. B) . .	10,193.23
	" " 19503 " " . .	605.55
	" " 24919 " " . .	301.73
4.	National City Bank of NY - Savings A/c with Vicenta Vda. de Lim - ½ of ₱217.06 (Exh. DD)	108.53
	T O T A L. . . .	₱ 48,564.61

The current and savings account deposited in the names of petitioner and/or his mother were divided equally between the two depositors in the absence of evidence that the same belongs exclusively to the petitioner. The savings deposit in the names of petitioner and/or his children were included in petitioner's cash on hand on December 31, 1950 because the said children are minors and without any visible means of income. For obvious reason, Savings Account No. 22065 in the amount of ₱10,207.06 and deposited with the PNB in the names of Vicenta Vda. de Lim and/or Mario P. Lim was excluded from petitioner's cash on hand on December 31, 1950. Hereafter, petitioner's accounts and deposits in banks with his mother will be apportioned in the manner computed above.

Buildings of petitioner on December 31, 1950.

The Vicenta Building on Nueva St., Manila, and the Otis elevator installed therein, valued at ₱200,000.00 and ₱45,000.00, respectively, should be included in the opening net worth of petitioner. This conclusion is based on the evidence adduced by the petitioner which is not disputed by respondent in his memorandum (pp. 16-17, Respondent's memo., CTA 846, pp. 237-238).

The Gilda Building at Espeleta St., Manila, valued at ₱250,000.00, was considered as a substantial part of petitioner's opening net worth by alleging that the same was substantially completed at the end of 1950 or early in 1951. Petitioner claimed that ₱210,500.00 was spent by him for the said building at the end of 1950 (Exh. C, p. 52, CTA 846.). The evidences in support of the alleged expenditures are not convincing to be sustained. On the contrary, the various workers' time books submitted by petitioner in evidence (Exhs. GG-5, GG-7, GG-8, GG-3 and GG-2) show that the labor force used in the construction of the Gilda Bldg. was paid for services rendered covering the period from May 27, 1950 up to September 28, 1951, or a period of 16 months. It cannot be said, therefore, that Gilda Bldg. was substantially finished at the end of December 1950 because it took almost 9 months thereafter to finish the construction of said building. As the Gilda Bldg. was valued at ₱250,000.00 and 7/16 thereof was completed in 1950, the amount of ₱109,375.00 should be included as a part of the opening net worth of petitioner on December 31, 1950.

As to the Liberty Building at Soler St., Manila, valued by petitioner at ₱300,000.00 in his 1953 income tax return (Exh. 13-E, p. 33, BIR rec. C 869.), petitioner claimed that ₱100,000.00 thereof forms part of his opening net worth because of the amount spent by him for the construction of the said building. The evidence shows, however, that the building permit for the construction of said building was issued by the City Engineer's Office on January 26, 1952, and, therefore, the said building was not in existence in 1950 or 1951.

Petitioner testified that at the end of 1950, the construction cost of Liberty Bldg. amounted to ₱100,000.00 (pp. 69, 95, 117, 155, 173 and 174, t.s.n.) while petitioner's witness, Mr. Venancio Manipol, admitted that the expenses for the said building in 1950 amounted to ₱50,000.00 (p. 296, t.s.n.). After examining the income tax returns of petitioner from 1951 to 1953 (Exhs. F, G and H) and the yearly summary of building expenditures incurred by the taxpayer (Exh. GG-16), we hold that petitioner had not invested any amount for the construction of said building from 1950 to 1952.

The opening net worth, therefore, of petitioner on December 31, 1950 amounted to ₱472,399.61, computed and itemized as follows:

<u>As of December 31, 1950</u>

<u>Assets</u> -

Cash on hand (Current & savings account) . . . . . . ₱ 48,564.61

Real estate - Land	₱ 73,950.00
Real estate - Vicenta Bldg. & elevator . .	245,000.00
Real estate - Gilda Bldg.. .	109,375.00
Total Assets . .	₱476,889.61
Reserve for depreciation - Building	4,490.00
Opening Net Worth	₱472,399.61

The residential building of petitioner at San Juan, Rizal, valued at ₱10,000.00, was already included by the revenue examiners in the value of the real estate (land) amounting to ₱73,950.00. The fact that petitioner's valuation of the land amounted to only ₱47,000.00, instead of ₱73,950.00 as reported by the revenue examiners, will not prejudice the said petitioner because the increased valuation, which was consistently carried from year to year, will not adversely affect the taxpayer's yearly increase in net worth.

