

JOSE LEON GONZALES, PETITIONER AND APPELLANT, VS. THE HON. COURT OF TAX APPEALS AND THE COLLECTOR OF INTERNAL REVENUE, RESPONDENTS AND APPELLANTS; JUANA F. GONZALES AND FORTUNAT...

G. R. Nos. L-14532-33. May 26, 1965

Ponente: DIZON, J.

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DIZON, J.:

Statement. - This is an appeal from the decision of the Court of Tax Appeals denying the refund of income taxes imposed on, and paid by, Jose Leon Gonzales and Juana F. Gonzales.

The Facts.-Jose Leon Gonzales and Juana F. Gonzales are brother and sister / the latter being married to Atty. Fortunato de Leon [1]/. Both petitioners are co-heirs and co-owners, (one-sixth each) of a tract of land of 871,982 square meters' which they, along with four other co-heirs, inherited from their mother.

This realty, located at Caloocan, Rizal, was the object of expropriation proceedings, which this Court finally decided in May 1954, in G. R. No. L-4918. Therein we fixed the just compensation for the property at P1.50 per square meter. We also ordered the payment of interest at the legal rate of 6% from January 25, 1947 (when the Government took possession of the property) to the date of payment, which payment was actually made on October 31, 1954. Excluded from the payment of interest the sum of P28,850.00, the amount deposited by the Government upon taking possession of the estate.

The total compensation paid the six heirs for the expropriated property amounted to P1,307,973.00. Subtracting therefrom the amount of P28,850.00 just mentioned, there remained a difference of P1,279,123.00, the interest on which, at the legal rate of 6% per annum, totalled P535,587.70. Divided among the six heirs, this total gave a share of P89,305.61 as interest to each of them.

Upon the amounts received from the Government, Jose Leon Gonzales and Juana F. Gonzales, were each ascertained to have made a capital gain of P213,328.82 [P1,279,973.00 [2] divided by 6 heirs]; and each of them to have received the amount of P89,309.61 as share in the interests of P535,587.70 (this sum is divided by 6). A tentative return for 1954 was thus prepared and filed for each of the two petitioners describing the amount of P213,328.82 as capital gain, and in addition, the amount of P89,309.61 as ordinary income. On the basis of such income, each of the petitioners was assessed P86,166.00.

The Government paid to petitioners the proceeds of the expropriation award and interest through the People's Homesite and Housing Corporation sometime in October 1954 the last check having been delivered on November 4, 1954. However, the sum of P532,234.70 was retained by the Housing Corporation; and on November 18, 1954, at the request of respondent Collector, it turned over to the Bureau of Internal Revenue the amount of P516,007.00 representing income taxes reportedly due and owing from the six co-heirs of the estate. Therefore, petitioners Jose Leon Gonzales and his sister Juana F. Gonzales were each credited income tax. (Official Receipts

Nos. 520491 and 520496 dated November 19, 1954.)

On February 29, 1956, petitioner Juana F. Gonzales wrote the respondent Collector a letter, seeking the refund of P24,426.00 allegedly representing excess payment of income taxes for 1954. The letter pertinently stated:

"We respectfully contend that the assessment was erroneous in that the amount of P80,309.61 representing interest, was considered as ordinary income and not merely capital gain. If the interest was computed as capital gain, there shall be due and owing from your office the amount of P24,426.00 assuming for argument's sake that your assessment was correct."

(Exh. H & 2, also par. 22, 'Stifacts')

On November 5, 1956, petitioner Jose Leon Gonzales also wrote a letter to said respondent requesting refund of a similar amount of P24,426.00 for the same reasons as his co-petitioner. No action appears to have been taken on this refund claim.

On November 12, 1956, respondent Collector denied the request of Juana F. Gonzales for refund of P24,426.00.

The Suits.- So on November 15, 1956, Jose Leon Gonzales and Juana F. Gonzales submitted to the Court of Tax Appeals a joint petition seeking a refund, this time of the amount of P86,166.00 for each of the two petitioners; but the next day, both petitioners amended their petition by filing separate petitions which were docketed separately as CTA Case No. 328 and CTA Case No. 329.

It appears that on November 24, 1956, Atty. Fortunato de Leon wrote the respondent Collector the following letter:

"Sir:

This is to acknowledge receipt today of your letter of November 12, 1956, denying the claim of Mrs. Juana F. Gonzales de Leon for refund, to which we take exception.

We are not only claiming the refund of P24,426.00 but the entire amount of P86,166.00 for various reasons more specifically contained in our petition before the Court of Tax Appeals on November 16 1956, Case No. 328. We had to file the petition because we believe our claim is meritorious and that the prescriptive period may run out.

For all legal purposes we shall consider your letter herein referred to as denial of the claim for refund of the total amount of P86,166.00. And the difference in amount may be considered for all purposes as variance only."

Respondent Collector, however, disclaims receipt of this second written claim for refund.

On December 5, 1956, respondent Collector contested the amended petitions. Trial ensued, and in the course thereof the parties signed a "Partial Stipulation of Facts."

Decision. - On July 16, 1958, a decision was rendered by the Court of Tax Appeals denying petitioners' claim for refund, with costs against them. Their motion for reconsideration and new trial having been denied, petitioners perfected this appeal and now pray for reversal.

Issue. - A careful perusal of the debated issues will show that the resolution of this appeal hinges decisively on two propositions:

- (1) Whether or not petitioner's claim for refund of the total of P86,166.00 may be properly entertained; and
- (2) Whether or not the sum of P89,309.61 which each of the petitioners received as interest on the value of the

land expropriated is taxable as ordinary income, and not as capital gain.

Discussion. - The record shows that on November 18, 1954, at the request of respondent Collector, the People's Homesite and Housing Corporation turned over to the Bureau of Internal Revenue the sum of P516,007.00 representing income taxes due from the six co-owners of the expropriated property. Of this amount, the two appellants Gonzales were each credited with the amount of P86,166.00 as income taxes for 1954. (The receipts evidencing such payments are O. R. No. 520491, dated November 19, 1954 for P86,166.00 for Jose Leon Gonzales and O. R. No. 520496 dated November 19, 1954 for Juana F. Gonzales.)

It likewise appears that appellant Juana F. Gonzales in letter of February 29, 1956, requested for the refund P24,426.00 (only), citing as sole ground therefor that amount of P89,309.61 which was her share in the interests paid on the expropriated property was taxed by respondent Collector as ordinary income. She contended that it should have been taxed as capital gain. Appellant Jose de Leon Gonzales on his part, in his letter of November 5, 1956, requested the refund of a similar amount of P24,426.00 (only).

Then a joint petition was filed by both parties before the Court of Tax Appeals first on November 15, 1956; but the next day, November 16, 1956, they filed separate petitions containing similar allegations.

It would appear, therefore, that from November 19, 1954, when the payments for income taxes were received from the appellants to February 29, 1956, when appellant Juana Gonzales filed her claim for refund and to November 5, 1956, and appellant Jose Leon Gonzales filed his own refund claim, less than two years had elapsed.

But, since their respective claims for refund were restricted to the amount of P24,426.00 only, it should be clear that their demand for the return of an amount in excess thereof (P86,166.00) is not included.

Remarkably, the so-called claim for refund of the amount of P86,166.00 was made only on November 24, 1956, (after the complaints had been filed) without giving the Collector "an opportunity to consider his mistake, if mistake has been committed." (Kiener Co. vs. David, 92 Phil. 945) And it refers specifically and exclusively to appellant Juana F. Gonzales' claim (Exh. "J"). Appellant Jose Leon Gonzales seems not to have filed any refund claim for a similar amount.

Be that as it may, this later claim for refund for P86,166.00 made on November 24, 1956, by appellant Juana F. Gonzales has been definitely filed beyond the statutory period of two years from the date of payment, which was November 19, 1954.

