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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MELCHOR J. JAVIER, JR.,
Petitioner,

- versus - C.T.A. CASE NO. 3393

RUBEN B. ANCHETA in his capacity as Commissioner of Internal Revenue,
Respondent.

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

7/21/83

D E C I S I O N

The question here is whether the proceeds of an erroneous bank remittance to a taxpayer over which he exercised complete dominion to the extent of disposing them beyond all chance of recovery constitute taxable income to him.

The facts are not disputed. As alleged by petitioner Melchor J. Javier, Jr. in his petition for review and admitted by respondent Commissioner of Internal Revenue in his answer:

> COMES NOW the Petitioner, through its undersigned counsel and to this Honorable Court respectfully alleges:
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> 1. That he is a Filipino citizen, of legal age, married and a resident of 108 (now 326) Jose Abad Santos Street, San Juan, Metro Manila; and that the respondent Ruben B. Ancheta is the Commissioner of Internal Revenue and holds his office at the Bureau of Internal Revenue in Quezon City where he may be served with summons and other processes of this Honorable Court.

2. That on or about June 3, 1977, Victoria L. Javier, the wife of the petitioner, received from the Prudential Bank and Trust Company in Pasay City the amount of US$999,973.70 remitted by her sister, Mrs. Dolores Ventosa, thru some U.S. banks among which is Mellon Bank, N.A.

3. That on or about June 29, 1977 Mellon Bank, N.A. filed a complaint with the Court of First Instance of Rizal (docketed as Civil Case No. 26899) against the petitioner, his wife and other defendants claiming that its remittance of US$1,000,000.00 was a clerical error and should have been US$1,000.00 only and praying that the excess amount of US$999,000.00 be returned on the ground that the defendants are trustees of an implied trust for the benefit of Mellon Bank with the clear, immediate and continuing duty to return the said amount from the moment it was received.

4. That on or about November 5, 1977, the City Fiscal of Pasay City filed an Information with the Circuit Criminal Court (docketed as CCC-VII-2369-P.C.) charging the petitioner and his wife with the crime of Estafa alleging that they misappropriated, misapplied and converted to their own personal use and benefit the amount of US$999,000.00 which they received under an implied trust for the benefit of Mellon Bank and as a result of the mistake in the remittance by the latter.

5. That on March 15, 1978, the petitioner filed his Income Tax Return for the taxable year 1977 showing a gross income of ₱53,053.38 and a net income of ₱48,053.38 and stating in the footnote of the return that "Taxpayer was recipient of some money received from abroad which he presumed to be a gift but turned out to be an error and is now subject of litigation."

6. That on or before December 15, 1980, the petitioner received a letter from the acting Commissioner of Internal Revenue dated November 14, 1980 together with income assessment notices for the years 1976 and 1977 demanding that petitioner pay on or before December 15, 1980 the amount of ₱1,615.96 and ₱9,287,297.51 as deficiency assessments for the years 1976 and 1977 respectively. A copy of the letter of the Acting Commissioner of Internal Revenue dated November 14, 1980 is attached hereto marked as Annex "A", and copies of the assessment notices for the years 1976 and 1977 are attached hereto marked Annexes "A-1" and "A-2" respectively.

7. That on December 15, 1980, the petitioner wrote the Bureau of Internal Revenue that he was paying the deficiency income assessment for the year 1976 but denying that he had any undeclared income for the year 1977 and requested that the assessment for 1977 be made to await final court decision on the case filed against him for filing an allegedly fraudulent return. A copy of the petititioner's letter dated December 15, 1980 is attached hereto, marked Annex "B" and made part hereof.

8. That on November 11, 1981, the petitioner received from Acting Commissioner of Internal Revenue Romulo Villa a letter dated October 8, 1981 stating in reply to his December 15, 1980 letter protest that "the amount of ₱7,020,000.00 representing that portion of Mellon Bank's erroneous remittance which you were able to dispose, is definitely taxable". A copy of said letter is attached hereto marked as Annex "C" and made an integral part hereof.

In specifically denying the allegation in paragraph 9 of the petition for review "That the decision of the Acting Commissioner of Internal

Revenue on the petitioner's protest on the deficiency income tax assessment for the year 1977 is against the law considering that the amount of US$1,000,000.00 remitted allegedly by mistake to his wife is not subject to income tax", for being mere opinion or conclusion on the part of petitioner, and erroneous, respondent avers in his answer as Special and Affirmative Defenses:

SPECIAL AND AFFIRMATIVE DEFENSES

3. Section 29(a) of the Tax Code provides:

> "Sec. 29. Gross Income.- (a) General definition.- 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, also from interests, rents, dividends, securities, of the transaction of business carried or for gain or profit, gains, profits, and income derived from any source whatever."

4. Section 21 of the National Internal Revenue Code provides that a tax is imposed upon the taxable net income received during each taxable year from all sources by every individual, whether a citizen of the Philippines residing therein or an alien residing in the Philippines. Net income under the Tax Code means the gross income computed under Section 29 of the Code less the deductions allowed by law;

5. The U.S. $1,000,000.00 received by petitioner from the Mellon Bank clearly falls under gross income as defined in Section 29(a) and therefore, subject to income tax as provided for under Section 21 of the National Internal Revenue Code;

6. A taxpayer, who received earnings, under a claim of right and without restriction as to its disposition, has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money and even though he may still be adjudged liable to restore its equivalent. (U.S. vs. Ellis R. Lewis, 340 U.S. 590-592);

7. The respondent's deficiency income tax assessment issued against petitioner in the amount of ₱9,287,297.51 for the calendar year 1977 was issued in accordance with law and existing revenue regulations; and

8. All presumptions are in favor of the correctness of the assessment. (Interprovincial Autobus Co., Inc. vs. Collector of Internal Revenue, G.R. No. L-6741, Jan. 31, 1956, 52 O.G. (11) p. 791).

As shown in Annex "A" of the petition for review, the deficiency income tax for the year 1977, which is contested by petitioner, is computed as follows:

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Net income per return	₱ 48,053.38
Add: Undeclared income	7,020,000.00
Net income per investigation	₱7,068,053.38
Less: Personal & additional exemptions .	5,000.00
Net taxable income	₱7,063,053.38
Income tax due thereon	₱4,899,377.00
Less: Amount already assessed	10,762.00
B a l a n c e	₱4,888,615.00
Add: 50% surcharge	2,444,308.00
14% int. fr. 3-15-78 to 7-31-80 . .	1,627,573.95
20% int. fr. 7-31-80 to 11-30-80. .	326,800.56
TOTAL AMOUNT DUE & COLLECTIBLE	₱9,287,297.51

The records of the case reveal that most, if not all, of the US$999,000.00 mistakenly remitted to Mr. & Mrs. Melchor J. Javier, Jr. by the Mellon Bank, N.A. have already been irretrievably spent by them as follows: (p. 78, BIR records; pp. 38-39, CTA records.)

1.	Purchase of 160 acre lot in California City - - - - - - - - - - - -	₱3,250,000.00
2.	Bank deposits - - - - - - - - - - - - - -	550,000.00
3.	Money market placements (approx.) -	1,300,000.00
4.	Legal fees - - - - - - - - - - - - - -	600,000.00
5.	Hospitalization and last illness of father - - - - - - - - - - - - - -	150,000.00
6.	Dole outs to relatives and friends-	315,000.00
7.	Household expenses - - - - - - - - -	60,000.00
8.	Gambling losses - - - - - - - - - -	280,000.00
9.	Others (US$120,000.00) - - - - - - -	900,000.00
		₱7,405,000.00

Petitioner's position is that the amount received by him from the Mellon Bank, N.A. "is not 'income' as the term is defined in Section 29 of the National Internal Revenue Code because the said amount is neither compensation for services rendered nor gains or profits realized from business or dealings in property; and that under the rule of *ejusdem generis*, the phrase 'and income derived from any source whatsoever' found in the definition of 'gross income' refers to compensation for services rendered and gains or profits from business or dealings in property, and cannot be interpreted to mean or include 'receipts' from any source whatsoever". (p. 104, CTA records.) "To be considered 'income' a 'receipt' must have been either (a) actively sought by the recipient, such as wages, salaries and compensation for services or for the exercise of one's profession, vocation, trade, business, commerce, sales or dealings in property, or (b) produced or derived from the recipient's ownership or use of property, such as rents, interests and dividends. The amount in question was neither actively sought by the petitioner, nor the product or fruits of his property. It is a 'receipt' but not an 'income'." (p. 105, CTA rec.)

Petitioner concedes "that unlawful gains, gambling winnings, etc. are subject to income tax although such receipts are not specifically mentioned in the definition of gross income". (p. 106, CTA records.) And rightly so. As a matter of fact, in the United States from which Section 29(a) of the Tax Code was copied almost verbatim from similar provisions of the United States Internal Revenue Code (formerly Section 22/a/), and of the regulations issued in connection therewith, it has been held that unlawful gains as those from ransom money paid to a kidnaper (Humphreys vs. Commissioner, 42 B.T.A. 857, affirmed, 7 Cir., 125 F. 2d 340); fraudulent misapplied moneys of a client by an attorney (United States vs. Wampler, D.C., 5 F. Supp. 796); graft (Chadick vs. United States, 5 Cir., 77 F. 2d 961, certiorari denied, 296 U.S. 609, 80 L. Ed. 432); lotteries (Droge vs. Commissioner, 35 B.T.A. 829; Huntington vs. Commissioner, 35 B.T.A. 835; Voyer vs. Commissioner, 4 B.T.A. 1192); illegal prize fighting pictures (Rickard vs. Commissioner, 15 B.T.A. 316); unlawful insurance policies (Patterson vs. Anderson, D.C., 20 F. Supp. 799), race-track bookmaking (M'Kenna vs. Commissioner, 1 B.T.A. 326); card playing (Weiner vs. Commissioner, 10 B.T.A. 905); illicit traffic in liquor (United States vs. Sullivan, 274 U.S. 259; 71 L. Ed. 1037) constitute taxable income. In an attempt to stay clear of such decisions, however, petitioner would take refuge in the lack of any effort on his part, allegedly, to seek the gain involved herein.

Petitioner misses the point.

The controlling statute is Section 29(a) of the National Internal Revenue Code before its amendment by Batas Pambansa Blg. 135. It defines "gross income", which term is employed in Section 28 (also before its amendment by Batas Pambansa Blg. 135) as part of the definition of "net income" subject to income tax under Section 21 in the case of individuals and Section 24 in the case of corporations. The definition combines a descriptive list of broad scope enumerating various activities giving rise to items of income with the catchall phrase"gains, profits and income derived from any source whatever". The definition is in sweeping terms. Thus, insofar as pertinent hereto, "Gross income includes gains, profits, and income derived from x x x dealings in property x x x growing out of the ownership or use of or interest in such property; also from x x x gains, profits, and income derived from any source whatever". The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories. (Helvering vs. Clifford, 309 U.S. 331, 334; 60 S. Ct. 554, 556; 84 L. Ed. 788.)

Accordingly, the Government may tax, not only ownership, but any right or privilege that is a constituent of ownership. Liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis. (Burnet vs. Wells, 289 U.S. 670, 678; 53 S. Ct. 761, 764; 77 L. Ed. 1439.) Although taxes are public duties attached to the ownership of property, the state should be able to exact their performance without being compelled to take sides in private controversies. Possession is general prima facie evidence of ownership, and is perhaps indeed the source of the concept itself, though the time is long past when it was synonymous with it. It would be intolerable that the tax must be assessed against both the putative tortfeasor and the claimant; collection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant. (National City Bank of New York vs. Helvering, 2 Cir., 98 F. 2d 93, 96.)

Now, to the case at bar. Here, petitioner's assertion of complete dominion over Mellon Bank's erroneous remittance of funds to his wife, his exercise of ownership over them to the extent of disposing of almost every centavo of the funds, and his consequent transfer of possession, use and title to the recipients as to make them the owners thereof, were for all intents and purposes exercise and enjoyment of rights and privileges that are constituents of ownership. He demonstrated positively and unequivocally his right to dispose of the Mellon Bank's funds, and he did even spend them, almost to the last centavo, beyond all chance of their recovery. This was clearly a use of the Mellon Bank's funds by petitioner for his own enjoyment and benefit just as amply and fully as though he had title to them. Such enjoyment and exercise by petitioner of "privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis" (Burnet vs. Wells, supra), can have no different tax consequences when the funds are earned in a lawful manner than when they are derived from illegal sources.

An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. (Burnet vs. Wells, 289 US 670, 678; 77 L. Ed. 1439, 1443; Corliss vs. Bowers, 281 US 376, 378; 74 L. Ed. 916, 917.) That occurs when cash, as here, is delivered by its owner to the taxpayer in a manner which allows the recipient freedom to dispose of it at will, even though it may have been obtained by fraud or mistake and his freedom to use it may be assailable by someone with a better title to it. (Rutkin vs. United States, 343 US 131, 137; 96 L. Ed. 835, 839.)

Such gains are taxable in the year during which they are realized. This statutory policy is invoked in the interest of orderly administation. (Rutkin vs. United States, supra.) Collection of the revenue cannot be delayed, nor should the Government be compelled to decide when a possessor's claims are without legal warrant. (National City Bank vs. Helvering [CA 2d] 98 F 2d 93, 96.) There is no adequate reason why assailable unlawful gains should be treated differently in this respect from assailable lawful gains. Certainly there is no reason for treating them more leniently. (United States vs. Sullivan, 274 US 259, 263; 71 L. Ed. 1037, 1039.)

As to petitioner's allegation (par. 5, petition for review) that in the footnote of his 1977 income tax return he stated that he "was recipient of some money received from abroad which he presumed to be a gift but turned out to be an error and is now subject of litigation", and his submission "that any assessment covering this matter should await final court decision" (p. 8, CTA records), there is nothing in the National Internal Revenue Code which expressly requires, as a condition of the existence of a taxable gain, that there also be an absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. In the case of National City Bank of New York vs. Helvering, supra, 98 F. 2d 95, the taxpayer was taxed on bonds which he had unlawfully withheld from the corporation of which he was an officer. These bonds were the property of the corporation in the sense that it could have reclaimed them. The Court said - "But there are several cases in which persons have been taxed upon property which could be recovered from them. For example, the lender upon usurious interest - if on an accrual basis - must include his apparent profit in his return, though possibly he may be allowed to deduct it as a loss if the borrower reclaims it. (Barker vs. Magruder, 68 App. D.C. 211, 95 F. 2d 22.)* Again, when a railroad collects too

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*The fact that interest is usurious under the law, and may be recovered back by the borrower, does not prevent it from being income, when received, to a taxpayer on the cash basis. Likewise, the taxability of an accrual of usurious interest is not affected because of its illegality. If in a subsequent year the amount becomes uncollectible, or a loss is sustained in respect thereof, a deduction on account thereof is then allowable. (Umali, R.M., Reviewer in Taxation, 1980 ed., pp. 87-88, citing 1955 PH Fed. Taxes, Par. 8010.)

large fares the excess is income, though the passengers have a theoretical right of restitution. (Chicago, R.I. & P.R. Co. vs. Commissioner, 7 Cir. 47 F. 2d. 990.

We note that in the deficiency income tax assessment under consideration, respondent further requested petitioner to pay 50% surcharge as provided for in Section 72 of the Tax Code, in addition to the deficiency income tax of ₱4,888,615.00 and interest due thereon. Since petitioner filed his income tax return for taxable year 1977, the 50% surcharge was imposed, in all probability, by respondent because he considered the return filed false or fraudulent. This additional requirement, to our mind, is much less called for because petitioner, as stated earlier, reflected in his 1977 return a footnote that "Taxpayer was recipient of some money received from abroad which he presumed to be gift but turned out to be an error and is now subject of litigation".

From this, it can hardly be said that there was actual and intentional fraud, consisting of deception willfully and deliberately done or resorted to by petitioner in order to induce the Government to give up some legal right, or the latter, due to a false return, was placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities (Aznar vs. Court of Tax Appeals, L-20569, August 23, 1974, 56 SCRA 519), because petitioner literally "laid his cards on the table" for respondent to examine. Error or mistake of fact or law is not fraud. (Insular Lumber vs. Collector, L-7190, April 28, 1956.) Besides, Section 29 is not too plain and simple to understand. Since the question involved in this case is of first impression in this jurisdiction, under the circumstances, the 50% surcharge imposed in the deficiency assessment should be deleted.

With the foregoing conclusions arrived at, the 1977 deficiency income tax liability of petitioner is hereby computed as follows:

Net income per return	₱ 48,053.38
Add: Undeclared income	7,020,000.00
Net income per investigation .	₱7,068,053.38
Less: Personal & additional exemptions	5,000.00
Net taxable income	₱7,063,053.38
Income tax due thereon	₱4,899,377.00
Less: Amount already assessed .	10,762.00
B a l a n c e	₱4,888,615.00
Add: 14% interest from 3-15-78 to 7-31-80	1,625,464.48
20% interest from 8-1-80 to 11-14-80	282,453.32
TOTAL AMOUNT DUE & COLLECTIBLE.	₱6,796,532.80
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Accordingly, petitioner Melchor J. Javier, Jr. is hereby ordered to pay to respondent Commissioner of Internal Revenue the sum of ₱6,796,532.80 as deficiency income tax for 1977, plus 10% surcharge and 20% per annum interest from November 14, 1980 up to full payment thereof but not to exceed the amount corresponding to three years pursuant to Section 51(e) of the National Internal Revenue Code as amended by Presidential Decree No. 1705.

WHEREFORE, the decision appealed from is modified as indicated in the above opinion of the Court. With costs.

SO ORDERED.

Quezon City, Metro Manila, July 27, 1983.

Amante Filler

AMANTE FILLER
Presiding Judge

WE CONCUR:

Took no part

CONSTANTE C. ROAQUIN
Associate Judge

Alex Z. Reyes

ALEX Z. REYES
Associate Judge