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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

JOSE M. BARCELONA and
JAIME E. BARCELONA,
Petitioners,

- versus - C.T.A. CASE NO. 1806

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
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12/29/75

D E C I S I O N

Appeal taken by the petitioners Jose Barcelona and Jaime Barcelona from a decision of the respondent Commissioner of Internal Revenue holding the former liable for the amounts of ₱77,605.92 and ₱75,531.12, respectively, or a total of ₱153,137.04, as deficiency income tax for the taxable year 1955.

There is no dispute as to the facts, the same having been substantially admitted by the parties or borne out by the records of the case. As narrated by counsel for petitioners, it appears that:

> "x x x On September 29, 1946, Consuelo de Santos Vda. de Barcelona executed a document in favor of her sons, the petitioners herein, entitled Deed of Donation with Valuable Considerations (Exh. A, pp. 111-113, BIR records). The donation ceded to the donees three (3) parcels of agricultural lands situated in the Municipalities of Nampicuan and Cuyapo, Nueva Ecija, with an aggregate area of 1611 Hectares, more or less. On June 23, 1955, following the enactment of the Land

Tenure Act (Republic Act 1400), with a view to conserving the aforementioned parcels of land within the folds of their family, petitioners herein, along with a few close relatives as nominal stockholders, organized the Barcelona Farms, Inc. From the Articles of Incorporation (Exh. B), it is seen that of the total authorized shares constituting the authorized capital stock of the corporation, 2000 shares was subscribed by petitioner Jose M. Barcelona, 2000 shares by his co-petitioner, Jaime E. Barcelona, 10 shares by Filomena Alonso Barcelona, the wife of Jose M. Barcelona, 10 shares by Basilia Barcelona, a maternal aunt of the petitioners, and 10 shares by Domingo Alonso, brother of Mrs. Filomena A. Barcelona. From the same Articles of Incorporation, it is seen that the subscriptions of Jose M. Barcelona and Jaime E. Barcelona were paid with property worth ₱102,400.00, while the subscriptions of the nominal incorporators of ₱500.00 each were paid in cash. The property used by the two petitioners to pay for their subscriptions to the corporation was actually one of the three parcels received by them under the Deed of Donation with Valuable Consideration, said parcel of land having an area of 118.6922 Has. more or less (Exh. C).

On July 5, 1955, the herein petitioners also transferred to the Barcelona Farms the two remaining parcels of land received by them under the Deed of Donation with Valuable Consideration with an aggregate area of 905.3078 Hectares more or less. The transfer was effected by means of a 'Deed of Absolute Sale with Mortgage' (Exh. D).

In this Deed of Absolute Sale with Mortgage, the petitioners herein Jose M. Barcelona and Jaime E. Barcelona sold, transferred and conveyed unto Barcelona Farms, Inc. the two parcels of land aforementioned for the consideration of

P921,600.00. Of this amount, according to the document, P600.00 was paid, while the balance of P921,000.00 was undertaken to be paid in ten (10) equal annual installments of P92,100.00 each, the first payment to be due on March 1, 1956 and the subsequent ones, every year thereafter up to March 1, 1965. To guarantee the payment of the said balance, a first mortgage was constituted by the buyer corporation in favor of the sellers Jose M. Barcelona and Jaime M. Barcelona. According to the books of the corporation, the payment of the balance of the amount of P921,000.00 was finally completed in the years 1970-71. The record of payments as proved during the trial (Exh. WW) is as follows:

'SCHEDULE OF INSTALLMENT PAYMENTS RECEIVED FROM BARCELONA FARMS, INC.