The worksheet of the revenue examiners show that petitioner had no cash on hand on December 31, 1951. During the trial of the case, however, it was shown that petitioner had cash in banks amounting to ₱39,855.83, computed as follows:

Monte de Piedad	₱ 26,120.88
Philippine Bank of Commerce (½ of ₱17,407.90) . . .	8,703.95
National City Bank (½ of ₱10,062.00) . . .	5,031.00
T O T A L	₱ 39,855.83

(Exhs. EE, FF and DD.)

The increase in the net worth of petitioner on December 31, 1951 amounted to ₱127,916.22 and the deficiency income tax and 50% surcharge due thereon are itemized and computed as follows:

<u>As of December 31, 1951</u>

Cash on hand	₱ 39,855.83
Land	73,950.00
Buildings (Vicente & Gilda)	495,000.00
Total Assets	₱608,805.83
Less: Reserve for depreciation	8,490.00
Ending Net Worth	₱600,315.83
Deduct: Net Worth, beginning	472,399.61
Increase in Net Worth	₱127,916.22
Income tax due thereon	₱ 51,816.00
Less: Amount already assessed	794.00
Deficiency income tax	₱ 51,022.00
Add: 50% surcharge	25,511.00
Total deficiency tax & surcharge	₱ 76,533.00

The personal, family and living expenses of petitioner in the sum of ₱4,200.00, which represented non-deductible items, were not added to the 1951 net worth of petitioner in determining his net income subject to tax because the personal and additional income tax exemptions of petitioner amounted to ₱4,200.00 also. In the absence of evidence that the personal, family and living expenses of petitioner were higher or lower than his personal and additional tax exemptions, the same items were not reflected in the figures stated above because of the balancing effect of the inclusion and deduction thereof from petitioner's net worth. For the succeeding years, we will disregard the said items and they will not be reflected in the computation of net worth for the sake of expediency despite the accounting entry required by the inventory method.

The cash in banks of petitioner on December 31, 1952 amounted to ₱159,051.17, computed as follows:

Monte de Piedad	₱ 21,393.06
Philippine Bank of Commerce (½ of ₱33,351.72)	16,675.86
National City Bank (½ of ₱10,673.00)	5,336.50
Bank of America	115,645.75
Total	₱159,051.17

(Exhs. EE, FF, DD and 14-A.)

On December 31, 1952, the value of the buildings and elevator of petitioner in 1951 was increased by ₱45,000.00, thereby making a total of ₱540,000.00, because of the addition of petitioner's wooden buildings at Bermuda and T. Pinpin Streets, Manila.

The increase in the net worth of petitioner on December 31, 1952 amounted to ₱150,445.34 and the deficiency income tax and 50% surcharge due thereon are itemized and computed as follows:

As of December 31, 1952

Cash on hand	₱159,051.17
Land	73,950.00
Buildings	540,000.00

Total Assets	₱773,001.17
Less: Reserve for depreciation	22,240.00
Ending Net Worth	₱750,761.17
Less: Net Worth, beginning	600,315.83
Increase in Net Worth	₱150,445.34
Income tax due thereon	₱ 63,860.00
Less: Amount already assessed	100.00
Deficiency Income Tax	₱ 63,760.00
Add: 50% surcharge	31,880.00
Total deficiency tax & surcharge	₱ 95,640.00

Petitioner's cash in banks on December 31, 1953 amounted to ₱150,058.66 as shown hereunder, to wit:

Monte de Piedad	₱ 21,745.17
Philippine Bank of Commerce (½ of ₱40,616.53)	20,308.27
National City Bank (½ of ₱10,673.00)	5,336.50
Bank of America	102,668.72
Total	₱150,058.66

(Exhs. EE, FF, DD and 14-A.)

For depreciation purposes, petitioner declared in his 1953 income tax return a semi-concrete building at Soler St., Manila, valued at ₱300,000.00. Consequently, the value of the buildings and elevator of petitioner at the end of 1953 amounted to ₱840,000.00.

The increase in the net worth of petitioner in 1953 amounted to ₱266,257.49 and the deficiency income tax and 50% surcharge due thereon are as follows:

As of December 31, 1953

Cash on hand	₱ 150,058.66
Land	73,950.00
Buildings	840,000.00
Total Assets	₱1,064,008.66
Less: Reserve for depreciation	46,990.00
Ending Net Worth	₱1,017,018.66
Less: Net Worth, beginning	750,761.17
Increase in Net Worth	₱ 266,257.49
Income tax due thereon	₱ 97,333.00
Less: Amount already assessed	883.00
Deficiency income tax	₱ 96,450.00
Add: 50% surcharge	48,225.00
Total deficiency tax & surcharge	₱ 144,675.00

The cash in banks of petitioner on December 31, 1954 amounted to ₱170,400.59, computed as follows:

Monte de Piedad	₱ 5,933.95
Philippine Bank of Commerce (½ of ₱28,120.86)	14,060.43
National City Bank (½ of ₱86,270.00)	43,135.00
Bank of America	107,271.21
Total	₱ 170,400.59

(Exhs. EE, FF, DD and 14-A.)

The net worth of petitioner on December 31, 1954 amounted to ₱1,008,110.59, computed as follows:

As of December 31, 1954

Cash on hand	₱ 170,400.59
Land	73,950.00
Buildings	840,000.00
Total Assets	₱1,084,350.59
Less: Reserve for depreciation	76,240.00
Ending Net Worth	₱1,008,110.59

Ending Net Worth	₱1,008,110.59
Less: Net Worth, beginning	1,064,098.66
No increase in net worth	(Exempt)

The cash in banks of petitioner on December 31, 1955 amounted to ₱4,801.71, computed as follows:

Monte de Piedad	₱ 1,048.73
Philippine Bank of Commerce (½ of ₱2,733.92)	1,366.96
National City Bank (½ of ₱3,097.00)	1,548.50
Bank of America	837.52
Total	₱ 4,801.71

(Exhs. EE, FF, DD and 14-A.)

In 1955, petitioner sold two (2) lots for ₱27,900.00 (Exhs. 10 & M-1), thereby reducing the value of the land from ₱73,950.00 to ₱44,050.00. The increase in the net worth, therefore, of petitioner at the end of 1955 amounted to ₱76,646.82 and the deficiency income tax and surcharge due thereon are computed as follows:

<u>As of December 31, 1955</u>

Cash on hand	₱ 4,801.71
Land	44,050.00
Buildings	840,000.00
Automobile	7,500.00
Limpan Investment Corp. (Stocks)	175,000.00
Limpan Investment Corp. (Loan Receivable)	118,895.70
Total Assets	₱1,190,247.41
Less: Reserve for depreciation	105,490.00
Ending Net Worth	₱1,084,757.41
Less: Net Worth, beginning	1,008,110.59
Increase in Net Worth	₱ 76,646.82

Income tax due thereon	₱ 25,878.00
Less: Amount already assessed	439.00
Deficiency income tax	₱ 25,439.00
Add: 50% surcharge	12,719.50
Total deficiency tax & surcharge	₱ 38,158.50

The cash in banks of petitioner on December 31, 1956 amounted to ₱6,091.22, computed as follows:

Monte de Piedad	₱ 1,075.17
Philippine Bank of Commerce (½ of ₱4,165.05)	2,082.53
National City Bank (½ of ₱4,192.00)	2,096.00
Bank of America	837.52
Total	₱ 6,091.22

(Exhs. EE, FF, DD and 14-A.)

