PEDRO B. BAUTISTA and
DATIVA CORRALES TAN,
Petitioner

- versus -

C.T.A. CASE NO. 98

February 18, 1957

THE COLLECTOR OF INTERNAL
REVENUE,
Respondent.

x - - - - - - - - - - - - - -x

D E C I S I O N

The spouses Pedro B. Bautista and Dativa Corrales Tan, petitioners herein, each filed a separate income tax return for the year 1947. The husband reported an income of ₱3,300 derived from the exercise of his profession as lawyer and dividend received from the law firm Camus, Zavalla, Bautista and Nuevas. He claimed a personal exemption of ₱2,500 for being a married person or head of family and an additional exemption of ₱500 for a minor child, Lorna C. Bautista. He paid an income tax of ₱9.00. The wife reported in her return an income of ₱9,999.90 derived from the sale of her share in a lot and building situated at Tabora Street, Manila, after deducting the cost of her share in said property and expenses of sale. She also claimed a personal exemption of ₱2,500 for being a married person or head of family and an additional exemption of ₱500 for the same minor child, Lorna C. Bautista. She paid an income tax of ₱490.00.

Upon investigation by examiners of the Bureau of Internal Revenue, the returns of the spouses were consolidated and a deficiency income tax was assessed against them in the sum of ₱15,564.57. The deficiency assessment was the result mainly of the alleged under-declaration of the proceeds of the sale of the wife's share in the Tabora property and the over-valuation of the cost thereof. Petitioners contested the assessment on the grounds that the amount actually received by them from the sale of the Tabora property was ₱49,999.90 and not ₱66,606.66; that they failed to claim deduction for losses sustained as a result of the fire which destroyed their house, including other personal property and cash; that the Tabora property was a capital asset and only 50% of the gain derived from the sale thereof was taxable because said property was held for more than 12 months; and that the right to assess the deficiency income tax had prescribed. In a letter dated November 30, 1954, respondent rejected the claims of petitioners and reiterated the assessment, plus 5% surcharge, 1% monthly interest and "compromise penalty", in the aggregate amount of ₱19,729.18, itemized as follows:

Net income reported by P. B. Bautista	₱ 3,300.00
Net income reported by D. C. Tan	9,999.90
Net income of spouses as per returns	₱13,299.90
Add: Undeclared income from sale of real property	42,018.04
Total net income	₱55,317.94
Less: Personal exemption	3,000.00
Net income subject to tax	₱52,317.94
Tax due	₱10,875.38
Less: Tax previously paid	499.00
Deficiency tax due	₱10,376.38

Deficiency tax due	₱ 10,376.38
Add: 50% surcharge	5,188.19
Total tax and 50% surcharge	₱ 15,564.57
Plus: (1) 5% surcharge	778.23
(2) 1% monthly interest from March 15, 1953 to December 31, 1954	3,346.38
(3) Compromise for late payment	40.00
Total tax and penalties	₱ 19,729.18

Petitioners have appealed to this Court from the foregoing decision of respondent.

The first question relates to the amount actually received by Dativa Corrales Tan as her share in the proceeds of the sale of the Tabora property. Respondent claims that petitioner Dativa Corrales Tan received as her share ₱66,666.66, while the latter alleges that she received only ₱49,999.90.

It appears that the property in question was, before the sale, owned in common by the brothers and sisters, namely, Gregoria, Santiago, Dativa, Amancio and Aurelio, all surnamed Corrales Tan, in the proportion of 10/24, 6/24, 6/24, 1/24 and 1/24, respectively. Gregoria, Dativa, Aurelio and Amancio sold all their rights to and interests in said property to their brother, Santiago Corrales Tan, for and in consideration of the sum of ₱200,000.00. Respondent determined the share of each vendee in the selling price as follows:

Gregoria Corrales Tan (owner of 10/24 part of the property) 10/18	₱ 111,111.12
Dativa Corrales Tan (owner of 6/24 part of the property) 6/18	66,666.66

Amancio Corrales Tan (owner of 1/24 part of the property) 1/18	₱ 11,111.11
Aurelio Corrales Tan (owner of 1/24 part of the property) 1/18	11,111.11
T o t a l	₱ 200,000.00

In other words, respondent claims that Dativa Corrales Tan received from the sale of her 6/24 part of the property 6/18 of ₱200,000.00 and not 6/24 of ₱200,000.00, or ₱49,999.90. On the other hand, petitioners allege that Dativa received only ₱49,999.90 as the buyer, Santiago, also received his proportionate share in the selling price of the property.

After a careful study of the records of the case, we are fully in agreement with the findings of respondent that the share of Dativa Corrales Tan in the selling price of the property is ₱66,666.66 and not ₱49,999.90. To give credence to the allegation of petitioners that Santiago Corrales Tan, the buyer, shared in the proceeds of the sale would be contrary to the express provisions of the deed of sale. Moreover, it is unnatural for a part owner of a property to buy his own share.

Respondent found after investigation that the cost or acquisition value of the share of Dativa Corrales Tan in the Tabora property was ₱14,648.72. Petitioners did not present any evidence to prove a different valuation. Therefore, the determination of the gain derived by petitioners from the sale of said property is in order.

An attempt has been made by petitioners that in May, 1947 they suffered losses as a result of a fire which destroyed a portion of their residence. The evidence adduced by petitioners to prove the occurrence of the fire is not convincing. If they really suffered losses by fire in 1947, they should have claimed the deduction of the loss actually sustained in their returns for that year. They did not claim such a deduction when they filed their returns in 1948. The claim that they suffered losses by fire was advanced only when a deficiency assessment was made against them by respondent sometime in 1953, more than five years after the occurrence of the alleged fire, and when petitioner Pedro B. Bautista, by his own admission, had already forgotten most of the details of said fire.

Even granting that petitioners suffered losses by fire in 1947, they failed to establish during the hearing of the case the amount actually lost to entitle them to the deduction. Section 30(d) of the National Internal Revenue Code permits individual taxpayers to deduct from their gross income losses actually sustained during the taxable year and not compensated for by insurance or otherwise of property not connected with the trade or business, if the loss arises from fires or other casualty. In order that a fire loss or casualty loss may be allowed as a deduction, the taxpayer must prove, among others, the actual amount lost and claimed as a deduction. A mere estimate of the loss can not be allowed as a deduction.

In this case, petitioner Pedro B. Bautista at first estimated his and his wife's losses as about ₱200,000, which was later reduced to about ₱100,000. Lastly, he estimated the losses as follows:

> "We submit that the occurrence of the fire of May 15, 1947 as sufficiently established; that the loss suffered by petitioners in movie films, chemicals, photographic materials, movie equipment, stock shots, scripts, etc. of an aggregate value of about ₱37,000.00 and a cash of about ₱20,000.00, likewise, was sufficiently traced; and the said loss constitutes a lawful deduction from the net income of the petitioners for the year 1947." (Page 23, Memorandum for Petitioners, October 30, 1956; underscoring supplied.)

Petitioners claim fire losses of about ₱37,000.00 in property and about ₱20,000.00 in cash. Under the circumstances, we feel that we are not authorized to permit the deduction of alleged fire losses of undetermined amounts.

Respondent considered the Tabora property as an ordinary asset and therefore the gain derived from the sale thereof is taxable in full. Petitioners claim that said property was a capital asset under Section 34 of the Revenue Code and the gain derived from the sale thereof is taxable to the extent of 50% of such gain. The law relied upon by petitioners is Section 34 of the Revenue Code, pertinent provisions of which are quoted below:

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

It is alleged that the real property in question was never used in the trade or business of petitioner Dativa Corrales Tan, she being merely a housewife. Therefore, said property, as far as the petitioners were concerned, was a capital asset. And since the share of petitioner Dativa Corrales Tan in said property was acquired more than twelve months prior to the sale, under paragraph (b) of Section 34 only 50% of the gain from the sale must be taken into account in determining the taxable gain.

The last portion of the definition of "capital assets" which reads -

> "or real property used in the trade or business of the taxpayer."

was added to subparagraph (1) of paragraph (a) of Section 34 of the Revenue Code by Republic Act No. 82 evidently to remove real property used in the trade or business of the taxpayer from the classes of property considered by law as capital assets, and to tax in full the gain derived from the sale of such property.

> "The provisions of sec. 132 of Reg. No. 2 insofar as it considers the land on which a building used by the taxpayer in his trade or business is constructed as capital assets is no longer in force, as such property is no longer capital asset, in view of the amendment contained in section 8, Republic Act No. 82 which excludes from the term capital assets real property used in the trade or business of the taxpayer." (I Formilleza, Commentaries on the National Internal Revenue Code, p. 259.)

The records show that the said property of petitioners was never occupied by petitioners as their residence. It was primarily held for rent. It is apparent that said property was used in the trade or business of petitioners and is, therefore, an ordinary asset. It follows that the gain derived from the sale of said property is taxable in full.]

Finally, petitioners allege that the right of the Government to assess the deficiency income tax in question has prescribed under Section 331 of the Revenue Code, which provides that internal revenue taxes shall be assessed within 5 years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. It is claimed that the assessment was received by petitioners on or about March 5, 1953, which is more than five years from March 1, 1948 when the returns of the spouses for 1947 were considered to have been filed. On the other hand, respondent claims that since the assessment dated January 21, 1953 was mailed long before March 1, 1953, it is presumed that the same was received by petitioners before that date; and, granting that the assessment was made after five years from the date the returns of petitioners were filed, since the returns were false or fraudulent, the respondent is authorized to assess the deficiency tax within 10 years from the date of discovery of the fraud.

The evidence is not clear in regard to the date of receipt by petitioners of the assessment dated January 21, 1953. While petitioners claim that said assessment was received five days before March 10, 1953, the circumstances narrated by them, instead of fortifying their allegation, point to a different conclusion. In their effort to prove that the assessment was received five days before March 10, 1953, petitioners allege:

> "Petitioner Pedro B. Bautista testified that he received the Assessment Notice by mail in the first week of March, 1953, five days at most before the 10th. He is sure of this because upon its receipt, he immediately went to the Bureau of Internal Revenue to consult Atty. Dionisio Roque, his classmate, about the assessment (t.s.n., pp. 16-17). It was only from the latter that petitioner Pedro B. Bautista learned that prescription works in his favor. It was after the consultation that petitioner's letter Exhibit 'F' was prepared. It was dated March 10, 1953 and filed with the office of the respondent on the same day, March 10, 1953." (Pp. 15-16, Memorandum for Petitioners, Oct. 30, 1956.)

However, petitioner Pedro B. Bautista, in his letter dated March 10, 1953 (Exh. "F") did not specify the date when he received the notice of assessment. If, as alleged, he was already aware of his defense of prescription, he should have indicated in said letter the precise date when he received the notice of assessment, when the events relating thereto were still fresh. He failed to do so and waited after the lapse of a considerable length of time to recall that he must have received said notice of assessment five days before March 10, 1953. Petitioner Pedro B. Bautista has been in the practice of the law profession since 1930. It is rather unusual that he should have omitted to specify in his reply letter the circumstances regarding the date of his receipt of the notice of assessment considering its importance in the determination of the issue of prescription.

At any rate, even if we were to grant petitioners the benefit of the doubt, respondent claims that the statute of limitations applicable to the case is Section 332, which provides that in the case of a false or fraudulent return with intent to evade tax, the Collector of Internal Revenue is authorized to assess internal revenue taxes within 10 years from the date of discovery of the fraud. To prove that petitioners filed false or fraudulent returns with intent to evade tax, respondent alleges (a) that the share of Dativa Corrales Tan in the proceeds of the sale of the Tabora property was under-declared; (b) that the cost of acquisition of said property was overvalued resulting in the under-statement of net gain; and (c) that petitioners failed to include or report in their returns income from the business of processing films in which petitioners were engaged at the time. The last circumstance is not worthy of consideration since there is no evidence that petitioners derived any income from the business of processing films. The first two, already discussed above, indicate an intention to evade tax, and for this reason respondent has correctly imposed the fraud penalty prescribed in Section 72 of the Revenue Code. Nowhere in the records of the case nor in the memoranda filed by counsel for petitioners has the assessment of the fraud penalty been disputed. It having been established that petitioners filed false or fraudulent returns with intent to evade tax, respondent is authorized to assess the deficiency tax within 10 years from the date of discovery of the fraud. The records show that the case was reported by examiners of the Bureau of Internal Revenue in 1952 and the assessment was made in 1953.

Moreover, as already adverted to, petitioners filed separate returns, each claiming personal exemption as a married person or head of family and an additional exemption for the same minor child. Under Section 45 (d) of the Revenue Code, in the case of husband and wife, only one consolidated return must be filed by either spouse to cover the income of both spouses. Separate returns may be filed only "where it is impracticable for the spouses to file one consolidated return". It does not appear that it was impracticable for petitioners to file a consolidated return. They were living together and could have easily filed a joint return. Not only did they file separate returns but they claimed personal exemptions which they knew were not authorized by law. These facts, considered in connection with the under-declaration of the share of petitioner Dativa Corrales Tan in the selling price of the Tabora property and the overvaluation of the cost of acquisition of said property, have convinced us beyond doubt that the returns filed by petitioners for the year 1947 were false or fraudulent with intent to evade tax. Hence, the assessment made by respondent is authorized under Section 332 of the Revenue Code. (See Perez v. Araneta, B. T. A. No. 189, Feb. 13, 1956; Reyes v. Collector, C. T. A. No. 42, July 26, 1956; William Li Yao v. Collector, C. T. A. No. 30, July 31, 1956.)

We note, however, that respondent imposed the 5% surcharge and the 1% monthly interest not only on the deficiency tax but also on the 50% surcharge, which is erroneous. The authority for the imposition of the 5% surcharge and 1% monthly interest is found in Section 51 (e) of the Revenue Code, which we quote:

> "(e) Surcharge and interest in case of delinquency.- To any sum or sums due and unpaid after the dates prescribed in subsections (b), (c) and (d) for the payment of the same, there shall be added the sum of five *per centum* on the amount of tax unpaid and interest at the rate of one *per centum* a month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons." (Underscoring supplied.)

The law imposes the 5% surcharge and 1% monthly interest on the "tax unpaid". It does not authorize the imposition of said surcharge and interest upon the 50% surcharge or other penalties. The word "tax" is totally different from the term "surcharge", "fine" or "penalty". (See Maria B. Castro v. Collector of Internal Revenue, C. T. A. No. 141, Dec. 29, 1956.)

It might be that respondent has relied on the provision of Section 72 of the Revenue Code which prescribes a penalty by way of surcharge in the amount of 50% of the tax unpaid in case the taxpayer willfully neglects to file a return or if a false or fraudulent return is willfully made, which penalty "shall be collected at the same time and in the same manner and as part of the tax." But the fact that the penalty is to be collected at the same time and in the same manner as the tax does not convert the penalty into a tax. The Income Tax Regulations (Revenue Regulations No. 2), promulgated by the Secretary of Finance upon recommendation of the Collector of Internal Revenue, defines "taxes", which are deductible from gross income under Sec. 30 (c), as follows:

> "The word 'taxes' means taxes proper and no deductions should be allowed for amounts representing interest, surcharge, or penalties incident to delinquency." (Sec. 80, Rev. Regs. No. 2, 39 O. G. 325.)

Certainly, Congress could not have attributed to the word "tax" in Sec. 72 a meaning different from that of the same word found in Section 30 (c). As aptly observed by the Supreme Court:

> "It appears, therefore, that in the opinion of the writer Black and of the Department of Finance, fines imposed for violation of law cannot be considered taxes paid to the

> Government, which should be deducted from income subject to the payment of income tax. The tax under consideration is levied on income, while the fine is paid as penalty for violation of the Internal Revenue Law. The fine, therefore, cannot be considered a tax, inasmuch as it is not levied on income. In providing that the fine should be added to the tax and collected at the same time and as a part thereof, the law had for its purpose merely to facilitate the collection of the fine or surcharge." (Anderson v. Posadas, 66 Phil. 205; underscoring supplied.)

With respect to the "compromise penalty" in the sum of ₱40, we have consistently held that the Collector of Internal Revenue has no power to impose a penalty in the guise of compromise without the consent of the taxpayer. (See Briñas v. Collector, C. T. A. No. 16, Sept. 14, 1955; University of Sto. Tomas v. Collector, C. T. A. No. 10, Sept. 10, 1956.) Consequently, the imposition of the alleged "compromise penalty" of ₱40 upon petitioners is illegal.

FOR THE FOREGOING CONSIDERATIONS, the decision appealed from is hereby modified, in line with the foregoing opinion, and petitioners are hereby ordered to pay the deficiency income tax for 1947 in the sum of ₱10,376.38, plus 50% surcharge in the sum of ₱5,188.19. Petitioners are likewise ordered to pay the surcharge of 5% and 1% monthly interest on the said deficiency tax of ₱10,376.38, the interest to be computed from March 15, 1953, to the date of payment. With costs against petitioners.

SO ORDERED.

Manila, February 18, 1957.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge