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September 25, 1961

GONZALO P. NAVA,
Petitioner,

- versus -

C.T.A.
CASE NO. 568

COMMISSIONER OF
INTERNAL REVENUE
Respondent.

x - - - - - - - - - x

DECISION

On May 15, 1951, the petitioner filed his income tax return for the year 1950. On the same date, an assessment was made by respondent against petitioner in the sum of ₱4,982.00 solely on the basis of the return as filed. At the same time, petitioner paid one-half of the tax due, which is ₱2,491.00. Subsequently, petitioner offered to pay the second installment by means of his backpay under Republic Act No. 304, but respondent rejected the offer. On July 28, 1953, petitioner requested respondent to hold in abeyance the collection of the second installment until the question of whether or not he was entitled to pay the balance of his income tax out of his backpay shall have been finally decided, but this was also rejected by respondent.

On March 30, 1955, after investigation of petitioner's 1950 income tax return, respondent issued a deficiency income tax assessment notice (Exh. 4, page 7, B.I.R. records), requiring petitioner to pay not later than April 30, 1955, the sum of ₱9,124.50, computed as follows:

Net income as per return -------		₱29,938.33
Add: Disallowances -		
(a) Commission paid ------	₱7,371.75	
(b) Car operations ---	5,400.00	
(c) Entertainment exp. -------	4,800.00	17,571.75
Net income per investigation ---		₱47,510.08
Less: Personal exemptions ------		5,400.00
Net taxable income ------------		₱42,110.08
Income tax due on ₱42,110.00 ---		₱11,064.00
Less: Amount previously assessed		4,981.00
Deficiency tax ---------------		₱ 6,083.00
50% surcharge ----------------		3,041.50
Total deficiency tax and surcharge -----------------		₱ 9,124.50

(See Exhs. C and 3, page 6, B.I.R. records)

It will be noted from the foregoing computation that the sum of ₱4,981.00 which was previously assessed on May 15, 1951, was deducted from the total tax due although only one-half thereof was actually paid, so that the claims of the Government against petitioner cover the sums of ₱9,124.50 and ₱2,491.00. Petitioner has appealed from the decision of respondent holding him liable for the sum of ₱9,124.50, but respondent filed a claim against petitioner in his answer for the sum of ₱2,491.00 by way of counterclaim.

Before answer was filed by respondent, he filed a motion to dismiss the appeal on the grounds that it was filed with this Court after the thirty-day period prescribed in Section 11 of Republic Act No. 1125 and that there was another action pending between the same parties for the same cause of action in the Court of First Instance of Manila. The motion to dismiss was denied in our resolution of October 6, 1958. When respondent filed his answer, petitioner filed a motion to declare the former in default, which motion was denied in an order issued on January 20, 1959 (certiorari denied in G. R. No. L-16346, Dec. 11, 1959 for being premature). Thereafter, petitioner filed a motion for a ruling on the issue of prescription. This Court decided to consider the question in conjunction with the issues raised on the merits of the case.

The issues raised by the parties, aside from the question of jurisdiction which has already been decided in our resolution of October 6, 1958, may be summarized as follows: (1) whether or not the right of the Government to assess and/or collect the sums of ₱2,491.00 and ₱9,124.50 has prescribed; (2) whether or not respondent committed error in disallowing as deductions from the gross income of petitioner the aggregate sum of ₱17,571.75, representing commission paid, expenses for car operations and entertainment; and (a) assuming the correctness of the deficiency assessment, whether or not the imposition of the fraud penalty (50% surcharge) is proper.

In connection with the issue of prescription as regards the sum of ₱2,491.00, it appears that this amount was assessed on May 15, 1951. Under Section 332 of the National Internal Revenue Code, the said amount may be collected by distraint or levy or by judicial action within five years from the date of assessment. No action was taken by respondent to collect said amount either by distraint or levy or by judicial action within five years from the date of assessment. The petition for review in this case was filed on August 8, 1958, and the answer of respondent wherein he filed a claim against petitioner for the said amount by way of counterclaim was filed only on November 3, 1958, long after the five-year period had prescribed.

It is, however, contended on behalf of respondent that petitioner has waived the defense of prescription. We quote from the memorandum of counsel for the Government:

> As regards the collection of the amount of ₱2,491.00 representing the balance on the original assessment, of which a tender or payment of petitioner's Negotiable Certificate of Indebtedness was made but refused by respondent, suffice it to say that petitioner has waived the defense of prescription. Petitioner paid the amount of ₱2,491.00 representing the first installment under Official Receipt No. 91941 on May 15, 1951. He subsequently acknowledged in his letters dated January 10, 1957 (Annex "G"), April 29, 1957 (Annex "I"), and April 11, 1958 (Annex "J") his tax obligation in the amount of ₱2,491.00 representing the balance of his income tax on the 1950 original income tax assessment. By paying partially his income tax for the year 1950 and by acknowledging his tax liability in his letters to the respondent, petitioner is estopped to claim the defense of prescription. (Pp. 6-7, Mémorandum for Respondent, July 31, 1961.)

An examination of the letters of petitioner referred to by counsel for the Government (Annexes "G", "I" and "J") shows that they were sent to respondent more than five years from the date of partial payment on May 15, 1951, and that although petitioner acknowledged the obligation as still unpaid, he insisted that he was released from liability because the right to collect the same had already prescribed. To quote from Annex "G":

> Your letter of February 5, 1955, confirms that my income tax liability for the year 1950 was only ₱2,491 and it is, therefore, very surprising to me that, after having paid the same, your office

> is now collecting from me the sum of ₱9,124.50 which I have no way to know. Moreover, as far as my 1950 income tax is concerned, you will agree with me that the same is already a closed issue for it has already prescribed for more than six years and which, I believe, we do not need to discuss now, following the ruling of our Supreme Court in the case of former Senator Avelino's income tax. (See page 17, C.T.A. records; emphasis supplied.)

The same or similar statements are contained in Annexes "I" and "J". We do not see in said letters any waiver on the part of petitioner of the defense of prescription. We are, therefore, of the opinion that the right of the Government to collect the said sum of ₱2,491.00 has already prescribed, pursuant to Section 332 of the Revenue Code.

With respect to the sum of ₱9,124.50, petitioner alleges that since his income tax return was filed on May 15, 1951 and that he came to know of the assessment for the first time only somtime in December, 1956, after more than five years from the date of the filing of the return, the right of the Government to assess the said deficiency income tax has prescribed, citing Section 51 (d) of the Revenue Code and Collector of Int. Rev. v. Compañia General de Tabacos de Filipinas, G. R. No. L-11151, July 30, 1960 and Collector of Int. Rev. v. Jose Avelino, G. R. No. L-9202, Nov. 10, 1956.

Section 51(d) of the Revenue Code and the doctrine laid down in the cases of Avelino and Compañia General de Tabacos de Filipinas are not in point. The law applicable to this case is Sections 331 and 332 of the Revenue Code which provide that an internal revenue tax may be assessed within five years from the date the return was due or filed, in non-fraud cases, and within ten years from the date of discovery of the fraud or omission to file a return. (See Collector of Int. Rev. v. Bohol Land Transp., G. R. Nos. L-13099 and L-13462, April 29, 1960.) And the tax so assessed may be collected by distraint or levy or by judicial action within five years from the date of assessment. When was the deficiency tax assessed in this case?

The duplicate copy of the income tax assessment notice indicates that it was issued on March 30, 1955 (Exh. 4, page 7, B.I.R. records). "Call-up" letters were sent to petitioner reminding him of the obligation. These call-up letters or notices are recorded in Exh. C for petitioner (Exh. 3 for respondent, page 6, B.I.R. records), to wit:

1st notice	4/10/56
2nd notice	7/ 3/56
Final -	9/25/56

In addition to the written notices sent to petitioner, he was also personally interviewed. A report on these written notices and personal interviews appears in the memorandum of an agent of the Bureau of Internal Revenue dated December 10, 1956, pertinent portion of which reads as follows:

> Several call up letters and repeated demands have been made to subject taxpayer, but inspite of the considerable length of time that has elapsed the above accounts still remain unsettled. The warrant assemblies of the above stated tax cases were assigned to Agent A. E. Aguilar and an interview with Mr. G. P. Nava revealed that the later refuse to pay alleging that these cases comes within the purview of the Avelino case, hence, the B.I.R. has no more right to collect from him. (Exh. D, page 8, B.I.R. records.)

Petitioner's claim that he came to know of the assessment only on or about December 19, 1956, can not be given much credence. We are inclined to believe that the assessment notice dated March 30, 1955 and the several call-up letters sent to him were received by him in due course of mail but that he ignored them because of his belief that the right of the Government to collect the tax had prescribed in view of the decision in the Avelino case. This conclusion finds support in a note sent or delivered by petitioner to an employee of the Bureau who interviewed him, wherein he stated:

> This is to certify that I have received today, <u>second final notice</u> from the Bureau of Internal Revenue delivered by Mrs. Canlas. My reply to your said <u>final notice</u>, as per your request, will be sent to you on or before January 3, 1957, in view of the fact that I may not be able to contact right away my Accountant. (Exh. E, page 9, B.I.R. records; underscoring ours.)

The fact that petitioner admitted receipt of the "second final notice" without protest is an indication that he received the previous notices.

Assuming that petitioner received the income tax assessment notice dated March 30, 1955 in due course of mail, that is, not later than April 10, 1955, the assessment was made within the five-year period since he filed his income tax return on May 15, 1951, even granting that the ten-year period applicable to fraud cases does not apply to this case. (The assessment includes the fraud penalty.) Since the deficiency income tax was assessed on or about April 10, 1955, the Government is authorized to collect the same by distraint or levy or by judicial action within five years from that date.

or not later than April 10, 1960. Judicial action was instituted in the Court of First Instance of Manila in Civil Case No. 32796 for collection of said amount, followed by the institution of the instant appeal in this Court by petitioner himself on August 8, 1958, both within the five-year period. Therefore, we are of the opinion that the right of the Government to assess and collect said deficiency income tax has not prescribed.

We now come to the legality of the claims of petitioner for deduction from his gross income of the alleged compensation paid by way of commission to an accountant, expenses for car operations and entertainment.

Respondent disallowed the deduction by petitioner of the sum of ₱7,371.75 which the latter paid to Mr. Manual San Jose as his share of the compensation earned in working for the claim for war damage compensation of the Sta. Rosa Mining Co. The facts surrounding the case, as narrated by the examiner who conducted the investigation are:

> In the year 1950, which is the subject of investigation by the undersigned, the Sta. Rosa Mining Company was paid the amount of ₱220,401.34 as second partial payment, 5% of which, or ₱11,020.07, was also paid to Mr. Gonzalo P. Nava by the Company. In the same year, the said taxpayer collected his salaries as president of the Sta. Rosa Mining Company in the total amount of ₱42,000.00 which corresponds to his salaries for the year 1950 and certain prior years. In other words, Mr. Nava received during the year 1950 the sum of ₱11,020.07 and ₱42,000.00 as 5% commission on the second partial payment and salaries for certain prior years, respectively, or a total of ₱53,020.07. Out of this total amount of ₱53,020.07, as the gross income of Mr. Nava, he paid a commission of ₱12,881.74 to Mr. San Jose, thereby leaving a balance of ₱40,138.33, which was declared in the income tax return of the tax-

> payer for the taxable year 1950. It must be reckoned that in the year 1949, Mr. Nava did not pay the corresponding 2-1/2% share of Mr. San Jose, or ₱7,371.75 on the commission of ₱14,743.50 received by the former from the company. Consequently, it became a personal liability of Mr. Nava to Mr. San Jose. It is claimed by the taxpayer that in 1950, he paid Mr. San Jose the sums of ₱7,371.75 and ₱5,509.99 as his 2-½% commissions on the first and second payments, respectively, made by the War Damage Commission to the Sta. Rosa Mining Company. Verification of the income tax return of Mr. San Jose for the year 1950, hereto attached, shows that the total amount of ₱12,881.75 has been declared in his 1950 return.
>
> (Exh. 2, pp. 4-5, B.I.R. records.)