The following buildings and their accessory (elevator) were sold by petitioner in 1956, itemized as follows:

Gilda Bldg. (Espeleta, Manila)	₱250,000.00
Vicenta Building & elevator (Nueva St.)	245,000.00
Liberty Building (Soler, Manila)	300,000.00
Total	₱ 795,000.00

Deducting the said amount of ₱795,000.00 from the buildings of petitioner valued at ₱840,000.00 in 1955, the remaining value of his buildings at the end of 1956 would be ₱45,000.00 only. On February 26, 1956, petitioner sold to Limpan Investment Corporation a lot for ₱3,720.00 (Exh. 47-A). Deducting the amount of ₱3,720.00 from the land of petitioner valued at ₱44,050.00 in 1955, the remaining value of his land at the end of 1956 would be ₱40,330.00. In 1956, Mr. & Mrs. Isabelo P. Lim invested ₱1,427,400.00 in shares of stock of Limpan Investment Corporation. At the end of the same year, petitioner had loans receivable from the said corporation amounting to ₱312,000.00.

It is to be noted that Limpan Investment Corporation (Limpan for short) was organized in June, 1955 with petitioner as its president (p. 25, t.s.n.). He and his wife owned majority (95%) of the shares of Limpan which was capitalized at ₱5,000,000.00 (p. 312, t.s.n.). In 1955, Mrs. Vicenta Vda. de Lim transferred to Limpan real property valued at ₱610,500.00 in exchange for 6,105 shares of stock. These shares of stock of Limpan were not issued to Mrs. Vicenta Vda. de Lim; instead they were subsequently issued to petitioner. This accounts for the huge investment of Mr. & Mrs. Isabelo P. Lim in Limpan amounting to ₱1,427,400.00 in 1956 although their original investment thereto amounted to ₱175,000.00 only in 1955.

The transfer by Mrs. Vicenta Vda. de Lim to Limpan of properties worth ₱610,500.00 and the issuance of 6,105 shares of stock of Limpan to petitioner is indeed an extraordinary business practice.

A normal corporate transaction calls for the issuance of shares of stock to the owner of the property transferred and not to somebody else. But the petitioner claimed that he issued a promissory note in favor of his mother acknowledging the debt of ₱610,500.00 representing the par value of 6,105 shares of stock of Limpan (Exh. KK). We are inclined to sustain that in 1956 petitioner was indebted to his mother, Mrs. Vicenta Vda. de Lim in the amount of ₱610,500.00. In the first place, Limpan is a family corporation under the control of petitioner. In the second place, Isabelo P. Lim and Mrs. Vicenta Vda. de Lim, as early as July 30, 1947, have constituted and appointed each other as attorney-in-fact (Exh. M, CTA Case No. 1139 [1958]). In the third place, in 1950 and the years thereafter, both parties (mother and son) have joint bank accounts with the Philippine Bank of Commerce and the National City Bank of New York, thereby showing the explicit trust of the mother to her son. In the fourth place, considering the very advanced age (84 years) of Mrs. Vicenta Vda. de Lim, the administration of her real properties and the investment of her assets were entirely left to the discretion of her only son, Isabelo P. Lim. In the fifth place, the loan of ₱610,500.00 did not involve any cash transaction between mother and son. Finally, the foregoing facts are corroborated in the denunciation of the informer, dated June 20, 1956, that petitioner's mother, Vicenta Vda. de Lim, had been transferring her properties to petitioner to avoid the payment of future estate and inheritance taxes (Exh. L, p. 53, BIR rec., CTA Case No. 869). The amount of ₱610,500.00 is, therefore, a liability of petitioner in 1956 and 1957 and should be considered in determining his net worth during the said years.

The increase in the net worth of petitioner at the end of 1956 amounted to ₱136,734.41 and the deficiency income tax and 50% surcharge due thereon are shown hereunder, to wit:

As of December 31, 1956

Cash on hand		₱ 6,091.22
Land		40,330.00
Buildings		45,000.00
Automobile		7,500.00
Limpan Investment Corp. (stocks)		1,427,400.00
Limpan Investment Corp. (Loans Receivable)		312,000.00
Total Assets		₱1,838,321.22
Less: Accounts Payable	₱610,500.00	
Reserve for depreciation	6,329.40	616,829.40
Ending, Net Worth		₱1,221,491.82