		Balance
Total Amount due as per Deed of Sale with Mortgage - July 5, 1955	P921,600.00	
Less: Down Payment	600.00	P921,000.00
Less: Installment Payments Received		
1956	P 49,400.00	871,600.00
1959	11,600.00	860,000.00
1961	26,080.00	833,920.00
1963-1964	92,160.00	741,760.00
1964-1965	92,160.00	649,600.00
1965-1966	92,100.00	557,500.00
1966-1967	92,100.00	465,400.00
1967-1968	92,100.00	373,300.00
1968-1969	92,100.00	281,200.00
1969-1970	92,100.00	189,100.00
1970-1971	92,100.00	97,000.00

CERTIFIED CORRECT:

(Sgd) German Esguerra Jr.
(Tpd) GERMAN ESGUERRA JR.
Certified Public Accountant' "

The records of the case further show that while petitioners individually and the Barcelona Farms, Inc. have been filing their income tax returns regularly, the former did not declare or report in their returns for the year 1955 nor in their returns for the succeeding taxable years whatever income derived by them from the abovementioned transaction although the said transaction was reflected in the balance sheets attached to the income tax returns of the latter. Petitioners' failure to include in their 1955 income tax returns the income derived from the said transaction was due apparently to their belief that said transaction was not taxable, or that if the same was taxable, the income derived therefrom should be reported in the year when the selling price of the lots would have been fully paid.

After a series of investigations of the income tax returns and the books of accounts and other records of petitioners and the Barcelona Farms, Inc. conducted by agents of the Bureau of Internal Revenue, covering the period from 1958 to 1965, respondent issued on February 26, 1965 letters of demand, accompanied by assessment notices, holding petitioners liable for the amounts of ₱77,605.92 and ₱75,531.12, respectively, as deficiency income tax for 1955, inclusive of surcharge and interest for late payment, on the profit derived from the sale of the aforesaid parcels of land.

On April 1, 1965, petitioners wrote respondent requesting a reconsideration of the aforementioned assessments. Without rendering a decision on such request for reconsideration, respondent served upon petitioners on November 10, 1965 a warrant of distraint and levy dated September 3, 1965. On November 29, 1965, petitioners protested the issuance of the aforesaid warrant, and at the same time called attention to their letter of April 1, 1965 which had not yet been favored with a reply. Again, without categorically deciding the protest of petitioners contained in their letter of November 29, 1965, respondent instead caused to be served upon them on August 10, 1966 warrants of distraint and levy dated June 15, 1966. Upon receipt of the said warrants of distraint and levy, petitioners called the attention of the agent who served the warrants to their letters of April 1, 1965 and November 29, 1965, which were not yet acted upon by respondent, and furnishing the said agent with photostat copies of the said letters. When this matter was brought to the attention of the Chief, Collection Branch, Regional Office No. 4, Quezon City, respondent caused the issuance of a notice of seizure dated September 2, 1966 and a notice of sale of several residential properties of petitioners. Hence, this appeal.

Upon motion of petitioners, and after due notice and hearing, this Court issued on October 27, 1966 a writ of preliminary injunction suspending the collection of the alleged deficiency income tax in question and enjoining respondent from proceeding with the auction sale of the properties of petitioners scheduled for October 28, 1966, conditioned upon the posting by petitioners of a surety bond in the sum of ₱155,000.00. After approval of the bond posted by petitioners, respondent filed his answer to the petition for review.

The issues raised by the parties have been summarized by counsel for petitioners, as follows:

1. Was the transfer of the parcels of land by the herein petitioners to the Barcelona Farms, Inc. under the Deed of Absolute Sale with Mortgage a taxable transfer?

2. Assuming that the transfer was a taxable transaction, should not the taxes be computed

during the years when payments were made by the Barcelona Farms, Inc. to the Barcelona brothers?

3. Considering the fact that the transaction in question has been duly reported in the income tax returns of the petitioners and the Barcelona Farms, Inc. from the date of the transaction and over the following years, may the taxpayers be charged with fraud in their returns as to preclude their claim of prescription?

4. Did not the series of investigations carried out on the books of accounts of the herein petitioners and the Barcelona Farms, Inc. amount to undue harassment and coercion?

In view of the importance of the issue raised by petitioners to the effect that the right of the Government to assess against them the deficiency income tax for the year 1955 had already prescribed when the assessments were received by them on March 17 and 22, 1965, we shall consider first this issue.

The records show that petitioners filed their income tax returns on February 29, 1956, the due date for filing individual income tax returns was March 1, 1956 under the law then in force. The assessments were both dated February 26, 1965, which must have been mailed much later as the said assessments were sent to the Commissioner of Internal Revenue for signature on March 1, 1965,[1] or a period of more than nine (9) years from the date the returns were due on March 1, 1956. It is contended on behalf of petitioners that the 5-year period provided in Section 331 of the National Internal Revenue Code should apply, so that the said assessments are void for having been made beyond the prescriptive period provided in said section. On the other hand, respondent claims that the ten-year period provided in Section 332 of the Revenue Code should apply, citing Aznar v. Court of Tax Appeals, L-20569, August 23, 1974, 58 SCRA 519, and not the five-year period provided in Section 331.

Section 331 of the Revenue Code provides that, except as provided in Section 332, "internal revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after expiration of such period." And Section 332 provides that in "the case of a false or fraudulent return with intent to evade tax or of a failure to file a

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1 See page 226, BIR rec.

return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission."

Were the income tax returns of petitioners for 1955 filed fraudulently with intent to evade tax so as to justify the application of the ten-year prescriptive period provided in Section 332 of the Revenue Code?

The evidence of record shows that the transaction in question was reported every year during the time that the installment payments were being made by the debtor corporation. While the sale and/or the profits derived therefrom were not reported by petitioners in their income tax returns for 1955 or subsequent years, the joint balance sheet of Jose Barcelona and Jaime Barcelona submitted with their income tax returns reflected accounts receivables which tallied with the mortgage payable as reported in the income tax returns of the Barcelona Farms, Inc. for the same period. From 1958 to 1965, the books of accounts and other records of both petitioners and the Barcelona Farms, Inc. were examined annually, sometimes even as many as three times a year, by the examiners and agents of respondent covering taxable years from 1955 to 1966, and this transaction was clearly reflected in the books and records of the corporation. Considering that petitioners are practically the sole stockholders of the debtor corporation, and they are also its creditors, and that a series of examinations were conducted simultaneously and at the same time by several examiners of the Bureau of Internal Revenue, fraudulent intent to evade tax can hardly be imputed to them. In fact, the books of accounts and other records of the taxpayers clearly show the nature and extent of the transaction involving the sale of the parcels of land between the Barcelona brothers and the Barcelona Farms, Inc. which appear to have been known to the examiners who examined the books and records of petitioners.

As a matter of fact, a memorandum report was submitted to the Regional Director of Quezon City, who has jurisdiction over the case, to the effect that, after narrating the facts and discussing the legal aspects of the sale of the lands in question, petitioners herein and the Barcelona Farms, Inc. were not subject to the payment of any deficiency income tax for the taxable years 1955 to 1959 (Exh. "RR"). The memorandum report was duly approved by the Chief of the Investigation Branch and concurred in by the Chief, Tax Audit Branch. While the records do not show the action taken by the Regional Director on the case, respondent on February 26, 1965 issued letters of demand accompanied by income tax assessment notices addressed to petitioners requiring them to pay the amount of ₱153,137.04 as deficiency income tax for the taxable year 1955. The foregoing shows that it was not only petitioners but also the examiners and agents of the Bureau of Internal Revenue assigned to investigate the case who committed a mistake in the appreciation of the case for purposes of income taxation.

Fraud cannot be presumed but must be proven. Fraudulent intent can not be deduced from a mistake, especially if the same mistake was also committed by agents of respondent as regards the taxability or non-taxability of a transaction. The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some legal right. Negligence, whether slight or gross, is not equivalent to fraud with intent to evade the tax contemplated by law.

It must amount to intentional wrong-doing with the sole object of avoiding the tax. (See Aznar vs. Court of Tax Appeals, supra.)

Since the 1955 income tax returns of petitioners are not fraudulent, is the five-year prescriptive period provided in Section 331 applicable to their case?

Construing Sections 331 and 332 of the Revenue Code, the Supreme Court, in Aznar vs. Court of Tax Appeals, supra, held that the ten-year period provided in Section 332 applies to three different cases, i.e., (1) false return, (2) fraudulent return with intent to evade tax, and (3) failure to file a return, while the five-year period prescribed in Section 331 should apply only to "normal circumstances." We quote from said decision:

> "To our mind we can dispense with these controversial arguments on facts, although we do not deny that the findings of facts by the Court of Tax Appeals, supported as they are by very substantial evidence, carry great weight, by resorting to a proper interpretation of Section 332 of the NIRC. We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any

> time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely - "falsity", "fraud" and "omission". That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional deceitful entry with intent to evade the taxes due."

Frankly, the construction given in the Aznar decision that the "false or fraudulent return with intent to evade tax" appearing in Section 332 of the Revenue Code contemplates of two different situations, that of "false" return without intent to evade tax and the other that of a "fraudulent" return with intent to evade tax, is not justified by the wording of the law. Obviously, the phrase "with intent to evade tax" is intended to qualify "false" return rather than "fraudulent" return. There is no need to qualify the term "fraudulent return" by the phrase "with intent to evade tax." When a return is established to have been filed fraudulently, there can be no other conclusion than that the taxpayer intended to evade tax. It is well nigh impossible to conceive of a person filing a fraudulent income tax return without intent to evade tax. It is believed, therefore, that in referring to a "false or fraudulent return with intent to evade tax" the law intends to refer only to cases involving fraudulent returns, otherwise, Section 331 providing for the five-year prescriptive period in non-fraud cases would be rendered nugatory. However, considering that this Court is bound by decisions of the Highest Court, we will endeavor to apply the ruling in the Aznar case as faithfully as it is possible for us to do so.

The Aznar decision classifies false returns or incorrect returns, not involving fraud, into two classes. The first refers to false or incorrect returns filed under "normal circumstances" to which the five-year period provided in Section 331 applies, and the second refers to false or incorrect returns to which the ten-year period provided in Section 322 is applicable. To quote from the Aznar decision:

> "The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the NIRC should be applicable to normal circumstances, but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to

> false returns, fraudulent return intended to evade payment of tax or failure to file returns, the period of ten years provided for in Sec. 332 (a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced."

The Aznar decision does not define nor has it attempted to explain the meaning of returns filed under "normal circumstances" to which the five-year period applies. It mentions, however, the cases to which the ten-year period are applicable. It is said that the ten-year period applies "whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns."

In the case at bar, no attempt has been made by petitioners to hide the transaction which brought about the disputed assessment. Their failure to include the gain derived from the transaction in question was due to their belief that it was not taxable, or that if it was taxable, it was taxable not in 1955 as the selling price of the lots sold had not then been fully paid. The records of the transaction were at all times available for examination by agents of the Bureau of Internal Revenue. There was, therefore, no attempt on the part of petitioners to prevent the Government agents from making proper assessment of their tax liability arising from said transaction. This is plainly a case arising under "normal circumstances" referred to in the Aznar case to which the five-year period provided in Section 331 of the Revenue Code is properly applicable. This is entirely different from the Aznar case where the assessment was the result of the application of the net worth expenditures method of determining unreported income. This method of assessment is resorted to only in cases where the sources of the unreported income of a taxpayer are not definitely ascertainable. Since the assessments against petitioners were made by respondent beyond the five-year period provided in Section 331 of the Revenue Code, it follows that the same are illegal and void.

In view of our opinion that the assessments in question were not validly made, it becomes unnecessary to pass upon the other issues bearing on the taxability of the transaction which gave rise to the disputed assessments. Mention may, however, be made regarding the charge of petitioners that "the series of investigations carried out on the books of accounts of the herein petitioners and the Barcelona Farms, Inc. amount to undue harassment and coercion." However, no relief is being sought in regard to this claim, and, for this reason, it would serve no useful purpose to consider the same.

For the foregoing considerations, the decision appealed from is hereby reversed, and the surety bond for ₱155,000 filed by petitioners is hereby cancelled. No pronouncement as to costs.

SO ORDERED.

Quezon City, December 29, 1975.

R M Umali

ROMAN M. UMALI
Presiding Judge

I CONCUR:

Estanislao R. Alvarez

ESTANISLAO R. ALVAREZ
Associate Judge

Associate Judge Ramon L. Avanceña
did not take part.