JOSE P. DE LEON, CECILIO P. DE LEON, and ALBINA DE LEON LIPANA, heirs of the Intestate Estate of the late Dr. Felix de Leon,
Petitioners,

- versus -

C.T.A. CASE NO. 738

THE COMMISSIONER, Bureau of Internal Revenue, and the PROVINCIAL REVENUE OFFICER, Regional District No. 4,
Respondents.

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D E C I S I O N

This is an appeal from a decision of the respondent Commissioner of Internal Revenue dated December 8, 1959, assessing against and demanding from the petitioners, corporate income taxes for the years 1956 and 1957, in the amounts of ₱7,832.00 and ₱9,495.00, respectively, totalling ₱17,327.00, inclusive of the 25% surcharge, on the ground that with their failure up to the present time to partition among themselves real properties inherited from their father since 1940, they _ipso facto_ formed an unregistered partnership, and therefore considered a corporation for income tax purposes, pursuant to Sections 24 and 84 (b) of the Tax Code. (Exh. R, pp. 60-61, BIR rec., Folder No. 1.)

The facts of the case as appearing in the "Stipulation of Facts" (pp. 17-24, CTA rec.) submitted by the parties, hereinafter to be referred to as STIFACTS for short, are not complex consisting mainly of documentary evidence.

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Here is a brief summary of the pertinent facts.

The three petitioners herein are the acknowledged natural children and legal heirs of the deceased Dr. Felix de Leon, who died intestate in the year 1940 leaving real properties including ricelands in the provinces of Bulacan and Nueva Ecija (par. 1, STIFACTS p. 17 CTA rec.; p. 126 CTA rec.). After the death of Dr. de Leon, intestate Special Proceedings No. 58390 was initiated in the Court of First Instance of Manila and with the view to expediting the final distribution of the estate, a compromise agreement (Exh. B, pp. 41-47, CTA rec.) was entered into by the petitioners herein on one side and the surviving, legitimate and childless spouse, Asuncion Soriano, on the other. It was stipulated in said compromise agreement, among others, that the petitioners would give a life annuity of 1,600 cavanes of palay to the surviving spouse, Asuncion Soriano (pars. 2 & 3, STIFACTS).

The agreed life annuity in favor of the surviving spouse which was a joint and solidary obligation of the herein petitioners, was annotated as first lien on all the agricultural lands left by the deceased in the municipality of San Miguel, Bulacan (par. 3, STIFACTS). In view of this subsisting joint and solidary obligation of the petitioners in favor of the surviving spouse, the petitioners agreed among themselves to keep in co-ownership, in equal shares, all the properties which they had inherited from their deceased father. (par. 4, STIFACTS.) The intestate estate proceedings of the deceased Dr. de Leon was closed on August 2, 1954. (par. 5, STIFACTS.)

Subsequently, the surviving spouse had to file in court civil actions (Civil Cases Nos. 135 and 488, C.F.I. Bulacan) against the petitioners for failure on their part to deliver in full during the years 1943 to 1952, inclusive, the quantity of palay provided in their compromise agreement. (par. 6, STIFACTS; pp. 126-138 CTA record.) The Court of First Instance of Bulacan, in a decision which was affirmed by the Supreme Court (G.R. No. L-7648), ordered the petitioners in said cases to pay the surviving spouse, Asuncion Soriano, the amount of ₱60,550.00, corresponding to the price of palay which they failed to deliver from 1947 to 1952, plus interest and attorney's fees. (par. 7, STIFACTS.)

The agricultural properties inherited by the petitioners were sold at public auction to satisfy the judgment of the court in favor of Asuncion Soriano. (par. the sum of
8, STIFACTS.) However, said agricultural properties were later redeemed by the petitioners upon payment of the sum of ₱97,500.00, which redemption price was raised by them by selling one of their commercial properties located at Magdalena St., Manila, which they had inherited from their father. (pars. 9 & 10, STIFACTS.)

Sometime in the year 1947, the petitioners-heirs

Jose P. de Leon and Cecilio P. de Leon, as joint administrators of the properties of the late Dr. de Leon, entered into a contract of lease with Messrs. Rivero and Pascual wherein the latter as lessees, agreed to construct a three-story semi-concrete building on a vacant lot belonging to the estate located at Quezon Boulevard, Manila, subject to the condition that upon the termination of the lease, the building and all the improvements thereon, shall become the exclusive and absolute property of the herein petitioners, without any obligation to refund to the lessees whatever expenses they may have incurred. (par. 11, STIFACTS.) The contract of lease was transferred by the original lessees to Cesar Ledesma, Inc., and upon the termination of the lease on June 30, 1954, the herein petitioners became the absolute owners of said building, which has come to be known as the "F. de Leon Building". (par. 12, STIFACTS.)

It appears that the income derived from all the properties inherited by the petitioners, as well as the expenses of administration, are borne equally by them, share and share alike, and each petitioner reported in their individual income tax returns for the years 1956 and 1957, their corresponding share of the income and expenses. (par. 13, STIFACTS; Exhs. K, K-1, L and L-2, pp. 111-122 CTA rec.) During all these years since the death of their father in 1940, the petitioners while administering the inherited properties, never contributed money to a common fund. Neither did they engage in real estate or any other business for profit using the inherited properties as capital, with a view to expanding or increasing their family holdings. On the contrary, because of their failure to comply in full with the life annuity agreed upon in favor of their co-heir, Asuncion Soriano, who is still living, they were hailed to court and forced to sell one of the inherited properties consisting of a commercial building located at Magdalena St. in Manila.

All these circumstances notwithstanding, the respondent, after due investigation ruled that the co-ownership of the petitioners is an unregistered partnership, and therefore taxable as a corporation under Sections 24 and 84 (b) of the Tax Code. Thus, the respondent issued the disputed assessments for corporate income taxes against the petitioners for the years 1956 and 1957 which are now the subject of this appeal.

The only issue to be decided in this case is whether or not under the circumstances stated above, the co-ownership of the petitioners over the properties inherited from their father, may be considered an unregistered partnership, hence, taxable as a corporation for income tax purposes under Sections 24 and 84 (b) of the National Internal Revenue Code.

For income tax purposes, Section 84 (b) of the Tax Code defines a corporation as follows:

"Sec. 84. When used in this Title -

x x x x

(b) The term 'corporation' includes partnerships, no matter how created or organized, joint-stock companies, joint accounts (cuentas en participacion), associations or insurance companies, but does not include duly registered general copartnerships (compañias colectivas)."

And Section 24 of the same Code, in prescribing the rate of corporate income tax, states in part as follows:

"Sec. 24. Rate of tax on corporations.- (A) In general, there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding taxable year from all sources by every corporation organized in, or existing under the laws of the Philippines, no matter how created or organized, but not including duly registered general copartnerships (compañias colectivas), domestic life insurance companies and foreign life insurance companies doing business in the Philippines, a tax upon such income equal to the sum of the following: x x x"

Pursuant to the above quoted provisions of the National Internal Revenue Code, the respondent Commissioner of Internal Revenue, in deciding the protests of the petitioners against the disputed assessments in question, has adhered to the strict and steadfast rule that "properties held by co-heirs which are income producing or profit earning, except those belonging to duly registered co-partnerships, x x x shall be considered as owned by unregistered partnerships and the income derived therefrom shall be subject to the payment of corporate income taxes". (Exh. R, pp. 60-61, BIR rec., Folder No. 1) On the basis of said ruling, the respondent con-

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cluded, and now insists that the petitioners herein are subject to the tax on corporations at the rate of 20% of the net income not exceeding ₱100,000.00 (Section 24 National Internal Revenue Code).

We believe that the interpretation given by the respondent to the term "corporation" as defined in Section 84 (b) of the Tax Code as to embrace without exception all possible co-ownerships over inherited properties which are income producing is much too unreasonable and stringent. Co-heirs who own properties which produce income should not automatically be considered partners of an unregistered partnership, or a corporation, within the purview of the income tax law. To hold otherwise, would be to subject the income of <u>all co-ownerships</u> of inherited properties to the tax on corporations, inasmuch as if a property does not produce any income at all, it is not subject to any kind of income tax, whether the income tax on individuals or the income tax on corporations. In short and in effect, to adopt the view of the Commissioner of Internal Revenue, would be tantamount to declaring that all co-ownerships, whether by co-heirs or not, are unregistered partnerships which in some particular instances might lead to unfair consequences. Certainly, the word "co-ownership" has a separate and distinct meaning from the term "partnership".

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And moreover, to rule that properties held by co-heirs which are income producing should be considered as owned by unregistered partnerships is contrary to the plain and clear provisions of Article 1769 of the New Civil Code which states in part that "Co-ownership x x x does not of itself establish a partnership, whether such co-owners x x x do or do not share any profits made by the use of property" and that the "sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived."

As explained by Mr. Justice Felix Angelo Bautista, in his concurring opinion in the case of Evangelista vs. Collector of Internal Revenue, G.R. No. L-9996, October 15, 1957, (54 O.G. 996, 1003) "the fact that those who agree to form a co-ownership share or do not share any profits made by the use of the property held in common does not convert their venture into a partnership. Or the sharing of the gross returns does not of itself establish a partnership whether or not the persons sharing therein have a joint or common right or interest in the property."

Furthermore, as far as we know, there is no law that requires heirs or co-owners of inherited properties without anyone of them asking for it or without any agreement to the contrary (Article 494 New Civil

Code) to partition among themselves within a specified period of time the properties acquired by inheritance or held in co-ownership. Article 494 of the New Civil Code must have foreseen the impossibility or impracticability of immediate partition in some instances to the extent that it allows co-ownership to exist by agreement for a period not exceeding ten (10) years subject to extension by a new agreement. The same article gives donors or testators the right to prohibit partition for a period which shall not exceed twenty (20) years. If we were now to give sanction to the theory of respondent that all co-ownerships, whether by co-heirs or not, are unregistered partnerships and therefore subject to an additional income tax burden, we would in effect render without meaning and much too burdensome for co-owners, donors and testators to avail themselves of the rights accorded them under the aforesaid article of the New Civil Code, irrespective of whether or not their intention to continue with the co-ownership is just for the purpose of rehabilitating, maintaining and preserving what they already own in common or for business and further expansion.

As is the situation in the instant case, it appears that during the years now in review (1956 and 1957), the petitioners have reported in their individual income tax returns and paid the corresponding income tax thereon on their share of income derived from the inherited properties. (par. 13, STIFACTS, p. 21 CTA rec.; Exhs. K, K-1, L and L-1, pp. 111-122 CTA rec.) Respondent now insists that the estate should likewise pay corporate income taxes for the same years in the total sum of ₱17,327.00 as an unregistered partnership.

While it is true that the definition of the term "corporation" as given in Section 84 (b) of our Tax Code is broader in scope and far more embracing than the ordinary definition of a corporation found in Section 2 of Act No. 1459, otherwise known as the Corporation Law, we still believe and so hold that on grounds of fairness and equity, the respondent should not apply the broader definition of the Tax Code indiscriminately so as to embrace within the definition all classes of co-ownerships irrespective of the underlying reason or reasons for their creation and existence. Undoubtedly, if the sole purpose of the co-heirs for maintaining in perpetuity their co-ownership over the inherited estate is to see it expand beyond limit by embarking in all kinds of business ventures, then the application of said sections of the Tax Code and the ruling of the Supreme Court in Eufemia Evangelista, et al. vs. The Collector of Internal Revenue, et al. _supra_, would be in order. However, there are instances when co-ownership over inherited properties is kept at status _quo_ for years through no liking of the co-owners or co-heirs but made so by some legal impediment as in the instant case where the petitioners _jointly_ and _solidarily_ agreed to give a life annuity of 1,600 cavanes of palay produced from their inherited hacienda in San Miguel, Bulacan, to their co-heir, Asuncion Soriano, who is still living at present.

To cite other specific instances. There are heirs who choose not to partition the estate left by their parents not for financial aggrandizement but for purely sentimental reasons and to maintain as closely knit as possible their family ties after the death of their ascendants. The family is a basic social institution which public policy cherishes and protects (Art. 216 New Civil Code). Others do so for practical reasons believing that with the estate left undivided, particularly small estates with numerous heirs, the expenses of administration could be considerably minimized and the obtaining of credit facilities for operational expenses made easier. Others find it simply impossible -- physically and legally -- to partition, much as they would want to, as is the case of numerous heirs inheriting an estate consisting let us say of just one commercial building or an ancestral home being leased to a third party where none of the heirs is willing to sell his undivided share to his other co-heirs or to outsiders. "Lex non intendit aliquid impossibile." Under Article 10 of the New Civil Code, in case of doubt in the interpretation or application of laws, it is presumed that the lawmaking body intended right and justice to prevail.

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In his memorandum, (pp. 169-173 CTA rec.) the respondent has made much capital of the fact that sometime in 1954, during the existence of petitioners' co-ownership, they were able to acquire a semi-concrete commercial building at Quezon Blvd., Manila from which they have been deriving substantial rentals. As heretofore stated, the petitioners inherited from their father among other properties, a vacant lot located at Quezon Blvd., Manila. In 1947, they entered into a contract of lease Exhibit I (pp. 10-14 Folder No. 1) with Messrs. Rivero and Pascual wherein the latter, as lessees, agreed at their expense to construct a three-story semi-concrete building on the vacant lot subject to the condition that upon the termination of the lease, the building and all the improvements thereon shall become the exclusive and absolute property of the petitioners, without any obligation to refund to the lessees whatever expenses they may have incurred (par. 11, STI-FACTS, p. 20 CTA rec.). The contract of lease was transferred by the original lessees to Cesar Ledesma, Inc., and upon the termination of said contract on June 30, 1954, the petitioners herein became the absolute owners of said building, which has come to be known as the "F. de Leon Building" (par. 12, STIFACTS, pp. 20-21 CTA rec.).

Respondent maintains that the share of each of the present petitioners in said building, for all intents and purposes, is their contribution to a common fund, an additional asset which did not exist at the time of their father's death in 1940 nor formed part of the

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decedent's estate. In short, the respondent concludes that the petitioners did engage in the real estate business and were able to expand their family interests while holding the inherited properties under the concept of co-ownership, and therefore, liable for the additional income tax demanded as an unregistered partnership following the doctrine laid down in the Evangelista case. (Respondent's Memorandum, pp. 171-172 CTA rec.)

It is of common knowledge, and this Court takes judicial notice of the fact, that before the last world war, as is the case at present, there were many families, particularly in populated areas like Manila, whose main source of income was derived from house rentals. As a result of the ravages of the last war, many heads of families perished leaving to their heirs after the liberation, nothing but empty lots where once stood commercial buildings, residential and apartment houses. In many cases, the heirs of these vacant lots who were left practically destitute after the liberation, chose not to partition post-hastedly believing and with good reason, that with their common properties and joint efforts; the war damage payments from the United States; and, other credit facilities extended the war victims by our Government such as those granted by the defunct Rehabilitation Finance Corporation, they would in the course of time replace their lost properties and make them income producing once again before partitioning the estate among themselves. If we sustain now the inflexible theory of the respondent, by holding that these estates should have been partitioned immediately after the liberation to free the heirs from an additional income tax burden as an unregistered partnerships, thereby leaving each heir to shift for himself, we would be adding many more years before the complete rehabilitation of our country is attained.

The ruling of the Supreme Court in the Evangelista case, supra, relied upon by respondent is not applicable to the present case, because the two cases are based on an entirely different set of facts.

The differences:

1. In the Evangelista case, the "common fund was not something they found already in existence. It was not a property inherited by them pro indiviso. They created it purposely. What is more, they jointly borrowed a substantial portion thereof in order to establish said common fund." In the instant case, the common fund was already in existence when the petitioners became the co-owners of the same. They did not create the fund but merely inherited the same from their father. The petitioners herein never borrowed money in order to establish or to add to the common fund;

2. In the Evangelista case, the taxpayers therein "invested the same, (i.e., the common fund), not merely in one transaction, but in a series of transactions. x x x The number of lots (24) acquired and transactions

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undertaken, as well as the brief interregnum between each, particularly the last three purchases, is strongly indicative of a pattern or common design that was not limited to the conservation and preservation of the afore-mentioned common fund."

In the case under consideration, all the actions of the petitioners were limited merely to the conservation and preservation of the inherited properties. They never contributed even a single centavo from their own pockets in order to invest the same. Whatever they received from their late father was already invested. And instead of adding to their co-ownership, they sold some of their inherited properties;

3. In the Evangelista case, the co-owners against whom the disputed assessments for corporate income taxes were issued, were Eufemia, Manuela, and Francisca, all surnamed Evangelista, and "the properties have been under the management of one person, namely, Simeon Evangelista," who was not one of the co-owners. "Thus the affairs relative to said properties have been handled as if the same belonged to a corporation or business enterprise operated for profit." In the present case, the petitioners are not merely co-owners but co-heirs, and the properties which they inherited were jointly managed by co-owners Jose P. de Leon and Cecilio P. de Leon, two of the three petitioners in this case; and,

4. In the Evangelista case, the taxpayers therein "have not testified or introduced any evidence, either on their purpose in creating the set up already adverted to, or on the causes of its continued existence. They did not even try to offer an explanation therefor." In the case at bar, as stated above, the petitioners did not create the "set up". It was created and established by the death of their father. And they explained to the satisfaction of this Court the cause for the continued existence of the co-ownership of the inherited properties, i.e., the subsisting joint and solidary obligation of the petitioners to deliver annually 1,600 cavanes of palay to Asuncion Soriano during the latter's life time, which from the records of the case, it appears that the petitioners are having a hard time to comply with.

WHEREFORE, in view of the foregoing considerations, the decision of the respondent Commissioner of Internal Revenue assessing against the petitioners corporate income taxes for the years 1956 and 1957, in the total amount of ₱17,327.00, is hereby reversed, without pronouncement as to costs.

SO ORDERED.

Manila, September 11, 1961.

AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge

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