Ending, Net Worth	₱1,221,491.82
Less: Net Worth, beginning	1,084,757.41
Increase in net worth	₱ 136,734.41
Income tax due thereon	₱ 41,874.00
Less: Amount already assessed	463.00
Deficiency income tax	₱ 41,411.00
Add: 50% surcharge	20,705.50
Total deficiency tax & surcharge	₱ 62,116.50

The cash in bank of petitioner on December 31, 1957 amounted to ₱2,032.61 as shown hereunder:

Philippine Bank of Commerce (½ of ₱4,065.22) (Exh. FF of petitioner.)	₱ 2,032.61

In 1957, petitioner sold a lot at T. Pinpin, Manila, to Limpan at ₱5,930.00 (Exh. 47-A). Deducting the said amount from the land of petitioner valued at ₱40,330.00 in 1956, the remaining value of his land at the end of 1957 would be ₱34,400.00. At the end of the same year, petitioner had loans receivable from the said corporation amounting to ₱546,130.00 (Exh. 47-A, BIR rec., p. 85, CTA Case 846).

The increase in the net worth of petitioner at the end of 1957 amounted to ₱219,641.39 and the deficiency income tax and 50% surcharge due thereon are shown hereunder, to wit:

	As of December 31, 1957
Cash on hand	₱ 2,032.61
Land	34,400.00
Buildings	45,000.00
Automobile	7,500.00

Limpan (stocks)		1,427,400.00
Limpan (Loans Receivable)		946,130.00
Total Assets		₱2,062,462.61
Less: Accounts Payable	₱610,500.00	
Reserve for depreciation	10,829.40	621,329.40
Ending Net Worth		₱1,441,133.21
Less: Net Worth, beginning		1,221,491.82
Increase in net worth		₱ 219,641.39
Income tax due thereon		₱ 76,822.00
Less: Amount already assessed		799.00
Deficiency income tax		₱ 76,023.00
Add: 50% surcharge		38,011.50
Total deficiency tax & surcharge		₱ 114,034.50

Petitioner's principal defense is that his yearly increases in net worth are not income but non-taxable receipts derived from cash loans given by his mother, Mrs. Vicenta Vda. de Lim. The said loans are not reflected in petitioner's books of accounts since he refused to have them examined and investigated by the revenue examiners. At the hearing of this case, no evidence whatsoever was presented to show that petitioner's mother was financially capable of giving the alleged loans amounting to ₱600,000.00 from 1951 to 1956 (p. 261, t.s.n.). Her income tax returns for various years, whether before, during or after the loans were allegedly given, were not submitted in evidence to prove her financial resources and capacity to grant the monetary loans. Even the tax census returns of petitioner's mother have not been submitted in evidence to show at least the financial capacity of the alleged lender. Her testimony on this point is evasive and of doubtful credibility considering the close relationship between the witness and the petitioner. The defense invoked by the petitioner, therefore, that his yearly increases in net worth came from non-taxable sources is not supported by the preponderances of evidence and should be ignored and cast aside.

50% Surcharge -

The 50% surcharge prescribed by Section 72 of the National Internal Revenue Code was imposed on petitioner's deficiency income tax because the income tax returns filed by him during the years covered by the tax assessments were considered fraudulent. From 1951 to 1957, petitioner declared in his income tax returns a total net taxable income of ₱40,556.00 only and paid to the Bureau of Internal Revenue a total of ₱3,455.00 as income tax for the said years, supra. On the bases of the findings of this Court, however, the net taxable income of petitioner in 1951, 1952, 1953 and 1955, 1956 and 1957 amounted to ₱127,916.22, ₱150,445.34, ₱266,257.49 and ₱76,646.82,

₱136,734.41 and ₱219,641.39, respectively. Under the circumstances, the huge and staggering under-declaration of net taxable income for a period of six (6) years made the imposition of the fraud penalty (50% surcharge) proper and imperative.

After determining and holding that petitioner is subject to the deficiency income tax under the "net worth-expenditures method" of tax investigation, we find that the balance of petitioner's deficiency income tax amounted to ₱335,509.96, computed as follows:

Year Involved	Deficiency Income Tax
1951	₱ 76,533.00
1952	95,640.00
1953	144,675.00
1955	38,158.50
1956	62,116.50
1957	114,034.50
T o t a l	₱ 531,157.50
Less: Amount paid	195,647.54
BALANCE	₱ 335,509.96

On the basis of the foregoing figures, petitioner's claim for the refund of ₱195,647.54 as erroneously paid deficiency income tax becomes untenable.

Third Issue:

On November 7, 1957, respondent assessed petitioner the sum of ₱373,641.00 as deficiency income tax and 50% surcharge for 1951. Under the income tax law before its amendment by Republic Act No. 2343, petitioner's 1951 income tax return should have been filed on or before March 1, 1952. There is no dispute that petitioner's 1951 income tax return was filed on time. Consequently, under Section 331 of the Tax Code, respondent's right to assess petitioner's 1951 deficiency income tax prescribed after March 1, 1957.

The prescriptive period of five (5) years embodied in Section 331 of the Tax Code, authorizing respondent to assess internal revenue taxes within the said period after the last day for the filing of a return, is subject to certain exceptions. (Under Section 332(a) of the same Code, the deficiency income tax due from petitioner may be assessed within ten (10) years after the discovery of the fraud. In the case at bar, we find that the declarations in the income tax returns filed by petitioner from 1951 to 1957 (except 1954) were false or fraudulent with the intent to evade the income tax. Accordingly, we hold that the right of respondent to assess petitioner's 1951 deficiency income tax has not prescribed although the same was issued beyond the five-year period.)

Deficiency interest of 1% a month.

An examination of the records of the BIR submitted to the Court shows that petitioner's deficiency income tax liability for 1951, 1952, 1953 and 1955 in the total of ₱586,495.50 was assessed by respondent on November 7, 1957 (Exh. 24, pp. 89-90, BIR rec., CTA Case No. 869). This assessment was revised on June 3, 1960 by eliminating the 1955 deficiency income tax of petitioner and imposing on the deficiency income tax for 1951, 1952 and 1953 the interest of 1% a month for delinquency (Exh. 51, pp. 165-166, BIR rec., CTA Case No. 846). On April 13, 1960, respondent assessed petitioner for deficiency income tax and penalties in the total of ₱775,-446.00 for the years 1955, 1956 and 1957. It will thus be seen that petitioner's income tax liability for 1957 and prior years were assessed after the effectivity of Republic Act No. 2343, which took effect on June 20, 1959, amending Section 51 of the Tax Code relative to interest.

Respondent's revised deficiency income tax assessment dated June 3, 1960 against petitioner for 1951, 1952 and 1953 deficiency income tax included the delinquency interest of 1% a month imposed by Section 51(d) of the National Internal Revenue Code before its amendment by Republic Act No. 2343. The Supreme Court, however, held that respondent Commissioner of Internal Revenue can impose ½% monthly interest (6% per annum) on the deficiency income tax due on income earned prior to 1959 but assessed after June 20, 1959 when Republic Act No. 2343 became effective, provided that the ½% monthly interest on the deficiency income tax is imposed from the date of the effectivity of said law but not exceeding a period of three (3) years, or a total of 18% (Central Azucarera Don Pedro, G.R. No. L-23236, May 31, 1967).

WHEREFORE, the decisions of the respondent Commissioner of Internal Revenue appealed from are modified. Petitioner is hereby ordered to pay respondent or his duly authorized collection agent the balance of his deficiency income tax liability for 1951, 1952, 1953, 1955, 1956 and 1957 in the sum of ₱335,509.96, plus 18% deficiency interest. If the said amount is not paid within thirty (30) days from the date this decision becomes final and executory, petitioner shall pay a surcharge of 5% of the unpaid income tax plus a delinquency interest of 1% a month on the unpaid deficiency income tax until fully paid provided that the maximum amount that may be collected as 1% delinquency interest per month shall not exceed a period of three (3) years, or 36%. Without pronouncement as to costs.

SO ORDERED.

Quezon City, April 21, 1969.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

R M Umali
ROMAN M. UMALI
Presiding Judge

Ramon L Avanceña
RAMON L. AVANCEÑA
Associate Judge