A stringent requirement of the Tax Code is that before a suit or proceeding for the refund of any internal revenue tax can be maintained in any court, a written claim for its refund shall be filed with the Collector of Internal Revenue before filing the action in court and before the expiration of two years from the date of payment of the taxes to be refunded.[3] This requirement is mandatory and failure to comply therewith is fatal to the action.[4] What is more, the claim for refund should set forth in detail the facts and the grounds upon which it is based, so as to apprise the Collector accordingly.[5]

Appellants maintain that it was not they who had paid the tax of P86,166.00 imposed upon each of them, but that it was respondent Collector himself who paid those taxes and issued receipts therefor without their knowledge and consent. And that even if the receipts of payment were in fact sent by the respondent Collector to the People's Homesite and Housing Corporation and were received by the latter on November 23, 1954, said receipts could not have been received by appellants earlier than November 28, 1954, considering that the Rules of Court treats a service as complete only upon the expiration of five days from mailing.

We find no merit in these contentions. To begin with, there is no proof positive on record that appellant Juana F. Gonzales' so-called refund claim for the amount of P86,166.00 had been sent to, let alone received, by

respondent. Neither have they protested against this payment by the Collector to the Collector. In the second place, the refund letter of November 24, 1956, assuming that it was duly filed, referred to Juana F. Gonzales' claim alone, and made no mention of Jose Leon Gonzales'. In the third place, the aforesaid refund claim does not set forth in detail the facts and grounds upon which it was based and failed to apprise the respondent of her grounds for raising her claim from P24,426.00 to P86,166.00 (see letter). Lastly, appellant Juana F. Gonzales' eleventh-hour modification upping her refund claim from P24,426.00 to P86, 166.00 was made on November 24, 1956 or eight days after the filing of her amended petition before the respondent court on November 16, 1956, and a few days after the two-year period.

Obviously then, the requirement of prior timely claim for refund of the sum of P86,166.00 has not been met in this case. The demand for refund must precede the suit, and this requirement is mandatory; so much so that noncompliance therewith bars the action. [[6]]

Appellants insist that payment of the tax was not made by them but by the respondent Collector himself, and that, therefore, the prescriptive period should begin not from the date of such payment but from the date appellants learned of such payment.

This contention offers no help to appellants' cause. Assuming that appellants indeed learned of their payments only on November 24, 1954, they should have claimed the refund of P86,166.00 from said date and before they filed their petitions with the respondent Court on November 15 or 16, 1956. Neither could they blame the respondent Collector for failing to act on their refund claims sooner for it was incumbent upon appellants' to urge him to act expeditiously on their claims, knowing as they did that the time for bringing an action for a refund of income tax, fixed by statute, is not extended by the delay of the Collector of Internal Revenue in giving notice of the rejection of their claim. [[7]]

Moreover, the provisions of section 306 of the Tax Code are mandatory and not subject to any qualification and, hence, they apply regardless of the conditions under which the payment has been made." [8]

With respect, therefore, to the issue of whether or not appellants claim for refund of P86,166.00 (each) could now be entertained, we believe that the same has been barred by prescription.

Anyway, it is mainly based on the proposition that our ruling in *Gutierrez vs. Court of Tax Appeals*, L-9738,9771, May 31, 1957, should be abandoned, a proposition we are not disposed to encourage.

This our decision will, therefore, address itself only to appellants' earlier claim for refund in the sum of P24,126.00. Which brings us to the question, of whether or not the sum of P89,309.61 which each of the appellants had received as share in the interest on the proceeds of the expropriation should be taxed as capital gain or as ordinary income.

Appellants argue that the accessory follows the principal, that the amount paid in expropriation proceedings (the principal) i.e. the profit thereon is admittedly capital gain, not ordinary income, and that therefore, the interest paid thereon (the accessory) is capital gain, not ordinary income.

This contention may not be sustained. In a previous case [9], we held that "the acquisition by the Government of private properties through the exercise of the power of eminent domain, said properties being justly compensated, is embraced within the meaning of the term "sale" or "disposition of property" and the definition of gross income laid down by Section 29 of the Tax Code of the Philippines. We also adhered to the view that the transfer of property through condemnation proceedings is a sale or exchange and that profit from the transaction constitutes capital gain.

But to say that the proceeds of expropriation which is the return of capital and, therefore, a capital gain, partakes of the same nature as interests paid thereon is far from correct; because interest is compensation for the delay in the return of such capital. In fact, the authorities support the conclusion that for income tax purposes, interest does not form part of the price paid by the Government in condemnation proceedings; and may not be treated as part of the capital gain. It was so held by the United States Supreme Court in *Kieselback vs. Commissioner of Internal Revenue*, 317 U.S. 399.

Borrowing the words and phrases of said Court, we could say now:

The sum paid these taxpayers above the award of P1,307,973.00 was paid because of the failure to put the award in the taxpayer's hands on the day, January 25, 1947, when the property was taken. This additional payment was necessary to give the owners the full equivalent of the value of the property at the time it was taken. Whether one calls it interest on the value or payments to meet the constitutional requirement of just compensation is immaterial. It is income paid to the taxpayers in lieu of what they might have earned on the sum found to be the value of the property on the day the property was taken. It is not a capital gain upon an asset sold. The sale price was the P1,307,973.00. [10]

The property was turned over in January, 1947. This was the sale. Title then passed. The subsequent earnings of the property went to the Government. The transaction was as though a purchase money lien at legal interest was retained upon the property. Such interest when paid would, of course, be ordinary income.

Incidentally, the above Supreme Court's decision disapproved the *Seaside Improvement* case on which petitioners rely.

We see, therefore, no reason to impute error to the opinion of the Collector of Internal Revenue and the Court of Tax Appeals that interest paid was ordinary income, bearing in mind that the Tax Code provided,

"Sec. 29. Gross Income.—(a) General Definition—"Gross income" includes Rains, profits, and income derived from x x x interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gain or profits and income derived from any source whatever." [11]

Having arrived at these conclusions, we deem it unnecessary to discuss the other points extensively argued in the appellants' brief.

Judgment.—Consequently, finding no error in the appealed decision, we hereby affirm it, with costs. So ordered.

Bautista Angelo, Concepcion, Reyes, J.B.L., Barrera, Paredes, Dizon, Rcgala, Makalintal, Bengzon, J.P. and Zaldivar, JJ., concur.

[1]For convenience, he will not referred to as petitioner, being practically a nominal party.

[2] Acquisition cost of land.....P28,000.00;
Payment by Government.....1,307,973.00
Therefore, capital gain.....1,279,973.00

[3]Sec. 306, National Internal Revenue Code. Giving him copy of the complaint is not enough. See Areñas, Annotations (1963) Vol. III, p. 206.

[4] *Wee Poco & Co. vs. Posadas*, 64 Phil. 640; *Bermejo vs. Col. of Internal Revenue*, 87 Phil., 96; 47 Off. Gaz., Suppl. 12, p. 292; *Keiner Ltd. vs. Court of Tax Appeals & Col. of Internal Revenue*, 52 Off. Gaz., 5226.

[5] *Asiatic Petroleum Co. vs. Posadas*, 52 Phil. 728; *Wee Poco vs. Posadas*, supra.

[6] Johnston Lumber Co. Inc. vs. Court of Tax Appeals & Col. of Internal Revenue, *supra*.

[7] U.S. vs. Michel, 282, U.S. 656 cited in Koppel (Phil) Inc. vs. Col. of Internal Revenue, L-10550, Sept. 19, 1961. See also: Kiener Col. Ltd. vs. S. David, *supra*.

[8]Guagua Electric Light Plant Co. vs. Col. of Internal Revenue & the Court of Tax Appeals, 59 Off. Gaz., Suppl. 27, p. 4207.

[9] Gutierrez vs. CTA & Col. of Internal Revenue, Col. of Internal Revenue vs. Gutierrez, et al., G. R. Nos. L-9738, 9771, May 31, 1957.

[10] The involuntary character of the transaction is not significant. Helvering vs. Hammel, 311 U.S. 504, 85 L ed 303, 61 S Ct 368, 131 ALR 1481.

[11] Sec. 29 (b) (4) does not apply , and is not invoked by petitioners.

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