In this appeal, Government counsel advanced three reasons in support of the non-deductibility of said expense, viz:

> 1. When Mr. Nava deferred the payment of the said amount in 1949, he in the sense borrowed the share corresponding to Mr. San Jose, which he paid only in 1950. It cannot constitute an expense deductible under Section 30(a)(1), because it is not a salary or compensation for personal services actually rendered but a payment of a loan which should be considered merely as a return of capital.
>
> 2. Mr. Nava did not declare in his 1950 income tax return the amount of ₱7,371.75 as deductions or commissions paid to Mr. San Jose.
>
> 3. Mr. Nava, as President of the Sta. Rosa Mining Company is no longer entitled to an additional compensation for working on the war damage claim of the said company.
>
> (Page 9, Memorandum for Respondent, July 31, 1961.)

An item of expense is a personal liability of a person from the moment that the obligation to pay arises. The nature of the obligation is not affected by the fact that payment is deferred to a later year. Its deductibility as an expense in the year of payment is not also affected by the fact that the obligation was incurred in a prior year in the case of a taxpayer filing his return on the basis of actual receipts and disbursements, which is not controverted in the present case. In fact, the law and regulations expressly require that deductions, in the case of a taxpayer filing his returns on the basis of actual receipts and disbursements, must be claimed in the year of actual payment, otherwise the right is lost. (Sec. 40, Rev. Code; Sec. 171, Rev. Regs. No. 2.) The allegation of Government counsel that payment of an expense in a year other than the year in which the obligation was incurred partakes of the nature of a return of capital is patently absurd.

The allegation that "Mr. Nava did not declare in his 1950 income tax return the amount of ₱7,371.75 as deductions or commissions paid to Mr. San Jose" is difficult to understand. If it was not claimed as a deduction, why was it disallowed?

There appears to be some confusion as to the problem involved. It appears from the evidence of record that petitioner earned a gross income of ₱53,020.07 in 1950, from which he deducted the sum of ₱12,881.74, representing the commission paid to Mr. San Jose, and reported in his income tax return for that year only the sum of ₱40,138.33. (See Exhs. 1 and 2.) Legally, he should have reported the sum of ₱53,020.07 and claimed as an expense deduction the sum of ₱12,881.74. Of course, the result would have been the same as far as petitioner is concerned.

The Bureau examiner, however, treated the problem differently. Although the sum of ₱12,881.74 was paid by petitioner to Mr. San Jose in 1950, he claims that ₱7,371.75 of said amount should have been paid to Mr. San Jose in 1949 so that petitioner is not entitled to claim the deduction in 1950. He treated the sum of ₱7,371.75 as a disallowable deduction instead of considering the entire amount of ₱12,881.74 as an undeclared income. After including the sum of ₱12,881.74 in petitioner's gross income, the question to be decided is whether or not the said sum constitutes an allowable expense deduction.

Finally, the contention that petitioner, as President of the Sta. Rosa Mining Company, is no longer entitled to an additional compensation for working on the war damage claim of the said company is entirely irrelevant. What is material is that petitioner earned a taxable income and he is entitled to deduct from such income all the ordinary and necessary expenses in connection with earning such income. It is not disputed that the payment to Mr. San Jose of said amount was an ordinary and necessary expense in earning petitioner's income. The decision of respondent disallowing the deduction must have to be reversed.

The second disputed item is the sum of ₱5,400.00, allegedly representing expenses in connection with the use of petitioner's car in 1950, itemized as follows:

2/3 of driver's salary of ₱150.00 per month ------	₱1,200.00
2/3 of gasoline expenses of ₱150.00 per month -------	1,200.00
2/3 of repairs of car --------	1,000.00
2/3 of depreciation of car, etc. --------------	2,000.00

(See page 31, Memorandum for Petitioner, July 1, 1961.)

The deduction is sought to be justified on the ground "that the said car was used in connection with his work to gather all the necessary data and other matters needed by the Philippine War Damage Commission, without which the company's war damage claim could not have been collected." On the other hand, respondent claims that petitioner failed "to submit adequate evidence as to where, how, when and with whom were these expenses spent."

Examination of the records of the case failed to sustain petitioner's claim that the expenses incurred for the use of his car in 1950 were in connection with his work to gather data and other matters needed by the Philippine War Damage Commission "without which the company's war damage claim could not have been collected." It appears that the company's war damage claim was settled long before 1950, as evidenced by the fact that the first installment of the claim of the company was paid in 1949 and the second in 1950. The disallowance of the deduction must perforce be sustained.

The third and last disputed item is the sum of ₱4,800.00, allegedly representing entertainment expenses and contributions to charitable organizations. Of the said amount, ₱4000.00 represents entertainment expenses and ₱800.00 as charitable contributions.

It is alleged in the memorandum of counsel for petitioner that the entertainment expenses were incurred in "entertaining people who could be, and in fact were, able to help petitioner in his work not only to collect the war damage claims of his company but increase the same." During the hearing of the case, petitioner testified that the said amount was spent to entertain War Damage Commission officials. Suffice it to state that expenses for the purpose of entertaining government officials are not allowable as deduction for being contrary to public policy. The disallowance of the deduction of the sum of ₱4,000.00 is, therefore, in order.

As regards the sum of ₱800.00, considering petitioner's position as a high executive official of a mining company, charitable contributions in the aggregate sum of ₱800.00 appear to us as reasonable, the said amount being less than the maximum of 6% of net income allowable under Section 30(h) of the Revenue Code. It is true that petitioner failed to produce receipts of payments to charitable organizations, but we are aware of the fact that in this country, contributions to the Boy Scouts, Girl Scouts, Community Chest, Anti-Tuberculosis Society and other charitable institutions are inevitable. Consequently, we are of the opinion that the sum of ₱800.00 is a proper deduction from petitioner's gross income in 1950.

The last issue relates to the legality of the imposition of the 50% surcharge as fraud penalty. We have examined the records of the case very carefully and found no evidence that petitioner willfully filed a false and fraudulent return for the purpose of evading payment of his income tax. While the 50% surcharge was added by the examiner who conducted the investigation, absolutely nothing was said as to why the said surcharge was imposed. Neither the decision of respondent contains any allegation justifying the imposition of said surcharge. In this appeal, Government counsel allege that since petitioner "failed to introduce evidence to assail the legality of the 50%, it is deemed that he admits the propriety thereof." Petitioner denies having committed fraud. Therefore, the burden is upon the respondent to prove its existence. There is no obligation on the part of petitioner to prove a negative fact.

In resumé, we are of the opinion that (1) the right of the Government to collect the sum of ₱2,491.00 has already prescribed; (2) the disallowance of the sums of ₱7,371.75 and ₱800.00, representing commission and charitable contributions, respectively, is not in order; (3) the disallowance of the sums of ₱5,400.00, as expenses for the car operation, and ₱4,000.00, as entertainment expenses, is in accordance with law; and (4) the imposition of the fraud penalty is not warranted. Accordingly, the decision appealed from is hereby modified, the deficiency income tax due from petitioner being only ₱3,057.00, instead of ₱9,124.50, itemized and computed as follows:

Gross income reported --------		₱40,138.33
Add: Undeclared income --------		12,881.74
Total gross income ------------		₱53,020.07
Less: Commission paid to Mr. San Jose ----	₱12,881.74*	

* This amount includes the disputed item of ₱7,371.75.

Charitable Contributions ----- 800.00	13,681.74
Net income -------------------	₱39,338.33
Less: Personal exemptions -----	5,400.00
Net taxable income ------------	₱33,938.33
Tax due on ₱33,938.00 ---------	₱ 8,038.00
Amount previously assessed -----	4,981.00
Deficiency tax still due -------	₱ 3,057.00

Petitioner is, therefore, ordered to pay the sum of ₱3,057.00 within thirty days from the date this decision becomes final, and if not so paid, there shall be added thereto the surcharge of 5% plus interest at the rate of 1% per month from the date of delinquency to the date of payment, subject to the limitation imposed by Section 51(e)(2) of the Revenue Code, as amended by Rep. Act No. 2343. With costs against petitioner.

SO ORDERED.

Manila, September 25, 1961.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge