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Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

FLORENCIO REYES
and ANGEL REYES,
Petitioners,

Sept. 30/64

- versus -

C.T.A. CASES NO. 518
and NO. 519

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

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DECISION

The respondent assessed against the petitioners the sum of ₱46,647.00 as income tax, surcharge and compromise for the years 1951 to 1954, the subject matter of the appeal in C.T.A. No. 518. The assessment was subsequently reduced to ₱37,128.00, plus a compromise of ₱400.00, or a total of ₱37,528.00, the reduction being the result of the elimination of the surcharge for failure to file income tax returns. Subsequently, another assessment was made against petitioners in the sum of ₱20,619.00 as income tax for the years 1955 and 1956, plus surcharge and compromise in the sum of ₱5,354.75, or a total of ₱25,973.75, the subject matter of the appeal in C.T.A. No. 519. Having failed to secure a reconsideration of the said assessments, petitioners have appealed. The two cases have been jointly heard as they involve the same facts and issues.

The facts which gave rise to the assessments in question may be briefly stated as follows: On October 31, 1950, petitioners, father and son, purchased a lot and building, known as the Gibbs Building, situated at

671 Dasmariñas Street, Manila, for ₱835,000.00, of which they paid the sum of ₱375,000.00, leaving a balance of ₱460,000.00, representing the mortgage obligation of the vendors with the China Banking Corporation, which mortgage obligation was assumed by the vendees. The initial payment of ₱375,000.00 was shared equally by petitioners. At the time of the purchase, the building was leased to various tenants, whose rights under the lease contracts with the original owners the purchasers, petitioners herein, agreed to respect. The administration of the building was entrusted to an administrator who collected the rents; kept its books and records and rendered statements of accounts to the owners; negotiated leases; made necessary repairs and disbursed payments, whenever necessary, after approval by the owners; and performed such other functions necessary for the conservation and preservation of the building. Petitioners divided equally the income derived from the building after deducting the expenses of operation and maintenance. The gross income from rentals of the building amounted to about ₱90,000.00 annually.

Respondent, considering the circumstances surrounding the case, held that petitioners established an unregistered partnership and assessed the corporate income tax on the net income of said partnership for the years already mentioned. On the other hand, petitioners claim they are merely co-owners of said property and that no partnership was established by them in the acquisition and continued maintenance thereof for rent. And even assuming that a partnership was established, the registration of the deed of sale and the issuance of a title in their names, jointly, constitute registration which exempts the partnership from income tax.

Section 24 of the National Internal Revenue Code imposes an income tax on corporations. A corporation subject to income tax is defined in Section 84 of said Code as including "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 (companias colectivas)."

For purposes of the income tax, partnerships, except registered general partnerships, are treated as corporations, no matter how such partnerships are created or organized. Under Article 1767 of the Civil Code, the essential elements of a partnership are (a) an agreement to contribute money, property, or industry to a common fund, and (b) intent to divide the profits among the contracting parties.

As to the first element, there is no question that petitioners each contributed money to a common fund for the purpose of acquiring the Dasmariñas property. As to the second element, we are convinced that the intent of petitioners to make use of the common fund for profit and to divide the profits among them is likewise present. At the time that the Dasmariñas property was acquired it was already being rented, the annual income therefrom being about ₱90,000.00. From the date of acquisition up to the present the net income derived from said property is shared equally by petitioners. Under the circumstances, we cannot see how the acquisition of said property can be divorced from the profit motive. As stated by the Supreme Court:

> To begin with, the tax in question is one imposed upon "corporations", which, strictly speaking, are distinct and different from "partnerships". When our Internal Revenue Code includes "partnerships" among the entities subject to the tax on "corporations", said Code must allude, therefore, to organizations which are <u>not</u> <u>necessarily</u> "partnerships", in the technical sense of the term. Thus, for instance, section 24 of said Code <u>exempts</u> from the aforementioned tax "duly registered general partnerships" which constitute precisely one of the most typical forms of partnerships in this jurisdiction. Likewise, as defined in section 84(b) of said Code, "the term corporation includes partnerships, <u>no matter how created or organized</u>." This qualifying expression clearly indicates that a joint venture need not be undertaken in any of the standard forms, or in conformity with the usual requirements of the law on partnerships, in order that one could be deemed constituted for purposes of the tax on corporations. Again, pursuant to said section 84(b), the term "corporation" includes, among others, "joint accounts (cuentas en participacion)" and "associations", <u>none of which has a legal personality of its own, independent of that of its members</u>. Accordingly, the lawmaker could not have regarded that personality as a condition essential to the existence of the partnerships therein referred to. In fact, as above stated, "duly registered general partnerships" - <u>which are possessed of the aforementioned personality</u> - have been expressly excluded by law (Sections 24 and 84 /b/) from the connotation of the term "corporation". It may not be amiss to add that petitioners' allegation to the effect that their liability in connection with leasing of the lots above referred to, under the management of one person - even if true, on which we express no opinion - tends to <u>increase</u> the similarity between the nature of their venture and that of corporations, and is, therefore, an additional argument <u>in favor</u> of the imposition of said tax on corporations. (Evangelista v. Coll. of Int. Rev., G. R. No. L-9996, Oct. 15, 1957.)

It is argued that, assuming that petitioners have established a partnership, "considering that said contract of sale, which partakes of the nature of articles of co-partnership, contains the names of the partners, the capital stock of the partnership, and the amount of stock of each partner the public must know, is registered in the Registry of Deeds", such registration is a substantial compliance with the requirements of the law as regards registration of a partnership in the mercantile registry. Therefore, it is alleged that the partnership is exempt from income tax as a registered general partnership. We do not think that registration of a contract of sale of real property owned by a partnership is a substantial compliance with the requirement of registration of a general partnership for purposes of its exemption from income tax. The registration required by law in the case of general partnerships is registration with the Securities and Exchange Commission.

We are, therefore, of the opinion that petitioner in acquiring the Dasmariñas property established a partnership which is subject to income tax as a corporation under Section 24 of the Revenue Code. However, while respondent decided to eliminate the 25% surcharge for failure to file income tax returns for the years 1951 to 1954, the said surcharge has been imposed with respect to the years 1955 and 1956. Since the failure to file income tax returns by the partnership was due to the honest belief that it was not taxable, it is error to impose the said surcharge. It is also not proper to include in the assessments in question the alleged compromise penalties for failure to file income tax returns.

IN VIEW OF THE FOREGOING, petitioners are ordered to pay the sums of ₱37,128.00 as income tax due from the partnership formed by herein petitioners for the years 1951 to 1954 and ₱20,619.00 for the years 1955 and 1956 within thirty days from the date this decision becomes final, plus the corresponding surcharge and interest in case of delinquency, pursuant to Section 51 of the Revenue Code. With costs against petitioners.

SO ORDERED.

Quezon City, September 30, 1964.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge