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ANTONIO MEDINA,
Petitioner,

- versus -

C.T.A.
CASE NO. 129

Nov. 26/58

COLLECTOR OF INTERNAL REVENUE,
Respondent.

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DECISION

This is an appeal from the decision of the Collector (now Commissioner) of Internal Revenue requiring petitioner to pay the amount of ₱3,325.68 as deficiency sales tax and surcharge from 1949 to 1952 and short tax and surcharge for the 3rd quarter of 1950, plus the sum of ₱200.00 and ₱50.00 as "compromise penalties".

It appears that petitioner Antonio Medina married Antonia Rodriguez during the Japanese occupation, or particularly on or about May 20, 1944. Before 1946, the spouses had neither properties nor business of their own. However, in 1946 petitioner, acquired forest concessions in the municipalities of San Mariano and Palanan, both in the province of Isabela. From 1946 to 1948, the logs cut and removed by petitioner from his concessions were sold to different persons in Manila through his agent, Mariano Osorio.

In 1949, petitioner's wife, Antonia R. de Medina, allegedly started to engage in business as a lumber dealer. Inasmuch as his wife was a duly licensed lumber dealer, petitioner, from 1949 to 1952, sold to her almost all the logs produced from his concession in San Mariano, Isabela. Petitioner's wife, in turn, sold in Manila the logs bought from her husband through the same agent, Mariano Osorio. The proceeds derived from the sales of logs were, upon instructions of petitioner, either received by Osorio for petitioner, or deposited by said agent in his (petitioner's) current account in the Philipppine National Bank in Manila.

After an investigation was conducted by an agent of the Bureau of Internal Revenue into the transactions between petitioner and his wife, the agent reported that the sales between the spouses were not valid for these transactions never actually took place. On the basis of the report of the agent, respondent assessed against petitioner on September 26, 1953 the sum of ₱4,553.54, as deficiency sales tax and surcharges from 1949 to 1952, and an additional sum of ₱643.94, as deficiency sales tax and surcharge on sales per petitioner's quarterly returns from 1946 to 1952, or a total of ₱5,358.47. Respondent also suggested that should petitioner desire to extrajudicially settle his penal liabilities arising from his failure to pay the correct taxes from 1946 to 1952 and to issue sales invoices, he should pay the sums of ₱200.00 and ₱50.00, in addition to the sum of ₱5,358.47 mentioned above. The deficiency sales tax from 1949 to 1952 was arrived at after disregarding the sales made by petitioner to his wife for being null and void pursuant to Article 1490 of the Civil Code (Art. 1458 of the old Civil Code) and considering the sales allegedly made by his wife in Manila as petitioner's original taxable sales pursuant to Section 186 of the National Internal Revenue Code.

On November 30, 1953, petitioner contested the aforesaid assessment on the ground that there is no law which prohibits a wife from engaging in business separate and distinct from that of her husband and the transactions, therefore, between him and his wife were valid, real and not fictitious. On April 13, 1954, respondent insisted that the sales of logs between petitioner and his wife were not bona fide sales because there was neither a separation of property agreed upon in a marriage settlement nor a judicial separation of property between the spouses as an exception to the prohibition contained in Article 1490 of the Civil Code.

On July 9, 1954, petitioner again filed a petition for reconsideration of the assessment, alleging for the first time that there exists a premarital agreement of complete separation of properties executed between him and his wife and that the deficiency sales tax imposed against him from 1946 to 1952 has already prescribed.

On September 10, 1954, the Conference Staff of the Bureau of Internal Revenue, after considering the evidence adduced by petitioner, found that the sales by petitioner to his wife during the years 1949 to 1952 were not bona fide and that there was no evidence sufficient to establish the existence, due execution and contents of the alleged pre-marital agreement between the spouses. However, it sustained petitioner's allegation that the short taxes assessed against him before 1948 had already prescribed pursuant to Section 331 of the Revenue Code. It further found that no fraud was committed by petitioner in selling logs to his wife from 1949 to 1952, and, therefore, it recommended the elimination of the 50% fraud penalty.

On January 8, 1955, respondent, in accordance with the findings of the Conference Staff, issued a modified assessment demanding the payment of the sum of ₱3,325.68, computed as follows:

5% tax due on ₱ 7,209.83 - 1949 ...	₱ 360.49
5% tax due on ₱16,945.55 - 1950 ...	847.28
5% tax due on ₱16,874.92 - 1951 ...	843.75
5% tax due on ₱11,009.94 - 1952 ...	550.50
Total sales tax due	₱2,602.02
25% Surcharge thereon	650.51
Short taxes per quarterly returns, 3rd quarter, 1950	58.52
25% Surcharge thereon	14.63
TOTAL AMOUNT DUE & COLLECTIBLE	₱3,325.68

Respondent reiterated the suggestion for petitioner to pay the sums of ₱200.00 and ₱50.00, in addition to the sum of ₱3,325.68 in extrajudicial settlement of the latter's alleged penal liabilities. Petitioner again requested reconsideration of respondent's modified assessment but the same was denied in respondent's letter dated April 4, 1955. Not satisfied with the decision of respondent, petitioner appealed to this Court.

Petitioner does not dispute the fact that if the sales of petitioner to his wife are to be disregarded, the resulting undeclared sales from 1949 to 1952 subject to tax is in the amount of ₱52,040.24 (Exh. 5-A, p. 12, BIR rec.). Accordingly, the deficiency assessment as computed above, would be mathematically correct. Hence, the instant appeal is mainly, if not exclusively, based upon the proposition that, inasmuch as there allegedly was a pre-marital agreement entered into between petitioner and his wife, the sales transactions between the spouses from 1949 to 1952 are valid and must be recognized, pursuant to Article 1458 of the old Civil Code and Article 1490 of the new Civil Code. On the other hand, respondent's defense is based upon the general proposition that the sales between petitioner and his wife are fictitious, simulated and not bona fide.

The issues as presented for our consideration may be stated as follows: (1) whether or not there exists a pre-marital agreement of absolute separation of property executed between the spouses, Antonio Medina and Antonia R. de Medina; and, assuming that there exists a pre-marital agreement between the said spouses, (2) whether or not the sales of the logs in question by petitioner to his wife were fictitious, simulated and not bona fide.

It is contended on behalf of respondent that the sales of logs by petitioner to his wife are null and void because of Article 1490 of the new Civil Code, which provides:

> "ART. 1490. The husband and the wife cannot sell property to each other, except:
> (1) When a separation of property was agreed upon in the marriage settlements; or
> (2) When there has been a judicial separation of property under Article 191."

This article is substantially the same as Article 1458 of the old Civil Code.

On the other hand, petitioner claims that he and his wife entered into a pre-marital agreement of separation of property, and consequently, his sales of logs to his wife, who was regularly engaged in business as a dealer thereof, cannot be annulled or disregarded. Petitioner sought to prove the existence of the pre-marital agreement in question by alleging that the said document was executed before Notary Public Herminio F. Verzosa in five copies (Exh. K. pp. 104-107 BIR rec.; see also Exh. G, pp. 90, 93 CTA rec.; Exh. D, pp. 36, 38 CTA rec.). Notary Public Verzosa in his deposition stated that out of the five copies of the alleged document he retained two copies and gave the rest to petitioner and one of the original (duplicate) copies which he retained was filed with the Clerk of Court of Isabela (Exh. G, pp. 94-95, CTA rec.). According to the deposition of petitioner Antonio Medina, he had the alleged document registered in the Register of Deeds of Isabela leaving the original copy with the Register of Deeds, and the two or three remaining copies were kept by him (Exh. D, p. 18, CTA rec.). It is claimed that the copies of the alleged pre-marital agreement in the possession of petitioner and the notary public were lost during the war. Likewise no trace could be found of the alleged document which was registered with the Register of Deeds. However, with regard to the copy allegedly filed with the Clerk of Court of Isabela, no evidence was adduced whether or not it was also lost. There is no showing that efforts have been exerted to secure a certified copy from the office of the Clerk of Court of Isabela where a copy of the alleged document appears to have been filed.

Under the best evidence rule, there can be no evidence of a writing other than the writing itself to prove its contents, except, among others, in a case where the original has been lost or destroyed. However, before a private writing may be proved by secondary evidence, it must be shown that the original document was duly executed and that it has been lost or destroyed (Secs. 46 & 51, Rule 123 of the Rules of Court). In order that secondary evidence may be allowed to prove the contents of a document, there must be evidence showing that diligent search had been made for all the original and duplicate copies in places where they are likely to be found and that all copies (original and duplicates) were duly accounted for as lost and can no longer be secured. (Moran, Comments on the Rules of Court, Vol. III, 1952 Ed., pp. 461-462 citing Gov't of P.I. v. Martinez, 44 Phil. 817, 827-828; Saldivar et al. v. The Municipality of Talisay, 18 Phil. 362, 364.) As there is no proof that the duplicate original of the alleged document allegedly filed with the Clerk of Court of Isabela has been accounted for as lost, the recollection of witnesses can not be given consideration to establish the contents of said document. Consequently, no finding could be made on the contents of the document, assuming arguendo that the evidence was sufficient to prove its existence and due execution.

Granting that the loss of all the original copies of the document was sufficiently established, and consequently secondary evidence consisting mainly of the recollection of witnesses may be admitted to prove the alleged document's contents, we are nevertheless of the belief that the entire evidence of petitioner, besides being irreconcilably conflicting, are insufficient to establish the existence, due execution and contents of the document.

By petitioner's secondary evidence, it would seem that about two months before the marriage of petitioner and his wife on or about May 20, 1944, said spouses entered into a pre-marital agreement of total separation of properties; that this document was duly executed and acknowledged before a notary public by said spouses, together with their instrumental witnesses, the brothers-in-law of petitioner; that the text of the alleged document was in English; that the document allegedly contained the agreement for a complete separation of future property and each can independently engage in business, and whatever gain or profit each will realize arising from said venture will accrue to his or her own benefit, but the expenses of the family will be borne by petitioner (Exh. C, pp. 28-29, CTA rec.; Exh. D, pp. 43-44, ibid; Exh. E, p. 71, ibid; Exh. G, pp. 98-101, ibid.; see also Exh. J, pp. 116-123, BIR rec.; Exh. K, pp. 104-115, BIR rec.); and, that the document was allegedly registered with the Register of Deeds of Isabela in the early part of 1944.

However, after carefully scrutinizing and weighing the evidence of petitioner to prove the existence, due execution and contents of the alleged pre-marital agreement, we observed, firstly, that the testimonies of the witnesses were inconsistent in their material respects. Petitioner Antonio

Medina and his wife testified before the Justice of the Peace of Ilagan, Isabela, that not having any property of their own at the inception of their marriage, they entered into an agreement concerning complete separation of future property and future business. However, notary public Herminio F. Verzosa, before whom the document was alleged to have been acknowledged, clearly stated that the alleged pre-marital agreement concerns total separation of properties before the marriage (Exh. G, p. 93 CTA rec.), which presupposes the existence of properties of the spouses at the time of their marriage on or about May 20, 1944. Jose Rodriguez, one of the instrumental witnesses to the alleged document, a brother-in-law of petitioner, testified that the text of the document was in Spanish (Exh. J, p. 122 BIR rec.) while the other witnesses of petitioner, including petitioner himself, his wife, the notary public and Manuel B. Tarampi, a former Senior Clerk of the Register of Deeds of Isabela, testified that the document was executed in English (Exh. C, p. 34 CTA rec.; Exh. D, p. 54, ibid; Exh. E, pp. 62-63, ibid).

Furthermore, although Tarampi testified that the alleged document was registered in the Registry of Deeds of Isabela in the early part of 1944, his testimony conflicts with that of Vicente M. Capellan, the latter being the incumbent Registrar of Deeds of Isabela, who testified that, if it were true that the document was registered, the day book which contains the daily transactions in the registry before and during the war, including as late as 1944, and which was preserved, should have disclosed that the alleged document was recorded therein (Exh. F, pp. 85-87, CTA rec.). As gleaned from the testimony of V. M. Capellan, he was not sure that the alleged document was registered. These inconsistencies in witnesses' statements make such testimonies unreliable.

Secondly, it is not disputed that petitioner Antonio Medina, who is a lawyer by profession, did not interpose the existence and due execution of the alleged pre-marital agreement when he first contested respondent's assessment. It was only after the denial of his first attempt to contest the assessment when he invoked for the first time the existence of the alleged pre-marital agreement. If the document really existed, there is no reason why he should have withheld information regarding the existence of the document when the validity of his sales to his wife was raised by respondent. His attempt to prove afterwards the existence of such document must have been merely an afterthought.

Thirdly and lastly, if it is true that there exists a pre-marital agreement concerning complete separation of property that was agreed upon between the spouses, they should have in the ordinary course of things acted in accordance with the provisions of their agreement; that is, it should have appeared that the properties owned by each and acquired during their marriage are separated and the ownership, usufructuary and the administration of their properties, including the fruits and produce of his or her labor, should have pertained exclusively to each of them. On the contrary, there is overwhelming evidence to the effect that during the marriage of said spouses, particularly during the taxable years 1949 to 1952, the ownership, usufructuary and administration of the properties and their businesses were in the petitioner. These facts run against the very essence and character of the system of complete separation of property under which they (petitioner and his wife) claim to be governed.

Neither has it been shown that petitioner's wife was engaged in business independently and separately. On the contrary, it was not only proven that petitioner assisted his wife in the business of buying and selling logs but it was also shown that instructions were given by him concerning the purported sales of the wife through agent Mariano Osorio (Exh. 10-B). It also appears that the instructions to Osorio concerning the logs in question, if not signed by petitioner, were signed for and in his behalf by the wife (Exhs. 10, 10-A & 10-B). And finally, the proceeds of the sales allegedly made by the wife, through Osorio, were received

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by the agent for and in behalf of petitioner and not his wife, and on almost all occasions the proceeds of such sales were deposited in petitioner's current account in the Philippine National Bank in Manila (pp. 358, 403-404 t.s.n.; see also Exh. 15, pp. 154-155, CTA rec.). These circumstances respecting the operation and management of their businesses argue strongly against the existence of a pre-marital agreement of total separation of properties entered into between them. There is actually a merger of their alleged separate and independent businesses and properties under the active management of petitioner.

The existence of a pre-marital agreement concerning complete separation of property between petitioner and his wife not having been established, we conclude that the spouses are, with respect to their property relations governed by the system of conjugal partnership. Hence, the sales of the logs in question by petitioner to his wife, being prohibited by Art. 1458 of the old Civil Code and Art. 1490 of the new Civil Code, are null, void and inexistent (Art. 4(1) of the old, Art. 5 of the new Civil Code). Consequently, we hold that the sales in Manila through agent Osorio, of the logs cut and removed from petitioner's concessions are the original taxable sales, not the alleged sales by petitioner to his wife.

But even granting arguendo that there is a pre-marital agreement entered into between the spouses, the facts of record indicate that the sales by petitioner to his wife were simulated, fictitious and not bona fide. Petitioner claims that the transactions between him and his wife were valid, real and not simulated; that the sales between him and his wife were entered into in the ordinary course of commercial relations and were duly entered and recorded in their respective books of accounts; that each of them has in fact engaged in a business separate and distinct from each other; that strangers cannot assail the validity of the transactions between him and his wife; and that the evidence availed of by respondent was illegally seized from petitioner, his wife and agent Osorio.

We find the contentions of petitioner not meritorious. The evidence adduced by respondent clearly show that the sales of logs by petitioner to his wife were purportedly covered by sales invoices issued by petitioner and duly signed by him as vendor, but which were, however, made out and written by the wife and who at times signed the said invoices for and in behalf of petitioner as vendor (Exhs. 3 & 3-A; Exhs. 8, 8-A to 8-C); that the logs sold by petitioner admittedly were not actually delivered to the wife (pp. 66-67, BIR rec.) as in fact the logs, from the place or places of production, were loaded, shipped and transported directly to Manila by petitioner himself who also attended to the sales of the logs in question (Exh. D, p. 58 CTA rec.; Exhs. 24 & K, p. 109, BIR rec.; see also pp. 73-74 BIR rec.); that the prices at which the logs were sold by petitioner are very much less than the prices of logs sold by different concessioners (Exh. 5-F); that the way-bills of petitioner were made out and signed by the wife for and in behalf of her husband (Exh. 14, pp. 98, 168); and, as heretofore found, that Mariano Osorio received the proceeds of the sales of logs in question (Exhs. 10, 10-A & 10-B; Exhs. 14 & 15) for and in behalf of petitioner and were deposited in the latter's current account in the Philippine National Bank.

From these facts, it is clear that the alleged sales of logs by petitioner to his wife were simulated solely with the aim in view of reducing petitioner's tax liability.

The fact that the alleged sales by petitioner to his wife were duly recorded in their respective books of accounts does not alter the situation. Books of accounts are only expedient means of recording ordinary business transactions and do not in any way record or reflect the true nature of these transactions. (Muñoz v. Hood, 12 Phil. 624, 639) Having previously found that petitioner and his wife were not engaged in a business separate and distinct from each other, we find it unnecessary for us to dwell on this question again.

The contention that the Government, being a stranger and not an interested party, cannot assail the validity of the sales between him and his wife, citing Cook v. McMicking (27 Phil. 10), overlooks the fact that the Government is always an interested party in all matters involving taxable transactions. Even granting that the sales transactions between the spouses are valid in all respects under our civil law, yet, for purposes of taxation, if they were in fact merely arrangements devised to diminish the true tax liabilities of petitioner, as has been shown in this case by preponderance of evidence, such transactions may be entirely disregarded (Helvering v. Clifford, 84 L ed 788; Sewell v. U.S. 73 F Supp 957). Respondent acted correctly in disregarding such transactions.

Petitioner's contention that the evidence used by respondent against him was illegally seized is without merit. Aside from the fact that there is no evidence to establish illegal seizure of the documents referred to by petitioner, it is well within the power of respondent or his representatives to subject the books of accounts, subsidiary books, and other accounting records of taxpayers to examination and inspection at any time (Sec. 337, Revenue Code). And it is a well-settled rule in this jurisdiction that articles illegally seized are admissible in evidence. (Wong & Lee v. Coll. of

Int. Rev., G. R. No. L-10155, Aug. 30, 1958.)]

We are, therefore, of the opinion that the sum of ₱3,325.68 as deficiency sales tax and surcharge has been correctly and validly assessed against petitioner. With respect to the sums of ₱200 and ₱50.00 which are sought to be collected from petitioner by way of compromise for his alleged violations of the Revenue Code, it does not appear that a compromise agreement has been entered into between the parties in accordance with Section 309 of the Revenue Code. Therefore, petitioner may not be compelled to pay said amounts. (See Briñas v. Collector of Int. Rev., C.T.A. No. 10, Sept. 10, 1956; Central Azucarera de Tarlac v. Coll. of Int. Rev., C.T.A. No. 206, Oct. 15, 1956, affd. in G. R. Nos. L-11760 & L-11761, July 31, 1958; Western Mindanao Lumber v. Coll. of Int. Rev., CTA No. 223, Oct. 27, 1956, affd. in G. R. No. L-11710, June 30, 1958.)

In addition to the aforesaid amounts, counsel for respondent, in their memorandum, have asked this Court to hold petitioner liable for the 50% fraud penalty in the sum of ₱1,951.52, pursuant to Section 183 (A) of the Revenue Code, and the further sum of ₱80.90, representing deficiency tax and surcharge corresponding to the third quarter of 1950 and the second and third quarters of 1952. The decision of respondent appealed from does not contain these amounts, and neither the answer of respondent to the petition for review contains any allegation concerning the same. But it is contended that this Court has power to increase the assessment, if supported by the evidence, citing Coll. of Int. Rev. v. Batangas Transportation Co., G. R. No. L-9692, Jan. 6, 1958. It appears, however, in said case of Batangas Transportation Co. that the assessment of respondent was duly amended and respondent's answer to the petition for review contained an allegation in regard to the increased assessment so that the same was squarely placed in issue during the proceedings of the case.

In the instant case, the assessment which is the subject of this appeal has never been amended, and the answer of respondent does not contain any allegation in regard to the additional amounts referred to in the memorandum of counsel for respondent. Consequently, the liability of petitioner as regards the said additional amounts has never been placed in issue in these proceedings. It was raised for the first time only in the memorandum of counsel for respondent dated September 2, 1958 after the termination of the hearing. We do not think that the case of Batangas Transportation Co. is in point, and the claim of respondent with respect to the additional amounts must have to be denied.

We should like to add, in connection with the fraud penalty, that this matter was fully and thoroughly considered by respondent during the pendency of the case in his office. The Conference Staff of the Bureau of Internal Revenue which reviewed the case expressed the opinion, and we quote:

> ". . .However, we do not believe that a surcharge of 75% should be imposed on said deficiency. The mere fact that the herein taxpayer sold to his wife, who is herself a duly licensed dealer on forest products, logs which he cut from his concessions does not in itself constitute fraud, particularly if we consider that all such purchases made by the wife from her husband have been properly recorded in her books of accounts. Fraud is not to be presumed, but must be established by clear and convincing evidence. (Vitelli & Sons v. U.S., 250 U.S. 355; 47 C.J.S. 888-889; Mitchell & Com. of Int. Rev. (1941) 118 F. 2d 310). In view thereof, only 25% surcharge should be imposed." (Exh. 27.)

The recommendation of the Conference Staff was approved by respondent and the fraud penalty was eliminated from the final assessment which is the subject of this appeal.

The decision appealed from is hereby affirmed, except with respect to the sums of ₱200 and ₱50.00 as alleged compromise "penalties", with costs against petitioner. The claim of respondent with respect to the fraud penalty in the sum of ₱1,951.52 and deficiency tax and surcharge amounting to ₱80.90 is hereby denied.

SO ORDERED.

Manila, November 26, 1958.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

Affd. G R L-15113, Jan. 28, 1961.

AUGUSTO M. LUCIANO
Associate Judge