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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

September 29, 1960

ESTEFANIA R. PIROVANO,
Petitioner,

- versus -

C.T.A.
CASE NO. 524

THE COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

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D E C I S I O N

The petitioner has appealed from the decision of the respondent holding her liable for the payment of deficiency income tax, plus 50% surcharge, for the years 1950 and 1951, itemized and computed as follows:

1950 Net Income as per return --	₱110,141.05
Add: Undeclared dividends from the De la Rama Steamship Co., Inc. -------	221,975.45
Disallowed claims for deductions (no proof) ----	10,283.50
Net Income as per investigation ----------------------	₱342,400.00
Less: Personal & additional exemptions -------------	5,400.00
Amount of income subject to tax ------------------------	₱337,000.00
Tax due thereon ---------------	₱168,980.00
Less: Amount previously assessed ---------------	39,685.00
Balance of tax due ------------	₱129,295.00
Add: 50% Surcharge ------------	64,647.50
TOTAL AMOUNT DUE AND COLLECTIBLE --------------	₱193,942.50
1951 Net income as per return --	₱ 5,269.64
Add: Undeclared dividends from the De la Rama Steamship Co., Inc. ------	106,380.00
Undeclared Director's bonus from the De la Rama Steamship Co., Inc. -	1,506.31
Net income as per investigation --------------------	₱113,155.95
Less: Personal & additional exemptions --------------	5,400.00

Amount of income subject to tax	₱107,755.95
Tax due thereon	₱ 41,253.00
Add: 50% Surcharge	20,626.50
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 61,879.50

On May 26, 1958, respondent filed a motion to dismiss the appeal on the ground that it was filed out of time. The motion to dismiss was denied in our resolution of October 6, 1958. (See pages 92-99, C.T.A. records.) The case was then set for hearing on the merits. During the hearing the parties submitted solely documentary evidence, after which they submitted their respective memorandum.

The records show that the deficiency income tax assessed against petitioner for the years 1950 and 1951 was brought about principally by the failure of petitioner to declare in her income tax returns for said years the dividends which she allegedly received from De la Rama Steamship Co., Inc. in the sums of ₱221,975.45 for 1950 and ₱106,380.00 for 1951. The correctness of the disallowance of certain deductions claimed by petitioner in her income tax return for 1950 in the sum of ₱10,283.50 and the finding of respondent as to the undeclared bonus of ₱1,506.31 for 1951 is apparently admitted by petitioner.

It appears that De la Rama Steamship Co., Inc. declared a dividend of 100% for the year 1950, as a consequence of which petitioner was entitled to receive as her share the sum of ₱342,400.00. Of the said sum of ₱342,400.00, only the sum of ₱120,424.55 was actually paid to petitioner. The balance of ₱221,975.45 was withheld by the Corporation and applied in partial settlement of petitioner's alleged indebtedness. For the year 1951, another dividend was declared by De la Rama Steamship Co., Inc. Petitioner's 1951 dividend was ₱106,380.00, but only the amount of ₱4,436.93 was actually paid to her, the sum of ₱101,943.07 having been withheld by the Corporation and applied in settlement of the balance of petitioner's alleged indebtedness. Petitioner assailed the right of the Corporation to withhold a part of the dividends to which she was entitled on the ground that whatever obligation she had with the Corporation was assumed by her deceased father. Her claim having been denied, she instituted against the Corporation an action in court (Civil Case No. 1392 of the Court of First Instance of Rizal) for recovery of the amount withheld by said Corporation. The case having been decided against her, she appealed to the Supreme Court (G. R. No. L-6817).

In the meantime, respondent assessed against petitioner the deficiency income tax referred to above, together with the surcharge of 50% as fraud penalty, pursuant to Section 72 of the National Internal Revenue Code. Petitioner sought a reconsideration of the assessment on the ground that she had no obligation with De la Rama Steamship Co., Inc., and therefore the application by said Corporation of a part of her dividends to the alleged indebtedness can in no way be construed as constructive receipt by her of the dividends withheld. She admitted, however, that if she was legally indebted to the Corporation, the withholding of said dividends and their application to the indebtedness may be considered as constituting constructive receipt by her of said dividends in the years they were so applied, and taxable to her in said years.

On July 31, 1958, the Supreme Court affirmed the decision of the Court of First Instance of Rizal in Civil Case No. 1392. There is, therefore, no longer any question as to the existence of the indebtedness and the legality of the application of a portion of petitioner's dividends to said indebtedness. It is likewise admitted that said dividends are taxable in 1950 and 1951. Accordingly, the only issues presented for our consideration are: (1) whether or not the right of the Government to assess and collect the deficiency income tax has prescribed; and (2) whether or not petitioner is liable for the surcharges, interest and other penalties, in the event that the right to assess and collect said deficiency income tax has not prescribed.

It is argued that the right of the Government to assess the deficiency income tax in question has prescribed as the assessment was made after three years from the dates the 1950 and 1951 income tax returns of petitioner were filed, pursuant to Section 51(d)[1] of the National Internal Revenue Code. The applicability of Section 51(d) of the Revenue Code to the right of the Government to assess and collect income tax has already been definitely settled by the Supreme Court in cases too numerous to require enumeration. It is enough to cite here the recent case of Alhambra Cigar & Cigarette Manufacturing Company v. Collector of Internal Revenue, G. R. Nos. L-12026 and L-12131, May 29, 1959, wherein it was stated:

> "It is well settled that taxes may be collected, either by distraint, or by judicial action. The period of three years prescribed in said section 51(d) refers to the assessment for purposes of 'immediate' collection of the tax due, that is to say, by summary proceeding or distraint. The aforementioned provision does not bar assessment as a step preliminary to collection by judicial action. (Coll. of Internal Revenue v. Villegas, 56 Phil., 554.)"

This was reiterated in Collector of Internal Revenue v. Bohol Land Transportation Co., G. R. Nos. L-13099 & L-13462, April 29, 1960. Therefore, the statute of limitation properly applicable to this case is Sections 331 and 332 of the Revenue Code providing that the right to assess internal revenue taxes prescribes after five years from the date the return was filed or was due, and that the right to collect the tax, if assessed within the statutory period, prescribes after five years from the date of assessment.

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[1] Repealed by Rep. Act No. 2343.

There is no question that the assessment in this case was made within five years from the dates the income tax returns of petitioner for 1950 and 1951 were filed or were due, and that judicial action for its collection was instituted within five years from the date of assessment when petitioner filed her petition for review with this Court on April 24, 1958.

With respect to the second issue, petitioner contends that it is not proper to impose upon her the 50% surcharge (fraud penalty), 5% surcharge for delinquency, 1% monthly interest, and compromise. The said surcharges and penalties, in relation to the deficiency income tax assessed against petitioner are itemized as follows:

For 1950:

Deficiency income tax -------		₱129,295.00
Surcharges & penalties:		
50% surcharge --	₱64,647.50	
5% surcharge ---	9,692.12	
1% monthly interest from 2/1/56 to 2/28/58 ------	48,485.50	
Compromise for late payment -	50.00	122,875.12
Total ----------------------		₱252,170.12

For 1951:

Deficiency income tax --------		₱ 41,253.00
Surcharges & penalties:		
50% surcharge ----	₱20,626.50	
5% surcharge ---	3,093.97	
1% monthly interest from 2/1/56 to 2/28/58 ------	15,469.75	
Compromise for late payment -	50.00	39,240.22
Total ----------------------		₱ 80,493.22

It will be observed that the 5% surcharge and 1% monthly interest were computed by respondent not only on the deficiency income tax proper but on the total of such tax and the 50% surcharge, which is not authorized. (See Bautista v. Coll. of Internal Revenue, C.T.A. No. 98, Feb. 18, 1957, affd. in G. R. Nos. L-12250 & L-12259, May 27, 1959.) Neither has respondent any authority to impose a compromise penalty without a binding compromise agreement entered into between him and the taxpayer. (University of Sto. Tomas v. Collector, G. R. Nos. L-11274 & L-11280, Nov. 28, 1958.)

As regards the 50% surcharge, the law provides for the imposition of said surcharge in case of <u>willful</u> neglect to file an income tax return, or in case a false or fraudulent return is <u>willfully</u> made. (Section 72, Revenue Code.) In order that the fraud penalty may be imposed, in case a return was filed, it is essential to establish that the taxpayer <u>willfully</u> filed a false or fraudulent return, that is, <u>with intent to evade the tax</u>.

In this case, it appears that petitioner did not include in her income tax returns the dividends withheld by De la Rama Steamship Co., Inc. believing that they were not taxable as they were not received by her. This is confirmed in the report of three internal revenue examiners to whom the case was assigned for reinvestigation and comment to determine the propriety of imposing the fraud penalty. To quote from their report:

> "The taxpayer filed her 1950 income tax return and declared the amount of dividends which she believed was the only amount of dividends due her which was ₱120,424.55 in actual cash receipt and the balance of ₱221,975.45 was applied to advances made to the late husband of the taxpayer, which advances were made by the De la Rama Steamship Co. before the war and also immediately after liberation to the family of the taxpayer. Since these advances were thought of by Estefania Pirovano on her honest belief that it should not be reported for income tax purposes as a result of the dividends applied to it, she did not report the said sum of ₱221,975.45 in her 1950 income tax return. However, in the investigation the said amount was included as forming part of the taxable income because it was part of the dividends declared by the De la Rama Steamship Co. to be due the said taxpayer, E. Pirovano. The imposition of additional deficiency income tax on this income did not include the 50% surcharge for the reason that in accordance with the Osmeña Case which had the same circumstances as in this case, in the absence of clear and convincing evidence of fraud or in the mere errors of judgment of whether an item is taxable or not which error does not constitute fraud, the Office does not see it justifiable to impose the said 50% surcharge. Inasmuch as the above allied case of Osmeña has been decided already in relation to the same question of fact, the undersigned examiners are hereby adhering to the same decision and no imposition of 50% surcharge was made on the additional income tax assessment on the subject-taxpayer. In this connection, therefore, the report of Examiner Gonzalo Castro is hereby submitted to be amended and made in conformity with the undersigned's report. This amendment is only made to his report in the 1950 income tax return and does not amend the report in the 1951 return. This 1951 report is herewith concurred in as no declaration was ever made by Mrs. E. Pirovano of the dividends she received in 1951 as her income tax return in this year showed." (Report of

Examiners Simeon P. Radam, Bonifacio Tuazon and Guillermo Catindig, dated Feb. 20, 1956, pp. 47-50, B.I.R. records.)

However, in the decision of respondent dated January 31, 1958, the question raised by petitioner in regard to the fraud penalty was entirely ignored. Instead, the amounts corresponding to the fraud penalty were added to the deficiency tax and treated in their entirety as the "Income tax due" as shown below:

"In view thereof, it is requested that you urge Mrs. Pirovano to pay the amounts of ₱252,170.12 and ₱80,493.22 computed below, not later than February 28, 1958, in order that this case may be closed:

AR-21187-55/50

Income tax due ----------	₱193,942.50
5% surcharge ------------	9,692.12
1% mo. int. from 2/1/56 to 2/28/58 -----------	48,485.50
Compromise for late payment ----------------	50.00
Total amount due on February 28, 1958 -----	₱252,170.12

43-EAR-204-55/51

Income tax due ----------	₱ 61,897.50
5% surcharge ------------	3,093.97
1% mo. int. from 2/1/56 to 2/28/58 -----------	15,469.75
Compromise for late payment -------------	50.00
Total amount due on February 28, 1958 -----	₱ 80,493.22"

(See Exh. 8 for respondent, pp. 102-105, BIR records.)

We have carefully searched the entire records of the case for any evidence which may indicate an intention on the part of petitioner to evade her income tax to justify the imposition of the fraud penalty. We have found none. It is true that for the year 1951, Examiners Radam, Tuazon and Catindig supported the recommendation of Examiner Castro for the imposition of the penalty on the sole ground that petitioner failed to include in her return the sum of ₱1,506.31, the amount which she actually received as director's bonus from De la Rama Steamship Co., Inc. However, we do not believe that the failure to report the sum of ₱1,506.31, considered in relation to her total reported income for the year involved, can be considered as evidence of an intention to evade the tax on said sum. It may also be added that counsel for the Government, in sustaining the theory that the right of the Government to assess and collect the tax in question has not prescribed, cited Section 331 of the Revenue Code which limits the right to assess and collect the tax within five years from the date the return was filed, which is the law applicable in non-fraud cases. (See page 5, Memorandum for Respondent.)

This Court has not hesitated to sustain the imposition of the fraud penalty in those cases where the intention of the taxpayers to evade payment of the taxes due from them has been clearly established. (Perez v. Araneta, B.T.A. No. 189, Feb. 13, 1956, affd. in G. R. No. L-10517, May 30, 1958; Reyes v. Collector, C.T.A. No. 42, July 26, 1956, affd. in G. R. Nos. L-11534 & L-11558, Nov. 25, 1958; Li Yao v. Collector , C.T.A. No. 30, July 31, 1956; Castro

v. Collector, C.T.A. No. 141, Dec. 29, 1956; Bautista v. Collector, C.T.A. No. 98, Feb. 18, 1957, affd. in G. R. Nos. L-12250 & L-12259, May 27, 1959; Buenaventura v. Collector, C.T.A. No. 139, June 24, 1957; Roqueza Ngujo v. Collector, C.T.A. No. 177, Feb. 28, 1958.) On the other hand, we have refused to sanction the imposition of said penalty where the failure to report an item of income is due merely to an honest belief that such income is not taxable in the year involved. (Gutierrez v. Collector, C.T.A. No. 65, Aug. 31, 1955, affd. in G. R. Nos. L-9738 & L-9771, May 31, 1957; Bohol Land Transportation v. Collector, C.T.A. No. 261, Sept. 25, 1957, affd. in G. R. Nos. L-13099 & L-13462, April 29, 1960; Yulo v. Araneta, C.T.A. No. 84, July 8, 1958; Brinker v. Collector, C.T.A. No. 366, July 17, 1959.) This case is one of them.

It is also argued by counsel for the Government that, assuming that petitioner is not liable for the fraud penalty, she should be held liable for the surcharge of 25% provided in Section 72 of the Revenue Code for failure or neglect to file her income tax return for 1951. The surcharge of 25% for failure to file an income tax return on time is distinct and different from the fraud penalty of 50% surcharge. They are not alternative penalties. Both may be imposed at the same time in proper cases.

Moreover, the jurisdiction of this Court in matters involving internal revenue taxes is limited to appeals from decisions of the Commissioner of Internal Revenue. The Commissioner has not rendered a decision in regard to the 25% surcharge. Therefore, we can not pass upon that question upon the mere suggestion of counsel for the Government in their memorandum.]

IN LINE WITH THE FOREGOING OPINION, the decision appealed from is hereby modified, and petitioner is ordered to pay the sums of ₱129,295.00 and ₱41,253.00 as deficiency income tax for the years 1950 and 1951 within thirty days from the date this decision becomes final. If the said sums are not paid within said period, there shall be added to the unpaid amount the surcharge of 5% plus 1% monthly interest from the date of delinquency to the date of payment. No pronouncement as to costs.

SO ORDERED.

Manila, September 29, 1960.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge