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[G. R. No. L-9692. January 06, 1958]

COLLECTOR OF INTERNAL REVENUE, PETITIONER, VS. BATANGAS TRANSPORTATION COMPANY AND LAGUNA-TAYABAS BUS COMPANY, RESPONDENT.

D E C I S I O N

MONTEMAYOR, J.:

This is an appeal from the decision of the Court of Tax Appeals (C.T.A.), which reversed the assessment and decision of petitioner Collector of Internal Revenue, later reffered to as Collector, assessing and demanding from the respondents Batangas Transportation Company, later referred to as Batangas Transportation, and Laguna-Tayabas Bus Company, later referred to as Laguna Bus, the amount of P54,143.54, supposed to represent the deficiency income tax and compromise for the years 1946 to 1949, inclusive, which amount, pending appeal in the C.T.A., but before the Collector filed his answer in said court, was increased to P148,890.14.

The following facts are undisputed: Respondent companies are two distinct and separate corporations engaged in the business of land transportation by means of motor buses, and operating distinct and separate lines. Batangas Transportation was organized in 1918, while Laguna Bus was organized in 1928. Each company now has a fully paid up capital of P1,000,000. Before the last war, each company maintained separate head offices, that if Batangas Transportation being in Batangas, Batangas, while the Laguna Bus had its head office in San Pablo Laguna. Each company also kept and maintained separate books, fleets of buses, management, personnel, maintenance and repair shops, and other facilities. Joseph Benedict managed the Batangas Transportation, while Martin Olson was the manager of the Laguna Bus. To show the connection and close relation between the two companies, it should be stated that Max Blouse was the President of both corporations and owned about 30 per cent of the stock in each company. During the war, the American officials of these two corporations were interned in Santo Tomas, and said companies

ceased operations. They also lost their respective properties and equipment. After Liberation, sometime in April, 1945, the two companies were able to acquire 56 auto buses from the United States Army, and the two companies divided said equipment equally between themselves, registering the same separately in their respective names. In March, 1947, after the resignation of Martin Olson as Manager of the Laguna Bus, Joseph Benedict, who was then managing the Batangas Transportation, was appointed Manager of both companies by their respective Board of Directors. The head office of the Laguna in San Pablo City was made the main office of both corporations. The placing of the two companies under one sole management was made by Max Blouse, President of both companies, by virtue of the authority granted him by resolution of the Board of Directors of the Laguna Bus on August 10, 1945, and ratified by the Boards of the two companies in their respective resolutions of October 27, 1947.

According to the testimony of joint Manager Joseph Benedict, the purpose of the joint management, which was called "Joint Emergency Operation", was to economize in overhead expenses; that by means of said joint operation, both companies had benn able to save the salaries of one manager, one assistant manager, fifteen inspectors, special agents, and one set of office clerical force, the savings in one year amounting to about P200,000 or about P100,000 for each company. At the end of each calendar year, all gross receipts and expenses of both companies were determined and the net profits were divided fifty-fifty, and transferred to the books of accounts of each company, and each company "then prepared its own income tax return from this fifty per centum of the gross receipts to it from the 'Joint Emergency Operation' and paid the corresponding income taxes thereon separately".

Under the theory that the two companies had pooled their resources in the establishment of the Joint Emergency Operation, thereby forming a joint venture, the Collector wrote the bus companies that there was due from them the amount of P422,210.89 as deficiency income tax and compromise for the years 1946 to 1949, inclusive. Since the Collector caused to be restrained, seized, and advertized for sale all the rolling stock of the two corporations, respondent companies had to file a surety bond in the same amount of P422, 210.89 to guarantee the payment of the income tax assessed by him.

After some exchange of communications between the parties, the Collector, on January 8, 1955, informed the respondents "that after crediting the overpayment made by them of their alleged income tax liabilities for the aforesaid years, pursuant to the doctrine of equitable recoupment, the income tax due from the 'Joint Emergency Operation' for the years 1946 to 1949, inlcusive, is in the total amount P54,143.54" The respondent companies

appealed from said assessment of P54,143.54 and reassessed the alleged income tax liability of respondents of P148,890.14, claiming that he had later discovered that said companies had been "erroneously credited in the last assessment with 100 per cent of their income taxed paid when they should in fact have been credited with only 75 per cent thereof, since under Section 24 of the Tax Code dividends received by them from the Joint Emergency Operation as a domestic corporation are returnable to the extent of 25 per cent". That corrected and increased reassessment was embodied in the answer filed by the Collector with the Court of Tax Appeals.

The theory of the Collector is the Joint Emergency Operation was a corporation distinct from the two respondent companies, as defined in section 84 (b), and so liable to income tax under section 24, both of the National Internal Revenue Code. After hearing, the C.T.A. found and held, citing authorities, that the Joint Emergency Operation or joint management of the two companies "is not a corporation within the contemplation of section 84 (b) of the National Internal Revenue Code much less a partnership, association or insurance company", and therefore was not subject to the income tax under the provisions of section 24 of the same Code, separately and independently of respondent companies; so, it reversed the decision of the Collector assessing and demanding from the two companies the payment of the amount of P54,143.54 and/or the amount of P148,809.14. The Tax Court did not pass upon the question of whether or not in the appeal taken to it by respondent companies, the Collector could change his original assessment by increasing the same from P54,143.14 to P148,890.14, to correct an error committed by him in having credited the Joint Emergency Operation, totally or 100 per cent of the income taxed paid by the respondent companies for the years 1946 to 1949, inclusive, by reason of the principle of equitable recoupment, instead of only 75 per cent.

The two main and most important question involved in the present appeal are: (1) whether the two transportation companies herein involved are liable to the payment of income tax as a corporation on the theory that the Joint Emergency Operation organized and operated by them is a corporation within the meaning of Section 84 of the Revised Internal Revenue Code, and (2) whether the Collector of Internal Revenue, after the appeal from his decision has been perfected, and after the Court of Tax Appeals has acquired jurisdiction over the same, but before said Collector has filed his answer with that court, may still modify his assessment subject of the appeal by increasing the same, on the ground that he had committed error in good faith in making said appealed assessment.

The first question has already been passed upon and determined by this Tribunal in the case

of Eufemia Evangelista et al., vs. Collector of Internal Revenue et al., * G. R. No. L-9996, promulgated on October 15, 1957. Considering the views and rulings embodied in our decision in that case penned by Mr. Justice Roberto Concepcion, we deem it unnecessary to extensively discuss the point. Briefly, the facts in that case are as follows: The three Evangelista sisters borrowed from their father about P59,000 and adding thereto their own personal funds, bought real properties, such as a lot with improvements thereon for the sum of P100,000 in 1943, parcels of land with a total area of almost 4,000 square meters with improvements thereon for P18,000 in 1944, another lot for P108,000 in the same year, and still another lot for P237,000 in the same year. The relatively large amounts invested may be explained by the fact the purchases were made during the Japanses occupation, apparently in Japanese military notes. In 1945, the sisters appointed their brother to manage their properties, with full power to lease, to collect and recieve rents, on default of such payment, to bring suits against the defaulting tenants, to sign all letters and contracts, etc. The properties therein involved were rented to various tenants, and the sisters, through their brother as manager, realized a net rental income of P5,948 in 1945, P7,498 in 1946, and P12,615. in 1948.

In 1954, the Collector of Internal Revenue demanded of them among other things, payment of income tax on corporations from the year 1945 to 1949, in the total amount of P6, 157, including surchage and compromise. Dissatisfied with the said assessment, the three sisters appealed to the Court of Tax Appeals, which court decided in favor of the Collector of Internal Revenue. On appeal to us, we affirmed the decision of the Tax Court. We found and held that considering all the facts and circumstances surrounding the case, the three sisters had the purpose to engage in real estate transactions for monetary gain and then divide the same among themselves; that they contributed to a common fund which they invested in a series of transactions; that the properties bought with this common fund had been under the management of one person with full power to lease, to collect rents, issue receipts, bring suits, sign letters and contracts, etc., in such a manner that the affairs relative to said properties have been handled as if the same belonged to a corporation or business enterprise operated for profit; and that the said sisters had the intention to constitute a partnership within the meaning of the tax law. Said sisters in their appeal insisted that they were co-owners, not co-partners, for the reason that their acts did not create a personality independent of them, and that some of the characteristics of partnerships were absent, but we held that when the Tax Code inlcudes “partnerships” among the entities subject to the tax on corporations, it must refer to organizations which are not necessarily partnerships in the technical sense of the term, and that furthermore, said law defined the term

"corporation" as including partneships no matter how created or organized, thereby indicating 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 corporation"; that besides, said section 84 (b) provides that the term "corporation" includes "joint acounts" (cuentas en participacion) and "associations", none of which has a legal personality independent of that of its members. The decision cites 7A Merten's Law of Federal Income Taxation.

In the present case, the two companies contributed money to a common fund to pay the sole general manager, the accounts and office personnel attached to the office of said manager, as well as for the maintenance and operation of a common maintenance and repair shop. Said common fund was also used to pay all the salaries of the personnel of both companies, such as drivers, conductors, helpers and mechanics, and at the end of each year, the gross income or receipts of both companies merged, and after deducting therefrom the gross expenses of the two companies, also merged, the net income was determined and divided equally between them, wholly and utterly disgarding the expenses incurred in the maintenance and operation of each company and of the individual income of said companies.

From the standpoint of the income tax law, this procedure and practice of determining the net income of each company was arbitrary and unwarranted, disregarding as it did the real facts in the case. There can be no question that the gross receipts and gross expenses of two, distinct and separate companies operating different lines and in some cases, different territories, and different equipment and personnel at least in value and in the amount of salaries, can at the end of each year be equal or even approach equality. Those familiar with the operation of the business of land transportation can readily see that there are many factors that enter into said operation. Much depends upon the number lines operated and the length of each line, including the number of trips made each day. Some lines are profitable, others break above even, while still others are operated at a loss, at least for a time, depending, of course, upon the volume of traffic, both passenger and freight. In some lines, the operator may enjoy a more or less exclusive operation, while others, the competition is intense, sometimes even what they call "cutthroat competition". Sometimes, the operator is involved in litigation, not only as the result of money claims based on physical injuries or deaths occasioned by accidents or collisions, but litigations before the Public Service Commission, initiated by the operator itself to acquire new lines or additional service and equipment on the lines already existing, or litigations forced upon said operator by its competitors. Said litigation naturally causes expense to the operator. At other times,

the operator us denounced by competitors before the Public Service Commission for violation of its franchise or franchises, for making unauthorized trips, for temporary abandonment of said lines or of scheduled trips, etc. In view of this, and considering that the Batangas Transportation and the Laguna Bus operated different lines, sometimes in different provinces or territories, under different franchises, with different equipment and personnel, it cannot possibly be true and correct to say that at the end of each year, the gross receipts and income and the gross expenses of two companies are exactly the same for purposes of the payment of income tax. What was actually done in this case was that, although no legal personality may have been created by the Joint Emergency Operation, nevertheless, said Joint Emergency Operation, joint venture, or joint management operated the business affairs of the two companies as though they constituted a single entity, company or partnership, thereby obtaining substantial economy and profits in the operation.

For the foregoing reasons, and in the light of our ruling in the Evangelista vs. Collector of Internal Revenue case, supra, we believe and hold that the Joint Emergency Operation or sole management or joint venture in this case falls under the provisions of section 84 (b) of the Internal Revenue Code, and consequently, it is liable to income tax provided for in section 24 of the same code.

The second important question to determine is whether or not the Collector of Internal Revenue, after appeal from his decision to the Court of Tax Appeals has been perfected, and after the Tax Court has acquired jurisdiction over the appeal, but before the Collector has filed his answer with the court, may still modify his assessment, subject of the appeal, by increasing the same. This legal point, interesting and vital to the interests of both the Government and the taxpayer, provoked considerable discussion among the members of this Tribunal, a minority of which the writer of this opinion forms part, maintaining that for the information and guidance of the taxpayer, there should be a definite and final assessment on which he can base his decision whether or not to appeal; that when the assessment is appealed by the taxpayer to the Court of Tax Appeals, the Collector loses control and jurisdiction over the same, the jurisdiction being transferred automatically to the Tax Court, which has exclusive appellate jurisdiction over the same; that the jurisdiction of the Tax Court is not revisory but only appellate, and therefore, it can act only upon the amount of assessment subject of the appeal to determine whether it is valid and correct from the standpoint of the taxpayer-appellant; that the Tax Court may only correct errors committed by the Collector against the taxpayer, but not those committed in his favor, unless the Government itself is also an appellant; and that unless this be the rule, the Collector of Internal Revenue and his agents may not exercise due care, prudence and pay too much

attention in making tax assessments, knowing that they can at any time correct any error committed by them even when due to negligence, carelessness or gross mistake in the interpretation or application of the tax law, by increasing the assessment, naturally to the prejudice of the taxpayer who would not know when his tax liability has been completely and definitely met and complied with, this knowledge being necessary for the wise and proper conduct and operation of his business; and that lastly. while in the United Staes of America, on appeal from the decision of the Commissioner of Internal Revenue to the Board or Court of Tax Appeals, the Commissioner may still amend or modify his assessment, even increasing the same, the law in that jurisdiction expressly authorizes the Board or Court of Tax Appeals to redetermine and revise the assessment appealed to it.

The majority, however, holds, not without valid arguments and reasons, that the Government is not bound by the errors committed by its agents and tax collectors in making tax assessments, specially when due to a misinterpretation or application of the tax laws, more so when done in good faith; that the tax laws, more so when done in good faith; that the tax laws provide for a prescriptive period within the tax collectors may make assessments and reassessments in order to collect all the taxes due to the Government, and that if the Collector of Internal Revenue is not allowed to amend his assessment before the Court of Tax Appeals, and since he may make a subsuquent reassessment to collect additional sums within the same object of his original assessment, provided it is done within the prescriptive period, that would lead to multiplicity of suits which the law does not ecourage; that since the Collector of Internal Revenue, in modifying his assessment, may not only increase the same, but may also reduce it, if he finds that he has committed an error against the taxpayer, and may even make refunds of amounts erroneously and illegally collected, the taxpayer is not prejudiced; that the hearing before the Court of Tax Appeals partakes of a trial de novo and the Tax Court is authorized to receive evidence, summon witnesses, and give both parties, the Government and the taxpayer, opportunity to present and argue their sides, so that the true and correct amount of the tax to be collected may determined and decided, whether resulting in the increase or reduction of the assessment appealed to it. The result is that the ruling and doctrine now being laid by this Court is, that pending appeal before the Court of Tax Appeals, the Collector of Internal Revenue may still amend his appealed assessment, as he has done in the present case.

There is a third question raised in the appeal before the Tax Court and before this Tribunal, namely, the liability of the two respondent transportation companies for 25 per cent surcharge due to their failure to file an income tax return for the Joint Emergency Operation, which we hold to be a corporation within the meaning of the Tax Code. We

understand that said 25 per cent surcharge is included in the assessment of P148,890.14. The surcharge is being imposed by the Collector under the provisions of Section 72 of the Tax Code, which read as follows:

> "The Collector of Internal Revenue shall assess all income taxes. In case of willful neglect to file the return or list within the time prescribed by law, or in case a false or fraudulent return or list is willfully made the collector of internal revenue shall add to the tax or to the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud, a surcharge of fifty per centum of the amount of such tax or deficiency tax. In case of any failure to make and file a return or list within the time prescribed by law or by the Collector or other internal revenue officer, not due to willful neglect, the Collector, shall add to the tax twenty-five per centum of its amount, except that, when the return is voluntarily and without notice from the Collector or other officer filed after such time, it is shown that the failure was due to a reasonable cause, no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

We are satisfied that the failure to file an income tax return for the Joint Emergency Operation was due to a reasonable cause, the honest belief of respondent companies that there was no such corporation within the meaning of the Tax Code, and that their separate income tax return was sufficient compliance with the law. That this belief was not entirely without foundation and that it was entertained in good faith, is shown by the fact that the Court of Tax Appeals itself subscribed to the idea that the Joint Emergency Operation was not a corporation, and so sustained the contention of respondents. Furthermore, there are authorities to the effect that belief in goof faith, on advice of reputable tax accountants and attorneys, that a corporation was not a personal holding company taxable as such constitutes "reasonable cause" for failure to file holding company surtax returns, and that in such a case, the imposition of penalties for failure to file return, is not warranted.[1]

In view of the foregoing, and with the reversal of the appealed decision of the Court of Tax Appeals, judgment is hereby rendered, holding that the Joint Emergency Operation involved

in the present case is a corporation within the meaning of section 84 (b) of the Internal Revenue Code, and so is liable to income tax under section 24 of the same code; that pending appeal in the Court of Tax Appeals of an assessment made by the Collector of Internal Revenue, the Collector, pending hearing before said court, may amend his appealed assessment and include the amendment in his answer before the court, and the latter may on the basis of the evidence presented before it, redetermine the assessment; that where the failure to file an income tax return for and in behalf of an entity which is later found to be a corporation within the meaning of section 84 (b) of the Tax Code was due to a resonable cause, such as an honest belief based on the advice of its attorneys and accountants, a penalty in the form of a surcharge should not be imposed and collected. The respondents are therefore ordered to pay the amount of the reassessment made by the Collector of Internal Revenue before the Tax Court, minus the amount of 25 per cent surcharge. No costs.

Paras, C. J., Bengzon, Padilla, Labrador, Concepcion, Reyes, J. B. L., Endencia, and *Felix, JJ.,* concur.

Reyes, A. J., concurs in the result.

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*Supra, p.140

[1]Walnut St. Co. vs. Glenn, D.C. Ky. 148, 83 F. Supp. 945; Safety Tube Corp. vs. Commissioner of Internal Revenue, 1947 8 T.C. 757 affirmed 168 F. 2d 787; Elm Beach Trust Co. vs. Commissioner of Internal Revenue, 174 F. 2d 527.

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